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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM ADMINISTRATIVE LAW COURT

Shirley C. Robinson, Administrative Law Judge

Docket No. 14-ALJ-17-0285-CC

Dish DBS Corporation f/k/a EchoStar, DBS Corp. and Affiliates ..... Appellant,

v.

South Carolina Department of Revenue ..... Respondent.

RECORD ON APPEAL

VOLUME I

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SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

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

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

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

STATEMENT OF THE CASE

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

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

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

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

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

ISSUE

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

FINDINGS OF FACT

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

Petitioner's Business Operations

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

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

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

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

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

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

Attracting Subscribers and Contracting for Service

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

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

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

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

Petitioner's Revenue

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

Petitioner's Tax Returns

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

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

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

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

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

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

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

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

> It is ***the final act***, the culmination of those enumerated activities[7]—the delivery of the signal into the homes and onto the television screens of its customers—that produces income for [Petitioner]. [Petitioner] does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. [Petitioner] is in the business of selling television broadcast subscriptions to customers, and without the actual delivery of that broadcast signal into South Carolina homes it would not have generated the income at issue here. It is that act alone for which South Carolina customers sign contracts and pay their monthly fees.

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

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

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

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

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

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

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

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

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

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

The Department's Historic Tax Policy

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

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

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

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

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

2005 Policy at 20.

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

CONCLUSIONS OF LAW

Standard of Review

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

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

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

South Carolina Corporate Income Tax Generally

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

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

Petitioner is a Service Provider

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

Apportionment Methods Generally

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

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

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

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

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

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

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

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

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

South Carolina's Apportionment Statute

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

> [T]he taxpayer shall apportion its remaining net income using a fraction [ratio] in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

S.C. Code Ann. § 12-6-2290 (2014).[14] Thus, a service-providing taxpayer is required to use a gross receipts apportionment ratio. Section 12-6-2295 defines "gross receipts" depending upon the type of business in which the corporation is engaged. S.C. Code Ann. § 12-6-2295 (2014). For corporations that provide services, subsection (A)(5) applies, and provides the following:

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> ***
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State . . . .

S.C. Code Ann. § 12-6-2295(A)(5) (2014).

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

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

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

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

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

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

Analysis

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

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

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

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

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

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

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

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

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

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

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

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

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

> Lockwood also argues the statute has not been consistently interpreted by the Tax Commission. *Lockwood refers to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters. We are not persuaded these businesses are comparable to Lockwood.* By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus

> on whether the services are performed in South Carolina. These situations are analogous and consistent with the situation of Lockwood.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> Analogizing the facts in this case to the holding in Mercury [Motor], the beaming of the satellite signals through the air of South Carolina to the customer's dish, set-top box, and television screen, and the collection of charges for such service, are also analogous to the loading, hauling, and delivery of freight following the customer's solicitation of that freight, and the collection of charges therefor. However, the other prior activities that prepare the way for DIRECTV's provision of services, i.e., the infrastructure for producing and collecting the programming content and transmitting the signals would, in comparison to the facts in the Mercury [Motor] case, be akin to the manufacturing and transfer of the freight through its infrastructure to a storage location, from which it is later – **only after an order is placed** (or "solicited," as the Supreme Court put it) – loaded, hauled, and delivered, and for which charges are collected.

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

Although this Court in DIRECTV found delivery of the signal into subscribers' homes and onto their television sets is the income-producing activity, the Court also suggested "other activities," particularly advertising, may be an income-producing activity. Id. at 14 n.15, 19-20. However, this Court ultimately found DIRECTV "did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina" and therefore did not include advertising as an income-producing activity.

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

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

> [u]nlike the taxpayer in Lockwood Greene, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here.

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

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

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

Where Does Petitioner's Income Producing Activity Take Place?

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

Substantial Understatement Penalties

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

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

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer. . . .

Subsection (D)(1) further adds that "[a] penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the

portion and that the taxpayer acted in good faith with respect to the portion." S.C. Code Ann. § 12-54-155(D)(1) (2014). Finally, "[u]nless specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." S.C. Code Ann. § 12-54-160 (2014).

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

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

CONCLUSION

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

ORDER[24]

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

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

AND IT IS SO ORDERED.

SHIRLEY C. ROBINSON
Administrative Law Judge

July 11, 2016
Columbia, South Carolina

CERTIFICATE OF SERVICE

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

This 11th day of July 2016

By: _____
Judicial Law Clerk

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

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

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

FILED
MAY 20 2016
SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

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

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

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

STATEMENT OF THE CASE

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

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

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

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

ISSUE

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

FINDINGS OF FACT

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

Petitioner's Business Operations

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

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

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

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

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

Petitioner's witness, Rex Povenmire, a former Project Manager for Petitioner, spoke extensively about the costs of obtaining programming. According to Povenmire's estimation, Petitioner's contract to televise ESPN costs around $725 million annually. Povenmire also testified that local programming in South Carolina is collected and sent to an uplink center in Texas, for example, where it is then processed before it is distributed. Incoming programming is processed at uplink centers to assure quality (e.g., amplifying the signal), to protect copyrights (e.g., by encrypting the data),[2] to insert content (e.g., public service announcements), and to put the signal into a form that can be transmitted from the uplink centers to satellites orbiting the Earth. After the programming is transmitted to the satellites, the satellites transmit the signal to small satellite dishes mounted on or near subscribers' homes. The small satellite dishes then relay the signal to subscribers' set-top boxes, which un-encrypt the signal and deliver the programming to the subscriber's television for viewing. Petitioner uses two types of satellites: Continental United States "CONUS" satellites and spot beam satellites. Povenmire testified to the hundreds of millions of dollars Petitioner spends to purchase/lease, launch, or otherwise operate and use the satellites. Petitioner owned or leased thirteen satellites during the tax years in question.

Attracting Subscribers and Contracting for Service

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

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

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

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

Petitioner's Revenue

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

Petitioner's Tax Returns

For the tax years at issue, Petitioner filed original and amended tax returns in South Carolina using inconsistent methods to calculate its corporate income tax liability in South

Carolina: sometimes Petitioner used the gross receipts ratio[3] and sometimes Petitioner used the four factor method.[4] The Department used the gross receipts ratio during the tax years in question. When Petitioner filed using the gross receipts ratio, it only sourced a portion of its income from South Carolina subscription receipts to the numerator of the ratio instead of 100% of its South Carolina subscription receipts.[5] Using the four factor method and the gross receipts ratio, Petitioner calculated gross receipts ratios of 0.2384%,[6] 0.2086%, 0.1258%, 0.2400%, .03086%, and 0.2717% for years 2005 through 2010, respectively.

In contrast, during its audit, the Department assessed Petitioner for income taxes and license fees for 2005 through 2010 using a gross receipts ratio that sourced 100% of Petitioner's South Carolina subscription receipts to the numerator of the ratio. The Department's method resulted in gross receipts ratios of 1.3467%, 1.3563%, 1.4537%, 1.4075%, 1.4982%, and 1.6144% for years 2005 through 2010, respectively.[7] In its Report of Field Audit dated June 29, 2012, the Department noted:

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

Later, in its Department Determination issued May 13, 2014, the Department sourced 100% of Petitioner's South Carolina subscription receipts to the numerator, asserting the Petitioner's South Carolina subscription receipts represent its income-producing activity in South

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[3] The "gross receipts ratio" represents a fraction used for multistate taxpayers "in which the numerator is [the taxpayer's] gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." S.C. Code Ann. § 12-6-2290 (2014).

[4] Petitioner used the four factor method in filing its 2005 return. Petitioner also filed using the four factor method in 2008, but amended its return to use the Gross Receipts method.

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

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

[7] Orville Sharpe, a Department employee working with multi-state taxpayers in the Department's Foreign Income Section, testified that businesses like Petitioner's generally have apportionment ratios that are consistent with a state's population in comparison to the United States population. Using data from the U.S. Census Bureau, Mr. Sharpe confirmed that South Carolina's population is approximately 1.5% of the United State population, and thus, Petitioner's apportionment ratio should parallel this ratio.

Carolina pursuant to the applicable statutes defining the gross receipts ratio. Discussing Petitioner's income-producing activity, the Department found:

> It is ***the final act***, the culmination of those enumerated activities[8] – the delivery of the signal into the homes and onto the television screens of its customers – that produces income for [Petitioner]. [Petitioner] does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. [Petitioner] is in the business of selling television broadcast subscriptions to customers, and without the actual delivery of that broadcast signal into South Carolina homes it would not have generated the income at issue here. It is that act alone for which South Carolina customers sign contracts and pay their monthly fees.

The Department further commented in its Determination that:

> South Carolina is not alone in this method of sourcing [subscription] receipts [to the numerator] for taxpayers like [Petitioner]. Twenty-three states have adopted the "audience approach" for assigning receipts from programing and broadcasting companies.

The Department's Tax Policy

The Department has used the gross receipts ratio for years to determine the tax liability for businesses not dealing in tangible personal property (i.e. service providers). In fact, the Department claims it has a long-standing policy of examining the specific activities of each applicable industry to determine what activities are income-producing prior to determining how gross receipts are sourced. For example, the Department asserts that when it sources the taxable income of an engineering firm, it looks to the actual engineering services as constituting the income-producing activity generating the gross receipts; and accordingly, sources the income to the location of the engineer. On the other hand, the Department contends it sources income received from the licensing of intangibles and from a financing operation to the location of the sale that generates the license fee (in the case of intangibles) and the location of the borrower (in the case of a financing company). Likewise, the Department maintains it sources gross receipts related to cable companies and telephone companies to the location of the sale, as it similarly did with Petitioner.

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

> South Carolina is not a "cost of performance state;" *i.e.*, a state where receipts are always sourced to the state where the costs to produce the receipts are incurred. It

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

> is also not a "market state;" *i.e.* a state where receipts are always sourced to the state where the item or service is consumed or the location of the payer.

Rick Handel, Deana West & William West, South Carolina Department of Revenue Policy: South Carolina Corporate Income Taxes 17 (2005). The policy manual goes on to discuss receipts from intangibles and makes the following statement:

> Receipts from intangible personal property are assigned to the state where the income-producing activity is. If the income-producing activity is performed partly within and partly without South Carolina, sales are attributable to South Carolina to the extent the income-producing activity is performed within South Carolina.

Id. at 18. Further, the policy manual provides the following comment discussing the two leading tax cases in South Carolina addressing gross receipts and apportionment:

> Considering Lockwood Greene[9] and Geoffrey,[10] together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; e.g., personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income. This conclusion is consistent with the longstanding administrative policy of the department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers.

Id. at 20.

The Department also introduced evidence of minutes from a Department meeting held on August 24, 1977, in which the Department reviewed a proposed regulation describing the gross receipts ratio. This proposed regulation provided that a taxpayer rendering "personal services . . . shall include in the numerator and denominator of the gross receipts ratio the amount charged for services performed within this State" and the denominator shall include the total charged for services without the state. According to handwritten notes on the minutes, instead of approving the regulation, the Department adopted it as a "rule of construction."[11] Id.

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[9] Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987).

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

[11] John Swearingen, a Department employee at the time this rule of construction was adopted, testified the rule has been followed ever since for businesses engaged in personal services, such as engineering firms.

CONCLUSIONS OF LAW

Standard of Review

This Court has jurisdiction to hear this contested case pursuant to section 1-23-600(A) of the South Carolina Code (Supp. 2014) and section 12-60-460 of the South Carolina Code (2014). The Court hears contested cases *de novo*. Hill v. S.C. Dep't of Health & Envtl. Control, 389 S.C. 1, 9, 698 S.E.2d 612, 616 (2010) ("The proceeding before the ALJ was a de novo hearing, which included the presentation of evidence and testimony."). The Court makes its factual findings based upon a preponderance of the evidence. See S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2014). Generally, the party asserting the affirmative issue in an adjudicatory administrative proceeding has the burden of proof. See Leventis v. S.C. Dep't of Health & Envtl. Control, 340 S.C. 118, 133, 530 S.E.2d 643, 651 (Ct. App. 2000) (citing 2 Am.Jur.2d *Administrative Law* § 360 (1994)). Here, Petitioner requested a contested case hearing and, therefore, has the burden of proof to show by a preponderance of the evidence that the Department's tax assessment is incorrect. See id.; Anonymous (M-156-90) v. State Bd. of Med. Examiners, 329 S.C. 371, 375, 496 S.E.2d 17, 19 (1998) (holding the standard of proof in "administrative hearings is generally a preponderance of the evidence"). Although a tax assessment is initially presumed correct, if a taxpayer establishes an assessment is incorrect, either by proving the actual valuation or through other evidence establishing that the assessment is incorrect, the presumption of correctness is removed and the taxpayer is entitled to appropriate relief. Cloyd v. Mabry, 295 S.C. 86, 88-89, 367 S.E.2d 171, 173 (Ct. App. 1988).

South Carolina Corporate Income Tax Generally

In South Carolina, corporate income tax "is imposed annually at the rate of five percent on the South Carolina taxable income of every corporation . . . transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce." S.C. Code Ann. § 12–6–530 (2014). "A corporation's taxable income in South Carolina is computed using the Internal Revenue Code with modifications as provided by South Carolina law, and this amount is 'subject to allocation and apportionment as provided in Article 17 of this chapter.'" Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 145, 694 S.E.2d 525, 528 (2010) (citing S.C. Code Ann. § 12-6-580 (2000)). Further, when "a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which

reasonably represents the proportion of the trade or business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014); see Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987) ("The purpose of the allocation statutes is to provide for imposition of South Carolina income tax 'upon a base which reasonably represents the proportion of the trade or business carried on within this State.'" (citation omitted)). This method of imposition is consistent with constitutional requirements for the taxation of corporations engaged in interstate commerce. See Geoffrey, Inc. v. S.C. Tax Comm'n, 313 S.C. 15, 23, 437 S.E.2d 13, 18 (1993) ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State.").

Petitioner is a Service Provider

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

Apportionment Methods Generally

Generally, there are two predominate methods for sourcing income from services: the "costs of performance" method and the "market share" or "audience" method. The costs of performance method

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

Hellerstein & Hellerstein, State Taxation ¶ 19.8, 46 (3rd ed. 2014). Costs of performance is the method utilized in the Uniform Division of Income for Tax Purposes Act ("UDIPTA"). Section 17 of UDIPTA utilizes standard costs of performance language:

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

Unif. Division of Income for Tax Purposes Act § 17 (Supp. 2013) (emphasis added). Under the costs of performance method, income is sourced based on where the costs occur for the income producing activity. Additionally, this method creates an "all-or-nothing" situation because, if the greater portion of the costs of performance takes place outside the taxing state, then income cannot be sourced to the taxing state.

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

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

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

In contrast, the market share/audience method or, as it has been referred to in this State, the "origin of payment" method, sources receipts "to where a taxpayer's customers are located and payments made." Lockwood Greene, 293 S.C. at 448, 361 S.E.2d at 347. Under this method, even if all the costs of performance take place in a foreign state, the taxing state can source income from the receipts of in-state purchasers. Hellerstein & Hellerstein's treatise provides several examples of market share language, including the following phrases: sales are in this state "if the taxpayer's market for the sale is in this state;" sales are attributable to the state in which the purchaser "received the benefit of the service;" or sales from services are assigned to the state "to the extent the purchaser of the service received the benefit of the service in this state." Hellerstein & Hellerstein, ¶ 19.8, 50-51.

South Carolina's Apportionment Statute

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

> [T]he taxpayer shall apportion its remaining net income using a fraction [ratio] in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

S.C. Code Ann. § 12-6-2290 (2014).[12] Thus, a service-providing taxpayer is required to use a gross receipts apportionment ratio. Section 12-6-2295 defines "gross receipts" depending upon the type of business in which the corporation is engaged. S.C. Code Ann. § 12-6-2295 (2014). For corporations that provide services, subsection (A)(5) applies, and provides the following:

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> ***
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State . . . .

S.C. Code Ann. § 12-6-2295(A)(5) (2014).

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

Petitioner claims the Department should not source 100% of South Carolina subscription receipts to the numerator of the gross receipts ratio. It claims South Carolina subscription receipts do not adequately reflect its income-producing activities in South Carolina. Additionally, Petitioner claims it has several income-producing activities that take place within and without

[12] In 2007, the General Assembly amended section 12-6-2290 by adding the last sentence: "For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295." 2007 Act Nos. 110 &116. Therefore, only section 12-6-2290 is applicable for tax years 2005 – 2006, and sections 12-6-2290 and 12-6-2295(A)(5) are applicable for tax years 2007-2010.

South Carolina and this activity is best measured by costs of performance principles. Petitioner's method of income sourcing is based on its assertion that South Carolina is a pro rata costs of performance state. As support for its sourcing theory, Petitioner offered the testimony of Ray Stevens, a tax attorney, and former Director of the Department and former Administrative Law Judge. The Court qualified Mr. Stevens as an expert in Policy Issues in Multi-State Taxation. Mr. Stevens testified that to his knowledge, South Carolina is not a strict costs of performance state or a market share state; rather, he believes it is a pro rata costs of performance state. He cited to Hellerstein & Hellerstein's tax treatise to support his theory, contending that Hellerstein & Hellerstein found South Carolina to be a pro rata costs of performance state.[13] Mr. Stevens also cited Mercury Motors[14] and Lockwood Greene, cases in which South Carolina courts rejected the argument that South Carolina is a market share state, to further suggest South Carolina sources income based on cost-based principles in contrast to market based principles. He then recounted his time litigating Lockwood Greene and opined Lockwood Greene stands for the principle that income tax is apportioned based on where the costs of performance are located. Although Mr. Stevens acknowledged that the court in Lockwood Greene mentioned different types apportionment methods for different types of industry, he asserted this was merely dicta and has no legal bearing on the current case. Mr. Stevens further acknowledged that the services provided by the taxpayers in Lockwood Greene, Mercury Motors, and Rent-A-Center[15] are different from the media broadcasting services at issue here, but opined that in each of these cases the underlying apportionment principles were based on pro rata costs of performance.

In contrast, the Department argues South Carolina apportions income tax solely based on where a business' income-producing activity takes place without necessarily relying on cost of performance factors to source that income.[16] To support its theory, the Department introduced the

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[13] See Hellerstein & Hellerstein at ¶ 9.18 n.1187 (citation omitted): "According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) *and South Carolina* (services only)."

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

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

[16] Regarding the Department's alleged long-term policy to source gross receipts from subscription revenues for Petitioner's type of business, I find this policy was recognized by the South Carolina Court of Appeals in Lockwood Greene and perhaps written down at some time, but it currently does not exist in written or regulatory form. Accordingly, I do not defer to it. See S.C. Code Ann. § 1-23-10(4) (2005) ("Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law."); see also Kirven v. Cent. States Health & Life

testimony of John Swain, a law professor specializing in state and local taxation, whom the Court qualified as an expert in Tax Policy and Multi-state Apportionment. Professor Swain testified he is one of the authors of Hellerstein & Hellerstein's treatise, and opined the treatise does not state South Carolina is a strict costs of performance state, nor does the treatise definitively state South Carolina is a pro rata costs of performance state.[17]

Professor Swain discussed the Department's method of income sourcing/apportionment in this case and described the Department's method as good tax policy for three specific reasons. First, he stated section 12-6-2290 of the South Carolina Code mandates the use of a gross receipts ratio, and commonly the purpose of a gross receipts ratio is to "reflect the contribution of the market state" (in this case, South Carolina) to Petitioner's income production, even though Petitioner is not principally located in South Carolina. Second, he noted the General Assembly's adoption of statutes mandating the use of a sales/gross receipts apportionment ratio reflects the nationwide movement to a "single-sales factor apportionment," which allows states to compete with other states in an age when "capital and labor are mobile." Third, he explained the Department's approach promotes equity by attempting to treat like taxpayers in a like manner, unlike Petitioner's approach, which would result in similar businesses in comparable industries being treated differently.[18] Professor Swain contrasted the Department's policy, which he described as easily applied, with UDIPTA's costs of performance method, which he described as leading to uncertainty for both taxpayers and the Department because the costs of performance method is "[c]onfusing and indefinite and plagued by vagueness, ambiguity, substantial debate, lack of clear guidance, whipsawing,[19] tremendous flexibility, and hence tax planning opportunities,

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Co., of Omaha, 409 S.C. 30, 45, 727 S.E.2d 794 802 (2014) ("[A]n agency guideline does not have the force of law, and in any event, can never trump a regulation . . . . Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law.") (quoting Doe v. S.C. Dep't of Health & Human Servs., 398 S.C. 62, 68 n.7, 727 S.E.2d 605, 608 n.7 (2011)).

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

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

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

[and] frequent litigation." Finally, Professor Swain stated the Department's method of sourcing, in addition to being good tax policy, is consistent with authority in other jurisdictions, including jurisdictions that have cost of performance statutes.[20]

Analysis

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

Initially, I find South Carolina is not a strict costs of performance state. Comparing section 12-6-2295(A)(5) to Hellerstein & Hellerstein's description of strict costs of performance and section 17 of UDIPTA, it is clear South Carolina has not adopted strict costs of performance. Specifically, while section 12-6-2295(A)(5) is similar to section 17 of UDIPTA, the differences between the two are determinative. The General Assembly, while aware of section 17 of UDITPA, *specifically chose not* to include the phrase "based on costs-of-performance" in section 12-6-2295(A)(5).[21] Moreover, unlike section 17 of UDIPTA or Hellerstein & Hellerstein's example of costs of performance, section 12-6-2295(A)(5) does not result in an all-or-nothing outcome where only the state with the most income-producing activity, *as measured by costs of performance*, can source receipts for tax purposes. Rather, section 12-6-2295(A)(5) focuses solely on the "income-producing activity" and where that activity takes place. The only real similarity between the South Carolina statute and UDIPTA is that both rely on "income-producing activity" as a measure of sales; however, as noted above, unlike section 12-6-2295(A)(5), section 17 of UDIPTA requires the use of cost of performance as a proxy for income-producing activity. Additionally, the Department's policy manual from 2005 claims South Carolina is not a cost of performance state.

[20] For example, Oregon, whose apportionment statute includes the phrase "based on costs of performance," recently determined the income-producing activity for a taxpayer's telephone service was the individual sales to customers, not the taxpayer's costs to run its network. AT&T Corp & Includible Subsidiaries v. Dep't of Revenue, 357 Or. 691, 358 P.3d 973 (2015). Also see Walter E. Heller W., Inc. v. Dep't of Revenue, 161 Ariz. 49, 775 P.2d 1113 (1989).

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

See Rick Handel, Deana West & William West, South Carolina Department of Revenue Policy: South Carolina Corporate Income Taxes 17 (2005). Therefore, based on the clear language of section 12-6-2295(A)(5) and its marked differences from section 17 of UDIPTA, I find South Carolina is not a strict cost of performance state.

Next, it is equally clear South Carolina is not a market share or audience state, although, as the Department points out, many states have adopted this method for media broadcasting companies.[22] Indeed, Hellerstein & Hellerstein comment:

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

Hellerstein & Hellerstein at ¶ 10.05, 1. However, section 12-6-2295(A)(5) does not include language typical of a market share statute because it does not include language referencing the taxpayer's "market for the sale" or "the place in which the purchaser received the benefit of the service." See Hellerstein & Hellerstein at ¶ 19.8, 50-51. Rather, section 12-6-2295(A)(5) focuses solely on the "income-producing activity" and where this activity is performed. Further, the Department's 2005 policy manual states South Carolina is not a market share state. See Rick Handel, Deana West & William West, South Carolina Department of Revenue Policy: South Carolina Corporate Income Taxes 17 (2005). Therefore, based on the foregoing, I find South Carolina is not a market share state.

Now we turn to Petitioner's contention that South Carolina is a pro rata costs of performance state. While pro rata costs of performance eliminates the all-or-nothing aspect of strict cost of performance, it still uses costs of performance as a proxy for income-producing activity. Section 12-6-2295(A)(5) focuses exclusively on *income-producing activity* and where it takes place without requiring or referencing a proxy to measure income-producing activity. Therefore, I conclude South Carolina is not a pro rata costs of performance state. Rather, as this

[22] In its Determination, the Department determined 100% of South Carolina subscriber's receipts should be sourced to South Carolina. The Department Determination noted: "South Carolina is not alone in this method of sourcing receipts for taxpayers like [Petitioner]. Twenty-three states have adopted the 'audience approach' for assigning receipts from programming and broadcasting companies." Petitioner claims this quote shows the Department inappropriately applied the market share/audience method in its audit. This Court finds the result of sourcing receipts based on income-producing activity in this case mimics the result of applying a market share or audience method. Therefore, I find the Department's comparison of its sourcing method in this case to a market share or audience method is perhaps misleading, but apt.

Court suggested in its decision in DIRECTV, I find South Carolina's apportionment statute provides a flexible standard based upon the income-producing activity for a given industry. See DIRECTV, Inc. & Subsidiaries v. South Carolina Department of Revenue, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC, 18 (finding "S.C. Code Section 12-6-2295(A)(5) provides 'flexibility' in determining the relative amount of income-producing activities in the State. This approach necessitates flexibility in application of law and policy to different and often diverse service industries."). In essence, South Carolina's statue was constructed to avoid a one-size fits all apportionment method because one size does not fit every industry. This position is supported by the Court of Appeals decision in Lockwood Greene.

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

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

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

Essentially, the court chose to use the phrase "place of activity," and never used the phrase "cost of performance" in its opinion even though it used payroll (a cost) as a proxy for income-producing activity. Id. Further, while the "place of activity" method resembles the cost of performance method to some extent, an all-or-nothing component was not applied based upon the location of the "greater proportion" of the activities. Thus, the court's "place of activity" method

resembles pro rata costs of performance. However, the court's comments in Lockwood Greene suggest the type of industry being taxed may affect the application of the statute:

> Lockwood also argues the statute has not been consistently interpreted by the Tax Commission. *Lockwood refers to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters. We are not persuaded these businesses are comparable to Lockwood.* By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus on whether the services are performed in South Carolina. These situations are analogous and consistent with the situation of Lockwood.

Id. 293 S.C. at 450, 361 S.E.2d at 348 (emphasis added). It is important to note that, in the context of the engineering firm in Lockwood Greene, the costs of performance and income-producing activity took place in the same location.[23] Moreover, payroll may have been the best representation of the income-producing activity available to the court, but it does not mean that payroll or a similar cost-based proxy for income-producing activity, will be the best metric in every case for every type of industry.

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

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

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

> According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) *and South Carolina* (services only)." P. Mata & M. Smith, "The Implementation of 'Market' Sourcing Rules: Practical Concerns," State Tax Notes, Sept. 6, 2010, p. 649 (citing statutes and regulations). (Emp. added.)

performance. See id. at 1-13. The focus was solely on where the income-producing activity took place.

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

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

income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State.").

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

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

Unfortunately, South Carolina's statutory law does not define "income-producing activity." Petitioner argues this Court should apply the Multi-state Tax Commission's[24] definition of income-producing activity developed for section 17 of UDIPTA to determine Petitioner's income-producing activities. This definition provides:

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

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

Petitioner argues South Carolina subscription receipts do not adequately represent its income-producing activities in the state. Petitioner claims it has eight income producing activities, including: (1) the acquisition of programming/content; (2) the operation of satellites and uplink centers; (3) advertising; (4) providing subscriber equipment; (5) installation of equipment; (6) in-home repair; (7) the operation of call centers; and (8) general and administrative activities.

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

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

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

To support its position, the Department introduced the testimony of Glenn Harrison, who this Court qualified as an expert in Applied Economics. Dr. Harrison testified that in his opinion, subscriber revenue is the simplest way to determine Petitioner's income-producing activity. He noted that Petitioner acknowledges in its own corporate filing to the United States Securities and Exchange Commission that it recognizes its subscription receipts as revenue when the service has been delivered.[25] Dr. Harrison opined Petitioner's expenditures on satellites, engineering skills, the purchasing of programming and networking licenses, etc., are intermediate inputs that generate costs rather than income, and stated he would not include these intermediate activities in a calculation of revenue. He further explained that while call centers, for example, are necessary to the ultimate income-producing activity of delivering the broadcasting service into customer homes, the call center itself does not actually produce income.

Dr. Harrison also opined it is appropriate to source Petitioner's income differently than a professional service firm like an engineering firm. Making the distinction, he explained an engineering firm does not "have to provide the services in the place that [the services are] actually

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

produced; whereas in the case of [Petitioner], and media services generally, [the services are] produced at the place in which they're consumed, whether it was my house in Irmo or counsel's house in Edisto Island." Dr. Harrison testified he believes the most accurate way to measure Petitioner's income-producing activity in South Carolina is to use Petitioner's subscription receipts from its South Carolina customers.

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

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

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

Id. 244 S.C. at 141, 135 S.E.2d at 759. Thus, the income-producing activity in Mercury Motor was the "hauling of freight." Petitioner seeks to analogize its preparatory activities, such as the acquisition of programming and processing at its uplink centers, to Mercury Motor's "picking up of freight, the hauling of freight, the delivery of the same and collections of charges therefor." Id.

I disagree with this analogy and find the analogy drawn by this Court in the DIRECTV decision to be more apt:

> Analogizing the facts in this case to the holding in Mercury [Motor], the beaming of the satellite signals through the air of South Carolina to the customer's dish, set-top box, and television screen, and the collection of charges for such service, are also analogous to the loading, hauling, and delivery of freight following the customer's solicitation of that freight, and the collection of charges therefor. However, the other prior activities that prepare the way for DIRECTV's provision of services, i.e., the infrastructure for producing and collecting the programming content and transmitting the signals would, in comparison to the facts in the Mercury [Motor] case, be akin to the manufacturing and transfer of the freight through its infrastructure to a storage location, from which it is later – **only after an order is placed** (or "solicited," as the Supreme Court put it) – loaded, hauled, and delivered, and for which charges are collected.

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

Although this Court in DIRECTV found delivery of the signal into subscribers' homes and onto their television sets is the income-producing activity, the Court also suggested "other activities," particularly advertising, may be an income-producing activity. Id. at 14 n.15, 19-20. However, this Court ultimately found DIRECTV "did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina" and therefore did not include advertising as an income-producing activity.

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

Also, I find it is appropriate, as Dr. Harrison opined, to distinguish the income-producing activity of media broadcasting company services from other services, like professional engineering services. Specifically, I agree with DIRECTV's differentiation between the income-producing activity of media broadcasting companies and the income-producing activity of personal

professional service providers like the engineering firm in Lockwood Greene. Analogizing Petitioner to DIRECTV, I agree with this Court's comment in DIRECTV that

> [u]nlike the taxpayer in Lockwood Greene, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here.

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

In sum, I conclude that pursuant to section 12-6-2295(A)(5), Petitioner's income-producing activity is the delivery of its signal into a subscribers' homes and onto the their television screens. Because South Carolina subscription receipts are directly tied to the income producing activity, I find Petitioner's South Carolina subscription receipts most accurately represent Petitioner's income attributable to this State. I also find subscription receipts, rather than Petitioner's costs of performance, most accurately reflect the proportion of business Petitioner carries on within this State in accordance with section 12–6–2210(B) of the South Carolina Code. S.C. Code Ann. § 12-6-2210(B) ("[T]he South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State."); see also Geoffrey, Inc., 313 S.C. at 23, 437 S.E.2d at 18 ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State."); Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 606, 258 S.E.2d 93, 99 (1979) ("A court's primary concern in the due process area is not to improvise a method for computing taxes, but to inquire as to whether or not the method provided imposes a tax which bears a reasonable relationship to the taxpayer's activities in this State."). Petitioner's costs of performance in South Carolina is not a fair representation of Petitioner's business in South Carolina because its costs of performance are relatively small in South Carolina compared to the revenue Petitioner's reaps from South Carolina subscribers.[26]

[26] For example, although Petitioner's South Carolina subscribers make up approximately 1.6% of Petitioner's total subscribers (and one would assume approximately 1.6% of its revenue as a result), Petitioner's gross receipts ratios that it calculated using pro rata costs of performance for the tax years at issue are much lower than 1.6%, illustrating

Where Does Petitioner's Income Producing Activity Take Place?

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

Substantial Understatement Penalties

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

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

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer. . . .

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its costs in South Carolina are a poor representation for the income Petitioner receives from South Carolina. See Petitioner's Exhibit #36.

Subsection (D)(1) further adds that "[a] penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the portion and that the taxpayer acted in good faith with respect to the portion." S.C. Code Ann. § 12-54-155(D)(1) (2014). Finally, "[u]nless specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." S.C. Code Ann. § 12-54-160 (2014).

Based on its audit, the Department determined Petitioner is responsible for a substantial understatement for the tax years at issue. As a result, the Department assessed Petitioner civil penalties. The Department's Determination shows it calculated Petitioner owes $544,286.00 in income taxes, $399,496.00 in related interest,[27] and $276,307.00 in related penalties. The Department also calculated Petitioner owes $90,551.00 in license fee taxes, $32,196.00 in related interest,[28] and $21,846.00 in related penalties. Based on my finding that the Department applied the correct gross receipts ratio during its audit to determine Petitioner's tax liability for tax years 2004-2010, I find the Department correctly calculated the taxes, interest, and penalties owed by Petitioner for this time period.

Regarding the civil penalties, Petitioner has presented no evidence to refute the Department's calculation of the penalties except its argument that the Department applied the wrong apportionment method and gross receipts ratio during its audit. Having determined the Department correctly conducted the audit, I must only determine whether the penalties were proper considering section 12-54-155(B)(2)(b). To this end, I find there was no substantial authority for Petitioner's treatment of subscription receipts. See id. Also, although Petitioner disclosed the relevant facts regarding the subscription receipts, I find there was no reasonable basis for Petitioner's tax treatment of the subscription receipts. Id. Therefore, I uphold the Department's assessment of penalties in this case.

CONCLUSION

Based on the foregoing, I find South Carolina statutes provide a flexible apportionment standard based on where the income-producing activity takes place for the particular industry being assessed. Further, in this case, I find the income-producing activity was the delivery of Petitioner's signal to South Carolina subscribers' set-top boxes and onto the subscribers' television sets.

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

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

Moreover, I find the income-producing activity takes place entirely within South Carolina. Because South Carolina subscription receipts represent the income-producing activity taking place in South Carolina, I find the Department appropriately sourced 100% of Petitioner's South Carolina subscription receipts to South Carolina in the numerator of the gross receipts ratio pursuant to sections 12-6-2290 and 12-6-2295(A)(5) of the South Carolina Code. Accordingly, I uphold the Department's Determination in its entirety.

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

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

AND IT IS SO ORDERED.

SHIRLEY C. ROBINSON
Administrative Law Judge

May 20, 2016
Columbia, South Carolina

CERTIFICATE OF SERVICE
This is to certify that the undersigned has served this order in the above-entitled action upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, or in the Interagency Mail Service addressed to the party(ies) or their attorney(s).
This 20 day of May 2016
By: Judicial Law Clerk

54346-1

FILED

APR 21 2015

SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation f/k/a EchoStar DBS, Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue Respondents.	Docket No. 14-ALJ-17-0285-CC **ORDER DENYING MOTION IN LIMINE TO EXCLUDE STIPULATION AND COURT TRANSCRIPTS**

This matter is before the South Carolina Administrative Law Court ("the ALC" or "the Court") pursuant to a request for a contested case hearing filed by Dish DBS Corporation f/k/a EchoStar DBS, Corp., and Affiliates ("Petitioner") challenging the South Carolina Department of Revenue's ("respondent's" or "the Department's") final determination, in which the Department assessed Petitioner for South Carolina income taxes. Specifically, Petitioner contests the apportionment method the Department used to determine the amount of income tax assessed during an audit for the tax years 2004-2010.

This Court has already addressed and denied cross-motions for summary judgment filed by the parties in an order issued February 3, 2015. Petitioner then filed a Motion in Limine to Strike Proposed Expert Witness from the Department's witness list. In an order issued March 25, 2015, this Court denied Petitioner's motion. Now Petitioner has filed a Motion in Limine to Exclude Stipulation and Court Transcripts. Specifically, Petitioner asks this Court for an order

> instructing all parties and witnesses to refrain from making any mention, directly or indirectly, in any manner whatsoever and/or to exclude the evidence or testimony relating to the Stipulation entered into in the Lockwood Greene State Tax Commision hearing . . . and subsequent Circuit Court appeal . . . as well as the Trial Transcript and Exhibits from the contested case hearing in that matter . . . .

The case to which Petitioner is referring is Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987). At the end of the South Carolina Court of Appeals' opinion in Lockwood Greene Engineers, Inc., the Court makes what Petitioner would categorize as an inappropriate reference to stipulations made in that particular

case that have no relevance to the current case. Petitioner argues it believes the Department intends to use the underlying stipulation and trial transcripts in violation of Rule 801 of the South Carolina Rules of Evidence ("SCRE"), the rule against hearsay. Petitioner also argues the stipulation and trial transcripts are inadmissible because they are irrelevant under Rule 401, SCRE. Petitioner further argues the stipulation and transcripts do not fall within Rule 803, SCRE's public records exception. Finally, Petitioner argues that the stipulation is inadmissible because it was not executed by Petitioner and because it states a legal conclusion.

The Department filed a Response in opposition to Petitioner's motion. The Department argues evidence of the stipulation and the trial transcripts will assist the Court in "understanding the testimony and the Department's long-standing policy regarding the apportionment of corporate income for businesses and/or industries." The Department also points out that the stipulation and trial transcripts at issue were recently admitted into evidence in a very similar case before this Court. It also argues that the stipulation and trial transcripts are not hearsay and that granting Petitioner's motion would be prejudicial and inequitable to the Department. It further argues Petitioner's motion is in violation of Rule 106, SCRE, because Petitioner's entire case is based upon the court of appeals' decision in Lockwood Greene Engineers, Inc.

Upon review of the parties' arguments and the documents submitted, the Court denies Petitioner's motion. The court of appeals' decision in Lockwood Greene Engineers, Inc. is integral to both parties' arguments, and a decision regarding the admissibility of this case's associated stipulations or transcripts and other related documents are not to be taken lightly. The Court is not inclined to rule on the admissibility of documents related to this case until the contested case hearing when the stipulation and trial transcripts can be placed in context and addressed individually.

Therefore, it is hereby **ORDERED** that Petitioner's Motion in Limine to Exclude Stipulation and Court Transcripts is **DENIED.**

SHIRLEY C. ROBINSON
Administrative Law Judge

April 21st, 2015
Columbia, South Carolina

CERTIFICATE OF SERVICE
This is to certify that the undersigned has this date served this order in the above entitled action upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, or in the interagency Mail Service addressed to the party(ies) or their attorney(s).
This 21 day of April, 2015
By: Kathy M Booker

54346-1

FILED

MAR 25 2015

SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a/ EchoStar, DBS Corp., and Affiliates, Petitioner, v. South Carolina Department of Revenue, Respondent.	Docket No.: 14-ALJ-17-0285-CC **ORDER DENYING MOTION IN LIMINE TO STRIKE PROPOSED EXPERT WITNESS**

APPEARANCES: Petitioner: Burnet R. Maybank, III, Esquire
Jim Rourke, Esquire
Respondent: Nicole M. Wooten, Esquire
William J. Condon, Esquire

STATEMENT OF THE CASE

This matter is before the South Carolina Administrative Law Court ("the ALC" or "the Court") pursuant to a Request for a Contested Case Hearing filed by Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates ("Petitioner") challenging the South Carolina Department of Revenue's ("Respondent's" or "the Department's") final determination, in which the Department assessed Petitioner for South Carolina income taxes. Specifically, Petitioner contests the apportionment method the Department used to determine the amount of income tax assessed during an audit for the tax years 2004-2010. Petitioner also contests assessments related to license fees, related penalties, and interest for the tax years 2006-2011.

This Court has already addressed and denied cross-motions for summary judgment filed by the parties in an order issued February 3, 2015. Now Petitioner has filed a Motion in Limine to Strike Proposed Expert Witness from the Department's witness list. Petitioner argues the testimony of the proposed expert, Glenn W. Harrison, Ph.D., has no relevance to the case. The Department filed a response in opposition to Petitioner's motion, arguing Dr. Harrison has been qualified as an expert in this Court previously in a case with an almost identical issue. Having reviewed the filings, I deny Petitioner's motion.

BACKGROUND

Petitioner is a multi-media broadcasting corporation engaged in providing access to digital television entertainment across the United States, including in South Carolina. Petitioner provides its service through the transmission of digital signals (programming) from several satellites to receiver boxes located in subscribers' homes. The individual subscribers pay for this service.

This controversy arose when the Department conducted an audit of Petitioner's tax filings for the years 2004-2010. Following the audit, the Department determined Petitioner had used inconsistent methods to calculate its income tax liability for the audit period, sometimes using what is referred to as the "cost of performance method" and sometimes using other methods. The issue in this case centers, in large part, on determining what form of tax apportionment South Carolina applies to a business like Petitioner's.

Dr. Harrison is employed at Georgia State University in Atlanta, Georgia. He is the Chair of Risk Management and Insurance in the Department of Risk Management Insurance in the Robinson College of Business and he is also the Director of the Center for the Economic Analysis of Risk. He has conducted research in the areas of public finances and law and economics, among other areas. He has taught courses on law and economics for over fifteen years. Dr. Harrison has a Masters degree and a Post Doctorate degree in economics from the University of California at Los Angeles. He has previously been qualified as an expert in several cases, including before this Court. More specifically, Dr. Harrison was recently qualified as an expert in economics generally and in economics and the law before Chief Judge Ralph King Anderson, Jr. in a case almost identical to this one.

DISCUSSION

Petitioner claims Dr. Harrison's knowledge as a person holding a Ph.D. in general economics without a demonstration that he has expert knowledge on the narrow issue of state tax apportionment makes his knowledge irrelevant to this proceeding. In rebuttal, the Department argues it is not attempting to qualify Dr. Harrison as an expert on the narrow subject of state tax apportionment; rather, it is interested in Dr. Harrison's expert general economic perspective on Petitioner's business to help the Court understand the evidence presented at the hearing. The Department cites Dr. Harrison's previous qualification as an expert witness in an almost identical case before this Court in which his testimony assisted the Court in distinguishing between what

have been categorized as Petitioner's prior, intermediate, and income-generating activities. The Department also argues Petitioner's request is extreme at this juncture.

Rule 702 of the South Carolina Rules of Evidence provides:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

Whether or not a person is qualified as an expert is in the Court's discretion. See McDill v. Mark's Auto Sales, Inc., 367 S.C. 486, 490, 626 S.E.2d 52, 55 (Ct. App. 2006) ("The qualification of an expert witness and the admissibility of his or her opinion are matters resting within the sound discretion of the trial judge.").

At this time, I am no persuaded by Petitioner's argument to strike Dr. Harrison from the Department's list of witnesses. Petitioner claims Dr. Harrison's testimony would be no more helpful than an expert in transportation or Parks, Recreation and Tourism. I disagree. The field of economics is indisputably tied to the field of business, and Petitioner is engaged in business, which is subject to the principles of economics. Furthermore, although it is not determinative, Dr. Harrison was previously qualified as an expert in economics generally and economics and the law in an almost identical case heard before this Court.

Based on the above, I find Dr. Harrison's testimony may be relevant and his specialized knowledge may assist the trier of fact. However, whether Dr. Harrison will be qualified as an expert and what weight his testimony may be given in this case is a determination this Court will make at the hearing. See Florence Cnty. Dep't of Soc. Servs. v. Ward, 310 S.C. 69, 72-73, 425 S.E.2d 61, 63 (Ct. App. 1992) ("A trier of fact is not compelled to accept an expert's opinion, but may give it the weight he determines it deserves.").

THEREFORE, IT IS HEREBY ORDERED that the Petitioner's Motion in Limine to Strike Proposed Expert Witness is **DENIED**.

AND IT IS SO ORDERED.

SHIRLEY C. ROBINSON
Administrative Law Judge

Columbia, South Carolina
March 25th, 2015

CERTIFICATE OF SERVICE
This is to certify that the undersigned has on this date served this order in the above entitled action upon all parties to this cause by depositing a copy thereof, in the United States mail, postage paid, or via Interagency Mail Service addressed to the party(ies) or their attorney(s).
this 25 day of March 2015
Kathy M. Bradham
Judicial Law Clerk

54346-1

FILED

FEB 10 2015

SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a/ EchoStar, DBS Corp., and Affiliates, Petitioner, v. South Carolina Department of Revenue, Respondent.	Docket No.: 14-ALJ-17-0285-CC **ORDER DENYING CROSS MOTIONS FOR SUMMARY JUDGMENT**

APPEARANCES: Petitioner: Burnet R. Maybank, III, Esquire
Jim Rourke, Esquire
Respondent: Nicole M. Wooten, Esquire
William J. Condon, Esquire

STATEMENT OF THE CASE

This matter is before the South Carolina Administrative Law Court ("the ALC" or "the Court") pursuant to a Request for a Contested Case Hearing filed by Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates ("Petitioner") challenging the South Carolina Department of Revenue's ("Respondent's" or "the Department's") final determination, in which the Department assessed Petitioner for South Carolina income taxes. Specifically, Petitioner contests the apportionment method the Department used to determine the amount of income tax assessed during an audit for the tax years 2004-2010. Petitioner also contests assessments related to license fees, related penalties, and interest for the tax years 2006-2011.

The Department issued its final determination on May 13, 2014. Petitioner timely appealed to this Court on June 12, 2014. On January 6, 2015, Petitioner filed a Motion for Summary Judgment pursuant to ALC Rule 19 and Rule 56 of the South Carolina Rules of Civil Procedure ("SCRCP") on the narrow issue of whether South Carolina is a "cost of performance"[1] state. Thereafter, on January 27, 2015, the Department submitted a Reply in opposition to Petitioner's motion and filed a Cross Motion for Summary Judgment. In its Reply, the Department argues Petitioner is not entitled to judgment as a matter of law because a genuine

[1] Cost of performance describes a particular method for apportioning income taxes for corporations providing services across multiple states.

issue of material fact exists as to what method South Carolina utilizes to apportion income taxes for corporations providing services across multiple states. In its Motion for Summary Judgment, the Department asks this Court to determine, as a matter of law, that the apportionment method it used in assessing Petitioner's income taxes, which it described as other than cost of performance, is the correct method. On January 30, 2015, Petitioner filed a reply to the Department's motion. On February 3, 2015, this Court held a hearing on the parties' cross motions for summary judgment.

BACKGROUND

Petitioner is a multi-media broadcasting corporation organized under the laws of Nevada, and its principal executive offices are located in Englewood, Colorado. Petitioner is engaged in providing access to digital television entertainment across the United States, including in South Carolina. Petitioner provides its service through the transmission of digital signals (programming) from several satellites to receiver boxes located in subscribers' homes. Subscribers pay Petitioner a monthly fee for access to this programming, which Petitioner purchases from vendors. Subscribers also pay Petitioner to rent a satellite dish, a receiver box, and remote controls. Petitioner's distribution of its satellite programming is comprised of five main elements: (1) the programming source; (2) the uplink center; (3) the satellite; (4) the receiving dish; and (5) the in-home receiver box.

Petitioner has approximately 14.057 million subscribers nationwide. Petitioner employs approximately 22,000 domestic employees. It also maintains an infrastructure to support its services. This infrastructure includes uplink centers, broadcast centers, customer call centers, service and remanufacturing centers, and warehouses. One of Petitioner's two service and remanufacturing centers is located in Spartanburg, South Carolina. Petitioner has no other principal properties located in South Carolina.

This controversy arose when the Department conducted an audit of Petitioner's tax filings for the years 2004-2010. Following the audit, the Department determined Petitioner had used inconsistent methods to calculate its income tax liability for the audit period, sometimes using the cost of performance method and sometimes using other methods. As a result of the audit, the Department issued a proposed notice of assessment on June 29, 2012, in which is instructed Petitioner that it should be filing using the "gross receipts" apportionment method and sourcing its receipts from South Carolina subscribers to this State. Moreover, pursuant to section 12-54-

155 of the South Carolina Code (Supp. 2013), the Department assessed substantial understatement penalties including $544,286.00 in income taxes, $399,496.00 in interest, and $276,307.00 in penalties, for a total assessment of $1,220,089.00 for the tax years 2004-2010.

DISCUSSION

This Court has jurisdiction to hear this contested case pursuant to section 1-23-600 of the South Carolina Code (Supp. 2014) and 12-60-460 of the South Carolina Code (2014). Generally, the party asserting the affirmative issue in an adjudicatory administrative proceeding has the burden of proof. See Leventis v. S.C. Dep't of Health & Envtl. Control, 340 S.C. 118, 133, 530 S.E.2d 643, 651 (Ct. App. 2000) (citing 2 Am.Jur.2d *Administrative Law* § 360 (1994)). Here, Petitioner requested a contested case hearing and, therefore, has the burden of proof to show by a preponderance of the evidence that the Department's tax assessment was incorrect. See id.; Anonymous (M-156-90) v. State Bd. of Med. Examiners, 329 S.C. 371, 375, 496 S.E.2d 17, 19 (1998) (holding the standard of proof in "administrative hearings is generally a preponderance of the evidence").

This Court's Rules of Procedure provide "[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied to resolve questions not addressed by these rules." ALC Rule 68. Rule 56(c), SCRCP, provides summary judgment is properly granted when the "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." See Bovain v. Canal Ins., 383 S.C. 100, 105, 678 S.E.2d 422, 424 (2009). In determining whether summary judgment is proper, this Court must construe all ambiguities, conclusions, and inferences arising from the evidence against the moving party. Byers v. Westinghouse Elec. Corp., 310 S.C. 5, 7, 425 S.E.2d 23, 24 (1992). Although the evidence and inferences drawn therefrom generally must be construed against the moving party, "the nonmoving party may not rest upon the mere allegations or denials of the pleadings, but a response by affidavit or otherwise . . . must set forth specific facts creating a genuine issue for trial." Rule 56(e), SCRCP.

The parties' motions essentially raise one issue: what apportionment method does South Carolina use to assess income taxes for corporations that provide services across multiple states? Petitioner argues South Carolina uses the cost of performance method. The Department argues

South Carolina does not use cost of performance; rather, South Carolina uses an undefined method based on Petitioner's "income-producing activity." I find that this question raises genuine issue of material fact under the circumstances of this case; therefore, I deny both parties' motions for summary judgment.

A. South Carolina Corporate Income Tax and Apportionment Theory

In South Carolina, corporate income tax "is imposed annually at the rate of five percent on the South Carolina taxable income of every corporation . . . transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce." S.C. Code Ann. § 12–6–530 (2014). "A corporation's taxable income in South Carolina is computed using the Internal Revenue Code with modifications as provided by South Carolina law, and this amount is 'subject to allocation and apportionment as provided in Article 17 of this chapter.'" Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 145, 694 S.E.2d 525, 528 (2010) (citing S.C. Code Ann. § 12–6–580 (2000)). Further, when "a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State." S.C. Code Ann. § 12–6–2210(B) (2014). See Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987) ("The purpose of the allocation statutes is to provide for imposition of South Carolina income tax 'upon a base which reasonably represents the proportion of the trade or business carried on within this State.'" (citation omitted)). This method of imposition is consistent with constitutional requirements for the taxation of corporations engaged in interstate commerce. See Geoffrey, Inc. v. S.C. Tax Comm'n, 313 S.C. 15, 23, 437 S.E.2d 13, 18 (1993) ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State.").

Generally, there are two predominate apportionment methods for sourcing income from services: the "cost of performance" method and the "market share" method. First, the cost of performance method

> requires the taxpayer first to determine which of its activities are the income-producing activities for its service income and then to determine where the costs of performing those income-producing activities were incurred. The taxpayer

> then compares the amount of costs of performance incurred in the taxing state to the amount of such costs in the other individual states. The sales are attributed to the state with the greatest amount of costs of performance.

Hellerstein & Hellerstein, State Taxation ¶ 19.8, 46 (3rd ed. 2014). Cost of performance is the method utilized in the Uniform Division of Income for Tax Purposes Act ("UDIPTA"). Section 17 of UDIPTA utilizes standard cost of performance language:

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

Unif. Division of Income for Tax Purposes Act § 17 (Supp. 2013) (emphasis added). Therefore, under the cost of performance method, income is sourced based on where the costs occurred for the income producing activity. Moreover, the provision creates an all-or-nothing situation because, if the greater portion of the costs of performance takes place outside the taxing state, then income cannot be sourced to the taxing state.[2]

In contrast, the market share method or, as it has been referred to in this State, the "origin of payment" method, sources receipts "to where a taxpayer's customers are located and payments made." Lockwood Greene Engineers, Inc., 293 S.C. at 448, 361 S.E.2d at 347. Under this method, even if all the costs of performance takes place in a foreign state, the taxing state can source income from the receipts of in-state purchasers. Hellerstein & Hellerstein provide several examples of Market Share language, including the following phrases: sales are in this state "if the taxpayer's market for the sale is in this state;" sales are attributable to the state in which the purchaser "received the benefit of the service;" sales from services are assigned to the state "to the extent the purchaser of the service received the benefit of the service in this state." Hellerstein & Hellerstein, State Taxation ¶ 19.8, 50-51 (3rd ed. 2014).

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[2] There is a modified version of cost of performance known as pro rata cost of performance, which Petitioner mentions in its brief. This approach eliminates the "all-or-nothing" factor associated with strict cost of performance and allocates the costs of performance between states. See Sutton et al., The Increasingly Complex Apportionment Rules for Service-Based Businesses: Basic Issues, 17-OCT JMTAX 24, 30-31 (2007 WL 3201540) ("Under the pro rata cost-of-performance approach, in contrast to the 'all-or-nothing' methodology, gross receipts derived from the performance of a service are prorated among multiple states based on the cost of performing the service in each state."). Interestingly, neither party argues South Carolina is a pro rata cost of performance state.

Although these two methods, as Petitioner points out, are the most prominent methods for allocating income taxes for corporations that provide service across multiple states, states are not obligated to choose one of these two methods to the exclusion of others they might develop. South Carolina has no statutes, regulations, or case law requiring the Department to use one of these two methods. Rather, the primary factor to consider in reviewing whether an allocation method is acceptable is whether the method fairy represents the income attributable to that state. See § 12–6–2210(B) ("[T]he South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State."); Geoffrey, Inc., 313 S.C. at 23, 437 S.E.2d at 18 ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State."); Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 606, 258 S.E.2d 93, 99 (1979) ("A court's primary concern in the due process area is not to improvise a method for computing taxes, but to inquire as to whether or not the method provided imposes a tax which bears a reasonable relationship to the taxpayer's activities in this State.").

B. South Carolina's Apportionment Statutes

In South Carolina, the applicable apportionment statute provides:

> If the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2252 or Section 12-6-2310, the *taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.*

S.C. Code Ann. § 12-6-2290 (2014) (emphasis added). Section 12-6-2295 defines "gross receipts" depending upon the type of business in which the corporation is engaged. S.C. Code Ann. § 12-6-2295 (2014).[3] For corporations that provide services, subsection (A)(5) applies and provides the following:

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> ***

[3] Section 12-6-2295 was not adopted until 2007. 2007 Act Nos. 110 &116.

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

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

C. Analysis

Comparing section 12-6-2295(A)(5) to § 17 of UDIPTA, it is clear the language of the two statutes is more different than similar:

UDIPTA § 17	§ 12-6-2295(A)(5)
Sales, other than sales of tangible personal property, are in this state if: *** (b) the *income-producing activity* is performed both in and outside this state and a *greater proportion* of the *income-producing activity* is performed in this state than in any other state, *based on costs of performance.*	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

(emphasis added).

Notably, the statutes are different in two important ways. First, unlike in section 17 of UDIPTA, the South Carolina legislature chose not to include the phrase "cost of performance" in section 12-6-2295(A)(5). Second, unlike section 17 of UDIPTA, our statute does not include language indicating the sourcing of receipts to South Carolina is all-or-nothing based on whether "a greater portion of the income-producing activity is performed in this state than in any other state." Our statute attributes income to South Carolina "to the extent the income-producing activity is performed within this State." The only real similarity between the two statutes is that they both rely on "income –producing activity" as a measure of sales.

Having identified the key differences between our statute and section 17 of UDIPTA, a recognized cost of performance statute, it becomes clear that South Carolina is, at the very least, not a strict cost of performance state. Further, section 12-6-2295(A)(5) does not include language typical of the market share method because it does proclaim the taxpayer's market for the sale is in this state or the sales are attributable to the state in which the purchaser received the

benefit of the service. Rather, section 12-6-2295(A)(5) focuses solely on the extent the "income-producing activity" is performed within this State.

Unfortunately, "income-producing activity" is not defined in our code; therefore, it is necessary to engage in statutory interpretation to determine the meaning of section 12-6-2295(A)(5). "The cardinal rule of statutory interpretation is to ascertain and effectuate the intention of the legislature." Ranucci v. Crain, 409 S.C. 493, 500, 763 S.E.2d 189, 192 (2014). "Words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand the statute's operation." Sloan v. Hardee, 371 S.C. 495, 498-99, 640 S.E.2d 457, 459 (2007). Courts generally "giv[e] deference to an administrative agency's interpretation of an applicable statute or its own regulation." Brown v. Bi-Lo, Inc., 354 S.C. 436, 440, 581 S.E.2d 836, 838 (2003). "Nevertheless, where . . . the plain language of the statute is contrary to the agency's interpretation, the [c]ourt will reject the agency's interpretation." Id.

"If the statute is ambiguous, however, courts must construe the terms of the statute." Town of Mt. Pleasant v. Roberts, 393 S.C. 332, 342, 713 S.E.2d 278, 283 (2011). "A statute as a whole must receive practical, reasonable, and fair interpretation consonant with the purpose, design, and policy of lawmakers." Id. "In interpreting a statute, the language of the statute must be read in a sense that harmonizes with its subject matter and accords with its general purpose." Id. "Courts will reject a statutory interpretation that would lead to a result so plainly absurd that it could not have been intended by the Legislature or would defeat the plain legislative intention." Id. at 342-43, 713 S.E.2d at 283.

The only case to address the meaning of section 12-6-2295(A)(5) to any extent is the South Carolina Court of Appeal's decision in Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 361 S.E.2d 346, (Ct. App. 1987). Petitioner contends this case proves South Carolina is a cost of performance state. I disagree.

In Lockwood Greene, the issue was how to define "gross receipts from within this State" under what is now codified as section 12-6-2290. Importantly, at the time Lockwood Greene was decided, South Carolina had not yet adopted section 12-6-2295(A)(5) defining "gross receipts," but Lockwood Greene is relevant because, in defining "gross receipts within this State," the court was essentially providing the definition later codified in section 12-6-2295(A)(5). 293 S.C. at 448, 361 S.E.2d at 347. In Lockwood Greene the petitioner asserted "receipts" were sourced to where a taxpayer's customers were located and payments made. Id.

This was a version of the market share method or, as the court phrased it, the "origin of payment" method. In contrast, the tax commission asserted "receipts" were sourced to the place where the services were performed, or what the court phrased the "place of activity" method. The court agreed with the commission. Specifically, the court determined:

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

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

Notably, the court chose to use the phrase "place of activity," and never used the phrase "cost of performance" in its opinion. Further, while the "place of activity" method resembles the cost of performance method to some extent, an all-or-nothing component was not applied based upon the location of the "greater proportion" of the activities. Thus, even if the court's "place of activity" method resembles the cost of performance method, it is not strict cost of performance.[4] Furthermore, the court's comments in Lockwood Greene suggest the type of industry being taxed may affect the application of the statute:

> Lockwood also argues the statute has not been consistently interpreted by the Tax Commission. Lockwood refers to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters. We are not persuaded these businesses are comparable to Lockwood. By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus on whether the services are performed in South Carolina. These situations are analogous and consistent with the situation of Lockwood.

Id. at 450, 361 S.E.2d at 348. It is important to note that, in the context of the engineering firm in Lockwood Greene, the cost of performance and income-producing activity take place in the same location, making it difficult to discern whether the court's decision focused on the place where the cost of performance was incurred or the place of the income-producing activity.

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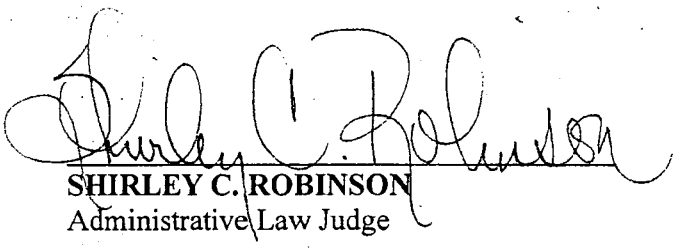
[4] This Court's 2012 decision in Rent-A-Center v. S.C. Dep't of Revenue, Docket No. 09-ALJ-17-0206-CC (filed January 6, 2012), is consistent with this interpretation of Lockwood Greene. In Rent-A-Center, this Court determined that management services performed in Texas for a South Carolina affiliate could not be sourced to South Carolina because the *income-producing activity* took place in Texas, not South Carolina. This Court referred to Lockwood Greene's "place of activity" test and at no time described the method of allocation as Cost of performance. Furthermore, although this Court determined no income should be sourced to South Carolina, it was not due to a determination that the greater proportion of income-producing activity took place in Texas; it was merely because the Court found no income-producing activity took place in South Carolina.

Thus, the decision in Lockwood Greene does not, as Petitioner contends, clearly demonstrate that South Carolina is a strict cost of performance state. Rather, Lockwood Greene could be interpreted to apply a flexible standard based on where the income-producing activity takes place, which varies upon industry type. For some industries, the cost of performance may occur in the same place as the industry's "income producing activity," but for other industries, the cost of performance may take place in one location and the income-producing activity in another location, or some combination of the two.

Accordingly, because I find South Carolina is not a strict cost of performance state, I deny Petitioner's Motion for Summary Judgment on this narrow issue. Furthermore, at this stage in the litigation, there are insufficient facts to determine what Petitioner's income-producing activities are and the extent to which those activities take place in South Carolina. For example, it is unclear whether or not Petitioner's income-producing activity is its sales to subscribers, or whether it is derived from its uplink centers, broadcast centers, the programs it purchases, or some combination of these and other elements. Further, it is unclear what role local programming may play in income-producing activity. Therefore, while courts will generally defer to an agency's interpretation of a statute, I deny the Department's Motion for Summary Judgment because there is a genuine issue of material fact as to whether the Department's undefined method of allocation based on "income-producing activity" is correct. See Brown, 354 S.C. at 440, 581 S.E.2d at 838 (holding courts generally "giv[e] deference to an administrative agency's interpretation of an applicable statute or its own regulation"); Rule 56(c), SCRCP (providing summary judgment is properly granted when the "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law").

THEREFORE, IT IS HEREBY ORDRED that the Petitioner's Motion for Summary Judgment is **DENIED**, and the Department's Motion for Summary Judgment is **DENIED**.

AND IT IS SO ORDERED.



SHIRLEY C. ROBINSON
Administrative Law Judge

February 10, 2015
Columbia, South Carolina

CERTIFICATE OF SERVICE

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

This 10 day of February 2015

By: Jeeba Henderson
Judicial Law Clerk

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

DIRECTV, Inc. & Subsidiaries, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 14-ALJ-17-0158-CC **AMENDED FINAL ORDER AND DECISION**

Appearances:

For the Petitioner: R. Gregory Roberts, Esq.; Andres Vallejo, Esq.; Bryson M. Geer, Esq.; and John von Lehe, Esq.

For the Respondent: Nicole M. Wooten, Esq.; William J. Condon, Jr., Esq.; Timothy C. Thompson, Esq.; and Mary Elizabeth Campbell, Esq.

STATEMENT OF THE CASE

This matter comes before the South Carolina Administrative Law Court (ALC or Court) following DIRECTV, Inc. & Subsidiaries' (DIRECTV or Petitioner) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (2014). DIRECTV is contesting the South Carolina Department of Revenue's (Department or Respondent) Determination denying DIRECTV's claim for a refund of South Carolina corporate income and license fee taxes for the tax years 2006 through 2008 and the assessment of South Carolina corporate income and license fee taxes, interest, and penalties for the tax years 2009 through 2011 (Tax Periods at Issue).[1]

The Department's Determination (Determination) concluded that applicable South Carolina law and long-standing Department policy require DIRECTV to source all of the gross receipts of its South Carolina subscription revenue to South Carolina because all of the income-producing activity related to DIRECTV's South Carolina customers occurs in South Carolina. DIRECTV asserts that little or no subscription revenue from South Carolina customers should be

[1] The tax years noted relate to income tax years. Income taxes are generally due in arrears, while license fees are due in advance. For clarity, when the Court refers to tax years, reference is being made to income taxes for that year and license fees due for the following year.

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included in the numerator of the gross receipts ratio because the majority of the income-producing activity occurs outside of South Carolina.

A hearing was held before this Court on January 13 and 14, 2015.

ISSUES

The following issues are raised in this proceeding:

1. To what extent under S.C. Code Sections 12-6-2290 and 12-6-2295(A)(5) did Petitioner's applicable income-producing activity occur within South Carolina?[2]
2. Whether the Department properly assessed substantial understatement penalties against DIRECTV for taxes owed for 2009 through 2011.

STIPULATIONS OF FACT

At the hearing into this matter and pursuant to Rule 25(C) of the Rules of Procedure for the Administrative Law Court (ALC Rules), the parties entered the following written stipulations of fact into the Record:

1. One of the issues presented by Petitioner for determination in this appeal is whether Respondent is seeking an alternative method of apportionment to source Petitioner's subscription revenue from the provision of its direct broadcast satellite services (Subscription Revenue).

2. In Petitioner's Request for Contested Case Hearing and Prehearing Statement filed with this Court, one of the issues presented for determination was whether Respondent satisfied its burden of proof for the use of an alternative apportionment methodology under S.C. Code Ann. § 12-6-2320.

3. The parties wish to clarify that Respondent does not assert that an alternative apportionment methodology under Section 12-6-2320 was used or should be used to source Petitioner's Subscription Revenue for tax years 2006 through 2011 (Period at Issue).

4. The sole remaining issue presented for determination with respect to the sourcing of Petitioner's Subscription Revenue is how that revenue should be sourced under Sections 12-6-2290 and 12-6-2295(A)(5).

5. As a result, Petitioner's Prehearing Statement is deemed to be amended to remove the assertions set forth in Paragraph No. 3(b) and Paragraph No. 4(b).

6. The parties submitted Exhibit A, a schedule setting forth the amount of (i) Petitioner's total Subscription Revenue for each year during the Period at Issue, (ii) Petitioner's

[2] The parties agree that at least some income-producing activity occurred within South Carolina.

total Subscription Revenue from South Carolina Customers for each year during the Period at Issue, (iii) the total revenue from leases of set-top boxes and sales of tangible personal property to South Carolina customers for each year during the Period at Issue, (iv) Petitioner's total revenue from leases of set-top boxes and sales of tangible personal property for each year during the Period at Issue, and (v) Petitioner's total gross receipts for each year during the Period at Issue.

7. The parties agreed to work together in good faith to verify and to confirm the amounts set forth in Exhibit A to provide this Court with a final version of Exhibit A within two weeks of the conclusion of the trial.

8. For each year during the Period at Issue, Petitioner included revenue from the leases of set-top boxes and sales of tangible personal property (e.g., remote controls) to South Carolina customers in the numerator of the gross receipts factor and the parties do not dispute the treatment of this revenue.

After the hearing, the parties determined Exhibit A that was attached to the Stipulations did not need to be amended. Based upon the Stipulations of the parties, the Court adopts the schedule setting forth the amounts listed in Exhibit A, and these figures shall be used in calculating the gross receipts ratio:

	S.C. Subscription Revenue	Total Subscription Revenue	S.C. Lease/Sale Revenue from Set-top Boxes	Total Lease/Sale Revenue from Set-top Boxes	Total Revenues
2006	265,155,289	13,583,081,711	3,376,851	160,263,938	13,743,345,649
2007	297,356,680	14,900,247,218	12,547,540	582,796,802	15,483,044,020
2008	334,652,301	16,321,615,758	19,605,211	923,326,252	17,244,942,010
2009	361,394,437	17,348,388,812	26,702,174	1,238,157,983	18,586,546,795
2010	392,627,654	18,654,864,389	31,565,700	1,444,720,825	20,099,585,214
2011	409,564,133	19,689,434,914	42,129,631	1,925,855,682	21,615,290,596

FINDINGS OF FACT

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

DIRECTV's Business Operations

DIRECTV is a multistate taxpayer headquartered in Los Angeles, California that offers direct broadcast satellite video services to customers throughout the United States. DIRECTV

accomplishes this through four general types of activities: marketing and sales; content development (both original and acquired programming); broadcast operations; and customer service.[3] Through DIRECTV's marketing and sales activities, it advertises its programming services to subscribers. DIRECTV engages in distinctive marketing activities on a national scale which includes South Carolina. The goal of DIRECTV's print and television advertising is to encourage customers to call a toll-free number to place an order for television services.

Customers pay DIRECTV a subscription fee for access to hundreds of television programming channels and other audio/visual options that are transmitted nationwide to customer's homes or businesses via satellites. DIRECTV receives its programming from third parties through satellite, fiber-optic cables, and over-the-air broadcast. DIRECTV also collects programming from local broadcast television stations through the use of local collection facilities throughout seven designated market areas (DMA). During the Tax Periods at Issue, DIRECTV had four to six local collection facilities in South Carolina.

The signals for the programming content are collected at broadcast and uplink centers. These broadcast centers and uplink facilities transmit the programming content signals to the satellites. The satellites then transmit the signals received from the broadcast centers and uplink facilities directly to DIRECTV satellite dishes mounted on or near customer homes. DIRECTV transmits its broadcast utilizing two types of beams from its satellites. One beam, the "CONUS" beam, covers the entire United States. It transmits the national programming sold to DIRECTV. The other beam is a narrow beam that transmits the local programming to the DMAs. Those signals are then relayed from the dish to a set-top box located in the customer's home or business, which delivers the signals to the customer's television set.

Customers pay a monthly subscription fee for access to basic channels and can also purchase premium channels and pay-per-view programs for an additional fee. In order to receive the receive programming, customers must contract with DIRECTV for the service, and then use a satellite dish, remote controls, and set-top box provided by DIRECTV in order to access DIRECTV's programming. During the Period at Issue, DIRECTV provided customer service support to customers in South Carolina through both owned-and-operated internal call centers and third-party call centers, none of which were located in South Carolina. DIRECTV also employed

[3] Although several affiliated entities are involved in the provision of DIRECTV's programming services, this case involves only DIRECTV Inc., and thus, the Court's focus is upon the activities of that entity.

two employees in South Carolina and contracted with third-party home service providers who installed and serviced equipment in homes of new customers in South Carolina. Also during the Tax Periods at Issue, DIRECTV began leasing the set-top boxes to customers in exchange for a lease fee. However, the importance of these services as to income production has not been sufficiently explained.

DIRECTV's source of revenue is the subscription revenue it receives from its approximately twenty million subscribers. DIRECTV's revenue includes monthly fees for subscribing to one or more packages of video programming; revenue from pay-per-view programming; revenue from the sale or lease of the set-top boxes; revenue from optional warranty on the leased boxes (protection plans); and revenues from fees associated with high-definition set-top boxes, set-top boxes with DVR, and multi-room viewing. I find that the rental and sales receipts received from South Carolina customers are properly included in the numerator of the gross receipts ratio.[4]

DIRECTV's Income Tax Returns

For the 2006 through 2008 tax years, DIRECTV filed corporate income tax returns in South Carolina in which it sourced 100% of subscription receipts from South Carolina customers to the numerator of the gross receipts ratio. By doing so, DIRECTV used gross receipts ratios of 1.9539%, 2.0016%, and 2.0543% for years 2006 through 2008, respectively. In 2008, the Department began an audit of DIRECTV. As a result of the audit, the Department accepted DIRECTV's original 2006 through 2008 corporate income tax returns as filed (i.e., the Department did not make any adjustments to the tax returns). DIRECTV subsequently filed amended corporate income tax returns for the 2006 through 2008 tax years, and the single change was the removal from the gross receipts ratio of 100% of the subscription receipts from South Carolina customers that DIRECTV originally included in the numerator. The amended gross receipts ratios for years 2006 through 2008 were 0.0246%, 0.081%, and 0.1137%, respectively. DIRECTV explained the change in a statement attached to each of the three amended returns:

> This return is being amended to apportion sales receipts to the state under S.C. Code Ann. § 12-6-2295 which sources sales of services under a pro-rata cost of

[4] The parties do not dispute the treatment of the rental income of the set-top boxes and agree that all such rental income from the set-top boxes received by DIRECTV from South Carolina customers should be included in the numerator of the gross receipts ratio for apportionment purposes. *See* Stipulation of Facts, filed January 13, 2015.

performance method.[5] The originally filed return incorrectly apportioned satellite television subscription receipts to South Carolina using market-based sourcing, rather than the cost of performance sourcing that is prescribed by statute.

Because of the amended returns for 2006 through 2008, DIRECTV decreased its tax and license fee liability by $5,976,816.00 and sought a refund in this amount. In a field audit report dated November 29, 2011, the Department denied the amended returns and related refunds and accepted the original returns as filed.

DIRECTV then filed its original 2009 through 2011 corporate income tax returns using the same costs-of-performance method that it used on its 2006 through 2008 amended returns; the Department audited these returns as well.[6] In a field audit report dated January 28, 2014, the Department assessed DIRECTV for income taxes and license fees for 2009 through 2011 using a gross receipts ratio that included all of the subscription receipts from South Carolina customers in the numerator.

The Department subsequently issued its Determination and found that the income-producing activity of DIRECTV was the delivery of the signal into the South Carolina customer's home or business and onto the customers' television sets and that, accordingly, DIRECTV should include 100% of the subscription receipts received from South Carolina customers in the numerator of the gross receipts ratio. DIRECTV subsequently requested a contested case hearing regarding this Determination.

CONCLUSIONS OF LAW

General Conclusions

This Court has subject matter jurisdiction in this case pursuant to S.C. Code Ann. §§ 1-

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[5] Both Petitioner and the Department originally erred in how they referenced South Carolina's apportionment method for receipts from services; Petitioner in its amended returns for 2006-2008 referred to it as a "cost of performance method," and the Department referred to it as "market base sourcing" in its Report of Field Audit of Petitioner's 2009-2011 receipts. However, both parties agree, and have subsequently clarified their positions to reflect, that South Carolina uses a method of apportionment based on the proportion of income-producing activity conducted within the State.

[6] DIRECTV did not include any of the subscription receipts from South Carolina customers in the numerator of the gross receipts ratio on its amended 2006 through 2008 returns and on its original 2009 and 2010 returns. On its 2011 South Carolina return, DIRECTV changed its method again by including approximately $22 million of its $410 million subscription receipts from South Carolina customers in the numerator. DIRECTV did this by sourcing 0.11% of its total subscription receipts to South Carolina based on a ratio of its alleged payroll in South Carolina to its total payroll. From 2006 through 2010, DIRECTV did not source any subscription receipts to South Carolina because it claims that the vast majority of its payroll and property were located outside of South Carolina.

23-600(A) (Supp. 2014) and 12-60-460 (2014). The hearing before the ALC is a contested case hearing and is heard de novo. *Marlboro Park Hosp. v. S.C. Dep't of Health and Envtl. Control*, 358 S.C. 573, 579, 595 S.E.2d 851, 854 (2004). This Court must make its factual findings based on the preponderance of the evidence. *See* S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2014); *see also Anonymous (M-156-90) v. State Bd. of Med. Exam'rs*, 329 S.C. 371, 375-78, 496 S.E.2d 17, 19-20 (1998); *Nat'l Health Corp. v. Dep't of Health and Envtl. Control*, 298 S.C. 373, 379, 380 S.E.2d 841, 844 (Ct. App. 1989). Because DIRECTV is challenging a determination by the Department that it must source its South Carolina subscription receipts from South Carolina customers to the numerator of the gross receipts ratio, DIRECTV has the burden of proof. *See Ford v. Atl. Coast Line R. Co.*, 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue. . . ."); *see also Leventis v. Dep't of Health and Envtl. Control*, 340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000). This burden requires DIRECTV to prove that the Department's determination is errant by a preponderance of the evidence. *See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime*, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992) ("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Applicable Law

It is well-settled law that the purpose of the South Carolina allocation and apportionment provisions is to provide for imposition of income tax "upon a base which reasonably represents the proportion of the trade or business carried on within this State." *Hertz Corp. v. S.C. Tax Comm'n*, 246 S.C. 92, 142 S.E.2d 445 (1965).[7] Furthermore, a statutory provision must be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute. *Hay v. S.C. Tax Comm'n*, 273 S.C. 269, 255 S.E.2d 837 (1979). The method of apportionment that a taxpayer must use depends upon the nature of the taxpayer's business in this

[7] Generally, allocation refers to the assignment of nonbusiness income to a specific state. *See* S.C. Code Ann. § 12-6-2220; *Emerson Elec. Co. v. S.C. Dep't of Rev.*, 395 S.C. 481, 486, 719 S.E.2d 650, 652-653 (2011) (noting that a multistate corporation's "non-business income is not apportioned among various states. Rather, non-business income is allocated to or deemed to be earned in a particular state . . . ."). Apportionment generally refers to the assignment of business income of a corporation that is taxable in more than one state. *See* S.C. Code Ann. § 12-6-2210(B); *Emerson*, 395 S.C. at 485, 719 S.E.2d at 652 (stating that "[a] corporation's business income is apportioned among the states in which it conducts business.").

State. During the Tax Periods at Issue, net income of a manufacturer or a dealer in tangible personal property was apportioned based on a three-factor formula and later on a single sales factor (*see* S.C. Code Ann. §§ 12-6-2250, -2252 (Supp. 2007)),[8] while net income of substantially all other taxpayers was apportioned based on a single gross receipts formula (*see* S.C. Code Ann. § 12-6-2290 (Supp. 2007)). Accordingly, for service providers, South Carolina law mandates the following method of apportionment:

> If the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2252 or Section 12-6-2310, the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

S.C. Code Ann. § 12-6-2290.[9] Thus, service providers are required to use the single gross receipts apportionment formula. For tax years after 2006, the final sentence of Section 12-6-2290 directs taxpayers to S.C. Code Ann. § 12-6-2295 for a non-exclusive list of the items to be sourced, or included, in the gross receipts apportionment ratio.[10] The relevant subsection in this matter is Section 12-6-2295(A)(5), which states:

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> * * *
>
> (5) receipts from services if the entire income producing activity is within this State. If the income producing activity is performed partly within and

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[8] In 2006, the South Carolina Legislature enacted a change in the apportionment method provided in Section 12-6-2250 for taxpayers whose principal business in South Carolina is manufacturing or any form of collecting, buying, assembling, or processing goods and materials within South Carolina, or selling, distributing, or dealing in tangible personal property within South Carolina. The three-factor apportionment method for a multistate taxpayer (based on property, payroll, and double weighted sales) changed to a single-sales-factor apportionment method. This change was phased-in for income tax years beginning in 2007 through 2010. For income tax years beginning in 2011, the single-sales-factor apportionment method in Section 12-6-2252 replaced the three-factor apportionment method in Section 12-6-2250. *See* S.C. Rev. Ruling #09-15.

[9] In 1995, the General Assembly repealed Chapter 7 and added Chapter 6 of Title 12. Accordingly, Section 12-6-2290 replaced Section 12-7-1190 as the statute that directed taxpayers how to apportion net income related to services. In 2007, the General Assembly amended Section 12-6-2290 by adding an additional sentence to the end of the existing statute. That sentence reads as follows: "For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295." 2007 South Carolina Laws Act 110 (S.B 91).

[10] 2007 South Carolina Laws Act 110 (S.B. 91) also added Section 12-6-2295, the companion statute to Section 12-6-2290. *See* 2007 South Carolina Laws Act 110, § 51.A; eff. June 21, 2007. These additions were effective for DIRECTV's 2007 tax year.

> partly without this State, sales are attributable to this State to the extent the income producing activity is performed within this State[.]

Taxpayer Is a Service Provider

DIRECTV provides direct broadcast satellite services to customers throughout the United States. Its income is subscription revenue from providing these services and is not from engaging in manufacturing or dealing in tangible personal property. In a similar case, a Texas administrative law court found that a direct broadcast satellite company was a service provider for purposes of its apportionment laws. *Anonymous Taxpayer v. Texas Comptroller of Pub. Accounts*, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013). As a service provider, Section 12-6-2290 is the applicable statute to apportion DIRECTV's adjusted net income to South Carolina. Further, after 2006, Section 12-6-2295(A)(5) is the supplemental sourcing statute when determining the numerator of the gross receipts ratio, and requires DIRECTV to source receipts from South Carolina customers to South Carolina if the income-producing activity occurs in this State. Therefore, for all Tax Periods at Issue, DIRECTV must apportion its net income to South Carolina using a gross receipts factor in Section 12-6-2290.

As noted above, since 1958, the applicable South Carolina apportionment statutes have always mandated that gross receipts be used when apportioning net income to South Carolina for a corporation whose income is generated from the provision of services.[11]

Income-Producing Activity of DIRECTV

The Court must first determine whether any income-producing activity occurred in this State and then decide whether that activity occurred within or without South Carolina. Only after identifying the income-producing activity is there a need to quantify how much of the income-producing activity occurred in South Carolina.

Identification of the Income-Producing Activity

Effective for the 2007 tax year, Section 12-6-2295(A)(5) was applicable and supplemented Section 12-6-2290.[12] Section 12-6-2295(A)(5) added the "income producing activity" language

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[11] Section 12-6-2295(A)(5) is the applicable sourcing statute for the 2007-2011 tax years at issue. Only Section 12-6-2290 is applicable for tax year 2006.

[12] Notably, when adding Section 12-6-2295(A) for the 2007 tax year, the General Assembly stated the following in 2007 South Carolina Laws Act 110, § 51.A, eff. June 21, 2007: "To Amend . . . by adding Sections 12-6-2252 and 12-6-2295 so as to further provide for allocation and apportionment of business income for state income tax purposes

to the apportionment statutes for service providers. The Department argues that the identity of DIRECTV's income-producing activity is the delivery of the signal into the homes and onto the television screens of its customers. Therefore, the Department contends that 100% of the subscription receipts from South Carolina should be sourced to the numerator of the gross-receipts ratio because there is no other income-producing activity related to DIRECTV's business in South Carolina. To the contrary, DIRECTV presented evidence that its income-producing activities in South Carolina could be identified using four "value drivers." Those "value drivers" are: 1) DIRECTV's content and programming; 2) DIRECTV's acquisition and distribution of the content to customers; 3) DIRECTV's marketing and sale of its service; and 4) DIRECTV's customer services.

The Court concludes that pursuant to Section 12-6-2295(A)(5), DIRECTV's income-producing activity includes the customers' subscriptions and delivery of the signal into the location and onto the television screens of its customers. In identifying this income-producing activity, the Court considered the activities of businesses in the direct broadcast services industry and the sources of income within the industry. DIRECTV derives income from monthly subscription receipts that customers pay to DIRECTV in order to view its video programs in their homes and businesses. These subscription receipts are received as a result of the delivery of the signal into the customer's home and onto the customer's television, and are therefore directly related to the income-producing activity of DIRECTV.

The Court, however, 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. Rather, the Court agrees with Professor Richard D. 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."

In *Walter E. Heller W., Inc. v. Dep't of Revenue*, 161 Ariz. 49, 775 P.2d 1113 (1989), the Arizona Supreme Court analyzed how interest income earned on loans made to Arizona customers should be sourced under provisions that mirrored the Uniform Division of Income for Tax

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by basing the determination only on a sales factor and to define the terms 'sales' and 'gross receipts' consistently and specifically for that purpose[.]"

Purposes Act (UDITPA).[13] In reaching its decision, the Arizona Supreme Court did not simply look to the location of the customer as the Department does here. Rather, the court determined that the income-producing activities consisted of the solicitation of new customers, the investigation of credit records of potential customers, and the servicing of such contracts, all of which occurred in Arizona. *Id.* at 53-54, 775 P.2d at 1116-17. Therefore, the court's reasoning implies that the location of customers does not necessarily identify the income-producing activities of the taxpayer and therefore is not a reasonable method of identification.

In this case, the evidence also suggested that there may be other activities, such as advertising, that influence the customer's decision to make the purchase. In explaining those activities from DIRECTV's perspective, Dr. Brian J. Cody testified that he employed DIRECTV's payroll and net value of assets as proxies in identifying DIRECTV's income-producing activities. Dr. Cody explained the "[t]wo measures which are proxies . . . [a]re not perfect, but they're proxies . . . ." However, that evidence is simply insufficient to satisfy DIRECTV's burden of proof.

Our Supreme Court "has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of Appellant, and has declared that 'rough approximation rather than precision' is sufficient." *Covington Fabrics Corp. v. S.C. Tax Comm'n*, 264 S.C. 59, 66-67, 212 S.E.2d 574, 577-78 (1975). The Court also noted that "[a]lthough exactness in apportionment is desirable, all that is required is a reasonable approximation." Though this Court recognizes that an exact determination of the identity of the income-producing activities is not possible, I find that Dr. Cody's proxies in identifying DIRECTV's income-producing activities are so far from perfect as to be of no practical value. DIRECTV did not sufficiently explain the effect of its value drivers on income production in this State. In other words, DIRECTV's evidence is just too nebulous to properly identify whether DIRECTV's value drivers are income producing and the extent to which such production occurs. Therefore, though Section 12-6-2295(A)(5) provides "flexibility" in determining the relative amount of income-producing activities in the State, Dr. Cody's payroll-and-assets method does not provide a reasonable approximation of the income-producing activities performed by DIRECTV in South Carolina or the value attributable to such activities. Though its evidence did

[13] UDITPA was created in 1957 by the Uniform Law Commission as a model statute for the division of income for income tax purposes. The goal of the Uniform Law Commission in drafting UDITPA was to develop a model act that would be widely adopted..

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. Instead, 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.

Moreover, it does not appear that some of the activities that DIRECTV attributes to income production are actually income-producing activities. DIRECTV argues that its cost to produce the content and broadcast of signals into South Carolina should be considered as an income-producing cost. The Department, on the other hand, argues that only the delivery of the signal into the customer's home and onto the customer's television is income-producing activity. Thus, the pertinent issue here is at what point DIRECTV's activities become income-producing. Both parties assert that the holding in *Mercury Motor Express, Inc. v. S.C. Tax Comm'n*, 244 S.C. 134, 135 S.E.2d 756 (1964) is applicable to this case. In *Mercury*, the South Carolina Supreme Court addressed the income-producing activity of an interstate freight hauler. The taxpayer argued that the apportionment formula produced an unconstitutional result because it apportioned 17% of its income to the State (reflecting that 17% of its mileage was in the State), while revenue from freight either originating or delivered to South Carolina accounted for only 1% of its gross revenue. The taxpayer asserted that when its trucks were merely traveling through South Carolina, they were not engaged in any activity that contributed to the taxpayer's net income. Rather, the taxpayer argued that the taxable event should only occur if it was delivering freight in the State of South Carolina; otherwise the State's mileage formula produced "an arbitrary, discriminatory and unconstitutional results, in violation of the commerce clause. . . ." In other words, the taxpayer in *Mercury* contended that the incidental act of transporting freight through the State should not be considered as a taxable event.

The Supreme Court listed a series of transactions that occurred in the freight hauling business: solicitation of the freight, picking up the freight, hauling the freight, dropping off the freight, and collecting the hauling charges. The Supreme Court held that while each of these transactions was "necessarily incidental to the production of [the business's] income," the activity that "primarily earn[ed] the income" was the hauling of freight "through and over the highways of the State of South Carolina." *Id.* Thus, the Court focused upon the company's primary activity in

determining whether South Carolina's tax was arbitrary. However, that focus did not specifically equate to the issue to be determined in this case.

In *Mercury*, the Supreme Court found that both the "incidental" and "primary" activities of the appellant's business "contribute[d] to the earnings and net income of the appellant" and were "necessarily incidental to the production of its income." Presumably, the Court distinguished those activities for a reason.[14] However, the Court gave no explanation of the distinction between the "incidental" versus "primary" activities or why such a distinction was made. Nevertheless, *Mercury* did not address activities occurring prior to the "solicitation of freight." Therefore, *Mercury* provides no guidance for activities occurring before the solicitation of DIRECTV's services.

Here, Petitioner engages in other "preparatory" activities that eventually lead to satellite signals being beamed into this State. But those activities have no bearing on a customer's decision to subscribe to, i.e. solicit, Petitioner's services, nor do they occur as a result of that decision to subscribe. For instance, the national programming through the CONUS beams would exist regardless of whether there were any subscribers in South Carolina. Thus, such "preparatory" activities are too attenuated to the production of income to be considered "income-producing activity" for purposes of Section 12-6-2295(A)(5).

Analogizing the facts in this case to the holding in *Mercury*, the beaming of the satellite signals through the air of South Carolina to the customer's dish, set-top box, and television screen, and the collection of charges for such service, are also analogous to the loading, hauling, and delivery of freight following the customer's solicitation of that freight, and the collection of charges therefor. However, the other prior activities that prepare the way for DIRECTV's provision of services, i.e., the infrastructure for producing and collecting the programming content and transmitting the signals would, in comparison to the facts in the *Mercury* case, be akin to the manufacturing and transfer of the freight through its infrastructure to a storage location, from which it is later – **only after an order is placed** (or "solicited," as the Supreme Court put it) – loaded, hauled, and delivered, and for which charges are collected. Though *Mercury* did not

[14] It is notable that the Supreme Court was not considering the same issue that is before the ALC. The Supreme Court was seeking to determine whether the taxing method utilized by this State was constitutional. The Court's purpose in considering whether South Carolina was taxing the primary activity could simply have been a method to determine whether the statute had a rational basis. Therefore, the emphasis placed upon the Court's analysis of "incidental" versus "primary" activities appears to be undue.

address such pre-order activities, I find that the ones at issue in this case are too attenuated to be considered income-producing.

More importantly, the evidence failed to establish that these services directly related to the production of income. In sum, DIRECTV failed to sufficiently identify its outside income-producing activities.[15] Even 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. Consequently, the remaining evidence is that the transmission of the beams to the customers, as well as the subsequent activities performed that allow South Carolina customers to experience DIRECTV's services – such as the sale/lease, installation, or repair of set-top boxes that are sold or leased to customers –are income-producing activities under Section 12-6-2295(A)(5); and all occur entirely within the State.

Sourcing of the Income-Producing Activity

DIRECTV argues that nearly all of the income-producing activities it identified in this matter occurring outside of South Carolina should be sourced to the location of the activities performed by DIRECTV. At the outset, the Court disagrees that DIRECTV has sufficiently identified its activities to be sourced.[16] Furthermore, even if it had identified those activities, DIRECTV failed to sufficiently establish that those activities should be sourced elsewhere.

Pursuant to Section 12-6-2295(A)(5), a service provider's gross receipts are sourced to South Carolina based on the location of the income-producing activity according to one of two prongs. In the first prong, all of the gross receipts are sourced to South Carolina "if the entire income-producing activity is within this State." S.C. Code Ann. § 12-6-2295(A)(5) (Supp. 2007). In the second prong, "[i]f the income-producing activity is performed partly within and partly

[15] For example, as will be discussed *infra*, advertising performed within or without the South Carolina could be considered income-producing activity. However, DIRECTV did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina.

[16] As noted above, DIRECTV argues its "value drivers," reflect its income-producing activity. While DIRECTV may rely heavily upon "value drivers" in determining the value of certain components within its company, DIRECTV has, as aforementioned, failed to sufficiently demonstrate whether and to what extent those value drivers are income-producing activities as required by the applicable and mandatory language of Section 12-6-2295(A)(5) when calculating the numerator of the gross receipts factor.

without this State, [gross receipts are sourced to South Carolina] to the extent the income-producing activity is performed in this State." *Id.*

DIRECTV argues that its income should be sourced based upon payroll and assets/property factors, similar to the taxpayer in *Lockwood Greene Eng'rs, Inc. v. S. C. Tax Comm'n*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987). The applicable statute for apportioning net income from a taxpayer whose principal profits were derived from services at the time of *Lockwood Greene* was Section 12-7-1190 (1976) which stated:

> If the principal profits or income of a taxpayer . . . are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing, or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State.

S.C. Code Ann. § 12-7-1190 (1976).

The taxpayer in *Lockwood Greene* unsuccessfully argued that the then-applicable apportionment statute for net income related to services – Section 12-7-1190 – prescribed one rule (i.e., the origin-of-payment rule) for all businesses that do not deal in tangible personal property. The South Carolina Court of Appeals did not accept the taxpayer's argument that Section 12-7-1190 was a one-rule statute and that all net income to be apportioned under Section 12-7-1190 must be apportioned under the same method. Several facts support the Court of Appeals' determination: (1) the Court of Appeals did not believe that the use of different methods for different industries when applying Section 12-7-1190 created a constitutional problem;[17] (2) the Court of Appeals clearly suggested a distinction between finance companies and media broadcasters on one hand and personal *professional* service firms, such as Lockwood, on the other when determining where to source service receipts;[18] and (3) the Court of Appeals noted that the

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[17] After hearing the taxpayer's argument (that the Department had not consistently applied Section 12-7-1190) and considering the guidelines (which illustrated the Department's policy of allowing the use of different methods for different industries), the Court of Appeals stated, "[w]e discern no constitutional basis for Lockwood's argument." *Lockwood Greene*, 293 S.C. at 450 n.1, 361 S.E.2d at 348 n.1.

[18] *Id.* at 450, 361 S.E.2d at 348 ("We are not persuaded [finance companies and media broadcasters] are comparable to Lockwood. By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus on whether the services are performed in South Carolina."). *Implicit in this finding* is the fact that the only reason for the Court of Appeals to distinguish a taxpayer like Lockwood from companies in other industries was the Court of Appeals' belief that Section 12-7-1190 was not a "one-rule statute," and that different methods could be used for different industries when applying Section 12-7-1190.

Lockwood firm "provides services to its clients through highly trained engineers and personnel in various offices" and that a "client pays an engineering firm for the **expertise and time** of its employees." *Lockwood Greene*, 293 S.C. at 449, 361 S.E.2d at 347 (emphasis added). Based on the specifics of Lockwood's business, the Court of Appeals then concluded, "Therefore, an engineering firm's business carried on in a state is reasonably measured by the services rendered by its personnel in the state," which "is epitomized by the 'place of activity' test advanced by" the Department. *Id.* Again, it would not have been necessary for the Court of Appeals to address the specifics of Lockwood Greene's business if Section 12-7-1190 was a "one-rule statute."

On one hand, the Court's decision in *Lockwood Greene* did **not** mandate that the net income of **all** service providers be apportioned based on a "place of activity" test that is quantified by a payroll factor or some other cost-based factor. The Court of Appeals specifically recognized that the Department's audit guidelines at the time sourced revenues of personal *professional* service providers (e.g., engineering, law, and accounting firms) to the "place of activity."[19] *Lockwood Greene*, 293 S.C. at 450, 293 S.E.2d at 348. At the same time, the court was **not persuaded** that service industries, such as finance companies and media broadcasters, were comparable, thus implying that revenues of service industries were sourced to the "origin of payment" (i.e., location of the borrower or customer) *Id.* The Court of Appeals also held that no constitutional problem existed with the Department's policy of sourcing revenues of services providers in a different manner for different industries. *Id.* at 450 n.1, 361 S.E.2d at 348 n.1.

Accordingly, the result of *Lockwood Greene* was the Court of Appeals' holding that (1) a personal professional service firm should source its gross receipts to South Carolina based on the "place of activity" test; and (2) affirmation that the Department's then-existing policy of using different methods for different industries to source service-related net income to South Carolina, was in compliance with Section 12-7-1190. Further, despite DIRECTV's contention, the Court of

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[19] The Department argues that it has had a longstanding policy in place regarding the sourcing of service-related net income and that it is therefore entitled to deference. However, this policy, though once apparently written down and acknowledged by the Court of Appeals in *Lockwood Greene*, is no longer written anywhere and apparently has not been for some time. As the finding of fact in *Lockwood Greene* is the only evidence of this policy, I find that this finding of fact is insufficient as a basis for deference. Moreover, "[p]olicy or guidance issued by an agency other than in a regulation does not have the force or effect of law." *See* S.C. Code Ann. § 1-23-10(4) (2005). *See also Kirven v. Cent. States Health & Life Co., of Omaha*, 409 S.C. 30, 45, 727 S.E.2d 794 802 (2014) ("[A]n agency guideline does not have the force of law, and in any event, can never trump a regulation.... *Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law.*") (quoting *Doe v. S.C. Dep't of Health & Human Servs.*, 398 S.C. 62, 68 n.7, 727 S.E.2d 605, 608 n.7 (2011)).

Appeals in *Lockwood Greene* did not impose a one-rule "place of activity" test for apportioning service-related income in South Carolina on *all* multistate corporate taxpayers. The Court of Appeals clearly supported the Department's use of different methods for different industries and did not reject Lockwood's "one-rule" argument only to replace it with a different one-rule requirement.[20]

Unlike the taxpayer in *Lockwood Greene*, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here. Indeed, as noted above, the national programming through the CONUS beams would exist regardless of whether there were any subscribers in South Carolina; therefore, such broadcasting is preparatory activity. As to local broadcasting in South Carolina, though it is almost completely geared towards South Carolina residents, DIRECTV provided no evidence of what impact the availability of local programming has on South Carolina customers' decision to subscribe to DIRECTV.

Furthermore, as noted above, Dr. Cody testified that he employed DIRECTV's payroll and net value of assets as proxies in determining and sourcing DIRECTV's income-producing activities. However, as with the determination/identification of income-producing activities, the Court also rejects as too nebulous this approach to sourcing gross receipts to South Carolina. In sum, the payroll-and-assets method of Dr. Cody does not provide a reasonable approximation of the income-producing activities performed by DIRECTV in South Carolina, and the value attributable to such activities.

Moreover, the approach proposed by Dr. Cody unduly emphasizes what amounts to "costs of performance." It is clear that South Carolina is not a UDITPA State, and it does not require

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[20] When Section 12-6-2295(A)(5) was enacted, the distinction between "place of activity" and "origin of payment" became irrelevant and the question then became whether the income-producing activity occurred completely within the State of South Carolina, and if only partly within the State, in what proportion it was conducted within the State. Lockwood Greene, in light of Section 12-6-2295(A)(5), still suggests that income-producing activity is the acts of a business that directly result in the purchase of a product or service. Finally, as discussed supra, the location of income-producing activity will vary depending on the industry.

apportionment of the net income of service providers based upon costs-of-performance elements. Although South Carolina's Section 12-6-2295(A)(5) is similar to UDITPA's Section 17, the General Assembly specifically chose not to include the phrase "based on costs of performance." South Carolina's applicable statutes merely require the apportionment of a service provider's net income using a gross-receipts ratio, and the gross receipts are attributable to South Carolina if the income-producing activity occurs within South Carolina or, if the income-producing activity occurs both within and outside of South Carolina, to the extent that the income-producing activity is performed within South Carolina.

Likewise, the South Carolina courts have never imposed a costs-of-performance approach to sourcing receipts of service providers to South Carolina. In addition to not being a costs-of-performance state, South Carolina has never been a state that always sourced receipts to the state in which the market exists (i.e., to the location of the customer or where the benefit is received). While some states, such as California, have statutorily adopted a market-based approach to source gross receipts of a service provider,[21] South Carolina has not adopted any such "blanket" approach, be it market-based, costs of performance, or otherwise. Rather, its policy has been one of apportioning net income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." *Lockwood Greene*, 292 S.C. at 449, 361 S.E.2d at 347 (citing *Hertz Corp. v. S.C. Tax Comm'n*, 246 S.C. 92, 142 S.E.2d 445 (1979)); *see also* S.C. Code Ann. § 12-6-2320(A) (Supp. 2000). Thus, the Court agrees with Professor Pomp that instead of mandating one method (*e.g.*, "costs of performance" or "market-based") for determining the amount and location of income-producing activities, S.C. Code Section 12-6-2295(A)(5) provides "flexibility" in determining the relative amount of income-producing activities in the State. This approach necessitates flexibility in application of law and policy to different and often diverse service industries. *See Dish DBS Corp.*, at *9-10 ("Lockwood Greene could be interpreted to apply a flexible standard based on where the income producing activity takes place, which varies upon industry type.").

Even in many states that **have** adopted the costs-of-performance language within their applicable statutes or regulations, such states have found that the income-producing activity was **not** located in the state(s) in which significant costs were incurred. For instance, in *Heller W.*,

[21] *See* Cal. Rev. & Taxation Code (R&TC) § 25136; Cal. Code Regs. § 25136-2.

Inc., the Arizona Supreme Court determined that the taxpayer's income-producing activity occurred solely in Arizona despite the fact that the California-based commercial financing company that received income from loans it made to Arizona borrowers incurred most of its costs in California. 116 Ariz. at 51, 53, 775 P.2d at 1115, 1117. Importantly, the applicable Arizona statute was the same as S.C. Code Ann. § 12-6-2295(A)(5) except that the Arizona sourcing statute **actually used** the phrase "costs-of-performance." Even though this language in the Arizona statute gave that taxpayer's costs-of-performance argument more merit, it was not enough to convince the court to find that the income-producing activity occurred outside of Arizona. The taxpayer argued that its income-producing activity was the borrowing of money by Heller Western through its Los Angeles headquarters to make loans to customers in Arizona. *Id.* at 50, 775 P2d at 1114. The Arizona Supreme Court held that "[t]hough borrowing of funds [in California] may be an important step in Heller Western's financing process, the direct generation of the loans occurred in Arizona. We conclude that Heller Western's sales activity in Arizona constituted the income producing activity contemplated by our tax regulations." *Id.* at 53, 775 P2d at 1117. That court went on to provide the following reasoning:

> Heller Western's costs in procuring the [product that it has sold to Arizona customers] are analogous to the costs of a merchandise retailer in procuring his inventory. Heller Western can no more argue that its receipts from Arizona loan consumers should not be taxed due to its out-of-state involvement in procuring its 'inventory' than a retailer who is engaged in extensive dealings out of state to buy his merchandise could argue that he should not be taxed on the goods he sells to consumers here."

Id. This reasoning is applicable in the instant case.

This is not to suggest that the Court should not consider out-of-state activity when determining whether activity is income-producing, nor does this suggest that no such out-of-state income-producing activity occurred in this case. For instance, it is possible that advertising performed within or without the South Carolina could be considered income-producing activity.[22]

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[22] For example, in *Ameritech Publ'g, Inc. v. Wis. Department of Revenue*, 327 Wis.2d 798, 788 N.W.2d 383 (Ct. App. 2010) (unpublished), 2010 WL 2519583, the Wisconsin Court of Appeals affirmed the taxing authority's determination that the income-producing activity of a company that received advertising revenue by placing the advertisements in telephone directories distributed in Wisconsin "was performed in Wisconsin when the advertisement reached its intended, Wisconsin audience." *Id.* at 2010 WL 2519583, *5. Indeed, the court found that the income-producing activity occurred *solely* in Wisconsin, even though the vast majority of the taxpayer's costs to gather the advertising and to publish the telephone directory were incurred outside of Wisconsin and despite the fact that the applicable Wisconsin statute *included* the phrase "costs of performance" (unlike the South Carolina statute). The Court of Appeals concluded that the advertising company's customers were paying for the broad access that the

However, DIRECTV did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina. Therefore, the Court cannot consider advertising in this case.

Finally, even if this Court ruled that South Carolina was a costs-of-performance state, and that costs of performance therefore applied in this case, DIRECTV did not present sufficient evidence to determine its income-producing activities or to quantify how much income-producing activity occurred in any applicable state. Furthermore, DIRECTV put no value on its subscriptions or the value perceived by its customers. DIRECTV simply did not provide sufficient information on how to apportion its subscription receipts between states in which it believes income-producing activities occur.

Substantial Understatement Penalties

Civil penalties are applied to every South Carolina tax law that requires a return unless otherwise provided. S.C. Code Ann. § 12-54-43. Such penalties are considered a tax owed to this State. *Id.* Further, "[i]f any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety." S.C. Code Ann. § 12-54-25(A). Section 12-54-155(A)(1) states that "[i]f there is an underpayment attributable to . . . a substantial understatement of tax for a taxable period . . . there **must** be added to the tax an amount equal to twenty-five percent of the amount of the underpayment." (emphasis added). For purposes of this subsection, "understatement" means the excess of the amount of the tax required to be shown on the return for the taxable period over the amount of the tax imposed which is shown on the return. "[T]here is a substantial understatement of tax for a taxable period if the amount of the understatement for the taxable period exceeds the greater of ten percent of the tax required to be shown on the return for the taxable period or five thousand dollars." *Id.* § 12-54-155(B)(1)(a). However, Section 12-54-155(B)(2)(b) adds the following:

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer. . . .

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company could provide to a Wisconsin audience, and that the taxpayer's income-producing activity was thus "the provision of access to a Wisconsin audience." *Id.* at *9-10

Moreover, subsection (D)(1) further adds that "[a] penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the portion and that the taxpayer acted in good faith with respect to the portion." Finally, "[u]nless specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." S.C. Code Ann. § 12-54-160.

In the instant matter, the Department was correct in its calculation of the understatement of taxes owed for 2009-2011 (and interest thereon), and that amount was properly not reduced. I find that there was no substantial authority for DIRECTV's treatment of subscription receipts. Also, though DIRECTV appropriately disclosed relevant facts affecting subscription receipts, I find that DIRECTV's basis for its tax treatment of the subscription receipts to be unreasonable.

I also find that the Department was correct to apply a substantial understatement penalty for underpayment of taxes owed for 2009 through 2011. Though DIRECTV acted in good faith with respect to bringing its claim regarding the portions of the understated tax amounts, I find that DIRECTV did not have "**reasonable** cause" (emphasis added) for the underpaid taxes, i.e., DIRECTV's method of calculating subscription receipts was unreasonable. Nevertheless, because the Court finds that DIRECTV acted with sufficient belief in bringing its claim regarding the portion of the understated tax amounts, the Court, pursuant to Section 12-54-160, concludes that a reduction in the penalty imposed upon DIRECTV should be reduced. Therefore, the Court shall reduce the penalty originally sought by the Department to 25% of that amount.

Conclusion

After considering the evidence in the record and the pertinent legal authorities, I conclude that based upon the reliable evidence, DIRECTV's income-producing activity is the delivery of the signal into the homes and onto the television sets of DIRECTV's customers. All of those income-producing activities related to South Carolina customers occurred entirely within South Carolina; therefore, 100% of DIRECTV's subscription receipts from South Carolina customers must be sourced to the numerator of the gross receipts ratio. This Court rejects DIRECTV's attempt to source the subscription receipts from South Carolina customers outside of South Carolina based upon costs of performance. Finally, DIRECTV is liable for substantial underpayment penalties.

ORDER

IT IS THEREFORE ORDERED that DIRECTV's refund requests for its amended 2006, 2007, and 2008 income tax returns are denied.

IT IS FURTHER ORDERED that DIRECTV be assessed $6,646,168.00 in tax and license fees, $653,425.00 in interest, and $1,246,155.75 in penalties with regard to its 2009, 2010, and 2011 income tax returns.

AND IT IS SO ORDERED.

Ralph King Anderson, III
Chief Administrative Law Judge

June 12, 2015
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail, to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair
Judicial Law Clerk

June 12, 2015
Columbia, South Carolina

FILED
MAY 31 2016
SC ADMIN LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar, DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No.: 14-ALJ-17-0285-CC **MOTION FOR RECONSIDERATION UNDER THE ALC RULE 29(D) AND/OR TO ALTER OR AMEND UNDER SCRCP RULE 59(E)**

Pursuant to South Carolina Rule of Civil Procedure 59(e) and Rule 29(D) of the Rules of Procedure for the Administrative Law Court, Petitioner Dish DBS corporation, f/k/a EchoStar, DBS Corp., and Affiliates (Dish) respectfully requests that this Court reconsider and alter or amend its Order dated May 20, 2016 ("Order"), a copy of which is attached hereto as Ex. A, which ruled in favor of the SC Department of Revenue regarding the apportionment of Petitioner's national income to South Carolina. This motion is based upon the grounds that the Administrate Law Court ("ALC") overlooked, misinterpreted or failed to apply South Carolina law and/or failed to consider certain evidence and arguments presented, which, when considered, necessitate a finding in favor of Petitioner.

Petitioner will not repeat all of its arguments herein but would incorporate by reference the arguments and factual assertions made in its Proposed Order. Briefly, however, Petitioner believes the ALC may have failed to consider certain facts and arguments, made erroneous factual findings, failed to make certain factual findings, and/or misinterpreted or misappropriated the law as follows:

I. THE ALC ERRED IN TREATING SOUTH CAROLINA AS A MARKET

SHARE STATE.

A. General

Both the DOR (in its 2005 Corporate Practice Manual) and the ALC Order find that South Carolina is not a market share state. The ALC Order accordingly states "it is equally clear South Carolina is not a market share or audience state."

Yet the DOR Department Determination is based on a classic market share approach. Footnote 22 of the ALC Order notes that the Department adopted a market share approach. The footnote states "In its Determination, the Department determined 100% of South Carolina subscriber's receipts should be sourced to South Carolina. The Department Determination noted: "South Carolina is not alone in this method of sourcing receipts for taxpayers like [Petitioner]. Twenty-three states have adopted the 'audience approach' for assigning receipts from programming and broadcasting companies."

While finding that South Carolina is not a market share state, the ALC Order nevertheless adopts a classic market share apportionment approach, by sourcing the income based exclusively on the location of the market or audience. The ALC erred by excluding all other income producing activities.

The market share approach benefits South Carolina businesses whose cost of performance is in South Carolina but whose customers are primarily located in other states. But the DOR has never through a Policy Document, Regulation, Instructions in its tax forms, etc. ever told South Carolina service providers that they don't owe taxes on income generated from their customers in other states. Why should this approach only be applied to out-of-state

businesses?

B. Is the DISH ALC Decision Good Tax Policy?

The ALC Order notes on several occasions that the market share approach is good tax policy.

Suppose Dish's 22,000 employees and its $9 billion in capital investment (together with its $13 billion in gross income) were located in Columbia, South Carolina rather than Englewood, Colorado. A corporation of that size is going to generate considerable demands on public services. (Dish's employees would be the 19th largest municipality in South Carolina, and only 5,000 persons smaller than Myrtle Beach and Anderson. It would be larger than North Augusta, Easley, Simpsonville and Hanahan.)

Would it be fair to South Carolina and the city of Columbia that Dish would pay taxes on only 1.6% of its federal income of $1,087,225,687 (its 2010 federal income with South Carolina modifications), when the great majority of its costs of performance (employees, buildings) -- and its demands for public services -- are located here?

The Dish decision basically tells every non-manufacturer in South Carolina (except for personal service providers) with customers in other states that they don't owe income taxes on the income generated by out-of-state customers and clients.

This is not necessarily a bad thing, maybe it's a good thing, but it's the type of pronouncement which should come from the South Carolina General Assembly, and not from the Executive Branch.

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And because most, if not all, of South Carolina's neighbors are cost of performance states this income is "no-where" income which won't be taxed anywhere.

II. THE COURT ERRED IN FINDING THAT SOUTH CAROLINA IS NOT A MODIFIED COST OF PERFORMANCE STATE.

Petitioner agrees that South Carolina is not a pure cost of performance state and that *Lockwood* is distinguishable. *Lockwood* is, however, illustrative that South Carolina is a modified COP state. And, as stated below, virtually every other authority (DOR, Hellerstein and ALC) hold that South Carolina is a modified COP state.

As stated many times previously, the taxpayer in *Lockwood Greene v. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (1987) made the identical argument as the DOR in this case. It argued income should be apportioned to where its customers are, *i.e.*, a classic market share approach. As noted in the Tax Commission decision "Lockwood Greene Engineers, Inc. (taxpayer) is a Massachusetts engineering firm with offices in several states, including South Carolina. When its clients have projects located in South Carolina, the taxpayer usually provides services for those projects primarily from its South Carolina office, though some South Carolina projects are serviced from other offices. Projects located outside this state are sometimes handled primarily by other offices. The taxpayer is normally paid for its services from the project owner's main office [Greenwood, South Carolina], which may be in a different state from the project location." (Accordingly, Lockwood Greene's cost of performance was located in Greenwood, South Carolina.)

It performed engineering services in numerous states and it attempted to reduce its income apportioned to South Carolina by arguing – exactly as the DOR asserts in this case –

that "'receipts' refers to where a taxpayer's customers are located and payments made." *Lockwood*, 293 S.C. at 448, 361 S.E.2d at 347. Lockwood accordingly asserted that it only owed taxes in South Carolina on income earned from South Carolina customers, and did not owe taxes for income derived from clients in other states, even though the clients paid for the services by sending checks to Greenwood. Because Lockwood had numerous customers outside of South Carolina, the market share approach would dramatically lower its income subject to South Carolina taxes. And presumably for this reason the former Tax Commission rejected the market share approach.

The Tax Commission noted that "Finally, we note that the activity test has been consistently applied since 1977." The Tax Commission's language is classic Cost of Performance.

The South Carolina Court of Appeals agreed with the Tax Commission's COP approach stating "an engineering firm's business carried on in a state is reasonably measured by the services *rendered by its personnel in the state*." *Id.* (emphasis added). (Cost of Performance in this example was calculated by which state – South Carolina – had the greater number of employees.) The South Carolina Court of Appeals then asserted a classic Cost of Performance test, and rejected Lockwood Greene's market share approach, as follows:

> For example, assume all of the engineering design services for a North Carolina client are performed by engineers in South Carolina. Under Lockwood's view, the gross receipts would be North Carolina receipts because the client is located in that state. This approach would not recognize the proportion of the engineering firm's business actually carried on in South Carolina.

361 S.E. 2d at 347. In *Rent-A-Center Texas, L.P. v. SCDOR*, 09-ALJ-17-0206, the ALC noted that "the legislature formally approved the Court of Appeal's interpretation [in *Lockwood*

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Greene] of 'gross receipts' as used in § 12-6-2290" and that this is consistent with current law, see footnote 5.

Hellerstein, in FN 1177 of ¶ 9.18 briefly summarizes the *Lockwood Greene* case as follows: "In *Lockwood v. Greene Eng'rs, Inc.*, 293 SC 447, 361 SE2d 346 (Ct. App. 1987), the court held that the statutory term "gross receipts from within this State" refers to the place where the services giving rise to the receipts are performed rather than the place from which the receipts are sent." Applying *Lockwood Greene* to this case, Dish has some 22,000 employees in the United States, the vast majority are located outside of South Carolina.

South Carolina has never diverged by statute, regulation or DOR policy document from the Lockwood Greene COP method for sourcing income. Indeed, in 2013 the DOR invoked the *Lockwood Greene* method in SC DOR PLR 13-3:

> . . . the income producing activity is the engineering services provided to clients. As a result, *the state where those engineering services are performed* is where gross receipts from its services should be sourced. (Emp. added.)

In the DOR 2014 Edition Economic Development Incentives the DOR plainly states:

> The "gross receipts" ratio is most commonly used by service businesses. The proper sourcing of gross receipts was reviewed in *Lockwood Greene Engineers v. South Carolina Tax Commission*, 361 S.E. 2d 346 (1987). The court held that in sourcing income of a multistate engineering firm, "gross receipts from within this State" were to be determined according to where the services were performed *rather than according to where the customers were located.* See also, *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993). (Emp. added.)

Indeed, at pg. 6 the DOR audit work papers in this case cite the COP rule:

> **Excerpts from The Department's Corporate Income Tax Manual which discussed sourcing of intangible receipts and Service Receipts**
> Comment: Considering Lockwood Greene and Geoffrey, together, it appears that gross receipts are sourced to the state

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> which is most significantly associated with the production of the income; *e.g.*, personal services, *where those services are performed*; intangibles, where those intangibles are used in a business for the production of income.78 This conclusion is consistent with the longstanding administrative policy of the Department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers. 78See also SC Tech. Adv. Memo. # 94-2. (Emp. added.)

Other commentators have noted that South Carolina is a cost of performance state. Hellerstein, in FN 1227 of ¶ 9.18 (included under **Exhibit 5**), states:

> Although South Carolina is not a state that generally follows UDITPA or the MTC regulations . . . its single-factor sales formula, as applied to receipts for services, generally resembles UDITPA's income-producing activity rule for attributing receipts from services. See SC Code Ann. § 12-6-2295(A)(5) (Westlaw 2014) (attributing receipts from services to the state "if the entire income-producing activity is within this State," and if the income-producing activity is performed partly within and partly without this state, receipts are attributable to the state "to the extent the income-producing activity is performed within this State").

Hellerstein also notes in FN 1187 of ¶ 9.18:

> According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) *and South Carolina* (services only)." P. Mata & M. Smith, "The Implementation of 'Market' Sourcing Rules: Practical Concerns," State Tax Notes, Sept. 6, 2010, p. 649 (citing statutes and regulations). (Emp. added.)

The South Carolina Corporate Income Tax Manual co-authored by senior members of the Policy Section of the South Carolina Department of Revenue, further discusses the Department's views on apportionment. The manual cites and discusses the *Lockwood Greene Engineers Inc.* case as the leading authority on the sourcing of receipts using the single sales factor apportionment methodology. The authors concluded that:

> [c]onsidering *Lockwood Greene* and *Geoffrey*, together, it appears that gross receipts are sourced to the state which is most

> significantly associated with the production of the income, *e.g.*, personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income.

Id. at Chapter .05-20.

Furthermore, the Administrative Law Court's decision in *Rent-A-Center Texas, L.P. vs. South Carolina Department of Revenue* reaffirmed the "COP" test as the proper means of sourcing sales from services. In that case Rent-A-Center Texas, L.P. performed management services for a related entity doing business in South Carolina. These management services were performed by professionals located in Texas. The court reasoned that the related entity was compensating Rent-A-Center Texas, L.P. for the time and knowledge of the personnel located in Texas. Therefore, the Court found that by applying the ruling of *Lockwood Greene* to the facts the revenue received by Rent-A-Center Texas, L.P. for work performed in Texas must be sourced to Texas. (Unlike Rent-A-Center Texas, L.P., DISH has no related entity performing services in South Carolina.) The ALC decision plainly states: "In conclusion, the revenue received by RAC Texas from the Management Services Agreement must be apportioned to Texas pursuant to *Lockwood Greene*. RAC Texas provided its management services to RAC East stores through skilled professionals located in Texas."

III. THE COURT ERRED IN DETERMINING WHAT CONSTITUTES PETITIONER'S INCOME PRODUCING ACTIVITIES.

A. UDITPA Section 17.

The Court erred in rejecting the UDIPTA definition of "income producing activities," found in section 17. While South Carolina is not a member of UDIPTA, simply put there is *no* other authoritative definition of "income producing activities," and UDITPA Section 17 has

been utilized by numerous cases. As the ALC Order correctly points out there is no statutory or regulatory definition or guidance in South Carolina law. Indeed, the ALC Order provides no definition of income producing activities other than to adopt market share.

B. The ALC Order correctly held that the Petitioner's Income Producing Activity is the delivery of the signal into a subscribers' home and onto their television screens.

The ALC Order (and several DOR witnesses) held that petitioner's income producing activity is (1) the delivery of a signal into a subscriber's home, and (2) onto their television screens. Exactly! This is indeed income producing, and petitioner produced extensive testimony that this fell under two categories – satellite/uplink and subscriber equipment.

C. Petitioner's Income Producing Activities.

Petitioner contended that its income producing activities were:

1. Programming/content.
2. Satellites/uplink.
3. Advertising.
4. Subscriber equipment.
5. Installation.
6. In-home repair.
7. Call centers; and
8. General and administrative.

And the DOR's expert witnesses and auditors agreed. Dr. Harrison agreed with Petitioner that a number of its activities should be considered income producing activities. Dr.Harrison acknowledged advertising and programming were income producing activities on three separate occasions.

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He affirmed that programming is an income producing activity for a third time when he stated:

> Q: Okay. And *so our income-producing activity is the provision of the content and the paying the bill*?
> A: *That's correct.*[1] (Emp. added)

Dr. Harrison also conceded that the number of third party installers and suppliers affected the Petitioner's ability to generate income.

Dr. Harrison also acknowledged that the charging of credit cards by the call centers was an income producing activity. With respect to the issue of whether the call center operations are considered an income producing activity, Dr. Harrison stated:

> Q: An activity that involves I *hand my credit card, and they run my credit card and they take my money, that's obviously income-producing activity, isn't it*?
> A: *That is income-producing activity, yes, as usually defined.*[2]

DOR Auditor Orville Sharpe agreed with Petitioner's position on what are income producing activities. Sharpe testified:

> Q: ... I wouldn't abandon my beloved free TV and start paying for it unless the pay TV had something more than the free TV, correct?
> A: Correct.
> Q: Okay. And then I've got to battle with Direct and cable. *You would agree that advertising plays some role in getting people to sign up for Dish*?
> A: *Yes, sir.*
> Q: *And we paid 700 million to ESPN and 600 million to Fox. In a state like South Carolina, that helps gin up a few more subscribers in South Carolina, doesn't it*?
> A: *Right....*[3] (Emp. added)

Sharpe accordingly agreed that Programming and Advertising were income producing.

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[1] Tr. 285:23-248: 1.
[2] Tr. 271:1-272:5.

Similarly, Sharpe testified:

> Q: What's your definition of income-producing activity?
> A: Okay. In this situation the definition is there's an event that triggers the production of the income, and that's *the delivery of the signal to the taxpayer's satellite, which is then transferred to the taxpayer's set-top box and ultimately allows the South Carolina subscriber to view the box.* That's the income-producing activity for the subscription receipts.[4] (Emp. added)

He accordingly agreed that satellite/uplink and subscriber equipment were income producing activities. Manager of foreign audit appeals for the Department Tim Donovan stated:

> Q: You agree with the notice that Clemson and Carolina, we love our football, don't we?
> A: Pretty much.
> Q: And were you aware Lady Gamecocks basketball team led the nation in attendance last year?
> A: I may have heard that but I don't think - - -
> Q: But you're certainly aware the USC baseball team won two national championships?
> A: Yes.
> Q: And so you would agree that Dish paying $800 million to ESPN to broadcast those games probably led to greater South Carolina customer subscribers; is that a fair statement?
> A: My understanding yes, that people like their sports and want access to them.[5]

The ALC Order further noted that "while call centers, for example, are necessary to the ultimate income-producing activity of delivering the broadcasting service into customer homes, the call center itself does not actually produce the income." Yet the call center took customer's subscription orders and ran their credit card for payment. The ALC Order correctly notes that South Carolina law does not define "income producing activities." Surely, however, taking a customer's order and their money is the ultimate income producing activity.

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[3] Tr. 412;16-413:4.
[4] Tr. 402:21-403:61.

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D. The ALC erred in misinterpreting DISH's 10-K

Quoting the DISH 10-K, the ALC Order notes that DISH recognizes revenue when the signal is received in customer homes. The revenue recognition note cited in Petitioner's Form 10-K is a purely accounting concept which addresses the **timing** of Petitioner's *revenue* recognition.

The U.S. Securities and Exchange Commission's Staff Accounting Bulletin Topic 13: Revenue Recognition (referred to as "SAB Topic 13") is the most widely used and accepted authority on recognizing revenue. According to SAB Topic 13, Paragraph A.1., revenue can be realized when all of the following criteria are met:

1) Persuasive evidence of an arrangement exists,
2) Delivery has occurred or services have been rendered,
3) The seller's price to the buyer is fixed or determinable, and
4) Collectability is reasonably assured.

https://www.sec.gov/interps/account/sabcodet13.htm

More importantly, in the bold print on page 7 of the Department's Order, when quoting Petitioner's Form 10-K, the Department states that Petitioner "recognizes revenue when . . . the goods and services have been delivered. Revenue from our subscription television services is recognized when programming is broadcast to subscribers." However, note the ellipses in the Department's quotation. In fact, the full text of that sentence in the Form 10-K states:

> "We recognize revenue when ***an arrangement exists, prices are determinable, collectability is reasonably assured and*** the goods and services have been delivered..." (Emp. added)

If this note in the 10-K is entitled to great significance, then the rest of the 10-K should also be so entitled. For example, Petitioner's Form 10-K describes its income producing activities on pp. 3-4:

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[5] Tr. 444:3-18.

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Distribution Channels.

While we offer receiver systems and programming through direct sales channels, *a majority of our new subscriber acquisitions are generated through independent third parties* such as small satellite retailers, direct marketing groups, local and regional consumer electronics stores, nationwide retailers, and telecommunications companies. *In general, we pay these independent third parties a mix of upfront and monthly incentives to solicit orders for our services.* In addition, we partner with telecommunications companies to bundle Dish Network programming with broadband and voice services on a single bill.

* * * *

Acquisition of New Subscribers

We incur significant upfront costs to acquire subscribers, including advertising, retailer incentives, equipment and installation. . . . . .

Advertising.

We use print, radio, television and Internet media, on a local and national basis to motivate potential subscribers to call Dish Network, visit our website or contact independent third party retailers.

Retailer Incentives.

We pay retailers an upfront incentive for each new subscriber they bring to Dish Network and, for certain retailers, we pay small monthly incentives for up to 60 months provided, among other things, the customer continuously subscribes to qualified programming.

* * * *

Customer Retention.

We incur significant costs to retain our existing customers, mostly by upgrading their equipment to HD and DVR receivers. As with our subscriber acquisition costs, our retention upgrade spending includes the cost of equipment and installation. In certain

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> circumstances, we also offer free programming and/or promotional pricing for limited periods for existing customers in exchange for a contractual commitment. A component of our retention efforts includes the installation of equipment for customers who move. Our subscriber retention costs may vary significantly from period to period.
>
> **Customer Service**
>
> ***Customer Service Centers.***
>
> *We use both internally-operated and outsourced customer service centers to handle calls from prospective and existing customers.* We strive to answer customer calls promptly and to resolve issues effectively on the first call. We intend to better use the Internet and other applications to provide our customers with more self-service capabilities over time.
> ***Installation and Other In-Home Service Operations.***
>
> *High-quality installations, upgrades, and in-home repairs are critical to providing good customer service.* Such in-home service is performed by both Dish Network employees and a network of independent contractors and includes, among other things, priority technical support, replacement equipment, cabling and power surge repairs for a monthly fee. (Emp. added)

Accordingly, the Form 10-K explicitly references advertising, installation, call centers and subscriber equipment as income producing activities, and the ALC erred in disregarding these portions of the 10-K.

IV. THE ALC ERRED IN RELYING UPON THE TESTIMONY OF PROFESSOR JOHN SWAIN.

The ALC Order relies in part on the testimony of Professor John Swain. Professor Swain spoke very eloquently on why South Carolina should adopt the market share theory. As the ALC Order notes "Professor Swain discussed the Department's method of income/sourcing/apportionment in this case and described the Department's method as good tax

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policy for three specific reasons."

Market sourcing is indeed good tax policy – but income tax compliance (and audits) is not based on good tax policy. Virtually everyone agrees (including Justice Toal in her concurring opinions in *Bodman v. State*, 403 S.C. 60, 742 S.E.2d 363 (2013)) that South Carolina's sales tax cap of $300 on vehicles is terrible tax policy.[6] The purchaser of a $60,000 Mercedes pays the same sales tax as the purchaser of a $24,000 Chevy.

Does this mean the DOR can administratively impose a $600 sales tax cap? Of course not. And the DOR should not be able to adopt a market share theory merely because its good tax policy.

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[6] Justice Toal commented:

> In my opinion, under the exemptions and caps scheme, retailers who specialize in selling exempted products are treated differently from retailers who sell non-exempted products, and this disparate treatment extends to manufacturers of exempted and non-exempted products. In my view, this disparate treatment does not bear a rational relationship to a legitimate governmental purpose.
>
> In 2009, the General Assembly created the South Carolina Taxation Realignment Commission (TRAC). The General Assembly directed TRAC to undertake a thorough assessment of the State's current tax structure. In its December 2010 report, TRAC noted that South Carolina adopted its motor vehicles sales tax cap of $300 in 1984 to compete with a similar cap utilized in North Carolina. The General Assembly sought to appease automobile dealers, particularly in border counties, who complained of lost sales to North Carolina car dealers. While originally intended to place South Carolina on competitive footing with North Carolina, the sales tax cap no longer serves this purpose because North Carolina has moved away from a flat, across the board tax cap on motor vehicles. Indeed, TRAC noted the obsolete nature of the cap, concluding, "South Carolina's $300 maximum sales tax cap on motor vehicle purchases is truly unique among the 50 states. The cap, entirely appropriate and necessary in 1984, 26 years later, represents one of the most regressive aspects of the State's entire sales and use tax code today."
>
> From my perspective, while South Carolina's sales tax cap for motor vehicles had a rational basis connected to a legitimate governmental purpose in 1984, in 2012, it has outlived the intended purpose of making South Carolina competitive with neighboring states with regard to the motor vehicle market. Moreover, section 12–36–2110's regressive nature is clearly evident in its application to consumers who purchase old or debilitated motor vehicles and those consumers with the financial means to afford modern luxury motor vehicles and private aircraft. Thus, in my view, section 12–36–2110(A) of the South Carolina Code represents an arbitrary and capricious exception to the sales tax.

Bodman, 403 S.C. at 74-5, 742 S.E.2d at 370-71 (citations omitted).

V. THE ALC ERRED IN DENYING PETITIONER'S MOTION IN LIMINE AND OBJECTIONS TO THE TESTIMONY OF DR. GLEN HARRISON.

Petitioner filed a Pre-Trial Motion in Limine to the testimony of Dr. Harrison and made numerous objections at trial to his testimony, all of which were denied. Harrison has a Ph.D. in economics. His current responsibilities are "teaching and research in the field of risk management and insurance." He was qualified as "an expert in applied economics." He has never taken, taught, or published in the area of state taxation, apportionment of income for multi-state taxpayers or the calculation of the numerator in a state tax apportionment scheme. He has also never taken a course, taught a course, or published an article on the calculation or definition of "income producing activities" for state tax purposes. Instead, his testimony was limited to his opinion "from an applied economic perspective."

At his deposition, Dr. Harrison cited two treatises that he based his opinion on: *Welfare Economics* and *Advanced Economic Theory*. At trial, he conceded neither treatise discussed income producing activities. He further conceded no economic treatise supports his testimony that Petitioner's only income producing activity was the mailing of the bill. The ALC erred in not granting the Motion in Limine and by overruling Petitioner's objections.

The ALC Order notes that "Dr. Harrison testified that in his opinion subscriber revenue is the simplest way to determine petitioner's income-producing activity." True, but so is a flat tax. Given that tax returns are prepared by the taxpayer (and not the DOR), and only a tiny percentage of returns are audited, is it good tax policy for taxpayers to self-assess their income or sales tax liability based upon "the simplest way?" Rest assured the "simplest way" will frequently result in less income going onto an income or sales tax return.

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Dr. Harrison also stated "The only thing that is necessary and sufficient to produce income is the subscriber in Edisto Island or me in Irmo...paying the revenue."

This, on its face is absurd. Why would anyone pay DISH any income unless it had spent billions of dollars for the satellites and box technology to get an adequate signal into the home?

And why would anyone pay DISH any income if it was merely replicating free television? People pay DISH income to watch ESPN and Fox news, which together cost DISH over $1.2 billion a year. And the subscriber in Edisto or Irmo pays the revenue to a call center, which costs DISH over a billion dollars a year to operate.

VI. THE ALC ERRED IN NOT ELIMINATING OR REDUCING THE SUBSTANTIAL UNDERSTATEMENT PENALTIES.

A. General

The Court upheld the Department's assessment of substantial understatement penalties in the Final Order, stating:

> Regarding the civil penalties, Petitioner has presented no evidence to refute the Department's calculation of the penalties except its argument that the Department applied the wrong apportionment method and gross receipts ratio during its audit. Having determined the Department correctly conducted the audit, I must only determine whether the penalties were proper considering section 12-54-155(B)(2)(b). To this end, I find there was no substantial authority for Petitioner's treatment of subscription receipts. See id. Also, although Petitioner disclosed the relevant facts regarding the subscription receipts, I find there was no reasonable basis for Petitioner's tax treatment of the subscription receipts. Id. Therefore, I uphold the Department's assessment of penalties in this case.

Final Order, page 25.

B. The DOR did not correctly conduct the Audit!

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The ALC Order states "Having determined the Department correctly conducted the audit...." Yet the beginning part of the Order acknowledges that the DOR used a market share approach - - which is explicitly acknowledged in the Department Determination. The ALC Order, the DOR Corporate Practice Manual and the various DOR witnesses acknowledged that South Carolina is not a market share state. True, the ALC Order reaches the same ultimate conclusion - - but under a different reasoning i.e. one that uses income producing activities that mimic the market share approach.

C. The ALC erred by finding a lack of Substantial Authority.

In any event, the Court erred by disregarding Petitioner's evidence of substantial authority once the Court determined that the Department correctly conducted the audit. *The existence of substantial authority is not dependent upon prevailing on the merits in a contested case hearing.*

Look at this from the opposite perspective. Suppose a South Carolina business on the North Carolina border (York, S.C.) most of whose customers are in North Carolina decided it didn't want to include the earnings earned from its North Carolina customers in its South Carolina income tax return. Further suppose this happened before the ALC Direct TV decision. On what authority could it take this position? There is no South Carolina statute, Regulation or DOR Policy Document which takes this position. The SC income tax returns do not say this. Prior to DirectTV, the only ALC decisions were to the contrary.

Hellerstein does not take this position. No law review article provides such authority. Indeed all say to the contrary, that South Carolina is a modified COP state.

No South Carolina Court of Appeals or Supreme Court decision provides support. The only case on point (*Lockwood Greene*) is to the contrary.

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Simply put, prior to DirectTV, there was not one single authority which supports this position.

And if the ALC concedes this is true, how on earth can you level penalties on a taxpayer for simply following what appeared to be the law? This is particularly true when the DOR used an erroneous audit technique (market share) which the ALC found is not the law in South Carolina.

The Court further erred by disregarding other statutory requirements to abate substantial understatement penalties.

D. Substantial authority existed for Petitioner's position.

S.C. Code Ann. § 12-54-155(B)(2)(b) states:

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item:
>
> (i) by the taxpayer if there is or was substantial authority for that treatment, or
>
> (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer.

Treasury Regulation Section 1.6662-4 governs the interpretation of "substantial authority," which states:

> **(2)** ***Substantial authority standard.*** The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. *The substantial authority standard is less stringent than the more likely than not standard* (the standard that is met when there is a greater than 50-percent likelihood of the position being upheld), but more stringent than the reasonable basis standard as defined in § 1.6662-3(b)(3).
>
> **(3)** ***Determination of whether substantial authority is present***
> **(i)** ***Evaluation of authorities.*** There is substantial authority for the tax treatment of an item only *if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.* All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether

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> substantial authority exists. The weight of authorities is determined in light of the pertinent facts and circumstances in the manner prescribed by paragraph (d)(3)(ii) of this section. There may be substantial authority for more than one position with respect to the same item. Because the substantial authority standard is an objective standard, the taxpayer's belief that there is substantial authority for the tax treatment of an item is not relevant in determining whether there is substantial authority for that treatment.
>
> (ii) ***Nature of analysis.*** . . . There may be substantial authority for the tax treatment of an item despite the absence of certain types of authority. Thus, a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision.

The regulation also provides additional guidance on how to accord weight to the authority and the types of authority typically relied upon. Id.

> Black's Law Dictionary defines "substantial" as the following:
>
> substantial *adj.* 1. Of, relating to, or involving substance; material <substantial change in circumstances>. 2. Real and not imaginary; having actual, not fictitious, existence <a substantial case on the merits>. 3. Important, essential, and material; of real worth and importance <a substantial right>. 4. Strong, solid, and firm <a substantial piece of Victorian furniture>. 5. At least moderately wealthy; possessed of sufficient financial means <a substantial supporter>. 6. Considerable in amount or value; large in volume or number <substantial support and care>. 7. Having permanence or near-permanence; long-lasting <the substantial presence of English-language books in libraries worldwide>. 8. Containing the essence of a thing; conveying the right idea even if not the exact details <a substantial portrait of the leader, even if some matters were slighted>. 9. Nourishing; affording sufficient nutriment <a substantial meal>.

SUBSTANTIAL, Black's Law Dictionary (10th ed. 2014).

The weight of the authority presented by Petitioner is substantial in relation to the weight of the authority for the Department's position. In fact, Petitioner has presented more authority for its position than has the Department, as shown in the chart below:

Petitioner's Authority	DOR's Authority
1. Relevant statutes; 2. *Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n*, 293 S.C. 447,	1. Relevant statutes; 2. *Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987);

361 S.E.2d 346 (Ct. App. 1987); 3. *Rent-A-Center Texas, L.P. v. South Carolina Department of Revenue*, Docket No. 09-ALJ-0206-CC (filed January 6, 2012); 4. *Boston Professional Hockey Association, Inc. v. Commissioner of Revenue*, 443 Mass. 276, 820 N.E.2d 792 (2005) 5. *Pan Am. World Airways, Inc. v. Duly Authorized Gov't of Virgin Islands*, 459 F.2d 387 (3d Cir. 1972) 6. *Howard Cotton Co. v. Olsen*, 675 S.W.2d 154, 160 (Tenn. 1984) 7. *Dental Ins. Consultants, Inc. v. Franchise Tax Bd.*, 1 Cal. App. 4th 343, 349, 1 Cal. 8. Rptr. 2d 757 (1991) 9. *BellSouth Advertising & Publishing Corp. v. Chumley*, 308 S.W.3d 350, 364 (Tenn. Ct. App. 2009) 10. *Schonwetter v. Commissioner of Revenue*, 316 N.W.2d 273, 276 (Minn. 1982) 11. *Commissioner of Revenue v. AT&T Corp.*, 82 Mass. App. Ct. 1106, 970 N.E.2d 814 12. (2012) (unpublished) 13. *Interface Grp. v. Comm'r of Revenue*, 75 Mass. App. Ct. 1116, 918 N.E.2d 97 (2009) 14. *Gen. Mills, Inc. v. Comm'r of Revenue*, 440 Mass. 154, 174-75, 795 N.E.2d 552, 569-70 (2003) 15. *Arkla Indus., Inc. v. Franchise Tax*	3. *Rent-A-Center Texas, L.P. v. South Carolina Department of Revenue*, Docket No. 09-ALJ-0206-CC (filed January 6, 2012);; 4. Expert Testimony by Dr. Glen Harrison 5. Expert Testimony by Professor John A. Swain 6. *DIRECTV, Inc. & Subsidiaries*, Amended Final Order and Decision, 14-ALJ-17-0158-CC (C.J. Anderson, Jun. 12, 2015); 7. *Anonymous Taxpayer v. Texas Comptroller of Public Accounts*, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013); 8. *Hertz Corp. v. S.C. Tax Comm'n*, 246 S.C. 92, 142 S.E.2d 445 (1965); 9. *Emerson Elec. Co. v. S.C. Dep't of Rev.*, 395 S.C. 481, 719 S.E.2d 650 (2011); 10. South Carolina Corporate Income Tax Manual; 11. *Walter E. Heller Western, Inc. v. Arizona Dep't of Revenue*, 161 Ariz. 49, 775 P.2d 113 (1989); 12. *Ameritech Publishing Incorporated v. Wisconsin Department of Revenue*, 327 Wis.2d 798, 788 N.W.2d 383 (Ct. App. 2010) (unpublished); 13. *AT&T Corp & Includable Subsidiaries v. Dep't of Revenue*, 357 Or. 691, 358 P.3d 973 (Sept. 11, 2015); 14. *Mercury Motor Express, Inc. v. South Carolina Tax Commission*, 244 S.C. 134, 135 S.E.2d 756 (1964); 15. TAA 12C1-006, Fla. Dep't of Revenue, May 17, 2012; 16. TAA 13C1-006, Fla. Dep't of Revenue, Nov. 21, 2013; 17. Indiana Department of Revenue, Letter of Findings: 02-20140455

Bd., 188 Cal. App. 3d 530, 233 Cal. Rptr. 495, 499 (Ct. App. 1986) 16. *Communications Satellite Corp. v. Franchise Tax Bd.* 156 Cal. 17. App. 3d 726, 203 Cal. Rptr. 779 (Ct. App. 1984) 18. *Storer Communications, Inc., v. Limbach*, 1986 WL 28659 19. *Toner v. C. I. R.*, 60 T.C.M. (CCH) 1016 (T.C. 1990) 20. VA Public Document (P.D.) 12-36 21. State of Illinois, 1990 WL 99829. 22. State of Illinois, 2004 WL 2732081 23. Letter No. IT 2005-0046-GIL VA P.D. 08-137 24. *Mercury Motor Exp., Inc. v. S.C. Tax Commission*, 244 SC 134, 135 S.E.2d 756 25. (1964) 26. *Economic Development Incentives* (2014), DOR. 27. Hellerstein & Hellerstein, *State Taxation.* 28. Uniform Division of Income Tax Purposes Act ("UDITPA") 29. Sutton et al., *The Increasingly Complex Apportionment Rules for Service Based Businesses: Basic Issues*, 17-OCT JMTAX 24 (2007 WL 3201540 30. The South Carolina Corporate Income Tax Manual	18. Uniform Division of Income Tax Purposes Act ("UDITPA")

There may be substantial authority for more than one position with respect to the same item and Petitioner need not prevail on the merits to meet its burden. Petitioner has met its burden in this case and the Court should abate the substantial understatement penalties. *Alltel Commc'ns, Inc. Petitioners*, 07-ALJ-17-0299-CC, 2008 WL 2127921, at *14 (Apr. 22, 2008) (holding substantial authority for petitioner's position existed when petitioner merely cited to three cases, one law review article, and South Carolina statutes.)

E. The Court erred in holding that Petitioner did not act with reasonable cause or in good faith.

S.C. Code Ann. § 12-54-155(D)(1) states:

> A penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the portion and that the taxpayer acted in good faith with respect to the portion. For purposes of this item, the words "reasonable cause" and "good faith" must be interpreted in accordance with Treasury Regulation Section 1.6664-4 as of the date on which the Internal Revenue Code is applied to state tax laws pursuant to Section 12-6-40. (emphasis supplied.)

Treasury Regulation Section 1.6664-4 states in part:

> The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. *Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances* . . . .

As stated above, Petitioner relied on substantial authority and thus had reasonable cause for its position. As stated above, prior to the DIRECTV decision, modified or pro-rata COP was the only position! South Carolina Code Ann. § 12-54-155(D)(1), by incorporating Treas. Reg. 1.6664-4, expressly states that substantial understatement penalties may be waived even if a taxpayer did not prevail on the merits in a contested case hearing. Accordingly, because Petitioner acted in good faith on what it believed to be the law based on substantial authority,

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the Court should abate the substantial understatement penalties assessed against Petitioner pursuant to S.C. Code Ann. § 12-54-155(D)(1).

F. The Court erred by not waiving or reducing penalties under S.C. Code Ann. § 12-54-160.

S.C. Code Ann. § 12-54-160 states that "[u]nless otherwise specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." Precedent and the facts warrant the waiver of penalties in this case.

In *Travelscape, LLC Petitioners*, 08-ALJ-17-0076-CC, 2009 WL 769017, at *21 (Feb. 12, 2009), this Court waived penalties assessed by the Department for failure to pay the Accommodations Tax owed by an online travel company providing services outside the State. The Court based its decision on several factors. First, the Court stated the case involved difficult and complex issues. Further, the Court noted that prior to the audit of the taxpayer, the Department had never pursued taxation of online travel companies for the Accommodation Tax. Nor had the Department published any official guidance regarding the application of the Accommodation Tax to online travel companies. Thus, the Court waived the penalties.

The present case, like *Travelscape*, involves complex issues. Prior to the audit, the Department has never published guidance on the specific issues of this case. The parties were forced to rely on precedent involving taxpayers that consisted of an engineering firm, a rent-a-car center, and other entities that were not in the same industry as Petitioner. Accordingly, given the complex and novel issues of this case, like *Travelscape*, the Court should waive the substantial understatement penalty pursuant to S.C. Code Ann. § 12-54-160.

Further, Petitioner is a reputable corporation that has always strived to comply with the law. Accordingly, the Court should waive the substantial understatement penalty because it will not have any deterrent effect. *Midlands Utility, Inc. v. S.C. Dept. of Health and*

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Environmental Control, 313 S.C. 210, 437 S.E.2d 120 (1993) (stating that the purpose of assessing a penalty is deterrence); *Anonymous Co., Petitioner*, 03-ALJ-17-0435-CC, 2004 WL 3154667, at *3 (Aug. 10, 2004) (waiving tax penalties and interest because they would not have any deterrent effect).

The uncertainty in the law warrants abatement of penalties in this case. In *Anonymous Taxpayers, Petitioners*, 01-ALJ-17-0446-CC, 2002 WL 512589, at *13 (Mar. 28, 2002), the taxpayer contested the Department's determination that certain settlement proceeds relating to a personal injury were taxable. The Court concluded that the statute at issue had been subject to numerous decisions interpreting the meaning of personal injury, and disagreement existed over which payments were excluded from taxation. The Court held that the taxpayer's tax treatment, though different than the position taken by the Department, was reasonable and accordingly waived substantial understatement penalties.

Here, Petitioner relied on substantial authority for its position and acted in good faith. As indicated by the authority relied on by both Petitioner and the Department, substantial disagreement exists in the tax treatment of the income at issue in the present case. Accordingly, like the above case, the Court should find that Petitioner's tax treatment was reasonable and should waive the substantial understatement penalties pursuant to S.C. Code Ann. § 12-54-160.

Finally, in DIRECTV, Inc. & Subsidiaries, Amended Final Order and Decision, 14-ALJ-17-0158-CC (C.J. Anderson, Jun. 12, 2015), a case relied upon by the Department, the Court found that DIRECTV acted with sufficient belief in bringing its claim regarding the understated tax amounts and thus reduced the amount of substantial understatement penalties by 75%. Not only did Petitioner have a sufficient belief in bringing its claim, but it relied on substantial authority in doing so.

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For the reasons mentioned above, abatement of the substantial understatement penalties against Petitioner is warranted.

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May 31, 2016
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 14-ALJ-17-0285-CC **RESPONDENT'S RESPONSE TO PETITIONER'S MOTION FOR RECONSIDERATION UNDER THE ALC RULE 29(D) AND/OR TO ALTER OR AMEND UNDER SCRCP RULE 59(E)**

COMES NOW, Respondent, South Carolina Department of Revenue (Department), by and through its counsel, provides the Administrative Law Court (ALC or Court) with the following response to Petitioner, Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates' (Petitioner or Dish DBS), Motion for Reconsideration Under the ALC Rule 29(D) and/or To Alter or Amend under SCRCP Rule 59(e) (Motion). As set forth more fully herein, the Court's Final Order and Decision dated May 20, 2016 (Order), fully and correctly addresses the issues in this case; therefore, the Petitioner's Motion must be denied. Further, pursuant to ALC Rule 29(D) and Rule 59(e), SCRCP, the South Carolina Department of Revenue (Department) respectfully requests that this Court amend its Order in one specific instance regarding the testimony of a Department witness.

I. **Petitioner's Motion for Reconsideration Must Be Denied.**

Petitioner's Motion presents numerous arguments which it asserts the Court did not properly address and/or evaluate in its Order and repeatedly mischaracterizes this Court's Order. The Petitioner's Motion must be denied because, contrary to Petitioner's assertions, the Court properly addressed the issues consistent with South Carolina law and properly considered the evidence in this case. Moreover, Petitioner's Motion does not address any new issues, but rather repeats the same arguments submitted in its proposed Order.

A. The Court Properly Interpreted and Applied South Carolina's Sourcing Statute and Did Not Treat South Carolina as a Market Share State.

Contrary to Petitioner's Motion, the Court found that "South Carolina is not a market share state." (Order, p. 15.) In fact, Petitioner acknowledges that the Court found that South Carolina is not a market share state. (Motion, p. 2.) The Court properly found that South Carolina is neither a market-share state nor a costs-of-performance state (Order, p. 18), but instead found that "South Carolina's apportionment statute provides a flexible standard based upon the income-producing activity for a given industry." (Order, p. 16.) In fact, Petitioner's expert acknowledged that the Department's income-producing activity approach does not result in a market-based result for every taxpayer. (Hr'g Tr.567:2-23, 570:12-571:4.)

Petitioner, however, twists its overall allegation that the Court found that South Carolina is a market-share state to complain that the result of the Order is the same as a market-share result. Petitioner asserts that the Court "nevertheless adopt[ed] a classic market share apportionment approach by sourcing the income based exclusively on the location of the market or audience. The ALC erred by excluding all other income-producing activities." (Motion, p. 2). Petitioner's arguments are flawed.

First, a similar result is proper as long as the facts and the law are followed, which the Court did as demonstrated by its Order. Second, this Court properly interpreted S.C. Code Ann. § 12-6-2295(A)(5) (2014) and related statutes and correctly identified the income-producing activity based on the evidence before it. The Court sourced the income of Petitioner based upon its income-producing activity within this State as required by section 12-6-2295(A)(5) and case law from South Carolina:

> Rather, section 12-6-2295(A)(5) focuses solely on the 'income producing activity' and where that activity takes place.

(Order, p. 14.)

> Section 12-6-2295(A)(5) focuses exclusively on *income-producing activity* and where it takes place without requiring or referencing a proxy to measure income-producing activity.

(Order, p. 15) (emphasis in original).

> Finally, just as the Department concluded in its Determination here, and this Court noted in its Order Denying Cross Motions for Summary Judgment, the DIRECTV decision concluded section 12-6-2295(A)(5) focuses solely on income-producing activity and where the income-producing activity is performed without requiring a particular method of sourcing. Id. at 18 ("South Carolina has not adopted any such 'blanket approach, be it market-based, costs of performance, or otherwise.")
>
> ***
>
> Simply put, South Carolina is neither a *strict* nor *pro rata* costs of performance state because South Carolina law does not require sourcing of a service provider's gross receipts based upon costs of performance principles. Neither is it a market share state. South Carolina's applicable statutes merely require the apportionment of a service provider's net income using a gross-receipts ratio, and the gross receipts are attributable to South Carolina if the income-producing activity occurs within South Carolina or, if it occurs within and without South Carolina, it is attributable to the extent it occurs within South Carolina. Where the income-producing activity takes place may vary upon industry, and South Carolina statutes do not require the income-producing activity to be measured using any particular method or proxy. Rather, the focus is on using a method that fairly represents the taxpayer's business activities in South Carolina.

(Order, p. 18.)

Based on this income-producing activity language, this Court found that "South Carolina's apportionment statute provides a flexible standard based upon the income-producing activity for a given industry." (Order, p. 16.) This Court considered the activities that Petitioner asserted were income-producing and considered Petitioner's testimony, but it found that these activities were merely "preparatory activities." (Order, pp. 19-21.) The Court further addressed Petitioner's claim that adverting is an income-producing activity, but the Court rejected that claim because Petitioner "presented no

evidence as to how this advertising affected its revenue generated in South Carolina." (Order, p. 22.) The Court considered the testimony of the Department's economic expert and other evidence and found that the income-producing activity was "the delivery of the Petitioner's signal into the subscriber's home and onto the subscriber's television." (Order, pp. 20-21, 23.)

Finally, Petitioner wrongly asserts that this Court sourced Petitioner's subscription receipts from its South Carolina customers to South Carolina "based exclusively on the location of the market or audience." (Motion, p. 2.) This allegation is wrong and demonstrates Petitioner's inability to accept that section 12-6-2295(A)(5) sources receipts based on income-producing activity, not based on costs-of-performance or the location of Petitioner's market (i.e., its customers). Here, the Court sourced the South Carolina subscription receipts to South Carolina based on the location of the income-producing activity, not based on the location of Petitioner's market. See (Order, p. 24.) Again, the result in this case may be similar to a result of a market-share approach, but this Court properly followed the facts and the law to make its decision.

Petitioner also makes a policy argument that this Court's Order is bad tax policy and states that the Order "tells every non-manufacturer in South Carolina (except for personal service providers) with customers in other states that they don't owe income taxes on the income generated by out-of-state customers and clients." (Motion, pp. 3-4.) Again, Petitioner mischaracterizes the Order because Petitioner is focusing only on the location of a taxpayer's customers and not on the taxpayer's income-producing activity. This Court did not say that all income of service providers located in South Carolina would be sourced to the state in which its customers reside, but it found that "South Carolina's apportionment statute provides a flexible standard based upon the income-producing activity for a given industry." (Order, p. 16.)

The Court should deny Petitioner's Motion on its market-share allegation based on the above and based upon its failure to cite any supporting authority. See First Sav. Bank v. McLean, 314 S.C. 361, 444 S.E.2d 513 (1994) (holding that Appellant was deemed to have abandoned issue for which he failed to provide any argument or supporting authority).

B. The Court Correctly Found that South Carolina is Not a Modified Cost of Performance State.

The Court correctly found that South Carolina is not a modified (i.e., pro rata) costs-of-performance state (Order, p. 15), and this Court should deny Petitioner's Motion on this issue. Petitioner mistakenly argues that the Court erred in finding that South Carolina is not a modified cost of performance state. As support for its assertion, Petitioner cites to Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987). (Motion, pp. 4-8.)

First, Petitioner states, "Petitioner agrees that South Carolina is not a pure cost of performance state and that Lockwood is distinguishable." (Motion, p. 4.) This statement alone means that Petitioner agrees that South Carolina is neither a strict (i.e., pure) or pro-rata (i.e., modified) costs-of-performance state. The only difference between the two is whether gross receipts are sourced to the state in which the most income-producing activity occurs or allocated on a pro-rata basis to all states in which income-producing activities occur. In substance, Petitioner has admitted that South Carolina is not a costs-of-performance state. The mere fact that the second prong of section 12-6-2295(A)(5) would source gross receipts if income-producing activity occurs in more than one state, does not make South Carolina a pro-rata costs-of-performance state. See § 12-6-2295(A)(5) (2014); (Order, p. 24.)

Second, the Department disagrees with Petitioner's unfocused arguments and respectfully requests the Court to refer to Respondent's Proposed Final Order and Decision dated January 12, 2016, for the Department's detailed analysis of this argument. (Resp't Proposed Final Order and Decision, pp. 12-18, 27-32.) The Court thoroughly addressed whether South Carolina requires cost-of-performance elements when sourcing the gross receipts from services to South Carolina, and the Court also addressed the application of Lockwood Greene. (Order, pp. 14-19.) Simply put, Lockwood Greene applies only to personal professional service providers and does not impose cost-of-performance sourcing on all service providers. It "could be interpreted to apply a flexible standard based on where the income-producing activity takes place, which varies upon industry type." Id. at 17.

Petitioner next states that other authorities have indicated that South Carolina is a cost-of-performance state. To the extent Petitioner's argument relies upon the *Hellerstein* treatise, this argument must fail, again. As discussed in the Respondent's Response to Petitioner's Proposed Order, the Department refers the Court to the testimony of Professor Swain, co-author of the treatise, who discusses Petitioner's characterization of cost of performance regarding South Carolina law. (Hr'g Tr. 476:8-481:24.) Specifically, Professor Swain testified that "the treatise hasn't made any declaration about, nor can we make South Carolina a cost of performance state. We've reported on the most recent litigation . . . . it would be unfair to the extent anyone left the impression that [the authors] have declared South Carolina to be a cost of performance state or that there is one clear way to read the UDITPA language is – would be inaccurate – would be inaccurate." (Hr'g Tr. 481:8-24.)

Petitioner next argues that the ALC's recent decision in Rent-A-Center Texas, L.P. v. South Carolina Department of Revenue, Docket No. 09-ALJ-17-0206-CC (filed January 6, 2012) "reaffirmed the 'COP' test as the proper means of sourcing sales from services." (Motion, p. 8.) The Department disagrees. Rent-A-Center Texas performed management services (i.e., a form of personal services similar to the engineering services at issue in Lockwood Greene) so the Rent-A-Center Texas Court addressed the sourcing only of personal services, not the type of services provided by Petitioner. See Rent-A-Center Texas, pp. 9-11. The Department respectfully requests the Court to refer to its discussion of that case in the Respondent's Proposed Final Order and Decision. (Resp't Proposed Final Order and Decision, pp. 33-35.)

Finally, Petitioner cites to Department policy documents or manuals for the assertion that the Department has "never diverged by statute, regulation or DOR policy document from the Lockwood Greene COP method for sourcing income." (Motion, p. 6.) This is completely incorrect. First, the Department has never applied a "COP" method of sourcing income. Second, the Department has never applied one sourcing rule to all service providers. Even the passage cited by Petitioner in the Motion acknowledges that the Department does not apply one sourcing rule to all providers:

> [c]onsidering *Lockwood Greene* and *Geoffrey*, together, it appears that gross receipts are sourced to the state which is

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

Moreover, although Petitioner cites to the Department's Corporate Tax Manual to support its argument, Petitioner neglects to include other comments within the Manual:

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

(Resp. Ex. 9 at 17) (excerpt from the South Carolina Corporate Income Tax manual). Accordingly, the Petitioner's arguments are without merit, and the Court correctly concluded that South Carolina is not a modified cost-of-performance state.

C. The Court Appropriately Considered And Addressed The Evidence To Determine Petitioner's Income Producing Activities.

Petitioner next argues that the Court erred in determining what constitutes Petitioner's income-producing activities in this matter. Initially the Court should deny Petitioner's Motion on the basis that Petitioner failed to cite any supporting authority for his argument. See First Sav. Bank, 314 S.C. 361, 444 S.E.2d 513. Nevertheless, the Department adamantly disagrees with Petitioner's contention. This Court's in-depth analysis within its Order demonstrates the Court thoroughly considered all of the evidence presented by both parties when determining that Petitioner's income-producing activity consisted solely of the delivery of the signal into the homes and onto the televisions of its South Carolina subscribers.

1. UDITPA Section 17.

Petitioner argues that the Court "erred in rejecting the UDITPA definition of 'income producing activities' found in section 17." (Motion, p. 8.) As the Court noted in its Order, the definition "was developed in the context of UDITPA's costs of performance approach for sourcing receipts for tax purposes." (Order, p. 19.) The Court further noted that because it previously "established South Carolina is not a UDITPA/costs of performance state and South Carolina is not a member of the Multi-state Tax Commission," the definition is "unpersuasive." Id. There is simply no reason to adopt UDITPA's definition of income producing activity given the origin of the definition, coupled with the South Carolina General Assembly's explicit omission of the cost of performance language from section 12-6-2295(A)(5).

Petitioner further asserts that the Court "provide[d] no definition of income-producing activities other than to adopt market share." Petitioner is incorrect in at least two ways. First, the Petitioner has confused the sourcing standard with the determination of the income-producing activity, as demonstrated by its statement that by adopting market-share sourcing, the Court provided a definition of income-producing activities. See (Motion, p. 9.) The Court recognized the distinction between these two concepts when it stated, "[h]aving determined that South Carolina applies a flexible income tax apportionment standard based on where the income-producing activity takes place for a particular industry, I now address what constitutes Petitioner's income producing activity . . . ." (Order, p. 19.) Therefore, unlike Petitioner, the Court has properly distinguished between the sourcing method and the determination of income-producing activities. Second, the Court appropriately recognized that South Carolina law does not define income-producing activities and used testimony and law to determine what the income-producing activity was in this case. (Order, pp. 19-24.) Despite Petitioner's concerns of not having a definition, the Court provided guidance regarding how to determine income-producing activities by finding that the activities that Petitioner asserts are income producing are in fact preparatory activities that, while necessary in the process, are not sufficient to be categorized as producing income. (Order, p. 21.) The Court also cited Mercury Motor Express, Inc. v. South Carolina Tax Commission, 244 S.C. 134, 135

S.E.2d 756 (1964) which found that some activities, while incidental to the production of income, are not income-producing activities. (Order, p. 21.)

2. The ALC Order Correctly Held That The Petitioner's Income-Producing Activity Is The Delivery Of The Signal Into A Subscriber's Home And Onto Their Television Screens.

Petitioner argues the Court erred in its determination regarding Petitioner's income-producing activity because it failed to determine that all of the activities asserted by Petitioner were income-producing activities. This argument was raised by Petitioner in its Proposed Order, and the Department responded to such argument in the Respondent's Response to Petitioner's Proposed Order.

Despite claiming in its Motion that general and administrative activities are income-producing activities (Motion, p. 9), based upon Petitioner's Revised Proposed Order filed with the Court on January 25, 2016, Petitioner does not consider its General Administrative activities to be income-producing activities in this matter. (Pet'r Revised Proposed Order, p. 36.) More specifically, Petitioner's Revised Proposed Order unequivocally stated that "General and Administrative Activities are not income producing activities." Id. Further, Petitioner has not provided any reference to the Record to support its assertion that General and Administrative activities should be considered an income producing activity in this matter. Thus, the Court should not amend its Order to include such activity.

Additionally, this Court was correct when it determined that Petitioner's activities regarding subscriber equipment, installation, and in-home repair (i.e., items 4 through 6 on page 9 of the Motion) were not income-producing activities. Petitioner concedes that the income received from items 4-6 are "certain non-programming revenue" and such revenue stream is already sourced 100% to South Carolina. (Pet'r Proposed Order, p. 36) (emphasis added); see also (Hr'g Tr. 138:3-21, 191:13-194:1.) Simply put, numbers 4-6 clearly do not fall within the revenue stream generated by programming revenue, and as acknowledged by Petitioner, the dispute in this matter "is limited to the proper apportionment of programming revenue." (Pet'r Proposed Order, p. 36) (emphasis added).

With respect to items 1-3 (i.e., programming/content, satellites/uplink, and advertising), Petitioner failed to show any impact these "activities" may have had upon a potential South Carolina customer. The Department respectfully requests the Court to refer directly to its Proposed Final Order and Decision for the Department's detailed positions and/or interpretations in this matter regarding the identification of Petitioner's income-producing activity. (Resp't Proposed Final Order and Decision, pp. 18-26.)

Finally, with respect to call centers (i.e., item 7), the Court did not err in its determination that call centers are not an income-producing activity, and Petitioner has not cited any authority or support for its assertion. Nevertheless, the Department reiterates that Petitioner's interpretation of income-producing activities is inconsistent with applicable law in South Carolina and the Department respectfully requests the Court to refer to the discussion of Mercury Motor Express, Incorporated v. South Carolina Tax Commission, 244 S.C. 134, 135 S.E.2d 756 (1964) in the Department's Proposed Final Order and Decision, pp. 23-24, and Respondent's Response to Petitioner's Proposed Order, p. 8.

Petitioner concludes its argument about what constitutes income-producing activities by stating that taking a customer's order and their money is the ultimate income-producing activity. (Motion, p. 11.) Petitioner confuses the activity of collections with the activity of earning income. If Petitioner never delivered that video service to a subscriber who had already paid, a refund would surely be due to the subscriber.

3. Testimony of Department Witnesses.

Petitioner next argues that the Department's witnesses agree with Petitioner's position regarding the identification of income-producing activities. Petitioner's argument is based upon a mischaracterization of the witnesses' testimony and takes such testimony out of context.

During the hearing, Dr. Harrison unequivocally stated that "the income-producing activity is the delivery of the service to you in Edisto Island." (Hr'g Tr. 276:10-12) (emphasis added). Petitioner took Dr. Harrison's statement that the income-producing activity is "the provision of the content" to the extreme conclusion that Dr. Harrison

meant that anything related to the delivery of the video onto a subscribers' television screen was also income-producing activity. However, as noted above, Dr. Harrison clearly stated that delivery of the video service to subscribers home is the income-producing activity. The programming/content activities and the satellite/uplink activities that Petitioner wants to include are too attenuated to the production of income to be income-producing activities.

With regard to the Department auditors, Mr. Sharpe specifically stated that he did not consider satellites and other infrastructure outside of South Carolina to be income-producing activities "[b]ecause I don't think they produce income. I think that they're all necessary to the taxpayer's business and they're integral parts, but they're preliminary, they occur before the actual income producing activity." (Hr'g Tr. 383:4-15.) Finally, nothing in Mr. Donovan's testimony cited by Petitioner supports Petitioner's assertion that Mr. Donovan agreed that Petitioner's "satellite/uplink" activity is an income producing activity." (Motion, p. 11.) In fact, at the hearing Mr. Donovan testified that the income-producing activity in this matter "is the delivery of the signal into the customer's house, basically, you know, to the unit." (Hr'g Tr. 428:21-23.)

Accordingly, the Department requests the Court to refer directly to a Department witness's entire testimony, as well as, the Department's Proposed Order when determining Department witness statements and/or positions asserted at the hearing. See (Resp't Final Order and Decision, pp. 4-7.)

4. The ALC Properly Interpreted Petitioner's 10-K.

Finally, Petitioner argues that the ALC misinterpreted Petitioner's 10-K regarding Petitioner's income-producing activities. This argument is without merit. The Court used various testimony and other evidence to determine that Petitioner's sole income-producing activity was the delivery of its signal into the homes and televisions of its South Carolina customers.

Regarding Petitioner's own revenue recognition policy, the Court recognized that the key to Petitioner's revenue is the delivery of the video service to its customers when it referenced Petitioner's own policy – as expressed in its financial statements attached to its Form 10-K – to recognize subscription receipts as revenue for financial statement

purposes when the video service had been delivered. See (Order, p. 20.) Without such delivery, Petitioner would have no subscription revenue. Specifically, Petitioner's audited financial statements that are included within its Form 10-K clearly stated, "[w]e recognize revenue when an arrangement exists, prices are determinable, collectability is reasonably assured, and the good and services are delivered. Revenue from our subscription television services is recognized when programming is broadcast to subscribers." (Exhibit 25, pp. 108-09; Tr. 268:21-269:2.). This a clear statement that Petitioner records revenue in its accounting records only when the video programming service is delivered to the customers. Petitioner does not recognize its subscription receipts as revenue at some prior time when the customer and Petitioner execute the service contract (i.e., when the contractual arrangement is established), when the Petitioner periodically publishes its rates (i.e., when prices are determinable), or when the preparatory acts (e.g., negotiating contracts with television content providers, gathering and manipulating signals to be sent to the satellites, launching satellites, advertising) occur.

Regarding Petitioner's argument that the Form 10-K supports other income-producing activities, Petitioner presented no evidence at the hearing regarding the activities it attempts to characterize as income producing. For example, when considering advertising as an income producing activity, the Court noted the following:

> Accurately measuring the effect advertising had on Petitioner's South Carolina revenue as opposed to its national revenue would be a difficult task and highlights one of the problems associated with using cost-based factors to estimate income-producing activity. Based on the lack of evidence of the effect adverting had on Petitioner's South Carolina revenue, I decline to include adverting in this Court's analysis.

(Order, p. 22.) Similarly, Petitioner produced no evidence regarding call centers. See also *supra* Section III, subsection (B) (discussing application of Mercury Motors).[1]

[1]Moreover, Petitioner previously conceded that the income received from installation and subscriber equipment are "certain non-programming revenue" and such revenue stream is already sourced 100% to South Carolina. See *supra* Section III,

Accordingly, the Court did not err in relying upon the statement contained in Petitioner's 10-K.

D. The Court Properly Considered the Testimony of Professor John Swain.

Petitioner next argues that the Court erred in relying upon the testimony of Prof. Swain. Notably, Prof. Swain did not testify that "South Carolina should adopt the market share theory." (Motion, p. 14.) Rather, as the Court stated, Prof. Swain "discussed the Department's method of income sourcing/apportionment in this case and described the Department's method as good tax policy for three reasons." (Order, p. 13.) Petitioner also cites to Bodman v. State, 403 S.C. 60, 742 S.E.2d 3643 (2013), for the proposition that the Department should not be able to adopt "a market share theory merely because its good tax policy."

Again, as discussed *supra*, Section I, neither the Department nor the Court has adopted a market-share approach in this matter. Second, Petitioner's reliance upon Bodman is misplaced. Notably, Justice Toal did not author the majority's decision in Bodman. Rather, her comments are contained in a concurring, separate opinion. Further, the sales tax cap rate discussed in Justice Toal's opinion in Bodman was enacted by the General Assembly and not a state agency. That is the same situation in the present matter: the General Assembly enacted section 12-6-2295(A)(5) in 2007, and it determined that Petitioner's income should be sourced to South Carolina based upon the income-producing activity of the taxpayer. The Court and the Department are simply following the pronouncement of the General Assembly in looking at the taxpayer's transaction to determine what the income-producing activity is in this matter.

E. The Court Properly Denied Petitioner's Motion in Limine and Objections to the Testimony of Dr. Glenn Harrison.

Petitioner next argues the Court erred in denying Petitioner's Motion in Limine and objections to the testimony of Dr. Glenn Harrison. The Court should deny

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subsection (B) above. See also (Pet'r Proposed Order, p. 36); (Hr'g Tr. 138:3-21, 191:13-194:1.)

Petitioner's Motion on the basis that Petitioner failed to cite any supporting authority for his argument. See First Sav. Bank, 314 S.C. 361, 444 S.E.2d 513.

Nevertheless, the "[q]ualification of an expert and the admission . . . of his testimony is a matter within the sound discretion of the trial court." Fields v. Regional Medical Center Orangeburg, 363 S.C.19, 25, 609 S.E.2d 506, 509 (2005). The trial court's qualification of an expert and admission of his testimony "will not be disturbed on appeal absent an abuse of discretion." Id. (citations omitted). "An abuse of discretion occurs when the ruling is based on an error of law or a factual conclusion that is without evidentiary support." Id. 363 S.C. at 26, 609 S.E.2d at 509. Here, Petitioner has not pointed the Court to any error of law or factual conclusion by Dr. Harrison that is without evidentiary support.

F. The Court Considered and Addressed Petitioner's Argument That Penalties Must Be Abated When There Is Substantial Authority and/or The Taxpayer Acted In Good Faith.

1. The Department Correctly Conducted the Audit.

Petitioner asserts that the Court erred in concluding that the Department did not correctly conduct the Audit based upon its "market share approach." See *supra* Section I for the response to Petitioner's market share approach argument.

2. The Court Properly Concluded That Petitioner Lacked Substantial Authority For Its Position In This Matter.

Petitioner next asserts that the substantial understatement penalties should be eliminated or reduced because there was substantial authority for its position. Specifically, Petitioner argues that it presented testimony and evidence that its treatment of subscription revenue was correct, and that its position is supported by relevant statutes and various case law from around the country. However, this Court properly concluded that the Department was correct to apply a substantial understatement penalty for the underpayment of taxes and license fees owed for tax years 2004 through 2011.

First, the Lockwood Greene decision does not explicitly or implicitly direct taxpayers, such as Petitioner, to file its corporate tax returns based on a costs-of-performance method or elements. In fact, the phrase "costs-of-performance" was not

used at all in the Court of Appeals opinion. As this Court recognized, in Lockwood Greene, "payroll may have been the best representation of the income-producing activity available to the [Court of Appeals], but it does not mean that payroll or a similar cost-based proxy for income-producing activity, will be the best metric in every case for every type of industry." (Order, p. 17.) The Lockwood Greene Court recognized that the Department sourced revenues of service providers such as engineering, law, and accounting firms to the place of activity, while sourcing income from other service industries, such as finance companies and media broadcasters, to the location of the borrower and the advertisers, respectively.

Petitioner is not like the taxpayer in Lockwood Greene: Petitioner's customers do not hire specific professionals and are not paying for those professionals' expertise and time. Further, this Court agreed with DIRECTV's "differentiation between the income-producing activity of media broadcasting companies and the income-producing activity of personal professional service providers like the engineering firm in Lockwood Greene." (Order at 22-23); see DIRECTV (Amended Order, p. 16) (stating "the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands.") Petitioner and its operations are not comparable to the taxpayer in Lockwood Greene, and there is no basis in Lockwood Greene upon which Petitioner may rely when filing its corporate income tax returns.

3. No Substantial Authority Exists for Petitioner's Position.

Next, Petitioner asserts that IRC Treasury Regulation § 1.6662-4 governs the interpretation of "substantial authority" in this case, and that it "also provides additional guidance on how to accord weight to the authority and types of authority typically relied upon." (p. 20.) While Treas. Reg. § 1.6662-4 may apply in proceedings before the Internal Revenue Service, it is not applicable in this instant matter.

Internal Revenue Code (IRC) § 6664(a) defines "underpayment" and the corresponding regulation – Treas. Reg. § 1.6662-4 – provides for the substantial understatement penalty of income tax "[i]f any portion of an underpayment, as defined in section 6664(a) and § 1.6662-4 . . . ." Treas. Reg. § 1.16662-4(a). However, IRC §

6664(a) is specifically not made applicable to South Carolina state taxes. S.C. Code Ann. § 12-6-50 (2014) provides in pertinent part:

> For purposes of this title and all other titles that provide for taxes administered by the department, except as otherwise specifically provided, the following Internal Revenue Code Sections are specifically not adopted by this State:
>
> ***
>
> (16) Sections 2001 through 7655, 7801 through 7871, and 8001 through 9602, except for Sections 6015 and 6701, and except for Sections 6654 and 6655 which are adopted as provided in Section 12-6-3910 and Section 12-54-55. However, Section 6654(d)(1)(D) relating to estimated tax payments for qualified individuals as defined in that item is not adopted.

Accordingly, neither IRC § 6664(a) nor Treas. Reg. § 1.6662-4, is applicable in this matter. Nevertheless, even if section 1.6662-4 applies in this matter, the regulation states there is "substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment." Section 1.6662-4(3)(i) (emphasis added). In its motion, Petitioner's reliance on the regulation is misplaced because it has confused quality of authority with sheer quantity of authority referenced by the parties. Simply because Petitioner has cited more authorities[2] than the Department, does not support its assertion that it had substantial authority for the positions taken on the returns.

4. The Court Did Not Err in Holding That Petitioner Did Not Act With Reasonable Cause or In Good Faith.

Finally, Petitioner asserts that the position it has taken (presumably, on its corporate tax returns for the Audit Period) demonstrates that it was acting in good faith to comply with South Carolina law. However, the Court was correct to uphold the substantial understatement penalty for the underpayment of taxes owed because there is

[2]The Department requests the Court to refer to its Respondent's Response to Petitioner's Proposed Order, pp. 6-8, for reference to the inapplicability of the cases cited by Petitioner in its Motion.

no substantial authority justifying how Petitioner treated the sourcing of subscription receipts. This is specifically evidenced by the fact that Petitioner filed its original (and amended) 2004-2010 income tax returns with little or no consistency: for some years, it filed sourcing its subscription receipts to the origin of its customers, while in other years, it sourced its revenue to Petitioner's corporate headquarters (based upon costs of performance). (Hr'g Tr. 375:8-376-8; Pet'r Ex. 1-12; Resp't Ex. 1.)

Moreover, Petitioner also oscillated between using the standard four-factor apportionment method and the gross receipts method for the tax years at issue. (Hr'g Tr. 219:19-220:21; Pet'r Ex. 1-12; Resp't Ex. 1.) Finally, as clearly shown through testimony and evidence at the hearing of this matter, Petitioner's "theory" or "new methodology" behind the filing of its returns in this matter continues to evolve. (Hr'g Tr. 223:13-224:4, 224:20-23; Pet'r Ex. 36; Resp't Ex. 1.)[3] It is hard to fathom that Petitioner has "substantial authority" for the treatment of the subscription receipts in this matter when: 1) the theory(ies) it relies upon for its position(s) in this matter continues to evolve since the filing of the initial returns in 2005; 2) the Department's long-standing policy with respect to sourcing of gross receipts of service providers requires taxpayer like Petitioner to source gross receipts from South Carolina customers to South Carolina; 3) the Court of Appeals' decision in Lockwood Greene distinguished the activities of an engineering firm from the activities of finance companies and media broadcasting companies; and 4) the General Assembly omitted the phrase "based on costs of performance" in section 12-6-2295(A)(5).

As stated above, *supra* Section II, South Carolina is absolutely not a costs-of-performance state (pure or modified), and this is clearly established, in addition to the case law recited above, by the actions of our General Assembly. As noted by this Court in is Order, while South Carolina's section 12-6-2295(A)(5) is similar to UDITPA's

[3] See also Resp't Ex. 14 (stating in Petitioner's request for a contested case hearing, that none of the subscription revenue from South Carolina customers should be sourced to South Carolina because the "subscription related income-producing activities are not performed in South Carolina and their receipts from these activities should not be sourced to South Carolina for income tax or capital tax, licensing fee apportionment purposes.")

section 17, "[t[he General Assembly, while aware of section 17 of UDITPA, *specifically chose not* to include the phrase 'based on costs-of-performance' in section 12-6-2295(A)(5)." (Order, p.14) (emphasis in original). Moreover, when adding section 12-6-2295(A) for the 2007 tax year, the General Assembly stated the following in 2007 South Carolina Laws Act 110, § 51.A; eff. June 21, 2007: "To Amend . . . by adding Sections 12-6-2252 and 12-6-2295 so as to further provide for allocation and apportionment of business income for state income tax purposes by basing the determination only on a sales factor and to define the terms 'sales' and 'gross receipts' consistently and specifically for that purpose[.]" The statutory amendment does not include the language "based on costs of performance" and there are no references to costs-of-performance elements, such as property and payroll. As such, Petitioner's reliance upon property and payroll factors to justify its position with regard to its position on its tax returns is unpersuasive.

5. The Court Did Not Err By Not Waiving Or Reducing Penalties Under S.C. Code Ann. § 12-54-160 (2014).

Finally, Petitioner argues that the Court erred by not waiving or reducing penalties pursuant to § 12-54-160. As support for its argument, Petitioner cites several cases[4] in its motion to support the argument that penalties should be waived in this matter because "substantial disagreement exits in the tax treatment of the income at issue in the present case." (Motion, p. 25.) Petitioner also points to the DIRECTV decision and argues that the penalties should be reduced in this matter by asserting that the DIRECTV Court "reduced the amount of substantial understatement penalties by 75%." (Motion, p. 25.) This is absolutely incorrect and a mischaracterization of the DIRECTV order. In its initial order, the DIRECTV Court ordered the taxpayer to be assessed "$1,661,541.00 in penalties with regard to its 2009, 2010, and 2011 income tax returns." (DIRECTV May 12, 2015 Order, p. 21). In the amended order, the DIRECTV Court reduced the original

[4]Travelscape, LLC v. S.C. Dep't of Rev., 2009 WL 769017 (Feb. 12, 2009); Midlands Utility, Inc. v. S.C. Dep't of Health and Envtl. Control, 313 S.C. 210, 437 S.E.2d 120 (1993); Anonymous Co. v. S.C. Dep't of Rev., 03-ALJ-17-0435-CC, 2004 WL 3154667 (Aug. 10, 2004); and Anonymous Taxpayers v. S.C. Dep't of Rev., 01-ALJ-17-0446-CC, 2002 WL 512589 (Mar. 28, 2002).

penalty assessment and ordered the taxpayer to be assessed "$1,246,155.75 in penalties with regard to its 2009, 2010, and 2011 income tax returns." (DIRECTV June 12, 2015 Order, p. 22). In doing so, the DIRECTV Court reduced the penalty assessment by 25% and not 75% as asserted by the Petitioner in its motion.

The Department disagrees with Petitioner's argument that penalties should be reduced or waived and respectfully refers the Court to its filings and arguments asserted in the hearing in this matter. As discussed above, Petitioner has not shown that it had substantial authority for how it sourced its South Carolina based subscription receipts. Further, Petitioner did not act in good faith to comply with S.C. Code Ann. §§ 12-6-2290 (2014) and 12-6-2295(A)(5), as evidenced by its evolving position since the filing of the tax returns at issue. More specifically, during the course of this single Audit Period, Petitioner utilized three different sourcing methodologies and presented a fourth method at trial. Moreover, Petitioner utilized a costs-of-performance method and/or elements, and the cases relied upon by Petitioner do not apply a costs-of-performance method – implicitly or explicitly – to services providers such as Petitioner. Finally, the General Assembly's statutory amendments and additions in 2006 and 2007 to the relevant statutory scheme, clearly do not envision the use of a costs-of-performance method in light of the distinct deletion of "based on costs-of-performance" from section 17 of UDITPA's model act.

Based on the above and because S.C. Code Ann. § 12-54-155 (2014) says that a substantial understatement penalty "must be added," Petitioner must be assessed the substantial understatement penalties, as there is no substantial authority for its position and it did not act in good faith.

II. Pursuant to ALC Rules 67 and 68, and Rule 60, SCRCP, the Department requests the Court to amend its Order regarding the testimony of a Department witness.

At the hearing of this matter, Department employees testified that it generally sources income of industries, such as cable and telephone companies, similar to the sourcing method Petitioner is required to use in South Carolina. In its Order, while discussing the treatment of income for similar taxpayers, the Court noted "the Department explained that for cable broadcast companies, like Time Warner Cable, and

telephone companies it sources gross receipts from South Carolina subscription revenue." (Order, p. 13, n. 18.) The language of the footnote appears to attribute the reference to a specific taxpayer (who is not a party to this proceeding) to the Department witness. After reviewing the transcript, the Department is unable to locate any reference by a Department witness to this specific taxpayer. Rather, the only reference the Department located in the transcript to such taxpayer was made by Petitioner's witness when describing its cable company competitors. See (Hr'g Tr. 35:19-36:4.)

Pursuant to S.C. Code Ann. § 12-54-240(A) (2014), the Department is prohibited from "divulg[ing] or mak[ing] known in any manner any particulars set forth or disclosed in any report or [corporate tax] return required" to be filed unless permitted by "proper judicial order." Section 12-54-240(A) does provide an exception to this prohibition for a taxpayer who seeks review of a Department decision by filing such action in a court proceeding; however, the specific taxpayer referenced in the order was not a party to the instant matter, and as such, that exception (or any exception) within the statute does not apply here. Accordingly, the Department respectfully requests the Court to amend its May 20, 2016, Order by removing any appearance that a Department witness made a statement regarding the treatment of an item on the tax return of a taxpayer who is not a party to the instant matter.

CONCLUSION

Petitioner has not put forth any grounds for which the Court needs to reconsider or substantially amend its Order in this case. To the contrary, the Court's Order properly considered and addressed the facts and evidence in this matter and should not be reconsidered or substantially amended. Further, the Department respectfully requests the Court to amend its Order to remove any reference or appearance that a Department witness made a statement regarding the treatment of an item on the tax return of a taxpayer who is not a party to the instant matter.

[signature on following page]

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Columbia, South Carolina
June 10, 2016

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No.: 14-ALJ-17-0285-CC **PETITIONER'S MOTION *IN LIMINE* TO EXCLUDE STIPULATION AND COURT TRANSCRIPTS AND MEMORANDUM OF LAW IN SUPPORT**

Pursuant to Rule 19A of the Rules of Civil Procedure for the Administrative Law Court, Petitioner, Dish DBS Corporation, by and through its undersigned counsel, hereby moves in limine for an appropriate order instructing all parties and witnesses to refrain from making any mention, directly or indirectly, in any manner whatsoever and/or to exclude the evidence or testimony relating to the Stipulation entered into in the Lockwood Greene State Tax Commission hearing (attached as **Exhibit A**) and subsequent Circuit Court appeal (hereinafter referred to collectively as the "Lockwood Greene case"), as well as the Trial Transcript and Exhibits from the contested case hearing in that matter (an index identifying those documents is attached as **Exhibit B**). The Stipulation was entered into by the South Carolina Attorney General's Office and legal counsel for Lockwood Greene, see *Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987).[1]

[1] At the end of its decision, the Court of Appeals briefly mentions Lockwood Greene's argument "refer[ring] to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters," which the Court distinguished from other "Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies...." *Lockwood Greene*, 293 S.C. at 450, 361 S.E.2d at 348. In fact, these so-called "guidelines" appear to be the Stipulation of Facts entered into between the parties and referenced in the record. See Exhibit A.

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SC ADMIN. LAW COURT

This contested case hearing will be conducted as a contested case under the Administrative Procedure Act. S.C. Code Ann. § 44-7-210(E) (Supp. 2000). The issues considered at a contested case hearing are limited to those presented or considered during Department of Revenue audit review and decision process.

It is expected that Respondent/South Carolina Department of Revenue intends to introduce as evidence the Stipulation and perhaps portion the Trial Transcript from that proceeding in this case.

Dish is requesting a ruling from this Court that prohibits the admission of the Lockwood Greene Stipulation and the associated Trial Transcript and Exhibits as evidence in this case and further prohibits the use of or reference to the Lockwood Greene Stipulation or the Trial Transcript and Exhibits during testimony from witnesses in this case.

MEMORANDUM OF LAW

I. THE COURT SHOULD EXCLUDE THE STIPULATION AS INADMISSIBLE HEARSAY

South Carolina Rule of Evidence 801 defines hearsay as a statement the declarant does not make while testifying at the current trial or hearing and that is offered into evidence to prove the truth of the matter asserted in the statement. S.C. R. EVID. 801. There is no question here that Respondent is attempting to prove the truth of the matter asserted, i.e., that the DOR had "longstanding audit guidelines" related to the apportionment of income for motion picture and media broadcast companies which differ from the Cost of Performance method. The Stipulation is not being offered for its independent legal significance as an agreement between Lockwood Greene and the DOR; if it was, it would be irrelevant under South Carolina Rule of Evidence 401. Under that rule, evidence is relevant only if it applies to a "fact that is of consequence to the determination of the action . . . ." S.C. R. EVID. 401. The Stipulation is not of consequence

to the determination of the present action because it is not binding on the Department of Revenue or Dish in the present action. *See* 73 Am. Jur. 2d Stipulations § 8 (2012) (stating that a stipulation is not binding on anyone but the parties in that litigation). Dish wasn't even in existence at the time Lockwood Greene and the DOR entered into the Stipulation in 1985. Thus, the Stipulation is an out of court statement offered to prove the truth of the matter asserted (*i.e.*, that the Department does not use the cost of Performance method to source income of motion picture companies) and is hearsay unless it falls under one of the hearsay exclusions or exceptions set forth in South Carolina Rules of Evidence 801(d), 802 or 803.

None of those exclusions or exceptions applies in this case. Specifically, no public record or "court record exception" applies here. South Carolina Rule of Evidence 803(8) states that records, reports, or statements of public offices or agencies are not excluded as hearsay only if the statement sets forth (1) the activities of the office or agency or (2) "matters observed pursuant to a duty imposed by law as to which matters there was a duty to report." S.C. R. EVID. 803(8).

The Stipulation does not set forth the office's activities. The Stipulation was a private agreement between Lockwood Greene and the Lawyers for the South Carolina Attorney General's Office. *See* 73 Am. Jur. 2d Stipulations § 1 (stating that Stipulations can be described as contracts); *see also e.g. Webster v. Holly Hill Lumber Co.*, 268 S.C. 416, 421, 234 S.E.2d 232, 234 (1977) ("A stipulation such as the one in question is an agreement, an understanding: it is to be construed like a contract . . . ."). The DOR was under no duty to enter into the Stipulation with Lockwood Greene. Therefore, South Carolina Rule of Evidence 803(8) does not apply. Further, holding that the Stipulation falls under South Carolina Rule of Evidence 803(8) merely because it was included in the record of a previous case and thus considered "published" would

be against public policy. It would allow all sorts of documents to circumvent the hearsay rule once included in the court record. Thus, the Stipulation does not fall under South Carolina Rule of Evidence 803(8) or any other hearsay exception or exclusion. As a result, Plaintiff's Stipulation is not admissible.

II. THE STIPULATION IS INADMISSIBLE AS IT WAS NOT EXECUTED BY DISH

The Department's brief in its motion for summary judgment repeatedly cites the Stipulation in *Lockwood Greene* as indicating that motion picture companies are not taxed under the *Lockwood Greene* cost of performance method.

To state the obvious, a Stipulation in one litigation case thirty years ago is not a statute, regulation or DOR Policy document.

A Stipulation is not binding on anyone but the parties in that litigation. *See* 73 Am. Jur. 2d *Stipulations* § 8 (2012) ("Therefore, it is recognized that a stipulation is not binding upon those who are not parties either to the stipulation or to the action or proceeding in which it was entered into."). "A concession that a witness, if called, would testify to a certain effect *is not admissible as evidence* in another action brought by one not a party to the former suit." *Id.* at § 9. (Emp. added.) Dish has not agreed to the Stipulation. (Dish was not even in existence when the Stipulation was executed; and the former South Carolina Tax Commission is no longer in existence.) Indeed, the Stipulation is not even binding on the DOR in any future case.

III. THE STIPULATION IS NOT ADMISSIBLE AS IT STATES A LEGAL CONCLUSION

In addition, the stipulation is to the legal method of apportionment for various industries and accordingly it is not a proper stipulation. *Id.* at § 4 states:

> Parties to an action may not stipulate to legal conclusions to be reached by the court. It has generally been stated that the resolution of questions of law rests upon the court, uninfluenced by

> stipulations of the parties and accordingly, it has been recognized that stipulations as to the law are invalid and ineffective.
>
> The propriety of enforcing the rule against stipulations as to matters of law is especially clear where the case in which the stipulation is made concerns the public.

See McDuffie v. McDuffie, 308 S.C. 401, 418 S.E.2d 331 (1992) ("this stipulation concerns a question of law and, therefore, is not binding on this court". *See also* 17A Am.Jur.2d Contracts § 339, at 346 (1991) (stipulating whether the language of a contract is ambiguous is a question of law for the court); 73 Am.Jur.2d Stipulations § 5, at 53940 (1974) (" 'It has generally been stated that the resolution of questions of law rests upon the court, uninfluenced by stipulations of the parties, and accordingly, virtually all jurisdictions recognize that stipulations as to the law are invalid and ineffective ...' "); *Morris v. Beacham*, 274 S.C. 320, 262 S.E.2d 921 (1980) ("Like the construction of a contract, it [whether legal documents created enforceable charitable trusts] is an improper subject for stipulation and any attempted stipulation is not binding on a court."); and *Walterboro Community Hosp. v. Meacher*, 392 S.C. 479, 709 S.E.2d 71 (2011) ("We believe these stipulations were akin to stipulations as to the law. Therefore, the circuit court was not required to accept these stipulations . . . .")

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EXHIBIT A

STIPULATION OF FACTS

STIPULATION OF FACTS

The parties stipulate the following facts:

1. Plaintiff will be referred to as "the Taxpayer" and Defendant as "the Tax Commission".

2. The Taxpayer is a Massachusetts corporation in the business of providing engineering and related services. Such services primarily consist of designing manufacturing facilities. The Taxpayer has offices in South Carolina, Tennessee, Georgia, Texas and New York. It provides services from its various offices relating to projects located in numerous states, including South Carolina, and receives payments from clients located in numerous states, including South Carolina. The principal issue in this case is the amount of the Taxpayer's income which is subject to income taxation in South Carolina.

3. From 1942 to 1961, the Taxpayer used separate accounting, i.e., reported to South Carolina the total income of the South Carolina office less total expenses of the South Carolina office. In certain years, the Taxpayer had substantial income in South Carolina, but losses in other states. As a result, the Taxpayer's income reported to South Carolina in certain years was more than the Taxpayer's total net income from all states combined. Thus it became advantageous for the Taxpayer to switch

from separate accounting to apportionment. ("Apportionment" means attributing to this State a percentage of a taxpayer's total net income.) The Taxpayer asked permission of the Tax Commission to use apportionment bu_ such request was denied. An auditor of the Tax Commission suggested instead a modified separate accounting method. The modified method allowed reporting gross income from the Taxpayer's work on client's projects located in South Carolina reduced by its costs of work on those projects, i.e., direct expenses and a percentage of overhead expenses. The Taxpayer accepted this modified separate accounting. That method, when applied to tax years 1958 through 1962, resulted in a net refund to the Taxpayer of $14,687.05. The Taxpayer has used this method ever since.

4. In 1975, the Tax Commission audited the Taxpayer's returns for tax years 1972, 1973 and 1974. The auditor noted the use of the modified separate accounting method. No change was made in that method or in the tax liability.

5. In 1980, the Tax Commission audited the Taxpayer's 1977, 1978 and 1979 tax returns. The same method of accounting was accepted for those years. However, the audit report delivered to the Taxpayer in November of 1980 stated that future returns should reflect

income based upon where the work was performed rather than where the job was located.

6. The Taxpayer continued filing its returns under the modified separate accounting method. That is, the tax returns for the years at issue here, 1981-1983 (Exhibits A-1, A-2 and A-3), continued to treat as South Carolina income the Taxpayer's net income from work on projects located in this state, i.e. its revenue from work on those projects minus the costs of that work. Such method resulted in a tax liability for the 1981-1983 tax years of $71,673 for income tax and $2,027 for license fees or a total of $73,700.

7. The Tax Commission audited the Taxpayer's returns for 1981, 1982 and 1983 and proposed an assessment of additional tax. (See the audit report, Exhibit B). The proposed assessment of additional tax required the Taxpayer to apportion its income to South Carolina based upon the gross receipts ratio of South Carolina Code of Laws, 12-7-1190.

8. The Taxpayer disagreed with the Tax Commission's interpretation of how "gross receipts from within this State" sh ld be computed under § 12-7-1190. The Taxpayer filed amended returns (which constituted claims for refund) for the three years at issue, adopting an apportionment method based upon its interpretation of

"gross receipts from within this state" (Exhibits C-1, C-2 and C-3). One amended return showed more tax due, and two showed less. The Taxpayer claimed a refund for the net tax reduction shown by the three amended returns combined. The Tax Commission denied the claim for refund. Its decision is attached as Exhibit D-1 and the Transcript of the proceedings before the Tax Commission is attached as Exhibit D-2. Material presented by the Taxpayer at the hearing is attached as Exhibit D-3 and material presented by the Field Services Division of the South Carolina Tax Commission is attached as Exhibit D-4.

9. South Carolina Code § 12-7-1190 states:

> "If the principal profits or income of a taxpayer, other than those described in former 1962 Code 65-256 or 12-19-100, are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing, or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without of the State."

10. The Taxpayer's amended returns apportioned a share of its income to South Carolina based on the percentage of its total gross receipts which were from payors located in this state, i.e., based on the location from which its fees were received. The Tax Commission

apportioned a share of the Taxpayer's income to South Carolina based on the view that the percentage of gross receipts from within South Carolina is the same as the percentage of services rendered in this state. Services rendered in this state were determined by the percentage of total direct job payroll represented by South Carolina direct job payroll.

11. Before its amendment in 1972, § 12-7-1190 referred to "receipts in this State" rather than "receipts from within this State".

12. The apportionment method specified by 12-7-1190 may be applicable to various multi-state businesses, including:

(a) finance companies

(b) radio and television broadcasters

(c) building contractors

(d) engineers and architects

(e) law firms and accounting firms

(f) entertainment and sports companies

(g) hospital management companies

(h) restaurant franchise companies

13. In determining when gross receipts are from within South Carolina for the above businesses, the following guidelines have been applied by the Tax Commission in prior instances.

(a) Finance companies. Receipts are "from within this State" if the borrower lives in this state. For example, if a finance company in Augusta, Georgia, makes loans to South Carolina residents, payments on those loans are receipts "from within this State" and the company must apportion its income partly to this state on that basis. By the same token, a South Carolina finance company making loans to Georgia residents apportions its income partly to Georgia on the same basis. Before the 1972 amendment to § 12-7-1190 some out-of-state finance companies took the position that "receipts in this State" meant only payments actually received by them in this state, regardless of where payments originated. However, the reason for the 1972 amendment is not known.

(b) Radio and TV broadcasters. Advertising receipts (broadcasters' main source of revenue) are "from within this State" if and only if the purchaser of the advertising is in this state.

(c) Building contractors. Receipts are "from within this State" if the services generating the receipts are performed in this state. In cases where services are rendered at the construction site, but fabrication of some materials occurs in another state, receipts are attributed in part to the state of fabrication since a portion of the work is performed there.

(d) Engineers and Architects (Multi-state). Before August 24, 1977, receipts were considered "from within this State" if the client's project was located in this state, regardless of where services were rendered or where the client paid from. On that date the Tax Commission adopted a new interpretation of the statute and has from that date considered all such taxpayers' receipts to be "from within this State" to the extent that the services are performed in this state. A Regulation stating that interpretation was proposed but, after a hearing, was not adopted. Instead, the Commission adopted an internal policy, which was never published. (Exhibit E.)

(e) Law firms and Accounting firms (Multi-state). Receipts are "from within this State" to the extent the services are performed in the State.

(f) Entertainment and sports companies. A company furnishing the services of entertainers or athletes must treat its receipts as "from within this State" if the service of the entertainer or athlete is performed in this state.

(g) Hospital management companies. Receipts are "from within this State" to the extent that services are rendered here.

(h) Restaurant franchise companies. This category refers to companies which do not operate the restaurant themselves, but which franchise the name and operation to third parties. Receipts are treated as "from within this State" if the restaurant is located here, regardless of where the franchisor's services are performed or where payments originate.

14. In the present case the following methods of apportioning the Taxpayer's income have the following South Carolina income tax and license fee results:

Method A. Apportion the Taxpayer's total net income, based on the ratio of the Taxpayer's direct job payroll for services rendered in this state to its total direct job payroll for services rendered everywhere, i.e., based on where its services are rendered. This was the method used in the Tax Commission's audit report (See Exhibit B).

(1)	Income taxes for three years	$207,293
(2)	License fees for three years	5,029
	TOTAL	$212,322

Method B. Apportion the Taxpayer's total net income, based on the ratio of receipts from payors located in South Carolina to total receipts, i.e. based on where receipts are paid from. This method was used on the Taxpayer's amended returns (See Exhibits C-1, C-2 and

C-3), but the numbers below reflect an adjustment made by the Tax Commission and accepted by the Taxpayer.

(1)	Income taxes for three years	$55,916
(2)	License fees for three years	1,387
	TOTAL	$57,303

15. The following tax results occur if two other methods of arriving at the Taxpayer's South Carolina income are employed:

Method C. Instead of using an apportionment method, account separately for the income of the Taxpayer's office in South Carolina. That is, fees for work performed in the South Carolina office reduced by the expenses of that work. This is separate accounting (and is different from the modified separate accounting method used on the Taxpayer's original returns). The parties agree separate accounting is not appropriate for this taxpayer since its records do not "clearly reflect net income arising from sources within this state", as required by law for the use of separate accounting. This method is presented to demonstrate the tax result which would result from separate accounting if such a method were appropriate. Separate accounting is normally applied only to businesses with separate units where each unit functions independently and locally, with only minor central administration (e.g. hotel or restaurant chains).

(1)	Income taxes for three years	$208,726
(2)	License fees for three years	5,795
	TOTAL	$214,521

Method D. Apportion the Taxpayer's entire net income partly to South Carolina, based on the ratio of receipts for work on client's projects located in South Carolina to total receipts, i.e., based on the location of the project.

(1)	Income taxes for three years	$87,313
(2)	License fees for three years	2,027
	TOTAL	$89,340

The Tax Commission does not agree that the resolution of this case can or should be obtained by applying either of these methods.

16. The parties reserve their rights to object to any of the stipulations on the grounds of lack of relevancy or materiality.

AGREED AND STIPULATED.

EXHIBIT B

INDEX TO *LOCKWOOD GREENE* RECORD

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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	**Docket No. 14-ALJ-17-0285-CC** **RESPONDENT'S RESPONSE IN OPPOSITION TO PETITIONER'S MOTION IN LIMINE TO EXCLUDE STIPULATION AND COURT TRANSCRIPTS**

TO: BURNET R. MAYBANK, III, AND JAMES P. ROURKE, COUNSEL FOR PETITIONER, DISH DBS CORPORATION, F/K/A ECHOSTAR DBS CORP., AND AFFILIATES:

Pursuant to ALC Rule 19(A) the undersigned, as attorneys for the Respondent, South Carolina Department of Revenue (Department), respond in opposition to Petitioner's Motion in Limine ("motion") as follows and assert that this Court should not exclude the evidence or testimony related to the Stipulations and trial transcript related to the Lockwood Greene Tax Commission hearing and the subsequent circuit court appeal, as well as the trial transcript and exhibits from the contested case hearing in that matter (collectively, the "Lockwood Greene documents")[1] in the hearing of the above-captioned matter. The witnesses' testimony and documentary evidence related to Lockwood Greene will assist this Court in understanding the testimony and the Department's long-

[1] Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987) is the final appellate decision related to the Taxpayer Lockwood Greene. The Lockwood Greene documents referenced by Petitioner and the Department in its motion and response, respectively, refer to the documents of the various lower courts or tribunals throughout the appeal of the Taxpayer's case.

standing policy regarding the apportionment of corporate income for businesses and/or industries.

I. This Matter Before The South Carolina Administrative Law Court Is Not Limited To The Issues Presented Or Considered By The Department During Its Review Process

S.C. Code Ann. § 12-60-460 (2014) creates the right for taxpayers to seek relief from the Department Determination (the final agency decision) by requesting a contested case hearing before the Administrative Law Court, and S.C. Code Ann. § 1-23-600 (Supp.2014) confers jurisdiction upon the ALC to hear this contested case. Petitioner correctly states in its motion that this matter will be conducted as a contested case under the Administrative Procedures Act; however, Petitioner is absolutely erroneous in stating that this matter is brought pursuant to S.C. Code Ann. § 44-7-210(E) and that the "issues considered at a contested case hearing are limited to those presented or considered during Department of Revenue audit review and decision process." (Pet'r Mot. at 2).

Article 3, Chapter 7 of Title 44 is entitled "State Certification of Need and Health Facility Licensure Act" ("Act") and the stated purpose of the Act is to "promote cost containment, prevent unnecessary duplication of health care facilities and services, guide the establishment of health facilities and services which will best serve public needs, and ensure that high quality services are provided in health facilities in this State." Section 44-7-210, entitled "Certificate of Need review procedures," provides for the process an "affected person" may pursue to challenge a Department of Health and Environmental Control staff decision related to a certificate of need. S.C. Code Ann. § 44-7-210(E) provides as follows: "[a] contested case hearing of the final agency decision must be requested in accordance with Section 44-1-60(G). The issues considered at the contested

case hearing considering a Certificate of Need are limited to those presented or considered during the staff review." There is absolutely no applicability of this Act, or of section 44-7-210(E) specifically, to the issues in this case. Further, despite Petitioner's assertion in its motion, the issues in this contested case are not limited to those presented or considered during the Department of Revenue's decision process in this matter. Section 44-7-210(E) applies to a "contested case hearing considering a Certificate of Need" and in no way applies to the issues and the parties in this matter.

The hearing in this matter is brought before the ALC as a contested case hearing under the Administrative Procedures Act, and the ALC serves as the finder of fact. See Reliance Ins. Co. v. Smith, 327 S.C. 528, 534, 489 S.E.2d 674, 677 (Ct. App. 1997) ("The Rules of Procedure for the [ALC] require that the ALJ make independent findings of fact in contested case hearings, *see* [ALC] Rule 29(B) . . . and the Administrative Procedures Act clearly contemplates that the ALJ will make his own findings of fact in a contested case hearing."). Thus, "the proceeding in front of the ALJ is a de novo hearing." Id.; see id. (citing Blizzard v. Miller, 306 S.C. 373, 375, 412 S.E.2d 406, 407 (1991) ("A trial de novo is one in which 'the whole case is tried as if no trial whatsoever had been had in the first instance.'")). Accordingly, contrary to Petitioner's assertion in its motion, the issues in this matter are not limited to those presented or considered by the Department during the audit review process.

II. This Court Should Not Exclude The Lockwood Greene Documents

This Court should not exclude the Lockwood Greene documents for the following reasons: (1) the Stipulations and related documents have recently been admitted into evidence in a very similar case in the South Carolina Administrative Law Court; (2) the

Lockwood Greene documents are not hearsay; and (3) granting Petitioner's motion and argument would be prejudicial and inequitable to the Department, as well as violative of Rule 106, SCRE, as *Petitioner's entire case* is based upon the Court of Appeals' Lockwood Greene decision.

A. The Lockwood Greene Documents Were Previously Admitted Into Evidence In A Similar ALC Hearing

Chief Judge Anderson in the hearing of DIRECTV, Incorporated & Subsidiaries v. South Carolina Department of Revenue, Docket No. 14-ALJ-17-0158-CC (January 13-14, 2015), admitted certain Lockwood Greene documents into evidence by rejecting opposing counsel's objections to relevance and hearsay. See Exhibit "A." During the DIRECTV hearing, the Department sought to introduce the documents, and opposing counsel objected on hearsay and relevance grounds. After hearing counsel's arguments, Judge Anderson overruled the objections and admitted the Stipulations into evidence. In overruling opposing counsel's objection with regard to hearsay, the DIRECTV court noted that the Department's witness testified, based upon his memory, "that these [Stipulations] appear to represent that which he remembered to be the guidelines . . . ." (Ex. A, Hr'g Tr. 336:14-18). The DIRECTV court also overruled opposing counsel's objection regarding relevance and noted that counsel's argument addressed the weight of the evidence but not its admissibility. (Ex. A, Hr'g Tr. 336:21-337:15).

B. The Stipulations Are Not Hearsay

Rule 801(c), SCRE, defines "hearsay" as "a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." South Carolina case law has further established that "evidence is

not hearsay unless it is an out of court statement offered to prove the truth of the matter asserted." State v. Brown, 317 S.C. 55, 63, 451 S.E.2d 888, 894 (1994). The hearsay rule "is founded upon the notion that statements must be subject to examination, and those statements, uttered outside the courtroom were not under oath, tested by cross-examination, or made under the seriousness and trappings of a legal proceeding." Trial Handbook for South Carolina Lawyers, § 16:2 Hearsay, generally. Here, the Stipulations and related documents are not "out of court statements" as contemplated by Rule 801(c), SCRE; rather, they were submitted to the trial court as part of the court proceedings in the Lockwood Greene case. Thus, the statements were subject to examination and "made under the seriousness and trappings of a legal proceeding." Trial Handbook for South Carolina Lawyers, § 16:2 Hearsay. Furthermore, these documents were submitted by attorneys – officers of the court – who are bound by certain duties and responsibilities when making such representations in court proceedings.

Further, "an out of court statement is not hearsay if it is offered for the limited purpose of explaining why a government investigation was undertaken." Brown, 317 S.C. at 63, 451 S.E.2d at 894. Even if the ALC were to determine the Lockwood Greene document were out of court statements, the Department's purpose for offering the evidence is analogous to the Brown court's analysis above. The Department intends to offer the Stipulations and related documents for the purpose of corroborating anticipated testimony as evidence of the Department's long-standing policy regarding the apportionment of corporate income. Put another way, the Department intends to provide testimony establishing the Department's practices regarding apportionment of income and why the Department asserted the position in this matter in rendering its final agency

decision. The Stipulations and related documents simply provide further evidence of the Department's long-standing policy (which came under attack in DIRECTV and most certainly will be questioned in the instant case) regarding apportionment of corporate income for service providers.

Finally, the Stipulations are not being offered for the truth of the matter asserted. The Department intends to introduce testimony establishing the Department's long-standing administrative practice or policy regarding apportionment of corporate income from service providers. The Stipulations simply corroborate the Department witnesses' anticipated testimony and/or memory that the Stipulations appear to represent the Department's guidelines regarding the apportionment of corporate income.

C. Prejudice to the Department

Rule 401, SCRE provides that "[a]ll relevant evidence is admissible, except as otherwise provided . . . ." Rule 401, SCRE defines "relevant evidence" as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." The witness testimony and documentary evidence related to Lockwood Greene are relevant in this matter because they will assist this Court in understanding the testimony and the Department's long-standing policy regarding the apportionment of corporate income for businesses and/or industries. In its motion, Petitioner requests the Court to prohibit "the admission of the Lockwood Greene Stipulation and the associated Trial Transcript and exhibits as evidence in this case and further prohibits the use of or reference to the Lockwood Greene Stipulation or the Trial Transcript and exhibits during

testimony from witnesses in this case." Pet'r Mot. at 2. However, granting Petitioner's motion would be prejudicial and inequitable to the Department.[2]

Petitioner has consistently maintained throughout this matter that South Carolina is a cost of performance state based upon the decision in Lockwood Greene. See Pet'r Prehearing Statement (August 7, 2015); Pet'r Mot. for Summ. J. (January 6, 2015). In fact, Petitioner even quoted and included the Tax Commission's decision in Lockwood Greene – one of the very same documents it complains of in its motion – as an exhibit to its Motion For Summary Judgment. See Pet'r Mot. for Summ. J. at 9-11, and Exhibit 7 to Mot. Petitioner devoted nearly two pages of its (summary judgment) motion to the Tax Commission's decision and Petitioner's interpretation of that decision. Pet'r Mot. for Summ. J. at 9-11. Clearly, Petitioner intends to utilize the Lockwood Greene documents when advantageous to its position but seeks to prohibit the Department from using them when advantageous to the Department's position. To allow Petitioner to cherry-pick evidence and documents related to Lockwood Greene and exclude the Department from using any Lockwood Greene documents would be prejudicial and inequitable to the Department in this matter.

Moreover, in addition to being prejudicial and inequitable to the Department, excluding the Lockwood Greene documents would violate Rule 106, SCRE. Rule 106, SCRE, entitled "Remainder of or Related Writings or Statements," provides for the following:

---

[2] Rule 403, SCRE, provides that relevant evidence may be excluded on the grounds of "prejudice, confusion, or waste of time." Conversely, the Department will be prejudiced if the Court grants Petitioner's motion and excludes relevant documents relating to the Lockwood Greene case.

> When a writing, or recorded statement, or part thereof is introduced by a party, an adverse party may require the introduction at that time of any other party or any other writing or recorded statement which ought in fairness to be considered contemporaneously with it.

As noted above, Petitioner's sole argument in this matter is that South Carolina is a cost of performance state based upon the decision in Lockwood Greene. It is without a doubt this Court "ought in fairness" consider Petitioner's evidence regarding Lockwood Greene with testimony and documents that the Department presents related to Lockwood Greene.

III. Petitioner's Other Arguments Are Not Persuasive

Although this Court should not exclude the Lockwood Greene documents for the reasons stated above, Petitioner's other arguments are not persuasive. Petitioner argues that the Stipulations are inadmissible because they were not executed by Petitioner. In making this argument, Petitioner asserts that the Department "repeatedly cites the Stipulation in Lockwood Greene as indicating that the motion picture companies are not taxed under the Lockwood Greene cost of performance method." Pet'r Mot. at 4. First, and most importantly, the Department has never stated, explicitly or implicitly, that Petitioner is a "motion picture company." To the contrary, the Department has referred to Petitioner as a media broadcasting company or a direct broadcast satellite service provider. Secondly, the Department has not stated or maintained that Lockwood Greene imposes a "cost of performance" method on any taxpayer.[3] In fact, the phrase "cost of performance" does not appear in the Court of Appeals' decision, as noted by this Court in

[3] Lockwood Greene certainly set the "place of activity" test for sourcing gross receipts from within South Carolina for professional personal service providers. Most importantly, the payroll factor that was used by the Department to source Lockwood's gross receipts to South Carolina was used merely as a proxy for calculating Lockwood's actual gross receipts from within South Carolina.

the Order Denying Cross Motions for Summary Judgment (Feb. 10, 2015) ("Order"). See Order at 9.

In its motion, Petitioner asserts that "[a] stipulation is not binding on anyone but the parties in that litigation." The Department agrees with Petitioner's statement. The Department is not seeking to "bind" Petitioner to the specific Stipulations stated in the Lockwood case. Rather, the Department intends to introduce the stipulations as evidence of the Department's long standing administrative guideline or policy related to the apportionment of corporate income. Further, as noted by the DIRECTV court, Petitioner's objection regarding the Stipulations in Lockwood as applied to Petitioner goes to the weight of the evidence and not to its admissibility. Ex. A (Hr'g Tr. 336:24:337-15).

Finally, Petitioner asserts that the Stipulation "is to the legal method of apportionment for various industries and accordingly it is not a proper stipulation." Pet'r Mot. at 4. Again, the Department intends to introduce the Stipulations as evidence of the Department's long standing administrative guideline or policy related to the apportionment of corporate income. The Department was created by statute and is charged with the power to administer and enforce the revenue laws of this State. See S.C. Code Ann. § 12-4-10 (2014). The guidelines provide further evidence of the Department's consistent administration and interpretation of the statutory apportionment of corporate income as related to a business or industry. Conversely, the ALC is given jurisdiction to hear contested cases regarding decisions of the Department, and this Court is charged with making the ultimate determination regarding the identification and location of Petitioner's income-producing activities performed in South Carolina.

Specifically, S.C. Code Ann. §§ 12-6-2290 sets forth the gross receipts apportionment method applicable to Petitioner, and S.C. Code Ann. § 12-6-2295(A)(5) provides that those gross receipts are attributable to South Carolina to the extent that the income-producing activity is performed in South Carolina – a determination to be made by the Court in this matter. The Department is merely providing evidence, both documentary and testimony, to the Court regarding the Department's long-standing interpretation of such applicable statutes in this matter.

Based on the above, this Court should not exclude the Lockwood Greene documents in this matter. The documents have been admitted by the ALC in another similar case, the documents are not hearsay, the action requested by Petitioner is prejudicial and inequitable to the Department, as well as violative of Rule 106, SCRE, should the Court grant Petitioner's Motion, and Petitioner's other arguments are not persuasive.

THEREFORE, by the undersigned counsel as attorneys for the Respondent, the Department respectfully requests that this Court deny the Petitioner's Motion in Limine, which asks this Court to exclude the Stipulation and Court Transcripts, related to the Lockwood Greene case, in the hearing of the above-captioned matter.

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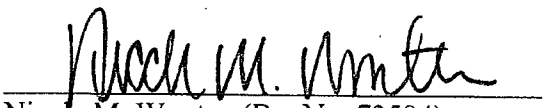
Respectfully submitted,



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March 23, 2015
Columbia, South Carolina

Exhibit "A"

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THE COURT: Okay. Go ahead.
Q: What do the contents of section 13 of this document represent?
A: To me, it would have been the guidance we used in determining how to source the receipts from within South Carolina for these companies, these type companies.
Q: And is that what we have been talking about for the last few minutes?
A: Yes.
Q: And is this --
A: I mean, I recall distinctly one about finances from within. I mean, I think it was -- of course, I couldn't find a copy of the older audit manual, but I'm pretty sure the one on finance companies, these were listed in the audit manual. But I just can't locate a copy of it. It would have been like 20 or 30 years ago. But we did -- I mean, this is how we would interpret how we applied the gross receipts factor for these type companies.
Q: Is what's here in section 13 a complete and accurate representation of the guidelines as you understood them?
MR. ROBERTS: Leading, objection, Your Honor.

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A: As best I recall.
THE COURT: Hold on a second. Let him finish the question and then I'll make a ruling on it.
MR. ROBERTS: Sorry, Your Honor.
THE COURT: I mean, I think the direct question can start with "is," if that's what you're going on. It has to finish out correctly.
Q: Are -- is the contents -- or are the contents of what's in section 13 a complete and accurate representation of what you believe the guidelines were?
MR. ROBERTS: Objection, Your Honor, leading.
THE COURT: Overruled.
A: As it relates to the companies listed, this is how we would apply the gross receipts factor and that's how we were taught as auditors and as a supervisor is how -- if someone had asked me the question, this is how I would've told them to apportion the receipts or source the receipts from within for these type companies.
MR. CONDON: Your Honor, I'd like to now move that Plaintiff's (sic) Exhibit Twenty-one be entered into evidence.
THE COURT: Respondent's?
MR. CONDON: Respondent's, I'm sorry.

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MR. ROBERTS: Your Honor, I object on hearsay, as well as on relevance. I don't think the witness has authenticated this. In fact, he said that he went back and tried to find the guidelines and he couldn't find a copy and that he remembered the finance company piece, but not all the other stuff.
And it's clearly hearsay. The Department is clearly offering this to go into the record for the truth of the matter asserted which is that these are the guidelines.
THE COURT: Let me back up. Your first objection went to authenticity. Did y'all not stipulate to authenticity?
MR. CONDON: (Nods head affirmatively.)
THE COURT: So I'm going to move on from that one. Then the hearsay aspect is, it's an out-of-court statement; I agree with you on that. But what he's testified to is, this particular out-of-court statement is a representation of the guidelines that the Department had.
So he's offering it -- or he's attesting that that is the guidelines that they utilized. So he's not -- he's offered it for the truth of

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the matter asserted in the statements in there. He's just also setting forth that these documents represent that which they utilized. And there is no statement in there that he's seeking to verify the truth in or the veracity thereof. Are you following me?
MR. ROBERTS: Yes, Your Honor.
THE COURT: So what is your response to that?
MR. ROBERTS: My response is, when we first started speaking about this, Counsel for the Department said that these are the guidelines. And that's clearly what they're being offered into evidence for.
THE COURT: Well, I don't take them as -- if he's offering them as guidelines, the testimony is, based on the memory of the witness, that these appear to represent that which he remembered to be the guidelines and they would be -- this Court would admit it only for that purpose. All right?
MR. ROBERTS: Fair enough, Your Honor. I have a second objection --
THE COURT: Yeah, go ahead.
MR. ROBERTS: -- on relevance. These -- as I've said before, this is a Stipulation of Facts in

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1986. DIRECTV was formed in 1994. There is nothing in here discussing subscription revenue. And we keep hearing about how the basis for the assessment in this case was these long-standing guidelines. This is being offered to establish something relating to those long-standing guidelines and these don't talk about subscription revenue.

THE COURT: That goes to the weight of the exhibit and, certainly, that is a pertinent point that you can raise as to what I need to consider in this case. But as far as their presenting -- they're responding, actually, to that -- some points that you've raised in your case in chief. So I overrule that one.

MR. ROBERTS: Thank you, Your Honor.

THE COURT: I'll still hear your argument on that later on.

MR. ROBERTS: Thank you, Your Honor.

MR. CONDON: Thank you, Your Honor.

THE COURT: But has it been offered?

MR. CONDON: Yes, it has been offered.

THE COURT: Okay. It's admitted.

(Respondent's Exhibit Number Twenty-one was admitted into evidence.)

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Q: Mr. Swearingen, were you involved in the Lockwood Greene case?

A: Not directly, no. I was -- I was actually -- I think I was in -- may have been right after I left appeals. I think it was '85 or so, but I don't believe I was directly involved in Lockwood Greene.

Q: Was the way the Department approached its audits affected by the decision in Lockwood Greene?

A: No, because it was my understanding that Lockwood Greene said that what we were doing was correct. But Lockwood Greene applied to architects and engineers. I think an engineering firm, actually. And that the guidelines we were utilizing were the correct -- correct application.

Q: Did the Department use a payroll factor in Lockwood Greene?

A: Yes, we did.

Q: Why would the Department have used a payroll factor in Lockwood Greene?

A: It was a method to come up with the services performed within the state to generate the engineering fees.

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Q: Could Lockwood or the Department have used other methods, another method, or -- to calculate the gross receipts from within South Carolina?

A: I assume that if Lockwood when they billed their customer and designated which state the billing services were performed in, they could have done it that way. But I don't believe they did it, their billing that way.

During the course of the audit, that was determined the best way to determine where it was -- actual engineering services were performed, which state, was based on the payroll within each state.

Q: What's the Department's view of the applicability of Lockwood Greene?

A: It's been, as far as my knowledge, the position it only applied to certain type companies; engineering, architects. We used to call them "personal service companies," companies that actually billed for their services; meaning, they actually -- an employee did work and they would bill for that employee's work.

Prior to the guidance that came out in '77, which never got put in as a regulation, we

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would source all those receipts to South Carolina, even though some of them may have been out of state.

I think that was the reason for the change that led to the proposed rules of construction, as we called -- termed it back then. But it never -- was never promulgated as a regulation. But it dealt primarily with contracts involving architects or engineers. It was an actual case. I believe the Commission ruled -- had a decision on it, but ...

Q: Are you familiar with the Department Determination that's -- that was issued in this case?

A: I have looked at it recently.

Q: And how do you understand the Department's conclusion as to where DIRECTV's subscription receipts ought to be sourced?

A: They were -- subscription receipts, services receipts, are from receipts rendered -- services rendered within South Carolina. I mean, they -- the -- we would have looked at gross receipts and where the gross receipts are earned.

And in this case, we thought or our position

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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 14-ALJ-17-0285-CC **PETITIONER'S MOTION IN LIMINE AND MEMORANDUM OF LAW IN SUPPORT OF MOTION IN LIMINE TO STRIKE PROPOSED EXPERT WITNESS FROM SOUTH CAROLINA DEPARTMENT OF REVENUE'S WITNESS LIST**

Respondent South Carolina Department of Revenue has submitted Answers to Interrogatories indicating its intent to call Glenn W. Harrison, Ph.D. as an expert witness in the trial of this case. Pursuant to Rule 19A of the Rules of Civil Procedure for the Administrative Law Court, Petitioner, Dish DBS Corporation, by and through its undersigned counsel, hereby moves in limine for an appropriate order striking Dr. Harrison as an expert witness in this case.

The South Carolina Department of Revenue called Dr. Harrison as an expert witness in *DirectTV & Subsidiaries v. South Carolina Department of Revenue*, Docket No. 14-ALJ-17-0158-CC, at the ALC trial of that matter in January 13, 2015. DirectTV and Dish involve the virtually identical matter, to wit the apportionment of income of a satellite TV provider. The DOR has asserted a market share apportionment method in both cases. Dr. Harrison testified as an expert witness in that case and has been listed as an expert witness in this case. A copy of his testimony in that case is attached as Exhibit A (hereinafter "Trial Testimony"). His testimony is expected to be similar in this case.

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Dr. Harrison has a "Master's Degree at UCLA and a Ph.D. in economics at UCLA." (Trial Testimony, p. 388, Lines 4-5). While Professor Harrison has an admirable resume, his testimony as an economic expert has no relevance to this case.

The DOR moved in the DirectTV hearing "to offer Dr. Harrison as an expert in economic principles generally and in economics and law." (*Id.* at p. 390, lines 9-11.) DOR Attorney Nicole Wooten (who represents the DOR in this case) explicitly noted that "[w]e [the DOR] haven't asked to offer Dr. Harrison as an expert on apportionment law, [or] state apportionment taxation. We've asked him to broadly look at economics and law in general." (*Id.* at p. 391, lines 17-21.) Ms. Wooten repeated: "So, again, we would just note that we are asking for economics and law and not specifically state apportionment issues." (*Id.* at p. 391, line 24-p. 392, line 2).

Ms. Wooten stated yet again that "[w]e are not offering him as an expert on South Carolina apportionment statutes from a legal perspective . . . but we are asking him for testimony regarding apportionment statutes from an economic's perspective." (*Id.* at p. 393, lines 12-20.)

Ms. Wooten asked three major questions:

> Q: And is the Department's Determination of the income-producing activity in this matter economically reasonable? (*Id.* at p. 405, lines 18-20.)
>
> Q: From an economic perspective, why is it appropriate for the taxpayer's income from South Carolina subscription revenue to be sourced to South Carolina? (*Id.* at p. 406, lines 3-6.)
>
> Q: And from an economist standpoint, what is the service being sold in South Carolina, the thing that gives value and generates income? (*Id.* at p. 406, lines 14-16.)

Simply put, a Ph.D. in economics is no more competent to provide relevant testimony on whether South Carolina sources income using cost of performance – or market share – than a Ph.D. in Transportation or Parks, Recreation and Tourism.

And while it might be understandable for the South Carolina General Assembly to hash out whether market sourcing is "economically reasonable" as an apportionment method it is of no relevance to this Court. Similarly, the General Assembly might debate whether "From an economic perspective, . . . it is appropriate for the taxpayer's income from South Carolina subscription revenue to be sourced to South Carolina" (*Id.* at p. 406, lines 3-6.) under the market share approach in legislation, but it is of no relevance once the General Assembly drafts and passes apportionment legislation. Once the Governor signs the Act into law, the economic reasonableness – or lack of economic reasonableness – becomes irrelevant.

Is it "economically reasonable" that prescription drugs are exempt from sales taxation but equally expensive non-prescription drugs are not? Is it "economically reasonable" that prescription drugs purchased from a pharmacy are exempt from sales taxation but the exact same drug administered by a doctor in a hospital room is not? Is it "economically reasonable" that a property owner who applied for and received the multi-lot discount in the years 2005, 2006 and 2007 should be denied the discount in 2008 when he submitted the application 8 days late? Is it "economically reasonable" that a large pharmaceutical company with nexus in South Carolina should not be liable for use tax for the sales of its prescriptions, with the liability instead imposed on the local doctor? Is it "economically reasonable" that the sales tax on a $90,000 Mercedes is the same on a $18,000 Ford? Simply put, it doesn't matter! Economic reasonableness is not an issue in a state tax case. And to the extent the ALC views "economic reasonableness" as a

justiciable issue, she is going to be faced with an economics professor expert witness in many sales and property tax cases!

The DOR annually publishes three lengthy and well written publications, *Economic Development Incentives*, *Property Tax* Manual and *Sales Tax* Manual. None of these publications have ever cited, quoted or discussed the "economic reasonableness" of any state tax matter. Not once.

The DOR has promulgated a number of Policy Documents on apportionment. Petitioner and Respondent cited them in our respective Summary Judgment Memorandums of Law. Not one references "economic reasonableness." Not one.

Economic reasonableness may play a role where either the taxpayer or the DOR asserts South Carolina's equitable apportionment statute, S.C. Code Ann. § 12-6-2320. The DOR has not asserted the statute in this case. It may also play a role in Due Process/Equal Protection constitutional challenges. Such are also not involved in this case.

Petitioner accordingly moves to strike Dr. Harrison as a witness in the trial of this case.

Respectfully submitted,

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Date: March 5, 2015

EXHIBIT A

TRIAL TESTIMONY – DR. GLENN W. HARRISON

Transcript of the Testimony of
DIRECTV, INC. V. SCDOR

Date: January 13, 2015

CREEL COURT REPORTING, INC.
Condensed Transcript and Word Index

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MR. CONDON: Thank you, Mary Beth.
THE COURT: All right. We're going to take a lunch break, then, I guess? You're waiting on a witness, I assume?
MS. WOOTEN: Yes, Your Honor. Our next witness is here. It's Dr. Glenn Harrison. We're happy to proceed similar to how Petitioner proceeded yesterday in doing preliminaries before we break for lunch or we can break for lunch and come back; whatever you would like to do.
THE COURT: Preliminaries, knock that out.
MR. ROBERTS: Preliminary are fine with us, Your Honor.
THE COURT: Yeah, let's just knock that out –
MR. ROBERTS: Does that make sense?
THE COURT: -- and keep on moving.
MS. WOOTEN: Okay. At this time –
THE COURT: Well, I say knock that out and keep on moving. Know that out and then break.
MS. WOOTEN: At this time the Department calls Dr. Glenn Harrison.
THE COURT: The movement would be out of the courtroom.
GLENN W. HARRISON, Ph.D., having been duly sworn, testifies and examines as follows:

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DR. HARRISON - DIRECT EXAMINATION BY MS. WOOTEN:
THE WITNESS: Good to go.
Q: Could you please state your full name for the record?
A: Glenn William Harrison.
Q: And, Dr. Harrison, where are you currently employed?
A: I'm employed at Georgia State University in Atlanta.
Q: And what is your job? What is your title?
A: I have two titles. One is -- I am the C.V. Starr, Chair of Risk Management and Insurance in the Department of Risk Management Insurance in the Robinson College of Business and I am also the director of the Center for the Economic Analysis of Risk located at GSU.
Q: And let's start with the first -- what are your duties as the C.V. chair?
A: My duties there are typical for an academic; that is, research, teaching, and service. So research being academic research, scholarly research. Teaching is teaching a range of courses over the years. And service is appearing on university committees and handling administrative matters within the department.

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Q: And what are the duties of the second position you mentioned?
A: Well, the second position relates to my center that I'm the director of, the Center for the Economic Analysis of Risk. There, I oversee the research activities of the constituent departments of the CEAR, which is the acronym for my center. That includes my home department, Department of Risk Management and Insurance in the business school. It includes the School of Accounting within the business school. It includes the Department of Economics over in the Andrew Young School of Policy Studies. It includes the Department of Finance in the business school. It also is affiliated with the research department at the Federal Reserve Bank of Atlanta.
Q: And what are your primary areas of research?
A: They vary over the years. I've -- I'm an economist, is my general training in economics. I have worked in a number of areas including environmental economics, tax policy, regional economics, public finance, a field called "experimental economics." I work in behavioral economics. I've worked in law and economics

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and I've worked in international trade. And I've published in all of those areas, including some in health economics.
Q: You stated public finance. Can you describe the public finance research area a little more?
A: Sure. Public finance refers to that area of economic activity that is affected by government activity in a broad sense. In other words, it includes the raising of revenue, the use of revenue, the manner in which revenues are raised, tax incidence, which -- and the term "incidence" here can refer to both legal incidence and economic incidence. And, indeed, one of the important areas of research is identifying differences between legal incidence and economic incidence.
It also refers to the nature of the goods that are produced by government. They're referred to by economists as "public goods," that they're shared by a lot of people, as disting (phonetic) from private goods, which are goods that privately consumed. And that makes a very, very big difference in terms of the implications for providing those -- raising revenue for providing those.

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Q: You also mentioned law and economics. Can you describe that in a little more detail?
A: Sure. The field of law and economics, which has its own journal and, indeed, has its own associations, refers to the interaction, the two-way interaction, between law, broadly defined, and economics; that is, the extent to which legal rules, legal jurisprudence, legal principles affect economic behavior. And in the reverse direction, the extent to which economics affects the application of the law, the efficacy of the law, and what might by economists be considered good laws or bad laws in terms of their revenue raising objectives or welfare enhancing objectives.
Q: And could you summarize your work history for the Court, please?
A: Certainly. It's in my CV and, as I said, I've moved from one areas to others over the years. My work history has been initially in the fields of general -- what's called "general equilibrium modeling," which means, essentially, modeling as an economist all of the sectors of the economy, both the private sectors, the public sectors, all of the

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industries in the economy.
I started actually doing that in terms of regional fiscal incidence. So some of my earliest work was in looking at regional inter-jurisdictional impacts using general equilibrium models.
A lot of that work also applied in international contexts because for economists, those are often synonymous. Domestic inter-jurisdictional issues are very similar from a modeling point of view and an analytical point of view to many of the international issues that we -- we studied. So a lot of my research was in both of those areas.
I spent a lot of time doing work in environmental damage assessment, environmental risk assessment. I spent time working in behavior economics, broadly defined, and there's a large number of publications in that area.
I've spent time working on health economics, in particular with respect to legal policies and litigation in that area. And I've spent a lot of time more recently looking at risk management, broadly defined, the evaluation of

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risk attitudes, the evaluation of risk perception, and most critically, risk management decisions that individuals, companies, and governments might make.
Q: As part of your teaching experience, have you taught a course called "economics and law"?
A: Yes, with that title or very closely related title, such as law and economics. I've taught that for -- I couldn't tally up the number of years, but it would be something like 15 or 20 years, both here at the Moore School of Business when I was a professor at USC, and also at the University of Central Florida, I taught those classes.
I don't teach them now because I'm actually in a department which has lawyers who like to teach that class and I have as a result of my administrative duties to CEAR, a reduced teaching load. But I taught that course for 15 or 20 years.
Q: Could you summarize your educational background?
A: Certainly. I have a Bachelor of economics honors, as the Australian English designation. So you do an honors degree, which is an extra

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degree. It's basically a Bachelor's of -- Bachelor of economics. I did a Master's degree in Australia at Monash University. I came to the United States and did a Master's degree at UCLA and a Ph.D. in economics at UCLA.
Q: Have you ever testified as an expert at trial before?
A: Yes, I have.
Q: Approximately how many times?
A: In trial, I would estimate about 15 times, 15 to 20 times.
Q: Have you ever testified as an expert before the South Carolina Administrative Law Court?
A: Yes, I have, in fact, in front of Judge Anderson, I believe.
Q: Do you recall those cases or any of the issues in those matters?
A: In general terms I do, yes. I often -- the details slide away with the years.
Q: If you will please refer to Respondent's Exhibit Number Fifteen.
A: (Witness complies.) Yes, I have that.
Q: Do you recognize this document?
A: Yes, I do. It's got a photograph of me.
Q: What is this document?

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A: It appears to be my current CV.
MS. WOOTEN: At that time, Your Honor, I'd like to offer Exhibit Fifteen into the record.
MR. ROBERTS: We have no objection, Your Honor.
THE COURT: It's admitted.
MS. WOOTEN: Thank you.
(Respondent's Exhibit Number Fifteen was admitted into evidence.)
Q: In looking at your CV, does this contain your expert testimony experience and the research and work experience that you've just described to the Court?
A: Yes, it does. In the back, I've list -- in the back of the CV, it lists my testifying experience in terms of the cases in which I've been designated as an expert and it completely lists my research, my scholarly research afterward.
Q: In what areas have you been recognized as an expert?
A: The exact designations I don't recall; there's been so many cases. Economics and applied economics. I've also been recognized as an expert in economics and law.
Q: Referring back to your CV, are there any

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publications of particular note that might be relevant to the issues in this case as you understand them?
A: Yes, my publications on regional fiscal incidence that I refer to and some of my publications in law and economics to the extent that they demonstrate an ability to understand the interaction between law and economics.
MS. WOOTEN: At this time, Your Honor, I'd like to offer Dr. Harrison as an expert in economic principles generally and in economics and law.
MR. ROBERTS: Well, Your Honor, I'd like to --
THE COURT: Voir dire?
MR. ROBERTS: -- ask the witness a few --
THE COURT: Okay.
MR. ROBERTS: -- questions, maybe.
DR. HARRISON - VOIR DIRE EXAMINATION BY MR. ROBERTS:
Q: Mr. Harrison, how many articles on state taxation and particularly on apportionment of income have you written?
A: I have written no articles on that narrow topic.
Q: Okay. Thank you. Have you taught any courses on state taxation and specifically courses involving apportionment of income?

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A: No, I have not.
Q: How many awards in state taxation have you received?
A: I have received no awards in state taxation.
Q: All right. Thank you.
MR. ROBERTS: Your Honor, I would object to having Dr. Harrison admitted as an expert in economics and the law; the law part. I don't think he -- there is nothing in his CV or in the testimony that we've just heard that would establish that he has any qualifications to talk about the apportionment statutes that are at issue in this particular case.
THE COURT: Do you wish to respond?
MS. WOOTEN: Sure, Your Honor.
THE COURT: Or ask any further questions?
MS. WOOTEN: Sure. Just as a general response, we haven't asked to offer Dr. Harrison as an expert on apportionment law, state apportionment taxation. We've asked him to broadly look at economics and law in general. He has referenced that he has taught classes for several years. He's done publications. He's done research in that area. So, again, we would just note that we are asking for

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economics and law and not specifically state apportionment issues.
THE COURT: He is qualified in keeping with your request.
MS. WOOTEN: Thank you, Your Honor.
THE COURT: All right. Anything else?
MS. WOOTEN: No, Your Honor.
THE COURT: Well, let's take a break for lunch.
(Lunch break from 11:42 a.m. to 1:30 p.m.)
THE COURT: All right. Who's up? Just don't ask any important questions for about two minutes until I can get my computer on.
MS. WOOTEN: I'll make sure to ask all the important questions.
THE COURT: Oh.
MS. WOOTEN: I'm kidding.
THE COURT: Go ahead. I'm fine.
MS. WOOTEN: Okay. When we had left off, we were talking about Dr. Harrison's expert designation and I just wanted to clarify your ruling, Your Honor. We had offered him as an expert in economics and law. I know there was some objection and I just want to clarify what your ruling was with regard to his designation.
THE COURT: Do you want the court reporter to read

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it back?
MS. WOOTEN: I can go into this if you would like to.
THE COURT: No, the bottom line is I said I was qualifying him in keeping with your offering.
MS. WOOTEN: Okay. And to clarify --
THE COURT: And if your offering was properly made, then you should be happy, but if you messed up on your offering, then you should be unhappy.
MS. WOOTEN: I wouldn't say that I messed up, but I would like to clarify if there's any question as to what I was offering him in. We are not offering him as an expert on South Carolina apportionment statutes from a legal perspective.
THE COURT: Well, I think I was -- yeah.
MS. WOOTEN: -- from a legal perspective, but we are asking him for testimony regarding apportionment statutes from an economic's perspective; looking at the terms of the statute from an economic's perspective, not a legal perspective.
THE COURT: Yeah, I think that was your objection anyways, so -- but I'll hear what you've got to say.

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MR. ROBERTS: The comment I would make is that I don't think there's anything in his CV that would qualify him to even talk about apportionment. He doesn't have any experience in state taxation, hasn't written on it, he hasn't spoken about it, so I'm not sure what the qualification is to even talk about apportionment.
THE COURT: What's your response to that?
MS. WOOTEN: I can ask a few questions of Dr. Harrison, if the Court would like.
THE COURT: Okay. Well, I won't say whether I like it or not. I'm just saying right now I ain't made up my mind, so.
MS. WOOTEN: Okay. Thank you, Your Honor.
DR. HARRISON - VOIR DIRE EXAMINATION BY MS. WOOTEN:
Q: You had discussed earlier that you taught law and economics course for approximately 15 to 20 years; is that correct?
A: That's correct, yes.
Q: What were the topics discussed in that class --
A: I actually made --
Q: -- or course?
A: Sorry. I made a point of discussing the full range of topics. I often taught that course

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for undergraduates, prelaw undergraduates, in fact, and wanted to cover all of the topics. So one of those that are included was taxation and, indeed, I had some discussion of inter-jurisdictional taxation, both international and domestic, flowing from my work on regional fiscal incidence.
Q: And as part of that course, did you examine and discuss statutes, specifically tax statutes, again?
A: Yes, I did. In fact, my normal mode of conduct for those classes was to go through Supreme Court cases, to go through specific cases with the students, and draw out the economic implication of them. A good example of that would be takings cases. Lucas v. South Carolina Coastal was a very famous one here in South Carolina, but it was also a very famous one in terms of the takings clause. So I would have the students go through that case and, again, the vast majority of these students are prelaw, so that was a good, easy way to motivate them and then talk about what are the economics behind the statutes or the case law.

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Q: And you had testified earlier that you have testified in prior cases before the South Carolina Administrative Law Court; is that correct?
A: That is correct, yes.
Q: If you will refer to your CV on page 20.
A: (Witness complies.) Yes.
Q: Can you name the cases that you testified in as an expert before the South Carolina Administrative Law Court?
A: Yes, they're listed there. One is -- I'll just mention the taxpayer for short --
Q: Sure.
A: -- for shorthand. One is ESA Services, that was in 2008; the second in 2010 was Carmax; the third was Rent-A-Center, but those were joined, Rent-A-Center West, Rent-A-Center Texas; Duke Energy Corporation.
Q: And do any of -- do you recall if any of those cases examined apportionment statutes?
A: All of them to some degree dealt with apportionment.
Q: Okay. And looking specifically at Rent-A-Center Texas, do you recall the issue in that case?

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A: Yes, in very general terms.
Q: Do you recall if there was an apportionment issue in that case?
A: Oh, there was, yes.
Q: And you were admitted as an expert in that case; is that correct?
A: That is correct.
Q: Do you recall the designation that you were admitted under under that case?
A: I believe it was as an economist and -- as an expert in economics and an expert in economics and law.
Q: And do you recall the Judge that presided over that case?
A: Yes, Your Honor here.
MS. WOOTEN: At this time, Your Honor, we'd like to renew our designation for Dr. Harrison as an expert in economic principles generally and in economics and law.
THE COURT: You know, she's in a way taken the argumentum ad hominem approach in identifying me as the Judge that did this in the past, but I'll hear your objection.
MR. ROBERTS: I would just maintain the same objections I've had, Your Honor. I don't

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really have anything else to add.
THE COURT: I'll qualify him --
MS. WOOTEN: Thank you, Your Honor.
THE COURT: -- as requested.
MS. WOOTEN: I'm sorry?
THE COURT: As requested regarding apportionment.
MS. WOOTEN: Thank you. For economic principles perspective; is that correct?
THE COURT: Yes.
MS. WOOTEN: Thank you.
DR. HARRISON - DIRECT EXAMINATION BY MS. WOOTEN (Continued):
Q: Dr. Harrison, did you review any documents in preparation for this case?
A: Yes, I did.
Q: And what documents do you recall reviewing?
A: Primarily, I reviewed the Department Determination. I also reviewed the response from the taxpayer. Then I -- as a result of the references in those cases -- in those materials, I reviewed the relevant statute and I reviewed the relevant case law that was referred to in those documents.
Q: As part of your preparation, did you specifically look at Section 12-6-2290?

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A: Yes, I did.
Q: Okay. If you will refer to, please, Respondent's Exhibit Thirty.
A: Three-zero?
Q: That's correct.
A: (Witness complies.) Yes, I have that.
Q: And are you familiar with this statute?
A: Yes, I am.
Q: From an economic standpoint, what is your understanding of this statute?
A: From an economic standpoint, this statute is identifying the nature of the business, the nature of the corporation, that is going to be subject to income taxation in South Carolina and indicating how it is going to be treated, how apportionment is then going to be treated.
MS. WOOTEN: Excuse me.
Q: And in looking at the statute, how is that income treated?
A: Well, the income is treated as gross receipts, in this case. If the industry in question doesn't meet the criteria for which you would apply the -- and prior to the current statute, the three-factor apportionment rule.
Q: And from an economic standpoint, what is the

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purpose of a gross receipts method?
A: The purpose of a gross receipts method can be to identify the extent of the business activity in South Carolina and, indeed, the extent of the income-producing activity in South Carolina.
Q: If you will now please refer to Respondent's Exhibit Thirty-two.
A: (Witness complies.) Okay.
Q: Are you familiar with this statute?
A: Yes, I am. This is 2295.
Q: And from an economic standpoint, what is your understanding of this statute?
A: Well, the purpose of this statute is really to define the term "sales" and "gross receipts" as referred to in 2290, to give some clarity to that and, in particular, the section that's relevant here is section five.
Q: A(5); is that correct?
A: That's correct, sorry.
Q: Okay.
A: It's A(5) not -- yep.
Q: And are you familiar with the taxpayer in this matter?
A: Yes, I am.

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Q: How are you familiar?
A: I am familiar from receiving the information about the Department's Determination and the taxpayer's letter and knowing generally what DIRECTV does. I should state that I'm not a DIRECTV subscriber, never have been, and probably never will be.
Q: What is your understanding of the sources of income DIRECTV has in South Carolina?
A: The sources of income derive fairly transparently from the payments of subscriptions for the product, the service that is provided to the homes in South Carolina, as well as the leasing from the boxes and that appears not to be in dispute, the latter part.
Q: And in your review of this case, have you reviewed the tax returns for DIRECTV for this audit period?
A: Yes, I did. I did review those.
Q: And what is your understanding of those returns specifically with regard to the gross receipts ratio?
A: My understanding is that the taxpayer initially apportioned receipts for some of the earlier years in the manner that the Department of

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Revenue had deemed consistent with the statute; that is -- and then they amended their returns to use an alternative apportionment basis that lowered the amount of money to be paid to South Carolina.
Q: And are you familiar with the taxpayer's argument on the gross receipts issue?
A: Yes.
Q: Okay. Can you briefly describe your understanding of that issue to the Court?
A: My understanding of the issue in terms of the economics that it implies is that they believe that the term "income-producing activity" refers to all activities that the corporation engages in and that pursuant to 2295(A)(5), they believe that means that one should look to the location of the intermediate or prior activities.
They would call them "income-producing activities." I think that's an incorrect term from an economics point of view. But they would look to the location of all of the activities of the corporation and then use that as the basis for discerning an apportionment factor to South Carolina.

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Q: You state that it's an incorrect terminology. Can you explain that statement a little bit more? I believe you said that they're looking at the income-producing activities outside of South Carolina; was that your testimony?
A: Not quite, but let me --
Q: Can you clarify that, please?
A: Sure. And, again, what I mean by -- this is an economist -- is there's a range of activities that all businesses engage in -- let's agree on that -- and that includes putting -- in this instance, let's focus on DIRECTV that includes the rocket science that we heard about yesterday of putting satellites up, it means downloading information, it means negotiating contracts and so forth. So all of that is completely understood and not in dispute that that that those activities exist.
Where the disagreement comes in -- and, again, I'm looking at this as an economist -- is where you draw the line between the activities in general that the -- that any business engages in and the income producing, the activities that actually produce the income.
My understanding of what the taxpayer is

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arguing in this case -- and I disagree with it -- is that all of the activities are income producing, that you cannot differentiate cost producing activities, and income-producing activities -- and that's the terminology that I would use here -- that many of the prior, secondary, intermediate activities that we heard about yesterday that are very real, are cost producing activities. If they simply occurred, then they'd be generating costs. They would not be generating any income, any revenue, whichever terminology you want to use. The only activity that we are talking about that actually generates income is the purchase of the product in South Carolina. It's purchase nationally, but of course we're focusing on the purchase in South Carolina.
Q: Thank you. You stated you reviewed the Department's Determination in this matter; is that correct?
A: That's correct, yes.
Q: And are you familiar with how the Department determined what is the income-producing activity in this matter?
A: Yes, I am.

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Q: And what is your understanding of that decision?
A: My understanding of that decision is that the Department focused on the delivery of the service in South Carolina, that the Department took the value of the subscription revenue in South Carolina as a direct measure of the value of those services in South Carolina. So there's no need for proxies. There's no need for approximations of any kind. You actually know the value that South Carolinians placed on the delivery of that service into the homes in South Carolina. And that they -- that's also a transparent item to identify from the accounting information that's provided. So that's my understanding of what the Department did.
Q: And is the Department's Determination of the income-producing activity in this matter economically reasonable?
A: Yes, it strikes me as economically reasonable in the sense that it is consistent with most of the principles that we normally apply when we're deciding if a taxation system is reasonable. It's also transparent. It's also

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consistent, in my understanding, with the statute and the case law.
Q: From an economic perspective, why is it appropriate for the taxpayer's income from South Carolina subscription revenue to be sourced to South Carolina?
A: Quite simply because that best represents the extent of the -- the extent of the business connection with South Carolina as far as the provision of the service goes. That's the clear statement from the statute and that's the most direct way to represent that and calculate it.
Q: And from an economist standpoint, what is the service being sold in South Carolina, the thing that gives value and generates income?
A: It strikes me as transparent that it is the provision of television services in your home. When I lived here, I used to live out in Irmo. I would like to go home and watch television in my home in Irmo. I didn't particularly want to have to travel to El Segundo to watch NFL on a Sunday night. So the service, to me, if I had been purchasing DISH in -- DIRECTV, forgive me -- in South Carolina would be to be able to

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watch NFL in my home in Irmo.
Q: The Department Determination references the decision of Lockwood Greene and the taxpayers argued that this case supports their position. During your deposition, you were asked questions regarding the distinction between Lockwood Greene and the facts of this case. You stated that your -- in your response that you had not given it much thought; is that correct?
A: That's correct.
Q: And why hadn't you given it much thought?
A: Actually, to be quite honest, because I was surprised that they even mentioned Lockwood Greene because Lockwood Greene had an exception for media broadcasting services, so I thought that was a slip on their part.
MR. ROBERTS: Objection, Your Honor. We're getting beyond the scope of economics here. He's giving a legal interpretation of the case.
THE COURT: Response?
MS. WOOTEN: I'm just asking him from an economics perspective some things that were asked in his deposition.
MR. ROBERTS: There was no question -- there is no

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question involving economic standpoint there.
THE COURT: Well, he went on -- he started talking about economics, but then he talked about the holding in Lockwood Greene. And he could get that from -- he said -- he made the statement that that's what the holding was, as opposed to his perspective. So I'm going to sustain the objection in accordance to how he testified.
MS. WOOTEN: Okay.
Q: From an economics perspective, could you answer that question?
A: I'm not sure what the question is that leads to an -- I was responding to what I was asked --
Q: I'm sorry.
A: -- why I was surprised.
Q: From an economics perspective, can you explain the distinction between Lockwood Greene and the facts of this case?
A: Certainly. Lockwood Greene had to do primarily with an engineering services firm. In fact, Lockwood Greene is a more famous firm in South Carolina. It also did architectural services, but the instant case was about engineering services. And the holding there had to do with whether engineering services, the apportionment

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should be on the basis of the place of activity, as the Court referred to it then. And as we've heard discussion, they used payroll to measure that from an economic perspective. The court also held that the same principles would apply to firms such as those providing accounting services and --

MR. ROBERTS: Objection, Your Honor. Again, he's not talking about an economic standpoint. He's giving his interpretation of Lockwood Greene.

THE COURT: Any response?

MS. WOOTEN: Which is from an economic perspective. I'm not asking him for the legal positions argued or the holding of Lockwood Greene from a legal standpoint. I'm asking his economic perspective how he's viewing the case.

MR. ROBERTS: He just testified that "the court held this." He's interpreting the case. He's not talking about it from an economic standpoint.

THE COURT: Well, I'm going to allow him to testify and place in the record that the caveat for which the Court is going to receive this is that it is his perspective of how he came to the conclusion that he came, but not the

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holding that was made in Lockwood.

MR. ROBERTS: Okay.

THE COURT: All right?

MS. WOOTEN: Thank you, Your Honor.

THE COURT: So proceed.

A: So an issue to an economist actually reading Lockwood Greene is: Does the economic nature of the firm change the way that the holding is applied? And that was the question that Mr. Gregory asked me in deposition. It was a perfectly sensible question. It's a question I think the Judge was asking about during opening statements. Because one of the features of the holding, as I interpreted it, from -- as an economist, is that for some types of firms, you know, economic types of firms, you should use apportionment based on cost of placement, and for other types of firms, such as media broadcasting, that does not apply. So, the question that Mr. Gregory asked me in deposition was: Is there some economic rationale for that distinction? It's not -- I'm not trying to interpret the Court's logic. They didn't state a full logic there, but he asked me what was the economic rationale for

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that.

Q: And what is the economic rationale or distinction between an engineering firm and a taxpayer such as DIRECTV?

A: The economic distinction that I would draw from that is that, if you take a firm such as an engineering firm or a law firm, in the examples that Dr. Pomp gave the other day, are perfectly fine. What is essential about the firm is the provision of expertise and opinions. To take the example in -- the court gave in Lockwood Greene of the firm located in South Carolina and the customer in North Carolina, but it could be a legal firm or an accounting firm -- it matters not whether the client drives down to receive the opinion or stays in North Carolina to receive the opinion. That's the example -- my paraphrasing of the example that Dr. Pomp gave, quite correctly, for those classes of firms. So what is essential is, from an economic --

MR. ROBERTS: Your Honor, I have an objection here. This is all brand new testimony. He did not prepare a written report. We didn't go into all this in the deposition. In fact, as

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Ms. Wooten said, he didn't really answer the question in the deposition because he said he hadn't had time to consider it. So we're kind of being -- you know, this is out of the blue for us, Your Honor.

THE COURT: Well, where does that statement come from? Is there something that the Department has given that presumes that they told you were that they were not going to go beyond the scope of --

MR. ROBERTS: We know nothing about his opinion. He didn't prepare a written report. Discovery was not supplemented, so ...

THE COURT: Was there a requirement that discovery be supplemented, is what I'm getting at?

MR. ROBERTS: There's a requirement that discovery be supplemented up until the time of trial, Your Honor.

THE COURT: All right. And where was -- is that in the ...

MR. ROBERTS: That's rules --

THE COURT: I mean, did y'all have an agreement? That's what I'm trying to get at. Is it coming out of our rules or was it coming out of --

MR. ROBERTS: We had interrogatories, Your Honor,

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and I believe Rule 33 requires that they be supplemented up until the time of trial.
THE COURT: Okay.
MS. WOOTEN: Your Honor, my understanding is there was no requirement per our agreement to have Dr. Harrison do an expert report. Dr. Harrison is -- or they are here to cross-examine him on any testimony that he has given today. You know, he's here to answer any questions they have.
THE COURT: All right. One more time. How is the scope exceeding that of your understanding of his --
MR. ROBERTS: Well, we asked him at his --
THE COURT: He was identified as an expert.
MR. ROBERTS: Correct, Your Honor.
THE COURT: He was asked questions.
MR. ROBERTS: He did not answer this question because he said --
THE COURT: I understand. That's obvious.
MR. ROBERTS: He said he had not thought of it and, also, he said -- we asked him for all of his opinions in this matter and, you know, this is a new opinion.
THE COURT: Yeah, but I -- this is a close one

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because I don't think he's gone that far afield of his opinion. Ask him the question again and let me just see where we're going to go here.
MS. WOOTEN: Okay. I asked him if there was an economic distinction between the engineering firm in Lockwood and the taxpayer in this case.
THE COURT: I'm going to overrule that at this point in time.
MR. ROBERTS: Okay.
THE COURT: But you're getting close.
MR. ROBERTS: Okay.
THE COURT: Go ahead.
THE WITNESS: The economic distinction is that for the taxpayer in this case, there is an essential part of the service delivered that has to occur physically in South Carolina. For an engineering firm, for an accounting firm, for a legal firm, it is not essential that the service occur in South Carolina. So in that sense, here you have the service being delivery of a product in a house in Irmo and in that sense, there's a physical matter that follows that it is different than accounting firms, legal firms, engineering firms.

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Q: Were you present yesterday for Mr. Goswitz's testimony?
A: Yes, I was.
Q: He testified regarding DIRECTV engineers. Does the fact that those engineers are located outside of South Carolina, does that impact your opinion on where the income should be sourced from an economic standpoint?
A: No, not in the least.
Q: Why is that?
A: Because we have a direct way to measure the income-producing activity in South Carolina, which is the provision of a service to a house in Irmo. Moreover, we have a way to accurately assess the value of that service, by looking at the amount of money that the subscriber paid in South Carolina.
Q: There was also some testimony presented yesterday regarding whether the business activities outside of South Carolina -- and I believe they're referred to as "value drivers" -- are the income-producing activities of the taxpayer. From an economic standpoint, do you agree with that?
A: Those terms are used in a business context but

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they can also be vaguely defined. So the term "value driver" can be used if you're doing a holistic analysis of a firm, a so-called "functional analysis" that Dr. Cody talked about, but they can be ambiguous in terms of what is driving value. So I tend not to use those terms myself.
Q: Can you explain how they're ambiguous?
A: Well, they're ambiguous because if you're talking about activities of the firm that are undertaken in anticipation of generating revenue, which is the language that I heard used yesterday, then that is completely correct. They are used in anticipation of generating revenue, but they are not the income generating activity.
The income-generating activity/producing activity is the sale of the product in South Carolina in this case. So they are antecedent to it. They are prior to it. They are intermediate activities, to use the language of economists. There are different terminology that you could use here. But they are cost generating. They are not income generating.
Q: From an economic standpoint, what is the final

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product or service in this case that's being sold in South Carolina?
A: NFL Sunday Night Ticket in an Irmo house and the other things that DIRECTV provides.
Q: And, again, in your opinion from an economic standpoint, how is that the income-producing activity in this case?
A: It's the income-producing activity because all of the other activities -- and there are many other activities -- do not generate income. They generate costs, as that term is standardly used. The only activity that generates income -- and we're leaving aside the leasing of the box right now. The only activity there that generates income is if somebody in South Carolina leases a box and is willing to pay for the subscription. If they lease the box or in some cases such as with -- I know with DISH you can purchase the box and they don't pay subscription, you just have a dead DISH box there.
So, in the case of DIRECTV, I understand from yesterday that they only lease the boxes now. But unless you pay that subscription in -- for delivery in South Carolina, you do not get to

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watch the product.
So DIRECTV incurs lots of costs -- in fact, that's a loss-making activity -- until that final activity occurs in South Carolina and the other states, of course, that generates the income.
Q: And were you present for Dr. Cody's testimony yesterday?
A: Yes, I was.
Q: Does his testimony change your opinion?
A: No, not in the least.
Q: Can you explain that to the Court?
A: Well, one of the things that he was saying, vis-a-vis the point I was just making, that all of the activities were cost generating and there's only one activity that was income generating, is he was presenting the view that you can't separate income and cost.
I mean, he talked about how -- may be paraphrasing what he said -- that even if you take the check that is paid for the final receipt of the service, there is a cost of processing that. So you can't differentiate income and cost. And with respect, I was embarrassed to hear a Ph.D. economist say

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something like that; that is just silly.
MS. WOOTEN: Your Honor, can I have a minute, please?
Thank you, Your Honor. That's all we have on Direct.
THE COURT: Who's up?
DR. HARRISON - CROSS-EXAMINATION BY MR. ROBERTS:
Q: All right. So, Dr. Harrison, at your deposition, you testified that, quote, "an income-producing activity is some activity but for the occurrence of that activity there would be no income," correct?
A: I recall saying something like that, yes.
Q: Thank you. In your deposition -- and I think just now, as well -- you also testified that DIRECTV is the broadcast center, the up-link facilities, and satellites can't be considered income-producing activity because, quote, "They are cost producing activities. They are not income-producing activities." Correct?
A: That is correct. That's what I said --
Q: And so when your --
A: -- just a moment ago.
MS. WOOTEN: Your Honor, I would ask that he would let the witness finish his statement before he

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asks the next question.
THE COURT: Let him finish the answer.
MR. ROBERTS: He answered my questions.
THE COURT REPORTER: I can't hear, though.
THE COURT: Oh.
MR. ROBERTS: Fair enough, sorry.
A: Yes, that's essentially what I said, that those are cost-producing activities and the only income-producing activity was the receipt in South Carolina.
Q: Okay. So, in your opinion, activities that generate cost for a taxpayer cannot be income-producing activities, right?
A: As those terms are standardly defined, that's correct.
Q: Thank you. In your deposition, you testified that, quote, "But here the income-producing activity is the person purchasing the product in South Carolina that occurs wholly within South Carolina." Correct?
A: That's correct, as I just said a moment ago in relation to the other questions.
Q: And you further testified in your deposition that the income-producing activity was, quote, "Turning on the box, watching the TV, and

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paying the bill." Correct?
A: That's correct, yes.
Q: You would acknowledge that all of those are activities of the customer, correct?
A: That is correct, other than the -- actually, no, that's not correct. Those are activities initiated by the customer, but the service only actually flows into the person's house if, indeed, all of the other activities have occurred. So those other activities are needed, but they're -- you don't actually see the service unless there's a satellite there.
Q: But those other activities, the delivery of the service into the house, you would acknowledge that delivery is a cost, right?
A: That's correct, that's a correct --
Q: And you just -- and you just said that cost cannot be an income-producing activity.
A: Let me answer my previous question, if you may. Do you want me to answer it?
Q: Right away.
A: Okay. Those are costs. All of those are costs. They are costs that are needed to produce the product.
Q: And did you not just testify that an activity

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that generates a cost cannot be an income-producing activity?
A: That's correct, and that follows from the definition of the terms as normally used in accounting and economics and business.
Q: So, again, the only -- in your opinion, from an economic standpoint, the only income-producing activity that occurs in this case are activities of the customer, correct?
A: In South Carolina, yes.
MR. ROBERTS: I have no further questions, Your Honor.
THE COURT: Redirect?
MS. WOOTEN: Nothing from the Department, Your Honor.
THE COURT: You may step down.
THE WITNESS: You don't have any witness questions?
THE COURT: Not right now.
MS. WOOTEN: Your Honor, just one administrative matter. Dr. Harrison has a flight this afternoon, so we would ask that he be excused.
MR. ROBERTS: Sorry, Nikki, I didn't hear, I'm sorry.
MS. WOOTEN: Dr. Harrison has a flight scheduled this afternoon and I was asking that he be

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excused from further questioning.
MR. ROBERTS: That's perfectly fine with us.
MS. WOOTEN: Okay.
THE COURT: You're excused.
THE WITNESS: Thank you.
MS. WOOTEN: Thank you.
(Witness excused.)
MR. CONDON: Your Honor, can we take a five-minute break?
THE COURT: You may.
MR. CONDON: My witness has seem to run out to the bathroom or something.
THE COURT: All right.
(Off the record from 1:38 p.m. to 1:50 p.m.)
MR. CONDON: You ready?
THE COURT: Yeah.
MR. CONDON: Your Honor, we call Professor John Swain.
THE COURT: Another professor.
JOHN A. SWAIN, having been duly sworn, testifies and examines as follows:
MR. SWAIN - DIRECT EXAMINATION BY MR. CONDON:
Q: Good afternoon, Mr. Swain.
A: Good afternoon.
Q: Would you please state your full name for the

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record?
A: Yes, John Allen Swain.
Q: And where do you live?
A: Tucson, Arizona.
Q: And who is your current employer?
A: The University of Arizona, Rogers College of Law.
Q: And how long have you been employed at the University of Arizona law school?
A: Since fall 2001.
Q: What is the nature of the work you perform at the University of Arizona?
A: I'm a professor of law at the University of Arizona, so I teach law classes, I engage in legal research, and I give service to the university.
Q: Do you teach on state and local tax issues?
A: Yes, I -- my course load is primarily in the taxation area. I teach state and local tax, as well as a number of other tax courses, federal income, corporate tax, advanced corporate tax, international tax, nonprofit organizations, and I may be missing something.
Q: Would the state and local tax course you teach include multi-state income tax apportionment?

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	**Docket No. 14-ALJ-17-0285-CC** **RESPONDENT'S RESPONSE IN OPPOSITION TO PETITIONER'S MOTION IN LIMINE TO STRIKE PROPOSED EXPERT WITNESS FROM SOUTH CAROLINA DEPARTMENT OF REVENUE'S WITNESS LIST**

TO: BURNET R. MAYBANK, III, AND JAMES P. ROURKE, COUNSEL FOR PETITIONER, DISH DBS CORPORATION, F/K/A ECHOSTAR DBS CORP., AND AFFILIATES:

Pursuant to ALC Rule 19(A) the undersigned, as attorneys for the Respondent, South Carolina Department of Revenue (Department), respond in opposition to Petitioner's Motion in Limine as follows and assert that this Court should not strike Dr. Glenn W. Harrison as an expert witness on behalf of Respondent in the hearing of the above-captioned matter. The testimony of Dr. Harrison will assist this Court in understanding the evidence and to determine facts at issue.

I. Applicable Law

Rule 702, SCRE permits an expert witness to testify as to his opinion regarding an issue at trial "[i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue" if such expert witness is "qualified as an expert by knowledge, skill, experience, training, or education[.]". It is well-established that "[t]he qualification of a witness as an expert in a particular field is within the sound discretion of the trial judge." Smoak v. Liebherr-Am., Inc., 281 S.C.

420, 422, 315 S.E.2d 116, 118 (1984). And "[w]here the expert's testimony is based upon facts sufficient to form the basis for an opinion, the trier of fact determines its probative value." Berkeley Elec. Coop, Inc. v. S.C. Pub. Svc. Comm'n, 304 S.C. 15, 20, 402 S.E.2d 674, 677 (1991). Moreover, "[a] trier of fact is not compelled to accept an expert's opinion, but may give it the weight he determines it deserves." Florence County Dep't of Social Servs. v. Ward, 310 S.C. 69, 72-3, 425 S.E.2d 61, 63 (Ct. App. 1992). Additionally, "the trier of fact may accept the testimony of one expert over that of another." Thomas A. Morris, Jr. v. S.C. Dep't of Health and Envtl. Control, 06-ALJ-07-0862-CC, (J. McLeod, June 12, 2007) 2007 WL 1933037 at *4 (citing S.C. Cable Television Ass'n v. S. Bell Tel. & Tel. Co., 308 S.C. 216, 417 S.E.2d 586 (1992)). South Carolina courts have used a five-factor analysis before excluding an expert witness. See e.g., Jumper v. Hawkins, 348 S.C. 142, 558 S.E.2d 911 (Ct. App. 2001). The five factors are (1) the type of witness involved; (2) the content of the evidence emanating from the proffered witness; (3) the nature of failure or neglect or refusal to furnish the witness' name; (4) the degree of surprise to the other party; and (5) the prejudice to the opposing party.[1] Id. (citing Laney v. Hefley, 262 S.C. 54, 202 S.E.2d 12 (1974)). Finally, the "exclusion of a witness is a sanction which should never be lightly invoked." Jumper, 348 S.C. at 149, 558 S.E.2d at 915, (citing Moran v. Jones, 281 S.C. 270, 276, 315 S.E.2d 136, 139, (Ct. App. 1984)); see also Jackson v. H&S Oil Co., 263 S.C. 407, 411, 211 S.E.2d 223, 225 (1975).

[1]Factors three through five are not relevant to the instant case as those factors apply regarding testimony of an undisclosed witness. See Jumper, 348 S.C. at 149, 558 S.E.2d at 915 (stating the Laney Court outlined the general rule regarding testimony of an undisclosed witness).

II. This Court Should Not Strike The Testimony Of Dr. Glenn W. Harrison Because His Testimony Will Assist The Court To Understand The Evidence Presented At The Hearing Of This Matter

This Court should not strike Dr. Glenn W. Harrison as an expert witness for the following reasons: (1) Dr. Harrison has recently been admitted as an expert in a very similar case in the South Carolina Administrative Law Court; (2) Dr. Harrison's testimony is relevant to this case because his testimony will assist this Court in understanding the evidence and determining facts at issue; and (3) Petitioner's requested sanction of excluding Dr. Harrison is unwarranted and extreme, particularly since Petitioner's argument for excluding Dr. Harrison is based primarily on a short answer to one question that the Department asked Dr. Harrison in the recent similar hearing.

Prior Qualification as an Expert:

Dr. Harrison recently testified as an expert witness in a very similar case[2] before Chief Judge Anderson on January 14, 2015, in the hearing of DIRECTV, Incorporated & Subsidiaries v. South Carolina Department of Revenue, Docket No. 14-ALJ-17-0158-CC. Pet'r Mot. in Limine at 1. In the DIRECTV matter, after hearing Dr. Harrison's qualifications and previous expert testimony in other apportionment cases before the Administrative Law Court (ALC or Court),[3] Chief Judge Anderson qualified Dr. Harrison

[2]Contrary to Petitioner's assertion in its motion, the Department did not assert "market share apportionment" in the DIRECTV case, and it is not asserting a "market share apportionment" in this matter.

[3]Dr. Harrison has been qualified and provided expert testimony in the following cases before the S.C. Administrative Law Court: ESA Services, LLC v. S.C. Dep't of Rev., Docket No. 08-ALJ-17-0047-CC (C.J. Kittrell) (Feb. 9, 2009); Carmax Auto Superstores West Coast, Inc. v. S.C. Dep't of Rev., Docket No. 09-ALJ-17-0160-CC (J. Matthews) (Apr. 22, 2010); Rent-A-Center West, Inc. v. S.C. Dep't of Rev. and Rent-A-Center Texas, L.P. v. S.C. Dep't of Rev., Docket Nos. 14-ALJ-17-0204-CC (Jan. 6,

as an expert witness in economic principles generally and in economics and law specifically. See Pet'r Mot. in Limine, Ex. A at Hr'g Tr. 397:16 – 398:9.

After being qualified as an expert in the DIRECTV case, Dr. Harrison provided information to the court that assisted in the evaluation of the facts at issue. For example, Dr. Harrison assisted the court in understanding DIRECTV's testimony about its activities by distinguishing between DIRECTV's intermediate or prior activities and its income producing activities. See Pet'r Mot. in Limine, Ex. A at Hr'g Tr. 402:6 – 404:17. Dr. Harrison also assisted the court in determining a fact at issue: what are DIRECTV's income-producing activities. See Pet'r Mot. in Limine, Ex. A at Hr'g Tr. 403:19 – 404-17. The DIRECTV court believed that Dr. Harrison would assist it in accordance with Rule 702, SCRE, and the Department has identified two examples of such useful testimony in the DIRECTV case. Accordingly, this Court should not exclude Dr. Harrison as an expert witness in this matter.

Dr. Harrison Will Assist This Court:

Dr. Harrison's testimony is relevant to this case and will assist this Court in understanding the evidence and determining facts at issue. Petitioner argues that Dr. Harrison's testimony as an economic expert "has no relevance to this case" and that a Ph.D. in economics is no more competent to provide relevant testimony on whether South Carolina sources income using cost of performance – or market share – than a Ph.D. in Transportation or Parks, Recreation and Tourism. Petitioner's argument is erroneous and unpersuasive.

2012) and 14-ALJ-17-0206-CC (Jan. 6, 2012); Duke Energy Corporation v. S.C. Dep't of Rev., (2011); and DIRECTV, Inc. and Subsidiaries v. S.C. Dep't of Rev., Docket No. 14-ALJ-17-158-CC (C.J. Anderson, January 13-14, 2015).

First, and most importantly, the Department has not asked Dr. Harrison to provide an opinion as to "whether South Carolina sources income using cost of performance – or market share" in this matter or any other matter pending before the Court. Moreover, as stated in this Court's Order Denying Cross Motions For Summary Judgment (Feb. 10, 2015) ("Order"), this Court has previously determined that "South Carolina is, at the very least, not a strict cost of performance state." (Order at p. 7). Further, the Court noted that the applicable statute in this matter, S.C. Code Ann. § 12-6-2295(A)(5) (Supp. 2007 and 2014), "focuses solely on the extent the 'income-producing activity' is performed in this State." Id. at 8. This determination is entirely consistent with the Department's position in this matter: the focus is and has always been on the income-producing activity of the business or industry at issue. To that end, Dr. Harrison's expertise in economics and law is relevant and helpful to the trier of fact – here, the Court – in evaluating the economic activities of the Petitioner and how those activities relate to the "income-producing activity" of Petitioner, as required by section 12-6-2295(A)(5) and Rule 702, SCRE.

Further, because neither section 12-6-2295(A)(5) nor any other South Carolina apportionment statute define the term "income-producing activity," Dr. Harrison's testimony may assist the trier of fact to "determine a fact at issue." Rule 702, SCRE. As noted by the Court in its Order, "at this stage in the litigation, there are insufficient facts to determine what Petitioner's income-producing activities are and the extent to which those activities take place in South Carolina." Order at 10. Dr. Harrison, as an expert in economics principles generally and in economics and law specifically, may provide significant insight and understanding from an economic perspective of the activities of the Petitioner and how those activities are valuable to Petitioner. Further, Dr. Harrison

may assist this Court in distinguishing among the various activities of Petitioner from an economic perspective.

Dr. Harrison's testimony will also add color and perspective to the testimony of Petitioner's witnesses. At this time, Petitioner has identified two expert witnesses, Ray Stevens and Rex Povenmire, but has yet to identify the subject matter of each expert's testimony.[4] Petitioner has also identified two lay witnesses who will testify regarding Petitioner's tax returns and activities. Given that Petitioner's argument in this matter is that its income should be apportioned based upon cost-of-performance factors, it is likely Petitioner's lay and expert witnesses will attempt to establish that the cost activities it performs outside of South Carolina are the income-producing activity in this matter. More specifically, it is likely Petitioner's witnesses will provide testimony related to its activities and how those activities are the income-producing activities referenced in section 12-6-2295A(A)(5). Dr. Harrison's testimony will aid the Court in understanding the economic impact or significance of these necessary, but intermediate, activities and how those activities may differ from the "income-producing activities" referenced in section 12-6-2295(A)(5). While Petitioner argues that Dr. Harrison's opinion related to the "economic reasonableness" are irrelevant to this matter, the Department asserts that Dr. Harrison's opinion, from an economic perspective, will aid this Court in understanding the facts in this case.

[4]It is the Department's understanding that Rex Povenmire, currently identified as an expert for Petitioner, will be a fact witness and will provide testimony related to cost of performance factors; however, Petitioner has not supplemented its interrogatories to change the designation of Mr. Povenmire as an expert witness.

Petitioner's Request Is Extreme:

Petitioner's argument for excluding Dr. Harrison as an expert witness in this case is based on Dr. Harrison's short answer to one question in the DIRECTV case. Dr. Harrison gave a seven-line answer to the Department's question about the economic reasonableness of the Department's determination of what constituted that taxpayer's income-producing activity. See Pet'r Mot. in Limine, Ex. A at Hr'g Tr. 405:18 – 406:2. Petitioner addressed only the question about "economic reasonableness" from the second paragraph of page 3 of its motion through the second full paragraph on page 4 of its motion. Pet'r Mot. in Limine at 3-4. If Petitioner objects to one of the Department's questions to Dr. Harrison (or even three questions), the appropriate time to object to such questions is during the hearing – assuming the Department asks an objectionable question. Moreover, the Department may not even ask the question(s) to which Petitioner objects in the hearing of this case. Therefore, excluding the expert testimony of Dr. Harrison is an extreme remedy, especially before an objectionable question is asked.

Based on the above, this Court should not strike Dr. Harrison as an expert witness. He has been qualified as an expert witness in another similar case, his testimony will assist this Court under Rule 702, SCRE and the action requested by Petitioner is extreme and should not be "lightly invoked." Jumper, 348 S.C. at 149, 558 S.E.2d at 915, (citing Moran v. Jones, 281 S.C. 270, 276, 315 S.E.2d 136, 139, (Ct. App. 1984)); see also Jackson v. H&S Oil Co., 263 S.C. 407, 411, 211 S.E.2d 223, 225, (1975).

THEREFORE, by the undersigned counsel as attorneys for the Respondent, the Department respectfully requests that this Court deny the Petitioner's Motion in Limine, which asks this Court to strike Dr. Glenn W. Harrison as an expert witness on behalf of Respondent in the hearing of the above-captioned matter.

Respectfully submitted,

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March 16, 2015
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 14-ALJ-17-0285-CC **PETITIONER'S MOTION FOR SUMMARY JUDGMENT**

TO: The Honorable Shirley C. Robinson, Administrative Law Judge:

PLEASE TAKE NOTICE that the undersigned, as attorneys for Petitioner Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, move for an Order of Summary Judgment pursuant to Rule 56(c), SCRCP, granting Petitioner's request find that the Respondent may not, as it has in this case, alter the income producing/cost of performance apportionment method it has used for over 35 years. The grounds for the Motion are that there is no genuine issue of material fact and that there is no statutory, regulatory, or policy document mechanism to that allows the DOR to invoke market share sourcing as a matter of law.

THEREFORE, by the undersigned counsel as attorneys for Petitioner, Petitioner respectfully requests that this Court grant Summary Judgment pursuant to Rule 56(c), SCRCP.

Respectfully submitted,

January 6, 2015
Columbia, South Carolina

Burnet R. Maybank, III
Jim Rourke
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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 14-ALJ-17-0285-CC **PETITIONER'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT**

The Petitioner has filed this motion for Summary Judgment. At issue is whether the South Carolina Department of Revenue – without a single statute, regulation or policy document in support – may alter the income Apportionment method it has used for over 35 years in order to collect more taxes from Dish.

I. INTRODUCTION

By way of background, South Carolina like most states has two different income apportionment methods, one for sales of services and another for sales of tangible personal property. This case involves a sale of services.

There are two main methods for apportioning services income: (1) Income Producing/Cost of Performance (hereinafter COP); and (2) market share. (There are other apportionment methods, such as separate accounting, which are not relevant.)

As detailed below, Costs of Performance sources service income to the state in which the majority of expenses are incurred in producing the income. Market Share sources income to the state where the customers are located. Both methods are subject to complexity and criticism. States are winners and losers under both methods. (For example, South Carolina loses tax

revenue under the market sourcing method for domestic businesses with significant clients in other states.)

Based upon South Carolina statutes and principally the *Lockwood Greene* case, South Carolina for over 35 years has been a Cost of Performance State.

Cost of Performance has been subject to considerable criticism, principally that it is often an "all or another" rule, and some states (including South Carolina) have adopted a pro rata COP rule. In addition, as the economy has changed, an increasing number of states have shifted from COP to market share. They have done this through enactment of statutes which they have fleshed out through Regulations. South Carolina has not done so.

In addition, some states have erected market share statutes and regulations explicitly for the media industry. South Carolina has not.

South Carolina does have a statute which allows the Department of Revenue (as well as taxpayers) to invoke a different apportionment method where the standard rule does not fairly reflect the taxpayer's business in the state, S.C. Code Ann. § 12-6-2320(A)(4). The DOR has not invoked this statute in this case.

Below are a number of facts regarding this Motion. These facts are relevant only to establish that Dish's cost of performance is not in South Carolina. This issue is not disputed and the facts are largely irrelevant.

Dish moves for summary judgment on a narrow, purely legal issue: whether the DOR can invoke a market share sourcing or apportionment method without a single statute, regulation or policy document which provides such authority, particularly in light of some 35 years of authority which provides that South Carolina is a COP state.

Dish does not dispute that market share is a reasonable, valid method to source service income. A number of states now use it and commentators applaud it. But South Carolina has not adopted it – and no South Carolina taxpayer can invoke to lower its taxes paid in South Carolina. And the DOR cannot on its own volition, with no statutory or regulatory authority, assert it.

Actually, the DOR can arguably invoke market share method in appropriate cases under S.C. Code Ann. § 12-6-2320(A)(4). But it has chosen not to do so in this case.

Incidentally, the argument the DOR in this case is exactly the same argument asserted by the taxpayer – and rejected by the DOR (and subsequently the Supreme Court) – in the *Lockwood Greene* case which is detailed below.

II. STATEMENT OF FACTS

DISH Network Corporation is a publicly-traded holding company organized in 1995 under the laws of the State of Nevada. DISH Network, Annual Report: Year Ending Dec. 31, 2013, p. 1 (excerpts **attached** as **Exhibit 1**). Its principal executive offices are located in Englewood, Colorado. *Id.* Its subsidiaries (including the Petitioner) operate two primary business segments: its DISH-branded satellite television service and its wireless service. As of December 31, 2013, Dish Network Corporation had approximately 25,000 employees, with 22,000 in the United States. *Id.* at 19.

The Petitioner operates the DISH Network pay-television service and provides its 14.057 million subscribers with a wide selection of local and national programming accessible by the subscriber via direct satellite communications. *Id.* at 1. The direct-to-home satellite system at issue includes five major elements: the programming source, the uplink center, the satellite, the receiving antennae (dish), and the in-home receiver. Petitioner does not create original

programming—instead, it purchases the right to broadcast news and entertainment programming produced by others. Those programming providers (e.g., ESPN, Disney, HBO) transmit content to Petitioner's uplink centers (none of which are located in South Carolina). Petitioner also obtains programming from local broadcast television stations but captures the local programming by utilizing either a cable network or antennas.

Equipment at the uplink centers processes the incoming programming signals to assure quality (e.g., amplifying the signal), to protect copyrights (e.g., by encrypting the data), to insert content (e.g., public service announcements), and to put the signal into a form that can be transmitted from the uplink centers to satellites orbiting the Earth. To capture and view the satellite signal, a consumer must sign a subscriber agreement and purchase or lease certain specialized equipment consisting primarily of a compatible satellite antenna dish, receiver, and remote control.

The Petitioner's principal digital broadcast facilities that it uses are EchoStar's facilities in Cheyenne, Wyoming and Gilbert, Arizona. *Id.* at 3. The Petitioner uses six regional digital broadcast operations facilities owned and operated by EchoStar that allows it to maximize the use of the spot beam capabilities of certain owned and leased satellites. *Id.* Non-local and local programming is delivered to these facilities by fiber or satellite transmission. *Id.* The Petitioner then processes, compresses, encrypts and uplinks the programming to owned or leased satellites for subsequent direct broadcast to its subscribers. *Id.*

The Petitioner broadcasts the non-local and local programming to subscribers using satellites that operate in the "Ku" band portion of the microwave radio spectrum. *Id.* The Ku-band is divided in two spectrum segments. Most of the Petitioner's programming is currently delivered using DBS satellites. *Id.* As of December 31, 2013, the Petitioner owned or leased

capacity on 15 satellites in geostationary orbit approximately 22,300 miles above the equator. *Id.* at 8.

The Petitioner has two equipment service and remanufacturing centers. *Id.* at 42. One is in Spartanburg, South Carolina and the other is in El Paso, Texas. *Id.* A summary of the Petitioner's principal properties, which is derived from its Annual Report, is **attached** as **Exhibit 2**.

During the periods at issue, the Petitioner sourced and reported income under the COP method. On audit, the Respondent determined that the proper method of reporting for corporate income and license tax purposes is the location of the subscriber, *i.e.*, market share approach.

III. LAW

A. Standard of Review

This Court's Rules of Procedure provide "[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied to resolve questions not addressed by these rules." ALC Rule 68. Rule 56(c) of the South Carolina Rules of Civil Procedure provides summary judgment is properly granted when the "pleadings, depositions, answers to interrogatories, and admission son file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." *See Bovain v. Canal Ins.*, 383 S.C. 100, 105, 678 S.E.2d 422, 424 (2009).

"The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder." *George v. Fabri,* 345 SC 440, 452, 548 S.E.2d 868, 874 (2001). "A court considering summary judgment neither makes factual determinations nor considers the merits of competing testimony; however, summary judgment is completely

appropriate when a properly supported motion sets forth facts that remain undisputed or are contested in a deficient manner." *David v. McLeod Reg'l Med. Ctr.*, 367 SC 242, 250, 626 S.E.2d 1, 5 (2006). Summary judgment should be granted when there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. *R.J. Hendricks, II v. Clemson Univ.*, 353 SC 449, 455, 578 S.E.2d 711, 714 (2003); Rule 56(c), SCRCP; see ALC Rule 68." *Dorn and Kate Smith v. Clarendon County Assessor*, 11 ALJ 17-0191 (2011).

B. Apportionment of Income in South Carolina

As stated in SC DOR publication Economic Development Incentives (2014) (relevant pages **attached** as **Exhibit 3**), South Carolina apportions income as follows:

> South Carolina generally requires the use of one of the following apportionment methods:
>
> 1. A single factor apportionment method (based on sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property. . . .
>
> 2. A "gross receipts" apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses, including businesses that install or repair tangible personal property, and contractors. See South Carolina Code §§ 12-6-2290 and 12-6-2295.
>
> 3. A "special apportionment method . . . for certain companies, such as railroad companies . . . .
>
> 4. An individualized apportionment method tailored to a particular taxpayer (a) because the standard method for that taxpayer does not fairly represent the extent of the taxpayer's business in South Carolina, . . .

This case involves the gross receipts apportionment method for service providers, no. 2 above.

The Gross Receipts method is described in the Economic Development Incentives book at pg. 11 as follows:

Gross Receipts Apportionment Methods. South Carolina Code §12-6-2290 provides for the "gross receipts" formula and states:

> If the principal profits or income of a taxpayer are derived from sources other than those described in South Carolina Code §§12-6-2252 or 12-6-2310, the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in South Carolina Code §12-6-2295.

C. Cost of Performance and Market Based Sourcing

As briefly stated above, the states use one of two methods of apportioning income for service providers. In Journal of Multistate Taxation and Incentives, *The Increasingly Complex Apportionment Rules for Service based Business: Basic Issues*, at 28 (Oct. 2007) (**attached** as **Exhibit 4**) the authors describe the two methods as follows:

> Generally, the states have taken two distinct approaches to sourcing gross receipts derived from the performance of services. These approaches involve either some method of income-producing activity sourcing or, alternatively, market-based sourcing. Under the income-producing activity rule, service receipts are sourced to the state where that activity is performed. In interpreting the income-producing activity rule, states have used either an 'all-or-nothing' calculating based on where the cost of performing the service is incurred, or a pro rata modified cost-of-performance/service-performed method. To complicate matters, even the 'all-or-nothing' calculating is sometimes preempted by special sourcing rules. Under market-based sourcing, service receipts are sourced to the location of the service recipient, or to the location where the customer is deemed to receive the benefit of the service.

The authors describe Income-Sourcing/Cost of Performance as follows:

> The cost-of-performance rule, which has been adopted by the majority of states, originates from UDITPA and the MTC regulations. Under UDITPA, gross receipts derived from activities *other than sales of tangible personal property* (for example, from the performance of services) are sourced to the state where the

> income-producing activity is performed. When the income-producing activity is performed in more than one state, the sale is sourced to the taxing state if that is where the greater proportion of the income-producing activity is performed, as compared with any other state, based on costs of performance. Thus, under this general rule, an 'all-or-nothing' approach is used to assign service revenue to a single states sales factor numerator.

Lastly, the authors describe pro-rata (as opposed to all or nothing) COP as follows:

> Under the pro rata cost-of performance approach, in contrast to the 'all-or-nothing' methodology, gross receipts derived from the performance of a service are prorated among multiple states based on the cost of performing the service in each state. More specifically, the gross receipts are sourced among the states in proportion to the costs associated with performing the service in each state. For example, if a taxpayer's cost of performance for a service activity is incurred 35% in state A, 40% in state B, and 25% in state C, and each of those states uses the pro rata method to source service revenue, the entire gross receipts from the performance of that service activity would be sourced among the three states based on those same percentages.
>
> * * *
>
> States that follow a pro rata method may source service receipts based on the relative values of service provided, the amount of time spent in performing the service within or outside a state, or some other reasonable method. Some states specify the method as to how this should be done, but many others provide very little guidance.
>
> *The basic pro rata approach is followed by several states, including . . . South Carolina.* (Emp. added.)

Hellerstein & Hellerstein, State Taxation (3d. Ed.) (relevant pages **attached** as **Exhibit 5**) describes Cost of Performance as follows:

> Despite the theoretical and practical objections to UDITPA's "income-producing activity"/"costs of performance" rule for attributing receipts from services to the numerator of a state's sales factor, most states with corporate income taxes still take this (or a closely analogous) approach. *Unless modified by statute or regulation*, this approach requires the taxpayer first to determine which of its activities are the income-producing activities for its service income and then to determine where the costs of

> performing those income-producing activities were incurred. The taxpayer then compares the amount of costs of performance incurred in the taxing state to the amount of such costs in the other individual states. The sales are attributed to the state with the greatest amount of costs of performance. (Emp. added.)

Id. at 46 (¶ 9.18[3][b]).

Hellerstein further notes that "For service providers, the clearest examples of income-producing activities are the activities involved in actually performing the services for which they are paid. Many state regulations expressly provide that income-producing activity includes the rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service." *Id.* at 48 (¶ 9.18[3][b][ii]).

D. The DOR has Utilized Market Sourcing in the Taxpayer's Audit

The DOR's audit (**attached** as **Exhibit 6**) sourced all income from South Carolina subscribers to South Carolina (*i.e.*, market share). As is usually the case the audit provides little explanation of the apportionment method but pg. 4 does state as follows:

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

E. South Carolina is a Cost of Performance State

As stated above, the taxpayer in *Lockwood Greene v. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (1987) made the identical argument as the DOR in this case. It argued income should be apportioned to where its customers are, *i.e.*, a classic market share approach. As noted in the Tax Commission decision (**attached** as **Exhibit 7**), "Lockwood Greene Engineers, Inc. (taxpayer) is a Massachusetts engineering firm with offices in several states, including South Carolina. When its clients have projects located in South Carolina, the taxpayer usually provides services for those projects primarily from its South Carolina office,

though some South Carolina projects are serviced from other offices. Projects located outside this state are sometimes handled primarily by other offices. The taxpayer is normally paid for its services from the project owner's main office [Greenwood, South Carolina], which may be in a different state from the project location." (Accordingly, Lockwood Greene's cost of performance was located in Greenwood, South Carolina.)

It performed engineering services in numerous states and it attempted to reduce its income apportioned to South Carolina by arguing – exactly as the DOR asserts in this case – that "'receipts' refers to where a taxpayer's customers are located and payments made." *Lockwood*, 293 S.C. at 448, 361 S.E.2d at 347. Lockwood accordingly asserted that it only owed taxes in South Carolina on income earned from South Carolina customers, and did not owe taxes for income derived from clients in other states, even though the clients paid for the services by sending checks to Greenwood. Because Lockwood had numerous customers outside of South Carolina, the market share approach would dramatically lower its income subject to South Carolina taxes. And presumably for this reason the former Tax Commission rejected the market share approach. The Tax Commission decision first noted:

> The question is the meaning of "gross receipts from within this State." The taxpayer asserts the language means that one looks to where the receipts originate. . . . In short, the origin of the payment determines the location of the gross receipts. This is the origin test [now known as market share].
>
> The Division asserts that one determines where the gross receipts are from by deciding where the services for which the client pays are performed. For example, a project in Rock Hill, South Carolina may consist of work performed in the taxpayer's South Carolina offices plus work performed in other out-of-state offices as well as work actually performed at the project site. The Division, in such an example, would find South Carolina gross receipts based upon the cost of services actually performed in South Carolina. This is the activity [now known as the COP] test.

> For the following reasons, we find and conclude the activity test is the proper approach for a service business such as that of the taxpayer.

The Tax Commission Decision concluded:

> We find and conclude the purpose of providing a reasonable allocation of income for South Carolina taxation is best met by interpreting § 12-7-1190 to utilize an activity test for service business. Such an approach recognizes that *gross receipts are earned where the service is performed. If the service of drafting and designing plans are performed in South Carolina such costs of performance create South Carolina gross receipts.* [Emp. added.]

The Tax Commission concluded that "Finally, we note that the activity test has been consistently applied since 1977." The Tax Commission's language is classic Cost of Performance.

The South Carolina Court of Appeals agreed with the Tax Commission's COP approach stating "an engineering firm's business carried on in a state is reasonably measured by the services *rendered by its personnel in the state.*" *Id.* (emphasis added). (Cost of Performance in this example was calculated by which state – South Carolina – had the greater number of employees.) The South Carolina Court of Appeals then asserted a classic Cost of Performance test, and rejected Lockwood Greene's market share approach, as follows:

> For example, assume all of the engineering design services for a North Carolina client are performed by engineers in South Carolina. Under Lockwood's view, the gross receipts would be North Carolina receipts because the client is located in that state. This approach would not recognize the proportion of the engineering firm's business actually carried on in South Carolina.

361 S.E. 2d at 347. In *Rent-A-Center Texas, L.P. v. SCDOR*, 09-ALJ-17-0206, the ALC noted that "the legislature formally approved the Court of Appeal's interpretation [in *Lockwood Greene*] of 'gross receipts' as used in § 12-6-2290" and that this is consistent with current law, see footnote 5.

Hellerstein, in FN 1177 of ¶ 9.18 (included as part of **Exhibit 5**) briefly summarizes the *Lockwood Greene* case as follows: "In *Lockwood v. Greene Eng'rs, Inc.*, 293 SC 447, 361 SE2d 346 (Ct. App. 1987), the court held that the statutory term "gross receipts from within this State" refers to the place where the services giving rise to the receipts are performed rather than the place from which the receipts are sent." Applying *Lockwood Greene* to this case, Dish has some 22,000 employees in the United States, the vast majority are located outside of South Carolina.

South Carolina has never diverged by statute, regulation or DOR policy document from the Lockwood Greene COP method for sourcing income. Indeed, in 2013 the DOR invoked the *Lockwood Greene* method in SC DOR PLR 13-3:

> . . . the income producing activity is the engineering services provided to clients. As a result, *the state where those engineering services are performed* is where gross receipts from its services should be sourced. (Emp. added.)

In the DOR 2014 Edition Economic Development Incentives (**attached** as **Exhibit 3**), the DOR plainly states:

> The "gross receipts" ratio is most commonly used by service businesses. The proper sourcing of gross receipts was reviewed in *Lockwood Greene Engineers v. South Carolina Tax Commission*, 361 S.E. 2d 346 (1987). The court held that in sourcing income of a multistate engineering firm, "gross receipts from within this State" were to be determined according to where the services were performed *rather than according to where the customers were located.* See also, *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993). (Emp. added.)

Indeed, at pg. 6 the DOR audit work papers in this case cite the COP rule:

> **Excerpts from The Department's Corporate Income Tax Manual which discussed sourcing of intangible receipts and Service Receipts**
> Comment: Considering Lockwood Greene and Geoffrey, together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; *e.g.*, personal services, *where those services are performed*; intangibles,

> where those intangibles are used in a business for the production of income.78 This conclusion is consistent with the longstanding administrative policy of the Department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers. 78See also SC Tech. Adv. Memo. # 94-2. (Emp. added.)

Other commentators have noted that South Carolina is a cost of performance state. Hellerstein, in FN 1227 of ¶ 9.18 (included under **Exhibit 5**), states:

> Although South Carolina is not a state that generally follows UDITPA or the MTC regulations . . . its single-factor sales formula, as applied to receipts for services, generally resembles UDITPA's income-producing activity rule for attributing receipts from services. See SC Code Ann. § 12-6-2295(A)(5) (Westlaw 2014) (attributing receipts from services to the state "if the entire income-producing activity is within this State," and if the income-producing activity is performed partly within and partly without this state, receipts are attributable to the state "to the extent the income-producing activity is performed within this State").

Hellerstein also notes in FN 1187 of ¶ 9.18:

> According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) *and South Carolina* (services only)." P. Mata & M. Smith, "The Implementation of 'Market' Sourcing Rules: Practical Concerns," State Tax Notes, Sept. 6, 2010, p. 649 (citing statutes and regulations). (Emp. added.)

The South Carolina Corporate Income Tax Manual (relevant sections **attached** as **Exhibit 8**), co-authored by senior members of the Policy Section of the South Carolina Department of Revenue, further discusses the Department's views on apportionment. The manual cites and discusses the *Lockwood Greene Engineers Inc.* case as the leading authority on the sourcing of receipts using the single sales factor apportionment methodology. The authors concluded that:

> [c]onsidering *Lockwood Greene* and *Geoffrey*, together, it appears that gross receipts are sourced to the state which is most

> significantly associated with the production of the income, *e.g.*, personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income.

Id. at Chapter .05-20.

Furthermore, the Administrative Law Court's decision in *Rent-A-Center Texas, L.P. vs. South Carolina Department of Revenue* reaffirmed the "COP" test as the proper means of sourcing sales from services. In that case Rent-A-Center Texas, L.P. performed management services for a related entity doing business in South Carolina. These management services were performed by professionals located in Texas. The court reasoned that the related entity was compensating Rent-A-Center Texas, L.P. for the time and knowledge of the personnel located in Texas. Therefore, the Court found that by applying the ruling of *Lockwood Greene* to the facts the revenue received by Rent-A-Center Texas, L.P. for work performed in Texas must be sourced to Texas. (Unlike Rent-A-Center Texas, L.P., DISH has no related entity performing services in South Carolina.) The ALC decision plainly states: "In conclusion, the revenue received by RAC Texas from the Management Services Agreement must be apportioned to Texas pursuant to *Lockwood Greene*. RAC Texas provided its management services to RAC East stores through skilled professionals located in Texas."

Admittedly, as Hellerstein notes in ¶ 9.18[3][c] (**attached** as **Exhibit 5**), "A growing number of states have modified their sales factor rules for receipts from services to attribute those receipts to the state of the taxpayer's market." Generally, ¶ 9.18 describes how various states have adopted a market share approach. *In every example the state has done so by statute and implementing regulations.* For example, ¶ 9.18[3][c][ai] discusses Alabama as follows:

> Effective 2011, Alabama adopted a market-based rule for sourcing sales other than sales of tangible personal property. The *revised statute*, which modifies UDITPA, provides that sales, other than sales of tangible personal property, are in the state if "the

> taxpayer's market for the sale is in this state." . . .. Detailed *implementing regulations*, along with instructive examples, provide guidance . . .. (Emp. added.)

Hellerstein, ¶ 9.18[3][c][ii], describes Georgia as follows:

> Georgia has adopted a market-state sales factor for gross receipts of taxpayers whose income is principally derived from activities other than the manufacture, sale, and production of tangible personal property. For such taxpayers "[g]ross receipts are in this state if the receipts are derived from customers within this state or if the receipts are otherwise attributable to the state's marketplace."[FN 1240][1] The *Georgia regulations* governing receipts from services attributed service receipts based on where the recipient of the service received the benefit of the service. (Emp. added.)

It bears repeating: South Carolina has not adopted a market share approach. Our General Assembly has not adopted a market share statute. And the SC DOR has not promulgated a market share Regulation or single policy document. (Perhaps it has not done so because domestic South Carolina taxpayers like Lockwood Greene would file refund claims under a market share approach.)

Indeed some states have adopted market share statutes specifically for the broadcast industry. Hellerstein discusses these in ¶ 10-05 (**attached** as **Exhibit 9**). Hellerstein states "Most states have modified their general apportionment rules for apportioning the income of radio and television broadcasters. *Many states have done so by adopting regulations* identical or similar to the Multistate Tax Commission's (MTC's) special rule for radio and television broadcasting and, in particular, the "audience factor" for assigning receipts from programming and advertising." *Id.* at ¶ 10.05[1]. (Emp. added.) *In every case the state has done so by statute and/or regulation.* See FN 181 in Hellerstein which lists the enabling legislation.

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[1] FN 1240 cites Ga. Code. Ann. § 48-7-31(d)(2)(A)(i).

Note that the SC DOR arguably has the authority to invoke a market share approach in appropriate cases under SC Code § 12-6-2320(A)(4). This equitable apportionment statute (and the apportionment of services income as is involved in this case) is discussed by the South Carolina Supreme Court in *Media General Communications v. S.C. Dep't of Revenue*, 388 S.C. 138, 694 S.E.2d 525) (2010) and very recently in *Carmax Auto Superstores v. S.C. Dep't of Revenue*, _____ S.C. ____, ____ S.E.2d ____ (Dec. 23, 2014) (**attached** as **Exhibit 10**), affirming as modified *Carmax Auto Superstores v. S.C. Dep't of Revenue*, 397 S.C. 604, 725 S.E.2d 711 (Ct. App. 2012). A number of Department of Revenues have done so, *e.g.*, *Bell South Advertising & Publishing Corp. v. Chumley*, 308 S.W. 3d 350 (2010).

The SC DOR has not invoked section 12-6-2320(A)(4) in this case – perhaps because the statute "goes both ways" and domestic South Carolina businesses with out of state customers would file refund claims under it.

CONCLUSION

In conclusion, this Motion involves a narrow, purely legal, issue.

First, is South Carolina a Cost of Performance state for purposes of apportioning service income? The South Carolina Supreme Court and the former Tax Commission so held in *Lockwood Greene*. The Department of Revenue continues to adhere to this approach in its Corporate Tax Manual as well as very recent PLR 13-3 and its 2014 Economic Development Incentives Manual. And at least one ALC so held in *Rent-A-Center Texas, L.P. vs. S.C. Department of Revenue.*

Second, if South Carolina is a Cost of Performance state, does the DOR have the legal authority to invoke the market share approach for purposes of taxing DISH without a single

statute, regulation or policy document so providing? Every other state which has done so has accomplished this by statute and regulation.

Third, may the DOR invoke COP against domestic South Carolina businesses (and tax all their income here) and invoke market share only against foreign corporations (and tax a portion of their income here) without violating the Commerce Clause? Obviously not.

While the DOR does arguably have some statutory authority to invoke market share in section 12-6-2320(A)(4) it has failed to invoke that statute in this audit.

Respectfully submitted,

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Date: January 6, 2015

TAB 1

HOME ENTERTAINMENT ANYWHERE

dish NETWORK®

ANNUAL REPORT
YEAR ENDING DECEMBER 31, 2013

PART I

Item 1. BUSINESS

OVERVIEW

DISH Network Corporation was organized in 1995 as a corporation under the laws of the State of Nevada. We started offering the DISH® branded pay-TV service in March 1996 and are the nation's third largest pay-TV provider. Our common stock is publicly traded on the Nasdaq Global Select Market under the symbol "DISH." Our principal executive offices are located at 9601 South Meridian Boulevard, Englewood, Colorado 80112 and our telephone number is (303) 723-1000.

DISH Network Corporation is a holding company. Its subsidiaries (which together with DISH Network Corporation are referred to as "DISH Network," the "Company," "we," "us" and/or "our," unless otherwise required by the context) operate two primary business segments.

- ***DISH.*** The DISH branded pay-TV service ("DISH") had 14.057 million subscribers in the United States as of December 31, 2013. The DISH branded pay-TV service consists of Federal Communications Commission ("FCC") licenses authorizing us to use direct broadcast satellite ("DBS") and Fixed Satellite Service ("FSS") spectrum, our satellites, receiver systems, third-party broadcast operations, customer service facilities, a leased fiber network, in-home service and call center operations, and certain other assets utilized in our operations. In addition, we market broadband services under the dishNET™ brand.

- ***Wireless.*** In 2008, we paid $712 million to acquire certain 700 MHz wireless spectrum licenses, which were granted to us by the FCC in February 2009 subject to certain interim and final build-out requirements. On March 9, 2012, we completed the acquisitions of 100% of the equity of reorganized DBSD North America, Inc. ("DBSD North America") and substantially all of the assets of TerreStar Networks, Inc. ("TerreStar"), pursuant to which we acquired, among other things, 40 MHz of AWS-4 wireless spectrum licenses held by DBSD North America (the "DBSD Transaction") and TerreStar (the "TerreStar Transaction"). The financial results of DBSD North America and TerreStar are included in our financial results beginning March 9, 2012. The total consideration to acquire the DBSD North America and TerreStar assets was approximately $2.860 billion. The FCC issued an order, which became effective on March 7, 2013, modifying our AWS-4 licenses to expand our terrestrial operating authority. That order imposed certain limitations on the use of a portion of the spectrum and also mandated certain interim and final build-out requirements for the licenses. As we review our options for the commercialization of this wireless spectrum, we may incur significant additional expenses and may have to make significant investments related to, among other things, research and development, wireless testing and wireless network infrastructure. See Note 16 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K for further discussion.

Discontinued Operations – Blockbuster. On April 26, 2011, we completed the acquisition of most of the assets of Blockbuster, Inc. (the "Blockbuster Acquisition"). Blockbuster primarily offered movies and video games for sale and rental through multiple distribution channels such as retail stores, by-mail, digital devices, the blockbuster.com website and the BLOCKBUSTER On Demand® service. Since the Blockbuster Acquisition, we continually evaluated the impact of certain factors, including, among other things, competitive pressures, the ability of significantly fewer company-owned domestic retail stores to continue to support corporate administrative costs, and other issues impacting the store-level financial performance of our company-owned domestic retail stores. These factors, among others, previously led us to close a significant number of company-owned domestic retail stores during 2012 and 2013. On November 6, 2013, we announced that Blockbuster would close all of its remaining company-owned domestic retail stores and discontinue the Blockbuster by-mail DVD service. As of December 31, 2013, Blockbuster had ceased all material operations. See Note 10 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K for further discussion.

Business Strategy

Our business strategy is to be the best provider of video services in the United States by providing high-quality products, outstanding customer service, and great value. We promote DISH branded programming packages as providing our subscribers with a better "price-to-value" relationship than those available from other subscription television providers. We believe that there continues to be unsatisfied demand for high-quality, reasonably priced television programming services.

- *High-Quality Products.* We offer a wide selection of local and national programming, featuring more national and local high-definition ("HD") channels than most pay-TV providers. We have been a technology leader in our industry, introducing award-winning DVRs, dual tuner receivers, 1080p video on demand, and external hard drives. To maintain and enhance our competitiveness over the long term, we introduced the Hopper® set-top box during the first quarter 2012, which a consumer can use, at his or her option, to view recorded programming in HD in multiple rooms. During the first quarter 2013, we introduced the Hopper set-top box with Sling, which promotes a suite of integrated features and functionality designed to maximize the convenience and ease of watching TV anytime and anywhere, which we refer to as DISH Anywhere,™ that includes, among other things, online access and Slingbox "placeshifting" technology. In addition, the Hopper with Sling has several innovative features that a consumer can use, at his or her option, to watch and record television programming through certain tablet computers and combines program-discovery tools, social media engagement and remote-control capabilities through the use of certain tablet computers and smart phones. We recently introduced the Super Joey™ receiver. A consumer can use, at his or her option, the Super Joey combined with the Hopper to record up to eight shows at the same time.

- *Outstanding Customer Service.* We strive to provide outstanding customer service by improving the quality of the initial installation of subscriber equipment, improving the reliability of our equipment, better educating our customers about our products and services, and resolving customer problems promptly and effectively when they arise.

- *Great Value.* We have historically been viewed as the low-cost provider in the pay-TV industry in the U.S. because we seek to offer the lowest everyday prices available to consumers after introductory promotions expire.

Programming. We provide programming that includes more than: (i) 280 basic video channels, including, but not limited to, 25 regional sports channels and 70 channels of pay-per-view content, (ii) 70 Sirius Satellite Radio music channels, (iii) 30 premium movie channels, (iv) 10 specialty sports channels, (v) 3,100 standard definition and HD local channels, and (vi) 300 Latino and international channels. Although we distribute over 3,100 local channels, a subscriber typically may only receive the local channels available in the subscriber's home market. As of December 31, 2013, we provided local channels in standard definition in all 210 TV markets in the U.S. and local channels in HD in more than 190 markets in the U.S.

Receiver Systems. Our subscribers receive programming via equipment that includes a small satellite dish, digital set-top receivers, and remote controls. Some of our advanced receiver models feature DVRs, HD capability, multiple tuners (for independent viewing on separate televisions) and Internet-protocol compatibility (to view movies and other content on televisions via the Internet and a broadband connection). We rely on EchoStar to design and manufacture all of our new receivers and certain related components. See "*Item 1A – Risk Factors.*"

Blockbuster@Home. Blockbuster@Home™ gives DISH subscribers streaming access to more than 10,000 movies and TV shows via their TV and online access to more than 25,000 movies and TV shows via their computer.

dishNET. On September 27, 2012, we began marketing our satellite broadband service under the dishNET brand. This service leverages advanced technology and high-powered satellites launched by Hughes Communications, Inc ("Hughes") and ViaSat, Inc. ("ViaSat") to provide broadband coverage nationwide. This service primarily targets approximately 15 million rural residents that are underserved, or unserved, by wireline broadband, and provides download speeds of up to 10 megabits of data per second ("Mbps"). We lease the customer premise equipment to

subscribers and generally pay Hughes and ViaSat a wholesale rate per subscriber on a monthly basis. Currently, we generally utilize our existing DISH distribution channels under similar incentive arrangements as our pay-TV business to acquire new broadband subscribers.

In addition to the dishNET branded satellite broadband service, we also offer wireline voice and broadband services under the dishNET brand as a competitive local exchange carrier to consumers living in a 14-state region (Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming). Our dishNET branded wireline broadband service provides download speeds of up to 20 Mbps.

We primarily bundle our dishNET branded services with our DISH branded pay-TV service, to offer customers a single bill, payment and customer service option, which includes a discount for bundled services. In addition, we market and sell our dishNET branded services on a stand-alone basis.

DISH Anywhere. A consumer can use DISH Anywhere, at his or her option, to remotely control certain features of their DVRs as well as view live TV and DVR recordings (with required compatible hardware) using the DISH Anywhere application on compatible devices such as smartphones and tablets, or on laptops and home computers by accessing dishanywhere.com. Dishanywhere.com offers more than 85,000 movies, television shows, clips and trailers.

Content Delivery

Digital Broadcast Operations Centers. The principal digital broadcast operations facilities we use are EchoStar's facilities located in Cheyenne, Wyoming and Gilbert, Arizona. We also use six regional digital broadcast operations facilities owned and operated by EchoStar that allow us to maximize the use of the spot beam capabilities of certain satellites. Programming content is delivered to these facilities by fiber or satellite and processed, compressed, encrypted and then uplinked to satellites for delivery to consumers. EchoStar provides certain broadcast services to us, including teleport services such as transmission and downlinking, channel origination services, and channel management services pursuant to a broadcast agreement ending on December 31, 2016. See Note 20 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K for further discussion of our Related Party Transactions with EchoStar.

Satellites. Our DISH branded programming is primarily delivered to customers using satellites that operate in the "Ku" band portion of the microwave radio spectrum. The Ku-band is divided into two spectrum segments. The portion of the Ku-band that allows the use of higher power satellites - 12.2 to 12.7 GHz over the United States - is known as the Broadcast Satellite Service band, which is also referred to as the DBS band. The portion of the Ku-band that utilizes lower power satellites - 11.7 to 12.2 GHz over the United States - is known as the FSS band.

Most of our programming is currently delivered using DBS satellites. To accommodate more bandwidth-intensive HD programming and other needs, we continue to explore opportunities to expand our satellite capacity through the acquisition of new spectrum, the launching of more technologically advanced satellites, and the more efficient use of existing spectrum via, among other things, better modulation and compression technologies.

We own or lease capacity on 14 DBS satellites in geostationary orbit approximately 22,300 miles above the equator. For further information concerning these satellites and satellite anomalies, please see the table and discussion under *"Satellites"* below.

Conditional Access System. Our conditional access system secures our programming content using encryption so that only authorized customers can access our programming. We use microchips embedded in credit card-sized access cards, called "smart cards," or security chips in our receiver systems to control access to authorized programming content ("Security Access Devices").

Our signal encryption has been compromised in the past and may be compromised in the future even though we continue to respond with significant investment in security measures, such as Security Access Device replacement programs and updates in security software, that are intended to make signal theft more difficult. It has been our prior experience that security measures may only be effective for short periods of time or not at all and that we

SATELLITES

DBS Satellites. Most of our programming is currently delivered using DBS satellites. We continue to explore opportunities to expand our available satellite capacity through the use of other available spectrum. Increasing our available spectrum is particularly important as more bandwidth intensive HD programming is produced and to address new video and data applications consumers may desire in the future. We currently utilize satellites in geostationary orbit approximately 22,300 miles above the equator detailed in the table below.

Satellites	Launch Date	Degree Orbital Location	Estimated Useful Life (Years)
Owned:			
EchoStar I (1)(5)	December 1995	77	12
EchoStar VII (2)(5)	February 2002	119	15
EchoStar X (2)(5)	February 2006	110	15
EchoStar XI (2)(5)	July 2008	110	15
EchoStar XIV (5)	March 2010	119	15
EchoStar XV	July 2010	45	15
Leased from EchoStar:			
EchoStar VIII (1)(3)(4)	August 2002	77	NA
EchoStar IX (1)(3)	August 2003	121	NA
EchoStar XII (1)(4)	July 2003	61.5	NA
Nimiq 5 (1)(3)	September 2009	72.7	NA
EchoStar XVI (1)	November 2012	61.5	NA
QuetzSat-1 (1)(3)	September 2011	77	NA
Leased from Other Third Party:			
Anik F3	April 2007	118.7	NA
Ciel II	December 2008	129	NA
Under Construction:			
EchoStar XVIII	2015	110	15

(1) See Note 20 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K for further discussion of our Related Party Transactions with EchoStar.
(2) During the fourth quarter 2012, the estimated useful life of these satellites was extended from 12 years to 15 years on a prospective basis based on management's assessment of, among other things, these satellites' useful lives, technological obsolescence risk, estimated remaining fuel life and estimated useful lives of our other DBS satellites. This increase in the estimated useful life of these satellites had an immaterial effect on our results of operations.
(3) We lease a portion of the capacity on these satellites.
(4) We generally have the option to renew each lease on a year-to-year basis through the end of the respective satellite's useful life.
(5) On February 20, 2014, we entered into agreements with EchoStar pursuant to which, among other things, we will transfer these satellites to EchoStar and lease back certain satellite capacity on these satellites. See below for further discussion.

Recent Developments

Recent developments with respect to certain of our satellites are discussed below.

of the intellectual property rights at a material cost, or to redesign those products or services in such a way as to avoid infringing any patent claims. If those intellectual property rights are held by a competitor, we may be unable to obtain the intellectual property rights at any price, which could adversely affect our competitive position.

We may not be aware of all intellectual property rights that our products or services may potentially infringe. In addition, patent applications in the United States are confidential until the Patent and Trademark Office either publishes the application or issues a patent (whichever arises first) and, accordingly, our products may infringe claims contained in pending patent applications of which we are not aware. Further, the process of determining definitively whether a claim of infringement is valid often involves expensive and protracted litigation, even if we are ultimately successful on the merits.

We cannot estimate the extent to which we may be required in the future to obtain intellectual property licenses or the availability and cost of any such licenses. Those costs, and their impact on our results of operations, could be material. Damages in patent infringement cases can be substantial, and in certain circumstances can be trebled. To the extent that we are required to pay unanticipated royalties to third parties, these increased costs of doing business could negatively affect our liquidity and operating results. We are currently defending multiple patent infringement actions. We cannot be certain the courts will conclude these companies do not own the rights they claim, that our products do not infringe on these rights and/or that these rights are not valid. Further, we cannot be certain that we would be able to obtain licenses from these persons on commercially reasonable terms or, if we were unable to obtain such licenses, that we would be able to redesign our products to avoid infringement.

ENVIRONMENTAL REGULATIONS

We are subject to the requirements of federal, state, local and foreign environmental and occupational safety and health laws and regulations. These include laws regulating air emissions, water discharge and waste management. We attempt to maintain compliance with all such requirements. We do not expect capital or other expenditures for environmental compliance to be material in 2014 or 2015. Environmental requirements are complex, change frequently and have become more stringent over time. Accordingly, we cannot provide assurance that these requirements will not change or become more stringent in the future in a manner that could have a material adverse effect on our business.

SEGMENT REPORTING DATA AND GEOGRAPHIC AREA DATA

For segment reporting data and principal geographic area data for 2013, 2012 and 2011, see Note 17 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K.

EMPLOYEES

We had approximately 25,000 employees at December 31, 2013, of which approximately 22,000 employees were located in the United States. We generally consider relations with our employees to be good. Approximately 60 employees in three of our field offices have voted to have a union represent them in contract negotiations. While we are not currently a party to any collective bargaining agreements, we are currently negotiating collective bargaining agreements at these offices.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Exchange Act and accordingly file our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and other information with the SEC. The public may read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the SEC at (800) SEC-0330 for further information on the operation of the Public Reference Room. As an electronic filer, our public filings are also maintained on the SEC's Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is http://www.sec.gov.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

The following table sets forth certain information concerning our principal properties related to our business segments. We currently do not have any material properties related to our wireless segment.

Description/Use/Location	Segment(s) Using Property	Owned	Leased From	
			EchoStar (1)	Other Third Party
Corporate headquarters, Englewood, Colorado	DISH		X	
Customer call center and general offices, Pine Brook, New Jersey	DISH			X
Customer call center and general offices, Tulsa, Oklahoma	DISH			X
Customer call center, Alvin, Texas	DISH			X
Customer call center, Bluefield, West Virginia	DISH	X		
Customer call center, Christiansburg, Virginia	DISH	X		
Customer call center, College Point, New York	DISH			X
Customer call center, Harlingen, Texas	DISH	X		
Customer call center, Hilliard, Ohio	DISH			X
Customer call center, Littleton, Colorado	DISH		X	
Customer call center, Phoenix, Arizona	DISH			X
Customer call center, Thornton, Colorado	DISH	X		
Customer call, warehouse, service, and remanufacturing center, El Paso, Texas	DISH	X		
Service and remanufacturing center, Englewood, Colorado	DISH		X	
Service and remanufacturing center, Spartanburg, South Carolina	DISH			X
Warehouse and distribution center, Denver, Colorado	DISH			X
Warehouse and distribution center, Sacramento, California	DISH	X		
Warehouse, Denver, Colorado	DISH	X		
Warehouse and distribution center, Atlanta, Georgia	DISH			X

(1) See Note 20 in the Notes to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K for further discussion of our Related Party Transactions with EchoStar.

In addition to the principal properties listed above, we operate numerous DISH service centers strategically located in regions throughout the United States. Furthermore, we own or lease capacity on 14 satellites which are a major component of our DISH pay-TV service. See further discussion under "*Item 1. Business – Satellites*" in this Annual Report on Form 10-K.

Item 3. LEGAL PROCEEDINGS

We are involved in a number of legal proceedings (including those described below) concerning matters arising in connection with the conduct of our business activities. Many of these proceedings are at preliminary stages, and many of these proceedings seek an indeterminate amount of damages. We regularly evaluate the status of the legal proceedings in which we are involved to assess whether a loss is probable or there is a reasonable possibility that a loss or an additional loss may have been incurred and to determine if accruals are appropriate. If accruals are not appropriate, we further evaluate each legal proceeding to assess whether an estimate of the possible loss or range of possible loss can be made.

For certain cases described on the following pages, management is unable to provide a meaningful estimate of the possible loss or range of possible loss because, among other reasons, (i) the proceedings are in various stages; (ii) damages have not been sought; (iii) damages are unsupported and/or exaggerated; (iv) there is uncertainty as to the outcome of pending appeals or motions; (v) there are significant factual issues to be resolved; and/or (vi) there are

TAB 2

Item 1B. UNRESOLVED STAFF COMMENTS

None.

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			EchoStar (1)	Other Third Party
Corporate headquarters, Englewood, Colorado	DISH		X	
Customer call center and general offices, Pine Brook, New Jersey	DISH			X
Customer call center and general offices, Tulsa, Oklahoma	DISH			X
Customer call center, Alvin, Texas	DISH			X
Customer call center, Bluefield, West Virginia	DISH	X		
Customer call center, Christiansburg, Virginia	DISH	X		
Customer call center, College Point, New York	DISH			X
Customer call center, Harlingen, Texas	DISH	X		
Customer call center, Hilliard, Ohio	DISH			X
Customer call center, Littleton, Colorado	DISH		X	
Customer call center, Phoenix, Arizona	DISH			X
Customer call center, Thornton, Colorado	DISH	X		
Customer call, warehouse, service, and remanufacturing center, El Paso, Texas	DISH	X		
Service and remanufacturing center, Englewood, Colorado	DISH		X	
Service and remanufacturing center, Spartanburg, South Carolina	DISH			X
Warehouse and distribution center, Denver, Colorado	DISH			X
Warehouse and distribution center, Sacramento, California	DISH	X		
Warehouse, Denver, Colorado	DISH	X		
Warehouse and distribution center, Atlanta, Georgia	DISH			X

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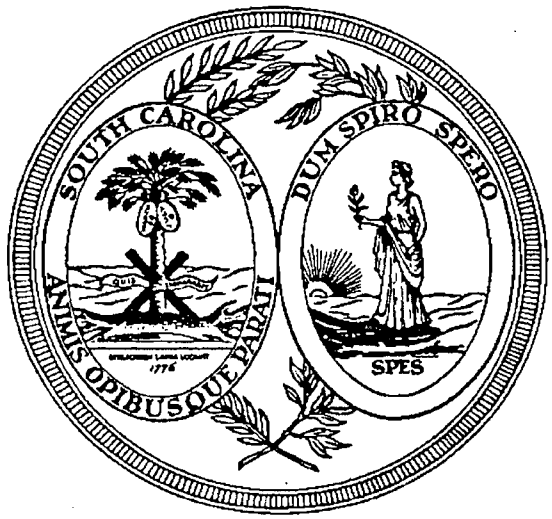
TAB 3

South Carolina Tax Incentives for Economic Development

2014 Edition



South Carolina Department of Revenue
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Columbia, SC 29211
www.sctax.org

The Honorable Nikki R. Haley, Governor
William M. Blume, Jr., Director

taxable income of the business for the taxable year. A taxpayer that transacts or conducts its business partly within and partly outside of South Carolina is subject to income tax based on the portion of its business carried on in South Carolina. This portion is determined through allocation and apportionment of income. The sum of these amounts is South Carolina taxable income.

South Carolina Code §§12-6-2220 and 12-6-2230 provide that certain classes of income, less related expenses, are allocated. Items directly allocated include nonbusiness interest, nonbusiness dividends, nonbusiness rents and royalties from the lease or rental of real estate or tangible personal property, gains and losses from the sale of real property, and nonbusiness gains and losses from sales of intangible property.

The income remaining after allocation is apportioned in accordance with South Carolina Code §12-6-2240. South Carolina generally requires the use of one of the following apportionment methods:

1. A single factor apportionment method (based on sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property. This method is typically used by businesses that manufacture, sell, or rent tangible personal property.

2. A "gross receipts" apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses, including businesses that install or repair tangible personal property, and contractors. See South Carolina Code §§12-6-2290 and 12-6-2295.

3. A "special" apportionment method provided in South Carolina Code §12-6-2310 for certain companies, such as railroad companies, telephone companies, pipeline companies, airline companies, and shipping lines.

4. An individualized apportionment method tailored to a particular taxpayer (a) because the standard method for that taxpayer does not fairly represent the extent of the taxpayer's business in South Carolina, or (b) as an economic incentive allowed the taxpayer. See subsections (b) and (c) below for more information on alternative apportionment provisions.

◆ Apportionment Methods

Single Sales Factor Apportionment Method. South Carolina Code §12-6-2252 (*i.e.*, the new single sales factor apportionment method) provides that a taxpayer whose principal business in South Carolina is manufacturing or any form of collecting, buying, assembling, or processing goods and materials in this state or whose principal business in South Carolina is selling, distributing or dealing in tangible personal property within South Carolina shall apportion income to South Carolina by multiplying the net income remaining after allocation under South Carolina Code §§12-6-2220 and 12-6-2230 by the sales factor defined in South Carolina Code §12-6-2280. However, if a sales factor

does not exist, the remaining net income is apportioned to the business's principal place of business. The single sales factor apportionment method is typically used by manufacturers and retailers having income in South Carolina, as well as other businesses that make or deal with tangible personal property.

"Principal place of business" means "the domicile of a corporation. However, when none of the business of the corporation is conducted in the state of domicile, the department shall determine the principal place of business of the corporation based upon the available evidence."

Gross Receipts Apportionment Method. South Carolina Code §12-6-2290 provides for the "gross receipts" formula and states:

> If the principal profits or income of a taxpayer are derived from sources other than those described in South Carolina Code §§12-6-2252 or 12-6-2310, the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in South Carolina Code §12-6-2295.

The "gross receipts" ratio is most commonly used by service businesses. The proper sourcing of gross receipts was reviewed in *Lockwood Greene Engineers v. South Carolina Tax Commission,* 361 S.E.2d 346 (1987). The court held that in sourcing income of a multistate engineering firm, "gross receipts from within this State" were to be determined according to where the services were performed rather than according to where the customers were located. See also, *Geoffrey, Inc. v. South Carolina Tax Commission,* 437 S.E. 2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993).

b. Fairness Based Alternative Apportionment Provisions

South Carolina Code §12-6-2320 provides for alternative methods to fairly apportion income for companies who do business in more than one state. Any taxpayer who believes that the statutory apportionment formula does not fairly represent the extent of the taxpayer's business within this state may apply to the Department for approval of an alternative method.

Under South Carolina Code §12-6-2320(A), a taxpayer may petition for, or the Department may require, with respect to all or any part of the taxpayer's business activity, one of the following alternatives for reporting:

1. Separate accounting;

2. The exclusion of one or more factors;

TAB 4

Journal of Multistate Taxation and Incentives
October, 2007

Corporate Franchise and Income Taxes
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Giles Sutton, Jeffrey M. Rhines, Jamie C. Yesnowitz, and Chuck Jones [FNa1]

THE INCREASINGLY COMPLEX APPORTIONMENT RULES FOR SERVICE-BASED BUSINESSES: BASIC ISSUES

***25** This is the first article in a three-part series dealing with multistate apportionment issues for corporate taxpayers engaged in providing services.

***26** The movement of the U.S. economy from a manufacturing-based to a service-based system has been an evolving trend for the last 50 years. Today, almost every business enterprise has a service component. In the multistate corporate income tax context, this trend has caused increased attention to the sourcing of service revenue for state apportionment purposes. The importance of this issue has been heightened by the economy's continued evolution from a traditional service economy to an information-service economy. Increasingly, the end product of many transactions is a digital file transmitted electronically or, alternatively, a service that is heavily technology and intangible dependent. Such transactions do not lend themselves well to either the traditional state income sourcing methods for the sale of tangible personal property or similar regimes for the apportionment of services.

When Is a Company a Service Provider?

In general, a company is considered to be a service provider when the company is receiving revenue from a transaction in which the customer's objective is to obtain the performance of an act rather than an item of tangible personal or real property or an intangible asset. As will be seen, it is very important to determine whether, in fact, a revenue stream results from the provision of a service or, arguably, from the provision of tangible personal property. Such a determination will affect (1) whether a company has nexus in a state, and (2) to the extent the company does have nexus, how the revenue from such transactions will be sourced for purposes of apportionment. Furthermore, certain specialized industries (some of which could be characterized as service providers) have their own apportionment systems, which this article will address separately.

Specifically, this article will look at issues impacting service-based apportionment for corporate multistate taxpayers, including the increased importance of sales-factor sourcing (highlighting the constitutional questions involved, as well as nexus issues); the traditional methods that are used to source service revenue (including various forms of sourcing that relate to the location of income-producing activity, as well as market-based sourcing); issues relating to apportionment formulas for service providers; and, as noted above, some industry-specific service revenue rules.

The Increased Importance of Sales-Factor Sourcing

Historically, states adopted a three-factor sourcing methodology using the primary economic drivers of profit for most enterprises: sales, payroll, and property. [FN1] Competitive economic pressures to attract high-wage jobs, however, have caused states, from a policy perspective, to reduce the apportionment weighting of physical-presence factors such as

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payroll and property and increase the weighting of the market-based sales factor. [FN2] This policy decision seems to reflect the realization that small or geographically disadvantaged states often cannot offer either the lucrative economic incentives or the quality of life requisites necessary to attract the physical investments they desire. As such, these states seek to tax access to markets. [FN3]

Three-factor formula becomes weighted toward sales.

Most states historically have followed the general approach to sourcing income set out by the Uniform Division of Income for Tax Purposes Act (UDITPA) [FN4] and the Multistate Tax Commission (MTC). [FN5] Under both UDITPA and the MTC regulations, business income [FN6] is apportioned to a state using an equally weighted three-factor formula based on the in-state-to-overall ratio of a corporation's property, payroll and sales. The apportionment *27 percentage for a given state (e.g., state X) is typically computed as follows:

$$\frac{\frac{\text{Property in state X}}{\text{Property everywhere}} + \frac{\text{Payroll in state X}}{\text{Payroll everywhere}} + \frac{\text{Sales in state X}}{\text{Sales everywhere}}}{3}$$

The formula yields a percentage that is applied to a taxpayer's total business income to determine the portion of that income subject to tax in state X. Both UDITPA and the MTC regulations set forth rules for what is to be included in each apportionment factor. [FN7]

In recent years, however, the uniformity goal of UDITPA and the MTC regulations has been largely thwarted, as most states, including many member states, have carved out numerous exceptions and distinctions from those rules. The most notable distinction has arisen from the fact that corporate income apportionment is becoming increasingly weighted toward the sales factor. When dealing with service revenue, of the 47 jurisdictions that impose a corporate income tax, as of July 2007: ten states use a pure single sales factor; [FN8] seven states disproportionately weight the sales factor; [FN9] 16 states double-weight the sales factor; [FN10] and three states provide taxpayers with multiple weighting options. [FN11] Only 11 jurisdictions still consistently employ a pure three-factor apportionment formula. [FN12]

Constitutional and other issues impacting apportionment.

Further complicating matters are the overarching constitutional issues that states must consider when determining what type of apportionment system to use. A corporation with nexus [FN13] in multiple states has the right to divide its in-

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come so that only a reasonable portion of that income is taxed by any given state. [FN14] States are constitutionally prohibited from taxing income that is not connected to business conducted in that state. Accordingly, for an apportionment scheme to be valid, it must pass muster under both the Due Process and Commerce Clauses of the U.S. Constitution. [FN15]

In considering service revenue apportionment to a state, the Due Process Clause requires that even if the minimal connection for nexus exists, the income attributed to the taxing state also must be rationally related to 'values connected with the taxing State.' [FN16] Under the Commerce Clause, along with the requirement for substantial nexus, the tax (1) may not discriminate against interstate commerce, and (2) must be fairly related to the services provided by the taxing state. [FN17] Further, the Commerce Clause also requires 'fair apportionment' of the income tax base. [FN18] Satisfaction of the fair apportionment standard requires that the apportionment be internally and externally consistent. Internal consistency requires that 'the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. ' External consistency requires that 'the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.' Apportionment formulas may be invalidated where 'the taxpayer can prove by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State, ... or has led to a grossly distorted result.' [FN19]

In general, in order to satisfy the minimal connection requirement and be 'entitled' to apportion, a corporation must be deemed to be engaged in business in more than one state. For this purpose, most states generally require that a company demonstrate 'business activity' [FN20] by: (1) engaging in business; (2) doing business; (3) carrying on business; or (4) being taxable in another state. The requirement that the taxpayer be 'taxable in another state' is satisfied***28** if (1) in that other state, the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that other state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does so. [FN21] Whether a taxpayer is 'engaged in business,' 'doing business,' or 'carrying on business' in a state can sometimes be difficult to determine, as the meanings of these terms are generally state-specific. Thus, a taxpayer must examine the particular terms as defined under each relevant state statute.

Traditional Methods of Sourcing Service Revenue

Generally, the states have taken two distinct approaches to sourcing gross receipts derived from the performance of services. These approaches involve either some method of income-producing activity sourcing or, alternatively, market-based sourcing. Under the income-producing activity rule, service receipts are sourced to the state where that activity is performed. In interpreting the income-producing activity rule, states have used either an 'all-or-nothing' calculation based on where the cost of performing the service is incurred, or a pro rata modified cost-of-performance/service-performed method. To complicate matters, even the 'all-or-nothing' calculation is sometimes preempted by special sourcing rules. Under market-based sourcing, service receipts are sourced to the location of the service recipient, or to the location where the customer is deemed to receive the benefit of the service. [FN22]

Income-producing activity sourcing.

The cost-of-performance rule, which has been adopted by the majority of states, originates from UDITPA and the MTC regulations. [FN23] Under UDITPA, gross receipts derived from activities *other than sales of tangible personal property* (for example, from the performance of services) are sourced to the state where the income-producing activity is performed. [FN24] When the income-producing activity is performed in more than one state, the sale is sourced to the taxing state if that is where a greater proportion of the income-producing activity is performed, as compared with any other state, based on costs of performance. [FN25] Thus, under this general rule, an 'all-or-nothing' approach is used to

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assign service revenue to a single state's sales factor numerator.

The two terms of note under the model UDITPA statute that have garnered the most attention from taxpayers, practitioners, and courts alike are 'income-producing activity' and 'costs of performance.' The MTC regulations attempt to address the scope of these two significant terms. Under those rules, 'income-producing activity' applies to each 'separate item of income' and means the transactions and activities directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. [FN26] In turn, a 'separate item of income' refers to receipts from services performed on a particular contract or obligation. [FN27] Referring to a 'separate item of income' as a contract or transaction for which services are performed, as opposed to solely as labor costs incurred in a state, more accurately provides for the sourcing of revenues. Accuracy is achieved because such a definition allows a taxpayer to account for the relative value and efficiency of the services performed with regard to a particular contract or transaction.

In general, according to the current MTC regulations, income-producing activities do not include 'transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. ' [FN28] The regulation then provides a non-exclusive list of income-producing activities, one of which includes '[t]he rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.' [FN29] The UDITPA concept of an 'income-producing activity' is generally not well-defined in state law, and uncertainties often arise regarding what the income-producing activity is and where it is performed.

The MTC regulations define 'cost of performance' as 'direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.' [FN30] The use of the 'costs of performance' analysis to identify income-producing activities and determine the location in which such activities are performed provides a measure for the applicable tests but still leaves some room for ambiguity when identifying specific costs and their locations.

***29** While, as noted above, the current MTC regulations exclude from the calculation of the cost of performance the costs of activities performed on behalf of the taxpayer, the MTC is considering removing this exclusion. Under a proposed amendment to the regulations, 'cost of performance' would include a taxpayer's payments to an agent or independent contractor for the performance, on the taxpayer's behalf, of personal services that give rise to the particular item of income. [FN31]

Generally, states that have taken an income-producing activity approach to sourcing gross receipts derived from the performance of a service have adopted one of three methods for sourcing sales from services, as discussed below.

Majority cost of performance (all or nothing). Illinois and Michigan (under that state's current Single Business Tax (SBT) regime) take a cost-of-performance approach based on a greater-than-50% test. [FN32] Under this approach, gross receipts from an income-producing activity that is performed in two or more states are sourced to the taxing state if more than 50% of the income-producing activity is performed there. [FN33] Where an income-producing activity is performed is determined based on the costs associated with the performance of the activity. For example, if state A uses the greater-than-50% test, and a taxpayer's cost of performance for a particular service activity are incurred 60% in state A, 10% in state B, and 30% in state C, the entire receipts from the performance of that service would be sourced to state A, for purposes of state A apportionment.

Under Michigan's SBT, sales of other than tangible personal property (e.g., sales of services) are sourced to Michigan if: (1) the business activity is performed in Michigan; (2) the business activity is performed both in and outside Michigan and, based on costs of performance, a greater proportion of the business activity is performed in Michigan than is per-

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formed outside the state; or (3) receipts are derived from services performed for planning, design, or construction activities within Michigan. [FN34]

Additional guidance provided by the Michigan Department of Treasury states that 'costs of performance' means direct costs that are determined in a manner consistent with a taxpayer's method of accounting for federal income tax purposes. A cost-of-performance analysis is not applied to a taxpayer's total business activity, but to each sale separately.***30** Costs of performance include costs directly related to the activity performed for the client. Indirect costs not directly related to the performance of the contracted service are not used in calculating the costs of performance. [FN35]

The Michigan guidance further provides that direct costs do not include fixed costs unrelated to the provision of property or services. [FN36] Also, direct costs do not include remotely related costs such as human resources management, accounting, advertising, or activities conducted to maintain the business but not to provide the particular business activity. Direct costs are determined based on an examination of the nature of the service performed, and may include: (1) labor costs of employees directly related to the performance of the service; (2) materials, equipment, and supplies directly related to the performance of the service; and (3) payments to an independent contractor who performs services directly related to the contractual obligations. [FN37]

In Illinois, sales, other than sales of tangible personal property and intangible property such as patents, copyrights, trademarks, and similar items, are sourced to Illinois if: (1) the income-producing activity is performed in Illinois; or (2) the income-producing activity is performed both within and without Illinois and a greater proportion of the activity is performed within Illinois than outside the state, based on performance costs. [FN38] Except for its use of the majority cost-of-performance rule, Illinois substantially follows the remainder of the MTC regulations with respect to sourcing service revenue. [FN39] Accordingly, activities of a taxpayer and its employees may be deemed the taxpayer's income-producing activities, while the activities of third parties are not. [FN40]

Preponderance cost of performance (all or nothing). The preponderance cost-of-performance test also results in an all-or-nothing sourcing of receipts, but this test differs from the majority cost-of-performance approach. Under the preponderance cost-of-performance approach, if the taxpayer's income-producing activity is performed in two or more states, all of the receipts from that activity are sourced to the state where the *greatest* proportion of the income-producing activity is performed. As with the greater-than-50% test, determining where the greatest proportion of the activity is performed is also based on the costs associated with the performance of the income-producing activity.

For example, if state A uses the preponderance cost-of-performance approach and a taxpayer's costs of performance for a service activity are incurred 40% in state A, 30% in state B, and 30% in state C, the entire gross receipts from the performance of that activity would be sourced to state A for purposes of state A's apportionment. In contrast, under the majority cost-of-performance approach (discussed above), none of the receipts would be sourced to state A.

A significant number of jurisdictions have statutorily adopted the preponderance cost-of-performance approach, including: Alabama, [FN41] Alaska, [FN42] Arizona, [FN43] California, [FN44] the District of Columbia, [FN45] Florida, [FN46] Kentucky, [FN47] Missouri, [FN48] New Mexico, [FN49] Oregon, [FN50] Pennsylvania, [FN51] and Virginia. [FN52] In practice, some of the states following the preponderance cost-of-performance approach may be flexible at the audit and administrative levels and allow a majority cost-of-performance rule. Several states with 'preponderance' statutes have informally endorsed the 'majority' approach in certain circumstances.

Pro rata cost of performance. Under the pro rata cost-of-performance ***31** approach, in contrast to the 'all-or-nothing' methodology, gross receipts derived from the performance of a service are prorated among multiple states based on the cost of performing the service in each state. More specifically, the gross receipts are sourced among the states in propor-

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tion to the costs associated with performing the service in each state. For example, if a taxpayer's cost of performance for a service activity is incurred 35% in state A, 40% in state B, and 25% in state C, and each of those states uses the pro rata method to source service revenue, the entire gross receipts from the performance of that service activity would be sourced among the three states based on those same percentages.

States that follow a pro rata method may source service receipts based on the relative values of service provided, the amount of time spent in performing the service within or outside a state, or some other reasonable method. Some states specify the method as to how this should be done, but many others provide very little guidance.

The basic pro rata approach is followed by several states, including: Louisiana, [FN53] Mississippi, [FN54] North Carolina, [FN55] Rhode Island, [FN56] and South Carolina. [FN57] In addition, some other states, such as Arkansas, New Jersey, New York, and Texas, could technically be considered 'pro rata' states, although they have adopted approaches that are not completely consistent with the other pro rata states listed above. For example, Arkansas's regulation for sourcing receipts from other than sales of tangible personal property states that when an 'income producing activity is performed both inside and outside of Arkansas, the portion of income reportable to Arkansas shall be the percentage that is used in the formula for apportioning income to Arkansas during the year of the sale.' [FN58]

New Jersey. New Jersey appears to have adopted a hybrid method blending the pro rata and market service income approaches. [FN59] In particular, for services performed both in and outside the state, New Jersey regulations state that 'the numerator of the receipts fraction includes receipts from services based upon the cost of performance or amount of time spent in the performance of such services or by some other reasonable method which should reflect the trade or business practice and economic realities underlying the generation of the compensation for services.' [FN60] The regulations***32** provide additional instruction, however, with regard to sourcing service fees 'from transactions having contact with [New Jersey].' In those instances, service fees are allocated based on the following:

- 'Twenty-five percent of such fees are allocated to the state of origination.'
- 'Fifty percent of such fees are allocated to the state in which the service is performed.'
- 'Twenty-five percent of such fees are allocable to the state in which the transaction terminates.' [FN61]

In interpreting this special rule, the New Jersey regulations offer the following example:

'Taxpayer earns income by providing on-line internet access to customers located within New Jersey and outside New Jersey. Taxpayer's physical equipment allowing such access is located outside New Jersey. Taxpayer must allocate 50 percent of its revenue from internet access charges to New Jersey based upon the origination and termination of such access from points within New Jersey. Absent specific identification of points of origination and termination, the customer's billing address will serve to locate these activities. For purposes of this example, the internet service provider has physical presence through a home office located in New Jersey.' [FN62]

The location where the transaction originates is usually the customer's location. The same service-fee receipts-sourcing method as discussed above should apply to sourcing New Jersey gross receipts for purposes of the 'alternative minimum assessment' (AMA). [FN63]

New York. New York adopts a pro rata service-revenue sourcing approach based on service performed within the state. [FN64] In particular, the state's regulations state: 'Where a lump sum is received by the taxpayer in payment of services performed within and without New York State, the portion of the sum attributable to services performed within New York State is determined on the basis of the relative values of, or amounts of time spent in performance of, such services within and without New York State, or by some other reasonable method.' [FN65] Accordingly, a taxpayer may have significant latitude in how it ultimately sources to New York service revenues arising from multistate activities.

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Texas. For purposes of apportioning both the taxable capital and earned surplus components of its soon-to-be-replaced franchise tax, Texas adopted a ***33** pro rata service-income sourcing approach based on services performed within the state. Apparently, similar rules will apply under the state's new margin tax. [FN66] In particular, Texas regulations state that service receipts 'are apportioned to the location where the service is performed. If services are performed both inside and outside Texas, then such receipts are Texas receipts on the basis of the fair value of the services that are rendered in Texas. ' [FN67] Texas has not clarified how to determine the fair value of services rendered in Texas.

Market-based sourcing.

In contrast to traditional 'cost-of-performance'-based sourcing of service revenue for sales-factor purposes, a recent trend has been for states to source such revenues on a market basis. Presumably, those states seek to avoid the complexity and the economic disincentives of taxing service-based businesses using a 'location-of-costs'-based analysis. The merits and mechanics of this trend will be discussed in detail in a subsequent article in this Journal.

Service Revenue and Income Tax Apportionment Formulas

Some states change their apportionment formulas from three-factor to two- or one-factor formulas based on the nature of the taxpayer corporation's business. For example, Connecticut uses a single sales factor to apportion income 'derived from business other than the manufacture, sale, or use of tangible personal or real property,' and for taxpayers primarily engaged in manufacturing. [FN68] To apportion income derived from the manufacture, sale, or use of tangible personal or real property, however, Connecticut uses a three-factor formula with a double-weighted sales factor. [FN69] Accordingly, to ensure accurate compliance and, potentially, successful planning, an understanding of when a taxpayer's income-producing activities may alter its mandatory use, or optional choice, of a given apportionment formula is necessary.

While Georgia is currently phasing out its three-factor formula, switching to a single sales factor effective for tax years beginning after 2007, [FN70] the state has retained the use of two apportionment formula calculations that vary slightly depending on the nature of the taxpayer's business. One formula is for use by taxpayers whose income is derived principally from the manufacture, production, or sale of tangible personal property. The second formula is for use by taxpayers whose income is derived principally from business other than the manufacture, production, or sale of tangible personal property. The distinction between the two formulas stems from the different methods used to compute the sales factor. [FN71]

Louisiana provides specific apportionment formulas for taxpayers in several specified businesses and industries. [FN72] According to a regulation, the Louisiana statute contemplates that the only formula to be used to determine a taxpayer's apportionment percentage should be the formula prescribed for the taxpayer's primary business. As a general rule, for a taxpayer engaged in more than one business, the primary business is the one that is the primary source of the taxpayer's net apportionable income. [FN73] A taxpayer whose business is not described in the apportionment statute must use the traditional three-factor (property, payroll, and sales) apportionment, with net sales made in the regular course of business and other gross apportionable income attributable to Louisiana included in the sales-factor numerator. [FN74]

For taxpayers whose net apportionable income is derived primarily from a service business in which the use of property is not a substantial income-producing factor, Louisiana specifies a two-factor (wages and gross income) apportionment formula. [FN75]

- ***34** Payroll factor: the ratio of salaries, wages, and other compensation paid by the taxpayer for personal services rendered in Louisiana, compared to the total of such payments by the taxpayer for personal services rendered in connection with the production of total net apportionable income. [FN76]

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• Sales factor: the ratio of the taxpayer's gross apportionable income from Louisiana sources, compared to the taxpayer's total gross apportionable income. The gross apportionable income from Louisiana sources includes the revenue from services performed in the state, and any other gross income derived entirely from sources within Louisiana. [FN77]

In Missouri, taxpayers may elect to use either the three-factor formula specified by the MTC or a single sales factor. [FN78] Further, taxpayers in specified industries such as transportation or communication may elect to use special apportionment methods. [FN79] Financial organizations, personal service corporations, and public utilities, however, may not use three-factor apportionment. [FN80] An eligible taxpayer can elect the single-factor formula by: (1) filing written notice with the Director of Revenue by the due date of the return (including extensions); or (2) failing to keep its books and records in a manner that shows the income applicable to Missouri. [FN81]

Industry-Specific Service Revenue Rules

The MTC regulations and state statutes and regulations provide significant guidance on how particular types of service industries are required to apportion their business income. Some of these nuances are described below.

Trucking.

An MTC regulation requires that trucking entities use three-factor apportionment consisting of property, payroll and sales. The sales factor includes all revenue that produces business income in the regular course of the taxpayer's business, including revenue from hauling freight, mail, and express, and other revenue. [FN82] With respect to revenue from hauling, the sales factor numerator includes all receipts from any shipment that both originates and terminates within the taxing state, as well as interstate receipts from movements or shipments passing through, into, or out of the state as determined by a ratio of mobile property miles traveled in the state compared to such miles between the points of origin and destination. [FN83] Other revenues are sourced in accordance with the general MTC apportionment rules for sales of tangible personal property and sales of other than tangible personal property. [FN84]

In contrast, some states require a single-factor apportionment based on some measure of miles traveled within the state. Other states employ an adaptation of the standard three-factor apportionment formula that also generally uses some measure of miles traveled within the state. Still other states require a four-factor approach, double-weighting the sales factor.

Airlines.

Under the MTC regulations, airlines use three-factor apportionment consisting of property, payroll, and transportation revenue. The transportation revenue numerator—the in-state revenue—is calculated as follows: the ratio of departures of aircraft in the taxing state, weighted as to the cost and value of aircraft by type, compared to total departures similarly weighted, is multiplied by total transportation revenue. The product of this calculation is *35 added to any non-flight revenues directly attributable to the state. [FN85]

Railroads.

The MTC regulations require that railroads use three-factor apportionment consisting of property, payroll, and sales. With respect to the sales factor, different rules apply depending on whether the revenues are from hauling freight, mail and express; from transporting passengers (including mail and express handled in passenger service); or from other sales. For freight, mail and express revenue, the sales factor numerator includes all receipts from shipments that both originate

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and terminate in the taxing state, as well as the portion of receipts from each movement or shipment passing through, into, or out of the state, as determined by a miles traveled ratio similar to the one described above for the trucking industry. [FN86]

In sourcing revenue from transporting passengers, the numerator of the sales factor includes all receipts from such transportation that both originates and terminates in the taxing state, as well as the portion of receipts from the transportation of interstate passengers as determined by a ratio of passenger miles in-state and everywhere. [FN87] Other revenues are sourced in accordance with the general MTC apportionment rules for sales of tangible personal property and sales of other than tangible personal property. [FN88]

Financial services.

There is a significant lack of conformity in the area of state taxation of services provided by financial institutions. While the MTC has issued a recommended apportionment formula for entities that qualify as financial institutions, [FN89] the document was not finalized as a regulation, and hence, fewer states follow this recommendation than follow MTC regulations.

The MTC recommendation includes a three-factor (property, payroll, and sales) apportionment formula. [FN90] With respect to special apportionment rules relating to services, the MTC recommendation for sourcing loan servicing fees depends on whether the loan is secured by real property. If the loan is so secured, the numerator of the receipts factor includes those loan servicing fees multiplied by the ratio of in-state vs. total interest and fees or penalties in the nature of interest from loans secured by real property. [FN91] If the loan is not secured by real property, the numerator includes the loan servicing fees multiplied by a similar 'in-state vs. total' ratio of interest and interest-type fees and penalties, but from loans *not* secured by real property. [FN92] The interest and interest-type fees and penalties from loans *not* secured by real property, as well as any fees for servicing the loans (whether or not secured) of another, are sourced based on where the borrower is located. [FN93] As for receipts from other services, such receipts are sourced under the general MTC preponderance cost-of-performance rule. [FN94]

Conclusions

As the U.S. economy becomes increasingly service-oriented, state apportionment issues pertaining to services take on a greater significance. This significance is amplified as state and local jurisdictions attempt to foster economic development within their borders by increasingly weighting apportionment towards the sales factor. [FN95] As the split between states that source service revenues based on income-producing factors and states that use market-based mechanics becomes more pronounced, understanding and applying the related apportionment mechanics becomes increasingly more important for corporate taxpayers.

While this article has attempted to highlight certain relevant issues associated with traditional cost-of-performance methods of service revenue apportionment, this area of state tax law is fluid and ever-evolving. Further, as noted, there often are industry-specific overlays to the application of state (and other jurisdictional) rules in this area. Thus, corporate taxpayers should pay particular attention to developments in this area of state tax law as well as to developments within their particular business models, as the trend towards the provision of services will significantly impact state taxation.

Competitive economic pressures to attract high-wage jobs have caused states to increase the weighting of the market-based sales factor.

Generally, the states have taken two distinct approaches to sourcing gross receipts derived from the performance of

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services.

The cost-of-performance rule, which has been adopted by the majority of states, originates from UDITPA and the MTC regulations.

In the calculation of 'cost of performance,' the MTC is considering removing the exclusion for the costs of activities performed on behalf of the taxpayer.

MTC regulations and some states provide significant guidance on how particular types of service industries are required to apportion business income.

Sidebar

Practice Note: **The Significance of Being a Service Provider**

In general, a company is a service provider when the company receives revenue from a transaction in which the customer's objective is to obtain the performance of an act rather than an item of tangible personal or real property or an intangible asset. The determination of whether a revenue stream results from the provision of a service or from the provision of an item of property can affect (1) whether a company has nexus in a state and, (2) to the extent the company does have nexus, how the revenue from such transactions will be sourced for purposes of apportionment. Furthermore, states often mandate particular apportionment schemes for certain specialized industries, some of which could be characterized as service providers.

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[FN1]. Hellerstein and Hellerstein, *State Taxation,* Vol. I, Third Edition (Warren, Gorham & Lamont, 2001), ¶9.01.

[FN2]. For example, Georgia and Wisconsin are currently phasing in a single sales factor (see Ga. Code Ann. §48-7-31 (d), and Wis. Stat. §71.25(6)).

[FN3]. Tax policy is often a matter of convenience. In particular, changing the apportionment formulas applicable to a known corporate tax base is often easier than systemically changing the underlying impediments to capital formation and business investment.

[FN4]. Originally promulgated in 1957, UDITPA was designed for enactment in states that impose taxes measured by net

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income. Prior to that time, various states used different methods to determine the portion of income that the state would tax, and many felt that a uniform approach for dividing income between and among the states was needed. UDITPA was the result of conferences held with representatives from the Controller's Institute of America and the Council on State Taxation (COST).

[FN5]. The MTC is an organization formed to promote interstate commerce through uniform state tax requirements. The MTC's governing document is the Multistate Tax Compact, which outlines the treatment of certain tax issues to be followed by all member states. The Compact is intended as an alternative to federal legislation in this area. For more information, see the MTC website at www.mtc.gov.

[FN6]. A corporate taxpayer's business income is subject to apportionment, while nonbusiness income is allocable to a specific state, typically the state of commercial domicile. The U.S. Supreme Court has stated that a distinction between operational (business) and investment (nonbusiness) income is constitutionally required. See Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768 (1992), which was discussed in Dyk and Bilich, '*Allied-Signal* and the Unitary Business Principle: Little Guidance, Many Questions,' 2 JMT 154 (Sep/Oct 1992).

[FN7]. See UDITPA §§15 to 18; MTC Regs. IV.15 to IV.18.

[FN8]. Connecticut, Illinois, Iowa, Maine, Mississippi, Nebraska, New York, Oregon, South Carolina, and Texas.

[FN9]. Georgia, Indiana, Michigan, Minnesota, Ohio, Pennsylvania, and Wisconsin.

[FN10]. Arizona, Arkansas, California, Florida, Idaho, Kentucky, Maryland, Massachusetts, New Hampshire, New Jersey, North Carolina, Tennessee, Vermont, Virginia, and West Virginia. Louisiana provides apportionment for service businesses using a two-factor formula consisting of payroll and income.

[FN11]. Colorado, Missouri, and Utah.

[FN12]. Alabama, Alaska, Delaware, the District of Columbia, Hawaii, Kansas, Montana, New Mexico, North Dakota, Oklahoma, and Rhode Island.

[FN13]. Both the Commerce Clause and Due Process Clause of the U.S. Constitution require that there be some connection or 'nexus' between a taxpayer and the state seeking to impose tax. The U.S. Supreme Court has ruled that due process requires only 'minimal contacts,' while the Commerce Clause requires 'substantial nexus' with the taxing state. See Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Many practitioners have construed substantial nexus to require physical presence in a state in order for that state to impose an income tax. In contrast, significant authority exists for the proposition that in Quill, the Supreme Court intended to limit the physical presence rule to sales and use tax. See, e.g., Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.Car., 1993), *cert. den.* 510 U.S. 992 (1993). See also West Virginia Tax Comm'r v. MBNA America Bank, N.A., 220 W.Va. 163, 640 S.E.2d 226 (2006), *cert. den.* U.S.S.Ct., 6/18/07, and Lanco, Inc. v. Director, Div. of Tax'n, 188 N.J. 380, 908 A.2d 176 (2006), *cert. den.* U.S.S.Ct., 6/18/07. For

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more background, see Eule and Richman, 'Out-of-State Mail-Order Vendors Need Not Collect Use Taxes—Yet!,' 2 JMT 163 (Sep/Oct 1992); Nolan, 'Crossing the Bright Line: Evaluating Physical Presence in *Quill*'s Shadow,' 7 JMT 244 (Jan/Feb 1998); Hammack, 'Taxing Out-of-State Entities With Intangible Assets: What Hath *Geoffrey* Wrought?,' 5 JMT 112 (Jul/Aug 1995). The more-recent decisions, Lanco and MBNA, were analyzed in Weiss, '*MBNA America Bank*: A New Standard for Nexus in Income and Franchise Taxation?,' 17 JMT 8 (Mar/Apr 2007).

[FN14]. See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

[FN15]. U.S. Const., Amend. XIV, §1 (Due Process Clause), and Art. I, §8, Cl. 3 (Commerce Clause).

[FN16]. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) (Court held Iowa's single sales factor apportionment system to be valid). Internal citation and quotation marks omitted.

[FN17]. The discriminatory analysis depends on the internal and external consistency of the tax in question. Specifically, internal consistency is deemed to exist when the hypothetical imposition of a tax, identical to the one in question, by every other state would put the same burden on both interstate and intrastate commerce. See Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995). External consistency requires that a state not reach beyond the portion of value that is fairly attributable to activity within the state. *Id.* To show that an apportionment formula is externally *inconsistent,* however, the taxpayer must show by 'clear and cogent evidence' that income being attributed to the state is 'out of all appropriate proportions to the business transacted in that State.' Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983). Internal citation and quotation marks omitted. (For more on *Jefferson Lines,* see Haynes, Schultz, and Stromen, '*Jefferson Lines*: Will the U.S. Supreme Court's Decision Be Extended to Other Services?,' 5 JMT 100 (Jul/Aug 1995).)

[FN18]. See Complete Auto Transit, Inc., *supra* note 14. For a detailed discussion of the Complete Auto standards, see Lieberman, '*Complete Auto Transit, Inc. v. Brady*: How Many Parts Are There?,' 3 JMT 4 (Mar/Apr 1993).

[FN19]. Container Corp. of America, *supra* note 17. Internal citations and quotation marks omitted.

[FN20]. See UDITPA §2.

[FN21]. See UDITPA §3.

[FN22]. The particulars of market-based sourcing of service revenue will be addressed in a subsequent article that will appear in an upcoming issue of JMT.

[FN23]. UDITPA §17(b); MTC Reg. IV.17(1).

[FN24]. UDITPA §17(a).

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[FN25]. UDITPA §17(b).

[FN26]. MTC Reg. IV.17(2).

[FN27]. MTC Reg. IV.17(4)(B)(c).

[FN28]. MTC Reg. IV.17(2).

[FN29]. MTC Reg. IV.17(2)(A). As a practical matter, many services are performed with the aid of sophisticated software and self-created or licensed intangibles. Therefore, the fact that the use of such intangibles constitutes an 'income-producing activity' under this regulation is significant.

[FN30]. MTC Reg. IV.17(3).

[FN31]. See 'Draft Amendment to MTC Regulation IV.17 Regarding Treatment of Activities Performed 'On Behalf Of' the Taxpayer' (November 2006), available on the MTC's website at www.mtc.gov/Uniformity.aspx?id=1820.

[FN32]. See 35 ILCS §5/304(a)(3)(C), 86 Ill. Admin. Code §100.3370(c)(3)(C), and Mich. Comp. Laws Ann. §208.53 (repealed effective for tax years beginning after 2007), all of which generally require that a sale of services be assigned to the state if 'a greater proportion of the income-producing activity is performed within this State than without this State, based on costs of performance.' Under the new Michigan Business Tax (MBT) (S.B. 94, 7/12/07; P.A. 36, effective for tax years beginning after 2007), however, services will be sourced using a market-based methodology. See MBT Act §305(2)(a).

[FN33]. Some other states apply a different method under the income-producing activity approach to sourcing service revenue, as discussed in the text below. Thus, revenues sourced to a state employing the greater-than-50% rule also may be fully or partially included in another state's sales-factor numerator under that other jurisdiction's sourcing rules.

[FN34]. Mich. Comp. Laws Ann. §208.53 (repealed effective for tax years beginning after 2007).

[FN35]. Internal Policy Directive No. 2006-8 (Mich. Dept. of Treasury, 9/29/06).

[FN36]. 'Fixed costs' as used in Internal Policy Directive 2006-8, *id.*, are not defined, and the term does not appear in any other state's cost-of-performance statutes or regulations. In this context, 'fixed costs' likely refers to general costs that would occur no matter what the taxpayer's activity was, and that cannot be traced to the taxpayer's particular performed service.

[FN37]. Internal Policy Directive 2006-8, *supra* note 35. Michigan's inclusion of independent contractor payments as a cost of performance differs from the traditional model regulation drafted by the Multistate Tax Commission and adopted

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by many states that excludes such costs. See MTC Reg. IV.17(2).

[FN38]. 35 ILCS §5/304(a)(3)(C).

[FN39]. See 86 Ill. Admin. Code §100.3370(c)(3).

[FN40]. See, e.g., Ill. Priv. Ltr. Rul. No. IT 01-0009-PLR, 9/15/01.

[FN41]. Ala. Code §40-27-1 (adopting the Multistate Tax Compact) Art. IV.17; Ala. Admin. Code r. 810-27-1-4-.17.

[FN42]. Alaska Stat. §43.19.010 (adopting the Multistate Tax Compact) Art. IV.17; 15 Alaska Admin. Code. §19.301.

[FN43]. Ariz. Rev. Stat. §43-1147; Ariz. Admin. Code R15-2D-806.

[FN44]. Cal. Rev. & Tax. Code §25136; 18 Cal. Code Regs. §25136. But see Cal. FTB Legal Rulings 2005-1, 3/21/05 (regarding what is a 'personal service'), 2006-1, 4/28/06 (regarding activities generating exempt income), and 2006-2, 5/3/06 (regarding the 'on behalf of' exclusionary rule). (Legal Ruling 2005-1 was discussed in Shop Talk, 'California Explains 'Personal' Services for Receipts Apportionment Factor,' 15 JMT 36 (September 2005).)

[FN45]. D.C. Code Ann. §47-1810.02(g)(3); D.C. Mun. Regs. §128.5.

[FN46]. Fla. Admin. Code Ann. r. 12C-1.0155(2)(e).

[FN47]. Ky. Rev. Stat. Ann. §141.120(8)(c)(3); 103 Ky. Admin. Regs. 16:270, §3(6).

[FN48]. Mo. Rev. Stat. §32.200 (adopting the Multistate Tax Compact) Art. IV.17; 12 Mo. Code Regs. §§10-2.075(55) and (59).

[FN49]. N.M. Stat. Ann. §7-4-18; N.M. Admin. Code §3.5.18.8.

[FN50]. Ore. Rev. Stat. §314.665(4); Ore. Admin. R. 150-314.665(4).

[FN51]. 72 Pa. Stat. Ann. §7401(3)2(a)(17); Pa. Admin. Code §109.5(c)(3)(iv).

[FN52]. Va. Code Ann. §58.1-416; Va. Admin. Code §10-120-230.

[FN53]. La. Rev. Stat. §47:287.95(D), which appears to allow a pro rata approach to source service income based on the

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in-state cost of performance.

[FN54]. Miss. Inc. Tax Reg. 806, §III.B.(9)(c).

[FN55]. N.C. Gen. Stat. §105-130.4(l)(3)c.

[FN56]. R.I. Gen. Laws §44-11-14(2)(ii); R.I. Regs. CT 04-04.2.b.

[FN57]. See S.C. Code Ann. §12-6-2280(C)(2) (applicable to tax years beginning before 2007); similar rules apply to tax years beginning after 2006 under S.C. Code Ann. §§12-6-2280(D) and 12-6-2295(A)(5). See also Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 361 S.E.2d 346 (1987); Handel, D. West, and W. West, 'South Carolina Corporate Income Taxes' (CCH S.Car. Tax Rptr., ¶400-333, 12/17/01), at .05E.2.c.7.

[FN58]. Ark. Corp. Inc. Tax Reg. 1.26-51-717(2). Also see Ark. Code Ann. §26-51-717.

[FN59]. See N.J. Rev. Stat. §54:10A-6(B)(4); N.J. Admin. Code §18:7-8.10.

[FN60]. N.J. Admin. Code §18:7-8.10(a).

[FN61]. N.J. Admin. Code §18:7-8.10(c).

[FN62]. N.J. Admin. Code §18:7-8.10(c), Example 2.

[FN63]. See *Questions and Answers Regarding the Business Tax Reform Act 2002* (N.J. Div. of Tax'n, updated 1/6/04), Q&A 42, on the Division's website at www.state.nj.us/treasury/taxation/cbtfaq.htm. The AMA has expired for most taxpayers for privilege periods beginning after June 2006, but taxpayers exempt from corporation net income tax pursuant to P.L. 86-272 continue to be subject to the AMA. For privilege periods beginning after 2006, however, a taxpayer exempt from income tax under P.L. 86-272 is not liable for the AMA if it consents to New Jersey's taxing jurisdiction and agrees to pay the state's corporation business tax (CBT). N.J. Rev. Stat. §54:10A-5a(e).

[FN64]. N.Y. Tax Law §210.3(a)(2)(B); 20 N.Y. Comp. Codes Rules & Regs. §§4-4.3(a) and (f)(1).

[FN65]. 20 N.Y. Comp. Codes Rules & Regs. §4-4.3(f)(1).

[FN66]. For the franchise tax, see Tex. Tax Code Ann. §§171.103(2) (taxable capital), 171.1032(a)(2) (earned surplus) (effective until 1/1/08). For the similar rules under the state's new margin tax, see Tex. Tax Code Ann. §171.103(a)(2) (effective 1/1/08 for reports due on or after that date). The margin tax was discussed in Jackson and Wellington, 'Major Tax Reform in Texas: An Overview of the State's New Margin Tax,' 16 JMT 8 (October 2006).

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[FN67]. 34 Tex. Admin. Code §§3.549(e)(38) (taxable capital), 3.557(e)(33) (earned surplus).

[FN68]. Conn. Gen. Stat. §§12-218(b), (k).

[FN69]. Conn. Gen. Stat. §12-218(c). Controversies have arisen regarding whether income is derived from the sale of tangible property. In Millward Brown, Inc. v. Comm'r of Revenue Services, 811 A.2d 717 (Conn. Ct. App., 2002), the taxpayer operated a market research business. The court determined that since the use of tangible personal property was an essential part of the taxpayer's ability to conduct its business profitably, it was entitled to use the three-factor apportionment formula rather than the one-factor formula required for service providers. Also see Schlumberger Technology Corp. v. Dubno, 521 A.2d 569 (Conn., 1987), in which the state's high court rejected the view that all service providers automatically had their income apportioned using the one-factor formula. There, the taxpayer provided wireline services to the oil and gas industry using a specially designed sensory instrument to gather data to create reports for its customers. The taxpayer was similarly allowed to use the three-factor formula.

[FN70]. Ga. Code Ann. §48-7-31(d).

[FN71]. In all instances, the gross receipts factor is determined by comparing total gross receipts from business done in Georgia vs. business done everywhere. Where the taxpayer's net business income is derived principally from the manufacture, production, or sale of tangible personal property, receipts are deemed to be derived from business done in Georgia only if the receipts are received from products shipped to customers in Georgia, or products delivered within Georgia to customers. Receipts from sales negotiated or effected through the taxpayer's offices outside Georgia and delivered from storage in Georgia to customers outside Georgia are excluded. See Ga. Code Ann. §48-7-31(d)(1). In contrast, where the taxpayer's net business income is derived principally from business other than the manufacture, production, or sale of tangible personal property, gross receipts are in Georgia if the receipts are derived from customers within Georgia or are otherwise attributable to Georgia's marketplace. See Ga. Code Ann. §48-7-31(d)(2).

[FN72]. La. Rev. Stat. §47:287.95; La. Admin. Code §61:I.1134(A).

[FN73]. La. Admin. Code §61:I.1134(A).

[FN74]. La. Rev. Stat. §47:287.95(F)(1).

[FN75]. La. Rev. Stat. §47:287.95(D). For taxpayers whose net apportionable income is derived primarily from a business in which the use of property *is* a substantial income-producing factor (e.g., manufacturing or merchandising businesses), Louisiana employs a single sales factor apportionment formula (for tax periods beginning after 2005). *Id.*, §47:287.95(F)(2)(b).

[FN76]. La. Rev. Stat. §47:287.95(D)(1). A member of an affiliated group of corporations serving as common paymaster must eliminate from the numerator and the denominator of its payroll factor all salaries, wages, and other compensation representing payments on behalf of affiliated companies for which the taxpayer has charged the affiliate the expense and

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that do not meet the definition of salary, wages, and other compensation insofar as the common paymaster is concerned. An affiliated company that is a member of or participant in a common paymaster plan for payroll purposes must include in the numerator and denominator of its payroll factor its payments to the common paymaster made as reimbursement for the affiliated company's salaries, wages, and other compensation. *Id.*, §47:287.95(J)(1).

[FN77]. La. Rev. Stat. §47:287.95(D)(2).

[FN78]. Mo. Rev. Stat. §32.200 (adopting the Multistate Tax Compact) Art. IV; Mo. Rev. Stat. §143.451.2(2).

[FN79]. Mo. Rev. Stat. §§143.451.4, 143.451.6.

[FN80]. Mo. Rev. Stat. §32.200, Art. IV.2.

[FN81]. Mo. Rev. Stat. §143.461.1. A taxpayer also may seek approval to use for tax purposes the allocation method it uses to keep its books and records. *Id.*, §143.461.2.

[FN82]. MTC Reg. IV.18(g)(3)(iv)A.

[FN83]. MTC Reg. IV.18(g)(3)(iv)B.

[FN84]. MTC Reg. IV.18(g)(3)(iv)A.

[FN85]. MTC Reg. IV.18(e)(2)(iv).

[FN86]. MTC Reg. IV.18(f)(3)(iv)A and B.

[FN87]. MTC Reg. IV.18(f)(3)(iv)C.

[FN88]. MTC Reg. IV.18(f)(3)(iv)A.

[FN89]. 'Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions' (Multistate Tax Comm'n, 11/17/94), available on the MTC's website at www.mtc.gov/Uniformity.aspx?id=496 (click on 'Special Rule: Financial Institutions').

[FN90]. 'Recommended Formula,' *id.*, §1(b). What constitutes 'property,' however, and in particular, the nature of 'intangible property,' has been somewhat uncertain. In Florida, for example, the property factor for a financial organization includes intangible personal property, except goodwill, that is owned and used in the business, valued at its federal income tax basis. Such property sited in Florida will include assets in the nature of loans (including balances due from

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depository institutions, repurchase agreements, federal funds sold, and bankers acceptances) that 'are located in' Florida; installment obligations on loans for which the customer initially applied at an office located in Florida; and loans secured by mortgages, deeds of trust, or other liens upon real or tangible personal property located in Florida. Fla. Stat. Ann. §220.15(3)(b).

[FN91]. 'Recommended Formula,' *supra* note 89, §3(k)(1)(A) (referencing §3(d), regarding the sourcing of interest and fees or penalties in the nature of interest from loans secured by real property).

[FN92]. 'Recommended Formula,' *supra* note 89, §3(k)(1)(B) (referencing §3(e), regarding the sourcing of interest and fees or penalties in the nature of interest from loans *not* secured by real property).

[FN93]. 'Recommended Formula,' *supra* note 89, §§3(e) and 3(k)(2).

[FN94]. 'Recommended Formula,' *supra* note 89, §3(l).

[FN95]. See, e.g., 'Wisconsin: State Enacts Single-Factor (Sales) Income Tax Apportionment,' 13 JMT 43 (Nov/Dec 2003). See also Goodman, Marcus, Wethekam, Hughes, and Browdy, 'Single-Factor Sales Apportionment: A Tax Incentive for the Future,' 7 JMT 196 (Nov/Dec 1997).

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TAB 5

*1 State Taxation: Third Edition
Current Through 2014
Walter Hellerstein [FNa]

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Part IV. Corporate Franchise, Net Income, and Capital Stock Taxes
Chapter 9. Allocation and Apportionment of Corporate Net Income Under State Law
Part C Implementation of Apportionment Factors

¶ 9. 18 RECEIPTS OR SALES FACTOR

The receipts or sales factor has been the focal point of the major controversies that have arisen over the implementation of the apportionment factors. All the states imposing corporate taxes measured by net income use a receipts or sales factor. [FN926] In recent years, moreover, the relative importance of the sales factor has increased as a growing number of states have relied more heavily (if not exclusively) on sales in their apportionment formulas. [FN927]

The terminology identifying the sales or receipts factor varies among the states, but whatever term is used, the factor has a much broader scope than receipts from sales of tangible personal property. It typically covers receipts from services, rentals, royalties, sales of stock, and business operations generally, at least in the absence of some specific statutory or regulatory limitation on its scope. Indeed, under UDITPA it covers "all gross receipts of the taxpayer not allocated" as nonbusiness income. [FN928] Many states may have adopted the somewhat restrictive term "sales factor" because the original three-factor formula had its origin in, and was designed principally for, mercantile and manufacturing companies. [FN929] Some states use the more appropriate term "receipts" to describe the factor. [FN930]

The universe of receipts included in the receipts factor is generally defined by reference to the receipts that give rise to apportionable income. [FN931] Consequently, if dividends are allocated to the state of the taxpayer's domicile, they are not included in the sales or receipts factor. [FN932] In the few states whose laws purport to apportion all income, [FN933] no such limitation is ordinarily applicable. All the taxpayer's receipts taken into account in determining net income likewise are included in the receipts factor.

Comment: The numerator of a receipts or sales factor is generally the value of business done by a corporation, measured by sales within the state. The table lists determinants that states use to make up the receipts numerator. "X" indicates influential elements that make receipts local, not out-of-state.

TABLE 9-8 Receipts in Apportionment Numerators

STATE A (1)	Col. B	OFFICE WHERE NEGOTIATED	Col. C	PROPERTY AT TIME OF ORDER	Col. D	RECEIPT OR ACCEPTANCE OF ORDER	Col. E	DELIVERY PLACE	Col. F	SHIPMENT ORIGIN	Col. G	OTHER

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same results as the traditional rule of attributing receipts to a state on the basis of the ratio of expenditure of time or costs incurred in the state. However, when the services involve the expenditure of substantial amounts of time or costs in more than one state, the UDITPA rule often produces capricious and inequitable results. Some states will receive no tax as a result of services performed in substantial part within their borders, whereas other states will receive tax windfalls from services performed, to a considerable extent, in other states. This is the weakness as a policy matter in the all-or-nothing approach employed by UDITPA as compared to an attribution rule that assigns receipts from services on a proportional basis to each state in which the work is performed.

As is so often the case, practical considerations of compliance and administration may justify the use of the all-or-nothing principle of attributing income from services despite the theoretical weakness of that rule. Indeed, the difficulty and expense of tracing costs of performance on a state-by-state basis, especially when records of such costs are not maintained in the ordinary course of the taxpayer's business, can be overwhelming. Income that department stores and other retailers derive from servicing major appliances they sell to customers residing in the taxing state, as well as neighboring states, is a case in point. In actual practice, many retailers apparently attribute the service income to the state in which the store that sold the appliance is located, even though the servicing takes place in another state. This is not only an all-or-nothing principle, but it also ignores the statutory rules. Yet the practice may be defended on the ground that it would be too expensive to trace the time spent or costs of performance of the services in various states, for which the data often would be unavailable. [FN1186]

There is, however, a more fundamental objection to UDITPA's costs-of-performance rule for attributing receipts from services—whether applied on an all-or-nothing basis or on a percentage-attribution basis, as some states do [FN1187] —namely, that the rule often fails to serve the purpose of the sales factor to reflect the contribution of the market state to the taxpayer's income. While services may often be performed in the same state in which they are consumed, this is not always the case, especially with regard to services such as advertising, consulting, and other professional services that may be performed in one state but effectively "delivered" in all of the states in which the service provider's customers carry on their activities. Accordingly, as a matter of policy, states adopting a market-oriented approach for service providers [FN1188] have embraced a much sounder solution to the problem of attributing the receipts of service providers than those states that rely either on UDITPA's costs-of-performance methodology or on the traditional rule of assigning services to the state in which they are performed.

*46 In recent years, UDITPA's "income-producing activity"/"costs of performance" criterion as applied to sales of services has been the object of increasing criticism along the lines advanced above. [FN1189] Beyond the weakness of the "all or nothing" rule, and the inconsistency of the "income-producing activity"/"costs of performance" standard with the "market state" attribution function of the sales factor, the standard has also come in for criticism because it has spawned considerable confusion and controversy in application due to the uncertainty surrounding what is, in many respects, an indeterminate test. As a consequence, "there has been a chorus of criticism addressed to the difficulty of interpreting and complying with UDITPA's attribution rule for service providers, and the voices from both the tax-paying and tax-collecting communities are in near (and rare) unison." [FN1190] In response to these complaints, a growing number of states have abandoned the traditional UDITPA rule for the more defensible "market state" approach to attributing receipts from sales of services for apportionment purposes. [FN1191]

The following subsections consider in greater detail the sales-factor approaches that states are now employing in apportioning income of service providers under UDITPA and other statutes.

¶ 9. 18[3][b] The "Income-Producing Activity"/"Costs of Performance" Test in Practice

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Despite the theoretical and practical objections to UDITPA's "income-producing activity"/"costs of performance" rule for attributing receipts from services to the numerator of a state's sales factor, most states with corporate income taxes still take this (or a closely analogous) approach. [FN1192] Unless modified by statute or regulation, [FN1193] this approach requires the taxpayer first to determine which of its activities are the income-producing activities for its service income and then to determine where the costs of performing those income-producing activities were incurred. The taxpayer then compares the amount of costs of performance incurred in the taxing state to the amount of such costs in the other individual states. The sales are attributed to the state with the greatest amount of costs of performance.

As we have just observed, income-producing activities and costs of performance are conceptually different in principle. Costs of performance are the geographically identifiable metric for determining the state in which income-income producing activities are carried on. Courts and administrative tribunals, however, frequently discuss the two concepts as if they were indistinguishable or interchangeable. Although we do our best in the ensuing discussion to treat these two concepts separately, we must, to some extent, "play the hand we are dealt" by the courts and administrative tribunals. Accordingly, because of the close relationship between the concepts in the adjudication of cases, and their interdependence in the determination of the ultimate attribution of receipts to a state, much of the ensuing discussion will consider these two concepts together.

¶ 9. 18[3][b][i] Income-producing activity in general.

*47 According to Multistate Tax Commission (MTC) regulations, which are followed by many states, the term "income-producing activity" generally means "the transactions and activity engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of producing that item of income." [FN1194] The MTC regulations further provide that "[t]he term 'income-producing activity' applies to each separate item of income." [FN1195]

Although a taxpayer's "income-producing activity" (and the "separate items of income" if it generates any) may be self-evident in many cases, in other cases that determination is far from obvious. For example, the Wisconsin Court of Appeals held that a Yellow Pages publisher's "income-producing activity" "was, at bottom, the provision of access to a Wisconsin audience" [FN1196] and that "this service of providing access to Wisconsin consumers is income producing activity performed in Wisconsin." [FN1197] The Tennessee Court of Appeals, by contrast, held that a Yellow Pages publisher's "income-producing activity" [FN1198] was "not just the distribution of Yellow Pages" [FN1199] in Tennessee, but was rather "a series of interdependent steps to the satisfaction of the advertisers from whom [the publisher] derives its income," [FN1200] and most of these "steps" occurred outside of Tennessee.

Massachusetts, whose law incorporates the "income-producing activity"/"costs of performance" test for attributing receipts from services, [FN1201] has adopted a very specific regulatory definition of an income-producing activity:

> [A]n income-producing activity is a transaction, procedure, or operation directly engaged in by a taxpayer which results in a separately identifiable item of income. In general, any activity whose performance creates an obligation of a particular customer to pay a specific consideration to the taxpayer is an income-producing activity. [FN1202]

The proof that this effort to fine-tune the definition of "income-producing activity" provides no panacea to those who must apply it is reflected in the litigation over its meaning. [FN1203]

In some states, the solicitation and negotiation of contracts or other "sales activity" are considered to be income-producing activities, because the taxpayer conducts such activities for the ultimate purpose of generating gains and profits. [FN1204] The Arizona Supreme Court, for example, has indicated that sales activity is the primary income-producing

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activity of some service providers. [FN1205] The Florida Department of Revenue concluded that the relevant income-producing activity for a company that collected and stored data, which customers could access from the company's servers for a fee, was the location of the taxpayer's customers. [FN1205.1] In a thorough opinion that carefully reviewed the relevant statutes, regulations, case law, and policy, the department observed that the result was "consistent with *Ameritech*, *Heller Western*, Florida's legislative history, and Hellerstein's analysis." [FN1205.2] Other tribunals, however, have indicated that sales activities, although conducted for the ultimate purpose of generating gains and profits, are not properly considered income-producing activities because they are not the activities for which the taxpayer is paid. [FN1206] Furthermore, under the Massachusetts and similar regulations, [FN1207] which define income-producing activity as one whose performance creates an obligation for the customer to pay, solicitation could not be considered an income-producing activity. In addition, with respect to personal services, the MTC regulations exclude consideration of time spent negotiating the service contract. [FN1208]

*48 Administrative and ministerial activities performed by the taxpayer may fall within the definition of an "income-producing activity" because presumably a business would not perform these activities unless they were for the ultimate purpose of obtaining gains and profits. At times, some tribunals have recognized such activities as income-producing. [FN1209] By contrast, other tribunals have concluded that the administrative or ministerial functions of a business are not properly considered income-producing activities because they are not the activities for which the taxpayer is paid. [FN1210]

Suffice it to say, at least for anyone who has had the fortitude to wend his or her way through the preceding footnotes, as we observed at the outset of this discussion and as other commentators have recognized, UDITPA's "income-producing activity"/"costs of performance" rules are

> confusing and indefinite" and plagued by "vagueness," "ambiguity," "substantial debate," "lack of clear guidance," "whipsaw[ing]," tremendous flexibility, and hence [tax planning] opportunity," "frequent litigation," "inconsistency," and "confusion for taxpayers and taxing authorities alike." [FN1211]

¶ 9. 18[3][b][ii] Personal services and the MTC's special rule for attributing receipts from personal services.

For service providers, the clearest examples of income-producing activities are the activities involved in actually performing the services for which they are paid. Many state regulations expressly provide that income-producing activity includes the rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service. [FN1212]

The MTC's regulations contain a special rule for attributing receipts for the performance of personal services. The rule divides the receipts among the states on a time-ratio basis in cases in which "services relating to a single item of income are performed partly within and partly without the state." [FN1213] The regulations treat theatrical performances given by roadshows as separate income-producing items in each of the states in which the performances are given. [FN1214] On the other hand, an opinion survey made in various states is treated as a single income-producing activity. [FN1215] As these examples illustrate, the determination of what constitutes a single "income-producing activity" gives rise to considerable controversy in applying UDITPA.

The drafters of UDITPA were aware of the problems raised by the attribution of receipts from services. Indeed, they explicitly excluded some service industries from the statute's scope, [FN1216] and they expressed the view that UDITPA's equitable apportionment provision could be utilized to deal with exceptional situations. [FN1217] The UDITPA special rule with respect to personal service income (like the special rule addressed earlier with respect to re-

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the cost of all activities directly performed by the taxpayer," but "[s]uch activities do not include activities performed on behalf of a taxpayer, such as those performed on its behalf by an independent contractor." [FN1229] The court declared:

> The language of Code § 58.1-418 is clear and unambiguous. By its express terms, the ratio to be used to apportion a financial corporation's income for purposes of Virginia taxation is the "cost of performance in the Commonwealth over the cost of performance everywhere." Nothing in this language limits costs of performance to direct costs or suggests that the Department may exclude costs for activities performed on behalf of a taxpayer by a third party. Thus, it is self evident that the narrowed definition of "cost of performance" is not consistent with the plain language of the statute. [FN1230]

¶ 9. 18[3][c] The Market-State Approach

A growing number of states have modified their sales factor rules for receipts from services to attribute those receipts to the state of the taxpayer's market. [FN1231] This development can probably be ascribed to the confluence of several factors (that may vary in importance from state to state), including (1) the recognition of the sales factor's purpose to reflect the contribution of the market state to the taxpayer's income; [FN1232] (2) avoidance of the difficulties in applying the "income-producing activity"/ "costs of performance" test described in the preceding section; [FN1233] and (3) "economic development" concerns associated with the increased or exclusive weight that an ever greater number of states are putting on the sales factor. [FN1234] Whatever the reasons for this development, and as much as we may applaud it as a matter of principle, the development brings with it a series of new challenges both because delineating the "market" state for services can be a daunting task [FN1235] and because the states have been far from uniform in their legislation adopting market-state rules for receipts from services.

We briefly describe below the various states' approaches to attributing receipts from services to the "market" for sales factor purposes.

¶ 9. 18[3][c][ai] Alabama [new].

Effective 2011, Alabama adopted a market-based rule for sourcing sales other than sales of tangible personal property. [FN1235.1] The revised statute, which modifies UDITPA, [FN1235.2] provides that sales, other than sales of tangible personal property, are in the state if "the taxpayer's market for the sale is in this state." [FN1235.3] With respect to services, the market is in the state "if and to the extent the service is delivered to a location in this state." [FN1235.4]

*51 Detailed implementing regulations, along with instructive examples, provide guidance as to whether, and the extent to which, services rendered to individual and unrelated business customers are considered to be delivered to a location within the state. [FN1235.5] For example, direct personal services provided to individuals are sourced to the state where the customer receives the service. [FN1235.6] Other services delivered to individuals are sourced on the basis of the customer's billing address. [FN1235.7] When either of the two preceding rules is difficult to administer or fails to reflect the taxpayer's market in the state, the taxpayer or the tax administrator may use other methodologies. [FN1235.8] For unrelated business customers, services are sourced on the basis of (1) their substantial connection to a specific geographic location; (2) the customer's commercial domicile when the service does not have a substantial connection to a geographic location; and (3) other methodologies when either of the two preceding rules is difficult to administer or fails to reflect the taxpayer's market in the state. [FN1235.9]

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¶ 9. 18[3][c][bi] Arizona [new].

Effective 2014, Arizona offers "multistate service providers" [FN1235.10] an election to assign sales by reference to the taxpayer's market rather than on the basis of UDITPA's "income-producing activity"/"costs of performance" test. [FN1235.11] A multistate service provider is a taxpayer that derives more than 85 percent of its sales from services to purchasers who receive the benefit of the services outside of Arizona. [FN1235.12] Sales are assigned to the state in which the purchaser "received the benefit of the service." [FN1235.13] If this state cannot be "readily determined," the services are considered to be received at the customer's home or, in the case of a business, the office of the customer from which the services were ordered in the regular course of the customer's trade or business. [FN1235.14] If the ordering location cannot be determined, the services are considered to be received at the home or office of the customer to which the services were billed.

¶ 9. 18[3][c][i] California.

Effective 2011, for taxpayers electing to apportion their income by a single-factor sales formula, [FN1236] California assigned sales from services to the state "to the extent the purchaser of the service received the benefit of the service in this state." [FN1237] Under implementing regulations, the benefit of a service is presumably received by *individuals* at the customer's billing address;if this presumption is overcome then the location of receipt is determined according to the contract between the taxpayer and the customer or the taxpayer's books and records; if this alternative is unavailable, the location of receipt is determined by a reasonable approximation of the customer's activities. [FN1238] The benefit of a service is presumably received by *businesses* at the locations determined by the contract between the taxpayer and the customer or by the taxpayer's books and records, but if the presumption is overcome, then the locations are determined in the following order (depending on availability): (a) a reasonable approximation of the customer's activities; (b) the location from which the customer placed the order; (c) the customer's billing address [FN1239].

¶ 9. 18[3][c][ii] Georgia.

*52 Georgia has adopted a market-state sales factor for gross receipts of taxpayers whose income is principally derived from activities other than the manufacture, sale, and production of tangible personal property. For such taxpayers "[g]ross receipts are in this state if the receipts are derived from customers within this state or if the receipts are otherwise attributable to the state's marketplace." [FN1240] The Georgia regulations governing receipts from services [FN1241] attribute service receipts based on where the recipient of the service receives the benefit of the service. If the service recipient receives only "some of the benefit of the service in Georgia, the gross receipts are included in the numerator of the apportionment factor in proportion to the extent the recipient receives benefit of the service in Georgia." [FN1242]

The regulations provide several examples to illustrate the rule. Two of the examples involve corporations performing a "direct mail" service [FN1243] — that is, the distribution of mail (normally advertisements) on behalf of their customers to their customers' prospective customers (normally households). The examples conclude that the recipient of the services receives the "benefit of the service" in Georgia to the extent that the direct mail recipients are in the state. [FN1244] The business location of the entity actually contracting for the direct mail services is not relevant for receipts attribution purposes. Another example involves a pest control contract with a real estate company that owns 100 in-state units and 400 out-of-state units. In this case, 20 percent (100/500) of the receipts from this contract would be attributed in state "in the absence of more accurate records." [FN1245]

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as Willis Comm. Rep., with the volume number preceding and the page number succeeding the citation]. In 1951, a committee of the National Tax Association (NTA), in recommending a three-factor apportionment formula of property, payroll, and sales, included in the sales factor of merchandising, mining, manufacturing, and farming businesses, receipts from services, as well as from sales of tangible personal property. The committee treated receipts "from services rendered within the state" as "within the state sales" under the formula, and hence includable in a state's sales factor numerator. "Final Report of Committee on Tax Situs and Allocation," 1951 Nat'l Tax Ass'n Proc. 456, 463. See also W. Beaman, Paying Taxes to Other States 7–10 (1963). One should not confuse the attribution of amounts *received* from the rendering of services for purposes of the receipts factor with the attribution of amounts *paid* for salaries and wages for purposes of the payroll factor. See supra ¶ 9.17.

[FN1176]
. See, e.g., NJ Admin. Code § 18:7-8.10(a) (Westlaw 2011); NY Comp. Codes R. & Regs. tit. 20, § 4-4.3 (Westlaw 2011). We discuss New Jersey's and New York's rules for attributing services in more detail infra ¶ **9. 18**[3] [d].

[FN1177]
. The New York and New Jersey regulations cited in the preceding note deem the sales representatives' commissions as earned from services rendered within those states if the sales representatives are attached to offices located in those states. The effect of these regulations is to substitute a sales-office-attribution rule for a place-of-performance rule. In Lockwood v. Greene Eng'rs, Inc., 293 SC 447, 361 SE2d 346 (Ct. App. 1987), the court held that the statutory term "gross receipts from within this State" refers to the place where the services giving rise to the receipts are performed rather than the place from which the receipts are sent.

[FN1178]
. See ¶ 4.16[1].

[FN1179]
. Indeed, as noted above, see supra ¶ 9.14, UDITPA contains no provision dealing with the allocation of income from services *at all* insofar as it constitutes nonbusiness income. (Of course, it is only when income from services constitutes apportionable business income that there is any justification for including the receipts from such services in the sales factor of the apportionment formula. See supra ¶ 9.15.) UDITPA excludes important service industries from its coverage—namely, financial services (including "any type of insurance company"), public utilities, and "the rendering of purely personal services by an individual." UDITPA §§ 1(d), 1(f), 2. See Chapter 10 for consideration of the allocation and apportionment of income of businesses other than manufacturing or mercantile companies, most of which are in the service sector.

[FN1180]
. The application of UDITPA's "residual" sales factor (UDITPA § 17) for receipts from services is analogous to the application of this factor to receipts from the rental of real or tangible personal property and from capital gains from the sale of such property. See supra ¶ **9. 18**[2].

[FN1181]
. UDITPA § 17. The use of the term "sales" to cover receipts from rendering of services and other receipts not attributable to the sale of tangible personal property apparently grew out of the fact that the model apportionment acts developed by the National Tax Association (NTA), and ultimately adopted in large part by UDITPA, were designed to deal essentially with manufacturing, mercantile, and other companies that derive their income essentially from sales of their products. See ¶ 8.06 and supra ¶ 9.04. Hence, a "sales" factor, within the customary use of the term "sales" as

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. See generally J. Swain, "Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts," 83 Tul. L. Rev. 285, 303 (2008) (citing numerous authorities to the same effect). At this writing, the Multistate Tax 'Commission's Income and Franchise Tax Committee has a task force charged with revising UDITPA § 17 and designing a new market-based provision for assigning receipts for receipts from services and intangibles. See www.mtc.gov/Uniformity.

[FN1221]
. Clipper Express Co. v. Comm'r of Revenue, No. 120514 (1986-409), 1986 WL 22656, at *4 (Mass. App. Tax Bd. Nov. 14, 1986).

[FN1222]
. MTC Reg. IV.17(3), reproduced in Appendix B. As noted and described more detail immediately below, infra ¶ 9. 18 [3][b][iv], [the MTC revised its regulations in 2007 to include in the definition of "income-producing activity" those activities that agents and independent contractors perform on behalf of the taxpayer. Accordingly, the MTC revised its definition of "costs of performance" to make it clear that a taxpayer's costs of performance includes "taxpayer's payments to an agent or independent contractor for the performance of personal services and utilization of tangible and intangible property which give rise to the particular item of income." MTC Reg. IV.17(3), reproduced in Appendix B.

[FN1223]
. See, e.g., Va. Admin. Code tit. 23, §§ 10-120-230(B), 10-120-230(C) (Westlaw 2011).

[FN1224]
. Communications Satellite Corp. v. Franchise Tax Bd., 156 Cal. App. 3d 726, 203 Cal. Rptr 779 (1984), appeal dismissed, 469 US 1201, 105 S. Ct. 1158 (1985), discussed in detail in ¶ 10.10.

[FN1225]
. MTC Reg. IV.17(2) (former version).

[FN1226]
. MTC Reg. IV.17(3) (former version).

[FN1227]
. MTC Reg. IV.17(2), reproduced in Appendix B. Needless to say, for states that still follow the earlier MTC regulations (or for years governed by such regulations, even if the state has adopted the amended regulations), the earlier rules continue to govern. See, e.g., AT&T Corp. v. Commissioner of Revenue, No. C293831, 2011 WL 2243933 (Mass. App. Tax. Bd. June 11, 2011) (applying Massachusetts regulation identical to pre-2007 MTC regulation).
Although South Carolina is not a state that generally follows UDITPA or the MTC regulations (see supra ¶ 9.05 (Table 9-4)), its single-factor sales formula, as applied to receipts for services, generally resembles UDITPA's income-producing activity rule for attributing receipts from services. See SC Code Ann. § 12-6-2295(A)(5) (Westlaw 2014) (attributing receipts from services to the state "if the entire income-producing activity is within this State," and if the income-producing activity is performed partly within and partly without this state, receipts are attributable to the state "to the extent the income-producing activity is performed within this State"). The South Carolina Department of Revenue has ruled that the work of independent contractors must be considered in applying this rule. Priv. Ltr. Rul. 13-3, SC Dep't of Revenue, Aug. 7, 2013, available at www.checkpoint.thomsonreuters.com.

[FN1228]
. Va. Code Ann. § 58.1-418 (Westlaw 2011).

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TAB 6

SOUTH CAROLINA DEPARTMENT OF REVENUE
Preliminary Draft of Potential Tax Due

TAXPAYER:	Dish DBS Corporation fka EchoStar DBS Corporation	FEI # :	84-1328967
ADDRESS:	9601 South Meridian Blvd. Englewood, CO 80112	FILE # :	20859669-7
		PERIOD:	12/31/04-12/31/10
		DATE:	5/18/12
Draft of Audit Adjustments, This is not a Bill !!		Auditor:	SHARPE Golebiowski
For Review and Discussion Purposes Only.			
INTEREST COMPUTED TO:			

INCOME TAX:

PERIOD ENDED	INCOME TAX	INTEREST	PENALTY	TOTALS
12/31/2004	-	$0	$0	$0
12/31/2005	365,040	$0	$0	$365,040
12/31/2006	400,887	$0	$0	$400,887
12/31/2007	313,237	$0	$0	$313,237
12/31/2008	(121,679)	$0	$0	($121,679)
12/31/2009	(439,263)	$0	$0	(439,263)
12/31/2010	26,064	$0	$0	26,064
TOTALS	544,286	$0	$0	$544,286

LICENSE FEE:

PERIOD ENDED	LICENSE FEE	INTEREST	PENALTY	TOTALS
12/31/2006	31,495	$0	$0	31,495
12/31/2007	38,602	$0	$0	38,602
12/31/2008	-	$0	$0	-
12/31/2009	-	$0	$0	-
12/31/2010	17,288	$0	$0	$17,288
12/31/2011	3,165	$0	$0	$3,165
TOTALS	$ 90,551	$0	$0	$ 90,551

SUMMARY:	TAX	INTEREST	PENALTY	TOTALS
INCOME TAX	$544,286	$0	$0	$544,286
LICENSE FEE	$ 90,551	$ -	$ -	$ 90,551
TOTALS	$634,837	$0	$0	$634,837

Interest and Penalties will be computed after the audit is submitted For Review and Billing.

(2)
Six Year Statute of Limitation Open for the 12/05-12/07 Years:

The Statute of limitations is open for the 12/05-12/07 years since the understatement of taxes is greater than 20%:

§ 12-54-85 -- Time limitation for assessment of taxes or fees; exceptions.
(C) Taxes may be determined and assessed after the thirty-six month limitation if:
(3) there is a twenty percent understatement of the total taxes required to be shown on the return or document. The taxes in this case may be assessed at any time within seventy-two months from the date the return or document was filed or due to be filed, whichever is later;

Understatement of Tax is Greater Than 20% for the audit years 12/05-12/07:

Understatement of Tax Reported

	Dec-05	Dec-06	Dec-07	Average Understatement
Tax Reported	56,848	72,864	29,674	
Tax Due	421,888	473,751	342,911	
Percentage of Tax Underreported	**86.53%**	**84.62%**	**91.35%**	**87.50%**

(3) SC NOL Computation

Entity	Tax Year NOL Generated	Amount of SC NOL	NOL Utilized 12/31/02	NOL Utilized 12/31/2004	NOL Carry Forward
Dish Network Services Corporation	12/31/1998	1,292			1,292
Dish Network Services Corporation	12/31/1999	15			15
Dish Network Services Corporation	12/31/2000	8,381			8,381
Dish Network Services Corporation	12/31/2001	911,816			911,816
Echosphere Corporation	12/31/2003	34,934			34,934
		956,438			956,438
	Utilized 12/31/02		(58,856)		(58,856)
	Utilized 12/31/02		(28,486)		(28,486)
	Carryover to 12/03				869,096
	Utilized 12/04			(869,096)	(869,096)
		956,438	**(87,342)**	**(869,096)**	-

TAXPAYER:	Dish DBS Corporation fka EchoStar DBS Corporation	SCHEDULE:	A	
FILE # :	20859669-7	AUDITOR:	SHARPE	Golebiowski
PERIOD:	12/31/04-12/31/10	DATE:	5/18/12	

Excerpts from The Department's Corporate Income Tax Manual which discusses sourcing of intangible receipts and Service Receipts

Comment: Considering Lockwood Greene and Geoffrey, together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; e.g., personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income.78 This conclusion is consistent with the longstanding administrative policy of the Department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers. 78See also SC Tech. Adv. Memo. #94-2.

TO COMPUTE THE GROSS RECEIPTS RATIO IN ACCORDANCE WITH SECTION 12-6-2290 (PREVIOUSLY 12-7-1190) SOUTH CAROLINA CODE OF LAWS. TAXPAYERS WHOSE BUSINESS IS OTHER THAN DEALING IN TANGIBLE PERSONAL PROPERTY ARE REQUIRED TO APPORTION INCOME USING THIS RATIO.

SCCL, Section 12-6-2290:

If the principal profits or income of a taxpayer are derived from sources other than those described in Section **12-6-2250** or Section **12-6-2310** , the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section **12-6-2295** .

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TAB 7

STATE OF SOUTH CAROLINA
BEFORE THE
SOUTH CAROLINA TAX COMMISSION

In Re:

A Finding Concerning The Income Tax Liability Of Lockwood Greene Engineers, Inc. For Tax Years 1981, 1982 and 1983.

FINDINGS OF FACT

Lockwood Greene Engineers, Inc. (taxpayer) is a Massachusetts engineering firm with offices in several states, including South Carolina. When its clients have projects located in South Carolina, the taxpayer usually provides services for those projects primarily from its South Carolina office, though some South Carolina projects are serviced from other offices. Projects located outside this state are sometimes handled primarily by the South Carolina office and sometimes by other offices. The taxpayer is normally paid for its services from the project owner's main office, which may be in a different state from the project location.

The taxpayer's original returns for the years in question (1981, 1982 and 1983) treated as South Carolina income its net income from projects located within this state. That net income was determined from the revenue derived from projects located in this state minus the costs of that work. The Field Services Division of the South Carolina Tax Commission found that the separate accounting method did not clearly reflect South Carolina income. The

Division determined that the taxpayer's net income from all business activities should be apportioned to South Carolina according to the percentage of gross receipts from within South Carolina compared to total gross receipts. Such method is found in § 12-7-1190. The taxpayer has not challenged the change in method from separate accounting to the gross receipts method but rather the taxpayer disagrees with the Division's interpretation of § 12-7-1190.

Finally, the Division determined that interest income of the taxpayer should be apportioned. The taxpayer has asserted that such interest income should be allocated away from South Carolina. We now address each of these issues.

CONCLUSIONS

1. Gross Receipts Apportionment.

Section 12-7-1190 reads as follows:

> "If the principal profits or income of a taxpayer, other than those described in former 1962 Code § 65-256 or § 12-19-100, are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State." (Emphasis added)

The question is the meaning of "gross receipts from within this State". The taxpayer asserts the language means that

one looks to where the receipts originate. For example, a project in Rock Hill, South Carolina with payment being made to the taxpayer from New York, New York is New York gross receipts. Likewise, a project in California with payments to the taxpayer being made from Columbia, South Carolina is South Carolina gross receipts. In short, the origin of the payment determines the location of the gross receipts. This is the origin test.

The Division asserts that one determines where the gross receipts are from by deciding where the services for which the client pays are performed. For example, a project in Rock Hill, South Carolina may consist of work performed in the taxpayer's South Carolina office plus work performed in other out-of-state offices as well as work actually performed at the project site. The Division, in such an example, would find South Carolina gross receipts based upon the cost of services actually performed in South Carolina. This is the activity test.

For the following reasons, we find and conclude the activity test is the proper approach for a service business such as that of the taxpayer. We first begin by noting that in construing uncertain language of a statute the legislative intent must prevail. Peoples National Bank of Greenville v. S. C. Tax Commission, 250 S.C. 187, 156 S.E.2d 769 (1967). The proper construction of the language here in dispute must be practical and consistent with the

purpose and policy of the statute. Hay v. S. C. Tax Commission, 273 S.C. 269, 255 S.E.2d 837 (1979).

The purpose and intent of § 12-7-1190 may be found by its relation to other statutes dealing with the same subject and originating from the same act of the General Assembly. Gregg Dyeing Co. v. Query, 166 S.C. 117, 164 S.E. 588, affirmed 52 S.Ct. 631, 286 U.S. 472. Act 731 of 1958, from which § 12-7-1190 originated, sought to develop a comprehensive scheme for determining a taxpayer's South Carolina taxable income. The Act sought to provide generally two methods of apportioning income: a three-factor formula of payroll, property and sales and a single-factor formula of gross receipts. Each method was to be applied depending upon the classification of the business of the taxpayer. The three-factor formula generally applied to businesses manufacturing or selling tangible personal property. The gross receipts formula generally applied to all other businesses. Thus it is clear the purpose of Act 731 and correspondingly the purpose of § 12-7-1190 was to "attain the objective of reasonable allocation of income ...". Hertz Corp. v. S. C. Tax Commission, 246 S.C. 92, 142 S.E.2d 445, 446 (1965).

We find and conclude the purpose of providing a reasonable allocation of income for South Carolina taxation is best met by interpreting § 12-7-1190 to utilize an activity test for service business. Such an approach

recognizes that gross receipts are earned where the service is performed. If the service of drafting and designing plans are performed in South Carolina such costs of performance create South Carolina gross receipts. Likewise, work performed at the project site creates gross receipts in the state where the project is located. This approach creates a reasonable apportionment.

The origin of the payment approach suggested by the taxpayer is not a reasonable apportionment approach. Such an approach leads to the conclusion that even where 100% of the work on a project is performed in South Carolina and even where the project is in South Carolina no South Carolina gross receipts result if the payment for the service is made from another state. Likewise, if all work and the entire project are outside South Carolina, the mere fact of payment originating from South Carolina would convert gross receipts into South Carolina receipts. Such a view raises due process considerations since such a method may impose an income tax on activities which have no reasonable relationship to activities of the taxpayer in South Carolina. See Exxon Corp. v. S. C. Tax Commission, 273 S.C. 594, 250 S.E.2d 93, appeal dismissed, 100 S.Ct. 3005, 447 U.S. 917 (1979). Given such a view, the taxpayer's approach must be rejected since one must always reject, as between two alternatives, the interpretation which renders a statute unconstitutional. Peoples National Bank, supra, at 771.

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Finally, we note the activity test has been consistently applied since 1977. Where the construction or administrative interpretation of a statute has been applied for a number of years and has not been changed by the Legislature, there is created a strong presumption that such interpretation or construction is correct. Ryder Truck Lines, Inc. v. South Carolina Tax Commission, 248 S.C. 148, 149 S.E.2d 435; Etiwan Fertilizer Company v. South Carolina Tax Commission, 217 S.C. 354, 60 S.E.2d 682. Additionally, the construction of a statute by the agency charged with executing it is entitled to the most respectful consideration and should not be overruled without cogent reasons. Faile v. South Carolina Employment Security Commission, supra; Stephenson Finance Company v. South Carolina Tax Commission, 242 S.C. 98, 130 S.E.2d 72. There are no cogent reasons to overrule the activity test interpretation at issue in this case.

2. Interest Income.

It is established that the interest income in dispute here resulted from the investment of excess working capital. This exact question was decided in Springs Industries, Inc. v. South Carolina Tax Commission, York County, No. 83-CP-46-186, where the circuit court held that such income was connected with the business of the taxpayer. Thus, the income is not allocated under § 12-7-1170(1) but rather is apportioned as business income. This same result

is reached in the instant case.

In conclusion we find and conclude the Field Services Division properly interpreted § 12-7-1190 and likewise properly apportioned the interest income in dispute.

AND IT IS SO FOUND AND ORDERED.

SOUTH CAROLINA TAX COMMISSION

John T. Weeks, Chairman

S. Hunter Howard, Jr., Commissioner

John M. Rucker, Commissioner

Columbia, South Carolina
June 17, 1985

TAB 8

South Carolina Corporate Income Taxes[1]

Rick Handel
Deana West
William West

South Carolina Department of Revenue
Governor Mark Sanford
Burnet R. Maybank III, Director

[1]The opinions expressed in this paper are the authors' opinions and should not be attributed to the South Carolina Department of Revenue. This paper is revised through June 10, 2005, but does not reflect legislation passed in the 2005 South Carolina legislative session.

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licensing agreement but South Carolina's customers. Geoffrey's South Carolina apportioned income was determined under the single factor, gross receipts, apportionment formula; *i.e.*, gross receipts from royalty payments from South Carolina sales divided by gross receipts from everywhere.

> **Comment:** Considering *Lockwood Greene* and *Geoffrey*, together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; *e.g.*, personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income.[78] This conclusion is consistent with the longstanding administrative policy of the Department, which was referenced in the *Lockwood Greene* case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers.

4. Special Apportionment Formulas for Particular Industries

Special apportionment formulas are provided for railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines.[79]

After allocation, the remaining income of these companies must be apportioned as follows:

1. Railroad companies

   Railroad companies use a fraction, the numerator of which is railway operating revenue from business done within South Carolina during the taxable year, and the denominator is total railway operating revenue from all business done by the taxpayer as shown by its records kept in accordance with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

   Railway operating revenue from business done within South Carolina means railway operating revenue from business wholly within South Carolina, plus the equal mileage proportion within South Carolina of each item of railway operating revenue received from the interstate business of the taxpayer. Equal mileage proportion means the proportion which the distance of movement of property and passengers over lines in South Carolina bears to the total distance of movement of property and passengers over lines of the taxpayer receiving the revenues. Interstate business means railway operating revenue from the interstate transportation of persons or property into, out of, or through South Carolina.

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[78] See also SC Tech. Adv. Memo. #94-2.

[79] SC Code §12-6-2310.

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TAB 9

*1 State Taxation: Third Edition
Current Through 2014
Walter Hellerstein [FNa]

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Part IV. Corporate Franchise, Net Income, and Capital Stock Taxes
Chapter 10. Allocation and Apportionment of Net Income of Businesses Other Than Manufacturing or Mercantile Companies

¶ 10.05 RADIO AND **TELEVISION** BROADCASTING

¶ 10.05[1] Specialized Statutory and Regulatory Provisions

Most states have modified their general apportionment rules for apportioning the income of radio and **television** broadcasters. [FN179] Many states have done so by adopting regulations identical or similar to the Multistate Tax Commission's (MTC's) special rule for radio and **television** broadcasting [FN180] and, in particular, the "audience factor" for assigning receipts from programming and advertising. [FN181] In addition to attributing receipts from **television** programming and advertising to the numerator of the state's sales factor by an audience factor, the MTC regulation eliminates "outerjurisdictional property" (i.e., property such as orbiting satellites and undersea transmission cables, which are not physically located in any particular state) from both the numerator and the denominator of the property factor in UDITPA's equally weighted three-factor formula. [FN182] The MTC special property factor rule also provides that audio and video cassettes or discs containing film or radio programming should be included in the property factor at original cost, and if the taxpayer licenses others to manufacture or distribute such cassettes or discs, their value should include the license or royalty fees capitalized at the rate of eight times the gross receipts from such fees. [FN183]

Following litigation over the proper treatment of broadcast fees of radio and **television** broadcasters for sales factor purposes, [FN184] the New York taxing authority adopted an audience-based method for attribution of such receipts. [FN185] California has a similar rule for receipts, including advertising revenue, from films in release to theaters and **television** stations located in the state. [FN186] For taxable years beginning in 2009, Illinois adopted a special rule for attributing receipts from the sale of broadcasting services to the numerator of the sales factor, based on whether the broadcast services are "received" in the state. [FN187] Whether the service is received in the state is based on a variety of criteria, depending on the precise context (e.g., the advertiser's commercial domicile for advertising revenue; the recipient's billing address for revenues received from recipients of the broadcast; and the portion of recipients located in the state, pursuant to an audience factor, for broadcasting revenue). Louisiana and Michigan have adopted rules that are similar to the Illinois rule described above. [FN188] Effective 2014, Oregon replaced its rule attributing a broadcaster's receipts to the location of its audience or subscribers with a rule attributing receipts from broadcasting (defined broadly to include income from advertising, licensing, or distributing film or radio programming and all other receipts from transactions in broadcaster's regular trade or business [FN188.1]) to the customer's commercial domicile. [FN188.2]

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¶ 10.05[2] Controversies

¶ 10.05[2][a] Power of Tax Administrator to Adopt Audience Factor

*2 The New Jersey Director of the Division of Taxation adopted an audience factor in apportioning receipts from advertising of **television** stations under the state's corporate franchise tax. None of the taxpayer's five stations were located in New Jersey, but they all reached substantial listening audiences in the state. The director rested his power to adopt an audience factor on the state's equitable apportionment provision. [FN189] The New Jersey Supreme Court set aside the director's use of the audience factor not because of any impropriety in the audience factor, but because it found that the director had failed to comply with the requirements of the New Jersey Administrative Procedure Act in adopting the factor. [FN190] The court stated:

> [W]e recognize that the language of the New Jersey Corporation Business Tax Act grants the Director needed broad authority to modify the statutory formula for determining a multi-state taxpayer's New Jersey tax base by which the tax is measured. In a case such as this, involving a multistate radio and **television** enterprise reaching audiences in several states, the language of the statute supports the determination of a more realistic method than provided by the statutory three-ply formula to calculate the receipts of the taxpayer that can fairly and reasonably be attributable to its activities in New Jersey. The "audience factor" is based upon a presumed economic correlation between revenues derived from advertising over the taxpayer's network and the size and location of its viewing and listening audiences. It would constitute a fair and appropriate method for allocating revenues. The actual determination to use such an allocation method, however, requires implementing regulations and recourse to rule-making procedures. [FN191]

¶ 10.05[2][b] Attribution of Advertising Revenues for Sales Factor Purposes and Film License Payments for Property Factor Purposes

In a Wisconsin case, questions arose concerning (1) the proper treatment of network and national advertising revenues received by a **television** station for sales-factor purposes, and (2) the proper treatment of film license fees paid by the station for property-factor purposes. [FN192] Under the then-applicable "income-producing activity"/"costs of performance" test for attributing receipts from services, the Wisconsin Tax Appeals Commission held that the revenues the station received were all includable in the numerator of the Wisconsin receipts factor despite the taxpayer's claim that much of the activity generating the revenue, such as negotiation and execution of the network affiliation agreements, occurred outside the state. As a concurring commission member declared:

> Taxpayer's argument fails, because it is based on the unsound premise that some of the activity which produced the income occurred outside of Wisconsin, when in fact and in law performance of the activity which produced the income—the local broadcasting of network programming—emanates from the taxpayer's studios in Milwaukee. [FN193]

*3 Under Wisconsin's current market-state approach to attributing receipts from sales of services for sales factor purposes, [FN194] the result would appear to be the same, at least insofar as the revenues were associated with the local broadcasting of network programming.

The commission further held that the film license fees were payments for the intangible right to exhibit the films

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rather than for the rental of tangible personal property (the film positives). The payments therefore did not have to be considered "rentals" for purposes of the Wisconsin property factor.

¶ 10.05[2][c] Attribution of Broadcasting Revenues Under Texas Margins and Franchise Tax

Under its margins tax, Texas assigns receipts from sales of services based on where the services are performed, [FN195] which is the same rule it applied under its former franchise tax. Applying this rule to the former franchise tax, the Texas Court of Appeals held that the revenues that a company received from educational, informational, and training programming produced in Texas but delivered via satellite broadcast to subscribers across the nation were attributable to Texas rather than to the locations where the broadcasts were received. [FN196]

¶ 10.05[3] Evaluation of the Rules for Attributing Advertising Receipts From Radio and **Television** Broadcasting

In evaluating the various attribution rules used in the radio and **television** broadcasting cases, as well as in the analogous magazine advertising cases, [FN197] one should start with the self-evident proposition that advertising essentially involves the sale of a service, not the sale of tangible personal property, even though tangible personal property may be transferred as incident to that service. However, the determination of the state to which receipts from advertising services rendered by a radio or **television** station should be attributed can give rise to controversy, as the foregoing discussion reveals.

Under UDITPA's general rule for attributing receipts from sales of services to the state in which the greatest costs of performance occurs, [FN198] the determination of the state to which a broadcaster should attribute its advertising receipts is a matter of considerable complexity. The services that radio and **television** broadcasters render to advertisers include a range of activities. They begin with the editorial and technical work relating to the script, much of which is done by advertising agencies acting for the advertiser and, in turn, by photographers, commercial artists, and others used by the advertising agency. They end with the work in the station itself of broadcasting programs, including the advertising, the preparation of the program tapes or digital files for prerecorded broadcasts, their distribution by national networks to affiliated stations, and the like. It is difficult, if not impossible, to attempt to trace and quantify the activities of broadcasting stations by reference to the costs of those activities in the states in which these various services are rendered.

*4 Both from an administrative standpoint and from the standpoint of the policy underlying the sales factor, an attribution rule based on audience location is the most defensible approach to the attribution of receipts from radio and **television** advertising. In fact, as we have already observed, this is the approach taken by most states, either by adopting the MTC's special rule for radio and **television** broadcasting or by adopting similar rules of their own. [FN199] The audience factor is relatively simple to administer because of widely available data on location of the listening audiences for radio and **television** broadcasting. More importantly, the adoption of an audience factor serves the purposes of the receipts factor by reflecting the market for the taxpayer's services.

[FNa]
Walter Hellerstein,Francis C. Shackelford Professor of Taxation, University of Georgia LawSchool. Mr. Heller-

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stein is also of counsel to Sutherland, Asbill & Brennan. He has written and practiced extensively in the state tax field and has been involvedin numerous state tax cases before the United States Supreme Court, having argued on behalf of taxpayers in both Hunt-Wesson, Inc. v. Franchise Tax Board, 528 U.S. 458 (2000), and Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768 (1992), in their successful constitutional challenges to state taxing provisions. He has also been deeply involved in issues relating to state taxation of electronic commerce and was a member of the Steering Committee of the National Tax Association's Telecommunicationsand Electronic Commerce Tax Project. He is currently an academic consultant to the Organization for Economic Cooperation and Development's Working Party No. 9 on Consumption Taxes, and he has also consulted with theWorld Trade Organization and the United Nations on cross-border tax issues. Mr. Hellerstein is a member of the American Law Institute and the District of Columbia, Illinois, and New York bars.

[FN179]
. See RIA State and Local Taxes, State and Local Tax Reporters (All States) ¶ 12, ¶ 020 (**television** and radio broadcasters), available at www.checkpoint.thomsonreuters.com.

[FN180]
. MTC. Reg. IV.18.(h), available at www.mtc.gov, and set out in full in Appendix B.

[FN181]
. See, e.g., Ala. Admin. Code r. 810-27-1-4.18(h) (Westlaw 2013); Ark. Admin. Code § 006.05.308-26-51-718(d)(2.26-51-718(d)) (Westlaw 2013); 1 Colo. Code Regs. § 201-3, Spec. Reg. 5A (Westlaw 2013); Conn. Gen. Stat. § 12-218(*l*) (Westlaw 2013); Fla. Admin. Code Ann. r. 12C-1.0155(2)(i) (Westlaw 2013); Ga. Comp. R. & Regs. 560-7-7.03(5)(c) 6(vii) (Westlaw 2013); Haw. Code R. § 18-235-38-06.04 (Westlaw 2013); Idaho Admin. Code. r. 35.01.01.580(01)(e) (Westlaw 2013); Iowa Admin. Code r. 701-54.7(5)(422) (Westlaw 2013); Md. Code Regs. 03.04.03.09 (Westlaw 2013); Mich. Comp. Laws Ann. § 208.1305(20) (Westlaw 2013); Mont. Admin. R. 42.26.1103 (Westlaw 2013); NH Code R. Rev. 304.09 (Westlaw 2013); NM Code R. § 3.5.19(18) (Westlaw 2013); ND Admin. Code R. 81-03-09-38 (Westlaw 2013); Or. Rev. Stat. § 314.684 (Westlaw 2013); Or. Admin. R. 150-314.684(4) (Westlaw 2013).

[FN182]
. MTC Reg. IV.18.(h)(4)(ii)(B).

[FN183]
. MTC Reg. IV.18.(h)(4)(ii)(B).

[FN184]
. In re Capital Cities Communications, Inc. v. State Tax Comm'n, 65 AD2d 25, 411 NYS2d 46 (3d Dep't 1978).

[FN185]
. Under the New York regulation:

The broadcasting of radio and **television** programs and commercial messages by way of radio and **television** antennae pursuant to a license granted by the Federal Communications Commission is deemed to be a service. When a lump sum is received for such service, that lump sum shall be allocated to New York State and another state or states according to the number of listeners or viewers in each state.

NY Comp. Codes R. & Regs. tit. 20, § 4-4.3(d)(2) (Westlaw 2013). New York adopted a similar location-of-the-subscriber rule for allocating the receipts from cable programming and video-on-demand services. NYT-G-07(1)C, NY Dep't of Tax'n and Fin. Jan. 17, 2007, available at www.checkpoint.thomsonreuters.com.

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[FN186]
. Cal. Code Regs. tit. 18, § 25137-8.2 (Westlaw 2013). The regulation provides, in pertinent part:
(3) Sales Factor.
(A) The numerator shall include all gross receipts derived by the taxpayer from sources within this state including, but not limited to, the following:
(i) Gross receipts, including advertising revenue, from films in release to theaters and **television** stations located in this state.
(ii) Gross receipts, including advertising revenue, from films in release to or by a **television** network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the **Television** & Cable Factbook (http://www.warren-news.com/ factbook.htm), if available, or by other published market surveys, or if none is available, by population data published by the United States Census Bureau, provided that the source selected is consistently used from year to year for that purpose.
(iii) Gross receipts, including advertising revenue, from films in release to subscription **television** telecasters shall be attributed to this state in the ratio that the subscribers for such telecaster located in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in Cable Vision, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the United States Census Bureau for all states in which the telecaster has subscribers, provided that the source selected is consistently used from year to year for that purpose.
...
Cal. Code Regs. tit. 18, § 25137-8.2(c)(3) (Westlaw 2013). The regulation is applicable to taxable years beginning on and after January 1, 2011.

[FN187]
. 35 Ill. Comp. Stat. 5/304(a)(3)(B-7) (Westlaw 2013).

[FN188]
. La. Rev. Stat. Ann. § 47:287.95(K) (Westlaw 2013) (effective for corporate income tax years beginning 2012 and for corporate franchise tax years beginning 2013); Mich. Comp. Laws Ann. § 206.665(20) (Westlaw 2013).

[FN188.1]
. Or. Rev. Stat. § 314.680(4) (Westlaw 2014). Receipts from the sale of real or tangible personal property are excluded from this rule.

[FN188.2]
. Or. Rev. Stat. § 314.684(4) (Westlaw 2014).

[FN189]
. See ¶ 9.20.

[FN190]
. Metromedia, Inc. v. Director, Div. of Taxation, 97 NJ 313, 478 A2d 742 (1984).

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[FN191]
. *Metromedia*, 97 NJ 313, 478 A2d 742, 755 (1984). Accord, as to the need to comply with the rules of the Administrative Procedure Act with respect to notice, hearing, and publication in adopting an audience factor attribution rule for receipts from broadcasting advertising, CBS, Inc. v. Comptroller, 319 Md. 687, 575 A2d 324 (1990). But see Letter of Findings No. 09-0826, Indiana Dep't of Revenue, Dec. 1, 2010, available at www.checkpoint.thomsonreuters.com (adopting audience factor for media company under equitable apportionment provision and distinguishing *Metromedia* and *CBS* cases because the department has been "consistent in its application" of the equitable apportionment provision, and "other states' interpretations of their laws, while interesting, have no precedential value in Indiana"); Letter of Findings No. 02-20110473, Indiana Dep't of State Revenue, Mar. 27, 2013, available at www.checkpoint.thomsonreuters.com (same).

[FN192]
. Hearst Corp. v. Wisconsin Dep't of Revenue, No. I-8511, 1990 WL 163888 (Wis. Tax Appeals Comm'n May 15, 1990).

[FN193]
. *Hearst*, No. I-8511, 1990 WL 163888, at *17 (Wis. Tax Appeals Comm'n May 15, 1990) (Bartley, Comm'r, concurring in part and dissenting in part).

[FN194]
. See ¶ 9.18[3][c][xi].

[FN195]
. Tex. Tax Code Ann. § 171.103(a)(2) (Westlaw 2013).

[FN196]
. Westcott Communications, Inc. v. Strayhorn, 104 SW3d 141 (Tex. App. 2003). This case is discussed further in ¶ 9.18[3][d][vi].

[FN197]
. See supra ¶ 10.04[2].

[FN198]
. See UDITPA § 17; ¶ 9.18[3][a].

[FN199]
. See supra ¶ 10.05[1].ST TAXN WGL ¶ 10.05

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TAB 10

THE STATE OF SOUTH CAROLINA
In The Supreme Court

Carmax Auto Superstores West Coast, Inc.,
Respondent/Petitioner,

v.

South Carolina Department of Revenue,
Petitioner/Respondent.

Appellate Case No. 2012-212203

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS

Appeal From The Administrative Law Court
Carolyn C. Matthews, Administrative Law Judge

Opinion No. 27474
Heard March 19, 2014 – Filed December 23, 2014

AFFIRMED AS MODIFIED

Adam N. Marinelli, Milton G. Kimpson, and Roxanna M. Tinsley, all of South Carolina Department of Revenue, of Columbia, for Petitioner/Respondent.

John C. von Lehe, Jr. and Bryson M. Geer, both of Nelson Mullins Riley & Scarborough, LLP, of Charleston, for Respondent/Petitioner.

Robert L. Widener and Erik P. Doerring, both of McNair Law Firm, PA, of Columbia, for Amicus Curiae, South

Carolina State Chamber of Commerce.

Burnet R. Maybank, III, of Nexsen Pruet, LLC, of Columbia and Alexandra E. Sampson, of Reed Smith, LLP, of Washington, DC, for Amicus Curiae, Council on State Taxation.

CHIEF JUSTICE TOAL: Both CarMax Auto Superstores West Coast, Inc., (CarMax West) and the South Carolina Department of Revenue (the Department) appeal the court of appeals' decision, reversing and remanding the decision of the Administrative Law Court (ALC) upholding the Department's use of an alternative apportionment formula to calculate CarMax West's income tax for tax years 2002-2007. We affirm as modified in an opinion which resolves all matters with finality and decline to remand at both parties' request.

FACTS/PROCEDURAL BACKGROUND

CarMax, Inc., (CarMax) was formed in 1993 as a subsidiary of Circuit City Stores, Inc., and is the nation's largest retailer of used automobiles. In 2002, CarMax became a separate, publicly-traded holding company of CarMax Auto Superstores, Inc., (CarMax East) and CarMax West, two wholly owned subsidiaries, which primarily performed retail automobile sales. CarMax East owned and operated the used car superstores on the East Coast and in the Midwest, including South Carolina, and managed all of the financial operations and corporate overhead of CarMax. CarMax West owned and operated the used car superstores on the West Coast and owned all of the intellectual property. From 2002-2004, CarMax East paid royalties to CarMax West for the use of this intellectual property in accordance with a licensing agreement.

In 2004, CarMax reorganized its corporate structure, and created CarMax Business Services, LLC (CBS), a multi-member limited liability company with two members: CarMax East and CarMax West. CarMax East contributed the financing operations and corporate overhead management to the partnership, and CarMax West contributed the intellectual property. Ownership percentages of CBS were based on the value of the assets contributed, and the members' income derives from their respective percentages of ownership.[1]

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[1] CarMax West owns 93.5% of CBS, and CarMax East owns 6.5% of CBS.

After the restructuring, CarMax East and CarMax West became vehicle retailers only, and CBS began to provide all of the corporate overhead services, house financing operations through its financing arm (CAF), and manage the intellectual property for its members. Both CarMax East and CarMax West pay CBS a management fee for these services.[2]

CarMax West claims that it has no financial connection to South Carolina outside of royalty payments from CarMax East. From 2002-2004, CarMax East made direct payments to CarMax West for use of the intellectual property; and since 2004, CarMax East has made management fee payments to CBS on a per-vehicle-sold basis, and CAF has generated further financing revenue in South Carolina. Because of its status as an LLC, CBS is taxed as a partnership; therefore, both sources of revenue "flow through" CBS to its members, and thus indirectly, to CarMax West.[3]

At issue is how an allocated portion of this income should be taxed in South Carolina. CarMax West initially filed timely corporate income tax returns for tax years 2002-2007.[4] In 2008, the Department audited CarMax West, and issued a proposed assessment, adjusting CarMax West's apportionment formula and imposing penalties. CarMax West filed a protest, and in early 2009, the Department issued a Determination upholding the Department's assessment.

Six months later, CarMax West filed the amended tax returns in question,

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[2] The management fee is assessed on a per-vehicle-sold basis. CBS further generates revenue from providing financing to CarMax East's and CarMax West's customers through CAF.

[3] By virtue of its status as a "pass-through" entity for taxation purposes, CBS pays no taxes in South Carolina.

[4] In its initial filing, CarMax West utilized a "three-factor" or "three-factor double weighted sales" formula, which calculates a taxpayer's taxable income in South Carolina by computing a ratio of the taxpayer's total property, payroll, and sales. *See* S.C. Code Ann. § 12-6-2250 (Supp. 2009), *repealed by* Act No. 110, 2007 S.C. Acts 557, 595, *and* Act No. 116, 2007 S.C. Acts 688, 741 (repealing with respect to tax years after 2010).

using the statutory apportionment method found in section 12-6-2290 of the South Carolina Code. *See* S.C. Code Ann. § 12-6-2290 (2000 & Supp. 2009). This method, commonly referred to as the "gross receipts method," calculates a multistate taxpayer's taxes due by creating an apportionment ratio that divides the taxpayer's receipts from financing and intangibles in South Carolina by the taxpayer's receipts from financing, intangibles, and retail sales everywhere else the taxpayer does business.[5] CarMax West then multiplied its net income by the apportionment ratio, and multiplied that number by South Carolina's income tax rate to arrive at its South Carolina income tax.

The Department rejected CarMax West's use of the gross receipts method, claiming it did not fairly represent the extent of CarMax West's business dealings in South Carolina. Rather, the Department proposed an alternate apportionment method pursuant to section 12-6-2320(A)(4) of the South Carolina Code. *See* S.C Code Ann. §12-6-2320 (2000 & Supp. 2009).

The Department's proposed alternative formula employed an apportionment ratio of CarMax West's South Carolina income from intangibles and financing divided by CarMax West's intangibles and financing income from everywhere else that it does business. According to the Department, this alternative formula focused on CarMax West's actual business activity in South Carolina. The Department sought to prevent CarMax West from diluting its income by inflating the denominator of its apportionment ratio with sales from its Western retail operations. Furthermore, the Department sought to include the income from the sale of securitized consumer lending contracts in CarMax West's South Carolina income. The Department still sought penalties.

After the Department issued a Final Agency Determination upholding the Department's use of the alternate formula, CarMax West filed a contested case in the ALC. The ALC affirmed the Department's use of an alternative apportionment formula, but dismissed the penalties assessed against CarMax West. The ALC found that (1) the Department demonstrated that the gross receipts formula failed to fairly represent CarMax West's business in South Carolina; (2) the Department's

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[5] Prior to reorganization, CarMax West classified gross receipts from South Carolina as the royalties, and after the reorganization, CarMax West attributed the royalty portion of CBS as South Carolina receipts, but CarMax West did not include the financing revenue within the numerator of the apportionment factor.

alternate apportionment formula was reasonable with respect to the extent of CarMax West's business activity in South Carolina; (3) the financing receipts were appropriately sourced to South Carolina; and (4) the alternative apportionment formula did not violate the Commerce Clause.

CarMax West appealed the ALC's decision to the court of appeals. *See CarMax Auto Superstores W. Coast, Inc. v. S.C. Dep't of Revenue*, 397 S.C. 604, 725 S.E.2d 711 (Ct. App. 2012). On appeal, CarMax West argued the ALC erred in: (1) applying the wrong burden and standard of proof; (2) failing to consider that CarMax West operates a unitary business and permitting the Department to use separate accounting procedures when calculating tax liability of a unitary business; (3) finding that CarMax West's South Carolina business activities were not accurately calculated using the gross receipts method; (4) using the wrong test in deciding that CarMax West's financing receipts should be sourced to South Carolina; and (6) finding that the Department did not violate CarMax West's constitutional rights by applying a separate accounting to a unitary business and by sourcing financing receipts to South Carolina. *Id.* at 606, 725 S.E.2d at 712. The court of appeals reversed and remanded the case to the ALC for application of the proper burden of proof, without considering the remaining issues. *Id.* at 611, 725 S.E.2d at 714.

Both parties filed petitions for a writ of certiorari. This Court granted review and accepted amici curiae briefs from the Council on State Taxation and the South Carolina State Chamber of Commerce.

STANDARD OF REVIEW

The Administrative Procedures Act[6] (the APA) "governs appellate review of a final decision from an administrative agency." *Hill v. Eagle Motor Lines*, 373 S.C. 422, 427, 645 S.E.2d 424, 428 (2007) (citation omitted). In appeals taken pursuant to the APA,

> [t]he court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:

[6] S.C. Code Ann. §§1-23-310 to -400 (Supp. 2013).

(a) in violation of constitutional or statutory provisions;

(b) in excess of the statutory authority of the agency;

(c) made upon unlawful procedure;

(d) affected by other error of law;

(e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or

(f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. § 1-23-380(5)(a)–(f) (Supp. 2013). However, the Court "may not substitute its judgment for the judgment of the agency as to the weight of the evidence on questions of fact." S.C. Code Ann. § 1-23-380(5); *MRI at Belfair, LLC v. S.C. Dep't of Health & Envtl. Control*, 379 S.C. 1, 6, 664 S.E.2d 471, 474 (2008).

ANALYSIS

In South Carolina, corporate income tax "is imposed annually at the rate of five percent on the South Carolina taxable income of every corporation . . . transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce." S.C. Code Ann. § 12-6-530 (2014). "A corporation's taxable income in South Carolina is computed using the Internal Revenue Code with modifications as provided by South Carolina law, and this amount is 'subject to allocation and apportionment as provided in Article 17 of this chapter.'" *Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue*, 388 S.C. 138, 145, 694 S.E.2d 525, 528 (2010) (quoting S.C. Code Ann § 12-6-580 (2000)). When "a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014).

"Article 17, entitled 'Allocation and Apportionment,' provides certain income that is not related to business activity in South Carolina must be directly

allocated to a taxpayer and is not subject to apportionment." *Media Gen.*, 388 S.C. at 145, 694 S.E.2d at 528 (citing S.C. Code Ann. §§12-6-2220, -2230 (2000 & Supp. 2009)). Any income "remaining after allocation is apportioned in accordance with the general apportionment statute, section 12-6-2250, or one of the special apportionment formulas" provided in Sections 12-6-2290 through 12-6-2310. *Id.* at 145 (citing S.C. Code Ann. § 12-6-2240 (Supp. 2009)).

In this case, CarMax West utilized the statutory formula found in section 12-6-2290 of the South Carolina Code, which requires a taxpayer to "apportion its . . . net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." *See* S.C. Code Ann. 12-6-2290. However, the Department sought to use an alternative method of apportionment pursuant to section 12-6-2320(A) of the South Carolina Code, which provides:

> If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (1) separate accounting;
>
> (2) the exclusion of one or more of the factors;
>
> (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Burden of Proof

On appeal, the Department takes issue with the burden of proof adopted by the court of appeals. Specifically, the Department contends the court of appeals erred in applying *Media General*.[7]

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[7] CarMax West does not contest these findings; rather, CarMax West argues that

In its Order, the ALC properly applied a preponderance of the evidence standard of proof, but also found that because the burden of proof "is generally upon the party asserting the affirmative in an adjudicatory administrative proceeding" and CarMax West requested the contested case hearing to challenge the Department's proposed assessment, then CarMax West bore the burden of proof.

The court of appeals reversed the ALC, finding it applied an incorrect burden of proof under section 12-6-2320(A). *CarMax*, 397 S.C. at 611, 725 S.E.2d at 714. The court of appeals reasoned:

> There are two burdens of proof which must be met in this case. First, we note both the Department and CarMax West agree the Department bears the burden of proving the gross receipts formula does not fairly represent CarMax West's business activity in South Carolina. Second, the Department bears the burden of proving its alternative accounting method is reasonable and more fairly represents CarMax West's business activity in South Carolina.

Id. at 611, 725 S.E.2d at 714–15. Moreover, the court of appeals stated that "based on *Media General*, the Department, as the proponent of the alternative apportionment method, must establish that its alternative method is not only appropriate, but more appropriate than any competing methods." *Id.* at 611, 725 S.E.2d at 714. Finding the ALC erred in requiring CarMax West satisfy the second prong of the analysis, the court of appeals reversed the ALC and remanded for a proper application of the burden. *Id.* at 612, 725 S.E.2d at 715.[8]

We find the statutory language of section 12-6-2320(A) clearly evinces a two-part analysis, and we affirm the court of appeals in that respect. However, the

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the court of appeals erred in refusing to consider the issues posed to it concerning CarMax's status as a unitary business, the sourcing of the financing receipts to South Carolina, and the constitutionality of the Department's application of South Carolina's taxation scheme to it.

[8] The court of appeals rejected CarMax West's contention below that the standard of proof was clear and convincing evidence, and CarMax West has not appealed that ruling. *CarMax*, 397 S.C. at 611–12, 725 S.E.2d at 714–15.

second prong of the analysis is met by a showing that the deviation from a statutory apportionment formula is reasonable, and no further showing is required at that stage. Thus, we find the court of appeals erred in requiring a showing that the Department prove its alternate formula "more fairly represents CarMax West's business activity in South Carolina," and further, we agree with the Department that the court of appeals misapplied *Media General* in holding the Department must prove that its alternate formula is "more reasonable than any competing method."[9]

Accordingly, when a party seeks to deviate from a statutory formula under section 12-6-2320(A), the proponent of the alternate formula bears the burden of proving by a preponderance of the evidence that: (1) the statutory formula does not fairly represent the taxpayer's business activity in South Carolina and (2) its alternative accounting method is reasonable.

In so holding, we reject the Department's argument that the court of appeals erred in failing to shift the burden to prove reasonableness to CarMax West. The Department suggests that because it was the proponent of the statutory formula to which the taxpayer raised an alternative formula in *Media General*, it was required to supply another more appropriate formula in the face of the taxpayer's proposed alternative. Consequently, in this case, where the roles are reversed, the Department argues CarMax West must now prove its formula is more appropriate

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[9] In *Media General*, it was undisputed that the gross receipts formula did not fairly represent the income of the multi-state taxpayer, and the alternative formula proposed by the taxpayer did in fact fairly measure the taxpayer's business activity in South Carolina. *Media Gen.*, 338 S.C. at 146, 694 S.E.2d at 529. In upholding the application of the alternative formula suggested by the taxpayer, we stated:

> Although the Department has the discretion to select an alternative method, the ALC has ordered in this case that the method be applied and we affirm this determination as the Department has not established that another method would be more appropriate.

Id. at 152, 152, 694 S.E.2d at 532. In contrast to the situation that arose in *Media General*—where both parties agreed that the statutory formula did not fairly represent the taxpayer's business in South Carolina—here, there was not the potential for competing alternatives. Therefore, the proponent's showing that the alternative formula is reasonable necessarily ends the inquiry.

than the Department's proposed alternative.

This argument is unavailing because it ignores the clear distinction between this case and *Media General*. There, both the Department and the taxpayer agreed that the statutory formula did not fairly represent the taxpayer's business in South Carolina. The taxpayer supplied an alternative formula, but the Department fell back on the statutory formula. Thus, in the context of that case, affirmation was appropriate on the basis that the Department failed to select an alternative method, but also failed to establish that another method would be more appropriate. Here, however—where the Department alone is arguing that the statutory formula does not fairly represent the taxpayer's business in South Carolina—the Department bears the burden to prove (1) that the statutory formula does not fairly represent CarMax West's business activity in South Carolina and (2) that the proposed alternative formula is reasonable. *Cf. St. Johnsbury Trucking Co. v. State*, 385 A.2d 215, 217 (N.H. 1978) (holding "an alternative formula is the exception, and the party who wants to use an alternative formula accordingly has the burden of showing that the alternative is appropriate"); *Donald M. Drake Co. v. Dep't of Revenue*, 500 P.2d 1041, 1044 (Or. 1972) (holding "the use of any method other than apportionment should be exceptional" and the party seeking to use an alternative method bears the burden of proof).

Therefore, we affirm the court of appeals finding that the ALC erred in placing the burden of proof on CarMax West.

Application of the Burden

The Department contends that because it has proved that the statutory formula did not fairly represent a taxpayer's business activity within the state, the only issue on appeal is what burden of proof to apply to the question of whether the Department's formula was reasonable. This formulation of the issue assumes that the Department made a sufficient showing regarding the first prong of the analysis. We find that it did not as a matter of law.[10]

While there is substantial evidence in the record to support the ALC's finding that the Department's alternative accounting method was reasonable, the

[10] At oral arguments, upon questioning by Justice Pleicones, both parties agreed that this case should be resolved on this Record as a matter of judicial economy, and that remand was unnecessary.

Department failed to prove the threshold issue that the statutory formula does not fairly represent CarMax West's business activity within South Carolina.

As noted by the South Carolina State Chamber of Commerce in its amicus brief, to satisfy its burden with respect to this first prong, the Department merely "describe[d] what it did rather than cite any evidence justifying what it did." Rather, at trial, the Department relied on CarMax West to refute its use of an alternate formula, and it was in this context that CarMax West raised its unitary business, sourcing, and constitutional arguments.

In its order, the ALC relied on testimony from an auditor that the business structure of CarMax West and CBS is often "linked with tax minimization strategies." Furthermore, the ALC relied on evidence regarding the sourcing of income, and the fact that CarMax West's apportionment ratio yielded a significantly lower tax than that of CarMax East, to support its determination that CarMax West's income was diluted. This was the extent of the evidence offered by the Department to prove the contention that the statutory formula did not fairly represent CarMax West's business activity in South Carolina, other than bald assertions by its witnesses that it satisfied this threshold question.

Even if these findings accurately characterize CarMax West's motives, they do not provide a sound evidentiary basis to support the conclusion that the statutory formula did not fairly represent CarMax West's business in South Carolina. *See St. Johnsbury Trucking Co.*, 385 A.2d at 217 ("Merely because the use of an alternative form of computation produces a higher business activity attributable to New Hampshire, is not in and of itself a sufficient reason for deviating from the legislatively mandated formula." (citations omitted)).

Therefore, we find that the Department failed to satisfy its burden of proof as a matter of law.[11]

CONCLUSION

[11] We need not reach the CarMax West's remaining issues on appeal, as they were all raised as defenses to the Department's use of an alternative apportionment method, and the proper allocation of the burden of proof resolves this appeal. *See Futch v. McAllister Towing of Georgetown, Inc.*, 335 S.C. 598, 613, 518 S.E.2d 591, 598 (1999).

For the foregoing reasons, the opinion of the court of appeals is

AFFIRMED AS MODIFIED.

BEATTY, HEARN, JJ., and Acting Justice James E. Moore concur. PLEICONES, J., concurring in part and dissenting in part in a separate opinion.

JUSTICE PLEICONES: I concur in part and dissent in part. I agree with the majority that the Court of Appeals was correct in reading S.C. Code Ann. § 12-6-2320(A) (2014) to place a two-part burden on the party seeking to deviate from the standard allocation formula. First, the proponent of the deviation must show that the gross receipts formula does not fairly represent the taxpayer's in-state business activity. Second, the proponent of change must demonstrate that its proposal is reasonable, but not that its alternative is fairer than any other formula. I therefore agree with the majority's modification of the test used by the Court of Appeals, but disagree with the majority's application of these principles here.

Since we are holding that the burden of proof is on the Department, I agree with the Court of Appeals that we should remand this matter to the ALC for reconsideration. Whether the Department can meet its burdens are questions of fact which, in my opinion, should not be decided on certiorari despite the parties' agreement that we do so. The ALC placed the burden of proof on CarMax West, and accordingly its findings of fact and conclusions of law are premised on that error of law. It is therefore not surprising that as the majority states, "the Department relied on CarMax West to refute [the Department's] use of an alternate formula," or that the Department, lacking any burden of proof, largely offered evidence of **what** it did rather than **why** it did it.

In light of our clarification of the burden of proof, I would remand to the ALC with instructions to reconsider this matter and to hold an evidentiary hearing if requested by either party. I would also permit the parties to reargue the points of law raised in their petitions of certiorari but not decided by the Court today.

For the reasons given above, I concur in part, dissent in part, and would remand for reconsideration.

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a Echo Star DBS Corp., and Affiliates, Petitioner, v. South Carolina Department of Revenue, Respondent.	**DOCKET NO. 14-ALJ-17-0285-CC** **RESPONDENT'S MOTION FOR SUMMARY JUDGMENT AND RESPONSE IN OPPOSITION TO PETITIONER'S MOTION FOR SUMMARY JUDGMENT**

TO: The Honorable Shirley C. Robinson, Presiding Judge:

Respondent South Carolina Department of Revenue (Department), by and through its counsel, moves this Court pursuant to Rule 56, SCRCP, and ALC Rule 19, to deny the Motion for Summary Judgment ("motion") filed by the Petitioner Dish DBS Corporation, f/k/a Echo Star DBS Corp., and Affiliates ("Petitioner") on or about January 6, 2015 and to grant summary judgment in favor of the Department. In denying Petitioner's motion, the Department asserts that Petitioner has both relied upon and ignored certain material facts in dispute in its motion; that further discovery is necessary to develop the facts in dispute; that Petitioner's motion is premature; and that Petitioner's motion asks this Court to draw inaccurate conclusions of law.

In support of its motion, the Department submits the following memorandum of law and for the reasons set forth more fully herein, the Department asks that Petitioner's motion be denied and the Department's motion be granted.

STATEMENT OF THE CASE

Petitioner filed its original 2004-2010 South Carolina corporate income tax returns with little consistency ("audit period"). Specifically, for some years it filed to reflect an approach which sourced its subscription receipts to the origin of its customers. In other years, it utilized a sourcing method based upon a cost-of-performance, and did not source its revenue to South Carolina because its corporate headquarters is in Colorado. Petitioner also oscillated between using the standard four-factor apportionment method and the gross receipts method for the tax years at issue.

The Department audited Petitioner's returns for the audit period, and in a letter dated June 29, 2012, issued a proposed notice of assessment to Petitioner. That notice asserted that Petitioner should be filing using the gross receipts apportionment method and sourcing its receipts from South Carolina subscribers to this State. It also assessed substantial understatement penalties pursuant to S.C. Code Ann. § 12-54-155 (2014). Petitioner timely protested the Department's assessments and adjustments on the returns in a letter dated September 26, 2012.

On May 13, 2014, the Department issued its final Department Determination finding that the gross receipts that Petitioner generates from the sale of subscriptions are directly produced from activity that occurs within the state of South Carolina, thereby upholding the proposed tax assessment and penalties. On June 12, 2014, Petitioner requested a contested case hearing in this Court seeking relief from the Department Determination. On or about January 6, 2015, Petitioner filed a Motion for Summary Judgment.

FACTS

Petitioner is a multi-state taxpayer headquartered in Englewood, Colorado, and provides access to digital television entertainment to South Carolina customers. It operates throughout the United States. Petitioner grants its subscribers access to hundreds of television programming channels and other audio/visual options that are transmitted nationwide to subscriber's homes or businesses via satellites. Subscribers pay a monthly fee for access to basic channels and can also purchase premium channels and pay-per-view programs for an additional fee. Before the customer can receive the programming, he must contract with Petitioner for the service, and he rents and/or purchases a satellite dish, remote controls, and receiver box in order to access Petitioner's programming from his home or business.

STANDARD OF REVIEW

Petitioner implies that there are no genuine issues of material fact by moving for judgment as a matter of law pursuant to Rule 56(c), SCRCP. To the contrary, under Petitioner's cost-of-performance approach for this case, material issues of fact exist such that summary judgment is not appropriate in this case and that a contested case hearing on the merits is necessary. Further, Petitioner's motion is grounded upon inaccurate conclusions of law because (1): South Carolina is not a cost-of-performance state; (2) Petitioner has misconstrued the analysis and holding of Lockwood Greene; and (3) the Department's longstanding administrative policy has always looked to the activities of each industry when determining how much a service provider's revenue should be sourced to South Carolina.

Under the Department's view of the case, however, applicable South Carolina law and long-standing Department policy require the Petitioner to source all the gross receipts of its South Carolina subscription revenue to South Carolina because all of the income-producing activity occurs in South Carolina.

"The party seeking summary judgment has the burden of clearly establishing the absence of a genuine issue of material fact." Wogan v. Kunze, 366 S.C. 583, 591, 623 S.E.2d 107, 112 (Ct. App. 2005) (citing McCall v. State Farm Mut. Auto. Ins. Co., 359 S.C. 372, 597 S.E.2d 181 (Ct. App. 2004); Singleton v. Sherer, 377 S.C. 185, 197, 659 S.E.2d 196, 203 (Ct. App. 2008); see also Leventis v. S.C. Dep't. of Health and Envtl. Control, 340 S.C. 118, 132-133, 530 S.E.2d 643, 651 (Ct. App. 2000) ("Generally, the burden of proof is on the party asserting the affirmative issue in an adjudicatory administrative proceeding." (Internal citation omitted)).

In determining whether any triable issues of fact exist, the evidence and all reasonable inferences therefrom must be viewed in the light most favorable to the non-moving party. Helms Realty, Inc. v. Gibson-Wall Co., 363 S.C. 334, 611 S.E.2d 485 (2005); Med. Univ. of S.C. v. Arnaud, 360 S.C. 615, 602 S.E.2d 747 (2004); Hackworth v. Greenville County, 371 S.C. 99, 637 S.E.2d 320 (Ct. App. 2006); Rife v. Hitachi Constr. Mach. Co., 363 S.C. 209, 609 S.E.2d 565 (Ct. App. 2005).

Summary judgment is a drastic remedy and should be cautiously invoked to ensure a litigant is not improperly deprived of a full and fair opportunity to complete discovery and a trial on disputed factual issues. Dawkins v. Fields, 354 S.C. 58, 69, 580 S.E.2d 433, 439 (2003); see also Hooper v. Ebenezer Senior Serv. and Rehab. Ctr., 377 S.C. 217, 224, 659 S.E.2d 213, 217 (Ct. App. 2008); Helena Chem. Co. v. Allianz

Underwriters Ins. Co., 357 S.C. 631, 644, 594 S.E.2d 455, 462 (2004); B & B Liquors, Inc. v. O'Neil, 361 S.C. 267, 270, 603 S.E.2d 629, 631 (Ct. App. 2004). Summary judgment is inappropriate where further inquiry into the facts of the case is necessary to clarify the application of law. Gadson v. Hembree, 364 S.C. 316, 320, 613 S.E.2d 533, 535 (2005); Wogan, 366 S.C. at 591, 623 S.E.2d at 112; Montgomery v. CSX Transp., Inc., 362 S.C. 529, 542, 608 S.E.2d 440, 447 (Ct. App. 2004).

"Summary judgment should not be granted even when there is no dispute as to evidentiary facts if there is dispute as to the conclusion to be drawn from those facts." Gignilliat v. Gignilliat, Savitz & Bettis, L.L.P., 385 S.C. 452, 456, 684 S.E.2d 756, 758 (2009) (citing Brockbank v. Best Capital Corp., 341 S.C. 372, 378, 534 S.E.2d 688, 692 (2000)).

In this case, the Department asserts that genuine issues of material fact exist under Petitioner's view of this case. More specifically, further inquiry into the facts of this case is necessary to clarify the application of the applicable law should this Court find that cost-of-performance elements should be considered. Moreover, Petitioner is not entitled to judgment as a matter of law as it has misconstrued, misstated, and misapplied the law in its motion. Under the Department's view of the case, however, applicable South Carolina law and long-standing Department policy require the Petitioner to source all the gross receipts of its South Carolina subscription revenue to South Carolina because all of the income-producing activity occurs in South Carolina.

DISCUSSION

Petitioner's motion essentially asserts that no genuine issue of material fact exists and that there is no statutory, regulatory, or policy document mechanism to permit the

Department to source the subscription revenue of its customers to South Carolina. However, Petitioner premises these arguments on two incorrect and improper conclusions of law: (1) that the Department altered the income apportionment method it has used for over 35 years; and (2) that the Department has invoked "market share sourcing" in the audit of Petitioner. The Department's argument, as follows, explains the relevant South Carolina Code provisions, case law, and policies relating to the sourcing of income for service providers and describes the necessity for further discovery into the facts and how the law applies to such facts.

I. Apportioning Net Income of Service Providers

A. South Carolina Apportionment Statutes for Service Providers

Petitioner is a media broadcasting company not regularly engaged in the sale of tangible personal property. Petitioner's primary income is derived from providing direct broadcast satellite video services to customers throughout the country, and the applicable statute to apportion Petitioner's adjusted net income to South Carolina mandates the method for apportioning gross receipts from services. S.C. Code Ann. § 12-6-2290 (2014) provides:

> If the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2252 or Section 12-6-2310, the taxpayer shall apportion its remaining net income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

The final sentence of section 12-6-2290 directs taxpayers to S.C. Code Ann. § 12-6-2295 for a non-exclusive list of the items to be included in the gross receipts formula. The relevant subsection in this matter is section 12-6-2295(A)(5):

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> ***
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State[.]

It is well settled law that the purpose of the South Carolina allocation and apportionment provisions is to provide for imposition of income tax "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Hertz Corp. v. S.C. Tax Comm'n, 246 S.C. 92, 142 S.E.2d 445 (1965). Furthermore, a statutory provision must be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute. Hay v. S.C. Tax Comm'n, 273 S.C. 269, 255 S.E.2d 837 (1979).

B. Legislative History of South Carolina Apportionment Statutes for Service Providers

Since 1958, South Carolina's apportionment statute for services has always mandated the use of a single-factor gross receipts ratio to apportion a corporate taxpayer's adjusted net income from services (i.e., sources other than from manufacturing and sales of tangible personal property and from certain industries). In 1958, section 65-279.10 imposed a gross receipts factor to apportion net income derived from sources other than manufacturing and sales of tangible personal property. Code of Laws of South Carolina, 1962. When the Code of Laws of 1976 was adopted, section 65-279.10 became section 12-7-1190. See 1977 Act No. 95, § 1. In 1995, the General Assembly subsequently repealed Chapter 7 and added Chapter 6 of Title 12 of the South Carolina

Code of Laws. As part of this change, section 12-7-1190 was replaced by section 12-6-2290 as the statute that directed taxpayers how to apportion net income related to services. See 1995 Act No. 76, § 1. Section 12-6-2290 stood alone as the applicable apportionment statute for services until 2006, when the General Assembly enacted section 12-6-2295 which delineates specific items that are included in the numerator of the gross receipts ratio. The General Assembly further added a sentence in section 12-6-2290 referencing section 12-6-2295. See 2007 Act No. 110 § 51A, § 54A, eff. June 21, 2007; 2007 Act No. 116 § 56.A, § 59A, eff. June 21, 2007.

II. This Action Involves Genuine Issues of Material Fact Under Petitioner's View of Applicable Law

A. Cost-of-Performance

In its motion, Petitioner asserts that South Carolina is a cost-of-performance state, and thus it must source its South Carolina subscription receipts to South Carolina only if the majority of expenses are incurred in South Carolina. As discussed more fully in Section III(A) of the Department's response, South Carolina is not a cost-of-performance state. Moreover, the primary issue in this case is not whether South Carolina is a cost-of-performance state. Rather, the primary issues in this case are determining the income-producing activity of Petitioner and how income received by Petitioner from the sale of subscriptions to South Carolina customers should be sourced.

In the event that this Court were to conclude that South Carolina is a cost-of-performance state and must apportion income from service providers under a cost-of-performance analysis (despite the clear and unambiguous deletion of such language by the South Carolina legislature discussed below), the Department submits that further

discovery is still necessary to aid this Court in ruling on the construction of the statutes and application of the facts at hand. Notably, Petitioner has failed to establish necessary evidentiary facts related to the costs or expenses incurred in producing the income at issue in this case as well as the state(s) in which such costs were incurred. Because Petitioner's primary argument is the blanket, summary statement (and incorrect conclusion of law) that South Carolina is a cost-of-performance state and in turn should apportion the income of service providers based upon the costs of the taxpayer, it is necessary for Petitioner to provide evidence of those expenses it claims were incurred in producing the income.

For instance, Petitioner states in its motion that it leases Echostar's facilities, that it leases capacity on satellites for subsequent direct broadcast to its subscribers, and that it owns an equipment service and remanufacturing center in Spartanburg, South Carolina. Leased or wholly-owned property in South Carolina may provide value to South Carolina, and further discovery should be conducted to determine what impact, if any, those properties in South Carolina have in the determination of the income-producing activity in this case. Put simply, Petitioner has not established or provided much, if any, information regarding its costs and operations and how each relates to its income-producing activity in this matter.

B. Lack of Identification of Income-Producing Activities

Similarly, Petitioner has not provided any information or identified what it believes is the income-producing activity in this matter. While section 12-6-2295(A)(5) does not include a definition of "income-producing activity," ample authority exists to support the Department's interpretation of income-producing activity in this case. A

review of applicable South Carolina case law as well as similar cases in other jurisdictions illustrates that "the income-producing activity" language of section 12-6-2295(A)(5) requires the sourcing of revenues of personal-service industries to the location of the services *as well as* the sourcing of revenues of industries like direct broadcast satellite and cable television services to the location of where the service was delivered. For example:

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

In Mercury Motor Express, Incorporated v. South Carolina Tax Commission, the South Carolina Supreme Court addressed income-producing activity of an interstate freight hauler. Mercury Motor Express, Inc. v. S.C. Tax Comm'n, 244 S.C. 134, 135 S.E.2d 756 (1964). The Supreme Court listed a series of transactions that occur in the freight hauling business including solicitation of freight, picking up the freight, hauling the freight, dropping off the freight, and collecting the hauling charges and that many of these transactions may occur outside of South Carolina. Id. at 141, 135 S.E.2d at 759. The Supreme Court held that, while each of these transactions are "incidental to the production of income," the income-producing activity is the hauling of freight "through and over the highways of the State of South Carolina." Id. This decision supports the Department Determination in this case because it affirms that significant out-of-state activities that are "incidental to the production of income" are not income-producing activities.

2. Ameritech Publ'g, Inc. v. Wisconsin Dep't of Revenue, 327 Wis. 2d 798, 788 NW2d 383 (Ct. App. 2010) (unpublished), 2010 WL 2519583.

In Wisconsin, the Court of Appeals affirmed the taxing authority's determination that the income-producing activity of a company that received advertising revenue by placing the advertisements in telephone directories distributed in Wisconsin "was performed in Wisconsin when the advertisement reached its intended, Wisconsin audience." Ameritech Publ'g, Inc., 327 Wis. 2d 798, 788 NW2d 383 (Ct. App. 2010) (unpublished), 2010 WL 2519583 at 5. Although the vast majority of the taxpayer's costs to gather the advertising and to publish the telephone directory were incurred outside of Wisconsin, and (unlike the South Carolina statute) the applicable Wisconsin statute *even included* the phrase "costs of performance," the Court of Appeals concluded that the taxpayer's income-producing activity was "the provision of access to a Wisconsin audience." *Id.* at 9-10 (holding that the entire income-producing activity was within Wisconsin although the majority of the costs were incurred in other states and the applicable sourcing statute in Wisconsin said, "If the income-producing activity is performed both in and outside this state the sales shall be divided between those states having jurisdiction to tax such businesses in proportion to the direct costs of performance incurred in each such state in rendering this service").

3. Walter E. Heller Western, Inc. v. Arizona Dep't of Revenue, 161 Ariz. 49, 51, 53, 775 P.2d 1113, 1115, 1117 (1989).

Similarly, the Arizona Supreme Court also determined that the income-producing activity occurred in Arizona despite the fact that the California-based commercial financing company that received income from loans it made to Arizona

borrowers incurred most of its costs in California. Importantly, like the statute at issue in Wisconsin in Ameritech, the applicable Arizona statute was the same as S.C. Code Ann. § 12-6-2295(A)(5) *except* that the applicable sourcing statute in Arizona *actually used* the phrase "costs-of-performance," giving the taxpayer's cost-of-performance argument more merit but not enough to convince the Court. Walter E. Heller Western, Inc. v. Arizona Dep't of Revenue, 161 Ariz. 49, 51, 53, 775 P.2d 1113, 1115, 1117 (1989). The income-producing activity issue for determination related to the borrowing of money by Heller Western through its Los Angeles headquarters to make loans to customers in Arizona. *Id.* at 161 Ariz. at 50, 775 P2d at 1114. The Arizona Supreme Court held, "Though borrowing of funds [in California] may be an important step in Heller Western's financing process, the direct generation of the loans occurred in Arizona. We conclude that Heller Western's sales activity in Arizona constituted the income producing activity contemplated by our tax regulations." Id. 161 Ariz. at 53, 775 P2d at 1117. This holding, given that the phrase "cost-of-performance" was left in the applicable Arizona statute for that court to consider, is illustrative of the "income-producing activity" analysis at issue in this case where the cost-of-performance language was deleted by the South Carolina legislature.

4. Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013).

In another case on point, a Texas administrative court also determined that the income-producing activity of a DBS services provider occurs in the customer's home. In Anonymous Taxpayer v. Texas Comptroller of Public Accounts, Texas Administrative

Law Judge characterized the income-producing activity for a DBS services provider as follows:

> The act Petitioner's customer contracts and pays to receive and the act that produces the receipts at issue, is the act performed by the receiver (i.e., the set top box) that Petitioner sells or leases to its subscribers. Petitioner's customers contract for the receipt of television programming. Petitioner contracts to provide the programming, and it is the microchips within the receiver that unscramble and decode the satellite's encrypted signal that completes the transaction and produces the programming receipt.

Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013). The approach the Department took in this matter is identical to the Texas ALJ's rationale. Petitioner produces income in South Carolina by providing receiver boxes that interpret a broadcast signal for South Carolina customers. To that extent, and in complete consistency with section 12-6-2290, those gross receipts should be sourced to South Carolina.

5. Florida Technical Assistance Advisement Memorandums

The Florida Department of Revenue has recently issued two Technical Assistance Advisement ("TAA") memoranda in which the income-producing activity was determined to be located in Florida although the taxpayers incurred significant costs outside of Florida. As in other cases cited herein, the Florida Department of Revenue made these determinations although the applicable sourcing statute included both "income producing activity" and "based on costs of performance" language. See TAA 12C1-006, Fla. Dep't of Revenue, May 17, 2012, available at https://revenuelaw.state.fl.us/LawLibrarydocuments/2012/05/TAA-111027_12C1-006.pdf; TAA 13C1-011, Fla. Dep't of Revenue, Nov. 21, 2013, available at

https://revenuelaw.state.fl.us/LawLibraryDocuments/2013/11/TAA-117960_13C1-011%20RLL.pdf.

In the May 17, 2012 TAA, the taxpayer provided online courses to students throughout the United States, including students residing in Florida. The Florida Department of Revenue concluded the following:

> the income producing activity is the convenience of taking courses from home at a time most suitable for the student . . . . The specific transactions and activities at issue that occur in regular course of the Taxpayer's trade or business are the provision of online courses to the student's location.

TAA 12C1-006 at 4. In the November 21, 2013 TAA, the Florida Department of Revenue concluded that the income-producing activity for a taxpayer that collected and stored data and gave customers who paid a fee access to that information via the taxpayer's remote servers was the location of the taxpayer's customers because the transaction that produced the taxpayer's income occurred in Florida for every Florida customer. See TAA 13C1-011 (November 21, 2013). The Florida Department of Revenue stated:

> The income producing activity in the present case occurs wholly within Florida if the Taxpayer's customer is located in Florida. Such a result is consistent with Ameritech, Heller Western, [and] Florida's legislative history . . . . The collection of data is not the income producing activity because there is no transaction involved . . . . The transaction occurs when the Taxpayer sells the final service to its customer and receives compensation for the service in return.

TAA13C1-011 at 9.

Based on the foregoing highly illustrative cases and analyses, the Department determined that Petitioner's income-producing activity in this case occurs in the homes and businesses of South Carolina customers and that significant authority and the

Department's longstanding policies supported this view. As a result, the Department turned to the portion of section 12-6-2295(A)(5) that says "sales are attributable to this State to the extent that income-producing activity is performed within this State." S.C. Code Ann. § 12-6-2295(A)(5) (Supp. 2006). Consequently, it is proper to source 100% of the Subscription Receipts from every South Carolina customer to the numerator of the gross receipts ratio because 100% of the income-producing activity for South Carolina customers occurs in South Carolina homes and business.

While the Department submits no cost of performance analysis should be performed in this matter, it is important to note that the Petitioner has not presented any evidence of a payroll, property, or other factor to represent its view of income-producing activity subject to analysis here. To the extent the Court determines a cost of performance analysis is necessary in this case, genuine issues of material facts exist as Petitioner has not provided any evidence or documentation of such analysis, or for that matter, identification and location of what it believes the income-producing activities are in this matter. Naturally, the Department contends discovery is essential regarding these facts and issues (should this Court find that cost-of-performance elements are necessary), as these facts impact the gross receipts analysis.

C. Inconsistent Method of Filing

Petitioner asserts in its motion that "[d]uring the periods at issue, Petitioner sourced and reported income under the [cost of performance] method." (Pet'r Motion at 5). However, as noted by the Department auditor who conducted the audit in this matter, it was unclear to the Department what method of filing Petitioner used during the audit period. See Exhibit "A." More specifically, for some years Petitioner filed to reflect an

approach which sourced its subscription receipts to the location of its customers (as currently advocated by the Department), but in other years Petitioner utilized a sourcing method based upon cost-of-performance. Petitioner also oscillated between using the standard four-factor apportionment method (not appropriate in this case under any circumstances), and the gross receipts method for the tax years at issue. Accordingly, genuine issues of material facts exist such that the Department is unclear what method Petitioner used throughout the audit period and the basis for using such method.

III. Application of Law and Policy

A. South Carolina is Not a Cost of Performance State

As stated in its motion, Petitioner asserts that it used a cost-of-performance method to justify sourcing subscription receipts from South Carolina customers to a jurisdiction outside of South Carolina. Under applicable South Carolina law and long-standing Department policy, the Department asserts that South Carolina is not a cost-of-performance state and a cost-of-performance method is not appropriate. Several items confirm that South Carolina is not a cost-of performance state:

1. Historical Perspective of South Carolina Apportionment Statutes

South Carolina's apportionment statutes related to the apportionment of net income of service providers have *never* dictated the use of either a cost-of performance *or* a pure market-based sourcing method.[1] It is vitally important to note that South

[1] From 1958 until 1996, South Carolina's apportionment statute regarding the sales factor in the three-factor formula and sales of intangible personal property used for apportionment of sales from *manufacturing* and *tangible personal property* included cost of performance language. S.C. Code Ann. § 12-6-2280(C)(2) (1995); see S.C. Code Ann. § 12-6-2250 (1995). However, even with regard to these industries more inherently linked to cost-of-performance elements, since 1996 South Carolina law has mandated that a single sales factor (meaning the deletion of property and payroll factors) be used to apportion sales in these types of industries (i.e., sales from manufacturing and sales of tangible personal property) and the statute regarding the sales factor no longer included cost-of-performance language. S.C.

Carolina's statute is unlike the statutes of other states that mandate a specific method. See S.C. Ann. §§ 12-6-2290 (Supp. 2007); 12-6-2290 (1995); 65-279.10 (1976). For example, some states have adopted section 17 of the Uniform Division of Income for Tax Purposes Act ("UDITPA") [2] which mandates that the apportionment be made "based on costs-of-performance." Uniform Division of Income for Tax Purposes Act, § 17, 1966. Other states have adopted a "market-based sourcing method or "audience factor" to apportion net income for television and radio broadcasting. See e.g., 1 Colo. Code Regs. § 201-3:5A(1)(d)(ii)(2)(b).

South Carolina is *not* a UDITPA state. Although South Carolina's section 12-6-2295(A)(5) is very similar to UDITPA's Section 17, the General Assembly *specifically chose not* to include the phrase "based on costs-of-performance." See S.C. Code Ann. § 12-6-2295(A)(5) (Supp. 2007). South Carolina's applicable statutes merely require the apportionment of a service provider's net income using a gross receipts ratio pursuant to section 12-6-2290, and gross receipts are attributable to South Carolina to the extent that the income-producing activity is performed within South Carolina, as delineated in section 12-6-2295(A)(5) (Supp. 2007). As a result, under South Carolina law, income-producing activity is specifically not *based* on costs-of-performance, nor does it even

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Code Ann. §§ 12-6-2252 (2007); 12-6-2280 (2007). Importantly, the sales factor discussed here, and hence any mention of cost of performance language, did not relate to the apportionment of net income of *service providers* under section 12-6-2290 and its predecessor statutes. Consequently, *any* discussion of cost-of-performance language or factors is totally inappropriate and inapplicable to this case *except* to further demonstrate the South Carolina legislature's move away from such factors. Furthermore, it is important to note that even that language, while not applicable, has been removed by the legislature even for the other industries and products.

[2] Section 17 of UDITPA states, "Sales, other than sales of tangible personal property, are in this state if: (a) the income-producing activity is performed in this state; or (b) the income producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on cost of performance." Uniform Division of Income for Tax Purposes Act, § 17, 1966. (emphasis added).

consider cost-of-performance factors, given this intentional deletion by the South Carolina legislature.

2. Recent Statutory Amendment

Despite Petitioner's UDITPA argument and other related allegations, the enactment of section 12-6-2295(A)(5) in 2007 did not make South Carolina a cost-of-performance state. Despite the fact that South Carolina is not a UDITPA state, Petitioner argues that UDITPA's section 17,a model act designed to address service providers and unchanged since 1957, specifically includes the term "cost of performance" so that gross receipts from service providers must be apportioned based solely on cost-of-performance. While informative about the model act, the fact is that in 2007 the South Carolina General Assembly specifically chose not to include "cost of performance" in section 12-6-2295(A)(5) (the applicable South Carolina statute that otherwise closely parallels UDITPA's section 17). Therefore, unlike the states that adopted an unmodified version of UDITPA, South Carolina specifically chose not to impose a cost-of-performance element, much less a standard, on the apportionment of net income of service providers.

3. Gross Receipts Formula

Applicable South Carolina law has always mandated the use of a gross receipts formula to apportion net income of service providers, and a gross receipts formula on its face implies a focus on *sales*, not *costs*. See § 65-279.10 (1962), S.C. Code Ann. §§ 12-7-1190 (1976), 12-6-2290 (1995 and Supp. 2007), and 12-6-2295 (Supp. 2007); see also 1977 Act No. 95, § 1; 1995 Act No. 76, § 1; 2007 Act No. 110 § 51A, § 54A, eff. June 21, 2007; 2007 Act No. 116 § 56.A, §5 9A, eff. June 21, 2007.

4. Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. of App. 1987).

As discussed more fully below, and despite Petitioner's incorrect conclusion of law, the decision in Lockwood Greene did *not* mandate that the net income of *all* service providers be apportioned based on a "place of activity" test that is quantified by a payroll factor or some other cost-based factor. See Lockwood Greene, 361 S.E. 2d 346, 347. In fact, the Court of Appeals specifically recognized that the Department's audit guidelines (discussed more fully below) sourced revenues of several service industries (e.g., finance companies and media broadcasters) to the "origin of payment" (i.e., location of the borrower or customer), and revenues of *professional* personal service providers (e.g., engineering, law, and accounting firms) to the "place of activity." Id. The Court of Appeals also held that no constitutional problem existed with the Department's policy of sourcing revenues of services providers in a different manner for different industries.[3] Lockwood Greene, 361 S.E. 2d 346, n1. Finally, the payroll factor that was used by the Department to source Lockwood's gross receipts to South Carolina was *used merely as a proxy* for calculating Lockwood's actual gross receipts from within South Carolina. If the Department had all of Lockwood's records, the Department would not have had to use the payroll proxy, but could have examined all of Lockwood's invoices and added the fees billed for the work of South Carolina engineers. In the instant case, Petitioner has presumably added up all of its actual subscription

[3] Lockwood Greene certainly set the "place of activity" test for sourcing gross receipts from within South Carolina for professional personal service providers. By analyzing an engineering firm's business and differentiating it from a finance company and a media broadcaster, Lockwood Greene also at least implicitly accepted that the statute allowed different methods for different industries. Finally, Lockwood Greene did not impose a cost-based factor to source gross receipts to South Carolina. It is clear that the Department used a payroll factor to *estimate* the actual gross receipts from within South Carolina because that was the only information available to the Department at the time.

receipts from South Carolina customers for the applicable tax years; therefore, no cost-based proxy is needed.

B. South Carolina's Longstanding Policy Regarding Apportionment and the Applicable Statutes

In addition to not being a pure cost-of-performance state, South Carolina also has never been a state that always sourced receipts to the state in which the market exists (i.e., to the location of the customer or a "pure market-based state"). The Department's longstanding policy is one of apportioning net income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Lockwood Greene, 292 S.C. at 449, 361 S.E.2d at 347 (citing Hertz Corp. v. S.C. Tax Comm'n, 246 SC 92, 142 S.E.2d 445 (1979)); see also S.C. Code Ann. § 12-6-2320(A) (Supp. 2000). This approach necessitates flexibility in application of law and policy to different and often diverse service industries. Accordingly, the Department has interpreted sections 12-6-2290 and 12-26-2295(A)(5) as wholly consistent with the Department's longstanding policy of looking at the *activities* of each industry when determining how much of a service provider's revenues should be sourced to South Carolina.

In Lockwood Greene, the Court of Appeals stated that the purpose of the applicable apportionment statute was to apportion net income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Id. The Court of Appeals concluded that sourcing an engineering firm's revenues to the place where the services were performed met this purpose because the customer of an

engineering firm is purchasing the *time* and *expertise* of an engineering *professional* and that that such services were performed at the engineer's location. Id.

The applicable statute for apportioning net income from a taxpayer whose principal profits were derived from services at the time of Lockwood Greene was section 12-7-1190 (1976), which stated:

> If the principal profits or income of a taxpayer . . . are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing, or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State.

S.C. Code Ann. § 12-7-1190 (1976).

In applying section 12-7-1190, the Department's audit division used a set of written guidelines ("Guidelines"). See Transcript of Record at 26-29, Lockwood Greene, 361 S.E.2d 346 (Ct. App. 1987) (Exhibit "B"); Lockwood, Brief of Respondent, p. 10-11 (Exhibit "C"). These guidelines were approved by the South Carolina Tax Commission (the governing administrative agency at the time). Id. In these Guidelines, the Department listed eight industries and set forth the method a taxpayer should use to determine when gross receipts are from within South Carolina in accordance with section 12-7-1190. Id. Despite Petitioner's incorrect conclusory allegations, the Guidelines clearly demonstrate that the Department did not impose one manner of sourcing revenues to South Carolina on all industries. On the contrary, the Department looked at the specifics of each industry and each revenue source to determine the manner in which income should be sourced.

As a result, it is clear from a plain reading of section 12-7-1190 and the Guidelines that, contrary to Petitioner's conclusory arguments, neither the South Carolina statute nor the Department imposed one method of determining whether gross receipts were from within South Carolina and hence sourced to South Carolina. In fact, it is equally obvious from the Guidelines that the Department used different methods when addressing different industries based on the *activities* of the companies in each industry.

To be more specific, at the time of Lockwood Greene, the Department used the Guidelines to conduct audits of multi-state corporate taxpayers, and these Guidelines demonstrate that the Department's policy was not to source all income from services based on a single cost-of-performance method, a single market-based method, or any other method. On the contrary, the Department clearly examined each industry separately. The Guidelines clearly illustrate that, prior to the Lockwood Greene decision in 1987, the Department applied the apportionment statute for services on an industry by industry basis by examining the *activity* conducted by the taxpayer in South Carolina. Id. For instance, per the Guidelines, a taxpayer should source interest income of a finance company to the location of the borrower because those payments by South Carolina borrowers are receipts "from within this State." Transcript of Record at 26-29, Lockwood Greene, 361 S.E.2d 346 (Ct. App. 1987). The Guidelines also state that a radio or television broadcaster should source its advertising receipts to South Carolina only if the advertiser (i.e., the payer for the advertising) is located in South Carolina. Id. Alternatively, the Department's guideline for *professional* personal service firms, including engineering, law, and accounting firms, was to source the income from professional personal service fees to the state in which the professional performed the

service. Transcript of Record at 28, Lockwood Greene, 361 S.E.2d 346 (Ct. App. 1987). Simply put, the Department's audit guidelines stated that some industries should source its service revenue to the location of the payer (finance companies and media broadcasters), while other industries, specifically professional personal service firms, should source its service revenue to the location of the services performed (e.g., engineering, law, and accounting firms).

Despite these Guidelines (stipulated to by the Department and the taxpayer, the taxpayer in Lockwood Greene unsuccessfully argued that the then applicable apportionment statute for net income related to services, section 12-7-1190, "prescribed one rule for all businesses that do not deal in tangible personal property." Brief of Petitioner-Appellant at 13, Lockwood Greene 361 S.E.2d 346 (Ct. App. 1987). Accordingly, the engineering firm asserted that section 12-7-1190 was a "one-rule statute" and that it "should not be applied differently" to different taxpayers. Id. In fact, the taxpayer argued under its so-called "one-rule statute" theory (similar concept to what the Petitioner in this case alleges) that the net income of *all* taxpayers subject to section 12-7-1190 should be sourced pursuant to the Department's guidelines for finance companies and media broadcasters (i.e., by sourcing the receipts to the location of the payer), instead of being sourced pursuant to the Department's guidelines for engineering, law, and accounting firms (i.e., by sourcing the receipts to the location of the services performed – the "place of activity" test). Brief of Petitioner-Appellant at 12-13, Lockwood Greene 361 S.E.2d 346 (Ct. App. 1987).

The South Carolina Court of Appeals did not accept the taxpayer's argument that section 12-7-1190 was a one-rule statute and that all net income to be apportioned under

section 12-7-1190 must be apportioned under the same method. Several facts support the Court of Appeals' determination. First, the Court of Appeals did not believe that the use of different methods for different industries when applying section 12-7-1190 created a constitutional problem. After hearing the taxpayer's argument (that the Department had not consistently applied section 12-7-1190) and considering the Guidelines (which illustrated the Department's policy of allowing the use of different methods for different industries), the Court of Appeals stated, "We discern no constitutional basis for Lockwood's argument." Lockwood Greene, 293 S.C. at 450, 361 S.E.2d at 348 n.1.

Second, the Court of Appeals clearly distinguished finance companies and media broadcasters from *professional* personal service firms, such as Lockwood, when determining where to source service receipts. Lockwood Greene, 293 S.C. at 450, 361 S.E.2d at 348. *Implicit in this finding* is the fact that the only reason for the Court of Appeals to distinguish a taxpayer like Lockwood from companies in other industries was the Court of Appeals' belief that section 12-7-1190 was not a "one-rule statute," and that different methods could be used for different industries when applying section 12-7-1190.

Finally, the Court of Appeals noted the specifics of Lockwood "provid[ing] services to its clients through highly trained engineers and personnel in various offices" and that a "client pays an engineering firm for the expertise and time of its employees." Lockwood Greene, 361 S.E.2d 346, 347 (Ct. App. 1987) (emphasis added). Based on the specifics of Lockwood's business, the Court of Appeals then concluded, "Therefore, an engineering firm's business carried on in a state is reasonably measured by the services rendered by its personnel in the state," which "is epitomized by the 'place of activity' test advanced by" SCDOR. Id. Again, it would not have been necessary for the Court of

Appeals to address the specifics of Lockwood's business if section 12-7-1190 was a "one-rule statute."

Accordingly, the result of Lockwood Greene was (1) the Court of Appeals' holding that a professional personal service firm should source its gross receipts to South Carolina based on the "place of activity" test and (2) the affirmation of the Department's longstanding policy of using different methods for different industries to source service-related net income to South Carolina, its compliance with section 12-7-1190, and the lack of a constitutional issue with such policy. Further, despite Petitioner's contention, in no way did the Court of Appeals in Lockwood Greene impose a one-rule "place of activity" test for apportioning service-related income in South Carolina on *all* multi-state corporate taxpayers. The Court clearly supported the Department's use of different methods for different industries and did not reject Lockwood's "one-rule" argument only to replace it with a different one-rule requirement.

C. The Department's Application of Apportioning Income of Service Providers Subsequent to Lockwood Greene

Despite Petitioner's statements to the contrary, the Department's analysis and audits subsequent to Lockwood Greene support the fact that (1) its longstanding policy of analyzing the activity of industries on a case-by-case basis did not change after Lockwood Greene, (2) the Department never interpreted Lockwood Greene as mandating the "place of activity" test (or even another cost-of-performance method) for apportioning net income of service providers in all cases, and (3) the Department never interpreted any statutory changes after Lockwood Greene to make the substantive change of requiring a cost-of-performance method.

For example, as the cable television industry developed, the Department naturally examined these businesses. Contrary to Petitioner's arguments, cable companies always have sourced their subscription receipts received from South Carolina customers to South Carolina, and the Department has always agreed with this sourcing methodology. This scenario alone provides evidence that a taxpayer similar to Petitioner has not interpreted Lockwood Greene as mandating a "place of activity" test and that the Department has not required such.

Furthermore, as noted previously, in 1995 the General Assembly replaced section 12-7-1190 with section 12-6-2290 as the statute that directed taxpayers on how to apportion net income of service providers. A review of the text of these statutes reveals that section 12-6-2290 closely parallels former section 12-7-1190. Consequently, the Department's existing guidelines and analysis concerning the apportionment of net income of service providers, as examined, reviewed and upheld in Lockwood Greene, remained in place. Then, after a West Virginia decision issued in 2006 determined a credit card company had nexus to West Virginia[4] (nexus being a key concept for out-of-state service providers), the Department began to analyze its approach to credit card companies and the nexus issue with out-of-state credit card companies.[5]

Similar to the claims of Petitioner in the instant case, a taxpayer claimed that Lockwood Greene precluded the Department from claiming that the credit card company's income from sources within South Carolina should be taxed in South Carolina. However, in its analysis of credit card companies, the Department recognized that Lockwood Greene does not stand for the proposition that all income is allocated and

4 See Tax Comm'r of West Virginia v. MBNA America Bank, N.A., 640 S.E.2d 226 (W.Va. 2006).

5 Traynham, Michael, Internal Memo titled "Credit Card Companies (2008). See Exhibit "D."

taxed on the basis of where the services related to the income are performed. Id. Rather, the Department noted that Lockwood Greene stands for allocating income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Lockwood Greene, 361 S.E.2d at 347 (citing Hertz Corp. v. SC Tax Comm'n, 246 S.C. 92, 142 S.E.2d 445 (1979)). The Department differentiated the activities of an engineering firm (which performs a majority of its services in one state but receives income from sources spread over numerous states) from a credit card company (where the generation of income is entirely dependent on the lending of credit to end customers and the services performed by employees are more or less incidental to the generation of income). Id. Accordingly, the Department determined that sourcing income received by a credit card company from a South Carolina borrower to South Carolina (i.e., to the location of the borrower or the "origin of payment" view) is a closer approximation of the economic realities of a credit card company. Id. Additionally, the Department noted that Lockwood Greene is consistent with its longstanding policy that finance companies must apportion their receipts according to the location of the borrowers.[6] Id.

Similarly, the 2007 addition to BNA's South Carolina Corporate Income Tax Portfolio, which was written by two Department employees (including the Department's Chief Counsel for Policy), and a local CPA, confirmed that the Lockwood Greene decision sourcing engineering revenue to the "place of activity" was consistent with the Department's longstanding policy, as referenced in the audit guidelines, to source gross receipts of a finance company to the location of finance company's customers. Rick Handel, Deana West, William C. West, Tax Management Multistate Tax Portfolios:

[6] Note that the issue between the Department and the credit card company taxpayer was resolved without litigation. We believe that a confidential settlement was reached between the parties.

South Carolina Corporate Income Tax, Tax Management, Inc., The Bureau of National Affairs, Inc., ISSN 1083-2289, S-158, 2280:0510d-0510e (2007). This BNA excerpt provides further evidence that the Department and others did not interpret Lockwood Greene to impose the "place of activity" test on all service providers and that sourcing gross receipts to South Carolina based on the location of the customer in some circumstances has been the longstanding policy of the Department.

Finally, Petitioner references the South Carolina Corporate Income Tax Manual, and asserts that Lockwood Greene is discussed in the manual "as the leading authority on the sourcing of receipts using the single sales factor apportionment methodology." (Pet'r Mo. At 13). However, Petitioner fails to cite the last sentence of the paragraph which notes that the conclusion reached in considering Lockwood Greene and Geoffrey together, "is consistent with the longstanding administrative policy of the department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers." South Carolina Corporate Income Tax Manual (2005) at 20. See Exhibit "E" (emphasis added). Most importantly, Petitioner also fails to cite the following language from the manual:

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

Id. at 17 (emphasis in original).

Furthermore, and again contrary to Petitioner's conclusory statements, the 2007 enactment of section 12-6-2295(A)(5) and section 12-6-2290's reference to it also did not change the Department's guidelines or analysis regarding the apportionment of net

income related to services. First, the Department's auditors were already examining the activities of taxpayers and assessing the extent to which gross receipts should be sourced to South Carolina. For example, the Department believes that under section 12-6-2290 and amplified by section 12-6-2295(A)(5), the income of a finance company should still be sourced to the location of the borrower because the income-producing activity is the granting of credit to borrowers in South Carolina.

Secondly, section 12-6-2295 certainly did not adopt the "place of activity" test (as was applied to Lockwood) for all taxpayers. If the General Assembly had intended to adopt the Lockwood Greene "place of activity' test for all taxpayers, it would certainly have used phrases like "place of activity" or "where the service was rendered" rather than using the phrase "income-producing activity."

Third, the applicable statute that addresses how to apportion net income from services is found in the first sentence of section 12-6-2290 (added in 1995). This is the provision that continued the legislative mandate of use of a "gross receipts" ratio to apportion net income from services. This mandate has not changed, and South Carolina law still requires (and has since 1958) that net income from services be apportioned based on a gross receipts ratio. Even the statutory use of the term "gross receipts" strongly implies an emphasis on *sales* rather than on *costs*.

Finally, and perhaps most importantly, the addition of section 12-6-2295(A)(5) did not turn South Carolina into a cost-of-performance state for apportioning net income from services. If that was the intent of the General Assembly, it would more reasonably have included (rather than deleted) the "based on costs of performance" language at the end of section 12-6-2295(A)(5), which is the language that is included in UDITPA's

section 17 and which is what makes UDITPA a cost-of-performance model act. Instead, as previously discussed, the General Assembly *specifically deleted* this language from the statute before adopting the remainder of UDITPA section 17 almost verbatim. Other than this specific exclusion of "based on costs of performance" by the General Assembly, section 12-6-2295(A)(5) is almost identical to UDITPA's section 17; thus, it is clear that the General Assembly intended *not* to mandate a "cost-of-performance" method when apportioning net income from services to South Carolina. See UDITPA § 17; S.C. Code Ann. § 12-6-2295(A)(5).

D. Administrative Law Court Decisions

Finally, a recent Administrative Law Court decision in Rent-A-Center Texas, L.P. v. South Carolina Dep't of Revenue is consistent with the Department's determination in this case. Rent-A-Center Texas, L.P. v. South Carolina Dep't of Revenue, Final Order & Decision, 09-ALJ-17-0206-CC, (C.J. Anderson, Jan. 6, 2012). In Rent-A-Center Texas, the court addressed the sourcing of management fees to South Carolina but had to factor in and consider section 12-6-2295(A)(5), which had not been enacted at the time of Lockwood Greene in 1987. The court noted that the Court of Appeals found that "gross receipts from within the state" for an engineering firm were sourced to the location where the services that generate the income are performed. Rent-A-Center Texas, L.P., v. South Carolina Dep't of Revenue, Final Order & Decision, 09-ALJ-17-0206-CC, p. 8 (Jan. 6, 2012) (citing Lockwood Greene, 293 S.C. at 448-50, 361 S.E.2d at 347-48). The court stated:

> Furthermore, in 2007, Lockwood Greene's interpretation of "gross receipts from within the State" was codified at S.C. Code Ann. § 12-6-

2295(A)(5) (Supp. 2010), which defines the terms . . . "gross receipts" as used in § 12-6-2290 to include the following:

> 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 that income producing activity is performed within this State.

§ 12-6-2295(A)(5). Thus, the Legislature formally approved the Court of Appeal's interpretation of "gross receipts" as used in § 12-6-2290.

Rent-A-Center Texas, Final Order & Decision, 09-ALJ-17-0206-CC, p. 9-11. The evidence showed that Rent-A-Center Texas ("RAC Texas") performed and was paid only for management services performed by skilled professionals in Texas, and accordingly, its revenue from management fees must be sourced to Texas pursuant to Lockwood Greene. Id.

In Rent-A-Center Texas, the court did not assert that section 12-6-2295(A)(5) imposed a "place of activity" test on all service providers, but that section 12-6-2295 required sourcing of gross receipts to South Carolina to the extent that the income-producing activity is in South Carolina. This Court found that Rent-A-Center East ("RAC East") contracted for and received management services from RAC Texas' skilled professionals and that those skilled professionals performed all of their work in Texas. Therefore, as in Lockwood Greene, the income-producing activity was the location where the skilled professionals, who were directly hired by the customer, performed the services. Rent-A-Center Texas, Final Order & Decision, 09-ALJ-17-0206-CC, p. 9-11. By stating that section 12-6-2295(A)(5) codified Lockwood Greene, the court clearly meant that under section 12-6-2295(A)(5)'s income-producing activity language, the

professional fees earned by a professional personal services firm, like Lockwood or RAC Texas, would still be sourced to the location of the services because that is the location of the income-producing activity. In Rent-A-Center Texas, the court noted that the ruling in Lockwood Greene "was consistent with Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies." Rent-A-Center Texas, Final Order & Decision, 09-ALJ-17-0206-CC, at 8.

These types of personal services, when performed directly for a client who hires the recipient of the service, are wholly different from engineering and other personal services that are performed as intermediate steps to the production of a service. In the former case, there is one-on-one communication between the personal service provider, while in this case Petitioner's customer presumably has no contact or relationship with the engineer or contract attorney who works for Petitioner, not the customer. As a result, consistent with Rent-A-Center Texas and pursuant to section 12-65-2295(A)(5), Petitioner must source its revenue based on the location of its income-producing activity, and that income-producing activity related to South Carolina customers is 100% in South Carolina.

In summary, the Department's longstanding audit guidelines demonstrate that it has consistently interpreted section 12-6-2290 and its predecessor statutes to allow the use of different methods in different industries to apportion net income from services. The Department has always looked at the activities performed by companies in an industry to determine how and where to source service-related income, and the changes in applicable law have not altered the appropriateness of the Department's audit guidelines or its continued use of those guidelines. Additionally, the Court of Appeals in

Lockwood Greene confirmed the use of the audit guidelines and the appropriateness of the Department's informed choice to use different methods in different industries to source service-related receipts.

CONCLUSION

Based on the foregoing, the Department respectfully requests that this Court deny the Petitioner's Motion for Summary Judgment, as genuine issues of material facts exist under Petitioner's theory of this case. Further, the Petitioner is not entitled to judgment as a matter of law as it has misapplied the law in its Motion for Summary Judgment. Accordingly, the Department requests that this Court deny the Petitioner's Motion for Summary Judgment. In addition, given the facts at issue in the Department's theory of the case, the Department requests that this Court grant the Department's motion for summary judgment, and uphold the Department's Determination finding that the Petitioner is required to source income related to the subscription revenue of South Carolina customers to South Carolina pursuant to S.C. Code Ann. §§ 12-6-2290 and 12-6-2295(A)(5).

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January 27, 2015
Columbia, South Carolina

Exhibit "A"

Orville Sharpe

From: Orville Sharpe
Sent: Monday, September 26, 2011 4:35 PM
To: Jerilynn VanStory
Cc: Tim Donovan; John Swearingen
Subject: Dish DBS Corporation fka Echostar DBS Corporation

Tracking:

Recipient	Delivery	Read
Jerilynn VanStory	Delivered: 9/26/2011 4:35 PM	Read: 9/27/2011 8:05 AM
Tim Donovan	Delivered: 9/26/2011 4:35 PM	
John Swearingen	Delivered: 9/26/2011 4:35 PM	Read: 9/26/2011 4:35 PM

Jerilynn,

I'm reviewing the 12/08 corp inc return for the above company and they appear to be filing unitary combined utilizing the 4 factor apportionment ratio to source SC receipts and net income. Is there an agreement that allows them to file unitary combined utilizing 4 factor apport. Ratio. ?

By the way, this company or an affiliate operates a call center in Spartanburg County which started operations in 2006. At the end of 2006 (according to the TC-4) they had an average of 1,094 employees located at the SC call center.

Tks for your help.

Orville C. Sharpe
South Carolina Department of Revenue
Field Operations
Telephone: (803) 898-5652
Fax: (803) 898-5825
Email: sharpeo@sctax.org

Exhibit "B"

STIPULATION OF FACTS

The parties stipulate the following facts:

1. Plaintiff will be referred to as "the Taxpayer" and Defendant as "the Tax Commission".

2. The Taxpayer is a Massachusetts corporation in the business of providing engineering and related services. Such services primarily consist of designing manufacturing facilities. The Taxpayer has offices in South Carolina, Tennessee, Georgia, Texas and New York. It provides services from its various offices relating to projects located in numerous states, including South Carolina, and receives payments from clients located in numerous states, including South Carolina. The principal issue in this case is the amount of the Taxpayer's income which is subject to income taxation in South Carolina.

3. From 1942 to 1961, the Taxpayer used separate accounting, i.e., reported to South Carolina the total income of the South Carolina office less total expenses of the South Carolina office. In certain years, the Taxpayer had substantial income in South Carolina, but losses in other states. As a result, the Taxpayer's income reported to South Carolina in certain years was more than the Taxpayer's total net income from all states combined. Thus it became advantageous for the Taxpayer to switch

from separate accounting to apportionment. ("Apportionment" means attributing to this State a percentage of a taxpayer's total net income.) The Taxpayer asked permission of the Tax Commission to use apportionment but such request was denied. An auditor of the Tax Commission suggested instead a modified separate accounting method. The modified method allowed reporting gross income from the Taxpayer's work on client's projects located in South Carolina reduced by its costs of work on those projects, i.e., direct expenses and a percentage of overhead expenses. The Taxpayer accepted this modified separate accounting. That method, when applied to tax years 1958 through 1962, resulted in a net refund to the Taxpayer of $14,687.05. The Taxpayer has used this method ever since.

4. In 1975, the Tax Commission audited the Taxpayer's returns for tax years 1972, 1973 and 1974. The auditor noted the use of the modified separate accounting method. No change was made in that method or in the tax liability.

5. In 1980, the Tax Commission audited the Taxpayer's 1977, 1978 and 1979 tax returns. The same method of accounting was accepted for those years. However, the audit report delivered to the Taxpayer in November of 1980 stated that future returns should reflect

income based upon where the work was performed rather than where the job was located.

6. The Taxpayer continued filing its returns under the modified separate accounting method. That is, the tax returns for the years at issue here, 1981-1983 (Exhibits A-1, A-2 and A-3), continued to treat as South Carolina income the Taxpayer's net income from work on projects located in this state, i.e. its revenue from work on those projects minus the costs of that work. Such method resulted in a tax liability for the 1981-1983 tax years of $71,673 for income tax and $2,027 for license fees or a total of $73,700.

7. The Tax Commission audited the Taxpayer's returns for 1981, 1982 and 1983 and proposed an assessment of additional tax. (See the audit report, Exhibit B). The proposed assessment of additional tax required the Taxpayer to apportion its income to South Carolina based upon the gross receipts ratio of South Carolina Code of Laws, 12-7-1190.

8. The Taxpayer disagreed with the Tax Commission's interpretation of how "gross receipts from within this State" should be computed under § 12-7-1190. The Taxpayer filed amended returns (which constituted claims for refund) for the three years at issue, adopting an apportionment method based upon its interpretation of

"gross receipts from within this state" (Exhibits C-1, C-2 and C-3). One amended return showed more tax due, and two showed less. The Taxpayer claimed a refund for the net tax reduction shown by the three amended returns combined. The Tax Commission denied the claim for refund. Its decision is attached as Exhibit D-1 and the Transcript of the proceedings before the Tax Commission is attached as Exhibit D-2. Material presented by the Taxpayer at the hearing is attached as Exhibit D-3 and material presented by the Field Services Division of the South Carolina Tax Commission is attached as Exhibit D-4.

9. South Carolina Code § 12-7-1190 states:

> "If the principal profits or income of a taxpayer, other than those described in former 1962 Code 65-256 or 12-19-100, are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing, or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without of the State."

10. The Taxpayer's amended returns apportioned a share of its income to South Carolina based on the percentage of its total gross receipts which were from payors located in this state, i.e., based on the location from which its fees were received. The Tax Commission

apportioned a share of the Taxpayer's income to South Carolina based on the view that the percentage of gross receipts from within South Carolina is the same as the percentage of services rendered in this state. Services rendered in this state were determined by the percentage of total direct job payroll represented by South Carolina direct job payroll.

11. Before its amendment in 1972, § 12-7-1190 referred to "receipts in this State" rather than "receipts from within this State".

12. The apportionment method specified by 12-7-1190 may be applicable to various multi-state businesses, including:

(a) finance companies

(b) radio and television broadcasters

(c) building contractors

(d) engineers and architects

(e) law firms and accounting firms

(f) entertainment and sports companies

(g) hospital management companies

(h) restaurant franchise companies

13. In determining when gross receipts are from within South Carolina for the above businesses, the following guidelines have been applied by the Tax Commission in prior instances.

location of borrower

(a) Finance companies. Receipts are "from within this State" if the borrower lives in this state. For example, if a finance company in Augusta, Georgia, makes loans to South Carolina residents, payments on those loans are receipts "from within this State" and the company must apportion its income partly to this state on that basis. By the same token, a South Carolina finance company making loans to Georgia residents apportions its income partly to Georgia on the same basis. Before the 1972 amendment to § 12-7-1190 some out-of-state finance companies took the position that "receipts in this State" meant only payments actually received by them in this state, regardless of where payments originated. However, the reason for the 1972 amendment is not known.

location of purchaser

(b) Radio and TV broadcasters. Advertising receipts (broadcasters' main source of revenue) are "from within this State" if and only if the purchaser of the advertising is in this state.

when performed

(c) Building contractors. Receipts are "from within this State" if the services generating the receipts are performed in this state. In cases where services are rendered at the construction site, but fabrication of some materials occurs in another state, receipts are attributed in part to the state of fabrication since a portion of the work is performed there.

(d) Engineers and Architects (Multi-state). Where performed
Before August 24, 1977, receipts were considered "from within this State" if the client's project was located in this state, regardless of where services were rendered or where the client paid from. On that date the Tax Commission adopted a new interpretation of the statute and has from that date considered all such taxpayers' receipts to be "from within this State" to the extent that the services are performed in this state. A Regulation stating that interpretation was proposed but, after a hearing, was not adopted. Instead, the Commission adopted an internal policy, which was never published. (Exhibit E.)

(e) Law firms and Accounting firms (Multi-state). Receipts are "from within this State" to the extent the services are performed in the State. Where performed

(f) Entertainment and sports companies. A company furnishing the services of entertainers or athletes must treat its receipts as "from within this State" if the service of the entertainer or athlete is performed in this state. Where performed

(g) Hospital management companies. Receipts are "from within this State" to the extent that services are rendered here. Where performed

Location of franchise

(h) Restaurant franchise companies. This category refers to companies which do not operate the restaurant themselves, but which franchise the name and operation to third parties. Receipts are treated as "from within this State" if the restaurant is located here, regardless of where the franchisor's services are performed or where payments originate.

14. In the present case the following methods of apportioning the Taxpayer's income have the following South Carolina income tax and license fee results:

Method A. Apportion the Taxpayer's total net income, based on the ratio of the Taxpayer's direct job payroll for services rendered in this state to its total direct job payroll for services rendered everywhere, i.e., based on where its services are rendered. This was the method used in the Tax Commission's audit report (See Exhibit B).

(1)	Income taxes for three years	$207,293
(2)	License fees for three years	5,029
	TOTAL	$212,322

Method B. Apportion the Taxpayer's total net income, based on the ratio of receipts from payors located in South Carolina to total receipts, i.e. based on where receipts are paid from. This method was used on the Taxpayer's amended returns (See Exhibits C-1, C-2 and

C-3), but the numbers below reflect an adjustment made by the Tax Commission and accepted by the Taxpayer.

(1)	Income taxes for three years	$55,916
(2)	License fees for three years	1,387
	TOTAL	$57,303

15. The following tax results occur if two other methods of arriving at the Taxpayer's South Carolina income are employed:

Method C. Instead of using an apportionment method, account separately for the income of the Taxpayer's office in South Carolina. That is, fees for work performed in the South Carolina office reduced by the expenses of that work. This is separate accounting (and is different from the modified separate accounting method used on the Taxpayer's original returns). The parties agree separate accounting is not appropriate for this taxpayer since its records do not "clearly reflect net income arising from sources within this state", as required by law for the use of separate accounting. This method is presented to demonstrate the tax result which would result from separate accounting if such a method were appropriate. Separate accounting is normally applied only to businesses with separate units where each unit functions independently and locally, with only minor central administration (e.g. hotel or restaurant chains).

(1) Income taxes for three years $208,726

(2) License fees for three years 5,795

TOTAL $214,521

Method D. Apportion the Taxpayer's entire net income partly to South Carolina, based on the ratio of receipts for work on client's projects located in South Carolina to total receipts, i.e., based on the location of the project.

(1) Income taxes for three years $87,313

(2) License fees for three years 2,027

TOTAL $89,340

The Tax Commission does not agree that the resolution of this case can or should be obtained by applying either of these methods.

16. The parties reserve their rights to object to any of the stipulations on the grounds of lack of relevancy or materiality.

AGREED AND STIPULATED.

Exhibit "C"

THE STATE OF SOUTH CAROLINA

IN THE SUPREME COURT

APPEAL FROM RICHLAND COUNTY

HONORABLE WALTER J. BRISTOW, JR., JUDGE

CASE NO. 83-CP 40-5148

Lockwood Greene Engineers, Inc.,

Appellant

vs.

South Carolina Tax Commission,

Respondent

BRIEF OF RESPONDENT

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QUESTIONS

1. Does the phrase "gross receipts from within this State" refer to an engineering firm's gross receipts from services performed in South Carolina or to gross receipts paid from clients located in South Carolina?

2. Does the phrase refer to receipts from projects located in this State?

STATEMENT

Lockwood Greene Engineers, Inc., the appellant (taxpayer) is a Massachusetts corporation earning its income by providing engineering services. (Tr., p. 11) These services are provided by the taxpayer's employees located in offices in South Carolina, Tennessee, Georgia, Texas and New York. Services are performed for clients located in numerous states. (Tr., p. 11) In determining the taxpayer's South Carolina income, a dispute has arisen as to the proper interpretation to be given to Section 12-7-1190. It is this dispute which is before the Court. (Tr., p. 13)

The dispute turns upon the meaning of the words "gross receipts from within this State" as used in Section 12-7-1190. (Tr., pp. 10-11) The taxpayer asserted to the Tax Commission (Tr., p. 160) and to the lower court (Tr., p. 11) that "gross receipts from within this State" were those receipts which were from payors located in South Carolina. (Tr., p. 29) (Method B of Stipulation 14) This view is the origin of payment view. (Tr., p. 11) The Tax Commission asserted both at the Commission hearing (Tr., p. 114) and before the lower court (Tr., p. 11) that "gross receipts from within this State" were found by determining that portion of the taxpayer's services that was performed in South Carolina. (Tr., p. 27) (Method A of

Stipulation 14) This view is the place of activity view. (Tr., p. 11)

The trial court held the Tax Commission's place of activity view was the proper interpretation of Section 12-7-1190. (Tr., p. 11) This conclusion was reached by the Court since the legislative history showed the purpose of Section 12-7-1190 was to tax only that portion of a business carried on within South Carolina and that the place of activity view best accomplished the stated purpose. (Tr., p. 15) In fact, the trial court held the taxpayer's origin of payment view had no relationship to the extent of business carried on within South Carolina since such a view gave South Carolina only 9% of the taxpayer's business even though 38% of the taxpayer's total gross receipts were received in South Carolina. (Tr., p. 16) The trial court further found the Tax Commission's interpretation was proper since it was supported by a consistently applied administrative interpretation, (Tr., p. 17) the view of sister states was consistent with the Tax Commission's view (Tr., p. 16) and prior amendments to Section 12-7-1190 supported the Tax Commission's interpretation. (Tr., pp. 18-20)

The taxpayer denied the validity of the trial court's conclusion. This appeal by the taxpayer followed.

ARGUMENT I

AN ENGINEERING FIRM'S GROSS RECEIPTS FROM WITHIN THIS STATE REFER TO GROSS RECEIPTS FROM SERVICES PERFORMED WITHIN THIS STATE AND DOES NOT REFER TO THE LOCATION FROM WHICH THE CLIENT PAYS.

The question before this Court is what interpretation is to be given to the phrase "gross receipts from within this State" (hereinafter disputed phrase) as used in Section 12-7-1190, South Carolina Code of Laws, 1976, as amended. The taxpayer asserts the disputed phrase "is clear and straightforward" and "is not ambiguous and needs no interpretation". (Appellant's Brief, p. 10) Such a view cannot be persuasive and does nothing more than beg the question.

It is well settled that where the terms of a statute are susceptible to more than one interpretation, courts must construe the statute to ascertain the intent of the General Assembly. Southeastern Fire Insurance Co. v. South Carolina Tax Commission, 253 S.C. 407, 171 S.E.2d 355 (1969). Here, the taxpayer asserts the disputed phrase makes gross receipts South Carolina receipts if the payor is located in South Carolina, i.e., the origin of the payment view. The trial court found the disputed phrase to make gross receipts South Carolina receipts if the services generating the receipts were performed in South Carolina, i.e., the place of activity view. (Tr., p. 11) Two interpretations are suggested. Thus the duty of the Court is to construe the statute to discover its meaning.

A. The Trial Court's View Is Correct Since It Furthers The Purpose And Intent Of The General Assembly.

While numerous rules of construction may be applied in construing a statute, all are subject to one cardinal rule: legislative intent must prevail. Peoples National Bank of Greenville v. South Carolina Tax Commission, 250 S.C. 187, 156 S.E.2d 769 (1967). The view which furthers the intent must prevail over one which defeats such intent.

In the instant case, the intent and purpose of the General Assembly as to Section 12-7-1190 has already been determined.

> "The purpose of this legislation . . . is to provide for the imposition of the South Carolina income tax . . . 'upon a base which reasonably represents the proportion of the trade or business carried on within this State'." Hertz Corporation v. South Carolina Tax Commission, 246 S.C. 92, 142 S.E.2d 445, 446 (1965).

The task of the trial court and now of this Court is to determine which interpretation furthers the purpose of the General Assembly to tax a reasonable proportion of the taxpayer's business carried on in South Carolina.

What portion of the taxpayer's business is carried on in South Carolina? The evidence shows that on the average for the years involved in this action 33% of the taxpayer's total direct job payroll was performed in South

Carolina. (Tr., p. 15) Further, the evidence shows that on the average for the years involved 38% of the firm's total gross receipts was received in South Carolina. (Tr., p. 16) These figures mean that slightly over one-third of the taxpayer's business is carried on in South Carolina.

Since approximately one-third of the taxpayer's business is carried on in South Carolina, the interpretation that taxes that share is the interpretation that more fully furthers the purpose of the statute. Which interpretation furthers the purpose? The taxpayer's interpretation allowed it to pay tax on the average for the years involved of only 9% of its gross receipts. (Tr., p. 16) Gross receipts reported to South Carolina by the taxpayer for the three years involved ranged as low as 6.5% in 1983 to no higher than 11% in 1981. (Tr., p. 172) The interpretation followed by the trial court required the taxpayer to pay tax on approximately one-third of its gross receipts. (Tr., p. 15) It is thus obvious that the trial court's utilization of the place of activity view more fully furthers the purpose of taxing the South Carolina business of this taxpayer since approximately one-third of its business is carried on here. Thus, the trial court correctly construed the statute.

B. The Trial Court's View Is Correct Since The Taxpayer's View Gives Unreasonable Results.

The origin of the payment view expressed by the taxpayer not only does not further the purpose of the statute but rather the taxpayer's view defeats the purpose and gives unreasonable results. For example, as the trial court pointed out (Tr., pp. 15-16), if 100% of the work on a South Carolina project were performed in South Carolina but payment for the project was made to the taxpayer from the client's New York headquarters, such payment under the taxpayer's origin of payment view would be 100% New York gross receipts. Having all of the work performed in South Carolina but with payment coming from New York gives South Carolina no taxable receipts. Such a view is unreasonable and leads to impractical results. A statutory provision should be given a reasonable and practical construction consistent with the purpose of the statute. Hay v. South Carolina Tax Commission, 273 S.C. 269, 255 S.E.2d 837 (1979).

The taxpayer's view is both unreasonable and impractical and should be dismissed. The taxpayer argues that the South Carolina gross receipts must be determined in the same manner for every type of business. (Appellant's Brief, p. 13) It then asserts the one and only way to find South Carolina receipts is to look to where the payment comes from. Such a view is incorrect.

The General Assembly intended Section 12-7-1190 to be a catch-all provision for all businesses that did not deal in tangible personal property. Hertz Corp., supra. To fulfill the purpose of Section 12-7-1190 to tax that portion of the business carried on in South Carolina, an interpretation must be given which allows the appropriate amount of tax to be collected.

Application of a single wooden rule for all businesses could never accomplish the General Assembly's goal. For example, a finance company earns income by the loaning of funds at interest. Its gross receipts consist of interest income. The best measure of South Carolina's gross receipts for a finance company is to determine where its "business" is. Its business is where its money is loaned, i.e., where the borrower lives. In other words, a finance company has South Carolina gross receipts not merely because the borrower lives in South Carolina but rather because the finance company's money is on loan in South Carolina. Because its money is here, its gross receipts on that money are South Carolina gross receipts. Thus, for finance companies the Tax Commission uses the approach that best accomplishes the General Assembly's purpose of taxing the South Carolina business. No wooden rule of location is followed.

Broadcasters present another example. To determine what portion of a broadcaster's business is in South Carolina, the Tax Commission has determined that a broadcaster's income is from selling air time. If the purchaser of the air time is in South Carolina, then the Tax Commission has determined the broadcaster's "air time" is in South Carolina. The criteria for determining a broadcaster's South Carolina gross receipts is not merely that the purchaser is in South Carolina but rather the criteria is that the broadcaster's air time is directed to South Carolina. Such a view is a reasonable approach to determine the extent of a broadcaster's South Carolina gross receipts.

Pursuing the taxpayer's argument to its logical conclusion shows how inappropriate it is. If all businesses within the scope of Section 12-7-1190 had South Carolina gross receipts only if those gross receipts came from South Carolina payors, it would be a simple enough matter to circumvent South Carolina's tax altogether. For example, multi-state engineering companies could simply have its clients pay from sources outside of South Carolina. Likewise, accounting firms performing all their services in South Carolina could have their client pay from locations outside of South Carolina. Under the taxpayer's approach, such a scheme would be perfectly proper and would

be a simple business decision that would avoid the payment of income taxes.

The trial court recognized that the taxpayer's interpretation would lead to an easy means to circumvent South Carolina's tax. (Tr., p. 18) The Court correctly concluded the General Assembly never intended such a result. Because of such, the taxpayer's argument should be dismissed as unreasonable and the trial court's view upheld.

C. The Trial Court's View Is Correct Since It Is Supported By A Consistently Applied Administrative Construction.

It is well settled that the construction of a statute by the agency charged with the administration and enforcement of that statute is most significant. Shasta Beverages v. South Carolina Tax Commission, 280 SC 48, 310 S.E.2d 655, 659 n.1 (1983); Etiwan Fertilizer Co. v. South Carolina Tax Commission, 217 S.C. 354, 60 S.E.2d 682, 684 (1950). Such construction is entitled to the most respectful consideration and should not be overruled absent compelling reasons. Emerson Electric Co. v. Wasson, 287 S.C. 394, 339 S.E.2d 118, 120 (1986). In fact, it has been held that such interpretations are of controlling weight unless the interpretation is plainly erroneous. Bowles v. Seminole Rock and Sand Co., 325 U.S. 410, 414 (1945).

In the instant case, it has been stipulated that the Tax Commission adopted an interpretation of Section

12-7-1190 on August 24, 1977 that established the place of activities view as to engineers. (Tr., p. 28, Stipulation 13(d)) That stipulation further shows the Tax Commission has consistently applied that view to all gross receipts of all engineering firms. (Tr., p. 28) Nothing in the evidence shows that the Tax Commission ever varied its interpretation of Section 12-7-1190 after August, 1977. Since the Tax Commission's interpretation is reasonable, there are no cogent reasons to overturn the Tax Commission's view.

D. The Trial Court's View Is Correct Since The Title Of The 1972 Amendment To Section 12-7-1190 Demonstrates No Significance Is To Be Given To The Words "From Within".

The taxpayer asserts the 1972 amendment to Section 12-7-1190 demonstrates that the statute intended gross receipts from within this State to refer to gross receipts from payors in this State. (Appellant's Brief, p. 13) Not only is this assertion incorrect, but in fact, the 1972 amendment demonstrates the location of the payor is irrelevant.

The 1972 amendment to what is now Section 12-7-1190 made only one change to the language of Section 12-7-1190. The language "gross receipts in this State" was changed to read "gross receipts from within this State". There are no legislative committee reports or discussions

which explain the reason for this change and the parties stipulated at Tr., p. 27 that the reason for the change was unknown.

The taxpayer has now asserted the reason for the change was for "requiring out-of-state finance companies to apportion income to this State if they have borrowers here". (Appellant's Brief, p. 14) There is absolutely no evidence which supports this position.

The stipulations at Tr., p. 27 make only one statement concerning the 1972 amendment and finance companies. The evidence shows that before the 1972 amendment some out-of-state finance companies took the position that "receipts in this State" meant only payments actually received by them in this State regardless of where the payment originated. No evidence shows that the General Assembly added the language "from within" to insure that out-of-state finance companies reported the proper amount of tax. In fact, if the General Assembly had wanted the location of the payor to constitute South Carolina gross receipts, it could have easily done so by stating South Carolina gross receipts shall be receipts paid from locations in South Carolina.

Of greater significance in determining the implication of the 1972 amendment is the title of the Act. Reference to the title or caption of an Act is proper to

determine the meaning of a statute. University of South Carolina v. Elliott, 248 S.C. 218, 149 S.E.2d 433 (1966). The title of Act 1189 which enacted the 1972 amendment is as follows:

> "An Act To Amend Section 65-279.10, Code Of Laws Of South Carolina, 1962, Relating To Taxation Of Remaining Income Of Certain Taxpayers, So As To Base Its Computation On The Ratio Of Gross Receipts Within This State During The Income Year To The Total Gross Receipts Of Such Year Within And Without The State."

Nowhere in the title are the words "from within" used. Rather, only the word "within" is used. Such shows the General Assembly gave no significance to the location of a payor and further shows the General Assembly meant only to compute a ratio based upon taxing gross receipts that were within South Carolina. The location of the payor was never suggested by the General Assembly as a means for determining South Carolina gross receipts.

The taxpayer's explanation of why the title of Act 1189 does not contain the words "from within" (which words are critical to its argument) is patently unpersuasive. The taxpayer asserts: "The omission of 'from' in the title was probably a clerical error and has no significance". (Appellant's Brief, p. 15) Such a view cannot prevail since according to the taxpayer the words "from within" were specifically designed to instruct finance companies to

report income to South Carolina based on payments made from South Carolina payors. If such were truly the purpose of the amendment, it is highly unlikely the Act could have moved through both chambers of the General Assembly with such a glaring clerical error. The Tax Commission asserts that no clerical error was made at all but rather the title was correctly written and gives no significance to the location of the payor.

ARGUMENT II

THE DISPUTED PHRASE DOES NOT REFER TO RECEIPTS FROM PROJECTS LOCATED IN THIS STATE.

The taxpayer has offered an alternative interpretation to Section 12-7-1190 which it refers to as the "location-of-the-project" interpretation. (Appellant's Brief, p. 22). In short, this interpretation says all businesses within Section 12-7-1190 would have South Carolina gross receipts if the "project" is located in South Carolina. (Appellant's Brief, pp. 22-23)

Several reasons prevent the application of the "location-of-the-project" view. First, such an interpretation does not further the legislative purpose of Section 12-7-1190 since it does not tax the portion of the taxpayer's business carried on in South Carolina. Second, the determination of the criteria of the location of the "project" is artifical since not all businesses have project locations. Rather, such an approach is only a poor

measure of where the services rendered are performed. These reasons are discussed below.

A. The Location-Of-The-Project View Does Not Further The Legislative Purpose Of Section 12-7-1190.

The purpose of Section 12-7-1190 is to tax that portion of the taxpayer's business carried on in South Carolina. Hertz Corp., supra. The trial court noted the taxpayer received 38% of its receipts in South Carolina and incurred 33% of its direct job payroll in South Carolina. (Tr., pp. 15 and 16) Under the taxpayer's original returns, shown an Exhibits A-1, A-2 and A-3 at Tr., pp. 41, 52 and 72, the percentage of receipts from projects in South Carolina to total receipts is 16.84% for 1981, 13.44% for 1982 and 9.84% for 1983. These percentages represent the taxpayer's receipts from work on projects located in South Carolina. (Tr., p. 24, Stipulation 6)

Does the taxpayer's suggested project location view approximate the business carried on in South Carolina? No. The evidence shows the taxpayer performs over one-third of its business from its South Carolina office. The fact that on the average only 13% (16.84% for 1981, 13.44% for 1982 and 9.84% for 1983) of its receipts is from South Carolina projects demonstrates that substantial services are performed in South Carolina for projects located outside South Carolina. The income is

earned where the services are performed and one-third of the services are performed in South Carolina. Thus, one-third of the taxpayer's gross receipts are apportioned to South Carolina.

The location of the project view is an attempt by the taxpayer to substitute an inaccurate measure of the taxpayer's business in South Carolina for the accurate measure of where the services are performed used by the trial court. Just as with the origin of payment view advanced by the taxpayer, the location of the project view leads to unreasonable results. For example, if all engineering services are performed in New York and the only connection to South Carolina is that the manufacturing plant designed in New York is to be built in Columbia, the taxpayer's total receipts from its services would be 100% South Carolina receipts. This would be true under the taxpayer's view even though absolutely no services were performed by the taxpayer in South Carolina. Correspondingly, if all engineering services were performed in South Carolina but the manufacturing plant was to be located in New York, the entire gross receipts would be New York gross receipts. The location-of-the-project view leads to unreasonable results and should therefore be dismissed.

B. The Location-Of-The-Project View Is Inappropriate For All Businesses Within The Scope Of Section 12-7-1190.

The taxpayer asserts the location of the project view can be appropriately applied to all businesses. Such a view is incorrect since not all businesses' "projects" have any relationship to the trade or business carried on in South Carolina. For example, the taxpayer seeks to argue that accounting firms and law firms have "projects" based upon where the client is located or the lawsuit is tried. Can it be reasonably said that an accountant derives gross receipts only where the client is located? Or is it reasonable to conclude an attorney derives gross receipts only where the case is tried? Obviously not. In both situations, substantial preparation is performed by an accountant away from the client's business and an attorney performs extensive work at his office prior to trying a case in a different location. Thus, the location of the project is an inaccurate measure of a taxpayer's business carried on in South Carolina.

The most accurate measure of a taxpayer's business in South Carolina is determining where the services for which the client is paying is incurred. If the service is incurred in South Carolina, then such payment for that portion of the service incurred in South Carolina is South Carolina gross receipts. This is the method employed by the Tax Commission. (Tr., p. 185, Exhibit E) This is the

method employed by the trial court. (Tr., p. 11) It is respectfully submitted the trial court's decision should be upheld.

CONCLUSION

Section 12-7-1190 requires that to compute the income of a service business like the taxpayer's, one must determine gross receipts from within South Carolina. To further the purpose of taxing only the portion of a taxpayer's business carried on within South Carolina, it is appropriate to tax only those gross receipts resulting from services incurred in South Carolina. Looking to where the location from which the client pays his bill or looking to the location where the client will have his manufacturing plant does not tax the taxpayer based on its business in South Carolina. Its business in South Carolina is more accurately measured by determining where its services are performed. This place of activity test is the proper interpretation for determining gross receipts from within South Carolina. Because of such, the trial court's decision should be upheld.

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Columbia, South Carolina
February _____, 1987

Exhibit "D"

Credit Card Companies

Presumed Factual Scenario:

The taxpayers subjected to potential tax liability under the foregoing analysis would include large national banks and other finance companies which may have little to no traditional "physical presence" in South Carolina as well as retailers and their subsidiaries engaged in marketing and issuing retailer preferred credit cards (i.e. a Belk card, Dilliard's card, Target card, etc). The retailers would likely have brick and mortar stores in South Carolina, as well as undertake many of the same activities to engage in the credit card business as their large financial institution counterparts. For the purposes of this discussion, these potential taxpayers will be referred to collectively as credit card companies or "CCCs."

One issue as to the players is worth noting. Although there are undoubtedly thousands of distinct entities in the credit card market, 80% of the market is ultimately owned by the top six players (Per Capital One 2007 Annual Report). Although the complexities of the corporate entities and structures involved could create more complicated audits than are necessarily desirable, this may mean that any given audit of a large CCC, successfully litigated, could be worth tremendous tax revenues.

Summary:

The burden is on the taxpayer to show that any Department assessments are incorrect, but as a matter of practice, the Department should be able to show that:

1. The CCC has purposefully directed activities toward residents of South Carolina and the economic market of South Carolina (see analysis of issue one – Due Process)
2. The taxed activities of the CCC have a "substantial nexus" to South Carolina, though traditional physical presence is clearly not required (see analysis of issue one – Commerce Clause);
3. The tax is fairly apportioned (see analysis of issue two), does not discriminate against interstate commerce, and is fairly related to benefits provided by the State.

ISSUE ONE: NEXUS – ASSERTING TAXING JURISDICTION OVER MULTISTATE CCCs OVER DUE PROCESS AND COMMERCE CLAUSE OBJECTIONS

In order to impose a state tax on a multi-state or non-domiciliary taxpayer, the tax must satisfy both the Due Process Clause and the Commerce Clause of the U.S. Constitution. See, e.g. Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

B. Due Process

The Due Process analysis is easily satisfied in most cases. Courts typically find that a tax does not offend the Due Process clause where traditional notions of fundamental fairness are

respected and where the taxpayer has a minimal connection with the taxing jurisdiction. See, e.g. Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1984); Geoffrey, Inc. v. S.C. Tax Comm'n, 437 S.E.2d 13 (S.C. 1993). The tax will not be barred by Due Process concerns where it is reasonable for the taxpayer to be subjected to defending a lawsuit in the taxing jurisdiction. See Shaffer v. Heitner, 433 U.S. 186, 212, 97 S.Ct. 2569, 2584 (1977). South Carolina has specifically found that intentionally availing oneself of the benefits of an economic market meets the Due Process test. Geoffrey, 437 S.E.2d 13.

The imposition of a state income tax on a CCC with customers in South Carolina would not offend the Due Process Clause. Where a CCC directed marketing efforts at South Carolina residents and received income in the form of fees or interest from those customers, the CCC would have reasonable notice that the state may exercise some power over it in relation to its business transactions within the state. Therefore, it is unlikely a Due Process challenge would avail such a taxpayer against the imposition of any state tax in South Carolina.

C. Commerce Clause

Modern Commerce Clause analysis of state taxing authority began with Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1977). In Complete Auto the Supreme Court addressed the factors it considered in testing the validity of a tax against a challenge[1]. The tax:

1. must apply to an activity with a "substantial nexus" to the taxing state;
2. must be fairly apportioned;
3. must not discriminate against interstate commerce; and
4. must be fairly related to benefits provided by the State.

See also Quill Corp. v. North Dakota at 311; Geoffrey, Inc. v. S.C. Tax Comm'n, 313 S.C. 15, 23, 437 S.E.2d 13, 18 (1993). The South Carolina Supreme Court has long held that taxpayers need not have a tangible, physical presence in the state to satisfy the "substantial nexus" prong of Complete Auto. Geoffrey, 313 S.C. at 23, 437 S.E.2d at 18. The Court noted that its holding was consistent with U.S. Supreme Court precedent. Id. (citing Int'l Harvester Co. v. Wisconsin Dep't of Taxation, 322 U.S. 435 (1944), for the proposition that states may tax the portion of income fairly attributable to events or transactions which occur within the state and are under its protection). The Geoffrey Court determined that nexus was established because of the taxpayer's use of intangible property (trademarks, etc.) within the state. Geoffrey, 313 S.C. at 23-24, 437 S.E.2d at 18. Other courts have reached similar conclusions regarding the necessity—or lack of necessity—of a tangible, physical presence to establish state income tax nexus. See, e.g., Bridges v. Autozone Properties, Inc., 900 So.2d 784, 789 (La. 2005); Lanco, Inc. v. Div. of Taxation, 879 A.2d 1234, 1238 (N.J. Super. Ct. App. Div. 2005); Geoffrey, Inc. v. Oklahoma Tax Com'n, 132 P.3d 632, 637 (Okla. Civ. App. 2005).

1. *MBNA* and economic presence statutes

[1] The Supreme Court noted in Quill that "[w]e have sometimes stated that the Complete Auto test, while responsive to Commerce Clause dictates, encompasses as well . . . due process requirement[s]." Quill at 313, n.7. Consequently, modern nexus analysis concerns itself more with the concerns of the Commerce Clause than with the Due Process Clause, as the court has openly suggested that a tax which satisfies the former will pass muster with the latter. Id.

In Tax Commissioner of West Virginia v. MBNA America Bank, N.A., 640 S.E.2d 226 (W.Va. 2006), the West Virginia Supreme Court analyzed a large credit card company's nexus with the state for income tax purposes. While distinguishing the case before it from the Geoffrey line of cases[2], the court adopted a "significant economic presence test" as a litmus test for nexus. MBNA 640 S.E.2d at 235. This test was, in the courts view, consistent with the opinion of legal commentators. Id. (citing Christina R. Edson, Quill's Constitutional Jurisprudence And Tax Nexus Standards In An Age Of Electronic Commerce, 49 Tax Lawyer 893, 945 (Summer 1996), for the proposition that an economic presence analysis would incorporate Commerce Clause and Due Process inquiries, and would also examine the degree to which the taxpayer has exploited a market). The nature of the scholarly support relied upon in MBNA is remarkably similar to the passages cited by the South Carolina Supreme Court in Geoffrey. 313 S.C. at 23, 437 S.E.2d at 18 (citing J. Hellerstein & W. Hellerstein, State Taxation P. 6.08 (2d ed. 1992).

The court determined that MBNA had a significant economic presence in West Virginia. MBNA at 236. In reaching this conclusion, the court relied on MBNA's systematic direct mail and telephone solicitation and its significant gross receipts (in excess of $8 million in tax year 1998) attributable to West Virginia customers. Id. The court rejected MBNA's argument that the court should follow J.C. Penney National Bank v. Johnson, a Tennessee Court of Appeals decision which denied substantial nexus existed under factually similar circumstances. MBNA at 235, citing 19 S.W. 3d 831 (Tenn. Ct. App. 1999). Although MBNA correctly pointed out that the J.C. Penney court denied nexus for lack of physical presence, the Tennessee Court of Appeal effectively limited J.C. Penney in America Online, Inc. v. Johnson, 2002 WL 1751434 (Tenn. Ct. App.), by holding that activities undertaken on behalf of a taxpayer were sufficient to uphold an assessment of state tax, even where physical presence was doubtful. America Online, Inc. at *2-*3.

West Virginia is not the only state which has taken the position that economic presence can establish substantial nexus for state tax purposes. Indiana statutes subject a business to tax within the state if the business solicits business from more than 20 Indiana residents or has assets attributable to Indiana of greater than $5 million. See Indiana Code § 6-5.5-3-4 (2006). This is substantially identical to the "economic presence" provisions of Minnesota's Statutes. Minn. Stat. Ann. § 290.015. Massachusetts has a similar statute which creates a rebuttable presumption that a financial institution is engaged in business within the commonwealth (that is, has substantial nexus with Massachusetts) where it (1) solicits business from 100 or more commonwealth residents, (2) has $10 million or more in assets attributable to sources within the commonwealth, or (3) has gross receipts in excess of $500,000 from sources within the commonwealth. Mass. Gen. Laws Ann. Ch. 63 § 1 (2005). These economic presence provisions appear to have escaped judicial challenge thus far, leaving very little case law supporting or refuting our proposed position.

2. Physical presence of certain CCCS

[2] The court specifically noted that the case before it, unlike Geoffrey and other similar cases, did not involve intangible property. MBNA, 640 S.E.2d at 232.

The above discussion provides a solid foundation for asserting nexus against those CCCs which are without physical presence in South Carolina. As noted previously, many CCCs will be corporate affiliates or subsidiaries of businesses which engage in substantial retailing activities in South Carolina (for example, Belk's, Home Depot, Barnes and Noble Booksellers, etc). These CCC's present factual scenarios with a far greater potential to assert income tax nexus. Although physical presence is not required to assert nexus for state income tax purposes, See Geoffrey, 313 S.C. at 23, 437 S.E.2d at 18, such nexus almost certainly exists where there *is* a physical presence.

Retailer-CCCs may create such physical presence, either directly or by attribution, where employees of the retailer within a forum state accept payments on credit cards, or where the retailer offers rewards, points, or discounts towards purchases made with the retailers card at the retailer's store. This would be the case even where the employee of the retailer was *not* deemed to be an employee of the retailer-CCC. See Scripto, Inc. v. Carson, 362 U.S. 207, 211-12 (1960); Tyler Pipe Industries, Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 250 (1987); Borders Online, LLC v. State Bd. Of Equalization, 29 Cal. Rptr.3d 176 (Cal. Ct. App. 2005). The assertion of this type of nexus would certainly strengthen any argument the Department might have against a CCC, but would be entirely dependent on the facts and circumstances of the particular CCC.

D. Taxpayer challenges to assertion of nexus

The Department has recently received communications from at least one taxpayer representative (TR) analyzing and challenging our proposed assertion of nexus over CCCs doing business in South Carolina. Setting aside the grammatical analysis of the various South Carolina statutes[3], the TR's position can be simplified into two basic arguments:

(1) The Department's proposed apportionment of CCC income is inconsistent with the South Carolina Supreme Court decision in Lockwood Greene; and
(2) The fourth prong of Complete Auto (related to benefits provided by the state) requires a taxpayer have some physical presence with a state

1. Lockwood Greene

In Lockwood Greene, the Tax Commission took the position that an engineering firm with significant payroll in South Carolina should allocate income to states in which its services were rendered. For example, if a South Carolina resident engineer performs drafting services in South Carolina for a project being constructed in North Carolina and is paid by a North Carolina resident, the income should be allocated to South Carolina. The engineering firm disagreed, taking the position that the source of the income is the determinative factor. Under its theory, the

[3] The TRs' analysis of South Carolina's Income Tax on Banks statute and Corporate Income Tax statute ostensibly serves a few functions within the TRs' challenge. First, the TR attempts to read a physical presence requirement into South Carolina's statutes. Second, the TR attempts to persuade the Department that, since the General Assembly did not revise the South Carolina Income Tax on Banks statute following the Geoffrey decision, Geoffrey is somehow not applicable to banks. Both these positions are without substantial merit.

income from the above example would be taxed in North Carolina. The Court of Appeals found for the Commission.

The TR now asserts that the position of the Tax Commission in Lockwood Greene, along with the court's decision in that case, effectively precludes the position asserted now—that CCC income from sources within South Carolina should be taxed in South Carolina. This argument ignores the underlying facts and realities of Lockwood Greene, as well as good economic sense. Lockwood Greene does not stand for the proposition that all income is allocated and taxed on the basis of where services related to the income are performed. Rather, Lockwood Greene stands for allocating income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Lockwood Greene, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (citing Hertz Corp. v. SC Tax Comm'n, 246 SC 92, 142 SE2d 445 (1979)); See also S.C. Code Ann. § 12-6-2320(A)(2000). In the case of an engineering firm which performs the vast majority of its services and activities in a single state, but receives income from sources spread over numerous states, this "place of activity" view is likely a more reasonable allocation than any alternative. For a CCC, however, where the generation of interest income and fees is entirely dependant on the lending of credit to end consumers, and the services performed by employees is more or less incidental to the generation of income, the "origin of payment" view espoused by the Lockwood Greene engineers is a closer approximation of economic realities. In truth, Lockwood Greene is less a barrier to the Department's position in this matter than a pillar of support for it. Lockwood Greene is consistent with the Department's longstanding interpretation that finance companies must apportion their receipts according to the location of their borrowers.

2. Physical Presence

The position of the TR that a taxpayer must have physical presence to be taxed by South Carolina fundamentally ignores the South Carolina Supreme Court's decision in Geoffrey. As noted above, Geoffrey found that a taxpayers' use of intangible property within South Carolina was sufficient to support the imposition of income taxes. In so holding, the Supreme Court specifically noted that the physical presence requirement of Quill and Bellas Hess had never been extended beyond the sales and use tax arena. Geoffrey, 313 S.C. 15, 23, 437 S.E.2d 13, 18 n.4. The courts analysis of physical presence and Commerce Clause substantial nexus in Geoffrey ignored the fourth prong of Complete Auto, but analyzed the benefits conferred on the taxpayer by the state and found them sufficient to satisfy Due Process. The TR's argument is disingenuous.

E. Conclusion

In light of the clear precedent set by Geoffrey, the Department is more than justified in asserting economic nexus over CCCs. The holding of MBNA is a logical extension of the Geoffrey decision, despite the MBNA court's distinction between the facts of the two cases. The nature of CCC income is similar in many respects to the income from intangibles at issue in Geoffrey: no tangible property of the company is involved, no employees perform services in the forum state, and ultimately the income is derived from South Carolina resident consumers. Indeed, seen from that perspective, the Department has a greater argument for asserting nexus over CCCS (receipts come *directly* from consumers) than it did over Geoffrey (receipts were filtered through another

corporation which received them from consumers). The TR's arguments hit upon many interesting points, but largely miss the point of South Carolina's overall taxing regime and the associated case law. The Department clearly has the authority to assert nexus against CCCs with an economic presence in the state.

ISSUE TWO: APPORTIONMENT OF INCOME
FOR CREDIT CARD OPERATIONS OF
CORPORATIONS (CHAPTER 6), BANKS (CHAPTER 11),
AND BUILDING & LOAN ASSOCIATIONS (CHAPTER 13)

Banks are taxed under Chapter 11, "Income Tax on Banks" and savings and loans are taxed under Chapter 13, "Income Tax on Building and Loan Associations." Both chapters provide that the provisions of Chapter 6 will be applied for administration of the tax[4]. Any other company may also own a "bank" that limits its activities to credit card operations and the acceptance of large denomination time and savings deposits.[5] When auditing, the Department has taken the position that the bank tax of Chapter 11 does not apply to these corporations as they are not engaged in "banking business."[6]

Section 12-6-530 levies a tax on the income of corporations "transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce. The terms "transacting", "conducting", and "doing business" include transacting or engaging in any activity for the purpose of financial profit or gain." South Carolina construes this language "as extending to the limits of the constitution South Carolina's authority to tax foreign corporations." *Geoffrey v. South Carolina Tax Commission*, 437 S.E.2d 13 (SC 1993), *cert. Denied* 114 S. Ct. 550 (1993).

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[4] Code Sections 12-11-40 and 12-13-60.

[5] These credit card banks may engage only in credit card operations, may not accept demand deposits, generally may not accept savings or time deposits of less than $100,000, may maintain only one office that accepts deposits, and may not engage in the business of making commercial loans.

[6] Code Section 12-11-10 provides "the words "banks" and "taxpayers," whenever used in this chapter, shall mean any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories." (Sections 36-9-102(8), 34-1-10 and 12-11-10 define bank similarly.) There is no specific statutory definition of what constitutes the business of banking. However, having a place of business where deposits are received and paid out on checks or other orders and where money is loaned upon security is the principal substance of the business of a banker. Comprehensively, the business of banking consists of the issuance of notes payable on demand and intended to circulate as money where the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper; in making loans of money on collateral security; in buying and selling bills of exchange; and, in negotiating loans and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations. The usual attributes of the banking business are receiving deposits, making collections and loans, discounting commercial paper, and issuing notes for circulation. 10 Am.Jur.2d, Banks and Financial Institutions, § 2

Code Section 12-6- 2210(B) provides that if a taxpayer is transacting or conducting business partly within and partly outside of South Carolina, then South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State.

S.C. Code Ann. Sections 12-6-2220 and 12-6-2230 provide for the direct allocation of dividends, nonbusiness interest, nonbusiness rents and royalties from the lease or rental of real estate or tangible personal property, certain gains and losses from the sale of real property, and nonbusiness gains and losses from sales of intangible property. After allocation, South Carolina apportions the remaining business income.

South Carolina generally requires the use of one of the following apportionment methods:

1. A "three factor" apportionment method (based on property, payroll, and double weighted sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property.[7]
2. A "gross receipts" apportionment method for taxpayers not dealing in tangible personal property.[8]
3. A "special" apportionment factor for railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines.[9]

Credit card companies are not dealing in tangible personal property and are not one of the particular types of industries required to use a special formula; accordingly, they must apportion income using a single factor formula based upon "gross receipts[10]." Under this formula the taxpayer's remaining net income (after statutory allocations) is apportioned using a fraction in which the numerator is gross receipts from within South Carolina during the taxable year and the denominator is total gross receipts from everywhere during the taxable year.

In *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13(1993), the court looking to the true source of income concluded:

> The real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers. *Cf. Avco Financial Services Consumer Discount Co. v. Director*, Division of Taxation, 100 N.J. 27, 494 A.2d 788 (1985). By providing an orderly society in which Toys R Us conducts business, South Carolina has made it possible for Geoffrey to earn income pursuant to the royalty agreement. See, e.g., *Allied Signal v. Comm'r of Finance*, 79 N.Y.2d, 588 N.E.2d 731, 580 N.Y.S.2d 696 (1991) (benefits afforded to an in-state corporation inure to non-resident shareholders). That Geoffrey has received protection, benefits, and opportunities from South Carolina is manifested by the fact that it earns income in

[7] Code Section 12-6-2250.
[8] Code Section 12-6-2290.
[9] Code Section 12-6-2310.
[10] Code Section 12-6-2295 (effective for taxable years beginning after 2006) provides "gross receipts" includes but is not limited to a listing of items included therein.

> this state. *Accord Aamco*, 93 N.M. at 393, 600 P.2d at 845 (quoting *Besser Co. v. Bureau of Revenue*, 74 N.M. 377, 394 P.2d 141 (1964)). That the tax is rationally related to these protections, benefits, and opportunities is evidenced by the fact that the State seeks to tax only that portion of Geoffrey's income generated within its borders...

In *Geoffrey*, sales of toys in South Carolina by its affiliate, *Toys R Us, Inc.* created account receivables which along with their trademarks, were intangible properties located in South Carolina, sustaining state's right to impose income tax. The court held that intangibles and their income could be taxed at their business situs and that Geoffrey's South Carolina customers were the real source of their income. Geoffrey's South Carolina apportioned income was determined under the single factor, gross receipts apportionment formula; i.e., gross receipts from royalty payments from South Carolina sales divided by gross receipts from everywhere.

The lower court in *Geoffrey, Inc. v. South Carolina Tax Commission.*, 90-CP-23-3939, 02/27/1992 concluded:

> In short, since the sales that produce the royalty are in South Carolina, the profit making activity is in South Carolina. This view is supported both by the longstanding administrative practice of the Tax Commission as well as by the case law of South Carolina.
>
> The Tax Commission's longstanding administrative practice is evidenced by numerous taxpayers whose sole activities in South Carolina are limited to the single activity that earns the income. For example, finance companies are taxed in South Carolina based on whether the borrower resides in this state. Engineers and architects are taxed here if they perform any services in the state. Law firms and accounting firms are subject to tax based on where they perform the services for which they are paid. Restaurant franchise companies that have no activity in this state except the presence of their franchise name from which they derive their income are subject to tax in South Carolina. The longstanding administrative practice of an agency charged with enforcement of specialized statutes are not to be overturned in the absence of compelling reasons. *Multi-Cinema Ltd. v. South Carolina Tax Com'n.*, 292 S.C. 411 , 357 S.E.2d 6 (1987). Here there are no such compelling reasons.
>
> Case law supports the administrative practice. In *Lockwood Greene Eng. v. South Carolina Tax Com'n.*, 293 S.C. 447 . 361 S.E.2d 346 (1987), the activity that earned the income was the engineering activity. The court found that since the engineer rendered his services where he physically worked, then the income derived from those services was part of the receipts of the state in which the engineer was located. Thus, work performed in South Carolina was held to be South Carolina receipts.
>
> Here, just as in *Lockwood Greene*, the facts show that the activity that produces the income is activity which takes place in South Carolina. Accordingly, the facts

> show the taxpayer's activities are for the purpose of financial profit or gain. Additionally, the facts, longstanding administrative practice and case law also show the profit activity occurs in South Carolina. Thus, the taxpayer is subject to tax under § 12-7-250.

The purpose of the apportionment and allocation statutes is to provide for imposition of South Carolina income tax "upon a base which reasonably represents the proportion of the trade or business carried on within this State." *Hertz Corp. v. S. C. Tax Commission*, 246 S. C. 92, 142 S. E. (2d) 445 (1965). The proportion of a credit card company's South Carolina business is determined by the proportion of its gross receipts paid by South Carolinians to its gross receipts from everywhere. This formula satisfies the fairness tests of *Container Corporation of America v. Franchise Tax Board*, 463 US 159 103 S Ct 2933 77 L Ed 2d 545, 06/27/1983. If all jurisdictions used the identical gross receipts formula South Carolina uses, only 100% of the taxpayer's income is taxed. In additions, the formula "reflect[s] a reasonable sense of how income is generated." The taxpayer's sole source of income in South Carolina is from South Carolina card holders receipts. This is the measure that South Carolina uses to determine the percentage of the taxpayer's net income. If there are no credit card activities by South Carolinians there are no taxes due and if only 10% of the taxpayer's credit card activities are in South Carolina, the taxpayer pays tax on 10% of its net income[11].

Possible challenges:

The receivables are taxable to the location of the credit card company's headquarters.

This view was rejected in Geoffrey:

> Geoffrey asserts that under the doctrine of *mobilia sequuntur personam*, the situs of its intangibles is its corporate headquarters in Delaware, not South Carolina. However, in *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980), the United States Supreme Court rejected the view that the constitution requires taxation of intangibles by allocation to a single

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[11] The result could also be reached by utilization of the equitable apportionment principles of S.C. Code Ann. Section 12-6-2320 which provides:

> (A) If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (1) separate accounting;
>
> (2) the exclusion of one or more of the factors;
>
> (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

situs, finding no adequate justification for preferring that rule over taxation by apportionment. The High Court concluded that:

> [a]lthough a fictionalized situs of intangible property sometimes has been invoked to avoid multiple taxation of ownership, there is nothing talismanic about the concepts of "business situs" or "commercial domicile" that automatically renders those concepts applicable when taxation of income from intangibles is at issue. The Court has observed that the maxim *mobilia sequuntur personam*, upon which these fictions of situs are based, "states a rule without disclosing the reasons for it." ... The Court has also recognized that "the reason for a single place of taxation no longer obtains" when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction.... Even for property or franchise taxes, apportionment of intangible values is not unknown.... Moreover, cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails. (Citations omitted).

Id. at 445, 100 S.Ct. at 1235, 63 L.Ed.2d at 525-26. See also *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 56 S.Ct. 773, 80 L.Ed. 1143 (1936) (intangibles may acquire a situs for taxation other than at the domicile of the owner if they have become integral parts of some local business); *Southern Express Co. v. Spigener*, 118 S.C. 413, 110 S.E. 403 (1920) (the situs of intangible property is within this State if the right afforded by it is exercised here); Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 Vand.L.Rev. 401 (1976); J. Hellerstein & W. Hellerstein, State Taxation, Para. 9.08-.09 (2d ed. 1992). We reject Geoffrey's claim that its intangible assets are located exclusively in Delaware. Accordingly, we find that Geoffrey's purposeful direction of activity toward South Carolina as well as its possessing intangible property here provide a definite link between South Carolina and the income derived by Geoffrey from the use of its trademarks and trade names in this State.

Lockwood Greene requires taxpayers to apportion using the "cost of performance."

South Carolina is not a "cost of performance state;" *i.e.*, a state where receipts are always sourced to the state where the costs to produce the receipts are incurred nor is it a "market state;" *i.e.*, a state where receipts are always sourced to the state where the item or service is consumed or the location of the payer. The South Carolina Code and regulations make no reference to these terms.

In fact, the court in *Lockwood Greene* specifically referenced the taxation of finance companies under the gross receipts method based on whether the borrower resides in South Carolina.

Exhibit "E"

South Carolina Corporate Income Taxes[1]

Rick Handel
Deana West
William West

South Carolina Department of Revenue
Governor Mark Sanford
Burnet R. Maybank III, Director

[1]The opinions expressed in this paper are the authors' opinions and should not be attributed to the South Carolina Department of Revenue. This paper is revised through June 10, 2005, but does not reflect legislation passed in the 2005 South Carolina legislative session.

Comment: South Carolina is not a "cost of performance state;" *i.e.,* a state where receipts are always sourced to the state where the costs to produce the receipts are incurred. It is also not a "market state;" *i.e.,* a state where receipts are always sourced to the state where the item or service is consumed or the location of the payer.[67]

Apportionable sales are receipts which are not allocated.

The sales factor includes:

1. The selling price from the sale of inventory. The selling price is the gross sales price less returns and allowances. "Returns" are defined as goods returned for credit. "Allowances" are credits from breakage, spoilage, inferior quality, shortages in shipping, and the like.

   Sales in South Carolina include sales of goods, merchandise, or property received by a purchaser in South Carolina other than the United States Government. The place where goods are received by the purchaser after all transportation is completed is considered to be the location of the sale. Direct delivery into South Carolina by the taxpayer to a person designated by a purchaser is considered delivery to the purchaser in South Carolina.[68]

   Note: It has been the longstanding administrative policy of the Department to allow sales to the United States Government to be included in the denominator. Only payments made directly by the United States Government to a seller pursuant to a contract for the sale of property are treated as sales to the United States Government. Sales made by a subcontractor to a United States Government prime contractor are included in the numerator and denominator even though the United States Government is the ultimate recipient and the work is subject to United States Government approval.

2. Interest receipts, service charges, and carrying charges resulting from sales of tangible personal property are assigned in the same manner as the sales of the tangible personal property to which they relate.

3. The net gain (not the selling price) from sales of assets, including intangibles, other than inventory.[69]

   Note: This factor does not include gain which is allocated pursuant to SC Code §12-6-2220.

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[67]See the discussion in Section .05. E. 3. of this portfolio regarding sourcing gross receipts.

[68]SC Code §12-6-2280(B).

[69]Commission Decision I.D. 309 (1982).

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 14-ALJ-17-0285-CC **PETITIONER'S MEMORANDUM OF LAW IN OPPOSITION TO RESPONDENT'S MOTION FOR SUMMARY JUDGMENT**

Petitioner submits this brief in opposition to the DOR's Motion for Summary Judgment and in support of its own Motion for Summary Judgment.

A. The DOR Asserts Summary Judgment is not Appropriate Because of Disputed Facts

The DOR argues that the granting of Summary Judgment in favor of Petitioner is not appropriate because of numerous factual issues regarding Petitioner's cost of performance. Specifically the DOR argues "it is necessary for Petitioner to provide evidence of those expenses it claims were incurred in producing the income" and "further discovery should be conducted to determine what impact, if any, those properties in South Carolina have in the determination of the income-producing activity in this case. Put simply, Petitioner has not established or provided much, if any, information regarding its costs and operations and how each relates to is income-producing activity in this matter." (DOR brief at p. 9). The DOR further argues "it is important to note that the Petitioner has not presented any evidence of a payroll, property, or other factor to represent its view of income-producing activity subject to analysis here." (*Id.* at p. 15.)

Petitioner has moved for summary judgment on a single very narrow legal issue. That issue is that South Carolina is a Cost of Performance state, and the Department has asserted an

invalid market sourcing "audience approach" method, not supported by any statute, regulation or policy document. That is the only issue for which Petitioner has moved for summary judgment. Petitioner does not claim, or even request, that the case be dismissed if summary judgment is granted.

Petitioner stipulates herein that if summary judgment is granted, a trial on the merits is still necessary to establish all the elements of cost of performance.

Petitioner is entitled to summary judgment on the very narrow legal issue of how South Carolina sources income for service providers. For 35 years South Carolina has utilized Cost of Performance. The DOR cannot use another "audience approach" method – one not sanctioned by the statute, regulation or policy document – just because it raises more revenue for the state.

B. Is South Carolina a Cost of Performance State?

The DOR states "As stated in its motion, Petitioner asserts that it used a cost-of-performance method to justify sourcing subscription receipts from South Carolina customers to a jurisdiction outside of South Carolina. Under applicable South Carolina law and long-standing Department policy, the Department asserts that South Carolina is not a cost-of-performance state and a cost-of-performance method is not appropriate" and "South Carolina's apportionment statutes related to the apportionment of net income of service providers have *never* dictated the use of either a cost-of-performance *or* a pure market-based sourcing method." (DOR Brief at p. 16 (footnote omitted).) The DOR further asserts "under South Carolina law, income-producing activity is specifically not *based* on costs-of-performance, nor does it even *consider* cost-of-performance factors, given this intentional deletion by the South Carolina legislature." (*Id.* at pp. 17-18.)

Contrast the assertions in the DOR brief with the following DOR Policy documents which assert the *Lockwood Greene* cost of performance method. In 2013 the DOR invoked the *Lockwood Greene* method in SC DOR PLR 13-3:

> . . . the income producing activity is the engineering services provided to clients. As a result, *the state where those engineering services are performed* is where gross receipts from its services should be sourced. (Emp. added.)

In the DOR 2014 Edition Economic Development Incentives, the DOR plainly states:

> The "gross receipts" ratio is most commonly used by service businesses. The proper sourcing of gross receipts was reviewed in *Lockwood Greene Engineers v. South Carolina Tax Commission*, 361 S.E. 2d 346 (1987). The court held that in sourcing income of a multistate engineering firm, "gross receipts from within this State" were to be determined according to where the services were performed *rather than according to where the customers were located.* See also, *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993) *cert. denied* 114 S. Ct. 550 (1993). (Emp. added.)

Indeed, at pg. 6 the DOR audit work papers in this case cite the COP rule:

> **Excerpts from The Department's Corporate Income Tax Manual which discussed sourcing of intangible receipts and Service Receipts**
> Comment: Considering Lockwood Greene and Geoffrey, together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; *e.g.*, personal services, *where those services are performed*; intangibles, where those intangibles are used in a business for the production of income.78 This conclusion is consistent with the longstanding administrative policy of the Department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers. 78See also SC Tech. Adv. Memo. # 94-2. (Emp. added.)

The South Carolina Corporate Income Tax Manual, co-authored by senior members of the Policy Section of the South Carolina Department of Revenue, further discusses the Department's views on apportionment. The manual cites and discusses the *Lockwood Greene*

Engineers Inc. case as the leading authority on the sourcing of receipts using the single sales factor apportionment methodology. The authors concluded that:

> [c]onsidering *Lockwood Greene* and *Geoffrey*, together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income, *e.g.*, personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income.

Other commentators have noted that South Carolina is a cost of performance state. Hellerstein, in ¶ 9.18 fn. 1227 states:

> Although South Carolina is not a state that generally follows UDITPA or the MTC regulations . . . its single-factor sales formula, as applied to receipts for services, generally resembles UDITPA's income-producing activity rule for attributing receipts from services. See SC Code Ann. § 12-6-2295(A)(5) (Westlaw 2014) (attributing receipts from services to the state "if the entire income-producing activity is within this State," and if the income-producing activity is performed partly within and partly without this state, receipts are attributable to the state "to the extent the income-producing activity is performed within this State").

Hellerstein also notes in fn. 1187:

> According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) *and South Carolina* (services only)." P. Mata & M. Smith, "The Implementation of 'Market' Sourcing Rules: Practical Concerns," State Tax Notes, Sept. 6, 2010, p. 649 (citing statutes and regulations). (Emp. added.)

The DOR's brief in this case is remarkably at odds with its own Policy Documents and national commentators.

C. South Carolina does have Specialized Apportionment Statutes

The General Assembly has adopted specialized apportionment methods similar to the "audience method" for a number of industries. These include railroad companies, telephone companies, pipeline companies, airline companies, and shipping companies. See S.C. Code §

12-6-2310. The DOR discusses at length *Mercury Motor Express, Inc. v. SC Tax Commission*, 244 S.C. 134, 135 S.E.2d 756 (1964). This case deals with the special apportionment method for trucking companies found in the predecessor statute to section 12-6-2310. But Section 12-6-2310 does not include the "audience method" for motion picture companies. Nor does any other statute.

The DOR has issued a few Regulations dealing with allocation and apportionment of income. See 117-700 *et. seq.* None provide an audience method for motion picture companies.

The DOR has issued multiple income tax policy documents. See DOR Income Taxes (attached as Ex. A). No policy document provides for an "audience method" for the motion picture industry. (And no Policy Document contains the "longstanding audit guidelines".)

D. Significance of Stipulation in *Lockwood Greene*

The Department's brief repeatedly cites the Stipulation in *Lockwood Greene* as indicating that motion picture companies are not taxed under the *Lockwood Greene* cost of performance method.

To state the obvious, a Stipulation in one litigation case thirty years ago is not a statute, regulation or DOR Policy document.

A Stipulation is not binding on anyone but the parties in that litigation. *See* 73 Am. Jur. 2d *Stipulations* § 8 (2012) ("Therefore, it is recognized that a stipulation is not binding upon those who are not parties either to the stipulation or to the action or proceeding in which it was entered into."). "A concession that a witness, if called, would testify to a certain effect *is not admissible as evidence* in another action brought by one not a party to the former suit." *Id.* at § 9. (Emp. added.) Dish has not agreed to the Stipulation. (Dish was not even in existence when the Stipulation was executed.) Indeed, the Stipulation is not even binding on the DOR in any future case.

In addition, the stipulation is to the legal method of apportionment for various industries and accordingly it is not a proper stipulation. *Id.* at § 4 states:

> Parties to an action may not stipulate to legal conclusions to be reached by the court. It has generally been stated that the resolution of questions of law rests upon the court, uninfluenced by stipulations of the parties and accordingly, it has been recognized that stipulations as to the law are invalid and ineffective.
>
> The propriety of enforcing the rule against stipulations as to matters of law is especially clear where the case in which the stipulation is made concerns the public.

See McDuffie v. McDuffie, 308 S.C. 401, 418 S.E.2d 331 (1992) ("this stipulation concerns a question of law and, therefore, is not binding on this court". *See* 17A Am.Jur.2d Contracts § 339, at 346 (1991) (whether the language of a contract is ambiguous is a question of law for the court); *see also* 73 Am.Jur.2d Stipulations § 5, at 53940 (1974) (" 'It has generally been stated that the resolution of questions of law rests upon the court, uninfluenced by stipulations of the parties, and accordingly, virtually all jurisdictions recognize that stipulations as to the law are invalid and ineffective ...' "); *Morris v. Beacham*, 274 S.C. 320, 262 S.E.2d 921 (1980) ("Like the construction of a contract, it [whether legal documents created enforceable charitable trusts] is an improper subject for stipulation and any attempted stipulation is not binding on a court."); *Walterboro Community Hosp. v. Meacher*, 392 S.C. 479, 709 S.E.2d 71 (2011) ("We believe these stipulations were akin to stipulations as to the law. Therefore, the circuit court was not required to accept these stipulations . . . .")

In any event, here is what the Stipulation (Respondent's Ex. A.) stated at pg. 26:

> 12. The apportionment method specified by 12-7-1190 may be applicable to various multi-state businesses, including:
>
> * * * *
>
> (b) radio and television broadcasters [and]

* * * *

(d) engineers and architects, [*i.e.*, Lockwood Greene.]

In addition to attaching the Stipulation in *Lockwood Greene*, the DOR also attaches (Respondent's Ex. C) the DOR's brief in that case. The brief contains the following:

> Here, the taxpayer asserts the disputed phrase ["gross receipts from within this State"] makes gross receipts South Carolina receipts if the payor is located in South Carolina, i.e., the origin of the payment view. The trial court found the disputed phrase to make gross receipts South Carolina receipts *if the services generating the receipts were performed in South Carolina*, i.e., the place of activity view. (Emp. added.)

(Ex. C, pg. 4.)

> The taxpayer asserts the 1972 amendment to Section 12-7-1190 demonstrates that the statute intended gross receipts from within this State to refer to gross receipts from payors in this State. (Appellant's Brief, p. 13) Not only is this assertion incorrect, but in fact, *the 1972 amendment demonstrates the location of the payor is irrelevant.* (Emp. added.)

(Ex. C, pg. 11.)

> In fact, if the General Assembly wanted the location of the payor to constitute South Carolina gross receipts, it could have easily done so by stating South Carolina gross receipts shall be receipts paid from locations in South Carolina.

(Ex. C, pg. 12.)

> *...[The] General Assembly gave no significance to the location of a payor . . . . The location of the payor was never suggested by the General Assembly as a means for determining South Carolina gross receipts.* (Emp. added.)

(Ex. C, pg. 13.)

> *The most accurate measure of a taxpayer's business in South Carolina is determining where the services for which the client is paying is incurred.* If the service is incurred in South Carolina, then such payment for that portion of the service incurred in South Carolina is South Carolina gross receipts. (Emp. added.)

(Ex. C, pg. 17.)

> To further the purpose of taxing only the portion of a taxpayer's business carried on within South Carolina, it is appropriate to tax only those gross receipts resulting from services incurred in South Carolina. *Looking to where the location from which the client pays his bill . . . does not tax the taxpayer based on its business in South Carolina. Its business in South Carolina is more accurately measured by determining where its services are performed.* This place of activity test is the proper interpretation for determining gross receipts from within South Carolina. (Emp. added.)

(Ex. C., pg. 18.)

Accordingly, the DOR in *Lockwood Greene* explicitly rejected the "audience method" asserted in this case. While the DOR Stipulation in *Lockwood Greene* is irrelevant, the DOR's view contained in its brief on apportioning income completely supports Dish.

E. The Department's Longstanding Audit Guidelines

The DOR repeatedly references its "longstanding audit guidelines." For example, pg. 32 of the Department's brief states:

> In summary, the Department's longstanding audit guidelines demonstrate that it has consistently interpreted section 12-6-2290 and its predecessor statutes to allow the use of different methods in different industries to apportion net income from services. The Department has always looked at the activities performed by companies in an industry to determine how and where to source service-related income, and the changes in applicable law have not altered the appropriateness of the Department's audit guidelines or its continued use of those guidelines.

The DOR attaches four exhibits to its brief but not a single one containing the purported "longstanding audit guidelines." What are these "longstanding audit guidelines" and why hasn't the DOR reduced them to writing in the form of a Regulation or Policy Document (*e.g.*, Revenue Ruling)?

Significantly, the Department does not cite a single statute, Regulation or Policy Document – not one!! – in support of its contention that "Petitioner is required to source income

related to the subscription revenue of South Carolina customers to South Carolina." (DOR Brief at 33.)

While a Court generally gives deference to an Agency's interpretation of a statute or regulation, *Brown v. Bi-Lo, Inc.*, 354 S.C. 436, 581 S.E. 2d 836 (2003), the SCDOR cites no statute or regulation in support of the "longstanding audit guidelines". "Secret" rules asserted by agency staff which have not been promulgated in regulations or binding policy documents are entitled to little, if any, deference. *See* S.C. Tax Comm'n Dec. 93-78 (rejecting taxpayer's use of longstanding agency interpretation stating that, "we do not believe there are any generally accepted consolidation rules which exist *if they are not codified*;" (emphasis added); S.C. Tax Comm'n Dec. 94-90 (likewise rejecting the taxpayer's "longstanding administrative policy," argument, stating "it is important to note that there are no Commission decisions or Department approved policy documents which support that [Department] decision"); *Seigfried v. S.C. Dep't of Rev.*, 2003 WL 24004736 (S.C. Admin. Law Judge Div. 2003); *S.C. Dep't of Motor Vehicles v. Lajuenesse*, 2008 WL 1740063 (S.C. Admin. Law Judge Div. 2008); *Coastal Conservation League v. S.C. Dep't of Health & Envtl. Control*, 363 S.C. 67, 610 S.E. 2d 482 (2005); and *Clarendon Cnty. Mem. Hosp. v. S.C. Dep't of Health & Envtl. Control*, 2006 WL 1430090 (S.C. Admin. Law Judge Div. 2006).

It bears repeating: the DOR brief repeatedly cites "longstanding audit guidelines" but does not provide a copy!

CONCLUSION

The fallacy of the DOR's argument is distilled in the DOR Department Determination (Ex. B) issued in this case at unnumbered page 5. The Determination states:

> South Carolina is not alone in this method of sourcing receipts for taxpayers like Dish Corp. Twenty-three states have adopted the

"audience approach" for assigning receipts from programming and broadcasting companies.[4]

Footnote 4 lists the statutes from the 23 statutes which adopt the "audience approach." The South Carolina General Assembly has not adopted such a statute! The Determination goes on to state "Florida, for example, adopted the following language:" The Determination quotes the Florida statute. South Carolina has no such statute!

Petitioner does not dispute that 23 states have adopted statutes imposing the "audience approach." Commentators like *Hellerstein* applaud the "audience approach." But the South Carolina General Assembly, unlike 23 other states, has not adopted such an "audience approach" statute. And the DOR has never promulgated an "audience approach" regulation or Policy Document. And the DOR has never published any "longstanding audit guidelines" which include the "audience approach."

In conclusion, to repeat the above, Petitioner does not contend that the granting of summary judgment in its favor, to wit that the DOR must utilize its 35 year practice of sourcing income based upon a pro-rata cost of performance approach – and not an "audience approach" disposes of this case.

The Department is entirely correct that a subsequent hearing must be held to assess Dish's cost of performance.

Petitioner asks only for a ruling that the South Carolina General Assembly, unlike the other 23 states, has not adopted an "audience approach," nor has the DOR adopted one in a regulation or Policy Document. The DOR consequently has no authority to impose the audience approach.

Respectfully submitted,

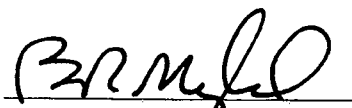

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EXHIBIT A

ADVISORY OPINIONS- INCOME TAXES (/POLICY/ADVISORY-OPINIONS-INCOME)

Income Taxes *299 docs*

Title	DocID	Year
Abandoned Buildings Revitalization Act-Demolition and New Construction Costs (/policy/plr14-3-doc)	PLR14-3	2014
Accounting Period Change - Returns Required (/policy/plr89-14-doc)	PLR89-14	1989
Administration Expense of Estate - Deduction (/policy/tam89-2-doc)	TAM89-2	1989
Apportionment - Election to File Consolidated Return (/policy/plr88-17-doc)	PLR88-17	1988
Apportionment - Election to File Consolidated Return		
Engineering Service Income (/policy/plr13-3-doc)	PLR13-3	2013
Apportionment Factor		
Applying for Alternative Method (/policy/rp09-1-doc)	RP09-1	2009
Applying for Alternative Method: Economic Development & Applying For Alternative Method (/policy/rpb02-4-doc)	RPB02-4	2002
Applying for Alternative Method: Economic Development & Applying For Alternative Method (/policy/rp96-3-doc)	RP96-3	1996
Apportionment Ratio		

Title	DocID	Year
Double Weighted Sales Factor (/policy/il95-17-doc)	IL95-17	1995
Intangible Drilling Costs - Property Factor (/policy/tam88-12-doc)	TAM88-12	1988
Motor Carrier (/policy/plr93-3-doc)	PLR93-3	1993
Single Sales Factor Phase-in (/policy/rr09-15-doc)	RR09-15	2009
Trade Name and Trademark Licensing (/policy/plr95-7-doc)	PLR95-7	1995
Trade Name and Trademark Licensing (/policy/plr95-9-doc)	PLR95-9	1995
Trade Name and Trademark Licensing (/policy/tam94-2-doc)	TAM94-2	1994
Assistance and Tax Relief		
Blackout Victims (/policy/il03-18-doc)	IL03-18	2003
Chlorine Leak in Graniteville (/policy/il05-2-doc)	IL05-2	2005
Earthquake Victims (/policy/il94-02-doc)	IL94-02	1994
Flood Victims (/policy/il94-18-doc)	IL94-18	1994
Flood Victims (/policy/il93-17-doc)	IL93-17	1993
Hurricane Victims (/policy/il12-13-doc)	IL12-13	2012
Hurricane Victims (/policy/il12-17-doc)	IL12-17	2012
Hurricane Victims (/policy/il11-15-doc)	IL11-15	2011
Hurricane Victims (/policy/il06-19-doc)	IL06-19	2006
Hurricane Victims (/policy/il06-4-doc)	IL06-4	2006
Hurricane Victims (/policy/il05-22-doc)	IL05-22	2005
Hurricane Victims (/policy/il05-26-doc)	IL05-26	2005
Hurricane Victims (/policy/il05-30-doc)	IL05-30	2005
Hurricane Victims (/policy/il05-32-doc)	IL05-32	2005
Hurricane Victims (/policy/il04-18-doc)	IL04-18	2004
Hurricane Victims (/policy/il04-24-doc)	IL04-24	2004

Title	DocID	Year
Hurricane Victims (/policy/il03-21-doc)	IL03-21	2003
Hurricane Victims (/policy/rp99-3-doc)	RP99-3	1999
Hurricane Victims (/policy/il96-21-doc)	IL96-21	1996
Hurricane Victims (/policy/il92-28-doc)	IL92-28	1992
Other Special Relief		
VA Tech Shootings/Intuit Problems (/policy/il07-10-doc)	IL07-10	2007
VA Tech Shootings/Intuit Problems (/policy/il07-9-doc)	IL07-9	2007
Snow Storm Victims (/policy/il93-5-doc)	IL93-5	1993
Storm, Tornado, and Flood Victims (/policy/il11-7-doc)	IL11-7	2011
Terrorist Attacks (/policy/rpb01-9-doc)	RPB01-9	2001
Terrorist Attacks (/policy/trpb01-9-doc)	TRPB01-9	2001
Tornado Victims (/policy/il11-6-doc)	IL11-6	2011
Tornado Victims (/policy/il94-19-doc)	IL94-19	1994
Wildfire Victims (/policy/il03-24-doc)	IL03-24	2003
Burial Contract		
Pre-Need Service Trust Agreement (/policy/plr88-8-doc)	PLR88-8	1988
Pre-Need Service Trust Agreement (/policy/rr88-3-doc)	RR88-3	1988
Capital Gains		
Estimated Tax (/policy/plr89-5-doc)	PLR89-5	1989
Nonresident Treatment Upon Moving to SC (/policy/plr92-1-doc)	PLR92-1	1992
Refunds of LTCG Pursuant to a Written Contract of Sale (/policy/rr91-1-doc)	RR91-1	1991
Refunds of LTCG Pursuant to a Written Contract of Sale (/policy/il89-1-doc)	IL89-1	1989

Title	DocID	Year
Refunds of LTCG Pursuant to a Written Contract of Sale (/policy/il89-30-doc)	IL89-30	1989
Refunds of LTCG Pursuant to a Written Contract of Sale (/policy/il88-15-doc)	IL88-15	1988
Special (Second Installment) Refund (/policy/il97-24-doc)	IL97-24	1997
Consolidated Returns		
Computation of SC Net Income (/policy/rr88-10-doc)	R88-10	1988
Computation of SC Net Income (/policy/tam88-8-doc)	TAM88-8	1988
Corporate Distribution - From Out-of-State Corporation (/policy/plr88-12-doc)	PLR88-12	1988
Corporations Permitted to File (/policy/plr12-4-doc)	PLR12-4	2012
Method of Computing SC Net Income (/policy/tam89-15-doc)	TAM89-15	1989
Net Operating Loss Crry Forward of Affiliated Group (/policy/tam89-22-doc)	TAM89-22	1989
Net Operating Loss Deduction (/policy/tam87-12-doc)	TAM87-12	1987
Regulation, Correction of Misprint (/policy/il91-16-doc)	IL91-16	1991
Corporate Headquarters Credit		
Expansion - Qualifying Costs/Employees (/policy/plr91-3-doc)	PLR91-3	1991
Expansion - Qualifying Costs/Employees (/policy/plr89-19-doc)	PLR89-19	1989
Expansion - Qualifying Costs/Employees (/policy/plr89-7-doc)	PLR89-7	1989
Legislative Changes in 1992 (/policy/il92-14-doc)	IL92-14	1992
Regional Headquarters - Qualifying Costs/Lease (/policy/plr91-2-doc)	PLR91-2	1991

Title	DocID	Year
Use Against License Tax (/policy/pro01-1-doc)	PRO01-1	2001
Credits		
AFDC Recipients Hired		
Credit Amount (/policy/il95-19-doc)	IL95-19	1995
Verification of Benefits (/policy/il97-5-doc)	IL97-5	1997
Angel Investor Credit (/policy/rr14-6-doc)	RR14-6	2014
Biomass Energy Credits to Limited Liability Company (/policy/plr11-6-doc)	PLR11-6	2011
College Tuition (/policy/rr09-3-doc)	RR09-3	2009
College Tuition (/policy/rab00-1-doc)	RAB00-1	2000
College Tuition (/policy/trab00-1-doc)	TRAB00-1	2000
College Tuition (/policy/rr99-4-doc)	RR99-4	1999
Conservation Credit - Transfer of (/policy/rp08-1-doc)	RP08-1	2008
Conservation Credit - Transfer of (/policy/rpb01-11-doc)	RPB01-11	2001
Displaced Worker - County Rankings (/policy/il96-23-doc)	IL96-23	1996
Economic Impact Zone Investment Tax Credit - Availability (/policy/rr97-8-doc)	RR97-8	1997
Economic Impact Zone Investment Tax Credit - Qualification of Communication Property (/policy/plr98-2-doc)	PLR98-2	1998
Infrastructure Credit (/policy/tam89-14-doc)	TAM89-14	1989
Minority Business (/policy/plr89-17-doc)	PLR89-17	1989
Motion Picture Project Credits (/policy/rr99-10-doc)	RR99-10	1999
Palmetto Seed Credit (/policy/il90-27-doc)	IL90-27	1990
Solar Energy and Small Hydropower Systems Credit (/policy/il09-16-doc)	IL09-16	2009

Title	DocID	Year
Taxes Paid to Another State: Married Filing Jointly (/policy/tam88-10-doc)	TAM88-10	1988
Taxes Paid to Another State: Pension Income (/policy/plr87-7-doc)	PLR87-7	1987
Textile Revitalization Credit- Demolition Costs (/policy/plr06-3-doc)	PLR06-3	2006
Deduction		
Age 65 and Older (/policy/il97-23-doc)	IL97-23	1997
State, Local, or Foreign Tax Deduction Allowed or Disallowed - Survey Responses (/policy/rr09-10-doc)	RR09-10	2009
State, Local, or Foreign Tax Deduction Allowed or Disallowed - Survey Responses (/policy/rr09-11-doc)	RR09-11	2009
State, Local, or Foreign Tax Deduction Allowed or Disallowed - Survey Responses (/policy/rr03-6-doc)	RR03-6	2003
Disability		
Withholding of Long-Term Disability Benefit Plan (/policy/plr88-1-doc)	PLR88-1	1988
Election		
Tax Year Other Than Required Tax Year (/policy/il88-6-doc)	IL88-6	1988
Energy Incentives for Individuals (/policy/il06-23-doc)	IL06-23	2006
Enterprise Zone Benefits		
Job Development Fee (/policy/plr95-5-doc)	PLR95-5	1995
Question and Answer Document (/policy/il95-29-doc)	IL95-29	1995
Estimated Assessments - Procedure (/policy/tam87-9-doc)	TAM87-9	1987
Estimated Tax		
Corporate Declaration (/policy/il87-7-doc)	IL87-7	1987

Title	DocID	Year
Interest Computation (/policy/tam87-7-doc)	TAM87-7	1987
Requirements		
Individual and Corporate Changes in 1992 (/policy/il92-18-doc)	IL92-18	1992
Exempt Interest		
Bonds Issued by Puerto Rico (/policy/rr87-3-doc)	RR87-3	1987
Dividends of State and Federal Obligations (/policy/plr87-6-doc)	PLR87-6	1987
G.N.M.A. Securities (/policy/rr87-4-doc)	RR87-4	1987
G.N.M.A. Securities (/policy/rr87-6-doc)	RR87-6	1987
G.N.M.A. Securities (/policy/tam87-4-doc)	TAM87-4	1987
Guidelines - Examples of Exempt and Non-exempt Interest (/policy/rr91-15-doc)	RR91-15	1991
Interest Dividends Distributed by Money Market Fund (/policy/il88-7-doc)	IL88-7	1988
Interest Dividends Distributed by Mutual Funds (/policy/plr93-8-doc)	PLR93-8	1993
Exempt Organizations - Filing Requirements (/policy/il92-15-doc)	IL92-15	1992
Federal Economic Stimulus Payment of 2008 (/policy/il08-7-doc)	IL08-7	2008
Filing Requirements Same-Sex Marriage Couples (/policy/rr14-8-doc)	RR14-8	2014
Foreign Dividend Income (/policy/rr92-13-doc)	RR92-13	1992
Foreign Sales Corporations - Deduction for Commissions (/policy/rr98-14-doc)	RR98-14	1998
Geoffrey, Inc. v. South Carolina Tax Commission (/policy/il93-20-doc)	IL93-20	1993
Income Tax Conformity		
2004 Temporary Proviso (Conformity and Exceptions) (/policy/rr05-2-doc)	RR05-2	2005

Title	DocID	Year
Bonus Depreciation Not Adopted (/policy/il03-17-doc)	IL03-17	2003
Federal Taxpayer Relief Act of 1997 (/policy/il98-2-doc)	IL98-2	1998
Income Tax Regulations		
Repealed (/policy/il88-14-doc)	IL88-14	1988
Individual Retirement Account: Distribution from Government Obligations (/policy/tam89-23-doc)	TAM89-23	1989
Individual Retirement Account: Taxability of Withdrawals (/policy/plr89-4-doc)	PLR89-4	1989
Internal Revenue Code Section 338(h)(10) Election - Tax Consequences (/policy/rr09-4-doc)	RR09-4	2009
Investment Income of Children Under Age 14 (/policy/tam90-10-doc)	TAM90-10	1990
Job Tax Credit, Subsidiaries (/policy/plr89-1-doc)	PLR89-1	1989
Job Tax Credit		
Computation and Examples (/policy/rr99-5-doc)	RR99-5	1999
Definitions - Expansion (/policy/rr05-5-doc)	RR05-5	2005
Definitions - Full Time Employee and Service Related Industry (/policy/rr87-5-doc)	RR87-5	1987
Designation of Counties for 1987 (/policy/il87-2-doc)	IL87-2	1987
Designation of Counties for 1988 (/policy/il88-1-doc)	IL88-1	1988
Designation of Counties for 1989 (/policy/il88-23-doc)	IL88-23	1988
Designation of Counties for 1990 (/policy/il90-4-doc)	IL90-4	1990
Designation of Counties for 1991 (/policy/il91-3-doc)	IL91-3	1991
Designation of Counties for 1992 (/policy/il92-4-doc)	IL92-4	1992

Title	DocID	Year
Designation of Counties for 1993 (/policy/il93-3-doc)	IL93-3	1993
Designation of Counties for 1994 (/policy/il94-01-doc)	IL94-01	1994
Designation of Counties for 1995 (/policy/il95-02-doc)	IL95-02	1995
Designation of Counties for 1996 (/policy/il96-2-doc)	IL96-2	1996
Designation of Counties for 1996 (Corrected) (/policy/il96-12-doc)	IL96-12	1996
Designation of Counties for 1996 (Rural Development Act) (/policy/il96-20-doc)	IL96-20	1996
Designation of Counties for 1997 (/policy/il97-2-doc)	IL97-2	1997
Designation of Counties for 1997 (Revised) (/policy/il97-16-doc)	IL97-16	1997
Designation of Counties for 1998 (/policy/il98-1-doc)	IL98-1	1998
Designation of Counties for 1999 (/policy/il99-2-doc)	IL99-2	1999
Designation of Counties for 2003 (/policy/il03-1-doc)	IL03-1	2003
Designation of Counties for 2004 (/policy/il03-30-doc)	IL03-30	2003
Designation of Counties for 2005 (/policy/il05-3-doc)	IL05-3	2005
Designation of Counties for 2006 (/policy/il06-1-doc)	IL06-1	2006
Designation of Counties for 2006 (Modified) (/policy/rr07-1-doc)	RR07-1	2007
Designation of Counties for 2007 (Revised) (/policy/il07-3-doc)	IL07-3	2007
Designation of Counties for 2008 (/policy/il08-1-doc)	IL08-1	2008

Title	DocID	Year
Designation of Counties for 2009 (/policy/il09-1-doc)	IL09-1	2009
Designation of Counties for 2010 (/policy/il10-1-doc)	IL10-1	2010
Designation of Counties for 2012 (/policy/il12-19-doc)	IL12-19	2012
Designation of Counties for 2013 (/policy/il13-6-doc)	IL13-6	2013
Designation of Counties for 2014 (/policy/il13-19-doc)	IL13-19	2013
Designation of Counties for 2015 (/policy/il15-1-doc)	IL15-1	2015
Designation of Counties for Tax Years Beginning after 6/18/02 (/policy/rib02-14-doc)	RIB02-14	2002
Qualification - Corporate Office Facility (/policy/rr98-10-doc)	RR98-10	1998
Small Business Provisions - Computation and Examples of New Provisions (/policy/trr07-2-doc)	TRR07-2	2007
Small Business Provisions - Computation and Examples of New Provisions (/policy/rr05-17-doc)	RR05-17	2005
Use of Credit By C Corporation if Jobs Created While S Corp (/policy/plr95-3-doc)	PLR95-3	1995
Use of Credit While Constructing Permanent Facility (/policy/plr94-5-doc)	PLR94-5	1994
Lease of Jail Property to County-Exemption (/policy/plr88-7-doc)	PLR88-7	1988
Lease		
Depreciation of Safe harbor Lease Transactions (/policy/tam88-9-doc)	TAM88-9	1988
Licensing of Intangibles/Sourcing Royalty Income (/policy/plr03-1-doc)	PLR03-1	2003
Limited Liability Company		
Check the Box Final Regulations (/policy/il96-25-doc)	IL96-25	1996

Title	DocID	Year
Entity Classification (/policy/il96-15-doc)	IL96-15	1996
Single Member (/policy/rr98-11-doc)	RR98-11	1998
Military		
Combat Pay (/policy/rib02-1-doc)	RIB02-1	2002
Federal Military Spouses Residency Relief Act of 2009 (/policy/rr10-5-doc)	RR10-5	2010
Federal Military Spouses Residency Relief Act of 2009 (/policy/trr10-5-doc)	TRR10-5	2010
Federal Military Spouses Residency Relief Act of 2009 (/policy/il09-21-doc)	IL09-21	2009
Nonresident Military - computation of Taxable Income (/policy/rr06-1-doc)	RR06-1	2006
Operation Allied Force (/policy/rp99-2-doc)	RP99-2	1999
Operation Desert Storm (/policy/il91-18-doc)	IL91-18	1991
Operation Desert Storm (/policy/il91-6-doc)	IL91-6	1991
Operation Enduring Freedom (/policy/rpb02-1-doc)	RPB02-1	2002
Operation Enduring Freedom (/policy/trpb02-1-doc)	TRPB02-1	2002
Operation Iraqi Freedom (/policy/rp03-2-doc)	RP03-2	2003
Operation Iraqi Freedom (/policy/trp03-2-doc)	TRP03-2	2003
Operation Joint Endeavor (/policy/il96-5-doc)	IL96-5	1996
Operation Joint Endeavor (/policy/rp96-2-doc)	RP96-2	1996
Tax Relief for Personnel Serving in Combat Zones (/policy/rp08-3-doc)	RP08-3	2008
Motor Carrier and Railroad Employees		
Nonresident Compensation (/policy/il90-34-doc)	IL90-34	1990
Motor Carriers		
Corporate Return Requirements (/policy/il90-30-doc)	IL90-30	1990
Moving Expense Deduction		

Title	DocID	Year
Allocation (/policy/il88-5-doc)	IL88-5	1988
Allocation (/policy/plr88-9-doc)	PLR88-9	1988
Allocation (/policy/rr88-4-doc)	RR88-4	1988
National Guard or reserve Members		
Deduction for Compensation Paid (/policy/rr09-16-doc)	RR09-16	2009
Deduction for Compensation Paid (/policy/tam89-16-doc)	TAM89-16	1989
Nexus		
Activities Exceeding Solication (/policy/plr91-4-doc)	PLR91-4	1991
Common Carrier (/policy/plr89-13-doc)	PLR89-13	1989
Doing Business (/policy/plr87-5-doc)	PLR87-5	1987
Filing Requirement Where Nexus is an Issue (Voluntary Filer) (/policy/rp09-2-doc)	RP09-2	2009
Filing Requirement Where Nexus is an Issue (Voluntary Filer) (/policy/rp07-1-doc)	RP07-1	2007
Filing Requirement Where Nexus is an Issue (Voluntary Filer) (/policy/rpb01-5-doc)	RPB01-5	2001
Filing Requirement Where Nexus is an Issue (Voluntary Filer) (/policy/rp96-1-doc)	RP96-1	1996
Filing Requirement Where Nexus is an Issue (Voluntary Filer) (/policy/rp92-2-doc)	RP92-2	1992
Geoffrey Implications - Non Taxable Examples (/policy/rr08-1-doc)	RR08-1	2008
Geoffrey Implications - Non Taxable Examples (/policy/rr98-3-doc)	RR98-3	1998
Geoffrey, Inc. v. South Carolina Tax Commission (/policy/il94-05-doc)	IL94-05	1994
Leasing Activities (/policy/plr94-8-doc)	PLR94-8	1994
Nexus Creating Activities for Income Taxes - Survey Responses (/policy/rr03-4-doc)	RR03-4	2003

Title	DocID	Year
Protected Activities (Public Law 86-272) (/policy/rr97-15-doc)	RR97-15	1997
Protected Activities (Public Law 86-272) (/policy/rr93-10-doc)	RR93-10	1993
Protected Activities (Public Law 86-272) (/policy/rr91-16-doc)	RR91-16	1991
Solicitation Standard Necessary (/policy/plr88-19 -doc)	PLR88-19	1988
Nonresident		
Child & Dependent Care Credit (/policy/il90-21-doc)	IL90-21	1990
Partnerships		
Income of Limited Partner Not Taxable (/policy/plr95-2-doc)	PLR95-2	1995
NOL Deduction (/policy/tam87-6-doc)	TAM87-6	1987
Nonresident Partner - Filing Single Returns (/policy/tam87-10-doc)	TAM87-10	1987
Personal Service Income of Resident Partners (/policy/rr97-7-doc)	RR97-7	1997
Pass Through Business		
Optional Rate on Active Trade or Business Income (/policy/rr08-2-doc)	RR08-2	2008
Optional Rate on Active Trade or Business Income (/policy/rr06-12-doc)	RR06-12	2006
Per Capita Income Figures for State and Counties (/policy/rr99-11-doc)	RR99-11	1999
Per Capita Income Figures for State of SC and SC Counties (/policy/il14-15-doc)	IL14-15	2014
Per Capita Income for Counties (/policy/il12-16-doc)	IL12-16	2012
Per Capita Income for Counties (/policy/il11-17-doc)	IL11-17	2011
Per Capita Income for Counties (/policy/il11-8-doc)	IL11-8	2011
Per Capita Income for Counties (/policy/il10-4-doc)	IL10-4	2010

Title	DocID	Year
Per Capita Income for Counties (/policy/il09-6-doc)	IL09-6	2009
Per Capita Income for Counties (/policy/il08-8-doc)	IL08-8	2008
Per Capita Income for Counties (/policy/il07-11-doc)	IL07-11	2007
Per Capita Income for Counties (/policy/il06-11-doc)	IL06-11	2006
Per Capita Income for Counties (/policy/il05-14-doc)	IL05-14	2005
Per Capita Income for Counties (/policy/il04-12-doc)	IL04-12	2004
Per Capita Income for Counties (/policy/il03-12-doc)	IL03-12	2003
Per Capita Income for State (/policy/il13-20-doc)	IL13-20	2013
Per Capita Income for State (/policy/il12-18-doc)	IL12-18	2012
Per Capita Income for State (/policy/il12-6-doc)	IL12-6	2012
Per Capita Income for State (/policy/il10-12-doc)	IL10-12	2010
Per Capita Income for State (/policy/il09-19-doc)	IL09-19	2009
Per Capita Income for State (/policy/il08-22-doc)	IL08-22	2008
Per Capita Income for State (/policy/il07-18-doc)	IL07-18	2007
Per Capita Income for State (/policy/il06-10-doc)	IL06-10	2006
Per Capita Income for State (/policy/il06-20-doc)	IL06-20	2006
Per Capita Income for State (/policy/il05-12-doc)	IL05-12	2005
Per Capita Income for State (/policy/il05-27-doc)	IL05-27	2005
Per Capita Income for State (/policy/il04-11-doc)	IL04-11-Revised	2004
Per Capita Income for State (/policy/il04-25-doc)	IL04-25	2004
Per Capita Income for State (/policy/il03-11-doc)	IL03-11	2003
Per Capita Income for State (/policy/il03-29-doc)	IL03-29	2003
Per Capita Income for State (/policy/rib02-10-doc)	RIB02-10	2002
Per Capita Income for State (/policy/rib02-20-doc)	RIB02-20	2002
Per Capita Income for State (/policy/rib02-9-doc)	RIB02-9	2002
Per Capita Income for State (/policy/rib01-11-doc)	RIB01-11	2001
Per Capita Income for State (/policy/rib01-12-doc)	RIB01-12	2001

Title	DocID	Year
Per Capita Income for State (/policy/rib01-17-doc)	RIB01-17	2001
Per Capita Income for State (/policy/rib00-13-doc)	RIB00-13	2000
Per Capita Income for State (/policy/il99-1-doc)	IL99-1	1999
Qualified Recycling Facility (/policy/plr97-2-doc)	PLR97-2	1997
Real Estate Investment Trust (/policy/plr92-7-doc)	PLR92-7	1992
Refund Checks (/policy/rr89-2-doc)	RR89-2	1989
Reorganization (Savings and Loan) (/policy/plr90-6-doc)	PLR90-6	1990
Retirement Benefits		
State Employees, Teachers, Police & Firemen (/policy/il89-20-doc)	IL89-20	1989
Retirement Income		
Election (/policy/rr95-15-doc)	RR95-15	1995
Election Not Intended, Amend Return (/policy/il98-20-doc)	IL98-20	1998
Surviving Spouse (/policy/il94-03-doc)	IL94-03	1994
Surviving Spouse (/policy/rr94-9-doc)	RR94-9	1994
Surviving Spouse (/policy/rr93-12-doc)	RR93-12	1993
S Corporations		
Election (/policy/tam89-24-doc)	TAM89-24	1989
Income from Out of State (/policy/rr87-2-doc)	RR87-2	1987
Qualified Subchapter S Subsidiaries (/policy/rp98-1-doc)	RP98-1	1998
SC Business Development Corporations (/policy/rr96-10-doc)	RR96-10	1996
Small Business Provisions - Computation and Examples of New Provisions (/policy/rr07-2-doc)	RR07-2	2007
State Agency, Thrift Shop (Tax Exempt) (/policy/plr87-8-doc)	PLR87-8	1987
Subsistence Allowance: Firefighters and EMS Personnel (/policy/rr96-5-doc)	RR96-5	1996

Title	DocID	Year
Subsistence Allowance		
Increase for 2003 (/policy/il04-1-doc)	IL04-1	2004
Tax Moratorium for Corporate Insurance Premium Taxes		
Procedure to Petition for and Claim (/policy/rp04-6-doc)	RP04-6	2004
Qualifying Counties for 2003 (/policy/il03-4-doc)	IL03-4	2003
Qualifying Counties for 2008 (/policy/il08-2-doc)	IL08-2	2008
Qualifying Counties for 2015 (/policy/il15-1-2-doc)	IL15-1	2015
Trust		
Short Period Return (/policy/il89-2-doc)	IL89-2	1989
Withholding		
Backup Income Tax		
Repealed (/policy/il90-6-doc)	IL90-6	1990
Repealed (/policy/il89-19-doc)	IL89-19	1989
Repealed (/policy/rr89-20-doc)	RR89-20	1989
Magnetic Media Requirements (/policy/rib00-19-doc)	RIB00-19	2000
Magnetic Media Requirements (/policy/il98-26-doc)	IL98-26	1998
Magnetic Media Requirements - Withdrawal of Policy Documents (/policy/rp08-5-doc)	RP08-5	2008
Nonresident Contractors		
Additional Exemptions after December 31, 1992 (/policy/il92-16-doc)	IL92-16	1992
Credit for 2% Withholding Tax (/policy/rp90-1-doc)	RP90-1	1990
Withholding Bond (/policy/tam88-2-doc)	TAM88-2	1988
Nonresident Partners and Shareholders (/policy/rp92-5-doc)	RP92-5	1992
Performers (/policy/plr94-9-doc)	PLR94-9	1994

Title	DocID	Year
Real Estate Sales by Nonresidents (/policy/rr09-13-doc)	RR09-13	2009
Real Estate Sales by Nonresidents (/policy/rab02-6-doc)	RAB02-6	2002
Real Estate Sales by Nonresidents (/policy/rr90-3-doc)	RR90-3	1990
Real Estate Sales by Nonresidents (/policy/il89-22-doc)	IL89-22	1989
Real Estate Sales by Nonresidents (/policy/rr89-15-doc)	RR89-15	1989
Real Estate Sales by Nonresidents (/policy/rr89-19-doc)	RR89-19	1989
Utility (/policy/il90-11-doc)	IL90-11	1990
W-4 (/policy/tam88-21-doc)	TAM88-21	1988
Withholding Agent - Definition (/policy/rp94-4-doc)	RP94-4	1994
Withholding Deposits, IRS New Regulations (/policy/rib01-2-doc)	RIB01-2	2001
Withholding Deposits, IRS New Regulations (/policy/il98-13-doc)	IL98-13	1998
Withholding Deposits, IRS New Regulations (/policy/il93-16-doc)	IL93-16	1993
Withholding Deposits, IRS New Regulations (/policy/il92-31-doc)	IL92-31	1992
Withholding Deposits: Interest on Late Deposits (/policy/rr95-17-doc)	RR95-17	1995
Withholding Deposits: Interest on Late Deposits (/policy/tam93-1-doc)	TAM93-1	1993

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EXHIBIT B

sourced for South Carolina apportionment purposes based on a cost of performance, but rather turns upon a factual analysis of the income producing activity.[3]

To that end, Dish Corp argues that its activities (a majority of which occur outside the State), including (1) selecting, negotiating, acquiring, and managing broadcast programming; (2) managing and servicing the subscriber network; (3) managing the broadcast infrastructure; and (4) receiving programming content (which is then uplinked to the satellites) are its actions that produce income. However, as noted above, Dish Corp's business is one centered upon broadcasting television programming via satellites into the homes of its customers. All of the specific activities identified by Dish Corp lack any and all intrinsic value without the actual provision of television programming to South Carolina customers. It is vital to note here that each and every one of the activities the Taxpayer attempts to characterize as "income producing" has no direct causal effect upon the generation of income. All of them are inherently indirect activities, or rather, precursors to the only direct activity that creates Dish Corp profit. It is ***the final act***, the culmination of those enumerated activities – the delivery of the signal into the homes and onto the television screens of its customers – that produces income for Dish Corp. It does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Dish Corp is in the business of selling television broadcast subscriptions to customers, and without the actual delivery of that broadcast signal into South Carolina homes it would not have generated the income at issue here. It is that act alone for which South Carolina customers sign contracts and pay their monthly fees.

South Carolina is not alone in this method of sourcing receipts for taxpayers like Dish Corp. Twenty-three states have adopted the "audience approach" for assigning receipts from programming and broadcasting companies.[4] Florida, for example, adopted the following language:

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[3] In fact, in 1995 language about "cost of performance" was removed from the sales factor statute by our legislature, which shows a clear legislative intent that the phrase "income producing activity was not to be limited in such a fashion.

[4] See e.g., Alabama - Ala. Admin. Code R. 810-27-1-4.18(h) (2013); Arkansas - Ark. Admin. Code § 006.05.308-26-51-718(d)(2.26-51-718(d)) (2013); Colorado - 1 Colo. Code Regs. § 201-3, Spec. Reg. 5A (2013); Connecticut - Conn. Gen. Stat. § 12-218(l) (2013); Florida - Fla. Admin. Code Ann. R. 12C-1.0155(2)(i) (2013); Georgia - Ga. Comp. R. & Regs. 560-7-7.03(5)(c) 6(vii) (2013); Hawaii - Haw. Code R. § 18-235-38-06.04 (2013); Idaho Admin. Code R. 35.01.01.580(01)(e) (2013); Iowa Admin. Code. R. 701-54.7(5)(422) (2013); Maryland - Md. Code Regs. 03.04.03.09 (2013); Michigan - Mich. Comp. Laws Ann. § 208.1305(20) (2013); Montana - Mont. Admin. R. 42.26.1103 (2013); New Hampshire - NH Code R. Rev. 304.09 (2013); New Mexico - NM Code R. § 3.5.19(18) (2013); North Dakota - ND Admin. Code R. 81-03-09-38 (2013); Oregon - Or. Rev. Stat. § 314.684 (2013); Or. Admin. R. 150-314.684(4) (2013); California – 18 CA ADC § 25137-8.1 (2013); Illinois – 35 ILCS 5/305(B7) (2013); Louisiana – La. Rev.

> Television and Radio Broadcasting. Gross receipts, including advertising revenues, from broadcasting within and without the state will be attributed to the numerator of the sales factor on the basis of the ratio of the audience within the state to the audience everywhere.

Fla. Admin. Code Ann. R. 12C-1.0155(2)(i) (2013). This approach has been tested in adjudicative proceedings as well, and courts in other jurisdictions have held that audience based sourcing for taxpayers like Dish Corp is the proper method. For example, in Texas an Administrative Law Judge illuminated the income producing activity when he held:

> The act Petitioner's customer contracts and pays to receive, and the act that produces the receipts at issue, is the act performed by the receiver (i.e., the set top box) that Petitioner sells or leases to its subscribers. Petitioner's customers contract for the receipt of television programming. Petitioner contracts to provide the programming, and **it is the microchips within the receiver that unscramble and decode the satellite's encrypted signal that completes the transaction and produces the programming receipt**. It is undisputed that each of the programming receipts scheduled within the audit are receipts Petitioner received from Texas subscribers. The ALJ finds the auditor correctly apportioned the receipts at issue.

Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013) (emphasis added.). The approach the auditor has taken here is identical to the Texas ALJ's rationale. Dish Corp produces income in South Carolina by providing receiver boxes that interpret a broadcast signal for South Carolina customers. To that extent, and in complete consistency with Section 12-6-2290, those gross receipts should be sourced to South Carolina.

II. The Penalties Assessed were Proper.

Civil penalties are applied to every South Carolina tax law which requires a return unless otherwise provided. S.C. Code Ann. § 12-54-43 (2014). Such penalties are considered a tax owed this State. Id. Further, "[i]f any tax is not paid when due, interest is due on the

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Stat. Ann. § 47:287.95(K)(2)(c)(i) (2013); New Jersey - Metromedia, Inc. v. Director, Div. of Taxation, 97 N.J. 313, 478 A.2d 742 (1984) (citing N.J. Stat. Ann. § 54:10A-8.(2013)); Ohio – Ohio Admin. Code 5703-29-17(9)(a) (2013); Rhode Island – R.I. Admin. Code § 60-1-194:1 (2013); Washington – Wash. Admin. Code 458-20-241(2013).

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Shirley C. Robinson, Administrative Law Judge

RECEIVED
AUG 08 2016
SC Court of Appeals

Case No. 14-ALJ-17-0285-CC

Dish DBS Corporation, f/k/a EchoStar, DBS Corp., and Affiliates ..... Appellant,

v.

South Carolina Department of Revenue ..... Respondent.

NOTICE OF APPEAL

Appellant Dish DBS Corporation, f/k/a EchoStar, DBS Corp., and Affiliates (hereinafter "Appellant") hereby appeals the Amended Final Order of the Honorable Shirley C. Robinson dated July 11, 2016, a copy of which is attached hereto as Exhibit A. Appellant received written notice of the entry of the Amended Final Order on July 11, 2016. Thus, pursuant to Rule 29(D)(4) of the Rules of Procedure of the Administrative Law Court, this Notice of Appeal is timely filed within 30 days of receipt of the Order on Reconsideration.

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August 8, 2016

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EXHIBIT A

AMENDED FINAL ORDER

FILED
JUL 11 2016
SC ADMIN. LAW COURT

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

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

RECEIVED
AUG 08 2016
SC Court of Appeals

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

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

STATEMENT OF THE CASE

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

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

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

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

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

ISSUE

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

FINDINGS OF FACT

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

Petitioner's Business Operations

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

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

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

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

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

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

Attracting Subscribers and Contracting for Service

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

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

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

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

Petitioner's Revenue

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

Petitioner's Tax Returns

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

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

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

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

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

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

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

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

> It is ***the final act***, the culmination of those enumerated activities[7]—the delivery of the signal into the homes and onto the television screens of its customers—that produces income for [Petitioner]. [Petitioner] does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. [Petitioner] is in the business of selling television broadcast subscriptions to customers, and without the actual delivery of that broadcast signal into South Carolina homes it would not have generated the income at issue here. It is that act alone for which South Carolina customers sign contracts and pay their monthly fees.

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

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

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

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

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

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

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

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

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

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

The Department's Historic Tax Policy

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

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

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

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

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

2005 Policy at 20.

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

CONCLUSIONS OF LAW

Standard of Review

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

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

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

South Carolina Corporate Income Tax Generally

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

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

Petitioner is a Service Provider

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

Apportionment Methods Generally

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

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

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

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

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

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

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

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

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

South Carolina's Apportionment Statute

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

> [T]he taxpayer shall apportion its remaining net income using a fraction [ratio] in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

S.C. Code Ann. § 12-6-2290 (2014).[14] Thus, a service-providing taxpayer is required to use a gross receipts apportionment ratio. Section 12-6-2295 defines "gross receipts" depending upon the type of business in which the corporation is engaged. S.C. Code Ann. § 12-6-2295 (2014). For corporations that provide services, subsection (A)(5) applies, and provides the following:

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> ***
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State . . . .

S.C. Code Ann. § 12-6-2295(A)(5) (2014).

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

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

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

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

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

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

Analysis

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

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

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

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

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

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

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

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

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

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

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

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

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

> Lockwood also argues the statute has not been consistently interpreted by the Tax Commission. *Lockwood refers to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters. We are not persuaded these businesses are comparable to Lockwood.* By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus

> on whether the services are performed in South Carolina. These situations are analogous and consistent with the situation of Lockwood.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> Analogizing the facts in this case to the holding in Mercury [Motor], the beaming of the satellite signals through the air of South Carolina to the customer's dish, set-top box, and television screen, and the collection of charges for such service, are also analogous to the loading, hauling, and delivery of freight following the customer's solicitation of that freight, and the collection of charges therefor. However, the other prior activities that prepare the way for DIRECTV's provision of services, i.e., the infrastructure for producing and collecting the programming content and transmitting the signals would, in comparison to the facts in the Mercury [Motor] case, be akin to the manufacturing and transfer of the freight through its infrastructure to a storage location, from which it is later – **only after an order is placed** (or "solicited," as the Supreme Court put it) – loaded, hauled, and delivered, and for which charges are collected.

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

Although this Court in DIRECTV found delivery of the signal into subscribers' homes and onto their television sets is the income-producing activity, the Court also suggested "other activities," particularly advertising, may be an income-producing activity. Id. at 14 n.15, 19-20. However, this Court ultimately found DIRECTV "did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina" and therefore did not include advertising as an income-producing activity.

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

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

> [u]nlike the taxpayer in Lockwood Greene, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here.

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

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

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

Where Does Petitioner's Income Producing Activity Take Place?

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

Substantial Understatement Penalties

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

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

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer. . . .

Subsection (D)(1) further adds that "[a] penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the

portion and that the taxpayer acted in good faith with respect to the portion." S.C. Code Ann. § 12-54-155(D)(1) (2014). Finally, "[u]nless specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." S.C. Code Ann. § 12-54-160 (2014).

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

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

CONCLUSION

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

ORDER[24]

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

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

AND IT IS SO ORDERED.

SHIRLEY C. ROBINSON
Administrative Law Judge

July 11, 2016
Columbia, South Carolina

CERTIFICATE OF SERVICE

This is to certify that the undersigned has this date served in accordance with the above administrative proceeding rules by depositing a copy hereof in the United States Mail, postage prepaid, addressed to the Petitioner and Respondent, or their attorney(s) at their last known address(es).

This 11th day of July, 2016.

By: _____
Judicial Law Clerk

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

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

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

Transcript of the Testimony of
DISH DBS CORPORATION V. SC DOR

Date: September 23, 2015

CREEL COURT REPORTING, INC.
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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT DIVISION
Docket No. 14-ALJ-17-0285-CC

Dish DBS Corporation, f/k/a EchoStar DBS Corporation & Affiliates,

Petitioner,

v.

South Carolina Department of Revenue,

Respondent.

COPY

ADMINISTRATIVE HEARING

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Wednesday, September 23, 2015
10:02 a.m. - 3:59 p.m.
Thursday, September 24, 2015
9:01 a.m. - 3:02 p.m.
Friday, September 25, 2015
10:02 a.m. - 12:27 p.m.

The hearing before the Honorable Shirley C. Robinson was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 23rd through 25th days of September, 2015, before Andrea R. Taylor, Court Reporter and Notary Public in and for the State of South Carolina.

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EXHIBITS

(The following exhibits were all admitted into the record. The listed page numbers indicate when the exhibit was mentioned in the record. Missing page numbers indicate no mention in the record after admittance.)

Petitioner's Exhibit Number 1 112
(2005 Original SC Corporate and License Fee Return)
Petitioner's Exhibit Number 2 112
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(2007 Amended SC Corporate and License Fee Return)
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(2008 Original SC Corporate and License Fee Return)

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(BNA, Tax Management Multistate Tax Portfolios: South Carolina Corporate Income Tax (S-158,2280:0510d-2280:0510e)
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(Uniform Division of Income for Tax Purposes Act)
Respondent's Exhibit Number 9 24
(Excerpt from the Department's Corporate Tax Manual)
Respondent's Exhibit Number 10 449
(I-D-214 re: Income Tax (April 15, 1976))

Respondent's Exhibit Number 11 24
(Index of Record submitted in *Lockwood Greene*)
Respondent's Exhibit Number 12 451
(Minutes of Meeting of SCTX on August 24, 1977 and adopted Rule of Construction)
Respondent's Exhibit Number 13 24
(Dish Customer Contract)
Respondent's Exhibit Number 14 24
(Request for contested case hearing)

(All original exhibits were retained by the Court.)

STIPULATIONS

It is stipulated and agreed that this hearing is being taken pursuant to the rules of the Administrative Law Court and the South Carolina Rules of Civil Procedure.

THE COURT: If everyone is ready, we'll get started. This is the case of Dish DBS Corporation as the petitioner versus the South Carolina Department of Revenue. It's Docket Number 14-ALJ-17-0285. We've got Mr. Burnie Maybank. Do we have Jim Rourke?

MR. MAYBANK: I'm sorry?

THE COURT: Jim Rourke?

MR. ROURKE: That's correct, Rourke.

THE COURT: Rourke, okay.

MR. ROURKE: That's correct.

THE COURT: Is also here representing the petitioner. We've got Nicole Wooten, William Condon and Mary Beth Campbell representing the Department; is that correct?

MS. WOOTEN: Yes, Your Honor. Thank you.

THE COURT: Okay. Thank you. If we don't have anything to address pre-hearing, I think we can get started ---

MR. MAYBANK: Thank you.

THE COURT: --- with today's proceedings.

MR. MAYBANK: Is it all right if we give a short opening argument, Your Honor?

THE COURT: Of course.

MR. MAYBANK: Good. Thank you.

OPENING STATEMENT BY MR. MAYBANK:

MR. MAYBANK: If it please the Court, I'm Burnie Maybank. I'm here today representing Dish. This case is very similar to the -- factually very similar to the DIRECTV case tried by Judge Anderson, which I understand is on appeal. The good news is there's only really one issue involved in this case; that is how you calculate the numerator for apportioning the income of a multi-state service provider. The DOR and Dish agrees on the denominator, and we pretty well agree on all the -- all the broad numbers themselves in the case. The argument is over how you calculate the numerator. So all of the testimony and all the facts and all of the law are going to apply to that one issue. And that one issue is the statute at issue says for multi-state service providers that, quote, "Sales are attributable to this state to the extent the income-producing activity is performed within this state." The problem, and I guess the reason we're here today is no statute or regulation or policy document tells you how to define, quote, "The extent to which income-producing activity is

performed in this state." And we'll have quite a brouhaha today as to what is even -- what even is income-producing activities. We contend that income-producing activities are all the things Dish does in the regular course of its business to gin up new business and to maintain the customers we have in a very highly competitive business. And our pay TV business is very highly competitive. To get a new customer we first have to compete with businesses that give away TV for free. This includes free TV, there's free radio for USC/Clemson football games, and there's a lot of material free on the internet. And we also sell movies and TV series, some of which you can get for free from the Richland County Public Library. You go on Assembly Street and they've got a huge selection of movies and they've got a huge selection of TV series, and all of that's just for the cost of a one-time library card. And of course there's a number of TV series and movies for free over the internet now, some of which are illegal. So the first thing we have to do is to convince a potential customer to pay for what they can

sometimes get for free. And then we have -- once we push them over the edge, yeah, maybe I do want to sign up for pay TV, we then have to get them to sign up with us instead of cable and DIRECTV. Comcast is in fact, Comcast Cable is, in fact, by far the biggest provider of pay TV in the U.S. today, DIRECTV is second, and Dish is third, and the phone companies have been getting into the pay TV business in a big way as well. Now, the way we gin up new customers is -- and keep existing customers is primarily content, our programming. I finally signed up coincidently for Dish, and I don't watch a whole lot of TV, but I signed up for Dish because the Gamecock football was on a big roll, Clemson started on a big roll, and so really Coach Spurrier was the primary reason I signed up for Dish TV, and that's waning every day. I think Dish is a little nervous about me maintaining my subscription. So we'll go into the factually how I get USC football and Fox News into my house on Edisto Island, Charleston County, South Carolina. My dad is a big Fox News fan. He goes to Edisto every weekend, and so that was the second reason I signed up for

it. So in addition to content, our other income-producing activities include advertising and call centers. One wouldn't think there would be an argument that advertising is an income-producing activity, but we'll have it today. But the purpose of our advertising is to convince people to leave free TV for pay TV. And then once we convince them of the value of pay TV, you get them to come to us and not Comcast or DIRECTV. Our call centers are big income-producing activities for several reasons. First during the audit years of 2005, 2010, you couldn't sign up for Dish online; you had to go through a call center. Second, no one bothers to read the minutia of our advertising over our contracts. They know like me, I know you've got USC football on there, but I don't know what you -- what else you've got on there. I don't bother to take any time to read it. And so when you call in to sign up for Dish, as I did, they then go through all the various alternatives and of course trying to sign you into a more premium contract. They don't want you signing up for basic, but they want you to sign up for one of the other three

alternatives which have a lot more -- a lot more packages. Second, they keep -- third, to keep existing customers happy who call with questions, and new subscribers frequently have questions, why aren't I getting the USC game, I thought I paid for it. Well, no, you bought the basic program, you didn't get the USC game, we'll sign you up right now, Burnie, for the ESPN/SEC network. And then occasionally we have people who get dissatisfied and they want to cancel their subscription and the call centers talk to them and comp them, give them free benefits and things like that to try and keep them happy and to maintain their subscription. And then lastly they collect overdue bills. I occasionally will get overdue on my bill and they call you. When you sign up they get your cell phone number, and they start calling you, hey, Burnie, you know, you're two months past on your bill. Some of that's automated, mostly human. And then they also handle pay-per-view. I've only signed up myself for pay-per-view once or twice where USC played a small college that wasn't on the SEC Network. But a lot of people do sign up for

pay-per-view, and if they want to sign up for pay-per-view, they have to go through a call center. The other income-producing, or big income-producing activities are the satellites and the subscriber equipment. There's a lot -- going to be a lot of dispute about whether satellites and subscriber equipment are income-producing activity, but in the Department of Revenue's determination, they said without the actual delivery of the broadcast signal into South Carolina homes, it would not have generated the income at issue here. And the Department determination also says Dish Corporation produces income in South Carolina by providing receiver boxes that interpret a broadcast signal for South Carolina customers. So I couldn't -- I couldn't have said that much better as to why satellites and subscriber equipment are income-producing activities. Now, the DOR's position is basically all you care about is turning on the TV and there's a signal there. And they argue correctly no one -- no one in South Carolina buys a satellite, no one buys satellite time. All I want to do is turn it on and there's the USC game. And

they say that's the only income-producing activity is I turn on the TV and there is the USC/Tennessee football game. But you do buy, or more typically lease, you lease the subscriber equipment. The satellite obviously plays an integral role in getting the show into your home. Without the satellite, you wouldn't have a show. And the satellite and the setup box make sure you get the best possible reception without snow, noise, or blackouts. And my home in Edisto in a rural area, the regular TV reception is subject to all of those things. I put up a big rabbit ears on my roof and it didn't do a whole lot better. And the setup boxes and the satellite make sure you get what you pay for. I sign up for a certain package, I get that package, and you don't get channels you didn't pay for and a fair number of people spend every waking hour figuring out how they can get Dish for free. Fraud is a terrible problem in the industry, and the satellite and the setup box play a critical role in keeping the fraud down. Now, we are going to establish what we feel our taxes would be under two different apportionment theories.

First is we filed our tax returns under the classic pro rata cost of performance basis. Now, why did we do that? Because the Court of Appeals and the Department of Revenue have told us for some 35 years that's the way you do it in South Carolina for multi-state service providers. In fact, our own audit report cites *Lockwood Greene* and cost of performance. But the Department's audit and the Department's determination says we should have done it on a market share basis. But if you're in Englewood, Colorado, you're a big multi-state corporation like Dish, and you're trying to figure out how you file returns in South Carolina and 49 states -- and Dish files returns in 49 states -- there is no market share statute, there's no market share regulation, and there's no market share policy document. And what every taxpayer, of course, does is read the instructions in the corporate income tax return and there are no instructions in the corporate income tax return that says South Carolina is a market share state. On top of all of that, the South Carolina Corporate Practice Manual says that South Carolina is

neither a cost of performance nor a market share state. So if you're in -- you're in Englewood, Colorado, and you're filing your first return in SC, it can be a difficult task. And Judge Robin- -- Judge Anderson and Your Honor said in our motion for summary judgment that South Carolina is not necessarily either a cost of performance nor a market share state. So in a sense, both our tax returns and the DOR audit are wrong, and you would be less than human if halfway through this you didn't start thinking they're both wrong. But given the ruling in DIRECTV and Your Honor's ruling in our motion for summary judgment, we've attempted to recalculate our taxes based on the DIRECTV income-producing test. Now, that's not easy. In the DIRECTV decision, which we obviously disagree with, but in that decision, Judge Anderson took great pains to say what DIRECTV did not do. He didn't give a whole of advice about what DIRECTV should have done, and he put a virtually impossible burden of proof on DIRECTV in that case. There's no way any corporation that does business in 50 states is going to be able to say we sent advertising

just into South Carolina just so that we could get you, Burnie, to sign up for it. That's just not the way the free enterprise system works for large multi-state corporations. But we closely examined both orders and the second part of our case, then, will be to prove our income tax liability in what we think is a holding on your -- y'all's order and our motion for summary judgment and the DIRECTV case. So to repeat, this case involves a single legal issue, how we calculate the numerator given the statutory mandate that sales are attributable to this state to the extent the income-producing activity is performed within this state. And we'll establish that two ways: first, under traditional pro rata cost of performance; and secondly, under the DIRECTV and your decision in Dish. The only thing we all agree on, all being Dish, Judge Anderson, Your Honor, and the DOR, is that the DOR's market share audit is wrong. As I previously stated, the South Carolina DOR Corporate Practice Manual says, flatly says, South Carolina is not a market share state. Now, Judge Anderson ultimately apportioned all of

DIRECTV subscription revenue to South Carolina, but he didn't do it on a market share method that DOR asserts in our case. He did -- and asserted in that case. He did so by finding that DIRECTV had no income-producing activities in South Carolina other than subscription revenue. And so a good part of our case today is going to be to establish the income-producing activities we have in South Carolina other than the simple cutting of the check or running Burnie's credit card. In the Department determination, they note that market -- the Department of Revenue notes that market share is an acceptable method, and no one denies it's an acceptable method. But they cite statutes from 20 or so market share states. South Carolina doesn't have a market -- not only does South Carolina not have a market share statute, regulation, or policy document, we've got a DOR corporate practice manual saying that's not the law in South Carolina. Now, the market share has winners and losers. The biggest winner of market share is a domestic South Carolina business whose cost of performance is all here but whose

customers are largely or entirely out of state. Under that scenario, your domestic business, all your cost of performance is here, all the checks are mailed here, but your customers are out of state, under their interpretation they wouldn't pay taxes on the income to the out-of-state customers. And that is exactly the argument that *Lockwood Greene* made and the old Tax Commission, the Circuit Court and the Court of Appeals said was -- was erroneous. There's one other -- one other issue in the case. Their market share method produced one other result. It resulted in a more than 20 percent understatement of taxes for 2005 and 2006. So they asserted the six year statute of limitations in those cases. Those years would have otherwise been barred by the three year statute of limitations but for the substantial understatement. And we contend they should be barred by the statute of limitations today. In conclusion, in the interest of time, we're only going to go over the tax year 2010. The audit is for 2005 through 2010, but our business is substantially the same. We prepared the returns substantially the same way and we'd be

here all week if we went through 2005 through 2009. So we're just going to stick with 2010 in the interest of saving a lot of time. That's all I have, Your Honor. Thank you.

THE COURT: Thank you. Ms. Wooten.

MS. WOOTEN: Thank you, Your Honor.

OPENING STATEMENT BY MS. WOOTEN:

MS. WOOTEN: This case is about petitioner's attempt to read five omitted words into a written statute. And those omitted words are based on cost of performance. The parties don't dispute that the Sections 12-6-2290 and 12-6-2295(A)(5) are the relevant statutes. The Department believes there are three issues in this case. The first is what is the income-producing activity. In the Department determination, the Department concluded pursuant to the clear language of the statute that the income-producing activity of petitioner is the delivery of the signal into the customers' homes and onto their television screens. The second issue is in what state or states should that or does that income-producing activity occur. Because the income-producing activity is the delivery of the signal into South

Carolina homes and onto television screens, that income-producing activity is related to each and every South Carolina customer or subscriber and occurs entirely in South Carolina. And finally, the third issue is how should the gross receipts be sourced to the state or states in which that income-producing activity occurs. The Court will see that the first prong of Section 12-6-2295(A)(5) requires that a hundred percent of its subscription receipts for South Carolina be sourced to South Carolina. In the Department's case you will hear from five witnesses who support the Department determination. The first is Orville Sharpe. He's our senior auditor who conducted the audit of the taxpayer, and he will describe the audit, the inconsistent apportionment methods used by the taxpayer on its returns, and the audit report and related income tax and license fee assessment. Our second witness is Tim Donovan, who is an audit supervisor, and he will testify about the Department's longstanding sourcing policies and about the Department determination in this case. Our third witness, John Swearingen, is a former

long-time Department employee, and he will testify that the Department has a longstanding sourcing policy that sources receipts on an industry by industry basis, that the Department considered the decision in *Lockwood Greene* to apply only to personal service providers, and that the Department determination in this case is consistent with those longstanding policies. Our fourth witness is Dr. Harrison, and he will testify that, from an economics perspective, companies incur costs called intermediate inputs that do not produce income. And finally our fifth witness is Professor Swain, and he will testify that the purpose of the single sales factor, like South Carolina single gross receipts factor in 2290, is to recognize the contribution of the market state, and in this case, that would be South Carolina. Professor Swain will also testify that the Department's position in this case is consistent with good tax policy. And as you heard in petitioner's opening, he will attempt to persuade this Court to insert those five omitted words into the written statute. However, the Court will hear testimony and receive other evidence supporting

the omission of this phrase from that statute. First, the Court can clearly see that those words, "based on cost of performance," do not appear in our statute. And secondly, by considering cost based factors in this matter, the Court would essentially turn a gross receipts ratio into a cost basis ratio. Third, South Carolina case law supports our determination of sourcing petitioner's income related to subscription receipts to South Carolina customers to South Carolina. Next, the Court of Appeals decision in *Lockwood Greene* distinguished engineering services from services provided by finance companies and media broadcasters such that *Lockwood Greene* only applies to personal service providers. The Court will also see that *Lockwood Greene* did not impose a cost of performance standard as a means to source receipts among states. And finally, the Department's current and former employees will testify that the -- will state that the Department's long term, longstanding audit guidelines support our position in this matter. So in conclusion, simply put, the Court will hear and see why

petitioner cannot insert those five omitted words into a written statute to achieve the tax results it desires. The statute is clear that South Carolina focuses on the income-producing activity of a business in apportioning its net income. And as you will hear from the Department's witnesses as well as the evidence, this is exactly what the Department has done. Accordingly, the Department requests that the Court uphold its Department determination in this matter. Thank you, Your Honor. The Department is ready to begin.

THE COURT: Thank you. Mr. Maybank.

MR. MAYBANK: Thank you. Your Honor, we only have two disputed exhibits, so what we would like to do, with your permission, is to go ahead and introduce all the exhibits, other than the two disputed exhibits of course, into evidence at this time, including both our exhibits and the Department's exhibits.

THE COURT: That's wonderful. Saves us time.

(Petitioner's Exhibit Numbers 1 through 35 and Respondent's Exhibit Numbers 1 through 14 were admitted into the record at this time.)

MR. MAYBANK: We'll call our first witness to the

stand, Rex Povenmire.

THE COURT: If you'll face the court reporter before you take your seat, she'll swear you.

COURT REPORTER: What was your name, sir?

MR. POVENMIRE: Rex Povenmire, P-O-V-E-N-M-I-R-E.

REX POVENMIRE, being duly sworn, testifies as follow:

MR. POVENMIRE - DIRECT EXAMINATION BY MR. MAYBANK:

Q: All right. Mr. Povenmire, as we heard in opening argument, the Department contends the income-producing activity is the delivery of the signal into the viewers home and where did that delivery occur. So I'd like to ask you in laborious fashion perhaps exactly what is the delivery of the signal and where does the delivery of that signal occur. Who is your current employer?

A: Dish Network.

Q: And you're an independent consultant ---

A: I am.

Q: --- who works for Dish?

A: I have many years with Dish Network, but I am now an independent contractor.

Q: Okay. And when did you retire from Dish?

A: 2013.

Q: All right. Did you ever work directly for Dish

as an employee?

A: I did.

Q: And when was that?

A: From 1993 through 2013.

Q: Okay. And state the positions you held at Dish during your employment.

A: When I first started I was program manager for the launch of Dish Network. My previous career had given me some background experience that they needed to be able to go into complex signal delivery as well as system security. I was a -- worked with the government contractor that did crypto gear, as well as radio communications with the military. So with that experience, I joined, at the time it was called EchoSphere. Program manager for the launch of the Dish Network in 1995. From there I held a variety of different positions. I took the experience that we had from launching Dish Network and went internationally to help do system integration for other companies and countries. For example, Canada and Madrid, we did uplink centers there. I did that for about three years. I then took over as the chief operating officer of a software development

company that handles our conditional access system. It was a joint venture at the time between our company and a Swiss company. I ran that for a couple of years. And then I was asked by the president of our company to come over and provide, I'll call it, specialized project support for him, and that would be in the probably the 2001 time frame. During that time frame I became kind of our resident expert on local delivery of distant managed broadcasts, various other types of programming, conditional access systems, call center systems, etcetera. From there my primary role was various variations on program management, specialty projects for both the chairman and our CEO and/or president at the time. Those included everything from negotiating our conditional access contracts to we did a major change in delivery of Dish networks that I managed. I routinely was involved with implementing locals and introducing new satellites into our constellation of satellites, which is an involved process. And I've been the primary interface for Dish Network with our subcontractor EchoStar. And

EchoStar is a spinoff from our company back in 2007. We separated the two companies. And I'm the technical interface on satellite issues, security issues, receiver issues, and handle most of the contract negotiations.

Q: Okay. Good. When you first started you said you were first hired as a project manager. How many project managers did the company have at that time?

A: At that time there was probably half a dozen project managers primarily involved with receiver development. The company was selling what we call BUDs, big ugly dishes, for the backyard satellite industry at the time. So most of the project managers were involved with developing receivers, and I became more of a system level project manager.

Q: Okay. And just in the interest of keeping the record clean, what was the name of the company that you did the -- that EchoStar did the joint venture with?

A: EchoStar, which was Dish Network at the time, did a joint venture with a company called Nagra Kudelski in Switzerland. And the name of the joint venture was NagraStar.

Q: Okay. And what exactly did it do?
A: Nagra in Switzerland has a conditional access system and a subscriber management system, and the functions of those are to keep track of the individual customers. The smart card is a device that's installed into the set top box to prevent people from watching programming they aren't authorized for, and to enable people to watch the programming that they are authorized for that they pick. So because Dish is such a large customer, we created a joint venture to be able to customize their basic product and make it unique and specific to our needs.
Q: Okay. And have you been involved in -- with call centers?
A: I have. I've been actively involved with call centers over the years. As a -- probably as a special projects leader, many of the activities that we do obviously involve not only call centers but the systems that the call centers operate on.
Q: Okay. And have you been involved in local channels?
A: Extensively, yes.
Q: Okay. If you could just briefly describe that.

A: When we first launched the service in 1996, almost all of the broadcasts that we did were what we would call national cable channels: CNN, Arts and Entertainment, the traditional channels that you might have gotten out of cable. But naturally, given the popularity of, at the time, the big three, ABC, NBC, CBS, and now Fox, with the popularity of those, it became important for us to provide those channels as well rather than encumber our customer base to switch their system around and get them off air. So we started implementing systems to deliver those signals directly into the demographic market area for an individual market. For example, Columbia we would -- eventually we launched specialized spot beam satellites that would take the Columbia signal and broadcast it back down into Columbia, because people in Montana can't watch it. So we were able to utilize the frequencies licensed by the FCC to better enable us to delivery those local channels into, today, all 210 markets. But that's been an evolutionary process.

Q: And have you been involved in smart cards and

anti-fraud devices?

A: Very much so. There are a number of different types of frauds that take place, and for the most part we try to stop those using smart cards, which are specialized secret chips that we put into the satellite receivers. And those chips are able to ---

Q: We'll come back to that.

A: Okay.

Q: But you are involved in the smart chip ---

A: Very much.

Q: --- smart card ---

A: Yes.

Q: --- development? And what did -- briefly, what did -- your last, say your last three years at Dish when you were a direct employee, what did you do?

A: During the last three years I've been actively involved in the management ---

Q: Well, I'm referring to when you were actually a Dish employee as opposed to today.

A: Okay. So up through about 2013?

Q: Right.

A: As I mentioned, I was involved in satellite negotiations, the provisioning of additional

local channels into markets. In fact, in 2012, we had launched a satellite that allowed us to bring the last of the HD channels into South Carolina specifically on spot beams. There's a tremendous amount of work involved with getting the systems put in place both in the uplink as well as receiver capabilities. So those -- a variety of different projects, interrelationships with our other corporations, our products.

Q: Okay. And then after you retired, you say Dish brought you back as a consultant. Could you briefly describe that?

A: Well, many of the projects I was working on, when I made the decision to leave the company, we did not really have the right expertise inside the company, so I was asked by Joe Clayton, our CEO at the time, if I would consider remaining with the company from a consulting standpoint, which met my personal needs as well as the needs of the company, and I've continued since that --it's been about two years now -- providing experienced guidance to some of the projects that are still underway.

Q: Okay. And who do you report to today as a

consultant?

A: Today I work -- report to Bernie Han, who is chief operating officer, and responsible for a good portion of our company.

Q: Okay. Briefly, because you've largely been over it, but the audit period in this case is from 2005 to 2010. Are you familiar with Dish's business and technical operations during this time period?

A: Yes, I am.

Q: Okay. And give us a brief overview of Dish itself. And feel free if you need to look at the Dish's 10-K to sort of tell us a little bit about Dish itself.

A: As I mentioned, Dish originally started in 1980 as a distributor of product. They quickly grew through a licensing arrangement to be able to license individual receivers to receive programming off of a variety of different satellites up there. In 1995, Dish was -- the corporation Dish was created. In '96, the service was launched. And that was launched onto EchoStar 1, a brand new satellite. Which rather than having a big dish that swung across the entire sky looking for other people's

satellites, this allowed Dish to consolidate programming content onto one satellite that was capable of broadcasting to a small dish. So in 2010, for example, I think we had about 14.3 million subscribers. If I may look at the 10-K briefly, I think it summarizes things pretty nicely.

Q: At what -- of that 14.133, what does that represent of the pay TV subscribers?

A: That's roughly about 15 percent of all pay TV subscribers.

Q: Okay. How many employees did you have at the end of 2010?

A: 2010, we would have had about 22,000 employees.

Q: Okay. And how many satellites did you own or lease in 2010?

A: Roughly 15 satellites. About half of those, probably six, owned by the corporation, seven leased from our sister corporation and a couple from outside parties.

Q: And where is your corporate headquarters physically located?

A: Englewood, Colorado.

Q: All right. And where are the -- where are your employees located?

A: I would say the majority of our departments and divisions are located right there in Englewood. We do have call centers and installation facilities around the U.S.

Q: Okay.

A: We have 11 call centers. But from the -- but the bulk of the activity takes place in Englewood.

Q: And are any of the call centers located in South Carolina?

A: No, they're not.

Q: All right. And where do you fit into the pay TV market?

A: Well, the pay TV market is still dominated by cable. They represent about two-thirds of the entire customer base, they pass the majority of households in the United States, 98 percent. So ---

Q: And who is the biggest cable operator?

A: Comcast would be the largest. DIRECTV is probably the second largest with maybe 20 percent market share. Dish is typically third largest with 15 percent. And then there's a variety of other smaller cable companies, Time Warner, Cox, etcetera. You now have telco

companies, AT&T and Verizon with U-verse and Fios. And obviously, from a competitive standpoint, we also have the internet and naturally traditional off-air television.

Q: Okay. And just very briefly, how did Dish get started?

A: Back in 1980, our founder and still chairman of the company, Charlie Ergen, recognized a need for a distributor of what at the time was kind of esoteric scientific equipment, and it was the equipment that allowed you to receive signals from the backhaul satellites that ABC, NBC use to distribute their signal around. So he started up a small company with Jim DeFranco. The two of them literally put together dishes and sold those locally in Denver out of a little garage shop down in one of the ---

Q: Those are the big huge dishes you used to see?

A: Those were the big dishes. They were typically, at that point in time, ten to 12 feet across. Charlie and Jim started adding engineers to innovate some of the product, and as companies do, it continually evolved to the point that they started selling licenses for

people to receive programming because the backhaul satellites started to be encrypted and monetized by the networks. So they took advantage of that opportunity and started selling programming contracts effectively. And then it became clear that with the advent of direct broadcast satellite by the FCC, satellites were more powerful, the FCC put in some special provisions and frequencies that they prepared to license. Corporations went after those licenses. Hughes Satellite Corporation was the one that ultimately became DIRECTV. And Charlie Ergen, a nobody, went for one of the other licenses; went out, signed a contract for six satellites, the first of which was EchoStar 1, launched in '95, and from there, started developing the Dish Network. And the big ugly dish business eventually waned away and, as you know, nobody is buying those right now, it's all the small dish.

Q: All right. Switching gears, in 2010, what programming did you provide?

A: We had a host of programming. If I may access this.

Q: Sure.

A: I know it's in here. It's easier than remembering. According to our 10-Q that was published in 2010 -- or 10-K, excuse me, we provide programming which includes more than 280 basic video channels, 60 Sirius satellite radios, 30 premium movie channels, 35 regional and specialty sports channels, 2,800 local channels, 250 Latino and international channels, and 55 channels with pay-per-view content. It was quite extensive programming.

MS. WOOTEN: For the record, can we get the witness to say which exhibit and page number he's reading from.

A: Yes.

MS. WOOTEN: Just to keep it clear.

A: I'm sorry.

Q: It's the 10-K.

A: The 2010 10-K, page nine of 182. And it is at the bottom of that page under Products and Services Programming.

MS. WOOTEN: Thank you.

Q: All right. How many of the thousands of programs did Dish produce?

A: A handful, perhaps two or three at the time. The vast majority are licensed by us from other

providers.

Q: Okay. And real quickly moving back a bit. In 2010, where were your corporate officers?

A: The corporate offices in ---

Q: Right.

A: --- 2010 were in Englewood.

Q: And they're still there today?

A: Still are there today, yes.

Q: How about legal and accounting?

A: Legal and accounting was in Englewood. Obviously ---

Q: IT?

A: IT was there. IT is actually a critical ---

THE COURT: I'm sorry. I'm sorry for interrupting you. But what is the exhibit number?

MR. ROURKE: It's Petitioner's Exhibit 19.

THE COURT: 19, thank you.

(Petitioner's Exhibit Number 19 was introduced into the record.)

MS. WOOTEN: And may I have -- I left my index with the court reporter. May I get it back for the exhibit list?

THE COURT: Yes.

MS. WOOTEN: Thank you.

Q: And where was IT, HR, finance, advertising and

the like in 2010?

A: In 2010, those were all located there, as well as product development, our advertising, programming organizations, in-home service.

Q: Okay. You say that Dish provides very little programming; it licenses them. Where were those licenses executed?

A: Our programming organization and the legal team that supports them are all located in Englewood, so they would have been executed there.

Q: Okay. Did you get all those channels for one price or do you have to -- do I have to buy different packages, I as a consumer?

A: The prices varied quite a bit based on the popularity of the channels, and we have then taken those various channels that we've licensed and, as part of negotiations, created different packages so that customers who want the bare minimum can have a relatively economical package and those that are interested in more programming can buy different packages. So we've got probably four major packages, between 15 and 20 additional packages that provide everything from -- well,

in your example, SEC football is one of those specialty packages that you can buy. We have a lot of international programming, etcetera.

Q: Okay. All right. And in the interest of time, let's turn to the Maybank family. I subscribe to Dish because I love USC football, and that love is waning, and my dad loves Fox News. So let's start with an example, USC plays Tennessee, and I want to watch that game at my house on Edisto Island, Charleston County, South Carolina. Very briefly walk me through it. Walk me through it if the game is played at South Carolina, and then we'll go in more detail if it's played at Tennessee.

A: Okay.

Q: So a game that's played in Columbia, I'm watching it on Edisto Island, how does that -- as the DOR says, how does that -- how is that signal delivered into my home and where did that delivery occur?

A: Well, kind of the first step in that process is we have to get you as a customer. So we will typically do advertising. We will work with national and regional subcontractors and retailers to be able to get our information in

front of you and get you enticed as a subscriber for the, in your case, Charleston --

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Q: Right. And let me briefly interrupt you. Where else can I listen or watch that USC/Tennessee game?

A: There's a variety of places. Obviously, radio, television, free television is available. We have a number of competitors that may very well have that product there. Everything from the cable companies, it's possible it could be on your local TV for free. You can get that from DIRECTV and the telcos.

Q: And how do you compete with DIRECTV, what's y'all's model?

A: Well, our primary method to compete with them is obviously we have advertising to make sure that our name is in front of the customer and they recognize the value. But I would say the three primary areas that we use to compete with DIRECTV would be the programming packages that we have, which we believe are extremely cost competitive, so the second item would be our pricing. DIRECTV tends to almost always be more expensive than us, as do the cable

companies. We are the low cost provider. And then the third area is that we continue to invest heavily in our technology, and we tend to stay a few steps ahead of the competition with our current products. The Hopper, for example, it leads the industry and has won many awards for consumer electronics.

Q: Okay. So you're trying to recruit me as a customer, how does your advertising work to accomplish that goal?

A: Well, we typically have advertising that we do in print, in radio. We have television advertising. We have direct mail advertising. We also enlist the services of a number of different companies across the United States. We've got local and regional consumer electronics companies. We have what we call independent satellite retailers. I think Columbia has one called U.S. Dish. But every community has a satellite and television retailer that typically carries our product, and we reimburse them for their efforts and pay for some of their advertising as well. So they're a local component. And then we also deal with national firms such as Best Buy and

Walmart and Costco. And while they may have different regions that they carry our product in different stores, nationally they handle all of that. And then we also have relationships with other providers such as telcos that don't necessarily offer video services. We may very well give them a commission for bringing us customers so that -- and vice versa. They may give us a commission for bringing them customers when they're contacted.

Q: Okay. And where is your -- do you have an advertising department?

A: We do.

Q: And where is that located?

A: It's at our headquarters in Englewood, Colorado, and we use a number of firms around the U.S.

Q: All right. And so the advertisements themselves, where are they devised, in Englewood?

A: Yes.

Q: Okay. All right. And I want to sign up -- in 2010 I want to sign up to watch the USC/Tennessee game, what happens next? Where do I sign up?

A: Well, if you want to join Dish Network to watch our services, in 2010 the typical approach would be one of two. You could go to one of the local retailers that I mentioned that can help walk you through some of the choices that you have. And then that retailer would call our call center and work with our call center operators. Or, based on your advertising, you could call the call center yourself and sign up directly with one of our customer service representatives.

Q: Could I sign up online in 2010?

A: No, you couldn't. You could probably educate yourself in 2010, but there was no ability to sign up online.

Q: Okay.

A: Today we are experimenting more with online sign-up, but I would say the traditional approach is still very much to have a conversation directly with a human.

Q: Okay. I call up to buy Dish to get the USC/Tennessee game, when I call up and the call center answers the phone, what are they going to tell me?

A: Well, the first they're going to do obviously

is kind of validate you as a customer, make sure that you're creditworthy and that your location is one that we can offer the services, which today we can just about everywhere. They'll also spend time walking you through the different programming packages that are available. It's a combination of making sure that you hang up the phone as a satisfied customer, but also that we effectively upsell you, to the extent we can. You were probably pretty easy to upsell the SEC add-on package. So we continue to show -- the CSRs would walk them through what the different options are, premium packages so that you could watch Game of Thrones and some of the other special programs. And, in fact, Showtime, HBO, a lot of the -- ESPN routinely do special campaigns inside our call centers to motivate the CSRs to sell Showtime, for example, and they would do giveaways and vacations and sometimes cars to the person that is able to upsell customers the most. And it works well for the CSRs because they're incented and they get bonuses based on the amount of upselling they're able to do to the typical customer.

Q: And CSR is customer service rep?
A: Customer service representative, yes.
Q: In y'all's experience, do most people who are calling the first time to a call center, are they familiar with what Dish offers?
A: Generally, no. It's an educational process. Our CSRs go through about six weeks of training and then every probably two to three months they have an additional several days of what we call uptraining to keep them current on what the offers are. We have so many channels, so many different packages, and because we have customers that go back literally to 1996, 1997, we have a host of different legacy programs that the CSRs need to be aware of. So it's very complicated. Typically the customer would need to have those systems explained to them, or those offerings explained to them.
Q: Right. Okay. All right. So you talked me into it, the CSR talks me into it, my credit card is processed, what happens next?
A: Well now the ---
Q: And back up, my credit card is processed, obviously the call center can take my credit card on line?

A: They can. They can. They can set you up -- credit card is obviously the preferred choice for us. It keeps our systems more efficient. Once the customer, yourself, has said that they want to sign up, they would establish which packages. Customer service representative would work with the subscriber management system that we have and the conditional access system, and they would effectively create the account, establish what was to be on your account, and then schedule a time for an installer to come out and do the installation. So they would create a work order for that installer. The installer could be an employee of Dish Network depending on the part of the country that you're in. Or the installer could be an independent third contractor, or it could actually, in some places, be the local mom and pop satellite store. So the installation is scheduled. The installer, let's say in this case the dish installer, would come to the home, determine where the best line of sight is, work with the customer in their home to establish where the dish is going to go, get the dish installed and pointed at the proper

set of satellites. And with 15 satellites, there are a lot of options as to where that's going to point. They would run the cable routing through the house, put the receivers where the consumer wants them, get the receiver hooked up. They would then typically call back to the call center and get the receivers authorized so that once the satellite -- or the receiver is looking at the satellite, the command can be sent over the satellite to turn that receiver on and get it authorized with the proper programming. Then the installer would go through a training process with the consumer to teach them how the guide works and some of the basics of operation with the remote control.

Q: And you must have a lot of training. When they were at my house, they were drilling holes in my wall, which always makes me a bit nervous.

A: Yes, it does.

Q: They have a good bit of, what I would call say carpentry type training?

A: They have quite a bit of installation training. The retailers have to go through a certification program before they can become

installers. But because the dish is pretty good size, it has what's called the wind load, so it's important that the installation be done properly. In the early years of the company we actually sold the dishes and handed them to the consumer, which worked okay for a while because most of those early adopters tended to be kind of techy types.

Q: Right.

A: But it's much better to provide those types of services for reliable service. If you want to have a quality reception of the product, you need to have them installed.

Q: And as I recall, they were in my house about an hour; is that about typical? Hour and a half?

A: I would say an hour and a half to two hours is more typical.

Q: Okay. And obviously y'all have security background checks. You know, somebody who is in my house, you know, for an hour and a half is a ---

A: We do. We try not to hire felons ---

Q: Right.

A: --- for the liability aspects.

Q: Okay. In South Carolina, aren't most of the

installers independent third party, or all the installers?

MS. WOOTEN: Objection. Leading.

Q: In South Carolina, are the installers third party or do they work for Dish?

A: Dish has no installation services directed by the company in South Carolina, so they're all third-party subcontractors or independent retailers.

Q: Okay. Does Dish manufacture the box or the antenna?

A: At one point in time many years back, Dish did manufacture boxes at a facility in Kuala Lumpur. But over time we recognized that being able to take advantage of the competitive landscape would help us keep our costs down. So at this point, Dish specifies what the capabilities of the box are going to be working with our engineering partner, EchoStar, and from there, EchoStar subcontracts out the manufacturing of those, typically to -- for a while the companies were in SCI in Huntsville, Alabama, but now predominantly I would say Mexico and China.

Q: Okay. In 2009, 2010, were you upgrading the

boxes?

A: We have always had a major upgrade program underway. In that time frame we were definitely upgrading. HD had been firmly established as a, kind of the standard du jour, so we had a lot of customers that were still using older SD boxes, even though most of the TVs you purchased were HD. So we were doing upgrade programs of our customers for HD. We found that if they had a hard drive in there and were able to record, it was a better customer experience and the customer was more likely to stay with us because of that experience. So we were constantly doing that. And we -- we were also moving heavily into what I call IP delivered video; pay-per-view movies and movies that could be downloaded not from our satellite necessarily but through the internet if you have your box internet connected. So we had 150,000 movies I think in that time frame, and it's several hundred thousand now.

Q: Did you have to have a new box to access all those additional capabilities?

A: You did. You did. The addition of

capabilities, for the most part we can do a little bit over software on the satellite, but for the most part those features can only be accomplished with physical hardware in the home.

Q: Okay. And in that time period, were you doing anything regarding fraud?

A: Absolutely. Our very first boxes, as I mentioned, shipped with Nagra smart cards. And the smart card was our primary mechanism to prevent the unauthorized viewing of programming. But at this point, we're on our fourth generation of smart card with a fifth generation smart card being worked. We have twice had to swap those smart cards out in the field. Most recently 2009 was one of my projects to swap out all smart cards to 25 million set-top boxes by literally mailing cards to each and every customer. So the security aspect of it was pretty good. And there's a number of types of fraud.

Q: Okay. And we'll come back to fraud. Does the box play any role in account management or billing?

A: Very much. The set-top box obviously is the

vehicle to deliver the video, but it also maintains control from a security standpoint with the smart card so that unauthorized viewing can't take place. But it has special built-in features as part of the smart card and the set-top box to facilitate pay-per-view viewing, calling back with some of the pay-per-view information to the -- to the headquarters there in Englewood. And it also allows the customer to pay their bill using a special application that we built. So they can do a credit card payment right through the set-top box. So it helps in revenue collection.

Q: Okay. Who owns the box and antenna?

A: It's possible for the consumers to buy the box and antenna. Some do. But for the most part, Dish owns the -- all of the set-top boxes, the receivers, and the antennas. And we do a lease program with the customer where we lease that box to them for a monthly fee.

Q: Are the box, the remote or antenna covered by any patents or copyrights?

A: Absolutely.

Q: And what are those?

A: I don't know all of them, although my name is

Q: Well, I mean just the number; how many patents?

A: North of 480 U.S. patents.

Q: How many trademarks?

A: Over 200 trademarks and copyrights and 400 or so international patents.

Q: Okay. All right. I sign up, pay my bill, turn on the USC/Tennessee game, so let's first start, just very briefly, it's being played in Columbia in South Carolina, if you could very briefly go through that and then we'll go through the game at Tennessee.

A: Okay.

Q: How do we get -- as the DOR says, how do we deliver that signal into my home?

A: Well, if the game is being played here in South Carolina, it might well be carried on one of your local broadcast channels, so I'll assume for a moment it is. So the first challenge is that we need to get that game from South Carolina back to our systems. So here in Columbia, I think the suburb is Irmo, we would have a what we call local receive facility. And that's basically 25 to 30 square feet of floor space leased from a local point of

presence, a fiberoptic provider such as Sprint or Global Crossing or a host of different companies. We typically go in and lease that space in that facility so that we have good access to fiberoptic cable, air conditioned facility, stable, clean, backed-up power because we -- it's crucial that we have reliability in this system. And then we would literally put satellite -- or excuse me, off-air antennas, like the ones that don't work at your house, we would put those on the roof of that building, which is located carefully to be able to receive the signal. We would then bring that in, process that signal to eliminate noise, interference. We would run it through some specialized compression equipment to be able to take out extraneous bits that the eye can't see. We would compress that, combine all of the local channels, in Columbia, for example, combine those all into a transport stream. And then we would send that to one of typically either our two major uplink centers or five regional uplink centers that we have scattered across the U.S., I'll say distributed across the U.S. I believe Columbia would go

through New Braunfels, Texas, and Mount Jackson, Virginia. From there, that signal, although those are not necessarily manned facilities, they have a small staff, they would go through that facility, be broadcast up to a special satellite. We have, I'll say, two types of satellites. There's a CONUS satellite, Continental United States, and the signal from each of the transmitters in that satellite cover the whole U.S. So anything you put on there can be received anywhere in the United States. But we also have specialized satellites that we developed with the satellite fabricators that are called spot beam satellites. Because the Columbia local channels are really only allowed to be viewed in Columbia, that's what the copyright holder is with your local stations, there's really no benefit to us of putting those on a CONUS satellite and broadcasting them to, say, Montana because no one can receive them there. So we have created a number of spot beam satellites that very carefully allow us to receive the Columbia signal from somewhere in the U.S. to we'll fiber it from Columbia to the

appropriate location across the U.S., let's say New Braunfels, Texas. So we'll bring that signal from Columbia via a leased fiber line directly into our uplink center in New Braunfels, Texas. From there, it gets combined with many other markets -- there's 210 total markets -- sent up to specific satellites that have specific spot beams that focus down on South Carolina, some are very narrow beams, others are a little bit larger and overlap between South Carolina and North Carolina, for example. So we have specialized transponders on specialized satellites specifically for this market.

Q: And they beam it into my box on Edisto?

A: They do. So from that point, the signal leaves Columbia on a multiplexed fiber. It goes in, gets put up to a frequency that the FCC has licensed for us to send up to the satellite. The satellite takes that information, modifies it into another frequency where we have a license to be able to downlink it. And very importantly, it amplifies it to a much higher level than what we were sending up and what it received. From there, that amplified signal

comes back down to your set-top box. The set-top box has a couple of primary components. The first would be the dish that's on the outside, which is just a reflector to concentrate the signal. But then it has what is called a low-noise block downconverter with feed horn, or LNBF. That downconverter takes that signal that came at a very high frequency from the satellite and lowers it back down into a frequency that can actually be sent over the cable going into your house. And we have, over the years, developed specialty switches that allow us to have the receiver select which satellite is coming down and which transponder to look at. And that gets sent over to the satellite receiver inside your home. The receiver then looks at that and says, Mr. Maybank, you have selected your local channel, probably Fox, carrying your game, so I'm going to go into this elaborate set of tables that were produced at the uplink and I'm going to determine that your Fox is on this table -- this satellite, this transponder, and within that big pipe of data, the ID for the audio and the video and everything is right here. So the

satellite receiver filters that out, takes just the information it wants and kind of discards the rest. And then that signal is sent through specialized decoding equipment that descramble the signal, assuming you're authorized for it, it allows the key to come in, descramble that signal. It gets converted back into very good quality SD or HD signal, and then the set-top box puts that into a format that it's able to send it over your television.

Q: Okay. And my box recognizes that I'm entitled to that channel?

A: It does. It has special information in the smart card to say that you have been authorized for that local and not another local, or that you have been authorized for ESPN, but not necessarily HBO.

Q: Okay.

A: And it keeps track of that.

Q: In terms of the quality of the TV on my house, my TV I get snow and haze, and what does the satellite do with the quality issue, quality of the screen issue?

A: Well, we bring in a lot of different signals from around the world and from across the U.S.,

and we have a variety of different stand- -- or I don't want to say standards, but quality levels. So one of the first things that happens, particularly on national broadcasts which have the widest variety of quality, we'll typically go through special processing. We remove noise; we level the audio signal between commercials, for example, and the normal contents so that there's nice -- that the viewing experience for the consumer is good. So there's quite a bit of activity that takes place in the uplink to improve the quality. Getting rid of noise. There's a lot of special software routines that we've created to be able to filter out that noise. And then from there we have -- and all of the systems in Cheyenne and Gilbert and our other uplink centers are all redundant so that if there's ever a failure, they automatically switch over, alarms are sounded and repairs are made. The satellites are routinely upgraded so that they have higher power. And with that higher power we're able to overcome interference in the atmosphere and minimize the amount of error correction necessary to give that perfect