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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 II

Burnet R. Maybank, III
Jim Rourke
NEXSEN PRUET, LLC
1230 Main Street, Suite 700 (29201)
Post Office Drawer 2426
Columbia, South Carolina 29202
PHONE: 803.771.8900
FACSIMILE: 803.253.8277
bmaybank@nexsenpruet.com
jrourke@nexsenpruet.com
Attorneys for Appellant Dish DBS
Corporation,
f/k/a EchoStar, DBS Corp., and Affiliates

Nicole M. Wooten, Counsel for Litigation
William J. Condon, Jr.
Managing Counsel for Litigation
Milton G. Kimpson
General Counsel for Litigation
P.O. Box 12265
Columbia, SC 29211
(803) 898-1826
Nicole.Wooten@dor.sc.gov
Attorneys for Respondent
South Carolina Department of Revenue

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1 quality signal. So the satellite plays a key
2 role in that. And then the set-box itself has
3 a number of different techniques to ensure that
4 the decoding of that signal, as well as the
5 recreation for the TV, is of the highest
6 quality.

7 Q: Okay. Let's switch gears to the USC/Tennessee
8 game being played in Tennessee, and we'll try
9 to avoid repetition. But first, is the
10 USC/Tennessee game in Tennessee, does Dish film
11 and televise the game?

12 A: Dish does not typically do filming of those
13 games. In that example, it would probably be,
14 let's say, ESPN that would carry that game. So
15 ESPN would license with the SEC or the NCAA for
16 the rights to be able to carry that. And it
17 could be another broadcaster, but ...

18 Q: Let's stick with ESPN.

19 A: Yeah. So with ESPN, they would license that.
20 They would either do the filming themselves or
21 subcontract it, depending on their
22 capabilities. They -- at that point, ESPN,
23 would take the game content, the video, they
24 would do their own production process where
25 they add in commentators and all the different



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1 statistics and graphics, etcetera. So they
2 would create their product. And then we would
3 have set up a license with ESPN to be able to
4 receive that signal, and we would work with
5 them to determine how we were going to receive
6 the satellite backhaul to Cheyenne, Gilbert, or
7 to our uplink centers, or whether it would come
8 via fiber or both. For redundancy we might
9 very well pay to have both of those
10 accomplished. So we would bring that signal
11 back. We would then go through our normal
12 quality control processes to make sure that
13 everything is good there. A lot of that is
14 monitoring, but there's often very urgent and
15 active efforts. If there's any kind of a
16 breakdown, you need qualified personnel to be
17 able to determine what the nature of the
18 problem is, where in your overall flow that
19 problem is, and get it resolved. So it's a key
20 part of our system. And then we would take
21 that ESPN signal, and since that's of national
22 interest to everyone across the country,
23 particularly those people that are fans of the
24 game, that signal would go out on ESPN and be
25 broadcast on one of our CONUS transmitters, and

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1 that would mean that it hit the entire United
2 States, including Edisto Island.

3 Q: Edisto.

4 A: Edisto.

5 Q: All right. And so you have a -- Dish has a
6 contract with ESPN to allow them to do the
7 game?

8 A: Yes, it's renewed periodically.

9 Q: Okay. Is it expensive?

10 A: Wildly expensive.

11 Q: And how much roughly is an ESPN contract?

12 A: An ESPN contract, I mean there's a number of
13 different programs, it's not just the
14 individual channel, but we are compelled by
15 ESPN to take them on. I want to say it's north
16 of 725 million.

17 Q: Okay. The 725 million is real money. Why do
18 you incur that expense?

19 A: Well, in general in the United States, sports
20 are very popular and ESPN is probably the
21 paramount. But, for example, here in South
22 Carolina, sports are very important, and if we
23 want to attract South Carolina customers, then
24 we need to provide the kind of sports that they
25 want, which is why we have the SEC channel, the



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1 NCAA. We have a variety of sports packages,
2 NASCAR racing, etcetera. So your local teams
3 have done quite well. Attendance is always
4 very high. The baseball team has been the --
5 won the national championship back to back,
6 pretty impressive. So those sports programs
7 are keenly important to our customer base, so
8 we pay what we have to to be able to provide
9 those -- those programs.

10 Q: All right. How do I get the -- how do you get
11 the USC/Tennessee game in Knoxville into my
12 home just very, very briefly? We don't need to
13 repeat.

14 A: If the game is in Tennessee, rather than going
15 to one of our regional uplinks, it would go
16 into the -- our two primary uplinks. Cheyenne,
17 Wyoming, tends to feed satellites that are
18 located in what we call the western arc. They
19 are our first satellites. And then Gilbert,
20 Arizona, tends to feed a satellite fleet that
21 we have in the eastern half of the United
22 States, obviously the eastern arc. They tend
23 to be a little bit more recent satellites.

24 Q: Okay. And then how does it -- again, not being
25 too repetitive, how does it get physically into



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1 my house?

2 A: Well, from there the signal would go down -- up
3 to the satellite, back over, down into your
4 receiver, and the receiver would check the
5 authorization to make sure that you have
6 subscribed to ESPN and allow that to pass over
7 to your television.

8 Q: Okay. Does Dish or EchoStar manufacture
9 satellites?

10 A: No. We typically work carefully with the
11 satellite manufacturers ourselves working with
12 experts we have at EchoStar and the -- we would
13 work with Lockheed Martin and Space Systems
14 Loral are probably the two primary
15 manufacturers in the U.S. today.

16 Q: And how do you launch them?

17 A: There's three or four different methods. The
18 most likely scenarios would be we would work
19 with a company called Integrated Launch
20 Services, which is a joint venture between the
21 Russian government and Lockheed Martin, it's
22 ILS. They launch satellites on proton rockets
23 out of Kazakhstan. We work with Arianespace,
24 a French company, that launches satellites out
25 of New Guinea. And we also work with a company



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1 called Sea Launch that actually uses a launch
2 pad similar to a giant oil derrick, and they
3 move that oil derrick out into the ocean at the
4 equator to get the best sling and they launch
5 the service.

6 Q: And are satellites expensive?

7 A: Yes. A simple satellite with just standard
8 CONUS beams and a reasonable power level is
9 \$200 million. If you have specialized beams or
10 high power, they can go up as high as 350
11 easily. And then to launch them, the launch is
12 pretty much dependent on weight, so the more
13 complicated and impressive the satellite is
14 from a capabilities standpoint, the more it
15 weighs, a launch, the best we've seen in years
16 is a \$100 million and they go up to \$150
17 million for the three companies. There are
18 companies that are more expensive, but we tend
19 to avoid those just from a cost savings
20 standpoint.

21 Q: Do you get insurance on the launch?

22 A: We occasionally get insurance. It depends on
23 the number of failures that have happened in
24 past years, the appetite by the insurance
25 companies. So if the rates are good, we may



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1 easily pay 20, 30, 40 million dollars for
2 insurance, which doesn't cover anything but
3 getting the satellite up to its orbital spot.
4 Other times, if the rates are too high, we're
5 an extremely cost conscious company, so we
6 might choose to self-insure and take the risk
7 ourselves.

8 Q: Okay. What's the useful life of a satellite?

9 A: We normally expect the satellite to have enough
10 fuel and enough redundancy to allow it to last
11 12 to 15 years. But in our experience, they
12 almost always suffer some form of anomaly,
13 either by small particles in space,
14 electromagnetic interference, infant fail- --
15 infant mortality of components. So they will
16 -- they will degrade over time and we normally
17 have a -- we always have an ongoing plan of
18 when and how we will replace satellites.

19 Q: And is the operating of a satellite subject to
20 a bunch of red tape?

21 A: Quite a bit, yes. There's the International
22 Telecommunications Union works with all of the
23 various countries. Obviously, the FCC is the
24 interface into the ITU for us, and they impose
25 considerable legal, technical, and financial



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1 constraints on us. And they also are
2 responsible for licensing of the orbital
3 locations that we use and the frequencies that
4 we can use, so.

5 Q: And who handles that red tape?

6 A: It's a combination; our legal team in
7 headquarters, myself and other technical staff,
8 working in conjunction with our primary
9 satellite partner, EchoStar, and they have a
10 legal team as well, they're experts from the
11 industry.

12 Q: And where is EchoStar located?

13 A: EchoStar is also located in Englewood,
14 Colorado, just about a mile from our location.

15 Q: Okay. And just give me the names of the
16 locations, not all the technical equipment.
17 The Department said in their opening statement
18 an income-producing activity is the delivery of
19 the signal into the viewer's home. So starting
20 with Tennessee and ending with Edisto Island,
21 where does it physically does that --
22 geographically does that signal go?

23 A: If you start from Tennessee, the signal would
24 go via a fiber optics over to -- let's see, I
25 think Tennessee would be an ESPN game.



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1 Q: You're right.

2 A: Yeah. So the signal would typically go either
3 by fiber or satellite from the local game to
4 ESPN. ESPN would do their processing. It
5 would then go by fiber and satellite to both
6 Cheyenne, Wyoming, and Gilbert, Arizona. We
7 would do additional processing, apply
8 additional labors of -- layers of metadata and
9 other information into the signal. We would
10 send that to satellites in both the eastern
11 half of the United States and the western half
12 of the United States. And then that signal
13 would be broadcast out over the entire U.S. in
14 multiple locations and eventually land on your
15 house.

16 Q: Okay. Any particular satellites used for that
17 type of thing?

18 A: Yes. The CONUS signals would typically come
19 from three different orbital locations. In
20 fact, four different orbital locations: two in
21 the West and two in the East. We would use
22 EchoStar 10, 11, EchoStar 14, CL2, a satellite
23 we lease from Canada, Nimiq, a satellite we
24 lease from Canada, and potentially EchoStar 16.

25 Q: Okay. And is there redundancy built in if



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1 something goes wrong along the way?

2 A: Never enough redundancy, but yes, all of the
3 satellites have redundant systems on them such
4 that some of those systems will kick in
5 automatically based on the satellite, but we
6 also have a satellite team that flies all of
7 the satellites, and some of the systems need to
8 be switched manually. When those redundancy
9 systems kick in, it invariably means that we
10 will have to react not just at the satellite
11 level but in terms of the feeds that go into
12 those satellites. There's a problem on a
13 transponder, then we need to adjust all of our
14 ground systems as well to be able to support
15 that so that the end viewer, yourself in South
16 Carolina, may see a glitch, but in theory they
17 would say nothing more, they wouldn't lose
18 their service. And behind the scenes we would
19 continue to juggle our assets to be able to
20 overcome whatever that failure was.

21 Q: Okay. So did you say -- I may have
22 misunderstood this -- that from Tennessee it
23 goes to not one but two uplink centers for
24 redundancy purposes?

25 A: Two primary uplink centers.



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1 Q: Does it go to both?

2 A: Actually, each of those centers has its own
3 redundancy. For example, the transmit dishes
4 that feed up to the satellite are 21 meters
5 across -- or excuse me, 13 meters across, so
6 that's -- it's a 40-foot antenna, it's quite
7 large, but we've got two of them because if the
8 motor fails and can't keep track of the
9 satellite, we need a second one there.

10 Q: Okay. Then it goes up to not one but two
11 different satellites?

12 A: In this case, it would actually go up to four
13 different satellites.

14 Q: Okay. All right. Is any -- to your knowledge,
15 has any SEC football game ever failed to get
16 into a viewer's home through a dish error?

17 A: Not that I'm aware of due to a dish error, but
18 I suspect that, particularly with the hurricane
19 season that you have down here, there may well
20 have been weather instances where individual
21 consumers might not been able to receive
22 momentarily.

23 Q: Okay. Anything you want to add about SEC
24 football that I've not covered?

25 A: Go Gamecocks.



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1 Q: We need that and more this season it would
2 appear. All right. Let's turn to Fox News.
3 From a technical aspect, I assume it's largely
4 the same?

5 A: Yes, Fox News is very much the same. We start
6 out with contract negotiations with Fox to
7 establish what channels are going to be carried
8 out of their suite of channels. We work with
9 them in terms of how that signal is going to
10 get delivered to both Cheyenne and Gilbert, go
11 through an extensive process very similar to
12 ESPN for Fox News.

13 Q: Okay. And, obviously, Dish doesn't provide
14 that programming?

15 A: No, we do not.

16 Q: And who provides the actual programming?

17 A: All of the programming comes from Fox News
18 and/or its affiliates.

19 Q: Okay.

20 A: Or the Fox organization and its affiliates.

21 Q: And do you know how much you paid Fox in 2010?

22 A: Fox is comprised of a couple aspects. Fox and
23 the owned and operated channels of Fox
24 Corporation, it's just under 700 million, I
25 want to say 600 maybe million in that time



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1 frame. But we also pay the network affiliates
2 across the country. Here in Columbia, for
3 example, we pay them directly independent of
4 Fox corporate. And they're -- I don't know how
5 much of that would go to Fox, but we pay 650
6 million a year to network broadcasters, and
7 Fox gets some percentage of that.

8 Q: And just sticking to the news, is Fox News more
9 watched in conservative red states or more
10 watched in liberal blue states?

11 A: I would say Fox News has a greater following in
12 conservative red states. I suspect South
13 Carolina is probably an extremely large
14 popularity item. Fox is one of the most
15 popular stations.

16 Q: And how important is Fox News to Dish?

17 A: It is critical that Dish have Fox News. We had
18 a dispute with Fox last year that was pretty
19 impactful.

20 Q: And what happened in that dispute? Not from a
21 technical standpoint. What happened to your
22 viewers in that dispute?

23 A: Well, Fox, we were up for renegotiations with
24 Fox, and I was not actively involved in those
25 negotiations, that's always handled by our



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1 programming department and our legal teams, but
2 Fox wanted to obviously increase their rates
3 dramatically, as well as to force us to put
4 additional channels up onto our network, which
5 bandwidth on our network is at a premium and
6 we're very cautious about what channels we do
7 and don't add. So we reached an impasse, and
8 we eventually took down Fox News from our
9 service. All hell broke loose. I don't know
10 how many calls came from South Carolina, but
11 I'm sure there were a few. Our call centers,
12 even though we knew there was going to be a
13 reaction, our call centers were overwhelmed,
14 wait times were very high, we monitored hangups
15 and call backs and all of that. And it was --
16 it was very disruptive. We know that Fox News
17 is the primary news source for conservative
18 viewers. So we were quite concerned about
19 churn. We have an entire portion of our call
20 center system that is called loyalty, and their
21 job is to talk the consumer out of churning.

22 Q: And what is churning?

23 A: Churning is when a customer decides that
24 they're going to leave us and go find some
25 other source for their -- their ---



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1 Q: Like Direct? Would be DIRECTV?

2 A: Yeah, DIRECTV, typically customers who have
3 satellite don't want to go back to cable, so
4 they tend to bounce between DIRECTV and
5 ourselves. So they might very well leave us
6 and go take a new offer from DIRECTV.

7 Q: Did DIRECTV take advantage of the situation?

8 A: With Fox?

9 Q: With Fox.

10 A: Oh, absolutely. They -- both they and their
11 retailers started doing advertising almost
12 immediately that if you want to watch Fox News
13 and you're a -- you're a staunch conservative,
14 this is your source, and you can't get it from
15 Dish Network so you need to go to DIRECTV. So
16 we did see a definite churn impact as a result
17 of that. But eventually, it's in our interest
18 to have Fox and it's in Fox's interest to have
19 our 14 million subscribers maintaining their
20 advertising base. So eventually these things
21 come to pass and both sides say they won.

22 Q: They got more money I suppose?

23 A: They did get more money.

24 Q: You mentioned you had a loyalty center in the
25 call center. Could you tell us a little bit



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1 about that?

2 A: Yes. All of our agents obviously are our front
3 line with the consumer. If the customer has
4 any type of a concern, an issue, they want to
5 modify their programming, the customer service
6 representative is the front line person that
7 they talk to; they're the face of the company.
8 But if, despite their training and
9 persuasiveness, they're unable to convince a
10 customer that they should not churn and leave
11 us, then they will typically be transferred
12 over to a loyalty agent whose specialty is
13 people management, as well as they are
14 authorized to provide incentives for the
15 customer to stay. If their concerns are an
16 individual channel, they might be able to tell
17 them when we'll have that channel added. If
18 their concerns are cost, we might be able to
19 give them X amount of free programming or a
20 certain number of pay-per-views. So those
21 agents are authorized to be able to provide
22 some form of compensation to keep the customer
23 on as a paying customer.

24 Q: All right. Let's briefly back go over several
25 technical issues. First, I've got two TVs in



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1 my house in Edisto, two Dish boxes, one
2 antenna, and we got the second set so I can
3 watch USC or Clemson and my dad can watch Fox.
4 How does that work?

5 A: Well, the -- there's one satellite dish that is
6 capable of feeding multiple set-top boxes or
7 receivers. Initially it was a one-to-one
8 relationship, but we've invested a lot of money
9 into the capability to allow one antenna to be
10 able to feed multiple -- multiple receivers.
11 So, at that point, each receiver would be
12 communicating through that cable connecting to
13 the antenna. They would be communicating that
14 your dad wants to watch Fox local. So,
15 therefore, one of the LNBS on that antenna
16 would need to tune and focus on a specific
17 satellite and a specific transponder to find
18 Fox local, and then that signal would be put
19 onto the cable and his set-top box would
20 recognize that, grab it and do the decoding
21 process that we talked about. And the same
22 would be true for ESPN for you. Your receiver
23 would tell the LNB out at the dish which
24 satellite to look at and which transponder to
25 go get, and then once that transponder comes



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1 down, that set-top box would be capable of
2 filtering out ESPN and giving it to you.

3 Q: Okay. Switching gears to what apps or
4 applications are on the box in my house?

5 A: It depends a little bit on your box, but there
6 are a number of different applications. The
7 most obvious one that people think about is the
8 interactive electronic program guide. It has
9 evolved tremendously over the years from
10 initially it allowed you to tune the set-top
11 box from one channel to the next and see what
12 was on. Now you can get a ton of extra
13 information about that. You can see what's
14 coming on in the future. You can set timers.
15 You can see what Rotten Tomatoes says the
16 rating of your movie is. There's a host of
17 different things. So the EPG is key. There
18 are a number of other apps that we have
19 developed over the years. The customer service
20 app that sits on the, all of our set-top boxes,
21 as I mentioned, allows you to view your bill,
22 pay your bill, understand what your billing is,
23 what programming you're signed up for so in
24 case you're missing a channel you know whether
25 or not it's actually a part of your package.



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1 We have pay-per-view apps. We have a variety
2 of apps now that have been introduced. I think
3 some of them were in 2010.

4 Q: Do you have any sports apps?

5 A: We do. We've got apps called Game Finder which
6 allow you to go in and the set-top box will
7 then go in, look at all of the various games
8 that you're authorized to watch, determine
9 where the game is at, tell you what the score
10 is, tell you whether it's an exciting game or
11 not or whether it's a snoozer. I won't comment
12 on your SEC team right now.

13 Q: I think the Gamecocks would have all been
14 snoozers the last two weeks.

15 A: So, and then if you have a game, you can start
16 watching one of those, you can set it to
17 record, you can set an automatic timer at that
18 point, so all the information is there. And
19 that's -- that's for a variety of different
20 sports. You can pick your sports and pick your
21 favorite teams that you want to watch. So all
22 of that's inside the app. We've got apps to
23 sling your live television from your home out
24 across the internet, over the wifi network to
25 your cell phone, so when you're somewhere else



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1 and can't watch the game at home, you can watch
2 on your iPad, your smart phone, or you can
3 watch anything that's on your hard drive for
4 that matter. So we have apps that handle that.
5 We have apps that allow you to skip commercials
6 in prime time programming. A variety of
7 different apps.

8 Q: Okay. All right. In 2010, how would I access
9 pay-per-view?

10 A: In the 2010 time frame, the two techniques that
11 were most common, most of our customers would
12 typically call in to the call center and state
13 that they wanted to watch a given movie, "Back
14 to the Future", at 7:30, and the customer
15 service representative would acknowledge that,
16 put it onto their account, send a command up
17 over the satellite, back down to the set-top
18 box, and from there the set-top box would then
19 be authorized so that when the consumer tried
20 to tune to it, it would be there ready to go,
21 otherwise they'd be blocked. The other
22 technique is many of our boxes had a telephone
23 connection, which if you had that telephone
24 connected to your set-top box, you could
25 potentially push the button right there. I



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1 would say the majority still called in.

2 Q: Okay. I don't have a land line anymore in
3 Edisto, so obviously I'd have to call the call
4 center to get pay-per-view?

5 A: Yes, particularly in 2010. We have started
6 more recently allowing smart phone apps, or not
7 apps but texting that will allow you to order
8 pay-per-view, but that's a much more recent
9 activity.

10 Q: Okay. What if I don't pay my bill, who gets
11 after me?

12 A: First and foremost, we have an entire section
13 of our call center that's responsible for
14 billing follow up. They will reach out
15 repeatedly and try to convince you to pay your
16 bill, explain to you the consequences if you
17 don't. Tied with our loyalty agents, they may
18 or may not forgive you some of your bill,
19 depending on how good a customer you have been.
20 Some of the circumstances we've had, during
21 hurricane season we have had instances where
22 we've allowed customers to not necessarily get
23 shut off, but modify their billing cycle a
24 little bit. That's all within the discretion
25 of the loyalty agents, so.



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1 Q: All right. Is fraud an issue for Dish?

2 A: Yes, very much so.

3 Q: And what are the major forms of fraud?

4 A: There's two, I'll call them, categories of
5 fraud. There's fraud against Dish the company,
6 and then there's what we call fraud against our
7 customers. So fraud against the company
8 normally takes the path of piracy. And that
9 piracy is effectively someone who has gone out
10 of their way to get equipment that will allow
11 them to receive our signal without our
12 knowledge and without paying. The most common
13 form of that is to, quote, break the smart
14 card. There are international criminals that
15 spend literally millions of dollars in efforts
16 to try and break our smart card. They dissect
17 the card layer by layer and trace the actual
18 transistors to figure out how they work. So
19 that is probably our most troublesome type of
20 piracy, and that's the reason we're now on our
21 fifth generation smart card in development and
22 our fourth generation in the field, because we
23 have had to swap out those cards. They have
24 been successful.

25 Q: And the smart card obviously plugs into the box



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1 in my home?

2 A: It does. It either plugs in or, in an effort
3 to prevent piracy, we actually took the small
4 chip, embedded it right on the circuit board
5 and encapsulated it in a crystalline structure
6 so that the pirates couldn't get to the chip.
7 They still do, but it slows them down. And
8 then the -- so that's one form of piracy. And
9 I would say, for the moment, we probably have
10 that at bay. We know that they're out there
11 and we have ways to determine who they are and
12 where they are, and we have legal teams that go
13 off and chase pirates. The other type is one
14 that the internet has actually created for us,
15 and that's what we call control word sharing or
16 key sharing. So what the pirates do there is
17 they get one of our boxes and they subscribe to
18 everything you can imagine, or they have 50
19 boxes, 100 boxes, 200 boxes, and they set up an
20 operation where they in those boxes they
21 subscribe to eventually all of our channels.
22 And then what they do is when that special key
23 that says, Burnie, you get to watch the SEC
24 game, when that special key comes over, they've
25 signed up for it and that key, because it was



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1 originally designed in 1996, that key goes from
2 the smart card where it gets decoded, the smart
3 code hands that key to the decoder chip on the
4 box. So they go right in between those two and
5 they sniff and capture that key with
6 specialized computer software. Then they take
7 that key -- and the key is only good for about
8 15 seconds. They take that key and they
9 distribute it to their client base on the
10 internet. The client, or the customer for
11 them, plugs their set-top box that was
12 manufactured illegally in South Korea and
13 smuggled into the country or imported under
14 guise, they provide that special little key to
15 that set-top box from South Korea and then
16 they're able to watch our programming for free.
17 So that is a huge fraud against not only us and
18 the efforts that we do to put out a good
19 signal, but it also goes against the copyright
20 holders. It's their signal that we're trying
21 to protect, as well as our own revenue stream.
22 So we -- we have a very extensive effort
23 underway with our own security teams, as well
24 as NagraStar and EchoStar to fight that.
25 There's the other type I mentioned ---

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1 Q: And so to finish there, that fraud occurs at
2 the box level, correct?

3 A: Yes.

4 Q: And you try to combat it at the box level?

5 A: We try to combat it across our system. We try
6 to combat it at the box level, but we also have
7 countermeasures that we do at the system level.
8 So the reason that NagraStar, that joint
9 venture, was created and is in Englewood as
10 well is so that all of the engineers and
11 software developers can work in conjunction to
12 create countermeasures. Because we don't know
13 where those boxes are at. We don't necessarily
14 know who has those boxes. But what we do know
15 is they have to get their signal from us, so
16 we'll use, I'll call it Trojan Horse techniques
17 to put special information into their boxes and
18 disable their boxes and only theirs. We can't
19 disable yours, you're a paying customer, so we
20 have to be very careful.

21 Q: Okay. And before we get into fraud against the
22 customer, what are -- just briefly describe the
23 anti-fraud devices in my box on Edisto, my new
24 box on Edisto?

25 A: There's three primary devices. The first



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1 device is actually at the LNB. We have what is
2 called -- excuse me, not the LNB, at the front
3 end that communicates with the LNB. We have a
4 device that is called an 8PSK chip. And 8PSK
5 is a modulation technique that the uplinks use
6 to communicate with the satellite and then the
7 satellite communicates with the box. So our
8 engineering team back in the early 2000s
9 created 8PSK Turbo, and the Turbo is a special
10 capability that improves the efficiency of 8PSK
11 by about ten percent, which is pretty
12 significant in our world. Because of that, we
13 patented that device, it is proprietary and
14 there is only one chip manufacturer in the
15 world that makes those chips for us. They are
16 not allowed to sell that chip to anyone else.
17 So if you want to have an HD box watching our
18 HD signal, you need an 8PSK chip. So we have
19 very tight controls in the factories in China
20 and in Mexico and at the factory that produces
21 the chips so that they're all accounted for by
22 reel. So that's probably the first area, those
23 chips are not available to the pirates. The
24 second area, obviously, is the smart card, and
25 I mentioned every time we come out with a new

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1 card it's got new capabilities. And then the
2 third area specifically to the key sharing is
3 that we have incorporated sophisticated
4 patented security programs on the set-top box
5 to help augment the capability of the smart
6 card and prevent keyword sharing from taking
7 place over the internet.

8 Q: Okay. And you mentioned there were two types
9 of fraud against your customers. If you could
10 briefly go over those.

11 A: Yeah. There's -- there's a lot of variations
12 on the theme, but I'll give you a couple
13 examples. One of the simplest frauds against
14 our customer is that someone acquires an old
15 set-top box at a garage sale or off of Ebay and
16 -- or one that they had a long time ago,
17 although that's a little less common. And they
18 will find another Dish Network customer and
19 they kind of parasite that customer. They call
20 up the call center, they typically have enough
21 information about that person, address, phone
22 number, name, enough to be able to convince ---

23 Q: Coworker?

24 A: A coworker, yeah. So they try to convince the
25 customer service representative that all they



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1 want to do is just add another receiver to
2 their account. How many receivers have I got
3 on there? Oh, there's three. Yeah, I want to
4 add a fourth receiver. So they convince the
5 customer service representative to add that
6 receiver to the account. So at that point,
7 they start getting all of the programming of
8 that victim and the victim starts paying us a
9 revenue stream for that additional receiver
10 because it's a leased receiver as far as we're
11 concerned. And we charge on a -- or not a
12 leased receiver, but it's an added receiver ---

13 Q: Right.

14 A: --- and we charge on a per receiver basis. So
15 that technique is surprisingly effective
16 because most people don't look carefully at
17 their bill, it's lost in the noise of pay-per-
18 view and other programming services, and it can
19 go on for months and sometimes years that one
20 person is paying for another person's service.
21 We have a director of security and fraud whose
22 job it is to help work with the call centers to
23 find techniques to avoid that. The other
24 method is -- it's also a fraud against our
25 customer base, but this often happens on



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1 international programming. I'll use Hindi
2 programming as an example from India. There
3 tend to be fairly large communities of Hindi
4 populations scattered around the U.S. and, for
5 some reason, they're being targeted by call
6 centers that people have set up, and there may
7 be some quantity of callers. But they will
8 call one of our customers, and they've somehow,
9 and we don't quite yet know how, determined
10 that that customer takes Hindi programming. It
11 could be they see the dish.

12 Q: Right.

13 A: They recognize they're Indian; they're in this
14 community. And they say okay, we know that --
15 you know, this is Dish Network, they pretend to
16 be Dish Network and we'd just like to verify a
17 couple pieces of information. Could you
18 confirm your account number? Just push right
19 here on your satellite TV, it will tell you
20 right there, if you could just confirm that for
21 me. Most people don't remember it. So they
22 provide their account number, they provide
23 other information. And the CSR says well,
24 we're having a special right now that if you
25 pay for a year's worth of programming, which



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1 could be quite expensive, let's say they're \$70
2 a month, you're at eight or nine hundred
3 dollars at that point. If you pay for a year's
4 worth of programming, we're only charge you for
5 six months and you'll get six months free. All
6 you have to do is give me your credit card or
7 you can do Green Dot and send a payment by
8 Western Union, whatever, however you want to do
9 that, but credit card and Green Dot work well
10 for us. And do you sign up for internet
11 access? No, I don't. Oh, well, that would
12 have been very convenient. So as soon as they
13 say they don't, someone in that call center
14 goes onto the internet, signs up as them,
15 creates their account, creates a password that
16 the consumer doesn't know, that the thief
17 knows, because he has their account number,
18 phone number, all of that, and then he says,
19 you know, as a token of our appreciation, let
20 us give you some programming package that isn't
21 already on there. Because now they can review
22 the customer's programming package and say let
23 me give you that special Hindi add-on package
24 you don't have. Go check your TV and there is
25 it, there's that special Hindi add-on pack.



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1 It's going to go on the customer's bill, but --
2 so unfortunately, it's a very persuasive, very
3 elaborate scam. And then ---

4 Q: And what are they stealing there, just the
5 credit card number; is that what they're trying
6 to do?

7 A: They're primarily getting the credit card
8 number, they're getting information about the
9 customer. They may -- and from there they can
10 either use the credit card, they can sell the
11 credit card, and it goes in a variety of
12 directions.

13 Q: Right.

14 A: But unfortunately for the consumer, they tell
15 them, you know, this is a special promotion,
16 our systems aren't quite current, it may take
17 as many as two billing cycles for this to show
18 on your bill. And unfortunately the customer
19 gets the first billing cycle and it still shows
20 on there and they've been warned, you know,
21 it's not going to be there, so they think
22 nothing of it and they don't pay their bill.
23 So eventually our call center starts calling
24 them and saying, by the way, you've been a
25 loyal customer all these years, you're not



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1 paying your bill. Oh, well, I did this special
2 thing with Dish Network.

3 Q: Okay.

4 A: Route it over to a special team inside the call
5 center ---

6 Q: Right.

7 A: --- who are designed to go in and help unravel
8 that. At that point, while it was initially a
9 consumer fraud, we work with credit card
10 companies to unravel that for the customer, get
11 them reimbursed if we can. And then obviously
12 we can't charge them for programming they
13 didn't get.

14 Q: Right.

15 A: So our goal is to set them up with a new clean
16 account, they wind up with new credit cards.
17 A whole -- a whole host of things. But it's a
18 -- it's a terrible fraud against the customers,
19 but we are the source of that. It's not
20 exclusive to Dish by no means. DIRECTV, our
21 legal teams work with their legal teams, we
22 share information. Not so much with the cable
23 companies, but I suspect they have similar
24 problems.

25 Q: Now, how much did you spend in 2009 and '10 to



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1 ensure I only got the programming I paid for at
2 Edisto?

3 A: In that time frame, we were under our most
4 recent contract with NagraStar. We would have
5 paid NagraStar in excess of \$50 million a year
6 for their services. We were completing our
7 smart card swap. That swap cost us in excess
8 of \$125 million to procure, mail, authorize,
9 explain to our 14 million customers and 25
10 million set-top boxes. So it's an ongoing
11 activity. It's -- every year it's north of \$50
12 million just as it relates to the smart card
13 activity.

14 Q: Okay. Switching gears entirely ---

15 **THE COURT:** Mr. Maybank, before you switch gears,
16 we're taking a ten-minute break.

17 **MR. MAYBANK:** Sure.

18 (Break from 11:46 a.m. until 12:05 p.m.)

19 **THE COURT:** Mr. Maybank, please continue.

20 **MR. MAYBANK:** And, Your Honor, we're winding down on
21 him now. We have two additional witnesses
22 after him.

23 **THE COURT:** Okay.

24 Q: Let me go back. I think you might have covered
25 these two, but just out of an abundance of



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1 caution. Why are you always trying to get the
2 new boxes in my home; why are you always
3 nagging me about that?

4 A: Over time we continue to add new features into
5 set-top boxes. We have found that those
6 features tend to make our customer base more
7 loyal, they grow attached to those features.
8 Things like, you know, when we first started,
9 all programming was in standard definition. We
10 have since introduced high definition. Hard
11 drives to be able to record programming so you
12 can watch it at a later date. 3D technology so
13 that you can feed 3D signals into your
14 television and watch 3D at home. We're working
15 -- in fact, just recently introduced 4K ultra
16 HD. So there's a variety of different features
17 that come along. And as I mentioned, there's
18 a host of different apps that we have created,
19 and you can download recordings over to your
20 iPad so that you can watch those on a plane and
21 not have to pay for the movie. So we're very
22 cost conscious for the customers and we've
23 continued to add those features. By adding
24 features into the set-top box, upgrading your
25 boxes, we do a couple of different things. We



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1 make you a stickier customer, which is always
2 our goal to maintain our revenue stream. And
3 the set-top box is a key feature in that. We
4 also are able to continue to improve our
5 security systems. I mentioned the special
6 coding that's buried in the chips on newer
7 generation boxes. We'd like to see that across
8 the field and today it's not there. So we have
9 multiple campaigns, many of which I ran, to
10 upgrade customers' receivers. And then the
11 more capable the receiver, the more flexibility
12 we have for things like ordering pay-per-five,
13 paying your bill, seeing your bill. So all of
14 those, I call them rudimentary items back in
15 the early 2000s are now much more
16 sophisticated, much more user friendly, but
17 they all assist.

18 Q: In 2010, what percentage of the TV market did
19 CBS, NBC, and ABC occupy?

20 A: In that time frame, I would say they probably
21 represented close to three-quarters of the
22 viewing people did during prime time.

23 Q: That's obviously fallen?

24 A: It has. As, you know, shows like Friends and
25 You've Got Talent and all of the other types of



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1 shows like that are still very popular -- not
2 so much Friends --) but you now have more and
3 more competition in a couple of ways. I mean,
4 we -- our business has a lot of competition
5 obviously, cable companies, telco companies,
6 off-air and free, etcetera. But the networks
7 also have competition in HBO, who pretty much
8 just swept the Emmys or did a pretty darn good
9 job of it, Showtime have their own original
10 series now. Even Netflix has an original
11 series.

12 Q: Okay.

13 A: So between ---

14 Q: Showcasing South Carolina, I might add,
15 Gaffney.

16 A: Yeah, there you go. So there's, you know, they
17 have seen their viewership overall drop, but
18 it's a free source of a lot of very good
19 content. So ---

20 Q: All right. And what -- does Dish prefer people
21 to sign up via call center even today?

22 A: Yeah. As I mentioned, we're experimenting with
23 people being able to sign up online, but the
24 reality is it is a complicated product and we
25 don't mind having an opportunity to help them



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1 decide the programming packages they want. If
2 left to themselves, they might very well miss
3 out on some of the things they want. They
4 might not recognize, for example, we've got an
5 SEC channel that focuses on the SEC Conference.

6 Q: Right.

7 A: So there's things like that that the CSRs are
8 trained to look at where the customer lives,
9 what their interests might be, what programming
10 we might have, and help get them into the right
11 package so that they get the full experience
12 and we get the full revenue.

13 Q: Okay. Switching gears again, Dish extensively
14 advertises, but where do their customers
15 actually come from? Where do the majority of
16 their customers actually come from? Is it me
17 watching TV or ad or is it third-parties?

18 A: I think, in fact, our 10-K even addresses that.
19 But, effectively, the majority of our
20 customers, they may see our ads nationally, but
21 they like to deal locally. So I mentioned U.S.
22 Dish here in Columbia, and there's usually
23 several. They may very well go to a third-
24 party independent retailer right in the area.
25 They could go to consumer electronics



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1 companies, they could go through a lot of
2 different sources. Calling us is one of those,
3 and scheduling it is one of those. But the
4 majority of our new customers do come through
5 third-party relationships.

6 Q: Okay. And obviously you pay those third
7 parties?

8 A: We do. We pay commissions. Sometimes they're
9 one time commissions. Other times, like with
10 our independent retailers, they may get a
11 commission as long as they continue to maintain
12 customer satisfaction, we will continue to pay
13 them for as much as a couple years, maybe even
14 longer, a small stipend every month. The more
15 customers that are happy, the more money they
16 make.

17 Q: Okay. And do you sell through some nationwide
18 retailers with stores in South Carolina?

19 A: We do. I don't know specifically which ones in
20 South Carolina, but we've got Best Buy,
21 Walmart, Costco. And it's a fluid list. It's
22 fluid by not only region but also contract.
23 The same way customers are always looking for
24 the best deal, we are as well as the national
25 companies like Best Buy, so.



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1 Q: Okay. And does Dish manages that, those third-
2 party retailers, those accounts at a national
3 level or state level; is that done through
4 someone in South Carolina or national level?

5 A: No, those are all handled by our teams in
6 headquarters in Englewood and they're all
7 handled at the national level.

8 Q: Okay.

9 A: I'm sure people know where the -- you know, the
10 national companies know what their population
11 attendance is and their store counts and all of
12 that in South Carolina, but that's not
13 something we normally have as a ---

14 Q: Okay. All right. Down to my last set of
15 questions. Let's turn to local broadcasting.
16 How many local broadcasting networks are there
17 in the U.S.?

18 A: We broadcast 2,800 channels, which is made up
19 of both the, I'll call them the big four, which
20 most major markets -- all major markets have
21 the big four. And at this point, all but maybe
22 20 or 30 smaller markets. And by market, I
23 mean a demographic market area.

24 Q: A DMA?

25 A: Yeah, a DMA. There's 210 ---



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1 Q: How many DMAs are there in the U.S.?

2 A: 210 DMAs. They're defined by Nielsen and
3 they're made up typically at the county level.
4 So, for example, South Carolina has three major
5 DMAs: Charlotte, Charleston -- excuse me,
6 Charleston, Columbia, and Myrtle Beach,
7 Florence. And then there is four additional
8 DMAs that kind of overlap into South Carolina,
9 whereas we think of them as DMAs outside,
10 Augusta, Savannah, Charlotte, and
11 Greenville/Spartanburg.

12 Q: Okay. And Greenville and Spartanburg of course
13 would be a South Carolina DMA, would it not?

14 A: It spans both North and South Carolina.

15 Q: Okay. All right. Can I look at -- in Edisto
16 I'm in the Charleston DMA, could I look at
17 Columbia local channels?

18 A: No, the FCC has some very explicit ruling as to
19 who can watch which stations, and it involves
20 the copyright license holders and it is
21 fundamentally designed to protect your
22 Charleston broadcasters from being kind of
23 subsumed into a larger audience in Columbia or
24 Charlotte or elsewhere. So if you live in the
25 counties that make up the Charleston DMA, you



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1 are only able to receive those counties. And
2 our conditional access system makes sure that
3 those are the counties you get. And even
4 though the signal for Columbia or Chapel Hill's
5 might land on your house, you are only
6 authorized to receive Charleston.

7 Q: Okay. And that -- the others are weeded out at
8 the box level or the satellite level?

9 A: Those are weeded out at the box level.

10 Q: Okay.

11 A: Because of the density of DMAs, for example,
12 South Carolina is a reasonably compact small
13 state compared to Montana or some of the
14 western states, so in order to be able to get
15 enough satellite capacity to be able to service
16 all of these DMAs I just mentioned, seven
17 different DMAs in a very tight area, it takes
18 three different spot beam satellites, three
19 different orbital locations broadcasting
20 specifically beams onto South Carolina. So
21 from those three different locations in order
22 to get all the channels that each of those
23 markets have put in there, those beams tend to
24 have some overlap on them. You may not see
25 Augusta, but you probably see Chapel Hill's,



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1 for example, and it may vary. So the satellite
2 is responsible for getting those signals down
3 so that they're available to the consumer, and
4 then the set-top box is responsible for making
5 sure that only those things that you're
6 authorized for, both by paying and legally, are
7 viewable for you. And that's all handled by
8 the conditional access system in Englewood and
9 the subscriber management system in Englewood.

10 Q: I suspect there's not a whole lot of fraud in
11 that regard; people trying to watch Columbia
12 channels?

13 A: Oh, there's a little bit, but we've -- you
14 know, over the years we've put systems in place
15 to try and minimize that so that people are
16 getting the programming that they are entitled
17 to.

18 Q: I don't have any further questions. Do you
19 have anything you wanted to add that we hadn't
20 been over?

21 A: No, I think you asked most of it.

22 MR. MAYBANK: Thank you, Your Honor.

23 THE COURT: Ms. Wooten.

24 MS. WOOTEN: Thank you.

25 MR. POVENMIRE - CROSS-EXAMINATION BY MS. WOOTEN:



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1 Q: Good afternoon, Mr. Povenmire.

2 A: Good afternoon.

3 Q: The primary income of the taxpayer in this case
4 is derived from providing services, correct?

5 MS. MAYBANK: If you wouldn't mind, speak a little
6 louder.

7 MS. WOOTEN: Sure. I'll try my best.

8 Q: Do you need to me to repeat the question?

9 A: Please.

10 Q: Sure. The primary income of the taxpayer in
11 this case is derived from providing services,
12 correct?

13 A: By services, you mean?

14 Q: Subscription revenue.

15 A: Well, there's -- yeah, there's subscription
16 revenue, but we also have revenue associated
17 with the leasing of set-top boxes. We have
18 revenue associated with in-home service,
19 warranty programs, obviously pay-per-view.
20 There's a number of different sources.
21 Advertising is another source where we bring
22 revenue in. So subscription services is
23 definitely one of them.

24 Q: And just to clarify, the revenue from the set-
25 top box leases is a separate revenue stream



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1 from the subscription receipts; is that
2 correct?

3 A: I believe it is, but I'm perhaps not the best
4 person to answer that.

5 Q: Okay. Dish does not own all the satellites it
6 uses, correct?

7 A: It does not own all of the satellites. In that
8 time frame, it probably owned half. However,
9 Dish is responsible for the -- ultimately
10 responsible for the FCC licensing of those and
11 the operation of those. We choose to lease
12 certain satellites and choose to pay people to
13 fly them for us.

14 Q: So you lease from other entities not related to
15 Dish Network or EchoStar?

16 A: We do lease a couple of satellites from others.
17 The majority are either -- at that point in
18 time, were either owned by Dish or owned by
19 EchoStar and leased to Dish. I believe we had,
20 in 2010 time frame, we would have had two
21 satellites that we leased from elsewhere.

22 Q: And of the satellites Dish owns, does Dish
23 lease them out to other corporations not
24 related to Dish Network, EchoStar, and the
25 related entities?



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- 1 A: Dish does not. Dish normally leases the
2 satellites we have. It's -- occasionally we
3 have nurtured programming by leasing small
4 parts of an individual transponder channel, a
5 video channel. But in terms of leasing out the
6 satellites, no, we do not normally do that.
- 7 Q: And the taxpayer had physical facilities in the
8 state during the tax -- the tax period at
9 issue, correct?
- 10 A: Which state is that?
- 11 Q: South Carolina?
- 12 A: Yes, we did have physical facilities here.
- 13 Q: And you also had equipment in South Carolina
14 during the audit period, correct?
- 15 A: Certain years of the audit period, yes.
- 16 Q: And you also had employees in South Carolina
17 during the audit period, correct?
- 18 A: We did.
- 19 Q: And you also used independent contractors in
20 South Carolina during the audit period?
- 21 A: Correct.
- 22 Q: Is every activity of Dish an income-producing
23 activity?
- 24 A: No. I -- I kind of see it as two types of
25 activities. If you think of our HR department



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1 and perhaps, you know, our corporate legal
2 department or the finance, those I see as
3 support activities, personally. But I would
4 say that as a very cost-conscious company, we
5 are not prone to spending money on activities
6 that are not prone to generating money. So if
7 we look at our biggest expenditures from where
8 we start with our contracts through the receipt
9 of the signal, the processing we do to uplink
10 it, the satellites that we invest to be able to
11 expand into different markets, all of those are
12 done so that we can continue to grow our
13 business and grow our revenue stream.
14 Otherwise we wouldn't do it. Call centers are
15 there to sell our product, service our
16 customer, support them so that they don't churn
17 and go to somebody else. So without them, we
18 don't have any revenue, so everything that --
19 in my view, everything we do to nurture those
20 relationships and maintain that quality of
21 service and product is, income producing.

22 Q: The value that Dish places on the delivery of
23 the signal to a subscriber's home is the
24 monthly subscription fee that's charged to the
25 customer, correct?



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1 A: That's one aspect of the value. But we may
2 well receive revenue from the set-top box. We
3 may well receive revenue by providing in-home
4 services for installation of flat screen TVs on
5 a wall or rerouting or selling them products
6 like surround sound systems and doing the
7 install on those, so.

8 Q: But those activities come from a separate
9 revenue stream, correct, the set-top box
10 leases, the in-home distribution?

11 A: Well, they're all paid for on the customer's
12 bill. I don't know what you mean by a separate
13 revenue stream.

14 Q: Are they separately stated on the customer's
15 bill?

16 A: For clarity you would want to make sure that
17 the customer knew what they were being charged
18 for, yes.

19 Q: Can a customer view Dish's programming without
20 the receiver or the set-top box?

21 A: No.

22 Q: And everything the set-top box does occurs in
23 South Carolina, correct, in the customer's
24 home?

25 A: The set-top box is in the customer's home, but



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1 without the processing, uplinking and delivery
2 of the signal, the set-top box is just a piece
3 of hardware sitting there. It's part of an
4 overall system and no single element of that
5 system can be missing or there won't be video.

6 Q: And I believe you referenced earlier, but just
7 to clar- -- or to refresh my memory, are you
8 familiar with the term "conditional access"?

9 A: Very much so.

10 Q: Okay. Conditional access is having access only
11 to video on the condition that the subscriber
12 subscribed to it and paid for it; is that
13 correct?

14 A: That's a fair assessment, yes.

15 Q: Okay. And the overarching function of the set-
16 top box is to ensure that the subscriber can
17 only watch programs for which he has
18 subscribed?

19 A: The overarching function of the set-top box is
20 to decode the signal from the satellites, turn
21 that into video at the behest of the consumer
22 so that they're watching the proper channel.
23 One of the many functions of the set-top box is
24 to ensure that only that programming that that
25 individual is subscribed for and is paying for



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1 comes through. Other functions are, as we
2 talked about, are some of the apps that are on
3 there. We have games that we charge for on the
4 set-top box that aren't related to the video.
5 It's just, you know, many customers like those
6 games. So I wouldn't say that it's uniquely to
7 stop them from watching video they haven't
8 subscribed to, but that's one element of it.

9 Q: And generally all of Dish's satellite signals
10 hit the small dish outside the subscriber's
11 home; is that correct?

12 A: There are a few regional anomalies where our
13 satellites don't necessarily, not all of our
14 satellites reach them, but normally speaking,
15 in South Carolina, the signals from our various
16 satellites would typically hit the customer's
17 home, assuming that they have a line of sight
18 to the satellite.

19 Q: And even though all of these signals hit the
20 small dish in the subscriber's yard, the
21 subscriber still needs the set-top box to
22 decode and limit what channels or programming
23 they can view in their home?

24 A: The set-top box is necessary for the decoding
25 of the signal and turning it into content that



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1 the television can understand.

2 Q: Do you separately charge the subscriber for the
3 smart card in the set-top box?

4 A: No, we don't.

5 Q: Is that part of the lease fee of the set-top
6 box?

7 A: It is incorporated as a component of the set-
8 top box, so if they're leasing the box, they
9 would be, in effect, paying for it.

10 Q: You referenced sling earlier as a new product.
11 That was not available in 2010, was it?

12 A: Sling was available in 2010. It was not
13 necessarily integrated into all of our
14 receivers at that point in time. We did have
15 receivers that had sling in it, and we also
16 offered sling as a separate standalone
17 component.

18 Q: 2009, what about that year?

19 A: I don't believe in 2009 it was integrated in
20 the receiver. It was only available as a
21 standard component -- or standalone.

22 Q: And you also talked a little bit with Mr.
23 Maybank about the SEC Network. That did not
24 exist in 2010, did it?

25 A: I do not know.



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1 Q: Dish doesn't get any income from subscribers
2 until they -- the contract is signed and the
3 service is delivered; is that correct?

4 A: We do not start any billing typically until the
5 customer has been installed and we have sent
6 the commands through the satellite system to
7 turn their box on, which typically happens at
8 the end of the installation process when the
9 consumer is there.

10 MS. WOOTEN: That's all I have, Your Honor.

11 MR. MAYBANK: I just have a few follow up.

12 THE COURT: Okay.

13 MR. POVENMIRE - REDIRECT EXAMINATION BY MR. MAYBANK:

14 Q: I think, I might have misunderstood this, but
15 the -- I think the question was the value of
16 the set-top box to the company is represented
17 by the customer's subscription fees. In fact,
18 the box does a lot more than what people pay
19 for in the sense that it has an extensive fraud
20 -- anti-fraud component, does it not?

21 A: It does. It has a number of different anti-
22 fraud capabilities.

23 Q: Okay. The question was asked everything a set-
24 top box does occurs in South Carolina. Isn't
25 there a substantial interplay between the box



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1 and Englewood? For example, didn't you say a
2 key goes down every 15 seconds from a
3 satellite?

4 A: Absolutely. The set-top box that we design is
5 unique and proprietary and will not work on
6 anyone else's satellite signals. You cannot
7 look at DIRECTV with our box and vice versa.
8 So the set-top box also -- we didn't go into
9 it, but if I might for just a moment.

10 Q: Sure.

11 A: One of the primary functions of the uplink is
12 to establish a very, very extensive set of
13 tables that are used, some of them are from the
14 Motion Picture Experts Group, MPEG, and it's
15 related to the actual way that the video and
16 audio signals are compressed and mixed
17 together. But others are related to the
18 Digital Video Broadcast Organization, DVB,
19 which is an international organization. And we
20 are members of both MPEG and DVB councils. And
21 DVB was created because it was recognized that
22 a simple MPEG video stream or an audio stream
23 like you might -- your CDs are MPEG 2 audio.
24 It was recognized that that stream in and of
25 itself is interesting, but there was no



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1 mechanism to be able to combine thousands of
2 video streams. So one of the things that is
3 incorporated in our uplink center by our
4 subscriber management system from Nagra and
5 systems we've created in-house is the ability
6 to implement DVB so that we can create an
7 extremely elaborate structure of tables cross-
8 referencing all types of information from the
9 program ID of a particular stream of video and
10 audio to the content that describes it to the
11 MPAA rating, so that if our customer in the
12 home says I don't want my children watching R
13 rated movies, they can select R rated on their
14 receiver, but that goes all the way back up to
15 our ability to make sure that that information
16 about that program at that instant in time has
17 been encoded into those tables broadcast out to
18 the entire satellite network. So a big chunk
19 of what our uplink center does is manage the
20 structure of those tables because, without
21 them, the set-top box is just a little bit of
22 silicon -- well, a few pieces of silicon --
23 looking at a pile of ones and zeros coming out
24 of the sky. So it's only when they're able to
25 sync up with the satellite and start



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1 deciphering this complex stream of information
2 that gets created instantaneously 24/7, 365
3 days a year. And it's maintained and it
4 changes constantly. Every day it's changing.
5 So all of that has to be communicated to the
6 set-top box; otherwise, it's just a device
7 sitting in a room.

8 Q: And just in layman's terms, aside from the TV
9 program it's beaming down, the satellite is
10 constantly beaming down instructions to the
11 set-top box, isn't it?

12 A: Absolutely. In fact, one of the most important
13 things we do is literally every night we shut
14 off most of our set-top boxes for a period of
15 up to two hours, and during that time frame, as
16 long as the customer isn't watching, during
17 that time frame, we will download completely
18 new software into the set-top box. We will
19 modify the features. Every night, if the box
20 is connected to the internet or to a telephone
21 line, the set-top box calls back and tells us
22 its health so that we know that the box is
23 working well. From a quality standpoint, we've
24 put temperature sensors on our hard drives to
25 warn our customers if they've stuck it inside



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1 a cabinet sandwiched in between three pieces of
2 equipment, you're going to damage your box, and
3 then you wouldn't be able to receive your
4 programming.

5 Q: Okay. And lastly, she said the overarching
6 function of the set-top box is to ensure I'm
7 watching what I'm pay -- I paid for, i.e.,
8 fraud. But in fact the box does considerably
9 more than that. The box adds to quality
10 control of the signal, does it not?

11 A: It does. It's quality control. It provides
12 features. It interfaces into the customer's
13 product.

14 Q: Application?

15 A: Yep, all of the apps that we've talked about,
16 and many more. There's -- there's north of 50
17 different applications on our most recent
18 receiver, which was just being introduced in
19 the 2010 time frame. Not all of those apps
20 were available right up front. We continue to
21 add them today. But many, many, many of our
22 apps have been around throughout the 2000s.

23 Q: Okay. And I can pay my bill on the set-top
24 box, can I?

25 A: Yes, you can.



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1 Q: Okay.

2 MR. MAYBANK: I have nothing further, Your Honor.

3 THE COURT: Thank you. Thank you, Mr. Povenmire.
4 Mr. Maybank, you've got two additional
5 witnesses?

6 MR. MAYBANK: I'm sorry?

7 THE COURT: You've got two additional witnesses?

8 MR. MAYBANK: Yes, ma'am.

9 THE COURT: Okay. Why don't we do this so you don't
10 have to interrupt your next witness in the
11 midst of his testimony, let's take our lunch
12 break now and then we'll come back.

13 MR. MAYBANK: Sounds good to me.

14 THE COURT: And then you can start with your next
15 witness.

16 MR. MAYBANK: Okay. What time should we be back?

17 THE COURT: At 1:30.

18 MR. MAYBANK: 1:30. Thank you.

19 (Lunch break from 12:33 p.m. until 1:33 p.m.)

20 THE COURT: If everyone is ready, we will reconvene.
21 Mr. Maybank, call your next witness.

22 MR. MAYBANK: We call Matt Sheers to the stand.

23 MATTHEW SHEERS, being duly sworn, testifies as
24 follows:

25 THE COURT: And I'm sorry, I didn't hear, but what



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1 was your name again?

2 MR. SHEERS: My name is Matt Sheers.

3 THE COURT: Okay. Thank you, Mr. Sheers.

4 MR. SHEERS - DIRECT EXAMINATION BY MR. MAYBANK:

5 Q: Why don't -- why don't you just get started,
6 please state your full name for the Court.

7 A: My name is Matthew Phillip Sheers.

8 Q: And who is your current employer?

9 A: My current employer is Dish.

10 Q: How long have you been at Dish?

11 A: I've been at Dish since November 2009.

12 Q: And what are your current responsibilities?

13 A: I'm vice president of corporate taxes, and so
14 I head up the tax function. That includes the
15 planning, the preparation of the returns, the
16 tax accounting and dealing with controversies
17 as well.

18 Q: All right. And what were your responsibilities
19 during the audit period of '05 through -- of
20 '05 through '10?

21 A: So I wasn't at Dish through that entire period.
22 I only started in November '09, but I would
23 have been there for the '09 returns and for the
24 '10 returns and some of the amended returns.

25 (Petitioner's Exhibit Number 33 was introduced into



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1 the record.)

2 Q: Okay. Petitioner's Exhibit 33 is your resume.
3 Did you prepare this?

4 A: Yes, I did.

5 Q: Okay. And is it a accurate reflection of your
6 professional experience?

7 A: Yes, it is.

8 Q: Please describe your educational background.

9 A: I have a bachelor's degree in accounting from
10 West Virginia University. I also have a
11 master's in accounting from West Virginia
12 University, and then once I started working I
13 had also picked up a master's in taxation from
14 Robert Morris University.

15 Q: Okay. Did Dish file returns with the DOR
16 during the audit period?

17 A: Yes, they did.

18 Q: Okay. And what is the audit period involved in
19 this case?

20 A: 2005 through 2011.

21 Q: Okay. For 2011 or '10?

22 A: Sorry, '10.

23 (Petitioner's Exhibit Numbers 1 through 12 were
24 introduced into the record.)

25 Q: Okay. And I'm going to hand you Petitioner's



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1 Exhibit 1 to 2. And if you could identify
2 that? Oh, 1 through 12, I'm sorry. If you'll
3 just identify these?

4 A: So first is a return for the year 2005; the
5 second one is a return for 2006; next is a
6 return for 2007; next is an income tax return
7 for '07, as well; there should be an amended
8 one. Next one is a return for 2008, that's
9 Exhibit 5; another one for '08, so another
10 amended; another one for '08, amended.

11 Q: The rest of them are just tax returns you
12 filed?

13 A: Amended, yeah.

14 Q: What -- correct?

15 A: That's correct.

16 Q: All right. Why did you -- why did you amend
17 your returns and why did you have so many
18 amendments?

19 A: Well, one of the reasons why we filed a lot of
20 amended returns is that every time that we go
21 ahead and amend our federal return, we're
22 required by state law to go ahead and amend the
23 state returns that are affected as well. And
24 so any time we make a change for federal
25 purposes that happens, and that happens



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1 regardless of whether we do that voluntarily or
2 whether the IRS causes us to change it. And so
3 like for some of the years that are involved
4 here we had had an IRS audit that had closed
5 through the '08 year. That immediately
6 required that, I think, within 60 days of
7 signing the revenue agent report that we have
8 to amend those returns. I think there are also
9 some amendments that are uniquely just for
10 South Carolina type issues, and I think the
11 final ones would've been ones that, you know,
12 we hoped that we got the apportionment factor
13 right. I had been hired in to kind of upgrade
14 the Dish tax department, so I think one of the
15 things we tried to do is go back and look at
16 those years and make sure that we had a
17 consistent basis throughout those years and
18 sometimes that involved correcting returns.

19 Q: Okay. And briefly, who did you work for before
20 Dish?

21 A: I had worked for AT&T, and then I had stayed
22 with a subsidiary they had spun off that was
23 called National Cash Register, NCR Corporation.
24 And then I'd gone with the subsidiary they had
25 spun off that was called Teradata Corporation.



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- 1 Q: All right. And so back to amended returns.
2 Some of them were -- you amended them because
3 you'd amended your federal income tax return,
4 correct?
- 5 A: That's correct.
- 6 Q: And some of them because the feds issued an
7 RAR, which was a change to your return; is that
8 correct?
- 9 A: That's correct.
- 10 Q: And you said state law required you to amend
11 your return whenever the feds issue an RAR?
- 12 A: I believe South Carolina law is in 60 days
13 after doing that.
- 14 Q: Okay. And then some of them were because of
15 the -- your cost of performance calculation?
- 16 A: That's correct.
- 17 Q: Okay. All right. So briefly just -- briefly
18 just by the types of returns?
- 19 A: So this is a -- returns typically that we file
20 in South Carolina is there's an income tax
21 return and then there's also a license fee
22 return that's in the same paperwork.
- 23 Q: All right. Are you familiar with the returns?
- 24 A: Yes, I am familiar with them.
- 25 Q: Who actually prepares them?



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- 1 A: So -- so for most of these years, what happens
2 is the return -- we pay somebody to prepare the
3 returns on our behalf. I think most of these
4 years it would have been accounting firm KPMG.
5 But we're involved in the preparation, we
6 reviewed the returns and at the end of the day
7 I sign the return because it was prepared under
8 my direction for the years that I was there.
- 9 Q: Okay. All right. Did Dish do business in more
10 than one state during the audit period?
- 11 A: Yes, we're -- for this audit period and for
12 quite some time we've been in all 50 states.
- 13 Q: All right. Is South Carolina combined
14 reporting or a separate entity state?
- 15 A: You said South Carolina?
- 16 Q: Yeah.
- 17 A: It's a separate entity state.
- 18 Q: Okay. How does the South Carolina income tax
19 return require you to report income?
- 20 A: So I think it starts with our federal income,
21 makes some adjustments, but then comes up with
22 an apportionment factor for what portion we pay
23 in South Carolina, and that apportionment
24 factor is a numerator and a denominator.
- 25 Q: Okay. Did the Department dispute the

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1 denominator?

2 A: I don't believe we have any dispute with the
3 regards to the denominator.

4 Q: It's just -- it's just the numerator?

5 A: Just the numerator.

6 Q: All right. And what did you report in the
7 apportionment factor denominator; what was that
8 number?

9 A: So that would have been our total revenue. It
10 would be the total revenue that we would have
11 reported in our federal return. And I think
12 now that we do make adjustments under South
13 Carolina law, so the number is slightly
14 different for South Carolina purposes.

15 Q: Okay. How does South Carolina require
16 companies to calculate the numerator? Does it
17 matter what kind of business you are?

18 A: Yeah. It does matter what type of business you
19 are, and so I think that we've got several
20 types of income that there's not dispute. But
21 one area of dispute is with our subscriber
22 revenue business, and I think there we try to
23 follow the law with regards to service
24 companies.

25 Q: Okay. And so does South Carolina tax



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1 manufacturers and service providers the same or
2 different?

3 A: No. It taxes them differently.

4 Q: Okay. And which is Dish?

5 A: So our subscriber revenue business we believe
6 is a service.

7 Q: All right. Did you file as a service provider?

8 A: Yes, we did.

9 Q: All right. Does DOR object to that?

10 A: I don't believe they've challenged that.

11 Q: Just very generally speaking, what is a
12 numerator? What's the numerator represent in
13 very general terms?

14 A: Okay. I think the South Carolina code is,
15 according to one of the pre-trial briefs, that
16 -- here is Section five says, Receipts from
17 services if the entire income-producing
18 activity is within the state. So if everything
19 was within the state, it would be all the
20 receipts. But then it also goes on to say that
21 if the income-producing activity is performed
22 partly within and partly without of the state,
23 sales are attributable to the state to the
24 extent that the income-producing activity
25 performed within the state.



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- 1 Q: Okay. Did the DOR audit object to the number
2 that Dish included in the numerator?
- 3 A: Yes, I believe that's our main dispute.
- 4 Q: Did they object to any other issues, other than
5 very minor ones?
- 6 A: Nothing significant.
- 7 Q: All right. Is the South Carolina statutes
8 unique?
- 9 A: That's kind of like one of those yes or no
10 questions. It seems like the statute comes out
11 of UDITPA. It's pretty much the same as a lot
12 of other states use. But -- but there is one
13 exception that it doesn't include the cost of
14 performance line that's in UDITPA.
- 15 Q: Okay. Just very briefly, who is UDITPA?
- 16 A: So this was way before I was born, which I
17 don't get to say that often. But there --
18 there had been a group that had got together
19 that tried to come up with model statutes for
20 states to use. And so a lot of states have
21 kind of followed that and adopted language from
22 that, South Carolina being one.
- 23 Q: Okay. You said it's similar to UDITPA, but
24 with one exception. What is the one exception?
- 25 A: They did not include the language that said



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1 cost of performance.

2 Q: Okay. And what does cost of performance
3 modify?

4 A: So I think there's -- there's kind of two types
5 of cost of performance, from my understanding.
6 There's a pro rata cost of performance and an
7 all or nothing. I think we didn't use the pro
8 rata cost of performance, but I think the cost
9 of performance was used to tell how you would
10 sit there and split the income-producing
11 activities within the state and without of the
12 state.

13 Q: Okay. All right. And how did UDITPA, the pure
14 UDITPA require you to prepare a numerator,
15 basically?

16 A: So I think what UDITPA would've looked at and
17 looked at these cost produced -- these income-
18 producing activities, and then it would have
19 said how do you measure where an activity is
20 performed? And I guess, you know, you could've
21 done that based on number of days or number of
22 hours or different ways. But I think most
23 states would sit there and say that not all
24 activities equal and so maybe the cost of
25 activities would be a good way to allocate it.



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1 So they do the cost that you incur in the state
2 and the cost that you in outside of the state.

3 Q: Okay. Is the cost of performance model common
4 throughout the U.S.?

5 A: It is common. Many states use that model.

6 Q: Okay. So does Dish use it in filing returns in
7 other states?

8 A: Yes, we do. We do it in other states that
9 allow cost of performance.

10 Q: Do some states use methods other than cost of
11 performance?

12 A: Yes. Other states do use methods other than
13 cost of performance. I'd say the most common
14 one would be one that would be based on mark --
15 you know, market share.

16 Q: Does South Carolina have a market share
17 statute?

18 A: Not for this type of income.

19 Q: Does it have a market share regulation?

20 A: No, it doesn't.

21 Q: Does it have a market share policy document?

22 A: No.

23 Q: A revenue ruling or anything of that nature,
24 revenue procedures, regu- ...

25 A: No, we did find this mentioned, but it seemed



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1 like everything that was there in the
2 publications and policy documents refer to cost
3 of performance, not market.

4 Q: Okay. All right. How about DOR publications,
5 their tax manuals, do they preference market
6 share?

7 A: Not market share.

8 Q: All right. Tell us how Dish or any other
9 multi-state corporate taxpayer, you're back in
10 Englewood, you're preparing return in 50
11 states. How do you know how to calculate the
12 numerator in South Carolina?

13 A: Some of it is we hire accounting firms that are
14 -- that are, you know, better experts than we
15 are in this. But I think what they do is they
16 look to the instructions that come from the
17 state, they look to the law, they look to the
18 regulations that are there. And I guess beyond
19 that they, you know, look to court cases or
20 anything else that could give us guidance in
21 how to do that.

22 Q: Okay. Would they look at DOR policy documents?

23 A: They would.

24 Q: Would they look at the instructions to the
25 state income tax returns?



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- 1 A: Yes, the instructions.
- 2 Q: Okay. Based upon your review, did you make a
3 determination of whether South Carolina is a
4 cost of -- a pro rata cost of performance or a
5 market share state?
- 6 A: So we believe South Carolina to be a cost of
7 performance state.
- 8 Q: Okay. What method does the audit assert?
- 9 A: It seems that they would prefer that we use a
10 market share approach for this.
- 11 Q: All right. Let's turn to South Carolina law
12 then. You quoted the statute. Does the
13 statute itself answer the question of whether
14 South Carolina is a COP or a market share
15 state?
- 16 A: No, it doesn't. It leaves out the COP language
17 when it mentions income-producing activity.
18 But it seems like that by choosing income-
19 producing activity you've decided not to be a
20 market share state.
- 21 Q: All right. But does that same statute include
22 market share language?
- 23 A: No.
- 24 Q: Does any DOR regulation answer the question of
25 whether we're market share or cost of



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1 performance?

2 **MS. WOOTEN:** Objection, Your Honor. This witness is
3 a fact witness and he's giving legal analysis
4 or interpretation of a South Carolina statute
5 or regulation. He hasn't been qualified as an
6 expert in tax policy or interpreting statutes.

7 **MR. MAYBANK:** No, but he prepares the returns. If
8 he doesn't -- if he can't speak to tax statutes
9 and regs, how can he prepare a return? And I'm
10 not asking him, by the way, legal questions or
11 some legal questions, it's just when he
12 prepares the return, does the statute say
13 whether we're a cost of performance or market
14 share?

15 **THE COURT:** I agree. I think he does have to
16 utilize the statutes in preparing returns.
17 Objection is overruled.

18 **MS. WOOTEN:** Thank you, Your Honor.

19 **Q:** All right. So does any DOR regulation answer
20 the question of whether South Carolina is COP
21 or market share?

22 **A:** No regulation.

23 **Q:** Okay. Does any DOR policy document, such as a
24 Revenue Ruling, PLR answer the question of
25 whether South Carolina's a market share or a



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1 COP state?

2 A: The policy documents that we could find seem to
3 treat it as a cost of performance state. I
4 think one of the documents we found was as
5 recent as 2013.

6 Q: Okay. Did any DOR publications answer the
7 question?

8 A: Okay. Kind of the same answer there. It seems
9 like they follow the cost of performance
10 methodology.

11 Q: Okay. Do corporations ever look at treatises
12 in determining how to calculate State income
13 tax returns, and if so, which ones?

14 A: Yeah. So a lot of times we will look for
15 expertise in treatises. I think the state and
16 local taxation treatise, which is under the
17 same title that we use is Hellerstein.

18 Q: Okay. Is there really any other treatise? I
19 know there are state and local textbooks. Is
20 Hellerstein about it for state and local tax
21 treatise?

22 A: I think with regards to treatises, I think we
23 used like some multi-state guides and ---

24 Q: Right.

25 A: --- and some text books but, as you said, it's



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1 the only treatise out there that we would
2 subscribe.

3 Q: Okay. And how does Hellerstein describe South
4 Carolina?

5 A: It treats it as a cost of performance state.

6 Q: Pro rata or all or nothing?

7 A: Sorry, pro rata. And I end up shorthanding all
8 the time. I should say pro rata every time.

9 Q: So what is pro rata versus cost of performance?
10 I'm sorry, pro rata versus all or nothing?

11 A: So all or nothing would be the example, I'll
12 make it as simple as possible, but, you know,
13 cause South Carolina and North Carolina. If
14 you had 51 in the state it gets everything; if
15 you had 49 you get nothing. It seems kind of
16 very unfair and you don't see that that much
17 anymore. I think pro rata is whatever your
18 percentage is, that's what you get.

19 Q: Okay. The Dish, in your accounts, did you
20 review South Carolina appellate decisions on
21 the issue of whether we're COP or market share?

22 A: We did like to see if there were any -- any
23 cases that we thought affected, and Lockwood
24 Greene did.

25 Q: Okay. Was Lockwood Greene the only case?



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- 1 A: I believe so, yes.
- 2 Q: Okay. Were there any appellate cases,
3 appellate as in Supreme Court or Court of
4 Appeals, after *Lockwood Greene*?
- 5 A: No, we did not see any.
- 6 Q: All right. Briefly describe *Lockwood Greene*.
- 7 A: So I think -- I think *Lockwood Greene* was kind
8 of opposite of our situation, the taxpayer
9 wanted to be taxed under market sourcing
10 because they had a lot of their income-
11 producing activities here in the state of South
12 Carolina. And so ---
- 13 Q: And where were the customers?
- 14 A: I forget which state. States outside of South
15 Carolina.
- 16 Q: Okay. And so based on -- so tell me what did
17 the taxpayer argue in *Lockwood Greene*?
- 18 A: So they -- I think the taxpayer wanted to argue
19 that they should only be taxed on this income
20 from services where the customers were located,
21 in essence, outside of South Carolina.
- 22 Q: Okay. So they argued that South Carolina was
23 a market share state?
- 24 A: So that's what they argued.
- 25 Q: How did the -- how did the court rule?



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1 A: I think the -- you know, the Department of
2 Revenue had argued the opposite. I believe the
3 court and the circuit court had ruled against
4 the taxpayer and so.

5 Q: Okay. Against the taxpayer and said South
6 Carolina was not a market share state?

7 A: Said it's not a market share.

8 Q: All right. Now, didn't the appellate court in
9 *Lockwood Greene* decision exclude TV stations?

10 A: They did. I think they excluded financial
11 services, and then they'd also included TV
12 stations at that time. So that was back in the
13 -- I guess the good old days when nobody paid
14 for TV and so all the revenue from TV came from
15 advertising revenues. They had a special rule
16 that allocated the advertising revenue, but TV
17 at that time didn't have subscription revenue
18 because people didn't pay for television.

19 Q: All right. We've been over appellate. Were
20 there any ALC decisions prior to this audit
21 which discussed whether South Carolina is COP
22 or market share?

23 A: No. This audit had begun before DIRECTV.

24 Q: Okay. Were there any ALC decisions discussing
25 cost of performance, though?



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- 1 A: I don't believe so.
- 2 Q: Okay. Does South Carolina income tax returns
3 for the audit years have instructions?
- 4 A: They do have instructions.
- 5 Q: And obviously y'all read them preparing the
6 returns?
- 7 A: We do look at the instructions when we prepare
8 the returns.
- 9 Q: Okay. Do the instructions advise taxpayers
10 whether South Carolina is a COP or market
11 shares state?
- 12 A: It really doesn't say anything else than quote
13 the statute that we read previously.
- 14 Q: Okay. All right. Let's turn to your tax
15 returns. What's the last year under audit?
- 16 A: 2010.
- 17 Q: Are you familiar with that return?
- 18 A: I am familiar with that return.
- 19 Q: Was it prepared similarly to prior year
20 returns?
- 21 A: Basically, yes.
- 22 Q: And were you director of the tax department at
23 the time that return was filed?
- 24 A: I was there for that return.
- 25 Q: Okay. What method did Dish use in both the



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1 original and amended returns?

2 A: We used pro rata cost of performance.

3 Q: All right. In the interest of time, let's
4 discuss the preparation of the numerator for
5 the first amended 2010 return. First let's
6 discuss Dish's income. How did Dish make a
7 buck in 2010?

8 A: So Dish primarily makes their money by getting
9 and obtaining customers. So we would have sold
10 them subscription services and we would also
11 been able to lease them boxes. We would sit
12 there and sell them installation services. We
13 would, you know -- you know a number of aspects
14 providing services to customers ultimately in
15 the state of South Carolina.

16 Q: Okay. Do you sell pay-per-view then?

17 A: Yeah. So we'd sell them their basically
18 programing packages, but yeah, we would try to
19 upgrade that as possible. So if they contacted
20 us or -- pay-per-view was coming along we'd try
21 to sell that to them. We'd try to sell them
22 pay-per-view movies and so forth.

23 Q: How about advertising? Do you sell
24 advertising?

25 A: We do sell advertising. We just don't have any



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1 customers for advertising in the state of South
2 Carolina.

3 Q: Okay. All right. Let's discuss the small
4 items first. How did Dish report box sales and
5 rentals to South Carolina residents?

6 A: So the -- the box sales ends up being a very
7 small portion; it's mostly the rental income
8 from the boxes. That is something that we
9 source 100 percent to where the customer is
10 located. And so all that revenue related to
11 South Carolina would have been sourced to South
12 Carolina.

13 Q: Okay. So you paid taxes on that?

14 A: Yes, we do pay taxes.

15 Q: How about box repair income?

16 A: So we treat box repair as a service as well --
17 or as a service. But it ends up that really
18 like the stuff that we do in the house all
19 happens in South Carolina. So that also ends
20 up being 100 percent South Carolina. It just
21 gets there differently.

22 Q: Okay. All right. Let's discuss the large
23 number, subscriber income. How do you report
24 this number?

25 A: So that ---



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1 Q: How do you report it across the country? You
2 do business in 50 states.

3 A: So this ends up being the largest area that
4 we're in disagreement on. And so what we would
5 do would depend on what the law is in that
6 particular state. If it was a state that had
7 a cost of performance law, we would sit there
8 and allocate it on a cost of performance basis.
9 If it was a state that had a market share
10 statute, we would follow a market share
11 statute.

12 Q: Okay. And how is income reported in a state
13 with a market share statute?

14 A: So there it depends on where the customer is
15 located. So if it was a sale to that
16 particular state we would include all that
17 revenue.

18 Q: Okay. All right. Let's turn to South
19 Carolina. How did you prepare the numerator in
20 South Carolina for subscription revenue?

21 A: So we -- we took and ---

22 Q: What test did you use or method?

23 A: The test we used, cost of performance.

24 Q: Okay. So let's go over Dish's cost of
25 performances in 2010. What were Dish's cost of



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1 performances in 2010?

2 A: Listed those in the pre-trial brief, so we
3 thought it was -- we have programing in our ---

4 MS. WOOTEN: Objection, Your Honor. He's reading
5 from the pre-trial brief and that's not been
6 admitted into evidence and it's not filed with
7 the Court as an official court filing.

8 MR. MAYBANK: Well, we have filed it with the Court.

9 MS. WOOTEN: It may have been filed -- excuse me.
10 It may have been filed with the Court, but it's
11 not an exhibit in this hearing.

12 MR. MAYBANK: He doesn't have to testify from
13 exhibits. He could pick up a newspaper and
14 testify from it if he wanted to. It doesn't
15 have to be an exhibit for him -- it has to be
16 an exhibit to be introduced into evidence.
17 Doesn't have to be an exhibit for him to
18 testify from it.

19 THE COURT: Can't he testify -- I mean he is the --
20 he does the financial -- he does the tax
21 returns.

22 MR. MAYBANK: Right.

23 THE COURT: Can he testify from his own knowledge?

24 MR. MAYBANK: He can. What if he ---

25 THE COURT: I would prefer that he not read from the



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1 pre-trial brief.

2 MR. MAYBANK: Okay.

3 Q: Why don't you go ahead and let's just -- what
4 you remember.

5 A: So it's programing and contents and satellites
6 and uplink. We'd also thought that
7 advertising, subscriber equipment,
8 installation, and home repairs and call
9 centers. And then we thought that there were
10 some G&A expenses that belonged in there as
11 well.

12 Q: Okay. So let's discuss in very brief terms
13 these cost of performance items. Why did you
14 include satellites as a cost of performance?

15 A: If we didn't have satellites we really wouldn't
16 have anything to deliver to our customers. So
17 that's involved in the delivery of the service
18 to the customers.

19 Q: Okay. Why is Dish corporate headquarters'
20 function part of your COP?

21 A: There's an awful lot that takes place at our --
22 at our headquarters. It starts out with
23 negotiation with people that provide us the
24 programing and the content that we give to our
25 customers and choosing what the -- what we'll



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1 be able to do there. You know, the contracts
2 related to our satellites, and you know, almost
3 basically all our outside negotiations takes
4 place there. It's where we do the accounting.
5 It's where we do the billing from and, you
6 know, just a lot takes place at headquarters.

7 Q: Okay. Why do you include call centers in your
8 cost of performance?

9 A: So our call centers are involved at different
10 levels of it. I guess the initial is they can
11 sign you up as a customer so they get you as a
12 customer. But then, you know, customers call
13 back and want service, they deal with customer
14 problems. A lot of times they'll sit there and
15 try to upsell them and sell them additional
16 services, the pay-per-view. They're involved
17 in making sure that the customers understand
18 their bills. They're involved in collecting
19 the bills if the customers don't -- don't pay
20 the bills. And, you know, almost all aspects
21 of customers ---

22 Q: Do they take customers' credit cards from time
23 to time?

24 A: Yeah.

25 Q: Does Dish provide its own programing?



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- 1 A: Very, very, very little. Most of our
2 programming comes from third parties.
- 3 Q: Okay. Why did you include advertising and
4 marketing in your COP?
- 5 A: So the reason we include advertising and
6 marketing is that's what helps us to get new
7 customers. And so, you know, we're always
8 interested in finding new customers and adding
9 value stream.
- 10 Q: Okay. Why do you include subscriber equipment
11 in your cost of performance?
- 12 A: I think that while the customer does lease the
13 equipment, and we do have a separate revenue
14 stream related to that, there's a lot more that
15 that box does. It helps you pick which
16 programing you're going to buy. It helps
17 upsell the programming. You can pay your bill
18 actually through your box. And it monitors
19 what's going on. We push -- I think as Rex had
20 mentioned previously -- we push off software
21 uploads every night to that box. And so it
22 monitors everything that takes place within the
23 customer relationship.
- 24 Q: Okay. Why do you include installation in your
25 cost of performance?



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1 A: Installation is one of those odd things. I
2 think we as as our competitors as well have
3 tried, at least for a while, to charge for a
4 big installation fee up front. And that just
5 didn't work; we would lose customers. And so
6 what happens is we offer the installation
7 / basically for free. But that customer
8 experience kind of sets the whole tone for
9 everything that we do. If that person tracked
10 mud through your carpet, you feel differently
11 about Dish. And in the state of South Carolina
12 most of that happens through our retailers.
13 It's very, very important that when our
14 retailers install that that it's a good
15 customer experience or it's just going to
16 flavor the customer relationship ---

17 Q: Okay.

18 A: --- downhill from there.

19 Q: You mentioned you don't do your own
20 programming. Who does do your programming?
21 Who are some of the leading ones?

22 A: So, you know, for sports it'd be ESPN. For
23 childrens' programing it'd be Disney, you know
24 HBO for movies. We buy from, you know, all the
25 big networks that you expect: ABC, NBC, CBS,



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- 1 FOX.
- 2 Q: And FOX?
- 3 A: Yeah, FOX.
- 4 Q: All right. Are any of those program providers
5 located in South Carolina?
- 6 A: I don't believe any of them are.
- 7 Q: All right. And are any of those licences
8 negotiated in South Carolina?
- 9 A: No, they're not.
- 10 Q: Where would they have been negotiated?
- 11 A: Primarily negotiations take place at our
12 headquarters in Englewood.
- 13 Q: Okay. So let's turn back to the Maybank
14 family's two family show -- two favorite shows,
15 the Gamecocks on ESPN and FOX News. Rex has
16 been over the technical aspects of it. Let's
17 just discuss the legal aspects. Starting with
18 the ESPN game of the week, USC vs. Tennessee at
19 Tennessee. Of course Dish does not film the
20 game, correct?
- 21 A: That's right.
- 22 Q: Who does film the game?
- 23 A: So ESPN would film the game.
- 24 Q: And how would you get that from -- legally get
25 that from ESPN?



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- 1 A: So we have a programming contract that we've
2 negotiated with ESPN to buy the rights to sell
3 that to our customers.
- 4 Q: Okay. And where is that contract negotiated?
- 5 A: In Englewood.
- 6 Q: All right. So how do you get me to watch that
7 game? Let's start at the very introductory
8 level of subscriber lever. How do I get that
9 game on Edisto Island?
- 10 A: So, first of all, we've got to convince you to
11 be a customer. So we try to get you to either
12 call our retailers' 800 number or call one of
13 our call centers.
- 14 Q: Okay. Is it difficult to get people to be a
15 customer for pay TV and for Dish specifically?
- 16 A: It is tough to get people to, I guess, first of
17 all cross the line and start paying for
18 something that they might be able to get for
19 free. And so ...
- 20 Q: And where could they get that type of thing for
21 free?
- 22 A: So sometimes, you know, the games are shown on
23 network TV, most of the games are. But that
24 would be one way to get them for free. I
25 believe all the games are -- you can at least



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1 hear them on the radio for free. And so
2 customers will do -- will do that rather than
3 pay for it.

4 Q: Okay. And then in general, besides just
5 football, how do you get people to get off --
6 to start paying money for something they might
7 get free?

8 A: I think what you have to combine it is with
9 something that they can't get for free ---

10 Q: Right.

11 A: --- but then make it so easy that the stuff
12 that they do get for free they want to have as
13 part of the rest of the package.

14 Q: Okay. So how do you talk me into subscribing?

15 A: So a customer in South Carolina, I think we'd
16 have the research department that would kind of
17 look and try to figure out what was the best
18 way to advertise in South Carolina. But where
19 we don't have a direct presence, a presence
20 with our retailers, I think what we would do is
21 we would kind of team with our retailers and
22 share the marketing fees for advertising in
23 South Carolina.

24 Q: Okay. Does Dish have independent retailers in
25 South Carolina?



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1 A: Yes, we do.

2 Q: Okay. Does Dish actually pay them to do the --
3 read the customers?

4 A: We share the marketing expenses of getting
5 those customers.

6 Q: Okay. Every weekend when I go to Edisto I
7 drive by a small store in Walterboro with a big
8 Dish sign; does Dish own that store?

9 A: We don't own that store. That would be an
10 example of one of our retailers.

11 Q: Okay. All right. The Gamecocks are having
12 some great years, not this year, and I want to
13 watch them. Gamecocks are on regular TV only
14 a couple of times a year. Do I have to sign up
15 with you to listen to or watch the Gamecocks?

16 A: No. You could watch it with somebody else.
17 Like, for example, a satellite TV competitor
18 would be DIRECTV. You could watch them on
19 DIRECTV or you could listen to them on the
20 radio, or I believe they're also provided on
21 local cable companies. You could get them ---

22 Q: Okay.

23 A: --- through cable companies.

24 Q: Is there any internet service where you can
25 watch the game?



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- 1 A: I believe there is now. I don't believe there
2 was in the years under audit.
- 3 Q: Okay. All right. So how do you get me to sign
4 up with you as opposed to cable or DIRECTV?
- 5 A: So I think what Dish has always done is try to
6 be the cost leader. Try to offer its customers
7 more -- more choice. And then I think more
8 recently we've tried to provide better features
9 in our boxes and things like that. But offer
10 the same service, but try to offer it in a way
11 that the customer cares it's better, price
12 usually helps that.
- 13 Q: Right. All right. And do you use third
14 parties to do that as well, third-party
15 installers?
- 16 A: Yeah. So we -- in this state a lot -- most of
17 our selling I think would come from the
18 retailers. And they would also be the ones
19 that would do the installation for us.
- 20 Q: Okay. It works, I decide to sign up. What
21 happens next from a legal/accounting
22 perspective?
- 23 A: So I guess from a legal point of view you sign
24 an agreement. So we'd have a contract that
25 would, I guess, standard language been prepared

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1 by our law department in Englewood.

2 Q: And how would I -- how would I mechanically do
3 that? I'd call a call center?

4 A: You can do it online, but I think as Rex had
5 testified, most people still like that personal
6 touch. And I think we like giving people that
7 personal touch. So yeah, you usually end up at
8 the call center.

9 Q: Okay. In 2010, did you have to call a call
10 center?

11 A: In 2010 you would. We didn't have quite as
12 many options that are now available over the
13 internet.

14 Q: Okay. So the legal department would've drafted
15 the call center script, so to speak?

16 A: They would have drafted the agreement and been
17 involved in drafting the script.

18 Q: Okay. All right. And then what did the
19 program division do after I agreed to sign up,
20 from a legal perspective?

21 A: So the -- from a programming standpoint, we
22 would have programing division that would have,
23 you know, gone out and negotiated the various
24 contracts with the different programming
25 companies so that we would have something to



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1 sell you. We would have had a procurement
2 group that would have made sure that there was
3 inventory boxes and antennas and things like
4 that in your area to be installed that would
5 have worked with, in South Carolina, a retail
6 company to go ahead and install it at your
7 house. And I think that would, you know, at
8 least get you set up so you could watch the
9 game.

10 Q: Right. All right. And then the satellite
11 division would have -- where would they have
12 fit in?

13 A: So, you know, we have to have a way to deliver
14 the programming. So they would have been the
15 ones that would have gone out there and, at
16 least, right now, have negotiated with our
17 sister company, EchoStar, to have a satellite
18 in place that would cover this area and send --
19 a place that we could uplink to and send -- and
20 send the beam down.

21 Q: Okay. I've signed up online, gotten my box and
22 antenna. What happens next to actually get the
23 service, from a legal perspective or a
24 technical perspective? You would have had
25 online sign up.



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1 A: Yeah, so you've done signed up and I guess you
2 would've subscribed to the package that would
3 have had the game that you were interested in
4 watching.

5 Q: Okay. All right. Are any of these services
6 performed in South Carolina?

7 A: The ones that I just mentioned, no.

8 Q: Where are they out of?

9 A: Let's see, the uplink center is in Cheyenne,
10 Wyoming; satellite's in space; law department
11 would have been in Englewood. I think --
12 almost everything would have been in Englewood
13 except I guess the service center would have
14 been the service center you would have called.

15 Q: Okay. And how about the call centers?

16 A: I'm sorry, call centers, not service center.
17 Yeah, we would -- we had eight or nine; none of
18 them would've been located in South Carolina.

19 Q: Okay. I want to watch the USC/Tennessee game
20 played in Knoxville. You said Dish doesn't
21 film the game. Who does?

22 A: So that would be an ESPN game.

23 Q: All right. So who would have filmed it?

24 A: So ESPN would.

25 Q: All right. So what interplay would y'all have



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1 had with ESPN to get the game on?

2 A: So as long as -- with a lot of other sports
3 programming, we would've negotiated a contract
4 with ESPN and an amount -- a certain amount
5 that we would charge each of our customers for
6 that.

7 Q: Okay. Is that an expensive contract?

8 A: It's one of the most expensive contracts. I
9 think we're talking about \$750 million here a
10 year -- so in the years in question.

11 Q: Okay. Now what's involved from a legal
12 perspective to get the signal into my home?
13 What's involved in the satellites?

14 A: So ---

15 Q: Does Dish own satellites in 2010?

16 A: So in 2010 it would be a mixed bag. Where we
17 are currently is all the satellites are owned
18 by EchoStar. I mean we license them from
19 Echostar. But at that time it would've been
20 about half and half. I think we would've owned
21 about six of the satellites, Echostar would've
22 owned the rest. But they would -- they
23 would've flown all the satellites.

24 Q: Okay. And the six under lease, who would've
25 drafted that legal work, the leases?



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1 A: So the ones that were leased our law department
2 would've drafted the lease documents.

3 Q: All right. From a legal perspective, what's
4 involved in getting the satellites which beam
5 into Edisto into space?

6 A: So satellites are built by Loral. We would
7 have legal agreements that would build them to
8 our specifications at Loral. After the
9 satellites are build, we work -- we work with
10 somebody that launches them into space. I
11 think, you know, Rex had mentioned the
12 different options there, but very rare -- it
13 seems like the US space agencies and military
14 use up the US launches. And so I think he
15 mentioned old Russian ones, but I think they're
16 in Kazakhstan and had also mentioned that
17 there's somebody that has an oil barrack that
18 they float out in the middle of the ocean, and
19 I guess before one of them blew up, we'd use
20 that as well.

21 Q: Okay. Is there any regulatory approvals from
22 the feds?

23 A: Yeah. So we're regulated by the FCC. So that
24 kind of has two parts to it. Part of it is the
25 frequencies that we're allowed to broadcast the



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- 1 satellite at. And then also they're the ones
2 that we get the slot over the equator where we
3 place the satellites, and so, you know, we meet
4 that regulation.
- 5 Q: Okay. So Dish, you've got to negotiate first
6 with the manufacturer of the satellite,
7 correct?
- 8 A: Yeah.
- 9 Q: Okay. And then they've got to negotiate with
10 the people who launch the satellite?
- 11 A: And then the federal agencies.
- 12 Q: The federal agencies. And where are those
13 negotiations?
- 14 A: All of that would be in Englewood. The stuff
15 with the FCC, though, would be DC.
- 16 Q: All right. Let's discuss my dad's favorite
17 program, Fox News. Does Dish produce Fox
18 News?
- 19 A: No, we buy Fox News from Fox.
- 20 Q: All right. What's it take to get, from a legal
21 perspective, Fox onto Edisto Island?
- 22 A: So we negotiate for Fox programming. Fox is a
23 very, very big company, owns a lot of names
24 other than Fox. I think we, in the years in
25 question, paid about \$800 million a year.



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1 Q: Okay. So y'all have pay Fox about 800 million?

2 A: Yeah.

3 Q: And do any licensing negotiations take place in
4 South Carolina?

5 A: No.

6 Q: Okay. All right. And in terms of getting the
7 show on my set, I assume the circumstances are
8 similar to ESPN?

9 A: That's correct.

10 Q: We don't need to go through any of the
11 satellite, Dish talk if they're similar or
12 identical?

13 A: It's the same satellites.

14 Q: Okay. All right. Switching gears to your cost
15 and revenue items. Does Dish actually capture
16 or document data for South Carolina? And let's
17 start with revenue. So you've got -- you've
18 got your revenue from all 50 states; you got
19 cost of some states. Let's start with revenue.
20 Does Dish actually track the revenue paid by
21 South Carolinians?

22 A: So yes, we do track the revenue by customers in
23 South Carolina.

24 Q: Okay. Obviously, that's not perfect. If I'm,
25 you know, Wells Fargo with 15 offices in South



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1 Carolina and 15 offices in North Carolina and
2 if the bill was sent to North Carolina, it's
3 not going to be perfect, but if they'd got a
4 South Carolina address, you're going to capture
5 that information?

6 A: We would capture if it's billed to a South
7 Carolina address.

8 Q: All right. How about cost?

9 A: Okay. Cost is different because the costs are
10 more tracked by the costs and where they're
11 performed. And so at the end of the day, for
12 example, we'd know what total programming was,
13 but there would be an allocation that would
14 tell us how much of that went to South
15 Carolina.

16 Q: Okay. If Dish would have the cost incurred --
17 or would Dish have the cost incurred in
18 purchasing the boxes and satellite antennas
19 furnished to South Carolina residents?

20 A: So you have cost related to equipment, we would
21 know exactly where it went.

22 Q: Okay. Does South Carolina charge -- does Dish
23 charge South Carolina residents for the box or
24 the antenna?

25 A: At the end of the day, we do, we lease them to.



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- 1 Q: Right. Okay. All right. Have I overlooked
2 anything regarding ESPN or Fox that you want to
3 add?
- 4 A: I don't believe so.
- 5 Q: Okay. In summary, given the above, where were
6 Dish -- Dish's costs of performance incurred to
7 get the USC/Tennessee game into my home at
8 Edisto?
- 9 A: A very large percentage outside of the state of
10 South Carolina.
- 11 Q: Okay. And where would that large percentage
12 be? Would corporate headquarters be part of
13 it?
- 14 A: Corporate headquarters would be part of it;
15 where our uplink centers would have been would
16 have been part of it; where the call centers
17 would have been would have been part of it.
- 18 Q: Okay. And are there any call centers in South
19 Carolina?
- 20 A: No call centers in South Carolina.
- 21 Q: All right. Are there any regional uplink
22 centers in South Carolina?
- 23 A: Not regional, no.
- 24 Q: Are the two major uplink centers are either of
25 them -- are either of them in South Carolina?



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1 A: Neither of the two major centers.

2 Q: All right. So let's discuss Dish's amended
3 returns. On what basis were they filed?

4 A: They were based on a cost of performance method
5 pro rata.

6 Q: Okay. And the final amended returns. does Dish
7 claim they were entitled to refunds?

8 A: For like 2010, yeah.

9 Q: Right. Okay. All right. And so the net
10 result was refund claims for South Carolina?

11 A: That's correct.

12 Q: All right. Let's switch gears totally to the
13 ALC decision in DIRECTV v. South Carolina DOR.
14 Have you reviewed this decision?

15 A: I have reviewed this decision.

16 Q: Does Dish's tax department agree with this
17 decision?

18 A: No, we didn't. The position we had taken was
19 that we were entitled to use cost of
20 performance.

21 Q: Okay. Briefly summarize the DIRECTV decision
22 from the perspective of a guy who's got to fill
23 out the return.

24 A: So it looked like the judge decided that South
25 Carolina was neither a market share nor a cost



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1 of performance state. And then I think that
2 what he did was focused in on the income-
3 producing activities and he said that DIRECTV
4 had not done enough to prove what their income-
5 producing activities were or where those
6 activities were performed.

7 Q: Okay. And how do you define income-producing
8 activity?

9 A: So the way I would -- I would define it is, you
10 know, anything that's necessary to help us get
11 a customer, anything that's necessary to help
12 us retain a customer that helps make that
13 income.

14 Q: Okay. You also have indirect costs?

15 A: Yeah. So ---

16 Q: Corporate headquarter's type cost?

17 A: Yeah. So we do have -- we do have indirect
18 costs, so I think when we kind of looked for,
19 you know, what was the definition of income-
20 producing activities I don't know that we found
21 a good statutory language or a good accounting
22 language. But if it did seem that if it was a
23 cost that was treated as a direct cost for GAAP
24 purposes that that would be a income-producing
25 cost.



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1 Q: Okay. There's no -- there's no statutory
2 definition in South Carolina, correct?

3 A: No.

4 Q: Okay. In light of the DIRECTV decision have
5 you prepared calculations based upon where your
6 income-producing activities occurred and what
7 they were and what they incurred?

8 A: So we definitely had a curiosity as to what the
9 results would be, and so we did try to go ahead
10 and prepare calculations for the years involved
11 to see what the outcome would be based on
12 whatever information was available in that
13 decision.

14 Q: Okay. In addition to DIRECTV, did you look at
15 any other law in South Carolina, any other
16 decisions?

17 A: Not any other decisions in South Carolina, but
18 if there was something that was referenced in
19 an ALC decision, we tried to incorporate that
20 into it. So like I think, for example, they
21 referenced a footnote related to advertising
22 expenses. We tried to follow that instruction.

23 Q: Okay. And you obviously reviewed the decision
24 in this case?

25 A: Yeah.



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- 1 Q: All right. Let me go through some things and
2 -- tell me whether these are income-producing
3 activities or not. Is programming content an
4 incoming-producing activity?
- 5 A: Yeah, we thought programming content was.
- 6 Q: All right. Is satellites and uplink?
- 7 A: We thought satellites and uplinks was. I think
8 we found a direct quote in the DIRECTV case
9 that said ---
- 10 Q: Okay. And I'll come back to them.
- 11 A: Okay.
- 12 Q: Let's just try and establish ---
- 13 A: Yes.
- 14 Q: Is advertising and marketing a cost of
15 performance item?
- 16 A: We believe so.
- 17 Q: How about subscriber equipment?
- 18 A: Yes.
- 19 Q: How about installation?
- 20 A: Also.
- 21 Q: How about in-home repair?
- 22 A: Yes.
- 23 Q: And how about call centers?
- 24 A: Yes.
- 25 Q: How is it -- how is programming the content an



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1 income-producing activity?

2 A: So I think one of the things was we thought it
3 was specifically listed in the court case, so
4 we thought that that defined it. But then just
5 as general it seemed like it would make sense
6 that programming content would be -- we've got
7 to sit there and I think as we've kind of said
8 before we've got to convince the customer that
9 we've got something to sell when they can get
10 a lot of the things that we provide for free,
11 as well, either -- either at the library or
12 over -- or over the air TV. So we go out and
13 try to get programming that they want. We try
14 to combine it with the things that are free and
15 making a special experience for the customer,
16 and I think there -- and once they get that
17 experience and find out they can DVR all the
18 shows that they want to watch and things like
19 that they're much more likely to -- to buy the
20 free stuff from us so that they can DVR and
21 watch it at their convenience.

22 Q: Okay. And do you spend a lot of money on
23 content?

24 A: We spend a whole bunch of money on content.
25 We've mentioned the ESPN, Fox. And programmers



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1 want more and more each year.

2 Q: So ESPN and Fox, just those two is about a
3 billion four, correct?

4 A: Yeah.

5 Q: Okay. All right. Is any content specifically
6 selected for little ole' South Carolina? They
7 might do a survey and hey, what do they want at
8 Edisto Island?

9 A: The direct answer to the question is no,
10 there's not something that's direct for South
11 Carolina. But I think what happens is the
12 different demographic groups that we are trying
13 to track and are trying to sell to, you have
14 lots of that here in South Carolina. So ---

15 Q: So let give you -- so ESPN, why is that -- why
16 do you say that's a South Carolina demographic?

17 A: So, you know, college sports fans are a group
18 of fans out there that we try to -- try to
19 attract. Our competitor DIRECTV has a little
20 bit of advantage when it comes to professional
21 football games. And so we try to counter that
22 with people that are interested in College
23 football. A state like South Carolina I think
24 you -- you know, at least attendance-wise
25 you've got two of the top 20 teams in the



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1 nation represented here. And it's not just
2 true with football. We get ESPN for other
3 sports like baseball or other college sports.
4 I think South Carolina you've had a couple
5 national championships when they do that,
6 college baseball world series. Not just mens'
7 sports, it's women's sports. I've raised
8 daughters, I think you've got the highest
9 attendance for college and basket -- and
10 college sports. Sports cross is a large part
11 of the market that we're trying to get to and
12 that just happens to cross into South Carolina.
13 It's not just sports, it's ---

14 Q: Let me stop you there. You say women's
15 basketball led the nation in attendance?

16 A: Yeah, I believe University of South Carolina
17 leads the nation.

18 Q: Okay. And what does that say to y'all when
19 we're 14th, 15th and the top 20 in football and
20 basketball? Does that necessarily mean we're
21 going to watch the away games on TV?

22 A: I would think you'd be interested in those away
23 games.

24 Q: Okay. All right. So we've been through
25 sports. What other aspects of the South



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1 Carolina demographic would Dish look at?

2 A: So I think -- I think, you know, we sit there
3 and look at what people would be, you know,
4 care about on ethnicity. And so, you know, for
5 example we do black entertainment television.
6 We have a lot of Latino programming that we use
7 as well. We, you know, different religious
8 beliefs. I believe that you guys are -- in the
9 Bible -- in the Bible belt as well here. We've
10 got a whole line of religious programming that
11 we sit there in channels and those channels
12 tend to attract South Carolina customers.
13 We've got a group of channels that are outdoor
14 and sportsmen channels. You're a state that
15 has a lot of hunters and has a lot -- a lot of
16 fishermen. You have one of the highest
17 instances of boat ownership in the nation; have
18 a longer hunting season that we have in
19 Colorado. Beyond that, I mean, there's other
20 sports. You know, Nascar would be another
21 sport that it's a demographic. You've got your
22 own Nascar track here. In Colorado, if you ask
23 somebody who their driver is they look at you
24 like you're crazy. But, you know, here that's
25 something that could attract, you know,



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1 customers that care about Nascar.

2 Q: And so y'all have Nascar channels?

3 A: We've got four different channels, I believe.

4 Q: Okay. How about hunting and fishing; do you
5 have hunting and fishing channels?

6 A: Yeah. So you want to watch the guy hunt the
7 deer, you can watch it on sportsman channel or
8 outdoorsmen.

9 Q: All right. How about religious channel; do you
10 have any?

11 A: Yeah. We've got quite a few religious
12 channels.

13 Q: Do you have anything on golf?

14 A: This is a primary destination for golfers to
15 come to. You've got an awful lot of golf
16 courses and yeah, we have the Golf Channel and
17 we show The Heritage every year as well.

18 Q: Okay. We have an occasional hurricane. Do
19 y'all have a weather channel?

20 A: Yeah, so we -- we've got the Weather Channel.
21 Everybody cares about weather about the same
22 amount. When it's talking about, you know,
23 making sure it's going to be a nice weekend for
24 your get together or whatever. I think you
25 guys probably watch it a little bit more during



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1 hurricane season than the rest of the country.
2 Q: Okay. All right. And let me get you to
3 identify this chart. I'm about to put it up on
4 the screen here. If you'll identify it and
5 tell us where the numbers came from. Got a
6 copy for everybody here.

7 MR. MAYBANK: All these extra copies ---

8 MS. WOOTEN: Sure. Thank you.

9 ME. MAYBANK: Need another one there?

10 Q: All right. If we could put it on the screen --
11 we might have to -- everybody's got a copy, but
12 I think it's a little bit -- little bit helpful
13 to put it up on the screen. And if you'll sit
14 there and kind of twiddle through it as we --
15 there we go. All right. So if you'll start by
16 introducing -- identifying this chart?

17 A: So as we were kind of talking before, there was
18 a decision that came down in *DIRECTV*. So this
19 is the summary of the calculation that we had
20 kind of put together to kind of show the what
21 ifs would have happened if we had prepared the
22 returns under the same methodology that the
23 judge had mentioned in the *DIRECTV* case.

24 Q: All right. And the chart appears to have three
25 scenarios -- three scenarios, South Carolina



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1 IPA, DIRECTV, South Carolina IPA, includes G&A,
2 South Carolina cost of performance's, what do
3 those three columns represent?

4 A: So three different scenarios. The first
5 scenario was trying to follow literally what
6 the judge said in the case. And so he had said
7 that it should be done on an income-producing
8 activity method. So we tried to do that in
9 accordance with the case. The case was silent
10 with regards as to whether to apply this to
11 general and administrative expenses. So, the
12 second scenario is exactly the same as the
13 first scenario with the sole difference being
14 that we -- we had included general
15 administrative expenses, as well. And at the
16 end of the day it made a small change in the
17 percentage, but not a very large change. And
18 then I think the third scenario was more just
19 kind of for reference purposes, but it was a
20 calculation that was based on cost of
21 performance.

22 Q: Okay. So the numbers -- the chart's got a
23 bunch of -- bunch of numbers on the far right
24 total. Where did those numbers come from?

25 A: So these numbers ultimately lead back to, you



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1 know, our 10-K for the year. And so I believe
2 that we have not only the 10-K but -- but then
3 also a statement of operations, a P&L that ties
4 up into the 10-K and shows the detail at an
5 account by account level, and that's where
6 these numbers come from.

7 Q: Okay. But some of the numbers come from the
8 tax return too?

9 A: The, you know, the financial statements ---

10 Q: For what ---

11 A: --- and the account -- and the account by
12 account detail is what we used to import into
13 the tax return. It's not necessarily the tax
14 numbers, but at least it's the book numbers
15 that we start with in preparing the tax return.

16 Q: All right. And so they basically come from two
17 or maybe three sources, 2010 10-K, the 2010 P&L
18 and maybe the 2010 federal income tax return;
19 is that correct?

20 A: That's correct.

21 Q: All right. And tell us very briefly about the
22 10-K. What's a 10-K and why does Dish prepare
23 it?

24 A: So Dish is traded on public stock exchange, the
25 NASDAQ and because of that we're subject to the



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- 1 SEC reporting requirements. And so we're
2 required to file with the SEC a report each
3 quarter, but at the end of the year we file an
4 annual report with them for the whole year and
5 that annual report is called a 10-K.
- 6 Q: Okay. And that's governed by federal law,
7 federal securities law?
- 8 A: It's governed by federal securities law. It's
9 also governed by GAAP and it's -- it's audited
10 by our test firm, KPMG.
- 11 Q: All right. And then is it prepared in the
12 regular course of business?
- 13 A: Yes.
- 14 Q: You're required to prepare it?
- 15 A: You would have to. You couldn't be publicly
16 traded otherwise.
- 17 Q: And do you prepare it every year?
- 18 A: We prepare one every year, yes.
- 19 Q: Okay. Is the 10-K available for the DOR's
20 inspection, the company in general?
- 21 A: And for any of our investors as well too. It's
22 available on our website. It's also available
23 directly from the EDGAR service at SEC.
- 24 Q: Okay. And did the DOR to the world ever
25 examine your 10-K?

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1 A: I believe they do when they audit us.

2 Q: Okay. All right. Are you generally familiar
3 with the numbers in the 10-K?

4 A: Generally familiar, yes.

5 Q: Okay. Does your office play a role in the 10-
6 K?

7 A: Very -- very, very little. We have
8 responsibility for the tax accounts in the 10-K
9 but nothing else.

10 Q: Okay. Let's turn to the 2010 P&L. What is a
11 -- what is a P&L and why do you prepare it?

12 A: So the, you know, the financial statement kind
13 of breaks into two parts. There's an income
14 statement, sometimes called statement of
15 operations, sometimes -- and that's what we
16 abbreviate and call it P&L. Then there's a
17 balance sheet, as well. This is the P&L that
18 would have been reported in the 10-K, it's just
19 at a greater level of detail, account by
20 account. Usually when somebody audits us they
21 go and look through it at the greater level of
22 detail and ask questions about particular
23 accounts.

24 Q: Is it prepared in the regular course of
25 business?



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1 A: Yes, it is.

2 Q: How often do you prepare it?

3 A: I think we have a month -- it's constantly
4 being prepared, but we have a monthly close
5 each month. And so 12 times during the year.
6 The one in December would be the annual.

7 Q: And who looks at the P&Ls in the company?
8 Who's it prepared for?

9 A: I mean, it's primarily prepared by our
10 controller. I mean, it serves a lot of useful
11 purposes. It is the accounting that becomes
12 the financial statements that gets audited by
13 the auditor, but it's also the accounting
14 that's used for management accounting purposes
15 to see how well we're doing in the year, if we
16 need to course correct and things like that.
17 We used it in the tax department to prepare the
18 tax returns.

19 Q: Okay. And then on the tax returns which may be
20 one or two numbers from the far right coming
21 from the tax returns, obviously you prepare tax
22 returns in the regular course of business?

23 A: Yeah.

24 Q: And you're obviously familiar with them?

25 A: That's true.



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1 Q: And I overlooked asking you when we were
2 finishing up on cost of performance, in your
3 opinion, do the amended returns accurately
4 reflect your cost of performance methodology in
5 South Carolina?

6 A: Yeah. I think the -- in each of the cases of
7 the years the last return we would have filed,
8 the last amended return would be ---

9 Q: Okay.

10 A: --- that we thought the right answer was.

11 Q: Okay. So we went through the raw numbers on
12 the chart. Let's go through the percentages.
13 Tell us about the percentage you used in parts
14 of the chart.

15 A: Okay. So in ---

16 MS. WOOTEN: Objection, Your Honor. This document's
17 not into evidence yet and he's testifying from
18 the numbers -- of the numbers from it.

19 MR. MAYBANK: Your Honor, we attend to put the
20 document into evidence at the end. We're still
21 trying to establish a foundation for the
22 document. But I repeat, he can testify from
23 any document, he could pick up the Bible and
24 quote it, he could quote the newspaper.
25 There's no requirement that a document be put



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1 into evidence.

2 **THE COURT:** I'm going to allow him to continue his
3 testimony. Your objection's overruled.

4 **MS. WOOTEN:** Thank you.

5 **Q:** Okay. So tell us about the percentages used in
6 parts of the chart.

7 **A:** So what we've done in the part -- the chart is
8 we've gone through and tried to determine how
9 much of each of the income-producing activities
10 took place in -- in South Carolina versus
11 elsewhere within the country. And so ---

12 **Q:** Okay. Go ahead.

13 **A:** And we were trying to sit there and figure that
14 out. So like, for example we had a percentage
15 that we used a lot would've been one that ended
16 up rounded to like 1.6 percent. But that
17 would've been a percentage that was based on
18 our number of subscribers in South Carolina
19 over our subscribers in the -- in the nation.
20 And so then we would take kind of the
21 programming, that was the way we would allocate
22 it and said this is the amount of programming
23 costs related to South Carolina.

24 **Q:** Okay. So sometimes it would be the percentage
25 of Dish prescribers who were South Carolinians?



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1 A: That's the number that we used the most. And
2 in other cases expenses it seemed like that
3 wasn't the relevant number. So like say, for
4 example, when we were looking at marketing
5 where we were marketing not just to our
6 customers but to the general population, that
7 would be an example where we would have used a
8 different percentage. The percentage there
9 would have been based on total population in
10 the U.S.. But it is of -- that percentage
11 ended up being very close as well and we ended
12 up rounded to the same 1.6 percent. There were
13 some cases where we had gone to a specific
14 department and asked actually what was taking
15 place. And so we used direct mail a little bit
16 more in South Carolina than we used other
17 places. They'd come back and said that that
18 percentage was like a two percent number, and
19 so we used that -- that there. We also get
20 analytics from Google related to our websites,
21 and so that had ended up being a percentage
22 that was lower than the 1.6 because we tend to
23 use the website less in South Carolina than
24 elsewhere. But we'd gone through and got
25 various percentages as a way of kind of coming



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1 up with what the costs were related to what we
2 did in South Carolina.

3 Q: Okay. All right. And would occasionally you
4 use census data? That's probably some
5 percentage of the U.S. population?

6 A: The census data was like if it was say like a
7 marketing expense that went after the general
8 population and we thought that that was better
9 than just our customer percentage, although
10 they ended up rounding to be very close to the
11 same.

12 Q: Okay. All right. Let's go -- let's go over --
13 I think you've already hit this, but just out
14 of abundance of caution, just at a very high
15 level what are -- what are these three charts?

16 A: Okay. So the first chart ---

17 Q: That's one on the left.

18 A: --- the first column, that's the one where we
19 tried to follow the judge's decision in
20 DIRECTV. And so we've listed there the various
21 income-producing activities, and then we've
22 tried to show what part of them takes place in
23 the state and what part takes place outside the
24 state of South Carolina.

25 Q: Okay.



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1 A: And so then ---

2 Q: And what's the middle chart?

3 A: The middle chart would be almost exactly the
4 same with the exception that about two-thirds
5 of the way down the page what we've done is
6 we've also included general and administrative
7 expenses.

8 Q: So these two charts are identical except for
9 general and administrative?

10 A: That's correct.

11 Q: And what are -- again, what is general and
12 administrative -- not the number, but what is
13 it in general?

14 A: So like -- like we, you know, like for example
15 our HR department; we capture those costs in
16 the HR department, but all these other income-
17 producing activities have all these HR
18 functions within them and HR support. And so
19 that would then be allocating back to then
20 their part of the HR function. The same thing
21 would be true with accounting or even my tax
22 function would be allocated in that general and
23 administrative.

24 Q: Okay. So would it be fair to say that this
25 column doesn't consider G and A to be income



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1 producing?

2 A: Right.

3 Q: And this column does?

4 A: Right.

5 Q: All right. Then what is the third column then?

6 A: And then the third column is more a cost of
7 performance that allocates a percentage against
8 the entire revenue nationwide and comes back
9 with -- with what we think would be the South
10 Carolina percentage. It has a much lower
11 percentage, but a much larger base. But
12 ultimately dollar-wise we were surprised that
13 there wasn't that great of a difference between
14 the different methodologies.

15 Q: Okay. And let's go back to the far left
16 column. What -- which it says at the top Dish
17 Network, South Carolina apportionment 2010
18 income-producing activity percentage analysis.
19 Don't give us a number, just tell us what's in
20 this column from here out.

21 A: So those were the items that we thought were
22 income-producing activities, and so the
23 different cat- -- and then how we captured
24 those activities. So that's programming and
25 content, satellites and uplink. I believe we



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1 included that one because the judge had said
2 the programming and the delivery of those
3 services were income-producing activities, we
4 had to include those. We included the
5 advertising. I think we would have included it
6 anyway, but the judge gave a specific footnote
7 and I think we followed that footnote in
8 deciding, you know, how to put the South
9 Carolina percentage in there. And then the
10 other categories were items that we thought
11 should be included as well. I think all of
12 those helped increase the amount that was being
13 allocated toward -- toward South Carolina, with
14 the exception of the call centers; that didn't
15 just because there's no call centers located in
16 the state of South Carolina.

17 Q: All right. So let's go start with the income-
18 producing activities and let's start at the
19 top, programming and content. That would be
20 the number on the far left at the very top, and
21 let's start with programming content
22 encompasses a variety of items, isn't that
23 correct, which is basic channels, premium
24 channels, etcetera?

25 A: Right. So that's what's broken out there. So



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1 we've got the cost of the basic channels, the
2 premium channels, the pay-per-view and the a la
3 carte. Then it also includes the local
4 channels related to the DMAs that are involved
5 in South Carolina. I think as was mentioned
6 before there's several DMAs that are purely
7 within South Carolina and then there's several
8 DMAs that are on cities that are on the border
9 of South Carolina. So I believe that what we
10 did was if the DMA was both within and without
11 South Carolina, we divided the cost based on
12 the number of counties that were serviced, that
13 came up with the amount that we thought was in
14 South Carolina ---

15 Q: Okay.

16 A: --- part of the numerator, the rest -- you
17 know, the total in the denominator.

18 Q: All right. So the high level, what was cost of
19 basic channels in 2010, which, Your Honor,
20 we're getting from the far right column. I
21 know this is very confusing. 3.4, that number.
22 So what's the cost and do y'all -- y'all each
23 have one, correct? Yeah. What's the cost of
24 basic channels in 2010?

25 A: So the cost of basic channels and -- and so



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1 we've got -- we've got, right, three different
2 columns here or three different analysis. And
3 so scenario one and scenario two, what's shown
4 there is the cost of basic channels that's just
5 related to South Carolina customers, and so
6 that would be the number that's 55 million .7.

7 Q: All right. Now where did you get the total 3.4
8 billion; where did that number come from?

9 A: So the 3.4 million is the number that's
10 reported in our 10-K and in the statement of
11 operations.

12 Q: Okay.

13 A: And then the 55 seven would be that times the
14 1.6 percent with South Carolina customers.

15 Q: All right. And so let's go to cost of premium
16 channels. What's the total cost of premium
17 channels across the country?

18 A: Across the country is the 671 number that
19 occurs ---

20 Q: 671 million.

21 A: 671 million.

22 Q: And where does that number come from?

23 A: Also the 10-K and the statement of operations.

24 Q: All right. And how much of that is in South
25 Carolina income-producing activity?



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- 1 A: And so we, for income-producing activity, we
2 multiply that times the 1.6 percent, that's the
3 percentage that we took in South Carolina.
- 4 Q: Okay. All right. And then let's take the next
5 number, cost of pay-per-view.
- 6 A: So ---)
- 7 Q: How much do you spend across the country on
8 pay-per-view?
- 9 A: So 141 million is what we pay across the
10 country, and then the 1.6 percent would be the
11 2.29 million number.
- 12 Q: All right. And the -- where did you get that
13 cost of pay-per-view?
- 14 A: It's kept separately in the statement of
15 operations.
- 16 Q: All right. And what is the local DMA
17 programming number?
- 18 A: Okay. So here this is different, and so the
19 135 is the cost around the nation for those
20 local channels ---
- 21 Q: 135 million.
- 22 A: Right. But the 27 is just the cost related to
23 the seven DMAs that are -- that are -- that
24 affect South Carolina. It's 100 percent of the
25 cost if the DA is completely in the state of



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1 South Carolina and if it's a DMA that's both in
2 South Carolina and another, we took the total
3 cost and we allocated it based on the number of
4 counties served.

5 Q: Okay. So two million 708 -- 2,708,000 you
6 attributed or allocated or apportioned all of
7 that to South Carolina; is that correct?

8 A: That's correct.

9 Q: And what does that 2.7 million figure
10 represent? Who did you pay that too

11 A: So we would have paid those to, you know, the
12 local stations that operated in each of those
13 DMAs.

14 Q: Okay. And trying to pick up the pace here a
15 bit. Satellites and uplink, the first number
16 is satellite transponder lease expense, what is
17 that number nationally?

18 A: So that's the national number allocated back a
19 percentage ---

20 Q: What is the national number?

21 A: National number is the 216 million .6.

22 Q: And where did you get that number from?

23 A: That's from 10-K and the statement of
24 operations.

25 Q: Okay. And does that -- what is attributed to



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1 South Carolina?

2 A: So we -- based on the percentages of
3 subscribers, we said the 3.5 million number.

4 Q: Okay. And did you -- in the interest or time
5 we're trying to speed this up a bit. Did you
6 calculate satellite and transmission expenses
7 and satellite depreciation the same way?

8 A: In the same way from the same sources.

9 Q: Okay. Then at the bottom, local uplink
10 expenses. What do you spend on local uplink
11 expenses around the country?

12 A: So the total -- the total amount is -- is the
13 billion 05 -- the billion 0 five four.

14 Q: All right. And where did you get that number
15 from?

16 A: That is from our financial statements, as well.

17 Q: Okay. And how much of that did you attribute
18 to South Carolina or apportion to South
19 Carolina?

20 A: So the South Carolina piece here is just what
21 relates to the local DMAs. And so that
22 equipment that we use to upload the signal from
23 the local DMAs and send it to a regional
24 center, that's what's involved there.

25 Q: Okay. So 100 percent of that -- I'm sorry --



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1 the four million 118, is that a percentage or
2 an actual ---

3 A: That's -- that's everything in South Carolina.

4 Q: Okay. But did you calculate it by a percentage
5 or is that just the actual checks you sent to
6 South Carolina companies?

7 A: That -- actual cost in South Carolina.

8 Q: All right. The advertising, you've got two
9 kinds of advertising, retention marketing and
10 subscriber acquisition. Very briefly, what's
11 the difference between those two?

12 A: Retention is trying to keep the customers that
13 we have; subscriber acquisition is trying to
14 get new subscribers.

15 Q: Okay. And -- well, let's go over retention
16 first. What items are included in retention,
17 just the names, the types of ad ---

18 A: So we use direct mail, we use cross channel, we
19 use statement marketing. We have a small other
20 category.

21 Q: And what is cross channel?

22 A: So cross channel -- give me a sec.

23 Q: Well, that ain't a big number. What's
24 statement marketing?

25 A: Okay. So we'll sit there and try to put some



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1 -- you know, people are reading their bill,
2 we'll try to do some advertising in the
3 statement.

4 Q: Oh.

5 A: And then also when a customer kind of calls
6 about their bill we'll try to sit there and
7 sell them something.

8 Q: Okay. And so what's subscript -- subscriber
9 acquisition marketing?

10 A: So that -- that's where we're trying to get the
11 new -- the new customers.

12 Q: All right. And how do you do that? What items
13 -- through what items?

14 A: So direct mail, print advertising, grand TV, VR
15 TV, radio, billboards, digital and through
16 third-party marketing.

17 Q: Okay. And the numbers -- to speed it up a bit
18 -- the numbers on the far right, the national
19 numbers, where do they come from when you spend
20 on direct mail across the country nine million
21 bucks?

22 A: So we went directly to our advertising
23 department that's responsible for the
24 advertising expense and the -- and the P&L and
25 asked them for the detail related to this time



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1 period.

2 Q: And would the same apply to subscriber
3 acquisition marketing?

4 A: Yeah. The -- the whole bit.

5 Q: All right. And those numbers all came out of
6 the -- where did the -- the national -- I think
7 you already answered this -- but where do the
8 national numbers come from?

9 A: So they're -- they're the numbers that are in
10 our financial statements in our accounts for
11 advertising. But we went and got the detailed
12 break down from the actual department
13 responsible for that, the advertising.

14 Q: Okay. And on your chart, your income-producing
15 activity, you put all of the advertising
16 dollars into the South Carolina column, meaning
17 they'll be tax -- increases your taxes. Why
18 did you do that?

19 A: We basically did that because of the footnote
20 reference in the *DIRECTV* case. And he made
21 reference to, I believe, a Wisconsin case, but
22 that's what they did in the Wisconsin case.
23 They sourced it and said that -- that it really
24 didn't matter where the money was spent, but it
25 depended where the customer was that was being



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1 advertised to. And so it allocated 100
2 percent, and even know that hurts our fraction,
3 we were trying to figure out what the judge had
4 said in the court case, and that's what he
5 said.

6 Q: All right. And just real briefly, direct mail,
7 where is that letter, you know, printed? I get
8 them all the time and I'm a customer. You
9 ought to weed them out and save yourself a few
10 bucks. But where is that letter with the huge
11 Dish network on the envelope, where is that
12 letter actually printed?

13 A: So we can buy that service from a lot of
14 different places, but ---

15 Q: Uh-huh. Mail order houses?

16 A: Right. So we do -- we do buy it from mail
17 order houses, but we don't buy any of them in
18 South Carolina. So they're actually dropped in
19 the mail someplace else but end up in your mail
20 here in South Carolina.

21 Q: Okay. All right. Then print advertising would
22 be what, magazines, newspapers or ---

23 A: So that -- that would be where we pay. We
24 usually buy that at a national level. The
25 stuff that's done by the -- that we reimburse



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1 the local retailers is the one that's on the
2 line that says third-party marketing.

3 Q: Okay. And is radio South Carolina radio or
4 Sirius radio or national radio or ...

5 A: So this would be we buy from different radio
6 networks and we purchase it from advertisement
7 agencies I think primarily in New York City,
8 but yeah, some of the spots that they sell are
9 in North Caro- -- are in South Carolina radio.

10 Q: All right. And just picking up the two biggest
11 numbers so we can move on. The two biggest
12 numbers are -- let's see here -- are DR TV.
13 What is that?

14 A: So we buy advertisement on other TVs. I think
15 that's be -- to be contrasted to brand TV, the
16 number that it's above. So my understanding,
17 I'm by no means the advertising expert, but my
18 understanding is that -- that one, the second
19 tries to get you to buy something right away.
20 So it's the -- you know, the example would be
21 the crazy Eddie type ads or things like that.
22 whereas brand is more trying to build a
23 positive relationship with the brand and make
24 you think positively about it, and then
25 hopefully indirectly that will involve your



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1 decision. So we had done some ---

2 Q: Is that one of those ads that get on my nerves
3 because they don't even have the product in the
4 ad?

5 A: Yeah, so we -- we had done some ---

6 Q: Usually got a puppy or a nut or something like
7 that, but none of them have the product ---

8 A: We had done one with these Boston guys that
9 spoke with a Boston accent; it didn't really
10 tell you anything else, but it somehow
11 attracted a subsection of the population that
12 likes Boston accents.

13 Q: All right. Let's go to, in interest in time,
14 moving on, subscriber equipment, you've got 800
15 and -- and what is it -- expense of subscriber
16 equipment across the country.

17 A: Yeah. So these kind of next few, like this has
18 nothing to do with the revenue, at least income
19 that we earn from customer equipment. We've
20 already sourced that 100 percent in the revenue
21 number. But what this would do is say what is
22 the cost involved and how does that cost affect
23 the programming? And so we put that all in the
24 South Carolina cost -- but that is the
25 equipment that is in South Carolina. And same



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1 thing would be true with the installation or
2 the in-home repairs, that is the cost related
3 to those items in South Carolina.

4 Q: Okay.

5 A: And all those, you know, increase it. We don't
6 have costs by every -- we don't have exact
7 costs for each in-home repair or each
8 installation visit. So what that department
9 does is the average cost is \$140 for a truck
10 roll, and so they allocate it based out on
11 number of truck rolls times the 140 percent.
12 And that's how they allocate it nationwide.

13 Q: Okay. So subscriber equipment, how much do you
14 have in South Carolina?

15 A: So we -- so related to the South Carolina truck
16 rolls, 100 percent in the numerator and 100
17 percent in the denominator.

18 Q: Okay. So but what is the actual dollar there
19 though?

20 A: Oh, sorry. So for the in-home repair for the
21 ---

22 Q: Well, subscriber equipment.

23 A: I'm sorry. Subscriber equipment's the 13
24 million three.

25 Q: And is that -- is that an actual South Carolina



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- 1 number or bigger number multiplied by a
2 percentage? Is that what you actually ...
3 A: That's the actual number.
4 Q: Okay. So you knew -- obviously you know the
5 numbers of South Carolinians subscriber
6 equipment ---
7 A: Yeah.
8 Q: --- correct?
9 A: Right.
10 Q: So you took it and you know roughly how much it
11 costs every time you go in there, correct?
12 A: Right. So we've got ---
13 Q: So you were able to produce the South Carolina
14 number?
15 A: Yeah.
16 Q: All right. How about installation?
17 A: So the installation and the in-home repair,
18 that's the ones that's based on the number of
19 truck rolls. So we have the actual number of
20 truck rolls related to each of those, and it
21 was times \$140 per truck roll.
22 Q: So that's the actual South Carolina number,
23 correct?
24 A: That is the way that department does it. They
25 don't judge the difference between a trip,



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1 whether it took three hours or two hours.

2 Q: All right. And the call center, what's the
3 national call center expense?

4 A: So that's everything that we spend on call
5 centers nationwide is a billion 113.

6 Q: Okay. That sounds a bit pricey.

7 A: We invest a lot of money there.

8 Q: All right. And then what percentage of call
9 centers is in South Carolina?

10 A: That would be based on the percentage of South
11 Carolina subscribers, and so that's that 1.6
12 percent.

13 Q: All right. And then there's no -- on the far
14 left column, there's no G&A expense in that
15 column, correct? None of that is -- we don't
16 consider that column, that to be an income-
17 producing activity?

18 A: Far left would be if the judge -- the judge was
19 just silent on this issue, and so that would be
20 the way if he said it wasn't an income-
21 producing activity.

22 Q: All right. And the only difference between the
23 right and the left column is that income-
24 producing activity is in the right column, it's
25 not in the left column, correct?



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1 A: And the thought being that if the judge had
2 said we should have included those expenses or
3 a portion of those expenses related to each of
4 the departments above, that's how it would have
5 looked.

6 Q: Okay. And then so the corporate G&A, how much
7 was corporate G&A?

8 A: So the corporate G&A total nationwide is that
9 625 million.

10 Q: And where does that number come from?

11 A: So that -- that is from our 10-K.

12 Q: And how about what are litigation expenses?

13 A: Part of our legal -- legal department expenses.
14 We tend to be involved in a lot of litigation.

15 Q: Okay. Two hundred and twenty-five million
16 dollars worth?

17 A: Seems like a lot of money to me.

18 Q: All right. And then so that -- that has given
19 us the first two columns. Now based upon your
20 -- let's go over the first column, which we
21 said closely tracks the *DIRECTV* decision the
22 best we could. If you'll quick -- well, let's
23 come back to 2010 on that. We'll go through
24 that in a minute. But I notice in this
25 methodology you would owe tax the first three



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1 years and you'd be entitled to a refund the
2 last three years. Do you know why it shifts
3 from a liability to a refund? It's the exact
4 same methodology, but what has changed in those
5 years; do you know?

6 A: So I think the biggest difference is whatever
7 was that original return that was filed we
8 would have made payments with that original
9 return. And so if there's something that then
10 later came on that would have reduced the tax
11 liability ---

12 Q: Okay.

13 A: --- whether it was the amended federal return
14 or the RAR ---

15 Q: Right.

16 A: --- that would be the amount that we were owed
17 back.

18 Q: All right. So let's go to the far right
19 column, South Carolina Cost of Performance
20 Calculation. And it looks almost identical to
21 the far left column except for G&A ---

22 A: So I think -- I think what this would show is
23 that -- you know, I think we said at the
24 beginning we didn't agree with the DIRECTV's
25 case. This would be the straight cost of



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1 performance. And under straight cost of
2 performance we would think that the state owes
3 us back \$867,000 as opposed to their contention
4 that we owe them 1.2 million. But I think what
5 was interesting here is that when we did it
6 under these various scenarios, the amount that
7 we thought that we were owed by the states
8 didn't change by a whole lot. It's not that
9 big a difference ---

10 Q: Right.

11 A: --- between the two different methodologies.

12 Q: And it looks like it's a far -- far left column
13 on the bottom, far one on the bottom there,
14 that says "Audit Assessment" and that's what
15 the DOR has sent you a bill for; is that
16 correct?

17 A: That's correct.

18 Q: Okay. That's what we're fighting about in this
19 case, correct?

20 A: Right. They say that we owe them a million
21 two.

22 Q: All right. So in 2005, '06, and '07, they say
23 you owed them money. They agreed in 2008 and
24 '09 you were entitled to a refund?

25 A: And a small amount in '10.



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1 Q: Yeah, then a very -- very small amount, just
2 \$26,000 in '10. So it looks like the big
3 dollars in their proposed assessment is 2005,
4 2006; is that correct?

5 A: Correct.

6 Q: And which would be normally well outside the
7 three year statute of limitations, correct?

8 A: That's correct.

9 Q: All right. Now, let me ask you just a few real
10 minor questions about it. Why is subscriber
11 equipment -- why is subscriber equipment an
12 income-producing activity?

13 A: I think like ---

14 Q: I pay for it, don't I?

15 A: So we've included it in the calculation. A lot
16 of that was just more to find out what the
17 numbers were. I think -- you know, I think
18 it'd obviously be in the taxpayer's favor to
19 argue that it wasn't in this case, but I think
20 we used the box to do a lot more than just what
21 we leased the box for. It gives us the ability
22 to get the customer to pay the bill; it gives
23 the customer the ability to upgrade to a pay-
24 per-view movie at the last minute. And so
25 there is some functionality to the box that it



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1 does seem like it affects our ability to sell
2 the programming and the content. So we
3 included it in for purposes of the calculation.

4 Q: Okay. All right. In 2010, you did your 10-K,
5 obviously with no thought to the mighty DOR
6 when you wrote it; it's not self-serving. If
7 you'll look at page 13 of your 10-K and tell us
8 what it says, just very brief summary fashion,
9 regarding installation?

10 A: So I don't have a copy of the 10-K with me.

11 MR. ROURKE: And, Your Honor, it's on Defendant's
12 Exhibit 19 page Dish 1055 is what he's
13 referring to.

14 A: So for installation? For installation?

15 Q: Yeah. I'm sorry.

16 MS. WOOTEN: Which Exhibit are you referring to?
17 I'm sorry.

18 MR. MAYBANK: This is the 10-K.

19 ME. SHEERS: This is the 10-K.

20 MS. WOOTEN: Which number?

21 MR. ROURKE: Petitioner's Exhibit 19.

22 MS. WOOTEN: Thank you.

23 A: And so at the bottom it says DVSH 1056
24 installation. We incur significant up-front
25 costs to install satellite dishes and receivers



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1 in the homes of our customers.

2 Q: Yeah. Where it says high quality
3 installations, upgrades and in-home repairs are
4 critical to providing good customer service.

5 MS. WOOTEN: What page is reading from? I'm sorry.

6 MR. MAYBANK: That's 13, but sometimes our 13 and --

7 -

8 MR. ROURKE: It's 1056 Bates number.

9 MS. WOOTEN: Thank you.

10 MR. ROURKE: Bates number 1056, Petitioner's 19.

11 Q: Let me just get it real quickly just to try to
12 speed it up. Hang on here. Just in the
13 interest of time just so we can move on, what
14 did your 10-K say in 2010 about the importance
15 of installation?

16 A: It says high quality installations, upgrades
17 and in-home repairs are critical to providing
18 good customer service.

19 Q: Okay.

20 A: Such in-home services performed by both Dish
21 Network employees and network with independent
22 contractors. I think those, among other
23 things, priority technical support, replacement
24 equipment, cabling, power surge repairs all for
25 a monthly fee.



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1 Q: All right. And ...

2 A: It seems like that installation is one of the
3 keys in getting new customers, and kind of
4 mentioned before, somebody tracks in dirt on
5 your carpet it's going to sour the
6 relationship. I think right above it it also
7 talks about our customer retention, and there
8 it says we incur significant costs for
9 obtaining existing customers mostly by
10 upgrading their equipment to HD and DVR
11 receivers. I think if like an existing
12 customer is out past kind of like the bargain
13 part of the contract, we'll do things to kind
14 of sweeten the deal for them. And so sometimes
15 that involves giving them the next higher grade
16 of service; either if they had a smaller DVR,
17 giving them a bigger DVR, giving them whatever
18 has the next function that we want to sell to
19 them.

20 Q: All right. And let me ask you one last number
21 on chart, Jim, if I can get you to -- the
22 three. All right. Let me get all three,
23 actually if you go to -- yeah. That's fine.
24 All right. That's good enough. All right. At
25 the -- towards the bottom of the -- of the



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1 chart it says "Total" and then it says "South
2 Carolina Percentage." The total on the far
3 left column is 46,112,251. First of all, what
4 does that 46,112,521 mean?

5 A: So that 46 million would have been the
6 numerator that we would have used and the 140
7 would have been the denominator. And so that
8 comes up with this fraction that's 32 percent.

9 Q: All right.

10 A: So what we would have used that fraction for is
11 that -- that's what we would have said how much
12 of the income-producing activity was in the
13 state versus how much was elsewhere. We would
14 have then taken that number and multiplied it
15 times the revenue that we had from subscriber
16 revenue in the state of South Carolina, and we
17 would have said then in this next fraction, the
18 fraction that we used for apportionment, we
19 would have only included -- included 32 percent
20 of the South Carolina revenue in the South
21 Carolina numerator. I think then we would have
22 added that to all the other categories of
23 income that we had talked about before. And so
24 like, for example, the leasing income in South
25 Carolina is already in there 100 percent, the



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1 installation's already in there 100 percent,
2 the in-home services, and all that would have
3 made the numerator that then ultimately has
4 shown up as the South Carolina apportionment
5 for each of the years in the column on the
6 side.

7 Q: All right. And so scenario two, instead of --
8 the 46.12 is identical, so that part's
9 identical but what's different is the
10 percentage. See, it drops from 32.8 percent to
11 22 percent ---

12 A: So it's all that ---

13 Q: --- 22.79. Why has it dropped?

14 A: So all that G&A took place outside the state of
15 South Carolina, so when we add it into the
16 denominator, it brings the fraction down, not
17 by a huge amount, but three percentage points.

18 Q: Okay. And then the final far right column. So
19 we've gone -- we've gone -- these numbers are
20 considerably bigger -- this number has dropped
21 dramatically from 32 percent down to 0.49
22 percent. And how did that happen?

23 A: So I think this is just kind of mathematically
24 doing the two different calculations, and I
25 think they come out to very close to the same



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1 numbers, just a different order that you do it.
2 When we did the cost of performance
3 methodology, we ended up coming up with a much
4 lower percentage that was in South Carolina.
5 But when you took that much lower percentage
6 and then multiplied it by the sales -- the
7 subscriber revenue that was everywhere, you
8 came up with a number. And when we did it
9 using this income-producing activity
10 methodology, we came up with a higher
11 percentage up front. But then when you
12 multiplied it by a lower number, it ends up
13 that the result, the product ended up being
14 very, very close. And so therefore, it's
15 impact on the South Carolina apportionment
16 wasn't that different.

17 Q: Okay. If we look at the bottom line -- if
18 you'll move that over. The bottom line is
19 whether we owe the DOR or the DOR owes us.
20 There aren't any -- and the number I'm looking
21 at is at the very, very bottom row there. So
22 those numbers are what under our three
23 scenarios we owe the DOR or the DOR owes us.
24 And they're actually not that different, but
25 the first scenario under IPA, South Carolina



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1 investment income-producing activities is
2 2,121,000, correct?

3 A: That's correct.

4 Q: And then where we added G&A in, meaning we
5 added in general overhead, it only dropped the
6 number really to 2,180,000?

7 A: Which is almost nothing, particularly if you
8 divide it by the number of years you owe.

9 Q: Right. And then lastly under traditional cost
10 of performance we say -- 26 -- actually, I
11 think I might have misspoke on the numbers
12 because the numbers we're actually looking at
13 are that one, that numbers are -- are totals.
14 So for 2010 under South Carolina income-
15 producing activities, we say we're entitled a
16 refund of 211,000 under the *DIRECTV* decision;
17 is that correct?

18 A: For '10, yes.

19 Q: Okay. And then for '10 under the IPA that
20 includes corporate headquarters, our refund
21 would be 220,000?

22 A: That only 10,000 difference, yes.

23 Q: Okay. And then under traditional cost of
24 performance, it'd be 216,000?

25 A: Right.



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1 Q: All right. And under their market share they
2 -- we only owe 24 grand 2010, according to
3 them?

4 A: I think 26 is what we've got on the chart.

5 Q: Okay. Twenty-six. All right. That might be
6 it from me on the questions.

7 MR. MAYBANK: All right. Your Honor, we move this
8 chart into evidence.

9 MS. WOOTEN: Your Honor, we object on several
10 different grounds. First, the witness did not
11 actually prepare this document and did not
12 gather the information. Also, petitioner is
13 claiming that scenario one and two are based on
14 the *DIRECTV* decision, but the *DIRECTV* decision
15 did not include income activity -- or income-
16 producing activities of satelink (sic) and
17 uplink and some other categories on the other
18 side. We also don't think it's relevant
19 because petitioner didn't file any tax returns
20 in accordance to the *DIRECTV* decision. And for
21 the third scenario, none of their tax returns
22 filed, original or amended, line up with these
23 figures on the other side. It doesn't reflect
24 a position on any of the tax returns filed.
25 Also, it's not reliable because it has some



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1 assumptions for 2005, 2006, '07, '08 and '09.
2 These numbers are from 2010 and yet they've got
3 liability refund and a portion of percentages
4 on the bottom of the chart related to years
5 that numbers are not reflected. So there's
6 some assumptions made to those numbers that
7 aren't on this piece of paper. And, again, we
8 would just say that number three would be
9 cumulative evidence because you have the tax
10 returns in evidence and these -- the scenario
11 three does not reflect any position taken on
12 those returns.

13 **MR. MAYBANK:** Your Honor, we would say that -- she
14 has so many objections I don't remember them
15 all. But primarily, it would go to the weight
16 of it, not the admissibility of it. If the
17 chart is wrong, that's not -- that's not a
18 reason not to let it into evidence, that's a
19 reason for you to discount it or -- perhaps.
20 But that wouldn't go to ---

21 **THE COURT:** Mr. Maybank, let me just interrupt you.
22 I am going to allow you to -- I'm going to
23 admit this into evidence. Ms. Wooten can
24 address all of her objections on the
25 reliability of the document during her cross.



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1 MS. WOOTEN: Thank you, Your Honor.

2 THE COURT: Thank you.

3 (Petitioner's Exhibit Number 36 was admitted into
4 evidence.)

5 Q: All right. We're going to go quickly into the
6 last part of it, which is how all of this
7 evidence goes on to whether we're owed dough or
8 whether we owe them dough. All right. So
9 let's try and translate this into your state
10 taxes owed. Again in the interest of time
11 we'll stick with 2010. First, how much does
12 the DOR say you owed in 2010?

13 A: I believe 26,000.

14 Q: All right. What do you say the taxes are owed?

15 A: I believe there -- we thought that we were
16 entitled to a refund under COP methodology of
17 216.

18 Q: Okay. But under the -- our version of the ---

19 A: Under this IPA it would be 211.

20 Q: Okay. And so tell us how you calculated that.
21 First, what is your South Carolina numerator?

22 A: So I believe these numbers are in the brief.
23 Am I allowed to look at the brief or ...

24 Q: Well, let me just ask you, is your numerator --
25 you used 98 million in your numerator?



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1 A: Yes. We used 98 million in the -- in the
2 numerators.

3 Q: And how'd you calculate the 98 million? Did
4 you add two numbers together?

5 A: Yeah. So about 53 of it would have been all
6 the other income that's not at -- in dispute,
7 and then the remainder would have been the
8 piece that's related to South -- subscriber
9 revenue in South Carolina and whether it's COP
10 or whether it's under the market share basis.

11 Q: Okay. So 98 million is composed of 53 million
12 and 45 million added together, 98?

13 A: And the 45 is the subscriber revenue.

14 Q: Okay. And the 53 million, we all agree to
15 that. There's been no argument about that,
16 correct?

17 A: Yeah.

18 Q: It's only the 45 that we're quarreling about?

19 A: Correct.

20 Q: All right. So that adds up to 98 million. Oh,
21 and just real quickly, give me some examples of
22 what goes into the 53 million that we're not
23 arguing about.

24 A: So I believe the biggest piece there would be
25 the lease revenue related to South Carolina.



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1 And so, therefore, we sourced that based on
2 where the customer was that was leasing it.
3 That's 100 percent South Carolina.

4 Q: All right. So how did you calculate the 45
5 million that we're quarreling about?

6 A: So the 45 would have been to take the entire
7 amount of South Carolina subscribing revenue
8 and then multiply that by the 32.8 percent,
9 which is in the first scenario up here on the
10 sheet that's on the screen.

11 Q: So the 137 million represents the total -- our
12 total revenue in South Carolina, correct?

13 A: Our total subscriber revenue in South Carolina.

14 Q: Right, total subscriber. And you multiply it
15 by -- that by 32 percent and where did you come
16 up with the 32 percent just so we're all
17 educated.

18 A: So that was us trying to follow the judge's
19 decision in the *DIRECTV* case and doing a split
20 between income-producing activities both within
21 the state and outside of the state.

22 Q: Okay. Well, 137 million times 32 percent
23 equals what, 45 million?

24 A: That was 45 million.

25 MS. WOOTEN: Leading. Objection. Sorry.



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1 THE COURT: Sustained.

2 MR. MAYBANK: I'm sorry?

3 THE COURT: Sustained. Her objection is sustained.

4 Q: All right. Well, then we'll get a calculator
5 out here. We'll just go in out here and do
6 every percentage you want. Do you have a
7 percentage -- a calculator on you?

8 A: I do not have a calculator on me.

9 Q: All right. Let me pull it up here. We'll go
10 ahead and -- do you know where the calculator
11 is on this thing? And what you'll be
12 multiplying is a 137 million times 32.8
13 percent, so that I won't be leading the
14 witness. All right. So what's 32 percent of
15 137? What's 33 percent of 137?

16 A: So 137 times -- what the 32.9 -- 32. around 87?
17 And so that's the 45 million that we're talking
18 about.

19 Q: Okay.

20 A: That gets added to the 53 and then that becomes
21 the numerator.

22 Q: All right. The 98. All right. What's your
23 denominator?

24 A: And so the -- the denominator for that would be
25 the revenue everywhere, and then that's what



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1 should give us the 7374 -- .7374. It shows the
2 South Carolina apportionment factor for 2010.

3 Q: Okay. Let me stop you there.

4 MR. MAYBANK: Did we -- and we have for our DOR, did
5 we assign an exhibit number?

6 COURT REPORTER: Is that the next number?

7 MR. MAYBANK: Yeah.

8 COURT REPORTER: It's not marked already, right?

9 ME. MAYBANK: Huh?

10 COURT REPORTER: Okay. It's 36.

11 A: So that's in Exhibit 36.

12 Q: All right. So your final South Carolina
13 apportionment percentage was 7374, did you say?

14 A: .7374 is what's shown here. So that ---

15 Q: All right. And how did you calculate that?

16 A: So I believe it's the year where we only have
17 sales factor. So that would be the \$93 million
18 number ---

19 Q: Or 98 million?

20 A: Ninety-eight million dollar number divided by
21 the denominator.

22 Q: Which would -- the denominator would be 13.3
23 billion?

24 A: Yes. It's the nationwide number.

25 Q: All right. So you've got a percentage. What



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1 income are you applying the apportionment
2 percentage against to arrive at your taxable
3 income?

4 A: So it would be federal taxable income with
5 South Carolina adjustments. So then that's the
6 number that we would need to apportion. We'd
7 multiply that times this apportionment rate,
8 the .7374. And we came up with a tax
9 liability, and I'm thinking it was like 422,000
10 or so.

11 Q: Okay. But getting there one step at a time,
12 you said the federal taxable income was a
13 billion comma 087?

14 A: Okay.

15 Q: All right. And what is the difference between
16 that -- we've always been talking about 13
17 billion, now we've dropped to one billion.
18 What is the difference between the two?

19 A: So before when we were doing the apportionment
20 factor we were doing the revenue number that
21 was in the return. Obviously the revenue
22 number is going to be a lot larger than our
23 taxable income.

24 Q: Okay.

25 A: Then we would deduct all the expenses that we



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1 were allowed and come up with the taxable
2 income, the billion dollar number that we just
3 mentioned ---

4 Q: Okay. So 13 billion is gross sales -- gross
5 revenue?

6 A: Everything we sold, no expenses.

7 Q: All right. And the one billion is what the fed
8 said that you owed?

9 A: That's ---

10 Q: I mean that's what you paid taxes on?

11 A: --- what they said our federal taxable income
12 was.

13 Q: All right. Does the DOR quarrel at the one
14 billion 1.087 number?

15 A: I don't think we had disagreements on the -- on
16 the base.

17 Q: All right. So that equals eight million
18 dollars and then what -- did you add EchoStar's
19 income on top of that?

20 A: Yeah. So for this year we not only had this
21 entity, but we also had an EchoStar entity
22 that's in the combined filing. So we added
23 their tax liability as well.

24 Q: Okay. So how much is 8,672,000? Eight million
25 ---



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- 1 A: I'm hoping it's 8,672,000.
- 2 Q: Okay. All right. So what's your next
3 calculation?
- 4 A: So that would have been taxable income, we'd
5 multiply it by the tax rate in the state. I
6 believe that's five percent.
- 7 Q: Well, didn't you have a NOL or ---
- 8 A: I'm sorry, that's right ---
- 9 Q: --- any other deductions?
- 10 A: --- we had about \$200,000 of NOL, so we would
11 have reduced taxable income by the NOL.
- 12 Q: All right. So what's 867 minus 200,000 then?
- 13 A: Roughly 8.4.
- 14 Q: All right. So what happens next then?
- 15 A: So then multiply it by the five percent tax
16 rate.
- 17 Q: All right. And what does -- what does that
18 equal?
- 19 A: That should be about 420,000.
- 20 Q: Okay. What's the next step?
- 21 A: I believe we're allowed a credit in South
22 Carolina that's equal to half our tax
23 liabilities. So that -- so the credit would be
24 half that number, but the amount of rate from
25 any tax would be half that number as well.



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1 Q: So that would be about 211?

2 A: So that's hopefully the 211 that's being shown
3 here.

4 Q: All right. Did the audit object to the
5 credits?

6 A: I don't believe there's been any objection to
7 the credits.

8 Q: All right. So what's the next step then?

9 A: Well, then you'd compare that against the taxes
10 we paid in and if we owed additional tax we
11 would owe the state. And I think in this case
12 they would owe us money back, according to our
13 -- this calculation.

14 Q: All right. And so what -- do you remember what
15 your estimated payments were?

16 A: They were in the 400,000 range.

17 Q: Okay. All right. So you owed 200, but since
18 you'd already made estimated payments of 400,
19 ss that what produced the refund?

20 A: The refund, yes.

21 Q: All right. I'm not going to go over all of
22 these laborious numbers through 2005 and '09
23 assuming they were prepared in the exact same
24 manner; is that correct?

25 A: They would be calculated in similar manner,



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1 yes.

2 Q: Okay. All right. We have no further questions
3 for this witness.

4 THE COURT: Okay. Ms. Wooten, before you begin your
5 cross, we'll take a ten-minute break.

6 MS. WOOTEN: Thank you, Your Honor.

7 (Break from 3:21 p.m. until 3:36 p.m.)

8 THE COURT: Okay. Ms. Wooten.

9 MS. WOOTEN: Yes, ma'am, thank you. May I approach
10 the witness, Your Honor?

11 THE COURT: I'm sorry?

12 MS. WOOTEN: May I approach the witness?

13 THE COURT: Oh, yes, you can.

14 MR. SHEERS - CROSS-EXAMINATION BY MS. WOOTEN:

15 Q: Mr. Sheers, I've handed you Respondents's
16 Exhibit 14. Do you recognize this document?

17 A: It looks like a request for a contested case
18 hearing form.

19 Q: Do you know what that is?

20 A: I know what form this is.

21 Q: Okay. Can you flip to the second page of that
22 exhibit, please?

23 A: Okay.

24 Q: If you will, please read the first line of that
25 paragraph.



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1 A: Dish objects to the inclusion of subscription
2 receipts as South Carolina sourced receipts.

3 Q: The next line, as well.

4 A: Dish contends the subscription related income-
5 producing activities are not performed in South
6 Carolina and their receipts from these
7 activities should not be sourced to South
8 Carolina for income tax or capital tax,
9 licensing fee apportionment purposes.

10 Q: So your position on the request for contested
11 case hearing is that no subscription receipts
12 should be sources to South Carolina; is that
13 correct?

14 A: So I believe that what had happened here was we
15 had taken the total subscription receipts and
16 already broken them into two categories, the
17 South Carolina piece and a non -- and a piece
18 that would not be South Carolina. And so --
19 and so this ended up mathematically with the
20 same result that we've been talking about, but
21 I think we just broke it into two pieces. We
22 treated the DMA separately from the non-DMA.

23 Q: Does that say that on this piece of paper?

24 A: No. I think this was just more objected to the
25 half of it.



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- 1 Q: And what's the date the request was filed?
- 2 A: Request is filed June 12th, '14.
- 3 Q: And this was after you filed all of the amended
- 4 tax returns in this case; is that correct?
- 5 A: I believe that's what the case is.
- 6 Q: I believe you testified earlier that the
- 7 correct apportionment method to use in South
- 8 Carolina is the gross receipts method; is that
- 9 correct?
- 10 A: For '10 subsequent, yes.
- 11 Q: For the entire audit period?
- 12 A: It's for the majority. I forget whether the
- 13 first year there were other -- there were other
- 14 factors as well.
- 15 Q: Okay. Bear with me just a moment while I find
- 16 my exhibit list. All right. If you will turn
- 17 to Exhibit Petitioner's Exhibit 1. Do you have
- 18 Petitioner's exhibits up there?
- 19 A: I believe so. Exhibit 1.
- 20 Q: What is this document?
- 21 A: So this is the tax return for the 2005 year.
- 22 Q: And if you will turn to Bate stamp 2369?
- 23 A: 2369.
- 24 Q: Look at Schedule H-1.
- 25 A: So Schedule H-1.



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1 Q: That's the four factor apportionment ratio,
2 correct?

3 A: Right. So ---

4 Q: And that's what you used on this tax return,
5 correct?

6 A: So for the first year, yes, it was four factor.

7 Q: You used four factor or it was four factor in
8 South Carolina?

9 A: I believe we used four factor, and I believe it
10 was four factor in South Carolina.

11 Q: And you never amended 2005; is that correct?

12 A: I don't know the answer to that. I don't
13 remember whether we amended 2005 or no. I
14 believe it was on the table in your brief. Am
15 I allowed to look at their brief?

16 Q: Sure. Sure. Well, not our brief. I'll show
17 you an exhibit. Respondent's Exhibit Number 1.

18 (Respondent's Exhibit Number 1 was introduced into
19 the record.)

20 Q: Was 2005 ever amended?

21 A: No, no, it wasn't.

22 Q: It was not. Thank you. All right. Let's go
23 to Petitioner's Exhibit 36. This is the -- I
24 believe it's been called the income-producing
25 activity chart. Is that what it was?



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- 1 A: Okay.
- 2 Q: The numbers in the three scenarios, the top
3 half of the box starting from programming
4 content down to call centers, all of the
5 numbers referenced, those are costs, right?
- 6 A: That's true, these are costs.
- 7 Q: So based on cost of performance?
- 8 A: Yeah, it's based on -- it's based on where the
9 cost of performance.
- 10 Q: And I believe you referenced earlier that a
11 percentage, specifically 1.6 percent of the
12 call centers were sourced to South Carolina
13 based on population percentage. Can you show
14 me where income was sourced to South Carolina
15 for call centers?
- 16 A: I don't -- I don't think -- so I think the
17 number that's showing up, the 16 million 685
18 number should be the 1.6 percent of the 1
19 billion 113 number.
- 20 Q: So the numbers are incorrect on the chart?
- 21 A: No, no. I believe that the number here, the
22 16685 is 1.6 of the total of a billion three.
- 23 Q: But that's included on the outside South
24 Carolina column; is that correct?
- 25 A: Right. So the amount of activities in the call



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1 centers that related to earning the subscriber
2 revenue in South Carolina, but it all was
3 incurred outside of South Carolina because
4 there was not a call center in there, in South
5 Carolina.

6 Q: And I guess let me back up and just ask a few
7 more questions, some preliminary questions.
8 You didn't actually prepare this document, did
9 you?

10 A: No, I did not personally prepare it.

11 Q: And no employee of the taxpayer prepared it,
12 correct?

13 A: I had employees involved, but we had hired
14 Deloitte and Touche to prepare it on our
15 behalf.

16 Q: And you had to have someone explain this
17 document to you; is that correct?

18 A: I think I described the document that I wanted
19 them to create. When they came back and
20 created the document, they did explain like how
21 they created -- created it to make sure it was
22 the document I had requested.

23 Q: All right. In scenarios one and two the
24 taxpayer is claiming that this is an accordance
25 with the ALC's decision in *DIRECTV*; is that



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1 correct?

2 A: We followed the judge's decision as best we
3 could. We would have obviously preferred to
4 have detailed instructions how to prepare it,
5 but we followed it as best we could.

6 Q: So, for example, programming content,
7 satellites and uplinks, taxpayer believe that
8 the *DIRECTV* decision said those were income-
9 producing activities?

10 A: We believe he did say that -- that the
11 programming customer paid for as well as its
12 delivery were income-producing activities.

13 Q: And for scenario three are you claiming -- is
14 the taxpayer claiming this is their final
15 position in this case?

16 A: I think what we tried to do is we tried to put
17 comparable numbers for the year together to
18 kind of show it. But yeah, it was -- it was
19 meant to match our final position, and kind of
20 say though that if you asked me what our final
21 position was I would have said it's the last
22 return that we filed in each of those years,
23 originals in, you know, '05 and '06 and the
24 last amended returns.

25 Q: Are the positions taken in scenario three



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1 exactly the same as the last amended -- the
2 positions taken on the last amended 2010
3 return?

4 A: They're not exactly.

5 Q: Are all the numbers with regard to 2010, did
6 you get those from tax year 2010, or did you
7 have to use other tax years to come up with
8 some of these numbers?

9 A: I think -- I think that everything we got from
10 the 10-K were from the operational statement
11 came straight from 2010 actual records we had.
12 I think there were some situations where when
13 we had gone back to the advertising department
14 that they had had stuff that was -- that was
15 like 2011 was the latest information that they
16 had.

17 Q: So you couldn't find all relevant information
18 for 2010 on this document; you had to use
19 another tax year's numbers?

20 A: When we filed this new methodology, we had to
21 go back and get information that we'd not
22 originally gathered in filing the original
23 returns and amended returns.

24 Q: Is there a similar chart for tax years 2005
25 through 2009?



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1 A: So I think we have similar calculations of
2 taxable income for each of the years. I don't
3 know that we have this amount of detail for the
4 -- for the percentages to apply.

5 Q: So you don't have the numbers to plug into
6 these categories for those years; is that
7 correct?

8 A: We had not gathered that.

9 Q: So for down at the bottom, tax years 2005
10 through 2009 you've got some numbers, liability
11 refund, apportionment percentages, you don't
12 have a chart with relevant information to back
13 up those numbers; is that correct?

14 A: We have the percentages we used for 2010. We
15 applied to the facts that were in those years.
16 We did not go back yet and do the actual counts
17 for each of those years.

18 Q: You believe the ALC's decision in *DIRECTV* was
19 neither cost of performance nor market based
20 but rather income-producing activity, correct?

21 A: That's correct.

22 Q: And you mentioned a second ago talking about
23 you pulled some of the numbers from the 10-K
24 for the far right-hand column on scenario
25 three. So let's take satellite and



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1 transmission expenses, the far total is 241
2 million; is that correct?

3 A: Two hundred and 41 million.

4 Q: Approximately, I'm rounding.

5 A: Right.

6 Q: And that is what you claim the 10-K represents
7 for satellite and transmission expenses?

8 A: It's information that came from the 10-K or the
9 statement of operations related to that.

10 Q: All right. If you'll flip to Petitioner's
11 Exhibit 25. Do you have that up there?

12 (Petitioner's Exhibit Number 25 was introduced into
13 the record.)

14 A: I don't believe I have 25.

15 Q: If you'll turn to page 96 of 189 in this
16 exhibit. Are you there?

17 A: I'm there.

18 Q: Okay. Can you tell me what the title of this
19 document is?

20 A: The entire document is our annual report for
21 2010. And the page 96 looks like it's the
22 Consolidated Statement of Operations and
23 Comprehensive Income Loss.

24 Q: And that's the document you were just
25 referencing when I asked you where some of the



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1 numbers in that right-hand column on scenario
2 three came from?

3 A: I think that this is the P&L that's included in
4 the annual report. I believe that there's a --
5 there's a greater level of detail that goes
6 down to the account by count basis that we call
7 our statement of operations. It's basically
8 this, if you need to peel down below this level
9 it's what we have.

10 Q: So for satellite and transmission expenses we
11 come over, and I believe these are in
12 thousands. So we add up these numbers 418, 39,
13 we get 894 million. I'm sorry, no.
14 Approximately 450 -- 58 million dollars; is
15 that correct?

16 A: So for satellite transmission expenses, 418 was
17 the first number, 418286 -- you want to add
18 that to ---

19 Q: 39, 776.

20 A: --- and 39 and the 776. Okay.

21 Q: So that's approximately 458 million?

22 A: Approximately.

23 Q: But yet you have 241 million on Exhibit 36?

24 A: Yeah.

25 Q: So that's incorrect. All right. Let's move to



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1 subscriber equipment. Let's go all the way to
2 the other side. We've got 822 million.

3 A: So which number to go to?

4 Q: Subscriber equipment. All the way to the far
5 right-hand side same column, 822 million. I'm
6 sorry. On Exhibit 36, the one page document
7 that was ---

8 Q: Oh, oh. Sorry.

9 A: Subscriber equipment, go all the way to the
10 end, 822 million; is that correct?

11 A: Yes.

12 Q: All right. Let's go over to Exhibit 25, same
13 document we were looking at, same page.

14 A: So the document that's in the 10-K, this is a
15 P&L at a very condensed level that rolls up a
16 whole bunch of expenses into one line. And I
17 believe that we don't separately report it
18 under SEC rules unless it makes up like five
19 percent of the separate balance. The statement
20 of operations I was referring to is this
21 statement of operations.

22 Q: Where is that?

23 A: So I believe that we've submitted this into
24 evidence, right?

25 MR. MAYBANK: That's what we gave you at the



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1 deposition and that's Number 13. I'm sorry,
2 Exhibit 13.

3 MS. WOOTEN: Number 13.

4 (Petitioner's Exhibit Number 13 was introduced into
5 the record.)

6 A: But it gives these numbers in an account by
7 account detail level. And that's where it came
8 from is the statement of operations.

9 Q: But this is an SEC filing, right, that has to
10 be correctly filed with the correct numbers?

11 A: That's true. So the sums that are in here with
12 greater level of detail are the numbers that
13 are included in here. This just has greater
14 level of account by account detail.

15 Q: So the 76 million on Exhibit 25 does not match
16 up with the 822 million reported on
17 Petitioner's Exhibit 36; is that correct?

18 A: So in the 10-K the account line that says that
19 it has other items included in it. So, yes,
20 the totals were not find in that case.

21 Q: Okay. And if you will refer to the total on
22 Exhibit Petitioner's 36, go to the total all
23 the way at the end, it's 9.3 billion; is that
24 correct?

25 A: Yeah.



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1 Q: And if you'll go back over to Exhibit 25 and
2 look at the total cost and expenses, it's
3 reported as 10.6 billion; is that correct?

4 A: That's right

5 MS. WOOTEN: That's all, Your Honor, from the
6 Department.

7 THE COURT: Mr. Maybank, do you have anything on
8 redirect?

9 MS. WOOTEN: Your Honor, may I ask one more
10 question, please, or a series of questions?

11 THE COURT: All right.

12 MS. WOOTEN: Thank you.

13 ME. MAYBANK: I should have hopped up quicker.

14 MS. WOOTEN: You should have.

15 Q: I believe you referenced earlier that Dish
16 Network has to pay for content providers such
17 as ESPN and Fox News; is that correct?

18 A: That's true. We have to pay the people that
19 provide us programming.

20 Q: And as far as that contract, you negotiate a
21 contract with or fee to pay to them; is that
22 correct?

23 A: That's correct.

24 Q: And I think you referenced 750 million for
25 ESPN?



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1 A: That was the amount we paid in 2010 to ESPN.

2 Q: And that number is represented by the number of
3 subscribers; is that correct?

4 A: I believe that number of subscribers is part of
5 the formula that calculates it. It's not the
6 only thing in the calculation.

7 Q: Thank you very much.

8 MS. WOOTEN: That's all, Your Honor.

9 MR. MAYBANK: I just have one or two questions.

10 MR. SHEERS - REDIRECT EXAMINATION BY MR. MAYBANK:

11 Q: She brought up some discrepancies or perceived
12 discrepancies between the 10-K and Petitioner's
13 Exhibit 13. The 10-K is actually a
14 consolidated financial statement, is it not?

15 A: That's correct.

16 Q: Okay. So there would be as many as 30 -- 30
17 subsidiaries listed in the 10-K? There's a
18 bunch of them, I know. But it's more than ten?
19 Would it be more than ten?

20 MS. WOOTEN: Objection, Your Honor. Leading.

21 THE COURT: Sustained.

22 Q: Do you know how many it would be, just what's
23 the minium number? Let me show you this, you
24 can probably find it a lot faster than me.
25 We'll just sit here and go through it. If you



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1 can find -- does that list the subsidiaries
2 there? I think it's a lot longer than that.

3 A: Yes, this is a list of subsidiaries. These are
4 actually two different 10-Ks that you've handed
5 me. This here is the 10-K for Dish Network
6 Corporation. And so we're required to file one
7 10-K a year because we're publicly traded, and
8 so it's the top company in -- in states. This
9 is consolidated Dish Network. The 10-K that's
10 here, that's Exhibit 25 ---

11 Q: Now, was that the one that she was asking you
12 out of?

13 A: That's the one that she was asking me about.

14 Q: Okay.

15 A: And this is also a 10-K that we filed, but it's
16 a 10-K for Dish DBS Corporation. It also was
17 a consolidated 10-K. But what happens is that
18 our bond debt is floated at a lower level than
19 our top company, and so we're required to
20 prepare two sets of financial statements for
21 the SEC each year, one for the -- one for our
22 shareholders and then the one for the bond
23 holders as well. This has DBS Corporation is
24 the top corporation, which is the entity that
25 is subject to tax in South Carolina. But it



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1 also consolidates other subsidiaries that are
2 not in our -- in our return in South Carolina
3 as well. And so it -- it has subsidiaries that
4 are below DBS that are owned by DBS, but
5 because we don't file a consolidated return in
6 South Carolina, those numbers are not included
7 in our numbers. We only included the DBS
8 parent company, which is the entity subject to
9 tax that we've been talking about.

10 **MR. MAYBANK:** We have nothing further, Your Honor.

11 **THE COURT:** Thank you, Mr. Sheers.

12 **ME. SHEERS:** Yes, ma'am.

13 **ME. MAYBANK:** We had just one further witness. Did
14 y'all ---

15 **MS. WOOTEN:** Yes. Your Honor, we have a witness
16 that has a travel arrangement conflict, and we
17 have asked petitioner and they have agreed to
18 allow us to call that witness today and
19 possibly finish up cross tomorrow if need be if
20 Your Honor is okay with that.

21 **THE COURT:** How long do you think your direct is
22 going to take with this witness?

23 **MS. WOOTEN:** I would hope not more than 45 minutes,
24 Your Honor.

25 **ME. MAYBANK:** Your Honor, there's no objection. We



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1 didn't actually bring our stuff for cross-
2 examination. So if you had no objection, she
3 would put him up for a direct today and then I
4 would cross-examine him first thing in the
5 morning. Obviously, cross-examination could be
6 much shorter and he would be out of here.

7 **THE COURT:** The reason I was asking that is because
8 I really wanted to conclude the hearing for
9 today ---

10 **MS. WOOTEN:** Okay.

11 **ME. MAYBANK:** All right.

12 **THE COURT:** --- and resume it tomorrow morning. If
13 you all would like we can start earlier than
14 10:00. We could actually start about 9:30,
15 something like that.

16 **ME. WOOTEN:** Your Honor, if we could start at least
17 by 9:00, if possible.

18 **THE COURT:** Okay. That's fine.

19 **MS. WOOTEN:** It's Dr. Harrison; he's our economics
20 expert. He has a flight and he has to leave
21 Columbia by 10:30, so we would need ---

22 **THE COURT:** Oh.

23 **MS. WOOTEN:** He has a flight in Columbia Airport and
24 he needs to be there -- be out of the courtroom
25 by 10:30.



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1 THE COURT: By 10:30?

2 MS. WOOTEN: And that's why we were -- the situation
3 arose. His flight got changed, or a previous
4 flight was canceled and a new flight time was
5 arranged and that's causing the conflict.

6 THE COURT: Okay. In that case ---

7 MS. WOOTEN: So, we can start at 9:00 if, you know,
8 if you're okay with that or we can get through
9 at that time.

10 THE COURT: Nine is fine with me. We were here
11 until 6:30 last night for a hearing.

12 MS. WOOTEN: I'm sorry.

13 MR. MAYBANK: Must have been a liquor case, an ABL.

14 THE COURT: So what we'll do is we'll adjourn the
15 hearing for today. We'll pick up with your
16 witness at 9:00 a.m. in the morning.

17 MS. WOOTEN: Okay. Thank you, Your Honor.

18 THE COURT: Thank you.

19 DAY 2 - THURSDAY, SEPTEMBER 24, 2015:

20 THE COURT: Okay.

21 PROFESSOR GLENN W. HARRISON, being duly sworn,
22 testifies as follows:

23 MS. WOOTEN: Good morning.

24 DR. HARRISON: Good morning.

25 MS. WOOTEN: I'm sorry, are you ready to begin, Your



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1 Honor?

2 THE COURT: Yes.

3 MS. WOOTEN: Okay.

4 PROFESSOR HARRISON - DIRECT EXAMINATION BY MS.
5 WOOTEN:

6 Q: Okay. Could you please state your full name
7 for the record?

8 A: Glenn William Harrison.

9 Q: And do you prefer to be called Dr. Harrison or
10 Professor Harrison?

11 A: Professor is fine, thanks. That's the way you
12 treat law professors.

13 Q: Professor Harrison, where are you currently
14 employed?

15 A: I'm a professor at Georgia State University.

16 Q: Are you employed anywhere else?

17 A: No, but at Georgia State I hold two positions.
18 One is the C.V. Starr Chair in Risk Management
19 and Insurance. It's an endowed chair in the
20 Department of Risk Management and Insurance in
21 the College of Business, the Robinson College
22 of Business. I'm also the Director of CEAR,
23 the Center for the Economic Analysis of Risk.

24 Q: Okay. Let's take those two positions
25 separately. What's the nature of the work you



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1 perform as the C.V. Starr Chair in the
2 Department of Risk Management and Insurance?

3 A: Well, that would be teaching and research in
4 the field of risk management and insurance,
5 which is a very broad field that spans
6 economics, finance, accounting and the law,
7 because we have some lawyers in our department.

8 Q: And what is the nature of the work you perform
9 as director of the Center for the Economic
10 Analysis of Risk at Georgia State University?

11 A: Well, as the title director of research there
12 I direct a program there. And CEAR is a
13 center, an interdisciplinary center that spans
14 the department of economics, which is in the
15 Andrew Young School that's not in our college.
16 It includes the school of accounting, which in
17 our college; it includes the department of
18 finance, which is in our college; and the
19 department of risk management and insurance,
20 which is in our college. It also includes the
21 research department of the Atlanta Federal
22 Reserve.

23 Q: And what are your primary areas of research?

24 A: My primary areas of research are behavioral
25 economics, they are environmental economics,



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1 international trade, risk analysis, risk
2 management at the moment, but they're varied
3 over the years.

4 Q: And what are your primary areas of teaching?

5 A: Primary areas of teaching right now are
6 econometrics and statistics and theory of risk
7 and in behavioral finance.

8 Q: And can you name some of the titles of the
9 classes that you teach?

10 A: That I currently teach or that I have taught?

11 Q: That you have taught or currently teach.

12 A: Oh, well, just reading from my C.V. ---

13 Q: Sure.

14 A: --- which is Exhibit 5, Respondent's Exhibit 5,
15 my teaching fields over my career have included
16 microeconomics, econometrics, game theory,
17 industrial organization, environmental
18 economics, law and economics, international
19 trade, and development economics. Now, they're
20 topics that I have taught over the 30 years or
21 so that I've been a professor.

22 (Respondent's Exhibit Number 5 was introduced into
23 the record.)

24 Q: What is applied economics?

25 A: Economics, applied economics is that part of



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1 economics that uses theories from economics but
2 applies them, whether it's in environmental
3 economics, it's in international trade, it's in
4 public finance or in applications to the law.
5 So it uses economic theories and ties them to
6 real world data and activities that you see in
7 the economy usually using statistics. That's
8 usually a featured of applied economics.

9 Q: What is a form 10-K?

10 A: Form 10-K is a required filing certainly for
11 public companies in the United States. It's an
12 annual filing that they produce. They produce
13 a quarterly filing called a 10-Q three times
14 through the year and then once the -- they
15 produce the 10-K. It's meant to be a summary
16 of the activities of the company. It includes
17 profit and loss data, it includes balance
18 sheets, it includes statements about risk
19 factors and what's going on in the company.
20 And most importantly it is -- it has to be
21 prepared using financial accounting principles,
22 consistency with generally accepted accounting
23 principles.

24 Q: Why would an economist review a 10-K?

25 A: We would review it in order to understand the



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1 structure of firms. That's particularly in the
2 field of industrial organization. But any time
3 that you're dealing with the behavior of firms
4 you might be interested in the nature of the
5 business, you might be interested in the risk
6 factors that they face. Certainly since I'm a
7 professor interested in risk management, the
8 10-K is a place where the company often has to
9 talk about risk factors that are -- that could
10 affect its performance in coming years so that
11 shareholders are appraised of those. And of
12 course we look at balance sheets and we look at
13 profit and loss statements as a normal course
14 of trying to understand the behavior of firms.

15 Q: Does the 10-K include a description of the
16 business?

17 A: Yes, it does usually. Usually a fairly
18 complete description.

19 Q: And why would you want to look at that
20 description of the business as an economist?

21 A: Oh, because that way you have an understanding
22 as to how the firm sees itself. And very often
23 one of the things that one has to be a bit
24 careful about is whether a company is just a
25 holding company, in effect it does a lot of



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1 different things so that it's not just in one
2 industry or another industry. It might appear
3 as if it's in one industry, but it could be
4 producing products in a whole range of
5 industries. We have what's called horizontally
6 integrated firms, conglomerates, for example.

7 Q: And why would you look at the financial
8 information of the business?

9 A: Well, the financial information tells us where
10 its revenues are coming from and it tells us
11 where its costs are coming from so we get an
12 idea of the nature of the business. Is it a
13 service business or is it producing good; what
14 are the types of inputs -- excuse me -- what
15 are the types of inputs that it uses to produce
16 its final product.

17 Q: And what is the difference between the
18 financial report and a managerial report?

19 A: Well, it's sort of -- it's akin to the
20 difference between financial accounting and
21 managerial accounting. A managerial report
22 produced in managerial accounting is basically
23 any report that helps managers improve the
24 functioning of the firm. So it doesn't have to
25 follow the same principles, GAAP principles



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1 that financial accounting does where you're
2 reporting to the SEC. And that's okay. It's
3 meant to be something that's using internal
4 information. It could be using information
5 that's collected consistently with GAAP, but it
6 can use other information as well. So
7 managerial accounting and cost accounting is an
8 area of accounting where people can do
9 modeling, for example, they can do "what if"
10 calculations. What if I invested in this area,
11 what will that do to my income, what will it do
12 to my net income and so forth. So it's an area
13 that's less constrained, if you want to put it
14 that way, in terms of the principles of
15 accounting.

16 Q: You mentioned GAAP. What is GAAP?

17 A: Generally accepted accounting principles. So
18 it's a series of guidelines to the preparation
19 of financial statements that is widely
20 accepted. It varies from country to country in
21 some details, but certainly in the U.S. it's
22 widely accepted.

23 Q: Have you taught any courses related to the area
24 of applied economics or used applied economics
25 in certain courses that you've taught over the



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1 years?

2 A: Yes. In fact, most of my courses have dealt
3 with applied economics. And the titles that I
4 read out earlier: industrial organization, game
5 theory, environmental economics, public
6 finances, they all deal with applied economics,
7 and certainly statistics.

8 Q: And have you authored any publications related
9 to the field of applied economics?

10 A: Yes, actually most of my publications in a
11 sense would be applied economics.

12 Q: And you mentioned industrial organization.
13 What is industrial organization?

14 A: Well, that's a field of economics that focuses
15 more directly on how industries are organized,
16 as the title suggests. In other words, is this
17 a competitive industry, is it a monopoly, is it
18 an oligopoly, is it an industry with one or two
19 large firms and a couple of small firms, as we
20 have in this instance. What's the nature of
21 the production processes that go on within
22 businesses. Are they scale economies, for
23 example, or are they what's called economies of
24 scope. Economies of scope are where you get a
25 lower unit cost by producing more products



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1 because they -- because of those economies. So
2 it's got -- it's the field of economics that
3 actually studies the behavior of firms in an
4 industry, but certainly the behavior of firms.

5 Q: Have you taught any courses related to the area
6 industrial economics?

7 A: Oh, yes. I've taught undergraduate classes,
8 advanced undergraduate classes here many years
9 ago at the Moore School of Business and in
10 Florida. And I have not taught any at Georgia
11 State, but I've taught some over the years.

12 Q: And have you published or authored any
13 publications related to the field of industrial
14 organization?

15 A: Yes, I have.

16 Q: If you will refer to Respondent's Exhibit 5.

17 A: Okay.

18 Q: Can you point the Court or direct the Court to
19 any publications of interest related to
20 industrial organizations?

21 A: Sure. So I'm looking on page five, publication
22 number three.

23 **THE COURT:** Ms. Wooten, do you have a copy of
24 Exhibit 5. I don't have a copy.

25 **MS. WOOTEN:** Sure.



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1 DR. HARRISON: Go ahead, Your Honor?

2 THE COURT: Yes.

3 A: Yeah, so it's publication three on page five,
4 publication eight on page six, publication 12
5 on page six. And I did some other things.
6 Publication 88 on page 11, publication six,
7 eight, and 12 on page 13, publication 20 on
8 page 14, publication six on page 16,
9 publication two on page 18, and publication 11
10 on page 19. Those are the ones that are very
11 clearly in industrial organization.

12 Q: Thank you. Does an applied economist have to
13 understand accounting terms such as income and
14 cost?

15 A: Yes. Yes, he or she does. That's ---

16 Q: Why is that?

17 A: Well, because inevitably -- well, often in
18 applied economics we are looking at the
19 behavior of firms and we have to understand how
20 those terms are defined by accountants, and
21 particularly how they're defined differently
22 than economists might define them, because you
23 don't want to be using the same words and you
24 actually do mean slightly different things,
25 particularly in the case of cost. So it's very



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1 important as an economist that you understand
2 how accountants use it, because you're using
3 accounting information. So very often if
4 you're using accounting information you need to
5 know under what principles it was collected, so
6 what do accountants mean by cost.

7 Q: And what is your experience using or applying
8 these terms as an applied economist?

9 A: Well, my experience has been in terms of
10 teaching, research, and also in terms of a
11 number of reports that I have authored for
12 various bodies or centers or governments.

13 Q: We talked a little bit about the income and
14 cost from an accounting perspective. Are you
15 familiar generally and can you describe that,
16 those terms revenue and cost from an accounting
17 perspective?

18 A: Yes, I could.

19 Q: Okay. Could you do that for the Court now,
20 please?

21 A: Sure. Sure. So revenue is the -- in an
22 accounting sense is the income that a firm
23 receives from the provision, usually from the
24 provision of goods and services when that is
25 realized or realizable. And those last two



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1 words can be a little bit difficult to
2 interpret depending on instances, but
3 especially when they're realized. And the
4 other term you asked about ---

5 Q: Cost.

6 A: --- was cost. So those are -- that refers to
7 the payment, the expenses that the firm incurs
8 to purchase inputs, intermediate inputs,
9 primary factors of production in order to
10 produce the goods and services that it sells.

11 Q: Do you have any experience as an expert
12 witness?

13 A: Yes, I do.

14 Q: How many times have you been qualified as an
15 expert witness in court?

16 A: That would be about a dozen or 15 times. I
17 don't know the exact count.

18 Q: Have you also served as an expert witness in
19 matters that did not reach the court stage?

20 A: Oh, yes, many times.

21 Q: And approximately how many times have you
22 served in that capacity?

23 A: About 35 or 40 times. They're listed in the
24 back of my CV.

25 Q: And what types of cases have you served as an



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1 expert witness?

2 A: Oh, a wide range of cases. A number of cases
3 in the Administrative Law Court as it happens.
4 I also served as a testifying witness in the
5 tobacco litigation. I was representing the
6 states, state of South Carolina as it happens
7 in the tobacco -- the Medicaid tobacco
8 litigation. I was the lead damages expert for
9 those cases. I've also worked on cases dealing
10 with the same issues in Canada. I've also
11 dealt with some issues to deal with risk
12 regulation or OSHA regulations about workplace
13 safety and a number of other cases.

14 Q: Do you recall any of the specific expert
15 designations for those cases?

16 A: Almost always it has been applied economics.

17 Q: And you mentioned that you testified as an
18 expert before the South Carolina Administrative
19 Law Court. Do you recall how many times?

20 A: Yes, excluding this case, six times.

21 Q: I see that you're referring to Respondent's
22 Exhibit 5. Could you identify that for the
23 Court?

24 A: Certainly. That's my C.V., my current C.V.

25 Q: And that's your most recent C.V.?



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1 A: Yes, it is.

2 Q: And does it contain your expert testimony
3 experience, the research and the work
4 experience that you've just described?

5 A: Yes, it does.

6 Q: And referring back to your C.V., is there a
7 particular publication that you'd like to note
8 today that might be relevant to the issues in
9 this case, specifically industrial
10 organization?

11 A: Yes. It's actually one of the papers that I
12 mentioned, and this is published in the
13 "Journal of Accounting Education." The title
14 of the paper is "Mooresville Honda Company, A
15 Case in Forensic Accounting."

16 Q: Can you describe that, the issues in that case?

17 A: Sure.

18 Q: Or your role in the case.

19 A: I'm sorry. Yes, certainly. Well, this was an
20 academic paper that arose out of some work I
21 did on a case here. And people in Columbia
22 will know this case pretty well. Back in the
23 1980s, there were some Honda dealers that were
24 convicted of dirty dealing, as the expression
25 goes. They were bribing American Honda to



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1 divert cars to them, because Hondas were
2 extremely popular in that period because of
3 their fuel efficiency. When a Honda went on
4 the lot, it went off the lot. I mean there was
5 a tremendous demand for them. So there were
6 several dealers, and there's one in particular
7 in Columbia, Rick Hendrick, who was a convicted
8 felon as was one of those dirty dealers, for
9 example. So we were retained to represent --
10 I don't name them because the case was settled
11 -- some Honda dealers who didn't get cars, who
12 didn't -- who were deprived of cars at a time
13 when they could have made a tremendous profit
14 from them. And folks that live in Columbia
15 will probably figure out who they are, but
16 they're all -- they were over the state of
17 South Carolina. As part of that case what we
18 had to do was actually an exercise in
19 managerial accounting, cost accounting, because
20 the question there was if those clean dealers
21 had received more cars, they'd incurred more
22 cost because they would have to pay for the
23 cars, would their net income have gone up. So
24 the question at issue there quantitatively was
25 from an accounting point of view, from a



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1 damages point of view, were cars, pardon the
2 pun, a driver of net income for the clean Honda
3 dealers. If they had more cars, would they
4 have made more profit. And that was the lost
5 business profit that they -- it was alleged
6 that they suffered because of this criminal
7 activity in moving cars. So the reason that I
8 think that's important is because I have
9 considerable expertise and I've published in a
10 peer reviewed accounting journal on what's
11 called cost drivers of profit, the managerial
12 accounting principles that are used to make
13 that sort of determination. And indeed, this
14 paper presents a case study in accounting that
15 is now widely used in this area.

16 MS. WOOTEN: Thank you. At this time, Your Honor,
17 the Department would like to offer Dr. Harrison
18 as an expert in applied economics.

19 MR. MAYBANK: Object, Your Honor. If we could ask
20 for a short voir dire.

21 THE COURT: Yes.

22 MR. MAYBANK: Thank you.

23 PROFESSOR HARRISON - VOIR DIRE EXAMINATION BY MR.
24 MAYBANK:

25 Q: Dr. Harrison, you've never taken a course on



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1 state taxation?

2 A: That's correct, I have not.

3 Q: Okay. You've never taken a course on the
4 apportionment of income for multi-state drivers
5 for state tax purposes?

6 A: That's correct, I have not.

7 Q: And you've never taken a course on how you
8 calculate the numerator in a state tax
9 apportionment scheme?

10 A: I didn't know they had courses on such a narrow
11 thing, but no, I haven't taken them.

12 Q: Okay. And you've never taught a course on
13 state taxation?

14 A: That's correct.

15 Q: And you've never taught a course on
16 apportionment of income for multi-state service
17 providers for state tax purposes?

18 A: No, not a course on that.

19 Q: And you've never taught a course on how you
20 calculate the numerator in a particular state
21 apportionment statute, have you?

22 A: No, I don't think I could imagine there'd be a
23 course on such a narrow topic, but no, I
24 haven't taught one.

25 Q: Okay. You've never published an article on any



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1 of these topics, have you?

2 A: I have published an article on regional fiscal
3 incidence, regional public finance that has to
4 do with fiscal arrangements in a federal
5 system, but not on state apportionment in a
6 narrow sense as you're talking about.

7 Q: Okay. Your testimony today will be similar or
8 very similar to your testimony in *DIRECTV*?

9 A: It depends on what I'm asked, and I don't think
10 it will be similar.

11 Q: Okay. But your testimony will be exclusively
12 on economics today?

13 A: That's what I'll be asked. Yes, in applied
14 economics.

15 Q: And not on the legal interpretation of the
16 statute at issue here?

17 A: I am not a lawyer.

18 Q: Okay. And so specifically your testimony will
19 relate to an economic reasonableness of the
20 market sourcing method?

21 A: Depends on the questions that I'm asked.

22 Q: Okay. Well, what is your opinion today?

23 A: Well, you're asking me -- I'm sorry, what is
24 the specific ---

25 Q: What is your opinion in this case today?



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1 A: About what?

2 Q: About this case.

3 A: Oh, about the case. That there is indeed a --
4 there is a simple way to determine the income-
5 producing activity, and that is the subscriber
6 related revenue that the taxpayer reports and
7 that that is an accurate way to reflect the
8 income generating activity in this -- in this
9 case from the perspective of economics and
10 accounting principles.

11 Q: Okay. And your testimony doesn't have anything
12 to do today or you don't have an opinion on
13 whether the DOR's position is economically
14 reasonable?

15 A: Well, I think it is economically reasonable,
16 but I'm not presenting an opinion on the legal
17 basis of it. But as an economist, I think it
18 is reasonable. In fact, I think it's the --
19 it's a very clear basis for determining the
20 numerator, as you put it in your opening
21 remarks.

22 Q: Okay. You mentioned you're going to testify in
23 income-producing activities. Have you ever
24 taken a course on how the state tax defines
25 income-producing activities?



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1 A: No, I haven't.

2 Q: Have you ever taken a course on how income-
3 producing activities are defined for
4 apportionment of income purposes?

5 A: No, I have not.

6 Q: Have you ever taught a course on how income-
7 producing activities are defined for state tax
8 purposes?

9 A: No, I have not.

10 Q: Have you ever taught a course on how income-
11 producing activities are used in apportionment
12 statutes?

13 A: No, I have not. But I'll add that I very often
14 do research in areas that I don't teach.

15 Q: Sure. Have you ever published an article on
16 the calculation or definition of incoming-
17 producing activities ---

18 A: No, I have not.

19 Q: --- for state tax purposes? You have not?

20 MR. MAYBANK: All right. Your Honor, we would
21 object to this particular witness. We would of
22 course renew our motion to exclude him. He
23 certainly has an admirable background. He's
24 got a master's degree and Ph.D. in economics,
25 but economics has -- economics professor, first



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1 of all, is not competent to talk about state
2 taxation issues particularly where the sole
3 issue in this case is the preparation of the
4 numerator. Now, he's also -- his testimony's
5 also not relevant. If you allow -- if you
6 start allowing economics experts in they're
7 going to -- you're going to start seeing them
8 in every case, every property tax case that's
9 economics -- it's not economically reasonable
10 to my property when a neighbor across the
11 street is half the value. It's not
12 economically reasonable I have to pay sales tax
13 when there's a \$500 sales tax cap on cars.
14 It's not economically reasonable that my blood
15 should be subject to sales taxation. They're
16 going to start popping up in every case and
17 they're going to make your job a lot more
18 difficult. But our contention is he's no more
19 competent to talk about what an income-
20 producing activity is than a Ph.D. in parks,
21 recreation and tourist who deal with the hotel
22 industry, restaurants, hotels every day. And
23 his testimony's not relevant. Economic
24 reasonableness is a matter of great concern to
25 the General Assembly, but it's a matter of no



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1 concern to the executive branch. Now,
2 economists have a clear role to play in state
3 tax cases. Two examples would be, and we don't
4 see them much at the state LLC but the federal
5 level, transfer pricing has two related
6 corporations, are they overcharging for goods
7 for state tax purposes. And second of all, in
8 the field of distortion. The Department of
9 Revenue can raise distortion under equitable
10 apportionment statutes and an economist would
11 play a -- obviously could play a vital role
12 there. But defining the term what is income-
13 producing activities for state tax purposes for
14 preparation of the numerator, he's no more
15 competent than a Ph.D. in parks, recreation and
16 tourism.

17 **THE COURT:** Mr. Maybank, that may be true, but the
18 State has offered him as an expert in the area
19 of applied economics. Obviously, from his C.V.
20 and his testimony, he is definitely qualified
21 as an expert in those areas -- in that area,
22 and I am going to allow him ---

23 **MR. MAYBANK:** Okay.

24 **THE COURT:** --- to provide expert testimony.

25 **MR. MAYBANK:** And it wasn't clear to me ---



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1 THE COURT: You may ---

2 MR. MAYBANK: --- what is he going to be allowed as
3 an expert in? What did you move?

4 MS. WOOTEN: Applied economics.

5 MR. MAYBANK: Okay. Applied economics for what?

6 MS. WOOTEN: That's just the general field. That is
7 what he's competent to testify in.

8 MR. MAYBANK: Okay.

9 MS. WOOTEN: If you believe a question is
10 objectionable or is inappropriate you may
11 object at that time, but his field is applied
12 economics.

13 MR. MAYBANK: Could I ask him one more question,
14 Your Honor, in voir dire?

15 THE COURT: I think you've fully covered everything.
16 Thank you. Ms. Wooten.

17 MS. WOOTEN: Thank you, Your Honor.

18 PROFESSOR HARRISON - CONT. DIRECT EXAMINATION BY MS.
19 WOOTEN:

20 Q: Professor Harrison, have you reviewed any
21 documents in preparation for your deposition in
22 this case or your work here today?

23 A: Yes, I have.

24 Q: And what are those documents, if you can
25 recall?



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- 1 A: I looked at the initial Department
2 determination, the petitioner's complaints.
3 Those are standard documents that I like to
4 read in this case. I've looked at the
5 depositions that you provided to me. I looked
6 at the 10-K for the firm. I looked at the
7 annual report for the firm as well on its
8 website. And I've essentially also reviewed
9 the statutes, although again, I'm not
10 presenting anything on the law.
- 11 Q: And what is the difference between an annual
12 report and a 10-K?
- 13 A: Well, the annual report, they'll actually
14 contain a lot of the same information, but the
15 annual report is a report that is provided to
16 shareholders. The 10-K is a specific report
17 produced under certain guidelines to the SEC.
18 So it's reporting the fiduciary obligation to
19 report under -- in certain rules. So they will
20 contain a lot of the same information.
- 21 Q:) As part of your preparation, what did you learn
22 about the taxpayer and its operations?
- 23 A: Well, I learned about -- that the taxpayer, and
24 this is also a matter of listening to some of
25 the testimony yesterday, which was quite



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1 interesting, about what it is that Dish does in
2 order to produce its final product. It sees
3 itself very much as somebody who's in the
4 television -- producing television programming
5 services. I'm using the term that's from their
6 10-K, and they use that term repeatedly
7 throughout.

8 Q: And when you say "their 10-K," which 10-K are
9 you referring to?

10 A: Yes, this is the 10-K -- Exhibit 25, which is
11 the 10-K since it was raised yesterday for the
12 taxpayer. And I was just looking, for example,
13 you know, the page ten of 189 to be specific,
14 or if we look at page 12 of 189, they say, "Our
15 business is focused on providing pay TV
16 services." So they see themselves very clearly
17 as in the pay TV industry, and they state that
18 in their 10-K filing.

19 Q: And this 10-K filing, is that information on
20 that document publicly available?

21 A: Yes, it is. That's available on the web in a
22 system known as EDGAR, which is the federal
23 system to access there. And that's where most
24 people get them.

25 Q: And what is your understanding of the revenue



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1 streams the taxpayer has?

2 A: Well, the vast majority of the revenue streams
3 are what it calls in its profit and loss
4 statement subscriber related revenues. And as
5 we heard yesterday, that can consist of a
6 number of -- number of items, including premium
7 services; it can include basic services; it can
8 include some other video games that might be
9 provided as well.

10 Q: Are you familiar with the taxpayer's arguments
11 in this case?

12 A: I believe so.

13 Q: And can you briefly describe your understanding
14 of those issues to the Court?

15 A: Certainly. It's -- well, as they said at the
16 outset, it's to do with how you calculate the
17 numerator in the apportionment ratio. So
18 focusing on the numerator, their argument is
19 that a more appropriate way to calculate that
20 would be to look at the cost of the services
21 produced, that that is from their perspective
22 a better way of calculating the income-
23 generating activity of the -- of the firm.

24 Q: In economics, what does the term "intermediate
25 inputs" refer to?



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1 A: Well, economists use that term to distinguish
2 intermediate inputs and final -- final
3 products. So when a firm is producing it will
4 buy products from other firms. So, for
5 example, if you're producing a brick house, you
6 have a construction firm, a brick is an
7 intermediate input for you. Your final product
8 is selling the house. To another firm that's
9 actually making the brick that may be the final
10 product. So the idea is that's why you would
11 actually look at something like the 10-K to
12 figure out what is it that this firm does as
13 its final product, its final good or service,
14 and what are the intermediate inputs to that
15 that are -- that may or may not be -- usually
16 they're necessary to produce the final product.
17 But we have a sharp distinction between an
18 intermediate input, final products. It's also
19 sometimes called primary product of the -- of
20 the firm.

21 Q: And from your reading of the 10-K and your
22 understanding, what is the final product or the
23 primary product in this case?

24 A: Well, I think it's stated very clearly, and I
25 gave you a couple of quotes earlier, and it's



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1 the provision of pay TV services related to the
2 various services that are provided by the box
3 that's in Edisto Island and other places in
4 South Carolina.

5 Q: From an applied economics perspective, do you
6 have an opinion about what the intermediate
7 activities of the taxpayer are?

8 A: Yes, I do. In fact, we had a very rich
9 description of that yesterday from the
10 representatives from the taxpayer.

11 MR. MAYBANK: Briefly, Your Honor, state tax law
12 contains no references to intermediate
13 activities, and we would object to the
14 question.

15 THE COURT: Your objection's overruled.

16 MS. WOOTEN: Thank you, Your Honor.

17 Q: Please continue.

18 A: Sorry. So yes, we got a very rich description
19 of that yesterday of those intermediate inputs.
20 And most of those are indeed quite necessary to
21 produce the final product. I don't think
22 there's any debate about that. There has to be
23 a satellite there, there has to be the purchase
24 of ESPN services. Some of them are not
25 necessary. You know, for example, as we heard



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1 for the box in Edisto Island, paying for the
2 local television station in Columbia's not
3 necessary because that won't be streamed down
4 to Edisto Island. But the big ticket items,
5 the satellites and the engineering skills that
6 go into that and the purchase of products from
7 ESPN and HBO that we heard about yesterday,
8 those are very much intermediate inputs that
9 allow them to produce their final product,
10 which is the box sitting in Edisto Island that
11 counsel talked about so much yesterday.

12 Q: From an applied economic perspective, do you
13 have an opinion about which activities of the
14 taxpayer generate its income from subscribers?

15 A: Yes. It's the provision of the box and the
16 payment and, specifically, there's a well-
17 defined transaction that occurs. It's the
18 revenue stream that comes from the taxpayer
19 that comes from Edisto Island to the taxpayer.
20 That's what generates the income of the firm.

21 Q: And from an applied economic perspective, where
22 does that income-generating activity occur?

23 A: It occurs -- the transaction occurs when the
24 subscriber purchases a contract with Dish.
25 More colloquially, it occurs when they turn it



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1 on, whether it's in Edisto Island or Irmo where
2 I used to live here in Columbia. So it's when
3 they turn it on and watch the TV service and
4 pay for it. I mean, the critical part is
5 paying for it because, in principle, you could
6 pay for the thing and actually not watch it.
7 But for all intents and purposes, when people
8 pay for it they're watching it, as counsel for
9 the taxpayer was explaining.

10 Q: From an applied economic perspective, do you
11 have an opinion about the most accurate way to
12 measure the extent of the taxpayer's revenue
13 generating activity in South Carolina?

14 MR. MAYBANK: Again, just very briefly, Your Honor?

15 THE COURT: Yes.

16 MR. MAYBANK: State tax law cares not a wit about
17 the applied economic definition of when you pay
18 for thing or intermediate income --
19 intermediate products.

20 THE COURT: Thank you. The objection is overruled,
21 although your objection is on the record.

22 A: Sorry. Could you restate the question, please,
23 to be clear?

24 Q: Sure. From an applied economic perspective, do
25 you have an opinion about the most accurate way



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1 to measure the extent of the taxpayer's revenue
2 generating activity in South Carolina?

3 A: Yes, I do. And that would be from the
4 subscriber related revenue. So as it happens,
5 that has nothing to do whatsoever with the
6 intermediate activities.

7 Q: And from an applied economic perspective, do
8 you have an opinion about the distinction
9 between an engineering firm and a provider of
10 satellite TV services with respect to
11 generating revenue?

12 A: Yes, I do. And typically an engineering firm,
13 not necessarily an engineering firm or a legal
14 firm or an accounting firm, it doesn't have to
15 provide the services in the place that they're
16 actually produced; whereas in the case of the
17 taxpayer, and media services generally, they're
18 produced at the place in which they're
19 consumed, whether it was my house in Irmo or
20 counsel's house in Edisto Island. So it's
21 necessary that they be produced in the state,
22 in the location that's where the final product
23 is located.

24 Q: And have you reviewed any 10-Ks for the
25 taxpayer?



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1 A: Yes, I have.

2 Q: And does it describe the services that it
3 provides?

4 A: Yes, it does.

5 Q: Do you have any references in front of you?

6 A: Yes, I do. While some of those I referred to
7 earlier where they talked about themselves. As
8 I said on -- this is Exhibit 25 and page 12 of
9 189 where they say, "Our business is focused on
10 providing pay TV services." They say literally
11 the same thing on page 13 of 189 and on page 53
12 of 189, they say that Dish Network direct
13 broadcast satellite DBS subscription television
14 services. So they see themselves very clearly
15 as producing that product.

16 Q: What does the concept of income recognition
17 mean?

18 A: Well, that's a concept in accounting to do with
19 when -- for what accounting period do you --
20 when do you recognize income or revenue
21 streams. Do you recognize them consistent with
22 cash accrual accounting, which is when the cash
23 is actually received, or do you receive them
24 usually, which is consistent with accrual
25 accounting that's used in preparing your 10-K,



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1 when they're realized or realizable. So it's
2 got to do with when do you recognize income in
3 terms of the time period that you're reporting.

4 Q: When does the taxpayer recognize its receipts
5 from its subscription TV services as revenue
6 for accounting purposes?

7 A: Well, actually ---

8 MR. MAYBANK: Your Honor, he's not an expert in
9 accounting. She just asked him for an
10 accounting definition.

11 THE COURT: His qualifications are so closely
12 related, quite frankly, in some instances
13 interrelated, I'm going to allow him to answer
14 the question. Objection is overruled.

15 MS. WOOTEN: Thank you, Your Honor.

16 A: Actually the taxpayer provides a very clear
17 statement of that in the 10-K. If you'd like
18 I could just read that.

19 Q: Sure, if you'll read that, and please note what
20 page and where you're reading.

21 A: Sure. This is Exhibit 25, pages 108 to 109 of
22 189. "We recognize revenue when an arrangement
23 exists, prices are determinable, collectability
24 is reasonably assured, and the goods and
25 services have been delivered. Revenue from our



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1 subscription television services is recognized
2 when programming is broadcast to subscribers."
3 They go on with some other features, but I
4 think that's the essential point, that they see
5 themselves not only as -- they clearly see
6 themselves as producing programming services.
7 I don't think that's much in dispute as their
8 final product, but they see -- they recognize
9 the revenue for accounting purposes and then in
10 their statements when the -- when the
11 programming is broadcast to the subscriber.

12 Q: Were you present for Mr. Povenmire's testimony
13 yesterday?

14 A: Yes, I was.

15 Q: He testified regarding satellites, engineers
16 and other activities regarding the taxpayer.
17 Did that testimony change or impact your
18 opinions?

19 A: No, it did not.

20 Q: Any why is that?

21 A: Well, I didn't -- it was a fascinating --
22 actually it was informative to do with the
23 structure, the production structure that Dish
24 goes through in order to produce its product,
25 and I learned a lot about how it produced it,



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1 but it was all about intermediate activities.
2 It was all about things that are necessary to
3 produce income, but the only thing that is
4 necessary and sufficient to produce income is
5 the subscriber in Edisto Island or me in Irmo
6 when I lived here, paying the revenue. So all
7 of these other items are definitely necessary
8 to produce, there's no question about that, and
9 it was fascinating to hear about the
10 engineering aspects of them, but they're not
11 necessary and sufficient to generate revenue.
12 The sole item that's necessary and sufficient
13 is the revenue stream that comes from Edisto
14 Island or Irmo.

15 Q: And what other opinions or analysis do you
16 have, if we have not covered them, that you
17 believe will assist the Court in this matter?

18 A: I think we've covered everything.

19 MS. WOOTEN: Thank you, Your Honor. That's all from
20 the Department.

21 THE COURT: Mr. Maybank.

22 MR. MAYBANKS: Thank you.

23 PROFESSOR HARRISON - CROSS-EXAMINATION BY MR.
24 MAYBANK:

25 Q: Applied economics is a science, isn't it?



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1 A: Yes, we like to think so. And, in fact,
2 economists get a Nobel Prize in science.

3 Q: It's based upon scientific principles, correct?

4 A: Yes.

5 Q: Okay. And your opinions are based upon
6 scientific principles, correct?

7 A: I believe so, yes.

8 Q: Okay. And those scientific principles are
9 found in treatises and articles and journals.
10 You don't make them up; you base them on
11 scientific principles, correct?

12 A: That's right. They're found in various
13 treatises. They're found in various articles,
14 such as the ones that I've published.

15 Q: Okay. And I think one thing we can agree on is
16 that activities which involve taking my credit
17 card are income-producing activities, are they
18 not?

19 A: I'm not sure I follow. You mean taking your
20 credit card, stealing it?

21 Q: Correct.

22 A: Stealing your credit card?

23 Q: No, running my credit card.

24 A: Oh.

25 Q: An activity that involves I hand my credit



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1 card, and they run my credit card and they take
2 my money, that's obviously income-producing
3 activity, isn't it?

4 A: That is income-producing activity, yes, as
5 usually defined.

6 Q: Okay. Now you testified Dish had many other
7 activities, but they don't generate income
8 under the microeconomic principle or applied --
9 I'm sorry, applied economics; is that right?

10 A: Well, under economic principles ---

11 Q: Okay.

12 A: --- or applied economics.

13 Q: They generate cost but not income, correct?

14 A: That's right. So those production activities,
15 if they were -- if they occurred in the absence
16 of you paying and me paying -- you paying in
17 Edisto and me paying in Irmo and folks in South
18 Carolina paying -- they would be loss
19 producing. They would generate costs to be
20 sure, and they would generate a loss. The only
21 time they turn into a net income is when there
22 is income, a revenue stream, from the
23 subscriber running his credit card, as you put
24 it.

25 Q: Okay. And so the only activity is this some --



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1 you testified is if someone in South Carolina
2 leases a box and pays for the subscription,
3 correct?

4 A: That's correct, yes.

5 Q: Okay. You personally don't subscribe to pay
6 TV, do you?

7 A: No, I used to. I used to have a Dish contract
8 for about two months.

9 Q: So you may not be aware in this case or weren't
10 aware before yesterday that in order to
11 subscribe to Dish I had to telephone a call
12 center in another state, give my credit card,
13 the call center charges my credit card to start
14 my subscription? Obviously that's income
15 producing?

16 A: No, the revenue stream that your payment isn't
17 income producing. That is an intermediate
18 input to the final product. The final product
19 that you're paying for is the provision of the
20 service in Edisto Island. That's what you're
21 paying for, and you're paying for it from
22 Edisto Island.

23 Q: Okay. I asked you a minute ago any function
24 involve somebody taking my credit card and
25 running it was obviously income-producing



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- 1 activity, and you answered correct.
- 2 A: That's correct. It's the sale ---
- 3 Q: I would call ...
- 4 A: I'm sorry. I haven't ---
- 5 Q: Go ahead.
- 6 A: It's the sale of the product is when you are
- 7 providing revenue to the firm. So the revenue
- 8 that is coming from you living in Edisto Island
- 9 is income producing.
- 10 Q: Okay. So when I call the call center I give
- 11 them my credit card, they turn on my
- 12 subscription, and they run my credit card,
- 13 that's obviously income-producing activity?
- 14 A: That's -- having a call center wherever it's
- 15 located, and let's just agree that it's located
- 16 outside of South Carolina, is certainly a
- 17 necessary input using their current technology
- 18 to produce the revenue stream that comes from
- 19 Edisto Island, yes.
- 20 Q: All right. Well, let me just ask you bluntly.
- 21 I call the call center because I have to, they
- 22 sign me up, they take my credit card, and they
- 23 run my credit card. That's obviously an
- 24 income-producing activity, isn't it? They've
- 25 taken my money.

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1 A: And the income comes from Edisto Island. It's
2 the revenue stream from Edisto Island from
3 South Carolina.

4 Q: Well, is it revenue stream from Edisto Island
5 they -- what's it got to do with Edisto Island?
6 My credit -- my bank is not on Edisto Island.

7 A: No, that's where the service is provided.
8 That's what I've been saying repeatedly, sir.
9 It's the final product of the taxpayer from an
10 economist's perspective, from an accountant's
11 perspective that generates the revenue stream.
12 That's the transaction. You are paying for
13 that product. That's a service that, as you
14 said, was delivered to Edisto Island for you
15 and your father to watch. It's not a service
16 that was delivered in Colorado or some other
17 place. That was a necessary intermediate input
18 to produce the final product which indeed you
19 talked about extensively about yesterday.

20 Q: All right. Well, let me just ask you to answer
21 yes or no. I call -- I have to call a call
22 center to subscribe, I can't do it online; they
23 sign me up; they take my credit card; they run
24 my credit card. Is that or is that not an
25 income-producing activity?



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1 A: Well, I can't answer it yes or no. And that
2 was the one you just asked me a moment ago and
3 it -- I can't tell you ---

4 Q: Are you unsure?

5 A: No, I'm quite certain. It's just that it's not
6 a question that is meant to be yes or no
7 answer. I would so no, it is not. The income-
8 producing activity, it's necessary for the
9 income-producing activity, no question about
10 that. But the income-producing activity is the
11 delivery of the service to you in Edisto
12 Island. You're living -- whether or not you in
13 fact -- you might not have called them from
14 Edisto Island or from South Carolina, but the
15 service is delivered to you in South Carolina.
16 That's the essential part of this company, they
17 say so that they're providing services to
18 people in Edisto Island.

19 Q: Okay. And what you've just said comes out of
20 economic treatises. You didn't just make that
21 up? That's based upon your Ph.D. in economics,
22 correct?

23 A: It's my general understanding of economic
24 principles. That's right.

25 Q: Okay. And so that would be found in leading



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1 economic treatises, correct?

2 A: Well, not specifically about Dish TV, but ---

3 Q: Well, right.

4 A: But the principles of how you talk about final
5 products or intermediate products. I have a --
6 for example, I have a publication that's on my
7 C.V. that I could rely on. It's in the
8 "Journal of the American Statistical
9 Association" or what's called "Input Output
10 Analysis," which is the field that defines what
11 you mean by intermediate products, intermediate
12 activities and final products. So I can rely
13 on my own publication in a primary journal in
14 statistics in the world.

15 Q: Okay. And you aren't aware that when I call a
16 call center to subscribe they do a great job of
17 convincing me to order more expensive packages.
18 Like when I go to Costco I always buy ten
19 things that I didn't go into Costco to buy.
20 But they have the -- they have a great ability
21 to talk, "Burnie, you really don't want the
22 introductory package. You want SEC football."
23 That costs a bit more. You weren't --
24 personally were not aware of that before
25 yesterday, were you?



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1 A: Actually, that's not true, because that's
2 precisely the reason that I cancelled my Dish
3 subscription. They were honest, I was just
4 naive. I was just a country boy. I called
5 them up, and I wanted to get access to
6 Australian television and football, which they
7 covered. They said they covered. And I spoke
8 to a charming person on the call center, and
9 they did exactly what you just described and we
10 heard about yesterday. And then I suddenly got
11 my bill, and what I thought would be a certain
12 amount was a huge amount. They did nothing
13 dishonest, they did nothing wrong. I was just
14 a naive fool, and I got charmed by somebody on
15 the phone, so I just said forget it, I'll
16 cancel; it's not worth that amount of money.

17 Q: Okay. And so when they call -- when I call up
18 there, or you've actually called up, and they
19 talked me into buying more than I originally
20 called up for, and they took my credit card and
21 they ran it, obviously that conversation was
22 income-producing activity. I bought more than
23 what I picked up the phone. That's obviously
24 income-producing activity, isn't it?

25 A: Well, I'll give you the same answer that you



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1 asked -- it's essentially the same question you
2 asked earlier about a different aspect of the
3 call center, so I'll give you the same answer.
4 The income-producing activity is related to the
5 provision of the final product, Edisto Island
6 or in Irmo or wherever it is. So that is
7 certainly an intermediate input, it's certainly
8 necessary for it, but it is not the income
9 itself.

10 Q: Okay. And what you just told me is found in
11 economic treatises, correct?

12 A: Well, it would be, but I'm just giving you the
13 general definition of what income is. And in
14 this case, it's talking about a revenue stream
15 ---

16 Q: And in general ---

17 A: --- and indeed I can give you a reference to
18 the 10-K of the taxpayer when the taxpayer, as
19 we talked about earlier, when it itself talks
20 about recognizing income, when your client
21 itself says, I recognize income when this
22 programming services are provided to you in
23 Edisto Island, it's giving you the answer right
24 there.

25 Q: But your -- you just gave us a good definition



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1 of income-producing activities. They don't
2 include taking my credit card. And that's
3 based upon scientific applied economics
4 principles, correct?

5 A: Yes, indeed. Yes, indeed.

6 Q: Okay. So we could pick up a treatise and it
7 would tell us just that?

8 A: Sure. Most of the standard principles of
9 economic treatises would talk about -- would
10 talk about income and expenses.

11 Q: Okay. And during your deposition you told me
12 two of the important treatises were welfare
13 economics and applied microeconomic theory,
14 correct?

15 A: No, they were two, but they're not the ones I
16 just referred to. I was just talking about
17 principles of economics, textbooks. Those are
18 specialist textbooks that occurred to me at the
19 time that you asked me on the deposition. The
20 textbooks I would probably refer you to to be
21 educated on these principles would be, for
22 example, a book, "Economics," by Joe Stiglitz,
23 a Nobel Prize winner. I actually worked on
24 that book, on that textbook by producing the
25 instructor's manual. I know it very well.



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1 It's a major principles of economics textbook.

2 Q: But that book doesn't talk about income-
3 producing activities for state tax purposes,
4 does it?

5 A: No, it doesn't use narrow terms like that. It
6 does use the terms that you are asking me
7 about, and that is the definition of income,
8 the definition of cost, the definition of
9 revenues, and most importantly, how those
10 differ between economists and accountants,
11 because as I said, one has to pay attention to
12 that.

13 Q: And you weren't aware of the order from me to
14 order pay-per-view I had to call a call center,
15 which would then run my credit card and then,
16 in your opinion, again, when I call the -- when
17 I want pay-per-view, I have to call a call
18 center, they take my credit card, they run it,
19 that's not income producing? Is that your
20 testimony?

21 A: Well, that's the question you've asked me three
22 or four times. The income-producing activity,
23 that is necessary to it, but the income-
24 producing activity itself is the provision of
25 programming services exactly as the taxpayer



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1 says, that's when they recognize the income.
2 So your own client is telling you the answer to
3 that question ---

4 Q: Okay.

5 A: --- and I think correctly.

6 Q: All right. Well, let's turn to advertising.
7 From an economics perspective, does it matter
8 that our biggest competitor is free?

9 A: It matters in terms of the profitability of the
10 company, certainly. So if one was assessing
11 the profitability of the company. one would ask
12 how competitive it is and that does matter,
13 yes.

14 Q: Now I'm referring to our competition. From an
15 economics perspective, does it matter -- we
16 charge, and our biggest competition doesn't
17 charge anything. From an economic perspective
18 that's a little bit unusual, isn't it?

19 A: No. I ...

20 Q: Well, give me another example.

21 A: Somebody who charges and somebody who gives
22 things away? I can't think of one right now,
23 but I don't see that as unusual, just that they
24 produce, provide a different product and they
25 have a different pricing scheme. They rely



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1 more on advertising. So they're differ- -- in
2 economics that's what's called a differentiated
3 product. Your client's product typically does
4 not have advertising interrupting it. So last
5 night trying to get an early night's sleep, I
6 turned on the TV and they had Iron Man 3. Now
7 what they do is they get to the last half hour
8 or so, they have ads every five minutes because
9 they know you're not going to turn it off and
10 they really pound you. Dish doesn't do that.
11 HB -- you know, DIRECTV doesn't do that. So
12 you have what economists call a differentiated
13 product. The product is actually the --
14 watching the movie with or without advertising.
15 So if you want to avoid paying for the services
16 of Dish TV, you're going to have to put up with
17 those ads. That's -- so it's a differentiated
18 product. So that's not at all that unusual.

19 Q: Okay. And let's turn to advertising then. We
20 spend a lot of money to advertise because we've
21 got to convince people they've got a lot of
22 what we offer for free, but they should sign up
23 for us. Now obviously if we did no advertising
24 we'd have a -- we'd have less revenue, would we
25 not?



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1 A: That's a very reasonable statement.

2 Q: Okay. And if we offered shabby programming, we
3 might get some revenue but we would have less
4 revenue, correct?

5 A: If there is justice in the world, that's also
6 a reasonable statement.

7 Q: All right.

8 A: But some people get away with what I would call
9 shabby programming, but that's a matter of
10 taste.

11 Q: All right. In your opinion, an activity that
12 generates a cost cannot by definition, be an
13 income-producing activity?

14 A: No. What I'm trying to explain is as those
15 terms are used in economics, and also in
16 accounting, cost is different than revenue, and
17 we have clearly a revenue produced by the
18 company in the subscriber related revenues.

19 Q: Okay. And -- all right. And so in your
20 opinion then, the income-producing activity,
21 the sole income-producing activity is the
22 mailing of the bill, correct?

23 A: No, it's actually providing the -- it's
24 providing the programming services, which is
25 then leading to ---



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1 Q: Right.

2 A: --- is associated with you paying the bill. If
3 you didn't pay the bill, let's assume, and it's
4 not exactly instantaneous, but more or less at
5 the same time you would not get the programming
6 services. The difference between those is
7 timing is not really critical.

8 Q: Okay. But so providing the programming
9 services is critical obviously?

10 A: That's the final product, so what's happening
11 is they're providing a final product, they're
12 providing a service, but let's assume they were
13 handing you a product such as the box, and then
14 you're giving them money. And of course it's
15 credit cards and after the box is there you
16 don't see anybody unless there's a problem.

17 Q: Okay.

18 A: But it's that's transaction -- it's that
19 transaction that generates the revenue stream.
20 The 10-K says it correctly from an accounting
21 perspective that's consistent with economists'
22 view as well.

23 Q: Okay. And so our income-producing activity is
24 the provision of the content and the paying the
25 bill?



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1 A: That's correct.

2 Q: Okay. All right. One other -- two small
3 points. I wasn't aware of it until I started
4 gearing up for trial that actually a majority
5 of Dish's customers come not through direct
6 sources but through third-party suppliers. You
7 probably saw that in the 10-K as well. Is that
8 correct?

9 A: That's true. Actually, and I did know about
10 that because the condo that I live in in
11 Atlanta, I was the president of the association
12 at the time, when we set up our television we
13 actually had somebody come on in who was a Dish
14 person, and he was -- he came to each condo and
15 said I'll wire your boxes. He was no doubt
16 licensed by Dish, and he was a third-party
17 person. Who anyone who signed up, he got a
18 little bit of extra money as a result.

19 Q: Okay. And as you know, we actually pay them.
20 They don't do it just for the money they get
21 from the customer, they also get some dough
22 from Dish. Dish incentivizes them, correct?

23 A: I did learn about that yesterday, yes.

24 Q: Okay. And obviously that's an income-producing
25 activity?



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1 A: Well, the income -- it's an intermediate input
2 to the final product, absolutely. No question
3 about that. It's the sale of the final
4 product, as I keep saying, that is the revenue
5 producing, the income-producing activity.

6 Q: But obviously Dish would have a lot -- would
7 have fewer subscribers, 51 percent fewer
8 subscribers but for the third-party suppliers,
9 correct? That's what their 10-K says.

10 A: Well, without the -- without -- we don't need
11 to disagree about the exact numbers, because --
12 -

13 Q: Right.

14 A: --- there would be other ways to provide it.
15 It's completely reasonable without those third-
16 party suppliers and other intermediate inputs
17 there would be less revenue and less income.
18 There's no question about that.

19 Q: Okay. Now you've testified on your definition
20 of income-producing activity. And at your
21 deposition I asked you for a couple of
22 treatises that you based your testimony on, and
23 you cited "Welfare Economics" and "Advanced
24 Microeconomic Theory." Can you point out to
25 where they define income-producing activities?



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1 A: Those wouldn't be ---

2 Q: Either of them.

3 A: Those wouldn't be the places to look. Those
4 are much more specialist graduate textbooks.
5 I think I also referred to Principles of
6 Economics textbooks. Those would be the ones
7 that would be most likely to define those
8 terms.

9 Q: And I asked you ---

10 A: And if I may, they don't use the term income-
11 producing activity.

12 Q: Right.

13 A: But I understand that's a term of art in the
14 law here. They all talk about income and they
15 all talk about revenues and costs.

16 Q: Okay. In your deposition I asked you at least
17 five times for the name of an economic journal.
18 Those are the only two you gave me. Is there
19 any reason you didn't mention the other book
20 now so I could have had a chance to look at it?

21 A: I didn't remember them at the time of the
22 deposition, and because of your questions it
23 occurred to me, well, you know, what would have
24 been a better answer, and later on I said well,
25 stick with -- I think I would have said any



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1 number of the standard principles of economic
2 textbooks. That's what I was -- so this is
3 such a common theme in the introduction, the
4 first class in economics people have in college
5 that it's kind of standard. I didn't remember
6 a particular book there and then, but I
7 remember one now because you asked that
8 question.

9 Q: Okay. And I'm down to my last -- I know you've
10 got to rush, I'm down to my last two questions
11 here. If you can -- let me show you your
12 deposition in this case, page 15 -- and I'm
13 sorry, page 19 and 20. And I'll let your
14 counsel get it.

15 MR. MAYBANK: We might have an extra ---

16 MS. WOOTEN: Yeah, do you have an extra copy? I
17 don't -- I can't find it right offhand.

18 MR. MAYBANK: Yeah, we may. I've got one here.

19 MR. ROURKE: Here's an extra copy.

20 MS. WOOTEN: Great. Thank you.

21 Q: All right. On page 20 -- on page 19 of your
22 deposition, the question was, "Can you give me
23 the name of a single economics treatise,
24 textbook, or journal article that supports your
25 testimony in *DIRECTV* that the only income-



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1 producing activity was the mailing of the
2 bill?" And you answered, just to speed it up
3 I'll go ahead and read it, "As I said, no
4 economic treatise or textbook would talk about
5 the mailing of the bill as being a critical
6 part." And then I asked you on page 20, "Well,
7 name me one that defines it exactly as you've
8 just described it." "Well, the textbook I
9 referred to earlier, 'Microeconomics Theory'."
10 Now Microeconomics Theory, I think we both
11 agree, doesn't discuss this subject at all,
12 does it?

13 A: No, it doesn't. It talks about economics
14 generally.

15 Q: All right.

16 A: But it talks about it in a very formal
17 mathematical way. And I'm not sure what the
18 earlier context was, but I can recall in my
19 deposition repeatedly trying to say well, if
20 you look at a range of principles of economic
21 textbooks they will talk about these
22 principles, and I've published on these and
23 these are sort of known to most economists. I
24 just didn't have a textbook in my head ---

25 Q: Sure.



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- 1 A: --- at the time when you were asking me.
- 2 Q: And that's certainly understandable, but the
- 3 question was, "Well, name me one that defines
- 4 it exactly as you've just described it," and
- 5 you said, "Well, the textbook I referred to
- 6 earlier, 'Microeconomics Theory'."
- 7 MR. MAYBANK: That's all I have, Your Honor.
- 8 MS. WOOTEN: No redirect from the Department, Your
- 9 Honor.
- 10 THE COURT: Thank you. Thank you, Professor
- 11 Harrison.
- 12 DR. HARRISON: I appreciate your flexibility, Your
- 13 Honor.
- 14 MS. WOOTEN: Judge Robinson, may Professor Harrison
- 15 be dismissed from this hearing?
- 16 MR. MAYBANK: Yeah, no objection.
- 17 MS. WOOTEN: Thank you.
- 18 DR. HARRISON: I appreciate the flexibility.
- 19 MS. WOOTEN: Thank you.
- 20 DR. HARRISON: Thank you.
- 21 THE COURT: Have a safe trip.
- 22 DR. HARRISON: Thank you.
- 23 MS. WOOTEN: Thank you.
- 24 THE COURT: I'm going to take a ten minute ---
- 25 MR. MAYBANK: Sure.



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1 THE COURT: --- at this point. I need to make sure
2 early dismissal plans are being complied with.

3 (Break from 10:02 a.m. until 10:11 a.m.)

4 THE COURT: Mr. Maybank, you can continue with your
5 witnesses.

6 MR. MAYBANK: Yes, Your Honor, we have our last
7 witness, Ray Stevens.

8 THE COURT: Okay.

9 RAY N. STEVENS, ESQUIRE, being duly sworn, testifies
10 as follows:

11 MR. STEVENS - DIRECT EXAMINATION BY MR. MAYBANK:

12 Q: All right. What's your full name?

13 A: Ray Nelson Stevens.

14 Q: Where are you currently employed?

15 A: Parker, Poe, Adams and Bernstein.

16 Q: All right. Starting with Parker Poe and moving
17 backwards, tell us where you've been employed.

18 A: Parker, Poe, Adams and Bernstein, been there
19 five years. I'm in charge of the firm's state
20 and local tax practice. Prior to that, I was
21 the director of the South Carolina Department
22 of Revenue for five years. Prior to that, I
23 had the privilege of being an Administrative
24 Law judge. I served in that capacity for ten
25 years. Prior to that, I was with the Attorney



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1 General's Office here in South Carolina
2 responsible for the tax division, litigated
3 pretty much all of their cases, and did that
4 for 15 years..

5 Q: Okay. And tell us a couple or some of your
6 more prominent cases.

7 A: The one that everybody talks about is *Geoffrey*
8 *v. Tax Commission*, basically held that a party
9 who is using an intangible in the state is
10 subject to the tax, even though -- in South
11 Carolina, even though they may not have
12 physical presence here. NCR, we litigated a
13 couple of those cases. They involved
14 apportionment and allocation. *Lowenstein* case,
15 again, was another case with allocation and
16 apportionment. *Emerson*, there were several
17 cases having to do with partnerships, about
18 where do you source the income partners.
19 *Dalton v. Department of Revenue or Tax*
20 *Commission* was one of those. There have been
21 a fair number of them.

22 Q: Okay.

23 MR. MAYBANK: Your Honor, we would move to admit Ray
24 Stevens as an expert on policy matters
25 regarding multi-state taxation, including



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1 policy matters regarding apportionment of
2 income for multi-state service providers.

3 MS. WOOTEN: The Department has no objection.

4 THE COURT: Okay.

5 Q: All right. Let's go over, in the interest of
6 time, just a few basic issues. How does South
7 Carolina tax multi-state corporations which
8 have nexus and do business in the state?

9 A: It depends on what activity they're engaged in
10 in the state. For instance, if you're a
11 manufacturer, you may have one method. If
12 you're in the service business you might have
13 another method. And we have some unique
14 statutes in the state that deal with railroads
15 and shipping companies, airline companies,
16 pipelines. I think ---

17 Q: Telephones?

18 A: Telephones. All of those are either based on
19 miles traveled in the state, tonnage. They're
20 rather unique to the particular industry.

21 Q: Okay. Very briefly, how do we tax
22 manufacturers?

23 A: Manufacturers are -- there's an interesting
24 history associated with them. Originally, we
25 taxed manufacturers based on payroll, property



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1 and sales. And the way we would do it is we
2 would take the payroll in South Carolina versus
3 payroll everywhere, property, same sort of
4 analysis. As the years went on our General
5 Assembly amended that statute. We still use
6 payroll, property and sales, but we double-
7 weighted the sales. And then finally, around
8 2006 and about that time, our General Assembly
9 amended the statute and we are now 100 percent
10 sales for that particular activity.

11 Q: And how does single sales or 100 percent sales,
12 how do we actually tax manufacturers?

13 A: Yeah, the way we do that is that our sales
14 statute looks to the location in which the
15 insert, the end delivery of the item takes
16 place. So if I am a manufacturer in South
17 Carolina, my customers are outside of the
18 state, I'm delivering outside of the state,
19 those sales are all sourced to the location
20 where the sales are delivered.

21 Q: Okay. To where the customers location?

22 A: Exactly.

23 Q: Okay. And so would you describe that as a
24 market share statute?

25 A: Yes, very much so.



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1 Q: All right. So the General Assembly knows how
2 to draft market share statutes?

3 A: It does.

4 Q: All right. And you've heard the testimony. Is
5 Dish a service provider or a seller of tangible
6 personal properties?

7 A: Dish is a service provider, although it has a
8 small portion of its income from the leasing of
9 tangible personal property.

10 Q: Okay. And how does the South Carolina Tax
11 multi-state providers, multi-state service
12 providers?

13 A: Service providers are by a particular statute,
14 it's 12-6-2295 Subsection (A)(5). And it
15 sources that based on the income-producing
16 activities entirely within the state, all of
17 that is in the state. But if the income-
18 producing activity is performed partly within
19 the state and partly outside the state, then
20 that income is sourced based on where those
21 performances occur.

22 Q: All right. Do you know the basis of the
23 statute?

24 A: Generally, it has similar language to the
25 UDITPA provisions, but as Her Honor has already



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1 pointed out to us in her summary judgment, the
2 statutes are not identical. They do have some
3 meaningful differences.

4 Q: Okay. And give us an example of some of the
5 meaningful differences.

6 A: One of them is that the specific language of
7 the UDITPA provision has a extra clause at the
8 end, and it says based on cost of performance.
9 The statute that South Carolina has adopted
10 does not literally contain that language.

11 Q: Okay. And briefly, how does cost of
12 performance -- what does cost of performance
13 measure or attempt to accomplish? And if I
14 might ask you just very quickly to quote
15 Hellerstein and Swain on the definition of cost
16 and performance. Do you have that up there?

17 A: No, I do not. I have certainly looked at it.
18 I don't have it literally in front of me.

19 Q: Okay. Let me just give you. Hellerstein gives
20 such a good definition, it might be better than
21 yours.

22 A: I suspect. All right. Despite the theoretical
23 and practical objections to UDITPA's income-
24 producing activity/cost of performance rule for
25 attributing receipts from services to the



1 numerator of a state sales factor, most states
2 with corporate income taxes still take this or
3 closely analogous approach. Unless modified by
4 statute or regulation, this approach requires
5 the taxpayer first to determine which of its
6 activities are the income-producing activities
7 for its service income and then to determine
8 where the cost of performing those income-
9 producing activities were incurred. The
10 taxpayer then compares the amount of cost of
11 performance incurred in the taxing state and
12 the amount of its cost to the other individual
13 states. The sales are attributed to the state
14 with the greatest amount of cost of
15 performance. And, of course, South Carolina
16 deviates from that because we don't have an
17 all-or-nothing statute. We have a pro rata
18 statute, so in South Carolina you would prorate
19 the cost of those activities here versus the
20 cost of the activities in other states.

21 Q: Okay. All right.

22 MS. WOOTEN: Your Honor, can we get the witness to
23 say what section and page he's reading from.

24 MR. MAYBANK: That's in Section 9.18(3)(b).

25 MS. WOOTEN: Thank you.



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- 1 Q: South Carolina doesn't have UDITPA cost of
2 performance language you just said. How does
3 a service provider located in Englewood,
4 Colorado, how do they fill out their tax
5 return? How would they calculate the income
6 apportioned to South Carolina?
- 7 A: Yeah ---
- 8 Q: And let me say, the only issue in this case,
9 mercifully, is the preparation of the
10 numerator.
- 11 A: Right. Like most taxpayers, of course, they
12 would begin with whatever the statute tells
13 them they're supposed to be doing.
- 14 Q: So they first look to the statute?
- 15 A: Correct.
- 16 Q: Okay. Does any statute make South Carolina a
17 market share state for service providers?
- 18 A: It does not.
- 19 Q: What would you look at next?
- 20 A: Hopefully you'd be able to find regulations
21 that gave you some guidance on how to complete
22 the return.
- 23 Q: Okay. Does any DOR regulation state that South
24 Carolina is a market share state for service
25 providers?



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- 1 A: No regulation says that.
- 2 Q: Okay. What would you look at next?
- 3 A: You would hope there would be some policy
4 documents issued by the agency that would help
5 you understand how to file.
- 6 Q: A policy document such as PLRs?
- 7 A: Yes. Revenue rulings, etcetera.
- 8 Q: Okay. Do any of these DOR policy documents
9 state South Carolina is a market share state
10 for service providers?
- 11 A: They do not.
- 12 Q: Okay. Do these policy documents state South
13 Carolina's a cost of performance state?
- 14 A: Yes. There is one, it's a Private Letter
15 Ruling. Of course, Private Letter Rulings can
16 be relied on specifically by the taxpayer to
17 whom they're granted. But, nonetheless, they
18 do give the thinking of the Department, so
19 taxpayers routinely look at Private Letter
20 Rulings to decide how best they should comply
21 with the law. And then Private Letter Ruling
22 2013, I think it is about ---
- 23 Q: I mean, three, 13-3?
- 24 A: 2013-3, the Department is asked about how to
25 source the income of an engineering company.



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1 And the Private Letter Ruling looks to *Lockwood*
2 *Greene*; it looks to where those services are
3 performed. And it specifically goes on to say
4 that in deciding where those services are
5 performed you can use independent contractors
6 as well.

7 Q: Okay. All right. So after, where would you
8 look, what would you look on the DOR website
9 next after you finish looking at policy
10 documents?

11 A: It's not unusual for agencies to publish
12 manuals, and the Department of Revenue has done
13 so. One of the manuals is the Economic
14 Incentive Manual. It does, at least, have some
15 guidance associated with how to file.

16 Q: Okay. Is that Economic Development Incentives
17 published by the DOR?

18 A: It is.

19 Q: Okay. Is that published every year?

20 A: It is updated as best they can. I don't know
21 that it's -- I think it is annually. But, and
22 the way the Economic Incentive Manual addresses
23 this issue is it looks to *Lockwood Greene* as
24 well. It asks us to decide where services are
25 performed. That's the standard.



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- 1 Q: Okay. Does it describe South Carolina as a
2 market share state for service providers?
- 3 A: No. South Carolina is not a market share
4 state.
- 5 Q: Okay. And you say this incentives manual does
6 cite *Lockwood Greene*?
- 7 A: Yes.
- 8 Q: All right. And there's a discontinued DOR
9 publication, Corporate Income Tax Manual, last
10 published in 2005. Are you familiar with it?
- 11 A: Yes, I am. And it says that South Carolina is
12 not a strict cost of performance state, and it
13 officially says that South Carolina is not a
14 market state.
- 15 Q: Okay.
- 16 A: Rather, the way that you determine the income
17 is based on the performance of the services.
- 18 Q: Okay. And what would you look at next?
- 19 A: It's often helpful to be sure the instructions
20 give you some indication of how to file.
- 21 Q: And our corporate income tax form has
22 instructions, correct?
- 23 A: It does.
- 24 Q: All right. Do the instructions tell you, a
25 service provider, that South Carolina is a



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- 1 market share state?
- 2 A: They do not.
- 3 Q: Okay. And does it simply cite the statute or
- 4 does it give any more detail?
- 5 A: It simply recites -- restates the statute.
- 6 Q: Okay. Have you ever had the occasion to look
- 7 at state surveys by B&A or other legal
- 8 publishers, and do they address the topic, or
- 9 you haven't been able to find any?
- 10 A: B&A does have an annual survey and I believe
- 11 that South Carolina, at least in the most
- 12 recent editions, seems to not answer the
- 13 question.
- 14 Q: Okay. How did they previously answer; do you
- 15 ---
- 16 A: Well, to the best of my recollection, and these
- 17 go way back, there was a common understanding,
- 18 at least in the tax practice industry, that is,
- 19 the accountants and those who practice in the
- 20 area, that South Carolina was a cost of
- 21 performance state.
- 22 Q: Okay. All right. Have you have occasion to
- 23 review the DOR's work papers in this case?
- 24 A: I have.
- 25 Q: And what rules does it assert to apply to the



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1 apportionment of Dish's income?

2 A: Yeah, they again look to ---

3 Q: And let me, what exhibit number is on there?

4 A: I believe this one is Respondent's Exhibit
5 Number 2.

6 **(Respondent's Exhibit Number 2 was introduced into**
7 **the record.)**

8 Q: Okay. Do they look at *Lockwood Greene*? Yeah,
9 let me back up a bit. Work papers being what
10 the DOR produced in this particular audit for
11 Dish?

12 A: Yes, they do rely on *Lockwood Greene*. It
13 appears that gross receipts are sourced in
14 this -- in the state, which is most
15 significantly associated with the production of
16 the income. And then it says, for example,
17 personal services, where those services are
18 performed and it goes on to address intangibles
19 ---

20 A: Okay. All right. And what do you look at next
21 after you go through all the DOR documents, you
22 go through the tax form, you go through the
23 work papers. What would an out-of-state
24 taxpayer in Englewood, Colorado, filling out
25 his first South Carolina return, what would he



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1 look to?

2 A: Yeah, it's essentially after having exhausted
3 the resources within the agency, you would look
4 outside the agency, and that's when you would
5 begin looking at court decisions that might
6 help.

7 Q: Okay. And is there appellate decisions that
8 answer the question of how multi-state service
9 providers apportion income to South Carolina
10 for purposes of preparing a numerator?

11 A: Yes, it's the *Lockwood Greene* decision.

12 Q: Okay. Did you play in role in *Lockwood Greene*?

13 A: Yes, I did. *Lockwood Greene* was a case that I
14 litigated when I was with the Attorney
15 General's Office, argued the case both at the
16 circuit court level and the appellate court
17 level, wrote the briefs, directed the trial,
18 intimately familiar with the case.

19 Q: Okay. And you were representing, obviously,
20 the former South Carolina Tax Commission?

21 A: That's correct.

22 Q: All right. What did the taxpayer argue in
23 *Lockwood Greene*?

24 A: The taxpayer was arguing, essentially, a market
25 share, although, they did not literally use



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1 that terminology. Rather the terminology they
2 used is that the income should be located at
3 the place of the payor.

4 Q: Okay. And let me -- I can't remember whether
5 we've introduced this into evidence or not. So
6 this is the Tax Commission decision in
7 Lockwood Greene. Out of abundance of caution,
8 I know we've introduced a lot of Lockwood
9 Greene, I just can't remember if this one is or
10 not. So out of an abundance of caution, I
11 would move to admit into evidence as an exhibit
12 the Tax Commission decision in Lockwood Greene.

13 MS. WOOTEN: No objection from the Department.

14 Q: Okay.

15 THE COURT: It's admitted.

16 (Petitioner's Exhibit Number 37 was marked for
17 identification purposes and admitted into evidence.)

18 Q: Now, getting back to ---

19 MS. WOOTEN: What number -- excuse me, what number
20 will this be, Petitioner's?

21 COURT REPORTER: 37.

22 MS. WOOTEN: 37. Thank you.

23 Q: All right. I would like to take you back to
24 Lockwood Greene a bit. Quickly, tell us again,
25 what did the taxpayer argue?



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- 1 A: The taxpayer argued that the income derived
2 from its engineering services should be sourced
3 to the location of the payor.
- 4 Q: Okay. Of its customers?
- 5 A: Correct.
- 6 Q: All right. Is that basically market share?
- 7 A: It is indeed.
- 8 Q: All right. And why did he make that argument?
- 9 A: Well, Lockwood Greene is a very successful
10 engineering company, but a large number of its
11 clients are outside the state. So by sourcing
12 its income to the location of its customers, it
13 would have eliminated or significantly reduced
14 its tax liability in South Carolina.
- 15 Q: Okay. Where were most of its costs of
16 performance?
- 17 A: Most of its cost of performance was in South
18 Carolina, specifically in its Greenwood office.
- 19 Q: Okay. So its cost of performance was in South
20 Carolina; its customers were largely in other
21 states?
- 22 A: Correct.
- 23 Q: All right. And what did the Tax Commission
24 argue?
- 25 A: Tax Commission argued that cost of performance



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1 was the appropriate way to handle sourcing.

2 Q: Did I give you that?

3 A: No.

4 Q: All right.

5 A: Yes, and I refer you to page five of the
6 exhibit beginning at the first portion of the
7 full paragraph. It says, "If the service of
8 drafting and designing plans are performed in
9 South Carolina, such cost of performance
10 creates South Carolina gross receipts."

11 Q: Okay. And they used kind of antiquated terms,
12 they didn't always use COP. What antiquated
13 term did the Tax Commission use?

14 A: Well, the Tax Commission, when the matter went
15 to trial, ended up using place of activity as
16 opposed to the taxpayer's use of the words
17 location of the payor.

18 Q: Okay.

19 A: But in essence, they're the same. Its market
20 sourcing was the location of the payor; cost of
21 performance was the place of activity.

22 Q: Okay. How did the Tax Commission rule?

23 A: Tax Commission ruled in favor of the Tax
24 Commission. They ruled against the taxpayer.
25 And again, it was based on the cost of



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1 performance methodology.

2 Q: Okay. Did the taxpayer appeal?

3 A: The taxpayer did appeal to the circuit court
4 and the same result occurred there, the circuit
5 court ruled against the taxpayer. The evidence
6 before the court was based on the payroll of
7 the engineers in South Carolina versus the
8 payroll in other states, a cost of production
9 factor.

10 Q: Okay. And so which rule did the circuit court
11 opine was the law in South Carolina?

12 A: Would have been the place of activity.

13 Q: Okay. Did the taxpayer further appeal?

14 A: The taxpayer did appeal. Court of appeals
15 heard the case. The result at the court of
16 appeals was the same. The taxpayer's place of
17 the payor was found -- the location of the
18 payor was found to be incorrect, and the Tax
19 Commission's place of activity was found to be
20 the correct place.

21 Q: Okay. Prior to the *DIRECTV* decision, was there
22 any ALC decisions on point?

23 A: Did you say prior to?

24 Q: *DIRECTV*?

25 A: Oh, prior to *DIRECTV*, Rent-A-Center.



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1 Q: Okay.

2 A: Was a matter addressed by the Administrative
3 Law Court.

4 Q: All right. And did the ALC in Rent-A-Center
5 reference *Lockwood Greene*?

6 A: Yes. It, in fact, ended up saying that
7 *Lockwood Greene* was about the only thing you
8 had out there and the fact that the General
9 Assembly had subsequently codified *Lockwood*
10 *Greene* as our law.

11 Q: Okay. And there was an aspect of -- was there
12 not an aspect of Rent-A-Center Texas versus the
13 DOR regarding the sourcing of services?

14 A: Yes. The sourcing of services had to do with
15 three entities really. We had Rent-A-Center
16 East, Rent-A-Center West, and we had Rent-A-
17 Center Texas. And Rent-A-Center Texas was the
18 entity that provided significant management
19 and accounting and lots of the other
20 administrative expenses. So those costs, those
21 services had to sourced to some place, and the
22 issue was where do they get sourced. In the
23 Rent-A-Center case, the court ended up finding
24 that those services were performed in Texas,
25 and therefore, its understanding was that



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1 that's where its cost were. And as a result,
2 those services were sourced to Texas.

3 Q: Okay. Because that's where the cost of
4 performance was?

5 A: Exactly.

6 Q: All right. And to your knowledge, I know
7 you're a former director of DOR, have any bills
8 been introduced to overrule *Lockwood Greene* and
9 make South Carolina a market share state?

10 A: I am not aware of one.

11 Q: Okay. And RAC Texas wasn't an engineering firm
12 like *Lockwood Greene*?

13 A: Correct. It was management services, which
14 engulfed a number of activities as I say,
15 accounting, human resources, advice and
16 management, that sort of things.

17 Q: But it wasn't a personal service, I guess
18 that's the term, personal service ---

19 A: Correct.

20 Q: --- firm like *Lockwood Greene*?

21 A: It was not a personal service activity.

22 Q: Okay. All right. For many years, the DOR
23 angrily introduces its own technical
24 corrections bill called back bill. Are you
25 aware of them ever including a market share



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1 statute in these bills?

2 A: I do not recall one.

3 Q: All right. Do tax professionals ever consult
4 treatises, and if so, which ones?

5 A: We do. And Hellerstein is the most noted.

6 Q: Okay. Hellerstein and Swain is the most noted?

7 A: Correct.

8 Q: How does that treatise describe South Carolina?

9 A: They describe them in footnotes. And South
10 Carolina is noted, at least in one spot, as
11 being a cost of performance on a pro rata
12 basis. It is identified, at least in a recent
13 version, *DIRECTV* is cited. In that particular
14 provision, they identify the statute that we
15 rely upon.

16 Q: Okay. All right. Let me ask you about another
17 South Carolina case, *Mercury Motors*. Would you
18 please discuss it?

19 A: Yes. *Mercury Motors* was a case back in the
20 '60s. I think it was '64 or '65 or so. And it
21 involved an entity whose business was to
22 transport various items of freight. And ---

23 Q: Let me interrupt you. What was the taxpayer's
24 argument in *Mercury Motors*?

25 A: The taxpayer's argument was that the taxing



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1 method used by South Carolina was
2 unconstitutional and that it violated due
3 process in the commerce clause. And their
4 essential grounds basically said, because South
5 Carolina taxed them on the amount of miles
6 driven through the state, because they didn't
7 pick up freight in the state and they didn't
8 deliver freight in the state, they were simply
9 taxed on the passing through the state. That
10 ended up taxing them on roughly 17 percent of
11 their income; whereby if you simply looked at
12 their deliveries and their pickups, they would
13 have only been taxed at less than one percent.
14 They thought that was distortion; it was
15 unconstitutional.

16 Q: Okay. So would it be fair to say they argued
17 South Carolina is a market share state?

18 A: Pretty much. They ended up -- the court
19 actually used the words "income-producing
20 activities" when they made their decision.
21 And in the case they found that all of the
22 activities carried out by the freight company
23 were all incoming producing, and since the
24 travel across the roads in South Carolina
25 occurred here, the court felt that it was not



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1 unconstitutional to subject them to the 17
2 percent tax.

3 Q: Okay. Whereas their percentage of customers in
4 South Carolina was how much?

5 A: I think it was either one percent or less than
6 one percent.

7 Q: Okay. All right. And what relevance does
8 *Mercury Motors* have to this case?

9 A: It has relevance because the court used the
10 phrase "income-producing activities." In
11 making its analysis it had to figure out what
12 were the income-producing activities. And it
13 said pretty much from beginning to end what it
14 was doing was selling the delivery of freight
15 and not only was the picking up and the driving
16 through and the dropping off, as well as the
17 solicitation for the business, they said all of
18 that was income-producing activities.

19 Q: Okay. And the Tax Commission had made a
20 similar argument, correct?

21 A: Correct.

22 Q: Okay. And obviously the reason the Tax
23 Commission did was because only one percent of
24 the customers were in South Carolina?

25 A: Right.



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1 Q: So what would a tax -- if we were a market
2 share state, what would the tax have been based
3 on?

4 A: It would have based on where the customer
5 actually was. And, in this instance, none of
6 those customers were in South Carolina. So
7 South Carolina would have gotten a nebulous
8 amount, a very negligible amount.

9 Q: And because the court ruled we were not a
10 market share state, how much income did South
11 Carolina get, percentage?

12 A: Well, we ended up -- yeah, 17 percent is a
13 significant difference.

14 Q: All right. And was that a Court of Appeals or
15 Supreme Court case?

16 A: Supreme Court case.

17 Q: Okay. Have you had a chance to review Judge
18 Anderson's decision in *DIRECTV*?

19 A: I have.

20 Q: And if you could briefly discuss your reason of
21 the case.

22 A: Yeah, in *DIRECTV* an entity sold programming and
23 Judge Anderson, when he heard the case, had to
24 ask the -- answer the question about the
25 income-producing activities. Essentially, he



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1 found that the parties in the case, the
2 taxpayer in the case, did not provide him with
3 sufficient factual data to allow him to
4 determine what the income-producing activities
5 were, so he was left to rely upon what the
6 Department of Revenue had provided. And
7 therefore, he ended up finding that even though
8 he suggested that there were other activities
9 that were income producing, what he believed
10 factually he had been shown only came from the
11 Department of Revenue. So he ended up adopting
12 the dollar amounts associated) with the
13 Department.

14 Q: Okay. Did you agree with the decision?

15 A: No, I do not.

16 Q: Okay. Have you reviewed Judge Robinson's
17 decision denying both our -- the DOR and our
18 motion for summary judgment?

19 A: Yes, I have.

20 Q: And how would you interpret that decision?

21 A: I think she has found that this is not purely
22 a legal question. She believes that there are
23 factual issues to be determined. And in her
24 denial of both parties' motions for summary
25 judgment, this Court found we are not a market



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1 state, and we are not strictly a cost of
2 performance state. And I believe that is a
3 correct position. And strictly cost of
4 performance, essentially means we have not
5 adopted hook, line, and sinker the UDITPA
6 method of sourcing income in South Carolina.

7 Q: Okay. So if you're in Englewood, Colorado,
8 you're filling out your first South Carolina
9 return, you've got 49 other states to do, you
10 look at the statutes, you look for regs or
11 policy documents, Lockwood Greene, Judge
12 Robinson's decision, how would you advise Dish
13 to prepare their return, the numerator?

14 A: Yes. I would advise them to prepare the
15 return, figure out the numerator, based on cost
16 of performance as the measure by which you
17 would decide where your income-producing
18 activities have occurred.

19 Q: Okay. It's the pro rata cost of performance?

20 A: We would do pro rata.

21 Q: And very briefly, give us the difference
22 between pro rata and non-pro rata cost of
23 performance.

24 A: Right. In the non-pro rata, which is commonly
25 referred to as the all-or-nothing, what you



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1 have to do is to identify the cost of
2 performance in your state. Then if you find
3 the costs of performance are higher in any
4 other state, you don't get anything in your
5 state. All of it is going to be sourced to
6 another state, so that's the all-or-nothing.

7 Q: And let me give you an example. If I'm in
8 South Carolina, 49 percent of my cost of
9 performance is in South Carolina, now right on
10 the North Carolina border, so 51 percent is in
11 North Carolina, how much does South Carolina
12 get under the classic rule?

13 A: They get zero.

14 Q: Okay. And what's pro rata cost of performance?

15 A: Following up on your example with the 51
16 percent in North Carolina cost of performance
17 and 49 percent in South Carolina cost of
18 performance, 49 percent of the revenue is
19 sourced to South Carolina. It's a very fair
20 and equitable method.

21 Q: Okay. So in this case you've got a -- you've
22 got a dispute. We contend South Carolina is a
23 pro rata cost of performance; the Department
24 says we're a market share state. What is your
25 opinion, you're advising taxpayers across the



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1 country filing their returns?

2 A: Yes. We are a cost of performance pro rata
3 state. We are not a market state. In order
4 for us to become a market state, legislation
5 would have to have been promulgated in order to
6 make the switch.

7 Q: Okay. And how does *Mercury Motors* affect your
8 opinion?

9 A: *Mercury Motors* supports the opinion because the
10 issue in *Mercury Motors* was how do I figure out
11 what the income-producing activities are. And
12 the court in *Mercury Motors* says it's the
13 entire transaction from the beginning of the
14 pick up of the freight, as well as the
15 solicitation of the orders all the way through
16 to the delivery of the freight. All of those
17 activities are income producing in this case.

18 Q: Okay. So the Supreme Court rejected the market
19 share theory in that case?

20 A: Correct.

21 Q: All right. Anything else you want to add
22 regarding pro rata or market share we haven't
23 discussed?

24 A: No, I think that covers it.

25 Q: Okay. Let's turn to the statute and Judge



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1 Anderson's decision and Judge Robinson's
2 decision. What is your opinion is an income-
3 producing activity?

4 A: Income-producing activity are any transactions
5 and activities encountered in the normal course
6 of ordinary business that are designed to
7 produce income or profit.

8 Q: What do you base your definition on?

9 A: It is not literally the definition of the
10 UDITPA or Multistate Tax Commission, but it is
11 the definition that is most prominent among the
12 cases decided.

13 Q: Okay. And just for purposes of the record,
14 extremely briefly, who is the Multistate Tax
15 Commission?

16 A: They're an entity that actually constitutes a
17 compact. Many of the western states are
18 members of it. The Multistate Tax Commission
19 promulgates regulations. The individual member
20 states, in essence, agree to adopt those and
21 apply those as their law in their state.

22 Q: Is South Carolina a full member of the MTC?

23 A: We are not.

24 Q: Are you a part member?

25 A: There is some membership associated with



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1 various nexus activities. At one point in
2 time there was some activity associated with
3 allowing MTC to make audits. But I think
4 that's since been dropped.

5 Q: Okay. All right. And very briefly, who's
6 UDITPA?

7 A: UDITPA is a group which designs uniform laws.
8 It's the Uniform Division for Income Tax
9 Purposes Act. And it is designed to create a
10 uniform framework. Many states have adopted
11 it. South Carolina is not a UDITPA member.

12 Q: Okay.

13 A: Has not adopted UDITPA as its statute.

14 Q: Okay. Do we have many statutes that are very
15 close to UDITPA?

16 A: We do. We do.

17 Q: Okay. Do UDITPA or MTC promulgate definitions
18 and regulations?

19 A: They do.

20 Q: Okay. Does MTC promulgate regulations?

21 A: They do.

22 Q: All right. And what does their regulation say
23 on income-producing activities?

24 A: Their regulation's much like what I just
25 described.



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1 Q: Okay.

2 A: And it is essentially one which decides whether
3 or not the transaction's in the ordinary course
4 of business and whether or not it's designed to
5 produce profit or income.

6 Q: Okay. Now there are winners and losers for
7 South Carolina domestic businesses under the
8 DOR's market share theory, aren't they?

9 A: Yes, there are winners and losers.

10 Q: And who is the big winners?

11 A: The big winners would be those individuals who
12 are in our state. If you're a manufacturer and
13 you've got lots of payroll and you've got lots
14 of property all right here in Columbia, but all
15 of your customers are outside of the state,
16 even though you're benefitting from significant
17 fire protection, police protection, all of the
18 services of the state, that income is going to
19 be sourced outside of the state because all of
20 your customers are out of the state.

21 Q: That example you gave us is found in a statute,
22 the explicit statute, correct?

23 A: It is indeed.

24 Q: All right. Who's the winner and loser in the
25 service industry under the DOR's market share



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1 theory?

2 A: Yeah. Under the service, the way the
3 Department wants to view this case is that the
4 services are going to be sourced where the
5 customer is.

6 Q: Okay.

7 A: So if you have extensive activities in the
8 state, again, you're benefitting from much of
9 the protections the state provides, but all of
10 your customers are outside of the state,
11 according to the Department, that income would
12 all be sourced outside the state.

13 Q: Okay. So if you are a South Carolina business
14 paying under a pro rata cost of performance,
15 you would be -- and you had the vast majority
16 of your customers out of state, you would be
17 way overpaying your taxes, correct?

18 A: You would be.

19 Q: Okay. Has the DOR ever told South Carolina
20 businesses through a policy document or
21 instructions in their forms, said, hey, you
22 don't have to pay taxes on revenue earned from
23 out-of-state customers?

24 A: I am unaware of any such document.

25 Q: Okay. All right. Moving back to the facts of



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1 this case. In your opinion, is programming an
2 income-producing activity?

3 A: It is.

4 Q: And why?

5 A: Programming is, as we've heard from our prior
6 witness, it is what Dish sells. And if it were
7 not for the adequacy of the content, there
8 would be no income.

9 Q: Okay.

10 A: No one contacts Dish and says I just want your
11 antenna; I just want the installation. Nobody
12 asks for that; what they're asking for is the
13 content.

14 Q: Okay.

15 A: And programming is critical to what they do to
16 produce their income.

17 Q: Okay. They pay \$750 million just to ESPN.
18 Would that be considered an income-producing
19 activity?

20 A: It is. All of the -- all of the activities
21 which they carry out in their normal course of
22 business which is designed to produce the
23 revenue, and the revenue is the programming,
24 all of those activities are activities that
25 produce income. And under the statute what



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1 we're looking for is identify the income and
2 then identify those activities which produce
3 the income.

4 Q: Okay.

5 A: Programming is certainly a part of that.

6 Q: And very briefly, are satellites and uplinks an
7 income-producing activity?

8 A: They are. And again, for much the same
9 reasoning. We've got to get programming to the
10 customer because that's what the customer's
11 purchased. I can't get the programming to the
12 customer unless I incur the activities, unless
13 I have those activities that allow me to get
14 the signal to where it's supposed to go.

15 Q: Okay. And how about advertising and marketing,
16 is that income produced?

17 A: Yes. Advertising and marketing are very much
18 income-producing activities because those
19 activities are necessary to convince me or you
20 to buy the service. The activities take place
21 in the form of direct marketing, any number of
22 methods that Dish uses to get me or you,
23 convince us to buy the service.

24 Q: Does it matter that we see a bunch of -- happen
25 to see it traveling. Does it matter that 99



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- 1 percent of the time you see the advertising,
2 you're seeing it in South Carolina?
- 3 A: Does it matter that you're seeing it here?
- 4 Q: Whether that -- does that make it more or less
5 income producing?
- 6 A: No, it does not. Again, all of these are
7 activities that are incurred to get me what
8 I've asked for. And what I've asked for is
9 the programming. Advertising is a necessary
10 part of that to get me to buy the service.
- 11 Q: Okay. How about subscriber equipment, very
12 briefly?
- 13 A: I'm sorry.
- 14 Q: Is it income producing? Subscriber equipment?
- 15 A: Oh, the equipment, yes. We heard much
16 testimony about how sophisticated the equipment
17 is. The equipment itself is a part of getting
18 me what I asked for; it's what I'm paying for.
19 So the equipment itself is a part of the
20 income-producing activities.
- 21 Q: All right. Now, is installation income-
22 producing activity?
- 23 A: Again, unless the equipment -- yes. Again,
24 unless the equipment is properly installed, I
25 don't get what I purchased, and therefore, it



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1 is income producing.

2 Q: And the fact that we actually bill for it, does
3 that make it income producing?

4 A: It does indeed.

5 Q: All right. Is in-home repair an income-
6 producing activity?

7 A: Same analysis, if I am not being able to
8 receive that which I have purchased, I am very
9 unhappy. Being sure that it is properly
10 repaired is a necessary activity to be sure
11 that the company receives the income that it's
12 hoping for.

13 Q: And the fact that we actually bill for it, does
14 that make it more income producing?

15 A: Indeed it does. Also income.

16 Q: Okay. Are call centers an income-producing
17 activity? As we've previously indicated they
18 actually take your credit card.

19 A: Yes, the call centers play an integral role
20 because, as we've been told numerous times, the
21 call center is an important aspect in getting
22 me to upgrade my services, be sure that I'm a
23 satisfied customer. It eliminates the process
24 of churning. It keeps me a satisfied Dish
25 customer.



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1 Q: Okay. And any activity that would actually
2 take and run my credit card, could you think of
3 any scenario that's not an income-producing
4 activity?

5 A: No, I'm not aware of a scenario which that
6 would not be an income-producing activity.

7 Q: Okay. From a fairness or an equity standpoint,
8 is there a problem with the market share
9 method?

10 A: Market share, yes. Market share fails to give
11 adequate consideration to the state that's
12 providing many of the services that the
13 taxpayer is receiving. For instance, if I'm
14 conducting a significant lab activity, I'm
15 providing a service that identifies some
16 particular antibody that's in your blood or
17 something, very sophisticated activity,
18 requires a significant amount of services from
19 the state. If all of my customers are outside
20 of the state, I don't pay any tax. This is
21 under the theory by the Department of Revenue.
22 So it is a bit unfair for the state to have
23 provided significant services for which I
24 receive -- the state receives no compensation
25 for.



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- 1 Q: Okay. If states -- switching gears. Regarding
2 market share, have the states adopted market
3 sourcing statutes or regulations?
- 4 A: There are many states who have adopted market
5 share or market sourcing, and they have done so
6 by statutes or regulations.
- 7 Q: And does Hellerstein list the various statutes?
- 8 A: He does. I don't remember the number, but it's
9 a growing number. States are routinely moving
10 in that direction. South Carolina has not.
- 11 Q: Okay. And in Hellerstein's discussion, would
12 it be fair to say that virtually everything it
13 cites is either a statute or a regulation?
- 14 A: Correct.
- 15 Q: Okay. Now, even if South Carolina is a pro
16 rata cost of performance state, doesn't the DOR
17 have an alternative where they feel the
18 taxpayer's income tax return doesn't accurately
19 -- is distortive or unfair to South Carolina --
20 I mangled it up a bit -- so the tax return is
21 accurate, but it's distorted, it's unfair to
22 South Carolina; does the Department have an
23 alternative there?
- 24 A: Yes, they do. And as you suggest, under the
25 statute what the Department would do is they



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1 would look at a taxpayer's activities in the
2 state. They would then ask themselves what is
3 the appropriate method for them to be filing.
4 They would then decide yes, they are filing
5 under the appropriate method. But after
6 looking at it, they would decide that the
7 appropriate method doesn't fairly represent
8 what they do in the state. And if they find
9 that to be the case, they then have the
10 authority to issue a different method and, in
11 fact, can force that on the taxpayer even if
12 the taxpayer doesn't like that method.

13 Q: Okay. So, for example, Dish was not in
14 Englewood, Colorado; it was in Columbia.
15 Thirteen billion dollars worth of revenue
16 flowing into Columbia, a billion dollars of
17 taxable income, and the state's only, according
18 to the Department of Revenue, they're only
19 taxing 1.5 percent of that. Would the
20 Department have the alternative under equitable
21 apportionment to say, hey, we're providing
22 services to 10,000 people, we think 1.5 percent
23 is a bit low?

24 A: They would have the authority to impose an
25 alternative apportionment method and, you



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1 know, the authority is there. It would be
2 interesting to see if they would exercise that
3 authority.

4 Q: Okay. But they didn't exercise it in this
5 case, correct?

6 A: They did not.

7 Q: And they have the burden of proof? Who has the
8 burden of proof?

9 A: Yes. The party who asserts that there's a new
10 method that should be imposed is the party who
11 has the burden of proving that method.

12 Q: Okay. We will all agree there's a growing
13 movement for states to move from cost of
14 performance to market share, and I think we'd
15 all agree market share is certainly a
16 reasonable method. If South Carolina wanted to
17 do that, how would it do it?

18 A: Well, they could probably do it in two ways.
19 The easiest way, of course, would be to have a
20 statute. They would get the General Assembly
21 to pass a statute that's specifically says we
22 would source services based on where the
23 benefit of the service is received. There are
24 any number of sort of magic words states are
25 using. And as we've said before, in the



1 delivery of tangible personal property, our
2 General Assembly was very clear, and it said
3 that we're going to be sourcing that sale at
4 the last place that the delivery of that
5 tangible personal property incurred. They
6 simply have not done that with services.
7 They've got the ability to do it; they simply
8 haven't done it. So the best way to do it
9 would be to pass a statute. The second way
10 that they could do it is to promulgate a
11 regulation. And under the regulation they
12 would be attempting to interpret an existing
13 statute. And I gather the one that would be
14 most likely to be interpreted is the one that
15 we're looking at, 12-6-2295(A)(5). But we
16 don't have a statute, and we don't have a
17 regulation.

18 Q: Okay. Could the DOR change the law by audit,
19 just take a routine uniform audit position?

20 A: No, they cannot.

21 Q: Why can't they?

22 A: Interpretations of statutes by way of audit
23 require applying existing law. The existing
24 law in South Carolina has been set by *Lockwood*
25 *Greene*. *Lockwood Greene* is a cost of



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1 performance case. In 2006, for tax years
2 beginning in 2007, our General Assembly adopted
3 a rather comprehensive analysis of how you
4 source income. One of the underlying issues or
5 sub-issues in the *Lockwood Greene* case had to
6 do with what do we do with other taxpayers.
7 And some of those other taxpayers was a finance
8 company and a franchise company. Under the
9 laws it changed in 2007. Franchise companies
10 and finance companies now have their income
11 source based on where the intangible is in use.
12 Under the *Lockwood Greene*, at least those
13 underlying issue in there had to do with at
14 least mentioning how do we tax franchise
15 companies and finance companies. The decision
16 at that time, at least the Department of
17 Revenue took the position, that in a finance
18 company the income is going to be sourced to
19 where the borrower lived. And as to the
20 franchise company, the income was sourced where
21 the franchise restaurant was. That's what the
22 law was before. In 2007, our General Assembly
23 took *Lockwood Greene*, took out the parts and
24 codified them. Franchise companies and finance
25 companies are taken care of in subsection



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1 three. All of the rest of the entities
2 mentioned in *Lockwood Greene* are taken care of
3 in subsection five. And those companies were,
4 if I can remember most of them, but there was
5 advertising, there was building construction
6 was a part of it, health administration was
7 included, entertainment, engineers and law
8 firms and accounting firms. All of those types
9 of services are now included in subsection five
10 by that single provision of our General
11 Assembly in which it says if that activity,
12 that service activity, is performed partly here
13 and partly elsewhere, we're going to tax our
14 share of that based on where that income-
15 producing activity is occurring, and under
16 *Lockwood Greene*, the only authority that we had
17 and still have under the services apportionment
18 is based on cost of performance. That's what
19 *Lockwood Greene* was decided on. Our General
20 Assembly has codified *Lockwood Greene*, which is
21 what the court has said in the *Rent-A-Center*
22 cases. It says we codified *Lockwood Greene*.
23 We believe that's a correct statement.

24 Q: Okay. So DOR can't take A market share
25 position just strictly through audit?



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- 1 A: No, they cannot. And only -- there's a concept
2 referred to as a binding norm. If an agency
3 undertakes an approach that is so pervasive,
4 that is so non-bending as to be a binding norm,
5 under our Administrative Procedures Act, that
6 position has to be promulgated as a regulation.
- 7 Q: Okay. And now what we -- as you said
8 previously, there is no market share
9 regulations?
- 10 A: There is none.
- 11 Q: Okay.
- 12 MR. MAYBANK: That's all we have, Your Honor.
- 13 THE COURT: Ms. Wooten?
- 14 MR. STEVENS - CROSS-EXAMINATION BY MS. WOOTEN:
- 15 Q: Good afternoon, Mr. Stevens.
- 16 A: Hello, how are you?
- 17 Q: Good. Dish's position in this case is that
18 cost of performance is an appropriate method of
19 apportionment; is that correct?
- 20 A: That's correct.
- 21 Q: And your opinion is that Dish's activities in
22 providing programming services should be
23 apportioned based on cost of performance,
24 correct?
- 25 A: Based on a pro rata share of cost of



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1 performance, yes.

2 Q: Okay. But unlike UDITPA, Section 17, 12-6-2295
3 (A)(5) does not include the phrase "based on
4 cost of performance," correct?

5 A: It does not include it, but when you look at
6 the totality of the statute, the statute itself
7 asks you where are these activities being
8 performed. And the first part of the statute
9 asks you, what's my income? And then the second
10 one says, what are the activities that produce
11 that income? And the production of that income
12 is the performance, and that performance is
13 cost of performance. And that's what *Lockwood*
14 *Greene* decided, that's what our General
15 Assembly codified, in my opinion.

16 Q: But the key phrase in 2295(A)(5) is "income-
17 producing activity," correct?

18 A: The key phrase is income, then the producing
19 activities are what we look at to decide what
20 activities produce the income. The way you
21 measure the activities that produce the income
22 is the cost of performance.

23 Q: And you would agree that good tax policy
24 includes carrying out the language of the
25 statute as written, correct?



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1 A: I do.

2 Q: And you also agree that South Carolina is
3 literally not a cost of performance state,
4 correct?

5 A: It is not literally a cost of performance, with
6 literally in quotes, because I think what most
7 of us tend to think of is the UDITPA
8 definition. And if you look at the UDITPA
9 definition, it has specific language that is
10 simply not applicable in South Carolina. And
11 one of them is, the literal requirement that we
12 always use cost of performance. And the
13 language "cost of performance" has less of a
14 meaning in South Carolina, but what it does say
15 is, under *Lockwood Greene*, we have an
16 engineering firm who incurred costs associated
17 with its payroll, that was enough for our Court
18 of Appeals to say that income was supposed to
19 be pro rata. For instance, in *Lockwood Greene*,
20 there was no discussion about how one decided
21 the cost of the blueprints. There was no
22 analysis of all of the activities associated
23 with cost of performance. So we are literally
24 not the UDITPA cost of performance, but we are
25 South Carolina's cost of performance. There is



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1 no other method that I am aware of that our
2 appellate courts have looked at in deciding how
3 to source the income from services.

4 Q: Let's talk about *Lockwood Greene* for a second.
5 Does *Lockwood Greene* use the phrase "cost of
6 performance"?

7 A: The finding determined by the Department of
8 Revenue, the foundational document for the
9 whole dispute, uses that phrase.

10 Q: Does the Court of Appeals' decision reference
11 cost of performance?

12 A: It does not use the literal words. But it is
13 unequivocal that it is based on the payroll of
14 the engineers.

15 Q: And you said before that you're the primary
16 attorney representing the state in the *Lockwood*
17 *Greene* case?

18 A: That's correct.

19 Q: And the state put together a list of how it
20 sourced gross receipts for different industries
21 during *Lockwood Greene*; is that right?

22 A: Correct.

23 Q: And as the attorney for the state, did you
24 approve the submission of that list to the
25 *Lockwood* trial court in the form of



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1 stipulations of fact?

2 **MR. MAYBANK:** Your Honor, just let me jump in. We
3 filed a motion in limine to exclude the
4 stipulation, and as we -- the stipulation she
5 just asked him about, as we pointed out in our
6 motion in limine, our Supreme Court,
7 surprisedly, in two, three cases have said a
8 proper stipulation cannot stipulate as to the
9 law. The law is up to the judge. The two
10 parties can't agree in a stipulation that
11 someone violated the antitrust laws or were
12 negligent. So the stipulation in *Lockwood*
13 *Greene*, of course, is obviously 30 years before
14 us. We weren't a party to that stipulation,
15 obviously, because it didn't exist, but, more
16 importantly, our Supreme Court has said two or
17 three time, maybe four times, a proper
18 stipulation to a court cannot include legal
19 conclusions because that's up to the court to
20 decide. So she's going down this path and I
21 just wanted to make that objection now.

22 **THE COURT:** Ms. Wooten.

23 **MS. WOOTEN:** First, Your Honor, it was a stipulation
24 of fact, not a stipulation of law. I haven't
25 asked him anything about what's in the



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1 stipulation. I just asked if he approved the
2 submission of that in the *Lockwood Greene* case.

3 **MR. MAYBANK:** They stipulated it's -- these entities
4 were taxed. Now how is that a stipulation of
5 fact? That's what the stipulation says, media
6 companies are taxed this way, loan companies
7 are taxed this way. That's not a stipulation
8 of fact; that's a stipulation of law. I guess
9 our proper objection would be she's asking him
10 -- she hasn't moved the stipulation into
11 evidence, but she's asking him about something
12 that is inadmissible.

13 **THE COURT:** Okay. We'll determine that if she
14 decides that she wants to submit it.

15 **MR. MAYBANK:** I'm sorry. I can't hear you, Your
16 Honor.

17 **THE COURT:** I said, we'll decide that if she submits
18 it.

19 **MR. MAYBANK:** Okay.

20 **THE COURT:** But I'm going to allow her to ask the
21 question; although, we haven't made the
22 decision whether it's admissible or not.

23 **MR. MAYBANK:** An can I remind you, she objected
24 yesterday when I asked questions about
25 documents that were not in evidence and you



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1 sustained the objection, I might add.

2 **THE COURT:** Okay. Thank you.

3 **MS. WOOTEN:** If I can just point out, the document I
4 asked about was not prepared by the person that
5 was on the stand. I'm asking Mr. Stevens as
6 the attorney representing the state, what type
7 of documents he filed in that case.

8 **MR. MAYBANK:** Oh, we have no objection to that.

9 **MS. WOOTEN:** Okay.

10 **Q:** Would you like for me to restate the question?

11 **A:** Please, yes.

12 **Q:** As attorney for the state, did you approve the
13 submission of that list to the Lockwood trial
14 court in the form of stipulations of fact,
15 correct?

16 **A:** It was a joint stipulation with the state and
17 the taxpayers, so I and Donnie Dial, the
18 opposing attorney, would have submitted the
19 document together.

20 **Q:** That's a yes?

21 **A:** Yes, we would have submitted the document
22 together.

23 **Q:** Thank you. In the Court of Appeals' decision
24 in *Lockwood Greene*, the court distinguished
25 engineering firms from finance companies and



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1 media broadcasting companies; is that correct?

2 A: Tell me the question one more time.

3 Q: In the Court of Appeals' decision in *Lockwood*
4 *Greene*, the court distinguished engineering
5 firms from finance companies and media
6 broadcast companies, correct?

7 A: No. By way of dicta, the court answered the
8 question of whether or not an engineering
9 company should be compared to finance companies
10 or any other type of companies. And so it did
11 engage in that analysis, but it was not because
12 they had to, rather, at the end of their
13 looking at it they said, we don't --
14 essentially, they said we don't have to answer
15 this question because the entity before us is
16 an engineering company.

17 Q: What did the court conclude or state, if the
18 engineering firms were comparable to, Lockwood
19 Engineering firm was comparable to media
20 broadcasting and finance companies? Are they
21 comparable?

22 A: Are engineering companies comparable to media
23 companies?

24 Q: Media broadcasting -- media broadcasters and
25 finance companies.



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- 1 A: The activities of an engineering company are
2 not the same activities of a media company,
3 that's correct.
- 4 Q: Thank you. And the Court of Appeals in
5 Lockwood Greene found that the customer was
6 purchasing the time and expertise of an
7 engineer, correct?
- 8 A: They found that the thing being purchased was
9 the expertise, which is represented by the time
10 and other activities of the engineers, yes.
- 11 Q: And a Dish subscriber is not purchasing the
12 time and expertise of any particular Dish
13 engineer or attorney; is that correct?
- 14 A: They are not literally purchasing the time of
15 the engineer, correct.
- 16 Q: And you believe all of the activities that Dish
17 undertakes to provide programming constitutes
18 income-producing activities; is that correct?
- 19 A: All of the activities that Dish undertakes to
20 produce the programming service, yes.
- 21 Q: In the *Mercury Motors* case, the South Carolina
22 Supreme Court found that many incidental
23 activities performed by the trucking company
24 were not income-producing activities, correct?
- 25 A: No, incorrect. My view is that in *Mercury*

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1 *Motors* the court was faced with a challenge of
2 the constitutionality. I think they were
3 reluctant to say that there would be some
4 activity that was purely incidental, that is
5 what I'm thinking they're saying is minor in
6 consequence for their analysis of whether or
7 not something was unconstitutional. But they
8 specifically found that the activity of driving
9 across South Carolina's roads was a significant
10 activity. And in the bit of a parenthetical
11 expression, they did say there was some
12 incidental. But essentially what they were
13 saying is that those, not really what's before
14 us, rather what we have to look at, what did
15 you do in our state and is that of some
16 consequence. And they found that it was, and
17 because of that they then decided it was not an
18 unconstitutional method of taxation.

19 Q: You briefly talked about the *Rent-A-Center* case
20 earlier. The management services of *Rent-A-*
21 Center are personal services like the *Lockwood*
22 Greene case, correct?

23 A: They are services that would need to be carried
24 out by a person. But they are not one-to-one
25 like a dentist or if I have someone paint my



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1 house. They are a general sort of activity.
2 Someone in South Carolina really doesn't know
3 the name of the individual who's handling his
4 human resources or the names of the individual
5 who's filing the tax return. So it is not a
6 personal service in the sense of dentist, the
7 lawyer, accountant and that sort of thing.

8 Q: But they did provide accounting services to RAC
9 East, correct?

10 A: I believe they did provide accounting services,
11 yes.

12 Q: You also referenced PLR 13-3. What were the
13 services being performed in that Private Letter
14 Ruling?

15 A: Engineering services.

16 Q: And are those the same type of services in the
17 Lockwood Greene case?

18 A: They certainly sound the same. I don't have
19 any reason to believe that they are
20 significantly different.

21 Q: And does the private letter ruling use the
22 phrase "cost of performance"?

23 A: I do not believe that it does.

24 MS. WOOTEN: May I approach, Your Honor?

25 THE COURT: Yes.



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1 (Respondent's Exhibit Number 7 was introduced into
2 the record.)

3 Q: If you will refer to Respondent's Exhibit 7.

4 A: I have it.

5 Q: And turn to the last page.

6 A: All right.

7 Q: And there's an indented paragraph, planning
8 point?

9 A: Yes.

10 Q: And you state that South Carolina is a cost of
11 performance state, correct?

12 A: Are you asking me what my opinion is?

13 Q: Yes. I'm asking you what your ---

14 A: Yes. Yes.

15 Q: Well, let me back up. What is this document?

16 A: It's identified as Tax Management, Multistate
17 Tax Portfolio, South Carolina Corporate Income
18 Tax.

19 Q: And did you reference this earlier in your
20 testimony as something a taxpayer may look at
21 for advice?

22 A: Yes. Yes.

23 Q: If South Carolina is a cost of performance
24 state, why would it need to list three
25 different examples of how income is sourced for



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1 different industries?

2 MR. MAYBANK: I would object. Not clear what you're
3 referring to. From the General Assembly
4 listing or whose listing?

5 MS. WOOTEN: This document, the Portfolio.

6 MR. MAYBANK: Let me ask you this. He didn't write
7 this portfolio. He can't answer why they wrote
8 something.

9 MS. WOOTEN: He is an expert in tax policy.

10 MR. MAYBANK: Right.

11 MS. WOOTEN: I'm asking for his opinion.

12 MR. MAYBANK: You asked him why did they write it.

13 MS. WOOTEN: What is his opinion on why this comment
14 is in this Portfolio?

15 MR. MAYBANK: Your Honor, he doesn't have the --
16 it's a minor point, but he doesn't know why
17 these authors wrote it. She's asking why did
18 they write it.

19 THE COURT: He can give his opinion as to why it was
20 written. Overruled.

21 MS. WOOTEN: Thank you.

22 A: Yes, ma'am. And for I ask -- my recollection,
23 subject to your correction, is that this
24 Portfolio is current as of 2005, is that ...

25 Q: I believe it's 2007 on the bottom of the



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1 exhibit.

2 A: Beginning for tax years in 2007, my
3 understanding is that significant employees of
4 Department of Revenue had a meaningful
5 involvement in the writing of this document and
6 that it was essentially current through 2005.
7 And it may still have been published with a
8 2007 date. But the statutes changed for tax
9 years 2007 and afterwards. The entities that
10 are addressed in the document, I think the
11 statement is no longer applicable. And that is
12 for an entity involved in loans, leasing,
13 interest income or a franchising, any of the
14 others, those are source based on the use of
15 the intangible. For services, again, we have
16 a statute that tells us what to do. So I'm not
17 sure that the document is a document -- I do
18 not believe the document is a document that is
19 relevant to what my opinion would be for Dish
20 in filing its returns.

21 Q: This being a Portfolio would have been
22 applicable for 2005 and '06, correct?

23 A: If the -- if they date to which this Portfolio
24 is authoritative is 2007, it would be. But
25 based on -- let me look at the language again.



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1 The document doesn't cite to the statute. The
2 document cites to *Lockwood Greene* and *Geoffrey*.
3 Obviously, those cases were long before 2005.
4 My view would be that the statement that's
5 listed in the document is not current law to
6 the extent that it attempts to explain what the
7 law would have been in 2005 and 2006. I mean,
8 I think I can address that, if that's -- is
9 that what you're asking?

10 Q: But a taxpayer filed income tax returns in 2005
11 and 2006 in this matter, correct?

12 A: Oh, I see, yes. Yeah, if the -- the document
13 itself would have been something that someone
14 would have looked at. But again, it's not so
15 much that they would follow it blindly. The
16 reference says considering *Lockwood Greene* and
17 *Geoffrey* together it appears that gross
18 receipts are sourced to the state in which it
19 is most significantly associated with the
20 production of income. And a party who would
21 review *Lockwood Greene* would find that South
22 Carolina has adopted a cost of performance
23 basis, one which in that instance was based on
24 payroll. So the planning point would have led
25 them to review case law, which would have given



1 them an indication of how they should have
2 filed.

3 MS. WOOTEN: Your Honor, can we have a two-minute
4 break before concluding with this witness?

5 THE COURT: Yes.

6 MS. WOOTEN: Thank you.

7 THE COURT: We'll take a ten-minute break at this
8 time.

9 (Break from 11:16 a.m. until 11:27 a.m.)

10 THE COURT: Okay. Ms. Wooten.

11 MS. WOOTEN: Just a few more questions, Your Honor.

12 Q: Mr. Stevens, I believe you stated earlier when
13 talking about the *Rent-A-Center* decision that
14 it referenced that *Lockwood Greene* was codified
15 in the amendments to 2295(A)(5); is that
16 correct?

17 A: Yes.

18 Q: And who wrote the decision in *Rent-A-Center*?

19 A: I believe it was Judge Anderson.

20 Q: And who wrote the decision in *DIRECTV*?

21 A: Judge Anderson.

22 Q: And was that decision issued after *Rent-A-*
23 *Center*?

24 A: Correct.

25 Q: Thank you. Just one more line of questioning.



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1 You had mentioned earlier or stated earlier
2 several income-producing activities of the
3 taxpayer. You stated installation services is
4 income-producing activities. I believe the
5 quote was, Unless it's installed, you can't get
6 it. Is that correct?

7 A: That sounds like what I said, yes.

8 Q: So delivery of the service is pretty important,
9 right?

10 A: There's never been a dispute that delivery is
11 important, but what the customer is buying is
12 the programming, and programming cannot be
13 purchased unless there is a means for receiving
14 it. The customer is not buying delivery;
15 they're buying the programming.

16 Q: So delivery of the signal into the home is an
17 income-producing activity, correct?

18 A: The delivery into the home is an activity which
19 is critical and necessary to the income that
20 they're paying for the programming. I can't
21 buy programming that I'm not going to be able
22 to see.

23 MS. WOOTEN: That's all from the Department, Your
24 Honor.

25 THE COURT: Thank you.



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1 MR. MAYBANK: Just very briefly.

2 THE COURT: Yes.

3 MR. STEVENS - REDIRECT EXAMINATION BY MR. MAYBANK:

4 Q: In *Lockwood Greene*, the Court of Appeals'
5 decision dealt with TV stations, obviously pay
6 TV wasn't even invented at the time of *Lockwood*
7 *Greene*?

8 A: Right, that's correct.

9 Q: Okay. In *Lockwood Greene*, Ms. Wooten
10 referenced -- she was referencing Dish. You
11 don't hire any particular engineer. Do most of
12 the customers in *Lockwood Greene* buying a --
13 building a \$100 million building, do they hire
14 a particular engineer or do they hire the firm?

15 A: No, they hire the firm for the expertise of the
16 firm, which is obviously represented by
17 talented engineers, so there's not the actual
18 hiring of the engineer.

19 Q: Okay. Ms. Wooten asked about *Rent-A-Center*,
20 the source of income in *Rent-A-Center*. In
21 fact, that income that was sourced was
22 corporate headquarter's type functions, was it
23 not?

24 A: It was. And all of those corporate
25 headquarters were deemed to be performed in



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1 Texas, and therefore, sourced to Texas.

2 Q: Okay. So exactly like the G&A, what was
3 sourced in Rent-A-Center was the G&A that we
4 talked about at some length yesterday?

5 A: Correct.

6 Q: G&A meaning general and administrative --

7 A: General and administrative.

8 Q: --- corporate headquarters? All right. We had
9 some discussion, I think I missed a little bit
10 on the tax management Portfolio, but you'll
11 read that -- isn't that sentence very similar
12 to what you've been saying?

13 A: I'm reading from the document that was
14 identified as Respondent's Exhibit 7, and the
15 sentence is, "It appears the gross receipts are
16 sourced to the state which is most
17 significantly associated with the production of
18 income; for example, personal services where
19 those services are performed." Yes, that --
20 what we have been saying, I think from the
21 beginning, is that under South Carolina law, I
22 am going to source the income from service
23 activity based on where those activities are
24 taking place. And the way you measure those
25 activities are the activ- -- are the cost of



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1 those activities.

2 Q: All right. Does removing the cost of
3 performance language from the statute mean that
4 cost of performance isn't still a valid
5 measurement, or does it open up alternatives to
6 determine income-producing activity?

7 A: It's the latter. When our General Assembly
8 decided to use the language that it did, had it
9 added the based on cost of performance, that
10 would have been the sole method. One would
11 have had to have used cost of performance. But
12 not having that language in there certainly
13 does not eliminate cost of performance, and our
14 General Assembly would have known that given
15 the fact that *Lockwood Greene*, in our view, is
16 a cost of performance statute. They were
17 simply codifying that which was already in
18 existence.

19 MR. MAYBANK: Nothing further from us, Your Honor.

20 THE COURT: Thank you, Mr. Stevens.

21 MR. MAYBANK: That's our last witness.

22 THE COURT: Okay. Ms. Wooten, are you prepared to
23 begin your case?

24 MS. WOOTEN: We may or whatever the Court would
25 like. If you'd like to take a lunch break or



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1 if you want us to begin we can do that.

2 THE COURT: You can begin.

3 MS. WOOTEN: Okay. The Department calls Orville
4 Sharpe.

5 ORVILLE SHARPE, being duly sworn, testifies as
6 follows:

7 MS. WOOTEN: Your Honor, I have the exhibits copied
8 in a binder that it might be easier for the
9 witness to flip through. Would it be okay to
10 use those instead of the official exhibits?

11 THE COURT: Yes.

12 MS. WOOTEN: Thank you. Sorry about that.

13 MR. SHARPE - DIRECT EXAMINATION BY MS. WOOTEN:

14 Q: Would you please state your name for the
15 record?

16 A: Orville Sharpe.

17 Q: And where are you currently employed?

18 A: South Carolina DOR.

19 Q: How long have you been employed by the
20 Department?

21 A: Thirty-seven and a half years.

22 Q: In what area of the Department do you work?

23 A: Foreign income.

24 Q: What is foreign income?

25 A: We audit corporate income and license fee



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1 returns for multi-state corporations generally
2 domiciled outside of South Carolina.

3 Q: Do you have any other job duties and
4 responsibilities other than the foreign audit
5 team?

6 A: That's basically it. I help with training the
7 new auditors.

8 Q: Are you familiar with the taxpayer in this
9 matter?

10 A: Yes.

11 Q: And what is the nature of your involvement with
12 the taxpayer?

13 A: I conducted a corporate income and license fee
14 audit for the audit years 12/04 through 12/10.

15 Q: And most I think all of the references have
16 been to 2005 through 2010. Can you explain why
17 2004 was included in the audit?

18 A: 2004 was audited exclusively for the purpose of
19 auditing their SC NOL that was carried forward
20 to the 12/05 year. We audited that return and
21 for 12/04 they actually had a substantial
22 understatement, but we couldn't assess it
23 because the statute of limitations had expired.

24 Q: Where did you conduct the audit on Dish DBS?

25 A: Englewood, Colorado.



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- 1 Q: Is that their headquarters?
- 2 A: Yes.
- 3 Q: And when did you conduct the audit?
- 4 A: I think it was 12/5 through 12/8/11.
- 5 Q: Were you the only auditor present?
- 6 A: No, I worked with another auditor, Amanda
- 7 Golebiowski.
- 8 Q: And what was her role in the audit?
- 9 A: She audited the income tax credits and there
- 10 were two affiliates, I think, of the taxpayer
- 11 that had nexus with South Carolina, and she
- 12 audited those two affiliates. I think they
- 13 were called Echo Broadcasting Corporation and
- 14 Echo -- there was another company -- the first
- 15 name was Echo -- Echo, I can't remember the --
- 16 no, EchoStar Broadcasting Corporation and the
- 17 other one -- the other one was EchoStar
- 18 something, I couldn't remember the name of it.
- 19 Q: And what was your role during the audit?
- 20 A: I was the lead auditor.
- 21 Q: As lead auditor, what were your job
- 22 responsibilities or duties?
- 23 A: Basically I set the audit up; I did the
- 24 preliminary review; I did the audit information
- 25 request; I did the audit confirmation letter



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1 and I assigned the duties to Amanda. She was
2 relatively new.

3 Q: And what was the basis of that particular
4 audit?

5 A: Let's see, the reason we selected them for
6 audit was we had a referral. There was an RAR
7 that they had filed, a federal RAR. They
8 admitted a return to incorporate an RAR
9 adjustment and that return was given to me to
10 review, and I started looking at that return,
11 and then I started looking at other returns,
12 and I found that they were inconsistent in the
13 apportionment methods that they used to source
14 South Carolina net income, as well as the
15 methods they used to source receipts to South
16 Carolina. And I was looking for an
17 apportionment ratio around 1.5 percent, and the
18 apportionment ratio was all over the place. So
19 they were -- they needed to be audited, so we
20 -- as a result of my review, we set up an
21 audit.

22 Q: And going back, you mentioned RAR. What is
23 RAR?

24 A: It's a revenue agent report from the Internal
25 Revenue Service. So the taxpayer has to notify



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1 us within 60 days of a settlement on a Internal
2 Revenue Service audit of any adjustments that
3 impact the South Carolina return and/or file an
4 amended case which -- amended return, and
5 that's what they did in this case.

6 Q: As part of the audit examination, did you
7 research the South Carolina population
8 percentage as compared to the United States
9 population percentage?

10 A: I did.

11 Q: And why did you do that?

12 A: Because generally when somebody like Dish
13 network has full coverage, you know, across the
14 United States, by relating the South Carolina
15 population to the U.S. population, whatever
16 that percentage is, that's what one would
17 expect, in my experience, for their
18 apportionment ratios to be if they have
19 complete coverage throughout the whole United
20 States, because that ratio is about 1.5
21 percent, so that's why I was looking for an
22 apportionment ratio around 1.5 percent.

23 Q: And where did you obtain that information?

24 A: The U.S. Census Bureau website.

25 (Respondent's Exhibit Number 3 was introduced into



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1 the record.)

2 Q: If you'll refer to Respondent's Exhibit 3, the
3 ones with the blue stickers.

4 A: Yes, I see it.

5 Q: And do you recognize that document?

6 A: Right.

7 Q: What is it?

8 A: It's the -- it's a schedule from the U.S.
9 Census Bureau that has the South Carolina
10 population and the U.S. population.

11 Q: And from the document, how did you calculate
12 the South Carolina population percentage
13 compared to the U.S. population percentage?

14 A: I divided the South Carolina population by the
15 U.S. population.

16 Q: And what are the standard statutory
17 apportionment methods available to most
18 business taxpayers in South Carolina?

19 A: Basically, prior to the tax year starting on
20 1/2011, it was four factor and gross receipts.

21 Q: When would a taxpayer use the four factor
22 apportionment method?

23 A: When they're dealing in tangible personal
24 property or manufacturing.

25 Q: And how would a taxpayer calculate the ratio



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1 used under the four factor apportionment
2 method?

3 A: They'd compute four separate ratios, and those
4 four separate ratios are a property ratio, a
5 payroll ratio, and a South Carolina ratio,
6 which is double weighted or computed twice, and
7 the numerator would be the South Carolina
8 payroll, the South Carolina property, the South
9 Carolina sales, and the denominator would be
10 the everywhere property, the everywhere
11 payroll, and the everywhere sales. / Those
12 ratios are computed, added, and divided by four
13 to get the four factor apportionment ratio.

14 Q: When would a taxpayer use the gross receipts
15 apportionment method?

16 A: If they're not dealing in tangible personal
17 property or manufacturing then they'd use the
18 gross receipts apportionment ratio.

19 Q: And how would a taxpayer calculate the ratio
20 under the gross receipts method?

21 A: They would divide the South Carolina gross
22 receipts by the everywhere gross receipts.

23 Q: And what apportionment method should Dish DBS
24 be using?

25 A: Dish should be using the gross receipts



1 apportionment ratio.

2 Q: And why is that?

3 A: Because they're not dealing in tangible
4 personal property or manufacturing.

5 Q: If you'll -- that binder you have, if you will
6 refer to Petitioner's Exhibit 1.

7 A: Uh-huh.

8 Q: And do you recognize this document?

9 A: Yes. It looks like the original filed 12/05
10 South Carolina Corporate Income Tax Return for
11 Echo DBS Corporation.

12 Q: Have you had an opportunity to review this
13 return?

14 A: Yes.

15 Q: If you'll please turn to Bates stamp page 2369.

16 A: Okay.

17 Q: And if you will refer to section -- or Schedule
18 H-1.

19 A: Okay.

20 Q: What type of apportionment factor did the
21 taxpayer use on this return?

22 A: They used a four factor apportionment ratio.

23 Q: And what four factor apportionment ratio did
24 the taxpayer use?

25 A: I'm not sure.



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1 Q: Not the ratio, the actual number?

2 A: Oh, the number, .2384 percent.

3 Q: And just for clarification, what do Schedules
4 H-1 and H-2 on the corporate income tax return
5 show?

6 A: Schedule H-1 you use if you're computing a four
7 factor apportionment ratio, and Schedule H-2
8 you use if you're using the gross receipts
9 ratio to source South Carolina net income -- to
10 apportion South Carolina net income.

11 Q: And to the best of your knowledge, did Dish DBS
12 file any amended returns for tax year 2005?

13 A: Not to my knowledge.

14 Q: All right. If you'll flip to Exhibit 2,
15 Petitioner's Exhibit 2. Do you recognize this
16 document?

17 A: Yes. It's the 12/06 South Carolina Corporate
18 Income and License Fee Return for EchoStar DBS
19 Corporation.

20 Q: And have you had an opportunity to review it?

21 A: Yes.

22 Q: If you'll flip to Bates stamp 2230.

23 A: Okay.

24 Q: Refer to Schedule H-2.

25 A: Okay.



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- 1 Q: What is the ratio reported on the 2006 return?
- 2 A: It's .2086 percent.
- 3 Q: And what apportionment method is that?
- 4 A: The gross receipts apportionment.
- 5 Q: What is your understanding of how Dish DBS
- 6 calculated the ratio for the 2006 return?
- 7 A: They used -- regarding the South Carolina
- 8 receipts?
- 9 Q: Yes.
- 10 A: In regards to the South Carolina receipts, they
- 11 used cost of performance.
- 12 Q: Did Dish DBS file any amended returns for tax
- 13 year 2006?
- 14 A: Not that I'm aware of.
- 15 Q: If you will flip to Petitioner's Exhibit 3.
- 16 A: Okay.
- 17 Q: Do you recognize this document?
- 18 A: Yes.
- 19 Q: What is it?
- 20 A: It's the South Carolina Corporate Income and
- 21 License Fee Return for 12/07 for EchoStar DBS
- 22 Corporation.
- 23 Q: Have you had an opportunity to review it?
- 24 A: Yes.
- 25 Q: If you'll please flip to Bates stamp 2223,



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- 1 refer to Schedule H-2.
- 2 A: Right.
- 3 Q: What is the ratio reported on this return?
- 4 A: It's .1258 percent.
- 5 Q: And what apportionment method did the taxpayer
- 6 use?
- 7 A: Gross receipts.
- 8 Q: And what's your understanding of how the
- 9 taxpayer calculated the ratio?
- 10 A: Cost of performance.
- 11 Q: Did Dish Network file any other amended tax
- 12 returns for tax year 2007?
- 13 A: Yes.
- 14 Q: Are you referring to Petitioner's Exhibit 4?
- 15 A: Yes.
- 16 Q: And have you had an opportunity to review this
- 17 return?
- 18 A: Yes.
- 19 Q: If you will turn to Bates stamp page 2208.
- 20 A: Okay.
- 21 Q: And refer to Schedule H-2.
- 22 A: Okay.
- 23 Q: What is the ratio reported on this return?
- 24 A: .1258 percent.
- 25 Q: And what apportionment method did the taxpayer



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- 1 use on its second amended 2007 return?
- 2 A: Cost of performance.
- 3 Q: What apportionment method did the taxpayer ---
- 4 A: Oh, I'm sorry. Gross receipts.
- 5 Q: And what's your understanding of how they
- 6 calculated that ratio?
- 7 A: The South Carolina receipts were calculated
- 8 utilizing cost of performance.
- 9 Q: If you'll please refer to Petitioner's Exhibit
- 10 5.
- 11 A: Okay.
- 12 Q: Do you recognize this document?
- 13 A: Yes.
- 14 Q: Have you had an opportunity to review it?
- 15 A: Yes.
- 16 Q: If you'll refer to Bates stamp page 2068, refer
- 17 to Schedule H-2. What is the ratio reported on
- 18 the return?
- 19 A: .2362 percent.
- 20 Q: And what apportionment method did the taxpayer
- 21 use on this return?
- 22 A: Gross receipts.
- 23 Q: And what is your understanding of how the
- 24 taxpayer calculated the ratio?
- 25 A: The South Carolina gross receipts were

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- 1 calculated using cost of performance.
- 2 Q: Did Dish file any amended returns for tax year
- 3 2008?
- 4 A: Yes.
- 5 Q: If you'll refer to Petitioner's Exhibit 6. Do
- 6 you recognize this document?
- 7 A: Yes.
- 8 Q: And have you had an opportunity to review it?
- 9 A: Yes.
- 10 Q: If you'll refer to Bates stamp page 2045.
- 11 A: Okay.
- 12 Q: What is the ratio reported on this return?
- 13 A: .2362.
- 14 Q: And what apportionment method did the taxpayer
- 15 use?
- 16 A: Gross receipts.
- 17 Q: And what is your understanding of how the
- 18 taxpayer calculated the ratio for this return?
- 19 A: Regarding the South Carolina receipts, they
- 20 utilized cost of performance.
- 21 Q: If you'll please refer to Petitioner's Exhibit
- 22 7.
- 23 A: Okay.
- 24 Q: And do you recognize this document?
- 25 A: Yes.



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- 1 Q: Have you had an opportunity to review it?
- 2 A: Yes.
- 3 Q: Please turn to page 1916. What is the ratio
- 4 reported on the return?
- 5 A: 2.2251 percent.
- 6 Q: What apportionment method did the taxpayer use
- 7 on its amended return?
- 8 A: A four factor apportionment ratio.
- 9 Q: And what apportionment method should the
- 10 taxpayer have used?
- 11 A: Gross receipts.
- 12 Q: What is your understanding of why the taxpayer
- 13 changed from the gross receipt methods of
- 14 apportionment in the prior returns and then
- 15 return to a four factor apportionment on this
- 16 return?
- 17 A: I have no idea.
- 18 Q: If you will please refer to Exhibit 8.
- 19 A: Okay.
- 20 Q: And do you recognize this document?
- 21 A: Yes.
- 22 Q: And have you had an opportunity to review it?
- 23 A: I don't remember this one specifically. I do
- 24 recognize this as being -- this was filed with
- 25 this return? Which return was this filed ---



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- 1 Q: I'm sorry, if you'll go to the next page to the
2 corporate income tax return.
- 3 A: Oh. Okay, 12/08?
- 4 Q: Yes.
- 5 A: Okay. The next 12/08 return?
- 6 Q: Yes.
- 7 A: Which is I think the second amended. No, it's
8 the third.
- 9 Q: It's going to be -- yeah.
- 10 A: The third amended 12/08?
- 11 Q: That's right.
- 12 A: Okay.
- 13 Q: And if you'll refer to Bates stamp page 389.
14 What is the ratio reported on this return?
- 15 A: .2400 percent.
- 16 Q: And what apportionment method did the taxpayer
17 use on the return?
- 18 A: Gross receipts.
- 19 Q: What is your understanding of how they
20 calculated the ratio?
- 21 A: The South Carolina gross receipts were
22 calculated using cost of performance.
- 23 Q: If you'll please refer to Exhibit 9.
- 24 A: Okay.
- 25 Q: And have you had an opportunity to review this



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1 return?

2 A: Yes.

3 Q: If you'll refer to Bates stamp page 1894.

4 A: Right.

5 Q: What is the ratio reported on the return?

6 A: The ratio reported on the return is 4.0000
7 percent, which is -- the ratio, is that ---

8 Q: Yes.

9 A: Four percent is the ratio that's reported on
10 the return.

11 Q: Is that an even number?

12 A: Yes.

13 Q: Is that the accurate number on the return?

14 A: No. This return was filed electronically and
15 our -- when returns are filed in our system
16 electronically, our system won't print out any
17 amounts lower than one percent. So the only
18 way you'd know what the actual percent is is
19 you actually have to do a calculation.

20 Q: And when you say lower than one percent, the
21 ratio was four percent. What do you mean by
22 lower than ---

23 A: Well, if it was like .4215 percent, the 215
24 wouldn't show up -- the .215 would not ---

25 Q: After the decimal?



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- 1 A: Right.
- 2 Q: The number in front of the decimal is correct?
- 3 A: Correct.
- 4 Q: And what apportionment method did the taxpayer
- 5 use on this return?
- 6 A: I have no idea. It's -- this ratio is way too
- 7 high for either market or cost of performance.
- 8 They just -- they made some kind of huge error
- 9 on this return.
- 10 Q: What are the amounts of the gross receipts that
- 11 South the taxpayer sourced to Carolina as
- 12 reported on the return?
- 13 A: 531,477,876.
- 14 Q: And how does that amount compare to the amounts
- 15 the taxpayer sourced to South Carolina in prior
- 16 years?
- 17 A: I'd have to go back and look. You want me ---
- 18 Q: Generally, you don't have to give me a specific
- 19 number, but generally, how does it compare?
- 20 A: Oh, it's way out of -- it's way too high.
- 21 Q: Did Dish DBS file any amended returns for tax
- 22 year 2009?
- 23 A: Yes.
- 24 Q: And how many amended returns were filed?
- 25 A: I think they filed two amended returns and one



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1 of those amended returns was just a duplicate
2 of the first amended return.

3 Q: And if you'll please refer to Exhibit 10.

4 A: Okay.

5 Q: Do you recognize this document?

6 A: Yes, I do.

7 Q: Have you had an opportunity to review it?

8 A: Yes.

9 Q: If you'll refer to Bates stamp 398.

10 A: Right.

11 Q: And what is the ratio reported on the return?

12 A: .3086 percent.

13 Q: And what apportionment method did the taxpayer
14 use for this return?

15 A: The apportionment method they used was gross
16 receipts. The sourcing method they used for
17 South Carolina gross receipts was cost of
18 performance.

19 Q: And the amount of gross receipts sourced to
20 South Carolina, what is that amount on this
21 return?

22 A: 38,410,411.

23 Q: And how does that amount compare to the prior
24 years return?

25 A: It's drastically lower. The other year was



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- 1 well over 500 million.
- 2 Q: And if you'll refer to Petitioner's Exhibit 11.
- 3 A: Okay.
- 4 Q: And do you recognize this document?
- 5 A: Yes, I do.
- 6 Q: Have you had an opportunity to review it?
- 7 A: Yes.
- 8 Q: And if you'll refer to page 468. What is the
- 9 ratio reported on the return?
- 10 A: This return is a little strange. They have a
- 11 four factor ratio that's filled in and a gross
- 12 receipts ratio that have the numbers in but no
- 13 ratio computed. This was also filed
- 14 electronically, and as I indicated, when
- 15 they're filed electronically the ratios don't
- 16 come across correctly. So I'd have to actually
- 17 do the computation to -- there's another
- 18 exhibit I think you have ---
- 19 Q: It is.
- 20 A: --- that I could look at.
- 21 Q: We'll talk about that in a moment.
- 22 A: Okay. So I can't really tell.
- 23 Q: Okay.
- 24 A: From looking at it. Well, regarding the if
- 25 they used the four factor apportionment ratio,



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1 I don't -- I can't figure it out from looking
2 at this return. I think I had to back into the
3 ratio.

4 Q: Did Dish DBS file any amended returns for this
5 year?

6 A: Yes.

7 Q: If you'll refer to Petitioner's Exhibit 12.

8 A: Okay.

9 Q: And do you recognize this document?

10 A: Yes.

11 Q: What is it?

12 A: It looks like their amended return for 12/10.

13 Q: If you'll refer to page 415.

14 A: Page what?

15 Q: 415.

16 A: Okay.

17 Q: What's the ratio reported on this return?

18 A: Let me make a point here. This is the first
19 year that Dish DBS Corporation filed a South
20 Carolina consolidated return with South
21 Carolina. This is the apportionment ratio just
22 for Dish DBS Corporation and that apportionment
23 ratio is .2717 percent.

24 Q: And what is your understanding of how Dish DBS
25 calculated the ratio?



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- 1 A: They utilized the gross receipts ratio, and the
2 South Carolina gross receipts were sourced
3 utilizing cost of performance.
- 4 Q: Was the taxpayer consistent in its method of
5 sourcing subscription receipts to South
6 Carolina during the audit period?
- 7 A: No.
- 8 Q: If you'll refer to Respondent's Exhibit 1.
- 9 A: 1?
- 10 Q: 1.
- 11 A: Okay.
- 12 Q: Do you recognize this document?
- 13 A: Yes.
- 14 Q: Did you prepare it?
- 15 A: Yes.
- 16 Q: And where did you locate the information
17 referenced on this exhibit?
- 18 A: From the returns filed by the taxpayer.
- 19 Q: And what is the purpose of the document?
- 20 A: The purpose is to give a summary of the returns
21 filed by Dish showing whether it was an
22 original return; the apportionment factor they
23 utilized; and if they amended the return, why
24 they amended the return and the type of
25 apportionment factor they used, four factor or



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1 gross receipts; and the amount of gross
2 receipts shown on the return if they utilized
3 the gross receipts ratio factor.

4 Q: For tax year 2005, what apportionment factor
5 did the taxpayer use?

6 A: Four factor.

7 Q: And was that return ever amended?

8 A: Not to my knowledge.

9 Q: And what is your understanding of the result of
10 the taxpayer amending its returns to source
11 South Carolina subscription revenue outside of
12 South Carolina?

13 A: Could you repeat the question again? I'm
14 sorry.

15 Q: What is your understanding of the result of the
16 taxpayer amending its returns to source the
17 subscription revenue outside of South Carolina?

18 A: Well, it's going to reduce the South Carolina
19 apportionment ratio and thereby the South
20 Carolina net income and ultimately the South
21 Carolina tax that they pay.

22 Q: And what impact does a lower gross receipts
23 ratio have on a taxpayer's license fee
24 liability?

25 A: It'll reduce the license fee base and thereby



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1 -- therefore the license fee tax that they pay.

2 Q: What is a license fee based upon?

3 A: The license fee is based on the capital and
4 paid in capital reflected on the taxpayer's
5 balance sheet at the year end.

6 Q: And how does the Department apportion the
7 license fee?

8 A: The license fee is apportioned utilizing the
9 income tax apportionment ratio.

10 Q: And why is the income tax year audit different
11 than the license fee audit year?

12 A: Because the license fee is paid one year in
13 advance, so a 12/10 income return will actually
14 be the 12/11 license fee year.

15 Q: And if you'll refer to Respondent's Exhibit 2.

16 A: Respondent's? Oh, this is Petitioner's. Okay.

17 Q: Do you recognize this document?

18 A: Yes, I do.

19 Q: What is it?

20 A: It's basically the audit report that goes to
21 the taxpayer. And it's in Excel format, and it
22 just shows what we computed the South Carolina
23 net income and tax and corporate income to be
24 based on our audit, and we give reasons if
25 there are adjustments why we adjusted the



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1 taxpayer's returns.

2 Q: Did you draft or complete the document?

3 A: Yes, except for the part about the job credits.
4 Amanda actually conducted the audit and the job
5 credits.

6 Q: And when did you complete this document?

7 A: I think it was 6/5/12.

8 Q: And what are the findings of the audit report?

9 A: Basically that the taxpayer was inconsistent in
10 the methods that they used to apportion South
11 Carolina net income and the method that they
12 used to -- and also inconsistent in the method
13 they used to source receipts to South Carolina.

14 Q: And what was the basis for the imposition of
15 the income tax assessment?

16 A: The basis for the income tax assessment?

17 Q: If you'll refer to Bates stamp page 335.

18 A: 335. Okay. Right. I'm saying that they were
19 incorrect and that the method they used to
20 source receipts to South Carolina that they
21 were -- I thought they were licensing an
22 intangible, they were relicensing programming
23 to South Carolina customers, and our law says
24 that if you're licensing intangibles for use in
25 South Carolina you use 12-26-2295(A)(3) and you



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1 source those receipts from intangibles to the
2 location of the customer.

3 Q: Did you make another finding ---

4 A: And I said that ---

5 Q: --- as well?

6 A: Yes. I said even if the access of the cable
7 programming was classified as the purchase of
8 services as opposed to a purchase of
9 intangibles, the auditor maintains that the
10 income-producing activity occurs for South
11 Carolina customers in South Carolina where the
12 taxpayer and/or affiliate/third party sells
13 and/or installs the equipment to for the South
14 Carolina customers which allow them to receive
15 the satellite signal which enables the South
16 Carolina subscribers to access the cable
17 programming. Since the income-producing
18 activity for the South Carolina subscriber
19 receipts occur in South Carolina, 100 percent
20 of the South Carolina subscriber receipts
21 should be sourced to South Carolina.

22 Q: What is the income-producing activity that you
23 identify in this matter?

24 A: I think it's access to the -- access of the
25 signal, which allows the subscriber to



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1 basically watch the programs.

2 Q: And how did this finding change the gross
3 receipts ratio used by the taxpayer on its
4 final returns for each year?

5 A: For each year. Okay. I won't include 12/04
6 because we -- right?

7 Q: Right.

8 A: Because ---

9 Q: Can you identify which page you're referring
10 to?

11 A: Okay. I'm looking at page one, one of six,
12 which is ---

13 Q: What is the Bates stamp number at the bottom of
14 the page?

15 A: I don't -- oh, I'm sorry, it's turned the other
16 way. It's 332.

17 Q: Okay.

18 A: Okay. For the -- I'll start with 12/05 because
19 we talked about 12/04 we couldn't assess that
20 year. We basically just audited it to adjust
21 the SC NOL carry forward. 12/05, obviously I
22 increased the South Carolina apportionment
23 ration. For 12/06, I increased the
24 apportionment ratio. For 12/07, I increased
25 the apportionment ratio. For 12/08, I reduced



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1 the apportionment ratio. And for 12/09 I
2 reduced the apportionment ratio.

3 Q: For 12/10 -- or for 12/10?

4 A: Oh, I'm sorry 12/09. Okay, 12/10, that was the
5 first year they filed a consolidated return, so
6 I have to go to -- actually I have to go to
7 Bates page 333. And for -- it looks like I
8 increased it slightly for Dish DBS Corporation
9 because they filed a South Carolina
10 consolidated return for that year.

11 Q: If you will refer to Bates stamp 343. What is
12 the purpose of Schedule B on this page?

13 A: It computes the South Carolina and total
14 receipts per the audit.

15 Q: And what did you include in the South Carolina
16 receipts line for each year?

17 A: Well, there's -- well, there's detail on pages
18 344 through 345 that spells out what I
19 included. Do you want me to read off all
20 these?

21 Q: Can you generally describe the categories?

22 A: It's basically -- they call it programming
23 services, but it was basically subscriber
24 receipts plus sales of tangible personal
25 property and/or rental of tangible personal



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1 property and installation charges and some
2 miscellaneous other income, and that's about
3 it.

4 Q: Is the audit report the Department's final
5 agency decision?

6 A: No.

7 Q: What is the final agency decision?

8 A: A Department Determination.

9 Q: And does the Department Determination represent
10 the Department's stance on an issue?

11 A: Yes.

12 Q: Can the Department Determination differ from
13 what the auditor found?

14 A: Yes.

15 Q: Can the litigation section of the Department
16 modify the legal basis of one of your arguments

17 ---

18 A: Yes.

19 Q: --- or audits?

20 A: Yes.

21 Q: Have you reviewed the Department Determination
22 in this case?

23 A: Yes.

24 (Respondent's Exhibit Number 4 was introduced into
25 the record.)



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1 Q: And is that represented in Respondent's Exhibit
2 4?

3 A: Yes.

4 Q: Did you consider the satellites and other
5 infrastructure outside of South Carolina in
6 determining the income-producing activity for
7 South Carolina?

8 A: No.

9 Q: Why don't you consider those activities to be
10 income-producing activities?

11 A: Because I don't think they produce income. I
12 think that they're all necessary to the
13 taxpayer's business and they're integral parts,
14 but they're preliminary, they occur before the
15 actual income-producing activity. I don't
16 think income-producing activity occurs until
17 the taxpayer gets what they purchase, which is
18 the programming via the satellite signal that
19 they have and that that's -- and that they
20 don't get any income until the taxpayer
21 receives that programming via the signal, the
22 satellite signal.

23 Q: What happens after the audit report is
24 completed?

25 A: I send it to my supervisor for approval.



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1 Q: After you submitted it for approval, did you
2 have any involvement or contact regarding the
3 taxpayer's audit?

4 A: Yes.

5 Q: What was that?

6 A: I remember talking with the taxpayer's
7 representative and she said she had basically
8 agreed with it and that basically a check was
9 in the mail, and then the next thing we know,
10 it was protested.

11 Q: And what is the result of the final audit
12 report?

13 A: It basically required the taxpayer to use the
14 gross receipts ratio on each and every one of
15 their returns to apportion South Carolina --
16 apportion South Carolina net income and also
17 utilize the location of the income-producing
18 activity to source their receipts, their South
19 Carolina receipts to South Carolina and -- are
20 you asking for the amounts also? No?

21 Q: No, I'm not.

22 A: Okay.

23 Q: We can refer to the exhibits for the amounts.

24 A: Okay.

25 Q: Were any penalties assessed against Dish DBS



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1 during the audit period?

2 A: Yes, substantial understatement.

3 Q: What is a substantial understatement penalty?

4 A: Generally if a taxpayer's understatement of
5 taxes is greater than ten percent, we're
6 required by statute to add the substantial
7 understatement penalty.

8 Q: And was interest added to the assessment?

9 A: Yes.

10 Q: Why was it added?

11 A: It's statutorily required.

12 Q: And when will interest stop accruing in this
13 matter?

14 A: Up until the date the taxpayer pays it or I
15 guess the judge overrules our assessment.

16 MS. WOOTEN: Thank you, Your Honor. That's all from
17 the Department.

18 THE COURT: Mr. Maybank.

19 MR. SHARPE - CROSS-EXAMINATION BY MR. MAYBANK:

20 Q: Orville, you testified that, in your opinion,
21 the only income-producing activity was the
22 payment of the bill, correct?

23 A: That's not what I said.

24 Q: What is the income-producing activity here?

25 A: The income-producing activity is when the tax



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1 -- when the subscriber accesses that cable
2 programming via their set-top box.

3 Q: So the only income-producing activity then is
4 when you turn on the box? When you watch the
5 box? What exactly is the income-producing
6 activity?

7 A: The income-producing activity is when the
8 taxpayer is able to watch the program.

9 Q: So when he's able to?

10 A: Right.

11 Q: So when he pays his bill -- I guess you're not
12 able until you pay your bill?

13 A: Well, I'm saying they all go together.

14 Q: Right.

15 A: I'm saying the income-producing activity is the
16 process which allows the taxpayer to access
17 their programming via the cable box which has
18 been provided by Dish.

19 Q: Okay. And so the satellite content, the box,
20 all of that is not an income-producing
21 activity?

22 A: Correct.

23 Q: Okay. And why isn't it an income-producing
24 activity?

25 A: Because it's preliminary to the actual income-



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1 producing activity. It's all integral parts of
2 the taxpayer's business, but it doesn't trigger
3 an income-producing activity. The only trigger
4 to the income-producing activity is allowing
5 the taxpayer to have the programming via their
6 cable box.

7 Q: So programming is an income-producing activity?

8 A: Access to that programming.

9 Q: Access to the programming?

10 A: Yes, sir.

11 Q: Okay. I don't want to put words in your mouth.
12 The only income-producing activity is access to
13 the programming?

14 A: Correct.

15 Q: So the box, the provision of the box itself is
16 not income-producing activity?

17 A: Well, not really because that -- they actually
18 lease those boxes and that's -- that's already
19 been reported. They're required to source
20 those receipts from the lease of the box ---

21 Q: Okay.

22 A: --- already. So they've already reported the
23 box. It just allows them to receive the signal
24 and thereby the programming.

25 Q: Okay. So we agree then the rental of the box



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1 is an income-producing activity, don't we?

2 A: Right. It will -- it's -- but it's not the --
3 it's not the subscription receipt. It enables
4 the -- it enables the viewer to watch the
5 programming.

6 Q: Okay. So we've got subscription receipts, the
7 viewing of the programming is income-producing
8 activity, correct?

9 A: The viewing? No, that's -- the viewing of the
10 program, that's what the taxpayer wants.

11 Q: Right.

12 A: But the things -- the providing the access to
13 the signal really is -- that's probably what
14 the income-producing activity ---

15 Q: Right, I'll agree with that, providing the
16 access to the signal is the income-producing
17 activity, correct?

18 A: Right.

19 Q: And then of course the box itself is income
20 producing?

21 A: Right.

22 Q: And the installation of the box is income
23 producing where warranty and repair, those are
24 all income producing, correct?

25 A: Right, those are separately charged. They



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1 already -- we don't disagree that the
2 installation charges are taxable; they already
3 included those.

4 Q: Okay. Now, and your audit message is sort of
5 modified by the agency determination, you
6 source income based on the address of the
7 customer?

8 A: The location of the subscriber.

9 Q: Location of the customer?

10 A: The location of the subscriber.

11 Q: All right. And you use a market sourcing audit
12 method, correct?

13 A: The location of the subscriber, which is where
14 we say the income-producing activity is. I
15 don't think I ever said market based.

16 Q: No, you didn't but the agency determination
17 used the term "market sourcing"; did it not?

18 A: I don't remember.

19 Q: Or audience approach?

20 A: I think they said that other entities, or other
21 states used that. But I don't -- that's the
22 way I remember reading it.

23 Q: Okay. All right. Now, the DOR can't make up
24 an apportionment method just to raise more
25 revenue for the state. We've got a raging



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1 recession; it wouldn't be proper for an audit
2 method to change just to raise more revenue,
3 correct?

4 A: Correct.

5 Q: And the DOR is governed by state statutes just
6 like taxpayers, correct?

7 A: Correct.

8 Q: And so really the General Assembly ultimately
9 makes the apportionment rules, correct?

10 A: Correct.

11 Q: Right, through statutes. The Department
12 Determination cites statutes from a bunch of
13 different states with market sourcing -- with
14 explicit market sourcing statutes. Now, in
15 those states the General Assembly has
16 explicitly told the DOR how to tax pay TV
17 revenue, don't they?

18 A: I'm not sure I understand your question.

19 Q: Okay. In the Department Determination y'all
20 cite a bunch of statutes dealing with pay TV?

21 A: I remember reading it, but I don't know the
22 particulars regarding the other state cases
23 they cited.

24 Q: Okay. Let me just -- this is your own
25 Department Determination. Just to -- and we'll



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1 only take a second ---

2 A: I didn't write it; the attorneys did it.

3 Q: Just very briefly, I think that's a Florida
4 statute. If you'll just read the last sentence
5 of it.

6 A: "Tell them --" ...

7 Q: Of the Florida one there that's at the very
8 top.

9 A: "Gross receipts including advertising revenues
10 from broadcasting within and without the state
11 will be attributed to the numerator of the
12 sales factor on the basis of the ratio of the
13 audience within the state to the audience
14 everywhere."

15 Q: That's an audience method, correct?

16 A: Correct.

17 Q: Now in that state in Florida the general
18 assembly passed a specific statute providing
19 for the market share method, correct?

20 A: I don't know.

21 Q: Well, you just read it.

22 A: I didn't see the statute. I don't know if that
23 came from the statute or not. I thought that
24 was a court case or either a decision.

25 Q: No, this is out of your Department



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- 1 Determination and you said earlier the
2 Department Determination modify -- not modifies
3 the right word -- governs your audit. Now, in
4 your Department Determination which you just
5 said, Florida, for example, adopted the
6 following language and you cited Florida
7 Administrative Code Annual Reg 12-C-1. So in
8 Florida they did it by explicit regulation,
9 correct?
- 10 A: I assume that's what -- I didn't ---
- 11 Q: I'll move along.
- 12 A: I didn't cite it. The attorneys wrote that.
13 I did not write that.
- 14 Q: All right. Well, we don't have an explicit
15 regulation for the pay TV industry in South
16 Carolina, do we?
- 17 A: Well, we have 12-26-2295(A)(5).
- 18 Q: And that's an explicit regulation for the pay
19 TV industry?
- 20 A: No. But I mean it's for all ---
- 21 Q: Yeah, we've got a statute, of course.
- 22 A: Right.
- 23 Q: But we don't have an explicit regulation like
24 Florida that directly deals with the pay --
25 sourcing of pay TV receipts?



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- 1 A: No.
- 2 Q: And we don't have, the DOR doesn't have a
- 3 market sourcing regulation in general, not
- 4 limited just to pay TV, a market sourcing
- 5 regulation in general, does it?
- 6 A: Right, we're not a market state.
- 7 Q: Okay.
- 8 A: Except for certain items. For example, the
- 9 sale of the tangible personal property or the
- 10 utilization of intangibles in South Carolina.
- 11 Q: In fact, unlike, say, telephones, we don't have
- 12 any regulations dealing with pay TV at all?
- 13 A: Correct.
- 14 Q: And we don't -- the DOR doesn't have any policy
- 15 documents or publications that assert -- which
- 16 assert that market sourcing is the law in South
- 17 Carolina, and you just said it's not, correct?
- 18 A: It's not and we didn't say it was.
- 19 Q: Okay. All right. You didn't say it was in
- 20 this case, or you didn't say it was in other
- 21 cases?
- 22 A: I didn't say it was in this case. I don't know
- 23 what has been said in the other cases. Well,
- 24 actually I do because I actually read the
- 25 DIRECTV case.



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- 1 Q: Okay. All right. Well, let me go -- I'll
2 quickly go through it again and we'll move on.
3 You said a few minutes ago that the Department
4 Determination was the final word, not your
5 audit, correct?
- 6 A: Right.
- 7 Q: Okay. So let me show you Respondent's Exhibit
8 4 and at the bottom -- the bottom is unnumbered
9 pages; we make that mistake too. Read the
10 highlighted sentence there.
- 11 A: This one right here?
- 12 Q: Yeah. Correct.
- 13 A: "South Carolina is not alone in the method of
14 sourcing receipts for taxpayers like Dish
15 Corporation. Twenty-three states have adopted
16 the audience approach."
- 17 Q: Okay. And we would agree the audience approach
18 is the same, just another term for market
19 sourcing approach?
- 20 A: I'm not familiar with the audience approach,
21 but I don't know to be honest with you.
- 22 Q: That's fine. All right. And in fact, the DOR
23 Corporate Practice Income Tax Manual
24 specifically says South Carolina is not a
25 market share source, correct, market sourcing

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1 state, correct?

2 A: Right, we're not a cost of performance or a
3 market.

4 Q: All right. And there's no instructions in the
5 corporate income tax form to tell you to
6 apportion your receipts based upon where your
7 audience is, correct?

8 A: Probably not that I -- I haven't read the
9 instructions.

10 Q: Now, there -- in the audience approach or
11 market sourcing there are winners and losers.
12 Wouldn't you agree the biggest winner would be
13 a domestic South Carolina business whose cost
14 of performance is here but whose customers are
15 primarily out of state?

16 A: Yes.

17 Q: Okay. And they're the big winners because
18 their cost of performance is here but all the
19 customers are out of state, and therefore, they
20 would only source to South Carolina where their
21 market was to five, ten percent of the South
22 Carolinians that bought their product; isn't
23 that correct?

24 A: Correct.

25 Q: Now, how do these South Carolina service



1 businesses know we're now a audience approach
2 or market share state?

3 A: Well, I don't think that we've said that we're
4 a audience or market.

5 Q: Okay.

6 A: I don't think anything attach that we've issued
7 says that we're a market or a -- state.

8 Q: Okay.

9 A: I think you read that into that decision, but
10 I don't even think in that decision we said
11 that.

12 Q: Okay.

13 A: We're ---

14 Q: So ---

15 A: I'm sorry. I didn't mean to interrupt.

16 Q: No. You go ahead.

17 A: I was just going to say that it's based on
18 where the -- first of all you've got to look at
19 what type of industry you're talking about, and
20 then you've got to find out what is the -- what
21 is the location of the income-producing
22 activity, and once you determine the income-
23 producing activity then you can determine, you
24 know, what to put into the gross receipts,
25 South Carolina gross receipts.



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1 Q: So if I'm a service business, but not personal
2 services, I'm a personal service businesses,
3 all of my cost of performance, my office is
4 here in South Carolina, I don't have an office
5 anywhere else, and I've got -- the great
6 majority of my customers are in North Carolina
7 and Georgia, how do I know whether to source
8 that income from North Carolina and Georgia to
9 pay taxes on it in South Carolina or not pay
10 taxes on it at all? How do I -- how do I know?

11 A: Well, if you're -- if you're a company or a
12 business ---

13 Q: Right.

14 A: --- you know what triggers your income. For
15 example, our experts read from the taxpayer's
16 own 10-K which says that they don't even book
17 revenue until the programming is delivered to
18 the subscriber. So, as a company, you're going
19 to know what produces your income, what income
20 activity produces your income.

21 Q: So Dish knows that but for advertising they'd
22 have a lot less revenue; they know that to be
23 income producing. Would you agree with that?

24 A: Well, not this situation, no, I would not
25 agree.



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1 Q: But to get back to it. I'm a -- I'm in the
2 personal service business. Let's say I'm a
3 contractor and I've got my contractor's office
4 in Cherokee County right next to the North
5 Carolina border and 80 percent of my customers
6 are in North Carolina, all of my cost of
7 performance is in South Carolina, 20 percent of
8 my customers are in South Carolina. Do I pay
9 taxes in South Carolina on 20 percent of my
10 income or 100 percent of my income?

11 A: It sounds like you would pay tax on 100 percent
12 of your -- because I was assuming those --
13 those companies are building a building in
14 South Carolina, then that's where the services
15 were performed that generated that income. So
16 ---

17 Q: They only performed 20 of them in South
18 Carolina. Twenty percent of our customers are
19 in South Carolina, 80 percent of them are in
20 North Carolina.

21 A: No, but the income-producing activity is the
22 building of the building.

23 Q: Right. And 80 percent of the buildings they
24 built are in North Carolina.

25 A: No, I thought you said that 100 percent of



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1 their cost of performance was in South
2 Carolina. If they're building a building, that
3 is not possible.

4 Q: Yeah, I'm saying -- that's correct. I'm saying
5 a majority of it because they're corporate
6 headquarters, all their employees, all their
7 cars are owned in South Carolina. And that
8 contractor, he feels 80 percent of his
9 contracts are in North Carolina.

10 A: That contract, their income-producing activity
11 is actually building the building, so you have
12 to look to where the place of the activity for
13 building those buildings was, and that's how
14 you would determine what produces the income.

15 Q: So 80 -- they built 80 percent of the buildings
16 they build are in North Carolina. So they
17 wouldn't pay taxes but on 20 percent of their
18 income?

19 A: Correct.

20 Q: Okay. Let's suppose Dish was located on Daniel
21 Island. They've got 2,000 employ -- or 5,000
22 employees on Daniel Island, \$100 million worth
23 of buildings, but \$13 billion flowing through
24 Daniel Island, and you're saying they -- that
25 Dish would only owe taxes on 1.2 percent of



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- 1 their -- 1.5 percent of those \$13 billion?
- 2 A: So you're saying that they don't have any
- 3 subscribers in South Carolina?
- 4 Q: Well, no, they would have 1.5 percent of their
- 5 subscribers.
- 6 A: Right, that's all -- by the way, that's all
- 7 we're asking for in this audit is ---
- 8 Q: Right.
- 9 A: --- 1.5 percent of their ---
- 10 Q: So if they ---
- 11 A: --- total receipts, so it's just a small
- 12 portion.
- 13 Q: So if they had \$100 million worth of buildings
- 14 on Daniel Island, 6,000 employees, \$13 billion
- 15 flow through Daniel Island, and you're saying
- 16 they only owe income taxes on 1.5 percent of
- 17 that?
- 18 A: Well, I would say probably they wouldn't owe
- 19 any income taxes because they would have -- as
- 20 you know, they'd have some -- if they put that
- 21 kind of investment in our state, they're
- 22 probably going to pay zero, as you know more
- 23 than anybody else, zero taxes in our state.
- 24 Q: Except it being a service they don't get quite
- 25 the -- quite the ---



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- 1 A: But you being a smart attorney you are, Burnie,
2 you know they're going to end up paying
3 nothing.
- 4 Q: Well, let's suppose they say that they had a
5 federal taxable income of one billion dollars,
6 which they had here.
- 7 A: Right.
- 8 Q: You're saying they would only owe the State of
9 South Carolina 1.5 percent of that?
- 10 A: Right.
- 11 Q: Okay. All right. Now, let's switch to income-
12 producing activities, which we tussled about
13 when we first started off. South Carolina
14 doesn't have a statute explicitly defining
15 income-producing activities, does it?
- 16 A: No, sir.
- 17 Q: And the DOR has never issued a regulation or a
18 policy document which defines it, correct?
- 19 A: I'm trying to think. I don't think so.
- 20 Q: Okay. And is South Carolina in some form or
21 fashion a member of the MTC, what I call a
22 junior member; isn't that correct?
- 23 A: We were at one point. I don't -- I'm not sure
24 we still are.
- 25 Q: At what point. Would you agree with the MTC



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1 definition, income-producing activity defined,
2 the term income-producing activity applies to
3 each separate income and means the transactions
4 and activity ultimately -- I'm sorry, activity
5 engaged in by the taxpayer in the regular
6 course of its trade or business for the
7 ultimate purpose of producing that item of
8 income. It's really pretty straightforward.
9 It's transactions of activity engaged in by the
10 taxpayer in the regular course of its trade or
11 business, factor one, for the ultimate purpose
12 of producing that item of income. Would you
13 agree with that definition?

14 A: No.

15 Q: Okay. And what is your definition of
16 production of income?

17 A: In this case, I can talk about this case, is
18 that okay?

19 Q: Yeah.

20 A: Okay. There's a ---

21 Q: And I might have misspelled it. What's your
22 definition of income-producing activity?

23 A: Okay. In this situation the definition is
24 there's an event that triggers the production
25 of the income, and that's the delivery of the



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1 signal to the taxpayer's satellite, which is
2 then transferred to the taxpayer's set-top box
3 and ultimately allows the South Carolina
4 subscriber to view the box. That's the income-
5 producing activity for the subscription
6 receipts. That's the only, in my opinion,
7 income-producing activity. All these other
8 items that you've talked about, they're very
9 -- they're integral to their operations, you
10 know, they're necessary, but they're
11 preliminary.

12 Q: Okay.

13 A: And I think that they actually said that in the
14 direct court case.

15 Q: And I'm not saying that's unreasonable, but I'm
16 asking you where did you get that from? You're
17 relying on a statute, a reg, a treatise?

18 A: Well, it says it in their 10-K. If you look at
19 their 10-K it tells you, as our expert
20 indicated earlier, what produces their income.

21 Q: Okay. And it says in there, for example, the
22 majority of their income is produced by third-
23 party retailers and that they pay the third-
24 party retailers a lot of money as a result of
25 that. So under your definition to the 10-K,



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1 obviously third-party retailers are an income-
2 producing activity?

3 A: Third-party retail ---

4 Q: Yeah. What happens is Dish advertises a lot
5 but most of their businesses actually end up
6 not by them but by third-party retailers --
7 Best Buy, Walmart are two big ones -- with the
8 local mom and pop store, local mom and pop
9 satellite pay TV store. So their 10-K says
10 that's the majority of actually where their
11 customers come from, not from directly calling
12 Dish. So under the definition you just gave,
13 obviously that's income producing.

14 A: I don't think I said that. You're putting --
15 you're putting words in my mouth.

16 Q: All right. Well, tell me again what's your
17 definition of an income-producing activity?

18 A: I'm -- for ---

19 Q: The last -- did you say the last thing actually
20 before the check is written?

21 A: No, that's not what I said.

22 Q: Okay. Well, what is it?

23 A: You can't come back to -- somehow you want me
24 to say that they're writing a check, and I'm
25 not going to say that because I don't believe



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1 that.. What triggered -- there's an event which
2 triggers the income production, and that occurs
3 when the subscriber receives the signal from
4 the satellite in the sky down to their dish
5 into their set-top box, which allows them to
6 view the programming. That is the only
7 transaction, in my mind, that is income
8 producing. There's nothing else, in my
9 opinion, that's income producing. That's the
10 only transaction.

11 Q: Okay. And I'm saying -- I'm not saying --
12 disagreeing that that's unreasonable. I said
13 where did you get that definition from? You
14 didn't get it from a statute.

15 A: Yes, I -- yes, I did. It says what they're --
16 Section 12-6-2295(A)(5), where does the income-
17 producing activity occur? It occurs in South
18 Carolina when they receive that signal based on
19 a review of their 10-K.

20 Q: Okay.

21 A: And they say that themselves in their 10-K.

22 Q: So you're saying the state statute you're
23 relying on, the state statute says for pay TV
24 the only income-producing activity is when it
25 comes into Burnie's house at Edisto? You're



1 saying the state statute says that?

2 A: I'm saying that if you read it in conjunction
3 with their 10-K, that's where the income-
4 producing activity, in my opinion.

5 Q: All right. So if the 10-K says a very
6 substantial portion of our business is actually
7 generated by third-party retailers, you agree
8 with that?

9 A: That their business is generated by third-party
10 retailers, yeah, I agree with that, they ---

11 Q: It came out of the 10-K?

12 A: Right, but it's not income producing. The
13 income producing is when -- when the satellite
14 signal is delivered to the dish and then on to
15 the set-top box which allows the South Carolina
16 subscriber to access the programming and
17 content.

18 Q: Okay. And since it's kind of the heart of your
19 case, let me bear down. Again, I'm not saying
20 what you said is unreasonable; what are you
21 basing that on? Let me start in the back. Did
22 you just make that up?

23 A: No, I just told you what I based it on.

24 Q: Right.

25 A: I said it was the South Carolina Code of Laws



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1 Section 12-6-2295 -- 2295(A)(5), I believe, and
2 the taxpayer's 10-K.

3 Q: So let's look up the statute and you tell me
4 where this statute says it's income producing
5 when it comes in through satellite.

6 MS. WOOTEN: Objection, Your Honor, asked and
7 answered. He's asked the same ---

8 MR. MAYBANK: He's not answered it at all; that's my
9 entire point.

10 MS. WOOTEN: He has answered it. It's just not to
11 counsel's liking.

12 THE COURT: Yes.

13 MR. MAYBANK: What I've asked him is where did he
14 get that definition, and he has not answered
15 that one iota.

16 THE COURT: Actually, he has. It may not be the
17 answer you're looking for, but he has answered.

18 MR. MAYBANK: All right. He's answered in the sense
19 he said it's in the statute?

20 THE COURT: What he said was the statute in
21 conjunction with the 10-K.

22 MR. MAYBANK: 10-K.

23 THE COURT: Yes.

24 Q: Okay. So it's not in the statute itself
25 purely? It's in the statute and the 10-K?



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- 1 A: Each -- you have to look at each taxpayer
2 according to *Lockwood Greene*, each ---
- 3 Q: I'm talking about -- we're focusing on Dish.
- 4 A: Right. But you look at the industry and one of
5 the things that you look at is the 10-K to
6 determine what type of business they're in.
7 Then you read that in conjunction with the
8 statute and that's how I came up with my
9 conclusion.
- 10 Q: Okay.
- 11 A: And I know you don't like it but that's my
12 conclusion.
- 13 Q: I'm just asking you where you came up with it.
14 But your definition is not found in any
15 regulation, correct?
- 16 A: No.
- 17 Q: Not found in DOR policy document?
- 18 A: No.
- 19 Q: It's not found in any DOR publication?
- 20 A: No.
- 21 Q: Not found in any MTC reg?
- 22 A: No.
- 23 Q: Not found in any UDITPA reg? I don't know --
24 UDITPA has a few on that?
- 25 A: Uh-huh.

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- 1 Q: All right. And then -- if I'm wrong, I'll let
2 you answer that. All right. Are you finished?
3 I'm sorry.
- 4 A: I didn't -- is there still a question or ---
- 5 Q: I was just asking -- never mind. I'll move on.
- 6 A: Okay.
- 7 Q: Now, you -- I know you do a whole bunch of
8 audits and you do a fabulous job on them, but
9 because you do quite a few, you don't have time
10 -- sometimes you don't have time to meet with
11 the technical people, and you didn't meet with
12 the technical people of Dish to talk about the
13 satellites and the call centers and the like,
14 did you?
- 15 A: No, I didn't. But it was really interesting
16 the other day to hear that expert talk about
17 it.
- 18 Q: That's why my bill is so high.
- 19 A: My head was hurting after listening to him.
20 It's amazing what all goes on.
- 21 Q: So prior to yesterday you were not aware that
22 during the audit period the only way a customer
23 could sign up with Dish was to call -- was to
24 telephone a call center?
- 25 A: The only way that -- could you repeat the



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1 question?

2 Q: The only way, during the audit period -- you
3 can do it differently today -- but during the
4 audit period the only way you could sign up for
5 Dish was to telephone a call center?

6 A: Yes, I think that's what the expert said
7 yesterday.

8 Q: Yeah, but I said you weren't aware of that
9 prior to yesterday?

10 A: No, I wasn't.

11 Q: Okay. And you weren't aware that the final act
12 of getting a subscription is calling the call
13 center with your credit card which they then
14 take; you weren't aware of that?

15 A: No, sir.

16 Q: Okay. And you ---

17 A: Can I ask you -- I can't ask you a question,
18 can it?

19 Q: Sure. Fair play.

20 A: When you say does that happen every time,
21 because I know -- I know when I got my cable,
22 they just came out and put it in. They didn't
23 ask me for a credit card and then they billed
24 me later. I guess it depends on the cable
25 company. But you're saying every time they



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1 require a credit card before they even come
2 out?

3 Q: Yeah.

4 A: That sounds kind of strange to me because it
5 seems like they'd come install it and then
6 charge you.

7 Q: Well, they come install it and then all the
8 sudden your credit card is declined and then
9 where are they?

10 A: Okay. Well, maybe they do a credit check or
11 something. I don't know.

12 Q: All right. You would agree that acquiring
13 content -- from listening to testimony
14 requiring content, that's in the regular course
15 of Dish's business, isn't it?

16 A: Yes.

17 Q: And it was done for the purposes of producing
18 a buck?

19 A: It's embodied, yes, into the subscriber
20 receipts, yes.

21 Q: And you'd agree that acquiring satellites and
22 advertising, subscriber equipment, installation
23 and repair, call centers, all of that's done in
24 the regular course of Dish's business?

25 A: Yes, sir.



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1 Q: And all that was done for the purpose of making
2 a buck, correct?

3 A: Ultimately embodied in the cost of the
4 subscription receipts.

5 Q: Okay. And you agree no one has to sign up for
6 Dish to watch TV, there's plenty of free TV,
7 correct?

8 A: Yes, sir.

9 Q: And they don't have -- if they want pay TV they
10 don't have to sign up with us, they can sign up
11 with cable or Direct?

12 A: Correct.

13 Q: Now, we had 13 billion in revenue
14 notwithstanding free TV, cable and Direct.
15 Obviously programming played some role in that.
16 I wouldn't abandon my beloved free TV and start
17 paying for it unless the pay TV had something
18 more than the free TV, correct?

19 A: Correct.

20 Q: Okay. And then I've got to battle with Direct
21 and cable. You would agree that advertising
22 plays some role in getting people to sign up
23 for Dish?

24 A: Yes, sir.

25 Q: And we paid 700 million to ESPN and 600 million



1 to Fox. In a state like South Carolina, that
2 helps gin up a few more subscribers in South
3 Carolina, doesn't it?

4 A: Right. And I think that whenever they pay that
5 amount for the subscribers, whenever they
6 execute these contracts, I think they're called
7 license distri- -- cable network ---

8 Q: Right.

9 A: --- distribution licensing agreements, it
10 indicates the number of subscribers. So
11 whenever they purchase this programming they're
12 purchasing it specifically for the subscribers,
13 and since some of them are located in South
14 Carolina, if you're saying that that's an
15 income-producing activity then of course a
16 portion of that programming should be sourced
17 to where that intangible, that content is
18 located in South Carolina.

19 Q: Okay. And you'd agree that subscribers, they
20 want a very high quality signal when they're
21 watching the USC Clemson game? They don't want
22 any noise, snow, blackouts, that kind of thing?

23 A: Correct.

24 Q: You're not as old as me but do you remember
25 back when the little stuff would come across



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1 your free TV screen and it would be a horrible
2 thing or ---

3 A: Yeah, you'd have the little -- you had to have
4 the ---

5 Q: Rabbit ears?

6 A: --- antenna on the roof or you had to have the
7 rabbit ears.

8 Q: Did you ever wrap aluminum foil around the
9 antenna?

10 A: Oh, yeah. Yes, of course.

11 Q: I don't know that it worked, but we did that
12 because we wanted a higher quality signal,
13 didn't we?

14 A: Correct.

15 Q: And of course that all costs Dish a lot of
16 money to make that higher quality signal. And
17 you'd agree that people would cancel or non-
18 renew if the reception for their SEC or their
19 ACC games 'was poor?

20 A: Correct.

21 Q: Okay. And you'd agree subscribers would be
22 furious if you paid your bill and Dish either
23 misapplied it or lost the payment; you wouldn't
24 be happy with that, would you?

25 A: No.



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- 1 Q: And so subscribers demand or expect a high
2 quality billing department when they pay their
3 money is going to be -- they're going to get
4 the channels they pay for, correct?
- 5 A: Correct.
- 6 Q: And that they're not going to take my payment
7 and apply it to -- mistakenly, not
8 fraudulently, apply it to your account?
- 9 A: Right.
- 10 Q: All right. And all of that, of course, costs
11 Dish money, costs Dish a lot of money, but
12 that's something that our subscribers expect
13 and if we didn't give it to them they'd cancel
14 or non-renew, would you agree?
- 15 A: Yes, sir.
- 16 Q: Okay. And I think we agreed that the
17 taxpayer's 10-K is typically a reliable source
18 of information?
- 19 A: Correct.
- 20 Q: Okay. You assess taxes -- switching gears here
21 -- I'm through beating -- beating you up on the
22 income approach. You assess taxes for 2005 and
23 '06, correct?
- 24 A: 2005 and -- yes, sir.
- 25 Q: And you did that under the six year statute of

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1 limitations for taxpayers on the 20 percent
2 understatement of taxes, correct?

3 A: Correct.

4 Q: Normally you would just have a three year
5 statute of limitations, correct?

6 A: Not normal for me, but yes.

7 Q: Normally for taxpayers ---

8 A: Right.

9 Q: --- it's a three year?

10 A: Yes.

11 Q: But in this case -- so if our income had not
12 been understated by 20 percent or more, '05 and
13 '06 would have rolled off per the statute of
14 limitations, correct?

15 A: Correct.

16 Q: All right. Let's quickly go over it -- I'm
17 almost through here -- the numbers we agree
18 with. Our biggest disagreement, and maybe our
19 only disagreement, is the calculation of the
20 numerator; wouldn't you agree with that?

21 A: Yes, sir.

22 Q: For 2010 we calculated the numerator as
23 98,278,000 bucks, and obviously, you disagree
24 with that? I'll say yes, you disagree.

25 A: You're on my audit report; is that what you're



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1 looking at or ...

2 Q: I'm looking at our calculation.

3 A: Okay. Okay. All right.

4 Q: Just say yes, you're right, Mr. Maybank, I
5 disagree with the numerator.

6 A: I disagree with the numerator.

7 MS. WOOTEN: Your Honor, can we let the witness
8 answer the question, please.

9 THE COURT: Yes, Mr. Maybank.

10 MS. WOOTEN: Thank you.

11 Q: All righty. Now, we calculated the numerator
12 by first adding non-programming revenue of 53
13 million to the programming revenue of 45
14 million and that came up with our 98 million.
15 You and I don't disagree over -- and we're all
16 talking about 2010 -- we don't disagree over
17 the non-programming revenue, do we ---

18 A: I want to look at ---

19 Q: --- 53 million?

20 A: I want to look at -- can I look at that
21 document?

22 Q: Sure.

23 A: Because -- where is it?

24 Q: It would be -- it would be the non-programming
25 revenue for 2010. I guess that would be the



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1 2010 tax returns.

2 A: Are you talking about this ---

3 Q: Box rentals and stuff like that. So 2010.

4 MS. WOOTEN: Which exhibit are you referring to for
5 this information?

6 MR. ROURKE: I believe it's listed on the audit
7 report.

8 MR. MAYBANK: That's right.

9 MR. ROURKE: Which we had previously discussed,
10 which is Respondent's Exhibit 4.

11 A: Oh, it's our -- that's the Department
12 Determination.

13 MR. ROURKE: I'm sorry, Respondent's Exhibit 2.

14 A: Are you talking about my actual calculation on
15 the audit; is that what you're talking about?

16 Q: Yeah, I'm just trying to go over what we agree
17 with. And so we have claimed that our non-
18 programming revenue for South Carolina for 2010
19 is \$53 million; does that sound accurate to
20 you? Non-programming revenue meaning ---

21 A: I don't see this on my worksheet. I can't --
22 I can't say. I can't answer that.

23 Q: All right. Let me get -- do you have the audit
24 report there? All right. Let me move on then
25 and we'll find that. You don't remember what



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1 the non-programming revenue was for 2010?

2 A: Well, it was made up of several different
3 categories. No, I don't remember what it was.

4 Q: Well, maybe -- I'll just move on from that. It
5 kind of looks like it's bundled into other
6 numbers. All right. Our apportionment factor
7 denominator was 13.3 billion; don't you agree
8 with that?

9 A: Yes, sir, I agree with the denominator for each
10 and every year in the audit.

11 Q: And then we calculated our -- our calculations
12 were based upon our DBS's federal income as
13 1.087 billion, and you agree with that?

14 A: Yes, sir.

15 Q: Okay. And then we took a \$244,000 net
16 operating loss. That wasn't at issue, was it?
17 You didn't disallow a \$240,000 net operating --
18 -

19 A: What year, for '10?

20 Q: '10, correct.

21 A: Right. Okay. I'm looking at it, yes, sir.

22 Q: Okay.

23 A: But it wasn't actually for Dish. It was for
24 EchoStar Broadcasting Corporation.

25 Q: Okay.



- 1 A: Because that's the year we filed -- they filed
2 a consolidated return.
- 3 Q: And then we multiplied our state taxable income
4 by the state corporate income tax rate of five
5 percent ---
- 6 A: Correct.
- 7 Q: --- obviously? And then we subtract the job
8 SEC's credits of 211,000. Is that number
9 right, the 211,000, or it was actually 400,000?
- 10 A: 448,596.
- 11 Q: Okay.
- 12 A: That's what I allowed in the audit.
- 13 Q: All right. And then we subtracted our
14 estimated payments made in South Carolina of
15 422,000; does that jibe with your ---
- 16 A: Yes, sir.
- 17 Q: Okay. Now, moving on. If the Court of Appeals
18 overturns *DIRECTV* and holds that South Carolina
19 is a pro rata cost of performance state, do you
20 have any -- off the top of your head, do you
21 have any substantial disagreements with any of
22 our numbers?
- 23 A: Yes, the programming.
- 24 Q: Okay.
- 25 A: You're talking about ---



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1 Q: If they overturn, if the Court of Appeals
2 overturns *DIRECTV*.

3 A: The programming you've got to -- I don't
4 understand why you didn't source the
5 programming to South Carolina.

6 Q: Okay.

7 A: That content is an intangible and it should be
8 sourced to the site of the intangible. That
9 intangible is located here in South Carolina
10 where the subscriber is located, so I don't
11 know why you didn't source that programming to
12 South Carolina. That seems totally out --
13 assuming that -- you're saying that we lose our
14 case, right?

15 Q: Right.

16 A: Okay. Yeah ---

17 Q: I didn't put it that way, but -- all right.
18 And then lastly, now obviously if the judge --
19 this gets all confusing. If the judge finds
20 that advertising, call centers -- advertisers
21 and call centers were income-producing
22 activities, then it would change the audit, it
23 would change your audit result; isn't that
24 correct?

25 A: Yes, sir.



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1 Q: Okay. And just in laymen's terms, can you tell
2 the judge how that would be accomplished or why
3 it has that effect?

4 A: I don't really know. We'd have to -- I don't
5 really know how -- what do you mean how would
6 it affect the audit; is that ---

7 Q: Right, how it would affect the audit.

8 A: It would probably reduce the apportionment
9 ratio; is that what you mean?

10 Q: Right.

11 A: And thereby the South Carolina net income and
12 the South Carolina tax.

13 Q: Okay. That's all -- okay. All right. You'd
14 mentioned revenue recognition. And let me show
15 you the 10-K.

16 MR. ROURKE: Petitioner's Exhibit 25.

17 Q: And it just is one little teeny sentence so I'm
18 not going to belabor it. If you'll read that
19 highlighted sentence there.

20 THE COURT: What page is that?

21 MR. ROURKE: Page 108 and 109 of Petitioner's
22 Exhibit 25.

23 A: It says, "Revenue from our subscription
24 television service is recognized when
25 programming is broadcast to subscribers."



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- 1 Q: Okay. So our 10-K says it's when it leaves our
2 satellite, not when it enters your home; isn't
3 that correct?
- 4 A: Well, you have to define what programmed to our
5 subscribers means. To me, that means when the
6 subscriber receives it.
- 7 Q: Well, obviously when we broadcast it we
8 broadcast it to someone. But it says there we
9 recognize income when we broadcast the signal,
10 not when the signal is received.
- 11 A: Uh-huh.
- 12 Q: Is that of significance?
- 13 A: I don't think ---
- 14 Q: Well, isn't that what you said earlier, you
15 relied on the 10-K in saying what's an income-
16 producing activity?
- 17 A: Right.
- 18 Q: Okay. And so according to us, the income-
19 producing activity is broadcasting the
20 satellite?
- 21 A: Broadcast to the ---
- 22 Q: Right.
- 23 A: --- to the subscriber.
- 24 Q: Right.
- 25 A: To me you can read it either way. I think you



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1 can read it to be when the -- when the
2 subscriber receives it or when the signal is
3 sent. I don't know which it means.

4 Q: All right.

5 A: Maybe your -- Dish can tell you.

6 MR. MAYBANK: We have nothing further, Your Honor.

7 THE COURT: Okay. Ms. Wooten, do you have anything
8 on redirect?

9 MS. WOOTEN: No, Your Honor, we don't.

10 THE COURT: Okay. Thank you, Mr. Sharpe. And at
11 this point we're going to break for lunch. We
12 will come back at two o'clock.

13 (Lunch break from 12:54 p.m. until 2:03 p.m.)

14 THE COURT: Ms. Wooten.

15 MS. WOOTEN: The Department calls Tim Donovan.

16 TIMOTHY S. DONOVAN, being duly sworn, testifies as
17 follows:

18 MR. DONOVAN - DIRECT EXAMINATION BY MS. WOOTEN:

19 Q: Please state your full name for the record.

20 A: Timothy S. Donovan.

21 Q: Where are you currently employed?

22 A: With the South Carolina Department of Revenue.

23 Q: How long have you been employed with the
24 Department?

25 A: Next week will be 25 years.



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1 Q: And what positions have you held during those
2 25 years?

3 A: I was originally hired as a domestic auditor
4 doing sales and use tax audits, withholding and
5 individual income tax audits. About 1993 I
6 took a job as a non-resident sales and use tax
7 auditor, did that for five years. 1998 was
8 hired into the office of appeals of the audit
9 division. And in 2006, I was hired as the non-
10 resident audit supervisor. And since 2010,
11 I've been the manager of foreign audit appeals,
12 nexus and discovery.

13 Q: Let's go back to your position in the office of
14 appeals. Can you describe that position and
15 the duties of that position?

16 A: Primarily we would get basically just about any
17 type of appeal, tax appeal that was filed
18 except for property taxes. So basically all
19 the taxes except for property tax. We would
20 review the file for completeness. We would
21 gather any additional facts. We would write an
22 appeals report outlining the facts and issues
23 and basically, you know, write an opinion, you
24 know, on the issue. In addition to that, we
25 would work closely with taxpayers to try to,



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1 you know, resolve the audits. We would hold
2 the initial taxpayer conference and either try
3 to resolve or at least get both parties on the
4 -- on the right track of what the facts of the
5 case were.

6 Q: Your next position after that was non-resident
7 supervisor. Can you describe the general job
8 duties of that position?

9 A: That position basically you oversaw a staff of
10 auditors. During that time I would have had
11 both sales and use tax, non-resident use tax
12 auditors as well as multi-state corporate
13 income tax auditors.

14 Q: And your next position is manager of foreign
15 audit. Can you describe the duties of that
16 position?

17 A: Currently I oversee a staff of probably an
18 audit supervisor as well as the nexus group,
19 which is three tax analysts, which the audit
20 supervisor is obviously the -- oversees the
21 audit staff of about ten or eleven auditors.

22 Q: And just to clarify, what is foreign audit?

23 A: That's essentially a term we use. It's
24 basically a non-domiciled South Carolina
25 company and it's typically our larger



1 taxpayers.

2 Q: And your division of nexus/discovery, what is
3 that?

4 A: That group is basically looking for non-filers,
5 or basically companies that are outside of
6 South Carolina that are doing business within
7 the state. We'll contact them basically to see
8 whether or not they have a presence and a
9 filing requirement in the state and try to get
10 them essentially registered and on the tax
11 rolls.

12 Q: Are you familiar with the taxpayer in this
13 case?

14 A: I am.

15 Q: And how are you aware of the taxpayer?

16 A: Through -- like I guess through our audit of
17 the taxpayer.

18 Q: And can you explain your involvement in the
19 audit of the taxpayer, if any.

20 A: For this particular audit, my only involvement
21 would have been once -- once the file was
22 appealed, we would have held informal
23 conferences with the taxpayer's representatives
24 and basically communications back and forth.

25 Q: And you were a part of those -- were you a part



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1 of those informal conferences?

2 A: Yes, I was.

3 Q: Are those through -- how are those conducted?

4 A: At that time, I had an appeals analyst or tax
5 analyst that was also the supervisor over the
6 nexus/discovery. She handled basically all of
7 the scheduling of the meetings, and then we'd
8 typically, any time that we met with the
9 taxpayer or the taxpayer representative, we
10 would do it as a group.

11 Q: And what is your understanding of the
12 Department's position in this matter?

13 A: As far as the position?

14 Q: Yes.

15 A: That we're essentially taxing the taxpayer on
16 its income-producing activity.

17 Q: Do you agree with that decision?

18 A: I do.

19 Q: What is the income-producing activity in this
20 matter?

21 A: It is the delivery of the signal into the
22 customer's house, basically, you know, to the
23 unit.

24 Q: Are you aware of any adjustments the auditor
25 proposed in this case?



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1 A: I am.

2 Q: And what were those adjustments?

3 A: My understanding the adjustments were to the
4 taxpayer's apportionment ratio.

5 Q: And what were the adjustments?

6 A: To basically to the numerator to identify or
7 have the numerator represent the income-
8 producing activity.

9 Q: And to your knowledge, did the taxpayer provide
10 any additional documentation to support their
11 position?

12 A: As during the appeals process, no. We had
13 asked the taxpayer representative multiple
14 times to give us a breakdown of the calculation
15 that was being reported by them and never
16 received any documentation on that.

17 Q: To your knowledge, were any new policy
18 decisions from an audit standpoint made prior
19 to the issuance of the audit report?

20 A: No.

21 Q: And what is your understanding of the method
22 Dish DBS used to file its most recent amended
23 returns during the audit period?

24 A: My understanding that it's related to a cost of
25 performance.



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1 Q: Is that an apportionment method?

2 A: It -- it's more of, I guess, a calculation, but
3 I guess you could say that it is -- could be --
4 could be viewed as an apportionment method.

5 Q: What is an apportionment method generally?

6 A: Your apportionment method essentially just a
7 method that represents the amount of business
8 the taxpayer is doing in a particular
9 jurisdiction. Once you do that calculation for
10 that apportionment percentage then that
11 percentage is used to tie back and used against
12 the taxpayer's apportionable income.

13 Q: Okay. In your current position or in your
14 former positions are you familiar with the
15 gross receipts method provided for by 12-6-2290
16 and supplemented by 12-6-2295(A)(5)?

17 A: I am.

18 Q: I'm going to provide these to you just for
19 reference if you need to look at them. And in
20 your position as foreign audit supervisor or
21 other positions with the Department, are you
22 familiar with the Department's application of
23 these statutes?

24 A: I am.

25 Q: And just in general, what type of business



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1 activities does a taxpayer engage in when they
2 utilize these two sections?

3 A: Typically they would be in some type of
4 service-related industry, but it's really a
5 catchall after, you know, the previous
6 statutes, a taxpayer who was selling tangible
7 personal property would have to follow that
8 particular statute. These particular statutes
9 just catch all everyone else that's not dealing
10 in tangible personal property.

11 Q: What apportionment method should the taxpayer
12 in this case use?

13 A: The method that they would use would be under
14 12-6-2295(A)(5).

15 Q: And why is that?

16 A: Because we essentially have deemed them to be
17 providing a service.

18 Q: And are you familiar with the Department's
19 practices on the sourcing of income from
20 service providers?

21 A: I'm sorry. I lost my train of thought there.
22 Wasn't paying attention when you started.

23 Q: Are you familiar with the Department's practice
24 on the sourcing of income from service
25 providers?



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1 A: I am.

2 Q: And in applying 2295(A)(5), what does the
3 Department look at when determining how a
4 taxpayer's income should be sourced or
5 apportioned to South Carolina?

6 A: Well, I believe first you have to look and
7 identify, you know, what is the income-
8 producing activity. Once you've identified
9 that activity, then you have to look at where
10 it takes places, basically taking, you know,
11 both into account to determine what the ratio
12 would be.

13 Q: How would the Department source the income
14 received by an engineering firm?

15 A: An engineering firm, we would essentially take,
16 you know -- it's very similar to payroll, but
17 I probably would say that it's more the
18 engineering billable hours or hours in -- that
19 take place within South Carolina to the
20 billable hours everywhere.

21 Q: And how would the Department source the income
22 from the licensing of intangibles?

23 A: The licensing of intangibles? Well, like the
24 Geoffrey case told us where the income is
25 earned on that intangible.



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1 Q: And ---

2 A: The place of activity.

3 Q: I'm sorry?

4 A: Place of activity.

5 Q: Place of activity?

6 A: Yeah.

7 Q: How would the Department source the income from
8 a financing operation?

9 A: Financing operations we would look at, you
10 know, where the loan was executed and basically
11 being, you know, from where you're talking
12 about finance of loans, where the loan was
13 executed and, you know, the interest that was
14 basically earned off of that loan.

15 Q: And how would the Department source the income
16 from a management company?

17 A: As we know through Rent-A-Center Texas LP, I
18 think it was, it is where the management
19 service is performed.

20 Q: And to the best of your knowledge as the
21 supervisor for foreign audit, are all of these
22 examples you just testified to consistent with
23 the audit division's application of the
24 Department's longstanding administrative policy
25 regarding apportioning of corporate income?



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1 A: I believe so.

2 MS. WOOTEN: Thank you, Your Honor.

3 THE COURT: Mr. Maybank.

4 MR. DONOVAN - CROSS-EXAMINATION BY MR. MAYBANK:

5 Q: Seemed like you said we were -- that South
6 Carolina service business are taxed on the
7 income-producing activities, correct?

8 A: Correct.

9 Q: Taxed on the IPA, not the market share or the
10 audience method?

11 A: Correct.

12 Q: And the market share or audience method is not
13 appropriate in South Carolina, correct?

14 A: Correct. I don't know of any audience factor
15 statute.

16 Q: And your opinion that the only -- and your
17 opinion in this case is the only investment
18 producing activity is the delivery of the
19 signal, and I missed it, is it the delivery of
20 the signal or the receipt of the signal?

21 A: Well, it's a ---

22 Q: Or both?

23 A: I think it's all just wrapped into one. I mean
24 it's the delivery and the receipt into the set-
25 top box.



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1 Q: Okay. And so from the satellite down to the
2 set-top box, that's the income-producing
3 activity?

4 A: The receipt of that signal, yes.

5 Q: Okay. Now you just said a second ago it was
6 leaving the satellite and then you said it was
7 both, and now you're saying it's the receipt.
8 So which -- which in your opinion is it?

9 A: Well, like you said, it's probably all
10 commingled into one quick minute second.

11 Q: Okay. And prior to DIRECTV, has the Department
12 audited pay TV or satellite TV?

13 A: I'm not aware of any.

14 Q: Okay. Now, we'll agree a 10-K is generally
15 reliable, it's not self-serving, it's not
16 written for purposes of litigation? Would
17 generally -- would you view it as a generally
18 reliable document done under penalties of
19 perjury and the like?

20 A: I really don't have an opinion on what a -- you
21 know, the 10-K represents.

22 Q: I don't mean our 10-K; I mean a 10-K in
23 general.

24 A: My understanding it's just a financial
25 reporting to the SEC and to the shareholders.



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1 Q: Okay. Haven't you used 10-K's hundreds of
2 times in your career, looked at them?

3 A: I've probably reviewed quite a few. I don't
4 know if I'd go to the hundreds; I hope not.

5 Q: But you've reviewed quite a few because you
6 generally find them informative, correct?

7 A: Correct.

8 Q: Now, you say management services are sourced to
9 the state where management services are
10 performed, correct?

11 A: I believe that's what -- what the court said.

12 Q: Okay. And management services would typically
13 in that case involve corporate headquarters
14 type functions?

15 A: I was not a part of the Rent-A-Center East and
16 Texas LP case.

17 Q: Right.

18 A: So I really -- I really don't know all the
19 facts of that case.

20 Q: Okay. All right. And I believe you said that
21 the Department's position in this case is
22 longstanding -- longstanding agency
23 determination?

24 A: I don't know that I've ever ---

25 Q: Said that?



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1 A: --- that I've said earlier that anything on
2 longstanding.

3 Q: All right. But it's not longstanding because
4 DIRECTV was the first one, correct, of pay
5 satellite TV?

6 A: I don't know if it's first. It's been -- but
7 it's the first one that I'm aware of.

8 Q: Okay. So you're dealing with the income-
9 producing activity of a satellite -- and let me
10 ask you this. Did you work on *DIRECTV* too or
11 just this one?

12 A: I did testify in *DIRECTV*.

13 Q: Okay.

14 A: I was ---

15 Q: So *DIRECTV*, was that six months ago or so or
16 something like that?

17 A: Something like that.

18 Q: So that's the first time you've run into what
19 is the income-producing activity for satellite
20 TV, correct?

21 A: Correct.

22 Q: Okay. The Department obviously only had two of
23 them. The Department obviously doesn't have
24 any written guidelines or rules or policy
25 documents on what's income producing for



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1 satellite TV?

2 A: I'm not aware of any.

3 Q: Okay. All right. Now, you imposed substantial
4 penalties and a six year statute of limitation
5 using a method which your Department
6 Determination described as a audience approach.
7 That doesn't -- and you've testified and
8 Orville's testified your corporate income tax
9 manual says you can't use the audience
10 approach. Does imposing penalties seem fair
11 and equitable in that scenario?

12 A: I think in this case, yes. I mean, we had
13 asked many times, you know, to get a breakdown
14 of the taxpayer's calculation with no avail.
15 The statute, you know, essentially calls for it
16 once -- once the -- you know, once the
17 thresholds are met of the 20 percent
18 understatement. So yes, I probably would.

19 Q: Okay. Now, asking you the same question that
20 I've asked several others, including Orville.
21 If I have a personal service business in South
22 Carolina, all my cost of performance in South
23 Carolina, 75 percent of my customers are out of
24 state, how do I know that I don't pay taxes on
25 75 percent of my income? Where has the DOR



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1 ever told me that?

2 A: Could you -- could you restate your scenario.
3 That wasn't very clear.

4 Q: If I'm a personal service company in South
5 Carolina headquartered here, so 100 percent of
6 my cost of performance, all my property and
7 payroll is here, but 75 percent of my customers
8 are out of state, which would be -- if I was in
9 York, Rock Hill, Lancaster, would be quite
10 common, how would I know that I don't pay taxes
11 on 75 percent of my income?

12 A: Well, if you're a personal service company here
13 in South Carolina, I think, you know, we would
14 have to look at what type of personal services
15 you're providing and then determine what the
16 income-producing activity was and then
17 determine, you know, where it takes place.

18 Q: Okay. So for some business it would be cost of
19 performance and some business it would be
20 market share?

21 A: No. I think you still have to look at what the
22 income-producing activity. Again, if you're a
23 personal service I think, you know, like
24 Lockwood determined that Lockwood was a
25 personal service and they said that those --



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1 you know, those engineering ---

2 Q: Yeah. I didn't mean to say personal service.
3 I meant if you're in the service business but
4 you're not a personal service ---

5 A: Okay.

6 Q: --- provider. All your employees are here;
7 your corporate headquarters is here, your
8 office building is in Lancaster, Rock Hill, but
9 75 percent of your client customers are in
10 North Carolina.

11 A: Right.

12 Q: But you're not personal services.

13 A: Right.

14 Q: But you are services, how do I know I don't
15 have to pay income taxes on 75 percent of my
16 income? How would I know that?

17 A: Well, if you're just moving into the state I'm
18 sure you would probably check on that question
19 up front.

20 Q: Right. But if you've been here for ---

21 A: Because I don't know that you would want to
22 make a large investment if we were a cost of
23 performance state.

24 Q: Right. Well, let's say I've got a big plumbing
25 -- big plumbing business, 75 percent of my



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1 customers are in North Carolina, you know, I
2 hire an accountant doing my returns every year,
3 how do I know based on what the DOR's telling
4 me that I don't owe income tax on 75 percent of
5 my income? How do I know that?

6 A: Again, what's your ---

7 Q: Plumbing was an example.

8 A: Like a plumbing contractor or ---

9 Q: Yeah.

10 A: --- plumbing salesperson?

11 Q: Plumbing contractor.

12 A: So you're -- let's say you're installing sewers
13 in North Carolina.

14 Q: Right.

15 A: We would say that basically the income-
16 producing activity was that, you know,
17 installing that sewer system in North Carolina
18 ---

19 Q: Okay. So I would know ---

20 A: --- and therefore sourced there.

21 Q: Under that I wouldn't owe taxes on 75 percent
22 of my income, correct? Seventy-five percent of
23 my contractors are in North Carolina in my
24 hypothetical.

25 A: You would owe 75 percent of your income



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1 hypothetically to North Carolina.

2 Q: Right. And only 25 percent to South Carolina?

3 A: Correct.

4 Q: And how would I know that though? It's not in
5 the instructions in the income tax return.

6 A: Pick up the phone and call us and we'll give
7 you an answer.

8 Q: All right. It's not in a policy document, is
9 it?

10 A: I'm not aware of any policy document on
11 plumbing contractors, but there may be a policy
12 document out there on contractors, but I don't
13 -- I'm not aware.

14 Q: Well, I just used that -- service providers.
15 So there's not a -- there's not one on service
16 providers, is there?

17 A: Not that just has a generic title of service
18 provider.

19 Q: So how would a service provider and discovered
20 Lockwood Greene cost of performance is no
21 longer the law in South Carolina, I'd be filing
22 a refund claim, wouldn't I?

23 A: What's that?

24 Q: I would be filing a refund claim if I figured
25 out South Carolina is no longer a cost of



1 performance state, correct? I've been
2 overpaying my taxes if I've been paying in
3 South Carolina.

4 A: If you're Lockwood Greene?

5 Q: No, if I'm the plumbing contractor ---

6 A: Oh.

7 Q: --- who thinks Lockwood Greene applies to him.

8 A: Under a -- I mean I -- yes, I can probably see
9 a scenario. But not having a strict example of
10 everything that's taking place, you know.

11 Q: Okay. And let me show you, here's a copy of
12 the DOR's policy website, and I know you want
13 to look at them, but I just have one or two
14 questions for that. The DOR churns out policy
15 documents, Revenue Rulings at the top.
16 Revenue Rulings alone just in 2015, there's 11
17 of them, there's revenue procedures, there's
18 information letters. You're churning them out;
19 you're doing a great job of doing that. Why
20 haven't you ever issued one that told service
21 providers hey, you don't owe any money, South
22 Carolina taxes for what you -- your customers
23 in other states; any particular reason?

24 A: I'm not over the policy section.

25 Q: Okay.



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- 1 A: I believe that would be up to them and their
2 policies.
- 3 Q: Just a few more questions and I'll be through.
4 You agree with the notion that Clemson and
5 Carolina, we love our football, don't we?
- 6 A: Pretty much.
- 7 Q: And were you aware Lady Gamecocks basketball
8 team led the nation in attendance last year?
- 9 A: I may have heard that but I don't think ---
- 10 Q: But you're certainly aware the USC baseball
11 team won two national championships?
- 12 A: Yes.
- 13 Q: And so you would agree that Dish paying \$800
14 million to ESPN to broadcast those games
15 probably led to greater South Carolina customer
16 subscribers; is that a fair statement?
- 17 A: My understanding yes, that people like their
18 sports and want access to them.
- 19 Q: Okay.
- 20 MR. MAYBANK: That's all I have, Your Honor.
- 21 MS. WOOTEN: Nothing on redirect.
- 22 THE COURT: Okay. Thank you, Mr. Donovan.
- 23 MS. WOOTEN: The Department calls John Swearingen.
- 24 JOHN SWEARINGEN, being duly sworn, testifies as
25 follows:

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1 MR. SWEARINGEN - DIRECT EXAMINATION BY MS. WOOTEN:

2 Q: Would you please state your full name for the
3 record?

4 A: John Swearingen.

5 Q: And are you currently employed?

6 A: No, I'm not. I'm retired.

7 Q: Where are you retired from?

8 A: Department of Revenue.

9 Q: And how long were you employed by the
10 Department?

11 A: Full time about 33 years and part time ten more
12 years. Close to 40 -- say 41, almost 42 years.

13 Q: And starting from the beginning, can you give
14 us a brief summary of the positions you've held
15 at the Department during that time?

16 A: I started in 1973 as a corporate income tax
17 auditor, and I was assigned to the Charleston
18 District. And I worked there for about three
19 years and I transferred to Columbia and became
20 a foreign corporate income auditor, much like
21 Orville, in '76. From '76 to about '83 I was
22 a foreign income tax auditor. In '83 I went
23 into an appeals group that's similar to the one
24 Tim described. And I was in appeals from '83
25 till about '87. And I think around '87 I went



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1 into policy. In '87 to about '95 I believe I
2 was in policy. About '95 I transferred out of
3 policy back into field audit. And I was like
4 in audit selection for two or three years, and
5 then I became the foreign audit supervisor in
6 1996, I think. And I was the income supervisor
7 job from '96 to about 2006, and I retired in
8 2006 from full-time employment. And I went
9 back part time in 2006 and I retired about six
10 months ago.

11 Q: And ---

12 A: Again.

13 Q: And can you describe your job duties when you
14 were a member of the policy group from '87 to
15 '94-'95.

16 A: It was to assist companies. I was -- I think
17 my primary responsibility was corporate income,
18 but I also did individual income and property
19 tax. We're to assist in guidance or questions
20 relative to application of law or our policy in
21 those areas.

22 Q: And when you left the policy decision and went
23 back to audit; is that correct?

24 A: Correct.

25 Q: Did you have any continued role or involvement



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1 with the policy division?

2 A: Just occasionally we would need interpretation
3 or some guidance on some issues or they'd ask
4 us for how we would treat some issue. We'd
5 still interact, of course.

6 Q: Your next position was the field audit manager
7 or supervisor?

8 A: Correct.

9 Q: And can you generally describe your duties as
10 a foreign audit manager?

11 A: I was in the same position Tim currently is in
12 and I would supervise -- I think we had 12 to
13 14 sales tax auditors, about 10 to 12 income
14 tax auditors that did mostly multi-state
15 corporate sales or income tax.

16 Q: And as foreign audit manager, what instructions
17 do you give your auditors regarding Department
18 audit policies?

19 A: Follow the audit policy. But we -- we did have
20 a manual that was written back in the '70s, but
21 I'm not sure -- it was never updated. But you
22 would look at the law, the regulations, the
23 Code -- I mean, Code, law, regulations, policy
24 documents, the court decisions. We used to
25 publish Commission decisions. You just look at



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1 the Commission decisions for different policy
2 issues, as well as court cases.

3 Q: And are you aware of the taxpayer in this
4 matter?

5 A: Yes.

6 Q: And how is that?

7 A: When I was -- last few years I was -- reviewed
8 returns, particularly RARs and large refund
9 claims, and review them for correctness before
10 the refunds were issued.

11 Q: And did you review the taxpayer's?

12 A: Most likely did. I'm pretty sure I did because
13 they filed RARs.

14 Q: What audit guidelines related to the
15 apportionment of net income of a service
16 provider does the Department use?

17 A: We really don't have any published ones. We
18 just have some that were listed back in the, I
19 guess, late '70s, early '80s leading up the
20 Lockwood Greene case, there was some policy
21 guidance in the -- the only place we could find
22 them would be in the transcript actually, the
23 Lockwood Greene, the only written place that
24 I'm aware of.

25 Q: Do you recall how these guidelines were



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1 developed?

2 A: I believe there was a case back in '77 where at
3 the time we were sourcing all the income from
4 like an engineering firm to South Carolina if
5 the contract was with a South Carolina facility
6 or taxpayer or site, and we would source all of
7 it to South Carolina. And, my understanding,
8 the taxpayer protested, and as a result of the
9 protest, there was a Commission decision
10 issued. But after the Commission decision was
11 issued the taxpayer protested or I presume it
12 could have gone to Court. But the Commission
13 reconsidered and decided that maybe the
14 taxpayer was correct. It dealt with
15 engineering services. And they issued what was
16 -- I think they proposed a regulation, but they
17 ultimately just issued what they called a rule
18 of construction dealing with professional or
19 personal service providers.

20 (Respondent's Exhibit Number 10 was introduced into
21 the record.)

22 Q: If you'll refer to Respondent's Exhibit 10.

23 A: Ten?

24 Q: Uh-huh. Do you recognize this exhibit?

25 A: Yes.



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1 Q: What is it?

2 A: It's a income tax decision issued by the Tax
3 Commission back in 1976. It's dealing with a
4 company that designs electric power generator
5 stations.

6 Q: If you'll refer to the bottom of the exhibit,
7 ID 214.

8 A: It's called ID 214, correct.

9 Q: Yes. Okay.

10 A: Which stood for Income Decision 214.

11 Q: 214. And at the time of this decision, what
12 was the Tax Commission's position regarding the
13 sourcing of gross receipts of an engineering
14 firm?

15 A: The engineering firm had a contract with a
16 South Carolina company to design a nuclear
17 power generating facility in South Carolina.
18 And, at that time, the division took the
19 position that all the receipts from the
20 contract would be South Carolina receipts. And
21 that's how ---

22 Q: Please continue.

23 A: And that's how the taxpayer asserted that some
24 of the receipts were earned outside of South
25 Carolina because the services were actually



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1 performed by personnel in another state. The
2 Tax Commission, I believe -- let's see --
3 upheld the division and said all the receipts
4 were in South Carolina. This was 1976.

5 Q: Shortly after ID 214, did the Tax Commission
6 change its guidelines for sourcing gross
7 receipts for service firms?

8 A: Yes, it did.

9 Q: Do you recall when that was?

10 A: I think it was sometime in 1977.

11 Q: Do you recall how they changed their
12 guidelines?

13 A: They initially were going to promulgate a
14 regulation stating that you look to where the
15 services of the engineering firm were
16 performed. And they didn't issue the
17 regulation; instead, the Commission at the time
18 approved what they called a rule of
19 construction instead of issuing a regulation.

20 Q: If you'll please refer to Respondent's Exhibit
21 13.

22 A: 13.

23 (Respondent's Exhibit Number 12 was introduced into
24 the record.)

25 Q: No, I'm sorry, 12.



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1 A: 12.

2 Q: And what is this document?

3 A: This is the minutes of a Commission meeting
4 from August 1977, and it's dealing with a --
5 apparently a claim for refund. And Mr. Brooks,
6 who is Carroll Brooks who was head of the
7 income tax division at the time, presented a
8 proposed regulation, and there's a copy of a
9 proposed regulation attached. But it's kind of
10 penciled note saying approved as a Tax
11 Commission position, not as a regulation. But
12 it's a Rule of Construction August 24, 1977.

13 Q: And was this meeting open to the public?

14 A: It was at the time, yes, it was open to the
15 public.

16 Q: And what does the Rule of Construction say?

17 A: It actually is written up as a regulation but
18 we know -- we just said that it was approved as
19 a Rule of Construction, not a regulation. It
20 says, a taxpayer whose principal business
21 activity in this state is the rendering of
22 personal service can apportion its income under
23 12-7-1190 of the SC Code of 1976 shall include
24 an enumerator and denominator of the gross
25 receipts ratio the amounts charged for services



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1 performed \ within this state. Services
2 activities actually performed without this
3 state shall not be included in the numerator of
4 the gross receipts ratio but shall be included
5 in the denominator. And it's signed by the
6 three commissioners.

7 Q: How does this Rule of Construction compare to
8 the audit guidelines used for sourcing of an
9 engineering firm's gross receipts after 1977?

10 A: To my knowledge, it's been followed ever since
11 1977 for engineering firms.

12 Q: And what type of businesses does the Rule of
13 Construction apply to?

14 A: I'm saying any company -- it says for personal
15 services. So I would say any company in the
16 business of providing personal services, which
17 could be engineers, architects, accountants,
18 management companies.

19 Q: And after 1977, are you aware of any changes
20 that were made to the audit guidelines?

21 A: I'm not aware of any.

22 Q: And do you have firsthand knowledge of these
23 guidelines?

24 A: About seven or eight years later there was a
25 court case called *Lockwood Greene*. And I was



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1 in appeals then and I presented the Department
2 -- the division's position on sourcing revenue
3 for personal services in the *Lockwood Greene*
4 case before the Commission. And I assume that
5 I subsequently assisted in the court case.

6 Q: In *Lockwood Greene*?

7 A: Correct.

8 Q: At the time of the *Lockwood Greene* audit and
9 litigation, what was the audit guideline for
10 engineering companies?

11 A: The same as I just read in the Rule of
12 Construction.

13 Q: At the time of the *Lockwood Greene* -- at the
14 time of the *Lockwood Greene* audit and
15 litigation, what was the audit guideline for a
16 finance company?

17 A: Finance company, you'd look to where the
18 customer or receivable was, and if the customer
19 was in South Carolina, the interest would be
20 sourced to South Carolina.

21 Q: You stated earlier that you were involved in
22 the *Lockwood Greene* case.

23 A: Yes.

24 Q: Can you go into a little bit more detail of
25 what your involvement was with that case?



- 1 A: Back then, as part of the appeals group, the
2 appeals group would research the issue and
3 consult with the attorney generals assigned to
4 the Department of Revenue and we'd try to
5 develop the case for the division to appeal to
6 the Commission. And I presented a case for
7 *Lockwood Greene* as to what the division's
8 position was, and the Commission would hear our
9 side and then the taxpayer's side and issue a
10 Commission decision.
- 11 Q: After *Lockwood Greene*, how were the subsequent
12 audits conducted by the Department affected by
13 the decision in *Lockwood Greene*?
- 14 A: We, of course, follow *Lockwood Greene* and we
15 follow the Rule of Construction that was passed
16 in 1977.
- 17 Q: And what was the decision in *Lockwood Greene*?
- 18 A: That you look to the -- where the income was
19 earned and the place of activity, actually, I
20 believe is what they say in *Lockwood Greene*.
21 Or they refer to it as income-producing
22 activity, and they kind of used -- to be used
23 interchangeably income-producing activity in
24 place of activity.
- 25 Q: Under the Department's guidelines, how did it

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1 treat personal service providers?

2 A: You'd look to see where the personal service
3 was rendered, which state, and if it was in
4 South Carolina, it would be included in the
5 numerator.

6 Q: What apportionment method was used in *Lockwood*
7 *Greene*?

8 A: Gross receipts method.

9 Q: Is that still applicable today to service
10 providers?

11 A: Yeah. Yes, it is.

12 Q: And what records of *Lockwood Greene* did the
13 Department have that provided *Lockwood's* gross
14 receipts in South Carolina?

15 A: I think on the audit the taxpayer was not able
16 to get all the information relative to each
17 contract or billing, and they used direct time,
18 direct activity or time from the employees
19 involved in each contract, the hours.

20 Q: The hours?

21 A: On payroll -- I think maybe they used -- I'm
22 not sure if they used hours or dollar amounts
23 in payroll within South Carolina to total.

24 Q: Outside of the payroll number, how could the
25 taxpayer in *Lockwood* or the Department have



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1 calculated Lockwood's gross receipts from
2 within South Carolina?

3 A: They could have, when they did their time cards
4 or billing, I guess they could have separated
5 between the time from South Carolina employees
6 and employees in the other state or wherever
7 they rendered the service.

8 Q: And are you familiar with the Department
9 Determination in this case?

10 A: Yes.

11 Q: Do you recall the Department's conclusions as
12 to where Dish DBS's subscription receipts
13 should be sourced?

14 A: South Carolina, the place of activity or where
15 the income-producing activity is located.

16 Q: And what is the income-producing activity?

17 A: My understanding it's the provision of cable
18 services to customers, consumers in South
19 Carolina.

20 Q: What other companies or industries has the
21 Department treated similar to the taxpayer with
22 regard to sourcing of income?

23 A: Similar, say regular cable companies for one.
24 That's one that sticks out. And cell phone
25 companies, internet companies.



1 Q: Are you familiar with 12-6-2290 and 2295(A)(5)?

2 A: Yes.

3 Q: And what are these statutes?

4 A: 12-2290 is the statute for taxpayers not
5 dealing in tangible personal property, it's the
6 gross receipts statute, and it sources gross
7 receipts from within South Carolina during the
8 taxable year as the numerator and the
9 denominator as gross receipts from everywhere.
10 It comes up with a ratio splitting the income.

11 Q: And under 2290 in general, what primarily
12 generates gross receipts?

13 A: It could be the sell of services, intangibles,
14 interest, finance companies, interest income,
15 management fees. I think in *Lockwood Greene*,
16 in that case on the transcript I think they
17 listed eight or ten separate categories of
18 income.

19 Q: Based on your long-term employment with the
20 Department, what's the Department's view on how
21 the income-producing activity should be
22 identified under 2295(A)(5)?

23 A: 2295(A)(5), you'll look at the type of income
24 that you're sourcing receipts from and
25 determine where the services were, the place of



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1 activity normally. That's what I would do.

2 Q: And what is your understanding of why the
3 Department did not include Dish DBS's
4 activities performed outside of South Carolina
5 to be an income-producing activity or
6 activities?

7 A: My understanding is we did not think -- we
8 thought that the customer in South Carolina was
9 a purchasing a paying TV service and all of the
10 service is actually performed in South Carolina
11 to give that company the TV -- the cable TV
12 service in the TV set and that what they did in
13 California was not what the customer is being
14 billed for.

15 Q: And are you familiar with the case of *Geoffrey*
16 *v. the South Carolina Tax Commission*?

17 A: Yes.

18 Q: How are you familiar with that case?

19 A: It was issued back in '83 and I was involved
20 somewhat. I'm not sure if I testified on
21 *Geoffrey* or not. I can't remember. I do
22 remember discussing it with an attorney. But
23 it looked at the place of activity that gave
24 rise to the royalty income. And in that case
25 it was the sale of property by Toys-R-Us stores



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1 in South Carolina. I think Geoffrey had
2 asserted that it -- should royalty attorneys
3 developing the trademarks and the patents and
4 the court held you look at the place of
5 activity where the sales took place, and that
6 was in South Carolina for sales that took place
7 in South Carolina.

8 Q: Is South Carolina a cost of performance state?

9 A: Not that I'm aware of.

10 Q: Is the Department's Determination consistent
11 with the decision of *Lockwood Greene*?

12 A: In that you look at the income-producing
13 activity, yes.

14 MS. WOOTEN: That's all from the Department, Your
15 Honor.

16 THE COURT: Mr. Maybank.

17 MR. SWEARINGEN - CROSS-EXAMINATION BY MR. MAYBANK:

18 Q: You said market -- market sourcing is not
19 correct, you look at where the income-producing
20 activity occurs?

21 A: Yeah.

22 Q: Okay. And income-producing activity is not
23 defined in statute or regulation in South
24 Carolina?

25 A: I'm not aware that it's defined, no, sir.



1 Q: Okay. But obviously any activity where you
2 actually collect a dollar is obviously income-
3 producing activity, isn't it?

4 A: Yeah, I would think so.

5 Q: Okay. And at the time -- and what was your
6 role actually in this case of this audit? Were
7 you actually involved in this audit?

8 A: I probably reviewed the returns because I was
9 at the time reviewing RARs.

10 Q: Okay. And then back to the call centers. I
11 don't pay my bill, a call center calls me up
12 and nags me unmercifully to pay my bill. I
13 give them my credit card over the phone.
14 That's obviously income producing?

15 A: I'm not sure the call center would send you a
16 bill for the time they spend doing that.

17 Q: No, they don't. They just take my money.

18 A: Right. But it's just included in the charge
19 for your cable service.

20 Q: Right. It's included in the charge but ---

21 A: Well, the cost of doing that.

22 Q: Right. And obviously Dish -- we'd agree Dish
23 wouldn't pay -- hire 7,000 people to do
24 something they didn't need to do, correct?

25 A: I wouldn't think so.



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1 Q: And some people just don't timely pay their
2 bills; it's just a fact of life, isn't it?

3 A: Yeah.

4 Q: And the call center calls them up and nags them
5 and then they pay the bill, correct?

6 A: I assume. I thought they had their credit card
7 up front.

8 Q: Yeah, they usually -- the reason they call you
9 is because the credit card isn't working
10 anymore. I know of what I speak in that
11 regard. They call you up, hey, Burnie, you
12 haven't paid your service, your credit card was
13 declined, can we have another credit card? All
14 right, I'll go get it. I give them my other
15 credit card and they charge it. I know of what
16 I speak. That's obviously income producing,
17 they're taking my credit card?

18 A: I'm not sure.

19 Q: So you're saying that there are activities
20 where they physically take my money which are
21 not income producing?

22 A: I think we're looking at two different things.
23 If General Motors doesn't get paid by a local
24 car dealer, we still wouldn't change the
25 receipt from General Motors. I mean you're



1 paying for the cable service.

2 Q: Right.

3 A: And all these costs associated with the
4 satellite are costs just not ---

5 Q: Right.

6 A: They're not factored into the receipt.

7 Q: Well, that's what you did in the audit,
8 correct. I'm just saying -- at the time of the
9 audit, you weren't familiar with Dish's
10 business model, were you?

11 A: No.

12 Q: I mean you didn't -- you didn't know, and no
13 reason why you should have, you didn't know
14 that Dish actually signed people up through a
15 call center, did you?

16 A: No.

17 Q: And you didn't know that Dish had seven or
18 eight thousand employees collecting late bills,
19 did you? I mean that's what they ---

20 A: I think they have a call center in Spartanburg,
21 I believe.

22 Q: They don't have -- they have a facility up in
23 ---

24 A: Facility. It's not a call center.

25 Q: Right. But you weren't aware of that, correct?



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1 A: No.

2 Q: Okay. And so the fact is there's been a lot of
3 testimony that, you know, people don't timely
4 pay their bill and the call center starts
5 nagging you and the call center physically
6 takes your credit card, they're physically
7 taking cash. Now how's something physically
8 taking cash not an income-producing activity?

9 A: They take your cash whether they call you or
10 not.

11 Q: Yeah, but the reason they're calling you is
12 because they ain't got ---

13 A: Well, normally they would charge you another
14 late fee ---

15 Q: --- card ---

16 A: I presume they would charge you a late fee.

17 Q: Yeah, they charge you a late fee. They collect
18 those too. Right. So my point is it's not in
19 the minutiae of the billing, you're saying that
20 the instant activity where they physically take
21 cash from me is not -- is not income producing?

22 A: Not in my mind.

23 Q: I'm sorry?

24 A: Not in my mind.

25 Q: Well, what is income-producing activity?



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1 A: Provision of the cable service in the
2 customer's home.

3 Q: Okay. But nobody takes my money when ---

4 A: You've already taken the credit card ---

5 MS. WOOTEN: Can we ---

6 THE COURT: Only one at a time. One at a time. Let
7 him finish his answer before you move on.

8 MR. MAYBANK: Okay.

9 THE COURT: Thank you.

10 A: When I sign up for cable TV service, all I want
11 is cable on my TV in my home. They send out an
12 installer who installs the satellite outside my
13 home and they put a box on my TV.

14 Q: Is that all I want is a TV signal in the home?

15 A: Yeah, pretty much.

16 Q: Okay.

17 A: That's what I want.

18 Q: Okay. So I care when I give them my credit
19 card, I call -- they care where I call for
20 service that it's promptly done, correct?

21 A: Yeah.

22 Q: And the customer cares that he gets what he
23 paid for, correct?

24 A: Correct.

25 Q: Okay. And the customer cares when he gives



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1 them the credit card that they correctly apply
2 the credit card, correct?

3 A: As long as they don't cut my TV off, I don't
4 care what they send.

5 Q: Well, if they apply your bill to Tim Donovan's
6 account, and it does happen, you care about
7 that, don't you?

8 A: Well, I call the call center, but they don't
9 send me another bill for that, do they?

10 Q: Okay. My point is ---

11 A: Go ahead.

12 Q: My point is if you pay a creditor and he
13 misapplies your credit, your check or your
14 credit card, you care about that, don't you?

15 A: Yeah.

16 Q: Okay. In fact, Director Reames was quoted in
17 the paper just last week, people getting mad
18 when they pay a bill and it's not correctly
19 credited to their account, correct?

20 A: Correct.

21 Q: And you care when you call up and you pay for
22 premium package two they give you premium
23 package two and not premium package one, don't
24 you?

25 A: Yeah.



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- 1 Q: And you care if the signal comes in perfectly,
2 doesn't have the snow, you're as old as me, you
3 remember the day when you had to put aluminum
4 foil around your antenna; people care about
5 that, too, don't they?
- 6 A: Yeah.
- 7 Q: And they care about the fact that the USC game
8 starts at 7:30 and that their cable doesn't --
9 their Dish doesn't start until 8:00, correct?
10 They care about that, don't they?
- 11 A: Yeah.
- 12 Q: And they care that the fraud, the neighbor
13 isn't doing their satellite on your bill; they
14 care about that too, don't they?
- 15 A: I presume they might. I don't know how they
16 would tell.
- 17 Q: Unfortunately, it happens. In fact, a lot of
18 people seem to spend a lot of time and effort
19 putting their service on somebody else's bill.
20 But you care your bill is accurate, that it's
21 not a victim of fraud, correct?
- 22 A: Yeah.
- 23 Q: All right. So they do care about -- people do
24 care about a bit more than just signal coming
25 across the TV, correct?



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1 A: Probably, yeah.

2 Q: All right. That may be all I have. Let me
3 quickly look here.

4 MR. MAYBANK: That's all I have, Your Honor.

5 THE COURT: Thank you.

6 MS. WOOTEN: Nothing further from the Department,
7 Your Honor.

8 THE COURT: Okay. Thank you, Mr. Swearingen.

9 MR. SWEARINGEN: Thank you.

10 MS. WOOTEN: Your Honor, I have a housekeeping
11 question. Our next witness will be our last
12 one but he will probably be a rather lengthy
13 witness. Given that we started early this
14 morning, how would the Court like to proceed?
15 Do you want to continue this afternoon or do
16 you want to start in the morning?

17 THE COURT: When you say lengthy, are we looking at
18 two, three hours?

19 MS. WOOTEN: At least.

20 THE COURT: I think that it would be best if we
21 resume with him. I'd rather not stay late this
22 afternoon. It's rather miserable outside.

23 MS. WOOTEN: It is. So I've heard. We didn't go
24 out for lunch today. We had it delivered, but
25 it didn't come back for 2:00, so. But yes, it



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1 is rather miserable outside.

2 THE COURT: Okay. Mr. Maybank, do you have a
3 problem with that?

4 MR. MAYBANK: No, that sounds great.

5 THE COURT: Okay. We'll resume in the morning at
6 10:00 a.m.

7 MS. WOOTEN: Thank you, Your Honor.

8 DAY 3 - FRIDAY, SEPTEMBER 25, 2015:

9 THE COURT: Good morning.

10 MS. WOOTEN: Good morning.

11 MR. MAYBANK: Good morning.

12 THE COURT: Please take your seats. Okay. I think
13 we're ready. Ms. Wooten, you can call your
14 final witness.

15 MS. WOOTEN: Thank you, Your Honor. The Department
16 calls John Swain.

17 JOHN A. SWAIN, being duly sworn, testifies as
18 follows:

19 PROFESSOR SWAIN - DIRECT EXAMINATION BY MS. WOOTEN:

20 Q: Would you please state your full name for the
21 record?

22 A: Yes. It's John A. -- John Allen Swain.

23 Q: And what is your educational background?

24 A: I have a B.A. from Dartmouth College, 1978.

25 MR. MAYBANK: We stipulate to his expert witness



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1 credentials.

2 MS. WOOTEN: Thank you, Your Honor. I'm still going
3 to -- I'd still like to proceed in asking him
4 a few preliminary questions.

5 THE COURT: Proceed.

6 MS. WOOTEN: Thank you.

7 A: Yes. And then I graduated from Yale Law School
8 in 1984.

9 Q: And where are you currently employed?

10 A: At the University of Arizona, Rogers College of
11 Law.

12 Q: And what is your position there?

13 A: My title is Chester H. Smith Professor of Law.

14 Q: And what is the nature of the work you perform
15 under that title?

16 A: Well, I teach, I do scholarship, and I provide
17 service to the University.

18 Q: And do you teach any courses in state and local
19 taxation?

20 A: Yes. My principal research area, or sole
21 research area, is state and local taxation.
22 And I teach a course in state and local
23 taxation, and I teach a number of other tax
24 courses.

25 Q: And what are the topics generally discussed in



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1 those classes or courses?

2 A: \ Well, state and local tax, we talk about the
3 federal limits on state and local taxations,
4 Constitutional issues, and some federal
5 statutes that limit the state's power to tax.
6 And then we focus on the different substantive
7 taxes, like corporate income tax, personal
8 income tax, sales taxes, and property taxes.

9 Q: And are you the co-author of any textbooks?

10 A: Yes, I am. I'm the co-author of -- I can't
11 remember the title, actually, it's state and
12 local taxation cases of materials with Walter
13 Hellerstein, Kirk Stark, and Joan Youngman.

14 Q: And does this textbook include any sections on
15 multi-state apportionment?

16 A: Yes. Probably both in the constitutional
17 section, because there are constitutional
18 issues related to state taxation -- excuse me,
19 multi-state corporate income taxation. I think
20 most of those cases are treated in our chapter
21 on corporate taxation.

22 Q: And are you the co-author of any treatise?

23 A: Yes, I am.

24 Q: And what is that?

25 A: It's called State Taxation, and I'm co-author



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1 -- it's really Hellerstein, Hellerstein, and
2 Swain. The first Hellerstein is the father of
3 the second Hellerstein, and he's deceased
4 actually, but he's on the title. And just to
5 be clear, my name isn't on the spine yet. It's
6 on the inside front matter. And I think even
7 the last supplement, they forgot to put it, but
8 I am listed as -- it's Hellerstein,
9 Hellerstein, and Swain. We're coming out with
10 a fourth edition in about a year, and my name
11 will be on the spine, and there will be no
12 confusion.

13 Q: You will assure your name is on the spine?

14 A: Yeah. I'll have to check on that.

15 Q: And how long have you been involved in that
16 publication?

17 A: Since about 2004, I believe.

18 Q: Okay. And what is your role in the treatise as
19 a whole?

20 A: Generally, we divide the labor. I work on
21 Volume 2, Walter Hellerstein works on Volume 1.
22 Volume 1 covers the constitutional issues and
23 the corporate income tax issues. I do Volume
24 2, which is the sales taxation and a few other
25 issues like -- I'm trying to think --



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1 intergovernmental immunities primarily, estate
2 and gift tax. So what we do generally is we --
3 we prepare three updates a year, three
4 supplements looking at the new case law. I
5 prepare them for Volume 2, he prepares them for
6 Volume 1. We share what we're doing, see if we
7 have any comments, and the publisher -- and the
8 treatise gets updated.

9 Q: And what is your role in Chapter 9 titled,
10 "Allocation and Apportionment of Corporate Net
11 Income Under State Law"?

12 A: Walter Hellerstein primarily writes that
13 chapter. And again, we review each other's
14 work. Actually, the particular section that's
15 pertinent in this case, which is Section 9.183,
16 he draws fairly heavily from a law review
17 article I wrote for the Tulane Law Review in
18 2007, I think it was.

19 Q: Have you written any articles that are relevant
20 to this case?

21 A: Yes. The Tulane Law Review article on the
22 market state forcing of receipts for corporate
23 income tax purposes. I think perhaps
24 tangentially there's an article I wrote on
25 state income tax jurisdiction for the William



1 and Mary Law Review.

2 Q: Do you have any experience as an expert
3 witness?

4 A: Yes, I do.

5 Q: Okay. And what types of cases have you served
6 as an expert witness?

7 A: Well, probably it's a handful total. So I
8 could probably just name them rather ---

9 Q: Sure.

10 A: --- than create types for them, but ---

11 Q: Okay.

12 A: I testified in the *DIRECTV* case here in South
13 Carolina, and I think we know what that's
14 about. I testified in Nevada regarding a
15 constitutional issue, whether a state tax
16 discriminated against interstate commerce.
17 I've testified in Alaska on the property tax
18 valuation of the Alaskan Pipeline. That was
19 quite an interesting valuation issue.

20 (Respondent's Exhibit Number 6 was introduced into
21 the record.)

22 Q: And if you'll refer to Respondent's Exhibit 6.
23 I'll let you use this one. Do you recognize
24 this exhibit?

25 A: Yes. It's my resume or CV or whatever word is



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1 en vogue.

2 Q: Does it contain your expert testimony and
3 experience research and work experience?

4 A: Yes, it does. Uh-huh.

5 Q: And ---

6 A: It doesn't have DIRECTV on it, so it's a little
7 dated in that regard, so.

8 Q: Okay.

9 MS. WOOTEN: Your Honor, I recognize that counsel
10 stipulated to him earlier, but I just wanted
11 for the record to make sure that we are
12 offering him as an expert in tax policy and
13 multi-state apportionment.

14 MR. MAYBANK: No objection.

15 MS. WOOTEN: Thank you.

16 Q: Professor Swain, have you reviewed any
17 documents in preparation for your work in this
18 case?

19 A: Yes.

20 Q: And do you recall what you've reviewed?

21 A: Generally. The statutes involved, some of the
22 pertinent case law across the country. I took
23 a look at the annual report that's online of
24 Dish and also DIRECTV. There are lots of
25 things I did in the DIRECTV case to educate



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1 myself on the satellite facts. There were some
2 audit work papers I looked at. And then the
3 deposition of Mr. Stevens. Those are the
4 things I recall immediately.

5 Q: And were you present for Mr. Stevens' testimony
6 yesterday afternoon?

7 A: Oh, yes. Yes.

8 Q: And do you have an opinion about Mr. Stevens'
9 characterization of cost of performance
10 regarding South Carolina law?

11 A: Well, I guess I'd like to start by I got the
12 impression that -- that either he or counsel
13 was trying to leave the impression that in the
14 treatise we had somehow declared South Carolina
15 to be a cost of performance state, and in the
16 treatise we have somehow said that there is
17 sort of one clear way to interpret UDITPA's
18 income-producing activity cost of performance
19 language. I sensed he was going to go on and
20 talk a little bit more about what he saw in the
21 treatise, and then the questioning moved in
22 another direction. But I felt it might be
23 important just to make sure we get the whole
24 picture rather than just look at little
25 snippets.



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1 Q: Sure.

2 A: And in that regard, I guess the first thing I'd
3 do is recommend or report respectfully that the
4 -- there's a section in the treatise where we
5 deal with this. It's about 15 pages long, some
6 horrendously long footnotes. I think to really
7 get the full view it would just be helpful to
8 have a look at that little section without --
9 outside the wagging tongue of lawyers. And --
10 but specifically -- and I won't go through all
11 of it that they went through yesterday, but
12 just a couple things is there was a reference
13 to -- I'll just say Footnote 1187 -- it's
14 embarrassing we have 1,187 footnotes -- where
15 we say, "According to two knowledgeable
16 observers, as of late 2010, four states use a
17 proportionate cost of performance method:
18 Arkansas, Mississippi, North Carolina, services
19 only South Carolina and services only." And we
20 cite the people who are saying this, and we're
21 actually quoting them. And I think it's
22 important to see why we put a footnote here.
23 And we go up -- so let's go up to where this
24 footnote comes from. It's in a sentence that
25 says, "There is, however, a more fundamental



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1 objection to UDITPA's cost of performance rules
2 for attributing receipts from services whether
3 applied on an all or nothing basis or on a
4 percentage attribution states as some states do
5 footnote." So we're footnoting the notion that
6 there are states out there that have the
7 proportionate rule. And we quote these people,
8 and they use some language that's not in -- we
9 all know this, it's not in the -- cost of
10 performance is not in the South Carolina
11 statutes. So there's some loose language here,
12 but the footnote was not a footnote about
13 trying to ascertain cost of performance, it was
14 to identify what states use the proportionate
15 method, so that's one. Two, we have done -- we
16 have not suggested that there is one way to
17 interpret cost of performance income-producing
18 activity. And I would just cite from -- you
19 know, it depends whether you use the online
20 version or the written version, but this is
21 Page 9-316 of the written version. It's the
22 last paragraph of Paragraph 9.183(b) -- 3(b),
23 3(b)1. And we say, "Suffice it to say at least
24 for anyone who has had the fortitude to wend
25 his or her way through the proceeding

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1 footnotes, as we observed at the outset of this
2 discussion and as other commentators have
3 recognized, UDITPA's income-producing cost of
4 performance rules are" -- and I'm going to list
5 these words. And these are all words from
6 other commentators we're quoting. "Confusing
7 and indefinite and plagued by vagueness,
8 ambiguity, substantial debate, lack of clear
9 guidance, whipsawing, tremendous flexibility,
10 and hence tax planning opportunities, frequent
11 litigation", here we are, "inconsistency, and
12 confusion for taxpayers and taxing authorities
13 alike." So the interpretation is far from
14 certain even with the UDITPA language. And
15 there's two more. Just to focus in on the
16 footnote, this is Footnote 1205.6. We cite the
17 South Carolina statute 2295(A)5, and we say,
18 "Unlike UDITPA's income-producing activity cost
19 of performance provisions for attributing
20 receipts from services, see supra", see an
21 earlier section of the treatise, "the South
22 Carolina provision does not adopt a 'cost of
23 performance test' for determining where income-
24 producing activities." Now, in fairness, where
25 does this footnote come from? Well, this is



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1 from recent -- the most recent supplement, and
2 we're up in -- so we go up to the call out for
3 this note, we go up to where the sentence
4 proceeding 12.056, and we say, "Relying heavily
5 on Heller Western and citing Ameritech with
6 approval, the South Carolina Administrative Law
7 Court has held that the income-producing
8 activity of DIRECTV, a provider of Direct
9 Broadcast Satellite Video Services was
10 'delivery of the signal into the homes and onto
11 the television sets of DIRECTV's customers'.
12 Accordingly under South Carolina single sales
13 factor formula for service providers, which
14 attributed receipts to South Carolina 'to the
15 extent the income-producing activity is
16 performed in the state,' all of DIRECTV
17 subscription receipts from South Carolina
18 customers were sourced to South Carolina
19 because 'all of those income-producing
20 activities related to South Carolina's
21 customers occurred entirely within the state'".
22 Now, this is -- this is repertage; we're just
23 recording what happened. And then we -- we
24 have a footnote to that, and I'll just mention
25 we -- I don't know if the word is immortalized



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1 or not, but we quote this Court. We say, "See
2 also Dish TV." I won't read the quote.
3 "Paren, holding that South Carolina is not 'a
4 strict cost of performance state' and remanding
5 case for consideration of criteria for
6 considering where income-producing activity
7 occurs within the meaning of the state
8 statutes." So again, the treatise hasn't made
9 any declaration about, nor can we make South
10 Carolina a cost of performance state. We've
11 reported on the most recent litigation. And I
12 will add, this is all Walter Hellerstein's
13 language. I didn't influence him in any way.
14 I didn't tell him to not include or include or
15 anything like that. This is information he
16 picked up from the advance sheets. So I don't
17 want to overly belabor that, but I think it
18 just would be fair to the extent anyone left
19 the impression -- it would be unfair to the
20 extent anyone left the impression that we have
21 declared South Carolina to be a cost of
22 performance state or that there is one clear
23 way to read the UPDITPA language is -- would be
24 inaccurate -- would be inaccurate.
25 Q: Thank you. Professor Swain, what is good tax

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1 policy?

2 A: May I put up on the screen a visual aid?

3 Q: Would you like for me to, or you want to walk
4 over there and do it?

5 A: I'll give it a shot.

6 Q: Okay.

7 A: Let's see. So that's working. That's why we
8 have these screens. Is it a little out of
9 focus? Is there some way to focus that? Okay.
10 Well, when I talk about good tax policy, I
11 usually think of three or four --I've added the
12 fourth one here -- things we think about. One
13 I broadly call equity. And first what I mean
14 by that is if we're having -- we have an income
15 tax, let's make sure it's an income tax. If we
16 have a consumption tax, let's make sure it
17 really taxes consumption and not something
18 else. The other equity issue is we want to
19 treat similarly situated taxpayers alike. And
20 so you just start drawing directly to the facts
21 in this case, I think we'd want to treat
22 satellite television companies similarly, and
23 we'd want to treat their competitors similarly,
24 like the Netflix, or Hulu or cable or even
25 broadcast networks. So that would be equity.



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1 The second is administrability. We like a tax
2 system that is easy to administer, it's clear,
3 that is not expensive to administer. I would
4 say that cost of performance says -- certainly
5 my personal observation on Wednesday was it
6 gets pretty darn confusing. We've got -- we
7 had -- we don't even -- we didn't know what
8 rules to apply really. We had three scenarios.
9 There's some questions about the
10 administrability. Third question is about the
11 administrability of the statute that says
12 income producing, and it's a very broad
13 principle that's not particularly self-
14 explaining. And so that's a -- that would be
15 a concern too. Non-tax policy goals, so we
16 sometimes use the tax code to do other things
17 than to get income exactly right or consumption
18 exactly right and tax it. We sometimes use the
19 tax code to pursue social or economic goals.
20 Like we may have childcare credits. We may
21 have -- we have earned income credit, if I'm
22 getting that right. We have incentives to use
23 environmentally friendly products or have nice
24 insulated windows, we have tax credits for
25 that, or at least used to. In this case, I

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1 think South Carolina is pursuing a non-tax
2 policy goal of economic development. We
3 sometimes use the tax code to pursue economic
4 development. As I think we'll get into later
5 in my testimony, the single sales factor
6 apportionment has that element to it. It's in
7 some ways sacrificing one, which is getting it
8 -- measuring income right for a non-tax policy
9 goal of attracting business and retaining
10 business in South Carolina. And then the
11 fourth is adequacy. And that's actually
12 something I added after reading some things by
13 -- and I'm sorry, I forget her name. She's a
14 very well known public finance economist at
15 Clemson. I'm just forgetting her name, I'm
16 sorry. But she -- and other economists
17 identified this, because where I picked it up,
18 is you want a tax system that's robust, meaning
19 strong, meaning you need to -- it needs to be
20 adequate to raise revenue to fund government.
21 And if you have tax rules that -- this is
22 related to three, economic development, that is
23 discourage economic activity that chase
24 taxpayers or don't attract them, then there
25 could be an adequacy issue. And I think that

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1 might come into play. It's sort of three and
2 four on my list here. Both go to that economic
3 development and having a robust economy, and
4 therefore, a robust tax system that can raise
5 some revenue and fund your government.

6 Q: What tradeoffs among these principles, if any,
7 are there?

8 A: Well, sometimes there are tradeoffs, and I
9 think I mentioned why. If you're going to
10 pursue a non-tax policy goal, such as economic
11 development, you almost invariably deviate from
12 what an economist would say is the proper
13 measure of income; maybe even the proper
14 apportionment. You may deviate from that
15 because you're pursuing another goal, and
16 that's a political choice that a legislature
17 makes.

18 Q: All right. Let's talk about UDITPA and the
19 history and policy rationales behind it.

20 A: Okay.

21 Q: Can you just briefly describe the history and
22 how UDITPA came about?

23 A: Sure. United States would have to pass a
24 constitutional amendment to have an income tax
25 back in 1913 or in that neighborhood. About



1 the same time, states started imposing a
2 corporate income tax. And at first, they tried
3 what was called the separate accounting method,
4 and it proved very quickly to be difficult to
5 apply. I mean, even back -- let's just take a
6 railroad that's passing through a state, and
7 it's this huge railroad system, and it's
8 passing through Iowa. I mean, how do you
9 separately account for the income of that
10 railroad, for example, or even in today's
11 world, how would you separately account for the
12 South Carolina income of a multi-national
13 company like Microsoft. And so they moved very
14 quickly to formula apportionment, which the
15 Supreme Court approved. And it's an approach
16 -- it's not really based in any real accounting
17 theory or anything. It's just someone's --
18 it's just a sense of what are the factors that
19 help you generate your income. And I have the
20 UDITPA formula in rough terms up on the screen
21 here where -- well, first states adopted many
22 formulas during this time, and it -- things
23 evolved where people settled on what was known
24 as the Massachusetts formula, the three factor
25 formula of property, payroll, and sales. And



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1 the sales -- and you'd take the average of
2 those, that's why I have divide by three on the
3 bottom of that chart there. And that would be
4 the apportionment factor that you'd got. So,
5 for example -- well, let me describe the
6 factors first. Property in state -- taxpayers
7 property in the state to its property
8 everywhere, or at least in the U.S. Let's just
9 ignore foreign property for a moment. Payroll
10 in the state over payroll everywhere, and then
11 sales in the state to sales everywhere. And
12 you divide by three, so if one-tenth of your
13 property and one-tenth of your payroll and one-
14 tenth of your sales were in the state, one-
15 tenth of your income would be apportioned or
16 is apportioned to the state. An interesting
17 observation to make about the formula, and I'll
18 just sort of footnote it -- well, I'll make it
19 more general. The property and payroll focus
20 on what I call the supply side of things. It's
21 where production occurs; it's where you produce
22 the product as the property -- payroll factor.
23 The sales factor gives credit to the state of
24 market, the market state, and the market
25 state's contribution to the income. That's

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1 demand. And that's how I like to look at it is
2 the property and payroll is the supply side and
3 the sales is the demand side. And I think to
4 generate income, you need both. You need
5 either supply and demand. And UDITPA tries to
6 tip its hat to both of those due to the
7 original formula. Now having said that, in
8 theory we run into a problem with the way
9 UDITPA is actually drafted. And so I -- below
10 there, I have an entry, it says a UDITPA
11 numerator, and then I say Section 16; that's
12 Section 16 of UDITPA. And it sources tangible
13 personal property, or attributes tangible
14 personal property based on the state of
15 delivery. Where the customer is essentially.
16 And so that works pretty well in reflecting the
17 contribution of the market state. Section 17
18 is this income-producing activity based on cost
19 of performance. And the traditional view of
20 that is that that means that that's going to
21 pick up a lot of your production activity,
22 where your plant is, where your -- well, it's
23 a service -- let me back up a second. Section
24 17 applies to all sales other than tangible
25 personal property. And what's left really are



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1 services and intangibles. You've got
2 tangibles, intangibles, services. And it has
3 the effect really of not, I think, serving the
4 purpose of the sales factor, which is to
5 reflect the contribution of the market state
6 because, at least under the traditional
7 reading, it's really duplicative, largely
8 duplicative of the payroll and the property
9 factor. Where are your costs of performance
10 under the traditional view? They're going to
11 be where your folks are, where your payroll is,
12 where your property is. So it sort of is
13 duplicative and redundant. The drafters -- why
14 did that happen? There's no great explanation
15 other than back in '57 we were largely in what
16 they call a manufacturing and mercantile
17 economy. We weren't as service oriented as we
18 were. Plus, UDITPA excluded personal services;
19 it excluded financial institutions and public
20 utilities. So it tried to exclude some of the
21 well-known service businesses. I don't know if
22 public utilities would have included the
23 regulated phone companies at that time. I
24 don't know. So the honest answer that the
25 folks who wrote this, it really wasn't that



1 well thought out. And it's been a problem;
2 it's been a problematic section since then.

3 Q: And from a tax policy perspective, what are the
4 flaws of cost of performance?

5 A: Well, the flaws are several fold. First, I
6 mentioned that it doesn't -- it's duplicative
7 of the payroll, at least in the traditional
8 view. The traditional -- duplicative of the
9 payroll and the property factor. It doesn't
10 reflect the contribution of the market state
11 often. When the production occurs in one
12 state, the supply is created in one state and
13 the demand is in another state. The other
14 thing, as I read before, it's just been a very
15 difficult statute to interpret. Courts are all
16 over the board. I mean people have been
17 talking about advertising, for example, and
18 marketing, and that comes up in the DIRECTV
19 decision. The majority rule is that isn't
20 included.

21 Q: That it is not included?

22 A: That advertising sales and marketing and
23 negotiations aren't included. But then some
24 states, like my state where I practiced for 12
25 years, Arizona, it isn't -- it was included at



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1 least under Heller Western. The law has
2 changed in Arizona. So -- and on and on. And
3 it's that -- we summarized it in that quote I
4 read at the beginning of my testimony. So it's
5 been very difficult to interpret. I think it's
6 also been difficult -- it's a lot of work to
7 figure out. I think we saw that on Wednesday.
8 I went to a conference in Nashville last year,
9 and this is a hot topic about how courts are --
10 how states are moving to market sourcing, and
11 how courts are now interpreting the traditional
12 language differently than they used to, and
13 taxing authorities. And this is a hot topic.
14 It was a topic at the seminar. And there -- I
15 was at the airport, and a woman runs up to me
16 and says, Professor Swain, Professor Swain, I
17 can't believe those guys were defending cost of
18 performance and why? And she's an accountant
19 for a private industry in Chicago. She says
20 cost of performance is the bane in my
21 existence. Well, what do you mean, of the
22 taxing -- no, she says -- it's just -- it's
23 just a lot of work and it's confusing. We
24 don't know exactly how to do it. You have to
25 capture information that you don't normally

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1 capture. And so, you know, it's -- people do
2 it; people do it all the time. It's been the
3 law in many states for many years. I'm not --
4 I don't want to overstate that, but there is a
5 lot of confusion both in what are the rules and
6 then the difficulty in applying -- in applying
7 the rules. And I think even this Court that it
8 goes in that direction, you've got to go
9 through each -- well, you don't have to do
10 anything, but I mean, go through each one of
11 those line items and decide if it's in or out
12 and if it's done right. I mean, it's hard. So
13 I think that's another problem with it. The
14 other problem is just the -- well, there's a
15 problem though -- well, just to be thorough.
16 So UDITPA has what we call an all or nothing
17 rule. So let's say that 40 percent of your
18 cost of performance are in Tennessee, 30
19 percent are in North Carolina and 30 percent in
20 South Carolina, UDITPA attributes, because the
21 preponderance is in Tennessee, would attribute
22 all the service receipts to Tennessee even
23 though it's contributing 40 percent. The nice
24 thing about that rule, it's really easy to
25 apply because you don't have to get it exactly



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1 right. I mean, if you can see which way the
2 wind is blowing and what state is the
3 predominant state, what I just said about how
4 hard it is for the accountants and so on, it
5 minimizes that a lot because if you know the
6 predominant state is Colorado or something,
7 you're done, and it's pretty easy to convince
8 an auditor. But it's not very -- you sort of
9 minimize it, then you're ignoring the
10 contribution to North Carolina and South
11 Carolina. As we discussed earlier, it's been
12 -- South Carolina has a proportionate rule. It
13 says if it's 20 percent South Carolina, 20
14 percent South Carolina -- 20 percent of your
15 cost of perform- -- well, here -- let's assume
16 that South Carolina is a cost of performance
17 state just to -- or let's take another state
18 that has the proportionate rule. Then it
19 becomes really important. Is it 21 percent, is
20 it 22 percent, is it 23 percent. You're
21 getting it right, but that's the trade off
22 again between getting it right equity and
23 administrability. It becomes harder to
24 administer; there's an asymmetry of
25 information. The taxpayer has a lot more of



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1 that information, which it is true a lot of the
2 times in tax. But I think it becomes hard to
3 administer. So that proportionality rule
4 creates some problems that I think if you just
5 look to where sales are it's easier to make
6 those determinations who's a South Carolina
7 customer and who's not. The other one I think
8 is a little more important, is whenever you
9 have rules that are different, so we have a
10 clear destination rule for personal property,
11 but then we have this cost of performance rule
12 again under UDITPA for services and
13 intangibles, you can get -- you get a different
14 result depending on the characterization of the
15 transaction, a completely different tax result.
16 So let me use two examples. One it -- this
17 has, I think, kind of been worked out, but I
18 think it's a good example because we can
19 understand it, is take software, and let's say
20 you're a software provider in California and
21 you -- all your costs of developing the
22 software are in California. And you allow
23 people in South Carolina to electrically --
24 electronically download the software. Is that
25 a service? Is that an intangible? Is that



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1 tangible personal property? There's litigation
2 on this. If it's -- why is there litigation?
3 Because the rules are different. Because if
4 you're in California and you could convince
5 California that it's a tangible personal
6 property, then it's going to get sourced to
7 South Carolina. You don't pay any, in fact,
8 any California tax. If you can convince South
9 Carolina it's not tangible personal property,
10 that it's an intangible or a service and it's
11 cost of performance, then South Carolina
12 doesn't tax you either. It gets thrown back,
13 I mean, it -- they say oh, your cost of
14 performance are in your service, your
15 intangible under UDITPA, and so we're going to
16 source those sales to California. And
17 California is sourcing them to South Carolina,
18 and this is I said whipsawing earlier, that's
19 an example where you -- and so it becomes a
20 problem or -- and, or let's even say -- I'm
21 trying to bring in a few ideas here. Let me
22 just say first, the whipsaw can work both ways.
23 So if California says we're cost of performance
24 and South Carolina says we're market, you get
25 taxed in both places. Okay. The other thing

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1 is -- so let's say you're selling software and
2 your business model is electronic download and
3 the other person's business model is send a
4 disc in the mail, and it's pretty -- and the
5 courts say, oh, disc in the mail is tangible
6 personal property, but electronic downloads
7 isn't. Well, the electronic download person
8 let's say won't pay tax in South Carolina,
9 because that's an intangible and the cost of
10 performance in California, while the business
11 selling it with discs is taxable in South
12 Carolina, and that's an inequity. I talked
13 about being fair to similarly situated
14 taxpayers. You can have very similar
15 businesses, but when you have a difference in
16 the rule, the treatment of those can turn on
17 slight differences in the model when they're
18 substantially in the same business and
19 competitors. And you -- and are competitors.
20 To make an example closer to home, let's take
21 satellite TV. First of all, you just have the
22 administrator problem. Is it a service? We
23 had the suggestion the other day that you're
24 actually kind of, it's a licensing arrangement.
25 That you have a viewer license to watch the



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1 material, and the auditor thought that was a --
2 under -- again, the rules are different. Under
3 South Carolina law now, you'd source the
4 licensing income from satellite clearly to
5 South Carolina. Under the taxpayer -- if it's
6 a service and under the taxpayer's view of cost
7 of performance in this case, you wouldn't. And
8 so a very important tax treatment turns on that
9 nuance. Now, you've got who do they compete
10 with? Well, some of the streaming video, for
11 example, and cable. There was a recent case in
12 Louisiana where the Louisiana tax authority
13 took the position that pay-per-view is tangible
14 personal property, took the -- that cable video
15 was tangible personal property. They lost the
16 case, but what if they had won? You know, what
17 if there is somehow a distinction in these
18 business models that can create a different tax
19 treatment, even though they're functionally the
20 same businesses and are in competition with
21 each other. So from a tax policy point of
22 view, we think there's no principal reason to
23 treat a service business or a manufacturer or
24 a seller of tangibles differently. There's no
25 principal of reason to have a different rule

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1 for those. These are just -- I mean, service
2 providers, they're in business, they try to
3 make money, they have a product, they sell it,
4 particularly satellite serve a commodified
5 product. They're reselling content. Netflix
6 does the same thing. There's a time when
7 Netflix would rent a disc to you, I think.
8 Clearly a South Carolina transaction, so
9 Netflix gets taxed, but -- but Dish, under
10 their view, doesn't. So for tax policy folks
11 like us, we would like a single rule applied so
12 that we have -- meet that first goal, equity.
13 So that's another flaw in having two different
14 rules.

15 Q: And we'll get to the modern development single
16 site factor that you were just referencing.
17 But just to back up one more point.

18 A: Uh-huh.

19 Q: How are gross receipts from personal services
20 sourced under UDITPA?

21 A: Well, they're sourced, if you read the statute,
22 under Section 17 based on income-producing
23 activity/cost of performance. What's
24 interesting is an organization called the
25 Multistate Tax Commission, which was formed



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1 right around the time states were adopting
2 UDITPA, and I think this was brought out in --
3 I think in Dish's case by Mr. Stevens, that --
4 so it's an organization of states, and one of
5 the tasks of Multistate Tax Commission has been
6 to try to encourage uniformity, and they've
7 written regulations. They've written
8 regulations under UDITPA, model regulations.
9 And they wrote a model regulation for personal
10 services that doesn't really follow Section 17.
11 And it's not clear what their authority was to
12 do that, but there's a separate set of -- at
13 least under the MTC regs -- rules for what we
14 call personal service businesses, like lawyers,
15 accountants. Perhaps the authority for that
16 was something called Section 18. It's a little
17 unclear, but it's a model reg, so.

18 Q: You spoke briefly about the, or made a
19 statement about the modern development and move
20 towards single sales factor. Can you discuss
21 that?

22 A: Yes. So what I've done so far is describe
23 UDITPA as it was adopted in 1957, and the three
24 factor formula that reflects both what I call
25 supply and demand. Demand being the sales



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1 factor; supply being the property and payroll.
2 There was a Supreme Court case called Moorman
3 -- I forget the date, I think in the 80's --
4 out of Iowa, where the Supreme Court said it's
5 okay to have a single sales factor, a factor
6 that only looks at the market, essentially; a
7 factor that doesn't look at the supply side, it
8 looks at -- that doesn't have a payroll factor
9 or property factor. So states pretty quickly
10 figured out -- and maybe I'll refer to this
11 Congressman. Now, there's a Congressman named
12 Charles McClure who made the observation, he
13 said, well, what is this formula, what is it
14 really. He said it really imposes three taxes.
15 It's a property tax, property factor, the more
16 property you add in a state, the more tax you
17 pay. It's a payroll tax, it's a head tax, the
18 more employees you have in a state, the more
19 tax you pay. It's kind of a sales tax. The
20 more sales you make in the state, the more tax
21 you pay. And states figured out that, oh, so
22 whether we're saying, for example, new
23 businesses by having a three factor formula,
24 we're saying come here. But when you add
25 payroll -- when you add property, your income



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1 taxes go up, which may be, you know, make a lot
2 of sense from sort of a benefits received point
3 of view of taxation; the more you have the more
4 benefits and services you receive from the
5 government. But states have made the decision
6 to basically draw a line through those two
7 factors and rely solely on what I call the
8 supply on the market. And that's been a big
9 trend nationwide, single sales factor
10 apportionment. Now, when states have that in
11 mind, remember what I said about Section 17 of
12 UDITPA, that it doesn't work very well in
13 reflecting the contribution of the market. It
14 is somewhat duplicative of the property and
15 sales factor. Cost of performance often are
16 your property and plant and there are where
17 your folks are. So it doesn't work very well
18 with the legislative intent behind single sales
19 factor apportionment, and so states routinely
20 when they go to single sales factor
21 apportionment have a more destination based
22 rule for -- for sales of services and
23 intangibles as well as tangible personal
24 property to correct that flaw, if you will, and
25 make sure that their economic -- I say economic

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1 development, I'll say their economic
2 development goals are met. I just want to
3 repeat, and I get this from talking to
4 economists, they say -- because there's this
5 notion that legislatures are being conned or
6 foolish or that this sort of cynicism around
7 the idea of economic development, it's really
8 economic survival and competitiveness. You
9 know, the wages of virtue here are poverty
10 because capital and labor are quite mobile.
11 And if you have a tax system that says we're
12 going to tax you on your new Mercedes Benz
13 plant, you know, they do. They find a state
14 that's going to be more friendly. And so it's
15 not just -- so I got a little long-winded on
16 that, but it's -- it's not just -- it's
17 competitiveness and survival as well as
18 development that's involved here when the
19 legislatures do this, particularly when all the
20 other states are doing it.

21 Q: And when you're speaking about the sales
22 factor, are you also speaking about the gross
23 receipts factor? How does that work together?

24 A: Okay. It sounds like you're -- gross -- that's
25 a term in the South Carolina statute is ---



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1 Q: That's correct.

2 A: So I think if we turn our attention to the
3 South Carolina statute, well, first of all to
4 answer your question, yeah, I say sales factor
5 and gross receipts factor, they're, in my view,
6 the same. Sales factor rolls off my tongue a
7 little easier, so they're the same. So South
8 Carolina adopted -- it was phased in, a single
9 sales factor apportionment, I think in -- you
10 know, I don't have all the dates quite right,
11 but I think in the 2006 legislature, maybe
12 effective 2007, but then it was some phase-ins
13 for various aspects of the statute. But it
14 created the statute that folks have been
15 talking about, though again this audit -- I
16 thought some of the years may predate this.
17 But the -- what South Carolina did, as I
18 understand it, before then, there was just a
19 gross receipts factor, South Carolina gross
20 receipts for service businesses, or maybe non-
21 sellers of tangible personal property, like
22 UDITPA's Section 17. And it just was gross
23 receipts in South Carolina over gross receipts
24 everywhere. Then they adopted a statute that
25 tried to put some flesh on the bones of how you



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1 determine a South Carolina gross receipt, and
2 that's 2295. And I tried to just boil it down
3 to its essentials in the bottom part of this
4 chart here. And as I understand it, the South
5 Carolina rule for tangible personal property is
6 essentially delivery to the consumer in South
7 Carolina, the purchaser. For intangibles, it's
8 where the purchaser uses the intangible in
9 South Carolina, which to me is a destination
10 rule. It's not where you maintain the
11 intangible; it's not where you incurred all the
12 R and D and so on to develop the patent, for
13 example, it's where it's used, where the
14 customer uses it. And then services, it --
15 it's this rule we've all been talking about,
16 income-producing activity based in South
17 Carolina. What I would observe, if you kind of
18 compare what South Carolina did to what UDITPA
19 is -- I'm going to take a risk and use my
20 finger on the screen -- is what South Carolina
21 did is by adopting single sales factor
22 apportionment is they drew a line through this,
23 they drew a line through this, the two supply
24 side factors, there they went to single sales
25 factor apportionment, which is a market

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1 approach, and then they drew a line through --
2 sort of implicitly when they said income-
3 producing activity, but did not choose to adopt
4 cost of performance, which in the traditional
5 view is also a supply side idea. They took out
6 all the supply side of the statute here, and it
7 seems to me to be a more demand oriented view
8 of things, which is completely consistent, in
9 my view, with what legislatures were doing
10 around the country at that time, and I assume
11 South Carolina, which was they had an economic
12 development goal behind adopting single sales
13 factor apportionment, and they didn't want to
14 chase businesses away.

15 Q: And just going off of that, the economic
16 development and your thoughts there, how -- can
17 you address how that would -- or that would
18 address petitioner's concern about economic
19 competitiveness that you heard yesterday or
20 treating taxpayers differently?

21 A: Yes. And again, hopefully I understood this
22 correctly. There seemed to be a suggestion
23 that it would be inappropriate to not tax a
24 service provider based on their equipment,
25 their property, their payroll in South



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1 Carolina. And I think the example was given,
2 you know, you mean if Dish had a billion dollar
3 investment in South Carolina they wouldn't pay
4 any more tax. The answer is that's right under
5 the Department's view. And that would be true
6 if Toyota came here, Mercedes came here, a cell
7 phone manufacturer came here. Because for
8 tangible personal property, I think it's
9 undisputed that that is the rule. In South
10 Carolina you aren't going to have a property or
11 payroll factor for those, and you're going to
12 have a destination sourcing. And that's what
13 the legislature decided. So to me what's
14 unusual is why do you want to punish service
15 businesses. Did you really single out service
16 businesses for unequal and discriminatory
17 treatment in South Carolina where they're going
18 to pay more taxes than the manufacturers and
19 the sellers of intangibles, because you have a
20 destination goal for intangibles. So I think
21 the factual observation is right, but I think
22 that's -- makes sense that's the only way you
23 don't discriminate against service businesses,
24 which are the fastest growing area of our
25 economy, and I suspect something that you all

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1 would like to see more of. You wouldn't get a
2 satellite company here, you'd never attract
3 one, I assume, because under the taxpayers'
4 interpretation because who wants to be taxed on
5 a cost of performance basis. And Colorado it's
6 some kind of audience rule. And so it's thrown
7 out of Colorado kind of like the whipsaw is
8 talking about.

9 Q: And do you have an example showing that the
10 same treatment makes good tax policy for
11 services and tangible personal property?

12 A: Well, I think I discussed that earlier. You
13 can have business models that are very similar.
14 I contrasted, say, electronic delivery of
15 software versus physical delivery of software;
16 how you might treat streaming video versus
17 satellite, maybe one's an intangible and maybe
18 one's a service, maybe it's tangible personal
19 property. I just think you want to treat --
20 you want to treat those business competitors
21 the same if you can. It's about having a
22 uniform attribution rule, conceptually uniform
23 attribution rule.

24 Q: And from a tax policy perspective, what's the
25 emerging trend from other jurisdictions



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1 regarding the interpretation of income-
2 producing activity?

3 A: Well, you have -- I'll just boil it down to
4 this. I think there's just three -- three
5 lines of cases, three lines of authority.
6 There are traditional, UDITPA, income producing
7 cost of performance states. There are states
8 that have explicitly adopted what we call
9 market sourcing. And then there's this third
10 line of cases, the Heller Western case from
11 Arizona. But more recently there's been this
12 growing trend, which starting with the
13 Ameritech case in Wisconsin and then a series
14 of rulings from Indiana and Florida. For
15 example, Indiana and Florida have both rules
16 that remote sellers of online educational
17 services are -- their receipts from Indiana
18 customers or Florida customers are sourceable
19 or attributed to Indiana and Florida even
20 though the educational content and teaching is
21 offline -- is out of the state. Even though
22 those are income-producing activity/cost of
23 performance, those are actually cost of
24 performance states. Same with Wisconsin. I
25 mentioned the Ameritech case. That was where



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1 Yellowpages books were, you know, produced out
2 of state but delivered into Wisconsin. And
3 even under a cost of performance standard, they
4 were taking -- they ruled that -- really, it
5 reached a market state result. And, you know,
6 initially I was a little bit sort of a
7 traditionalist and thought, wow, that's kind of
8 wild. Particularly when the Wisconsin court
9 ruled, but more and more states are embracing
10 it. South Carolina embraced it recently. And
11 then just two weeks ago, two weeks ago today,
12 the Oregon Supreme Court ruled in a case called
13 AT&T, which is not in the treatise yet, but
14 Walter Hellerstein has already written it up,
15 and he says -- and I'll say this respectfully,
16 he says it should be required -- the cases
17 should be required reading for anyone who has
18 to grapple with these issues, so I highly
19 recommend it. And there, the Oregon Supreme
20 Court was faced with how do you source long
21 distance service -- well, telephone services
22 from eight -- and to be honest, it's a new case
23 and I haven't committed it enough to memory.
24 But basically, how do you source the income of
25 AT&T on calls, services provided to Oregon



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1 customers. And they did what these other
2 courts are doing. They're drawing a tighter
3 circle around income-producing activity and a
4 more destination-based approach to what income-
5 producing activity is. And the two things from
6 a policy perspective that I think are
7 beneficial about that approach are I think it's
8 more reflective of what the sales factor should
9 be and it's easier to administer. The smaller
10 income producing circle you have, the fewer
11 costs and things you need to worry about in a
12 traditional cost of performance state. Oregon
13 is traditionally a UDITPA state. It has UDITPA
14 regs; it's got the UDITPA statute by and large.
15 And what the Oregon Supreme Court said is
16 basically it just drew a line through what it
17 called the network cost. All of AT&T's New
18 Jersey equipment, not a cost of performance
19 because it wasn't part of the income-producing
20 activity. And there's a lot of technical
21 analysis that I don't really want to get into
22 because I really haven't committed it to
23 memory, all of it to memory. But it basically
24 said that the income-producing activity, you
25 look at a call by call basis, and it's that



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1 delivery of the call, the cost involved with
2 delivering the call to each Oregon customer,
3 which the Department of Revenue's point of view
4 was the fee AT&T has to pay to the local
5 carrier because AT&T can't do the local -- it
6 has to pay a fee to the local carrier in
7 Oregon, which was an Oregon expense. And the
8 Department of Revenue also said electricity to
9 carry the call, and I don't understand
10 telecommunications or electrical markets to
11 know exactly what that means. The court did
12 not have to reach that issue because it ruled,
13 you know, somewhat like *DIRECTV* that the --
14 AT&T prepared a 300-page report on its cost of
15 performance, and the court said it just wasn't
16 the right analysis; that these aren't the cost
17 of performance. These aren't what you should
18 have been looking at. And sort of as an
19 academic observer, I sense in these decisions
20 people are kind of staring cost of performance
21 in the face and kind of the mess that it is and
22 backing away and getting to the right policy
23 result, and it's just a -- it's just a visceral
24 feeling I have.

25 Q: From a tax policy perspective, how do you



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1 measure the extent of the income-producing
2 activity performed in a state?

3 A: Pardon me?

4 Q: From a tax policy perspective, how do you
5 measure the extent of the income-producing
6 activity that is performed in the state?

7 A: Well, I'm not sure there's a tax policy answer
8 to what income-producing activity is. Just to
9 be -- because that's a legal term -- I mean,
10 it's a term in a statute that it's the province
11 of the court to interpret. But I guess from a
12 tax policy point of view, I mean what I'd say
13 is this, based on that three lines -- the line
14 of -- the modern line, the current recent trend
15 of courts to look at cost of performance,
16 income producing/cost of performance statutes,
17 and getting a market oriented result by
18 focusing on drawing that tighter and more
19 destination oriented circle around income-
20 producing activity, to me that generates --
21 one, generates the best result from a policy
22 point of view, and given those authorities,
23 given the Oregon decision, for example, there's
24 plenty of -- there's enough play in the joints
25 in the term to reach that conclusion. So



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1 there's nothing at this point outrageous about
2 it, although it kind of -- again, when
3 Ameritech came down, and there was nothing else
4 along with it, it was -- it was -- you know, it
5 was certainly different from the traditional
6 view. Now, we say UDITPA is very -- it's
7 always been a lot of contention around these
8 concepts, but -- but there's kind of a wave.
9 I don't think the court in this case would be
10 really pioneering anymore.

11 Q: Does it concern you that there is no expressed
12 rule or statute for satellite companies?

13 A: Well, sure. I mean, it's all -- I believe in
14 the more guidance the better. But I guess it
15 -- just because there isn't, doesn't mean they
16 get a free pass. I mean, we've got to
17 interpret the statute. And it's just the way
18 it is. I tell my students that's what legal
19 analysis is; it's applying rules to new facts.
20 And that's the hard part of law school. We can
21 all memorize those rules, but we get to that
22 final exam and we confront that hypothetical,
23 those are new facts, maybe not on all -- all
24 for us with any cases we've read or any statute
25 isn't going to just provide us the answer and



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1 we have to do our best. But I think more
2 guidance the better, for sure.

3 Q: Have you read the decision of *Lockwood Greene*?

4 A: Yes. Yes.

5 Q: And did it change your opinion that the
6 Department's position in this case is good tax
7 policy?

8 A: Well, *Lockwood Greene*, I mean, it is what it
9 is. It seems to me to be a personal service in
10 this case. I thought Judge Anderson handled
11 that case really nicely. It's a personal
12 services case, and the last paragraph said we
13 really aren't speaking to these other
14 distinguishable industries. And it left it
15 open, if you will, but it certainly left an
16 impression that you might be treated
17 differently if you're one of those issues. I
18 think there was some discussion of maybe the
19 lack of prior guidance, but I think if you read
20 *Lockwood Greene* it would give you pause if say
21 you were a satellite company about how you
22 should report, because it really doesn't answer
23 the question. I think they're right, you look
24 around, and I think the testimony is there
25 wasn't anything defined. I know, you know I



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1 practiced state and local tax 12 years. I
2 probably would have picked up the phone and
3 called the Department. Maybe that happened.
4 I don't know. So I mean I appreciate the --
5 I'm kind of digressing, but *Lockwood Greene* to
6 me doesn't really answer the question. It left
7 the question open but left open the idea that
8 maybe if you're not a personal service
9 provider, there might be a different treatment.
10 And at that time, as I recall, what -- they
11 were just interpreting the phrase gross --
12 what's a South Carolina gross receipt, and the
13 statute's changed.

14 Q: And there was also some discussion yesterday of
15 the *Mercury Motors* case. Do you agree with the
16 characterization that all the activities in
17 that case are income-producing activities?

18 A: You know, I -- when I read *Mercury Motors*, it's
19 a constitutional case. It's the one thing you
20 have that uses the phrase income-producing
21 activity. It seemed to me that the court there
22 was focusing on what I call the true object of
23 the transaction, which might be a decent way to
24 look at income-producing activity, what we call
25 the true object test in sales tax. And it said



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1 there are these peripheral activities, but at
2 bottom, it's okay to focus on one. And Judge
3 Anderson I thought did a good -- an excellent
4 job with that case too. I don't remember how
5 his opinion about -- but I remember sort of
6 nodding my head. It's -- it is what it is.
7 It's not about an apportionment statute; it's
8 what you've got in South Carolina with the
9 words "income-producing activity" in it.

10 Q: And what is your understanding about the
11 Department's interpretation and application of
12 2290 and 2295 in this case?

13 A: Well, I think you're saying that it's the
14 ultimate delivery of the signal to the customer
15 that is the income-producing activity and all
16 that's occurring in South Carolina. I mean
17 again, we're getting into the weeds a little
18 bit, but I mean sort of what I hear you saying,
19 and I think of it from the supply and the
20 demand point of view. Dish creates this
21 signal. It's a scrambled signal or encoded --
22 whatever the word is, I'll call it scrambled --
23 signal, and it's out there. It's coursing
24 through our bodies right now, I assume. Maybe
25 I'm wrong, but I think it might be. And -- but



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1 it -- that sort of supply, I mean, there it is.
2 And what creates the income, it's the
3 subscriber saying give me one of them there
4 boxes, excuse my bad grammar, that'll
5 unscramble the signal, I'll pay you to do that,
6 and I'll get some television programming. And
7 so they give you this box. It's quite
8 sophisticated. This is what I call an
9 automated service. They don't have a little
10 elf doing it. They've got a machine that's a
11 sophisticated machine in your home that's
12 providing that automated service of
13 unscrambling that signal. I mean, that seems
14 to be what you're saying. I think there's a
15 Texas controllers decision that said something
16 similar. So that's my understanding of what
17 your position is.

18 Q: And from a tax policy perspective, why do you
19 believe the Department's interpretation is good
20 tax policy?

21 A: Well, I think it's good tax policy because we
22 have -- it reflects the purpose of the sales
23 factor, which is to reflect the contribution of
24 the market state. I think it's a more
25 administrable policy. I think it would in



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1 application to other, sort of these mass
2 commodified service providers, and if it were
3 applied to other similar service providers,
4 you'd have equal treatment, equitable treatment
5 of the industry. There may be some other
6 reasons, but those are the basic ones.

7 Q: How is economic competitive relevant to the
8 policy analysis?

9 A: Oh, well -- well, yes. We talked about market
10 state approach, equal treatment of taxpayers.
11 I think it meets the -- what I see as the
12 economic competitiveness goal of the
13 legislation in which it was enacted. You know,
14 I look at all the other factors, you know,
15 tangible and intangible property, and there's
16 destination approach. I mean, why would you
17 not want to do that for services. And again,
18 if you read Heller Wester case, the court goes
19 into some similar reasoning. It looks at the
20 overall structure and purpose of the statute a
21 reg is interpreting, and it says it's all
22 customer oriented, and we're going to do the
23 same thing here. So that's another reason.
24 And then again, I just -- given the authority
25 that's out there, there's certainly enough



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1 room, playing the joints in interpreting that
2 statute to get to that result as a matter of
3 just positive laws.

4 Q: Do you have any other opinions or analysis that
5 you believe will assist the Court in this case?

6 A: Well, I think I've already said that I would --
7 I would think very hard before embracing cost
8 of performance because it's a hard thing to
9 apply. Second -- the second thing I notice in
10 your statutes that I didn't mention yet or
11 before is you have this standard which is
12 called South Carolina gross receipts. Then
13 2295 or these four or five subsections that
14 are, as I recall, they're sort of principles,
15 rules, ways to try to figure out what a South
16 Carolina gross receipt is. But at the end of
17 the day, if you read those in conjunction,
18 that's the goal, is to figure out what a South
19 Carolina receipt is. And just in my own mind
20 when I think of, say, a professional service,
21 it's a lot easier -- it's easy to think of a
22 lawyer in their office in Columbia, no matter
23 where their clients are, being a South Carolina
24 receipt. I have a lot of trouble just from a
25 common sense point of view or common meaning



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1 point of view thinking that South Carolina
2 subscriptions for satellite TV are a Colorado
3 receipt or, you know, a Wyoming receipt or
4 wherever they're located. And that's probably
5 not tax policy, honest. That's just sort of a
6 visceral response to your statutory structure.

7 Q: Do you have any other opinions?

8 A: No.

9 Q: All right.

10 MS. WOOTEN: Thank you. That's all from the
11 Department.

12 THE COURT: Thank you. Mr. Maybank, before you get
13 into your cross, I know it's a little bit
14 early, I normally wait a little longer, but
15 let's take a break here so we don't have to do
16 it in the midst of cross.

17 MR. MAYBANK: Sure.

18 (Break from 11:11 a.m. until 11:23 a.m.)

19 THE COURT: Okay. Mr. Maybank.

20 MR. MAYBANK: Thank you.

21 PROFESSOR SWAIN - CROSS-EXAMINATION BY MR. MAYBANK:

22 Q: All right. Just to jump around a little bit
23 before I get into it. Professor Swain, your
24 expertise relies on the fact you've taken state
25 and local tax courses in law school, you've



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1 practiced state law, including private
2 practice, you've taught classes in state and
3 local and you've published extensively on state
4 and local tax apportionment. Would you feel
5 comfortable testifying in area such as, for
6 example, intellectual property law where you've
7 never taken a course, never taught a course,
8 never published in that area?

9 A: I would feel comfortable in testifying as to
10 the application of tax laws in intellectual
11 property, but there would be a limit to what I
12 would feel comfortable doing.

13 Q: But would you feel comfortable testifying about
14 intellectual property itself with no relevance
15 to taxes?

16 A: Again, I would feel comfortable testifying as
17 to the tax characterization of intellectual
18 property, but if it were a non-tax issue, then
19 I would generally not feel comfortable,
20 although I do teach property in law school, and
21 I do teach a segment on IP.

22 Q: But just in general, do you think it's a good
23 idea an expert witness would testify in an area
24 that he'd never taken a course, never -- never
25 taken a course, never given a course, never



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1 published in that area?

2 A: Well, certainly not.

3 Q: Okay. All right. You've discussed -- you
4 quoted your discussion with Hellerstein of
5 DIRECTV which is in a supplement of the
6 treatise.

7 A: Yeah. In fairness, that was -- I don't know
8 when -- I know it's been online for a while,
9 but I don't know when the publisher sent that
10 out.

11 Q: Okay.

12 A: It may not be in your hard copies.

13 Q: All right. And let me -- turn into the
14 supplement, which I think you have the
15 supplement there. You were quoting from it
16 earlier.

17 A: Yeah. I didn't ---

18 Q: All right. And just in the interest of time,
19 I'll show it to you.

20 A: --- in Arizona. Yeah.

21 Q: All right. In your -- in the supplement you
22 state -- and I'll show it to you after I read
23 it. "Relying heavily on Heller Western and
24 citing Ameritech with approval, the South
25 Carolina Administrative Law Court held that the



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1 income-producing activity of DIRECTV, a
2 provider of direct broadcasting satellite video
3 services, was the delivery of the signal into
4 the homes and onto the television sets of
5 DIRECTV's customers."

6 A: Right.

7 Q: Okay. And so the sole income-producing
8 activity in DIRECTV what Hellerstein says was
9 the broadcasting of the signal, correct?

10 A: Correct. You know, with a qualifier, it's
11 treating this in two sentences.

12 Q: Right. Okay. And you also say, let me get
13 that back from you. Can you find yours, or are
14 you like me, you've just got too much stuff to
15 find. It's on page 46.

16 A: I'm probably worse than you.

17 Q: Well, you get it free. I've got to pay for
18 mine. You say ---

19 A: I'm sorry, where? I probably ---

20 Q: That's okay. And it says, "Relying heavily on
21 Heller Western and citing Ameritech with
22 approval." That's accurate? Okay. That's
23 accurate, I quoted it out of your book.

24 A: I'm sorry, is it -- that was a question. There
25 was an inflected -- yeah. Yes.



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1 Q: Okay. All right. Now, that's not what *DIRECTV*
2 decision says at all. Read the amended final
3 order and decision on that paragraph there.

4 A: Okay. I mean ---

5 Q: Well, you skipped a paragraph. Read that
6 paragraph there.

7 A: Okay. We're going to read snippets. The
8 Court, however, does not adopt the view that
9 the Department's income-producing activity of
10 the business within the direct broadcast
11 services industry is completely limited to
12 delivery of the signal into the customer's home
13 and onto the customer's television; rather the
14 Court agrees with Professor Pomp that opinions
15 can differ on how to measure the extent to
16 which income-producing activities take place in
17 South Carolina but answering the question that
18 -- answering that question by simply ignoring
19 the activities -- the outside activity is
20 unacceptable.

21 Q: Okay. And Hellerstein, your Hellerstein and
22 Swain, let me get that back from you there for
23 just one second. Hellerstein and Swain says
24 relying heavily on *Heller Western* and citing
25 *Ameritech* with approval, they held that only



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1 the satellite was the only income-producing
2 activity. Now, Judge Anderson didn't say that
3 either, did he? In fact, he said just the
4 opposite.

5 A: I don't know.

6 Q: Go ahead and read what's highlighted there.
7 This is -- this case is Heller, which you say
8 Judge Anderson relied on heavily. Tell us what
9 Judge Anderson said about Heller. I
10 highlighted it there for you.

11 A: Okay. If you want me to tell you what Judge
12 Anderson said about Heller, I think I need to
13 read everything rather than what you've
14 highlighted.

15 Q: Okay. Well, let me read it to you to speed it
16 up in the interest of time.

17 MS. WOOTEN: Objection, Your Honor.

18 THE COURT: Let's let him read it, Mr. Maybank.

19 MR. MAYBANK: Okay. Just trying to speed it up.

20 THE COURT: Okay.

21 A: Okay.

22 Q: All right. Now, as I've seen what the order
23 says is, it says just the opposite of what you
24 say in the book. In Walter Heller versus --
25 I'm going to give this back to you to rebut me.



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1 In Walter Heller v. the Department of Revenue,
2 quote, In reaching its decision, the Arizona
3 Supreme Court did not simply look to the
4 location of the customer as the Department does
5 here. . . Rather, the court determined the income-
6 producing activities consisted of solicitation
7 of new customer, investigation of credit
8 records, servicing of contracts. Therefore,
9 the court's reasoning implies that the location
10 of customers does not necessarily identify the
11 income-producing activities of the taxpayer,
12 and therefore, is not a reasonable method of
13 identification. Now, you disagree with what
14 Judge Anderson stated there?

15 A: I didn't really absorb all of that.

16 Q: Well obviously you've read ---

17 A: He's reporting what the Arizona Supreme Court
18 did. Frankly, it did very much look to where
19 the customer location in that case. It's a
20 very customer-oriented case. I recommend to
21 the court, or to anyone, read the case, read
22 the last six paragraphs of the case. That will
23 give you a lot of guidance on how to resolve
24 this case. And again, we're getting into law.
25 I would also draw your attention -- if we're



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1 going to do this, later on in the decision, a
2 part of the decision you didn't point out to
3 me, the court continues to discuss Heller
4 Western. And there's a long paragraph that --
5 I'll just read the last indented quote. I
6 don't know how to direct everyone to this, but
7 there's an indented quote starting out "Heller
8 Western's cost". And he's -- again, I just --
9 I mean, I don't control the proceeding, but he
10 quotes from Heller Western, and then says "This
11 reasoning is applicable to the instance case."
12 Now, I'm just not smart enough to read -- I
13 mean, if you want to -- I can spend the time
14 and read this paragraph that you didn't point
15 out to me and evaluate again the extent to
16 which Judge Anderson relied on Heller Western,
17 but I think the Court can do that -- whatever.
18 The one thing I will say about the writeup and
19 I want to be clear about in the treatise, is I
20 was completely hands off on those writeups.
21 And that's -- I just want -- I want to be very
22 clear about that in terms of my own personal
23 integrity.

24 Q: And again, we're not arguing over whether
25 Heller Western was decided rightly or wrongly.



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1 We're only arguing over ---

2 A: And just ---

3 Q: I think that ---

4 A: --- to be informative ---

5 Q: --- your book is ---

6 MS. WOOTEN: May the witness finish, please, Your
7 Honor.

8 THE COURT: Let the witness finish, Mr. Maybank,
9 before you proceed to your next question.

10 A: I think that, you know, maybe to be more
11 constructive, an important thing that -- he did
12 rely on Heller Western, for example, to suggest
13 that advertising, for example, and selling
14 costs could be the cost of performance or a
15 measure of income-producing activity. I
16 thought the Judge did a great job with Lockwood
17 and with Mercury. There's a nuance in Arizona
18 law that is not picked up because at that time
19 when Heller Western was decided, the standard
20 was not exactly where the sale went; it's where
21 the sales activity occurred. And the court in
22 Heller Western was applying where the -- and
23 the court in Heller Western says where the
24 sales activity occurs is not necessarily where
25 the customer is located. But then it goes on



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1 to say, well -- but in fact it very frequently
2 is, and in this case it is. So I think he --
3 it was a misstep to suggest that advertising
4 and selling costs, which you've talked about
5 your call centers and so on, are relevant,
6 because a careful reading of Heller Western is
7 that it's relying on kind of a dated view, one
8 of the views at the time that you would source
9 sales not to where the destination is but to
10 where the sales activity occurs. And that's
11 not the current rule in Arizona or really
12 nationwide anymore. It's more of the
13 destination approach. So -- and, for example,
14 he relied on Heller Western for that, but I
15 think it was a bit of a footfall.

16 Q: Are you finished?

17 A: Uh-huh.

18 Q: All right. So moving on, again, and I'm going
19 to ask you, your book says the South Carolina
20 Administrative Law Court held that the income-
21 producing activity of DIRECTV was delivery of
22 the signal into the homes and into the
23 televisions of DIRECTV's customers. That's how
24 you cite Judge Anderson's order. Judge
25 Anderson, by contrast, says, "The court,



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1 however, does not adopt the view of the
2 Department that income-producing activities of
3 businesses with the direct broadcast service
4 industry is completely limited to the delivery
5 of the signal into the customer's home and into
6 the customer's television. Rather, the Court
7 agrees with Professor Pomp, opinions can differ
8 on how to measure the extent to which income-
9 producing activities take place in South
10 Carolina, but answering that question by simply
11 ignoring the outside activities is
12 unacceptable." Now, when you wrote that
13 sentence, you were actually on the Department's
14 payroll for the case here today, were you not?
15 Or when the book wrote that sentence?

16 A: Yes, I was retained.

17 Q: Okay.

18 A: And that's why I wasn't involved in writing
19 that for that reason.

20 Q: Okay.

21 A: Wally and I, we do not pull punches
22 academically, and that's like rule number one.
23 And it's what I learned from him is we -- we
24 can't do that.

25 Q: But I go and I hear him speak at NYU every



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1 year, he always points out when he's speaking
2 on cases that he's been retained in the case,
3 correct? Isn't that largely the case?

4 A: I don't -- when he's speaking about a case?

5 Q: Yeah.

6 A: I don't -- I don't really know. I would, I
7 think.

8 Q: Right. Don't you think that's a good idea?

9 A: Well, you know, I -- let me think about that.
10 Maybe that is a good idea to say that one of
11 the authors was involved in this case, although
12 we're reporting on *DIRECTV*, which I thought was
13 ended at that time, but I think that's not a
14 bad suggestion.

15 Q: Okay. Moving on. You -- I know you don't pore
16 over audits; I don't pore over them either, but
17 you've glanced at the audit, correct?

18 A: Yeah. Yes.

19 Q: And you've closely read the Department
20 Determination, correct?

21 A: I'm sorry. I read the Department's
22 Determination, yes.

23 Q: Okay. And we're dealing with Section 12-6-
24 2295(5) correct? And I'll show you -- show you
25 that. I don't memorize statutes either. Isn't



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1 that primarily what we're dealing with today?

2 A: Yes.

3 Q: All right. And the section contains two
4 sentences. Would you just quickly read the
5 first sentence, the highlighted subsection
6 there? Or I'll read it.

7 A: The highlighted one, so that's five. "Receipts
8 from services in the entire income-producing
9 activity is within this state. If the income-
10 producing activity is performed partly within
11 and partly without this state, sales are
12 attributed to the state to the extent the
13 income-producing activity is performed within
14 this state."

15 Q: Okay. And which of those two subsections are
16 we under today, entire or partly?

17 A: Two subsections?

18 Q: Well, one refers to ---

19 A: Sentences, you mean?

20 Q: Right.

21 A: Well, the whole thing we need to read -- and
22 really more, we need to read the entire statute
23 and -- as I suggested earlier, for example, a
24 suggestion, we're ultimately determining what a
25 South Carolina gross receipt is. So, but we're



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1 focused in on this, yes.

2 Q: Okay. So that subsection, though, gives you
3 two alternatives, doesn't it?

4 A: Uh-huh.

5 Q: All right. Which alternative are we under?

6 A: Well, I think -- I'm guessing there's a dispute
7 over that.

8 Q: Okay. Well, in your opinion, which are we
9 under?

10 A: Well, I don't have a legal opinion. It's the
11 province of the court. The Department's
12 position is that all the receipts are in South
13 Carolina and Dish's position is that there are
14 cost of performance both in and out of South
15 Carolina. And I believe I've testified that I
16 think from a tax policy point of view, the
17 better result would be to draw a tighter circle
18 around income-producing activity and -- because
19 for the reasons I stated, it reflects the
20 contribution of the market state to the
21 satellite -- to Dish's activity.

22 Q: Okay. But you personally don't have an opinion
23 -- I know you're not here testifying to the
24 Judge obviously, but you don't personally have
25 an opinion as whether we're under the sentence



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1 with entire or whether we're in the sentence
2 with partially in, partially without?

3 A: I would rather leave it as I said. I've
4 testified as what I think the best sort of tax
5 policy interpretation is ---

6 Q: Okay.

7 A: --- of the statute. And secondly, that there
8 is a line of cases nationally that would
9 support the Department's position.

10 Q: Okay. But you don't ---

11 A: And a case in this jurisdiction.

12 Q: But you don't personally have an opinion as to
13 ---

14 MS. WOOTEN: Objection. Asked and answered.

15 MR. MAYBANK: I haven't asked the question yet.

16 THE COURT: Yeah, let's let him finish the question
17 before we object, please.

18 Q: But you don't have an opinion that the clause
19 that says receipt from services if the entire
20 income-producing activity is within this state
21 applies in this case?

22 A: Well, I think it could. And, for example,
23 let's say that -- I think I've used this
24 example before. There's some, say, sports bar
25 chain that is a subscriber to satellite that's



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1 both inside and outside of South Carolina and
2 they get a bill. Well, some of those receipts
3 are attributable to, say, the Georgia sports
4 bar and some are attributable to the South
5 Carolina sports bar. So even under the
6 Department's view, you'd have to do some
7 allocating there in and out, and so the second
8 sentence would kick in, for example, in that
9 situation.

10 Q: Okay. And ---

11 A: And then there's also another way to look at
12 this, okay, because when you're dealing with --
13 it depends on -- there's this issue and it's
14 prominent in the Oregon case. Do we look at a
15 subscriber -- subscriber basis or a system-wide
16 basis? And so if we're looking at a system-
17 wide basis, and I might say, well, yeah, it's
18 actually in and without because they have
19 customers in 50 states, and what we're really
20 doing is applying sentence two and pulling out
21 the South Carolina subscribers. But if we look
22 at it subscriber by subscriber basis, and we're
23 looking at sentence one. So depending on the
24 bird's eye view we're taking or the worm's eye
25 view, we might apply a different sentence but



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1 get the same result.

2 Q: All right. And moving on. Your book discussed
3 market share states at length. South Carolina
4 is not a market share state, is it?

5 A: It has not adopted a market share statute. For
6 example, it's reaching that result in this
7 case. It frankly reaches the result in a lot
8 of cases, for example, under anyone's
9 interpretation that the service provider is in
10 South Carolina and the customer is in South
11 Carolina ---

12 Q: Okay.

13 A: --- it would be a market state in that case.
14 But it's not an explicit market state. The
15 question before it is this new trend of cases,
16 really, is it going to follow those. And on
17 top of that, is they've got to -- there's a
18 unique statute here that needs to be
19 interpreted.

20 Q: Okay. And when you say the new line of cases,
21 those are market share cases, whatever you're
22 referring to?

23 A: No, these are actually states that are income-
24 producing activity, cost of performance states,
25 like Wisconsin, like Indiana, the Department



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1 ruled like Florida and like the two weeks ago
2 in Oregon where they get a -- I would call a
3 market state result, if you will, but they
4 don't have an expressed market state or market
5 share statute.

6 Q: Okay. And your book refers to South Carolina
7 in a footnote, and I've written about eight
8 books, so I know you just can't proof
9 everything, but your book refers to South
10 Carolina as a modified cost of performance
11 state, doesn't it?

12 A: I don't know. Can you show me where you're
13 reading from?

14 Q: Okay.

15 A: That's a lot of books, by the way, eight.

16 Q: And I'm referring to Footnote 1187, page 95.
17 This is the same footnote you referenced
18 earlier in your testimony.

19 A: I explained this. It was a footnote trying to
20 identify states that use the apportion method.
21 We were citing another author. And the other
22 footnote I cited, 1207, I think clarifies that
23 we were focused in on apportionment and not
24 this nuance of proportionality. We read the
25 statute. And the statute is there for everyone



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1 to read.

2 Q: Right. And you would agree, again having
3 published a bunch -- or having a bunch of books
4 published by the DOR, you would agree a lot of
5 multi-state taxpayers use your book when they
6 are preparing South Carolina tax returns or
7 returns in other states?

8 A: Yes, they do.

9 Q: And they rely on it?

10 A: Maybe I need to up my malpractice insurance,
11 because I think I know where you're going.

12 Q: Well, they have the right to rely on your book,
13 don't they? I won't say right to rely, or
14 right to rely is not the correct terminology.

15 A: It's something you consult.

16 Q: Right.

17 A: Reliance is a legal term.

18 Q: Right.

19 A: They need to rely on the statute and the regs,
20 and it's an authority. among others.

21 Q: But the DOR has asserted penalties in this
22 case, and if you're in Englewood, Colorado,
23 you're preparing returns for 50 states, it's
24 certainly not unreasonable they would pull your
25 book out and examine whether South Carolina was



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1 a market share or cost of performance state,
2 would they?

3 A: I don't know the penalty standard in the state.
4 It wouldn't be unreasonable for them to consult
5 that along with other materials. For example,
6 there are services like CCH and Commerce
7 Clearing House, and Checkpoint, REA Research,
8 which are actually more in the business of
9 tracking day-to-day developments, tracking
10 statutes and getting all the raw FBI files, if
11 you will. And that's where I would start.
12 That's what I used in practice normally. And
13 when I had an interpretative question, a
14 difficult question, I'd go to the Hellerstein
15 treatise frequently.

16 Q: And I looked at all the ones you just mentioned
17 prior to this case, and I couldn't find where
18 the services, CCH discuss the issue for South
19 Carolina. Did I miss any to your knowledge?
20 None of them said whether South Carolina was a
21 cost of performance or market share state. I
22 couldn't find one. Were you able to? Are you
23 aware of one?

24 A: That surprises me because I think there are
25 tables that deal with this. A table, it's hard



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1 to rely on a table, but I think there are
2 tables that go through this.

3 Q: But I couldn't find that table.

4 A: Well ---

5 Q: Did I miss one?

6 A: We could sit and find -- I'll bet I could find
7 it.

8 Q: Okay.

9 A: But ...

10 Q: All right. And did you not look for fear that
11 you would find South Carolina listed as a cost
12 of performance state?

13 A: Well, in the *DIRECTV* litigation, at my
14 deposition somebody stuck a footnote from a
15 table from Checkpoint where they said that.

16 Q: South Carolina was a cost of performance state?

17 A: Yeah. Well, I think they said -- well, they
18 addressed that issue. Yeah. And so I guess
19 it's there. I forget what question you asked
20 me, but ...

21 Q: But the Checkpoint didn't list South Carolina
22 on the chart as a cost of performance state,
23 didn't it?

24 A: My recollection is they said something like
25 that, but I -- it's like a -- you've got to



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1 read the primary sources ---

2 Q: Right. But there's no ---

3 A: --- before you go to the secondary sources.
4 It's just typical legal research. And pick up
5 the phone.

6 Q: Now, there's no regulation on service
7 performance or cost of performance, is there,
8 South Carolina DOR regulations?

9 A: Not that I'm aware of.

10 Q: Okay. And the only DOR policy documents
11 referenced cost of performance; isn't that
12 correct?

13 A: I don't really know.

14 Q: Okay. All right. And you don't know because
15 you didn't look at them, the policy documents?

16 A: No, I don't recall reviewing policy documents.
17 I remember some were being discussed, but I
18 don't remember reviewing anything like that.
19 There is a case called *Lockwood* which, to me --
20 -

21 Q: Right.

22 A: --- it sends a little message out there if
23 you're not a professional service business.

24 Q: And the reason you didn't review them, because
25 your testimony today is really on tax policy,



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1 correct?

2 A: Yes.

3 Q: It's really not -- it's not on tax law as
4 applied; it's on what's good and bad tax
5 policy, correct?

6 A: That's correct.

7 Q: All right. And now Judge Anderson's order
8 noted the DOR has no written guidelines for
9 service providers. From a law professor
10 standpoint, isn't it a good idea to have a --
11 for a state agency, it's not a good idea for a
12 state agency to have secret rules, a rule that
13 only they know about? That's not a good idea,
14 is it?

15 A: No, the more guidance, the better. The more
16 transparency, the better for pretty much any
17 government agency but the CIA, I suppose.

18 Q: Okay. And there are winners and losers to an
19 income-producing activity that says you only
20 look at the last act of the transaction,
21 correct? And let me back up.

22 A: Well, it depends what the status quo is.

23 Q: Right. In your opinion -- well, let me -- I'm
24 just going to move on from that. If South
25 Carolina domestic corporations are not aware of



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1 the DOR's interpretation today, and they're
2 paying taxes in South Carolina on customers in
3 North Carolina, they're overpaying their taxes,
4 aren't they? A service business?

5 A: It depends on where their income-producing
6 activity is.

7 Q: Correct. So let's take a pest control agency,
8 which I notice your law review article
9 referenced that. If you're a pest control
10 agency under North Carolina ---

11 A: Oh, really?

12 Q: Huh?

13 A: I didn't remember that.

14 Q: I thought it was a good one. I was frantically
15 trying to think of yesterday some services that
16 weren't personal services, and that's why I
17 noticed that. If I was a pest control agency
18 in South Carolina, 60 percent of my customers
19 are in North Carolina, is that scenario he
20 shouldn't be paying taxes on 60 percent of his
21 income, correct?

22 A: Well, I would say that -- again, you said you
23 were going to talk about policy and now you're
24 in law. But anyway, the -- it would depend on
25 where the work is being done. I mean, I would



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1 be tempted if I were that business to say that,
2 you know, my income-producing activity is --
3 because I'm physically going out and doing the
4 job in North Carolina, I don't know -- I don't
5 know how those guys -- I don't know how pest
6 control companies report. On the other hand,
7 if it's treated as a personal services business
8 and maybe you'd follow Lockwood, which I think
9 used some sort of payroll factor. And so maybe
10 more of their income would be -- would come
11 back to their headquarters because they've got
12 someone answering the phone there.

13 Q: In your article I think you use that as an
14 example of someone who is not a personal
15 service corporation.

16 A: You're referring to -- I'd really like to see
17 what you're referring to because ---

18 Q: Well, there's nothing wrong with using pest
19 control as a service. I thought it was a good
20 example. Let's real quickly, I'm going to try
21 and pick up the pace here, go through
22 Hellerstein again. And I've highlighted the
23 sections I'm going to ask you about. I'm going
24 to try to pick up the pace here. Now, I'd like
25 to turn to income-producing activities. Now,



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1 wouldn't you agree that a taxpayer's income-
2 producing activity may be self-evident, but in
3 other cases the determination is far from
4 obvious?

5 A: Undoubtedly.

6 Q: Okay. And in the book y'all discuss a number
7 of cases on income-producing activities. Some
8 take a destination approach, and others say
9 it's the entire business that's income
10 producing, correct?

11 A: I'm sorry. I don't know where you're referring
12 to.

13 Q: Well, I'm asking that as a question.

14 A: You said in -- I thought you said in the
15 treatise we say something, and I would really
16 like to ---

17 Q: Well, let me just -- to speed it up, aren't
18 there cases that say -- aren't there cases that
19 take a destination approach and others say it's
20 the entire business that's income producing?

21 A: Yes. Yes.

22 Q: All right. And the MTC defines income
23 producing, and let me -- I'll turn that page to
24 you. I'll just read it in the interest of time
25 to speed things up. Everything in here is



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1 highlighted, so I'll pull it over and make it
2 a little easier for you. The MTC defines
3 income-producing activity as "The transactions
4 and activity engaged in by the taxpayer in the
5 regular course of its trade or business for the
6 ultimate purpose of producing that item of
7 income." Isn't that correct?

8 A: That's what the MTC regulation says, yes.

9 Q: And you as a tax professor of policy, is that
10 a good definition of income producing?

11 A: You know, our view now, it's just a mess. It's
12 a mess. Income-producing activity under
13 UDITPA, it's very hard to interpret. There are
14 all kinds of interpretations. And I would go
15 with what -- again, I think from a policy point
16 of view to try to draw a tight circle around
17 it, destination oriented circle so it serves
18 its purpose of reflecting market state
19 contribution is a little more easy to
20 administer.

21 Q: Okay.

22 A: And the MTC, this is a -- that's the reg.

23 Q: Okay. But our General Assembly hasn't drawn
24 the tight circle yet. They drew the tight
25 circle for manufacturers though, did they not,



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1 aren't we a destination state for
2 manufacturers?

3 A: Yeah. That's clearer.

4 Q: Right. All right. But since we don't have a
5 definition of income-producing activity in our
6 state statute, or a DOR reg, wouldn't you agree
7 that the MTC's definition -- and we haven't
8 drawn the tight circle, but in the absence of
9 the tight circle and in the absence of DOR
10 regulations or policy documents, don't you
11 agree the MTC gives a pretty good definition,
12 Transactions and activity engaged in by the
13 taxpayer in the regular course of its trade or
14 business for the ultimate purpose of producing
15 that item of income?

16 A: No.

17 Q: You just think it's a bad definition?

18 A: Well, there's a lot of dispute over ultimate
19 purpose, for example. And so some taxing
20 authorities take again the sort of more
21 destination -- it's ultimate purpose is that
22 final act, that final act, that final ultimate
23 act that is the income-producing activity. So
24 that's one interpretation. There are others.
25 I think, to some extent, the MTC, and this was



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1 written a long time ago is -- I say no because
2 they're answering -- A, they're answering the
3 wrong question. I think they should be more
4 answering -- but they -- and secondly, just the
5 history is that this hasn't been very --
6 there's been a lot of dispute over this kind of
7 language. This language, if I'm not mistaken,
8 is in the Oregon regulations or the Oregon
9 Supreme Court drew that tight circle. You're
10 saying South Carolina hasn't done that. I feel
11 like it did that or started to do that in
12 *DIRECTV*. And secondly, the first folks
13 typically who interpret a tax statute is the
14 taxing authority. And that's what they're
15 doing, that's what the taxing authority is in
16 Indiana. I don't think it's gone to a court
17 yet in Indiana. That's what the taxing
18 authority has done in a nicely reasoned
19 taxpayer advisement -- assistance advisement in
20 Florida. So I disagree with the premise of the
21 question that there isn't anything drawn. The
22 legislature certainly with express language
23 didn't say anything. But I read the overall
24 structure and purpose of the 2007 legislation
25 and the context in which it was written to

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1 imply to me that the Department is doing
2 something that is consistent with the intent of
3 the legislature, certainly legislatures across
4 the country at that time.

5 Q: Okay. Now, 2007 the General Assembly did two
6 things: they adopted a market sourcing statute
7 for manufacturers, and they adopted an income-
8 producing activity statute for service
9 providers, correct?

10 A: Correct.

11 Q: All right. So in 2007, the General Assembly
12 knew how to write a market sourcing statute,
13 correct?

14 A: Correct.

15 Q: And did ---

16 A: Well, I assume so.

17 Q: Uh-huh. Well, I mean, that's what it is, isn't
18 it? We agree that manufacture statute is a
19 market sourcing state?

20 A: Well, it says -- yes. It says delivery to the
21 ultimate purchaser, I think is the language, or
22 shipment to the ultimate purchaser.

23 Q: And your opinion, only -- and you're saying
24 clearly the final act is an income-producing
25 activity. Are you saying that's the only



1 income-producing activity?

2 A: I resist saying what an income-producing
3 activity is. I'd rather just rely on what I
4 call the positive law that's out there. It's
5 the court's province to say what it is. It's
6 no platonic answer to that question. And it's
7 interesting, I think the Oregon court said, you
8 know, common meanings aren't very helpful here.
9 It's an interesting statement by a court.

10 Q: But that is in your book though, so I mean you
11 can't -- you can't go too far?

12 A: I think our ultimately -- we state our ultimate
13 conclusion. I read that at the beginning.
14 It's just -- you know, Wally says it's a mess.
15 He says the states have seen the light ---

16 Q: And ---

17 A: --- the book yet.

18 Q: And your book says, and I'll turn it to you,
19 it's got a footnote 49 on it. Your book says
20 -- page 52. "Administrative and ministerial
21 activities performed by the taxpayer may fall
22 within the definition of an income-producing
23 activity, because presumably a business would
24 not perform those activities unless they were
25 for the ultimate purpose of obtaining gains in



1 profits." Is that an accurate statement from
2 your book?

3 A: Yeah. We're talking about the authority out
4 there, and so there's a footnote to 1209.
5 There's some cases that say that.

6 Q: Okay.

7 A: It's what I repertage.

8 Q: And then below that, you say for service
9 providers, the clearest examples of income-
10 producing activities are the activities
11 involved in actually performing the services
12 for which they are paid. That's a -- I think
13 we'd all agree with that, wouldn't we?

14 A: In a dictionary sense, yes, perhaps. But there
15 are courts that are saying otherwise. You're
16 talking about -- can you -- show me where
17 you're reading.

18 Q: At the bottom of that page.

19 A: Yeah. And so -- thank you. So this is a
20 special section we have on the treatment of
21 service providers, which are often an exception
22 to the general UDITPA rule. And there are
23 special MTC regs on that. In my view, there's
24 a special -- there's a South Carolina case on
25 that called *Lockwood*. So you're reading from



1 a paragraph where we're discussing the
2 treatment of personal service providers. So I
3 would not extrapolate from that to the UDITPA
4 regs and then further to the 2007 act.

5 Q: And then let me turn you to the next page.

6 A: Okay.

7 Q: Did I take it back from you? All right.
8 Again, in the interest of speeding it up, I'm
9 going to read it. "Once cost of performance
10 has been identified, they're generally found to
11 be incurred where the income-producing
12 activities are performed by employees or
13 independent contractors where real and personal
14 property used in performing such activities is
15 located. In Communication Satellite
16 Corporation v. Franchise Tax Court, for
17 example, the California Court of Appeals
18 determined that income-producing activity with
19 respect to receipts from satellites take place
20 at the location from which the satellites are
21 operated. The court held that the income-
22 producing activity was the operation of the
23 satellites themselves, and because they were
24 operated from California, the activity was
25 performed in California." Now, your book



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- 1 blandly states that without any criticism of
2 the decision, doesn't it?
- 3 A: I think the alternative would be to source the
4 receipts to Mars or the moon or some place.
5 This is a satellite case. I mean ---
- 6 Q: So you would agree that Dish should source
7 their receipts to the moon, right?
- 8 A: This is a ---
- 9 Q: They don't have to pay South Carolina, we'll
10 just send them to the moon.
- 11 A: Thank you.
- 12 Q: We'll file a return with the moon.
- 13 A: And I'm not at all facetious about this. This
14 is one of my concerns.
- 15 Q: I'm not either.
- 16 A: This is one of my concerns about your cost of
17 performance approach. A lot of your costs are
18 satellite, satellite leasing. It's in outer
19 space. What do we do with that? What are you
20 doing with it? It's just a tough test, the
21 cost of performance. And by the way, you know,
22 this is about cost of performance. We don't,
23 you know, we don't get there until we identify
24 IPA, income-producing activity.
- 25 Q: Right. And didn't the state actually try to



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1 put property taxes on a satellite?

2 A: Yeah. I think we say the law -- sovereigns a
3 core -- a vacuum. Sovereigns will fill a
4 vacuum, or there's a -- in high seas or in
5 space.

6 Q: A few more questions, and then that will be it
7 for me. Let's turn to income-producing
8 activities. Now, you state that you didn't
9 particularly like the empty seat definition of
10 income-producing activity. Now, in our view,
11 when we spend \$600 million in advertising, we
12 do it for the purpose of producing revenue. Do
13 you think we do it for any other reason?

14 A: I think it's probably everything you do is to
15 generate revenue. And then having said that,
16 I know the majority rule is we don't include
17 advertising as a cost of performance, and
18 there's dispute over that.

19 Q: Okay. And content ---

20 A: Courts abstain.

21 Q: You said everything we do, which I totally
22 agree with, so I'll ask you one more question
23 and then we'll move on. Obviously to get
24 people to drop their pay TV and start paying
25 dough to us every month, obviously we've got to



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1 have content, more content than pay TV or
2 they're just going to stick with pay TV,
3 correct?

4 A: Yes. I mean, in marketing, one of the four P's
5 is productivity. You need good product, you
6 try to improve it. Yeah.

7 Q: Okay. And then in my mind, the clearest
8 example, the call center, any activity where
9 they actually take and charge my credit card is
10 clearly income-producing activity, isn't it?
11 Isn't that not the quintessential income-
12 producing activity, running Burnie's credit
13 card?

14 A: Okay. Income-producing activity is a legal
15 term, okay. And I think the fact of the matter
16 if you did the research, I haven't, probably
17 these back-office operations of collecting
18 bills, collecting bills from people who don't
19 pay them, from running credit cards, I suspect
20 that that's excluded. I'm not an accountant,
21 but I recall that there are a lot of
22 regulations that distinguish between direct and
23 indirect costs in creating your product. And
24 you're talking about what I think is an
25 indirect cost, but I'm willing to be corrected



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1 on that point.

2 Q: Okay. Is there any -- from a tax professor
3 standpoint, is there any policy reason why you
4 would treat one service provider different from
5 another? And I'm not talking about personal
6 service providers; I'm talking about every
7 other service provider. Is there a policy
8 reason why one service provider would be
9 treated differently than another?

10 A: Well, it's a very general question. I'll try
11 to apply it to these facts or to South
12 Carolina. My writing, for example, the market
13 sourcing articles I -- there may be some
14 exceptions, but I -- sort of the let's go to
15 market sourcing guide, right, in my article.
16 What South Carolina's done that's different,
17 and I think it may explain why it adopted the
18 standard it did, though there might be better
19 ways to do it, is for personal service
20 businesses people think of sort of a smaller
21 business that has more limited resources and
22 tax reporting. And you don't want them having
23 to file -- you know, they go do a deposition in
24 Georgia, one in Tennessee that they've got to
25 file eight tax returns. I think there's a --



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1 the policy reason to treat personal service
2 businesses different from other service
3 business, in my opinion, would be an
4 administrative concern.

5 Q: Yeah, and I'm referring ---

6 A: Yes.

7 Q: --- not referring to personal service
8 providers.

9 A: Okay.

10 Q: Is there a reason outside all the other service
11 providers, is there any policy reason why you
12 would treat one different than another?

13 A: I mean stated generically, no. You'd have to
14 present me with some -- the case. Like what --
15 maybe there's somebody who's different that I'm
16 not thinking of.

17 Q: Okay.

18 A: You would do it the same way. It's equity.

19 Q: All right.

20 A: Particularly her business competitors.

21 Q: Have you read Professor Hellerstein's article
22 that a taxpayer should have a constitutional
23 right for some factor apportionment for the
24 sourcing of receipts from intangible assets?
25 Your book discussed it lightly. He wrote a



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