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THE STATE OF SOUTH CAROLINA
In The Supreme Court

S.C. SUPREME COURT

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Chief Administrative Law Judge

Case No. 14-ALJ-17-0158-CC
Appellate Case No. 2018-000211

DIRECTV, Inc. and its Subsidiaries,..... Appellant,

v.

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

APPELLANT'S REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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Appellant DIRECTV, Inc. and its Subsidiaries (“DIRECTV”) respectfully submits this Reply in support of its Petition for Writ of Certiorari (the “Petition”) and in response to Respondent South Carolina Department of Revenue’s (“SCDOR”) Return (the “Return”). For the reasons presented in DIRECTV’s Petition and below, the Court should grant the Petition.

ARGUMENT

I. THIS CASE INVOLVES NOVEL ISSUES AND A CONFLICT WITH A PRIOR DECISION OF THIS COURT.

SCDOR makes conclusory statements in its Return that (a) this case does not involve novel questions of law (claims it is a “routine application of this Court’s precedent”), and (b) the Court of Appeals decision does not conflict with a prior decision of this Court. Return at pp. 10-11. Surprisingly, however, SCDOR does not specifically address or refute any of the reasons given in DIRECTV’s Petition as to why the case is novel and how it conflicts with a prior decision of this Court, including the following:

- That a novel issue is involved because no published decision has interpreted S.C. Code Ann. § 12-6-2295(A)(5) and more specifically what constitutes income producing activity (“IPA”) and whether the statute requires that all of a taxpayer’s IPAs within and without the State be considered in determining its gross receipts in South Carolina.
- That a novel issue is involved because the burden of proof set forth in *Cloyd v. Mabry*, 295 S.C. 86, 367 S.E.2d 171 (Ct. App. 1988) has been applied in cases involving property taxes, personal income taxes, sales taxes and accommodations taxes, but the Court of Appeals declined to apply it here because no case had applied it in the context of corporate income taxes.
- That a novel issue is involved because no South Carolina court has examined whether a penalty is appropriate under S.C. Code Ann. §§ 12-54-155(B)(2)(b) or 12-54-155(D)(1) where a taxpayer’s returns track existing law and SCDOR has no published guidance (regulations, policy documents or otherwise) to alert taxpayers to any policy that interprets the apportionment statute to require market-based sourcing for subscription revenue.
- That the Court of Appeals’ decision conflicts with a prior decision of this Court, *Mercury*

Motor Express, Inc. v. South Carolina Tax Commission, 244 S.C. 134, 135 S.E.2d 756 (1964), in which this Court rejected the taxpayer's argument that the only activity that led to income was the pick-up or delivery of freight (akin to delivery of the signal in this case) and instead adopted the view that all activities in the series of transactions in which a taxpayer engages to produce income be considered.

Accordingly, DIRECTV has established that "special and important reasons," including novel issues and a conflict between the Court of Appeals' opinion and a prior decision of this Court, weigh in favor of this Court granting DIRECTV's Petition. *See* SCACR 242.

II. THE COURT OF APPEALS ERRED IN CONCLUDING THAT DIRECTV'S IPAs CONSIST SOLELY OF THE DELIVERY OF THE SIGNAL AND BY DISREGARDING UNDISPUTED EVIDENCE OF OTHER SUBSTANTIAL IPAs.

A. The Court of Appeals' Decision is Contrary to S.C. Code Ann. § 12-6-2295(A)(5) and *Lockwood Greene*.

In its Petition, DIRECTV argues that the Court of Appeals erred in concluding that DIRECTV's IPAs consist solely of delivery of the signal and by disregarding its other substantial IPAs. SCDOR appears to misunderstand the basis of this argument and mistakenly claims that DIRECTV's position is that S.C. Code Ann. §12-6-2295(A)(5) and/or *Lockwood Greene* impose a method for apportioning service-related income for all multi-state service providers based either on payroll and/or property proxies. Return at p. 11. This is not correct. Rather, DIRECTV asserts that the statute requires that the method for apportioning all multi-state service providers be based on their IPAs as the statute states, and which the predecessor law in *Lockwood Greene* (which the statute essentially codified) referred to as "place of activity." In *Lockwood Greene*, a payroll factor was deemed appropriate for an engineering firm, while for DIRECTV (which is more asset intensive than an engineering firm), payroll and property are appropriate factors; however, other factors might be appropriate for other service providers as the statute and case law provide some flexibility in making this determination. What the law does not allow,

however, is for SCDOR to simply look to the location of the taxpayer's customers and source on a market basis (i.e. where customer is located and payment made, which is akin to delivery of signal here). *See also infra* § III (regarding SCDOR's improper use of a market-based approach).

Additionally, both lower courts' decisions and SCDOR's Return reflect a fundamental misunderstanding of the apportionment statute and how it works. Section 12-6-2295(A)(5) provides that the term "gross receipts" as used in § 12-6-2290 includes, but is not limited to, the following items if they have not been separately allocated:

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

S.C. Code Ann. § 12-6-2295(A)(5)(emphasis added). The issue in this case is the extent to which "the income-producing activity is performed within this State" versus "without this State" *Id.* The entire "receipts from services" are only included in the numerator of the apportionment formula "if the entire income-producing activity is within this State." *Id.*

The ALC and SCDOR ignore DIRECTV's core business activities (such as development and transmission of premium television content) and instead only count delivery of the signal to its customers in this State. This ignores the "partly within and partly without" statutory language, which dictates that the focus be on the taxpayer's activities as a whole. The apportionment statute seeks to determine the portion of a taxpayer's total business activity that should be attributed to South Carolina, and all of the activities in the series of transactions that lead to income must be considered. S.C. Code Ann. § 12-6-2295(A)(5). *See also infra* §I(B). Even the ALC acknowledged that DIRECTV had IPAs outside this State (Order, App. pp. 10-11), so "the

entire income-producing activity” is clearly not “within this State” as the statute would require in order to apportion 100% of DIRECTV’s South Carolina gross receipts here as SCDOR did.

B. The Court of Appeals’ Decision is Contrary to *Mercury Motor*.

DIRECTV has also argued that the Court of Appeals’ conclusion that delivery of the signal is the only IPA is counter to *Mercury Motor Express, Inc. v. S.C. Tax Comm’n*, 244 S.C. 134, 135 S.E.2d 756 (1964). SCDOR’s interpretation of this decision in the Return is wrong. *Mercury Motor* does *not* say that “only hauling the freight was an IPA” as SCDOR claims. Return at p. 14. Instead, the Court states as follows:

The appellant operates a unitary business and its gross income and, therefore, **its net income, is derived from a series of transactions**. Here the series of transactions consists of the solicitation of freight, the picking up of freight, the hauling of freight, the delivery of the same and the collections of charges therefor. **Each transaction in the series contributes to the earnings and net income of the appellant. . . .**

Mercury Motor, 244 S.C. at 141, 135 S.E.2d at 759-60 (emphasis added).

This Court is acknowledging that *all* of the transactions in the series, both within and without the State, contribute to the production of income and thus are IPAs. *Id.* It then further states that “while each transaction is necessarily incidental to the production of its income, the transaction which primarily earns the income is the hauling of the freight.” *Id.* This makes perfect sense where the only issue before this Court was whether it was unconstitutional to take into account the income related to the hauling of freight. The Court did not consider or address whether it would be appropriate to ignore some IPAs when applying a statutory apportionment method based strictly on the IPAs of a taxpayer. In fact, to the extent the opinion can be read to discount some IPAs (each one of which could be viewed individually as “incidental”), it is

delivery of the freight, which would be akin to *delivery of the signal* into the customers' homes here, that this Court discounted. Hauling of the freight over the highways in South Carolina, not delivery of the freight, whether here or in another state, was considered to be the primary IPA. *Id.*, 244 S.C. at 141, 135 S.E.2d at 759-60. SCDOR and the lower courts' interpretation of the statute and *Mercury Motor* runs completely counter to this as it only recognizes delivery of the freight at the customer's location (delivery of the signal here) and would disregard the hauling of freight (development and transmission of content here). SCDOR's Return makes no effort to address or explain how picking up and dropping off freight is not analogous to delivery of the signal or how hauling of freight is not analogous to development and transmission of content.

Moreover, even if this Court determined on some basis that delivery of the signal was the only IPA, the unrefuted evidence establishes that this involves a multitude of activities, including collection of programming content signals and transmission of same to broadcast centers, uplink facilities, satellites and customers, which all occur outside of South Carolina. Petition at p. 4, n. 2. SCDOR's Return fails to address how these activities can be ignored even if one assumes that delivery of the signal is the only IPA.

C. The Court of Appeals' Decision is Based on an Error of Law that Caused it to Reach a Conclusion that is Contrary to the Unrefuted Evidence of DIRECTV's Multiple IPAs Taking Place In and Outside of South Carolina.

As DIRECTV argued in its Petition, the Court of Appeals made an error of law in concluding that DIRECTV's only IPA is the delivery of the signal into its customers' homes and that this occurs entirely in South Carolina, which caused it to reach a conclusion that is contrary to the unrefuted evidence of DIRECTV's multiple IPAs in and outside of this State. In response, SCDOR first points to testimony of its expert economist, Dr. Glenn Harrison, that "it's the

provision of television services in your home” that generates income. Return at p. 15. First, Dr. Harrison follows this testimony by admitting the importance of programming content (not just the signal) as he states that the service that generates income from an economic perspective is being able to “watch [the] NFL in my home....” Tr., R.p. 529:14- 530:1. Moreover, he later retreated from saying delivery of the signal was the IPA; and instead claimed that the IPAs here are the **customer’s actions** of “turning on the box, watching the TV, and paying the bill.” Tr., R. pp. at 543:23- 545:10. He testified that all prior activity by DIRECTV, including content development, broadcast services, marketing, customer service and **even delivery of the signal**, constitute costs, which he said could not be IPAs. *Id.*

In light of this testimony, SCDOR’s argument that all taxpayer activities are costs and cannot be IPAs is non-sensical. More importantly, it is contrary to South Carolina law, which requires this Court to consider the IPAs of the taxpayer that lead to income, not the actions of its customers (i.e. a market-based approach). S.C. Code Ann. § 12-6-2295(A); *Mercury Motor*, 244 S.C. at 141, 135 S.E.2d at 759-60; *Lockwood Greene*, 293 S.C. at 449, 361 S.E.2d at 347 (specifically rejecting “origin of the payment” (i.e. customer location) as the IPA). Thus, Dr. Harrison’s analysis, which attempts to measure the customers’ actions, is measuring the wrong thing. As Dr. Cody put it, the fact that the TV set is turned on tells you “absolutely nothing about the location of all of [the] infrastructure [and] all of the activities of DIRECTV that have gone into bringing that signal to the house.” Tr., R. p. 326:1-24.

Next, SCDOR points to testimony of Mr. Gosowitz (DIRECTV’s vice-president of space, communications and video) regarding DIRECTV’s content, broadcasting and transmission activities. Return at p. 16. This evidence supports DIRECTV’s position, not SCDOR’s, as it

establishes the DIRECTV IPAs that allow it to provide programming content to its customers. SCDOR also references Mr. Gosowitz's testimony that DIRECTV provides "direct to home" video services and must install a satellite dish, a coaxial cable and a set-top box. *Id.* How this testimony is an "admission" supposedly establishing that delivery of the signal is DIRECTV's only IPA is a mystery that SCDOR does not explain. *Id.* DIRECTV does not dispute those facts; it simply contends that omitting from consideration all of DIRECTV's other IPAs within and without the State must also be counted as the statute requires. Considering but dismissing all IPAs outside the State, as the ALC has done here, is an error of law. *See supra* I(B) (discussing that even if delivery of the signal is the only IPA, this would include many activities that take place outside South Carolina).

Finally, after failing to identify any evidence supporting that delivery of the signal is DIRECTV's only IPA, SCDOR argues that DIRECTV failed to present sufficient evidence to establish its IPAs. Return at pp. 18-20. More specifically, SCDOR points to the ALC's conclusion that the payroll and asset method used by DIRECTV's expert economist to locate DIRECTV's IPAs did not "sufficiently explain" the effect of the value drivers on income production in this State. *Id.* at p. 18-19. This statement reflects the ALC's mistaken belief that the whole series of transactions engaged in by a taxpayer to earn income should not be considered. If the ALC had not committed this error of law and had instead viewed the evidence as the law requires, it could not have reached the legal conclusion that DIRECTV's only IPA is delivery of the signal. *See supra* I(A) and (B).

First, as previously stated, SCDOR's own expert economist testified that delivery of the signal is not an IPA. *See* Tr. R. pp. at 543:23- 545:10. More importantly, no evidence in the

record supports SCDOR's claim that DIRECTV's customers are only paying for delivery of a signal; instead, the unrefuted evidence established that customers are paying for, among other things, access to premium programming content. *See e.g.* Tr., R. at pp. 329-339; 344-346; 351-54. No customer would pay the fees charged by DIRECTV if he only received a test signal or what is available on free television. DIRECTV's premium product with its original programming, premium programming (such as HBO, ESPN and Starz), sports packages and unique offerings such as NFL Sunday Ticket and the Masters Experience is what induces customers to subscribe and generates income. *See* Am. Final Brief, App. pp. 103-4 (for more detail on content related activities).¹ Customers also would not pay fees if the satellite and broadcast operations did not ensure a clear, high-end video experience. *Id.* at pp. 104-6 (for more detail on broadcast operations). The evidence also established that the marketing, sales and customer service activities generate additional income from new and existing customers. *Id.* at pp. 106-8 (for more detail on marketing, sales and customer service activities). And DIRECTV's economist explained in great detail how each of these activities impacts DIRECTV's ability to charge premium prices, to convert potential customers into subscribers and to retain and drive additional income from existing customers. Tr., R. pp. at pp. 329:17- 339:22 and 346:6-11. DIRECTV customers are paying for a premium product, which is created, acquired, developed, produced, broadcast, marketed and serviced outside the state.

And, in fact, SCDOR, its expert economist and the Court of Appeals all acknowledged that DIRECTV customers are actually paying for access to programming content and not merely

¹ To highlight the significance of content on value, AT&T's acquisition of DIRECTV was contingent upon the renewal of DIRECTV's exclusive deal with the NFL for Sunday Ticket. Cody Rpt., R. p. 750; Tr., R. pp. 330:24- 331:16.

receipt of a signal.² Where there is no factual dispute that DIRECTV customers are paying fees for programming content, the out-of-state IPAs directly associated with that content cannot logically be called “incidental” or “too attenuated” to be IPAs, and DIRECTV presented unrefuted evidence establishing these IPAs and their location.

SCDOR also claims that DIRECTV’s use of payroll and assets proxies to locate its IPAs in South Carolina is unreasonable because it only has two employees here and its only assets here are four collection facilities and the equipment its customers lease or purchase. Return at pp. 12.³ It is precisely because DIRECTV has few employees and assets here that the payroll and assets proxies are reasonable. Fewer assets and employees mean fewer demands on South Carolina infrastructure such as roads, police and fire services and the courts, and, thus, a lower tax burden is appropriate. Consider if DIRECTV was based here and had thousands of employees and millions of dollars of assets in this State. Under SCDOR’s approach, this would all be ignored despite the fact that such an increase in workforce and assets would place much greater demands on South Carolina resources. This simply makes no sense under a statute that focuses on IPAs and not customer location. *See* S.C. Code Ann. § 12-6-2295(A)(5).

² *See* Return at p. 2 (SCDOR stating that “For a subscription fee, DIRECTV grants its customers access to television programming and other audio/visual options that are transmitted nationwide to customer’s (sic) homes or businesses via satellite”) and p. 3 (SCDOR admitting that customers are paying fees to access basic channels, premium channels and pay-per-view); Tr., R.p. 529:14-530:1 (SCDOR’s expert testifying that from an economic perspective, the service that generates income for DIRECTV is the provision of television services and the ability “to watch [the] NFL in my home”); Order, App. at p. 13 (Court of Appeals stating that “. . . DIRECTV’s source of income does not derive from its engineers, but rather from subscriptions to programming packages”).

³ SCDOR incorrectly refers to the asset and payroll proxies as “cost elements.” Return at p. 19. These are not cost elements but rather proxies for DIRECTV’s IPAs. DIRECTV agrees that South Carolina is not a cost of performance state where receipts are apportioned based on costs.

III. CONCLUDING THAT DELIVERY OF THE SIGNAL IS THE ONLY IPA IMPROPERLY REQUIRES A MARKET-BASED APPROACH.

SCDOR's Return argues that concluding that delivery of the signal is the only IPA does not wrongfully interpret § 12-6-2250(A)(5) as requiring market-based sourcing, it is not "blindly sourcing subscription receipts to the location of the customer," and the IPA here "just happened to occur in the homes of its South Carolina customers." Return at pp. 12-14. It also states that SCDOR's witnesses testified that the Department "examines the specific activities of each applicable service industry to determine where the taxpayer's income should be sourced. *Id.* at p. 13. These self-serving, conclusory statements are contrary to the bulk, if not all, of the evidence in the record regarding how SCDOR assessed DIRECTV in this case, including the following:

- SCDOR auditor's testimony that he conducted no background research and did not interview any DIRECTV employees to determine how the business operated. Tr., R. p. 422:13- 423:3.
- SCDOR's auditor and his supervisor's testimony that the audit determination was based solely on "customer location." Tr., R. pp. 423:4- 426:6; 437:15-23.
- SCDOR policy witness's testimony that the audit determination was based solely on customer location, that DIRECTV's activities conducted outside of the state were not relevant, and that "[w]e're only looking at what they would charge their South Carolina customer." Tr., R. p. 467:25- 468:9.
- SCDOR's Report of Field Audit for the 2009 through 2011 tax years, which states that "market base [sic] sourcing" was used. Field Audit Report, R. pp. 908.
- Testimony of SCDOR's tax policy expert that SCDOR was "taking a market state approach to the attribution of receipts." Tr., R. pp. 577:10-18 and 578:23-25.

The result sought by SCDOR in this case was clear- source 100% of DIRECTV's receipts to the customers' locations in South Carolina. With an apportionment statute that requires the focus to be on all IPAs of a taxpayer, this could only be accomplished by completely discounting

all out-of-state IPAs and calling delivery of the signal the only IPA (although as discussed above, even this does not occur only in South Carolina). *See supra* § I(B). First, SCDOR's witnesses admitted that they did not actually attempt to determine any IPAs, as the statute and case law require, but instead looked solely to customer location. In addition, even if SCDOR had performed an analysis of IPAs, it is illogical to call delivery of the signal the only IPA. Consider the following scenarios: (1) a car is detailed and serviced in South Carolina; and (2) a car is picked up from South Carolina, taken to Georgia to be detailed and serviced, and then delivered back to a South Carolina customer. Under SCDOR's position and the lower courts' decisions, in both scenarios the entire IPA is determined to be in South Carolina. This defies logic and produces an absurd result that should not be upheld by this Court.

The undercurrent of SCDOR's position and the lower courts' rulings appears to be a concern that DIRECTV had substantial receipts here and thus should have a correspondingly substantial tax bill and that the General Fund would be shorted if DIRECTV's South Carolina receipts were not all sourced here. SCDOR's tax policy expert had a similar focus and discussed whether a market-based approach is "best" from a policy standpoint. However, market-based sourcing is not on its face pro or anti-taxpayer or pro or anti-general fund. It is pro-taxpayer for businesses located here with substantial customers in other states (as in *Lockwood Greene*). On the other hand, it is anti-taxpayer with respect to out of state taxpayers with substantial customers here (as in this case). Stated differently, market-based sourcing will sometimes be pro-General Fund and generate a large tax (as it would here) and other times will be anti-General Fund (as with *Lockwood Greene*). Additionally, whether a state has a market-based statute or an activities-based statute can also impact whether and which businesses decide to invest in this State, locate

their headquarters here, target customers here, etc. But the decision as to whether South Carolina is market-based or activity-based lies with the Legislature, which can examine the pros and cons and decide which approach best supports the State's economic policies and goals. The Legislature chose to focus on IPAs, not customer location (or delivery of the signal). Thus, this Court should not interpret an IPA statute to reach a market-based result.⁴

IV. SCDOR'S ARGUMENT ON THE BURDEN OF PROOF IS UNAVAILING AND, IN ANY EVENT, THE PRIMARY ISSUE IN THIS CASE IS A LEGAL ONE.

In its Petition, DIRECTV argued that *Cloyd v. Mabry* shifts the burden of proof in certain cases; more specifically, although a tax assessment is initially presumed correct, once a taxpayer establishes that it is incorrect, the presumption of correctness is removed, and the taxpayer is entitled to appropriate relief. 295 S.C. at 88-89, 367 S.E.2d at 173.

SCDOR first criticizes *Cloyd* because it is a property tax case. However, as set forth in DIRECTV's Petition, multiple other South Carolina tax cases have cited the presumption in *Cloyd* with approval, including cases involving personal income, sales and accommodation taxes (*see* Petition at pp. 20-21), and SCDOR offers no reason why it should not apply to a corporate income tax matter. Alternatively, SCDOR claims that even if *Cloyd* applies, the proper remedy is not dismissal. Return at pp. 20-21. However, SCDOR fails to say what the appropriate relief is and instead tries to impose additional hoops for the taxpayer to jump through to obtain appropriate relief. *Id.* Where the ALC acknowledges that the assessment is incorrect (*see* R. pp. 40-41), the taxpayer is entitled to appropriate relief, be that dismissal, remand for additional findings by the ALC or other relief.

⁴ DIRECTV would note that SCDOR could have attempted to impose a market-based sourcing method under the alternative apportionment statute if it believed that § 12-6-2250(A)(5)'s IPA rule did not accurately reflect DIRECTV's business activities here and that market-based sourcing did. However, SCDOR chose not to do so.

Moreover, the burden of proof is almost beside the point in this case where there really are no factual issues, only legal ones. The key issue is whether South Carolina law (1) requires an apportionment of receipts and dictates that receipts be attributed to South Carolina only to the extent the IPA occurs in this State (as DIRECTV asserts), or (2) does not require apportionment but instead requires 100% of the receipts from South Carolina customers to be attributed here based on the customer's location (framed as "delivery of the signal") (as SCDOR claims). The burden of proof is really irrelevant here where only a legal issue is involved.

V. THE IMPOSITION OF SUBSTANTIAL UNDERSTATEMENT PENALTIES WAS NOT PROPER.

As previously argued in DIRECTV's Petition, any understatement penalties must be reduced by the amount for which there was (1) "substantial authority" for the treatment, (2) "adequate disclosure" of the relevant facts and a "reasonable basis" for the tax treatment; or (3) "reasonable cause" for an understatement and the taxpayer acted in "good faith." *See* S.C. Code Ann. §12-54-155(B)(2)(b); S.C. Code Ann. §12-54-155(D)(1); Petition at pp. 22-24. DIRECTV submits that it meets all three bases, even though only one is needed to justify reducing the penalty. The ALC already determined that the substantial understatement penalty should be reduced by 25% because it found that DIRECTV acted in good faith and "appropriately disclosed relevant facts affecting subscription receipts" (*see* Am. Final Order, R. p. 51), so DIRECTV will only address whether it had substantial authority, a reasonable basis or reasonable cause.

SCDOR's Return claims that the statute, *Lockwood Greene* and *Mercury Motor* do not stand for the propositions that DIRECTV claims and, thus, DIRECTV had no substantial authority for its position and its tax treatment of the subscription receipts was unreasonable and thus penalties are appropriate. Return at p. 21. DIRECTV will not repeat all of the arguments above and in its Petition but

would ask the Court to consider the following in evaluating whether DIRECTV had substantial authority, a reasonable basis or reasonable cause to report its income as it did:

- *Lockwood Greene* requires apportionment based on “place of activity;” it contrasts this with the “origin of payment” approach, which focuses on the location of the customer. It approves of the use of a payroll proxy to locate the taxpayer’s activities. Its discussion of SCDOR’s use of the “origin of payment” approach for certain other taxpayers like finance companies and media broadcasters (neither of which DIRECTV is) is contained in dictum and merely states that such a policy does not dictate the same result as to engineers.
- S.C. Code Ann. 12-6-2295(A)(5), which was enacted after *Lockwood Greene* and thus controls to the extent there are differences between the two, expressly requires apportionment based on IPAs. It does not state or imply that apportionment of receipts is based on the customer’s location or the location of the final step in delivering a product.
- *Mercury Motor* acknowledges that *all* of the transactions in the series of taxpayer activities contribute to the production of its income. It holds that it is not unconstitutional to take into account the income related to the hauling of freight because that transaction primarily earns the income. It does not consider or address whether it would be appropriate to ignore some IPAs when applying a statutory apportionment method. To the extent it can be read to discount certain “incidental” activities (and it stated that all activities could be labeled as such), delivery of the freight (akin to *delivery of the signal* here) would be discounted.
- SCDOR has published no guidance (regulations, policy documents or otherwise) to alert taxpayers to any policy that interprets the apportionment statute to require market-based sourcing for subscription revenue, and, in fact, its own auditor testified in his deposition that he was not even aware of such a policy or practice (Tr., R.p. 426:1-8).

Here, DIRECTV filed its 2009-10 returns based on set-top box rental receipts and its 2011 returns based on payroll. The set-top box rentals are the only income at issue that is earned in South Carolina and are the most obvious reflection of the IPAs here as they illustrate the footprint of DIRECTV and its minimal IPAs here. The 2011 return using a payroll proxy tracks *Lockwood Greene* to the letter and is also a reasonable reflection of DIRECTV’s IPAs here.

To consider this issue from a different perspective, imagine if DIRECTV was based in South Carolina with thousands of employees and millions in assets, and those employees and assets

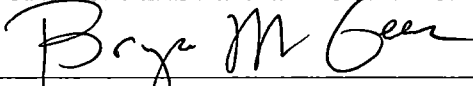
represented 95% of the payroll and 95% of the company's assets. Under this hypothetical, a very high percentage of the South Carolina receipts would be counted in the apportionment formula due to the very high percentage of IPAs located here. It is hard to imagine that DIRECTV could effectively argue— as it can under the actual facts— that only a small portion of the subscription revenues are attributable here when (1) the statute says IPA; (2) Lockwood Greene speaks to “place of activity” and endorses a payroll proxy, and (3) *Mercury Motor* discounts delivery of the freight (akin to delivery of the signal). Filing on a basis that takes into account the taxpayer's IPAs here (versus one that looks only to customer location or delivery of the signal) is the position that is consistent with the law. The substantial understatement penalties should be dismissed because DIRECTV's position is supported by the law with no SCDOR published guidance to the contrary and thus DIRECTV had substantial authority, reasonable cause and a reasonable basis for its tax treatment.

CONCLUSION

As set forth above and in its Petition previously filed, DIRECTV respectfully requests that this Court grant its Petition for Certiorari to consider the novel issues involved in this matter as well as the conflict between the ALC's decision and a prior decision of this Court.

Respectfully submitted,

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March 26, 2018

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MAR 29 2018

S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Administrative Law Judge

Case No. 14-ALJ-17-0158-CC
Appellate Case No. 2018-000211

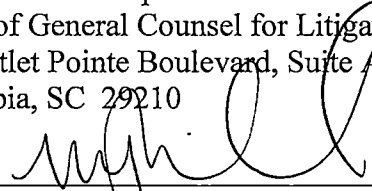
DIRECTV, Inc. & Subsidiaries, Appellant,
v.
South Carolina Department of Revenue Respondent.

PROOF OF SERVICE

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

Pleadings: APPELLANT’S REPLY IN SUPPORT OF PETITION FOR
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