STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

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

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

STATEMENT OF THE CASE

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

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

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

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

BACKGROUND

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

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

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

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

DISCUSSION

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

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

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

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

A. South Carolina Corporate Income Tax and Apportionment Theory

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

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

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

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

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

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

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

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

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

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

B. South Carolina's Apportionment Statutes

In South Carolina, the applicable apportionment statute provides:

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

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

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

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

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

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

C. Analysis

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

UDIPTA § 17	§ 12-6-2295(A)(5)
Sales, other than sales of tangible personal property, are in this state if: *** (b) the *income-producing activity* is performed both in and outside this state and a *greater proportion* of the *income-producing activity* is performed in this state than in any other state, *based on costs of performance*.	If the *income-producing activity* is performed partly within and partly without this State, sales are attributable to this State *to the extent* the *income-producing activity* is performed within this State

(emphasis added).

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

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

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

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

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

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

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

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

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

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

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

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

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

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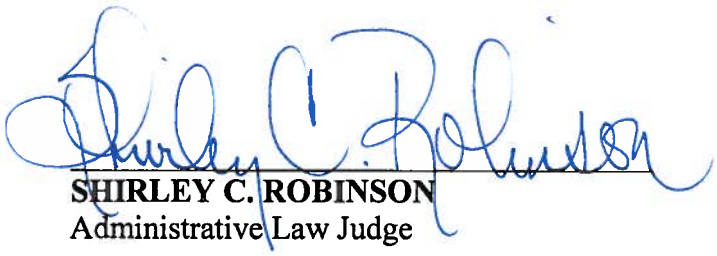
[4] This Court's 2012 decision in Rent-A-Center v. S.C. Dep't of Revenue, Docket No. 09-ALJ-17-0206-CC (filed January 6, 2012), is consistent with this interpretation of Lockwood Greene. In Rent-A-Center, this Court determined that management services performed in Texas for a South Carolina affiliate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

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

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

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

AND IT IS SO ORDERED.



SHIRLEY C. ROBINSON
Administrative Law Judge

February 10, 2015
Columbia, South Carolina

CERTIFICATE OF SERVICE
This is to certify that the undersigned has this date served this order in the above entitled action upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, or in the Interagency Mail Service addressed to the party(ies) or their attorney(s).
This 10 day of February 2015
By: Judicial Law Clerk