STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Media General Communications, Inc., and Media General Broadcasting of South Carolina Holdings, Inc. Petitioners, v. South Carolina Department of Revenue, Respondent.	)))))))))	Docket No. 07-ALJ-17-0089-CC **AMENDED ORDER ON MOTIONS FOR SUMMARY JUDGMENT**
Media General, Inc., Petitioner, v. South Carolina Department of Revenue, Respondent.	)))))))))	Docket No. 07-ALJ-17-0090-CC

APPEARANCES: For Petitioner: Burnet R. Maybank, III, Esquire
For Respondent: Lynn M. Baker, Esquire
Ronald Urban, Esquire

This matter is before the Administrative Law Court ("ALC" or "Court") pursuant to Motions for Summary Judgment filed on September 29, 2008 by Media General Communications, Inc. ("MGC"), Media General, Inc., ("MGI"), and Media General Broadcasting of South Carolina Holdings, Inc. ("MGB"), the "Petitioners," and the South Carolina Department of Revenue ("Department" or "Respondent"). After notice, a hearing was held on October 2, 2008. At the conclusion of the hearing, the Court requested the parties file supplemental information, which was submitted on October 17, 2008. After careful consideration of the motions, the Court granted

Petitioners' Motions for Summary Judgment. The Court issued its original Order on Motions for Summary Judgment on April 2, 2009. On April 30, 2009, the parties filed a Joint Motion to Correct this Order based on a clerical omission or mistake wherein the Petitioner, MGB, was inadvertently not included in the case caption or the first paragraph of the original order as a Petitioner. Accordingly, this Court now issues an Amended Order on Motions for Summary Judgment to rightfully include Petitioner, MGB.

BACKGROUND

The Department conducted a corporate income tax audit of MGI and MGC for the years December 2000 through December 2003, and of MGB for the years September 1998 through December 2003. (MGI, MGC, and MGB are collectively known herein as the "Taxpayers"). MGI is the parent company in a consolidated group of communication companies situated primarily in the Southeast which has interests in newspapers, television stations, and interactive media. As a result of the audit, on July 12, 2005 the Department issued proposed assessments to MGI in the amount of $682,850; to MGB in the amount of $5,281,071; and to MGC in the amount of $625,664. The proposed assessments included corporate income tax, licensing fees, interest, and penalties.

Taxpayers timely filed protests to the proposed assessments on December 14, 2005.[1] On February 2, 2007, the Department issued its final decisions in each matter ("Determinations") which denied Taxpayer's protests and upheld the proposed assessments. Taxpayers timely filed requests for contested case hearings with this Court on March 1, 2007. The requests were granted and the cases were consolidated for discovery and hearing purposes on June 26, 2007.

Subsequently, Taxpayers and the Department filed cross-motions for summary judgment on August 14, 2008. In their motions, the parties asked the Court to grant summary judgment on the sole issue of whether S.C. Code Ann. §12-6-2320(A)(4) (2000) allows Taxpayers, in determining any corporate income tax owed, to utilize (or be required to utilize) a combined entity apportionment methodology of accounting in order to more fairly represent their business activities in South Carolina when they have made a showing that the standard allocation and apportionment statutory provisions do not fairly represent the extent of their business activity in this State. The parties

entered into Stipulations of Fact for purposes of the motions.

In asking the Court to rule on this issue, the parties agree that the Department's standard apportionment method (the "separate entity apportionment method," sometimes referred to as the "direct" or "segregated" method of accounting)[2] for determining income results in a statutory distortion of Taxpayers' income in South Carolina, and that the combined entity apportionment method more fairly represents their business activities in this State.

STIPULATED FACTS

On September 5, 2008, the parties filed the following Stipulations of Fact (# 1-43), which are incorporated by reference:

1. Media General, Inc. ("MGI"), a Virginia corporation, is an independent, publicly owned communications company headquartered in Richmond, Virginia.

2. MGI is the parent company in a consolidated group of communication companies situated primarily in the Southeast with interests in newspapers, television stations and interactive media. The group's publishing assets include The Tampa Tribune, Richmond Times-Dispatch, Winston-Salem Journal and twenty-two other daily newspapers in Virginia, North Carolina, Florida, Alabama and South Carolina, as well as nearly one hundred periodicals and a twenty percent interest in The Denver Post. The group's twenty-six network-affiliated television stations reach more than thirty percent of the television households in the Southeast and nearly eight percent of those in the United States while its extensive interactive media offerings include more than fifty online enterprises.

3. MGI maintains its commercial domicile and is subject to income tax in the Commonwealth of Virginia.

4. MGI owns all of the issued and outstanding shares of capital stock of Media General Communications, Inc. ("MGC"), a Delaware corporation domiciled, and subject to income tax, in the Commonwealth of Virginia. MGC owns all of the issued and outstanding shares of Media General Operations, Inc. ("MGO"), a Delaware corporation. MGO owns all of the issued and outstanding

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[1] Upon timely request by Taxpayers, the Department granted them an extension until December 15, 2005 to file their protests.

shares of Media General Broadcasting of South Carolina Holdings, Inc. ("MGB"), a Delaware corporation, domiciled in, and subject to income tax in, the Commonwealth of Virginia. MGO was not assessed during the audit and is not considered in the term "Taxpayers" and/or "Petitioners" as used herein.[3]

5. The South Carolina Department of Revenue ("Department") conducted a corporate income tax audit of MGI and MGC for the years December 2000 through December 2003 and MGB for years September 1998 through December 2003.

6. During the audit period, MGC owned intangible assets utilized in MGO's multistate operations including those operations conducted in South Carolina. Specific to South Carolina, MGC owned all licenses and other authorizations issued by the Federal Communications Commission ("FCC") for the operation of WCBD, an NBC television broadcasting affiliate located in Charleston, South Carolina, and other intellectual property including trademarks for this station, and all trade names and trademarks of the Florence Morning News, a daily newspaper located in Florence, South Carolina (collectively the "MGC intangibles").

7. During the audit period, MGB owned intangible assets utilized in MGO's multistate operations including those operations conducted in South Carolina. Specific to South Carolina, MGB owned all licenses and other intellectual property or authorizations issued by the FCC for operation of WSPA, a CBS television broadcasting affiliate located in Greenville/Spartanburg, South Carolina, WASV, a UPN television broadcasting station servicing the upstate region of South Carolina and western North Carolina, and WBTV, a CBS television broadcasting affiliate serving the Florence/Myrtle Beach, South Carolina area (collectively "the MGB intangibles").

8. The MGB intangibles were previously owned by Spartan Broadcasting Company, which was a wholly-owned subsidiary of Spartan Communications, Inc. MGI acquired Spartan Communications, Inc. in March 2000. The intangibles were transferred to MGB as a result of that acquisition.

9. The acquisition of Spartan Communications included 12 network-affiliated television stations and one UPN affiliate, which is operated under a local marketing agreement.

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[2] *Amoco Production Co. v. Armold,* 213 Kan. 636, 518 P. 2d 453 (1974).

[3] Notwithstanding any terminology used in the stipulated findings of fact, the Court treats all three corporations (MGI, MGC and MGB) as the "Taxpayers" in this Order.

10. MGI and its affiliates comprise a unitary group. A unitary group as used herein is defined as a business in which there is a high degree of interrelationship and interdependence among related entities so that the value of the business as a whole exceeds the sum of its individual elements. Generally, unitary groups share a unity of management, ownership, and control of operations resulting in unquantifiable flows of value among the related entities of the business.

11. MGI and its affiliates operate converged media operations where television, newspaper, and online products and information are merged and leveraged off each other. MGI and its affiliates' unitary characteristics include but are not limited to:

- Companies are wholly-owned or a majority ownership interest exists
- Common officers
- Common directors
- **Strong centralized management** evidenced by shared services including but not limited to:
  - Treasury
  - Cash management
  - Corporate communications which handle corporate branding and promotion
  - Tax
  - Accounting
  - Financial reporting
  - IT
  - Purchasing
  - Legal
  - Internal audit
  - Human Resources
  - Insurance
  - Borrowings
  - Billings
  - Accounts payable
  - Budgeting
- Common headquarters and corporate facilities
- Common corporate policies
- Common professional firm relationships
- Common banking relationships

12. Pursuant to a license agreement between MGC and MGI, dated December 27, 1999, MGC licensed the MGC intangibles to MGI.[4]

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[4] Two license agreements were issued on that date between the parties. One was for the licensing of FCC Licenses, Programming Contracts, and Intellectual Property; the other for the licensing of Mastheads.

13. Pursuant to a license agreement between MGB and MGI, dated March 27, 2000, MGB licensed the MGB intangibles to MGI.

14. MGB and MGC charged MGI a flat royalty fee in exchange for the use of the MGB intangibles and MGC intangibles, respectively. The flat fee royalty began to accrue upon the effective date of the respective license agreement.

15. MGI sublicensed the MGC intangibles and MGB intangibles to MGO under three separate sublicensing agreements for an initial ten-year period. One sublicensing agreement, dated December 27, 1999, pertained specifically to the intangible property, including newspaper mastheads, trademarks, trade names, service marks, and trademark registrations, of newspapers, which included the Florence Morning News. The other two sublicensing agreements pertained specifically to the licenses, permits, and authorizations issued by the FCC to operate various television stations, including WCBD, WSPA, WASV, and WBTW, certain network affiliation agreements, programming agreements, and other intangible assets. The two sublicensing agreements were signed, one on December 27, 1999 for the MGC intangibles and the other on March 27, 2000 for the MGB intangibles. The sublicense agreements were established for a ten-year period with an automatic renewal for an additional five-year period, provided that either MGI, MGC, or MGB elected not to terminate their respective agreements.

16. Pursuant to the sublicensing agreements, MGI charged MGO a royalty fee equal to a certain percentage of MGO's revenues generated by its multistate operations, including its South Carolina operations. Certain royalties are attributable to MGO's revenues from WCBD, WSPA, WASV, WBTW and the Florence Morning News earned within South Carolina during the audit period.

17. The revenues generated by MGO from its South Carolina broadcasting and publishing operations consist mostly of advertising sales revenues. The revenues from the broadcasting television stations are derived from the sale of commercial advertisement time or "spots." Similarly, the bulk of the revenues earned by the Florence newspaper are earned through the sale of print advertisements. A less significant portion of a newspaper's revenue is generated by sales of the paper itself to its readers. Print and broadcast advertising are sold to local, regional, and national advertisers.

18. MGI earned royalties from MGO, a portion of which is attributable to revenues earned by MGO's South Carolina operations, in the following amounts:

	FYE 12/00	FYE 12/01	FYE 12/02
Florence Morning News	$687,665	$1,556,683	$1,515,338
WCBD – Charleston	1,964,605	1,774,060	2,080,487
IMD – Florence	0	1,159	11,504
IMB – WCBO	0	1,769	469
WSPA – Spartanburg	5,290,529	5,938,441	7,317,163
WASV – Spartanburg	870,415	954,038	1,165,228
WB TV – Myrtle Beach	3,073,896	3,275,855	4,293,610
IMD – WSPA	0	1,493	4,149
Total	$11,887,110	$13,503,498	$16,387,948

19. In addition to the license agreements, MGC and MGB signed an Administrative Services Agreement with MGI, dated December 27, 1999. Under the agreement, MGI managed the license agreements, monitored the performance of licensees, negotiated additional license agreements, managed the collection and disposition of funds, and such other duties that were prescribed. Additionally, MGI leased office space to each company and agreed to perform certain services for each company. These services included: cash management, audits of the books, supervision of each company's finances, financial consolidation services, services to maintain compliance with federal, state and local laws, payment of Board of Director fees, payment of

professional fees, telephone answering service, clerical and secretarial support, filing of franchise and information returns, and such other services requested by each company. The Administrative Services Agreement expires December 31, 2009 and automatically renews for another five-year period, provided that either MGI, MGC, or MGB elected not to terminate the agreement.

20. The license agreements, sublicense agreements, and Administrative Services Agreement, referenced in stipulations 12, 13, 15, and 19 above, were all signed on behalf of each entity by the same individual who is a corporate officer for each company (i.e., MGO, MGI, MGC, and MGB).

21. MGI's federal return reflected operating losses in the following amounts during the period involved: ($23,323,424) for the fiscal year ended December 2000; ($60,852,978) for the fiscal year ended December 2001; ($57,916,003) for the fiscal year ended December 2002; ($55,519,809) for the fiscal year ended December 2003.

22. The Department issued a proposed assessment to MGI for $682,850 on July 12, 2005. The proposed assessment was for the fiscal years ended December 31, 2000 through December 31, 2003 for income taxes and December 31, 2001 through December 31, 2004 for license fees. The proposed assessment included a license fee in the amount of $401,350, interest in the amount of $63,413, and penalty in the amount of $218,087. The penalties were based on a failure to file, failure to pay, and negligence.

23. The Department determined that MGB earned royalties attributable to the licensing of the MGB intangibles for use within South Carolina in the following amounts: $8,872,777 for the fiscal year ended December 2000; $10,260,988 for fiscal year ended December 2001; $10,840,520 for fiscal year ended December 2002; and $10,519,507 for fiscal year ended December 2003. A detailed breakdown of such receipts is as follows:

	FYE 12/00	**FYE 12/01**	**FYE 12/02**	**FYE 12/03**
WSPA – Spartanburg	$5,290,529	$5,938,441	$7,317,163	$6,454,153
WASV – Spartanburg	870,415	954,038	1,165,228	1,287,171

WBTV – Myrtle Beach	3,073,896	3,275,855	4,293,610	3,759,514
IMD – WSPA	0	1,493	4,149	13,015
IMD – WASV	0	0	0	333
* Adjustment	(362,063)	91,161	(1,939,630)	(994,679)
Total	$8,872,777	$10,260,988	$10,840,520	$10,519,507

* Royalties adjusted by markup to reflect actual royalties received by MGB.

24. The Department divided the amount of royalties received by MGI by the amount of royalties paid by MGI in order to compute a markup percentage which was applied to the MGB royalties. MGB royalties were determined by the amount of royalties paid by MGO to MGI for the use of MGB intangibles in stations physically located in South Carolina.

25. Spartan Broadcasting Company had previously earned royalties attributable to a license of such intangibles to Spartan Communications, Inc. for use within South Carolina. The Department determined that Spartan Broadcasting Company received $7,446,210 total royalties for fiscal year ended September 27, 1998; $23,850,679 for fiscal year ended September 26, 1999; and $10,014,596 for fiscal year ended March 27, 2000. The Department applied the sales ratio of the South Carolina operating company, Spartan Communications, Inc., to the total royalties to determine Spartan Broadcasting Company's South Carolina taxable income.

26. The Department issued a proposed assessment to MGB on July 12, 2005 in the amount of $5,281,071, which included tax of $2,047,420, license fees of $832,876, interest of $662,730, and penalties of $1,738,045. The proposed assessment included the tax, license fee, interest, and penalties assessed against Spartan Broadcasting Company. The proposed assessment was for the fiscal years ended September 1998 through December 31, 2003 for income taxes and September 1999 through December 31, 2004 for license fees.

27. The Department determined that MGC earned royalties attributable to the licensing of the MGC intangibles for use within South Carolina in the following amounts: $2,548,285 for the fiscal year ended December 2000; $3,363,554 for fiscal year ended December 2001; $3,060,246 for fiscal year ended December 2002; and $3,491,096 for fiscal year ended December 2003. A detailed

breakdown of such receipts is as follows:

	FYE 12/00	FYE 12/01	FYE 12/02	FYE 12/03
Florence Morning News	$687,665	$1,556,683	$1,515,338	$1,543,058
WCBD - Charleston	1,964,605	1,774,060	2,080,487	2,261,453
IMD – Florence	0	1,159	11,504	12,839
IMD – WCBD	0	1,769	469	3,849
* Adjustment	(103,985)	29,883	(547,552)	(330,103)
Total	$2,548,285	$3,363,554	$3,060,246	$3,491,096

* Royalties adjusted by markup to reflect actual royalties received by MGC.

28. The Department divided the amount of royalties received by MGI by the amount of royalties paid by MGI in order to compute a markup percentage which was applied to the MGC royalties. MGC royalties were determined by the amount of royalties paid by MGO to MGI for the use of MGC intangibles in stations and newspapers physically located in South Carolina.

29. The Department issued a proposed assessment to MGC on July 12, 2005 in the amount of $625,664, which included tax of $344,061, license fees of $18,768, interest of $61,037, and penalties of $201,798. The proposed assessment was for the fiscal years ended December 31, 2000 through December 31, 2003 for income taxes and December 31, 2001 through December 31, 2004 for license fees.

30. MGO filed South Carolina corporate income tax returns related to its broadcasting and newspaper operations within South Carolina during the audit period. However, MGO paid no tax because its deductions, inclusive of the royalties paid to related companies, exceeded its reported income.

31. Although MGI filed consolidated federal income tax returns with its affiliates during the audit period, MGI did not file South Carolina corporate income tax returns.

32. MGC and MGB (and Spartan Broadcasting Co.) did not file returns with South Carolina for the periods at issue reporting the royalty income generated from their licensing of FCC

licenses, authorizations, and other intellectual property.

33. The petitioners timely filed a protest to the proposed assessments on December 14, 2005. The Department issued its Final Agency Determination on February 2, 2007 effectively denying petitioners' protests. Petitioners then timely filed Requests for Contested Case Hearings on March 1, 2007. The Requests for Contested Case Hearings were granted by the Administrative Law Court of South Carolina. The cases were consolidated for discovery and hearing purposes by the Court on June 26, 2007.

34. MGI, MGB, MGC, and MGO, as a group, timely petitioned, through the audit process, for the employment of a combined apportionment methodology as an alternative method to fairly represent their business activities in South Carolina pursuant to S.C. Code Ann. § 12-6-2320(A)(4) which provides that if the allocation and apportionment provisions do not fairly represent the taxpayer's business activities in South Carolina, the taxpayer may petition for, or the Department may require, if reasonable, the employment of any other method to effectuate the equitable allocation and apportionment of the taxpayer's income.

35. S.C. Code Ann. § 12-6-2320(A) is identical to Uniform Division of Income for Tax Purposes Act ("UDITPA") section 18, Equitable Adjustment of Formula and was passed by the South Carolina General Assembly in 1995.

36. The Department's application of South Carolina's standard apportionment formula utilized in its proposed assessment does not fairly represent petitioners' business activities in South Carolina thus resulting in a statutory distortion of petitioners' activities within South Carolina.

37. South Carolina's statutory apportionment methodology as utilized in the Department's assessments and the calculation of taxes on returns filed during the audit period results in income tax and license fee for MGI, MGB, MGC, and MGO in the amount of $3,758,320. The combined apportionment methodology results in income tax and license fee for MGI, MGB, MGC, and MGO in the amount of $863,179. The South Carolina statutory apportionment method utilized results in an assessment that is 435% of the income tax and license fees resulting from the combined apportionment method. The combined apportionment method, utilizing the activities of unitary affiliates, more fairly represents the activities of MGI, MGB, MGC, and MGO in South Carolina as compared to South Carolina's statutory apportionment method used in separate filing, so that S.C.

Code Ann. § 12-6-2320(A) is applicable.

38. Although the Department agrees that the combined apportionment methodology fairly represents MGI's, MGB's, MGC's, and MGO's business activities in South Carolina during the audit period, as compared to South Carolina's standard apportionment methodology, the Department declined the group's petition for the employment of combined apportionment pursuant to S.C. Code Ann. 12-6-2320(A)(4) on the grounds that the Department has no authority to either grant a petition for, or require, the use of a combined apportionment methodology.

39. South Carolina statutes and UDITPA have no express provisions specifically authorizing the use of a combined apportionment methodology (or, are silent as to specifically allowing the use of combined apportionment methodology).

40. The Department asserts that its longstanding administrative interpretation is that S.C. Code Ann. § 12-6-2320(A)(4) does not allow for the Department to either grant a petition for, or require, the use of a combined apportionment methodology.

41. South Carolina has historically been a separate entity filing state.

42. The Department has not allowed Taxpayers to file returns utilizing the combined apportionment methodology under the general apportionment statute based on the ruling in *NCR Corporation v. South Carolina Tax Commission*, 304 SC 1, 402 S.E.2d 666 (1991). *NCR* was decided prior to the adoption of UDITPA section 18 in 1995 by South Carolina, as codified in S.C. Code Ann. § 12-6-2320(A).

43. The term "combined apportionment methodology" means the following when used herein: an accounting method whereby each member of a group carrying on a unitary business computes its individual taxable income attributable to activities in South Carolina by taking a portion of the combined net income of the group through the utilization of combined apportionment factors.[5] The combined income of the unitary group is not computed for the purpose of taxing such income, but rather as a basis for determining the portion of income from the entire unitary business attributable to sources within South Carolina which is derived by members of the group subject to South Carolina's taxing jurisdiction.[6] The purpose of the combined apportionment methodology is

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[5] See *Caterpillar Tractor Co. v. Department of Revenue*, 289 Ore. 895, 896, 618 P.2d 1261, 1262-63 (1980).

[6] See *Chesapeake Indus. v. Comptroller*, 59 Md. App. 370, 376, 475 A.2d 1224, 1227 (1984).

1) to determine the income or other tax base of the in-state taxpayer by viewing the taxpayer as part of the unitary business, and applying the apportionment factors of the entire unitary business to the taxable net income of the unitary business[7] and 2) to capture the many subtle and largely unquantifiable transfers of value that take place among related companies of a single business enterprise.

ISSUE

As stated heretofore, the parties stipulate that the Department's separate entity apportionment method (the Department's standard apportionment methodology which it utilized in determining Taxpayer's income) results in statutory distortion of Taxpayers' business activities in South Carolina for the years at issue herein, and the alternative method (the combined entity apportionment method sought by Taxpayers) more fairly represents Taxpayer's business activities in this State. Notwithstanding, the Department avers that the General Assembly has not given it authority to apply the combined entity apportionment methodology to any corporate taxpayer in computing its taxable income in this state. Thus, the sole issue before the Court is the construction of the phrase "any other method" contained in § 12-6-2320(A)(4) (2000) and, did South Carolina's General Assembly when it enacted this provision in 1995: (1) intend that it is inclusive of the combined entity apportionment methodology for reporting income and, if so, (2) whether the Department must authorize its usage in this state.

SUMMARY JUDGMENT

"The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder." *George v. Fabri,* 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). "A court considering summary judgment neither makes factual determinations nor considers the merits of competing testimony; however, summary judgment is completely appropriate when a properly supported motion sets forth facts that remain undisputed or are contested in a deficient manner." *David v. McLeod Reg'l Med. Ctr.,* 367 S.C. 242, 250, 626 S.E.2d 1, 5 (2006). Summary judgment should be granted when there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. *R.J. Hendricks, II v. Clemson Univ.,* 353 S.C. 449, 455, 578 S.E.2d

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[7] See J. Hellerstein & W. Hellerstein, State Taxation (3d ed.), §8.11[1] (hereinafter referred to as "State Taxation").

711, 714 (2003); Rule 56(c), SCRCP; see ALC Rule 68. In this case, the parties have stipulated to the facts. Since the Court agrees with the parties that there is no genuine issue of material fact, it finds that the disposition of this case by way of summary judgment is appropriate.

STATUTORY CONSTRUCTION

"Matters of taxation, especially assessments, are administrative in their character and should remain free of judicial interference in the absence of fraud, corruption or conduct so oppressive, arbitrary or capricious as to amount to fraud." *Amoco Production Co. v. Armold,* 213 Kan. 636, 518 P.2d 453 (1974). "The determination of proper methods of allocation income of a multistate corporation and of the amount of tax due from the corporation is an administrative duty cast upon the State Tax Commission and is to be performed by it." *Union Pac. R. Co. v. State Tax Comm'n,* 145 Kan. 715, 68 P.2d 1 (1937).

However, it is the duty of the courts to interpret a statute and to give it the effect intended by the legislature. The legislature's intent should be ascertained primarily from the plain language of the statute. *State v. Landis*, 362 S.C. 97, 606 S.E.2d 503 (Ct. App. 2004). The language used should be given its plain and ordinary meaning without resort to subtle or forced construction to expand or limit the scope of the statute. *Berkebile v. Outen*, 311 S.C. 50, 426 S.E.2d 760 (1993). Notwithstanding, the language must be read in a sense which harmonizes with its subject matter and accords with its general purpose. *Mun. Ass'n of South Carolina v. AT&T Communications of Southern States, Inc.,* 361 S.C. 576, 606 S.E.2d 468 (2004). The Court should not consider the particular clause being construed in isolation, but should read it in conjunction with the purpose of the whole statute and the policy of the law. *State v. Gordon*, 356 S.C. 143, 152, 588 S.E.2d 105, 110 (2003).

The South Carolina Supreme Court has held that the "usual roles of statutory construction apply to the interpretation of tax statutes." *Multi-Cinema, Ltd. v. S. C. Tax Comm'n*, 292 S.C. 411, 413, 357 S.E.2d 6, 7 (1987). In *Palmetto Net, Inc. v. S. C. Tax Comm'n*, 318 S.C. 102, 456 S.E.2d 385 (1995), the court held that the plain meaning rule must be applied when interpreting tax statutes. Moreover, where substantial doubt exists as to the construction and interpretation of legislative action with respect to the enactment and enforcement of tax statutes, the doubt must be resolved against the government. See *Columbia Ry., Gas & Elect. Co. v. Carter*, 127 S.C. 473, 121 S.E. 377

(1924). See also *Coble Dairy Products Coop., Inc. v. Livingston,* 239 S.C. 401, 123 S.E.2d 301, 302 (1961) ("A tax statute is not to be extended beyond the clear import of its language, and any substantial doubt as to its meaning is to be resolved in favor of the taxpayer.").

In South Carolina the cardinal rule of statutory interpretation requires the trier of fact to ascertain the intent of the legislature. *State v. Scott*, 351 S.C. 584, 588, 571 S.E.2d 700, 702 (2002). In doing so, the court must give a reasonable and practical construction to the statute that is consistent with the purpose and policy expressed in the statute. *Davis v. NationsCredit Fin. Servs. Corp.*, 326 S.C. 83, 484 S.E.2d 471 (1997). All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute. *McClanahan v. Richland County Council*, 350 S.C. 433, 567 S.E.2d 240 (2002). The determination of legislative intent is a matter of law. *Charleston County Parks & Recreation Comm'n v. Somers*, 319 S.C. 65, 459 S.E.2d 841 (1995). If a statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory construction are not needed and the court has no right to impose another meaning. *Hodges v. Rainey*, 341 S.C. 79, 533 S.E.2d 578 (2000).

"Where a statute is ambiguous, the Court must construe the terms of the statute." *Wade v. Berkeley County*, 348 S.C. 224, 229, 559 S.E.2d 586, 588 (2002). In construing a statute, the court looks to the language as a whole in light of its manifest purpose. *Adams v. Texfi Industries*, 320 S.C. 213, 464 S.E.2d 109 (1995). An ambiguity in a statute should be resolved in favor of a just, beneficial, and equitable operation of the law. *State v. Hudson*, 336 S.C. 237, 519 S.E.2d 577 (Ct. App. 1999). Furthermore, where substantial doubt exists as to the construction and interpretation of a legislative action with respect to the enactment and enforcement of tax statutes, the doubt must be resolved against the government. *Columbia Ry., Gas & Elec. Co. v. Carter*, 127 S.C. 473, 121 S.E. 377, 380 (1924).

Although Courts give great weight to an agency's long-standing construction of a statute, such a construction is not dispositive. *Plyler v. Evatt*, 313 S.C. 405, 408, 438 S.E.2d 244, 246 (1993). While the Court typically defers to an agency's construction of its own regulation, where the plain language of the statute is contrary to the agency's interpretation, the Court will reject its interpretation. *Brown v. South Carolina Dep't of Health and Envtl. Control*, 348 S.C. 507, 560

S.E.2d 410 (2002).

GENERAL LAW

Commerce Clause Doctrine, Due Process Doctrine, and UDITPA

The accelerated industrial transformation in this county during the last century gave impetus to the expansion of trade, industry, and finance on a national scale. Multistate enterprises and large-scale industry grew and distances between them were shortened as transportation and communication was modernized. As this occurred, state boundary lines lost much of their economic importance.

With this rapid increase came an expansion of public services and the need for increased revenue. States were forced to seek out additional sources and they enacted statutes which taxed income generated by businesses. With these new taxes, the division of state tax measures became one of the most significant issues in the state tax field[8] as multistate businesses raised legitimate claims for their protection from multiple taxation of their tax base by the various states their businesses touched.

The states' taxation of multistate corporations that conduct business within and without a state is restricted by the Commerce[9] and Due Process Clauses[10] of the U. S. Constitution. The U.S. Supreme Court in *Mobil Oil Corp. v. Commissioner of Taxes*[11] held that the Commerce Clause

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[8] State Taxation at §8.01.

[9] See U. S. Const., art. I, §8, clause 3. This clause grants Congress the power to regulate commerce with foreign Nations, among the several States, and with the Indian Tribes. It limits the taxing powers of the states by barring them from enacting taxes which would impose undue burdens on interstate commerce. This constitutional provision also gives Congress the power to regulate intrastate commerce that may affect its regulation of interstate commerce. *Shreveport Rate Case*, 234 U.S. 342, 34 S.Ct. 833 (1914). For a definition of what commerce means in tax law, see State Taxation, §4.01. See also *Board of Trustees v. United States*, 289 U.S. 48, 56, 53 S.Ct. 509 (1933), *United States v. South-Eastern Underwriters Ass'n,* 322 U.S. 533, 64 S. Ct. 1162 (1944), *Radovitch v. National Football League*, 352 U.S. 445, 77 S.Ct. 390 (1957), *United States v. Schubert*, 348 U.S. 222, 75 S.Ct. 277 (1955), and *North Am. Co. v. SEC,* 327 U.S. 686, 66 S.Ct. 785 (1946).

[10] The Due Process Clause demands that there exist "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," as "well as a rational relationship between tax and the…values connected with the taxing state." *MeadWestvaco Corp., v. Illinois Dep't of Revenue*, 128 S.Ct. 1498, 1505 (2008); *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992); *Miller Brothers Co. v. Maryland*, 347 U. S. 340, 344-345, 74 S.Ct. 535 (1954).

[11] *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223 (1980). The Court, in deciding whether the state of Vermont could tax an apportioned share of the dividends that Mobil (a New York domiciliary) received from its foreign subsidiaries, held that the Commerce Clause protects taxpayers against the risk of multiple taxation, and not merely the actuality, of multiple taxation. Further, it held that a tax that exposes a multistate taxpayer to the risk of multiple taxation is invalid under the Commerce Clause. In addition, it held that where the taxpayer derives income from

doctrine, which protects a multistate taxpayer from the risk of multiple taxation, ensures a division of the taxpayer's income where the taxpayer is able to show that the income is taxable in more than one state. Furthermore, "[t]he Commerce and Due Process Clauses impose distinct but parallel limitations on a State's power to tax out-of-state activities, and each subsumes the 'broad inquiry' "'whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. . . .' "[12]

In the leading case dealing with constitutional distortion, the U. S. Supreme Court in *Hans Rees' Sons v. North Carolina* held that North Carolina's standard statutory apportionment method led to a distorted constitutional result, since its usage resulted in tax that exceeded 250% of the tax owed if the taxpayer had used an alternative accepted method. Further, the court held that the standard method used by North Carolina's Commissioner of Revenue, as applied to taxpayer's business for the years in question, operated "unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant (taxpayer) in that state."[13]

Because of the risk of double taxation of multistate corporations, the National Conference of Commissioners on Uniform State Laws at its annual conference in 1957 approved and recommended for enactment by all states the Uniform Division of Income for Tax Purposes Act ("UDITPA").[14] The purpose of the act was to permit taxpayers whose income is taxable within several states to apportion and allocate their income among those states. It is well established that the Commerce Clause gives taxpayers, within constitutional limits, the right to apportion their tax base among the various taxing states where it does business through formulas that utilize in-site aspects of interstate affairs.[15]

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a unitary business conducted in a number of states, the "income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method." *Id.* at 445-46. See also *American Trucking Ass'ns, Inc. v. Scheiner,* 483 U.S. 266, 107 S.Ct. 2829 (1987).

[12] *MeadWestvaco v. Illinois Dep't of Revenue*, 128 S.Ct. 1498, 1500 (2008), quoting *ASARCO Inc. v. Idaho Tax Comm'n*, 458 U.S. 307, 315, 102 S.Ct. 3103 (1982).

[13] *Hans Rees' Sons v. North Carolina*, 283 U.S. 123, 134, 51 S.Ct. 385 (1931). In *Hans Rees*, the average income having its source in the State of North Carolina was 17%; however, the State assessed the corporation on approximately 80% of its income.

[14] The House of Delegates of the American Bar Association approved UDITPA during its annual meetings held in July 1957. William J. Pierce, *The Uniform Division of Income for State Tax Purposes,* 35 Taxes 747 (Oct. 1957).

[15] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 79 S.Ct. 357 (1959).

Subsequent to the enactment by Oregon's legislature of UDITPA, its Supreme Court addressed a taxpayer's (multistate corporation) use of an alternate method to compute its taxable income in Oregon in lieu of using Oregon's standard apportionment formula. In *Twentieth Century-Fox Film Corp. v. Dept. of Revenue,*[16] the Oregon court explained in detail the issues involved when a multistate taxpayer challenges a state's standard apportionment formula on the ground that it does not adequately represent taxpayer's business activity within the state, not merely that the state's standard formula fails to reflect taxpayer's income in the taxing state. The court held that Oregon's Department of Revenue proved that Oregon's statutory apportionment formula (as applicable to the excise taxation of corporations) did not fairly represent the extent of taxpayer's motion picture producer and distributor's business activity in Oregon. In addition, it held that the relief provision (usage of the combined entity apportionment method) allowed the Department to employ a method of accounting that was different from its standard formula in those instances where 1) the taxpayer showed that the standard method did not adequately reflect taxpayer's business activity and that the income it earned within the state and, 2) where the taxpayer showed that the alternative apportionment method was "reasonable." The Oregon court held that a party, in order to prove reasonableness, must show that the division of taxpayer's income using the alternative apportionment method 1) fairly represents taxpayer's business activity in the state and would result in taxation there of no more *or* no less than 100 % of taxpayer's income, 2) fosters uniformity among UDITPA states; and 3) reflects the economic reality of taxpayer's business activity in the state.

The Supreme Court in Kansas addressed this same issue in *Amoco Production Co. v. Armold.*[17] The court reversed the determination by Kansas's Director of Taxation which required the taxpayer to use the standard method of accounting. The court noted that it is common in allocation states such as Kansas, which had adopted UDITPA, to include a general relief provision which authorizes the state's tax administrator to depart from the use of the general apportionment method if such is necessary to obtain fair or equitable results.[18]

Subsequent to the decisions by the Kansas and Oregon courts, but four years prior to South

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[16] *Twentieth Century-Fox Film Corp. v. Dept. of Revenue*, 700 P.2d 1035 (Or. 1985).

[17] 213 Kan. 636, 518 P.2d 453 (1974).

[18] Keesling & Warren, California's Uniform Division of Income for Tax Purposes Act (Part I), 15 UCLA L. Rev. 156, 170 (1967). Kansas had adopted UDITPA and codified it at K.S.A. and K.S.A. 1973 Supp. 79-3271 *et seq*.

Carolina's adoption of section 18 of UDITPA [as § 12-6-2320(A)(4) in 1995],[19] South Carolina's Supreme Court held in *NCR Corp. v. S. C. Tax Comm'n*[20] that fairness is the test in this state of due process constitutionality in the context of unitary business income taxation. Further, it held that a taxpayer, in order to establish a violation of due process, must clearly and cogently prove that the apportionment formula applied by the Tax Commission led to a "grossly distorted result" or that "the income attributed to the state is in fact out of all proportion to the business transacted …in that State." *Id.* at 11-12, quoting *NCR Corp. v. Comptroller of the Treasury,* 313 Md. 118, 544 A.2d 764 (1988).

Notwithstanding, subsequent to the enactment by this state of the relief provision codified as §12-6-2320(A)(4), multistate corporate taxpayers no longer have to make a showing of constitutional distortion in order to use an alternate method of apportionment. In addition, the statute does not require a showing of a "grossly distorted result" or that the income attributed to South Carolina "is in fact out of all proportion to the business transacted" in this state. The multistate corporate taxpayer must only show in its request to the Department that the alternative method is "reasonable," represents the extent of its business activity in South Carolina, and that the usage of the standard apportionment method produces a distortion.

The parties agree that Taxpayers are not required to prove constitutional distortion. Further, they agree that South Carolina's standard statutory apportionment formula does not fairly represent the extent of Taxpayer's business activity in South Carolina for the years at issue and that its usage creates distortion in calculating Taxpayer's taxable income.

Apportionment Methods and the Unitary Business Principle

The bedrock principle established by the Commerce and the Due Process Doctrines that a state may not tax activities with which it does not have a concrete connection generally confines the exercise of a state's tax power to activities conducted within its borders. However, a state may only tax an apportioned share of the value generated by a multistate enterprise's intrastate and extrastate

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[19] See 1995 Act No. 76.

[20] *NCR Corp. v. S. C. Tax Comm'n* , 304 S.C. 1, 402 S.E.2d 666 (1991).

activities that form part of a unitary business.[21] Thus, where a multistate corporation does business within a state, the inquiry shifts from the notion of whether the state may tax to the notion of what the state may tax. Thus, under the unitary business principle, a state need not 'isolate the intrastate income-producing activities from the rest of the business but may tax an apportioned sum of the corporation's multistate business if the business is unitary. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992).

The taxation of a multi-state business by a taxing state is accomplished by allocating and apportioning its income. Although the courts favor allocation and apportionment to determine that income taxable to multi-state taxpayers which transact business in various states, it is often difficult to determine with precision the amount of income attributable to each state. The U. S. Supreme Court long ago recognized this difficulty and permitted the states to determine the income or receipts of a multijurisdictional corporation attributable to the state through apportionment.[22] In *Container Corp. v. Franchise Tax Bd.,* the court held that the three factor formula used by most states as the standard apportionment method to determine the income of a multi-state taxpayer is the benchmark against which other apportionment formulas are judged.[23]

The unitary combined method of apportioning for tax purposes was developed by the U. S. Supreme Court over the last several decades in response to the evolution of "new methods of finance and new forms of business"[24] and the conduct of a single business through multiple entities. The court cited *Mobil* in *Allied-Signal, Inc. v. Director, Division of Taxation,*[25] noting that the virtue of

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[21] *Hunt-Wesson, Inc. v. Franchise Tax Bd. of Cal*, 528 U.S. 458, 460, 120 S.Ct. 1022 (2000).

[22] Apportionment, under which the measure of a tax is divided by formula, is based on the use of selected factors for attributing the tax base to the states in which the taxpayer employs its property or carries on its activity. Taxing authorities first utilized this methodology in this country in connection with the taxation of railroads, telegraph and express companies, toll bridges and other transportation businesses conducted in more than one taxing jurisdiction. See *Western Union Tel. Co. v. Taggart*, 163 U.S. 1, 16 S.Ct. 1054 (1896); *Pittsburgh C. & St. L. Ry. v. Backus*, 154 U.S. 421, 14 S.Ct. 1114 (1894); *State Railroad Tax Cases*, 92 U.S. 575, 608 (1875); *Delaware Railroad Tax*, 85 U.S. 206 (1873). This unit rule was the progenitor of the contemporary "unitary business principle" that underlines the use of the formulary apportionment by the various states applicable to taxing vertically integrated multistate manufacturing-selling and mercantile businesses. See State Taxation, §8.05.

[23] *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 167 (1983).

[24] See *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-121 (1920).

[25] 504 U.S. 768, 112 S.Ct. 2251 (1992). *Allied-Signal* is the latest decision by the U. S. Supreme Court that delineates the unitary business concept, in general, and the apportionability of income from intangibles.

the unitary business[26] principle of taxation is that it does a better job of accounting for the unquantifiable transfers of value between the components of a single unitary enterprise than a method of geographical or transactional accounting. Further, it noted that it rejects geographical or transactional accounting and instead, calculates the local tax base by first defining the scope of the unitary business of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportions the total income of that unitary business between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. Further, the theory underlying unitary taxation is that the certain intangible flows of value within the unitary group serve to link the various members together as if they were essentially a single entity."

In *MeadWestvaco Corp. v. Ill. Dep't of Revenue,*[27] a decision authored by Justice Alito in 2008, the court recognized once again its long-held doctrine that states have flexibility in applying unitary business principles to different factual circumstances and that this discretion is appropriate and logically consistent with the underlying principles motivating the end result in applying a unitary business principle to taxation. The court noted that central to the unitary business principle is the recognition that the "whole of the enterprise is generally more valuable than the sum of its parts."[28] However, in over eighty years of decisions, the court has consistently held that the primary constraint in applying unitary business principles, those principles which are understood to be based upon factual determinations and are not inflexible, is that the result must be reasonable and not inherently arbitrary.

The U. S. Supreme Court also recognized in *Container* that the unitary business concept "is

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[26] Case law among the various states vary on the definition of a "unitary business" for purposes of determining the scope of the apportionable tax base. In *Butler v. McColgan*, 17 Cal. 2d 664, 111 P.2d 334 (1941), aff'd, 315 U.S. 501, 62 S.Ct. 701 (1942), the Supreme Court approved California's test as an acceptable definition of a unitary business as a matter of federal constitutional law by affirming California's decision which found that the unitary nature of appellant's business was established by the presence of (1) unity of ownership, (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. State Taxation, §8.09(1). In *MeadWestvaco v. Illinois Dep't of Revenue*, 18 S.Ct. 1498 (2008), Justice Alito, writing for the majority, addressed the issue of taxation of multistate corporations and stated that "[T[he unitary business principle addressed this problem by shifting the constitutional inquiry from the niceties of geographic accounting to the determination of the taxpayer's business unit." Further, he noted that the unitary business principle is not so inflexible that as new methods of finance and new forms of business evolve it cannot be modified or supplemented where appropriate.

[27] 128 S.Ct. 1498 (2008).

not…so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach."[29] These observations by the court have had important implications for the delineation of the unitary business principle under state tax law by allowing states to adopt their individual approaches to apportionment. Long ago the court upheld the constitutionality, under the Federal Constitution, of this unitary business apportionment method to the tax base of a unitary group of corporations, some of whose members were not taxable by the state, as a way to ascertain the income of those corporations that were taxable. Notwithstanding, the court held that any method applied by a state is subject to certain "constraints." In defining what was meant by "constraints," the *Container* court referenced three of its earlier decisions, including its *Hans Rees* decision in 1931 where a North Carolina apportionment statute, when applied to the facts therein, was found to operate "unreasonably and arbitrarily."[30] The term "constraint," as defined in *Underwood,*[31] means that the method must not be "inherently arbitrary" and must not produce "an unreasonable result."

The timeless application of these standards remains, despite the fact that the court in *Container* endorsed "variations on the theme" over the years. Therefore, while states retain the ability to develop various methods of apportioning the income of a unitary business, the method when applied to a particular taxpayer must be reasonable in result and not inherently arbitrary.[32]

Summary of South Carolina Tax Law Concerning the Allocation and Apportionment of Income by Multistate Corporations

Chapter 6 of Title 12 of the South Carolina Code of Laws is entitled the "South Carolina Income Tax Act." Various sections in the chapter address the taxation of corporations in South

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[28] Id. at 1505.

[29] *Container*, 463 U.S. at 167 (1983). The court in *Container* upheld the three factor formula used by both California and South Carolina and the differences between the taxing schemes in the two states. California ignores corporate identities and uses the combined entity apportionment method whereas South Carolina utilized at the time of the decision the separate entity method.

[30] *Hans Rees' Sons v. N. C.*, 283 U.S. 123, 51 S. Ct. 385 (1931).

[31] *Underwood,* 254 U.S. at 120-121.

[32] In *NCR Corp. v. S.C. Tax Comm'n*, 304 S.C. 1, 402 S.E.2d 666 (1991), the South Carolina Supreme Court cited *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988), stating that it "cannot be doubted that 'fairness is the test of due process constitutionality in the context of unitary business income taxation.'"

Carolina, the computation of the tax, and the allocation and apportionment of the tax.

Section 12-6-530 imposes an income tax on all corporations that transact, conduct, or do business within this State, or which have income within this State. Section 12-6-580 provides for the computation of a corporation's gross and taxable income and Section 12-6-1130 lists various modifications to deductions as provided in the Internal Revenue Code ("IRC") to determine the taxable income of a corporation.

Article 17 in Chapter 6 of Title 12 is entitled "Allocation and Apportionment." Section 12-6-2210, passed as part of Act 76 in 1995, is entitled "Taxation of business; determination whether entirely or partly transacted or conducted within State." Subsection 12-6-2210(A) reads:

> If the entire business of a taxpayer is transacted or conducted within this State, the income tax as provided in this chapter is measured by the entire net income of the taxpayer for the taxable year. The entire business of the taxpayer is transacted or conducted within the State if the taxpayer is not subject to a net income tax or a franchise tax measured by net income in another state, the District of Columbia, a territory or possession of the United States, or a foreign country, and would not be subject to a net income tax in another taxing jurisdiction if the other taxing jurisdiction adopted the net income tax laws of this State.

The general/standard apportionment rule applicable in South Carolina is contained in §12-6-2210(B). It reads:

> If 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. A taxpayer subject to taxation under this section is considered to have been transacting or conducting business partly within and partly without the State if the taxpayer is subject to a net income tax or a franchise tax measured by net income in another state, the District of Columbia, a territory or possession of the United States, or a foreign country, or would be subject to the net income tax in any other taxing jurisdiction if the other taxing jurisdiction adopted the net income tax laws of this State. (Emphasis added).

S.C. Code Ann. §12-6-2230, also enacted as part of Act 76 in 1995, provides that any income which is allocated under §12-6-2220 and is not properly includable in the net apportionable income of taxpayers engaged in interstate commerce under the Constitution of the United States because it is unrelated to the business activity of the taxpayer conducted partly within and partly without this

State, is allocated to the state in which the business situs of the investment is located.

S.C. Code Ann. § 12-6-2240 (for all tax years through 2010) reads: "[A]ll income remaining after allocation under §§ 12-6-2220 and 12-6-2230 is apportioned in accordance with § 12-6-2250, or one of the special apportionment formulas provided in §§ 12-6-2290 through 12-6-2310."

S.C. Code Ann. § 12-6-2250 provides for a three-factor apportionment formula. It states that a taxpayer[33] whose principal business in this State is:

> manufacturing or any form of collecting, buying, assembling or processing goods and materials within this State, or selling, distributing, or dealing in tangible personal property [34] within this State, shall make returns and pay annually an income tax which includes its income apportioned to this State. Its income apportioned to this State is determined by multiplying the net income remaining after allocation under Sections 12-6-2220 and 12-6-2230 by a fraction, the numerator of which is the property ratio, plus the payroll ratio, plus twice the sales ratio, and the denominator of which is four…The property payroll, and sales ratios[35] must be determined in accordance with Sections 12-6-2260, 12-6-2270, and 12-6-2280, respectively. (Emphasis added).

This method, based on property, payroll, and double-weighted sales, is used for taxpayers whose principal business in South Carolina is dealing in tangible personal property (typically used by businesses that manufacture, sell, or rent tangible personal property).

Notwithstanding the allocation and apportion provisions contained in Chapter 6, of Title 12, the relief provision contained in § 12-6-2320(2000) provides that if any of the statutory

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[33] Taxpayer, as defined in §12-6-30(1), includes "an individual, trust, estate, partnership, association, company, corporation, or any other entity subject to the tax imposed by this chapter or required to file a return."

[34] "Tangible property", pursuant to § 12-6-30 (11), includes "real property and corporeal personal property but does not include money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property."

[35] In *Ward Europa, Inc. v. Comptroller of the Treasury*, 503 A. 2d 1371, 66 Md. App. 332 (1986), Maryland's Court of Special Appeals, on appeal of a decision by its Tax Court, defined the "Payroll Factor" and the "Sales Factor" as applied in tangible property cases. It provided the following formulas:

> "Maryland income" = property factor plus payroll factor plus sales factor divided by three.
>
> "Property factor" = value of Maryland property divided by value of all property everywhere.
>
> "Payroll factor" = Taxpayer's Maryland payroll divided by taxpayer's entire payroll everywhere (the same definition as delineated in Section 13 of UDITPA).

Thereafter, the three factors are averaged and the resulting fraction, expressed in a percentage, is multiplied by the income within the state. South Carolina defined the factors in the same manner in *NCR Corp. v. S. C. Tax Comm'n*, 304 S.C. 1, 402 S.E.2d 666 (1991).

apportionment provisions contained in Article 17 of Chapter 6 does not fairly represent taxpayer's business activities in South Carolina, the taxpayer may petition the Department for an alternative apportionment method, or the Department may require an alternative method in respect to all or any part of the taxpayer's business activity, if reasonable. These methods are:

> (1) separate accounting;[36]
> (2) the exclusion of one or more of the factors;
> (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. (Emphasis added).

Separate Entity and Combined Entity Apportionment Methods

Numerous states generally apply two methods of apportioning income of a multi-state business. The first method, known as the separate entity apportionment method, considers each entity having nexus with the taxing state as a separate and distinct entity, even if it is part of a unitary business. The second method, known as the unitary combined entity apportionment method, considers the entities that are part of the unitary business such that the numerator represents all of the unitary entities' gross receipts from within the taxing state and the denominator consists of all of the unitary entities' gross receipts from everywhere.

South Carolina uses the separate entity apportionment method as its standard method to determine the taxable income related to intangible property[37] of multistate businesses transacting or

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"Sales factor" = Sales by taxpayer within Maryland divided by total sales by taxpayer everywhere (this definition is the same as the definition in Section 15 of UDITPA).

[36] Separate accounting is a technique of carving out of the taxpayer's overall business the activities taking place, the property employed, and the income derived from sources within a single state and by accounting analysis ascertaining the profits attributable to that portion of the business. It involves identifying all items of income and costs that are related to the taxpayer's activities within the taxing state and constructing a statewide net income from these items. It is extremely expensive, ignores the interdependence and integration of the business operations conducted in the various states, and desires to treat them as separate, independent, and nonintegrated. This accounting method has become less viable in practice and more dubious in principle. With the enactment by most corporate income tax states of UDITPA and similar statutes, under which business income is usually apportioned and non-business is allocated, this accounting method has generally been abandoned State Taxation, § 8.03. Further, the Supreme Court in *Allied Signal* stated that the "principal virtue of the unitary business principle of taxation is that it does a better job of accounting for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied Signal, Inc. v. New Jersey*, 504 U.S. 768, 783 (1992), quoting *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164-165 (1983).

[37] "Intangible property," pursuant to §12-6-30(12), includes "all property other than tangible property."

doing business in South Carolina.[38] The method's numerator consists of gross receipts from within the state compared to a denominator consisting of gross receipts from everywhere. Both the separate entity apportionment method and the combined entity apportionment method can use either the "three factor apportionment method" or the "gross receipts apportionment method."

To determine the tax of a related entity of a multistate corporation in South Carolina using the separate entity apportionment method, each individual entity must determine a ratio to apply against its taxable income in South Carolina to arrive at a net taxable income. The ratio is determined by dividing each individual entity's gross receipts in this State or the sum of each individual entity's property, payroll and sales within this State, by each individual entity's gross receipts everywhere or the sum of each individual entity's property, payroll and sales everywhere. It then applies this ratio to the entity's taxable income in South Carolina to determine its net taxable income. The corporate tax rate (5%) is then applied to ascertain the tax owed this State.

To determine the tax of a related entity or related entities of a multistate corporation in South Carolina by using the combined entity apportionment method, the individual entity or all related entities (if more than one taxpayer is transacting business in this state), must determine a ratio to apply against its/their taxable income to arrive at its/their net taxable income in South Carolina. The ratio is determined by dividing the gross receipts of all the related entities of the multistate corporation in South Carolina or all the related entities property, payroll, and sales from within South Carolina, by all the related entities gross receipts from everywhere or the related entities property, payroll, and sales from everywhere. The taxpayer (individual entity) then applies this ratio to the entity's taxable income in South Carolina to determine its net taxable income. The corporate tax rate (5%) is then applied to ascertain the tax owed this State.

The parties in this case utilized an example[39] for illustrative purposes during the motion

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[38] See *NCR Corp. v. S.C. Tax Comm'n*, 304 S.C. 1, 9, 402 S.E.2d 666, 671 (1991).

[39] **Unitary Group**

(the unitary group consists of 17 subsidiaries, including three, Corporations A, B, and C, which transact business in South Carolina)

Total combined net taxable income of the Unitary Group = $500,000
Total Gross Receipts of the Unitary Group everywhere = $2,000,000

Total taxable income of A Corp: $60,000

hearing. It contains various assumptions to which the parties applied both South Carolina's standard apportionment method and the combined entity apportionment formula. As seen in the example, there was distortion in excess of **44%** using the standard apportionment method versus the combined entity apportionment formula. The parties stipulated that South Carolina's statutory apportionment method, as applied to the facts in this case, results in an assessment that is **435%** of the income tax and license fees compared to that resulting from the use of the combined entity apportionment method authorized in §12-6-2320(A).

The example reflects that the use of the separate entity apportionment method may at times result in an unreasonable and arbitrary apportionment of income of a multistate corporate taxpayer's in-state activities, thereby violating the constraints established in *Container*. When using the separate entity apportionment method, the single entity's receipts are not combined with other related entities' receipts within the parent multistate corporate entity. Such usage results in a method which is unreasonable in result or arbitrary in application. After all, "the linchpin of apportionability . . . is the unitary business principle."[40]

The Department agrees that its separate entity filing method, as enunciated in Section 12-6-2250, when applied to the multistate operations of Taxpayers, results in distortion in taxing their income in South Carolina. Since both parties agree that the Department's application of its unitary

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Total taxable income of B Corp; $30,000
Total taxable income of C Corp: $80,000

Total Gross receipts of A Corp within SC: $4,000
Total Gross receipts of B Corp within SC: $2,000
Total Gross receipts of C Corp within SC: $15,000

Total Gross Receipts of A Corp from everywhere: $100,000
Total Gross Receipts of B Corp from everywhere: $60,000
Total Gross Receipts of C Corp from everywhere: $200,000

Using the separate entity apportionment method (gross receipts factor formula), the ratio determined for Corp A = 4%, for Corp B = 3.33%, and for Corp = 7.5%. In applying that ratio to the taxable income of each corporation in South Carolina, the net taxable income is $2,400, $999, and $6,000, respectively. The tax is $120.00, 49.95 and $300.00, respectively, with a combined tax on the combined return of $469.95.

Using the combined entity apportionment method (gross receipts factor formula), the combined gross of all three corporations in South Carolina ($21,000), divided by the combined receipts of the unitary group everywhere ($2,000,000), provides the ratio of income generated in South Carolina to all the income generated by the group (1.055%). This ratio equates to the percentage of income generated in South Carolina for the entire group. Applying that ratio to the entire income ($500,000) generated in South Carolina equates to a taxable income allocable to the entire group in South Carolina of $5,250. The tax (5%) on that amount = $262.50.

business apportionment method leads to an unreasonable result for Taxpayers, clearly a different method of apportionment (as required by *Container)*, must be applied.

Department's Position on the Use of the Combined Entity Apportionment Method

The Department's predecessor, the South Carolina Tax Commission, recognized in SCTC Decision 94-1 [issued three years after *NCR Corp.*[41] was decided, but prior to the enactment of Section 12-6-2320(A)(4) in 1995] that the combined entity apportionment method is an acceptable method for apportionment when unitary business principles exist. The decision, which referenced the decision in *Container,* states:

> A state could select the combined report method [combined apportionment method] whereby the entire net incomes of several commonly owned unitary corporations . . . are included in the taxpayer's apportionable unitary net income base. . . . Any of these methods are permitted.

Further, this Court notes that other federal and state court decisions have recognized the combined entity apportionment method as an acceptable unitary formula apportionment method.[42]

The Department has no official written policy or guidance on apportionment and allocation of taxable income for multistate corporations.[43] However, it lists on its website (www.sctax.org) a publication entitled "South Carolina Corporate Income Taxes." This publication, revised through June 10, 2005, was written by William C. West III, a certified public accountant and director with Deloitte & Touche LLP in Columbia, South Carolina, and two Department employees, Rick Handel, Chief Counsel for Policy, and Deana West, Revenue Law Advisor in the Department's Policy Section ("authors"). The publication provides an overview of allocation and apportionment of income by multistate corporations in South Carolina, stating that:

> South Carolina and other states generally use allocation and apportionment to assure they are taxing multistate and multinational corporations on an appropriate amount of

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[40] *Mobil Oil,* 445 U.S. at 439.

[41] 304 S.C. 1, 402 S.E.2d 666 (1991).

[42] *See, e.g., Barclay's Bank PLC v. Franchise Tax Bd.,* 512 U.S. 298 (1949); *Coca Cola Co. v. Department of Revenue,* 271 Or. 517, 533 P.2d 788 (1975); *Leathers v. Jacuzzi, Inc.,* 326 Ark. 857, 935 S.W.2d 252 (1996); *Caterpillar Tractor Co. v. Lenckos*, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981); *American Smelting & Refining Co. v. Idaho State Tax Com.,* 99 Idaho 924, 592 P.2d 39 (1979); *PMD Investment Co. v. State*, 216 Neb. 553, 345 N.W.2d 815 (1984).

[43] This court notes that there are several old South Carolina Tax Commission Decisions (1974 I. D. 179, 88-195, 90-33, and 94-44) and Reg. §117-710.1, which offer some insight to the Department's position.

> income. National policy expressed through the Due Process and Commerce clause of the Constitution prevent[s] states from over taxing multistate and out-of-state businesses. They do this by…limiting states to taxing property, activities or income earned within their geographical limits.[44]

The authors state that a taxpayer transacting or conducting business partly within and partly outside South Carolina is subject to income tax based on the portion of its business carried on in South Carolina. They write that apportionment in South Carolina "is tied to the unitary business concept"[45] and that a state cannot tax value earned outside its boundaries. They cite *Ford Motor Co. v. Beauchamp*[46] for the notion that "[I]n a unitary enterprise, property outside the state, when correlated in use with property within the state, necessarily affects the worth of the privilege within the state." They agree that the privilege of doing business within a state may be made more valuable owing to its being an integral part of a multistate operation. Further, the authors note that a taxing state cannot determine the amount of taxable income subject to taxation until it determines what the taxpayer's trade or business is and whether the taxpayer conducts more than one unitary business or whether it encompasses a group of related corporations. After recognizing the indicia of a unitary multistate business as delineated by the U. S. Supreme Court in *Butler Bros, Container, Mobil, F. W.*

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[44] "South Carolina Corporate Income Taxes," § .05 A. (June 10, 2005) and "South Carolina Corporate Income Taxes Draft," § .05 A. (December 17, 2001). In addition, the authors state in §.05 A. of their publication that state political considerations "generally assure that states do not over tax in-state businesses compared with multistate and out-of-state businesses" and, that a taxpayer "transacting or conducting business partly within and partly outside of South Carolina is subject to income tax based on the portion of its business carried on in South Carolina." They discuss in § .05 A. 1.-4. the various methods for apportionment in this State and write in § .05 A. that the income remaining after allocation is apportioned using one of the following methods:

> (1) A "three factor" apportionment based on property, payroll, and double-weighted sales (normally used by taxpayers whose principal business in South Carolina deals with tangible personal property);
> (2) A "gross receipts" apportionment method (normally used by taxpayers who do not deal with tangible personal property, such as financial businesses and service businesses, contractors and others who install or repair tangible personal property);
> (3) The "special" apportionment method provided for in S. C. Code Section 12-6-2310 (normally used by railroad companies, telephone companies, pipeline companies, airline companies, and shipping lines); and
> (4) An individualized apportionment method as authorized in Section 12-6-2320(4) tailored to a particular business because the normally required method would not fairly represent the extent of the taxpayer's business in South Carolina. (Emphasis added).

[45] Under the unitary business principle, if a taxpayer is carrying on a single "unitary" business within and without the state, the state has the requisite connection to the out-of-state activities of the business to justify inclusion in the taxpayer's apportionable tax base all of the property, income, or receipts attributable to the combined effect of the out-of-state and in-state activities. State Taxation, § 8.07(1).

Woolworth, and Underwood, the authors opine that no method of assigning net income can precisely determine the exact amount of income attributable to any geographic area or to any given part of a series of multistate business operations.

Notwithstanding these principles, the authors state that South Carolina generally treats related corporations as if they were unrelated. They note the various indicia of a unitary business, as determined by the U. S. Supreme Court in numerous decisions.[47] They opine that a corporation can have income which is not connected with a trade or business, and that a corporation can conduct more than one unitary business. However, they state that income and apportionment must be computed separately for each unitary business, citing *Emerson Elec. Co. v. Wasson*[48] as support for the Department's practice in refusing to authorize the use of the combined entity apportionment method by related corporations, even when they are part of one unitary business.

Notwithstanding the Department's practice, the authors state that §12-6-2320(A) is a "relief provision," which provides that if the standard statutory allocation and apportionment provisions do not fairly represent the extent of a taxpayer's business activity, the taxpayer is authorized to petition for or, the Department is authorized to require the taxpayer to, in respect to all or any part of the taxpayer's business activity, use a different method in ascertaining its taxable income. In addition, the authors note that although this type of alternative combined apportionment has been discussed, the Department has never attempted to impose it on a taxpayer over the taxpayer's objection. The authors did not discuss whether any taxpayer has petitioned the Department for its use.

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[46] 308 U.S. 331, 336 (1939).

[47] *Butler Bros. v. McColgan*, 315 U.S. 501, 62 S.Ct. 701 (1942), *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), *Mobil Oil Corp. v. Vermont,* 445 U.S. 425 (1980), *F. W. Woolworth Co. v. New Mexico*, 458 U.S. 354 (1982), and *Underwood Typewriter Co. v. Chamberlain*, 254 U. S. 113 (1920). Also, see *Exxon Corp. v. S. C. Tax Comm'n*, 273 S.C. 594, 258 S.E.2d 93 (1979), where the Supreme Court discusses the characteristics of a business that is unitary in nature, such as unitary ownership, unity of management, and unity of operation as delineated in *Butler Bros*. The Court further cited S. C. Reg. §117.87.17 (since recodified as S. C. Reg. §117.710.1) which provides that a taxpayer that operates a unitary business in South Carolina within and without this state shall be subject to the allocation formula.

[48] *Emerson Elec. Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986). In *Emerson*, a case decided before the enactment of §12-6-2320(4), the court recognized that South Carolina respects separate corporate entities. It found that even though corporations filed a consolidated South Carolina income tax return, they were not to be considered a single entity. They construed the phrase "to impose the tax upon the taxpayers concerned" in former S. C. Code Ann. §12-7-1570 (1976), a provision where the court focused on the use of the term "taxpayers" in the consolidated return, as holding that "the legislature's use of the plural 'taxpayers' instead of 'taxpayer' indicted that corporations filing consolidated returns are not to be considered a single entity."

As stated hereinbefore, the parties agree that that Taxpayers are part of a unitary group,[49] the standard apportionment formula does not accurately reflect Taxpayer's business activities in this state and that its use results in a substantial distortion of Taxpayer's activities in South Carolina, [50] that the combined entity apportionment methodology is an acceptable apportionment method under unitary business principles, accurately reflects Taxpayer's business activities in South Carolina and is not unreasonable or arbitrary in its application, that Taxpayers timely petitioned to utilize the "relief" provisions of §12-6-2320(A), the query for the court is whether the combined entity apportionment method fits the definition of "any other" apportionment method authorized for use by §12-6-2320(A)(4) which provides an equitable allocation and apportionment of Taxpayer's income and, if so, whether §12-6-2320(4) grants to the Department the authority to allow Taxpayers to use the combined entity apportionment methodology.

DOES THE COMBINED ENTITY APPORTIONMENT METHOD QUALIFY AS "ANY OTHER METHOD" UNDER S. C. CODE ANN. § 12-6-2320(A)(4) and, DOES IT EFFECTUATE AN EQUITABLE ALLOCATION AND APPORTIONMENT OF TAXPAYER'S TAXABLE INCOME?

Section 12-6-2320(A) was passed by South Carolina's General Assembly in 1995. It allows for the use by a taxpayer of "any other method" to equitably allocate and apportion the taxpayer's income in order to fairly represent its business activities in South Carolina. Prior to 1995, the only relief under §12-6-2350 was separate accounting.

While not reflected in so many words in the statute, it is clear that the intent of the General Assembly when it enacted the general allocation and apportionment provisions was to allow taxpayers to reasonably and fairly apportion their taxable income to fairly reflect their business activity in South Carolina. That intent is further confirmed by the General Assembly through its adoption in 1995 of the "relief provision" in §12-6-2320(A) which allows alternative methods of apportionment. The language used by the legislature in adopting the "relief provision" of §12-6-2320(A) is simple and easily discernible--it allows the use of "<u>any other method</u>" to effect an

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[49] Stipulations #10 and #11.

[50] Stipulation # 37. The statutory apportionment method ("separate entity apportionment method") utilized by the Department results in income tax and license fees in the amount of $3,758,320 whereas the "combined entity apportionment method" results in income tax and license fees in the amount of $863,179.

equitable result. The word "any" is defined as "[o]ne or another without restriction or exception."[51] The General Assembly, in enacting this statutory provision, did not limit which apportionment method a corporate taxpayer could utilize to equitably apportion its income.

Courts are required to read the language of a statute in light of its intended purpose. Clearly, the purpose of §12-6-2320(A) is to provide equitable apportionment relief when the general apportionment and allocation methods do not fairly represent the business activities of a taxpayer in South Carolina.

Both parties have agreed that 1) in the current case, the business activities of Taxpayers in South Carolina are not fairly represented through the use of South Carolina's general apportionment and allocation methods; 2) that the provisions of §12-6-2320(A) are applicable; and, 3) that the combined entity apportionment method results in equitable apportionment.[52] It is axiomatic that the combined entity apportionment method was contemplated by the General Assembly as "any other method" which may be used to equitably allocate and apportion a taxpayer's income in order to fairly represent the taxpayer's business activities in South Carolina.

Furthermore, §12-6-2320(A) is the same, word for word, as Section 18 of the Uniform Division of Income for Tax Purposes Act ("UDITPA"). The drafters of UDITPA intended that tax administrators would have broad authority and wide latitude in fairly apportioning income. Section 18 of UDITPA specifically provides for "separate accounting;" however, it remains silent as to the use of the combined entity apportionment method. William Pierce, one of the drafters of UDITPA, writes:

> Section 18 is a general section which permits the tax administrator to require, or the taxpayer to petition, **for some other method of allocating and apportioning the income where unreasonable results ensue from the operation of the other provisions of the act.** This section necessarily must be used where the statute reaches arbitrary or unreasonable results so that its application could be attacked successfully on constitutional grounds. Furthermore, it gives both the tax collection agency and the taxpayer some latitude for showing that for the particular business activity, some more equitable method of allocation and apportionment could be achieved. Of course departures from the basic formula should be avoided except where reasonableness requires. (Emphasis added)

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[51] Webster's II New College Dictionary 51 (2001).

[52] Stipulations #36-38.

William J. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 781 (Oct. 1957).

Notwithstanding the adoption by South Carolina's General Assembly of Section 18 of UDITPA, the Department contends it does not have statutory authority to allow the usage of the combined entity apportionment method as requested by Taxpayers. It submits that the legislature must specifically direct it to allow the usage of this method.

The Arkansas Department of Finance and Administration in *Leathers v. Jacuzzi, Inc.*,[53] adopted a similar position as the Department. Although Arkansas' legislature had adopted verbatim the provisions contained in Section 18 of UDITPA, its revenue department subsequently disallowed a request by taxpayer and its wholly owned subsidiary to use combined income tax reporting method, asserting that its policy prohibited such. An administrative law judge heard the matter and held that the statutory provision permitted the revenue department to accept combined reporting by a taxpayer that was part of a unitary business; however, he found for the revenue department, holding that its policy did not allow it to accept combined reporting. On appeal, Arkansas' Supreme Court stated that the statutory provision was a discretionary provision upon which combined reporting could be allowed. It noted that the method had been allowed by a number of states that had adopted UDITPA. The court also held that the statute did not prevent the use of the combined apportionment method. Further, although it found that the statute did not contain an express authority allowing the use of the combined apportionment method, it held that such mandate did not prevent Arkansas' revenue department from authorizing its use. The *Leathers* court cited *Caterpillar*[54] for the holding that the absence of a specific directive to the taxing authority is not required for the taxing state to authorize the combined entity apportionment method:[55]

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[53] *Leathers v. Jacuzzi, Inc.,* 326 Ark. at 857, 935 S.W.2d at 252. The court noted that in a combined report, the combined income of the affiliated group is not computed for the purpose of taxing such income, but rather as a basis for determining the portion of income from the entire unitary business attributable to sources within the state which is derived by members of the group subject to the state's jurisdiction. It also noted that a combined report is an accounting method whereby each member of a group carrying on a unitary business computes its individual taxable income by taking a portion of the combined net income of the group. It stated that a consolidated return is a taxing method whereby two corporations are treated as one taxpayer.

[54] *Caterpillar Tractor Co. v. Lenckos*, 84 Ill. 2d 102, 49 Ill. Dec. 329, 417 N.E.2d 1343 (1981).

[55] *Leathers*, 935 S.W.2d at 252.

The absence of specific reference to the unitary method is not, however, critical, for in a number of jurisdictions that adopted UDITPA, courts have held that unitary apportionment or combined reporting was authorized though the particular income tax statute made no reference to this method of reporting.

In *Coca Cola Co. v. Department of Revenue,*[56] the Oregon Department of Revenue applied a combined apportionment method of accounting to the income tax returns of the plaintiff corporation and its wholly owned subsidiaries The court held that its apportionment statute (an adoption of UDITPA's language) more accurately reflected the income of the unitary business operation. The Oregon court also held that the company's syrup and bottling operations were so inextricably connected as to constitute a unitary business, stating: "The combined method of apportionment reporting is wholly consistent with, and a natural extension of, the apportionment method."[57] (Emphasis added).

The U. S. Supreme Court in *Butler Bros. v. McColgan*[58] held that the absence of any statutory reference to the unitary method of reporting did not forbid its use. In that case, the plaintiff was an Illinois corporation that was licensed to conduct business in California. It conducted a wholesale goods and general merchandise business and had wholesale distributing divisions located in seven states, including California. Although California's tax statute did not specifically authorize the combined method of reporting, or make any references to unitary operations, the court upheld California's decision to apply the unitary method to the combined income derived from the operations of plaintiff's seven divisions. In its holding, the court noted that unity of the use and management of a business which is scattered through several states may be considered when a state attempts to impose a tax on an apportionment basis.

In *Commonwealth v. General Electric Co*. and *Ward Europa v. Controller of the Treasury,*

[56] 271 Or. 517, 533 P. 2d 788 (1975). The legislature in Oregon had adopted Section 18 of UDITPA.

[57] Id. at 529, 533 P. 2d at 794.

[58] 315 U.S. 501, 62 S.Ct. 701 (1942).

cases heard by the Supreme Court of Virginia and the Court of Appeals in Maryland, respectively,[59] the courts issued rulings similar to that of the Arkansas Supreme Court in the *Leathers* case. The revenue department in both states argued that the standard three-factor formula did not accurately reflect income and, since the subsidiary corporations and the parent corporation were part of a unitary business, it should be able to combine the factors of the parent and the subs for purposes of calculating state income taxes. The courts in both states agreed.

Applying these principles to the case at hand, this Court finds that the combined entity apportionment approach, an accounting method which apportions the individual income of a taxpayer by considering the net income and apportionment factors of the combined group, qualifies as and is contemplated as "any other method" as delineated in §12-6-2320(A)(4).[60] However, even assuming that the statute is ambiguous, the court nevertheless finds that the resolution of the ambiguity must still lead to the same conclusion. The court finds that the Department's assertions that South Carolina's Income Tax Act refers to the term "taxpayer" in the singular and that the allowance of the combined entity apportionment method might allow taxpayers to run afoul of the consolidated return statute are without merit. In *Coca Cola Co. v. Department of Revenue*, the court noted that although the applicable statute spoke of the taxpayer in the singular, the statutory language was no bar to the use of the using the combined entity method. Likewise, I find no bar to use of the combined entity method in this instance. To adopt the Department's assertion would run afoul of the General Assembly's intent to provide relief to taxpayers who would otherwise be required to use a reporting method which distorts the taxpayer's business activities in this State.

The U.S. Supreme Court and other state courts have recognized the combined entity apportionment methodology as an acceptable means of apportioning taxpayer's income.[61] Since the

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[59] *Commonwealth v. General Electric Co.*, 236 Va. 54, 372 S.E.2d 599 (1988); *Ward Europa v. Controller of the Treasury*, 66 Md. App. 332, 503 A.2d 1371 (1986).

[60] As stated in *Chesapeake Indus. v. Comptroller*, 59 Md. App. 370, 376, 475 A.2d 1224, 1227 (1984), "in a combined report . . . the combined income of the affiliated group is not computed for the purpose of taxing such income, but rather as a basis for determining the portion of income from the entire unitary business attributable to sources within the state which is derived by members of the group subject to the state's jurisdiction." As noted by one of the drafters of UDITPA, "Nonetheless, some alternative method must be available to handle the constitutional problem as well as the unusual cases, because no statutory pattern could ever resolve satisfactorily the problems for the multitude of taxpayers with individual business characteristics." Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 781 (1957).

[61] *Barclay's*, 512 U.S. at 298, *Coca Cola*, 271 Or. at 517, 533 P.2d at 788; *Leathers*, 362 Ark. at 857, 935 S.W.2d at 252; *Caterpillar*, 84 Ill. 2d at 102, 417 N.E.2d at 1343; *American Smelting*, 99 Idaho at 924, 592 P.2d at 39.

Department agrees that this is an apportionment methodology, since the U.S. Supreme Court and other state courts have allowed the utilization of this method, and since this court finds §12-6-2320(A)(4) must be interpreted broadly in accordance with the comments provisions to Section 18 of UDITPA, this Court finds that the combined entity apportionment qualifies as "any other [apportionment] method" under § 12-6-2320(A)(4).

In addition, Taxpayers and the Department agree that the utilization of the combined entity apportionment methodology in the current factual circumstances effectuates an equitable allocation and apportionment which reasonably reflects each Taxpayer's South Carolina taxable income.[62]

Secondly, the question is whether the combined entity apportionment method is equitable. The Department determined in SCTC Decision 94-1 and the Supreme Court held in the 1991 *NCR Corp*. case[63] that the determination of taxable income is limited to a consideration of the factors contained within a separate corporate entity. However, the court noted that if there had been a distortion in the application of the apportionment methods, it would have authorized the use of another entity's apportionment factors in equitably apportioning the taxpayer's taxable income. The Court stated:

> Because the trial court did not adequately consider this disproportionality issue, we remand this case . . . for a re-factoring of the formula, considering in the formula denominator the proportionate measure (as determined by the trial court led by the broad guidelines set out in this opinion) of the foreign subsidiaries' property, payroll, and sales. . . . .[64]

The Court was clear that, although the combined entity apportionment method utilizes the income and apportionment factors of other unitary entities, the combined apportionment computations equitably determine each individual member's taxable income attributable to South Carolina activities.[65] Unlike consolidated filings, the unitary group is not treated as one taxpayer but rather the combined apportionment computations consider the unquantifiable flows of values among the unitary group to fairly apportion each individual member's taxable income attributable to the taxing jurisdiction of South Carolina.

The separation of unitary business activities into separate legal entities operating in South

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[62] Stipulations of Fact #37-38.

[63] *NCR Corp. v. S.C. Tax Comm'n*, 304 S.C. 1, 9, 402 S.E.2d 666, 671 (1991).

[64] Id. at 14.

[65] See *Chesapeake*, 59 Md. App. at 370, 376, *Caterpillar Tractor*, 289 Or. at 895, 896,

Carolina has resulted in an unreasonable apportionment of Taxpayers' income to South Carolina by the Department, although the activities of Taxpayers in South Carolina have not changed. The business of all the corporations, both the parent and its subsidiaries, are all part of the same unitary operation which consists of newspapers, television stations, and interactive media. Each constitutes an inseparable portion of a business carried on within and without the State of South Carolina. The businesses of all the corporations are so inextricably connected to the parent corporation that to state that the profits of one were not dictated by the operations of the other would be inconceivable. They are all part of one business and are all owned and managed under one centralized system. As stated by Keesling, "Simply stated, the purpose of the combined report is to insure that the income of a business conducted partly within and partly without the taxing state shall be determined and apportioned in the same manner regardless of whether the business is conducted by one corporation or by two or more affiliated corporations."[66]

The Court finds that the combined entity apportionment method results in a reasonable apportionment of each Taxpayers' taxable income based on its South Carolina business activities and is consistent with the definition of taxpayer in S.C. Code Ann. § 12-6-30(1) as only the income of individual taxpayers subject to the taxing jurisdiction of South Carolina are taxed.[67]

SOUTH CAROLINA'S LONGSTANDING AGENCY INTERPRETATION:

General Law

The Department asserts that its long-standing interpretation and policy that the combined entity apportionment method cannot be used because there is no express directive in the statute authorizing its use should be adopted by this Court. Further, the Department asserts that it has never applied the combined entity apportionment method, even when the standard method resulted in a lower tax liability. It contends that it has consistently applied the statute in a particular manner and that its construction of §12-6-2320 should not be overturned. See *S.C. Cable Television Ass'n v. Southern Bell Tel. & Tel. Co.,* 308 S.C. 216, 417 S.E.2d 586 (1992) (holding that where an

[66] Keesling & Warren, California's Uniform Division of Income for Tax Purposes Act (Part I), 15 UCLA L. Rev. 156 (1967).

administrative agency has consistently applied a statute in a particular manner, its construction should not be overturned absent cogent reasons); see also *Emerson Electric Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986).

A court "generally gives deference to an administrative agency's interpretation of an applicable statute or regulation." Such deference is tempered, or even eliminated, under a variety of circumstances. For example, "Where, as here, the plain language of the statute is contrary to the agency's interpretation, the Court will reject the agency's interpretation."[68] Further, although the construction of a statute by the officials charged with its administration, which has been acquiesced in by the legislature for a long period of time, should be given great weight, the final responsibility for the interpretation of the law rests with the courts. *Etiwan Fertilizer Co. v. S.C. Tax Commission*, 217 S.C. 354, 60 S.E.2d 682 (1950). "At most, administrative practice is a weight in the scale, to be considered, but not to be inevitably followed. * * * While we are of course bound to weigh seriously such rulings, they are never conclusive."[69]

Finally, administrative agency interpretations are not given deference where the statutory language is unambiguous. "Executive construction is usually and properly restricted to cases in which the meaning of the statute is really doubtful, there being no occasion for it where the language of the statute is plain and unambiguous and conveys a clear and definite meaning." *Davidson v. Eastern Fire & Casualty Ins. Co.,* 245 S.C. 472, 141 S.E.2d 135 (1965). citing *Glens Falls Ins. Co. v. City of Columbia,* 242 S.C. 237, 130 S.E.2d 573 (1963).

The level of deference afforded an agency also varies according to whether the agency's interpretation is formally promulgated. The rule was clearly stated in *S. C. Dep't of Motor Vehicles v. Lajuenesse* [70] as follows:

> The level of deference that should be accorded an agency's interpretation of a statute often depends on its form – for example, whether the interpretation is a binding norm or a general statement of policy. When the agency's interpretation is validly promulgated as a regulation, it has the force and

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[67] The combined apportionment method is also consistent with the legislative intent of §§ 12-6-2210(B) and 2320(A) in reasonably and fairly apportioning Taxpayers' income to South Carolina.

[68] *Brown v. Bi-Lo, Inc.*, 354 S.C. 436, 581 S.E.2d 836, 838 (2003).

[69] *Stone Mfg. Co. v. S. C. Employment Security Comm'n*, 219 S.C. 239, 64 S.E.2d 644, 648 (1951).

[70] *S. C. Dep't of Motor Vehicles v. Lajuenesse*, 2008 WL 1740063 (S.C. Admin. Law Ct. 2008). See also Randolph R. Lowell, *South Carolina Administrative Practice and Procedure*, at 15-16 (2d ed. 2008).

> effect of law . . . "[W]hether an agency's action or statement amounts to a rule - which must be formally enacted as a regulation - or a general policy statement - which does not have to be enacted as a regulation - depends on whether the action or statement establishes a binding norm." . . . When an agency's interpretation is not a binding norm, but simply a general policy statement, it is less clear what deference, if any it should be given. (Citations omitted.)

Furthermore, departmental staff determinations are not entitled to deference. In *Seigfried v. S. C. Dep't of Revenue,* 2003 WL 24004736 (S.C. Admin. Law Judge Div. 2003), the Court stated:

> Consequently, the Department established an interpretation of its statutes through its Revenue Ruling and is entitled to most respectful consideration. However, individual members of the Department's staff do not set policy for the Department and thus a staff member's treatment of what is "timely" in an application protest is not entitled to deference.

See also *S.C. Coastal Conservation League v. S.C. Dep't of Health & Envtl. Control*, 363 S.C. 67, 75, 610 S.E.2d 482, 486 (2005) (noting that courts should give deference to the policy decisions and regulatory interpretations of the Coastal Zone Management Appellate Panel of the Department's Office of Ocean and Coastal Resource Management (OCRM), but not to such decisions and interpretations of OCRM staff); Clarendon *County Memorial Hospital v. DHEC,* 2006 WL 1430090 (S.C. Admin. Law Ct. 2006) (internal staff memoranda which were not promulgated as regulations or adopted by the DHEC Board were not binding on the Court).

Finally, South Carolina courts have also typically held that little weight is due to an agency's statutory interpretation when the issue is the scope of the agency's own power.[71]

The Department's interpretation espoused herein has not been reduced to writing in the form of a binding regulation, revenue ruling or procedure. The Department's only published authority is contained in the publication listed on its website which endorses the use of the combined entity apportionment method. See South Carolina Corporate Income Taxes, www.sctax.org. Although the Department issued a policy document (S.C. Rev. Proc. 95-4) shortly after the enactment of § 12-6-

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[71] See *Captain's Quarters Motor Inn, Inc. v. S.C. Coastal Council*, 413 S.E.2d 13, 14-15 (1992) (holding that agency violated statute requiring it to promulgate regulations for evaluating permits; giving no express weight to agency's presumable view that it was in compliance with statute); *Charleston Television, Inc. v. S.C. Budget & Control Bd.*, 392 S.E.2d 671, 674-75 (1990) (holding that agency regulation, as applied in that case, exceeded agency's statutory authority; giving no express weight to agency's apparent view that its regulation was authorized under statute); *Milliken & Co. v. S.C. Dep't of Labor*, 269 S.E.2d 763, 763-65 (1980) (holding that Department of Labor regulations exceeded its rule-making power; giving no express weight to agency's apparent view that its regulations were authorized by statute).

2320, the document is silent as to the issue in this case.

The Department asserts that its interpretation of §12-6-2230 is also based in part on two cases, NCR *Corp. v. S.C. Tax Comm'n*, 304 S.C. 1, 9, 402 S.E.2d 666, 671 (1991) (the 1991 *NCR* case) and *NCR Corp. v. S.C. Tax Comm'n*, 312 S.C. 52, 439 S.E.2d 254 (1993) (the 1993 *NCR* case), which involved the application of South Carolina's apportionment statutes. In each case, the Supreme Court declined to embrace the combined entity apportionment method. In the 1991 *NCR* case, the South Carolina Tax Commission (now the Department) sought to include royalty income and interest that the parent corporation, NCR, received from its foreign subsidiaries. The Court rejected NCR's claim, noting that each of the statutory sections defining the ratio of property, payroll, and sales used the singular word "taxpayer."[72] Citing *Emerson Elec. Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986), the court found that parent and subsidiary corporations are not to be considered a single entity for purposes of apportionment if they file a consolidated return. The court held that "[B]ecause NCR is the only 'taxpayer' involved in this case, the apportionment statute contemplates that only its factors of property used, payroll paid and sales made are relevant for inclusion in the denominator of the apportionment function." [73] The 1993 NCR case also involved the representation of NCR's subsidiaries' payroll, property, and sales in the apportionment formula, focusing primarily on whether the tax imposed was "grossly disproportionate" to the business transacted by NCR in South Carolina. NCR argued that royalty and interest income paid by all of its foreign subsidiaries should be combined and then divided by the combined income of all the subsidiaries to determine the proportionate contribution of sales, property, and payroll of foreign subsidiaries to be included in the factors to determine if distortion was present. The South Carolina Tax Commission, however, contended that the calculation was to be made separately for each subsidiary and each separate amount added to the denominator of the apportionment formula. In its opinion, the court stated that the Tax Commission's method of calculation was the better approach since it was consistent with general tax principles. It found that the forty-four subsidiaries were to be

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[72] §12-6-2280 reads as follows: "The sales factor is a fraction in which the numerator is the total sales of the taxpayer in this State during the taxable year and denominator is the total sales of the taxpayer everywhere during the taxable year." (Emphasis added). The remaining apportionment statutes contain similar verbiage.

[73] *NCR Corp.*, 304 S.C. at 6.

treated as separate entities for tax purposes.[74]

I find that both the 1991 and the 1993 *NCR* cases are distinguishable from the present matter. Both were decided prior to the enactment of §12-6-2320 and their analyses were based on the general apportionment statutes in effect at the time. The Court notes that in the 1991 *NCR* case the Supreme Court determined that factors of other entities could be considered if distortion existed and it remanded the case for consideration of all relevant factors for distortion. It is probable that if the 1991 and the 1993 *NCR* cases were decided today and distortion was found, the Supreme Court would decide differently based on the "relief provision" found in the 1995 enactment.

The Department's policy contravenes the express language of the statute and is not entitled to deference. Further, I find that the plain language of the statute is contrary to the Department's interpretation.

CONCLUSION

The language used by the legislature in adopting the relief provision in §12-6-2320(A) is simple and easily discernible. The statute allows for the use of "any other method" to effect an equitable result in the event that distortion occurs. The Department's interpretation would thwart legislative intent clearly expressed in the general allocation and apportionment statues, would deny Taxpayers the equitable relief intended by the legislature when it enacted §12-6-2320(A), and would leave Taxpayers with an unreasonable and arbitrary apportionment of their taxable income in this state. .

Accordingly, I conclude that the combined entity apportionment method of reporting by a multi-state corporate taxpayer is contemplated by §12-6-2320(A)(4). Based upon the parties' stipulations that substantial distortion of the taxpayers' income in South Carolina results by using the standard apportionment formula and that the use of the combined entity apportionment formula is reasonable because it fairly represents the extent of the Taxpayers' business activities in South Carolina, and based upon the analysis of case law and the discussion herein, the Court finds and concludes that the Department is authorized to allow the Taxpayers to use the combined entity

[74] Note that both of the *NCR* cases were decided after *Container Corp.* In the first case, the court stated that the *Container* case specifically recognized that both separate entity apportionment and combined entity apportionment were

apportionment method to determine their taxable income in South Carolina for the years at issue in this matter. Further, I find that any tax, interest, or penalties owed by Taxpayers must be determined by utilizing the combined apportionment method of accounting.

ORDER

Accordingly, it is hereby

ORDERED that the Petitioners' Motion for Summary Judgment is GRANTED; and it is further

ORDERED that the Department's Motion for Summary Judgment is DENIED.

AND IT IS SO ORDERED.

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Marvin F. Kittrell
Chief Judge

May 4, 2009
Columbia, South Carolina

permissible methods of calculating income as a general matter, but that South Carolina had chosen to use separate entity apportionment to determine income.