STATE OF NORTH CAROLINA COUNTY OF WAKE	GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 19-CVS-_____
MONARCH TAX CREDITS, LLC, formerly known as STATE TAX CREDIT EXCIIANGE, LLC Plaintiff-Petitioner, v. NORTH CAROLINA DEPARTMENT OF REVENUE and RONALD G. PENNY, SECRETARY, in his official capacity, Defendants-Respondents.	**PETITION FOR JUDICIAL REVIEW AND COMPLAINT FOR DECLARATORY RELIEF AND DAMAGES ARISING FROM CONSTITUTIONAL VIOLATIONS**

Plaintiff-Petitioner Monarch Tax Credits, LLC, formerly known as State Tax Credit Exchange, LLC ("Monarch"), appearing by and through the undersigned counsel, hereby respectfully submits this petition for judicial review of the denial by Defendants the North Carolina Department of Revenue and Ronald G. Penny, Secretary of Revenue (collectively, the "NCDOR") of Monarch's request for a declaratory ruling and complaint for constitutional violations. Monarch alleges the following:

INTRODUCTION

1. This action arises from an executive agency, NCDOR, overreaching its authority and attempting to make, rather than administer and interpret, tax law pertaining to investments in renewable energy tax credits, mill restoration tax credits, and historic redevelopment tax credits in North Carolina.

2. The General Assembly created these tax credits and established the ability of taxpayers to claim these credits when they are members of partnerships or other pass-through entities which invest in qualifying projects.

3. Notably, with respect to these credits, the General Assembly chose not to adopt federal tax law concerning when a taxpayer is a partner for purposes of claiming tax credits for federal income tax purposes. Accordingly, North Carolina law alone establishes when a taxpayer is entitled to claim state renewable energy tax credits, mill restoration tax credits, and historic redevelopment tax credits.

4. As described below, NCDOR has engaged in conduct, which, if not addressed, would effectively rewrite North Carolina tax law by both adopting and then misapplying federal tax law that the General Assembly chose not to adopt.

5. The NCDOR's conduct includes initiating burdensome and needlessly drawn-out audits of Monarch's customers, who invested in renewable energy, mill restoration, and historic redevelopment projects in this state through Monarch-sponsored partnerships, and, in the few circumstances when it has issued a decision, denying tax credits to those customers based on NCDOR's attempt to adopt and misapply federal tax law. This course of action has damaged Monarch's ability to remain in business in North Carolina.

6. NCDOR's conduct also includes issuing in 2018 a written "Important Notice: Tax Credits Involving Partnerships" that purports to exercise lawmaking functions belong exclusively to the North Carolina General Assembly. This Notice

effectively denies Monarch the ability to facilitate customer investments that will result in those customers receiving tax credits.

7. Monarch operates a renewable energy, mill restoration and historic rehabilitation tax credit investment business. NCDOR's actions as described herein have severely injured that business and have effectively foreclosed Monarch from continuing to do business in North Carolina.

8. As a result, among other things, Monarch sent to NCDOR a request for declaratory ruling pursuant to N.C. Gen. Stat. § 150B-4, which is a process created by the General Assembly whereby the validity of a rule adopted by an executive branch agency can be questioned and challenged.

9. This action arises from NCDOR's refusal to issue the declaratory ruling and thereby attempting to avoid having its unconstitutional and unlawful rule scrutinized by this Court. Rather than complying with the statutorily-established procedure allowing members of the public to request a declaratory ruling from an agency of state government, NCDOR called the use of that statute a "weapon against the Department" and refused to comply with the request.

10. In this action, Monarch also seeks to recover appropriate relief for NCDOR's violations of the North Carolina Constitution, which have injured and continue to injure Monarch.

THE PARTIES, JURISDICTION, AND VENUE

11. Monarch is a limited liability company organized and existing pursuant to the laws of the State of Georgia, with a principal office in Georgia, as well as an

office in Charlotte, North Carolina and staff working and living in Chapel Hill, North Carolina.

12. Secretary Ronald G. Penny, sued herein only in his official capacity, is the Secretary of NCDOR.

13. NCDOR is a state government agency tasked with applying and enforcing (but not enacting) the tax laws passed by the General Assembly and signed into law by the Governor.

14. Monarch has no adequate administrative remedy for the violation of its rights by the Respondents described in this Petition for Judicial Review, and this Court has jurisdiction over the subject matter of this action pursuant to N.C. Gen. Stat. §§ 150B-4, 150B-43 and 150B-45, as shown more fully in the facts alleged herein.

15. This Court also has jurisdiction over the subject matter of this action pursuant to *Corum v. University of North Carolina*, 330 N.C. 761, 413 S.E.2d 276 (1992), which authorizes a direct cause of action to address violations of the North Carolina Constitution.

16. This Court possesses personal jurisdiction over the parties to this matter.

17. Venue is proper in this court.

THE CONSTITUTIONAL MANDATE THAT STATE TAX LAW MUST ORIGINATE IN THE GENERAL ASSEMBLY

18. Article I, Section 6 of the North Carolina Constitution provides, "The legislative, executive, and supreme judicial powers of the State government shall be forever separate and distinct from each other."

19. Under Article II of the North Carolina Constitution, lawmaking is a legislative function solely to be exercised by the General Assembly in accordance with legislative determinations of the public interest and sound policy.

20. Article II, Section 23 and Article V of the North Carolina Constitution establish the power to make tax law as a legislative function and the province of the General Assembly.

21. Article V, Section 2(1) of the North Carolina Constitution mandates that "[t]he power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away."

22. These provisions prohibit the General Assembly from surrendering to the federal government the power to make or change North Carolina state tax law.

23. The General Assembly may adopt an existing provision of federal Internal Revenue Code (the "Code") if it chooses to do so, but as our Supreme Court has held, the general rule is that, without a "[c]lear and specific reference" in Chapter 105 invoking the Code, the Code has no application with respect to North Carolina tax law. *Fidelity Bank v. N.C. Dep't of Revenue*, 370 N.C. 10, 19, 803 S.E.2d 142, 149-150 (2017).

24. Indeed, Chapter 105 of the North Carolina General Statutes separately uses the term "the Code" approximately 333 times, generally for the purpose of adopting a specific provision of the Code, but never once for the purpose of adopting it wholesale.

25. Article II, Section 5(4) of the North Carolina Constitution provides for the executive branch to execute the law.

26. Section 105-264 of the General Statutes confirms the power of NCDOR to administer and interpret laws, but as a matter of constitutional law, NCDOR cannot enact laws and cannot adopt rules that have the effect of exercising the exclusive lawmaking power of the General Assembly.

27. As is described below, NCDOR has failed to observe these constitutional limitations on its authority.

THE GENERAL ASSEMBLY ENACTED TAX LAWS THAT GRANT TAX CREDITS FOR INVESTMENT IN SOCIALLY DESIRABLE PROJECTS

28. The General Assembly, exercising its lawmaking authority, enacted statutes designed to encourage private investment in renewable energy projects, mill restoration projects, and historic rehabilitation projects. Those statutes award North Carolina taxpayers tax credits against their North Carolina income tax in proportion to those taxpayers' investments in qualifying renewable energy projects and historic mills rehabilitation projects.

North Carolina's Renewable Energy Tax Credit

29. Enacted in 1999, North Carolina's Renewable Energy Tax Credit is set out at N.C. Gen. Stat. § 105-129.16A.

30. The legislative history demonstrates that the General Assembly enacted the Renewable Energy Tax Credit, at least in part, to:

a. Promote development of indigenous energy sources;

b. Keep more energy-related dollars in the local economy,

c. Improve local air quality;

d. Reduce carbon emissions; and

e. Create jobs and sustainable development.

31. The General Assembly determined that "tax incentives can help stimulate the demand for environmentally sound, renewable energy options, help grow the solar industry in our State, produce a stronger local economy, and allow North Carolina to continue to grow but in a sustainable manner." H.R. 1472, 99th Sess. (N.C. 1st ed. May 13, 1999).

32. N.C. Gen. Stat. § 105-129.16A allows a tax credit to be claimed for thirty-five percent (35%) of the cost of renewable energy property constructed, purchased or leased by a taxpayer and placed into service in North Carolina during a taxable year.

33. The credit is designed to stimulate investment in and development of equipment related to solar, wind, hydroelectric, biomass, geothermal and certain biofuel energy sources.

34. For business-purpose renewable energy systems, the credit is taken in five equal installments beginning with the year in which the property is placed in service. If the credit is not used entirely during these five years, the remaining amount may be carried forward for the next five years. The credit may not be carried back.

35. Pursuant to N.C. Gen. Stat. §§ 105-129.16A(f) and (g), the Renewable Energy Tax Credit applies to renewable energy property placed into service prior to either January 1, 2016 or January 1, 2017, depending on whether certain delayed subset provisions are met.

North Carolina State Historic Tax Credits and Mill Rehabilitation Credits

Article 3D Credits

36. The General Assembly has authorized taxpayers to claim State Historic Tax Credits pursuant to Chapter 105, Articles 3D, 3H, and 3L of the North Carolina General Statutes.

37. The original State Historic Tax Credit is set out in Article 3D. The credit permitted a taxpayer to claim 20 percent of most qualified rehabilitation expenditures ("QREs") or 40 percent of QREs related to a former state training school for juvenile offenders. Article 3D credits were taken in five equal installments, beginning in the year in which the property was placed in service.

38. Pursuant to N.C. Gen. Stat. § 105-129.39, Article 3D has expired for QREs incurred on or after January 1, 2015 or for QREs incurred before that date if the related property is not placed in service by January 1, 2023

39. Pursuant to N.C. Gen. Stat. § 105.35(b), a pass-through entity could allocate the Article 3D credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the certified historic structure is placed in service was at least forty percent (40%) of the amount of credit allocated to that owner.

Article 3H Credits

40. Enacted to address the closure of significant numbers of textile, tobacco, and furniture plants, the State Mill Rehabilitation Tax Credit is set out in Article 3H. This credit permitted up to a forty percent (40%) state tax credit for the "certified rehabilitation" of income-producing historic structures. It is also subject to the requirement that, in the case of the receipt of the tax credit through a pass-through entity, the recipient must have a federal tax basis in the pass-through entity at least equal to forty percent (40%) of the tax credits received as of the end of the year in which those credits were received. The Article 3H credit is allocable among the members of the pass-through entity as agreed to by its members.

41. Pursuant to N.C. Gen. Stat. § 105-129.75, the Article 3H State Mill Rehabilitation Tax Credit has the same expiration dates as the original Article 3D State Historic Tax Credit.

42. Pursuant to N.C. Gen. Stat. § 105-129.72(b), the Article 3H State Mill Rehabilitation Tax Credit has similar allocation provisions for pass-through entities as the original Article 3D State Historic Tax Credit.

Article 3L Credits

43. Article 3L codifies the State Historic Rehabilitation Tax Credits Investment Program, which provides for a new tax credit for historic rehabilitation. It became effective January 1, 2016 and sunsets January 1, 2020. These Article 3L credits have the same forty percent (40%) basis rule as the Article 3H State Mill Rehabilitation Tax Credit.

44. The State Historic Rehabilitation Tax Credits Investment Program provides for tiered base credits and bonus credits.

45. Pursuant to N.C. Gen. Stat. § 105-129(b), Article 3L credits are subject to similar allocation provisions by pass-through entities as Article 3D and 3H credits.

THE GENERAL ASSEMBLY HAS MADE THE LEGISLATIVE DETERMINATION THAT PARTNERS MAY RECEIVE ALLOCATIONS OF PARTNERSHIP TAX CREDITS

46. N.C. Gen. Stat. § 105-269.15, titled "Income tax credits of partnerships" provides as follows:

> (a) Qualification. - A partnership that engages in an activity that is eligible for a tax credit qualifies for the credit as an entity and then passes through to each of its partners the partner's distributive share of the credit for which the partnership entity qualifies. Maximum dollar limits and other limitations that apply in determining the amount of a tax credit available to a taxpayer apply to the same extent in determining the amount of a tax credit for which the partnership entity qualifies, with one exception. The exception is a limitation that the tax credit cannot exceed the amount of tax imposed on the taxpayer.
>
> (b) Allowance of Credit to Partner. - A partner's distributive share of an income tax credit passed through by a partnership is allowed to the partner only to the extent the partner would have qualified for the credit if the

> partner stood in the position of the partnership. All limitations on an income tax credit apply to each partner to the extent of the partner's distributive share of the credit, except that a corporate partner's distributive share of an individual income tax credit is allowed as a corporation income tax credit to the extent the corporate partner could have qualified for a corporation income tax credit if it stood in the position of the partnership. All limitations on an income tax credit apply to the sum of the credit passed through to the partner plus the credit for which the partner qualifies directly.
>
> (c) Determination of Distributive Share. - A partner's distributive share of an income tax credit shall be determined in accordance with sections 702 and 704 of the Code.

47. Section 105-134.1(7a) of the North Carolina General Statutes, in turn, defines a "partner" under North Carolina state law to include a member in limited liability company.

48. Of significance to the present dispute, Section 105-269.15 does not define the term "partnership" by referring to federal law generally. Rather, Section 105-269.15 provides only, at subsection (c), that a partner's distributive share of a tax credit shall be determined in accordance with federal Code sections 702 and 704. Thus, North Carolina has adopted the federal tax code *only* for purposes of determining federal Adjusted Gross Income and that North Carolina has *not* made a wholesale adoption of federal income tax definitions and principles.

49. Notably, the General Assembly chose to adopt Code sections 702 and 704, but chose not to adopt Code section 707.

50. Section 707 re-characterizes an otherwise permissible allocation of property to a partner as a sale of the allocated asset from the partnership to the

partner solely for determining the federal taxable income of the partnership and the partner.

51. Because the General Assembly chose not to adopt Code section 707, its provisions are not a part of *North Carolina state tax law*.

52. As is explained below, NCDOR has refused to accept the General Assembly's decision not to adopt Code section 707 for state income tax purposes.

53. Instead, though it lacks the authority to do so, NCDOR has adopted Code section 707 and has misapplied it to deny the state tax credits which were created by the General Assembly, properly earned by partnerships, and properly allocable to partners under North Carolina law.

MONARCH DESIGNED PARTNERSHIP STRUCTURES CONSISTENT WITH THE GENERAL STATUTES AND OBTAINED GUIDANCE FROM NCDOR IN WHICH NCDOR DID NOT IDENTIFY ANY PROBLEMS WITH THOSE STRUCTURES

54. Following the tax laws enacted by the General Assembly, Monarch developed structures that would give taxpayers the opportunity to invest in partnerships that would develop renewable energy projects and historic mills rehabilitation projects. In exchange, those investors would receive allocations of one year of the North Carolina tax credits generated by those projects. This structure allowed individual, smaller investments to be pooled together so that they would be more likely to accomplish the investment goals inherent in the General Assembly's tax credit legislation.

NCDOR Did Not Initially Identify Any Problems With The Monarch-Sponsored Partnership Structure

55. In exercise of due caution, a controlled subsidiary of Monarch issued a request for a private letter ruling from NCDOR that investors in the Monarch-sponsored partnerships would be able to claim the related tax credits. In August of 2013, this controlled subsidiary of Monarch received two Private Letter Rulings (the "PLRs") from NCDOR. True and accurate copies of the PLRs are attached hereto as **Exhibit 1**.

56. As a result of the PLR process, Monarch fully disclosed, and the DOR was clearly aware of, Monarch's intention to admit a new group of investors each year during the Credit Period to claim each year's Renewable Energy Tax Credits through the use of the Annual Fund – Master Fund Structure. Notably, NCDOR did not respond that the described departure of partners and admission of new partners rendered the partnership interests invalid under any law, including federal law.

57. Further, NCDOR did not indicate in the PLRs that the described transaction involved a disguised sale for federal income tax purposes. Nor did the PLR's indicate that principles outside of North Carolina tax law or non-Fourth Circuit federal law would be controlling for purposes of allocating North Carolina tax credits.

58. In reliance on the NCDOR PLRs and established North Carolina tax law, Monarch proceeded with sponsored partnerships for renewable energy projects and historic rehabilitation projects in which individual taxpayers could invest.

59. Numerous taxpayers invested in these partnerships, resulting in a substantial combined investment in renewable energy and historic rehabilitation

projects in North Carolina, which led directly to substantial economic development in renewable energy (primarily solar), higher property tax values, job creation, and other advantages to the State, all of which were consistent with the goals established by the General Assembly in enacting the related tax credit legislation.

The Monarch-Sponsored Partnerships

60. Monarch created the following structure for Renewable Energy Partnerships:

a. Monarch established a limited liability company (the "Master Fund") whose primary purpose was to invest, directly or indirectly, in a renewable energy project in North Carolina. The underlying projects generated North Carolina Renewable Energy Tax Credits.

b. The Master Fund typically acquired roughly a 99 percent membership interest in a limited liability company (the "Project LLC") that developed qualified renewable energy equipment eligible for the North Carolina Renewable Energy Tax Credits (the "Qualified Equipment"). All Master Fund investments were made before 2017.

c. The North Carolina Renewable Energy Tax Credits were generated and claimed over a five-year period (the "Credit Period").

d. During each year of the Credit Period, the Project LLC allocated roughly 99 percent of its North Carolina Renewable Energy Tax Credits to the Master Fund.

e. For each year of the Credit Period, Monarch established a new limited liability company (each, an "Annual Fund") the primary purpose of which was to invest in the Master Fund and receive an allocation of the applicable year's North Carolina Renewable Energy Tax Credits.

f. Each Annual Fund admitted third-party investors for purposes of making investments in renewable energy and receiving allocations of the applicable year's North Carolina Renewable Energy Tax Credits.

g. Each successive year, the previous Annual Fund's ownership interest was diluted and, simultaneously, a new Annual Fund made an investment in the Master Fund.

h. Monarch established a limited liability company (the "State Tax Credit Exchange Member"), which served as the managing member and owned a 0.01 percent interest in the Master Fund and the Annual Fund.

61. Through these Monarch-sponsored partnerships, investors pooled their capital in support of a common business enterprise, specifically the development and operation throughout North Carolina of projects classified by the General Assembly as socially desirable and important to the economy of this state.

62. The Master Fund, the Project LLC, and the Annual Fund were formed as limited liability companies under Georgia law with the intention to be classified as partnerships for U.S. federal tax purposes and for North Carolina tax purposes, and each filed all required federal and North Carolina partnership returns for each year in which they operated.

63. Monarch also established Annual Funds which invested in historic redevelopment and mill rehabilitation partnerships that generated and are generating Article 3D, 3H, or 3L credits for a particular year and then allocate the credits among the investing partners.

64. Investors in the Monarch-sponsored partnerships have been, and are, valid partners under North Carolina tax law.

65. Though it is irrelevant to the present dispute, investors in the Monarch-sponsored partnerships have been, and are, also valid partners under federal tax law, and the allocation of partnership tax credits to them did not, and does not, violate Code section 707.

The Monarch-Sponsored Renewable Energy Related Partnerships Functioned Consistent with NCDOR Guidance

66. Monarch began investing in NC renewable energy projects in 2012. It began ramping up its investments upon receiving the PLRs in 2013 and continued making robust investments in North Carolina renewable energy through 2016.

67. After the investors contributed capital to the Annual Fund, that money was contributed to the Master Credit Fund, which in turn made capital contributions to Project LLCs or paid off debt incurred to fund Project LLCs.

68. In total, Monarch's structures led to investment in over 80 separate renewable energy projects which represented a minimum of $900 million of investment in North Carolina Renewable Energy resources which the citizens of North Carolina enjoy today and will continue to enjoy for the foreseeable future.

69. These projects funded through Monarch's structures are located across the State of North Carolina and generate over 560 MWh of renewable energy—enough to power over 60,000 homes.

70. These projects also directly employ over thirty people in the renewable energy field in North Carolina, and indirectly employ numerous others who support and maintain the various renewable energy facilities. Another obvious but often overlooked benefit of these solar projects is the dramatic increase in property tax values due to these investments, which pay sorely needed property tax revenues annually to rural counties in North Carolina.

71. These successes were the intended result of the General Assembly's tax credit legislation: the renewable energy projects in which Monarch drove investments that helped to make North Carolina the second highest solar energy-producing state in the nation.

72. The pooled capital structure, combined with the investment and management oversight provided by Monarch, was critical to the successful development of the underlying renewable energy projects.

73. Without the pooled capital structure created by Monarch and funded by Monarch's customers, many (if not all) of the underlying renewable energy projects would never have occurred and the investments encouraged by the General Assembly's adoption of the North Carolina Renewable Energy Tax Credits legislation would not have been made.

The Creation and Functioning of Monarch-Sponsored Historic Rehabilitation Related Partnerships Consistent with North Carolina Law

74. Monarch facilitated investments in historic and mill redevelopment projects through Monarch-sponsored partnerships beginning in 2012 and continuing through 2018.

75. Monarch has invested in 15 projects, and these Monarch-sponsored partnerships have facilitated over $140 million of historic redevelopment investments.

76. These projects contributed to North Carolina economy by generating jobs, capital investment, and additional property tax and income tax revenues.

77. These successes were the intended result of the General Assembly's tax credit legislation: the mill rehabilitation and historic redevelopment projects in which Monarch facilitated investments generated over $25 million of North Carolina Mill Rehabilitation and Historic Redevelopment Tax Credits, which helped to redevelop and revitalize communities across North Carolina.

AFTER THE STATE RECEIVED THE INVESTMENTS INSPIRED BY LEGISLATION, NCDOR CAUSED THE STATE TO RENEGE ON THE UNDERLYING PROMISE OF TAX CREDITS TO INVESTORS

78. After North Carolina received the benefits of the investments inspired by the tax credit legislation, NCDOR undertook a concerted effort to disregard the PLRs it had previously issued to Monarch's subsidiary, to impermissibly adopt new tax laws under the guise of issuing informal rulemaking, to misapply the impermissibly adopted federal Code provisions, and to use an aggressive and drawn-

out audit process against Monarch's tax credit customers in an effort to prevent their use of the credits awarded them by the General Assembly due to those customers' investments in North Carolina.

79. Beginning in January 2018, NCDOR placed all or nearly all of the investors in the Monarch-sponsored partnerships under audit. As evidenced by NCDOR's Information Document Requests ("IDRs") issued to those audit targets, the clear and unmistakable focus of the audits were the tax credits properly claimed by those investors in connection with the Monarch-sponsored partnerships.

80. Though the partnership structures under audit were consistent with the 2013 NCDOR PLRs, and notwithstanding numerous requests by Monarch to address any questions NCDOR might have, NCDOR unreasonably delayed the audit process (which remains ongoing in many instances) in a manner that it knew would prevent – and which in fact has prevented – North Carolina taxpayers from investing in Monarch-sponsored partnerships while the audits are ongoing.

81. During the audits, NCDOR engaged in an inappropriate pattern of rejecting Monarch's efforts to have meaningful and substantive discussions about NCDOR's supposed concerns, refusing to set promised follow-up meetings, and otherwise stonewalling to prevent a fair and reasonable resolution.

82. NCDOR took deliberate steps to prevent investments in structures such as the Monarch-sponsored sponsorships by publicly, but incorrectly, declaring that such investments were in violation of North Carolina tax law. NCDOR did so by issuing on its website a September 10, 2018 "Important Notice: Tax Credits Involving

Partnerships" (the "September 10 Notice"). A true and accurate copy of the September 10 Notice is attached hereto as **Exhibit 2**.

83. In the September 10 Notice, NCDOR informed taxpayers of NCDOR's position that if NCDOR determines a partnership transaction is a disguised sale for federal income purposes or would result in the technical termination of a partnership for federal income tax purposes, then NCDOR would not recognize a state tax credit allocation as valid for state income tax purposes. The September 10 Notice invoked Code section 707 as the basis for this position, which as indicated above, was never adopted by the General Assembly and is not part of North Carolina state tax law. In the September 10 Notice, NCDOR contended, contrary to North Carolina Supreme Court precedent, that North Carolina generally follows the federal Code.

84. The September 10 Notice also effectively overrules N.C. Gen. Stat. § 105-134.1(7a)'s definition of "partner" under North Carolina state law and supplants it with a definition supposedly lifted from federal law.

85. Not only did NCDOR erroneously adopt a federal Code provision that it lacked authority to adopt, but in the September 10 Notice, NCDOR also misapplied that provision. To arrive at its novel interpretation of this (inapplicable) provision, NCDOR cited two inapposite cases, *Historic Boardwalk Hall, LLC v. C.I.R.*, 694 F.3d 425 (3rd Cir. 2012) ("Historic Boardwalk") and *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129, 145-46 (4th Cir. 2011) ("Virginia Historic Tax Credits"). These decisions plainly do not support NCDOR's interpretation of federal tax law.

86. *Historic Boardwalk* does not apply or interpret Code section 707; rather it is a case involving general federal law partnership taxation principles applicable in Third Circuit at the time it was decided. *Historic Boardwalk* is a case from a different tax jurisdiction that is not binding in North Carolina and in any event, does not apply North Carolina tax law. Further, *Historic Boardwalk* states that it does not apply to fact patterns post-2010. For these and other reasons, NCDOR erroneously invoked *Historic Boardwalk.*

87. *Virginia Historic Tax Credits* also does not apply North Carolina tax law. It deals with Federal taxes and explains that state credits are not affected by the decision. For these and other reasons, NCDOR erroneously invoked *Virginia Historic Tax Credits.*

88. The erroneous nature of NCDOR position regarding these credits is evidenced by, *inter alia*, the fact that the 2013 PLRs provided NCDOR's favorable ruling on the Monarch-sponsored partnership structure and that one of the Monarch-sponsored funds was audited by the IRS and received a no-change response.

89. The positions set out in the September 10 Notice are the ultimate positions that NCDOR has taken in the few matters in which it has finally (and recently) completed audits. Specifically, NCDOR has taken the positions that: (A) the investors' interests in the Monarch-sponsored partnerships are not valid partnership interests, such that the investors should not be allowed the use of the credits, and (B) the investors in the Monarch-sponsored partnerships effectively received their credits in what the DOR has recharacterized as disguised sales.

90. NCDOR issued the September 10 Notice nineteen (19) years after the General Assembly adopted the Renewable Energy Tax Credit legislation (N.C. Gen. Stat. § 105-129.16A) and two (2) years after the legislation's expiration.

91. The September 10 Notice effectively changed North Carolina tax law and overrode the will of the General Assembly in two respects. First, as indicated above, NCDOR effectively amended N.C. Gen. Stat. § 105-269.15 when doing so was the exclusive province of the legislature. Second, NCDOR broke the promise that the General Assembly made to taxpayers in the General Statutes – that they would receive the tax credits created by the legislature if they invested in North Carolina renewable energy projects in compliance with North Carolina law.

92. At the time of issuance of the September 10 Notice, NCDOR knew or should have known that a substantial amount of investment had been made in North Carolina renewable energy projects and historic mill rehabilitation projects, that a substantial amount of resulting North Carolina income tax credits had already been allocated to customers of Monarch, and that those tax credits had already been applied, or soon would be applied, to those customers' tax calculations.

93. The effect and, upon information and belief, the intended purpose of the September 10 Notice is to reduce or prevent investments in partnerships that obtain tax credits on an annual basis, such as the Monarch-sponsored partnerships, as well as to deny taxpayers the benefit of their previously-received tax credits. As a direct result of the issuance of the September 10 Notice, Monarch has been left in possession

of millions of dollars of tax credits that it cannot provide to customers and has nearly been forced out of business in North Carolina.

94. NCDOR lacks the lawful authority to engage in the above-referenced assumption of lawmaking functions that are constitutionally reserved for the General Assembly. Its unauthorized and unlawful course of conduct has denied Monarch the right to engage in lawful and beneficial business activities and has otherwise violated Monarch's rights and taken its property, thereby resulting in hundreds of millions of dollars in losses to Monarch.

MONARCH REQUESTED A DECLARATORY RULING PURSUANT TO N.C. GEN. STAT. § 150B-4, WHICH NCDOR REFUSED TO PROVIDE

95. Section 150B-4 of the North Carolina General Statutes provides that "a person aggrieved may request that an agency issue a declaratory ruling as to the validity of a rule or as to the applicability to a given state of facts of a statute administered by the agency or of a rule or order of the agency."

96. Monarch is a party aggrieved entitled to seek a ruling under this provision.

97. Chapter 150B defines "agency" as "an agency or an officer in the executive branch of the government of this State and includes . . . a department . . . in the executive branch."

98. NCDOR is an agency under this provision.

99. Chapter 150B defines "rule" to include "any agency regulation, standard or statement of general applicability that implements or interprets an enactment of

the General Assembly or Congress or a regulation adopted by a federal agency or that describes the procedure or practice requirements of an agency."

100. The September 10 Notice is a rule under this provision.

101. By letter dated August 1, 2019, Monarch requested such a declaratory ruling from NCDOR related to the September 10 Notice and pursuant to N.C. Gen. Stat. § 150B-4 (the "Declaratory Ruling Request"). A true and accurate copy of the Declaratory Ruling Request is attached hereto as **Exhibit 3**.

102. In the Declaratory Ruling Request, Monarch noted the authority under which it requested a declaratory ruling, background information related to Monarch, and the relevant history both before and after issuance of the September 10 Notice.

103. The Declaratory Ruling Request sought a declaratory ruling as to eleven items, specifically that:

a. NCDOR lacks constitutional and statutory authority to adopt the federal tax code's (the "Code") provisions concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

b. Chapter 105 does not incorporate the Code's provisions concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

c. Chapter 105 incorporates North Carolina state law principles concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

d. Chapter 105 does not expressly adopt or incorporate Code Section 707 or 761;

e. Chapter 105 does not impliedly adopt or incorporate Code Section 707 or 761;

f. Chapter 105 does not include any provisions addressing so-called "disguised sales";

g. *Historic Boardwalk* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership or may claim tax credits under Chapter 105;

h. *Virginia Historic Tax Credits* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership or may claim tax credits under Chapter 105;

i. The determination of whether a valid partnership interest exists for North Carolina state income tax purposes depends solely upon application of North Carolina's statutory and common law concerning partnerships and business organizations;

j. North Carolina's statutory and common law concerning partnerships and business organizations applies to Chapter 105's provisions governing partnerships and business organizations; and

k. For North Carolina income tax purposes, the rulings set out in the Private Letter Rulings CPLR 2013-04B and CPLR 2013-05B are not subject to Code Section 707, *Historic Boardwalk*, or *Virginia Historic Tax Credits* or other supposedly governing principles of federal tax law concerning whether a bona fide partnership interest exists.

104. The Declaratory Ruling Request also included an analysis explaining why the ruling was necessary in light of the September 10 Notice. That analysis explained the two-fold problem with NCDOR's position stated in the September 10 Notice. First, NCDOR lacks authority to follow federal tax law as opposed to North Carolina tax law to determine whether a state taxpayer is a partner for purposes of claiming North Carolina state tax credits. Second, even if one ignored this lack of authority, NCDOR's position is based on a misinterpretation and misapplication of the federal tax law that it incorrectly seeks to apply to Monarch's customers.

105. In response to the Declaratory Ruling Request, Anthony Edwards, Assistant Secretary for Tax Administration for NCDOR, issued a letter dated August 29, 2019, stating:

a. NCDOR supposedly was prohibited by statute from issuing a declaratory ruling;

b. NCDOR supposedly was precluded from issuing a declaratory ruling during ongoing litigation;

c. Monarch supposedly failed to meet the standards of N.C. Gen. Stat. § 150B-4;

d. The request supposedly was in contravention of the statutory and constitutional duty of NCDOR; and

e. Monarch's supposed failure of adequate due diligence should excuse NCDOR from the statutory obligation of issuing of a declaratory ruling.

A true and accurate copy of NCDOR's Response to Declaratory Ruling Request is attached hereto as **Exhibit 4**.

106. NCDOR 's denial of the Declaratory Ruling Request subjects the denial and the underlying issues raised in the Declaratory Ruling Request to judicial review pursuant to Article 4 of Chapter 150B. In addition to the other relief it seeks, Monarch hereby requests judicial review as NCDOR's refusal to issue the declaratory ruling prejudices Monarch's substantial rights.

107. The response by NCDOR refusing to issue the declaratory ruling is in violation of constitutional provisions, in excess of the statutory authority or jurisdiction of NCDOR, made upon unlawful procedure, and affected by other errors of law because, *inter alia*, NCDOR lacks the lawful authority to refuse to issue the declaratory ruling, lacks the lawful authority to assume lawmaking functions that are constitutionally reserved for the General Assembly, and both NCDOR's response and the September 10 Notice are based on cases and procedural authorities both irrelevant and inapplicable.

108. NCDOR's contention that it need not answer a request for a declaratory ruling is inconsistent with the General Statutes. The General Assembly specifically

chose *not* to exempt NCDOR from the declaratory ruling process that is applicable to state agencies.

109. NCDOR's contention that requests and challenges to NCDOR must be pursued only under Chapter 105 is inconsistent and disingenuous, particularly in this dispute. NCDOR knows that Monarch is not a taxpayer under audit and that its business model has been effectively destroyed by NCDOR's actions and the September 10 Notice. Monarch is a party aggrieved under Chapter 150B, Article 4 of the General Statutes, which is the procedure for seeking relief under such circumstances.

110. NCDOR's remaining contentions also are factually and legally incorrect.

111. Distilled to its essence, NCDOR contends that it is above the law and beyond question through the declaratory ruling request process that the General Assembly has made applicable to all state agencies. NCDOR's assertion of this position, in itself, is an unconstitutional abuse of the separation of powers doctrine.

112. Further, NCDOR's violations of constitutionally-established separation of powers, and NCDOR's unconstitutional failure to provide appropriate advance notice of the change in law it has impermissibly imposed, have damaged Monarch and are independently actionable.

FIRST CAUSE OF ACTION
(Judicial Review of Denial of Declaratory Ruling)

113. Monarch hereby incorporates by reference the foregoing allegations as if fully set forth herein.

114. Section 150B-4 of the General Statutes provides as follows:

(a) On request of a person aggrieved, an agency shall issue a declaratory ruling as to the validity of a rule or as to the applicability to a given state of facts of a statute administered by the agency or of a rule or order of the agency. Upon request, an agency shall also issue a declaratory ruling to resolve a conflict or inconsistency within the agency regarding an interpretation of the law or a rule adopted by the agency. The agency shall prescribe in its rules the procedure for requesting a declaratory ruling and the circumstances in which rulings shall or shall not be issued. A declaratory ruling is binding on the agency and the person requesting it unless it is altered or set aside by the court. An agency may not retroactively change a declaratory ruling, but nothing in this section prevents an agency from prospectively changing a declaratory ruling.

(a1) An agency shall respond to a request for a declaratory ruling as follows:

(1) Within 30 days of receipt of the request for a declaratory ruling, the agency shall make a written decision to grant or deny the request. If the agency fails to make a written decision to grant or deny the request within 30 days, the failure shall be deemed a decision to deny the request.

(2) If the agency denies the request, the decision is immediately subject to judicial review in accordance with Article 4 of this Chapter.

(3) If the agency grants the request, the agency shall issue a written ruling on the merits within 45 days of the decision to grant the request. A declaratory ruling is subject to judicial review in accordance with Article 4 of this Chapter.

(4) If the agency fails to issue a declaratory ruling within 45 days, the failure shall be deemed a denial on the merits, and the person aggrieved may seek judicial review pursuant to Article 4 of this Chapter. Upon review of an agency's failure to issue a declaratory ruling,

> the court shall not consider any basis for the denial that was not presented in writing to the person aggrieved.

115. Monarch made a valid declaratory ruling request pursuant to this section.

116. NCDOR responded pursuant to N.C. Gen. Stat. § 150B-4(a1)(1) by denying the request and refusing to issue a declaratory ruling.

117. The substantial rights of Monarch have been prejudiced by NCDOR's denial of Monarch's request for a declaratory ruling because NCDOR's denial decision was:

a. In violation of constitutional provisions;

b. In excess of the statutory authority or jurisdiction of NCDOR;

c. Made upon unlawful procedure;

d. Affected by other errors of law; and

e. Arbitrary, capricious, and an abuse of discretion.

118. In its denial of the Declaratory Ruling Request, NCDOR erred as described in paragraph 117 above because:

a. NCDOR's denial decision was in violation of constitutional provisions, in excess of statutory authority or its jurisdiction, made upon unlawful procedure, and affected by other errors of law because NCDOR, an agency of the Executive Branch of state government, lacks constitutional and legal authority to make laws, a power granted solely to the General Assembly through the North Carolina Constitution, Article I, Section 23;

b. NCDOR's denial decision was in violation of constitutional provisions and in excess of statutory authority or its jurisdiction because the September 10 Notice impermissibly overrules a state statute, N.C. Gen. Stat. § 105-134.1(7a), which defines a "partner" under North Carolina state law to include a member in limited liability company and purports to supplant it with a definition supposedly lifted from federal tax law;

c. NCDOR's denial decision was in excess of statutory authority or its jurisdiction because the September 10 Notice impermissibly overrules North Carolina Supreme Court precedent which provides that North Carolina has adopted the federal tax code *only* for purposes of determining federal Adjusted Gross Income and that North Carolina has *not* made a wholesale adoption of federal income tax definitions and principles;

d. NCDOR's denial decision was in violation of constitutional provisions and in excess of statutory authority or its jurisdiction because the September 10 Notice impermissibly amends North Carolina law to include federal disguised sale principles when the General Assembly chose not to do so;

e. NCDOR's denial decision was in excess of statutory authority or its jurisdiction because N.C. Gen. Stat. § 105-241.19 applies solely to actions submitted by a taxpayer and specifically references procedures in §§ 105-241.11 through 105-241.18, none of which are applicable here;

f. NCDOR's denial decision was affected by other errors of law as the authority it cites for the proposition that ongoing litigation precludes it from issuing a declaratory ruling are inapposite because *Equity Sols. of the Carolinas, Inc. v. N. Carolina Dep't of State Treasurer*, 232 N.C. App. 384, 754 S.E.2d 243 (2014) and *Catawba Mem'l Hosp. v. N. Carolina Dep't of Human Res.*, 112 N.C. App. 557, 561, 436 S.E.2d 390, 392 (1993) concerned ongoing litigation or contested hearings with the same parties prior to seeking the declaratory ruling and Monarch does not have ongoing litigation or a contested hearing against NCDOR;

g. NCDOR's denial decision was in violation of constitutional provisions, in excess of statutory authority or its jurisdiction, and affected by other errors of law because it purports to assert sovereign immunity from the provisions of a statute enacted by the General Assembly, which is expressly authorized to waive sovereign immunity;

h. NCDOR's denial decision was in excess of statutory authority or its jurisdiction, made upon unlawful procedure, and affected by other errors of law because Monarch is a person aggrieved under N.C. Gen. Stat. § 150B-4 as it stated in the Declaratory Ruling Request because NCDOR's disallowance of tax credits to taxpayers renders renewable energy, historic redevelopment, and mill restoration projects economically unviable and Monarch is harmed because it has been unable to receive investments due to the September 10

Notice and its ability to conduct business has been and continues to be damaged due to the September 10 Notice;

i. NCDOR's denial decision was in violation of constitutional provisions, in excess of statutory authority or its jurisdiction, made upon unlawful procedure, and affected by other errors of law because the September 10 Notice is a "rule" as defined in Chapter 150B as it is an "agency regulation, standard, or statement of general applicability that implements or interprets an enactment of the General Assembly or Congress or a regulation adopted by a federal agency or that describes the procedure or practice requirements of an agency" and in particular, the September 10 Notice, for the first time, provides a list of "sources of information to assist in evaluating the validity and potential amount of the respective tax credits;"

j. NCDOR's denial decision was arbitrary, capricious, and an abuse of discretion and made upon unlawful procedure as NCDOR bases its denial, in part, on purported undated, internal documents from Monarch that are selectively cited and not included in their entirety in NCDOR's response;

k. NCDOR's denial decision was arbitrary, capricious, and an abuse of discretion and made upon unlawful procedure as NCDOR bases its decision on language in the PLRs, but a PLR is not subject to judicial review, whereas a declaratory ruling is reviewable. NCDOR should not be permitted to hide behind its unilateral interpretation of the tax law without that interpretation

being subject to judicial review like nearly every other agency of State government; and

l. NCDOR's denial decision was arbitrary, capricious, and/or an abuse of discretion and made upon unlawful procedure because, by the express language of the statutes enacted by the General Assembly, the declaratory ruling process established by Chapter 150B applies equally to NCDOR as it does to nearly every other executive branch agency of state government and is one of the only mechanisms available to the public to obtain independent judicial review of agency adoption of tax rules outside the context of an assessment or refund request. Without such a review process in place, NCDOR could issue erroneous "Important Notices" and similar proclamations of tax policy and force taxpayers either to accede to those erroneous rules or to incur substantial tax liabilities and penalties under audit in order to challenge the erroneous rule.

119. In accordance with N.C. Gen. Stat. § 150B-45, this petition is timely filed within thirty (30) days of the date which the denial of the Declaratory Ruling Request was served on Monarch.

120. Monarch is entitled to, and justice and the law requires, an order reversing NCDOR's erroneous refusal to issue a declaratory ruling.

SECOND CAUSE OF ACTION
(Judicial Review of Declaratory Ruling in Substance)

121. Monarch hereby incorporates by reference the foregoing allegations as if fully set forth herein.

122. The Department's denial of the Declaratory Ruling Request is effectively a substantive denial of the merits because it makes clear that NCDOR is adopting a substantive position that is materially adverse and in disagreement with Monarch on all issues on which Monarch has requested the declaratory ruling.

123. Specifically, NCDOR is maintaining that it has authority to make its novel and erroneous interpretation of Code section 707 the law of North Carolina when the General Assembly has chosen not to do so.

124. NCDOR also has forecast that it will not issue a formal decision on the merits within forty-five (45) days of the time when it has made the substantive decision, which is at the latest forty-five days from the time when NCDOR issued the denial of the Declaratory Ruling Request.

125. Accordingly, NCDOR has denied Monarch's Declaratory Ruling Request on the merits, such that it is ripe for substantive review of the underlying issues pursuant to N.C. Gen. Stat. § 150B-4(a1)(4).

126. NCDOR has acted improperly in refusing to issue a decision on the merits and attempting to avoid the review process afforded by law.

127. NCDOR's substantive position, which essentially affirms the September 10 Notice, has prejudiced Monarch and is made upon unlawful procedure because it is:

a. In violation of constitutional provisions;

b. In excess of the statutory authority or jurisdiction of NCDOR;

c. Made upon unlawful procedure;

d. Affected by other errors of law; and

e. Arbitrary, capricious, and an abuse of discretion.

128. NCDOR has erred as described in paragraph 127 above because:

a. NCDOR lacks constitutional and statutory authority to adopt the federal tax code's (the "Code") provisions concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

b. Chapter 105 does not incorporate the Code's provisions concerning the validity of partnership interests for purposes of determining the allocation of North Carolina tax credits;

c. Chapter 105 incorporates North Carolina state law principles concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

d. Chapter 105 does not expressly adopt or incorporate Code Section 707 or 761;

e. Chapter 105 does not impliedly adopt or incorporate Code Section 707 or 761;

f. Chapter 105 does not include any provisions addressing so-called "disguised sales";

g. *Historic Boardwalk* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership or may claim tax credits under Chapter 105;

h. *Virginia Historic Tax Credits* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership or may claim tax credits under Chapter 105;

i. The determination of whether a valid partnership interest exists for North Carolina state income tax purposes depends solely upon application of North Carolina's statutory and common law concerning partnerships and business organizations;

j. North Carolina's statutory and common law concerning partnerships and business organizations applies to Chapter 105's provisions governing partnerships and business organizations; and

k. For North Carolina income tax purposes, the rulings set out in the Private Letter Rulings CPLR 2013-04B and CPLR 2013-05B are not subject to Code Section 707, *Historic Boardwalk*, or *Virginia Historic Tax Credits* or other supposedly governing principles of federal tax law concerning whether a bona fide partnership interest exists.

129. In accordance with N.C. Gen. Stat. § 150B-45, this petition is timely filed within thirty (30) days of NCDOR's refusal to issue a decision on the merits.

130. Monarch is entitled to, and justice and the law require, an order reversing NCDOR's substantive decision on the merits.

THIRD CAUSE OF ACTION
(Declaratory Judgment Declaring NCDOR's Conduct Unconstitutional)

131. Monarch hereby incorporates by reference the foregoing allegations as if fully set forth herein.

132. NCDOR's conduct, as described herein, violates Article I, Section 6 and Articles II and III of the North Carolina Constitution because NCDOR assumed and exercised legislative authority to make tax law for this state in contravention of constitutionally-required separation of powers.

133. NCDOR's conduct, as described herein, violated Article II, Section 23 and Article V of the Constitution because NCDOR assumed and exercised the power to make tax law when doing so is a legislative function and the province of the General Assembly.

134. NCDOR's conduct, as described herein, violated Article V, Section 2(1) because NCDOR failed to exercise the power of taxation in a just and equitable manner.

135. NCDOR's conduct, as described herein, also violated Article V, Section 2(1) because NCDOR impermissibly surrendered the power to make North Carolina tax law to Congress by adopting federal law principles and Code section 707, which were not adopted by the General Assembly.

136. NCDOR's conduct, as described herein, also violated Article I, Section 16 because NCDOR has sought to retrospectively tax acts previously done.

137. NCDOR's conduct, as described herein, also violated Article I, Section 19 of the North Carolina Constitution because it deprived Monarch of its property, without proper notice and by *ultra vires* conduct, in violation of the law of the land.

138. There is an actual, justiciable controversy between Monarch and NCDOR regarding each of these constitutional violations.

139. Monarch has been damaged by NCDOR's numerous constitutional violations.

140. Section 105-241.19 of the North Carolina General Statutes does not shield NCDOR from answering for its unconstitutional misconduct. Monarch is not disputing the denial of a requested refund, its liability for a tax, or the constitutionality of a tax statute. Rather, it is party aggrieved by NCDOR's unconstitutional actions which are damaging Monarch's relationship with its taxpayer customers and preventing Monarch from conducting its business of facilitating individual investments in projects that have generated more than $50 million in tax credits, which are currently being held by Monarch.

141. Monarch is entitled to, and justice and the law requires, a declaratory judgment that NCDOR has violated the North Carolina constitution by issuing the September 10 Notice and taking the positions it has asserted in the September 10 Notice and that, as a result, NCDOR's related conduct is void and of no effect.

142. Alternatively, if the court concludes that N.C. Gen. Stat. § 105-241.19 would bar an action for declaratory judgment regarding the unconstitutionality of NCDOR's actions as described herein, Monarch would be denied an effective remedy

for these violations of its constitutional rights. Accordingly, it is alternatively entitled to declaratory relief based on a direct right of action under *Corum v. University of North Carolina Through Bd. Of Governors*, 330 N.C. 761 (1992), which right of action is inherent in the Constitution of North Carolina and cannot be barred by § 105-241.19.

FOURTH CAUSE OF ACTION
(Direct Claim for Damages For Violations of Monarch's North Carolina Constitutional Rights)

143. Monarch hereby incorporates by reference the foregoing allegations as if fully set forth herein.

144. The unlawful actions and inactions of NCDOR complained of herein constitute violations of the foregoing constitutional provisions and deprive Monarch of its constitutional rights and liberties thereunder.

145. Upon information and belief, NCDOR's unconstitutional conduct is and was intentional.

146. In the absence of an adequate state remedy, one whose state constitutional rights have been abridged has a direct claim against the State under the North Carolina Constitution.

147. Monarch has no adequate remedy to recover its damages, other than a direct claim under the state Constitution against the Secretary in his official capacity.

148. This case does not implicate conduct that is subject to redress under the North Carolina Tort Claims Act.

149. As a direct and proximate result of NCDOR's conduct alleged herein, Monarch has suffered, and will continue to suffer, damages in an amount to be determined at trial, but in excess of $5,000,000.

PRAYER FOR RELIEF

WHEREFORE, Monarch respectfully prays that the Court grant it the following relief:

1. Enter judgment in favor of the Monarch and against NCDOR on all claims and causes of action asserted herein and any putative defenses NCDOR may assert;

2. Reverse NCDOR's decision denying the declaratory ruling requested by Monarch in its entirety on the grounds that NCDOR's decision was in violation of constitutional provisions; affected by other error of law; and arbitrary and capricious;

3. Declare that the September 10 Notice, and the positions taken therein, are contrary to North Carolina law and are an erroneous and unlawful limitation on the use of the tax credits described herein established by the North Carolina General Assembly;

4. Declare that NCDOR has violated the North Carolina Constitution by issuing the September 10 Notice and taking the positions it has asserted in the September 10 Notice and that, as a result, NCDOR's related conduct is void and of no effect.

5. Award Monarch damages caused by NCDOR's violations of the North Carolina Constitution;

6. Tax NCDOR with Monarch's reasonable costs and attorneys' fees as allowed by law, including, *inter alia*, as provided in N.C. Gen. Stat. § 6-19.1;

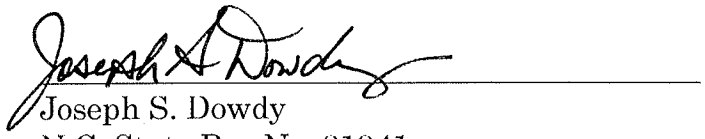
7. Empanel a jury and conduct a jury trial on all issues so triable; and

8. Grant Monarch such other and further relief as this Court deems just and proper.

[SIGNATURES FOLLOW ON NEXT PAGE]

This the 26th day of September, 2019.

KILPATRICK TOWNSEND & STOCKTON LLP

By: 

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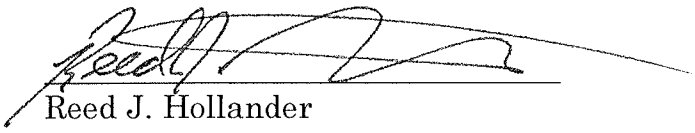
By: 

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Counsel for Plaintiff-Petitioner Monarch Tax Credits, LLC, formerly known as State Tax Credit Exchange, LLC

EXHIBIT 1

North Carolina Department of Revenue

Pat McCrory
Governor

Lyons Gray
Secretary

August 5, 2013

Hunton & Williams LLP
Post Office Box 109
Raleigh, North Carolina 27602

Attn: Ms. Jean Gordon Carter, Esquire

Re: Private Letter Ruling Request
Taxpayer: State Tax Credit Exchange, LLC
FEIN: 45-2530519

Dear Ms. Carter:

This letter is in response to a letter from Mr. Lee Peterson dated November 19, 2012, wherein he requested a private letter ruling from the North Carolina Department of Revenue ("Department") on behalf of your client, State Tax Credit Exchange, LLC ("Taxpayer"). Specifically, he requested that the Department clarify four technical matters related to the North Carolina Tax Credit for Investing in Renewable Energy Property provided under N.C. Gen. Stat. § 105-129.1 6A.

The statement of facts submitted for the Department's consideration is summarized as follows:

The taxpayer is 100% owner of STCE North Carolina Historic Tax Credit Fund Manager, LLC, which is the managing member and tax matters partner of STCE North Carolina Historic Tax Credit Fund, LLC, (hereinafter "LLC"). LLC is taxable as a partnership for federal income tax purposes and is classified as a partnership for North Carolina franchise, income and premium tax purposes. LLC will own 5% of ProjectCo, LLC[1] which will own, and use in its trade or business, renewable energy equipment eligible for the North Carolina renewable energy property tax credit.

The renewable energy being generated by the renewable energy property is being sold to a North Carolina public utility, along with the Renewable Energy Certificates (RECs) in some cases. As part of its regular business, the LLC from time to time will experience changes in its ownership for tax purposes, whereby at various times within the five-year renewable energy property tax credit period, one or more partners will leave, and other new, and unrelated partners may join the LLC, either by purchasing a partnership interest, or by being admitted as a member to the LLC in exchange for a contribution of capital.

[1] ProjectCo, LLC will be created as an entity taxable as a partnership for federal income tax purposes.

Specifically, ProjectCo, LLC will lease the project equipment to Lessee, LLC[2] under a seven year lease agreement. Lessee, LLC will make lease payments to ProjectCo. LLC. The ultimate purchase of the power will be a utility. Lessee, LLC will obtain ProjectCo, LLC's written certification that the ProjectCo, LLC will not claim the renewable credit with respect to the property and therefore, Lessee, LLC will be eligible to claim the North Carolina state energy tax credits. LLC will own 99.9% of Lessee, LLC. As such, LLC will receive their distributive share of the North Carolina state energy tax credits (99.9%) from Lessee LLC.

Third party investors will invest into STCE North Carolina 2012 Historic Tax Credit Fund, LLC, which will invest in LLC to receive the historic and energy tax credits allocable to the third party investors. In 2013, a new entity taxable as a partnership will be created, STCE North Carolina 2013 Energy Tax Credit Fund, LLC which will invest in LLC to receive the North Carolina energy credits allocable to persons taxable as partners for 2013. In 2014, another new fund, STCE North Carolina 2014 Energy Tax Credit Fund, LLC will invest in LLC to receive the North Carolina energy credits allocable to persons taxable as partners in 2014. This pattern of investment activity will continue for at least five (5) taxable years, with partners in prior funds either selling their interests or redeeming out. Possible avenues for acquiring a partnership interest:

- Old partner to new partner sale and purchases of interest
- Partner contribution of capital in exchange for an interest
- Redemption and retirement of interest by partnership
- Having an entity taxable as a partnership other than LLC purchase interests from retiring or withdrawing partners of LLC and re-sell such purchased interests to new, unrelated partners.

Rulings Requested:

1. That a partner[3] who acquired their partnership interest after the close of the first taxable year of the five-year tax credit period (via purchase from a prior partner) is allowed to claim the prior partner's post initial year allocable share of the North Carolina credit, because the sale of the prior partner's interest to another person is not considered to be a disposition of the underlying renewable energy tax credit property by either the partnership or any partner and because North Carolina tax law does not otherwise prohibit such a replacement partner from claiming the tax credit in this manner.

   Department's Response: If the transaction is not considered to be a disposition of the property for federal income tax purposes and the partnership agreement allows for such allocation, then the partner that acquires a partnership interest from a former partner after the close of the first taxable year of the five-year tax credit period is allowed to claim the prior partner's allocable share of the North Carolina credit. [N.C. Gen. Stat. § 105-269.15(c)]

   For federal income tax purposes, the partnership agreement's allocation of partnership items of income, loss, deduction, and credit among the partners is respected provided the allocation has substantial economic effect or is otherwise consistent with, or is deemed to be consistent with, the partners' interests in the partnership. [Code Sec. 704(a); Reg. §1.704-1(b)(1)(i)]

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[2] Lessee LLC will be created as an entity taxable as a partnership for federal income tax purposes.

[3] For purposes of this Ruling Request, the term "partner" means the owner of an LLC interest taxable as a partner for North Carolina tax purposes, and the term "partnership" means an entity taxable as a partnership for North Carolina tax purposes.

2. Where a partner is redeemed in whole or in part, and surrenders any interest in LLC to LLC, and a new, replacement partner acquires a partnership interest directly from LLC after the first taxable year but within the five year credit period as a result of having made a capital contribution in lieu of purchasing an interest from any partner, the newly entering partner is entitled to their respective share of the North Carolina credit for that otherwise eligible year, because the redemption of a prior partner's interest is not considered the disposition of the underlying tax credit eligible property and because North Carolina tax law does not otherwise prohibit a newly admitted partner from claiming the proper allocable share of such tax credit.

   Department's Response: As stated in our response to *Issue # 1*, if the sale or surrender of an interest in a partnership to another person or to the partnership is not considered to be a disposition of the underlying renewable energy tax credit property by either the partnership or any partner for federal income tax purposes, then the newly entering partner would be entitled to their allocable share of the North Carolina credit for any year in which the partnership is eligible to allocate installments of the credit.

3. The addition or exit of a partner during the five year credit period does not, require the partnership to update the renewable energy property's Certificate of Compliance nor is it required to obtain any similar inspector-issued documentation attesting to the property remaining in service in cases where the underlying renewable energy property eligible for the credit remains in trade or business use at all times by the partnership.

   Department's Response: The Department cannot make this determination. As stated in our "Guidelines for Determining Tax Credit for Investing in Renewable Energy Property," all systems must be inspected and approved by the local building inspections department. Please contact your local authorities for information regarding this issue.

4. A federal determination that a person is not classified as a partner for federal income tax purposes does not impact the determination of whether that same person is classified as partner for North Carolina income, franchise or premium tax credit purposes absent a separate, independent, and express ruling by a court or state jurisdiction in the state of North Carolina.

   Department's Response: We disagree. North Carolina General Statutes reference the Internal Revenue Code which means the federal determination of a "partner" is applicable for North Carolina income tax purposes except when there is a North Carolina General Statute that specifically addresses the topic. In such case, the North Carolina statute would supersede the Internal Revenue Code.

N.C. Gen. Stat. § 105-269.15 provides specific guidance with regard to income tax credits of partnerships. Subsection (c) of the statute states that "a partner's distributive share of an income tax credit shall be determined in accordance with sections 702 and 704 of the Code." IRC section 704 provides guidance with regard to a partner's distributive share of income, gain, loss, deduction, or credit. Since the statute references the IRC to determine the distributive share of a credit allocated to each partner, North Carolina must rely on the federal determination. If a person is not classified as a partner for federal income tax purposes and not entitled to claim distributive share of income, gain, loss,

deduction, or credit for federal purposes, then they would not qualify to receive distributive share of income, gain, loss, deduction, or credit for North Carolina purposes.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. Your statement of facts and our findings are subject to audit verification. If the facts and circumstances given are not accurate, or if there are other facts that were not disclosed that might cause the Department to reach a different conclusion, then the taxpayer requesting this ruling may not rely on it. A letter ruling is not equivalent to a Technical Advice Directive that generally affects a large number of taxpayers. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Should you have any questions, please contact me.

Very truly yours,

B. L. Weaver Jr.

Bobby L. Weaver, Jr., Administrative Officer
Income Tax Division -- Corporate Tax Section
Telephone: (919) 814-1163
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North Carolina Department of Revenue

Pat McCrory
Governor

Lyons Gray
Secretary

August 13, 2013

Hunton & Williams LLP
Post Office Box 109
Raleigh, North Carolina 27602

Attn: Ms. Jean Gordon Carter, Esquire

Re: Private Letter Ruling Request
Taxpayer: State Tax Credit Exchange, LLC
FEIN: 45-2530519

Dear Ms. Carter:

This letter is in response to a letter from Mr. Lee Peterson dated December 10, 2012, wherein he requested a private letter ruling from the North Carolina Department of Revenue ("Department") on behalf of your client, State Tax Credit Exchange, LLC ("Taxpayer"). Specifically, he requested that the Department clarify five technical matters related to the North Carolina Tax Credit for Investing in Renewable Energy Property provided under N.C. Gen. Stat. § 105-129.1 6A. This ruling amends and supersedes the private letter ruling dated August 6, 2013.

The statement of facts submitted for the Department's consideration is summarized as follows:

Taxpayer is 100% owner of STCE North Carolina Historic Tax Credit Fund Manager, LLC, which is the managing member and tax matters partner of STCE North Carolina Historic Tax Credit Fund, LLC, (hereinafter "LLC"). LLC is taxable as a partnership for federal income tax purposes and is classified as a partnership for North Carolina franchise, income and premium tax purposes. LLC will own 99.99% of ProjectCo, LLC[1] which will own and lease to Lessee, LLC[2] pursuant to a "capital lease," renewable energy equipment eligible for the North Carolina renewable energy property tax credit. Lessee, LLC will lease and use the equipment in its trade or business for the production and sale of electricity.

The renewable energy being generated by the renewable energy property is being sold to a North Carolina public utility, along with the Renewable Energy Certificates (REC) in some cases. As part of its regular business, the LLC from time to time will experience changes in its ownership for tax purposes, whereby at various times within the five-year renewable energy property tax credit period, one or more partners will leave, and other new, and unrelated partners may join the LLC, either by

[1] ProjectCo, LLC will be created as an entity taxable as a partnership for federal income tax purposes.
[2] Lessee, LLC will be created as an entity taxable as a partnership for federal income tax purposes.

purchasing a partnership interest, or by being admitted as a member to the LLC in exchange for a contribution of capital.

Specifically, ProjectCo, LLC will lease the project equipment to Lessee, LLC under a twenty (20) year lease agreement. Lessee, LLC will make lease payments to ProjectCo, LLC, the present value of which exceeds 90% of the fair market value of the equipment. Lessee, LLC will have an option to purchase the equipment at the end of the lease term for $1.00. Lessee, LLC will provide written certification to ProjectCo, LLC's wherein Lessee, LLC waives all rights to claim the renewable credit with respect to the equipment, and ProjectCo, LLC will not give written certification to Lessee, LLC that it will not claim the renewable credit with respect to the equipment. Therefore, ProjectCo, LLC will be eligible to claim the North Carolina state energy tax credits. LLC will own 99.99% of ProjectCo, LLC. As such, LLC will receive their distributive share of the North Carolina state energy tax credits (99.99%) from ProjectCo, LLC.

Third party investors will invest into STCE North Carolina 2012 Historic Tax Credit Fund, LLC, which will invest in LLC to receive the historic and energy tax credits allocable to the third party investors. In 2013, a new entity taxable as a partnership will be created, STCE North Carolina 2013 Energy Tax Credit Fund, LLC which will invest in LLC to receive the North Carolina energy credits allocable to persons taxable as partners for 2013. In 2014, another new fund, STCE North Carolina 2014 Energy Tax Credit Fund, LLC will invest in LLC to receive the North Carolina energy credits allocable to persons taxable as partners in 2014. This pattern of investment activity will continue for at least five (5) taxable years, with partners in prior funds either selling their interests or redeeming out. Possible avenues for acquiring a partnership interest:

- Old partner to new partner sale and purchases of interest
- Partner contribution of capital in exchange for an interest
- Redemption and retirement of interest by partnership
- Having an entity taxable as a partnership other than LLC purchase interests from retiring or withdrawing partners of LLC and re-sell such purchased interests to new, unrelated partners.

Rulings Requested:

1. The leasing arrangement described in the statement of facts is a "capital lease" for North Carolina tax purposes.

   Department's Response: We agree. The leasing arrangement described would be considered a capital lease.

2. The lessor in a capital lease transaction is entitled to claim the Credit for Investing in Renewable Energy Property under N.C. Gen. Stat. § 105-129.16A if it does not provide the lessee with written certification required by N.C. Gen. Stat. § 105-129.16A(d) that it will not claim the credit.

   Department's Response: Yes. The lessor in a capital lease transaction is entitled to claim the tax credit provided under N.C. Gen. Stat. § 105-129.16A if it does not provide Lessee with written

certification that it will not claim the credit. Pursuant to subsection (d) of the statute, a taxpayer that leases renewable energy property from another taxpayer may not claim the credit allowed for renewable energy property unless the taxpayer obtains the lessor's written certification that the lessor will not claim the renewable credit with respect to the property. Therefore, only if the lessor gives the lessee a written certification that it will not claim the credit, may the lessee claim the North Carolina Renewable Energy Tax Credit. In this case, because ProjectCo will not provide written certification to Lessee that ProjectCo will not claim the credit, ProjectCo, as the lessor, has the right to allocate the North Carolina Renewable Energy Tax Credit to its partners for North Carolina tax purposes.

3. That a partner who acquired their partnership interest after the close of the first taxable year of the five-year tax credit period (via purchase from a prior partner) is allowed to claim the prior partner's post initial year allocable share of the North Carolina credit, because the sale of the prior partner's interest to another person is not considered to be a disposition of the underlying renewable energy tax credit property by either the partnership or any partner and because North Carolina tax law does not otherwise prohibit such a replacement partner from claiming the tax credit in this manner.

   Department's Response: If the transaction is not considered to be a disposition of the property for federal income tax purposes and the partnership agreement allows for such allocation, then the partner that acquires a partnership interest from a former partner after the close of the first taxable year of the five-year tax credit period is allowed to claim the prior partner's allocable share of the North Carolina credit. [N.C. Gen. Stat. § 105-269.15(c)]

   For federal income tax purposes, the partnership agreement's allocation of partnership items of income, loss, deduction, and credit among the partners is respected provided the allocation has substantial economic effect or is otherwise consistent with, or is deemed to be consistent with, the partners' interests in the partnership. [Code Sec. 704(a); Reg. §1.704-1(b)(1)(i)]

4. Where a partner is redeemed in whole or in part, and surrenders any interest in LLC to LLC, and a new, replacement partner acquires a partnership interest directly from LLC after the first taxable year but within the five year credit period as a result of having made a capital contribution in lieu of purchasing an interest from any partner, the newly entering partner is entitled to their respective share of the North Carolina credit for that otherwise eligible year, because the redemption of a prior partner's interest is not considered the disposition of the underlying tax credit eligible property and because North Carolina tax law does not otherwise prohibit a newly admitted partner from claiming the proper allocable share of such tax credit.

   Department's Response: As stated in our response to *Issue # 3*, if the sale or surrender of an interest in a partnership to another person or to the partnership is not considered to be a disposition of the underlying renewable energy tax credit property by either the partnership or any partner for federal income tax purposes, then the newly entering partner would be entitled to their allocable share of the North Carolina credit for any year in which the partnership is eligible to allocate installments of the credit.

5. A federal determination that a person is not classified as a partner for federal income tax purposes does not impact the determination of whether that same person is classified as a partner for North Carolina income, franchise or premium tax credit purposes absent a separate, independent, and express ruling by a court or state jurisdiction in the state of North Carolina.

   Department's Response: We disagree. North Carolina General Statutes reference the Internal Revenue Code which means the federal determination of a "partner" is applicable for North Carolina income tax purposes except when there is a North Carolina General Statute that specifically addresses the topic. In such case, the North Carolina statute would supersede the Internal Revenue Code.

   N.C. Gen. Stat. § 105-269.15 provides specific guidance with regard to income tax credits of partnerships. Subsection (c) of the statute states that "a partner's distributive share of an income tax credit shall be determined in accordance with sections 702 and 704 of the Code." IRC section 704 provides guidance with regard to a partner's distributive share of income, gain, loss, deduction, or credit. Since the statute references the IRC to determine the distributive share of a credit allocated to each partner, North Carolina must rely on the federal determination. If a person is not classified as a partner for federal income tax purposes and not entitled to the claim distributive share of income, gain, loss, deduction, or credit for federal purposes, then they would not qualify to receive distributive share of income, gain, loss, deduction, or credit for North Carolina purposes.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. Your statement of facts and our findings are subject to audit verification. If the facts and circumstances given are not accurate, or if there are other facts that were not disclosed that might cause the Department to reach a different conclusion, then the taxpayer requesting this ruling may not rely on it. A letter ruling is not equivalent to a Technical Advice Directive that generally affects a large number of taxpayers. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Should you have any questions, please contact me.

Very truly yours,

B. L. Weaver, Jr.

Bobby L. Weaver, Jr., Administrative Officer
Income Tax Division -- Corporate Tax Section
Telephone: (919) 814-1163
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EXHIBIT 2

NCDOR | NORTH CAROLINA DEPARTMENT OF REVENUE

IMPORTANT NOTICE: TAX CREDITS INVOLVING PARTNERSHIPS

The Department has recently received inquiries regarding the requirements for claiming North Carolina tax credits, particularly with regard to credits claimed in connection with a taxpayer's transactions with a partnership (or other flow-through entity). While each individual situation should be evaluated with the assistance of tax advisors knowledgeable in both tax credits and partnership tax rules, this notice provides sources of information to assist in evaluating the validity and potential amount of the respective tax credit. These sources are not intended to be an exhaustive list of relevant available information and should not be relied on as such.

North Carolina and Federal Tax Statutes

Credits against North Carolina tax are generally contained in Articles 3A through 3L of Chapter 105 of the General Statutes. With a few exceptions, most of these credits have expired. However, for credits or installments of credits still in effect, N.C. Gen. Stat. §§ 105-228.90 and 105-269.15 provide relevant definitions and guidance for a taxpayer claiming a credit through a transaction with a partnership. Some of these statutes require an understanding of federal income tax partnership and basis rules.

The Internal Revenue Code ("Code") provides guidance for the formation of bona fide partnership arrangements and allocation of partnership items to taxpayers. North Carolina generally follows the Code, subject to statutory exceptions and definitional differences.[1] In certain instances, North Carolina law or Chapter 105 directly references the Code. For example, N.C. Gen. Stat. § 105-269.15 specifically refers to sections 702 and 704 of the Code. In addition, this statute further references a "partner's distributive share," terms explained in sections 702 and 704.

It is the Department's position that relevant statutes in Chapter 105 include consequences resulting from federal income tax treatment of transactions generally known as "disguised sales" pursuant to section 707 of the Code and the regulations thereunder. Thus, a "disguised sale" determination prevents tax credits from being allocated to a taxpayer under section 704 or from creating sufficient basis in the partnership necessary for a taxpayer to use the tax credits.

Furthermore, the Department believes the termination of a partnership under section 708(b)(1)(B) of the Code, occurring prior to the repeal of section 708(b)(1)(B), are also

[1] *See, e.g., The Fidelity Bank v. North Carolina Department of Revenue*, 803 S.E. 2d 142 (2017).

applicable. Thus, a partnership that terminated under section 708(b)(1)(B) would lose its allocable credits at the time of the section 708(b)(1)(B) transaction.

Federal Case Law

Several U.S. Circuit Courts of Appeals, as well as the Tax Court, have addressed federal income tax issues that are relevant for North Carolina tax credits claimed by partnerships and taxpayers. Notably, Virginia Historic Tax Credit[2] provides an analysis of disguised sale transactions involving state tax credits, and Historic Boardwalk[3] discusses bona fide partner and partnership arrangements.

Because Virginia Historic Tax Credit is a Fourth Circuit Court of Appeals decision, the case is controlling for North Carolina. In a Private Letter Ruling, the Department has specifically stated its position that a person not qualifying as a partner under federal income tax would not qualify for allocation of a credit.[4]

North Carolina Private Letter Rulings

The Department has issued private letter rulings on the use of partnerships with various credits. Rulings from 2010 forward have been redacted and made publicly available at the direction of the General Assembly. These rulings, redacted pursuant to N.C. Gen. Stat. § 105-264.2(c), are available at:

https://www.ncdor.gov/taxes/corporate-income-franchise-tax/determinations/corporate/written-determinations-corporate-tax

Taxpayers should be aware that private letter rulings are only binding with respect to the requesting party, address only the specific rulings requested, and based only on the facts as presented. Accordingly, they should not be viewed as a blanket guarantee that all the criteria for claiming the credit have been met, including the party receiving the ruling.

Conclusion

In response to the inquiries received, the Department suggests that taxpayers review the above referenced materials, as well as information available from other sources, and discuss with their tax advisors the impact on the availability and amount of credits available for use against North Carolina tax liabilities. In addition, a taxpayer may request a private letter ruling through the Department's Written Determination policy, available at:

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[2] *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011).

[3] *Historic Boardwalk Hall, LLC v. Commissioner*, 694 F.3d 425 (3d Cir. 2012), *cert. denied*, 133 S.Ct. 2734 (2013).

[4] CPLR 2013-09R (August 13, 2013).

https://www.ncdor.gov/taxes/corporate-income-tax-information/corporate-income-franchise-and-insurance-tax-bulletins/determinations/written-determinations

After reviewing the above information, if taxpayers or tax advisors believe the amount of tax credits claimed on original returns are incorrect, they may file amended returns with the Department. If the amended return reflects additional tax due, the taxpayer will avoid a late-payment penalty if the additional tax reflected on the amended return is paid when the amended return is filed. If the amended return reflects additional tax due but some or all of the additional tax is not paid when the amended return is filed, the unpaid tax is subject to applicable penalties. In addition, statutory interest accrues on tax not paid by the original due date of the tax return. Taxpayers that owe additional North Carolina income tax may request a waiver of penalties resulting from the underpayment of tax attributable to such income within the provisions of the Department's penalty waiver policy available at:

https://www.ncdor.gov/documents/penalty-waiver-policy

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this important notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this important notice, the provisions contained in this important notice supersede the previous guidance.

EXHIBIT 3

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ATTORNEYS AT LAW

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August 1, 2019

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By Hand Delivery (Courier)

North Carolina Department of Revenue
c/o Secretary Ronald G. Penny
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Raleigh, NC 27604

RE: REQUEST FOR DECLARATORY RULINGS FROM THE NORTH CAROLINA DEPARTMENT OF REVENUE PURSUANT TO N.C. GEN. STAT. § 150B-4

Dear Secretary Penny:

My colleague, Reed Hollander of Nelson Mullins Riley & Scarborough, LLP, and I represent Monarch Tax Credits, LLC, formerly known as State Tax Credit Exchange, LLC ("Monarch"). We are writing on behalf of Monarch to formally request declaratory rulings from the North Carolina Department of Revenue ("NCDOR") pursuant to N.C. Gen. Stat. § 150B-4, as described more fully below.

I. Authority

The Administrative Procedure Act "establishes a uniform system of administrative rule making ... for agencies" which "confers procedural rights" on the public. N.C. Gen. Stat. § 150B-1(a) and (b). The only portion of that Act from which the Department of Revenue is exempted is "the notice and hearing requirements contained in Part 2 of Article 2A." N.C. Gen. Stat. § 150B-1(d)(4).

That Act specifically provides for declaratory rulings of the type requested here to be issued by NCDOR. N.C. Gen. Stat. § 150B-4 provides in pertinent part:

> On request of a person aggrieved, an agency shall issue a declaratory ruling as to the validity of a rule or as to the applicability to a given state of facts of a statute administered by the agency or of a rule or order of the agency.

Further, N.C. Gen. Stat. § 150B-2(1a) provides: "Agency" means "an agency or an officer in the executive branch of the government of this State and includes ... a department ... in the executive branch." Further, a "rule" is broadly defined to include

"any agency regulation, standard, or statement of general applicability that implements or interprets an enactment of the General Assembly or Congress or a regulation adopted by a federal agency or that describes the procedure or practice requirements of an agency." N.C. Gen. Stat. § 150B-2(8a).

This request regards the validity of a rule – namely, the September 10, 2018 "Important Notice: Tax Credits Involving Partnerships" (hereinafter, the "September 10 Notice") (copy enclosed).

II. Background

Monarch is a Georgia limited liability company that facilitates investments in renewable energy, historic redevelopment, and mill restoration projects throughout North Carolina. The North Carolina General Assembly has enacted tax credit programs to encourage investment in projects based on political priorities, which projects otherwise would be economically unviable. Taxpayers complied with North Carolina's renewable energy mandate and the legal requirements set forth by the General Assembly and NCDOR. NCDOR's disallowance of these tax credits punishes taxpayers for accepting the General Assembly's invitation to make investments in North Carolina by participating in a politically-identified priority and socially responsible initiative.

During the relevant time period, Monarch's customers invested in these projects via Monarch-sponsored partnerships and expected to receive an allocation of state tax credits pursuant to North Carolina General Statutes Chapter 105 ("Chapter 105") Articles 3B, 3D, 3H, and/or 3L. NCDOR has asserted standards and made statements interpreting enactments of the General Assembly in the September 10 Notice that have substantially harmed Monarch, including in its ability to receive investments and its relationships with its investors. For these reasons and others, Monarch is a party aggrieved entitled to make these requests.

The September 10 Notice asserts standards and makes statements that:

(A) NCDOR should apply federal tax law partnership principles in determining whether investors' interests are valid partnership interests and whether the investors can use the tax credits allocated to them;

(B) Chapter 105 includes the consequences resulting from federal income tax treatment of "disguised sale" transactions under federal Internal Revenue Code (the "Code") Section 707 and the regulations thereunder, and a disguise sale determination prevents credits from being allocated

to a taxpayer or from creating sufficient basis in the partnership necessary for a taxpayer to use the tax credits; and

(C) Federal tax law decisions in *Historic Boardwalk Hall, LLC v. C.I.R.*, 694 F.3d 425 (3rd Cir. 2012) ("*Historic Boardwalk*") and *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129, 145-46 (4th Cir. 2011) ("*Virginia Historic Tax Credits*") are authoritative or controlling concerning when a North Carolina taxpayer can claim North Carolina renewable energy, mill redevelopment, or historic redevelopment tax credits.

Monarch views these positions as inconsistent with the constitution and laws of North Carolina. Accordingly, it requests the following declaratory rulings set forth in Section III below.

By way of further background, NCDOR's conduct surrounding the September 10 Notice violates the mandate of North Carolina Constitution Article V, Section 1 that "[t]he power of taxation shall be exercised in a just and equitable manner." Specifically, Monarch contends that NCDOR has acted with secrecy and undue delay when it possesses knowledge that its actions and failures to take action are substantially injuring Monarch's business operations.

Beginning in January 2018, investors in Monarch-sponsored partnerships for certain projects began receiving audit notices from NCDOR for tax years 2014 to 2016. The focus of the audits were the investments in the various tax credit projects in North Carolina through Monarch-sponsored partnerships. The Information Document Requests ("IDRs") associated with the audits were substantially similar. Monarch assisted the investors in responding to these audits and provided everything NCDOR requested on a timely – if not expedited – basis. Monarch also requested a meeting with NCDOR to address the agency's supposed concerns and to attempt to resolve the audits in a mutually agreeable manner, even though NCDOR's audits lacked a proper factual or legal foundation.

An initial meeting, held in May 2018, was attended by NCDOR representatives Ronald Penny (Secretary), Ken Wright (Legislative Liaison), Anthony Edwards (Assistant Secretary for Tax Administration), Eileen Sinclair (Administrative Assistant) and Jocelyn Andrews (Chief Operating Officer and Assistant Secretary for Tax Compliance), along with George Strobel, Nelson Freeman, and Ed Turlington representing Monarch. At this meeting, Monarch asked NCDOR's representatives to explain the agency's position regarding any claimed problems with the tax credits or the Monarch-sponsored partnership structure. NCDOR's representatives declined to respond substantively or to explain NCDOR's positions, but they did agree to a

second meeting. NCDOR's representatives specifically indicated that Monarch and NCDOR could discuss resolution at this second meeting.

A second meeting, held in July 2018, was attended by different NCDOR representatives, namely Alan Woodard (Director of Audit and Examinations), Rick Gilbert (Assistant Director for Interstate Audit), David Simmons, Lara Rose Eileen Sinclair (Administrative Assistant), and Ken Wright (Legislative Liaison). Monarch's attendees included George Strobel, Howard Williams, Nelson Freeman, and Craig Hoffman. At this second meeting, NCDOR's personnel commenced an interrogation of Monarch's attendees while refusing to discuss a resolution, as previously promised. NCDOR also refused to explain its position regarding any claimed problems with the tax credits or the Monarch-sponsored partnership structure, which was inconsistent with the Private Letter Rulings ("PLRs") issued by NCDOR in 2013 and NCDOR guidance issued in 2014. Moreover, NCDOR refused to answer any questions.

At a third meeting, NCDOR representatives stated that NCDOR had no inclination to enter into any settlement at that time.

Monarch consistently and repeatedly requested meetings to try to resolve the supposed issues with NCDOR or, at a minimum, to understand its position, but NCDOR has repeatedly declined to hold such a meeting or to engage in such substantive discussions. Notwithstanding that the September 10 Notice resulted in significant and substantial business losses to Monarch, NCDOR continued to delay the audits and claimed that it needed further information to better understand the situation when, in fact, it did not. NCDOR also consistently and repeatedly rejected Monarch's pleas to render a final decision and place it before an administrative law judge early in 2018 so that there could be a ruling on the lawfulness of NCDOR's apparent rejection of the credits, such that Monarch would possibly still have time to obtain investors in 2018. It appears that NCDOR delayed and drew out the audit process to deter third-party investments in Monarch's structures in 2018 and 2019, causing further losses to Monarch.

III. Declaratory Ruling Request

Consistent with our analysis below, and with reference to the September 10 Notice, pursuant to N.C. Gen. Stat. § 150B-4, Monarch seeks declaratory rulings that:

(1) NCDOR lacks constitutional and statutory authority to adopt the Code's provisions concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

(2) Chapter 105 does not incorporate the Code's provisions concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

(3) Chapter 105 incorporates North Carolina state law principles concerning the validity of partnership interests for purposes of determining North Carolina state income tax;

(4) Chapter 105 does not expressly adopt or incorporate Code Section 707 or 761;

(5) Chapter 105 does not impliedly adopt or incorporate Code Section 707 or 761;

(6) Chapter 105 does not include any provisions addressing so-called "disguised sales";

(7) *Historic Boardwalk* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership or may claim tax credits under Chapter 105;

(8) *Virginia Historic Tax Credits* is not binding authority concerning whether, for North Carolina state income tax purposes, a North Carolina taxpayer possesses a valid partnership interest in a partnership, has engaged in a disguised sale, or may claim tax credits under Chapter 105;

(9) The determination of whether a valid partnership interest exists for North Carolina state income tax purposes depends solely upon application of North Carolina's statutory and common law concerning partnerships and business organizations;

(10) North Carolina's statutory and common law concerning partnerships and business organizations applies to Chapter 105's provisions governing partnerships and business organizations; and

(11) For North Carolina income tax purposes, the rulings set out in Private Letter Rulings CPLR 2013-04B and CPLR 2013-05B are not subject to Code Section 707, *Historic Boardwalk*, or *Virginia Historic Tax Credits* or other supposedly governing principles of federal tax law concerning whether a bona fide partnership interest exists.

IV. Analysis

The North Carolina General Assembly possesses the exclusive power to make state tax law. N.C. Const. Art. I, § 23. The General Assembly has done so by enacting Chapter 105. N.C. Gen. Stat. § 105-1, *et. seq.* The General Assembly has delegated to NCDOR only the power to interpret the tax laws promulgated by the General Assembly. N.C. Gen. Stat. § 105-264. NCDOR's limited role exists not only as a matter of legislative mandate, but also as a matter of constitutional imperative. N.C. Const. Art. II, § 1. ("The legislative power of the State shall be vested in the General Assembly."); N.C. Const. Art. I, § 6 ("The legislative, executive, and supreme judicial powers of the State government shall be forever separate and distinct from each other."). Both the General Assembly and NCDOR are bound by the North Carolina Constitution's mandate that "[t]he power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away." N.C. Const. Art. V, § 2(1). The positions stated in NCDOR's September 10 Notice violate these constitutional and statutory protections.

Federal tax law is irrelevant to the determination of whether a valid partnership exists for purposes of Chapter 105. The general rule is that, without a "[c]lear and specific reference" in Chapter 105 invoking the Code, the Code has no application in determining taxable income in North Carolina. *Fidelity Bank v. N.C. Dep't of Revenue*, 370 N.C. 10, 20 (2017). In *Fidelity*, NCDOR argued that the Revenue Act was not "a wholesale adoption of all Code provisions and definitions" in an effort to prevent a taxpayer from using Code principles to conform the federal tax treatment of market discount income as deductible interest because the state tax provision contained no language evidencing legislative intent to require state law to mirror federal law. NCDOR is not a lawmaking body and cannot arrogate to itself legislative power to adopt federal tax law when it serves to increase taxes but reject federal tax law when it would reduce taxes.

Chapter 105 makes "clear and specific" references to only two Code provisions addressing federal partnership taxation principles, as follows:

> (a) Qualification. - A partnership that engages in an activity that is eligible for a tax credit qualifies for the credit as an entity and then passes through to each of its partners the partner's distributive share of the credit for which the partnership entity qualifies. Maximum dollar limits and other limitations that apply in determining the amount of a tax credit available to a taxpayer apply to the same extent in determining the amount of a tax credit for

> which the partnership entity qualifies, with one exception. The exception is a limitation that the tax credit cannot exceed the amount of tax imposed on the taxpayer.
>
> (b) Allowance of Credit to Partner. - A partner's distributive share of an income tax credit passed through by a partnership is allowed to the partner only to the extent the partner would have qualified for the credit if the partner stood in the position of the partnership. All limitations on an income tax credit apply to each partner to the extent of the partner's distributive share of the credit, except that a corporate partner's distributive share of an individual income tax credit is allowed as a corporation income tax credit to the extent the corporate partner could have qualified for a corporation income tax credit if it stood in the position of the partnership. All limitations on an income tax credit apply to the sum of the credit passed through to the partner plus the credit for which the partner qualifies directly.
>
> (c) Determination of Distributive Share. - A partner's distributive share of an income tax credit shall be determined in accordance with **sections 702 and 704 of the Code**.

N.C. Gen. Stat. § 105-269.15 (emphasis added).

Notably, this provision does not define the term partnership by reference to the Code, nor does it invoke the Code's provisions concerning when federal tax law treats a partnership interest as valid. Instead, Section 269.15 incorporates only two provisions of the Code – Sections 702 and 704 – for purposes of determining how to calculate a partner's distributive share. There is no indication in Section 269.15, or otherwise in Chapter 105, that the General Assembly intended for NCDOR to deviate from North Carolina law governing business entities to determine the existence of a valid partnership interest. *See, e.g.*, N.C. Gen. Stat. § 105-153.3(13) (defining partnership); *id.* § 59-36 (same). Further, no Code provisions other than Sections 702 and 704 are adopted in Section 269.15.

NCDOR lacks the authority to adopt the Third Circuit's analysis in *Historic Boardwalk* as North Carolina law or to rely upon it as persuasive authority concerning whether a partnership interest is valid under North Carolina law. The General Assembly has not adopted *Historic Boardwalk*; it is a case that does not apply

North Carolina law or correspond to any provision of North Carolina law, and decisions of the federal Third Circuit Court of Appeals are not binding in North Carolina or outside of the Third Circuit.

The foregoing analysis also governs NCDOR's invocation of Code Section 707, which sets out federal tax law governing disguised sales. Chapter 105 does not incorporate Section 707 and NCDOR has no authority to engage in the legislative function of adopting Section 707 as a provision of North Carolina tax law.

NCDOR similarly lacks the authority to adopt *Virginia Historic Tax Credits* as binding on North Carolina taxpayers. NCDOR's basis for invoking *Virginia Historic Tax Credits* is its analysis of federal Tax Code Section 707. But, as Section 707 does not apply to North Carolina state taxes, neither does *Virginia Historic Tax Credits*. More generally, *Virginia Historic Tax Credits* interprets federal tax law and does not govern whether an investor can claim North Carolina state tax credits. *Virginia Historic Tax Credits* did answer the question of whether the investors at issue in that case could claim state historic tax credits for purposes of state taxation.

Assuming arguendo that *Virginia Historic Tax Credits* has any applicability to North Carolina state tax credits, NCDOR has misconstrued the decision. The case addresses whether the recipient of a contribution must recognize federal income from a transfer, not the allowance or disallowance of state tax credits. *Virginia Historic Tax Credits*, 639 F3d at 146, n.20. It provides no basis for disallowing tax credits claimed by Monarch's investors.

The September 10 Notice also inaccurately describes federal law by cherry-picking cases without the context and evolution of the economic substance doctrine now codified in Section 7701(o). Federal case law, along with Congressional codification of the economic substance doctrine, make clear that a pre-tax profit is not required for a government sanctioned tax credit. *Sacks v. Commissioner*, 69 F.3d 982 (9th Cir. 1995). Moreover, federal case law makes clear that the taxpayers at issue would be partners under federal law.

The September 10 Notice also creates confusion concerning NCDOR's position on Private Letter Rulings CPLR 2013-04B and CPLR 2013-05B. The Private Letter Rulings do not reference Code Section 707, *Historic Boardwalk*, or *Virginia Historic Tax Credits* or other supposedly governing principles of federal tax law concerning whether a bona fide partnership interest exists. NCDOR needs to clarify that the rulings set out in Private Letter Rulings CPLR 2013-04B and CPLR 2013-05B are not subject to any federal law principles not specifically recited therein.

V. CONCLUSION

We appreciate your attention to this request and look forward to hearing from you within the time provided by N.C. Gen. Stat. § 150B-4(a1). Please feel free to contact us should you have any questions.

Warm regards,

Joseph S. Dowdy

Joseph S. Dowdy

cc:

By Hand Delivery (Courier) and email

North Carolina Department of Revenue
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Anthony.edwards@ncdor.gov

By Certified Mail, Return Receipt Requested
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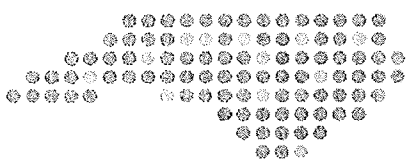

NCDOR | NORTH CAROLINA DEPARTMENT OF REVENUE

IMPORTANT NOTICE: TAX CREDITS INVOLVING PARTNERSHIPS

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North Carolina and Federal Tax Statutes

Credits against North Carolina tax are generally contained in Articles 3A through 3L of Chapter 105 of the General Statutes. With a few exceptions, most of these credits have expired. However, for credits or installments of credits still in effect, N.C. Gen. Stat. §§ 105-228.90 and 105-269.15 provide relevant definitions and guidance for a taxpayer claiming a credit through a transaction with a partnership. Some of these statutes require an understanding of federal income tax partnership and basis rules.

The Internal Revenue Code ("Code") provides guidance for the formation of bona fide partnership arrangements and allocation of partnership items to taxpayers. North Carolina generally follows the Code, subject to statutory exceptions and definitional differences.[1] In certain instances, North Carolina law or Chapter 105 directly references the Code. For example, N.C. Gen. Stat. § 105-269.15 specifically refers to sections 702 and 704 of the Code. In addition, this statute further references a "partner's distributive share," terms explained in sections 702 and 704.

It is the Department's position that relevant statutes in Chapter 105 include consequences resulting from federal income tax treatment of transactions generally known as "disguised sales" pursuant to section 707 of the Code and the regulations thereunder. Thus, a "disguised sale" determination prevents tax credits from being allocated to a taxpayer under section 704 or from creating sufficient basis in the partnership necessary for a taxpayer to use the tax credits.

Furthermore, the Department believes the termination of a partnership under section 708(b)(1)(B) of the Code, occurring prior to the repeal of section 708(b)(1)(B), are also

[1] *See, e.g., The Fidelity Bank v. North Carolina Department of Revenue*, 803 S.E. 2d 142 (2017).

applicable. Thus, a partnership that terminated under section 708(b)(1)(B) would lose its allocable credits at the time of the section 708(b)(1)(B) transaction.

Federal Case Law

Several U.S. Circuit Courts of Appeals, as well as the Tax Court, have addressed federal income tax issues that are relevant for North Carolina tax credits claimed by partnerships and taxpayers. Notably, Virginia Historic Tax Credit[2] provides an analysis of disguised sale transactions involving state tax credits, and Historic Boardwalk[3] discusses bona fide partner and partnership arrangements.

Because Virginia Historic Tax Credit is a Fourth Circuit Court of Appeals decision, the case is controlling for North Carolina. In a Private Letter Ruling, the Department has specifically stated its position that a person not qualifying as a partner under federal income tax would not qualify for allocation of a credit.[4]

North Carolina Private Letter Rulings

The Department has issued private letter rulings on the use of partnerships with various credits. Rulings from 2010 forward have been redacted and made publicly available at the direction of the General Assembly. These rulings, redacted pursuant to N.C. Gen. Stat. § 105-264.2(c), are available at:

https://www.ncdor.gov/taxes/corporate-income-franchise-tax/determinations/corporate/written-determinations-corporate-tax

Taxpayers should be aware that private letter rulings are only binding with respect to the requesting party, address only the specific rulings requested, and based only on the facts as presented. Accordingly, they should not be viewed as a blanket guarantee that all the criteria for claiming the credit have been met, including the party receiving the ruling.

Conclusion

In response to the inquiries received, the Department suggests that taxpayers review the above referenced materials, as well as information available from other sources, and discuss with their tax advisors the impact on the availability and amount of credits available for use against North Carolina tax liabilities. In addition, a taxpayer may request a private letter ruling through the Department's Written Determination policy, available at:

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[2] *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011).

[3] *Historic Boardwalk Hall, LLC v. Commissioner*, 694 F.3d 425 (3d Cir. 2012), *cert. denied*, 133 S.Ct. 2734 (2013).

[4] CPLR 2013-09R (August 13, 2013).

https://www.ncdor.gov/taxes/corporate-income-tax-information/corporate-income-franchise-and-insurance-tax-bulletins/determinations/written-determinations

After reviewing the above information, if taxpayers or tax advisors believe the amount of tax credits claimed on original returns are incorrect, they may file amended returns with the Department. If the amended return reflects additional tax due, the taxpayer will avoid a late-payment penalty if the additional tax reflected on the amended return is paid when the amended return is filed. If the amended return reflects additional tax due but some or all of the additional tax is not paid when the amended return is filed, the unpaid tax is subject to applicable penalties. In addition, statutory interest accrues on tax not paid by the original due date of the tax return. Taxpayers that owe additional North Carolina income tax may request a waiver of penalties resulting from the underpayment of tax attributable to such income within the provisions of the Department's penalty waiver policy available at:

https://www.ncdor.gov/documents/penalty-waiver-policy

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this important notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this important notice, the provisions contained in this important notice supersede the previous guidance.

EXHIBIT 4

North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

August 29, 2019

By Hand Delivery

Mr. Joseph S. Dowdy
Kilpatrick Townsend
4208 Six Forks Road
Suite 1400
Raleigh, NC 27609

RE: Request for Declaratory Rulings from the North Carolina Department of Revenue

Dear Mr. Dowdy:

We are in receipt of your letter dated August 1, 2019 ("Request Letter"). Secretary Ronald Penny has authorized me to respond for the Department. For the following reasons, the Department is denying the request of your client, Monarch Tax Credits, LLC ("Monarch"), formerly State Tax Credit Exchange, LLC ("STCE").

(1) The Department is prohibited by statute from issuing a declaratory ruling

STCE's request seeks to dispute a taxpayer's liability for a tax under Chapter 105 of the N.C. General Statutes. N.C. Gen. Statute § 105-241.19 prohibits the Department from issuing a declaratory ruling. The statute lists the exclusive means of resolving tax disputes and specifically disallows "an action for declaratory judgment, an action for an injunction to prevent the collection of tax, nor any other action(.)" *See Gust v. NC Department of Revenue*, 231 N.C. App. 551 (2014). Instead, N.C. Gen. Stat. §§ 105-241.11 through 105-241.18 provide the exclusive remedies for resolving tax disputes and N.C. Gen. § 105-264 provides the exclusive means for receiving written advice from the Secretary. As the North Carolina Court of Appeals held in *Gust,* the doctrine of sovereign immunity protects the Department from other actions.

(2) The Department is precluded from issuing a declaratory ruling during ongoing litigation

The Department currently has pending litigation related to the issues under request and therefore is not required to issue a ruling. *See, e.g., Equity Solutions of the Carolinas, Inc. v. N.C. Dep't of State Treasurer*, 232 N.C. App. 384 (2014) and *Catawba Mem. Hosp. v. N.C. Dep't of Human Resources*, 112 N.C. App. 557 (1993).

(3) STCE fails to meet the standards of N.C. Gen. Statute § 150B-4

Even if N.C. Gen. Statute § 105-241.19 were deemed not to apply, STCE fails to meet the requirements of N.C. Gen. Statute § 150B-4 for the following reasons:

a. STCE is not a "person aggrieved" within the meaning of N.C. Gen. Statute § 150B-2(6). STCE has failed to show that it was "affected substantially in his or its person, property or employment by an administrative decision." The Request Letter fails to adequately state this requirement is met. Assuming STCE is able to demonstrate that it meets the "affected substantially" requirement, the Important Notice issued September 10, 2018 ("Important Notice"), which is attached to STCE's letter requesting a ruling, is not an administrative decision within the meaning of N.C. Gen. Statute § 150B-2(6).

b. The Important Notice is not a "Rule" within N.C. Gen. Statute § 150B-2(8a). The Important Notice is a "(n)onbinding interpretive statement within the delegated authority of an agency that merely define[s], interpret[s], or explain[s] the meaning of a statute or rule." N.C. Gen. Statute § 150B-2(8a)c. The Secretary issued the Important Notice under the authority of N.C. Gen. Statute § 105-264(a), which provides that it is the "duty of the Secretary to interpret all laws administered by the Secretary."

(4) The request contravenes the statutory and constitutional duty of the Department

Article V of the North Carolina Constitution provides to the General Assembly the power of taxation. That Article and Chapter 105 of the North Carolina General Statutes impose a duty on the Department to fairly administer the tax statutes. N.C. Gen. Statute § 105-264 provides the statutory support for the Secretary's interpretation of the laws. STCE's request contravenes this constitutional order and statutory framework provided by the General Assembly by asking the Department to make declarations of law rather than administer and provide interpretations as provided by statute.

(5) STCE's failure of adequate due diligence prevents the issuance of a declaratory ruling

a. STCE was aware of the issues for which it seeks a declaratory ruling but failed to request guidance from the Department under statutory procedures and published Department policy

In its internal documents, STCE specifically identified Internal Revenue Code section 707, disguised sale, as a tax risk to investors. In private placement memoranda provided to taxpayers who purchased the credits from STCE, STCE specifically cited to *Virginia Historic Tax Credit*,[1] and indicated that clients face the risk of audit on these issues by the Internal Revenue Service and the Department. Nevertheless, STCE indicated it would **not** seek a ruling from either the IRS or the Department on this issue.

STCE was also aware of the section 707 disguised sale risks with respect to North Carolina Historic Tax Credits. In a letter dated March 15, 2017 from Monarch Private Capital advocating for legislative changes, Monarch stated that "[w]e are very concerned that most

[1] *Virginia Historic Tax Credit Fund 2001, LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011).

syndications of the North Carolina Historic Tax Credit would be viewed by the IRS as a disguised sale (particularly since NC is in the same circuit as the Virginia Historic Tax Cred v. Comm., 4th Cir. Decision)." In that letter, Monarch requested that it be shared with the Department.

b. STCE ignored the clear guidance provided in private letter rulings and failed to seek additional clarification

STCE sought and received private letter rulings which clearly indicated the Department's position with respect to following the Internal Revenue Code regarding partnership tax rules. Additional private letter rulings, redacted for publication, provided similar guidance.

i. In CPLR 2013-08 dated August 5, 2013, the Department informed STCE that "(i)f a person is not classified as a partner for federal income tax purposes and not entitled to claim distributive share of income, gain, loss, deduction, or credit for federal purposes, then they would not qualify to receive distributive share of income, gain, loss, deduction or credit for North Carolina purposes."

ii. In CPLR 2013-09R dated August 13, 2013, the Department again notified STCE that it followed federal tax law with respect to partnership determinations.

iii. In CPLR 2015-03 dated January 16, 2015, the Department responded to the STCE ruling request on Mill Credits that discussed the holding in the *Virginia Historic* and related cases in which STCE specifically asserted that the department should not apply these rulings in determining the credit. However, the Department explicitly disagreed. The Department ruled that "(b)ased on our understanding of the Statement of Facts and the authorities cited therein, Investor will not meet the required adjusted basis threshold in the Project Partnership pursuant to the allocation provisions of the aforementioned statute because a significant amount of its contributions will be attributable to the purchase price for the Mill Credits rather than a capital contribution to a Project Partnership for federal income tax purposes."

Accordingly, STCE's assertions that the Department has changed its position is simply not supported by the facts. The Department contends that taxpayers, or persons marketing tax planning strategies to taxpayers, who fail to undertake adequate due diligence should be precluded from using N.C. Gen. Statute § 150B-4 as a weapon against the Department when that failure results in negative audit consequences. Such a conclusion undermines Chapter 105 and significantly impairs the Department's ability to fulfill one of its vital functions.

Importantly, the Department remains open to discuss paths to resolution consistent with the law and departmental policy.

Very truly yours,

Anthony Edwards
Assistant Secretary for Tax Administration

Cc: Reed Hollander, Nelson Mullins Riley & Scarborough, LLP