STATE OF NORTH CAROLINA **COUNTY OF WAKE**	**BEFORE THE NORTH CAROLINA DEPARTMENT OF REVENUE** **OAH NO: 09 REV 5669**
[Taxpayer], **Petitioner,** **v.** **NORTH CAROLINA DEPARTMENT OF REVENUE,** **Respondent.**	**FINAL AGENCY DECISION**

THIS MATTER came before the North Carolina Department of Revenue ("Department") pursuant to N.C. Gen. Stat. § 150B-36 for the Department to make a final agency decision. Upon consideration of Petitioner's Motion for Summary Judgment, Respondent's Motion for Summary Judgment, the parties' respective responses thereto, the parties' respective oral arguments, and for good cause shown, Administrative Law Judge ("ALJ") Joe Webster granted Petitioner's motion for summary judgment and denied Respondent's motion for summary judgment in the Decision by Summary Judgment filed in the Office of Administrative Hearings ("OAH") on November 24, 2010.

The official administrative record was transmitted by the OAH to the Department on December 22, 2010. By letter dated December 22, 2010, each party was notified of the opportunity to file exceptions to the ALJ's Decision as well as file a supporting brief and proposed order.

The parties have mutually agreed to a response schedule which extended the period within which the Department was to issue the final agency decision to and including April 21, 2011.

Upon a full review of the entire record of this matter, including the official record as defined in N.C. Gen. Stat. § 150B-37(a), as well as the exceptions, written arguments, proposed orders, and other documents submitted by the parties, the Department makes the following Final Agency Decision:

Deletions from the Issue, Findings of Fact, Stipulated Documents, and Conclusions of Law of the ALJ are marked with ~~strikethroughs~~ and additions/modifications are in **bold**.

APPEARANCES

For Petitioner: [Law Office/Attorney Names and Address]

For Respondent: Gregory P. Roney, Esq.
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ISSUE

The Department hereby adopts the Issue as set forth in the Decision of the ALJ, as follows:

Was the capital gain that Petitioner recognized from the 2004 sale of its minority limited partnership interest in [LP 1] apportionable income or nonapportionable income under G.S. 105-130.4?

STIPULATED FINDINGS OF FACT

The Department hereby adopts the Stipulated Findings of Fact, except as below modified, as set forth in the Decision of the ALJ as follows:

1. During all relevant times, Petitioner was a Texas limited partnership with its commercial domicile in [City 1], Texas.

2. Respondent North Carolina Department of Revenue ("DOR") is an agency of the State of North Carolina.

3. During all relevant times, [Corporation 1] was a publicly traded Delaware corporation. [Corporation 1] owned interests, either directly or indirectly through its subsidiaries, in affiliated corporate entities and partnerships, referred to hereinafter as "[the affiliated group]."

The Department modifies Finding of Fact No. 4 to identify the Petitioner.

4. During 2000-2004, [the affiliated group] included, but was not limited to, [Taxpayer] **(Petitioner)**, [Corporation 2], and [Corporation 3].

5. [Corporation 3] was a Texas corporation and a wholly owned subsidiary of [Corporation 1].

6. [Corporation 2] was a Texas corporation.

7. [LP 2] was a Delaware limited partnership.

8. [LLC 1] was a Delaware limited liability company.

9. [LP 1] was a Delaware limited partnership with its principal place of business in [City 2], Texas.

August 2000 Transactions

10. Prior to August 2000, Petitioner and [Corporation 3] operated an automobile consumer finance business.

11. This specialized consumer finance business was engaged in the purchase, securitization, and servicing of retail installment contracts originated by automobile dealers in many states, including North Carolina. Retail installment contracts were acquired principally from manufacturer-franchised dealers in connection with the sale of used and new automobiles and light duty trucks to customers with limited credit histories or past credit issues.

12. In August of 2000, Petitioner and [Corporation 3] contributed, through a series of steps, all of their respective interests in the automobile consumer finance business to [LP 1], a new limited partnership created to receive and operate this automobile consumer finance business ("August 2000 transactions").

13. The August 2000 transactions resulted in the following ownership structure:

(a) [Corporation 2], a Texas corporation, owned a 1% general partnership interest in and managed Petitioner. [Corporation 2] was owned by [Corporation 3] (80% interest) and [LP 2] (20% interest).

(b) [Corporation 3] owned a 79.2% limited partnership interest in Petitioner.

(c) [Corporation 1] owned 100% of [Corporation 3].

(d) [LP 2] owned a 19.8% limited partnership interest in Petitioner. [LP 1] was the limited partner and [LLC 2] was the general partner of [LP 2]. [LP 1] owned 100% of [LLC 2].

(e) [LLC 1] owned a 0.1% general partnership interest in and managed [LP 1]. [Corporation 3] owned 31% of the stock of [LLC 1]. Parties unrelated to Petitioner owned 69% of the stock of [LLC 1].

(f) [LLC 1] was managed by six individuals named as Managers. A majority (four) of these managers were appointed by parties unrelated to Petitioner.

(g) Petitioner owned, as its only asset, a 35.9269125% limited partnership interest in [LP 1].

(h) Parties unrelated to Petitioner and Lending owned the remaining limited partnership interests in [LP 1] ([LLC 3] owned a 45.4301636% limited partnership interest and [LP 3] owned a 18.5429239% limited partnership interest), in addition to the .1% general partnership interest of [LLC 1].

Petitioner's North Carolina tax returns, 2000-2004

14. Petitioner filed North Carolina corporate income and franchise tax returns for the years 2000-2004, having elected to be treated for tax purposes as a corporation.

15. On these returns, Petitioner reported it's [*sic*] pro rata share of income derived from its limited partnership interest in [LP 1].

16. For the 2004 year, Petitioner apportioned income to North Carolina based on the following apportionment factors: a property factor of 0.0 percent, a payroll factor of 0.5552 percent, and a double weighted sales factor of 6.1589 percent.

Petitioner's sale of limited partnership interest in [LP 1]

17. On November 1, 2004, Petitioner sold its only asset, the limited partnership interest in [LP 1], for $108,391,500, generating a gain of $56,860,313.

18. On November 23, 2004, Petitioner filed a Certificate of Cancellation with the Secretary of State of Texas.

19. Petitioner signed its 2004 North Carolina corporate income tax return on October 13, 2005. DOR received Petitioner's 2004 North Carolina corporate income tax return on October 17, 2005.

20. On Petitioner's North Carolina corporate income tax return, Petitioner reported the gain from the sale of its limited partnership interest in [LP 1] as nonapportionable income that was not subject to North Carolina corporate income tax.

Audit and assessment

21. The DOR audited Petitioner's 2004 corporate income tax return and issued a proposed corporate income tax assessment on September 17, 2008.

22. The DOR reclassified Petitioner's gain from the sale of its limited partnership interest in [LP 1] as apportionable income.

23. The DOR determined Petitioner's North Carolina apportionment factor by treating Petitioner as an excluded corporation under G.S. 105-130.4(a)(4).

24. DOR also determined the sale of the limited partnership interest in [LP 1] was a casual sale of property under G.S. 105-130.4(a)(7)a, thereby excluding the proceeds of such sale from the numerator and the denominator of the sales factor.

25. The DOR increased Petitioner's apportionment factor for 2004 from 3.2183% to 6.1589%.

26. Petitioner timely requested a review of the proposed assessment on October 30, 2008.

27. The DOR issued its Final Determination on August 18, 2009, confirming the assessment of tax, penalty, and interest.

STIPULATED DOCUMENTS

The Department hereby adopts the list of Stipulated Documents, except as below modified, as set forth in the Decision of the ALJ as follows:

Petitioner and DOR stipulate that the documents listed below, copies of which are attached hereto and incorporated herein by reference, are true and accurate copies, are genuine, and if relevant and material, may be received into evidence without further identification or proof:

Exhibit A: Organizational Chart depicting ownership structure after August 2000 transaction

The Department modifies Exhibit Nos. 1 through 7 to correct a scrivener's errors in the decision:

Exhibit 1: The following corporate documents of Petitioner~~;~~**:** Articles of Conversion, Assumed Name Certificate, Certificate of Limited Partnership, Agreement of Limited

Partnership, Amended and Restated Agreement of Limited Partnership, and First Amendment to the Agreement of Limited Partnership.

Exhibit 2: The following corporate documents of [Corporation 2]**:** Secretary's Certificate and attached Articles of Incorporation, Bylaws, board resolutions concerning the August 2000 transactions, Stock Register; and officer/director list for [Corporation 2] in 1999.

Exhibit 3: The following corporate documents of [LP 2]**:** Certificate of Secretary of General Partner of [LP 2] and attached Certificate of Limited Partnership, Agreement of Limited Partnership, and resolutions concerning the August 2000 transactions.

Exhibit 4: The following corporate documents of [LLC 2]**:** Certificate of Secretary of [LLC 2] and attached Certificate of Formation, Limited Liability Company Agreement, and resolutions concerning the August 2000 transactions.

Exhibit 5: The following corporate documents of [LP 1]**:** Certificate of Secretary and attached Certificate of Limited Partnership, Amended and Restated Agreement of Limited Partnership, Agreement of Limited Partnership, and resolutions concerning the August 2000 transactions.

Exhibit 6: The following corporate documents of [LLC 1]**:** Certificate of Secretary and attached Certificate of Formation, Amended and Restated Limited Liability Company Agreement, and resolutions concerning the August 2000 transactions.

Exhibit 7: The following corporate documents of [Corporation 3]**:** Certificate of [Corporation 3] and attached Articles of Incorporation, Articles of Correction, and Bylaws.

Exhibit 8: Petitioner's CD-405 C Corporation Tax Return for calendar year 2000.

Exhibit 9: Petitioner's CD-405 C Corporation Tax Return for calendar year 2001.

Exhibit 10: Petitioner's CD-405 C Corporation Tax Return for calendar year 2002.

Exhibit 11: Petitioner's CD-405 C Corporation Tax Return for calendar year 2003.

Exhibit 12: Petitioner's CD-405 C Corporation Tax Return for calendar year 2004.

Exhibit 13: **[**Corporation 3]'s balance sheet for year ending December 31, 2002.

The Department modifies the wording of Exhibit 14 to identify the Petitioner.

Exhibit 14: Securities Purchase Agreement entered into in 2004 by [Corporation 1], [Corporation 3], [Taxpayer] **(Petitioner)**, [Corporation 2], [LLC 4], [LLC 3], [LP 3], [LLC 5], [LP 2], [LLC 1], and [LP 1].

Exhibit 15: The first 11 pages of the Form 10-K annual report for fiscal year ending December 31, 2002 that was filed with the Securities and Exchange Commission.

Exhibit 16: Excerpt of Petitioner's federal corporate income tax return for Petitioner for calendar year 2004, including Form 1120, Form 4626, Form 851, Schedule D to Form 1120, and Statements 1-29.

Exhibit 17: Preliminary audit work papers of the DOR for the corporate income and franchise tax audit of Petitioner dated April 9, 2008.

Exhibit 18: Final draft of the audit comments of the DOR for the corporate income and franchise tax audit of Petitioner dated May 15, 2008.

Exhibit 19: Proposed assessment of additional corporate income tax for 2004 dated September 17, 2008.

Exhibit 20: Taxpayer's objection and request for review dated October 30, 2008.

Exhibit 21: Notice of Final Determination dated August 18, 2009.

Exhibit 22: Balance sheets of Petitioner for 2001, 2002, 2003, and 2004.

Exhibit 23: Certificate of Cancellation for [Petitioner] filed in the Office of the Secretary of State of Texas on 11/23/2004, Articles of Dissolution for [Corporation 2] filed in the Office of the Secretary of State of Texas on 11/23/2004**,** and Certificate of Account Status for [Corporation 2] filed in the Office of the Secretary of State of Texas on 11/23/2004.

Exhibit 24: Letter from Petitioner's Accountant with attachments dated 10/30/2008.

Exhibit 25: Letter from Petitioner's Accountant with attachments dated 3/9/2009.

Exhibit 26: Letter from Petitioner's Accountant with attachments dated 6/18/2009.

Exhibit 27: [Corporation 1] Form 8-K from 8/3/2004.

Exhibit 28: [Corporation 1] Form 8-K from 9/21/2004.

Exhibit 29: [Corporation 1] Form 8-K from 10/21/2004.

Exhibit 30: [Corporation 1] Form 8-K from 11/1/2004.

Exhibit 31: [Corporation 1] Form 8-K from 11/4/2004.

Exhibit 32: [Corporation 1] Form 8-K from 11/12/2004.

Exhibit 33: [Corporation 1] Form 8-K from 2/16/2005.

Exhibit 34: [Corporation 1] Form 10-K for fiscal year ended 12/31/2004.

Exhibit 35: [Corporation 1] Form 10-K/A for fiscal year ended 12/31/2004.

CONCLUSIONS OF LAW

The Department hereby adopts the Conclusions of Law, except as below modified, as set forth in the Decision of the ALJ, as follows:

1. The Office of Administrative Hearings has jurisdiction over this contested case.

The Department modifies Conclusion of Law No. 2 to correct a scrivener's

error in the decision:

2. A party is entitled to summary judgment when the evidence shows the absence of a genuine issue of material fact and that it is entitled to a judgment as a matter of law. N.C. Gen. Stat. § 1A-1, Rule 56~~©~~**(c)**.

3. The parties stipulate that this case is ripe for disposition, have stipulated to the Facts, Exhibits and that Summary Judgment is appropriate. "On a motion for summary judgment the court may consider the pleadings, depositions, answers to interrogatories, affidavits, admissions, oral testimony, documentary materials, facts which are subject to judicial notice, such presumptions as would be available at trial, and any other material which would be admissible in evidence at trial." *Gebb v. Gebb,* 67 N.C. App. 104, 107, 312 S.E.2d 691, 694 (1984).

The Department adds Conclusions of Law Nos. 3A through 3E to show the OAH's authorization to consider whether or not a tax statute is unconstitutional as applied.

3A. The OAH has jurisdiction over contested tax cases pursuant to G.S. 105-241.15. "A taxpayer who disagrees with a notice of final determination issued by the Department may contest the determination by filing a petition for a contested case hearing at the Office of Administrative Hearings in accordance with Article 3 of Chapter 150B of the General Statutes." G.S. 105-241.15.

3B. The OAH is required to dismiss a tax case for lack of subject matter jurisdiction where "the sole issue is the constitutionality of a statute and not the application of a statute." G.S. 105-241.17(3).

3C. The Hearings Division of the OAH has a regulation governing the decisions of the ALJ which contemplates that the ALJ will consider constitutional principles:

An administrative law judge's decision shall fully dispose of all issues required to resolve the case and shall contain…(6) conclusions of law based on the findings of fact and applicable constitutional principles, statutes, rules, or federal regulations[.] 26 N.C.A.C. § 03.0127(c).

3D. The statute governing jurisdiction of the superior court over contested tax cases further supports the ALJ being authorized to decide constitutional issues in the context of the application of a statute. A taxpayer may bring an action in superior court only if "[t]he Office of Administrative Hearings dismissed the contested case petition for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute." G.S. 105-241.17(3).

3E. The OAH is not prohibited from hearing evidence and adjudicating issues involving constitutional principles in the context of the application of a statute. Respondent's Motion to Dismiss Constitutional Claims in this matter was therefore denied by the ALJ by Order Denying Motion to Dismiss filed March 31, 2010.

The Department modifies Conclusion of Law No. 4 to correct a scrivener's error in the decision:

4. "Apportionable income" means **"**all income that is apportionable under the United States Constitution." G.S. 105-130.4(a)(1). Income that is "apportionable income" is apportioned to North Carolina based on the appropriate statutory apportionment formula in G.S. 105-130.4. The apportionment formula for an "excluded corporation" is determined under G.S. 105-130.4(r).

The Department modifies Conclusion of Law No. 5 to correct a scrivener's error in the decision:

5. "Nonapportionable income" means "all income other than apportionable income." G.S. 105-130.4(a)(5). Income that is "nonapportionable income" is allocated to North Carolina based on the provisions of G.S. 105-130.4(c) through G.S. 105-130.4(h).

6. Partnership income which is nonapportionable income is allocated to North Carolina "if the business situs of the activities or investments is located in this State." G.S. 105-130.4(h).

7. Gain or loss from the sale of an intangible asset which is nonapportionable income is allocated to North Carolina "if the corporation's commercial domicile is in this State." G.S. 105-130.4(e)(3).

8. Petitioner's limited partnership interest in [LP 1] was an intangible asset that was sited at Petitioner's commercial domicile in Texas. (Affidavit of [Petitioner's Representative] ¶ 33.) If the capital gain from the sale of this limited partnership interest was nonapportionable income, then it was not allocable to, and not taxable in, North Carolina, because Petitioner's commercial domicile was in Texas. The capital gain from the sale of this limited partnership interest was subject to North Carolina corporate income tax only if the capital gain was apportionable income. G.S. 105-130.4(a)(1); G.S. 105-130.4(b).

9. Income of a non-resident corporation, or a partnership which is taxed as a corporation, is apportionable under the Commerce Clause only if the income is earned as part of a unitary business. *Allied-Signal, Inc. v. Dir. Div. of Taxation,* 504 U.S. 768, 78081 (1992).

10. The three-part test for whether income from a business has a unitary relationship with the taxpayer is whether there is "(1) functional integration[,] (2) centralization of management[,] and (3) economies of scale" between that business and the taxpayer's business. *Allied-Signal, Inc. v. Dir. Div. of Taxation,* 504 U.S. 768, 781 (1992).

11. There was not a unitary relationship between either Petitioner and [LP 1] or [the affiliated group] and [LP 1] under the three-part unitary business test. The undisputed material facts show that none of the three hallmarks of a unitary relationship existed, for the following reasons:

(a) Regarding the "functional integration" prong of the unitary business test, neither Petitioner nor [the affiliated group] had any functional integration with [LP 1], because:

i. Neither Petitioner nor any other member of [the affiliated group] had integrated physical assets, intangible property, supplier contracts, purchasing agreements, joint ventures, physical facilities, marketing operations, collections operations, accountants, legal services arrangements, tax services providers, information technology resources, or independent contractors with [LP 1]. (Affidavit of [Petitioner's Representative] ¶ 28(a).)

ii. Neither Petitioner nor any other member of [the affiliated group] rented property from [LP 1], and [LP 1] did not rent property from Petitioner or any other member of [the affiliated group]. (Affidavit of [Petitioner's Representative] ¶ 28(a).)

iii. There was no shared property or payroll between Petitioner, or any member of [the affiliated group], and [LP 1]. (Affidavit of [Petitioner's Representative] ¶ 28(a).)

iv. None of the members of [the affiliated group] loaned money to [LP 1], and [LP 1] did not loan money to the members of [the affiliated group]. (Affidavit of [Petitioner's Representative] ¶ 28(a).)

(b) Regarding the "centralization of management" prong of the unitary business test, separate management teams oversaw and operated Petitioner and [LP 1], so there was no centralized management between the two. (Affidavit of [Petitioner's Representative] ¶ 27.)

(c) Regarding the "economies of scale" prong of the unitary business test, because there were no shared employees, assets, or common business ventures between either [LP 1] and Petitioner or [LP 1] and [the affiliated group], there were no economies of scale. (Affidavit of [Petitioner's Representative] ¶ 29.)

12. The facts before this Court pertinent to the three-part unitary business test are similar in their material respects to the facts in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), which the U.S. Supreme Court held failed to satisfy the constitutional unitary business test. *Allied-Signal* also involved the gain from the sale of the taxpayer's passively held interest in an unrelated business. The Supreme Court held that, because the taxpayer passively held this interest, the taxpayer was not unitary with the unrelated business, so the gain from the sale of the interest was nonapportionable income. The undisputed material facts lead to the same conclusion in the case before this Court.

The Department modifies Conclusion of Law No. 13 to correct a scrivener's error in the decision:

13. 17 N.C.A.C. § **5C.**1702 simply inquires whether the corporate partner actively participates in the operations of the partnership or is a passive investor.

14. The most recent U.S. Supreme Court cases concerning the unitary business principle, *Allied-Signal v. Director, Division of Taxation*, 504 U.S. 768 (1992), and

MeadWestvaco Corp. v. Illinois Department of Revenue, 553 U.S. 16 (2008), offer no support for treating companies differently based on the quantity of activity that the taxpayer conducts.

15. Respondent's position is also inconsistent with cases in other states applying the unitary business test to holding companies, including *In the Matter of PBS Building Systems*, No. 94-SBE-008, 1994 Cal. Tax LEXIS 434 (Cal. State Bd. of Equalization Nov. 17, 1994), a case which Respondent cites, and *In the Matter of Insul-8 Corp.,* 92-SBE-007 (Cal. St. Bd. of Equalization Apr. 23, 1992), and *First National Bank of Manhattan, Kansas v. Kansas Dep't of Rev.*, 13 Kan. App. 2d 706, 779 P.2d 457 (1989). These cases hold that the three-part unitary business test is applied without modification between holding companies and subsidiary businesses.

The Department modifies Conclusion of Law No. 16 to correct a scrivener's errors in the decision:

16. Respondent contends that the fact that Petitioner previously paid North Carolina corporate income tax on partnership income received from [LP 1] constitutes an admission that capital gain on the sale of [LP 1] is taxable in North Carolina. This Court does not agree for the following reasons:

(a) The partnership income from [LP 1] was taxable in North Carolina regardless of whether it was apportionable or nonapportionable income~~:~~**.** If the partnership income was apportionable income, then it would be apportioned to North Carolina pursuant to the appropriate statutory apportionment formula in G.S. 105-130.4. If the partnership income was nonapportionable income, then it would be allocated to North Carolina according to G.S. 105-130.4(h).

(b) Nonapportionable capital gains are treated differently from nonapportionable partnership income under G.S. 105-130.4(e)(3) and G.S. 105-130.4(h). Under G.S. 105-130.4(e)(3), gain or loss from the sale of an intangible asset which is nonapportionable income is allocated based on the state of the taxpayer's commercial domicile, whereas under G.S. 105- 130.4(h), partnership income which is nonapportionable income is allocated based on the business situs of the activities or investments producing the income.

~~(c)~~ **(c)** In any event, the propriety of Petitioner's tax positions with respect to partnership income is not before this Court.

17. Respondent contends that [LP 1] was an integral part of Petitioner's business operations because Petitioner's sale of [LP 1] contributed to the working capital of [the affiliated group]. Respondent cites *National Service Industries, Inc. v. Powers,* 98 N.C. App. 504, 391 S.E.2d 509 (1990), in support of its position. *National Service Industries* does not control this case. The facts in the case before this Court are materially different from the facts in *National Service Industries* in three respects:

(a) First, the parties in *National Service Industries* "stipulated that the several operating arms of plaintiff's business are joined by a 'highly centralized' cash management and business operations system. From this record [the Court] conclude[d] that plaintiffs conglomerate corporation is a unitary business for tax purposes." *National Service Industries,* 98 N.C. App. at 509. Therefore, the parties in *National Service Industries* stipulated that the entire operations of the taxpayer were a unitary business as a matter of law. The facts before this Court are wholly different. In the case before this Court, the undisputed facts show that there was no centralized management of finances

for [LP 1] and Petitioner, or [LP 1] and [the affiliated group]. Likewise, there was not a centralized "business operations system" for [LP 1] and Petitioner, or [LP 1] and [the affiliated group].

(b) Second, the equipment leases at issue in *National Service Industries* involved ongoing lease payments that regularly contributed to working capital of the taxpayer. In contrast, the gain from the sale of [LP 1] resulted from a one-time sale that was not a regular contribution to the working capital of either Petitioner or [the affiliated group]. Under *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768 (1992), the mere fact that a transaction conferred a financial benefit on the taxpayer, a financial benefit which the taxpayer then used in its business, does not mean that the income is apportionable income. *Allied-Signal,* 504 U.S. at 788-89. All income inherently has a financial benefit to its recipient. Rather, in order for income to be apportionable, the unitary business test must be met. *Id.* at 789. Likewise, under *Allied-Signal,* the mere fact that ownership of an asset makes a business more creditworthy does not mean that the asset is part of the taxpayer's unitary business. Without this distinction between a unitary business and a mere investment, "the 'unitary business' limitation becomes no limitation at all." *Allied-Signal,* 504 U.S. at 589.

(c) Third, the lease payments at issue in *National Service Industries* derived from the rental of equipment owned by the taxpayer. In contrast, the capital gain at issue in the case before this Court derives from the sale of a separate, self-contained business. In *MeadWestvaco Corp. v. Illinois Department of Revenue,* 553 U.S. 16 (2008), the U.S. Supreme Court held that where "the asset in question is another business, we have described the 'hallmarks' of a unitary relationship as functional integration, centralized

management, and economies of scale." *MeadWestvaco*, 553 U.S. at 30 (emphasis added). Because [LP 1] was "another business," the three-part unitary business test applies to this case.

18. Respondent contends that, unlike shareholders of a corporation, partners are deemed to be operating the business of a partnership by virtue of their status as partners, and therefore a partnership interest is automatically unitary with the partner, thus resulting in apportionable income. Respondent's position is inconsistent for the following reasons:

(a) Respondent's regulation, 17 N.C.A.C. § 5C.1702, contradicts Respondent's contention that partners are automatically deemed to derive apportionable income from partnerships. Rather, the regulation provides for a fact-specific inquiry into whether the corporate partner is actively engaged in the day-to-day operation of the partnership or whether it is a mere passive investor.

(b) Also, Respondent's position on income received from a partnership is inconsistent with the U.S. Supreme Court's holding in *MeadWestvaco Corp. v. Illinois Department of Revenue*, 553 U.S. 16 (2008).

(i) In *MeadWestvaco*, the capital gain at issue was derived from the sale of LexisNexis, which was a division of the taxpayer's predecessor-in-interest, Mead Corporation. Even though LexisNexis was not a separate corporate entity, the U.S. Supreme Court nevertheless applied the three-part unitary business test and found that the LexisNexis business was not unitary with the remaining operations of Mead Corporation. *MeadWestvaco*, 553 U.S. at 30.

(ii) Therefore, regardless of the corporate form of the transaction, the rule in *MeadWestvaco* is that where "the asset in question is another business,"

the determination of whether the other business was unitary with the taxpayer is made based on the fact-specific three-part unitary business test.

19. The constitutional unitary business test is not met in this case for the reasons outlined above.

20. Respondent's proposed assessment treating Petitioner's gain from the sale of its limited partnership interest in [LP 1] as apportionable income violates Commerce Clause principles, and therefore the gain does not meet the statutory definition of "apportionable income" as set forth in G.S. 105-130.4(a)(1).

21. The gain from the sale of Petitioner's interest in [LP 1] was nonapportionable income that was not allocable to North Carolina for taxation, but instead was allocable to Texas, because Petitioner's commercial domicile was Texas. G.S. 105-130.4(e)(3).

22. Respondent's contention in this case that Petitioner's gain was apportionable income is also inconsistent with its own regulation concerning partnership income, 17 N.C.A.C. § 5C.1702. This regulation provides that partnership income is nonapportionable income "where the corporate partner limits its connection to the partnership to the mere investment of funds or property and does not regularly or materially participate in the day-to-day operation of the partnership." The undisputed facts demonstrate that Petitioner's connection to [LP 1] was a mere investment of funds that was passive. (Affidavit of [Petitioner's Representative] ¶ 22.) Likewise, the undisputed facts demonstrate that neither Petitioner nor [the affiliated group] regularly or directly participated in the day-to-day operation of the partnership in any way. (Affidavit of [Petitioner's Representative] ¶¶ 27-28.)

23. Respondent's proposed assessment was therefore unlawful under G.S. 105--130.4(a)(1), because the gain from the sale of [LP 1] was nonapportionable income under

controlling U.S. Supreme Court precedent and 17 N.C.A.C. § 5C.1702, and Petitioner's commercial domicile was not in North Carolina.

24. No additional corporate income tax is due from Petitioner for the 2004 tax year.

DECISION

The Department determines that the Stipulated Findings of Fact and Conclusions of Law of the ALJ, as adopted by the Department, support the ALJ's Decision granting Petitioner's motion for summary judgment and denying Respondent's motion for summary judgment. Based on the foregoing, the Department hereby UPHOLDS and ADOPTS the Decision of the ALJ granting Petitioner's motion for summary judgment and denying Respondent's motion for summary judgment.

No additional corporate income tax is due from Petitioner for the 2004 tax year.

This the 21st day of April, 2011.

NORTH CAROLINA DEPARTMENT OF REVENUE

/s/ Janice W. Davidson

Janice W. Davidson
Agency Legal Specialist, II.
North Carolina Department of Revenue