# North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

January 18, 2019

[redacted]

**Re: Request for Written Determination for** [redacted]

Dear [redacted]

This letter is in response to your letter dated August 28, 2018, wherein you requested on behalf of [redacted] ("Taxpayer") that the North Carolina Department of Revenue ("Department") issue a letter ruling regarding the requirement to file a North Carolina Partnership Income Tax Return ("Partnership Return") and pay North Carolina income tax on behalf of nonresident members. Taxpayer requested the ruling to be based on the current and possible future activities of the Taxpayer.

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

- Taxpayer is a private investment company operating under the North Carolina limited liability company organization with over 100 equity members.
- All income is derived from short-term commercial loans, secured with real estate as collateral, that generate interest income.
- Taxpayer provides no other goods or services and is operated by a management company.
- None of the income is from other activities, whether within or outside North Carolina, nor received directly or flowing through from other pass-through entities.
- The management fees and annual audit costs are the only expenses of Taxpayer.
- Taxpayer believes that its current operations may not require the Taxpayer to file an annual Partnership Return with the Department, because the investment partnership exception may apply to the Taxpayer.
- Taxpayer states that in the future it may be forced to foreclose on a loan and accept title to the real estate used as collateral. These foreclosed assets would then be sold, and any gain or loss would flow through to the equity members along with interest income. Any asset obtained by Taxpayer through foreclosure proceedings would not be held or operated but immediately sold.

In addition, the Department notes that Taxpayer's website describes Taxpayer's process for its loan program. The following is a summary of that process:

- Once an initial loan application is received, Taxpayer conducts a preliminary review.
- Taxpayer contacts the applicant with any outstanding questions about the applicant's project.
- If Taxpayer is the right fit for the applicant's project, Taxpayer issues a loan commitment letter.
- Once the commitment letter is signed and returned to Taxpayer, Taxpayer begins the underwriting process.
- Taxpayer then works with the applicant to determine an appropriate closing date.

**Relevant Information from Directives and Administrative Rules**

Directive PD-04-2 clarifies when a partnership is an "investment partnership" for North Carolina tax purposes. Under that Directive an "investment partnership" is a partnership in which all income or loss is derived from changes in the value of its investments in intangible assets (capital appreciation) or from intangible income (i.e., dividends or interest) derived from the assets in which the partnership invests (*emphasis added*) and such income is solely for the benefit of the partnership's owners. If any of the partnership's income is from other activities, either within or outside this State or either received directly or flowing through from other pass-through entities, the partnership is not an "investment partnership" for North Carolina income tax purposes. Other activities include but are not limited to providing services or products to customers and holding real property for appreciation and income.

Administrative rule 17 NCAC 6B .3503 states that a partnership whose only activity is as an investment partnership shall not be considered to be doing business in North Carolina. An investment partnership means a partnership that is not a "dealer in securities," as defined in section 475(c)(1) of the Internal Revenue Code, and that derives income exclusively from buying, holding, and selling securities for its own account (*emphasis added*) . If any of the partnership's income is from other activities, either within or outside this State, either received directly or flowing through from other pass-through entities, the partnership is not an investment partnership for North Carolina tax purposes. Directive PD-04-2 further clarified that other activities include but are not limited to providing services or products to customers and holding real property for appreciation and income.

**Department's Response**

Based on review of the facts from your letter dated August 28, 2018, Taxpayer's activities related to short-term commercial loans are well beyond activities of a partnership that simply invests in assets that generate intangible income or one that derives income exclusively from buying, holding, and selling securities for its own account. This is true even if a management company conducts the activities related to the short-term commercial loans. Therefore, Taxpayer does not meet the requirements to qualify as an investment partnership. As such, Taxpayer is required to file an annual Partnership Return with the Department and pay the tax due on behalf of the nonresident members on the nonresident member's distributive share of the income for the business in this State.

This ruling is based solely on the facts submitted to the Department for consideration and on a review of the Taxpayer's process for its loan program as described on the Taxpayer's website. 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, 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.

Sincerely,

[redacted] Administrative Officer
Personal Taxes Division
Phone: [redacted]
Fax: [redacted]