



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 Credit² provides an analysis of disguised sale transactions involving state tax credits, and Historic Boardwalk³ 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:

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.