STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

The Honorable John D McLeod
Administrative Law Judge

Case No 09-ALJ-17-0532-CC

Centex International, Inc & Affiliates, Appellant,

v

South Carolina Department of Revenue, Respondent

FINAL BRIEF OF RESPONDENT

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STATEMENT OF THE CASE

This matter came before the Administrative Law Court (ALC) pursuant to S C Code Ann §§ 12-60-460 and 12-60-470 (Supp 2010) This action began when the Centex International Inc & Affiliates (Appellant or taxpayer) filed amended returns in 2007 adjusting the apportionment ratio for its income from the sale of bundled mortgages for the 2002-2005 tax years The amended returns also claimed infrastructure tax credits based upon the expenditures made by subsidiaries of the Appellant, operating in South Carolina as a general partnership The South Carolina Department of Revenue (Respondent or Department) determined the taxpayer was not entitled to the apportionment adjustments, or the claim for infrastructure tax credits made therein, on the basis that the infrastructure expenses were incurred by an unqualified affiliate of the taxpayer, a general partnership, rather than the taxpayer directly On July 25, 2007, the Department disallowed the adjustments made on the Appellant's amended returns for the 2002-2005 tax years, issued a notice of proposed assessment, and denied the claim for credits On October 23, 2007, the Appellant wrote the Department appealing the denial of the credits and the notice of proposed assessment The Department issued its Department Determination on December 4, 2009, setting forth the legal basis for its adjustments and denial of the claim for credits On December 7, 2009, the Appellant requested a contested case hearing before the ALC to dispute the Department Determination Prior to a hearing on the merits, the Department filed a Motion for Partial Summary Judgment on the infrastructure credit question, to which the Appellant responded with a Cross-Motion for Summary Judgment on the same issue A hearing was held before The Honorable John D McLeod on March 31, 2011, and the

Department's motion was subsequently granted Appellant timely filed a Motion for Reconsideration pursuant to Rule 59(e), SCRCP, on June 13, 2011 The Department filed a Reply in Opposition on June 16, 2011, and a hearing on that motion was held at the offices of the ALC on July 7, 2011 The Appellant's motion was subsequently denied, and this appeal followed

STATEMENT OF THE FACTS

This action was brought by the Appellant to challenge the Department's denial of its request for a refund for approximately $5,100,000,[1] based upon a disallowed infrastructure tax credit for the 2002-2005 income tax years The infrastructure tax credit claimed by the taxpayer is based on an attempted flow-through of the expenses incurred by Centex Homes, a general partnership that is wholly owned by three corporate affiliates of Centex International It purchases, develops, sells land or lots, and constructs and sells single family homes in South Carolina and many other states As part of its business in this State, the partnership incurred expenses from constructing or improving the infrastructure within certain developments, more specifically roads, sewers, and water lines

For tax years 2002-2005, the parent company - Centex International & Affiliates filed amended corporate income tax returns, which included amended partnership returns for Centex Homes, claiming tax credits pursuant to S C Code Ann § 12-6-3420 (Supp 2010) for expenses that the partnership, Centex Homes, incurred in constructing or

[1]In the event that the ALC's decision is overturned, determining the actual amount of the refund due will require a further audit of the infrastructure projects and the taxpayer's tax returns, as the amount was never fully ascertained once the Department's interpretation of the statutory language was deemed proper by legal counsel

improving infrastructure in those areas that the partnership developed Upon audit, these credits were denied by the Department

ARGUMENTS

In an appeal from the decision of an administrative agency, the Administrative Procedures Act provides the appropriate standard of review Olson v S C Dep't of Health & Envtl Control, 379 S C 57, 63, 663 S E 2d 497, 500-501 (Ct App 2008), Turner v S C Dep't of Health & Envtl Control, 377 S C 540, 544, 661 S E 2d 118, 120 (Ct App 2008), Clark v Aiken County Gov't, 366 S C 102, 107, 620 S E 2d 99, 101 (Ct App 2005) S C Code Ann § 1-23-610(D) (2005) provides the applicable standard

> (D) The review of the administrative law judge's order must be confined to the record The reviewing tribunal may affirm the decision or remand the case for further proceedings, or it may reverse or modify the decision if the substantive rights of the Appellant has been prejudiced because of the finding, conclusion, or decision is
>
> > (a) in violation of constitutional or statutory provisions,
> > (b) in excess of the statutory authority of the agency,
> > (c) made upon unlawful procedure,
> > (d) affected by other error of law,
> > (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record, or
> > (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion

When reviewing the grant of a summary judgment motion, the appellate court applies the same standard which governs the trial court under Rule 56(c), SCRCP summary judgment is proper when there is no genuine issue as to any material fact and

the moving party is entitled to judgment as a matter of law Miller v Blumenthal Mills, Inc , 365 S C 204, 219, 616 S E 2d 722, 729 (Ct App 2005)

An interesting addition to the Appellant's proposed standard of review includes a call for lower deference, due to the adoption of the Department's proposed order by the ALC (Appellant's Initial Br 6) In support of this proposition, the Appellant cites Anderson v City of Bessemer, 470 U S 564, 572-73 (1985) A cursory review of that case and the remaining string citations reveal that the Supreme Court's decision was based upon a lower court's adoption of the disputed facts in a litigant's proposed order As such, the Bessemer holding should have no bearing upon an action where the facts are not at issue, as is the case here This Court's review is one of the law, and although the legal arguments to be considered should be confined to the record, a *de novo* review requires no deference to the ALC This argument, therefore, has no bearing upon this case

When construing a statute, the cardinal rule is to ascertain the intent of the Legislature Georgia-Carolina Bail Bonds, Inc v County of Aiken, 354 S C 18, 22, 579 S E 2d 334, 336 (Ct App 2003) "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute " Id at 23, 579 S E 2d at 336 The words of the statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute's operation Hitachi Data Sys Corp v Leatherman, 309 S C 174, 178, 420 S E 2d 843, 846 (1992) Furthermore, "[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration

and will not be overruled absent compelling reasons " Brown v S C Dep't of Health & Envtl Control, 348 S C 507, 515, 560 S E 2d 410, 414 (2002) (quoting Dunton v S C Bd of Examin'rs in Optometry, 291 S C 221, 223, 353 S E 2d 132, 133 (1987)), see also Nucor Steel v S C Pub Serv Comm'n, 310 S C 539, 543, 426 S E 2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason)

Most important to this case is the proposition that a court should not consider a particular clause being construed in isolation, but should read it in conjunction with the purpose of the whole statute and the policy of the law South Carolina Coastal Council v South Carolina State Ethics Comm'n, 306 S C 41, 44, 410 S E 2d 245, 247 (1991) According to the doctrine of *noscitur a socius* the meaning of particular terms in a statute may be ascertained by reference to words associated with them in the statute 73 Am Jur 2d Statutes § 213 (1974) "The Court may not, in order to give affect [sic] to particular words, virtually destroy the meaning of the entire context, that is, give the particular words a significance which would be clearly repugnant to the statute, looked at as a whole, and destructive of its obvious intent " S Mut Church Ins Co v S Carolina Windstorm & Hail Underwriting Ass'n, 306 S C 339, 342, 412 S E 2d 377, 379 (1991) (citing Creech v S C Public Service Commission, 200 S C 127, 138, 20 S E 2d 645, 649 (1942)

Furthermore, it is well established that tax credits and deductions from gross income are not a matter of right They are a matter of legislative grace, and a taxpayer claiming one must bring himself squarely within the terms of a statute expressly authorizing it Allied Corp v S C Tax Comm'n, 288 S C 197, 199, 341 S E 2d 139,

141 (1986)

I THE ALC WAS CORRECT IN FINDING THAT THE APPELLANT DID NOT QUALIFY FOR AN INFRASTRUCTURE TAX CREDIT UNDER THE PLAIN LANGUAGE OF S C CODE ANN § 12-6-3420 (SUPP 2010) FOR INDIRECT EXPENDITURES MADE BY CORPORATE AFFILIATES OPERATING AS A PARTNERSHIP

A The Plain Language Of § 12-6-3420 Does Not Allow A Partnership To Earn The Tax Credit

Quite simply, a general partnership is not entitled to an infrastructure tax credit that is expressly limited to corporations Section 12-6-3420 unambiguously states

> (A) A **corporation** may claim a credit for the construction or improvement of an infrastructure project against taxes due under Section 12-6-530 or Section 12-11-20 for
>
> (1) expenses paid or accrued by the taxpayer,
> (2) contributions made to a governmental entity, or
> (3) contributions made to a qualified private entity in the case of water or sewer lines and their related facilities in areas served by a private water and sewer company

(Emphasis added) The Department's clearly founded application of this provision is that it extends only to expenses incurred by corporations, not general partnerships This interpretation is fundamentally grounded in the plain wording of the statutory language and the doctrine of *ejusdem generis* Under that doctrine, the meaning of general words (in this case, taxpayer) may be restricted by words of specification which precede them (corporation) on the theory that, had the Legislature intended the general words be used in their unrestricted sense, there would have been no mention of the particular class State v Four Video Slot Machines, 317 S C 397, 400, 453 S E 2d 896, 898 (1995) (citing State v Patterson, 261 S C 362, 200 S E 2d 68 (1973))

The Appellant has attempted to claim this credit by asserting that the general partnership is a "taxpayer," as defined by the language in the definitional section of Chapter 6, pursuant to S C Code Ann § 12-6-30(1) (2000) (Appellant's Initial Br 14) This section enumerates the types of entities taxed under Title 12 The Appellant argues that since its disregarded subsidiaries (for tax purposes) are corporations that have indirectly accrued expenses to create or improve infrastructure as members of the general partnership, it somehow qualifies for the infrastructure tax credit in § 12-6-3420(A)(1) Id This interpretation is unfounded and fails to place the taxpayer squarely within the terms of the statute, as it conflates the entity that is claiming the credit with the unqualified entity that generated it

As noted above, when § 12-6-3420(A)(1) is read in its entirety, it is clear that "**the** taxpayer" in subsection (A)(1) is limited to the "corporation" attempting to claim the credit against taxes due in subsection (A) (Emphasis added) "The word '*the*' is a word of limitation – a word used before nouns, with a specifying or particularizing effect, [as] opposed to the indefinite or generalizing force of 'a' or 'an '" People v Enlow, 135 Colo 249, 262-63, 310 P 2d 539, 546 (1957) (citing United States v Hudson, 65 F 68 (W D Ark 1894)) If the Legislature had intended the term "taxpayer" in subsection (A)(1) to mean all entities defined under § 12-6-30(1), it would have used the indefinite article "a" The use of the definite article "the" is a clear and unambiguous choice of language to relate back to the specific corporate limitation contained in the first line of the credit statute Creatively, the Appellant argues that because the corporate partners contributed to the general partnership's activities in South Carolina, there is no conflict with allowing the corporate parent company from claiming this credit However, as will be discussed in

greater detail in relation to the pass-through statute, such maneuvering disregards the essential law surrounding business associations, choice of entity, and basic partnership tax treatment Because a partnership directly incurred these expenses, (not **the taxpayer** attempting to claim it) no credit was ever earned in the first place, and the partners have no legal right to claim it here

Moreover, if taxpayer was intended to be read without limitation, as the Appellant believes, two separate absurdities become apparent First, subsections (A)(2) and (A)(3) remain devoid of a reference to any type of entity, leaving a relation back to corporation as the only proper conclusion To argue that expenditures under those two subsections should be made by corporations only, but the qualifying expenses under subsection (A)(1) opens the infrastructure credit to all forms of taxpayers is patently illogical Second, the definitional section invoked by the Appellant for the term "taxpayer" includes copious entities that have no application here Indeed, the ALJ properly determined that the definitional statute's version of taxpayer was not meant to be applied

> These entities include individuals, trusts, estates, partnerships, associations, companies, corporations, "or any other entity subject to the tax imposed by this chapter or required to file a return " Section 12-6-30(1) However, in order for this Court to apply the definition of § 12-6-30(1) to the infrastructure credit's inclusion of the word "taxpayer," each of the entities enumerated therein must be a feasible substitution [2]
>
> [2] Inserting "individual" or "trust" for the word taxpayer, for example, presents an unworkable disjunction between subsection (A) and (A)(1)

(R , p 35) The Appellant insists that the Court should interpret taxpayer broadly, as defined by the definitional section of Title 12, but then refutes the ALJ's conclusion

above by arguing that the other enumerated entities are merely superfluous and could not invoke the credit statute in the first place (Appellant's Initial Br 19) Not surprisingly, this logic mirrors the fundamental basis for the Department's interpretation, insofar as the plain language of the statute simply does not afford non-corporate entities the opportunity to generate the infrastructure credit The Appellant does not want the full range of "taxpayer" to be inserted, but rather, "corporations and partnerships," and there is no legal basis to do so This flies in the face of well settled jurisprudence concerning statutory construction Courts will reject a statutory interpretation which would lead to a result so plainly absurd that it could not have been intended by the Legislature or would defeat the plain legislative intention State v Sweat, 386 S C 339, 351, 688 S E 2d 569, 575 (2010) (citing Unisun Ins Co v Schmidt, 339 S C 362, 368, 529 S E 2d 280, 283 (2000)) If "the taxpayer" in subsection (A)(1) is interpreted as the broad definition found in § 12-6-30, it produces a large amount of inapplicable and unworkable disjunctions This is improper, as our Supreme Court has clearly held, "[a] statute should be so construed that no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous" Id (citing In re Decker, 322 S C 215, 219, 471 S E 2d 462, 463 (1995) (citation omitted))

Furthermore, § 12-6-3420(G), (H), and (I), all make references that leave no doubt that § 12-6-3420 refers only to corporations when read as a whole in context, viz

> (G) If a road qualifying for the credit is subsequently removed from the state highway or public road system, the amount of the credit allowed for the construction of the road must be added to any **corporate income tax due from the taxpayer** in the first taxable year following the removal of the road from public use The department may

> implement the provisions of this subsection by rules or regulation
> (H) A **corporation** which files or is required to file a consolidated return is entitled to the income tax credit allowed by this section on a consolidated basis The tax credit may be determined on a consolidated basis regardless of whether or not **the corporation entitled to the credit** contributed to the tax liability of the consolidated group
>
> (I) The merger, consolidation, or reorganization of a **corporation** where tax attributes survive does not create new eligibility in a succeeding **corporation** but unused credits may be transferred and continued by the succeeding **corporation** In addition, a **corporation** may assign its rights to its unused credit to another **corporation** if it transfers all, or substantially all, of the assets of the **corporation** or all, or substantially all, of the assets of a trade or business or operating division of a **corporation** to another corporation

(Emphasis added) Thus, the limitation found in subsection (A) mandates that a corporation must be the entity which incurs the expenses that generate the tax credit Because the expenses in question were directly incurred by a general partnership (an unqualified entity that fails to generate this credit), the corporate partner cannot then place the proverbial "cart before the horse" and claim the credit based upon its indirect involvement in the partnership's business activity

B The Appellant's Arguments Concerning Economic Incentives Are Without Merit

In defense of its tenuous position of reading the credit statute disjunctively, the Appellant presents a number of tangential arguments This veritable smoke screen is presented to draw attention away from the simple and central flaw of its case – the fact that a general partnership cannot earn a corporate credit, and therefore, cannot pass it on to its partners as part of its distributive shares

The Appellant paints a vibrant picture of the purpose of this credit, economic development incentives, and then argues that the Department's application controverts what the Legislature intended to encourage (Appellant's Initial Br 8-14) As the ALC properly determined, however,

> While I agree that this is indeed an economic incentive statute, I am not persuaded that applying the unambiguous corporate limitation included in subsection (A) defeats the encouragement of such investments Evaluating the efficacy or validity of the Legislature's prerogative to limit such incentives to a particular type of business entity rests not with this Court, and the policy decisions to encourage corporate activity need not be examined here

(R , p 10) The Department's application of the infrastructure credit does not undermine the encouragement of investments in this State by the entities that properly qualify for it in the first place, as proscribed by the plain language of the statute The Appellant, as a sophisticated legal entity, chose to operate in this State as a partnership, and that critical decision carries significant benefits and some possible disadvantages To be certain, access to corporate tax credits is undeniably one of those disadvantages for a partnership

C The Appellant's Arguments Relating To The License Tax Credit Pursuant To S C Code Ann § 12-20-105 (Supp 2010) Are Without Merit

The Appellant attempts to expand the scope of the infrastructure credit's language by cross-referencing another credit statute for license taxes, § 12-20-105, with § 12-6-3420 (Appellant's Initial Br 14) Appellant mistakenly states that subsection (F) of § 12-6-3420 includes electrical cooperatives as a "qualified private entity" that may claim the infrastructure credit Id With a mere cursory reading of the statute, however, one should easily discern that this contention is simply incorrect Subsections (A)(3) and

(C)(1)(c) outline the fact that water and sewer lines deeded to a "qualified private entity" that maintain the infrastructure are acceptable "projects" that are eligible for the credit It does not include qualified private non-corporate entities as possible claimants Subsection (C)(2) then defines a "qualified private entity" as properly licensed utilities to which such a project is deeded, and no mention of an electric cooperative is included In fact, there is no mention of any infrastructure related to electricity in any portion of the infrastructure credit statute Furthermore, Form SC SCH TC 6, which corporate taxpayers must fill out and attach to their income tax return to claim this credit, also further illuminates that this credit is only for water lines, sewer lines, and roads (R , p 405)

While the Appellant is correct that the license tax credit found in § 12-20-105 includes utility companies and electric cooperatives, as well as a cross reference to the infrastructure credit to prevent double dipping, the inclusion of both those entities in an annotated reference note was likely an oversight by the Code Commissioner and has no binding legislative value Both entities pay license taxes, but only corporate utility companies would qualify for the infrastructure credit One duty of the Code Commissioner is to "[c]ompile the public statutes of the State " S C Code Ann § 2-13-60(1) (1986) Part of this duty includes preparing indices to the statutes, noting court decisions under appropriate statutory sections, and adding references to new acts and joint resolutions § 2-13-60(2), (3), and (6) The Code Commissioner is only authorized to "[c]orrect typographical and clerical errors " State v Huntley, 349 S C 1, 4, 562 S E 2d 472, 473 (2002) (citing § 2-13-60(10)) He is not authorized to expand, delete, or alter statutes Id While utility companies are typically incorporated entities, and fit

within the limitation of subsection (A)(1), electric cooperatives are not eligible to claim the infrastructure credit, and such an assertion to expand the corporate limitation of § 12-6-3420 is completely unfounded As such, this argument is meritless and also has no bearing upon a partnership's inability to earn a corporate tax credit

II THE ALC WAS CORRECT IN DETERMINING THAT THE APPELLANT'S PARTNERSHIP SUBSIDIARY DID NOT QUALIFY FOR THE INFRASTRUCTURE CREDIT PURSUANT TO THE PASS-THROUGH PROVISIONS OF S C CODE ANN § 12-6-3310 (SUPP 2010)

A The Pass-Through Provisions Of § 12-6-3310 Are Not Triggered By The Partnership's Expenditures

One exception to the general rule, which would allow an avenue for indirect expenditures to create access to tax credits, is contained within § 12-6-3310(B)(1) The pass-through provisions of that section state that "**[u]nless specifically prohibited**, an 'S' corporation, limited liability company taxed as a partnership, or **partnership that qualifies for a credit** pursuant to this article may pass through the credit earned to each shareholder of the 'S' corporation, member of the limited liability company, or partner of the partnership" (emphasis added) To that extent, a tax credit may only be passed through to individual partners after the partnership itself **qualifies** for the tax credit Section 12-6-3310 does not create unfettered access to tax credits for pass-through entities As noted above, the tax credit the Appellant is seeking to pass through its partnership is exclusively limited to corporations by the General Assembly, as § 12-6-3420 plainly states that only a "corporation may claim [the credit] against taxes due under Section 12-6-530 " The intent of the Legislature to limit the eligibility for this credit solely to corporations is unambiguous and clear from the plain language This application of § 12-6-3420 is further supported by the Legislature's reference to S C

Code Ann § 12-6-530 (2000), which is South Carolina's corporate income tax statute During oral arguments at the ALC, counsel for Respondent presented several examples of tax credits[2] that incorporated express language for the applicability of the pass-through provisions of § 12-6-3310 (R , p 276, line 23 – p 277, line 19) No such language is present within the language of the credit at issue, nor is there ever a reference to any specific entities other than corporations It is important to note, that the infrastructure credit was amended after the enactment of the pass-through statute, and no language referencing pass-through entities was included

The Appellant contends that the use of the word "claim" in § 12-6-3420(A) should be read as separate from the act of generating the credit, and therefore, any corporate member of the Centex Homes partnership that indirectly incurred some of the infrastructure expenses should be able to claim the credit This argument is also without merit Tax credits are conferred by legislative grace and are not assignable in the absence of either explicit contractual or statutory language DaimlerChrysler Services N Am , LLC v Ariz Dep't of Revenue, 210 Ariz 297, 304, 110 P 3d 1031, 1038 (Ct App 2005) (quoting DaimlerChrysler Services N Am , LLC v State Tax Assessor, 817 A 2d 862, 866 (Me 2003)) Income tax is generally assessed on a single taxpayer, and concurrently, tax credits and refunds are generally conferred upon the taxpayer that originally generated the credit Absent a statutory provision stating otherwise, the general rule is that tax benefits may only be claimed by the taxpayer that generated that

[2]See, S C Code Ann §§ 12-6-3340 - Renewable Energy Credit, 12-6-3370 - Water Control Structure Credit, 12-6-3560 - Motion Picture and Advertisement Company Credit (2000) (The Motion Picture credit expressly provides for corporate partners generating the credit through indirect expenditures in a general partnership)

benefit While entertaining, the Appellant's assertion that the Department promulgated this general premise as a "secret" interagency rule is specious at best (Appellant's Initial Br 24) It logically follows that the general rule is that the entity generating the credit must be the entity that claims it, for if it was not, exceptions written directly into individual credit statutes (i e , the consolidated return portion of the credit at issue in subsection (H)) and the pass-through provisions of § 12-6-3310 would have been completely unnecessary Our Legislature included the "qualified claimant prerequisite" in the flow-through provisions of § 12-6-3310(B)(1), on the basis of this general rule In fact, pass-through entities would have access to all credits without this restriction, and it essentially mandates that the pass-through entity is statutorily permitted to stand in the shoes of the entities allowed to generate such credits As stated earlier, tax credits are not a matter of right, but legislative grace, and taxpayers that did not earn a credit themselves may not claim it without express legislative permission

It is upon this sound logical application of our code that the Department interpreted the infrastructure credit to read "**the** taxpayer" generating it as synonymous with the corporation claiming it In order for the flow-through provisions of § 12-6-3310 to remain consistent with the corporate limitation of § 12-6-3420, the word "claim" must be interpreted as synonymous with "generate" And, in order for the doctrine of *in pari materia* to truly be upheld, the word "qualify" must be interpreted as something much more than simply making the qualified expenditures, as the Appellant attempts to argue (Appellant's Initial Br 22) The Appellant points out that all three state witnesses admitted that the Department had no policy, written or otherwise, regarding the infrastructure credit and pass-through entities Id at 24 The insinuations made by this

observation are easily cast aside, as the Department has never allowed or even been asked to allow a non-corporate entity's claim for the corporate infrastructure credit As such, no internal policy or publication was ever necessary, and certainly would have been a waste of taxpayer resources by a state agency The pass-through statute is simply not triggered when there is an express limitation that disqualifies a partnership from being eligible for a credit, such as the corporate limitation of § 12-6-3420 Consequentially, because the partnership is not qualified to claim the infrastructure credit in the first place, none of its corporate partners may do so under the pass-through provisions of § 12-6-3310(B)(1)

The Appellant further argues that South Carolina's adoption of the Internal Revenue Code provisions for partnerships, specifically S C Code Ann §§ 12-6-40, 12-6-50, and 12-6-600 (Supp 2010), dictates that the tax credit be treated as if the individual corporate partners generated credits directly under a modified "aggregate theory"[3] (Appellant's Initial Br 43) This contention is tenuous at best I R C § 702(b), states in relevant part

> The character of any item of income, gain, loss, deduction, or **credit** included in a partner's distributive share under paragraphs (1) through (7) of subsection (a) shall be determined as if such item were realized directly **from the source from which realized by the partnership or**

[3]The Appellant essentially argues from an equity standpoint that it is unfair to deny the corporate partners the tax credits when they spent over 64 million dollars on infrastructure and have to pay corporate income taxes on their distributive share from the partnership However, equitable considerations would not serve the Appellant well As a sophisticated business entity, the ramifications of choosing to operate as a partnership, including tax implications, should have been part of that decision making process See also United States v Brockamp, 519 U S 347, 352 (1997) (holding that tax law, after all, is not normally characterized by case-specific exceptions reflecting individualized equities)

incurred in the same manner as incurred by the partnership

(Emphasis added)

The Appellant's assertion that I R C § 702(b) allows the individual partners to realize all the general gains, losses, deductions, and credits that the partnership realized is absolutely correct This does not, however, give the individual partners the ability to extend the reach that the partnership has in regards to its **eligibility** for tax credits with specific limitations "It is well settled that [Internal Revenue Code] § 702(b) reflects a 'conduit' approach whereby the character of an item of income, gain, loss, deduction, or credit **is determined at the entity or partnership level before the item is passed through** to the partners " Rath v Comm'r, 101 T C 196, 203 (1993) (emphasis added) Therefore, in order for any sort of pass through to take place, the initial entity through which the credit is being transferred must have been eligible in the first place Here, the partnership is simply not entitled to the infrastructure credit, and in that regard, it has nothing to pass through to its partners

B The Appellant's Arguments Concerning *In Pari Materia* Are Without Merit

The Appellant asserts that the word "qualify" within the pass-through provisions pertaining to partnerships in § 12-6-3310 should be interpreted to merely mean "make the qualifying expenditures " (Appellant's Initial Br 22) This argument is predicated upon the simple fact that partnerships have no income tax liability, and ostensibly would never use a credit, in the most basic sense of the word However, partnerships are required to file informational returns that include the distributive shares of income, losses, deductions and credits to each partner, and therefore this depiction of partnerships as

ethereal entities that have no legal purpose or ramifications in the realm of taxation is erroneous Partnerships do, in fact, claim credits It is only the method of claiming that differs from other taxpayers To illustrate, there are many examples of credits (See supra note 3) that contain express instructions for pass-through entities seeking to claim those credits, including how to allocate the credit among partners after it is claimed While a partnership claiming an allocable credit does not offset an aggregate tax liability for the group, it can qualify for and pass through credits – and this is the method by which partnerships "use" credits The credit must first be accessible to a partnership, however, and the mere making of expenditures that mirror the type expenses a corporation must incur to claim it does not expand the scope of the credit's possible claimants which "qualify"

The fundamental fallacy in the Appellant's logic appears within the first three words of the pass-through statute, which states "[u]nless specifically prohibited " The express corporate limitation of § 12-6-3420(A) is, in fact, a quite specific prohibition This direct statutory mandate firmly undercuts the partnership's ability to ever **qualify** for the credit, and therefore, the credit cannot be claimed and passed through to the partners The infrastructure credit includes no language that indicates pass-through entities could qualify, nor does it begin with the more common phrase "[a] taxpayer may claim" The use of that indefinite article, which would broaden the range of possible claimants, is used in **every other credit statute** that does provide for pass-through entities Such is not the case for § 12-6-3420

The doctrine of *in pari materia* is not disturbed by the Department's application of the infrastructure credit statute There remains a harmonious result between the pass-

through provisions of § 12-6-3310 and the infrastructure statute Because the corporate limitation of the credit is clear and unambiguous, the partnership in this case is not considered a "qualifying" entity and therefore the pass-through statute is simply not triggered

C The Appellant's Interpretation Of The Applicable Case Law Is Incorrect

The Appellant erroneously states that the ALC relied primarily upon Bell Atlantic Nynex Mobile, Inc v Comm'r of Revenue Services, 273 Conn 240, 869 A 2d 611 (2005) to make its decision (Appellant's Initial Br 25) While the ALC clearly relied upon the plain language of § 12-6-3420, the Court did entertain the instructive holdings of three important cases from other states In the first, Bell Atlantic, the Supreme Court of Connecticut addressed the applicability of a credit provision by which corporate partners of a partnership attempted to claim a tax credit under C G S A § 12-217t for payment of personal property taxes on electronic data processing equipment The language in § 12-217t, similar to the infrastructure credit at issue here, provided a property tax credit for "taxpayers " In its analysis of the controlling statute, the Court observed "[a]s the payer of the property tax on the electronic data equipment, [the partnership] qualifies as a 'taxpayer' as that term is generally understood This general understanding of the meaning of 'taxpayer' does not control the term's usage in § 12-217t, however, because § 12-213 contains the statutory definition of the term " Id at 256, 869 A 2d at 621 C G S A § 12-213(a)(1) defines "taxpayer" to mean

> [A]ny corporation, foreign municipal electric utility, as defined in section 12-59, electric distribution company, as defined in section 16-1, electric supplier, as defined in section 16-1, generation entity or affiliate, as defined in

> section 16-1, joint stock company or association or any fiduciary thereof and any dissolved corporation which continues to conduct business but does not include a passive investment company or municipal utility, as defined in section 12-265[ ]

Because "partnership" was absent from the entities qualifying as taxpayers, the partnership was precluded from claiming a credit under § 12-217t Id Therefore, the court concluded that "[the partnership] has not used and, indeed cannot use the tax credit against taxes paid under either the corporation business tax or other chapters specified in § 12-217t as required by the statute because, as a partnership, it has no income tax liability under those chapters " Id at 257, 869 A 2d at 621

The Appellant has attempted to discount this decision's applicability based upon the presence of a limiting definition of taxpayer in the Connecticut statute (Appellant's Initial Br 25) However, it is quite clear that the plain language of our infrastructure credit also contains a specific limitation for corporations, and as such the analogous nature of these two credit statutes should be quite apparent Just like the partnership in Bell Atlantic, the Centex Homes partnership is simply not eligible to claim a corporate credit

After the plain language argument failed, remaining undaunted the partnership in Bell Atlantic then asserted that the corporate partners were entitled to claim the credit under a conduit approach **exactly** as the Appellant argues here Id at 261, 869 A 2d at 624 The Court again disallowed the credit, stating

> Establishing that corporation business tax attributes pass through the partnership to the partners with the same character that they had at the partnership level does not suffice to establish that [the partnership's] payment of the municipal property tax resulted in a credit that can be

> attributed to the partners Under the conduit approach, 'the character of [the tax attribute] is determined **at the entity or partnership level** before the item is passed through to the partners ' In the present case, [the partnership's] payment of the municipal property tax was just that, a payment, not a tax credit Not every action taken by the partnership passes through to the partners as if they performed the act Section 702(b) of the Internal Revenue Code provides that '[t]he character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership ' This provision does pass credits through a partnership to its partners It does not, however, create credits ***[The partnership's] payment of the municipal property tax did not result in a tax credit because, under the Connecticut tax statute, it cannot be said that [the partnership] was plainly and unambiguously eligible to receive such a credit.***

Id at 264-65, 869 A 2d at 625-26 (internal citations omitted) (emphasis added)

Finally, the corporate partners of the partnership asserted that an unjust result would occur if the Court disallowed the tax credit, nearly identical to claims of the taxpayer here The Court addressed this argument and declared

> Finally, the plaintiffs argue that an interpretation of § 12-217(t) that does not permit the partners to use the tax credit leads to an absurd result because it denies two corporations acting through a partnership a benefit that each party could obtain if it acted on its own All parties agree that, had the plaintiffs operated as thirteen separate corporations, instead of through a partnership, and had those corporations collectively paid the same taxes on the same equipment, each corporation would fall within the definition of "taxpayer" and would be able to use the associated tax credit to offset its tax liability under the corporation business tax, as the plaintiffs seek to do in the present case **The plaintiffs, however, chose to operate through a partnership, not as separate corporations Sophisticated business entities recognize selection of a business form as a critical decision that carries with it certain legal**

> **consequences, including tax implications** The legislature's decision to grant a tax credit to certain business forms while denying it to others does not constitute an absurd result The fairness of such decisions remains within the prerogative of the legislature, not of this court

Id at 265, 869 A 2d at 626 (emphasis added)

Here, the Appellant chose the form of its business organization Such a choice carries with it the exact implications as described by the Supreme Court of Connecticut, and the Appellant must accept the benefits and costs of its decision to organize in such a fashion

The second case to which the ALC lent credence was from the Court of Appeals of Wisconsin, which came to an identical conclusion regarding corporate tax credit eligibility for partnerships who sought to claim " a tax reduction credit pursuant to sec 71 043(2), Stats , based on its distributive share of the sales and use taxes paid by [the general partnerships] " L & W Construction Co v Wisc Dep't of Revenue, 149 Wis 2d 684, 687, 439 N W 2d 619, 620 (Ct App 1989) The relevant portion of that statute stated

> (2) The tax imposed upon or measured by corporation net income may be reduced by an amount equal to the sales and use tax under ch 77 paid by the corporation in such taxable year on fuel and electricity consumed in manufacturing tangible personal property in this state

Id Upon consideration of the statute, the Court stated that if " a different entity owned by the corporation actually pays the sales and use taxes, there is no statutory provision for a tax credit to the corporation " Id at 689, 439 N W 2d at 621 The Court construed the tax credit strictly against the taxpayer and found that "[b]ecause L & W did not directly pay the partnerships' costs of fuel and electricity, nor the resultant sales and

use tax, it ha[d] not met the burden of showing that it [was] clearly within the terms of the credit statute" and therefore was " not entitled to the sec 71 043(2), Stats , income tax reduction for the sales and use tax paid by the partnerships " Id at 691, 439 N W 2d at 621

The Appellant's only distinguishing characteristic of this holding is that the statute in L&W states "expenses paid by the corporation" as opposed to "paid by **the taxpayer**" which is found in our infrastructure credit (Appellant's Initial Br 26) This difference in wording is entirely irrelevant to the applicability of the logic in that case It is undisputed that the plain language of our infrastructure credit clearly limits the credit to corporate claimants and its applicability to corporate taxes With this limitation in place, the specific phrase "the taxpayer" has no other possible meaning other than **the** corporation that pays those corporate taxes Centex Homes, the Appellant's partnership which incurred the infrastructure expenses is simply not "**the taxpayer**" that the credit statute specifically mandates to incur the expenditures

Finally, the Appellant attempts to argue that the Rath decision supports its position, which the ALC relied upon in holding for the Department (Appellant's Initial Br 28) However, the Appellant's logic presented to reach this conclusion is flawed The holding in Rath is important to this case, not because the deduction statute at issue in that case was akin to our infrastructure credit (it was not), but rather because in applying I R C §§ 1366(a) and 702(b) the Rath court echoed the Department's position here – that the character of every item of income, loss, deduction or credit retains its character before a pass-through to its partners This holding directly contradicts the Appellant's claims that a partnership should be treated as an amorphous non-entity when it comes to tax

credits In Rath, despite the fact that the initial entity was precluded from claiming the ordinary loss deduction, the shareholders of the S corporation argued that they were entitled to report the loss on the sale of the stock on their federal income tax returns pursuant to a flow-through provision in I R C § 1366(b), which states in pertinent part

> (b) Character Passed Thru The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation

The Rath court found that the shareholders' reliance on the flow-through provision was misplaced, and applied the conduit approach used in I R C § 702(b) to find that although the "Petitioners read section 1366(b) as requiring an S corporation shareholder to step into the shoes of the corporation for purposes of determining the character of a loss incurred on a sale of section 1244 stock section 1366(a) and (b) requires the character of the loss to be determined from the viewpoint of the S corporation rather than from the viewpoint of its individual shareholders " Id at 204 The claimed loss was therefore denied Applying this holding to our case, before the infrastructure credit can be "incurred in the same manner as" the partnership, the partnership must be deemed eligible to incur the credit in the first place Such is not the case here, and therefore the Rath decision is certainly useful when considering the Appellant's unfounded attempts to invoke the pass-through provisions of § 12-6-3310

Although these three decisions are not binding on South Carolina jurisprudence, they are highly instructive and support the Respondent's position that a flow through of the infrastructure tax credit may take place only when the initial entity is qualified to

claim it in the first place Simply put, Centex Homes does not qualify for the corporate tax credits because it is a general partnership Because Centex Homes is not eligible for the infrastructure tax credits, it cannot pass through these credits to its individual corporate partners

To counter the logic found in these holdings, the Appellant first presents a New York Department of Taxation Advisory Opinion and a case from the Appellate Court of Illinois (Appellant's Initial Br 29) The Advisory Opinion can be swiftly dealt with, as the credit at issue in that case had no limitation and read "**a taxpayer** is allowed a credit " See New York Tax Law § 210 12(a) This broadly accessible credit was properly determined to allow a pass-through entity to qualify and then pass it on to its partners within the constraints of I R C § 702(b) Unfortunately, such sweeping language is not found in South Carolina's infrastructure credit, and as noted above, the express corporate limitation bars a partnership from earning it and therefore no pass through can occur

The second authority the Appellant presents is Bordon Chemicals and Plastics, LP v Zehender, 312 Ill App 3d 35, 726 N E 2d 73 (2000), in which the First District of the Illinois Appellate Court determined that a partnership was allowed to pass through an investment credit to its partners The issue at bar in that case was as follows

> As in effect during the tax years in issue, section 201(e) did not explicitly provide whether pass through of the investment credit from partnerships to partners was allowed or disallowed, nor did the statute expressly prohibit pass through The statute was silent In 1997, the statute was amended to explicitly allow the credit to pass through to a partner Thus, the threshold issue is whether the amendment applies to the instant case

Id , 312 Ill App 3d at 46, 726 N E 2d at 82 The Illinois Appellate Court, in considering whether the amendment allowing the pass-through was dispositive, determined that

> the better approach is the 'vested rights' approach, in which a court does not engage in the examination of legislative intent, but instead applies the general rule that a court should apply the law as it exists at the time of the appeal, unless doing so would interfere with a vested right

Id., 312 Ill App 3d at 47, 726 N E 2d at 83 Once it was concluded that no vested rights would be trampled by employing the amended version of the credit, it was determined proper to allow the pass through to take place

This case fails to support the Appellant's position on two fundamental grounds First and foremost, there is absolutely no mention of pass-through options within the language of § 12-6-3420 Second, the infrastructure credit was amended in 2006, well after the passage of the pass-through provision of § 12-6-3310, and the Legislature did not add any language to indicate that pass-through entities have access to it Unlike the credit in Bordon, our infrastructure credit has been around since 1988, amended, recodified, and never been altered to include language to support the Appellant's interpretation As noted above, many of our credits have, and the Department would posit that this indicates the lack of any legislative intent to allow it See supra note 3

The Appellant then resubmits two South Carolina cases that the ALC properly determined supported the Department's position The first, Ellis v S C Tax Commission, 280 S C 65, 309 S E 2d 761 (1983), dealt with the disallowance of individual income deductions for expenses incurred on out-of-state real estate by a partnership the individuals had invested in The Appellant argues vigorously that Ellis supports its position for a complete disregard of the partnership entity and for each individual partner to realize every item of income, loss, deduction, and credit as if acting independently (Appellant's Initial Br 33-34) This is simply not correct It is important

to first note that the United States Supreme Court has weighed in on the legal recognition of partnerships, when it held

> Thus, while the partnership itself pays no taxes, 26 U S C § 701, it must report the income it generates and such income must be calculated in largely the same manner as an individual computes his personal income For this purpose, then, the partnership is regarded as an independently recognizable entity apart from the aggregate of its partners

United States v Basye, 410 U S 441, 448 (1973) While the aggregate theory is applied in Ellis, the deductions for out-of-state losses against in-state income were properly denied in Ellis by the Court's recognition of the "conduit theory" approach, which simply means that every item of income, loss, credit, or deduction **retains its character** before being passed through to the partners The holding in Ellis affirms the Respondent's position that the character of the infrastructure credit should be retained before it can be passed through to Centex's partners To that extent, the Appellant is mistaken in its application of aggregate theory, as it begs the question on whether or not the partnership earned the credit in the first place Upon examination of the same quotation proffered by the Appellant with slightly different emphasis added, it becomes clear that the Ellis Court understood that premise

> The "pass through" rule is equally applicable to limited partnerships Section 12-7-300 makes no distinction between a general or limited partnership By reason of the "pass through" rule, **the character of any item of income, gain, loss deduction or credit included in a partner's distributive share of gains and losses shall be the same as if such item was realized directly from the source from which realized or incurred by the partnership** In other words, each item of income, gain, loss, deduction or credit is treated as if it were realized or incurred by the partner directly from the source without ever having passed through the partnership If this were not the case, then

> partners in real estate or other business ventures could not take advantage of depreciation write-offs and other operating expenses or losses

Ellis, at 68, 309 S E 2d at 762-63 (emphasis added) The Appellant's argument, as noted above, puts the proverbial cart before the horse in presupposing that the partnership ever actually realized the corporate infrastructure credit Before the partnership entity is disregarded and an individual partner can realize a credit, take a deduction, or pay tax on income that is part of its distributive share, the **partnership must have earned that credit, taken deductible losses, or made taxable gains in the first place** The three corporate partners of Centex Homes are certainly entitled to their distributive shares of reportable income and the deductions for losses incurred through the operation of the partnership They are not, however, entitled extraordinary reach to tax credits that were simply not accessible by a partnership before such distributive shares were calculated

The same logic is easily applied to the nearly identical decision of Dalton v S C Tax Commission, 295 S C 174, 367 S E 2d (1988), where the Court again recognized that character of every item of gain, loss, deduction and credit is retained before the pass through takes place To condense this type of tax treatment down to its most elementary form, the square peg of the corporate infrastructure credit cannot be forced through the round hole of a partnership

D The Appellant's Argument Concerning Limited Liability Companies Is Without Merit

The Appellant mistakenly points to the addition of sweeping language regarding LLC's that was added to the pass-through statute in a 2008 amendment found in subsection (C) of the current version, as the basis for a general partnership's claim for a corporate tax credit (Appellant's Initial Br 40) While this amendment is unequivocally

inapplicable, it is important to note that this amendment was enacted three years after the tax periods at issue in this case, and is therefore wholly irrelevant on that basis alone In the construction of statutes, there is a presumption that statutory enactments are to be considered prospective rather than retroactive in their operation unless there is a specific provision in the enactment or clear legislative intent to the contrary See S C Dept of Revenue v Rosemary Coin Machines, Inc , 339 S C 25, 28, 528 S E 2d 416, 418 (2000) (citing Hyder v Jones, 271 S C 85, 245 S E 2d 123 (1978))

Regardless of the temporal inapplicability of this amendment to § 12-6-3310, the underlying legal application has no bearing here as well LLC's have been granted a wide berth by the Legislature in regards to tax credits, as the amendment found in subsection (C) reads, "[a] limited liability company not organized as a business entity expressly qualified for the credits allowed pursuant to this article nevertheless qualifies for such credits " While LLC's can elect to be taxed as a partnership under Title 12, the entity remains organized as an LLC The argument that the Legislature's grant of access to this type of business entity somehow opens the door to credits for general partnerships is a complete *non sequitur* The choice of the Legislature to limit credits for specific types of entities is a policy question not fit for judicial review, and although seemingly arbitrary, such choices are simply outside of the purview of the issues presented to this Court

III THE ALC DID NOT ERR IN ITS APPLICATION OF THE AGGREGATE AND ENTITY THEORIES AND ITS DETERMINATION THAT SUCH THEORIES DID NOT CREATE ACCESS TO THE INFRASTRUCTURE CREDIT FOR A PARTNERSHIP

The Appellant, at all stages of this litigation has attempted to argue that based upon the aggregate and entity theories, the individual partners may generate corporate credits based upon indirect expenditures made through the general partnership As noted above in Point Heading II (B) and (C), this is the incorrect application of these theories, and the ALC properly held that the character of the corporate infrastructure credit bars a partnership from generating it or distributing it as allocable shares to its partners With respect to brevity, the Respondent reiterates the arguments noted above in regards to Appellant's Point Heading II

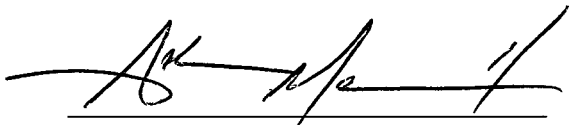
IV THE ALC DID NOT ERR IN DETERMINING THAT THE FILING OF A CONSOLIDATED RETURN BY THE APPELLANT DID NOT GRANT ACCESS TO THE INFRASTRUCTURE CREDIT FOR THE PARTNERSHIP

The Appellant points to subsection (H) of § 12-6-3420 as an indication that the credit statute was intended to be broadly construed for "taxpayers" (Appellant's Initial Br 48) Paraphrased, this provision allows a consolidated group of corporations that include one corporation that was entitled to the credit to use it for the group's consolidated liability While the Appellant is correct that its consolidated group is treated as a single taxpayer, it is important to note that Centex Homes, as a partnership, is not included on that consolidated return The partnership files its own separate return, and as the Supreme Court of the United States recognized, it is a distinguishable and independent entity United States v Basye, 410 U S at 448 Interestingly enough, S C Code Ann § 12-6-5020(F) (Supp 2010) describes the application of tax credits to a consolidated group with an unmistakable caveat – "**[i]f** a corporation which files or is required to file a consolidated return is entitled to one or more income tax credits "

(emphasis added) The Appellant's belief that single taxpayer treatment for a group of consolidated corporations bypasses the tax treatment of the partnership and allows the corporate group extraordinary reach in regard to tax credits is completely unfounded

CONCLUSION

This Court may affirm a lower court's order based on any ground appearing in the record See I'On v Town of Mt Pleasant, 338 S C 406, 420, 526 S E 2d 716, 723 (2000) Based on the record in this case and the foregoing arguments, the Department respectfully requests that this Court affirm the Order and Decision of the ALC, granting the Department Motion for Partial Summary Judgment and denying the Appellant's refund request



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STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

The Honorable John D McLeod
Administrative Law Judge

Case No 09-ALJ-17-0532-CC

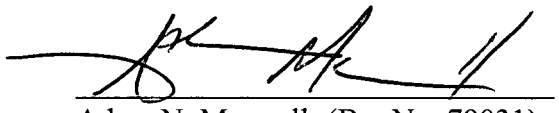
Centex International, Inc & Affiliates, Appellant,

v

South Carolina Department of Revenue, Respondent

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Brief complies with Rule 211(b), SCACR



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PROOF OF SERVICE

I, Jean M O'Connor, hereby certify that I have caused to be mailed, postage prepaid, a copy of the South Carolina Department of Revenue's Final Brief in the above-referenced case to Burnet R Maybank, III, Esquire, Nexsen Pruet, LLC, PO Drawer 2426, Columbia, SC 29202-2426, on this 2nd of March 2012

Jean M O'Connor