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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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 REPLY BRIEF OF APPELLANT

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I THE ALC ERRED AS A MATTER OF LAW BY CONCLUDING THAT THE CORPORATE AFFILIATES OF APPELLANT WERE NOT ELIGIBLE TO CLAIM THE INFRASTRUCTURE TAX CREDIT AS PARTNERS OF THE CENTEX HOMES PARTNERSHIP

A The Clear and Plain Language of the Statute Allows the Corporate Affiliates of Centex to Claim the Infrastructure Tax Credit

As the South Carolina Supreme Court very recently stated in *Grimsley v SLED*, __S C __, __ S E 2d__ (Opin No 27085) (2012)

> The cardinal Rule of statutory interpretation is to ascertain and effectuate the intent of the legislature *Sloan v Hardee*, 371 S C 495, 498, 640 S E 2d 457, 459 (2007), "As such, a court must abide by the plain meaning of the words of a statute When interpreting the plain meaning of a statute, courts should not resort to subtle or forced construction to limit or expand the statute's operation" *State v Jacobs* 393 S C 584, 587, 713 S E 2d 621, 622 (2011) (internal citations omitted) But "[w]here the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has not right to impose another meaning" *Hodges v Rainey*, 341 S C 79, 85, 533 S E 2d 578, 581 (2000)

Under the plain language of the statute, Section 12-6-3420 ("The Infrastructure Credit Statute") allows a credit to be claimed on a corporate income tax return if expenses or contributions are made on behalf of or to a governmental entity in building or improving an infrastructure project

Accordingly, there are two simple questions to be answered before the infrastructure credit may be claimed First, were infrastructure expenditures or contributions made for the benefit of South Carolina? Second, was the infrastructure tax credit claimed against the corporate income tax? In our case the Appellant Corporation

claimed the credit for infrastructure expenses paid by a general partnership whose partners were corporations included in a consolidated tax return

Plain and simple, Appellant claimed the credit in the manner prescribed by law and incurred approximately $68 million of infrastructure costs (e g , sewer lines, water lines and roads) for the benefit of the State as prescribed by law Clearly, Appellant has done what was intended by the General Assembly and has properly applied the law as it was intended and drafted by the General Assembly, however, the DOR has tried to give the appearance of a complicated tax case with incorrect and inconsistent interpretations of the tax law

Specifically, the DOR asserts that the plain language of Section 12-6-3420 does not allow a partnership to earn and then pass through the infrastructure tax credit to be claimed by a corporate partner In reaching this conclusion, the DOR makes the following primary arguments

1 The statutory definition of "taxpayer", which includes partnerships, as provided in Section 12-6-30 does not apply when interpreting the credit statute

2 Instead, "taxpayer" means corporation because earlier language used in the credit statute contained the term "corporation" and thus there's a restriction as to which (type of) entity may "earn" the credit

3 A "corporation" (not just any "taxpayer") must directly make the infrastructure expenditures because the terms "claim" and "earn" are synonymous

4 The Infrastructure Credit Statute is controlling and Section 12-6-3310 ("The Pass Through Statute") is irrelevant and inapplicable unless the Infrastructure Credit Statute expressly addresses flow through entities as far as the type of taxpayer that qualifies to earn the credit

Before addressing each of the above individually, Appellant would like the Court to consider new guidance from the DOR in Letter Ruling #11-6 (November 4, 2011), which was published on the day Appellant filed its initial brief and is not only inconsistent, but completely opposite with its interpretation in this case

This recent ruling relates to Section 12-6-3620 ("Biomass Credit Statute"), which has language nearly identical to the Infrastructure Credit Statute, and is important to this case because it addresses the same issues, as faced in this case (e g , the definition of "taxpayer" and the ability of a non-corporate entity to "earn" and Pass-through a credit pursuant to Section 12-6-3310(B))

The language in both statutes is intended to induce taxpayers to incur certain costs while restricting the "use" of the credit to corporate income taxes and, thus, written in a very similar manner as follows

> **Biomass Credit Statute** " there is *allowed* a credit against the *income tax imposed pursuant to Section 12-6-530* or license fees imposed pursuant to Section 12-20-50, or both, for 25% of the *costs incurred by a taxpayer* "
>
> **Infrastructure Credit Statute** "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* "

In both credit statutes, the term "taxpayer" is preceded by a corporate income tax qualifier with respect to claiming the tax credit In other words, a taxpayer that is

required to file a corporate income tax return in order to claim the credit is by definition a corporation for income tax purposes Additionally, neither corporate credit statute specifically addresses flow through entities The plain language of both statues is almost identical and clearly the context of both credit statutes is the same, therefore, they should be interpreted in the same manner

In Letter, the relevant issue addressed by the DOR was

> May ABC, a limited liability company taxed as a partnership, pass through the biomass credit to Member A?

As indicated above, the DOR concluded that a limited liability company may pass through the biomass credit to its member, which is then able to claim the credit on its tax return In reaching its conclusion, the DOR takes a very detailed and methodical approach in addressing the same issues before the Court, which are addressed as follows

Arguments #1 and #2 Since the language in the credit statute refers to claiming a corporate income tax and then uses the term "taxpayer" with respect to incurring costs or expenditures in the context of earning the credit, is a taxpayer other than a corporation allowed to earn such credit? The answer provided in the ruling was

> Code Section 12-6-6320 provides that the biomass credit is equal to 25% of the costs incurred by a *taxpayer* for the purchase and installation of eligible equipment and a *taxpayer* may use up to $650,000 of credit for a single taxable year
>
> Under Code Section 12-6-30(1) the definition of "'Taxpayer' includes an individual, trust, estate, *partnership*, association, company, corporation, or any other entity subject to the tax imposed by this chapter *or required to file a return*" [emphasis added] While ABC, a limited liability company taxed as a partnership, is not subject to tax, it is required to file a return so it is considered a taxpayer

> When dealing with a flow through entity, both the flow through entity itself and the individual members, shareholders or partners of the entity may be taxpayers

Based upon the above excerpts from Letter Ruling #11-6, p 6, the statutory definition of taxpayer should be used to interpret the Infrastructure Credit Statute as the plain language indicates and the context of which is identical to that of the Biomass Credit Statute

Arguments #3 and 4 If the credit statute does not explicitly permit nor prohibit a flow through entity from earning the credit through incurring the costs or expenditures, as specified with the statute, may a corporation claim the credit through application of the Pass Through Statute and, thus, indirectly earn the credit? The answer provided in the ruling was

> Code Section 12-6-3620 does not address the pass through of credits by flow through entities However, Code Section 12-6-3310(B) provides general rules relating to the pass through of credits by flow through entities Under Code Section 12-6-3310(B)(1) "Unless 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 the credit earned to each *shareholder of the 'S" corporation member of the limited liability company*, or partner of the partnership "
>
> * * *
>
> The biomass statute, Code Section 12-6-3620, is not the statute that allows ABC to pass through the credit That statute is Code Section 12-6-3310
>
> * * *
>
> Therefore, if the credit is passed through to a corporate member, partner, or shareholder, it is clear that the corporate member, partner, or shareholder would be able to use the credit against its corporate income tax

B "A" versus "The"

Blissfully ignoring the Supreme Court's recent admonition in *CFRE, LLC v Greenville County Assessor*, 395 S C 67, 716 S E 2d 877 (2011), that "we must read the statute so "that *no word,* clause, sentence, provision, or part shall be rendered surplusage, or superfluous," (emphasis added) the DOR argues that "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," and that "The word '*the*' is a word of limitation " The DOR further asserts that 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 DOR makes a similar "a" vs "the" argument regarding the pass through statute Pg 19 of Respondent's initial brief similarly states

> "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 " (Emphasis in original)

In comparing the plain language of the Biomass and Infrastructures Credit Statutes, both are restrictive in nature as far as an offset to corporate income tax for certain qualifying costs or expenses Specifically, the Infrastructure Credit Statute states that a corporation may claim a credit for qualifying expenses paid or accrued by the taxpayer and the Biomass Resource Credit Statute states that a corporate income tax credit is allowed for qualifying costs incurred by a taxpayer The fact that one statute uses the word "the" and another one uses "a" should not result in different interpretations,

where both words come before a statutorily defined term "taxpayer" in the context of limiting the use of a credit against the corporate income tax

The precise language within the Infrastructure Credit Statute as it pertains to a qualified private entity in subsections (C) and (F) demonstrates that the General Assembly knows how to preclude taxpayers from claiming the Section 12-6-3420 credit Had the General Assembly wanted to limit the entities or taxpayers that "qualify" for the credit to just corporations, then they could have (and would have) used the term "corporation" in Section 12-6-3420 such that it would read as follows

> 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 expenses paid or accrued by the ~~taxpayer~~ corporation

Unfortunately Westlaw does not have the ability to search "the taxpayer" in Title 12[1] Title 12, Chapter 6, Article 25 contains most of the tax credit provisions A cursory manual search - - which was halted about halfway through Article 25 - - reveals 35 tax credit statutes which use the term "the taxpayer "

Specifically, the state's major income tax credit (certainly the one with the largest fiscal impact) is the Job Tax Credit It is found in Section 12-6-3360 As referenced in the respondent's quote above, it contains explicit pass-through treatment, see Section 12-6-3360(K) Contrary to the Appellant's assertion (in bold that no other credit statute uses the term "the taxpayer,"), it uses the term "the taxpayer" nine times This section uses the term "taxpayer" as follows

[1] Westlaw disregards the word the even when enclosed in parenthesis

Term	No of Usage
"Taxpayers"	7
"A Taxpayer"	12
"The Taxpayer"	9
"That Taxpayer"	2

Indeed, in subsection (A) alone, the term "the taxpayer" is used once, "a taxpayer" is used once, and "taxpayers" is used twice

The DOR next argues that given the specific reference to "corporation" in (A)(1), it is improper to invoke the definition of "taxpayer" contained in Section 12-6-30 The DOR has repeatedly argued to the contrary, most recently in the *Media General Communications, Inc v South Carolina Department of Revenue*, 388 S C 138, 694 S E 2d 525 (2010) The Supreme Court summarized the DOR's argument in that case as follows

> *The Department disagrees and argues section 12-6-2320 (A)(4) should not be construed* to allow the combined entity apportionment method *based on the legislative intent expressed in the corporate tax statutes* requiring the filing of tax returns by a single entity *Specifically, the South Carolina Code defines "taxpayer"* as including "an individual, trust, estate, partnership, association, company, corporation, or any other entity subject to the tax imposed by this chapter or required to file a return " S C Code Ann §12-6-30 (1) (200) (emphasis added) *The Department notes the definition refers to a single corporation* as a taxpayer and thus to separate filing requirements for each entity Consequently, this definition must be used for the meaning of "taxpayer" as it appears in Section 12-6-2320(A) and it limits the statute's application to a separate entity 694 S E 2d at 530 (Emphasis added)

Indeed, in the very recent DOR PLR# 11-6, as previously stated, the DOR asserted the definition of "taxpayer" contained in Section 12-6-30(1) to allow a corporate income tax credit provided in Section 12-6-3620 to be earned by a pass through entity

The DOR also invoked the statutory definition of "taxpayer" contained in the predecessor statute, Section 12-7-20(1) in two Tax Commission decisions dealing with consolidated corporate income tax returns, Commission Decision 93-78 (993 WL 461306)(1993) and I-D-283 (1980) Commission Dec 93-78 involved the Job Tax Credit, which at that time was limited (like the infrastructure tax credit) to corporations The Tax Commission held that the definition of "taxpayer" contained in Section 12-7-20(1) prevented the corporate taxpayer from using the Job Tax Credit in a corporate consolidated return basis in the manner sought by the taxpayer *See also Emerson Electric Co v Wasson,* 287 S C 394, 339 S E 2d 118 (1986) in which the Department made similar arguments

The Respondent also argues that subsections 12-6-3420 (G), (H) and (I) of the Infrastructure Tax Credit "leave no doubt that §12-6-3420 refer only to corporations " Subsection (G) is an add back provision which is applicable where a taxpayer (1) constructs a road, (2) donates it to the SCDOT or county, (3) a corporation takes the infrastructure tax credit, and (4) the SCDOT or county *subsequently* refuses the donation or returns the donated road (For example, the SCDOT might discover the road was not built to applicable standards, or no longer wished to incur the maintenance expenses) Given that the corporation had previously taken the Infrastructure Tax Credit - - both Appellant and Respondent agree, only corporations may do so - - obviously the corporation (and not the taxpayer) would add back the since it was the entity that had previously claimed the credit

Subsection (H) refers to the treatment of the credit on a consolidated corporate income tax return, and (I) refers to the treatment of the credit in a merger or acquisition of

the original corporation which took the credit It bears repeating - - Appellant and Respondent agree, only corporations may take the credit - - so obviously both sections would only include corporations

The basic thrust of the DOR's argument is that "the taxpayer" and "the corporation" are by definition the same entity The statute, however, refers to three possible entities (1) the corporation, (2) the taxpayer, and (3) a "qualifying private entity"

Who is this qualifying private entity? According to the Code Commissioner, see Sections 12-20-100-105(D) & (G), it includes utility coops, which do not pay corporate income taxes A qualifying private entity, such as the for-profit corporation in the above example, which incurs expenses on public infrastructure which it does not own, manage or, operate is allowed the credit Given that coops pay no corporate income taxes, the limitation is entirely superfluous – unless the coop is part of a business organization, and one of its partners is a corporation which does pay corporate income taxes

In addition, as discussed at length in Appellant's initial brief, the only published decision dealing with the Infrastructure Tax Credit is *Anonymous Corp v South Carolina Department of Revenue,* 98-ALJ-17-0533 (S C Admin Law Judge Div 1999) The ALC noted in its Finding of Facts

> The taxpayer is a conglomerate which files a consolidated corporate tax return annually with the State of South Carolina
>
> At all times relevant to this case, *one of the taxpayer s subsidiaries* was in the business of developing real estate for profit This business was included in the taxpayer's consolidate return filings *For purposes of this contested case this business shall also be referenced as "Taxpayer"* *Id* (emphasis added)

Accordingly, it is clear that the entities making the infrastructure expenditures were not the parent corporation filing the return The DOR did not challenge this issue before the ALC In fact, as discussed above, the DOR has published guidance stating that where a credit statute does not address the pass through of credits by flow through entities, Section 12-6-3310 is applied, which allows a flow through entity to pass through such credit to its owners See PLR #11-6 (Nov 4, 2011)

C Ejusdem Generis

The DOR attempts to complicate this case by applying the doctrine of *Ejusdem Generis* The DOR asserts that the statute should be read as if it stated "a corporation may claim a credit only for expenses that the corporation accrued " However, this is not what the statute says, and the Legislature could quite easily have stated this and Appellant submits would have so stated if such a result had been intended In further support of its position, DOR points to the doctrine of *ejusdem generis*, which ordinarily provides that "where general words follow the enumeration of particular classes or subjects, the general words should be construed as limited only to those of the general nature or class enumerated " *State v Wilson*, 274 S C 352, 264 S E 2d 414 (1980) The classic example is a laundry list of items followed by a phrase like "and any other [fill in the blank] " Under the doctrine, "and any other [fill in the blank]" would be construed to be of like or similar kind to the items specifically enumerated before or after it *Id* (explaining how doctrine might be applied to phrase "and any other" in statute at issue)

Respondent cites as authority for the imposition of *ejusdem generis* in this case *State v Patterson*, 261 S C 362, 200 S E 2d 68 (1973) in which two individuals were indicted for violation of former code Section 16-302, the burglary tool statute The tools

named in the indictment were preprinted checks, fake I D cards and credit cards As noted in the DOR's brief, the Supreme Court indeed dismissed the indictment under the doctrine of *Ejusdem generis* The Court held that the items enumerated in the statute "are obviously suitable for use where force is needed to break and enter burglariously," 200 S E 2d at 69, whereas it could not be forcefully argued that forged checks, I D cards and credit cards are used for a like purpose

A comparison for *ejusdem generis* purposes between former Section 16-302 and the Infrastructure Tax Credit statute is illustrative

WORDS OF SPECIFICATION
(*Enumerated Classes*)

§ 16-302	12-6-3420
Engine	Corporation
Machine	
Tool	
False Key	
Picklock	
Bit	
Nippers	
Nitroglycerine	
Dynamite Cap	
Coil or Fuse	
Steel Wedge	
Drill	
Tap-pin	

GENERAL WORDS

§ 16-302	12-6-3420
Other implement or thing adapted, designed or commonly used for the commission of burglary, larceny or safecracking	Taxpayer

WORDS CLAIMED TO VIOLATE
EJUSDEM GENERIS DOCTRINE

§ 16-302	12-6-3420
Forged Checks, Fake IDs and Credit Cards	Taxpayer (statutory definition)

In addition, this rule of statutory construction is only to be applied as an aid in ascertaining intent and has no application if doing so would defeat the clear purpose of the statute *See U S v Alpers*, 338 U S 680 (1950) and *State v Southern Farm Bureau Life Ins Co* , 265 S C 402, 410-411, 219 S E 2d 80, 84 (1975) (refusing to apply doctrine of *ejusdem generis* where doing so would defeat clear purpose of the statute)

II THE ALC ERRED 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) AND IRC

Appellant would submit that even if the Court were to determine that the Legislature intended "taxpayer" to refer only to corporations, that does not end the inquiry in this case As discussed more fully below, the federal and South Carolina partnership rules, add another hurdle for the DOR to overcome in denying an otherwise qualifying taxpayer (e g , a corporation), which owns a pass-through entity, the right to claim the infrastructure tax credit

A Pass Through Statute – Credits

As the Respondent's Brief notes, 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*, and '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) The Respondent's brief states that "Income tax is generally assessed on a single taxpayer[2], 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 benefit" Respondent cites no authority - - statute, regulation, case law, or treatise in support of its statements

The Respondent correctly notes that the pass-through statute requires a partnership to qualify for a credit before it may pass it on The Infrastructure Tax Credit somewhat uniquely bifurcates the credit process A corporation *claims* a credit against expenses *incurred* by the taxpayer The expenses in this case were incurred by a general partnership whose partners were corporations Respondent argues that claiming the credit and generating the credit are synonymous Read literally, however, the credit is generated and earned when infrastructure expenses are paid or accrued by the taxpayer (and the infrastructure is properly donated) The credit is subsequently claimed by the filing of a corporate income tax return which includes the proper amount of the credit

Indeed, this is the exact view expressed by the Auditor of Appellant in an e-mail to his supervisor

> This is regards to the Infrastructure credit I'm working for Centex International, Inc & Affiliates *The credits were earned by the Partnership* Centex Homes The Partnership is owned by three different Corporate affiliates of Centex International

[2] The DOR ignores the 500,000 or so joint individual income tax returns which are filed on an annual basis

> AAA Holdings, Inc (owns 80% of the partnership), Nomas Corp (owns 18% of the partnership), Centex Real Estate Corporation (owns 2% of the Corporation) The Partnership not the corporations would have paid the infrastructure expenses Would the Corporations be able to claim *credits earned by the partnership* since the partners pro rata share of the partnership's income flows to the corporations or does the infrastructure expenses have to be paid by a corporation before any resulting infrastructure credits can be claimed? Below is the Section of law dealing with infrastructure credits, it's not clear to me (R p 339) (Emphasis added)

The very recent SCDOR PLR #11-6 is illustrative of the breadth of the pass through statute The Biomass Tax Credit Statute, Section 12-6-3620, is a corporate income tax credit Utilizing Section 12-6-3310, the pass through statute, and the definition of "taxpayer" contained in Section 12-6-30(1), the DOR held that an LLC taxed as a partnership was able to earn and pass through a corporate income tax credit to its member (an S Corporation), which in turn passed the credit through to its individual (natural persons) shareholders, for inclusion on their individual income tax returns "even though the biomass statute seems to restrict the use of the credit to corporate income tax liability"[1] *(Id.)*

The PLR Also states

> The second part of the question posed by ABC concerns the use of the credit by an individual or corporate taxpayer On its face, Code Section 12-6-3620 appears to preclude the use of the credit against individual income taxes since individual income taxes are imposed under Code Section 12-6-510 while Code Section 12-6-530, the section imposing corporate income taxes, is referenced in the biomass credit statute *Therefore, if the credit is passed through to a corporate* member, *partner*, or shareholder, *it is clear that the corporate member partner*, or shareholder would be able to use the credit against its corporate income tax However, on the face of the biomass credit statute, *if the credit is earned* by a pass-through entity, such as ABC

> or Member A, *the credit may be able to be passed through* to an individual shareholder, member or partner, but *would not be able to be used to offset* the individual income tax of that individual (Emphasis added)

This paragraph makes clear that claiming and generating a credit are not synonymous The PLR clearly distinguishes between (1) generating, (2) earning, (3) passing through, and (4) actually being able to claim a tax credit

B Limited Liability Companies – Pass Through of Credits

The DOR argues that limited liability companies taxed as partnerships must be distinguished from partnerships with respect to applying and interpreting the Pass Through Statute as it applies to the infrastructure credit That is, the DOR argues that the Pass Through Statute is turned off with respect to partnerships, but not limited liability companies taxed as partnerships for purposes of earning and, then, claiming the infrastructure tax credit Appellant agrees that additional benefits have been extended, but only to the extent of individual member-partners That is, subsection (C) does not change the tax treatment otherwise provided in subsection (B) of the Pass Through Statute, which allows corporate partners of partnerships and limited liabilities companies taxed as partnerships to claim the credit

The DOR publication, South Carolina Tax Incentives for Economic Development Winter Edition 2009 at pg 22, specifically discusses limited liability companies as follows

> South Carolina Code § 12-6-3310(C) contains special provisions concerning the qualification and use of credits by limited liability companies that are not organized as a legal entity that expressly qualifies for a credit in Article 25 of Chapter 6, Title 12 Note These special provisions do not apply to credits in other Articles or Titles of the South Carolina Code, such as Chapter 14 of Title 12 containing

> the economic impact zone credit, or Chapter 65 of Title 12 containing the textile revitalization credit The rules include
>
> Limited Liability Company Taxed as a Partnership
>
> Individual Member The limited liability company may earn and pass through any credits allowed by Article 25 The individual member will use any credits against individual income taxes imposed under South Carolina Code §12-6-510
>
> Corporate Member The limited liability company may earn and pass through any credits allowed by Article 25 *The corporate member will use any credits against corporate income taxes imposed under South Carolina Code* §12-6-530
>
> *Note South Carolina Code § 12-6-3310(c) controls over the statutory language of a particular tax credit For example the infrastructure credit in South Carolina Code § 12-6-3420 specifically states that the credit is claimed against corporate income taxes imposed under South Carolina Code § 12-6-530 or bank taxes imposed under South Carolina Code § 12-11-20 however an individual member of a limited liability company taxed as a partnership can use the credit against individual income taxes imposed under South Carolina Code § 12-6-510* (R p 349-50)

Accordingly, the DOR makes it clear that with respect to the infrastructure tax credit, the special provisions under subsection (C) allow an individual member-partner to claim a corporate income tax credit that was not otherwise available Therefore, the only benefit extended by subsection (C) with respect to limited liability companies taxed as partnerships is the additional ability to "claim" the infrastructure credit for individuals

This conclusion is consistent with the DOR's responses to Centex's Requests for Admission regarding the 2008 amendment to the Pass Through Statute, which specifically addressed the right of a limited liability company to pass through a credit

earned by it to a member The DOR's policy section advised the taxpayer who was lobbying for this amendment that the amendment was unnecessary because the statute's existing language already allowed a limited liability company (an entity other than a "corporation") to qualify, earn and pass through to be claimed by its members

Most recently, as previously discussed in detail, the DOR issued Letter Ruling #11-6 with respect to the biomass tax credit, which similar to the infrastructure tax credit is a corporate tax credit with no specific language addressing flow through entities In rendering its ruling, the DOR made the following statements

> Code Section 12-6-3620 does not address the pass through of credits by flow through entities However, Code Section 12-6-3310(B) provides general rules relating to the pass through of credits by flow through entities Under Code Section 12-6-3310(B)(1) "Unless 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 the credit earned to each *shareholder of the "S" corporation, member of the limited liability company*, or partner of the partnership *Under (B)(2) for an "S" corporation owing corporate level tax a credit must first be used at the entity level with only the remaining credit passing through to the shareholders of the "S" corporation* This provision allows the pass through of the credit by ABC to Member A It also allows the pass through of the biomass credit from Member A on to the individual shareholders of Member A
>
> The second part of the question posed by ABC concerns the use of the credit by an individual or corporate taxpayer On its face, Code Section 12-6-3620 appears to preclude the use of the credit against individual income taxes since individual income taxes are imposed under Code Section 12-6-510 while Code Section 12-6-530, the section imposing corporate income taxes, is referenced in the biomass credit statute *Therefore if the credit is passed through to a corporate member partner or shareholder it is clear that the corporate member, partner, or shareholder would be able to use the credit against its corporate income tax* However, on the face of the biomass credit statute, if

> the credit is earned by a passthrough entity, such as ABC or Member A, *the credit may be able to be passed through to an individual shareholder member or partner, but would not be able to be used to offset the individual income tax of that individual* However, under Code Section 12-6-3310(C) a limited liability company not organized as a legal entity which is a taxpayer expressly specified as qualifying for the credits allowed pursuant to this article nevertheless qualifies for such credits and the limited liability company may *earn and pass through* the credits to an individual member who may then apply them against his individual income tax under Section 12-6-510 This statute allows ABC to pass through the biomass credit to an individual member and would allow that member to use the credit against his individual income tax, even though the biomass statute seems to restrict the use of the credit to corporate income tax liability

If the statutory definition is not applied and means corporation, as asserted by the DOR, then only a corporation as specified in the Infrastructure Credit Statute may claim the credit Thus, what other way is there for a limited liability company taxed as a partnership to qualify for the credit, which the DOR has clearly interpreted to be the case (as discussed above)? To be consistent with Letter Ruling #11-6, we must apply a two-step approach including (1) determine if subsection (B) of the Pass Through Statute applies with respect to allowing flow through entities to earn the credit, and (2) apply both the general "claim" rules under Subsection (B) and the special "claim" rules under subsection (C) for certain limited liability companies Since the Infrastructure Credit Statute does not specifically prohibit a flow through entity from earning the credit, the Pass Through Statute subsection (B) is applicable allowing an "S" corporation, limited liability company taxed as a partnership, or partnership to earn the credit Under the general subsection (B) rules, only a corporate partner or member-partner of a partnership or limited liability company taxed as a partnership may claim the credit Also, individual

shareholders of an S-Corporation may claim the credit Under the special subsection (C) rules, individual member-partners (whether through direct ownership or through another flow through entity) of a limited liability company taxed as a partnership may claim the credit Also under this interpretation, the type of taxpayers able to claim the credit fall within the legislative intent of the Infrastructure Credit and Pass Through Statutes subsection (B) and (C) (i e , corporations and individuals – only if members of a limited liability company or shareholders of an s-corporation) Either way, it is clear the corporate partners of a partnership may claim the infrastructure tax credit

The DOR argues that the treatment of limited liability companies taxed as partnerships is irrelevant to our case because the amendment to the Pass Through Statute addressing limited liability companies was enacted in 2008 (three years after the tax periods at issue in this case) However, this argument is misplaced since our case does not necessarily need and/or rely upon Section 12-6-3310(C) As shown above, the portion of the Pass Through Statute that applies in this case is Section 12-6-3310(B)(1), which was enacted on June 18, 2003

As of 2003, it is clear that a partnership may earn and, then, pass through the infrastructure credit to be claimed by a corporate partner How about tax years before 2003 when there was no Pass Through Statute dealing with tax credits?

The federal partnership rules allow the infrastructure tax credit to be earned by Centex Homes and, then, claimed by its corporate partners for tax years preceding the 2003 enactment date of the Pass Through Statute In 1985, South Carolina adopted all the partnership provisions of the IRC including the check-the-box election A partnership including a limited liability company taxed as a partnership shall determine the amount,

character, and timing of the income, deductions, gains, losses, and credits generated by its activities, generally without regard to the identity, or tax characteristics, of its partners See IRC Section 702(a) and (b), Treasury Regulation 1 702-1(a) Then, each partner reports an allocable share of all partnership items, combined, as appropriate, with items of the partner's other tax significant transactions for the year to be reported on their own tax returns See IRC Sections 701, 703 and 704 Under federal tax rules, it is clear that the infrastructure tax credit passes through from Centex Homes to its partners in the same manner as the qualifying infrastructure expenditures generating the credit

Accordingly, prior to the enactment of the Pass Through Statute in 2003, tax credits pass through under the federal rules, which allow credits to be earned by partnerships and passed through to partners unless specifically stated otherwise in the credit statute In such cases, the qualified expenditures or costs incurred are reported to the partner, who in turn determines whether or not it qualifies for such credit as if the qualifying expenditures were made directly by such partner See IRC Section 702(a), and Treasury Regulation 1 702-1(a) regarding separately stated items

C **Partnership Rules – Qualifying Expenditures**

The Infrastructure Tax Credit somewhat uniquely bifurcates the credit process A corporation may *claim* a credit against expenses *incurred* by the taxpayer The expenses in this case were incurred by a general partnership whose partners were corporations The DOR argues that the Pass Through Statute is not triggered or is "turned off" with respect to the tax credit However, that does not mean the infrastructure expenditures do not pass through to the corporate partners As a matter of federal partnership law and, thus South Carolina through adoption of the IRC, the infrastructure expenditures pass through as if directly accrued by the corporate partners and, thus, they may claim the

infrastructure tax credit

D Rath

The ALC and DOR's reliance on *Rath v Commissioner*, 101 T C 196 (1993) is misplaced In *Rath* an S corporation sold securities for a loss The individual shareholders of the S corporation reported the loss as an ordinary loss on their individual income tax returns Normally individuals who sell stock for a loss are required to report a capital loss, which is not as advantageous from a tax perspective as an ordinary loss Congress enacted section 1244 of the IRC as exception to this general rule in order to "aid and encourage" investments by individuals The ordinary loss exception afforded by section 1244, however, is only available to individuals and partnerships In *Rath* the stock was sold for a loss by a corporation – not an individual or partnership, and the IRS regulation on point, section 1 1244(a) 1(b)(2) explicitly prohibited sales of stock by a corporation from ordinary loss treatment

The taxpayers in made three arguments in favor of 1244 ordinary loss flow-through First, they argued that section 1366(b) of the Code, regarding the character pass-through in S corporations, required character (ordinary v capital) to be determined as if the individual shareholders, not the S corporation, sold the 1244 stock Secondly, the taxpayers argued "that the legislative history demonstrates that Congress intends for the character of items passing through to S corporation shareholders to be determined under the same rules applicable to partnerships " Thirdly, taxpayers in *Rath* argued that the language of section 1363(b) of the Code, "the taxable income of an S corporation shall be computed in the same manner as in the case of an individual," as "individual" in section 1244 includes S corporations

In *Rath*, the court rejected each of the taxpayers' arguments First, the court held that character is determined at the S corporation level Secondly, the court held that the legislative history did not indicate a Congressional intent to amend section 1244 (a) to allow S corporations to qualify for ordinary loss flow-through to their shareholders The court required "unequivocal evidence of legislative purpose" to overcome the "plain meaning" of section 1244(a), which states that the 1244 stock issued to an "individual" or "partnership" can qualify for ordinary loss treatment

Specifically the Court stated

> We likewise reject petitioner's argument that the legislative history of section 1366(b) supports their position While the legislative history indicates that Congress intended for the income tax to generally apply to S corporations in the same manner as it applies to partnerships, there is no indication that Congress intended to amend section 1244 (a) to extend relief to S corporations

Thirdly, the court held that "individual" in section 1244 (a) did not include S corporations, despite section 1363(b) The court cited section 1371(a)(2) of the Code, where the dividends received deduction, available to corporations, is specifically denied to S corporations With regard to the taxpayer's third argument, the Tax Court stated

> For the same general reasons, we cannot agree with petitioners that section 1363(b) helps their cause While the latter provision provides that the taxable income of an S corporation is to be computed in the same manner as an individual, an S corporation is not included within the definition of the term "individual" set forth in section 1244 (d)(4)

The basis for the ALC's reliance on *Rath* is not readily apparent Section 1244 explicitly allows a partnership like Centex to receive ordinary loss treatment The Deduction Statute in *Rath* specifically prohibits an S corporation from characterizing a deduction as an ordinary loss (i e , stock must be issued directly to an individual or

partnership), whereas the Infrastructure Credit Statute does not have such a prohibition and, in fact, explicitly allows partnerships to earn and, then, pass through the credit, which the DOR has explained and illustrated with its interpretation as the Biomass Resource Credit (i e , a credit statute with language that is almost identical) See PLR #11-6 (Nov 4, 2011) The remainder of the case dealt with conduit treatment of Sub Chapter S corporations under two federal Subchapter S statutes, neither of which are relevant here Lastly, an IRS Regulation, prohibiting corporations from receiving ordinary loss treatment, was directly on point

March 6, 2012

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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM ADMINISTRATIVE LAW COURT

John D McLeod, Administrative Law Judge

Docket No 2009-ALJ-17-0532-CC

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v

South Carolina Department of Revenue **Respondent**

CERTIFICATE OF COUNSEL

The undersigned certified that this Reply Brief of Appellant complies with Rule 211(b), SCACR

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PROOF OF SERVICE

I certify that I have served the Final Reply Brief of Appellant on the South Carolina Department of Revenue by mailing a copy of it, on March 6, 2012, to their attorney of record, Adam Marinelli, SC Department of Revenue, 301 Gervais Street, Columbia, SC 29201

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