NORTH CAROLINA

WAKE COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
20 CVS 10244

NORTH CAROLINA FARM BUREAU MUTUAL INSURANCE COMPANY, INC., Petitioner, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Respondent.	AMICUS CURIAE BRIEF OF AMERICAN COUNCIL OF LIFE INSURERS et al.

TO THE HONORABLE NORTH CAROLINA SUPERIOR COURT:

Amici hereby submit this amicus curiae brief in connection with Petitioner's request for reversal of the OAH's decision.[1]

I. AMICI'S INTEREST

Amici are a group of both life and property-casualty insurance companies, along with trade associations representing both of those sectors, that operate in North Carolina and other states. Amici insure the lives and property of their respective policyholders, which include millions of North Carolinians with millions of active

[1] Amici attest that no party or its counsel authored or paid for the preparation of this brief, and no one other than Amici paid for the brief. For convenience, defined terms relate to those used in Amici's motion for leave.

insurance policies. Amici have a common interest in ensuring that insurance companies and other taxpayers are taxed fairly and accurately in North Carolina.

Amici have a substantial interest in this case. As explained below, they and other insurance companies responded to a legislative inducement by utilizing partnership structures to invest hundreds of millions of dollars in North Carolina's renewable energy industry, thus providing a critical source of funding. Amici, like Petitioner, now find themselves involved in disputes with the DOR and face both current and proposed denials of renewable energy credits allocated to them by investment partnerships. The DOR is making substantially the same arguments in Amici's disputes as here; thus, the Court's decision is likely to have a significant impact on Amici and numerous other taxpayers. If affirmed, the decision would allow a state agency to financially penalize taxpayers after the State invited them to make investments through a partnership structure. The DOR had the opportunity to signal its disapproval of such structures before the investments were made, but did not. Amici therefore have a significant interest in ensuring that the Court is fully and accurately informed of the relevant issues and legal arguments.

II. DISCUSSION

Amici address the following issues: (1) Amici's reliance on the General Assembly's expansion of renewable energy credits to incentivize insurance companies to invest in renewable energy projects; (2) legal errors not specifically covered by Petitioner that are inherent in the DOR's "bona fide partner" and "disguised sale" arguments; and (3) the negative legal and economic impact an adverse decision would have on North Carolina and its citizens.

A. <u>Amici's Reliance on North Carolina Law</u>.

North Carolina has a long history of encouraging investments in industries and projects it deems economically and socially beneficial through the granting of tax credits. In 1999, the General Assembly enacted legislation providing for income tax credits for investing in renewable energy projects. Following the 2007-2008 financial crisis, and to encourage further investments, it expanded the law in 2009 to allow insurance companies to invest and claim such credits against their gross premiums tax. Because most investors themselves cannot independently construct renewable energy projects (e.g., lack of expertise and operations to do so) and therefore would be passive institutional investors, investment partnerships were sanctioned as a means to encourage such projects.[2] G.S. 105-269.15.

Amici heeded the State's call, investing hundreds of millions of dollars in partnerships that constructed, purchased, or leased renewable energy properties (creating jobs and serving some impoverished areas) and met the statutory requirements to qualify for tax credits that could be passed through to partners. The State's plan was an overwhelming success – it created an impressive solar industry and catapulted to the top of the Nation's solar energy ranks. Its purpose accomplished, the program ended in 2016.

[2] Around this same time, the General Assembly enacted legislation endorsing transactions structured for tax benefits consistent with legislative intent. *See* Part II.B.

Amici's investments in renewable energy projects were not casual decisions. Insurance companies are historically conservative when investing their policyholders' premiums. They manage risk carefully, looking for safe investments to meet future claim obligations. In the wake of the financial crisis, the expansion of the renewable energy tax credits program comported with their risk profile. The State promised renewable energy tax credits, specifically recognizing the use of investment partnerships in G.S. 105-269.15, for all those insurance companies that agreed to invest. And, the DOR issued guidelines in October 2014 acknowledging partnership qualification for such credits[3] and several private letter rulings ("PLRs") before 2016 regarding partnership structures in which taxpayers could participate and receive the credits. These structures ranged from sale-leaseback to upper-tier partnership investments, and the DOR never questioned the use of such partnerships. Notably, the DOR had notice and knowledge of the existing decisions in *Virginia Historic Tax Credit Fund 2001 L.P. v. Commissioner*, 639 F.3d 129 (4th Cir. 2011), and *Historic Boardwalk Hall, LLC v. Commissioner*, 694 F.3d 425 (3d Cir. 2012).

Amici did exactly as the State requested – and invested in projects that the State deemed economically and socially important, followed the DOR's then-existing guidance, and claimed the tax credits earned through those investments, which (without the credits) would not have yielded sufficient returns to warrant Amici's capital. Amici, along with other taxpayers, acted in good faith and responded to these

[3] "Guidelines for Determining The Tax Credit for Investing in Renewable Energy Property" (available at https://files.nc.gov/ncdor/documents/administrative-rules/renewable_energy_credits.pdf).

assurances that tax credits would be available if they invested their policyholders' premiums in renewable energy projects.

Now, after Amici have invested and claimed renewable energy tax credits, and a significant amount of time had passed since the *Virginia Historic* and *Historic Boardwalk* decisions, the DOR argues that such investments through partnerships lacked substance and that no party to such a transaction was entitled to the credits. This position flies in the face of the General Assembly's intent and purpose, and, as explained in more detail below, should be rejected.

B. The DOR's Erroneous Arguments.

The DOR labels Petitioner's use of a partnership structure as "an abusive tax avoidance strategy," thereby denying tax credits to any party. This case does not contain any of the hallmarks of tax abuse and avoidance: (1) no double-counting of benefits occurred and the relationship between the cash investments and the credits claimed matched the General Assembly's expectation; (2) no circular flow of funds exists; (3) no inflation of value or tax basis occurred; and (4) the tax credit recipients were the parties who contributed actual cash to the projects. Simply put, these transactions involved unrelated parties (developers and investors) that engaged in real transactions to create solar facilities benefitting North Carolina, for which investors received modest returns.

To support its tax avoidance strategy position, the DOR asserts that the substance of the transactions was a sale of tax credits and the transactions lacked both a business purpose and economic substance because they were engaged in solely for tax benefits. It relies on federal "bona fide partner" and "disguised sale" concepts and the *Virginia Historic* and *Historic Boardwalk* cases to support this position.[4]

Amici understand that Petitioner and other amici will address in detail the background and history of North Carolina law on renewable energy tax credits, focusing on the plain language of the relevant statutes as well as the underlying purpose and legislative history. Petitioner and other amici will also address the factual and legal underpinnings of the DOR's substance-based arguments. Accordingly, Amici submit additional reasons why the DOR's legal position is misplaced.

The clearly and unambiguously expressed intent of a legislature must be followed, and agency attempts to re-draft a statute must fail. *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 256-57 (4th Cir. 2011), *aff'd* 566 U.S. 478 (2012). When the legislature passes laws to encourage taxpayers' behavior (e.g, as here, to invest in renewable energy projects), it is inappropriate to apply substance-based doctrines focused solely on the tax benefits claimed by the taxpayer. As explained below, because the investment partnership structure was not an abusive tax avoidance strategy and the transaction follows the statute's intent and purpose of promoting and allowing tax benefits, such benefits should be allowed.

[4] In both cases the Tax Court held for the taxpayers. Because the Tax Court is not bound to follow an adverse decision of an appellate court – although it will follow such a decision if the case before it is appealable to that circuit (*Golsen v. Commissioner*, 54 T.C. 742 (1970)) – if this Court considers *Virginia Historic* and *Historic Boardwalk* it should review their rationales and analyses at both the Tax Court and the appellate court levels.

Sacks v. Commissioner, 69 F.3d 982, 992 (9th Cir. 1995), briefly addressed by Petitioner, warrants further discussion. As here, *Sacks* involved clear legislative action intended to promote renewable energy projects. In the 1970s, widespread concern existed regarding the future of oil as a commodity, including its future price, supply, and impact on the environment. To address this concern, "Congress passed a package of tax and other laws to encourage people to invest in windmills, solar energy, geothermal energy, and other alternative energy sources, and to discourage 'gas guzzler' automobiles and other petroleum consumption." *Id.* at 984. Arizona, where the taxpayers resided, enacted similar state tax credits.

The new state and federal tax incentives induced the taxpayers to make passive investments in solar energy projects. As here, the taxpayers made their investment through a newly-formed entity. The entity sold the solar equipment to investors who then leased the equipment back to the entity. The entity then leased the solar equipment to end users, Arizona homeowners. As structured, the taxpayers claimed depreciation deductions and investment tax credits on the solar energy equipment.

The Internal Revenue Service ("IRS") disallowed the claimed benefits, labeling the investments as shams that lacked substance. The Ninth Circuit disagreed, stating:

> Congress and the Arizona legislature purposely skewed the neutrality of the tax system, even more than the usual tax credits and accelerated depreciation designed to encourage more investment in capital goods than would otherwise be made, because they sought to induce people to invest in solar energy.

Id. at 991. Relying on the purpose and intent of the tax credit legislation, the court explained:

> If the government treats tax-advantaged transactions as shams unless they make economic sense on a pre-tax basis, then it takes away with the executive hand what it gives with the legislative. A tax advantage such as Congress awarded for alternative energy investments is intended to induce investments which otherwise would not have been made. Congress sought, in the 1977 energy package, of which the solar tax credits were a part, to increase the use of solar energy in U.S. homes and business.
>
> If the Commissioner were permitted to deny tax benefits when the investments would not have been made but for the tax advantages, then only those investments would be made which would have been made without the Congressional decision to favor them. The tax credits were intended to generate investments in alternative energy technologies that would not otherwise be made because of their low profitability. Yet the Commissioner in this case at bar proposes to use the reason Congress created the tax benefits as a ground for denying them. That violates the principle that statutes ought to be construed in light of their purpose.

Id. at 992 (citations in original omitted).

Sacks represents well-established jurisprudence. For example, in *Van Duzer v. Commissioner*, T.C. Memo. 1991-249, the taxpayer invested in windfarms and claimed various tax benefits. The IRS asserted that the purchase price for the windfarms was inflated solely to generate such benefits. The Tax Court reviewed Congress' purpose and intent for granting tax benefits for windfarm investments, finding that it intended to encourage investment into alternative energy resources like solar and wind energy. The court also explained that many transactions are likely to be significantly tax motivated, which is wholly permitted if those transactions are aligned with and sanctioned by the legislature's intent and purpose in enacting the law. In *Van Duzer*, the court held that the taxpayer was entitled to claim the tax benefits created by his investment because the result was aligned with the legislature's intent to encourage investment into alternative energy resources to diminish dependence on imported oil.

In *Cross Refined Coal, LLC v. Commissioner*, No. 19502-17 (Aug. 29, 2019) (involving federal refined coal credits), the Tax Court recently followed *Sacks*. There, as here, the investment was through a partnership. The IRS argued that the investments lacked substance. The court disagreed, explaining that "[t]here are indeed abusive transactions in which the tax law will disregard transactions that lack substance apart from tax manipulations, but this is not such a circumstance." *Id.* at *44. In upholding the taxpayer's entitlement to the tax credits and use of an investment partnership, the court reasoned: "here the partners deliberately and conscientiously pursued the economic goal that Congress incentivized them to seek … ." *Id.* at *45.

Sacks, *Van Duzer*, and *Refined Coal* all recognize that economic substance in the tax credit arena is not relevant if a taxpayer's actions comport with the intent and purpose of the statute. If an investment structure satisfies the legislature's intent and purpose and does not involve tax abuse or avoidance, the structure must be respected.

The facts and issues in the above three cases are strikingly similar to the present situation. In response to the financial crisis and a desire to become a prominent player in the solar energy marketplace, North Carolina enacted legislation expanding the availability of renewable energy tax credits to insurance companies like Amici for the clear purpose of inducing their investments in solar energy assets. This comported with the General Assembly's amendment just two years earlier to its policies "[t]o promote the development of renewable energy and energy efficiency" by encouraging "private investment in renewable energy and energy efficiency." G.S. 62-2(a)(10); S.L. 2007-397 (2007); *see also Innovative 55, LLC v. Robeson Cty.*, 801 S.E.2d 671, 679 (N.C. App. Ct. 2017) ("Our legislature has determined the public policy of our State encourages solar requirement and facilities and the use of solar energy.").

As Petitioner and other amici will explain, the statutory framework is straightforward and the General Assembly's intent is clear. There is no evidence whatsoever that the General Assembly intended that substance-based concepts be used in the manner advocated by the DOR to deny tax credits to taxpayers that invested in renewable energy projects through a partnership that, in fact, "constructed, purchased, or leased renewable energy property." Now, after the purpose behind the 2009 legislation has been accomplished – North Carolina has received hundreds of millions of dollars from Amici and others and become a leader in solar infrastructure development – and the program has ended, the DOR wants to claw back the tax benefits that induced Amici's investments in the first place (indeed, under the DOR's position no passive investor would be entitled to such credit, although it is undisputed that investment in renewable energy occurred). The DOR is impermissibly attempting to use its executive power to eliminate what North Carolina's legislative branch offered to insurance companies in return for their investments. This position unabashedly violates the very purpose of the relevant statutes and should be rejected.

Amici's entitlement to tax credits is even more compelling in light of federal and North Carolina legislation enacted contemporaneously with the expansion of renewable energy tax credits in 2009. In 2010, Congress codified the economic substance doctrine by enacting Internal Revenue Code ("IRC") § 7701(o). The history behind the statute demonstrates the limitations on an agency's use of the very substance-based concepts advocated by the DOR:

> If the realization of the tax benefits of a transaction is *consistent with the Congressional purpose or plan* that the tax benefits were designed by Congress to effectuate, *it is not intended that such tax benefits be disallowed*. . . . Thus, for example, it is not intended that a tax credit (e.g., section 42 (low-income housing credit), section 45 (production tax credit), section 45D (new markets tax credit), section 47 (rehabilitation credit), section 48 (energy credits), etc.) be disallowed in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage.

Staff of the Joint Committee on Taxation, *General Explanation of the Reconciliation Act of 2010*, at n. 344 (emphasis added).

Shortly thereafter, the General Assembly enacted legislation tracking IRC § 7701(o). G.S. 105-130.5A(g). Importantly, it recognized that a substance-based analysis is different (and limited) when state tax credits are involved:

> If State income tax benefits resulting from a transaction, or a series of transactions of which the transaction is a part, are consistent with legislative intent, such State income tax benefits shall be considered in determining whether such transaction has business purpose and economic substance.

G.S. 105-130.5(g)(3). In other words, a transaction should not be disregarded as lacking substance when the tax benefits claimed are precisely those authorized by the legislature.

This codification further supports the *Sacks*, *Van Duzer*, and *Refined Coal* analyses. The legislative intent behind the 2009 expansion of entitlement to renewable energy tax credits to insurance companies was to grant such credits to taxpayers that either directly, or indirectly through partnerships, invest funds to construct, purchase, or lease renewable energy property. If such an investment was made, a taxpayer was entitled to a tax credit under the clear statutory scheme. Here, the DOR ignores both the statutes granting the tax credits and the economic substance codification. These statutes confirm the points above that investment structures that comport with the intent and purpose of the statute granting tax credits are deemed to have business purpose and economic substance.

Reliance on federal substance-based concepts in the instant case is misplaced for other reasons as well. North Carolina has never adopted the federal "bona fide partner" or "disguised sale" concepts. Amici agree with Petitioner that a clear and specific reference to a provision of the IRC is required before it is incorporated in North Carolina's statutes. *Fidelity Bank v. N.C. Dept. of Revenue*, 803 S.E.2d 142 (2017). Amici further agree that IRC § 707 is not clearly and specifically incorporated into North Carolina law and, therefore, the DOR's disguised sale argument is unavailing (the same is true for the DOR's bona fide partner position). There are several other reasons, not addressed herein but discussed by Petitioner and other amici, why IRC § 707 does not apply in this situation. A limitation on the wholesale incorporation of the IRC into North Carolina tax law makes even more sense when one considers the context of the instant dispute.

Moreover, while the IRC overall can be daunting, the federal partnership tax rules in subchapter K are especially known for their complexity. The Tax Court, comprised of Judges with deep tax knowledge and experience, has repeatedly made this point over the past half-century:

> The distressingly complex and confusing nature of the provisions of subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years in the tax field.

Foxman v. Commissioner, 41 T.C. 535, 551 n.9 (1964), *aff'd* 352 F.2d 466 (3d Cir. 1965); *see also Tigers Eye Trading, LLC v. Commissioner*, 138 T.C. 67, 92 (2012); *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. 533, 539 (2000); *Frankfort v. Commissioner*, 52 T.C. 163, 168 (1969).

Given the stakes here, and the lack of clear and specific references in North Carolina's laws to IRC § 707 or any bona fide partner concept, the Court should reject the DOR's invitation to broadly incorporate subchapter K's distressingly complex and confusing provisions without specific legislative intent. Indeed, in Amici's experience state tax credit structures generally do not follow federal subchapter K rules in their entirety. Moreover, given that each state has laws for out-of-state institutional investors to follow, along with the differences in size, scope and duration of state tax credits and structures, it would be impractical and unreasonable to expect such investors to follow federal partnership rules not specifically incorporated into state statutes.

In summary, investing in a North Carolina renewable energy project through a partnership was not an abusive tax avoidance strategy. The Court need not accept the DOR's complex substance-based arguments. Taxpayers who invested in partnerships that constructed, purchased, or leased qualifying renewable energy property and met the statutory requirements should be allowed the promised tax credits for which they were induced to invest. North Carolina specifically encouraged these investments, which accomplished its purpose and plan of promoting solar energy. The DOR's position should be rejected as contrary to the General Assembly's clear intent.[5]

C. Impact of DOR's Position.

The issue presented in this case impacts many taxpayers, from individuals to passive institutional investors operating in North Carolina and nationwide. The monetary consequences are significant, and the issue may extend well beyond renewable energy credit investments.

Amici have the choice of where to invest their policyholders' premiums. When determining whether and where to pursue transactions involving tax considerations, particularly transactions involving entitlement to federal or state tax credits, investors need certainty. Taxpayers must be able to rely on the clear statutory scheme

[5] If the Court determines that it must engage in the detailed and complex substance-based analysis advocated by the DOR, and determines that such analysis warrants holding against Petitioner, Amici respectfully submit that the Court should make clear that such a holding is limited to the facts before it given that the investment partnership structures utilized by Amici and others varied.

enacted to encourage investments in state projects. They cannot operate their businesses with uncertainty about whether a state agency will assert positions contrary to state statutes based on previously unannounced agency policies, and then be required to pay millions of dollars in unanticipated taxes as a result. The DOR is making North Carolina an outlier – no other state in which Amici have similar investments is seeking to recoup tax credits based on the type of federal substance-based concepts advocated by the DOR. The DOR's position, if allowed to stand, will be a significant factor in Amici's, and other businesses', decisions to make future investments in North Carolina's economy and infrastructure.[6]

[6] The negative legal and economic impact of the DOR's position is not necessarily limited to the State's renewable energy industry. An adverse decision could be equally applied to other state sanctioned economically and socially beneficial projects such as affordable housing, historic rehabilitation, and film, which all provide tax credits as an inducement when the investment is made through a partnership. If this were to occur, North Carolina may also face the loss of future funding for these projects.

Respectfully submitted this 25th day of January, 2021.

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Pruco Life Insurance Company

The Northwestern Mutual Life Insurance Company

The Prudential Insurance Company of America

Transamerica Life Insurance Company

United States Automobile Association

CERTIFICATE OF SERVICE

I, the undersigned, do hereby certify that the foregoing document has been filed with the North Carolina Business Court's electronic filing system, which will effect service to all parties and counsel of record in accordance with BCR 3.9(a).

This, the 25th day of January, 2021.

/s/ Jennifer B. Routh
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CERTIFICATE OF WORD COUNT

Pursuant to BCR 7.8, I certify that this brief contains 3,750 words. The word count includes the body of the brief, headings and footnotes, and relies upon Microsoft Word for the word count.

/s/ Jennifer B. Routh
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