



North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

August 11, 2017

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Re: [REDACTED] & Subsidiaries
Voluntary Redetermination Agreement Request

Dear [REDACTED]:

After reviewing the facts presented from submitted documentation and from information gathered in additional conversations and correspondence, we respectfully decline [REDACTED] and Subsidiaries (" [REDACTED] ") request to file a combined income tax return for the tax year beginning January 1, 2016. A summary of the relevant facts and basis of this conclusion is discussed below.

In October 2012, [REDACTED] and the Department entered into an agreement allowing for a combined return filing for the then existing companies located in the United States. The agreement was for an undefined term; however, certain defined actions, including a material change, were set out in the October 2012 agreement as events that could terminate the agreement. In January of 2014, [REDACTED] took actions on its own initiative which caused a material change. In June of 2015, [REDACTED] informed the Department of a restructure, which resulted in a material change for [REDACTED].

In the June 2015 correspondence, [REDACTED] also requested a new agreement based on a combination of newly created entities, including a newly created entity formed in [REDACTED]. Because such a combination was not allowed by North Carolina statute, the Department denied the request in July of 2015. In August of 2015, [REDACTED] proposed a new agreement based on combining the U.S. entities and making an adjustment to eliminate the intercompany profits by an add-back on the North Carolina return. On August 26, 2015, after a meeting with [REDACTED], the Department requested information to evaluate this proposal. However, in an email dated August 31 from [REDACTED], [REDACTED], [REDACTED], [REDACTED] informed the Department that, although the Department's request was reasonable, they did not feel comfortable reversing valid transactions, and therefore withdrew the request for a new agreement.

Because estimated tax payments for 2014 and part of 2015 had been made using the existing combined methodology and because the Department extended agreements with other similarly

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situated taxpayers to years 2014 and 2015, ██████████ requested an extension of the original 2012 agreement. In October of 2015, the Department granted the extension for these two years, with adjustments, as an equitable accommodation but explicitly notified ██████████ that beginning January 1, 2016, separate North Carolina income tax returns would be required.

In January of 2016, ██████████ proposed two alternative filing methods under N.C. Gen. Stat. § 105-130.5A(c), although one of the methods was premised on an alternative apportionment methodology. Subsequent meetings were held and correspondence was exchanged, but no new agreement was reached. Accordingly, on April 19, 2017, the Department notified ██████████ that the terms of the October 2015 extension, including the separate filing requirement, continued to apply. At ██████████ request in a letter dated May 3, 2017, additional conversations were held, and in a subsequent letter dated July 25, 2017, ██████████ reiterated its request for a new agreement allowing a combined filing based on the October 2015 extension of the original agreement.

N.C. Gen. Stat. § 105-130.5A(c) allows the Secretary discretionary authority to allow an alternative filing methodology “if the Secretary has reason to believe that any corporation’s State net income properly attributable to its business carried on in this State is not accurately reported on a separate return...because of intercompany transactions(.)” However, ██████████ has consistently and vigorously asserted that its intercompany transactions have economic substance and are validly priced. Further, ██████████ has not produced information related to intercompany pricing for the Department to review despite admitting such a request is reasonable. Thus, the Secretary is not willing to exercise his authority since ██████████ has not articulated or provided documentation for this rationale.

Instead, ██████████ has asserted an economic substance over form theory and, because it is a unitary business, should be allowed to file combined because based on some unspecified distortion. However, other than noting the apportionment factors on one entity are significantly higher when filing a separate return, and that the combined filing results in less income taxes to North Carolina than the total of the separate filing entities, no evidence of distortion has been provided. Of note, ██████████ has not put forth evidence that any double income taxation occurs as a result of intercompany transactions or based on the North Carolina statutory apportionment methodology.

The mere fact that a combined return would result in a lower State income tax liability than separately filed State income tax returns does not establish that net income is not properly attributable to the State. In the Department’s opinion, when a taxpayer asserts, and the Secretary has no evidence to the contrary, that intercompany transactions are at fair value and have economic substance but believes that the amount of tax paid to the State is not appropriate based primarily on the results of the statutory apportionment factor, a remedy under N.C. Gen. Stat. § 105-130.5A(c) is not appropriate. For this reason, the initial agreement was incorrectly issued pursuant to the statutory requirements of N.C. Gen. Stat. § 105-130.5A(c). Therefore, ██████████ argument that such a methodology should be endorsed based on consistency reasons is inconsistent with sound tax administration and must be rejected.

