No. 62A23 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

****

PHILIP MORRIS USA, INC. Petitioner-Appellant	)	
v.	)	From Wake County
NORTH CAROLINA DEPARTMENT OF REVENUE Respondent-Appellee	)	

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RESPONDENT-APPELLEE'S BRIEF

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TABLE OF CONTENTS

TABLE OF CASES AND AUTHORITIES

Cases

Statutes

Other Authorities

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RESPONDENT-APPELLEE'S BRIEF

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INTRODUCTION

This appeal arises out of the disallowance of tax credits claimed by Philip Morris USA, Inc. on its North Carolina Corporate returns by the North Carolina Department of Revenue. Philip Morris argues the decision in the case will be determined by the meaning of the phrase "credit allowed" found in N.C. Gen. Stat. § 105-130.45. However, this case is about the meaning of six words added to N.C. Gen. Stat. § 105-

130.45(b) during a special session convened by the General Assembly. The words "may not exceed six million dollars" specifically limited the amount of credits a taxpayer could generate on the exportation of cigarettes. The amendment did not disturb the separate and preexisting cap on the amount of credits that a taxpayer could use on its tax return during a single year in subsection (c). Despite a plain reading of the amended language, Philip Morris contends that subsection (b) does not limit the amount of credit that can be generated in any given year and only limits the amount that can be claimed in a tax year. Thus, Philip Morris continued to incorrectly generate credits in excess of the $6 Million Cap.

Philip Morris is a C-corporation commercially domiciled in Richmond, Virginia that manufactured cigarettes in North Carolina during the years 1999 through 2007. (R p 445) In 1999, the General Assembly enacted a statute that provided a tax credit to companies that manufactured cigarettes in North Carolina based on their yearly volume of exported cigarettes. *See*, S.L. 1999-333, codified in N.C. Gen. Stat. § 105-130.45 ("1999 Export Credit Statute"). Only two cigarette manufacturers qualified for the Export Credit, Philip Morris and its

competitor, RJ Reynolds a tobacco company domiciled in North Carolina. Philip Morris utilized the credits to reduce its tax liability; however, the credit was set to expire on 1 January 2005. (R p 207)

In late 2003, Philip Morris became aware that RJ Reynolds was lobbying the General Assembly for a new tobacco tax credit that unlike the Export Credit, Philip Morris would not qualify for. (R pp 10, 319) Seeing an opportunity to seek an extension of the Export Credit, Philip Morris contacted the Governor and members of General Assembly to ensure it would continue to qualify for a tax credit. (R pp 319, 320). The General Assembly amended the Export Credit Statute through Act of Dec. 10, 2003, S.L. No. 2003-435, 2003 N.C. Sess. Laws 435 ("2003 Amendment"). However, among the changes, the General Assembly inserted language into N.C. Gen. Stat. § 105-130.45(b) limiting the amount of credits generated by the export process ("Export Credits") to $6,000,000 per year ("Generation Limit") for tax years beginning 1 January 2005. The 2003 Amendment continued to cap the amount of credits that a taxpayer could use on its tax return during a single tax year under a separate provision of the statute found in N.C. Gen. Stat. § 105-130.45(c). While the Generation Limit limited the number of credits

created by a taxpayer in one year, N.C. Gen. Stat. § 105-130.45(c) separately placed a cap on the amount of credits a taxpayer could use against their income in one year.

Despite the plain language of the 2003 Amendment, Philip Morris purported to generate credits in excess of the Generation Limit. For tax years 2005, 2006, and 2007, Philip Morris calculated its Export Credits generated in the amount of $28,767,799, $27,374,957, and $14,310,414 respectively, far exceeding the $6,000,000 limit. (R pp 204, 207) Philip Morris then improperly attempted to carry forward the unauthorized credits to its 2013 and 2014 corporate tax returns. (R pp 204, 205, 207)

Through this appeal, Philip Morris now continues to lobby for better treatment than its competitor RJ Reynolds by attempting to question the statutory construction of an unambiguous statute: N.C. Gen. Stat. § 105-130.45, as revised in 2003. Br. at 4, ¶¶ 1-3. This position was rejected by both the Office of Administrative Hearings and the North Carolina Business Court. (R pp 41, 507) Philip Morris's argument that this Court should adopt its reading of the statute fails for two principle reasons.

First, the clear language of N.C. Gen. Stat. § 105-130.45, read in context with all its subsections, should be interpreted using its plain

meaning. N.C. Gen. Stat. § 105-130.45 places the rules relating to how an Export Credit is generated and calculated in subsection (b) titled "Credit" and separately places the rules relating to what amount of credit may be used in subsection (c) titled "Cap." A plain reading of the limitation in both subsection (b) and then again in subsection (c) supports the Department's reading that there is a $6 million limitation on both the generation and use of the Export Credits. As correctly explained by the Business Court Judge, "the inquiry begins and ends with the plain language of the statute, and the General Assembly's clear drafting leaves nothing to be interpreted by the Court." (R p 507). Therefore, there is no need to consider legislative intent or extraneous statements in the application of the statute.

Second, "[o]nly where the statutory language is ambiguous is 'judicial construction [necessary] to ascertain the legislative will.'" *Parkdale Am., LLC v. Hinton*, 200 N.C. App. 275, 684 S.E.2d 458 (2009) (citing *Burgess v. Your House of Raleigh*, 326 N.C. 205, 209, 388 S.E.2d 134, 137 (1990)). Philip Morris must demonstrate an ambiguity in the language of the statute to warrant further inquiry into legislative intent. N.C. Gen. Stat. § 105-130.45 does not contain any ambiguous statutory

language. In subsection (b), the General Assembly inserted six words to the already existing language. Those words limited the preexisting credit generation allowance to $6 million. Philip Morris has not demonstrated that the statute is ambiguous. Tax credits, such as the ones sought in this case, are considered privileges, not rights, allowed as matter or legislative grace. *Aronov v. Sec'y of Revenue*, 323 N.C. 132, 140, 371 S.E.2d 468, 472 (1988). As such, the credits are considered an exemption from taxation. To the extent there is ambiguity in the language of the exemption it should be resolved in favor of taxation. *Aronov*, 323 N.C. at 140, 371 S.E.2d at 472.

For these reasons, the decision of the Business Court Judge that left in place the Department's adjusted tax assessment should be affirmed.

STATEMENT OF THE FACTS

Philip Morris is a Virginia C-corporation that manufactured cigarettes in North Carolina from 1999 through 2007. (R p 445). From 1983, Philip Morris maintained and operated a cigarette manufacturing facility in Concord, North Carolina that manufactured cigarettes. *Id.* However, Philip Morris stopped manufacturing cigarettes for export at

the Concord facility in 2007. *Id.* Philip Morris closed the Concord plant completely in 2009 and has not manufactured cigarettes in North Carolina since closing the plant. (R p 204)

A. The General Assembly provided a tax credit for cigarette manufacturers operating in the state of North Carolina that exported cigarettes.

In 1999, the General Assembly added a new section to Chapter 105 of the General Statutes titled "Credit for Manufacturing Cigarettes for Exportation." Act of July 14, 1999, S.L. No. 1999-333, 1999 N.C. Sess. Laws 333. The 1999 Export Credit Statute allowed for a tax credit against the income of cigarette manufacturers that manufacture cigarettes in North Carolina for export outside the United States. From its enactment, the 1999 Export Statute allowed only a limited number of cigarette manufacturers to qualify for the Export Credit. (R p 204)

The newly codified statute was organized into four distinct subsections. Subsection (b), titled "Credit," outlined how a taxpayer "engaged in the business of manufacturing cigarettes for exportation to a foreign country" creates an Export Credit. This section concludes with the "amount of credit allowed is as follows" and a formula to calculate how much credit can be generated. N.C. Gen. Stat. § 105-130.45(b)(1999)

In contrast, subsection (c), titled "Cap," capped the amount of credit a taxpayer could use against its income in a tax year. While both sections include the phrase "credit allowed," each section has a differing purpose for how that phrase is used.

Session Laws 1999-333, sec. 10, provided that the Export Credits created by the 1999 Export Credit Statute expired on January 1, 2005. Philip Morris used the entirety of the 1999 Export Credits and carryforwards by tax year 2009 and those credits have no application in this case. (R p 207; App. p 4, T p 72)

B. The General Assembly amended N.C. Gen. Stat. § 105-130.45 and provides additional parameters to how much tax credit may be generated.

The General Assembly amended the 1999 Export Credit Statute through 2003 Amendment. Among other changes, the 2003 Amendment extended the statute sunset of the credit until 1 January 2018, imposed requirements on manufacturers for the use of North Carolina ports, and added provisions for a successor in business. Most relevant here, the 2003 Amendment imposed a limit of $6 Million on the generation of the credit by inserting limiting language to the existing language of the statute. The following is a reproduction of the relevant parts of N.C. Gen. Stat. §

105-130.45 showing the 2003 Amendment additions and deletions to the 1999 Export Credit Statute:

> N.C. Gen. Stat. § 105-130.45. Credit for manufacturing cigarettes for exportation
>
> (a) Definitions. - The following definitions apply in this section:
>
> (1) Base year exportation volume. - The number of cigarettes manufactured and exported by a corporation during the calendar year ~~1998~~ 2003.
>
> (2) Exportation. - The shipment of cigarettes manufactured in the United States to a foreign country sufficient to relieve the cigarettes in the shipment of the federal excise tax on cigarettes.
>
> (3) Successor in business. - A corporation that through amalgamation, merger, acquisition, consolidation, or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the cigarette exportation business.
>
> (b) Credit. - A corporation engaged in the business of manufacturing cigarettes for exportation to a foreign country and that waterborne exports cigarettes and other tobacco products through the North Carolina State Ports during the taxable year is allowed a credit against the taxes levied by this Part. The amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with the corporation's base year exportation volume, rounded to the nearest whole percentage. In the case of a successor in business, the amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the

corporation's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage. The amount of credit allowed may not exceed six million dollars ($6,000,000) and is computed as follows:

Current Year's Exportation Volume Compared to its Base Year's Exportation Volume	Amount of Credit per Thousand Cigarettes Exported
120% or more	40 cent(s)
119% - 100%	35 cent(s)
99% - 80%	30 cent(s)
79% - 60%	25 cent(s)
59% - 50%	20 cent(s)
Less than 50%	None

(c) Cap. - The credit allowed under this section may not exceed the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of tax imposed by this Part for the taxable year reduced by the sum of all other credits allowable, except tax payments made by or on behalf of the taxpayer. This limitation applies to the cumulative amount of the credit allowed in any tax year, including carryforwards claimed by the taxpayer under this section for previous tax years. Any unused portion of a credit allowed in this section may be carried forward for the next succeeding ~~five~~ ten years.

(d) Documentation of Credit. - A corporation that claims the credit under this section must include the following with its tax return:

(1) A statement of the base year exportation volume.

(2) A statement of the exportation volume on which the credit is based.

(3) A list of the corporation's export volumes shown on its monthly reports to the Alcohol and Tobacco

> Tax and Trade Bureau ~~Bureau of Alcohol, Tobacco, and~~ Firearms of the United States Treasury for the months in the tax year for which the credit is claimed.
>
> (e) No Double Credit. - A taxpayer may not claim this credit and the credit allowed under G.S. 105-130.46 for the same activity.

Act of Dec. 10, 2003, S.L. No. 2003-435, 2003 N.C. Sess. Laws 435 , § 5.2. (Additions in underline, deletions in crossed text.) (App. 5-8, R S p 739-741)

As stated *supra*, subsection (c) always included a six million dollar cap on the amount of credit a taxpayer could use during a tax year. The amended language however inserted the words "may not exceed six million dollars" to the already existing language of "the amount of credit allowed" in subsection (b). In addition to the new limiting language, the General Assembly also added the words "is computed" prior to the formula used to calculate the amount of credit generated. The amending language, whether clarifying or substantive, clearly placed limiting language in subsection (b) relating to the generation of credits.

Following the 2003 Amendment, Philip Morris did not request a private letter ruling from the Department on the correct way to calculate

Export Credits. (R p 510) The Department, however, published a "Supplement to 2003 Tax Law Changes." With regards to the statute in question, the Department indicated that *"[s]ubstantive and clarifying changes were made to subsection (b). … The clarifying change clarifies that the maximum allowable credit for cigarettes exported during a tax year is six million dollars, before applying the tax limitations provided for in subsection (c)."* (R p 239)

C. Despite the clear language from the 2003 Amendment, Philip Morris ignored the limitation on the generation of credits.

For Tax Years 2012, 2013 and 2014, Philip Morris timely filed North Carolina corporate franchise and income tax returns claiming Export Credits for each tax year. (R p 205) On each respective return, Philip Morris computed the amount of Export Credits it claimed using Forms CD-478 and CD-425. *Id.* On Form CD-478, Philip Morris claimed Export Credits in the amount of $5,075,808 for 2012, $5,946,034 for 2013 and $5,551,895 for 2014. The claimed amounts correspond directly with the amounts listed on Philip Morris's Schedule of Cigarette Manufacturing Credit for Export Credit Carryforward. *Id.* Based on this schedule, Philip Morris carried forward Export Credits that it calculated

as generated during the 2005 year and claimed them on its 2012, 2013 and 2014 tax returns. *Id.* at ¶ 11. The 2003 Amendment to N.C. Gen. Stat. § 105-130.45(b) was effective for cigarettes exported on or after on 1 January 2005. Despite the clear limitation of $6 Million for the generation of credits, Philip Morris claimed to have generated $28,767,799 in export tax credits during Tax Year 2005 ("2005 Credit").

Based on its own interpretation, Philip Morris claimed the 2005 Credit through various tax years as follows:

Total 2005 Credit	2010	2011	2012	2013	2014	2015
$28,767,799.00	$4,645,270	$4,392,320	$5,075,808	$5,946,034	$5,551,895	$3,156,472

(R p 207[1])

The Department audited Philip Morris's filed returns for Tax Years 2012, 2013 and 2014. Upon review, the Department disallowed the excess of $6 Million of the 2005 Credit and issued a proposed assessment.

[1] Philip Morris interpretation accepts that each tax year the credit claimed cannot exceed the lesser of $6 Million or fifty percent (50%) of the amount of tax. The variance on each year's tax liability and the requirement of using the lesser amount, resulted in different amounts of credit claimed each year which are all less than $6 Million.

At the request of the taxpayer, the Department conducted a Departmental Review and confirmed the assessment through a Notice of Final Determination. (R pp 122, 205)

Philip Morris timely filed a Petition at Office of Administrative Hearings challenging the Department's Final Determination. (R p 102) While preparing its motion for summary judgment, the Department adjusted the Final Determination and assessment to allow Philip Morris to use all Export Credits claimed in 2012 and a portion of the Credits in 2013. (R p 34) The following is an illustration of the proper use of the credits in the way most favorable to the taxpayer, as determined by the Department:

	Max. credit generated pursuant to N.C.G.S. § 105-130.45(c)	2010	2011	2012	2013	2014
2005	$6,000,000	$4,645,270	$1,354,730			

2006	$6,000,000		$3,037,590	$2,962,410		
2007[2]	$6,000,000			$2,113,398	$3,886,602	

As a result of the adjustment, the amount of the disputed Export Credits was adjusted to $2,004,366 for tax year 2013 and disallowed completely for tax year 2014 in the amount of $5,266,861. (R pp 436, 498) After cross motions for summary judgment, on November 3, 2021, OAH granted summary judgment in favor of the Department upholding the adjusted assessment disallowing credits in excess of six million dollars of export tax credits generated by Philip Morris after 1 January 2005, under N.C. Gen. Stat. § 105-130.45.[3] (R p 32) Based on the plain language of the Export Credit statute, OAH determined that Subsection (b) addresses "how taxpayers can generate Export Credits to offset what taxes and in what amount." (R p 36) It reached that conclusion because it held "the phrase '[t]he amount of credit allowed may not exceed six million dollars ($6,000,000)' immediately preceding the calculation formula limits the

[2] Philip Morris ceased manufacturing cigarettes in North Carolina in 2007. "Joint Stipulations of Undisputed Material Facts", R. p. 445, ¶ 4.
[3] The statute codified under N.C. Gen. Stat. §105-130.45 was repealed effective 1 January 2018 and is no longer in effect. It is relevant for the assessment at issue as will be explained further in this Brief.

amount of Export Credits that a taxpayer can generate in any year." (R pp 36, 37) OAH also noted that, "[t]he work of statutory construction is done when the analysis of the plain meaning within the context of the statute yields an unambiguous meaning for the phrase at issue." (R p 37)

Philip Morris timely appealed to the North Carolina Business Court. Judge Julianna Theal Earp issued an Order and Opinion on Petition for Judicial Review upholding the Final Decision issued by OAH affirming the assessment issued by the Department on Philip Morris's 2013 and 2014 corporate income tax. In the Order and Opinion, the Business Court agreed with the Administrative Law Judge's conclusion that "[t]he General Assembly adopted a logical structure for the [Export] Credit Statute, putting the rules governing how a taxpayer can earn Export Credits and their calculation in the Credit Subsection [subsection (b)], and the rules governing how much credit can be claimed and the carryforward of excess credits in the Cap Subsection [subsection (c)]." (R p 506) The Business Court also found that the limitation should be read in the context of the Credit Subsection because it was placed by the General Assembly in that subsection. *Id*. The Court noted the legislative decision to place the limiting words immediately preceding the

calculation formula of the credit, makes it clear that the limiting words were not intended in another context, as argued by Philip Morris. *Id.*

SUMMARY OF THE ARGUMENT

The Business Court rightly concluded that Philip Morris cannot generate more than $6 Million worth of Export Credits in a year because the plain language of N.C. Gen. Stat. § 105-130.45(b) limits the amount of credits that can be created in a year. The 2003 Amendment by the General Assembly inserted the phrase "may not exceed six million dollars" to the sentence in the statute directly relating to the computation of the Export Credit.

Philip Morris's argument focuses on the phrase "credit allowed" while ignoring the placement of the limiting language in the portion of the statute that determines the amount of credit that is generated in a year. Its argument next strays from longstanding precedent requiring a showing of ambiguity in a statute prior to engaging in judicial construction of a statute. *State v. Jones*, 358 N.C. 473, 477, 598 S.E.2d 125 (2004). This Court need not look to legislative history to determine the legislative intent where the statute is clear and unambiguous. *State v. Hinton*, 361 N.C. 207, 211, 639 S.E.2d 437, 440 (2007).

N.C. Gen. Stat. § 105-130.45(b) clearly states, "The amount of credit allowed may not exceed six million dollars ($6,000,000) and is computed as follows." If the Court accepts Philip Morris's argument that this inserted language is simply for a "successor in business" and would not apply to them, then Philip Morris would not have an available formula to calculate the amount of its available Export Credits. The language directing the computation of the credit and $6 Million cap are found in the same sentence, in the same section of the statute directing how the credit is generated.

ARGUMENT

Standard of Review

This Court reviews de novo the Business Court's order that granted summary judgment in favor of the Department. *Midrex Techs. v. N.C. Dep't of Revenue*, 369 N.C. 250, 257, 794 S.E.2d 785, 791 (2016).

This case calls for the Court to interpret tax credits enacted by the General Assembly. This Court reviews questions of statutory interpretation de novo. *State v. Cox*, 367 N.C. 147, 151, 748 S.E.2d 271, 275 (2013).

In reviewing a taxpayer's challenge to an exemption from tax, the Court is also mindful that tax credits, a type of exemption from taxation, "are privileges, not rights, and are allowed as a matter of legislative grace." *Aronov,*323 N.C. at 140, 371 S.E.2d at 472 (1988). Accordingly, [w]hen a statute provides for an exemption from taxation any ambiguities therein are resolved in favor of taxation." *Id.* A taxpayer claiming an exemption from taxation "must bring himself within the statutory provisions authorizing" the exemption. *Ward v. Clayton,* 5 N.C. App 53, 58, 167 S.E.2d 808 (1969). Further, [t]he burden of proving eligibility for a credit and the amount of credit rests upon the taxpayer." N.C. Gen. Stat. § 105-129.18

I. The language of the relevant statute is clear and unambiguous

In its opening brief, Philip Morris acknowledges that the answer to this dispute is in the plain language of N.C. Gen. Stat. § 105-130.45. In the words of Philip Morris, "[t]he statute's text and context should end this case." Br. at 38, ¶ 2.

Notwithstanding this admission, Philip Morris dedicates over 30 pages of its Brief presenting arguments about the legislative intent of the 2003 Amendment. To reach its objective, the appellant argues that this

Court look beyond the plain language and into the legislature's state of mind when it drafted and approved the 2003 Amendment. While Philip Morris attempts to raise an issue as to "[w]hat the General Assembly meant when it said, in subsection (b) [of N.C.G.S. § 105-130.45], that the "credit allowed" by the Amended Export Credit Statute could not exceed $6 Million," such inquiry is not necessary. Br. at. 25, ¶ 2. As correctly determined in the Order and Opinion by the trial court, "the Court is compelled to interpret the meaning of the statute from the words as the exist on the page." (R p 506.)

A. The plain meaning of the language used in N.C. Gen. Stat. § 105-130.45(b) is clear and unambiguous and limits taxpayer's ability to generate more than $6 million in export credit.

It is well established that "[w]here the language of the statute is clear and unambiguous, there is no room for judicial construction and the courts must construe the statute using its plain meaning." *Burgess v. Your Hours of Raleigh, Inc.*, 326 N.C. 205, 209, 388 S.E.2d 134, 136 (1990). "The intent of the General Assembly may be found first from the plain language of the statute" and if the language of the statute is clear, "the court must implement the statute according to the plain meaning." *Lenox Inc. v. Tolson*, 353 N.C. 659, 664, 548 S.E.2d 513, 517 (2001).

Present in both the 1999 Export Credit Statute and the 2003 amendment is subsection (b) that established the method to compute the amount of Export Credits that can be generated for a tax year. Further, in both statutes there is a separate section that applies a cap to the cumulative amount of Export Credits that may be used, including carryforwards, by a taxpayer in a given tax year, found in subsection (c). The Cap on using Export Credits is either a maximum amount of $6 million dollars or 50% of the tax liability for the year, whichever was lesser. N.C. Gen. Stat. § 105-130.45(c).

Significantly, the 2003 Amendment provided an additional limitation in N.C. Gen. Stat. § 105-130.45(b) on the amount of Export Credit that could be generated in a tax year before applying the cap found in N.C. Gen. Stat. §105-130.45(c). The General Assembly inserted the phrase "may not exceed six million dollars ($6,000,000)" after the already existing language of "credit allowed." This language immediately precedes the formula used by any eligible taxpayer to determine the computation of the credit. It is clear and unambiguous that the credit that arises from the formula cannot exceed $6 Million. This is evident from the construction of the statute. The statute first caps the amount of

the credit at $6 Million and then states that its computed using the *current year's* exportation volumes. To determine how much credit is generated, a taxpayer must first limit the amount to $6 Million and next use the current year's exportation volumes to determine the amount of credits. In contrast, subsection (c) of N.C. Gen. Stat. § 105-130.45 provided a cap for the use of the credit. In its relevant part, it reads:

> c) Cap. - The credit allowed under this section may not exceed the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of tax imposed by this Part for the taxable year reduced by the sum of all other credits allowable, except tax payments made by or on behalf of the taxpayer. . ..
>
> N.C. Gen. Stat. § 105-130.45(c).

"[T]he words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809, 109 S. Ct. 1500, 1504 (1989). North Carolina Courts have long followed this same principle. *E.g., Rhyne v. K-Mart Corp.*, 358 N.C. 160, 188, 594 S.E.2d 1, 20(2004) ("This Court does not read segments of a statute in isolation."); *State v. James*, 371 N.C. 77, 89, 813 S.E.2d 195, 204 (2018) (a statute must be read "contextually and in its entirety"). Subsection (c) exists to determine how much credit a taxpayer can use against its corporate tax liability for a tax year. While

subsection (b) determines how much Export Credit a taxpayer may generate each year. A taxpayer could generate more credit than they have tax liability under N.C. Gen. Stat. § 105-130.3. For example, if a taxpayer had $4 million worth of liability but generated $6 million worth of credits, pursuant to subsection (c) they could only use $2 million worth of credits for the tax year. To not apply the plain language of the statute would not appropriately apply both limitations provided by the General Assembly.

The court below conducting a plain reading analysis, found the structure of the statute and the context of the words in each subsection adopted a "logical structure" placing the law around how a taxpayer can earn and the calculation of the Export Credits in subsection (b) and the rules governing how much credit can be claimed in subsection (c). (R p 506) The Business Court correctly determined that Philip Morris arguments could not "carry the day in the face of established principles of statutory interpretation. If the words of the statute are clear, the inquiry need go no further." (R p 505)

Simply put, because the General Assembly inserted the phrase "credit allowed may not exceed six million dollars" before the formula

that entitles the computation of the credit, it is clear and unambiguous that the credit generated by the formula cannot exceed $6 Million. This Court "need go no further" to find legislative intent based on a plain reading of the statute.

Despite the clear language, Philip Morris erroneously states that "the Department conceded that, in the original 1999 Export Credit Statute, the phrase 'credit allowed' limited only the taxpayer's ability to claim more than $6 million in tax credits." Br. at. 25, ¶ 2. The Department has made no such concession. Phillip Morris further erroneously states, "the Department now insists—and the trial court agreed—*that adding the phrase "credit allowed" a sixth time* by the 2003 amendments changes the statute's meaning." Br. at p. 26, ¶ 1. (emphasis added.) The phrase "credit allowed" has always been in last sentence of N.C. Gen. Stat. § 105-130.45(b). In fact, the words added by the 2003 Amendment to the last sentence in the paragraph are the only relevant consideration before this Court. The General Assembly added the phrase "may not exceed six million dollars ($6,000,000)" to the already existing language of N.C. Gen. Stat. § 105-130.45(b).

The relevant portion of the statute always referred to the term "credit allowed." A plain reading of the 2003 Amendment demonstrates that the General Assembly modified the amount of the credit allowed with language limiting the amount of the "credit allowed" to six million dollars in the section of statute used to determine how much credit is generated.

Despite this plain reading on the 2003 Amendment, Philip Morris argues that, pursuant to certain dictionary definitions, "allowed" means "to claim" when used with respect to tax credits. Br. at 27, ¶ 3 - p. 28, ¶¶ 1-2. Therefore, it argues that the phrase "credit allowed" used in subsection (b) of N.C. Gen. Stat. § 105-130.45 only limits the credit a taxpayer may claim yearly on its tax return, not the credits a taxpayer may generate. Br. at 26, ¶ 2. Phillip Morris claims that the ordinary and historical meaning of the phrase "credit allowed" support its argument. But the historical and ordinary meaning of this phrase do not lead to such a conclusion.

For starters, the Philip Morris cites dictionary definitions of the term "allow" that provide that the term means to "[t]o put no obstacle in

the way of", "tolerate", "approve", "permit", etc.[4] None of those definitions refers to the action verb of "claim".

Further, the plain meaning of the word "allowed" does not mean that the "tolerated", "approved" or "permitted" conduct or act cannot be limited. Philip Morris uses the example of a parent that "might allow a child to break curfew" or an employer that allows an employee to take some time off. Br. at. 28, ¶ 2. Conveniently, the appellant's does not discuss that both the parent and the employer in the example can set a time limit for the child to be back home after curfew or the employee to get back to work after taking some time off. While the grantee may use the maximum of the thing allowed by the grantor, the grantor can still impose a limit on the allowance. And this is exactly what the General Assembly did in the 2003 Amendment. It set a limit on the legislative grace given.

Similarly, Philip Morris also cites two cases, *Virginia Hotel Corp. v. Helvering*, 319 U.S. 523, 63 S. Ct. 1260 (1943), and *Department of Revenue v. Hudson*, 196 N.C. App. 765, 675 S.E.2d 709 (2009), that it

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[4] See, Appellant's Brief at p. 27, ¶ 3, citing Black's Law Dictionary and Am. Heritage Dictionary.

claims shows the term "allowed" in the statute should be read to mean "claimed." But these cases do not support its reading of this term.

First, the issue before the United States Supreme Court in *Virginia Hotel* was about whether a reasonable allowance for depreciation under the Internal Revenue Code was allowed when the Internal Revenue Service adjusted the amount of the depreciation in years where the taxpayer would receive no tax benefit. *Virginia Hotel* at 524. In holding that "'Allowed' connotes a grant," the Court determined that unchallenged or unaudited deductions were allowed. *Id.* at 527. The context of the holding is simple: absent a challenge from the Service, what is on a return is "allowed." That is not the circumstance in this case. Here, the applicable statute includes limiting language of what is granted. Further, Export credits are not used to determine the taxable income. Rather, the credits are offered as payment of the tax that is determined under different basis.

Likewise, the issue decided by the North Carolina Court of Appeals in *Hudson*, 196 N.C. App. 765, 675 S.E.2d 709, is not applicable to this matter. First, nowhere in *Hudson* is it stated that "allowed" means "claimed" as represented by Philip Morris. Br at 29, ¶ 2). The statute

discussed in *Hudson* included language not found in N.C. Gen. Stat. § 130-45(b), directly referring to the investment credit allowed a taxpayer per "single taxable year."[5] The court in *Hudson* held that the statute in question had no language imposing a limit on investments that a taxpayer could *make* in a single year and that absence of language was significant. 196 N.C. App. at 768, 675 S.E.2d at 711. Finally, *Hudson* was decided in 2009 and its result could not be known by the General Assembly when enacting the 2003 Amendment.

Here, unlike the statute discussed in *Hudson*, N.C. Gen. Stat. § 105-130.45 (b) does include language imposing a maximum on the credit generated. That plain language must be read pursuant to the principles of statutory construction.

B. The 2003 Amendment added a limitation on the generation on the credit and the added language rules for the period at issue.

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[5] The statutes at issue in *Hudson* were N.C.G.S. §105-163.011(b1), providing that "[t]he aggregate amount of credit allowed an individual for one or more investments in a single taxable year under this Part, whether directly or indirectly as owner of a pass-through entity, may not exceed fifty thousand dollars ($ 50,000)" and N.C.G.S. §105-163.012(b) providing that "[t]he total amount of all tax credits allowed to taxpayers under G.S. 105-163.011 for investments made in a calendar year may not exceed six million dollars ($ 6,000,000)."

The assessment at issue is based on the use of credit that was generated during the year 2005 and was claimed on the 2013 and 2014 corporate income tax returns. (R pp 207, 436, 498). The 2003 Amendment stated that the changes related to the credit were effective for cigarettes exported on or after 1 January 2005.[6] Therefore, the language used in the 2003 Amendment is the controlling language for the credit generated during the year 2005 and used for the tax years at issue.

Philip Morris's claims that the term "credit allowed" was understood to mean "credit claimed" before the 2003 Amendment, it implies that this understanding was accepted by the Department, and therefore the phrase should keep the same meaning after the 2003 Amendment.

For clarity, it must be stated that the Department has not conceded on a definition of the phrase "credit allowed," as used in the prior statute.[7]

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[6] 2003 N.C. Sess. Laws 435, Sec. 5.4

[7] Contrary to Philip Morris's argument, the Department did not concede at the lower tribunal on any definition of the phrase "credit allowed" as used in the prior statute. The Appellant's Brief refers to R. p. 221-222 and to R.S. p. 711 which contains the Department's argument at the OAH and at Business Court. While the Department's statements were made in reference to an "additional limitation" included in the 2003 Amendment for the generation of the credit, none of the statements speak to a definition of the word "allowed" as implied by Philip Morris.

The only relevant statute is the 2003 Amendment and the assessment at issue, as modified by the Department, only includes the credit generated after such amendment.[8]

The 2003 Amendment inserted language into subsection (b) of N.C. Gen. Stat. §105-130.45. While amending the last sentence of the subsection, the General Assembly added critical language after the phrase "credit allowed." Before the amendment, the last sentence of subsection (b) read: "The amount of credit allowed is as follows: …". After the amendment the sentence reads: "The amount of credit allowed may not exceed six million dollars ($ 6,000,000) and is computed as follows: . . ."

The added language not only provides a maximum amount of credit but also includes the conjunction "and" and the adverb "computed." The result is a change in the statute that entitles the generation of credit. Therefore, what is central to this issue is the language added in the 2003 Amendment and its context in the subsection where it was placed, even if the rewritten statute kept some words of its prior version.

---

[8] See Transcript of Hearing on Petition for Judicial Review, p. 41:13-42:15.

As stated by the Department in the 2003 Supplement, the 2003 Amendment clarified the limitation on the credit. Referring to subsection (b) the Department stated that the amendment *"clarifies that the maximum allowable credit for cigarettes exported during a tax year is six million dollars, before applying the tax limitations provided for in subsection (c).*" (R p 239).

Therefore, what Philip Morris understood on the meaning of the phrase "credit allowed" in the old statute is without merit, because the added language made clear that the credit could not exceed $6 million before applying the cap limitations provided in subsection (c).

C. The words used in session law 2003-435 in relation to cigarette tax credits supports the Department's interpretation.

Philip Morris argues that the title and preamble of the legislation reflects intent to expand or grow economic incentives and should be considered in the plain language interpretation. Br. at 31-32. The title of S. L. 2003-435, in its relevant part, is: "An act to make the following changes recommended by the governor: . . . (4) extend the sunset on and modify the cigarette exportation tax credit and modify the base year." (R p 347; App. 5-8, R S p 739) Far from supporting the Philip Morris's

position, the session law title reflects that the cigarette export tax credit was "modified" by the legislation. Nothing in that title suggests that the General Assembly meant to exempt the kind of income at issue in this case from taxation.

Philip Morris also compares the language used in N.C. Gen. Stat. § 105-130.45(b) with the language used in the Enhanced Cigarette Exportation Tax Credit, N.C. Gen. Stat. § 105-130.46 and argues that if the General Assembly wanted to limit the credit generation in the 2003 Amendment it knew how to do so.

The Enhanced Cigarette Exportation Tax Credit, N.C. Gen. Stat. § 105-130.46, was also enacted in S. L. 2003-435. This statute created a different credit for corporations engaged in manufacturing cigarettes for exportation that satisfy certain employment level requirements. Philip Morris argues that the General Assembly used the word "'earned" when restricting the amount of credit that a taxpayer could generate under the Enhanced Credit Statute, N.C. Gen. Stat § 105-130.46(d), but chose not to use the word "earned" in N.C. Gen. Stat. § 105-130.45. Br. at 35.

Importantly, Philip Morris admitted that it could not qualify for the Enhanced Credit, N.C. Gen. Stat. § 105-130.46, based on new job

creation. Its competitor, RJ Reynolds, a tobacco company headquartered in North Carolina, that was planning to acquire another tobacco company, lobbied the General Assembly for that credit. (R pp 10, 319).

Phillip Morris' interpretation would imply that the generation of the cigarette export credit under § 105-130.45(b) would not be limited, while the generation of the Enhanced Credit under §105-130.46 would be. That interpretation would render superfluous the Enhanced Credit enacted on §105-130.46 because there would be no reason to claim such Enhanced Credit. That would defeat a purpose of encouraging employment, obviously shown by the inclusion of employment level requirements in N.C. Gen. Stat. §105-130.46.

Further, as determined by OAH, the choice of words is not significant in this case because N.C. Gen. Stat. § 105-130.46 itself used the two words "allowed" and "earned" synonymously. This is shown in the second and third sentences of subsection (d) of § 105-130.46 which state:

> Credit. - A corporation that satisfies the employment level requirement under subsection (b) of this section, is engaged in the business of manufacturing cigarettes for exportation, and exports cigarettes and other tobacco products through the North Carolina State Ports during the taxable year is *allowed* a credit as provided

> in this section. The amount of credit *allowed* under this section is equal to forty cents (40¢) per one thousand cigarettes exported. The amount of credit *earned* during the taxable year may not exceed ten million dollars ($10,000,000).
>
> N.C. Gen. Stat. § 105-130.46(d). Emphasis added.

The second sentence in this subsection shows that the word "allowed" is used as a synonym for "earned" because the sentence provides the amount of credit that is earned per cigarettes exported, 40 cents per one thousand cigarettes. Therefore, Philip Morris's argument that the General Assembly did not use the word "earned" when limiting the amount of credit on N.C. Gen. Stat. § 105-130.45(b) is meritless.

II. The added language in the 2003 Amendment is not intended exclusively for the successor in business.

A. The Department's reading of the statute does not violate principles of grammar.

Philip Morris argues that the position of the Department and trial court violates grammar principles and is inconsistent with the doctrine of "the last antecedent." It relies on the opinion issued on *Wilkie v. City of Boiling Spring Lakes*, 370 N.C. 540, 809 S.E.2d 853 (2018). The court in *Wilkie* found that the doctrine of the last antecedent supported a plain meaning construction on the statute at issue in that case, which was

about inverse condemnation. The Court referred to the doctrine as "'relative and qualifying words, phrases, and clauses ordinarily are to be applied to the word or phrase immediately preceding' rather than 'extending to or including others more remote,' 'unless the context indicates a contrary intent.'" *Id.* at 548-49, 809 S.E.2d at 859 (quoting *HCA Crossroads Residential Ctrs. v. N.C. Dep't of Human Res.*, 327 N.C. 573, 578, 398 S.E.2d 466, 469 (1990).

Philip Morris argues, the 2003 Amendment to subsection (b) added language intended for the successor in business. It argues that the added language comes immediately after a sentence addressed to the successor in business. Br. at 36, ¶ 3 This argument relies on the placement of the added language in the following sequence:

> In the case of a successor in business, the amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage. The amount of credit allowed may not exceed six million dollars ($6,000,000) and is computed as follows: …
>
> S. L. 2003-435, §5.2. (Additions in underline, deletions in crossed text.) (R. S. p. 739-741)

The principle of the last antecedent, as explained above, supports the Department interpretation. The phrase "and is computed as follows" used in the last sentence of subsection (b) is related to the phrase "The amount of credit allowed may not exceed six million dollars." This limiting phrase immediately precedes the calculation of the credit and is in the same sentence that states how the credit is calculated. Therefore, the principle of last antecedent actually supports the Department's position.

Further, Philip Morris argues that the Department wrongfully isolates the last sentence of subsection (b), which contains the limiting phrase on the credit generation, from its precedent sentence, which is addressed to the successor in business. Through this argument, the Appellant implies that the limiting phrase is exclusive to its competitor RJ Reynolds, domiciled in North Carolina, but is not applicable to Philip Morris, a corporation headquartered in Virginia. If the added language of the 2003 Amendment would only be applicable to the successor in business, Philip Morris would be left without any credit at all because it would not have a formula available to determine the amount of Export Credit. As stated in *Wilkie*, the doctrine of the last antecedent can be

used in statutory construction "unless the context indicates a contrary intent". *Wilkie v. City of Boiling Spring Lakes*, 370 N.C. at 548-49, 809 S.E.2d at 859 (2018). Here, the context clearly indicates that there is no way in which the statutory clauses that follow the successors in business clause only apply to said successor in business. If that reading were accepted, the statute would be totally incoherent and there will be no way to calculate the cigarette export tax credit for anyone who is not a successor in business.

B. The language used in the 2003 Amendment does not shift meanings.

Philip Morris argues that under the Department's interpretation the word "allowed" shifts meanings among subsections (b) and (c) of N.C. Gen. Stat. § 105-130.45. This argument is based on the incorrect premise that the word "allowed" means "claimed." This premise contradicts Philip Morris own statements on the dictionary definition of the term "allowed" as "permitted." Br. at 28, ¶ 1. It also ignores the context of each subsection of the statute.

The General Assembly divided § 105-130.45 into five subsections. Each subsection is preceded by a title that gives a preview of the

subsection's content. Subsection (a) is titled "Definitions", subsection (b) is titled "Credit", subsection (c) is titled "Cap", subsection (d) is titled "Documentation of credit" and subsection (e) is titled "No double credit".

The word "allowed" is used four times in subsections (b) and three times in subsection (c). In each of those instances the word "allowed" affords the same dictionary definition as "permitted," "consented" or "approved," as argued by Philip Morris. For example, the most relevant part of subsection (b) reads: "[t]he amount of credit allowed may not exceed six million dollars ($6,000,000) and is computed as follows: …", can easily be read as "[t]he amount of credit *permitted* may not exceed six million dollars ($6,000,000) and is computed as follows…". Likewise, the relevant part of subsection (c) reads: [t]he credit allowed under this section may not exceed the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of tax imposed by this Part for the taxable year ….", can easily be read as "[t]he credit *permitted* under this section may not exceed the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of tax imposed by this Part for the taxable year …." Therefore, the word does not shift meanings, as purported by Philip Morris.

Also, it is well known that "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis,* 489 U.S. at 809, 109 S. Ct. at 1504 (1989). North Carolina Courts have long followed this same principle. *E.g., Rhyne,* 358 N.C. at 188, 594 S.E.2d at 20 (2004) ("This Court does not read segments of a statute in isolation") and *James*, 371 N.C. at 89 813 S.E.2d at 204 (2018) (a statute must be read "contextually and in its entirety.")

Therefore, even if the word "allowed" could have various meanings when read in isolation, the principle of statutory construction caution against this kind of reading. Further, the word "allowed" was used in subsections that address different purposes. Subsection (b), titled "Credit," provides the creation of the credit, while subsection (c) titled "Cap" limits the use of the credit per year. The word "allowed" can be read in the context of each subsection without causing ambiguity and conserving its plain meaning.

III. The Department's position is not contrary to the General Assembly's intent which is found in the plain meaning of the statute.

Philip Morris argues that the legislative history of the 2003 Amendment demonstrates the General Assembly's intent of expanding

the tax credit as an incentive for economic growth and that the Department's position is contrary to that intent. Br. at 40, ¶¶ 1-2; at 42, ¶ 3.

This argument is yet again without merit because "the intent of the General Assembly may be found first from the plain language of the statute." *Lenox Inc.* 353 N.C. at 664, 548 S.E.2d at 517 (2001).

Notwithstanding, nothing in the record shows that a limitation on the generation of the credit would deter economy growth. Importantly, the 2003 Amendment also added provisions that are not necessarily in line with an unrestricted grant of credits to Philip Morris. Among others, the 2003 Amendment included changes in definitions, addition of the successor in business provision, and a requirement that the manufacturers export through the North Carolina ports.

The Proclamation for an Extra Session convened the General Assembly to vote on the incentives. (R p 334) The General Assembly added changes to House Bill 2 and voted to approve what became the 2003 Amendment. Philip Morris implies that the addition of the limiting phrase in subsection (b) was made by mistake of the General Assembly. However, that would render the added language a surplusage, violating

a fundamental principle of statutory construction. *In the Matter of: B.L.H.*, 376 N.C. 118, 122-23 (2020) ("It is presumed that the legislature . . . did not intend any provision to be mere surplusage.")

IV. The Department's and lower tribunals' interpretation does not create surplusage or an absurd result.

The Business held that accepting Philip Morris's argument that reading the amended language as a second limit on the amount of credit that can be claimed would lead to surplusage. (R p 506) Philip Morris argues that the trial court surplusage analysis concerning subsection (b) creates a larger surplusage problem in subsection (c). Br. at 48, ¶ 2. It argues that if a taxpayer could generate only $6 Million in credit per year, there would be no need for the carryforward system of subsection (c) and the portion of the statute on carryforward would become surplusage. While the Appellant admits that the language of subsection (c) might not result in surplusage for all taxpayers, it argues that it did for Philip Morris and RJ Reynolds because they could claim the maximum credit of $6 Million, which was reasonably known by the General Assembly. Br. p. 49, ¶ 2. This argument is not supported by the record.

As an initial matter, this argument imputes knowledge to the General Assembly based on a report from the Fiscal Research Division allegedly based on discussions with the Department and an industry representative. That report was not made part of the statute and does not prove that members of the General Assembly took part in the alleged discussions. Even if they had, however, any discussion on the same would have no bearing here, because the plain language of the statute controls its interpretation. See, *State ex rel. N.C. Milk Com. v. Nat'l Food Stores, Inc.*, 270 N.C. 323, 332-33, 154 S.E.2d 548, 555 (1967) ("Testimony, even by members of the Legislature which adopted the statute, as to its purpose and the construction intended to be given by the Legislature to its terms, is not competent evidence upon which the court can make its determination as to the meaning of the statutory provision").

In any event, the Department's interpretation of the statute actually creates no surplusage at all. Subsection (c) limits the maximum credit that a taxpayer can use on its yearly tax returns. This subsection provides a formula with limitations and not a fixed amount. The formula for the use of the credit per year is the lesser of $6 million or fifty percent of the amount of tax imposed for the taxable year, reduced by all other

credits allowable, except payments on the tax. N.C. Gen. Stat. 105-130.45(c). Thus, if 50% of the tax imposed for a tax year falls below $6 Million, thereby capping the credit that can be claimed that tax year below $6 Million, the taxpayer can carry forward any unused credits generated that year for use in future years. This is *directly* applicable to Philip Morris here, because it did not have enough North Carolina taxable income to claim the maximum $6 million on each of the tax years between 2010 and 2017. (R p 207).[9]

Indeed, the record clearly demonstrates that Philip Morris could use Excise Credit carryforwards under the correct interpretation of subsection (b) of the 2003 Amendment, which limits credit generation to $6 Million. For example, for tax year 2010, Philip Morris used $4.645 Million of its 2005 Credit. (R p 207). Accordingly, $1.354 Million, from the $6 Million 2005 Credit generated, was available to carryforward to the next year, 2011.

[9] It can be assumed that the amounts claimed were the 50% of the yearly tax liability because subsection (c) orders to use the lesser of $6 Million or the 50% of tax due.

In tax year 2011, Philip Morris claimed $4.392 Million in credits, which indicates that the 50% taxable income limitation of subsection (c) applied. In claiming the $4.392 Million credit amount, the $1.354 Million carryforward of the 2005 Credit is applied first, and then $3.037 Million from the 2006 Credit. Because Philip Morris would still have credit carryforward from the 2006 Credit, it is allowed to carryforward these amounts up to the maximum of 10 years. Philip Morris ceased manufacturing in North Carolina in 2007, and thus stopped generating export tax credits as explained *supra*. (showing the proper way to carryforward the credits using the amounts reported by Philip Morris). However, if Philip Morris had continued manufacturing operations, the revised 10 year carryforward would have prevented the expiration of carryforwards, even with the 50% income limitation, that had occurred under the 1999 Export Credit Statute. (R p 207) Thus, Philip Morris's argument that a generation limit of $6 Million precludes the benefit of carryovers is simply incorrect.

Lastly, Philip Morris asserts that even if its interpretation creates surplusage, the same should yield to legislative intent and the added

language should be treated as a clerical error to avoid an absurd or illogical result. Br. at 49, 51.

This argument would imply to consider that the whole eight new words were added in error, when these words are clear and consistent with a limitation for the generation of credit under section 105-130.46. Further, it is Philip Morris's reading of the statute that produces absurd and illogical results: If subsection (b) were only applicable to successors in business, such as its competitor RJ Reynolds, Philip Morris would not have any credit to claim, because it would not have a formula to generate the credit.

V. Extrinsic evidence is not competent and does not support Phillip Morris' interpretation.

Philip Morris contends that Senator Kerr's contemporaneous statements in a news article show intent to create economic incentives and that he added the language in subsection (b) to ensure that successors in business could only claim $6 Million per year pursuant to subsection (c). Br. at 53-54.

In making this argument, Philip Morris once again asks this Court to consider legislative history that cannot be used to construe the

meaning of the statute. It has long been held that *"[t]he meaning of a statute and the intention of the legislature which passed it cannot be shown by the testimony of a member of the legislature; it 'must be drawn from the construction of the act itself.'"* See, *D & W, Inc. v. Charlotte*, 268 N.C. 577, 581, 151 S.E.2d 241, 244 (1966) (emphasis added) (citing *Goins v. Indian Training School*, 169 N.C. 736, 739, 86 S.E. 629, 631 (1915)). Also, "[w]hatever may be the views and purposes of those who procure the enactment of a statute, the legislature contemplates that its intention shall be ascertained from its words as embodied in [the statute]. And courts are not at liberty to accept the understanding of any individual as to the legislative intent." *D & W, Inc.*, 268 N.C. at 582, 151 S.E.2d at 244 (citing *State v. Partlow*, 91 N.C. 550, 552 (1884)).

But even if this news article were considered by this Court, nothing in it shows an intent to give unrestricted credit to Philip Morris, or that only RJ Reynolds would be subject to the credit generation limit. Further, the argument that the added language in subsection (b) was intended only to ensure that RJ Reynolds would not use more than $6 Million in its yearly tax return is implausible, because the language for the yearly use of the credit is in subsection (c), not in subsection (b). The plain

language of the 2003 Amendment shows that the additions for the successor in business respond to the base year calculation for that successor and nothing else. ("In the case of a successor in business, the amount of credit is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage." *See*, S.L. 2003-435, Sec. 5.2 in R.. p 740).

Additionally, Philip Morris argues no one understood the amendments to subsection (b) to effectuate a substantive change to the statute because the Department's publication "Supplement to 2003 Tax Law Changes" did not identify the 2003 Amendment to subsection (b) as a substantive change that would impact the generation of credits. Br. at 55. This argument is also meritless because the Supplement to 2003 Tax Law Changes specifically advises on how the changes to subsection (b)'s credit generation formula would affect the limits that subsection (c) places on how credits are used. In its relevant part, the Department's Supplement reads: "*The clarifying change clarifies that the maximum allowable credit for cigarettes exported during a tax year is six million*

dollars, before applying the tax limitations provided for in subsection (c)." (R p 239).

Lastly, the Appellant tries to undermine the Department's reading of the statute by noting that the Department did not correct Philip Morris's interpretation prior to 2017. Philip Morris relies on a cover letter sent to the Department in 2006 with its Amended Corporate Tax return for Tax Year 2004. It also mentions that the Department did not adjust Phillip Morris's 2007 tax return implying that said return included a calculation "after the 2003 Amendment."

However, these tax returns are irrelevant in evaluating the plain language of the 2003 Amendment. The 2003 Amendment was not in effect for any credit claimed in the 2004 tax return. Likewise, the credits claimed by Philip Morris in its 2007 and 2008 tax returns were carry forward amounts generated during the years 2002 and 2003, before the effective date of the 2003 Amendment. (R p 207. T p. 72)

The Appellant also mentions that the Department issued its 2008 statutorily-required economic incentives report recognizing that Philip Morris generated credits above the 6 million cap which are available to be taken in future years. Br. at. 57. This report cited by Philip Morris

also fails to be relevant to the period at issue. The report provides statistics on information provided by taxpayers. The report is titled "North Carolina Department of Revenue Cigarette Export Credits processed during calendar year 2008." (R p 134) Clearly, the information "processed" during calendar year 2008 refers to information reported to the Department up to that date. The tax returns filed up to 2008 had to include information prior to 2008, i.e. returns for tax years 2007 and 2006. As explained *supra*, the credits generated under the old statute were carried forward and used up to tax year 2009. The credit generated under the 2003 Amendment, the 2005 Credit, started to be used for tax year 2010. Therefore, there is no way that the statistic information reflected in this report for credits processed during calendar year 2008 could constitute an opinion of the Department on the interpretation of the 2003 Amendment.[10]

Further, the Revenue Act provides the means by which a taxpayer can be protect by the Department's interpretation. It provides that "[w]hen the Secretary interprets a law by adopting a rule or publishing a

[10] It is also notable that the report contains a procedural note stating that the amount for Philip Morris reflects credits taken in multiple years [prior to 2008] and that this taxpayer did not provide the required information. R p 134.

bulletin or directive on the law, the interpretation is a protection to the officers and taxpayers affected by the interpretation, and taxpayers are entitled to rely upon the interpretation." N.C. Gen. Stat. § 105-264(a). Also, a taxpayer can request specific written advice to the Department pursuant to N.C. Gen. Stat. § 105-264(b).

Here, the report on credits taken in 2008 does not amount to a rule, bulletin or directive on the law, much less specific written advice given by the Department in response to any request by Philip Morris.

Therefore, all the extrinsic evidence relied on by Philip Morris cannot defeat the Department's interpretation of the statute, which both OAH and the Business Court correctly accepted below.

CONCLUSION

The Department respectfully requests that this Court affirm the Business Court's decision that left in place the Department's adjusted tax assessment.

Respectfully submitted, on 2 June 2023.

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N.C. R. App. P. 33(b) Certification:
I certify that the attorney listed below has authorized me to list his name on this document as if he had personally signed it.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this day a copy of the foregoing document was served on the persons indicated below by electronic mail addressed as follows:

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On 2 June 2023.

JOSHUA H. STEIN
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/s/ Tania X. Laporte-Reveron
Tania X. Laporte-Reveron
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CONTENTS OF APPENDIX

No. 62P23

IN THE NORTH CAROLINA GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
IN THE BUSINESS COURT

* *

PHILIP MORRIS USA, INC.,
Petitioner,

Wake County
21 CVS 16006

versus

NORTH CAROLINA DEPARTMENT OF REVENUE,
Respondent.

* *

TRANSCRIPT, Volume 1 of 1

(Pages: 1 through 81)

Thursday, August 4, 2022

* *

August 4, 2022, Special Session
The Honorable Julianna Theall Earp
Special Superior Court Judge Presiding

Hearing on Petition for Judicial Review

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before applying the tax limitations provided for in Subsection (c). That is the position the Department took back in 2003. That is the position that the Department took at the time the legislation went into effect. That was their explanation that they do when they -- when they're summarizing tax changes that have occurred. That was all done before this litigation ever got started.

THE COURT: Okay. But you -- you clarify things when they're ambiguous. Right? You clarify things when they're ambiguous. So this is a clarifying change to Subsection (c) before -- to (b) before you get to (c).

MR. PELAEZ: Yes.

THE COURT: So tell me why the Department conceded the 2012 and portion of the 2013 audit amount.

MR. PELAEZ: The Department conceded that because it was in the -- the application of the old statute.

THE COURT: Say that again?

MR. PELAEZ: The Department conceded that it was under the application of the old statute. There is an argument, which is set forth within the final determination, as to the application of the 1999, meaning the original statute. The Department did not -- the -- the Department moved from that position and said that "what we'll do is go ahead and deal with the case under the revised statutes, instead of the statutes that are in effect, moving forward."

THE COURT: So you allowed Philip Morris its position with respect to carryforward credit for 2012 --

MR. PELAEZ: And a portion of 2013.

THE COURT: And then was it -- does the math work out that that essentially used up credit that was generated prior to 1/1/05?

MR. PELAEZ: Prior to what? I'm sorry, Your Honor.

THE COURT: The effective date of the amendment?

MR. PELAEZ: Yes, Your Honor.

THE COURT: Okay.

MR. PELAEZ: That would be my understanding.

THE COURT: All right.

MR. PELAEZ: Okay.

THE COURT: Thank you.

MR. PELAEZ: Yes. The language here in the revised statute, which is the only statute before this Court, is plain and unambiguous. It states in clear language that the amount of credit allowed under the generation is six million dollars. That's the same position that the final determination took -- I'm sorry -- the final decision took and the ALJ. Philip Morris's response to that has been twofold: One is that there's no substantive change to the statute. And the second part is that they had a deal with the General Assembly. So I'll take it in two pieces.

wrong, but it doesn't change the fact that, by this letter, Mr. Beggans is communicating their view that the new law can allow for the continuation of a carryforward.

And, Your Honor, a point of clarification: We -- Philip Morris has -- just wanted me to clarify that there was no 1999 credit that was used after Year 2009. So I might have misspoke during our earlier conversation.

THE COURT: So the nine -- every credit prior to the amendment was used up by 2009? Is that what you said?

MS. HOBART: Yes.

THE COURT: Thank you.

MS. HOBART: I confess to not completely following the argument about *de novo* review, but, I mean, I think it's clear that this comes before this Court on a *de novo* basis, and you are free to accept or reject the decision below and freely consider the issues before you.

Related to burden, the Department says its interpretation is considered to due consideration. That simply is not the case, Your Honor. There's been no interpretation by the Department under 105-264. And the *National Services Industries* case out of the Court of Appeals is very clear that unless there has been an administrative rule promulgated, that an interpretation does not -- is not considered *prima facie* correct under 264. That's not been done.

GENERAL ASSEMBLY OF NORTH CAROLINA
SECOND EXTRA SESSION 2003

SESSION LAW 2003-435 SECOND EXTRA SESSION
HOUSE BILL 2

A BILL TO BE ENTITLED

AN ACT TO MAKE THE FOLLOWING CHANGES RECOMMENDED BY THE GOVERNOR: (1) APPROPRIATE TWENTY-FOUR MILLION DOLLARS FOR INDUSTRIAL SITE INFRASTRUCTURE FOR MAJOR PROJECTS; (2) MODIFY THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; (3) PROVIDE INCENTIVES FOR MAJOR PHARMACEUTICAL AND BIOPROCESSING FACILITIES BY EXTENDING THE BILL LEE ACT SUNSET FOR THESE INDUSTRIES AND AUTHORIZING SALES TAX REFUNDS FOR CONSTRUCTION MATERIALS FOR THESE INDUSTRIES; (4) EXTEND THE SUNSET ON AND MODIFY THE CIGARETTE EXPORTATION TAX CREDIT AND MODIFY THE BASE YEAR, (5) CREATE AN ENHANCED TAX CREDIT FOR CIGARETTE EXPORTATION, AND (6) CREATE A LIFE SCIENCES REVENUE BOND AUTHORITY.

The General Assembly of North Carolina enacts:

PART 1. MAJOR INDUSTRIAL SITE INFRASTRUCTURE

SECTION 1.1. Part 2 of Article 10 of Chapter 143B of the General Statutes is amended by adding a new section to read:

"**§ 143B-437.02. Site infrastructure development.**

(a) Findings. – The General Assembly finds that:

(1) It is the policy of the State of North Carolina to stimulate economic activity and to create new jobs for the citizens of the State by encouraging and promoting the expansion of existing business and industry within the State and by recruiting and attracting new business and industry to the State.

(2) Both short-term and long-term economic trends at the State, national, and international levels have made the successful implementation of the State's economic development policy and programs both more critical and more challenging; and the decline in the State's traditional industries, and the resulting adverse impact upon the State and its citizens, have been exacerbated in recent years by adverse national and State economic trends that contribute to the reduction in the State's industrial base and that inhibit the State's ability to sustain or attract new and expanding businesses.

(3) The economic condition of the State is not static and recent changes in the State's economic condition have created economic distress that requires the enactment of a new program as provided in this section that is designed to stimulate new economic activity and to create new jobs within the State.

(4) The enactment of this section is necessary to stimulate the economy, facilitate economic recovery, and create new jobs in North Carolina and this section will promote the general welfare and confer, as its primary purpose and effect, benefits on citizens throughout the State through the creation of new jobs, an enlargement of the overall tax

under this subsection with respect to the facility, the facility loses its eligibility and the owner forfeits all refunds already received under this subsection. Upon forfeiture, the owner is liable for tax under this Article equal to the amount of all past taxes refunded under this subsection, plus interest at the rate established in G.S. 105-241.1(i), computed from the date each refund was issued. The tax and interest are due 30 days after the date of the forfeiture. A person that fails to pay the tax and interest is subject to the penalties provided in G.S. 105-236."

SECTION 4.2. It is the intent of the General Assembly that the provisions of this part not be expanded. If a court of competent jurisdiction holds any provision of this part invalid, the section containing that provision is repealed. The repeal of a section of this part under this section does not affect other provisions of this part that may be given affect without the invalid provision.

SECTION 4.3. This part becomes effective January 1, 2004, and applies to sales made on or after that date.

PART 5. CIGARETTE EXPORTATION TAX CREDIT

SECTION 5.1. Section 10 of S.L. 1999-333 reads as rewritten:

"**Section 10.** Sections 2, 3, and 4 of this act are effective for taxable years beginning on or after January 1, 1999. Sections 5 through 8 of this act become effective December 1, 1999, and apply to offenses committed on or after that date. The remainder of this act is effective when it becomes law. Section 4 of this act is repealed effective for cigarettes exported on or after January 1, ~~2005.~~2018."

SECTION 5.2. G.S. 105-130.45 reads as rewritten:

"**§ 105-130.45. Credit for manufacturing cigarettes for exportation.**

(a) Definitions. – The following definitions apply in this section:

(1) Base year exportation volume. – The number of cigarettes manufactured and exported by a corporation during the calendar year ~~1998.~~2003.

(2) Exportation. – The shipment of cigarettes manufactured in the United States to a foreign country sufficient to relieve the cigarettes in the shipment of the federal excise tax on cigarettes.

(3) Successor in business. – A corporation that through amalgamation, merger, acquisition, consolidation, or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the cigarette exportation business.

(b) Credit. – A corporation engaged in the business of manufacturing cigarettes for exportation to a foreign country and that waterborne exports cigarettes and other tobacco products through the North Carolina State Ports during the taxable year is allowed a credit against the taxes levied by this Part. The amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with the corporation's base year exportation volume, rounded to the nearest whole percentage. In the case of a successor in business, the amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage. The amount of credit allowed may not exceed six million dollars ($6,000,000) and is computed as follows:

Current Year's Exportation Volume Compared to its Base Year's Exportation Volume	Amount of Credit per Thousand Cigarettes Exported
120% or more	40¢
119% – 100%	35¢
99% – 80%	30¢
79% – 60%	25¢

59% – 50%	20¢
Less than 50%	None

(c) Cap. – The credit allowed under this section may not exceed the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of tax imposed by this Part for the taxable year reduced by the sum of all other credits allowable, except tax payments made by or on behalf of the taxpayer. This limitation applies to the cumulative amount of the credit allowed in any tax year, including carryforwards claimed by the taxpayer under this section for previous tax years. Any unused portion of a credit allowed in this section may be carried forward for the next succeeding ~~five~~ ten years.

(d) Documentation of Credit. – A corporation that claims the credit under this section must include the following with its tax return:

(1) A statement of the base year exportation volume.

(2) A statement of the exportation volume on which the credit is based.

(3) A list of the corporation's export volumes shown on its monthly reports to the Alcohol and Tobacco Tax and Trade Bureau ~~Bureau of Alcohol, Tobacco, and Firearms~~ of the United States Treasury for the months in the tax year for which the credit is claimed.

(e) No Double Credit. – A taxpayer may not claim this credit and the credit allowed under G.S. 105-130.46 for the same activity."

SECTION 5.3. G.S. 105-130.45(a)(2) reads as rewritten:

"(2) Exportation. – The shipment of cigarettes manufactured in the United States to ~~a foreign country~~ any of the following sufficient to relieve the cigarettes in the shipment of the federal excise tax on ~~cigarettes.~~ cigarettes:

a. A foreign country.

b. A possession of the United States.

c. A commonwealth of the United States that is not a state."

SECTION 5.4. Section 5.2 of this part is effective for cigarettes exported on or after January 1, 2005. Section 5.3 of this part is effective for taxable years beginning on or after January 1, 2004. The remainder of this part is effective when it becomes law. If any clause or other portion of this act is held invalid, that decision shall not affect the validity of the remaining portions of this act, which are severable.

PART 6. ENHANCED CIGARETTE EXPORTATION TAX CREDIT

SECTION 6.1. Part 1 of Article 4 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-130.46. Credit for manufacturing cigarettes for exportation while increasing employment and utilizing State Ports.**

(a) Purpose. – The credit authorized by this section is intended to enhance the economy of this State by encouraging qualifying cigarette manufacturers to increase employment in this State with the purpose of expanding this State's economy, the use of the North Carolina State Ports, and the use of other State goods and services, including tobacco.

(b) Definitions. – The following definitions apply in this section:

(1) Employment level. – The total number of full-time jobs and part-time jobs converted into full-time equivalences.

(2) Exportation. – The shipment of cigarettes manufactured in the United States to a foreign country sufficient to relieve the cigarettes in the shipment of the federal excise tax on cigarettes.

(3) Full-time job. – A position that requires at least 1,600 hours of work per year and is intended to be held by one employee during the entire year.

(4) Successor in business. – A corporation that through amalgamation, merger, acquisition, consolidation, or other legal succession becomes

SECTION 7.4. This part is effective when it becomes law.

In the General Assembly read three times and ratified this the 10th day of December, 2003.

Beverly E. Perdue
President of the Senate

James B. Black
Speaker of the House of Representatives

Michael F. Easley
Governor

Approved 11:39 a.m. this 16th day of December, 2003