

No. 242A23

TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

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

From Wake County

Philip Morris USA, Inc.'s Reply Brief

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Respondent-Appellant	)	
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Philip Morris USA, Inc.'s Reply Brief

I. OAH has the power to resolve as-applied constitutional challenges.

Philip Morris' dispute with the Department centers on a core question: Does OAH have authority to resolve as-applied constitutional challenges? The answer is yes.

OAH is given jurisdiction over all challenges to determine whether a governmental agency (like the Department) acted in excess of the agency's authority or in violation of the law. N.C.G.S. § 150B-23(a)(1), (2), and (5) [App. 1-3]. A taxpayer may file a petition for a contested case

hearing before OAH to present these challenges, and any party aggrieved by the decision in the contested case may seek judicial review before the North Carolina Business Court. N.C.G.S. §§ 105-241.15, 105-241.16 [App. 4-5].

Notwithstanding the broad scope of OAH's jurisdiction set forth in Article 3 of Chapter 150B—and § 105-241.16's directive that any OAH decision on tax matters is subject to judicial review before the Business Court—the Department now contends that § 105-241.17 [App. 6] adds a procedural hurdle by removing jurisdiction from OAH and precluding OAH from deciding *any* constitutional challenge (facial or as-applied). The Department contends the procedural hurdle in § 105-241.17 must be followed for any constitutional challenge, and thus, an as-applied constitutional challenge must be dismissed by OAH and the case re-filed before the Business Court. The Department is wrong.

There is no dispute that OAH lacks authority to decide whether a statute is facially unconstitutional. All parties agree that § 105-241.17 requires a facial challenge to be dismissed by OAH, and, moreover, this Court settled the question as to facial challenges more than 25 years ago in *Meads v. Department of Agriculture*. There, the Court determined that

a person aggrieved by an unconstitutional regulation could not challenge its constitutionality before an administrative body because “it is the province of the judiciary to make constitutional determinations.” 349 N.C. 656, 670, 509 S.E.2d 165, 174 (1998).

But *Meads* does not resolve this case. The *Meads* petitioner argued only that the challenged regulation was “per se unconstitutional,” in other words, facially unconstitutional. *Id.* at 674, 509 S.E.2d at 176.

Relying on § 105-241.17 and other inapt authorities, the Department now contends that this jurisdictional bar extends to as-applied constitutional challenges. The Department argues that “it [is] commonly understood” that “administrative bodies” (or agencies) lack jurisdiction to determine “the constitutionality of a tax, including with respect to its application.” Appellee’s Br. at 28. The Department also cites §§ 150B-23 and 150B-33 as support for its view that administrative law judges cannot decide *any* constitutional issue. *See* Appellee’s Br. at 22. Both arguments fail.

A. It is regularly and properly understood that agencies have the power to resolve as-applied constitutional challenges.

The Department's claim that agencies lack the power to review the constitutionality of their own actions is wrong. Quite simply, there is no "common understanding" as the Department alleged. Agencies or administrative bodies regularly decide as-applied challenges, and these decisions are then subject to judicial review.

A recent decision from the Court of Appeals for the Sixth Circuit is instructive. *See generally Jones Bros., Inc. v. Sec'y of Labor*, 898 F.3d 669 (6th Cir. 2018) (Sutton, J.). Its holding and analysis are closely comparable to the issues here. In *Jones Brothers*, a company fined by the Mine Safety and Health Administration, an agency within the Department of Labor, argued, for the first time in its petition for review, that the administrative law judge who initially upheld the fine was not constitutionally appointed. *Id.* at 672. Siding with the Department of Labor, the Sixth Circuit concluded that the petitioner had forfeited its argument because it failed to raise it before the Federal Mine Safety and Health Review Commission, which was the body that heard the

company's appeal from the administrative law judge's decision.¹ *Id.* at 674-77.

The court determined that the Commission could have resolved the petitioner's as-applied constitutional challenge (i.e., petitioner's Appointments Clause argument). The court explained that administrative agencies may not "look the other way when it comes to as-applied constitutional challenges[.]" *Id.* at 674. Instead, they "**must** continually interpret and apply their statutory duties in light of constitutional boundaries." *Id.* (emphasis added). In reaching this conclusion, the court drew "a distinction between the constitutional applicability of legislation to particular facts," on the one hand, and the "constitutionality of legislation in the first instance," on the other. *Id.* at 675; accord *Meredith Corp. v. FCC*, 809 F.2d 863, 874 (D.C. Cir. 2001) ("[The FCC] **must** . . . explicitly consider[] [the petitioner's] claim that the FCC[s]. . . [actions] deprive[d] [the petitioner] of its constitutional rights." (emphasis added)).

¹ The Federal Mine Safety and Health Review Commission is the independent agency responsible for reviewing the Mine Safety and Health Administration's actions. See 30 U.S.C. § 823.

An agency can resolve constitutional claims that challenge its own actions, even if the agency cannot resolve challenges to the statutes that authorize those actions. Specific to the dispute here, OAH can resolve constitutional claims that challenge other executive branch actions (like the actions of the Department), even if OAH cannot resolve challenges to the statutes that authorize those actions. “Agencies may interpret the jurisdictional reach and substantive content of the statutes that [the legislature] entrusts to their administration,” but “only the courts have authority to take action which runs counter to the expressed will of the legislative body.” 898 F.3d at 675. The distinction differentiates between when the petitioner challenges an agency’s statutory duties (facial) versus when the petitioner challenges the way the agency carries those duties out (as-applied). *Id.*

As explained in its principal brief and further below, Philip Morris is not challenging N.C.G.S. § 105-122(b) itself but rather the Department’s application of that statute. There is no doubt that the General Assembly has the power to establish a franchise tax. But the way that the Department calculated Philip Morris’ capital base in assessing the franchise tax offends the Commerce Clause. This is an as-applied

constitutional challenge that an administrative law judge can initially resolve, recognizing that this decision is subject to judicial review by the North Carolina Business Court. *See generally* §§ 105-241.15 and 105-241.16. The *Jones Brothers* court's analysis fits squarely with § 105-241.17's framework and Philip Morris' contentions here.

Furthermore, the *Jones Brothers* court's conclusion is not an outlier. Other states allow agencies to resolve as-applied constitutional challenges. *See, e.g., Prince George's Cnty. v. Ray's Used Cars*, 922 A.2d 495, 506 (Md. 2007); *Lehman v. Penn. State Police*, 839 A.2d 265, 275 (2003); *Commonwealth v. DLX, Inc.*, 42 S.W.3d 624, 628 (Ky. 2001); *Richardson v. Tenn. Bd. of Dentistry*, 913 S.W.2d 446, 455 (Tenn. 1995). Other states have similarly explained the distinction between facial and as-applied challenges by highlighting the agency's critical fact-finding role in an as-applied challenge. *E.g., Malecon Tobacco v. State ex rel. Dep't of Taxation*, 59 P.3d 474, 475–76 (Nev. 2002) (citing *HOH Corp v. Motor Vehicle Indep. Licensing Bd.*, 736 P.2d 1271 (Hi. 1987)).

The Department errs in referencing a “common understanding” to support its position. The Department's position is far from “common” in North Carolina or among other states. *See, e.g., id.; Jones Bros.*, 898 F.3d

at 674-77; *Quad Graphics, Inc. v. N.C. Dep't of Revenue*, 19 REV 00334, ¶ 13 (N.C.O.A.H. 2020) (resolving as-applied constitutional challenge) [App. 27-36]; *Cottonwood Pre-Elementary Inc. v. N.C. Dep't of Health and Human Services*, 2021 WL 6802992, 21 DHR 04830, ¶¶ 8-9 (N.C.O.A.H. 2021) (resolving as-applied constitutional challenge) [App. 37-41].

The Department's reliance on two non-binding Court of Appeals' decisions for this "common understanding" also is misplaced. Both cases are inapposite, and they were decided before the adoption of Session Law 2007-491, which set forth the specific procedure for taxpayer challenges in §§ 105-241.15 through 105-241.19 that are at issue in this case.

The Department first contends that *Central Telephone v. Tolson*, 174 N.C. App. 554, 559, 621 S.E.2d 186, 190 (2005), extended this Court's ruling in *Meads* against agency determinations of facial constitutional challenges to as-applied constitutional challenges. *Central Telephone* is far from clear on this point, and *Central Telephone's* reliance on *Meads* suggests the challenge may have been viewed as a facial constitutional challenge. But more importantly, *Central Telephone* is without any analysis or reasoning, failing to explain why facial and as-applied constitutional challenges merit the same treatment. If this was its

holding, as the Department alleges, *Central Telephone* was both wrong when it was decided and later rendered moot when N.C.G.S. § 105-241.15 was adopted in 2007 to place contested tax cases before OAH.

The Department next cites to *Kane v. N.C. Teachers & State Employees Comprehensive Major Medical Plan*, 229 N.C. App. 386, 747 S.E.2d 420 (2013), for the proposition that there is a “widespread” view that OAH lacks jurisdiction over constitutional challenges. *See* Appellee’s Br. at 28. But *Kane* does not stand for this proposition. *Kane* has no holding on constitutional challenges of any kind. In fact, the quote chosen by the Department is only a recitation of a party’s argument before OAH that was not reached on appeal because of a failure to exhaust administrative remedies.

Kane has nothing to do with the issue before the Court, and if *Central Telephone* is the alleged foundation for the Department’s “common understanding,” it stands on a flimsy and outdated pedestal. At most, *Central Telephone* is an unsupported outlier without precedential value, and Session Law 2007-491 (adopting § 105-241.15, *et seq.*) has upended its import entirely. The more common rule remains that

agencies may—and, indeed, *must*—decide whether their actions deprive a party of its constitutional rights.

B. Contrary to the Department’s suggestion, the Administrative Procedure Act allows OAH to determine whether agency actions are constitutional.

This Court likewise should not be persuaded by the Department’s flawed interpretation of the Administrative Procedure Act, N.C.G.S. § 150B-23 and § 150B-33. While that statute may not give OAH the power to resolve facial constitutional claims, OAH’s authority is broad enough to allow it to review the constitutionality of agency actions, like the Department’s improper application of the franchise tax statute at issue here.

The Sixth Circuit’s decision in *Jones Brothers* is once again instructive. Like § 150B-23, the Mine Safety and Health Act at issue in *Jones Brothers* did not expressly authorize the Federal Mine Safety and Health Review Commission to consider constitutional arguments. Even so, the court cited the statutory provision authorizing the Commission to determine whether administrative decisions were “contrary to law” to support its authority to adjudicate as-applied constitutional challenges. 898 F.3d at 674; *accord* 30 U.S.C. § 823(d)(2)(A)(iii). The court explained

that when an agency's actions violate the Constitution, those actions are "contrary to law." *See* 898 F.3d at 674–75.

The same logic applies to § 150B-23, governing administrative proceedings, which allows petitioners to challenge agency action either as in excess of the agency's authority or in violation of the law. § 150B-23 (a)(1), (2), and (5). Thus, a petitioner may challenge an agency's actions as unconstitutional, even if a petitioner cannot raise a facial constitutional challenge to the source of the agency's authority. Section 150B-23's broad expanse covering all claims where the Department exceeded its authority or acted in violation of the law naturally encompasses as-applied constitutional challenges.

This proper understanding of § 150B-23's broad scope further demonstrates how § 105-241.17 establishes a framework for handling facial constitutional challenges, not as-applied challenges, because facial challenges are different than an issue about the "application of a statute." *See* Appellant's Br. pp 20-26. This understanding peacefully marries together the broad authority to challenge the Department under § 150B-23 with the narrow carve out of facial constitutional challenges under § 105-241.17, without any textual conflict. Rather than supporting the

Department's position, the Administrative Procedure Act, N.C.G.S. § 150B-23 and § 150B-33, instead demonstrates how as-applied constitutional challenges fall within the ambit of OAH's jurisdiction.

II. Contrary to the Department's view, nothing in § 105-241.17 alters the principle that agencies may resolve as-applied constitutional issues.

OAH had the power to resolve Philip Morris' as-applied constitutional challenge. The Department's reading of § 105-241.17 to strip the agency of that power strains the plain words beyond their limits. The Department further supports its reading with a host of inapt cases, none of which inform the proper reading of § 105-241.17.

A. The text of § 105-241.17 does not deprive OAH of the power to hear as-applied constitutional challenges.

The Department makes two complementary arguments to support its contention under § 105-241.17 that OAH lacked jurisdiction to decide Philip Morris' as-applied constitutional challenge. The Department primarily argues that the first sentence of § 105-241.17—that a taxpayer who “claims that a tax statute is unconstitutional” may sue in Wake County Superior Court—resolves this case in its favor. The Department also maintains that the remainder of that provision bolsters that conclusion. Neither argument is correct.

1. The first sentence of § 105-241.17 does not strip OAH of its power to hear as-applied constitutional challenges.

The Department contends that § 105-241.17's first sentence allowing a taxpayer to sue when it "claims that a tax statute is unconstitutional" strips OAH of jurisdiction to resolve *all* constitutional claims. Not so.

For starters, contrary to the Department's argument, § 105-241.17 does not change the scope of § 150B-23 or strip OAH of jurisdiction over as-applied constitutional challenges. Instead, a taxpayer is required to give OAH the opportunity to determine whether it has jurisdiction to resolve a constitutional challenge before filing suit, thereby entrusting OAH to decide whether a petitioner's challenge is facial or as-applied. *See* N.C.G.S. § 105-241.17 (3); Appellant's Br. at 36-39 (historical practice); *see also* R pp 24-25 (practice applied in this case).

The Department reaches the contrary result by asserting that the first sentence of § 105-241.17 fails to differentiate between facial and as-applied challenges. But the Department fails to analyze what the statute actually says. Section 105-241.17 describes how a taxpayer may ask a trial court to declare "that a tax statute is unconstitutional." That

language must refer to a facial constitutional challenge—one that challenges the “constitutionality of legislation in the first instance.” *Jones Bros.*, 898 F.3d at 675. An as-applied challenge, by contrast, does not ask whether “a . . . statute is constitutional.” § 105-241.17. An as-applied challenge instead asks whether an otherwise valid statute can be “constitutional[ly] appli[ed] . . . to particular facts.” *Jones Bros.*, 898 F.3d at 675.

Rather than analyze the statutory text, the Department relies on cases that have nothing to do with the interpretation of § 105-241.17.

First, the Department relies heavily on *State v. Packingham*, 368 N.C. 380, 777 S.E.2d 738 (2015). *Packingham* provides only the general rule that a statute can be unconstitutional either “on its face” or “as applied” to a particular set of facts. *Id.* at 383, 777 S.E.2d at 743. Philip Morris does not dispute this basic proposition.

The Department then appears to suggest that, under *Packingham*, both facial and as-applied constitutional challenges ask whether “a statute is constitutional.” They do not. An as-applied challenge does not challenge “*a statute’s general constitutionality*” but instead challenges whether applying a statute to a particular situation results in an

unconstitutional outcome. *See State v. Grady*, 372 N.C. 509, 562, 831 S.E.2d 542, 579–80 (2019) (Newby, J., dissenting) (quoting As-Applied Challenge, *Black’s Law Dictionary* (10th ed.)) (emphasis added). Nothing in *Packingham* changes this distinction: a facial constitutional challenge tests the constitutionality of a statute; an as-applied challenge tests the statute’s effect in a given case.

Second, the Department relies on *Sea-Land Service v. R.V. D’Alfonso Co.*, 727 F.2d 1 (1st Cir. 1984), to argue that, because § 105-241.17 uses “general” language, it necessarily exempts both facial and as-applied challenges to tax statutes from being heard by an administrative tribunal. *Sea-Land*, again, has no application to this case. There, the First Circuit determined that a stipulation granting the defendant extra time to “respond” to a complaint also gave the defendant extra time to bring a permissive counterclaim.² 727 F.2d at 1–2. The plaintiff argued that an extension of time to “respond” did not include an extension of time to bring counterclaims, and thus the counterclaim was untimely. *Id.* at 2. The appellate court rejected that argument, observing that the phrase

² Without the stipulation, the defendant’s counterclaim would have been barred by the statute of limitations. *Sea-Land Servs. v. R.V. D’Alfonso Co.*, 727 F.2d 1, 1–2 (1st Cir. 1984) .

“responsive pleading,” as used in Federal Civil Rule 12, encompassed counterclaims. *Id.*

Sea-Land has no application here. The issue before the Court is not whether a general reference also includes the specific. Instead, the parties ask the Court to decide what the General Assembly meant when it established a procedure for taxpayer suits to determine whether “a tax statute is unconstitutional.” § 105-241.17. As explained, deciding whether a “statute is unconstitutional” is not the same as deciding whether a constitutional statute has an unconstitutional effect as applied in a given case.

Finally, in a footnote, the Department cites *Stephenson v. Bartlett*, 358 N.C. 219, 595 S.E.2d 112 (2004), and *In re Couch*, 258 N.C. 345, 128 S.E.2d 409 (1962), to support its general-includes-the-specific argument. *Stephenson* and *Couch* are, like *Sea-Land*, inapplicable. In *Stephenson*, this Court determined that § 1-267.1(a), and specifically the provision governing redistricting challenges, did not “unconstitutionally create a new court.” 358 N.C. at 227, 595 S.E.2d at 117–18. In *Couch*, this Court determined that the City of Durham could not stop a property owner from building a car wash when the project met all City requirements for the

issuance of a building permit. 258 N.C. at 345–46, 128 S.E.2d at 410–11. Neither case has any bearing here.

Specifically, neither case determines whether declaring that a statute “is unconstitutional” refers to a facial or as-applied challenge. Fortunately, other cases have answered that question, and they have done so in Philip Morris’ favor. *See, e.g., Cmty. Success Initiative v. Moore*, 384 N.C. 194, 213, 886 S.E.2d 16, 32 (2023) (explaining how facial challenge is an “attack on a statute itself as opposed to a particular application”).

2. Nothing else in § 105-241.17 deprives OAH of its ability to hear as-applied constitutional challenges.

Beyond the first sentence of § 105-241.17, the Department claims that the remainder of that statute bolsters its position that OAH lacks jurisdiction to hear facial constitutional challenges. The Department is wrong.

a. Contrary to the Department’s suggestion, adopting Philip Morris’ interpretation of § 105-241.17 would not alter the Business Court’s jurisdiction over as-applied claims.

The Department contends that § 105-241.17’s requirement that a taxpayer “follow the procedures for a mandatory business case set forth

in G.S. 7A-45.4(b) through (f)” confirms its view that OAH lacks jurisdiction over as-applied constitutional challenges. The Department appears to suggest that, if § 105-241.17 did not encompass as-applied constitutional challenges, it would be inconsistent with § 7A-45.4(b)(1), which requires the plaintiff to designate any case “containing a constitutional challenge to a tax statute” as a mandatory business case.

The Department’s analysis of § 7A-45.4(b)(1) is a red herring and, in all events, incorrect. The Department selectively quotes § 7A-45.4(b)(1). To be sure, as the Department claims, that statute requires any action “under G.S. 105-241.17 containing a constitutional challenge to a tax claim” to be designated as a mandatory complex business case. N.C.G.S. § 7A-45.4(b)(1). But it *also* requires that a plaintiff designate any action “involving a material issue related to the tax law that has been the subject of a contested tax case for which judicial review is required under G.S. 105.241.16” to the Business Court. *Id.* Because OAH has jurisdiction to resolve as-applied constitutional challenges, those challenges would be brought to the Business Court under § 7A-45.4(b)(1) and § 105-241.16 in a contested case petition—the same route that Philip Morris took here. Adopting Philip Morris’ reading of § 105-241.17 would

not remove as-applied constitutional challenges from the purview of the Business Court. This argument from the Department is flawed; all paths lead back to the Business Court.

b. Nothing in § 105-241.17's last clauses support the Department's argument.

Section 105-241.17 concludes by identifying five things that must occur before a taxpayer may file a facial constitutional claim in Wake County Superior Court. Among these requirements, and before a taxpayer can file a civil suit, OAH must have “dismissed the [taxpayer’s] contested case petition for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute.” The Department claims this clause creates a limitation on jurisdiction. It does no such thing.

To support its claim that § 105-241.17(3) creates a jurisdictional rule, the Department cites the Court of Appeals’ decision in *Tillett v. Town of Kill Devil Hills*, 257 N.C. App. 223, 809 S.E.2d 145 (2017). See Appellee’s Br. at 21. That case, the Department says, demonstrates that when the General Assembly uses the word “jurisdiction,” it means to create a jurisdictional rule, not a procedural one. It is true that *Tillett* confirms that the General Assembly’s use of the word “jurisdiction” *in a*

statute conferring jurisdiction imposes a jurisdictional rule. *Id.* at 224, 809 S.E.2d at 147. But it does not follow that a passive reference to the word jurisdiction merits the same treatment.

As Philip Morris pointed out in its principal brief, § 105-241.17(3) is better read as a rule of procedure—a description of what must happen before a taxpayer can file a civil suit with a facial challenge. The statute at issue in *Tillett*, N.C.G.S. § 132-9(a), provides that trial courts “shall have jurisdiction to issue” orders granting access to public records if the applicant has complied with other statutory requirements. The General Assembly intended to create jurisdiction there. The same is not true of § 105-241.17(3), which says only that, before a taxpayer may file a facial challenge, OAH must first assess its own jurisdiction and dismiss the case. Jurisdiction is established elsewhere, not in § 105-241.17.

The Department next focuses on the last words of § 105-241.17(3)’s final clause, stating that OAH’s dismissal must be “because the sole issue is the constitutionality of a statute and not the application of a statute.” The Department claims these words bolster its position. Again, they do not. Like the statute’s first sentence, the phrase “the constitutionality of a statute” refers to a facial challenge. But the phrase “application” of a

statute means *any* error in application of a statute, including whether applying the statute to a particular case or party results in some unconstitutional *outcome*. See *Grady*, 372 N.C. at 562, 831 S.E.2d at 579–80; *see also* Appellant’s Br. at 22-24.

B. The Department’s attempt to compare § 105-241.17 with § 1-267.1 falls flat.

Departing from text, the Department points to N.C.G.S. § 1-267.1 as proof that, if the General Assembly had wanted to limit § 105-241.17 to facial constitutional challenges, it could have done so. But the statutes are too dissimilar to be useful comparators.

Section 1-267.1 requires that some constitutional challenges be decided by a three-judge panel in Wake County Superior Court. In particular, that statute says that a plaintiff who brings “any action challenging the validity of any act of the General Assembly . . . shall be filed in” Wake County Superior Court. § 1-267.1(a). The next sentence goes onto say that if the action is “a facial challenge to the validity of an act of the General Assembly,” it must be transferred to Wake County Superior Court. *Id.*

The statute’s language does not support the Department’s preferred outcome here. Contrary to the Department’s argument, the statute *does*

not use the phrase “facial challenge” as part of its directive that certain statutory challenges have to be brought in Wake County Superior Court; instead, § 1-267.1 says that any “action challenging the validity” of a statute has to be brought in Wake County Superior Court.

The statute goes on to clarify that “challenging the validity” means a “facial” challenge. In fact, the language that the General Assembly used when selecting Wake County as the proper venue is almost identical to the language used in § 105-241.17. Section 1-267.1, on the one hand, describes an “action challenging the validity” of a statute; section 105-241.17, on the other, describes any “claim[] that a tax statute is unconstitutional,” or invalid. Section 1-267.1, therefore, appears to bolster Philip Morris’ interpretation of § 105-241.17. The text of both statutes, while not identical, refer to challenges to a statute’s validity. § 1-267.1(a); *Jones Bros.*, 898 F.3d at 675 (a facial challenge to a statute tests the “constitutionality of legislation in the first instance”). These are two different ways to describe a facial challenge. As the Department concedes, § 1-267.1(a)’s language also refers to a facial constitutional challenge, which is precisely what Philip Morris explains the introductory sentence of § 105-241.17 references to explain and direct the

substance of this statute and its procedure, *see* Appellant's Br. at 19-22. To the extent § 1-267.1 sheds any light on the meaning of § 105-241.17, it supports Philip Morris' position.

C. Even if the statute's text and context were unclear, the Department has failed to explain why the Court should disregard Philip Morris' other arguments.

The Department also disputes Philip Morris' other, non-textual arguments, three of which merit special mention.

First, the Department responds to Philip Morris' surplusage argument erroneously by ignoring, or narrowly confining, OAH's general jurisdiction. *See* Appellee's Br. at 25. In its principal brief, Philip Morris explained that reading § 105-241.17 to encompass both facial and as-applied challenges would create a surplusage problem; sections 105-241.15 and 105-241.16 already prescribe how a taxpayer files a contested case petition in OAH and seeks judicial review of as-applied constitutional challenges. *See* Appellant's Br. at 23-24. Section 105-241.17, therefore, must be intended to focus on facial challenges.

The Department suggests that § 105-241.17 is only repeating what is "beyond" OAH's authority, but this ignores the use of the negative ("not the application of") used in this statute to show what is *not* being

procedurally carved away from OAH by § 105-241.17's unique procedure. The Department ignores the reality that § 150B-23 already gives OAH jurisdiction over as-applied constitutional challenges.

Second, the Department relies on *Electric Supply Co. v. Swain Electric*, 328 N.C. 651, 403 S.E.2d 291 (1991), to discount Philip Morris' reliance on legislative history. As Philip Morris explained, 2007 Finance Law Changes, a memorandum prepared by the General Assembly contemporaneous with § 105-241.17's enactment, explains the statute's meaning and confirmed that it applies only to facial constitutional challenges. *See* Appellant's Br. at 30–32.

The Department cites *Electric Supply Co.* for the proposition that this Court has “cautioned against discerning legislative intent from sources like memoranda written by attorneys who drafted legislation.” *See* Appellee's Br. at 27. But that's not what *Electric Supply Co.* says. There, this Court cautioned against using legal memoranda that *were not contemporaneous with the bill's passage*. 328 N.C. at 656–57, 403 S.E.2d at 295. The legislative memoranda at issue in *Electric Supply Co.* purported to interpret a statute that predated it by nearly 15 years. *Id.*

The 2007 Finance Law Changes memoranda does not suffer from the same defect. (R pp 381–89).

Finally, the Department rejects Philip Morris’ administrative-consistency argument (that OAH consistently has considered as-applied challenges) by citing the procedural history from *Kimberly Rice Kaestner 1992 Family Trust v. Department of Revenue*, 371 N.C. 133, 814 S.E.2d 43 (2018), and arguing that, since 2007, the agency’s view has been that OAH lacked jurisdiction over as-applied constitutional challenges. This argument first disregards the other cases cited by Philip Morris in its principal brief where the Department has taken a different position. *See* Appellant’s Br. at 36-39. More importantly, the Department’s view of OAH’s jurisdiction is irrelevant. Tribunals have an independent obligation to ensure that they have subject-matter jurisdiction. *See, e.g., Lemmerman v. A.T. Williams Oil Co.*, 318 N.C. 577, 580, 350 S.E.2d 83, 85–86 (1986). OAH is no different. When OAH believes that it lacks jurisdiction, it can dismiss a case of its own initiative. *E.g., Roper v. N.C. Dep’t of Pub. Safety*, 20 DSC 02922, 2021 WL 3519136 (N.C.O.A.H. June 4, 2021). OAH often has concluded that it *does* have subject matter jurisdiction over as-applied constitutional challenges. *See, e.g., Graybar*

Electric Co., Inc. v. N.C. Dep't of Revenue, 16 REV 07936, p 2 (N.C.O.A.H. 2017) [App. 7-26]; *Quad Graphics, Inc. v. N.C. Dep't of Revenue*, 19 REV 00334, ¶ 13 (N.C.O.A.H. 2020) [App. 27-36].

The Department mistakenly cites *Kaestner* as an example of OAH dismissing an as-applied challenge for lack of subject-matter jurisdiction. In *Kaestner*, it is true that this Court and the Supreme Court of the United States ultimately evaluated the challenge as an as-applied challenge. *Kimberley Rice Kaestner 1992 Fam. Tr. v. N. Carolina Dep't of Revenue*, 371 N.C. 133, 138, 814 S.E.2d 43, 47 (2018), *aff'd sub nom. N. Carolina Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Fam. Tr.*, 588 U.S. 262, 139 S. Ct. 2213, 204 L. Ed. 2d 621 (2019). But petitioner's claim before OAH was determined to be a facial challenge. See Final Decision and Order of Dismissal, 11 REV 03547 (N.C.O.A.H. 2011), Record on Appeal (Printed) at *13, *Kimberly Rice Kaestner 1992 Family Trust v. Dep't of Revenue*, No. COA15-896 (12 August 2015) (finding in OAH dismissal that Petition for Contested Case Hearing before OAH was "challenging the constitutionality of the *enactment* of [tax statute]" (emphasis added)) [App. 42-44]. In fact, the Department actually argued to OAH that the petitioner's claim before OAH in

Kaestner was challenging “enactment” of the tax statute, which is, in other words, a facial challenge. See Department’s Motion to Dismiss in Lieu of Pre-Hearing Statement, *Kimberly Rice Kaestner 1992 Family Trust v. Dep’t of Revenue*, 11 REV 03547 (N.C.O.A.H. 2011) (explaining that “Petitioner challenges the constitutionality of the *enactment* of [the tax statute]” (emphasis added)) [App. 45-46]. The administrative law judge accepted the Department’s characterization of the petitioner’s challenge as a challenge to enactment (i.e., facial) [App. 42], which would be consistent with Philip Morris’ position here—that OAH lacks jurisdiction over purely facial challenges. The fact that the petitioner in *Kaestner*, after OAH dismissal, subsequently filed a new complaint and contended before this Court that the tax statute at issue was both facially unconstitutional and unconstitutional as-applied to the petitioner does not alter how OAH viewed the petitioner’s claim in its contested case. *Kaestner* provides no support to the Department.

D. The Department waived its ability to argue that § 105-241.17 prohibits any constitutional challenge to a tax statute.

Philip Morris has argued that the Department waived its ability to argue that § 105-241.17 strips OAH of the ability to hear any

constitutional challenge to a tax statute, by not raising that argument before OAH. In responding, the Department mischaracterizes Philip Morris' position, erroneously claiming that Philip Morris is rejecting this Court's decisions holding that jurisdiction can be challenged at any time. The Department's interpretation of Philip Morris' argument is incorrect.

As Philip Morris explained in its principal brief, the Department waived its ability to argue that § 105-241.17(3) imposed a new or additional process for as-applied constitutional challenges. *See* Appellant's Br. at 49. Generally, administrative agencies have the power to hear as-applied constitutional challenges. *See supra* § I.

Before OAH, the Department never argued that OAH must dismiss Philip Morris' contested case petition because § 105-241.17 requires *all* constitutional challenges to be dismissed. (R pp 219–22). The Department argued only that Philip Morris' petition presented a facial constitutional question, which required dismissal. (R pp 221–22). First before the trial court—and then again before this Court—the Department changed its argument to now contend that § 105-241.17 required a different procedure for *all* constitutional challenges.

To argue against waiver, the Department claims that § 105-241.17(3) strips OAH of jurisdiction, thus making the statute jurisdictional, not procedural. But that is incorrect. When the General Assembly wants to alter a tribunal's jurisdiction, it knows how to do so. *See, e.g., Tillett*, 257 N.C. App. at 224, 809 S.E.2d at 147; *Bowling v. Margaret R. Pardee Mem'l Hosp.*, 179 N.C. App. 815, 819–20, 635 S.E.2d 624, 628 (2006) (holding that the North Carolina Disabilities Act, which reads “No court shall have jurisdiction over an action filed under this Chapter” in certain conditions “prevents this State's courts” from exercising jurisdiction). As Philip Morris explained in its principal brief, § 105-241.17(3) does not contain the same clear mandate usually seen in jurisdictional statutes.

Section 105-241.17 is descriptive, explaining what must happen before an aggrieved party may file a facial challenge suit in Wake County Superior Court. Without a “clear indication” that a rule is jurisdictional, the Court should consider the rule procedural—a “claims-processing rule.” *Tillett*, 257 N.C. App. at 225, 809 S.E.2d at 148 (citing *Henderson v. Shinseki*, 562 U.S. 428, 435 (2011)). Claims-processing rules “seek to promote the orderly progression of litigation by requiring parties to take

certain procedural steps at specified times.” *Henderson*, 562 U.S. at 435. These rules “may be waived or forfeited.” *Hamer v. Neighborhood Housing Servs.*, 583 U.S. 1, 20 (2017).

As Philip Morris has explained, § 105-241.17(3) is *at best* a claims-processing rule. *See* Appellant’s Br. at 55-59. It does not alter OAH’s jurisdiction to hear as-applied constitutional challenges. Thus, by failing to argue that the statute required OAH to dismiss Philip Morris’ contested case petition because *all* constitutional challenges must be dismissed, the Department waived that argument and should not have been allowed to advance it in the trial court.

III. The trial court incorrectly held that Philip Morris’ challenge to § 105-241.17 was facial, not as applied.

The Department also attempts to defend the trial court’s incorrect alternative conclusion—that Philip Morris’ challenge to § 105-241.17 is facial. The Department advances two arguments, neither of which have any merit. First, it argues that the trial court had the power to decide the nature of Philip Morris’ constitutional challenge as an “alternative holding.” Next, the Department argues that, in all events, Philip Morris’ challenge was facial, so the trial court’s holding must be correct.

A. Once it determined that § 105-241.17 deprived OAH of jurisdiction to decide constitutional challenges, the trial court should have ended its analysis.

As Philip Morris explained in its principal brief, once the trial court concluded that it lacked jurisdiction under § 105-241.17, its analysis should have stopped. *See* Appellant’s Br. at 41-43. It does not appear that this Court has ever approved the rule sometimes applied in federal court that alternative holdings are appropriate. *E.g.*, *M.E. v. T.J.*, 275 N.C. App. 528, 542, 854 S.E.2d 74, 91 (2020) (relying on Eleventh Circuit precedent). Nor should it. As already explained, when a trial court concludes it lacks jurisdiction—for whatever reason—it makes any alternative holding unnecessary and, thus, dicta.

The Department fails to offer any compelling argument to the contrary. In a footnote, it argues that courts “often without controversy facilitate review on appeal by providing alternative rationales for their holdings.” *See* Appellee’s Br. at 44 n.8 (citing *Potts ex rel. Steel Tube, Inc. v. KEL, LLC*, 2021 WL 5161922, at *8 (N.C. Super. Ct. Nov. 5, 2021)). But in *Potts*, the trial tribunal made two alternative holdings on the merits. *Potts*, 2021 WL 5161922, at *8. It did not, as the trial court did here, conclude that it lacked jurisdiction. Because the trial court

determined it lacked jurisdiction under § 105-241.17, it should not have further characterized Philip Morris' arguments.

B. Philip Morris asserted only an as-applied constitutional challenge.

Contrary to the Department's view, Philip Morris challenges only whether § 105-122(b) can be constitutionally applied to it. This is not a facial challenge. "An individual challenging the facial constitutionality of a legislative act must establish that no set of circumstances exists under which the act would be valid." *State v. Thompson*, 349 N.C. 483, 491, 508 S.E.2d 277, 282 (1998) (cleaned up) (quoting *United States v. Salerno*, 481 U.S. 739, 745 (1987)). "The fact that a statute might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid." *Id.* (cleaned up).

While Philip Morris' challenge implicates the Department's ability to enforce § 105-122(b) against Philip Morris, the argument would not preclude enforcement of that statute in all circumstances. A law violates the Dormant Commerce Clause on its face only if it "authorizes differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Cibolo Waste, Inc. v. City of*

San Antonio, 718 F.3d 469, 475 (5th Cir. 2013); *accord Or. Waste Sys. v. Dep't of Env't'l Quality*, 511 U.S. 93, 99 (1994).

This is not a case where the law should be viewed as discriminating against in-state and out-of-state corporations on its face. On its face, § 105-122(b) does not give domestic North Carolina corporations a benefit over their out-of-state competitors. For example, nothing in the statute singles out foreign corporations and imposes an additional tax on them. Instead, the statute is unconstitutional as applied to companies with affiliates in other states. In particular, companies that are wholly within North Carolina receive favorable tax treatment when the statute is applied to them, while companies like Philip Morris, with affiliates in Virginia and elsewhere, receive unfavorable tax treatment in that circumstance.

The Department has taken every avenue available to avoid reaching the merits of this as-applied constitutional claim, including this procedural battle over whether the Business Court could reach the merits in this case or whether a separate action must be filed that takes the parties right back to the Business Court again. The merits of Philip

Morris' claim should be reached, as the actions of the Department in applying § 105-122(b) are constitutionally infirm.

CONCLUSION

For the foregoing reasons and the reasons set forth in Philip Morris' principal brief, this Court should reverse the trial court and determine that the Department's application of § 105-122(b) to Philip Morris was unconstitutional. To reach this outcome, this Court should determine that OAH had jurisdiction to rule upon as-applied constitutional challenges pursuant to § 105-241.17(3), that Philip Morris brought an as-applied constitutional challenge under § 105-241.17(3) against the Department's application of § 105-122(b) to Philip Morris, and that the trial court erred in not affirming the OAH decision. In the alternative, this Court should reverse the trial court on its interpretation that § 105-241.17 requires all constitutional challenges to be dismissed by OAH, determine that Philip Morris brought an as-applied constitutional challenge to the Department's application of § 105-122(b), and remand to the trial court to resolve Philip Morris' as-applied constitutional challenge.

Respectfully submitted, this the 16th of April 2024.

/s/ Alex C. Dale

Alex C. Dale

N.C. State Bar I.D. No.: 28191

email: acd@wardandsmith.com

Ward and Smith, P.A.

Post Office Box 7068

Wilmington, NC 28406-7068

Telephone: 910.794.4800

Facsimile: 910.794.4877

Attorneys for Respondent-Appellant

Philip Morris USA, Inc.

I certify that all of the attorneys listed below have authorized me to list their names on this document as if they had personally signed it.

Christopher S. Edwards

N.C. State Bar I.D. No.: 48385

email: csedwards@wardandsmith.com

Ward and Smith, P.A.

Post Office Box 7068

Wilmington, NC 28406-7068

Telephone: 910.794.4800

Facsimile: 910.794.4877

Kay Miller Hobart
N.C. State Bar I.D. No.: 16746
email: kayhobart@parkerpoe.com
Parker Poe Adams & Bernstein LLP
PNC Plaza
301 Fayetteville Street, Suite 1400
Raleigh, NC 27601
Telephone: 919.835.4597
Facsimile: 919.834.4564

Dylan Z. Ray
N.C. State Bar I.D. No.: 56383
email: dylanray@parkerpoe.com
Parker Poe Adams & Bernstein LLP
Bank of America Tower
620 South Tryon Street, Suite 800
Charlotte, NC 28202
Telephone: 704.335.6022
Facsimile: 919.834.4564

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing PHILIP MORRIS USA, INC.'S REPLY BRIEF via email addressed to the following person at the following email address which is the last address known to me:

James W. Doggett
Email: jdoggett@ncdoj.gov
Tania X. Laporte-Reveron
Email: tlaportereveron@ncdoj.gov
Ronald D. Williams, II
Email: rdwilliams@ncdoj.gov
Mary Elizabeth D. Reed
Email: mreed@ncdoj.gov
North Carolina Department of Justice
Post Office Box 629
Raleigh, NC 27602

This the 16th of April, 2024.

/s/Alex C. Dale
Alex C. Dale
N.C. State Bar I.D. No.: 28191
email: acd@wardandsmith.com
For the firm of
Ward and Smith, P.A.
Post Office Box 7068
Wilmington, NC 28406-7068
Telephone: 910.794.4800
Facsimile: 910.794.4877
Attorneys for Respondent-Appellant

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§ 150B-23. Commencement; assignment of administrative law judge; hearing required; notice; intervention.

(a) A contested case shall be commenced by paying a fee in an amount established in G.S. 150B-23.2 and by filing a petition with the Office of Administrative Hearings and, except as provided in Article 3A of this Chapter, shall be conducted by that Office. The party that files the petition shall serve a copy of the petition on all other parties and, if the dispute concerns a license, the person that holds the license. A party that files a petition shall file a certificate of service together with the petition. A petition shall be signed by a party, an attorney representing a party, or other representative of the party as may specifically be authorized by law, and, if filed by a party other than an agency, shall state facts tending to establish that the agency named as the respondent has deprived the petitioner of property, has ordered the petitioner to pay a fine or civil penalty, or has otherwise substantially prejudiced the petitioner's rights and that the agency did any of the following:

- (1) Exceeded its authority or jurisdiction.
- (2) Acted erroneously.
- (3) Failed to use proper procedure.
- (4) Acted arbitrarily or capriciously.
- (5) Failed to act as required by law or rule.

The parties in a contested case shall be given an opportunity for a hearing without undue delay. Any person aggrieved may commence a contested case under this section.

A local government employee, applicant for employment, or former employee to whom Chapter 126 of the General Statutes applies may commence a contested case under this Article in the same manner as any other petitioner. The case shall be conducted in the same manner as other contested cases under this Article.

A business entity may represent itself using a nonattorney representative who is one or more of the following of the business entity: (i) officer, (ii) manager or member-manager, if the business entity is a limited liability company, (iii) employee whose income is reported on IRS Form W-2, if the business entity authorizes the representation in writing, or (iv) owner of the business entity, if the business entity authorizes the representation in writing and if the owner's interest in the business entity is at least twenty-five percent (25%). Authority for and prior notice of nonattorney representation shall be made in writing, under penalty of perjury, to the Office on a form provided by the Office.

(a1) Repealed by Session Laws 1985 (Regular Session, 1986), c. 1022, s. 1(9).

(a2) An administrative law judge assigned to a contested case may require a party to the case to file a prehearing statement. A party's prehearing statement shall be served on all other parties to the contested case.

(a3) A Medicaid enrollee, or the enrollee's authorized representative, who appeals a notice of resolution issued by a managed care entity under Chapter 108D of the General Statutes may commence a contested case under this Article in the same manner as any other petitioner. The case shall be conducted in the same manner as other contested cases initiated by Medicaid enrollees under this Article. Solely and only for the purposes of contested cases commenced pursuant to G.S. 108D-15 by enrollees of LME/MCOs to appeal a notice of resolution issued by the LME/MCO, an LME/MCO is considered an agency as defined in G.S. 150B-2. The LME/MCO is not considered an agency for any other purpose. When a prepaid health plan, as defined in G.S. 108D-1, other than an LME/MCO, is under contract with the Department of Health and Human Services to issue notices of resolution under Article 2 of Chapter 108D of the General Statutes, then solely and only for the purposes of contested cases commenced pursuant to G.S. 108D-15 to appeal a notice of resolution issued by the prepaid health plan, the prepaid health plan is considered an agency as defined in G.S. 150B-2. The prepaid health plan is not considered an agency for any other purpose.

(a4) If an agency fails to take any required action within the time period specified by law, any person whose rights are substantially prejudiced by the agency's failure to act may commence a contested case in accordance with this section seeking an order that the agency act as required by law. If the administrative law judge finds that the agency has failed to act as required by law, the administrative law judge may order that the agency take the required action within a specified time period.

(a5) A county that appeals a decision of the Department of Health and Human Services to temporarily assume Medicaid eligibility administration in accordance with G.S. 108A-70.42 or G.S. 108A-70.50 may commence a contested case under this Article in the same manner as any other petitioner. The case shall be conducted in the same manner as other contested cases under this Article.

(b) The parties to a contested case shall be given a notice of hearing not less than 15 days before the hearing by the Office of Administrative Hearings. If prehearing statements have been filed in the case, the notice shall state the date, hour, and place of the hearing. If prehearing statements have not been filed in the case, the notice shall state the date, hour, place, and nature of the hearing, shall list the particular sections of the statutes and rules involved, and shall give a short and plain statement of the factual allegations.

(c) Notice shall be given by one of the methods for service of process under G.S. 1A-1, Rule 4(j) or Rule 4(j3). If given by registered or certified mail, by signature confirmation as provided by the United States Postal Service, or by designated delivery service authorized pursuant to 26 U.S.C. § 7502(f)(2) with delivery receipt, notice is deemed to have been given on the delivery date appearing on the return receipt, copy of the proof of delivery provided by the United States Postal Service, or delivery receipt. If giving of notice cannot be accomplished by a method under G.S. 1A-1, Rule 4(j) or Rule 4(j3), notice shall then be given in the manner provided in G.S. 1A-1, Rule 4(j1).

(d) Any person may petition to become a party by filing a motion to intervene in the manner provided in G.S. 1A-1, Rule 24. In addition, any person interested in a contested case may intervene and participate in that proceeding to the extent deemed appropriate by the administrative law judge.

(e) All hearings under this Chapter shall be open to the public. Hearings shall be conducted in an impartial manner. Hearings shall be conducted according to the procedures set out in this Article, except to the extent and in the particulars that specific hearing procedures and time standards are governed by another statute.

(f) Unless another statute or a federal statute or regulation sets a time limitation for the filing of a petition in contested cases against a specified agency, the general limitation for the filing of a petition in a contested case is 60 days. The time limitation, whether established by another statute, federal statute, or federal regulation, or this section, commences when notice is given of the agency decision to all persons aggrieved that are known to the agency by personal delivery, electronic delivery, or by the placing of the notice in an official depository of the United States Postal Service wrapped in a wrapper addressed to the person at the latest address given by the person to the agency. The notice shall be in writing, shall set forth the agency action, and shall inform the persons of the right, the procedure, and the time limit to file a contested case petition. When no informal settlement request has been received by the agency prior to issuance of the notice, any subsequent informal settlement request shall not suspend the time limitation for the filing of a petition for a contested case hearing. When the Chief Justice of the North Carolina Supreme Court determines and declares that catastrophic conditions exist or have existed in one or more counties of the State and issues an order pursuant to G.S. 7A-39(b), the chief administrative law judge may by order entered pursuant to this subsection extend, to a date certain no fewer than 10 days after the effective date of the order, the time or period of limitation, whether established by another statute or this section, for the filing of a petition for a contested

case. The order shall be in writing and becomes effective for each affected county upon the date set forth in the order, and if no date is set forth in the order, then upon the date the order is signed by the chief administrative law judge. The order shall provide that it expires upon the expiration of the Chief Justice's order.

(g) Where multiple licenses are required from an agency for a single activity, the Secretary or chief administrative officer of the agency may issue a written determination that the administrative decision reviewable under Article 3 of this Chapter occurs on the date the last license for the activity is issued, denied, or otherwise disposed of. The written determination of the administrative decision is not reviewable under this Article. Any licenses issued for the activity prior to the date of the last license identified in the written determination are not reviewable under this Article until the last license for the activity is issued, denied, or otherwise disposed of. A contested case challenging the last license decision for the activity may include challenges to agency decisions on any of the previous licenses required for the activity. (1973, c. 1331, s. 1; 1975, 2nd Sess., c. 983, s. 65; 1985, c. 746, s. 1; 1985 (Reg. Sess., 1986), c. 1022, ss. 1(9), (10), 6(2), (3); 1987, c. 878, ss. 3-5; c. 879, s. 6.1; 1987 (Reg. Sess., 1988), c. 1111, s. 5; 1991, c. 35, s. 1; 1993 (Reg. Sess., 1994), c. 572, s. 2; 2009-451, s. 21A.1(a); 2011-332, s. 2.1; 2011-398, s. 16; 2012-187, s. 6; 2013-397, s. 4; 2014-120, ss. 7(a), 48, 59(a); 2016-94, s. 12H.17(c); 2017-57, s. 11H.22(d); 2018-114, s. 1; 2019-81, s. 11; 2020-3, s. 4.26(a); 2021-88, s. 16(e); 2022-74, s. 9D.15(z).)

§ 105-241.15. Contested case hearing on final determination.

(a) Contest Final Determination. – A taxpayer who disagrees with a notice of final determination issued by the Department may contest the determination by filing a petition for a contested case hearing at the Office of Administrative Hearings in accordance with Article 3 of Chapter 150B of the General Statutes. A taxpayer may file a petition for a contested case hearing only if the taxpayer has exhausted the prehearing remedy. A taxpayer's prehearing remedy is exhausted when the Department issues a final determination after conducting a review and a conference.

(b) Contest Statute of Limitations. – A taxpayer who disagrees with a notice of denial issued by the Department pursuant to G.S. 105-241.7(c1) may contest the statute of limitations determination by filing a petition for a contested case hearing at the office of Administrative Hearings in accordance with Article 3 of Chapter 150B of the General Statutes on the sole issue of whether the statute of limitations bars the taxpayer's claim. A final decision by the administrative law judge regarding the statute of limitations is subject to judicial review under Article 4 of Chapter 150B of the General Statutes and under G.S. 105-241.16. In the event judicial review of the decision is not sought and the final decision is that the taxpayer's claim was not barred by the statute of limitations, then the administrative law judge must remand the matter to the Department for consideration of the substantive issues. In the event judicial review is sought and it is finally determined that the taxpayer's claim was not barred by the statute of limitations, then the matter shall be remanded to the Department for consideration of the substantive issues. Any remand shall be regarded as a new amended return or claim for refund timely filed within the statute of limitations under G.S. 105-241.7(c). (2007-491, s. 1; 2016-76, s. 2(b).)

§ 105-241.16. Judicial review of decision after contested case hearing.

A party aggrieved by the final decision in a contested case commenced at the Office of Administrative Hearings may seek judicial review of the decision in accordance with Article 4 of Chapter 150B of the General Statutes. Notwithstanding G.S. 150B-45, a petition for judicial review must be filed in the Superior Court of Wake County and in accordance with the procedures for a mandatory business case set forth in G.S. 7A-45.4(b) through (f). Before filing a petition for judicial review, a taxpayer must pay the amount of tax, penalties, and interest the final decision states is due. A party may appeal a decision of the Business Court to the appellate division in accordance with G.S. 150B-52. (2007-491, s. 1; 2010-95, s. 9; 2017-204, s. 4.1(e).)

§ 105-241.17. Civil action challenging statute as unconstitutional.

A taxpayer who claims that a tax statute is unconstitutional may bring a civil action in the Superior Court of Wake County to determine the taxpayer's liability under that statute if all of the conditions in this section are met. In filing an action under this section, a taxpayer must follow the procedures for a mandatory business case set forth in G.S. 7A-45.4(b) through (f). The conditions for filing a civil action are:

- (1) The taxpayer exhausted the prehearing remedy by receiving a final determination after a review and a conference.
- (2) The taxpayer commenced a contested case at the Office of Administrative Hearings.
- (3) The Office of Administrative Hearings dismissed the contested case petition for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute.
- (4) The taxpayer has paid the amount of tax, penalties, and interest the final determination states is due.
- (5) The civil action is filed within two years of the dismissal. (2007-491, s. 1.)

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
16 REV 07936

Graybar Electric Company Inc., Petitioner, v. NC Department of Revenue, Respondent.	FINAL DECISION
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THIS MATTER comes before the Honorable Donald W. Overby, Administrative Law Judge presiding, for consideration of Petitioner's Motion for Summary Judgment with accompanying Memorandum of Law filed with the Office of Administrative Hearings ("OAH") on June 9, 2017, as well as Respondent's Motion for Summary Judgment with accompanying Memorandum of Law filed with OAH likewise on June 9, 2017. A hearing was held on the cross Motions on July 5, 2017, and counsel for the respective parties presented oral argument as well as cited authority. At the conclusion of the hearing on the motions, mediation was suggested to the parties; however, the parties communicated to this Tribunal that mediation does not present a suitable alternative under the parameters of this contested case.

SUMMARY JUDGMENT LEGAL STANDARD

N.C. Gen. Stat. § 150B-34(e) authorizes this Tribunal to grant summary judgment. The purpose of summary judgment is to bring litigation to an expeditious and efficient decision on the merits "where only a question of law on the indisputable facts is in controversy." McNair v. Boyette, 282 N.C. 230, 234-35, 192 S.E.2d 457, 460 (1972). Summary judgment is appropriate when no genuine issue of material fact exists and the movant is entitled to judgment as a matter of

law. N.C.R. Civ. Proc. 56(c); *see also* Dendy v. Watkins, 288 N.C. App. 447, 219 S.E.2d 214 (1975).

Summary judgment is only proper under Rule 56 of the North Carolina Rules of Civil Procedure if “there is no genuine issue as to any material fact and . . . any party is entitled to a judgment as a matter of law.” N.C. Gen. Stat. § 1A-1, Rule 56 The North Carolina Rules of Civil Procedure apply to proceedings in the Office of Administrative Hearings (“OAH”) unless otherwise specified. 26 NCAC 03 .0101(b)

A motion for summary judgment ‘shall be’ granted ‘if the pleadings, depositions, answers to the interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to judgment as a matter of law.’ Estate of Williams v. Pasquotank County Parks & Rec. Dep’t, 366 N.C. 195, 198, 732 S.E.2d 137, 140 (2012) (quoting N.C. Gen. Stat. § 1A-1, Rule 56(c)).

Summary judgment is an extreme remedy and should be awarded only where the truth is quite clear. *See* Lee v. Shor, 10 N.C. App. 231, 178 S.E.2d 101 (1970). To entitle one to summary judgment, the movant must conclusively establish a legal bar to the non-movant’s claim or complete defense to that claim. *See* Virginia Elec. And Power Co. v. Tillett, 80 N.C. App. 383, 343 S.E. 2d 188, cert. denied, 317 N.C. 715, 347 S.E. 2d 457 (1986).

In the Motions before this Tribunal, each party has filed a cross-motion for summary judgment, and both parties have agreed and concluded that no material facts are disputed.

PROCEDURAL HISTORY

Prior to November 5, 2014, Graybar Electric timely filed amended North Carolina corporate income tax returns to report federal adjustments for tax years 2008, 2009 and 2010. Nine days after receipt of the amended returns, the Department, on November 14, 2014, began an audit of Graybar Electric's North Carolina corporate income tax returns for tax years 2008 through 2013.

The Department concluded its audit, produced an audit report, and on August 12, 2015, issued the audit report to Graybar Electric. The audit report proposed changes seeking to create an assessment of corporate income tax for tax years 2008, 2012 and 2013. The proposed changes sought to reduce Graybar Electric's net economic loss carryovers. Graybar Electric disagreed with the proposed changes, and on September 16, 2015, timely filed a request for review.

The Department reviewed Graybar Electric's submission but the Department declined to change its views. Instead, on June 14, 2016, the Department issued a notice of final determination sustaining the assessments of tax, penalty and interest for tax years 2008, 2012 and 2013. To obtain relief, Graybar Electric filed this request for a contested case on August 10, 2016, seeking to dismiss the proposed tax, penalty, and interest.

After completing discovery, and with the agreement of Graybar Electric and the Department, both sides submitted cross-motions for summary judgment on June 9, 2017.

STATE CORPORATE INCOME TAX: AN OVERVIEW

All statutory references contained in this Decision are those which were in effect during the years at issue.

North Carolina levies an income tax “on the State net income of every C Corporation doing business in this State.” N.C. Gen. Stat. § 105-130.3 The term “State net income” is defined as a “taxpayer’s federal taxable income as determined under the [Internal Revenue] Code, adjusted as provided in G. S. § 105-130.5.” N.C. Gen. Stat. § 105-130.2(5c) When determining State net income, subsection (b) of N.C. Gen. Stat. § 105-130.5 authorizes a taxpayer to deduct certain items from its federal taxable income, including, “[l]osses in the nature of net economic losses sustained by the corporation in any or all of the 15 preceding years pursuant to the provisions of G.S.105-130.8.” N.C. Gen. Stat. § 105-130.5(b)(4)

A corporation has a net economic loss for any year in which, “allowable deductions for the year other than prior year losses exceed income from all sources in the year including any income not taxable under this Part,” referring to the particular “Part” of the “Corporation Income Tax Act.” N.C. Gen. Stat. § 105-130.8 (a)(2) Net economic loss of prior years may be carried forward from prior years and deducted from income in a succeeding taxable year; however, no loss may be carried forward for more than 15 years. N.C. Gen. Stat. § 105-130.8(a)(3) and (a)(6) In determining the amount of net economic loss deduction in the succeeding years, any net economic loss carryforward must be reduced or offset by any “income not taxable” received in the succeeding year. N.C. Gen. Stat. § 105-130.8(a)(3)

Every corporation doing business in the State is required to file a State Tax Return reflecting its liability for State corporate income taxes. N.C. Gen. Stat. § 105-130.16(a) A corporation claiming a deduction for a net economic loss on its State Tax Return for the current year or carried forward from a prior year, “must maintain and make available for inspection by the Secretary [of Revenue] all records necessary to determine and verify the amount of the deduction.” N.C. Gen. Stat. § 105-130.8(b) The Secretary of Revenue (“Secretary”) has the express authority to, “redetermine an item originating in a taxable year that is closed under the statute of limitations for the purpose of determining the amount of net economic loss that can be carried forward to a taxable year that remains open under the statute of limitations.” *Id.*

If, upon review of a taxpayer’s records, the Secretary determines that additional tax is due, he “may propose an assessment against a taxpayer for tax due from the taxpayer,” which includes interest and penalties. (Emphasis added). N.C. Gen. Stat. § 105-241.9(a); *see also* N.C. Gen. Stat. § 105-228.90(b)(7) (defining the term “tax” to include penalties and interest). By law, a “proposed assessment of the Secretary is presumed to be correct.” N.C. Gen. Stat. § 105-241.9(a)

STATEMENT OF FACTS

Graybar Electric is incorporated in New York, headquartered in St. Louis, Missouri, and authorized to do business in North Carolina. It distributes electrical and communications and data networking products and provides related supply chain management and logistics services.

Graybar Electric is an operating entity filing as a “C” corporation for both federal and North Carolina tax purposes and tax filings. It also serves as the parent corporation of several wholly owned subsidiaries, including Graybar Services, Inc. ("Graybar Services") and Commonwealth Controls Corporation ("Commonwealth"). Graybar Services is also taxed as a “C” corporation for federal and North Carolina income tax purposes and has filed North Carolina corporate income tax returns since 1998. In 2007, Graybar Services paid Graybar Electric from Graybar Services’ North Carolina taxed earnings and profits a dividend of \$400,000,000. Commonwealth is taxed as a “C” corporation for federal income tax purposes, and in 2008 issued a dividend of \$1,000,000 to Graybar Electric with the dividend paid from Commonwealth’s earnings and profits.

Graybar Electric included the Graybar Services \$400,000,000 dividend on line 4 of Graybar Electric’s 2007 federal Form 1120 as dividend income. Graybar Electric included the Commonwealth \$1,000,000 dividend on line 4 of Graybar Electric’s 2008 federal Form 1120 as dividend income. Graybar Electric claimed on its federal returns a dividends-received deduction under IRC §243 for each dividend based on 100% ownership of Graybar Services and Commonwealth.

For each respective year of 2007 and 2008, Graybar Electric's North Carolina Corporate income tax returns listed the \$400,000,000 dividend and the \$1,000,000 dividend on its Schedule G as "Federal Taxable Income Before NOL Deduction." Graybar Electric did not deduct the \$400,000,000 and \$1,000,000 dividends in determining State net income under N. C. Gen. Stat. § 105-130.5. Rather than deduct, Graybar Electric included the \$400,000,000 and \$1,000,000 dividends as apportionable income and did not treat the dividends as non-apportionable income not allocable to this State under N. C. Gen. Stat. § 105-130.4.

On audit, the Department made no adjustment to the \$400,000,000 or \$1,000,000 dividends. Further, the audit found Graybar Electric was entitled to a Net Economic Loss ("NEL") Carryforward from 2006 to 2007 of \$10,058,273. However, the audit found Graybar Electric's NEL Carryforward from 2007 to 2008 was zero and its NEL Carryforward from 2008 to 2009 was also zero. With those changes reducing the NEL Carryforward to zero, the audit disallowed a portion of Graybar Electric's NEL deductions.

According to the Department's audit, the NEL Disallowances are needed because an "adjustment to the NEL for Federal Special Dividends is required as . . . [the Federal Special Dividend] was not taxed to this taxpayer." The audit says the reduction is required because, "[b]efore a net economic loss brought forward may be deducted, . . . [the net economic loss brought forward] must be reduced by any current-year nontaxable income . . . (G.S. 105-130.8(3))." The Department identifies the "current-year nontaxable income" used to reduce the NEL as the \$400,000,000 dividend from Graybar Services in 2007 (apportioned to North Carolina as \$14,194,000) and the \$1,000,000 dividend from Commonwealth in 2008 (apportioned to North Carolina as \$34,465).

CONCLUSIONS OF LAW

I. Net Economic Loss Carryforward deduction; “Income Not Taxable”

Principal to the dispute between the parties is a disagreement over the meaning of the statutory requirements for an NEL Carryforward deduction. Both the Department and Graybar Electric agree the dollar amount of an NEL deduction in the carryforward year must be reduced by any “income not taxable” received in the year to which the carryforward is to be applied. The phrase “income not taxable” is relevant to computing an NEL Carryforward deduction because § 105-130.8(a)(3) uses that phrase to limit the NEL deduction. N. C. Gen. Stat § 105-130.8(a)(3) states:

Any net economic loss of prior years brought forward and claimed as a deduction in any income year may be deducted from net income of the year only to the extent that the loss carried forward from the prior years exceeds any income not taxable under this Part received in the same year in which the deduction is claimed . . .

To explain the meaning of the phrase “income not taxable,” the General Assembly includes a specific definition at § 105-130.8(a)(5), a subsection of § 105-130.8. N. C. Gen. Stat. § 105-130.8(a)(5) states:

[A]ny income item deductible in determining State net income under the provisions of G.S. 105-130.5 and any nonapportionable income not allocable to this State under the provisions of G.S. 105-130.4 shall be considered as income not taxable under this Part. (Emphasis added)

Thus, § 105-130.8(a)(5)’s language of “shall be considered as income not taxable” defines “income not taxable” as used in §105-130.8(a)(3). Where a statute itself contains a definition of a phrase used in the statute, the statutory definition controls even if contrary to the ordinary meaning of the word. *See In re Clayton–Marcus Co.*, 286 N.C. 215, 219, 210 S.E.2d 199, 203 (1974). Here, § 105-130.8(a)(5), having defined the phrase “income not taxable,” and doing so within the same

statute that creates the phrase “income not taxable,” controls the meaning of “income not taxable.”
Id.

The Department rightfully points out that the language of § 105-130.8(a)(5) does not contain any indicia that the General Assembly intended that section to be an exhaustive list of all types of income that would be considered as “income not taxable.” The Department points to its long-standing interpretation in departmental bulletins to support the conclusion that the list is not exhaustive. The Department does not point to any other statute for expansion of the list.

While the Bulletin is entitled to some deference, it is not controlling and does not carry the weight of a properly promulgated rule or statute.

The Bulletin states that “income not taxable” arises only in three cases. First, income is not taxable if the “income . . . has been deducted in computing State net income under G.S. § 105-130.5.” For Graybar Electric, that provision does not make its dividends “income not taxable” since a deduction under the U.S. Internal Revenue Code §243 is not listed in G.S. § 105-130.5. Second, income is not taxable if “nonapportionable income . . . has been allocated directly to another state under G.S. § 105-130.4.” Again, such is not the case with Graybar Electric since Graybar Electric has no income allocated to another state.

Finally, the Bulletin explains “income not taxable” may arise from “other income that is not taxable under State law” and cites Dayco Corporation v. Clayton as support. The “other income that is not taxable” condition does not apply to Graybar Electric since Dayco holds that dividend income “allocable to states other than North Carolina . . . is income upon which no tax is imposed by the Revenue Act.” Dayco, 269 N.C. at 497, 153 S.E.2d at 33 (1967). There is no dividend income allocable to other states at issue in this contested case.

There is nothing in the Bulletins that gives anyone notice that an I.R.C. §243 deduction converts taxable dividends into “income not taxable.”

The phrase “income not taxable” as defined in G.S. § 105-130.8(a)(5) and set forth above encompasses only two classes of income: 1) “any income item deductible in determining State net income under the provisions of G.S. 105-130.5,” and 2) “any nonapportionable income not allocable to this State under the provisions of G.S. 105-130.4.” Hence, to be “income not taxable,” the dividends must fall into one of those two classes of income. Neither class governs the dividends under review in this contested case.

The Graybar Electric dividend income is not an “income item deductible under G.S. 105-130.5” because G.S. § 105-130.5 does not require subtracting dividends covered by I.R.C. §243. Rather, only two items found at G.S. § 105-130.5(b)(3a) & (23) address dividend deductions, neither of which are applicable the facts of this contested case.

No dispute exists on how Graybar Electric treated the dividend income under review. It treated the income as apportionable. Thus, the dividends are not “income not taxable” because the dividends are not “nonapportionable income not allocated to North Carolina.”

Therefore, because the statutory definition of “income not taxable” as stated in G.S. § 105-130.8(a)(5) does not include dividends for which an I.R.C. §243 deduction is taken, the fact that Graybar Electric claimed an I.R.C. §243 deduction does not convert such dividends into “income not taxable.” Accordingly, the Department incorrectly reduced Graybar Electric’s NEL Carryforward deductions.

However, the Department does contend that dividend income reported on a return for which a deduction is claimed under I.R.C. §243 is “income not taxable,” which is a crucial part to the dispute between the parties. According to the Department, because Graybar Electric claimed a

deduction in 2007 under I.R.C. §243, the \$14,194,000 of 2007 apportioned dividends must reduce the \$10,058,273 NEL Carryforward of 2007. If correct, and given the I.R.C. §243 deduction of \$14,194,000 exceeds the NEL Carryforward of \$10,058,273, the Department's position reduces Graybar Electric's NEL Carryforward to zero and denies Graybar Electric any further benefit of the carryforward it originally claimed on its corporate returns. The Department's position is incorrect.

The dollar amount of an NEL Carryforward deduction is mandated by statute and Graybar Electric meets the statutory requirements. The controlling statute establishing the dollar amount of an NEL Carryforward is N.C. Gen. Stat. § 105-130.8(a)(3) as set forth above. The statute sets two requirements for the NEL deduction. First, a "loss carried forward from the prior years," and second, the loss carryforward deduction must "exceed any income not taxable under this Part," again meaning the particular Part of the North Carolina Corporation Tax Act.

Graybar Electric has a loss carried forward from prior years. The audit confirms Graybar Electric has a "loss carried forward from the prior years." The audit tracks and quantifies Graybar Electric's NEL Carryforward from 2001 through 2006.

The loss carryforward is deductible because the carryforward "exceeds any income not taxable under this Part." The audit sets the Graybar Electric carryforward loss from 2006 to 2007 as \$10,058,273. To establish the NEL Carryforward deduction in 2007, the carryforward amount of \$10,058,273 must survive any reduction from "income not taxable."

The Department claims Graybar Electric's \$10,058,273 loss carryforward to 2007 must be reduced by the \$14,194,000 of apportioned dividends classified by the Department as "income not taxable." The Department's claim is based on the assertion that Graybar Electric claimed a

dividend received deduction under IRC §243—a deduction which the Department asserts converts the dividend into “income not taxable.” The Department is mistaken.

The fact of claiming an IRC §243 dividend deduction does not convert the dividend into “income not taxable” because the statutory definition of “income not taxable” does not include dividends for which an IRC §243 deduction is taken.

The dividends are not “income not taxable” because the dividends are taxable income as a matter of law and have been treated as taxable income by Graybar Electric as a matter of undisputed fact. Since the dividends are taxable income as a matter of law, the dividends are not “income not taxable.”

For an NEL, income is either “taxable income” or “income not taxable.” Dayco Corp. v. Clayton, 269 N.C. 490, 498, 153 S.E.2d 28, 33 (1967). “Taxable income” is income upon which “the State of North Carolina . . . levies a tax” and “[a]ll other income is ‘income not taxable under this article.’” Id.

North Carolina levies an income tax “on the State net income of every C Corporation doing business in this State.” (Emphasis added) N.C. Gen. Stat. § 105-130.3 A corporation’s “State net income” is the “federal taxable income as determined under the Code” (*see* N.C. Gen. Stat. § 105-130.2(15)), with the “Code” being “[t]he Internal Revenue Code as enacted as of January 1 [of the applicable tax year].” N.C. Gen. Stat. § 105-228.90(b)(1b)

Federal taxable income includes dividends, a class of income specifically identified as subject to income tax. IRC §61(a)(7) (“gross income means all income from whatever source derived, including (but not limited to) . . . Dividends.”). And, North Carolina, having adopted “[a] state tax based on federal . . . income, [has imposed] a tax on each and every component of that [federal] income.” Comptroller of the Treasury, Income Tax Div. v. First United Bank & Trust,

320 Md. 352, 361, 578 A.2d 192, 196 (1990). Thus, the dividends are included in federal taxable income by IRC §61(a)(7). Federal taxable income is the base upon which State net income is computed, and State net income is that upon which North Carolina levies an income tax. Therefore, the dividend income reported by Graybar Electric in 2007 and 2008 was taxed by North Carolina as “taxable income.” The \$10,058,273 loss carryforward deduction cannot be reduced by the \$14,194,000 apportioned dividend because the \$14,194,000 is not “income not taxable under this Part.”

As discussed above, the dividends are not “income not taxable” as a matter of law, but additionally, the dividends were indeed taxed as a matter of fact. Graybar Electric included the Graybar Services \$400,000,000 dividend on line 4 of Graybar Electric’s 2007 federal Form 1120 as dividend income. Graybar Electric included the Commonwealth \$1,000,000 dividend on line 4 of Graybar Electric’s 2008 federal Form 1120 as dividend income. The audit did not treat the dividends as excluded from gross income. The audit included the dividends in Graybar Electric’s gross income.

For each respective year of 2007 and 2008, on Schedule G of Graybar Electric’s North Carolina Corporate income tax returns, Graybar Electric listed the \$400,000,000 dividend and the \$1,000,000 dividend as “Federal Taxable Income Before NOL Deduction.” Thus, Graybar Electric included the dividends in gross income, income which is subject to both federal and North Carolina income tax. Accordingly, the \$14,194,000 is not “income not taxable” because Graybar Electric included the \$400,000,000 dividend from Graybar Services and the \$1,000,000 dividend from Commonwealth as federal and North Carolina income.

II. Deduction v. Exclusion:

The Department incorrectly asserts the dividends are “income not taxable” by virtue of the “exclusion” of IRC §243. The Department, in its Prehearing Statement, claims the Department “properly utilized the Dividends to reduce [Graybar Electric’s NEL Carryforward] when calculating the amount, . . . [Graybar Electric] would be entitled to deduct for net economic loss.” The Department concludes that a dividend deduction under IRC §243 causes the dividend itself to be excluded from income. (Emphasis added). Department Prehearing Statement, p. 6, fn. 5 There, the Department states, “[d]ividends deducted pursuant to IRC §243 are . . . excluded from a corporation’s federal taxable income, as well as its State net income.” (Emphasis added). The Department is incorrect: a deduction is not the equivalent of an exclusion, and a deduction produces no exclusion.

It is widely held that an “exclusion” results when the authority to tax is withheld. Chester Cty. v. Herdeg, 539 A.2d 486, 487 (Pa. 1988) (“since the act does not give municipalities the authority to impose such taxes the exception in question is [an exclusion as] . . . a limitation of the general authority to tax otherwise conferred.”); Rossi v. Com., 342 A.2d 119, 122 (Pa. 1975) (“Exclusions are items which were not intended to be taxed in the first place.”); Aabakus, Inc. v. Huddleston, No. 01A-01-9505-CH-00215, 1996 WL 548148, at Ftn. 7 (Tenn. Ct. App. Sept. 25, 1996) (“For the purpose of taxation, exclusions are items that were never in the taxing statute in the first place.”); Harrah's Bossier City Inv. Co., LLC v. Bridges, 41 So. 3d 438, 448 (La. 2010) (“An exclusion removes a certain transaction from the scope of the tax, *ab initio*.”).

On the other hand, “[d]eductions are commonly understood to be items . . . subtracted from the amount of total receipts to arrive at a lesser amount.” In re Raiman, 172 B.R. 933, 938 (B.A.P. 9th Cir. 1994). *See Menard Inc. v. Dep't of Treasury*, 838 N.W.2d 736, 741 (MI 2013) (“A ‘tax deduction’ is a ‘subtraction from gross income in arriving at taxable income.’”).

Hence, an exclusion arises when the taxing jurisdiction has no authority to tax and a deduction arises when the taxing jurisdiction grants a subtraction from items already taxed.

Applying these concepts to Graybar Electric, the IRC §243 amount is “subtracted from the amount of total receipts to arrive at a lesser amount” (*see In re Raiman*), and is a “subtraction from gross income in arriving at taxable income” (*see Menard Inc. v. Dep't of Treasury*) to produce Graybar Electric’s “taxable income.” Thus, the IRC §243 deduction is simply a subtraction from the total receipts already included in taxable income. *See OBH, Inc. v. United States*, 397 F.Supp.2d 1148, 1157 (D. Neb. 2005) (“The dividends-received deduction [of IRC §243] permits corporate taxpayers to deduct from their taxable income an amount based on dividend income received from the stock of other corporations.”) (Emphasis added).

Here, the undisputed facts are the total receipts included in gross income for Graybar Electric for 2007 and 2008 include the \$400,000,000 and \$1,000,000 dividends as reported on line 4, Form 1120. Those dividends form a portion of the gross income accumulated and totaled on line 11, Form 1120, identified as “Total income.” No basis exists for finding the dividends are excluded from income since to do so requires a showing by the Department the dividends “were not intended to be taxed in the first place.” Rossi v. Com., 342 A.2d 119, 122 (Pa. 1975). Such is not the case since IRC §61(a)(7) holds, “gross income means all income from whatever source derived, including (but not limited to) . . . Dividends.” The dividend deduction under IRC §243 creates no exclusion of the dividend income of \$400,000,000 and \$1,000,000. Rather, the

dividends are taxed, are not “income not taxable,” and cannot be used to reduce Graybar Electric’s NEL Carryforward deductions.

The Department’s position is contrary to the Supreme Court’s articulation of the purpose for allowing the deduction at all. “The purpose in allowing the deduction of net economic loss of a prior year or years is that of granting some measure of relief to taxpayers who have incurred economic misfortune. . . .” (Emphasis added) Dayco Corp. v. Clayton, 269 N.C. 490, 495, 153 S.E.2d 28, 31 (1967).

III. Case Law:

Case law in North Carolina confirms “income not taxable” does not include dividend income for which a deduction is permitted by IRC §243. Rather, “income not taxable” exists only when North Carolina lacks authority to tax, not when income is taxed.

The facts between this contested case and Dayco are distinguishable. Dayco Corp. v. Clayton, Comr. of Revenue, 269 N.C. 490, 153 S.E.2d 28 (1967) concerns dividends received from stock in non-subsidiary corporations, unlike the corporations in this contested case. There, the Court held the dividends were “clearly ‘income’ in the year received.” Dayco, 153 S.E.2d 28, 32–33 (1967). However, because the income was from out-of-state transactions not taxable by North Carolina, the dividend income had to be deducted from the claimed NEL Carryover. In holding that the dividends are taxable, the dividends are included in income, and the dividends are reported on federal and North Carolina returns, Dayco supports Graybar Electric. Dayco sets forth a nine-step process for determining “net economic loss.” There is no contention that such process has not been followed, and followed correctly. The disagreement of the parties is over what numbers are applicable.

In Aberfoyle Mfg. Co. v. Clayton, 265 N.C. 165, 143 S.E.2d 113 (1965), a corporation liquidated its wholly owned subsidiaries. The liquidation produced a gain. The gain was not taxable under North Carolina's taxation statutes. However, the gain was income "from all sources including income not taxable" under the former NEL statute of N.C.G.S. § 105-147(9)(d)(2). The gain, not being taxable by North Carolina but being income, had to reduce the NEL carryover as "income not taxable." Again, just as in Dayco, the conclusion in Aberfoyle helps clarify "income not taxable" and the NEL Carryover, and thus supports Graybar Electric's contentions.

Here, the Graybar Electric dividends were included in federal and North Carolina income and were taxed in 2007 and in 2008. No exemption or exclusion prevented the dividends from being included in income on either the federal or North Carolina returns. Thus, having been taxed, the dividends are not "income not taxable."

The Department's reliance on Wal-Mart Stores is somewhat misplaced. Wal-Mart Stores East v. Hinton, 197 N. C. App. 30, 676 S.E.2d 634 (2009). Essentially, the Wal-Mart Stores case was based upon constitutional questions concerning the authority of the Secretary of Revenue's authority to order a parent company and its subsidiaries to file consolidated returns for the purposes of corporate income tax. The Wal-Mart Stores was relying on a corporate structure which allowed it to classify as dividends amounts that were actually rental income. The Court of Appeals held that the Secretary was correct, and that there was no constitutional problem in ordering the parent company and the subsidiaries to file consolidated corporate income tax returns under the facts of that particular case.

As relevant to the instant case, the Court of Appeals relies substantially on Atlantic Coast Line R. Co. v. Doughton, 262 U.S. 413, 43 S.Ct. 620, 67 L.Ed. 1051 (1923). The North Carolina Court of Appeals noted in Wal-Mart Stores that in deciding Atlantic Coast Line, "the United States

Supreme Court made clear that the dispute in that case was not what particular items made up ‘net income,’ but on which particular entity net income should be calculated.” 262 U.S. at 420–21, 43 S.Ct. at 623, 67 L.Ed. at 1059–60. The Court of Appeals notes that defining “net income” for purposes of applying the North Carolina Constitution is a matter of first impression. Wal-Mart Stores, 197 N.C. App. at 53, 676 S.E.2d at 651.

In the current case, the parties agree that the federal taxable income is the starting point for state taxation. The disagreement comes in determining state net taxable income, specifically the computation of the NEL Carryforward as discussed above. As stated by the United States Supreme Court in Atlantic Coast Line, “[T]he differences between the parties arise, in the main, *not from difference in the method of determining what is net income*, but from difference as to what is the subject of the tax. In other words, they differ as to the thing of which the net income is to be ascertained.” (Emphasis added by Court of Appeals) 262 U.S. at 422, 43 S.Ct. at 624, 67 L.Ed. at 1060. Such is the case here.

In Atlantic Coast Line, the United States Supreme Court points out that:

“[t]he term ‘net income,’ in law or in economics, has not a rigid meaning. Every income tax act necessarily defines what is included in gross income; what deductions are to be made from the gross to ascertain net income; and what part, if any, of the net income, is exempt from taxation. These details are largely a matter of governmental policy.”

In accord, the North Carolina Court of Appeals held “[A] taxpayer claiming a deduction must bring himself within the statutory provisions authorizing the deduction.” Ward v. Clayton, 5 N.C. App. 53, 58, 167 S.E.2d 808, 811 (1969), aff’d, 276 N.C. 411, 172 S.E.2d 531 (1970). It is concluded in this contested case that Graybar has in fact brought itself within the “statutory provisions authorizing the deduction.”

In the holding by the Court of Appeals in Wal-Mart Stores, the Court concludes in relevant part, “that while article V, section 2(6) requires deductions and allows only net income to be taxed, it implicitly recognizes the authority of the General Assembly to determine what deductions from gross income are properly allowed in the computation of net income.” Wal-Mart Stores E., Inc. v. Hinton, 197 N.C. App. 30, 55, 676 S.E.2d 634, 52 (2009) Graybar has properly followed the enactments of the General Assembly in determining what deductions it used in computing state net taxable income.

The Court of Appeals also noted that “[t]ax statutes are to be strictly construed against the State and in favor of the taxpayer.” Wal-Mart Stores E., Inc. v. Hinton, 197 N.C. App. 30, 42, 676 S.E.2d 634, 644 (2009).

IV. Constitutional Questions:

The Office of Administrative Hearings does not have the authority to find any provision of either the United States Constitution or the North Carolina Constitution unconstitutional. OAH has the authority to find that a particular statute or rule is unconstitutional as applied.

Because of the holding of this contested case, it is not necessary to rule on Petitioner’s constitutional argument. However, in part, Petitioner’s argument rests on the premise that the Department’s position and interpretation of relevant statutes has the practical effect of creating a double taxation on the same income. This Tribunal agrees with the premise that the Department’s position creates a double taxation on the same income, which is contrary to the purpose for which North Carolina adopted IRC §243 as stated in Dayco. Dayco Corp. v. Clayton, 269 N.C. 490, 495, 153 S.E.2d 28, 31 (1967).

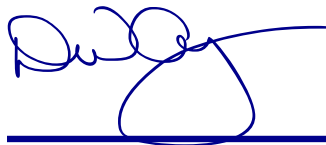
DECISION

NOW THEREFORE, based upon the foregoing mixed Findings of Fact and Conclusions of Law, Petitioner Graybar's Motion for Summary Judgement is **ALLOWED**. Respondent Department's Motion for Summary Judgment is **DENIED**. The Department's June 14, 2016 Notice of Final Determination is set aside and **DISMISSED**. The Department's reduction of Graybar's tax year 2007 and 2008 Net Economic Loss Carryforward is hereby **REVERSED**, and Graybar is allowed to utilize the Net Economic Loss Carryforward consistent with the Notice of Final Determination being dismissed.

NOTICE

Under the provisions of N.C. Gen. Stat. §§ 150B-34 and 150B-45, any party wishing to appeal the final decision of the Administrative Law Judge must file a Petition for Judicial Review in the Superior Court of Wake County. **The appealing party must file the petition within 30 days after being served with a written copy of the Administrative Law Judge's Final Decision.** In conformity with the Office of Administrative Hearings' rule, 26 N.C. Admin. Code 03.0102, and the Rules of Civil Procedure, N.C. Gen. Stat. § 1A-1, Article 2, **this Final Decision was served on the parties as indicated on the Certificate of Service attached to this Final Decision.** N.C. Gen. Stat. § 150B-46 describes the contents of the Petition and requires service of the Petition on all parties. Under N.C. Gen. Stat. § 150B-47, the Office of Administrative Hearings is required to file the official record in the contested case with the Clerk of Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be sent to the Office of Administrative Hearings at the time the appeal is initiated in order to ensure the timely filing of the record.

This the 16th day of October, 2017.



Donald W Overby
Administrative Law Judge

CERTIFICATE OF SERVICE

The undersigned certifies that, on the date shown below, the Office of Administrative Hearings sent the foregoing document to the persons named below at the addresses shown below, by electronic service as defined in 26 NCAC 03 .0501(4), or by placing a copy thereof, enclosed in a wrapper addressed to the person to be served, into the custody of the North Carolina Mail Service Center who subsequently will place the foregoing document into an official depository of the United States Postal Service:

James N Greene
Parker Poe Adams & Bernstein
jimmygreene@parkerpoe.com
Attorney For Petitioner

Ray N Stevens
Parker Poe Adams & Bernstein LLP
raystevens@parkerpoe.com
Attorney For Petitioner

Madison Felder
Parker Poe Adams & Bernstein, LLP
madisonfelder@parkerpoe.com
Attorney For Petitioner

Tenisha S Jacobs
Special Deputy Attorney General, Revenue Section
tjacobs@ncdoj.gov
Attorney For Respondent

This the 16th day of October, 2017.



Donna R Buck
Paralegal
Office of Administrative Hearings
6714 Mail Service Center
Raleigh NC 27699-6700
Telephone: 919-431-3000

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
19 REV 00334

Quad Graphics Inc Petitioner, v. NC Department of Revenue Respondent.	FINAL DECISION
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Upon consideration of Respondent's Motion for Summary Judgment, accompanying brief and exhibits, Petitioner's Motion for Summary Judgment, Respondent's Response to Petitioner's Motion for Summary Judgment, Petitioner's Response to Respondent's Motion for Summary Judgment, all accompanying exhibits to such motions and responses, pursuant to N.C. Gen. Stat. § 1A-1, Rule 56 of the North Carolina Rules of Civil Procedure, and for good cause shown, the undersigned hereby **GRANTS** Summary Judgment for Respondent as follows:

APPEARANCES

For Petitioner: Douglas W. Hanna, Graebe Hanna & Sullivan, PLLC
Michael J. Bowen, Akerman, LLP
Attorneys for Petitioner

For Respondent: Matthew H. Sommer,
Terence D. Friedman
Assistant Attorneys General
North Carolina Department of Justice

ISSUE

Whether Petitioner's sales of printed materials from September 1, 2009 through December 31, 2011 were subject to North Carolina sales tax under N.C. Gen. Stat. § 105-164.1, *et. seq.*?

BRIEF OVERVIEW OF UNDISPUTED FACTS

While Findings of Fact are not appropriate in a grant of summary judgment, the undersigned provides a brief overview of the undisputed facts in this matter to provide context for the undersigned's analysis and ruling. See, *e.g.*, *Hyde Ins. Agency, Inc. v.*

Dixie Leasing Corp., 26 N.C. App. 138, 142 (1975). See also N.C. Gen. Stat. § 150B-34(e).

Petitioner was an S-Corporation and commercial printer engaged in the production and sale of printed books, magazines, catalogs, and other items (“printed materials”), which included delivery of printed materials to addresses in North Carolina. Upon receiving orders for and producing printed materials, Petitioner would deliver the printed materials to the United States Postal Service or some other common carrier at a site outside North Carolina for delivery to either customers in North Carolina or to some third-party recipients with North Carolina addresses. The addresses of third-party recipients were provided to Petitioner by its customers via mailing lists, which identified the recipients and their addresses. Customers paid for printed materials regardless of whether printed materials were shipped to the customers in North Carolina or to third-party recipients in North Carolina.

While Petitioner’s corporate headquarters was located in Wisconsin, Petitioner employed sales representatives throughout the United States. Beginning in September 2009, Petitioner employed a sales representative in North Carolina. Petitioner’s sales representative in North Carolina specifically solicited the sale of tangible personal property to customers both inside and outside of North Carolina.

In 2011, Respondent conducted a sales and use tax audit related to Petitioner’s business activities within North Carolina for the period January 1, 2007 through December 31, 2011. On November 12, 2015, Respondent issued a Notice of Proposed Sales and Use Tax Assessment finding Petitioner liable for uncollected and unremitted sales tax resulting from sales of print materials for the period September 1, 2009 through December 31, 2011. (“sales at issue”). Respondent determined that Petitioner had a sales tax nexus for the period at issue based upon the physical presence of its sales representative in North Carolina. The proposed Assessment included, among other things, the sales at issue in this case.

Petitioner appealed the Notice of Assessment through Respondent’s Departmental review process. During that review, Respondent removed some sales and adjusted the proposed assessment to reflect those changes. On November 30, 2018, Respondent issued a Notice of Final Determination upholding the imposition of uncollected and unremitted sales tax resulting from Petitioner’s sales of printed materials during the period at issue. Respondent found that Petitioner was a retailer engaged in business in North Carolina as it maintained a resident employee who solicited sales and serviced customer accounts in this State. See N.C. Gen. Stat. §§ 105-164.4, 105-164.4B. Respondent also found that:

Petitioner failed to establish with proper documentation that its customers took possession of the Print Media outside North Carolina or that it had been placed into storage outside of North Carolina. As such, the sourcing of Taxpayer’s sales of Print Media delivered into North Carolina for storage,

use or consumption is governed by the sourcing principles included in N.C. Gen. Stat. § 105-164.4B.

(Notice of Final Determination) In this Notice, Respondent concluded that because the print media was received by Petitioner's customers or their designee in North Carolina, the sales of such print media are sourced to this State under N.C. Gen. Stat. § 105-164.4B(a)(2) and (d)(2).

On January 29, 2020, Petitioner appealed the Notice of Final Determination and filed a petition to the Office of Administrative Hearings alleging Respondent deprived Petitioner of property, and ordered it to pay a fine or civil penalty AND exceeded its jurisdiction, acted erroneously and failed to act as required by law or rule in issuing the Notice of Final Determination as:

- I. The disputed transactions are not subject to North Carolina retail sales or use tax because all relevant aspects of the disputed transactions took place outside North Carolina,
- II. The Assessment of North Carolina Sales and Use Tax violates the Due Process and Commerce Clauses of the United States Constitution, and
- III. The specific transactions included in the assessment should be excluded or are otherwise exempt from the North Carolina Sales and Use Tax.

(Petition) It is undisputed that Petitioner is no longer pursuing Claim III in its petition.

STANDARD OF REVIEW

"An Administrative Law Judge may [r]ule on all prehearing motions that are authorized by G.S. 1A-1, the [North Carolina] Rules of Civil Procedure." N.C. Gen. Stat. § 150B-33(b)(3a); See 26 NCAC 03 .0101(a) (specifically adopting the North Carolina Rules of Civil Procedure in contested cases at the Office of Administrative Hearings).

Summary judgment, under Rule 56(c) of the North Carolina Rules of Civil Procedure is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." The party moving for summary judgment "has the burden of establishing the lack of any triable issue of fact. His papers are carefully scrutinized and all inferences are resolved against him." *Kidd v. Early*, 289 N.C. 343, 352, 222 S.E.2d 392, 399 (1976). As both parties have moved for summary judgment in this matter, both parties acknowledge, and the undersigned determines, that there is no genuine issue as to any material fact in this contested case.

CONCLUSIONS OF LAW

1. This matter is subject to dismissal pursuant to N.C. Gen. Stat. §§ 1A-1, Rule 56 of the North Carolina Rules of Civil Procedure, 150B-33(b)(3a), and 26 NCAC 03 .0101(a). This Tribunal has subject matter jurisdiction over this matter and personal jurisdiction over the parties.

2. “A proposed assessment of the Secretary is presumed to be correct.” N.C. Gen. Stat. § 105-241.9(a).

3. During the period at issue, North Carolina imposed a sales tax on the gross receipts from a retailer’s sales at retail of tangible personal property if the retailer had a constitutional nexus with North Carolina and the sales were sourced to North Carolina. See N.C. Gen. Stat. §§ 105-164.3(9), 105-164.4(a), 105-164.4(a)(1), 105-164.4B, and 105-164.8. (The relevant portions of the Revenue statutes at issue in this contested case, including N.C. Gen. Stat. § 105-164.1, *et seq.*, are from 2010 and will, therefore, be used in this Final Decision unless specifically stated otherwise.)

I. The Sales at Issue Were Taxable in North Carolina

A. Petitioner was a retailer making sales at retail of tangible personal property

4. A “retailer” was “[a] person engaged in the business of . . . [m]aking sales at retail, offering to make sales at retail, or soliciting sales at retail of tangible personal property, digital property, or services for storage, use, or consumption in this State.” N.C. Gen. Stat. § 105-164.3(35)(a).

5. A “person” was as “[a]n individual . . . limited liability company, a corporation . . . or another group acting as a unit” by reference to N.C. Gen. Stat. § 105-164.3(26) in N.C. Gen. Stat. § 105-228.90(5).

6. Under N.C. Gen. Stat. § 105-164.3(46), “tangible personal property” was defined as “personal property that may be seen, weighed measured, felt, or touched or is in any other manner perceptible to the senses.” “Direct mail,” a particular type of tangible personal property relevant to the case at hand, was defined by N.C. Gen. Stat. § 105-164.3(7c) as:

printed material delivered or distributed by the United States Postal Service or other delivery service to a mass audience or to addresses on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items is not billed directly to the recipients.

7. A “sale” was “[t]he transfer for consideration of title or possession of tangible personal property or digital property or the performance for consideration of a service.” N.C. Gen. Stat. § 105-164.3(36). Additionally, a “sale at retail” or “retail sale” was “[t]he sale, lease, or rental for any purpose other than for resale, sublease, or subrent.” N.C.

Gen. Stat. § 105-164.3(34). There is no dispute that the printed materials in the sales at issue were tangible personal property and the printed materials shipped directly to the third-party recipients in North Carolina were “direct mail.”

8. Any person maintaining “permanently or temporarily . . . any representative, agent, sales representative, or solicitor operating in this State in the selling or delivering” of tangible personal property was “engaged in business” in North Carolina. N.C. Gen. Stat. § 105-164.3(9)(a). It is undisputed that Petitioner employed a sales representative in North Carolina whose duties were the solicitation of sales to customers located both inside and outside of North Carolina during the period at issue. As a result, Petitioner was “engaged in business,” as defined by N.C. Gen. Stat. § 105-164.3(9)(a), during the period at issue.

9. Applying the above statutory definitions to the undisputed facts in this case, the undersigned concludes that Petitioner’s sales of printed materials were “sales,” that the printed materials were “tangible personal property,” that there was a “transfer of title for consideration,” that the printed materials were “stored, used, and consumed” in North Carolina, and that Petitioner was a “person” who was “engaged in business” in North Carolina during the period at issue. As a result, Respondent was a “retailer” as defined in N.C. Gen. Stat. § 105-164.3(35)(a) and was obligated to collect and remit tax on all of its sales sourced to North Carolina. N.C. Gen. Stat. §§ 105-164.8, 105-164.4B.

B. Petitioner had a sufficient constitutional nexus with North Carolina

10. Generally, there are two types of potential constitutional challenges to a statute, facial and as applied. In asserting a facial constitutional challenge, the proponent must “show that there are no circumstances under which the statute might be constitutional.” *Beaufort County Bd. of Educ. v. Beaufort County Bd. of Com’rs*, 363 N.C. 500, 502, 681 S.E.2d 278, 280 (2009). In contrast, “[a]n as-applied constitutional challenge contests whether the statute can be constitutionally applied to a particular defendant, even if the statute is otherwise generally enforceable.” *State v. Packingham*, 368 N.C. 380, 383, 777 S.E.2d 738, 743 (2015), *rev’d and remanded on other grounds*, 137 S. Ct. 1730 (2017).

11. “It is a well-settled rule that a statute’s constitutionality shall be determined by the judiciary” and not an administrative tribunal or entity. *Matter of Redmond by & through Nichols*, 369 N.C. 490, 493, 797 S.E.2d 275, 277 (2017) (quoting *Meads v. N.C. Dep’t of Agric.*, 349 N.C. 656, 670, 509 S.E.2d 165, 174 (1998)).

12. Similar to other administrative bodies, such as the Industrial Commission and the Utilities Commission, the Office of Administrative Hearings is an “administrative agency created by the legislature . . . [and] has not been given jurisdiction to determine the constitutionality of legislative enactments” despite its power to conduct hearings, make decisions, and issue orders. *Matter of Redmond by & through Nichols*, 369 N.C. 490, 493, 797 S.E.2d 275, 277 (2017) (emphasis added). Similarly, the Office of Administrative Hearings is “not a court with general implied jurisdiction but primarily is an

administrative agency of the state” that is “granted judicial power as is necessary to perform the duties required of it by the law which it administers.” *Id.* (citing *Hogan v. Cone Mills Corp.*, 315 N.C. 127, 137, 337 S.E.2d 477, 483 (1985) (discussing the limited jurisdiction of the Industrial Commission)).

13. Petitioner raises arguments alleging that Respondent’s actions against Petitioner violates the Due Process Clause of the 14th Amendment and the Commerce Clause. While this Tribunal is barred from concluding and assessing the constitutionality of the relevant sales tax statutes in this matter, the undersigned may, however, analyze constitutional principles as applied to Petitioner in considering the propriety of Respondent’s imposition of uncollected and unremitted sales tax resulting from the sales of printed materials during the period at issue.

14. In *South Dakota v. Wayfair*, 138 S. Ct. 2080, the United States Supreme Court explained that the substantial nexus requirement contained within the Commerce Clause is “closely related” to the due process requirement that there be “some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax[.]” *Wayfair*, 138 S. Ct. at 2093 (emphasis added) (internal quotation marks and citation omitted). This standard requires only that there be substantial nexus between the state and the person *or* the state and the property *or* the state and the transaction. Nothing in this standard suggests that only the state in which the transfer of title or possession occurs may tax the transaction.

15. Rather, in *Wayfair*, the Supreme Court expressly noted that this substantial nexus requirement is met simply when a taxpayer “avails itself of the substantial privilege of carrying on business in that jurisdiction.” *Id.* at 2099 (internal quotation marks and citations omitted). Therefore, as was the case in *Wayfair*, this standard is met even when there is only a sufficient connection between a state and the property subject to the transaction being taxed.

16. Here, there was a sufficient connection between both North Carolina and Petitioner, through its resident sales representative in North Carolina, and North Carolina and the printed materials’ delivery into and use, storage, and consumption in North Carolina. In addition to shipping tangible personal property directly into this State, far in excess of the \$100,000 threshold contemplated in *Wayfair*, Petitioner had a physical presence by way of its sales representative located in North Carolina.

17. Moreover, to the extent that any such nexus with the state is required between both the person and the transaction, the holding in *Wayfair* implies that such a requirement is met even when the destination of the tangible personal property that is the subject of the transaction is the sole connection between the state seeking to impose a tax and the transaction. In this case, it is undisputed that the printed materials in the sales at issue were delivered directly to North Carolina. Accordingly, North Carolina was well within its rights under the Due Process Clause and the Commerce Clause to impose sales tax on these transactions in which the printed materials were shipped directly to North Carolina for storage, use, and consumption in this State.

18. Because Petitioner was a retailer with a constitutional nexus to North Carolina and the sales at issue were properly sourced to this State, Respondent correctly and constitutionally assessed Petitioner for unpaid sales tax on the sales at issue.

II. The Sales at Issue Were Properly Sourced to North Carolina

19. Sourcing is used to assign a location for where a transaction occurred, so that it may be taxed in the appropriate jurisdiction. North Carolina is a classic destination-based sales and use tax state as set forth in N.C. Gen. Stat. § 105-164.4B. In a destination-based sales and use tax state, a sale is sourced to, to deemed to have occurred in, the location where the product is delivered.

20. North Carolina had two relevant provisions under its sourcing statute that apply to the sales at issue. First, N.C. Gen. Stat. § 105-164.4B(a)(2) specifically stated that: “When a purchaser receives a product at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser receives the product.”

21. Second, N.C. Gen. Stat. § 105-164.4B(d)(2)(b) applied to direct mail and stated that direct mail was “sourced to the location where the property is delivered” when “the purchaser provides the seller with information to show the jurisdictions to which the direct mail is to be delivered.”

22. The undisputed facts show that Petitioner shipped the sales at issue directly to customers located in North Carolina or directly to third-party recipients in North Carolina based on mailing lists provided by its customers. The shipments directly to customers, without contention, fall within N.C. Gen. Stat. § 105-164.4B(a)(2) as sourced to North Carolina because North Carolina was the location where the customers received the printed materials.

23. Regarding shipments to third-party recipients, those shipments fall squarely within N.C. Gen. Stat. § 105-164.4B(d)(2)(b) because the customers provided Petitioner, via the mailing lists, the information showing the jurisdictions to which the printed materials were to be delivered. In the case of the sales at issue, those were all delivered to North Carolina.

24. Based upon the application of the above statutes to the undisputed facts, Respondent properly sourced the sales at issue delivered directly to the customers in North Carolina to the “location where the purchaser receive[d] the product,” which was North Carolina. N.C. Gen. Stat. § 105-164.4B(a)(2). Respondent also correctly sourced the portion of the sales at issue that were shipped directly to third-party recipients, *i.e.*, direct mail, “to the location where the property [was] delivered,” which was also North Carolina, because “the purchaser provide[d] the seller with information to show the jurisdictions to which the direct mail is to be delivered,” which were all in North Carolina. N.C. Gen. Stat. § 105-164.4B(d)(2)(b).

25. The sales at issue were therefore properly sourced to North Carolina, and Petitioner was required to remit tax on those transactions.

26. Applying the plain language of the applicable sales tax statutes set forth *supra*, Petitioner had a constitutional nexus with North Carolina and made taxable sales of tangible personal property to North Carolina but failed to collect and remit sales tax on these sales during the period at issue. Respondent did not deprive Petitioner of property when it issued its Notice of Final Determination, and did not exceed its jurisdiction, did not act erroneously and did not fail to act as required by law or rule in issuing the Notice of Final Determination.

27. As there was no genuine issue of material fact and because Respondent's proper application of the applicable sales tax statutes resulted in the sales at issue being taxable in North Carolina, Respondent is entitled to summary judgment as a matter of law.

FINAL DECISION

Since there is no genuine issue of material fact and Respondent is entitled to summary judgment as a matter of law, the undersigned hereby **GRANTS** Respondent's Motion for Summary Judgment, pursuant to Rule 56 of the North Carolina Rules of Civil Procedure, N.C. Gen. Stat. § 1A-1, and hereby **DISMISSES** this contested case with prejudice.

NOTICE OF APPEAL

This is a Final Decision issued under the authority of N.C. Gen. Stat. § 150B-34.

Under the Administrative Procedure Act of North Carolina, N.C. Gen. Stat. § 150B-1 *et. seq.*, and N.C. Gen. Stat. § 105-241.16, any party aggrieved by the Final Decision may seek judicial review by filing a Petition for Judicial Review in the Superior Court of Wake County and in accordance with the procedures for a mandatory business case set forth in N.C. Gen. Stat. § 7A-45.4(b) through (f). **Before filing a petition for judicial review, a taxpayer must pay the amount stated in the Notice of Final Determination, plus applicable interest, which continues to accrue until the tax is paid.** N.C. Gen. Stat. § 105-241.21.

The party seeking review must file the petition within 30 days after being served with a written copy of the Final Decision. In conformity with 26 N.C. Admin. Code 3.0102, which incorporates the provisions of electronic service as defined in 26 N.C. Admin. Code 3.0501, **the Certificate of Service attached to this Final Decision shows the date of service on the parties.**

N.C. Gen. Stat. § 150B-46 describes the contents of the Petition for Judicial Review and requires service of the petition on all parties. Because the Office of Administrative Hearings is required to file the official record in the contested case under

review, the party seeking judicial review must send a copy of the Petition for Judicial Review to the Office of Administrative Hearings when the judicial review is initiated.

This the 24th day of June, 2020.



Melissa Owens Lassiter
Administrative Law Judge

CERTIFICATE OF SERVICE

The undersigned certifies that, on the date shown below, the Office of Administrative Hearings sent the foregoing document to the persons named below at the addresses shown below, by electronic service as defined in 26 NCAC 03 .0501(4), or by placing a copy thereof, enclosed in a wrapper addressed to the person to be served, into the custody of the North Carolina Mail Service Center who subsequently will place the foregoing document into an official depository of the United States Postal Service:

Michael J Bowen
Akerman LLP
50 N Laura St Ste 3100
Jacksonville FL 32202
Attorney For Petitioner

Douglas W. Hanna
Graebe Hanna & Sullivan, PLLC
dhanna@ghslawfirm.com
Attorney For Petitioner

Matthew Hammond Sommer
North Carolina Department of Justice
msommer@ncdoj.gov
Attorney For Respondent

David D Lennon
North Carolina Department of Justice
dlennon@ncdoj.gov
Attorney For Respondent

Terence D Friedman
N.C. Department of Justice - Attorney General's Office
tfriedman@ncdoj.gov
Attorney For Respondent

This the 24th day of June, 2020.



Jerrod Godwin
Administrative Law Judge Assistant
N.C. Office of Administrative Hearings
1711 New Hope Church Road
Raleigh, NC 27609-6285
Phone: 919-431-3000

STATE OF NORTH CAROLINA
COUNTY OF ROBESON

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
21 DHR 04830

Cottonwood Pre-Elementary Inc., Petitioner, v. N.C. Department of Health and Human Services, Division of Child Development and Early Education, Respondent.	ORDER FOR DISMISSAL
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THIS MATTER comes on a Motion to Dismiss for Late Filing (the “Motion”) filed by Respondent, North Carolina Department of Health and Human Services, Division of Child Development and Early Education, on November 22, 2021, in the Office of Administrative Hearings (“OAH”). Respondent filed the Motion seeking dismissal of this contested case on the grounds that Petitioner, Cottonwood Pre-Elementary, Inc., untimely filed the petition for a contested case hearing (the “Petition”). All parties having been given an opportunity to be heard, the Motion is therefore ripe for adjudication.

Having carefully considered the Motion and other matters of record, the Undersigned GRANTS the Motion for the reasons explained below.

PARTIES

For Petitioner: Steven C. Lawrence
Anderson, Johnson, Lawrence & Butler, L.L.P.
slawrence@andersonjohnson.com

For Respondent: Stacy L. Hannah
Associate Attorney
N.C. Department of Justice
shannah@ncdoj.gov

ISSUE

Whether this contested case must be dismissed in its entirety for being untimely filed.

FINDINGS OF FACT

The Undersigned makes the following Findings of Fact:

1. Respondent issued a Special Provisional License (the “License”) to Petitioner on October 7, 2021. The License was sent to Petitioner at its last known address, via certified mail, on October 8, 2021. The License was available at Petitioner’s post office box location on October 12, 2021. It was signed for by an employee of Petitioner on October 18, 2021.

2. Included in the mailing to Petitioner was a formal notice of Petitioner’s right to appeal Respondent’s administrative action by filing a petition with OAH within 30 days of the date the License was mailed.

3. Thirty days from the mailing date was Sunday, November 7, 2021, and thus effectively November 8, 2021. N.C. Gen. Stat. § 1A-1, Rule 6(a).

4. The Petition was placed in the mail on November 9, 2021 and received and filed by OAH on November 10, 2021.

5. On November 22, 2020, Respondent filed a motion to dismiss pursuant to North Carolina General Statute §§ 1A-1, Rule 12(b)(1), 110-94, 150B-23, and 150B-33, and the Doctrine of Sovereign Immunity, on the grounds that the Petition was untimely filed, thus depriving the tribunal of subject matter jurisdiction.

6. On December 2, 2021, Petitioner filed a response to the motion to dismiss (“Petitioner’s Response”) alleging that the Petition was timely filed.

7. On December 10, 2021, Respondent filed a reply to Petitioner’s Response.

CONCLUSIONS OF LAW

Based on the forgoing Findings of Facts, the Undersigned makes the following Conclusions of Law:

1. Chapter 150B of the North Carolina General Statutes, commonly known as the Administrative Procedures Act, allows a person aggrieved by an administrative decision to commence a contested case at OAH. N.C. Gen. Stat. § 150B-1 *et. seq.*

2. If “another statute...sets a time limitation for the filing of a petition in contested cases against a specified agency” the other statute controls. N.C. Gen. Stat. § 150B-23(f). North Carolina General Statute § 110-94 provides for a 30-day time limit for childcare contested cases and thus controls this contested case.

3. The limitations period “commences when notice is given of the agency decision to all persons aggrieved who are known to the agency by personal delivery or by the placing of the notice in an official depository of the United States Postal Service wrapped in a wrapper addressed to the person at the latest address given by the person to the agency.” N.C. Gen. Stat. § 150B-23(f). The period ends on the day petition is filed with OAH. *Id.*

4. The Petition was filed for this purpose when it was placed in the care and custody of the OAH Chief Clerk. 26 N.C.A.C. § 3.0102 and *Gummels v. N.C. Dept. of Human Resources*, 98 N.C. App. 675, 678 (1990).

5. The undisputed evidence demonstrates that the Petition was filed 2 days after the 30-day time period, set forth in Section 110-94 and calculated as described in Section 150B-23(f), ended. However, Petitioner argues that the time of notice for the commencement of the 30-day period is not controlled by Section 150B-23(f), but by Sections 150B-23(c) and 1A-1, Rule 4. Rule 4 provides that “notice,” for the purposes of summonses in civil actions before the Superior and District Courts, begins upon proof of receipt of the summons. Rule 4(j)(1).

6. Petitioner is mistaken that Rule 4 applies to the filing of the Petition. Section 150B-23(c) describes the time of notice for the hearings described in Section 150B-23(b). “The time when notice is given of the agency decision” for the purpose of determining when the time limitation for the filing of the Petition commenced, is found in Section 150B-23(f).

7. Petitioner asserts that the right to a 30-day notice period contained in Section 110-94 cannot be shortened, in practice, by the application of Section 150B-23(f), because the language of Section 110-94 is clear and unambiguous. However, “[s]tatutes dealing with the same subject matter must be construed in *pari materia*, as together constituting one law, and harmonized to give effect to each.” *Williams v. Williams*, 299 N.C. 174, 180–81 (1980). This maxim of statutory construction unquestionably applies in the case at hand. Section 110-94 cites Section 150B-23, thus leaving no doubt that the legislature was aware that the latter section would have the effect of allowing childcare facility operators less than 30 days from actual notice to file an appeal. The legislative intent that Section 150B-23(f) govern the calculation of the date by which Petitioner must have filed the Petition could not be clearer.

8. Petitioner alleges that commencing the 30-day period when the agency action is mailed constitutes “a violation of the ‘equal protection clauses’ provided under both the State and Federal Constitutions.” Response p. 3. The tribunal, as a creature of the General Assembly, does not have the power to declare statutes unconstitutional. To the extent that Petitioner seeks this remedy, its claim constitutes a facial constitutional challenge, over which the tribunal has no jurisdiction.

9. However, Petitioner complains that facilities in Raleigh have “a much longer time period in which to Appeal the Notice of Violation” than those “further removed from Raleigh, such as Cottonwood.” Response, p. 3. The tribunal interprets this as an “as applied” constitutional challenge. Such a challenge does not seek the nullification of the statute complained of, only asks for relief from the application of the statute for the party before the court upon a showing that the statute, as applied to that party, violates the higher law of the North Carolina or United States Constitution. Such a determination furthers the intent of the legislature that its laws be enforced in an equitable manner.

10. Petitioner assumes that childcare facilities located away from Raleigh will have shorter periods in which to file a petition with OAH, on average, because the mail will have to travel a longer distance. Petitioner wrongly concludes, based on this reasonable assumption, that

the possibility of this shorter period after actual notice denies Petitioner equal protection under the law, guaranteed by the North Carolina and United States Constitutions.

11. The tribunal may agree that it is unwise of the legislature to subject the citizens of this State to the fortunes of delivery by the United Postal Service. However, in the case before the tribunal, Petitioner had a period of 27 days, from October 12, 2021 to November 8, 2021, to file the Petition after the Special License was delivered to Petitioner's post office. Petitioner had 20 days after picking up the Special License from the post office. Neither period is an unreasonably short period of time for accomplishing the filing of the Petition. Given that Petitioner was accorded a reasonable period of time to accomplish securing its right to an appeal, Petitioner has not demonstrated a clear and plain violation of its constitutional guarantee to equal protection under the law.

12. Finally, Petitioner complains that Respondent acted arbitrarily in "establishing response dates starting with actual Notice to the facility provider" and then imposing a different "triggering date for response." Response, p. 5. This statement is incorrect. The governing statute, not Respondent, determined the beginning of the period for filing the Petition. It is within Respondent's discretion to define "notice" differently for the running of limitation periods it affords Petitioner than the definition used for the filing of petitions with OAH.

13. The untimely filing of the Petition precludes OAH from acquiring subject matter jurisdiction over this case. *Gray v. N.C. Dept. of Environment and Natural Resources*, 149 N.C. App. 374, 378 (2002) ("timely filing of a petition is necessary to confer subject matter jurisdiction") and *Gummels*, 98 N.C. App. 675 (upholding an ALJ's dismissal of a contested case where petitioner filed the petition for a contested case hearing one day after the statutory deadline).

14. In light of the foregoing, the Undersigned concludes that Respondent's Motion must be granted as the tribunal lacks jurisdiction over Petitioner's claim.

FINAL DECISION

IT IS THEREFORE ORDERED that Respondent's Motion to Dismiss is **GRANTED** and this contested case is **DISMISSED WITH PREJUDICE**.

NOTICE OF APPEAL

This is a Final Decision issued under the authority of N.C. Gen. Stat. § 150B-34.

Under the provisions of North Carolina General Statute § 150B-45, any party wishing to appeal the final decision of the Administrative Law Judge must file a Petition for Judicial Review in the Superior Court of the county where the person aggrieved by the administrative decision resides, or in the case of a person residing outside the State, the county where the contested case which resulted in the final decision was filed. **The appealing party must file the petition within 30 days after being served with a written copy of the Administrative Law Judge's Final Decision.** In conformity with the Office of Administrative Hearings' rule, 26 N.C. Admin. Code 03 .0102, and the Rules of Civil Procedure, N.C. General Statute § 1A-1, Article 2, **this Final**

Decision was served on the parties as indicated by the Certificate of Service attached to this Final Decision. N.C. Gen. Stat. § 150B-46 describes the contents of the Petition and requires service of the Petition on all parties. Under N.C. Gen. Stat. § 150B-47, the Office of Administrative Hearings is required to file the official record in the contested case with the Clerk of Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be sent to the Office of Administrative Hearings at the time the appeal is initiated in order to ensure the timely filing of the record.

IT IS SO ORDERED.

This the 15th day of December, 2021.



Linda F. Nelson
Administrative Law Judge

Filed

STATE OF NORTH CAROLINA 2011 AUG 22 PM 5:28 IN THE OFFICE OF
COUNTY OF WAKE Office of ADMINISTRATIVE HEARINGS
Administrative Hearings 11 REV 3547

THE KIMBERLY RICE KAESTNER,
1992 TRUST,
Petitioner,

v.

NORTH CAROLINA DEPARTMENT
OF REVENUE
Respondent.

FINAL DECISION
ORDER OF DISMISSAL

THIS CAUSE comes forward before the undersigned Administrative Law Judge, Augustus B. Elkins II, on Respondent's Motion to Dismiss. The Respondent is represented by Assistant Attorney General Peggy S. Vincent. The Petitioner is represented by attorney Thomas D. Myrick.

The Motion seeks to dismiss Petitioner's challenges on the grounds that the claims alleged and relief sought by Petitioner against the Respondent exceeds the jurisdiction of the Office of Administrative Hearings. Having considered the Motion to Dismiss filed by the Respondent and the Prehearing Statement filed by the Petitioner, and upon review of the entire record, the Undersigned finds that the Respondent's Motion and matters contained therein are now ripe for disposition.

FINDINGS OF FACT

1. Respondent issued a Final Determination which denied Petitioner's claims for refunds of individual income taxes for tax years 2005, 2006, 2007, and 2008.

2. Petitioner filed a Petition for Contested Case Hearing challenging the constitutionality of the enactment of N.C. Gen. Stat. § 105-160.2.

3. Petitioner contends that the tax imposed under the Income Tax Act for Estates, Trusts and Beneficiaries violates the Due Process Clause and Commerce Clause of the United States Constitution and Article I, § 19 of the North Carolina Constitution.

CONCLUSIONS OF LAW

1. Administrative tribunals only have such authority as is properly conferred upon them by the Legislature. State ex rel. Utilities Comm'n v. Carolina Utility Customers Ass'n, Inc., 336 N.C. 657, 446 S.E.2d 332 (1994); Meads v. N.C. Dep't of Agriculture, 349 N.C. 656, 509 S.E.2d 165 (1998). It is a well-settled rule that a statute's constitutionality shall be determined by the judiciary and not an administrative tribunal. Meads, 349 N.C. at 670-676, 509 S.E.2d at 174-178.
2. Because the Office of Administrative Hearings lacks jurisdiction over constitutional claims, there are no set of facts upon which it can grant relief in this case.
3. Where it is obvious that the Court lacks the authority to hear a matter, the Court is precluded from exercising its jurisdiction and is therefore obliged to dismiss the case. Lovern v. Edwards, 190 F.3d 648 (4th Cir.1999).
4. The constitutional claims in Petitioner's Petition are subject to dismissal pursuant to N.C. Gen. Stat. §§ 150B-33, 150B-36, and N.C. Gen. Stat. § 1A-1, Rule 12(b), because the Office of Administrative Hearings lacks jurisdiction to determine constitutional claims and for the failure of the Petitioner to state a claim upon which the Office of Administrative Hearings could grant relief.
5. If Petitioner seeks to pursue a remedy in the judiciary on the constitutional claims, Petitioner need not pursue any further administrative remedies as they will be deemed inadequate and exhaustion thereof will not be required. Shell Island Homeowners Ass'n v. Tomlinson, 134 N.C. App. 217, 517 S.E.2d 406 (1999).

BASED UPON the foregoing Findings of Fact and Conclusions of Law the Undersigned makes the following:

FINAL DECISION

NOW, THEREFORE, based on the foregoing, the Undersigned hereby finds proper authoritative support of the Conclusions of Law noted above and grants the Respondent's Motion to Dismiss the whole of the Petition brought by Petitioner. The North Carolina Office of Administrative Hearings lacks jurisdiction to hear and render the requested relief in this matter. It is hereby ORDERED that this contested case be DISMISSED with prejudice.

NOTICE REGARDING THIS FINAL DECISION, ORDER OF DISMISSAL

Pursuant to the provisions of NORTH CAROLINA GENERAL STATUTES Chapter 150B, Article 4, any party wishing to appeal the final decision of the Administrative Law Judge may commence such appeal by filing a Petition for Judicial Review in the Superior Court of Wake County or in the Superior Court of the county in which the party resides. The party seeking review must file the petition within 30 days after being served with a written copy of the Administrative Law Judge's Decision and Order. N.C. GEN. STAT. § 150B-46 describes the contents of the Petition and requires service of the Petition on all parties. Pursuant to N.C. GEN. STAT. § 150B-47, the Office of Administrative Hearings is required to file the official record in the contested case with the Clerk of Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be sent to the Office of Administrative Hearings at the time the appeal is initiated in order to ensure the timely filing of the record.

FURTHER NOTICE AND ORDER

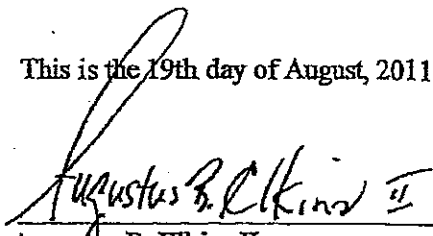
The taxpayer commenced a contested case at the Office of Administrative Hearings and the Office of Administrative Hearings has hereby dismissed the contested case petition for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute.

Pursuant to N.C. Gen. Stat. § 105-241.17 (if all of the conditions in the section are met), Petitioner may bring a civil action within two years of the date of this dismissal in the Superior Court of Wake County to determine Petitioner's liability, if any.

This is a Final Decision pursuant to N.C. GEN. STAT. § 150B-36(c).

IT IS SO ORDERED.

This is the 19th day of August, 2011.


Augustus B. Elkins II
Administrative Law Judge

FILED

STATE OF NORTH CAROLINA

2011 MAY -4 PM 12:35

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
11 REV 3547

COUNTY OF WAKE

THE KIMBERLY RICE KAESTNER
1992 TRUST,

Petitioner,

v.

NORTH CAROLINA DEPARTMENT
OF REVENUE,
Respondent.

RESPONDENT'S MOTION
TO DISMISS IN LIEU OF
PRE-HEARING STATEMENT

NOW COMES Respondent, the North Carolina Department of Revenue ("Department"), and moves the Court to dismiss the petition in its entirety. This motion is made pursuant to N.C. Gen. Stat. § 1A-1, Rule 12(b)(1) for lack of subject matter jurisdiction. In particular, Respondent contends the petition should be dismissed for the following reasons:

1. The Department issued a Final Determination which denied Petitioner's claims for refunds of individual income taxes for tax years 2005, 2006, 2007 and 2008.

2. Before this tribunal, Petitioner challenges the constitutionality of the enactment of N.C. Gen. Stat. § 105-160.2.

3. N.C. Gen. Stat. § 105-160.2 establishes a tax on trusts "computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State".

4. Petitioner contends that the Act violates the Due Process Clause and Commerce Clause of the United States Constitution and Article I, § 19 of the North Carolina Constitution.

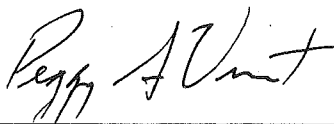
5. Administrative agencies, such as OAH, do not have subject matter jurisdiction over constitutional issues. *Great American Insurance Co. v. Gold*, 254 N.C. 168, 173, 118 S.E.2d 792, 796 (1961), *overruled on other grounds by Smith v. State*, 289 N.C. 303, 222 S.E.2d 412 (1976); *see also Johnston v. Gaston County*, 71 N.C. App. 707, 713, 323 S.E.2d 381, 384 (1984) ("Constitutional claims will not be acted upon by administrative tribunals."). Rather, the question of the constitutionality of a statute is for the judicial branch. *Great American Insurance*, 254 N.C. at 173, 118 S.E.2d at 796.

6. This tribunal therefore lacks subject matter jurisdiction over Petitioner's constitutional challenges to the Act, and its petition must be dismissed pursuant to N.C. Gen. Stat. § 1A-1, Rule 12(b)(1).

WHEREFORE, Respondent prays this Court to dismiss Petitioner's petition in its entirety under N.C. Gen. Stat. § 1A-1, Rule 12(b)(1), for lack of subject matter jurisdiction. Respondent also prays the Court to order that Petitioner is entitled to no costs or attorneys' fees.

Respectfully submitted, this the 2nd day of May, 2011.

ROY COOPER
Attorney General



Peggy S. Vincent
Assistant Attorney General
N.C. State Bar No. 16088
pvincent@ncdoj.gov
N.C. Department of Justice
Post Office Box 629
Raleigh, North Carolina 27602-0629
Telephone: (919) 716-6092
Fax: (919) 715-3550

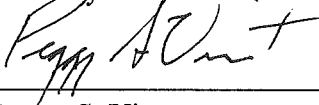
CERTIFICATION

The undersigned hereby certifies that she has this day served a copy of the foregoing Respondent's Motion to Dismiss In Lieu of Pre-Hearing Statement upon the persons indicated below by depositing same in the United States mail, postage prepaid, addressed as follows:

Thomas D. Myrick
Moore & Van Allen, PLLC
Bank of America Corporate Center
100 North Tryon Street, Floor 47
Charlotte, NC 28202

This the 2nd day of May, 2011.

ROY COOPER
Attorney General



Peggy S. Vincent
Assistant Attorney General