

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
20 REV 04215

<p>Philip Morris USA Inc Petitioner,</p> <p>v.</p> <p>NC Department of Revenue Respondent.</p>	<p>FINAL DECISION GRANTING SUMMARY JUDGMENT FOR PETITIONER</p>
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THIS MATTER comes before the undersigned for consideration of Petitioner's Motion for Summary Judgment, filed with the Office of Administrative Hearings ("OAH") on September 3, 2021. Respondent filed a Response to Motion for Summary Judgment on September 13, 2021. A hearing on the Motion for Summary Judgment was held on September 22, 2021, in Raleigh, North Carolina. The parties agree that there is no genuine issue of material fact in dispute.

After careful consideration of the parties' written submissions and oral arguments, the undersigned **GRANTS** Petitioner's motion for summary judgment.

APPEARANCES

For Petitioner: Kay Miller Hobart
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Raleigh, North Carolina

For Respondent: Perry J. Pelaez
Special Deputy Attorney General
North Carolina Department of Justice
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SUMMARY JUDGMENT STANDARD

This tribunal is authorized to grant summary judgment. N.C. Gen. Stat. § 150B 34(e). The purpose of summary judgment is to bring litigation to an expeditious and efficient conclusion on the merits “where only a question of law on the indisputable facts is in controversy.” Summary judgment is 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(c) and 26 N.C. Admin. Code 03 .0101(b).

Summary judgment is “an extreme remedy and should be awarded only where the truth is quite clear.” *Lee v. Shor*, 10 N.C. App. 231, 233 (1970). “All inferences of fact . . . must be drawn against the movant and in favor of the party opposing the motion.” *Caldwell v. Deese*, 288 N.C. 375, 378 (1975). “[W]hen a moving party has met his burden of showing that he is entitled to an award of summary judgment in his favor, the non-moving party cannot rely on the allegations or denials set forth in [its] pleading, and must, instead, forecast sufficient evidence to show the existence of a genuine issue of material fact in order to preclude an award of summary judgment.” *Steele v. Bowden*, 238 N.C. App. 566, 577 (2014).

UNDISPUTED FACTS

Findings of fact are neither necessary nor desirable when granting a motion for summary judgment. *Hyde Ins. Agency, Inc. v. Dixie Leading Corp.*, 26 N.C. App. 138, 142 (1975). OAH decisions granting such motions need not include such findings. N.C. Gen. Stat. § 150B-34(e). This tribunal does not make findings of fact on motions for summary judgment; rather, the tribunal summarizes material facts it considers to be uncontested. *See, e.g., Vizant Techs., LLC v. YRC Worldwide, Inc.*, 373 N.C. 549, 551(2020). This tribunal summarizes the following undisputed facts in its legal analysis to provide context for its ruling:

1. Petitioner is a C corporation commercially domiciled in Virginia and authorized to do business in North Carolina. Petitioner is subject to the North Carolina Franchise Tax (the “Franchise Tax”).

2. At all times during the tax periods at issue in this case, Petitioner was wholly-owned by Altria Group, Inc., which is the parent of an affiliated group of corporations (the “Altria Group”).

3. During the tax periods at issue in this case, Petitioner borrowed money from and lent money to other members of the Altria Group, some of which were subject to the Franchise Tax and some of which were not.

4. On August 31, 2020, Respondent issued a Notice of Final Determination to Petitioner stating that Petitioner owed Franchise Tax liability, penalties, and interest (computed to August 31, 2020) of \$113,818 for the 2012 tax year, \$107,446 for the 2013 tax year, and \$123,730 for the 2014 tax year.

5. Following a 2016 audit, Respondent issued a proposed Notice of Final Determination to Petitioner stating that Petitioner understated its “capital stock base,” one of the three bases on which the Franchise Tax was annually levied during the years at issue. The alleged understatement resulted from Petitioner deducting from its capital stock base amounts borrowed from its affiliated corporations, as required by North Carolina General Statute § 105-122(b) and North Carolina Administrative Code, Title 17, Chapter 5B .1110.

6. Petitioner filed a timely request for review by Respondent. Petitioner agreed that Respondent’s add back of payables to Petitioner’s capital stock base was proper. However, Petitioner argued that Respondent must allow a deduction for receivables made to affiliated

corporations not doing business in North Carolina, even though the statute does not allow the deduction.

7. Respondent denied the deduction and issued the Notice of Final Determination on August 31, 2020.

8. Petitioner timely filed an appeal from the Notice of Final Determination with OAH on October 27, 2020.

9. On September 3, 2021, Petitioner filed a Motion for Summary Judgment. Respondent filed a response on September 13, 2021. A hearing on the Motion was held on September 22, 2021.

10. Responding to a request by this Tribunal for supplemental briefing, both parties filed supplemental briefs on November 15, 2021.

JURISDICTION

This tribunal has jurisdiction over contested tax cases pursuant to Sections 150B-22(b) and 105-241.15.¹ Generally, an administrative law judge (ALJ) is charged to “fully dispose of all issues required to resolve the case” before the judge. 26 N.C. Admin. Code 03. 0127(c).

However, as a creature of the General Assembly, the jurisdiction of OAH is limited. OAH was created by Section 7A-750, under Article III, § 11 and Article IV, § 3 of the North Carolina Constitution. OAH’s mission is to foster legislative intent by

ensuring that administrative decisions are made in a fair and impartial manner to protect the due process rights of citizens who challenge administrative action and to provide a source of independent administrative law judges to conduct administrative hearings ... and thereby prevent the commingling of legislative, executive, and judicial functions in the administrative process.

¹ References to Sections herein are to sections of the North Carolina General Statutes which were in effect during the years at issue.

N.C. Gen. Stat. § 7A-750. The General Assembly is without the power to delegate its authority to make or unmake laws. N.C. Const., Art. II, § 1 (“The legislative power of the State shall be vested in the General Assembly...”), and *Bulova Watch Co. v. Brand Distributors of N. Wilkesboro, Inc.*, 285 N.C. 467, 475 (1974). Thus, the “judicial powers” granted OAH cannot include the power to unmake a law by declaring a statute unconstitutional.

OAH’s limited jurisdiction regarding constitutional challenges is reflected in Section 105-241.17. That statute requires that a petitioner seeking a declaration that a tax statute is unconstitutional petition OAH for review and receive a dismissal of the action based on lack of jurisdiction before the petitioner can proceed to the Superior Court for adjudication of the claim. This tribunal is thus required, by this statute, to examine the constitutional claim made by Petitioner to determine if dismissal is appropriate “because the sole issue is the constitutionality of a statute.” N.C. Gen. Stat. § 105-241.17(3). The alternative to such a finding is the finding that the issue is the legality of “the application of a statute” to Petitioner. *Id.* In the latter case, this tribunal must issue a final decision. As discussed below, this tribunal holds that it has jurisdiction to render a final decision in this case because Petitioner has properly claimed that the sole issue in this case is the constitutionality of the statute at issue, as applied to Petitioner, alone.

INTRODUCTION

A. The Franchise Tax

The Franchise Tax is “a privilege or excise tax” levied exclusively on corporations.² N.C. Gen. Stat. § 105-122(a1). During the years at issue, corporations domiciled in North Carolina paid the Franchise Tax for the privilege of holding a corporate charter granted by the State. N.C. Gen.

² Only corporations (and limited liability companies that choose to be taxed as C corporations) are subject to the Franchise Tax. N.C. Gen. Stat. § 105-114(b)(2). There are no privilege taxes imposed on other entities by North Carolina for the right to engage in general business or hold a charter.

Stat. § 105-114(a) and (a1)(1). Corporations domiciled outside of North Carolina paid the Franchise Tax for the privilege of doing business in North Carolina. N.C. Gen. Stat. § 105-114(a1)(2). The Franchise Tax is imposed on a separate entity basis. Every member of an affiliated group of corporations, *i.e.*, those sharing common ownership, calculates its Franchise Tax liability separately.

B. The Adjustments to Capital Stock Base at Issue

During the years at issue, the Franchise Tax was calculated as a percentage of the greater of 1) a corporation's "capital stock base"; 2) 55% of the assessed value of the corporation's assets located in North Carolina; and 3) the value of the corporation's investment in tangible property in North Carolina. N.C. Gen. Stat. § 105-122(d).³ The Franchise Tax liability at issue in this case was calculated on the capital stock base.

The capital stock base is calculated by reference to the taxpayer's books and records, with certain adjustments required by Section 105-122(b). Two adjustments are relevant to this contested case. The first adjustment is to add back to the capital stock base amounts owed to affiliate corporations ("Affiliate Payables"). The other adjustment is to deduct from the capital stock base amounts owed to the corporation by affiliate corporations ("Affiliate Receivables"), but only to the extent that the Affiliate Receivables are not included in the affiliate debtor's capital stock base under the first adjustment. Petitioner claims the second adjustment's limitation to Affiliate Receivables owed by affiliates doing business in North Carolina discriminates against interstate commerce.

³ The resulting amount is then allocated to North Carolina using the same allocation formula as is used for the taxpayer corporation's income. N.C. Gen. Stat. § 105-122(c).

ISSUES

1. Whether the sole issue in this contested case is the constitutionality of the provision within Section 105-122(b) denying taxpayer corporations a deduction for Affiliate Receivables owed by corporations not doing business in North Carolina.

2. Whether Respondent's denying Petitioner a deduction of Affiliate Receivables owed by corporations not doing business in North Carolina constitutes discrimination against interstate commerce prohibited by the Commerce Clause of the U.S. Constitution.

DISCUSSION

A. Constitutional Challenges in Contested Tax Cases (Section 105-241.17)

Respondent argues that this tribunal must dismiss this contested case for lack of subject matter jurisdiction pursuant to Section 105-241.17, because Petitioner's claim must be treated as a claim that the statute is unconstitutional.⁴ Respondent's Response to Motion for Summary Judgment, pp. 7-8.

Petitioner asserts that this tribunal must consider Petitioner's constitutional challenge because Petitioner seeks only a ruling that the statute is unconstitutional as applied to Petitioner, not that the statute is unconstitutional on its face. Petitioner cites a single OAH decision involving an "as-applied" challenge in a contested tax case. *FirstCity Funding L.P v. NCDOR*, 09 Rev 5669 (2011). In that case, after first arguing that the ALJ was required to dismiss the constitutional challenge, Respondent acquiesced to the ALJ's ruling that he had jurisdiction because the claim

⁴"It is well settled that 'the courts of this State will avoid constitutional questions, even if properly presented, where a case may be resolved on other grounds.'" *Holdstock v. Duke University Healthcare Sys., Inc.*, 270 N.C.App. 267, 277 (2020), quoting *Anderson v. Assimos*, 356 N.C. 415, 416 (2002). The parties and this tribunal agree that the sole issue in this contested case is a constitutional question and that the dispute over the Notice of Final Determination cannot be resolved on other grounds.

was an as-applied constitutional challenge. Following the ALJ's recommendatory decision in favor of the petitioner, Respondent issued the final decision in favor of the petitioner.⁵

Respondent has not raised an objection to this tribunal's jurisdiction over as-applied challenges. Section 105-241.17(3)'s distinction between facial and as-applied challenges suggests that this tribunal must hear and decide cases involving claims alleging unlawful application of a statute to a petitioner by Respondent. Clearly, OAH has jurisdiction over disputes in which a petitioner asserts that Respondent "substantially prejudiced the petitioner's rights," N.C. Gen. Stat. § 150B-23(a), by the failure "to act as required by law." N.C. Gen. Stat. § 150B-23(a)(5). That jurisdiction is not defeated by the fact that the "required" law is the law of the U.S. Constitution, rather than a State statute. Therefore, this tribunal holds that if Petitioner has correctly characterized the issue in this contested case as an as-applied constitutional challenge, this tribunal must render a final decision.

B. Facial and As-Applied Constitutional Challenges

Petitioner maintains that Respondent's method of calculating the amount of Franchise Tax due from Petitioner, specifically denying the deduction for Affiliate Receivables owed by corporations not subject to the Franchise Tax, discriminates against interstate commerce in violation of the "dormant" Commerce Clause of the U.S. Constitution. Respondent asserts that this claim is a "facial" challenge that this tribunal must dismiss because Petitioner does not contend that the complained of provision of Section 105-122(b) is "generally enforceable."

The North Carolina Supreme Court described the two types of challenges as follows:

An as-applied constitutional challenge contests whether the statute can be constitutionally applied to a particular defendant, even if the statute is otherwise generally enforceable. *Frye v. City of Kannapolis*, 109 F.Supp 2d 436, 439 (M.D.N.C. 1999). A facial challenge maintains that no constitutional applications of the statute exist, prohibiting its enforcement in any context. *Id.* The

⁵ At the time *FirstCity* was decided, ALJs did not have final decision-making authority.

constitutional standards used to decide either challenge are the same. *Edwards v. District of Columbia*, 755 F.3d 996, 1001 (D.C. Cir. 2014).

State v. Packingham, 368 N.C. 380, 383 (2015), *rev'd and remanded on other grounds*, 137 S.Ct. 1730 (2017).

After holding that the statute at issue in the case before it was not unconstitutional on its face, the *Packingham* Court considered the defendant's claim as an as-applied challenge, stating "[a] statute that is constitutional on its face nevertheless may be unconstitutional as applied to a particular defendant." *Id.* at 392.

Respondent quotes the first sentence of the *Packingham* Court decision excerpted above to support its contention that an as-applied challenge is only proper where a petitioner can show that the provision complained of is otherwise generally enforceable.⁶ This tribunal is not convinced that Respondent correctly interprets that sentence.

The *Packingham* Court had two claims before it: the first, that the statute in question was facially unconstitutional, and the second, that the statute was unconstitutional as applied to the plaintiff. The Court first examined whether the complained-of statute was capable of general constitutional application before addressing the possibility of an as-applied violation. The Court stated that it would start with the facial claim. That analysis required a showing that "no constitutional applications of the statute exist." *Id.* at 383.

After determining that the statute was not unconstitutional on its face, the Court then analyzed the as-applied challenge. However, the Court did not state that an as-applied challenge

⁶ In response to this tribunal's questioning if the complained-of provision is generally enforceable, Petitioner described five situations where interstate affiliated group would not suffer the constitutional discrimination Petitioner claims for itself. Petitioner's Supplemental Brief, pp. 15-18. However, in none of those scenarios does the member of the interstate affiliate group doing business in North Carolina both calculate Franchise Tax based on its capital stock base calculation and have Affiliate Receivables from an affiliate corporation not doing business in North Carolina. Therefore, Petitioner could not describe a situation where the complained of provision could be applied constitutionally, if a court found it was unconstitutional as applied to Petitioner. This tribunal believes a facial challenge could be sustained in the Superior Court.

would be improper unless the statute was constitutional when applied in other circumstances. *Packingham* is silent on whether as-applied challenges *require* a showing of constitutional applications of the complained-of statute.

Elsewhere, the North Carolina Supreme Court has stated that the Court itself may choose to treat a complaint of unconstitutionality as an as-applied challenge, even where the statute might fail a facial challenge. In *State v. Grady*, 372 N.C. 509, 554 (2019), *on remand from* 135 S.Ct. 1368, the Court stated

while this directive [from the U.S. Supreme Court] could be interpreted as instructing us to address the facial constitutionality of the State’s SBM program...we address instead the constitutionality of the SBM program as applied to the narrower category...to which defendant belongs.”)[Brackets added].

As support for this statement, the Court cited *Bulova Watch Co.*, 285 N.C. 467. In that case, the Court pointedly refused to consider whether the statute at issue was generally constitutional in holding that the statute was unconstitutional as applied to the defendant. The *Bulova Watch Co.* Court stated:

when asked to determine the constitutionality of a statute, the Court will do so only to the extent necessary to determine that controversy. It will not undertake to pass upon the validity of the statute as it may be applied to factual situations materially different from that before it.

Id. at 472.

More recently, the North Carolina Supreme Court in *The Kimberley Rice Kaestner 1992 Fam. Trust v. NCDOR*, 371 N.C. 133, 138 (2018), *aff’d*, 139 S.Ct. 2213 (2019), commenting on the as-applied challenge before it, observed that in as-applied cases courts “look to whether the

statute is constitutional in the limited context of the facts of the case before [it]...” The Court did not question whether there were constitutional applications of the statute in question.⁷

Based on the precedents discussed above, this tribunal concludes that Petitioner may elect to proceed with a claim that Section 105-122(b) is unconstitutional as applied to Petitioner without having to show that the statute is generally enforceable. This tribunal therefore has jurisdiction and must render a final decision on the matter.

C. The Dormant Commerce Clause

The “dormant” Commerce Clause is a doctrine developed by the U.S. Supreme Court that bars States from imposing undue burdens (including tax burdens) on interstate commerce. Petitioner argues that, as applied to Petitioner, the denial of a deduction for Affiliate Receivables owed by affiliates not taxed by North Carolina violates the dormant Commerce Clause prohibition of discrimination against interstate commerce. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).⁸

The discrimination prohibited by the dormant Commerce Clause has been described in subsequent U.S. Supreme Court decisions as having two elements, *i.e.*, differential treatment of intrastate and interstate businesses **and** a burden on interstate business or a benefit to intrastate business. *E.g., Oregon Waste Systems, Inc. v. Dep. Of Env. Quality of State of Oregon*, 511 U.S. 93, 99 (1994) (“discrimination” simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”)

⁷ The Court may have dispensed with such an analysis since the case before it was a nexus case which is usually heavily facts and circumstances based. However, this tribunal finds it more likely that the Court’s silence reflects its belief that such a showing is not necessary to mount an as-applied challenge.

⁸ The challenges in *Complete Auto* and other cases discussed in this section were facial rather than as-applied constitutional challenges. That distinction is irrelevant to this discussion of whether Section 105-122(b) violates the dormant Commerce Clause as “[t]he constitutional standards used to decide either challenge are the same.” *Packingham*, 368 N.C. at 383.

By allowing Petitioner a deduction for Affiliate Receivables only if the debtor pays Franchise Tax, Section 105-122(b) denies Petitioner a deduction where the debtor is not incorporated in and does not do business in North Carolina. Such “differential treatment” based on the location of the debtor’s business in-state or out-of-state is clearly discrimination and is a violation of the dormant Commerce Clause if it burdens interstate business or benefits intrastate business.

Petitioner is denied deductions for some of its Affiliate Receivables, while a corporation that loans only to affiliates that do business in North Carolina can deduct all its Affiliate Receivables. The deduction for Affiliate Receivables is clearly needed to prevent double taxation where the debtor corporation is subject to the Franchise Tax, since a debtor corporation subject to the Franchise Tax must add back the receivables as Affiliate Payables in calculating its capital stock base. But limiting the deduction to Affiliate Receivables owed by debtor corporations subject to the Franchise Tax is not necessary to achieving the legislative intent to prevent double taxation or otherwise preserve the integrity of the Franchise Tax.

As Respondent points out, the Franchise Tax “is imposed on a separate entity basis” and “the separate impact to the debtor and creditor corporations must be examined independently.” Respondent’s Supplemental Brief, p. 2. That Petitioner’s debtor is not subject to Franchise Tax is no reason to deny Petitioner a deduction allowed all corporations that lend to North Carolina affiliates.

The complained-of provision of the Franchise Tax treats Petitioner differently based solely on the interstate element of its business. It burdens Petitioner by denying Petitioner deductions to reduce its tax liability which are allowed all corporations not doing interstate affiliate lending.

That is enough to support a holding that, as applied to Petitioner, the denial of the Affiliate Receivables deduction is a violation of the dormant Commerce Clause.

When calculating Petitioner's capital stock base for Franchise Tax liability purposes, therefore, Respondent may not apply the second half of the final sentence of Section 105-122(b), which reads: "to the extent that the debt has been included in the tax base of the parent, subsidiary, or affiliated debtor corporation reporting for taxation under the provisions of this section."

FINAL DECISION

NOW, THEREFORE, based on the foregoing, the undersigned holds as follows:

Petitioner be granted summary judgment that the Franchise Tax assessment is unconstitutional as applied to Petitioner to the extent that it reflects the denial of a deduction from its capital stock base for Affiliate Receivables owing from corporations not doing business in North Carolina. The Notice of Final Determination is hereby reversed and rescinded to the extent that it conflicts with the holding of this tribunal.

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.*, N.C. Gen. Stat. § 150B-45(a)(1), 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 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 03 .0102, which incorporates the provisions of electronic service as defined in 26 N.C. Admin. Code 03 .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.

IT IS SO ORDERED.

This the 30th day of December, 2021.



Linda F. Nelson
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.

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This the 30th day of December, 2021.



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