N.C. Dep't of Revenue v. Philip Morris USA, Inc., 2023 NCBC 33.

STATE OF NORTH CAROLINA

WAKE COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
22 CVS 1162

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

PHILIP MORRIS USA, INC.,

Respondent.

ORDER AND OPINION ON PETITION FOR JUDICIAL REVIEW AND PETITIONER'S MOTION TO STRIKE

1. THIS MATTER is before the Court on the North Carolina Department of Revenue's Petition for Judicial Review of a Final Agency Decision issued by the Office of Administrative Hearings ("OAH") in a contested tax case, as well as Petitioner's Motion to Strike. Central to the appeal is whether OAH had jurisdiction to render the decision below.

2. Because the Court determines that OAH did not have subject matter jurisdiction to determine the constitutionality of the statute at issue, the Court REVERSES the Final Agency Decision and REMANDS this matter with instructions to DISMISS the case on jurisdictional grounds.

North Carolina Department of Justice, by Ashley H. Morgan, for Petitioner North Carolina Department of Revenue[1].

[1] Ms. Morgan has since withdrawn as counsel for the Department. Taking her place is Tania X. Laporte-Reveron, Assistant Attorney General of the North Carolina Department of Justice.

Parker, Poe, Adams, & Bernstein LLP, by Kay H. Miller and Dylan Z. Ray, for Respondent Philip Morris USA, Inc.

Earp, Judge.

I. NATURE OF THE DISPUTE

3. Philip Morris USA, Inc. ("Philip Morris") is a corporation domiciled in Virginia and authorized to do business in North Carolina. It is one of an affiliated group of companies owned by Altria Group, Inc. ("Altria Group"). (R.16.)[2]

4. Philip Morris is required to pay an annual franchise tax for the privilege of doing business in this State. *See* N.C.G.S. § 105-122 (2012). For tax years 2012–14, Philip Morris used its "Capital Base" to calculate its franchise tax in accordance with Section 105-122(b).[3]

5. During the relevant period,[4] Section 105-122 specified that a corporation's Capital Base was to be calculated by first totaling the amount of the company's "issued and outstanding capital stock, surplus, and undivided profits." From that number, deductions were permitted for various liabilities, among them definite and accrued legal liabilities, declared dividends, depreciation reserves, accrued taxes, and reserves for certain environmental or recycling equipment. *Id.* § 105-122(b).

---

[2] Citations to the Official Record on Judicial Review, (ECF No. 15), are denoted as "R."

[3] Section 105-122(d)(2) provides that in order for a taxpayer to use its Capital Base to determine its franchise tax liability, the Capital Base calculated "shall not be less than fifty-five percent (55%) of the appraised value as determined for ad valorem taxation of all the real and tangible personal property in this State of each corporation nor less than its total actual investment in tangible property in this State."

[4] The statute has since been amended.

6. The adjustments were not limited to deductions, however. Relevant here, the statute required that "[e]very corporation doing business in the State which is a parent, subsidiary, or affiliate of another corporation" add to its capital stock, surplus, and undivided profits "all indebtedness owed [by it] to a parent, subsidiary, or affiliated corporation" (an "affiliate payable"). On the other hand, if the corporation loaned capital to its affiliate, the corporation could subtract from its Capital Base the amount of indebtedness owed to it (an "affiliate receivable")—but only "to the extent that the debt [was] included in the tax base of the parent, subsidiary, or affiliated debtor corporation reporting for taxation under the provisions of this section." In other words, in order for a corporation subject to North Carolina's franchise tax to deduct an affiliate receivable, the affiliate receiving the loan had to be subject to North Carolina's franchise tax. *See id.* § 105-122.

7. During the 2012–14 period, Philip Morris borrowed money from and loaned money to various affiliates of Altria Group. Some of these affiliates were subject to North Carolina's franchise tax, but others were not. (R.62–64.)

8. In 2016, the North Carolina Department of Revenue ("Department") conducted an audit of Philip Morris' franchise tax liability for the 2012–14 tax years. Philip Morris took the position during the audit that it should be able to deduct from its Capital Base any amounts it loaned to its affiliates, regardless of whether the debtors were subject to North Carolina's franchise tax. The Department rejected that position and determined that Philip Morris' deduction of these amounts from its

Capital Base had resulted in the underreporting of its tax liability for each of the audited years.[5] (R.10, 58, 62–64, 185.)

9. Following the audit, Philip Morris objected to the proposed assessment and requested further review. (R.9–13.) The company framed the issue for this Court's review in its brief as follows:

> [T]he Department calculated the 'affiliated indebtedness' component of the franchise tax base to require the addition of Philip Morris' intercompany 'payables' to all of its affiliates (the creditor corporations) regardless of whether the affiliates filed North Carolina franchise tax returns, but permitted a deduction for Philip Morris' intercompany 'receivables' from its affiliates (the debtor corporations) only if the affiliates were doing business in North Carolina and filing franchise tax returns.

(Respondent's Brief, ["Resp. Br."] 3, ECF No. 24.)

10. On 31 August 2020, the Department issued a Notice of Final Determination upholding its determination and assessing more than $300,000.00 in franchise taxes, penalties, and interest for tax years 2012, 2013, and 2014. (R.16–22.)

II. PROCEDURAL HISTORY

11. On 27 October 2020, Philip Morris filed a petition with the Office of Administrative Hearings ("OAH") challenging the tax assessment. (R.1.) In its subsequent motion for summary judgment in that proceeding, Philip Morris argued that Section 105-122(b)'s differing treatment of affiliate receivables, which turned on whether the affiliate was subject to North Carolina's franchise tax, violated the

[5] According to the Department, its determination was also based on adjustments made to Philip Morris' calculation of "Other Reserves," but Philip Morris objected only to the treatment of affiliated debt. (R.58, 19, 10–13.)

dormant commerce clause of the United States Constitution.[6] Therefore, Philip Morris argued that application of the statute to it was unconstitutional. (R.174–80.)

12. Citing Section 105-241.17 of the North Carolina General Statutes, the presiding administrative law judge ("ALJ") determined that OAH was required "to examine the constitutional claim made by [Philip Morris] to determine if dismissal is appropriate 'because the sole issue [was] the constitutionality of the statute.' " In addition, the ALJ determined that if the issue was "the application of [the] statute," OAH was required to issue a final decision. Conflating the two concepts, the ALJ then concluded, "this tribunal holds that it has jurisdiction to render a final decision in this case because [Philip Morris] has properly claimed that the sole issue in this case is the constitutionality of the statute at issue, as applied to Petitioner, alone." (R.241.)

13. But the tension between the ALJ's treatment of the case as one involving the application of the statute to Philip Morris as opposed to its constitutionality is evident in footnote 6 of the ALJ's opinion. There, the ALJ wrote: "In response to this tribunal's questioning if the complained-of provision is generally enforceable . . . 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." (R.245, n.6.) Nevertheless, the ALJ accepted Philip Morris'

[6] The so-called "dormant commerce clause" is a reference to an analysis used to determine whether state and local laws violate the U.S. Constitution because they place an undue burden on interstate commerce. *See, e.g.*, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

characterization of its challenge as one involving the application of Section 105-122 only to the company and proceeded to decide the case.

14. After determining that OAH had jurisdiction, the ALJ held that the statute as applied to Philip Morris was unconstitutional because it violated the dormant commerce clause. She found problematic the statute's differing treatment of affiliate indebtedness between companies that were subject to North Carolina's franchise tax and those that were not. To remedy the constitutional infirmity, the ALJ granted Philip Morris' motion for summary judgment and ruled that "[w]hen calculating [Philip Morris'] Capital Base for Franchise Tax liability purposes . . . [the Department] 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.' " (R.249.) The ALJ then reversed and rescinded the Department's Notice of Final Determination. (R.249.)

15. The Department petitions this Court for judicial review of the ALJ's decision. (*See* Petitioner's Brief, ["Pet. Br."] 1, ECF No. 19.) It also moves to strike exhibits that were not made part of the Record but that Philip Morris referenced and attached to its briefing on appeal to this Court. (*See* Mot. Strike, ECF No. 28.)

16. After filing the petition, the Department moved to bifurcate these proceedings so that the issue of OAH's jurisdiction to render the decision below would be addressed before the merits of the Department's appeal were considered. (Mot. Bifurcate, ECF No. 11.) The Court granted the Department's motion and entered a

Scheduling Order on 2 May 2022, requiring, as an initial matter, briefing and oral argument limited to the jurisdictional issue. (Order, ECF No. 18.) The Court has reviewed this briefing and conducted a hearing on 16 November 2022 at which both parties participated through counsel. The jurisdictional issue is now ripe for disposition.

III. STANDARD OF REVIEW

17. When conducting judicial review of a final agency decision, "the court shall determine whether the petitioner is entitled to the relief sought in the petition based upon its review of the final decision and the official record." N.C.G.S. § 150B-51(c). The court acts in an appellate capacity to determine whether the evidence supports the agency's findings of fact, whether the findings support the agency's conclusions of law, and whether the conclusions of law are proper statements and applications of the law. *See Mann Media, Inc. v. Randolph Cty. Planning Bd.*, 356 N.C. 1, 12–13 (2002). The Court may reverse or modify a final agency decision if the agency's findings, inferences, conclusions, or decision are:

> (1) In violation of constitutional provisions;
>
> (2) In excess of the statutory authority or jurisdiction of the agency or administrative law judge;
>
> (3) Made upon unlawful procedure;
>
> (4) Affected by other error of law;
>
> (5) Unsupported by substantial evidence admissible under G.S. §§ 150B-29(a), 150B-30, or 150B-31 in view of the entire record as submitted; or
>
> (6) Arbitrary, capricious, or an abuse of discretion.

N.C.G.S. § 150B-51(b).

18. Whether OAH had subject matter jurisdiction is a question of law that is reviewed *de novo*. *See* N.C.G.S. § 150B-51(b)(4), (c). Under the *de novo* standard of review, the court "considers the matter anew and freely substitutes its own judgment for that of the lower [tribunal]." *Midrex Techs. v. N.C. Dep't of Revenue*, 369 N.C. 250, 257 (2016) (cleaned up). The scope of the Court's review is limited to "the final decision and the official record." N.C.G.S. § 150B-51(c).

IV. ANALYSIS

19. The Department seeks to reverse the decision below and to reinstate its Final Determination assessing Philip Morris' franchise tax liability. The immediate question before the Court is whether OAH was the proper forum to decide a constitutional challenge to Section 105-122(b), or whether the appropriate course was for the ALJ to dismiss Philip Morris' petition for lack of jurisdiction. *See* N.C.G.S. § 105-241.17.

A. OAH Does Not Have Jurisdiction to Determine the Constitutionality of This Statute.

20. The Administrative Procedure Act's provisions establishing OAH's jurisdiction do not address challenges to the constitutionality of a tax statute. *See* N.C.G.S. § 150B-23. Instead, a taxpayer's standing to bring such a challenge is addressed in Section 105-241.17, which requires the taxpayer to meet the following conditions before filing a civil action challenging constitutionality in the Superior Court of Wake County:

(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[;] and

(5) The civil action must be filed within two years of the dismissal.

N.C.G.S. § 105-241.17 (1)–(5). Subpart three is at issue here.

21. The Department argues that OAH lacked subject matter jurisdiction to decide the constitutionality of Section 105-122(b) because OAH is not a court of general jurisdiction and therefore has limited power to adjudicate disputes. The Department observes that Section 150B-23, which delineates the issues subject to OAH's review, does not address a statute's constitutionality. Rather, Section 7A-45.4(b)(1) provides that the North Carolina Business Court, a court of general jurisdiction, is the designated forum to hear constitutional challenges to tax statutes brought pursuant to N.C.G.S. § 105-241.17. *See* N.C.G.S. § 7A-45.4(b)(1).

22. The Department is correct. Constitutional challenges to tax statutes are heard by the North Carolina Business Court. *See Forsythe v. N.C. Dep't of Revenue*, 2022 NCBC LEXIS 106, at *21 (N.C. Super. Ct. Sept. 9, 2022) (observing that a civil action under § 105-214.17 that challenges the constitutionality of a tax statute "can only proceed as a mandatory complex business case before a Business Court Judge").

However, to have standing to bring a civil action in which the sole issue is a tax statute's constitutionality, the taxpayer must first satisfy the statutory conditions in N.C.G.S. § 105-241.17, including the requirement that OAH dismiss the contested case petition for lack of jurisdiction. N.C.G.S. § 105-241.17(3).

23. This is where, as the Department argues, the ALJ misstepped. Even after twice recognizing that the sole issue in this case is the constitutionality of Section 105-122(b), (R.241, 243, n.4), the ALJ did not dismiss the case. Rather, she concluded that Philip Morris "may elect to proceed [before OAH] with a claim that Section 105-122(b) is unconstitutional as applied to [the company] without having to show that the statute is generally enforceable." (R.247.) Then, focusing on the portion of N.C.G.S. § 105-241.17(3) that excepts matters involving "application of a statute" from dismissal,[7] the ALJ concluded that an "as-applied" constitutional challenge is one that involves application of a statute and held that "[t]his tribunal . . . has jurisdiction and must render a final decision on this matter." (R.247.)

24. The Department contends that the ALJ wrongly interpreted the last seven words of Section 105-241.17(3) ("and not the application of a statute") in isolation, without considering the language of the statute as a whole. (Pet. Br. 8.) When read in context, the Department argues that the statute requires OAH to dismiss any case in which the sole issue is the constitutionality of a statute, regardless of whether the challenge to constitutionality is facial or as-applied. (Pet. Br. 8.)

---

[7] Section 105-241.17(3) provides: "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."

25. The Court agrees with the Department. Section 105-241.17 does not authorize OAH to examine whether a tax statute is unconstitutional on its face or as applied to a particular taxpayer when determining whether OAH has jurisdiction. If the sole issue is a constitutional challenge—any constitutional challenge—section 105-241.17 mandates that the matter is one for the courts. Indeed, our Supreme Court has made clear that "North Carolina courts have the authority and responsibility to declare a law unconstitutional," *Hart v. State*, 368 N.C. 122, 126 (2015), and that "a statute's constitutionality shall be determined by the judiciary, not an administrative board," *In re Redmond*, 369 N.C. 490, 493 (2017) (citations omitted). *See also Great American Insurance Co. v. Gold*, 254 N.C. 168, 173 (1961) (the "question of constitutionality of a statute is for the judicial branch"); *cf. Emp. Sec. Comm'n v. Peace*, 128 N.C. App. 1, 8–9 (1997) ("OAH was established as part of the executive branch pursuant to N.C. Const. art. III, § 11, it is not a court[.]").

26. As the title and content of the statute makes plain, the overarching purpose of Section 105-241.17 is to venue constitutional challenges to tax statutes in the courts and leave to OAH a review of matters involving the technical misapplication of those statutes. The reference in Subsection 3 to "application of a statute," then, merely reflects an effort to distinguish misapplication challenges from constitutional ones—not facial constitutional challenges from those that are as applied.

27. The canons of statutory construction support the Court's conclusion. First, North Carolina law is clear that "[p]ortions of the same statute dealing with the same subject matter are to be considered and interpreted as a whole, and . . . every part of

the law shall be given effect if this can be done by any fair and reasonable intendment." *Huntington Props., LLC v. Currituck Cty.*, 153 N.C. App. 218, 224 (2002) (cleaned up); *see also In re Hardy*, 294 N.C. 90, 95–96 (1978) ("Words and phrases of a statute may not be interpreted out of context, but individual expressions must be construed as a part of the composite whole and must be accorded only that meaning which other modifying provisions and the clear intent and purpose of the act will permit.") (citations omitted); *State v. Tew*, 326 N.C. 732, 739 (1990) ("All parts of the same statute dealing with the same subject are to be construed together as a whole, and every part thereof must be given effect if this can be done by any fair and reasonable interpretation."). "Consequently, 'a provision will not be read in a way that renders another provision of the same statute meaningless.' " *State v. Daw*, 277 N.C. App. 240, 254 (2021) (quoting *Brown v. Brown*, 112 N.C. App. 15, 21 (1993)).

28. Further, our appellate courts have instructed that "[s]tatutes dealing with the same subject matter must be construed in pari materia, and harmonized, if possible, to give effect to each." *Hoffman v. Edwards*, 48 N.C. App. 559, 564 (1980) (citations omitted); *see also Carter-Hubbard Publ'g Co., Inc. v. WRMC Hosp. Operating Corp.*, 178 N.C. App. 621, 626 (2006) ("Statutes in *pari materia* must be harmonized, to give effect, if possible, to all provisions without destroying the meaning of the statutes involved.") (cleaned up).

29. Philip Morris' interpretation of section 105-241.17 violates these basic tenets. Viewing the statute as a whole, it is clear from its title ("Civil action challenging statute as unconstitutional") and first line ("[a] taxpayer who claims that

a tax statute is unconstitutional may bring a civil action in the Superior Court of Wake County") that it speaks to a taxpayer's standing to bring constitutional challenges. It then sets out the conditions a taxpayer must meet to proceed to court. Those conditions are designed to ensure the sole issue is a constitutional one. If OAH had jurisdiction to decide as-applied constitutional challenges, the legislature would have drafted section 105-241.17 to distinguish "as applied" from other constitutional challenges in its title, first line, and the initial clause of 105-241.17(3). That is not the case.

30. Moreover, harmonizing Sections 105-241.16 and 105-241.17 with Section 7A-45.4,[8] and giving effect to the words of each statute, the Court concludes that Philip Morris' interpretation of the final seven words is contrary to legislative intent. If OAH had jurisdiction to decide as-applied constitutional challenges, the legislature would have excluded "as applied" challenges from its mandate in Section 7A-45(b)(1) that the Business Court decide all constitutional challenges to tax statutes. It did not.

31. Furthermore, because the distinction between facial and as-applied constitutional challenges is not always clear,[9] basing a forum's jurisdiction on that

---

[8] Section 7A-45.4(b)(1) mandates that both appeals from contested tax cases pursuant to Section 105-241.16 and civil actions challenging the constitutionality of a tax statute be designated to the Business Court.

[9] To understand what an "as-applied" constitutional challenge is, it is helpful to contrast it to a facial challenge. The former term is used when the language of a statute, neutral on its face, has an unconstitutional effect when applied to particular circumstances. "An as-applied challenge to a statute contest[s] whether it 'can be constitutionally applied to a particular defendant, even if the statute is otherwise generally enforceable.' " *Kelly v. State*, 2022-NCCOA-675, at ¶ 21 (*quoting State v. Packingham*, 36 N.C 380, 383 (2015)). For example,

distinction would create fundamental uncertainty. As the Court of Appeals recently observed, "[t]here is no clear-cut test to distinguish facial challenges from as-applied challenges." *Kelly v. State*, 2022-NCCOA-675, at ¶ 23 (citing *Citizens United v. FEC*, 558 U.S. 310, 331 (2010)). In fact, "the line between facial and as-applied relief is a fluid one, and many constitutional challenges may occupy an intermediate position on the spectrum between purely as-applied relief and complete facial invalidation." *AFSCME Council 79 v. Scott*, 717 F.3d 851, 865 (11th Cir. 2013). The reality that this spectrum exists and that constitutional challenges do not always fall neatly into one category or the other supports vesting jurisdiction for constitutional challenges in the courts absent unequivocal instruction from the General Assembly. *See Great Am. Ins. Co.*, 254 N.C. at 173 ("Administrative boards have only such authority as is properly conferred upon them by the Legislature.").

Cryan v. Nat'l Council of YMCA of the United States, 280 N.C. App. 309 (2021), involved N.C.G.S. § 1-17(e), a statute allowing the victim of sexual abuse as a minor to bring an action for claims arising from that abuse within two years of the date the perpetrator was criminally convicted. Defendant argued that the statute*, as applied to it,* was unconstitutional because it would result in a revival of particular claims against it that had been barred by the statute of limitations prior to the enactment of section 1-17(e). The Court of Appeals determined that the challenge was not to the language of the statute itself, but rather that, as applied to the defendant's circumstances, the statute had an unconstitutional effect. *Id.* at 317.

In contrast, a facial challenge is one in which the language of the statute is constitutionally infirm and there is no application of the language that would be constitutional. "[A] facial challenge 'is an attack on the statute itself' rather than its application." *Kelly,* 2022-NCCOA-675, at ¶ 22 (quoting State v. Grady, 372 N.C. 509, at 522 (2019)). For example, in *State v. Lovette*, 233 N.C. App. 706 (2014), the defendant "contend[ed] that [a] new sentencing statute [was] erroneous as written because it 'vest[ed] the sentencing judge with unbridled discretion providing no standards[.]' " *Id.* at 715. The Court of Appeals concluded that the challenge was facial in nature "because defendant is arguing that no matter what the trial court's ultimate determination was, the new sentencing statute is unconstitutional because of the amount of discretion given to the trial court in making its determination." *Id.* at 716. Thus, the argument was over the language of the statute, not its application.

32. In short, neither the North Carolina Constitution nor the General Statutes anywhere vest OAH with jurisdiction to rule on the constitutionality of a tax statute. Indeed, the appellate case law is to the contrary. *See, e.g.*, *Central Telephone Co. v. Tolson*, 174 N.C. App. 554, 559 (2005) (holding that it was a "well-settled rule" that the former Tax Review Board "lacked the authority or jurisdiction to make a determination regarding the constitutionality of tax resulting from the application of [a tax statute]."); *cf. State ex rel. Utilities Comm'n v. Carolina Utilities Customers Ass'n*, 336 N.C. 657, 673 (1994) ("As an administrative agency created by the legislature, the [Utilities] Commission has not been given jurisdiction to determine the constitutionality of legislative enactments.") As the ALJ in the instant case aptly observed, "[t]he 'judicial powers' granted OAH cannot include the power to unmake a law by declaring a statute unconstitutional." (R.241.)[10]

33. A tribunal only has "the power to hear a case" when it has subject-matter jurisdiction. *Forsythe v. N.C. Dep't of Revenue*, 2022 NCBC LEXIS 106, *6 (quoting *Union Pac R.R. v. Bhd. of Locomotive Eng'rs & Trainmen Gen. Comm. of Adjustment*, 558 U.S. 67, 81 (2009)). Conversely, the lack of subject matter jurisdiction "divests the [tribunal] of any authority to adjudicate." *In re Z.T.B.*, 170 N.C. App. 564, 572 (2005). Because OAH lacked subject matter jurisdiction to decide the constitutionality of the tax statute at issue here, the ALJ's final decision is without

[10] Philip Morris cites OAH's final agency decision in *FirstCity Funding L.P. v. N.C. Dep't of Rev.*, OAH No. 09 REV 5669 (April 21, 2011) to contend that the Department has taken the position that OAH may decide as-applied constitutional challenges. However, a determination of whether a forum has jurisdiction is for the Court and does not turn on a party's conduct. *See In re T.R.P.*, 360 N.C. 588 (2006) ("Jurisdiction rests upon the law and the law alone. It is never dependent on the conduct of the parties.") (citation omitted).

legal effect. *See Monarch Tax Credits, LLC v. N.C. Dep't of Revenue*, 2021 NCBC LEXIS 9, at **16–17 (N.C. Super Ct. Jan. 25, 2021) ("[W]here a taxpayer challenges as unconstitutional the application of a tax statute to his own liability . . . an administrative remedy must first be pursued even if the constitutional challenge is the sole issue, and the administrative law judge is required to dismiss the contested case for lack of jurisdiction before a judicial challenge is ripe.").

34. The cases cited by Philip Morris to contend that the ALJ had jurisdiction to render the decision below were decided under different circumstances and, consequently, are unpersuasive. In *Quad Graphics, Inc. v. N.C. Dep't of Revenue*, Quad Graphics petitioned for judicial review of OAH's decision requiring it to pay sales tax on certain sales to North Carolina customers. The ALJ first determined that Quad Graphics was a "retailer" as defined by N.C.G.S. § 105-164.3(35)(a) and then found that the sales at issue were properly sourced to North Carolina under N.C.G.S. § 105-164.4B(a)(2) and § 105-164.4B(d)(2)(b). Despite acknowledging that she was "barred" from ruling on constitutional challenges, the ALJ nevertheless opined that the physical presence of Quad Graphic's sales representative in North Carolina created a sufficient constitutional nexus with the State to support the imposition of North Carolina's sales tax.

35. In its opinion reversing the ALJ's decision, the Business Court acknowledged that, by determining a constitutional issue, the ALJ had strayed beyond her jurisdiction. *See Quad Graphics, Inc. v. N.C. Dep't of Revenue*, 2021 NCBC LEXIS 56, at *5 n.6 (N.C. Super. Ct. June 23, 2021) ("It is well established

that in North Carolina, constitutional questions must be resolved by the courts and not by the State's administrative agencies."). The Court then analyzed whether OAH had misapplied the term "retailer" in the relevant tax statute. Concluding that the term had been applied correctly, the Court moved to Quad Graphic's argument that the Department's imposition of a sales tax in the circumstances presented violated the commerce clause of the United States Constitution. The Court began by determining that the challenge was to the manner in which the statute was applied to the particular taxpayer. It was not a facial challenge in which no constitutional application of the statute existed and its enforcement in any context was prohibited. *Id.* at *20–21.

36. The Court ultimately held that North Carolina did not have a "sufficient transactional nexus" with the sales at issue to impose a sales tax without violating the commerce clause and, therefore, that imposition of the sales tax on Quad Graphics was unconstitutional. *Id.* at *41. On appeal, the North Carolina Supreme Court disagreed, reversing the trial court's order and entering summary judgment for the Department. *Quad Graphics, Inc. v. N.C. Dep't of Revenue*, 382 N.C. 356 (2022).

37. Although the trial court ruled on the constitutionality of the tax statute as applied to Quad Graphics without first requiring OAH to dismiss the case for lack of jurisdiction under Section 105-241.17, *Quad Graphics* was not a case in which the "sole issue" to be decided was the constitutionality of a statute. The case concerned both misapplication and constitutional issues, and it reached this Court on an appeal from a summary judgment ruling that involved misapplication. Once vested with

jurisdiction, this Court decided the constitutional law issue. The Supreme Court's subsequent opinion centered on the Court's analysis of that issue, but it did not speak to OAH's jurisdiction to address the constitutional law issue in the first place. *Id.*

38. In *N.C. Dep't of Revenue v. Graybar Electric Company, Inc.*, another case relied upon by Philip Morris, the Department filed a petition for judicial review after OAH entered summary judgment for Graybar holding that (1) the Department had mischaracterized certain dividends for purposes of calculating the corporation's net economic loss ("NEL") deduction, and (2) a reduction of its NEL deductions was unconstitutional because it resulted in income being taxed twice. The Court first addressed the NEL deduction before turning to the constitutionality of the tax statute as applied to Graybar. Because it concluded that it was Graybar, not the Department, that had misapplied the statute, the Court reversed OAH's decision and entered summary judgment for the Department. *N.C. Dep't of Revenue v. Graybar Electric Company, Inc.*, 2019 NCBC LEXIS 2, at *23 (N.C. Super Ct. Jan. 9, 2019).

39. As for the constitutional law issue, the Court observed that, in light of the ALJ's application of the statute to Graybar, the ALJ had not deemed it necessary to weigh in on Graybar's constitutional argument, except to agree generally with Graybar's contention that the Department's position resulted in double taxation of the same income. Consequently, OAH did not render a decision based on the constitutionality of a tax statute and, therefore, the Business Court on appeal did not need to address OAH's jurisdiction to decide constitutional issues. Instead, the Court concluded that the "applied constitutional challenges" presented by the case were

properly before the Business Court because N.C.G.S. § 150B-51(d) afforded the Court the ability to enter any order allowed by Rule 56. *Id.* at *23–24. In that context, the Court then rejected Graybar's constitutional challenges to the statute as applied. *Id.* at *28.

40. As with *Quad Graphics*, *Graybar* presented both misapplication and constitutional issues. It reached the Business Court as a result of an appeal from a summary judgment ruling that involved misapplication. The Court therefore did not address OAH's jurisdiction to decide constitutional issues, and neither did the Supreme Court, which affirmed the Business Court's order and opinion *per curiam*. *N.C. Dep't of Rev. v. Graybar Elec. Co.*, 373 N.C. 382 (2020).[11]

41. The Court recognizes the expertise of OAH's adjudicators with respect to tax matters, and its decision in no way implies that these able public servants lack the ability to decide as-applied constitutional challenges to tax statutes. The Court decides only that the language of Section 105-241.17 does not enable them to do so. The bedrock constitutional principle mandating the separation of powers among the three branches of government counsels for a clear, unmistakable direction to this agency of the executive branch before it may be permitted to do the work of the other two branches of government. *See* N.C. Const. art. I, § 6 ("The legislative, executive,

---

[11] Other cases cited by Philip Morris in its brief to support the premise that OAH has jurisdiction to decide cases in which the sole issue is an "as applied" constitutional challenge were decided by OAH itself, limiting their persuasive effect. There is no indication that any of these cases were reviewed by a court. *See Cottonwood Pre-Elementary, Inc. v. N.C. Dep't of Revenue,* 2021 WL 6802992 (N.C.O.A.H. Dec. 15, 2021); *Mooresville Hospital Mgt. Assocs., Inc. v. N.C. Dep't of HHS*, 2002 WL 32002727 (N.C.O.A.H. Nov. 26 2002); *Watkins v. N.C. Dep't of HHS*, 2007 WL 4385665 (N.C.O.A.H. Aug. 7, 2007); *Valley Proteins, Inc. v. N.C. Dep't of Agriculture & Consumer Servs.*, 2020 WL 8613525 (N.C.O.A.H. Dec. 21, 2020).

and supreme judicial powers of the State government shall be forever separate and distinct from each other."). No such direction exists in Section 105-241.17.

42. To be sure, other states have delegated responsibility for addressing as-applied constitutional challenges to their administrative agencies, at least as a first step. Some limit the agency's role to development of the factual record. Others allow for an administrative determination of constitutionality, which is then subject to appeal to a court. However, in those states, unlike in North Carolina, the jurisdiction of the agency is expressly delineated by statute or in well-developed case law. *See, e.g.*, Code of Ala. § 40-2B-2(g)(6) ("The Alabama Tax Tribunal shall decide questions regarding the constitutionality of the application of statutes to the taxpayer . . . but shall not have the power to declare a statute unconstitutional on its face."); *Commonwealth v. DLX, Inc.*, 2001 Ky. LEXIS 59, at **6–7 ("Exhaustion of administrative remedies is not necessary when attacking the constitutionality of a statute or a regulation as void on its face. This is because an administrative agency cannot decide constitutional issues . . . [However,] exhaustion of administrative remedies is not futile to an as-applied challenge to a statute."); *Richardson v. Board of Dentistry*, 1995 Tenn. LEXIS 788, at ** 20 ("In cases in which a party challenges the application of a statute in a given situation, the Tennessee courts have acknowledged the agency's authority to resolve the issue before submitting the matter to judicial review."). Again, the difference between North Carolina and these states lies in the language of N.C.G.S. § 105-241.17.

B. The Constitutional Challenge to this Statute is Facial, Not As-Applied.

43. Even if North Carolina's OAH had jurisdiction to determine as-applied constitutional challenges as Philip Morris contends, OAH could not have decided this case because the challenge presented here is facial, not as-applied. The distinction is evident in the remedy the ALJ ordered. She did not find that the statute was misapplied and order that it be applied differently; instead, she ordered that the Department not apply the final clause of Section 105-122(b) to Philip Morris at all.

44. That clause permits a deduction from the taxpayer's Capital Base for affiliate receivables, but only "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." According to the ALJ, applying this portion of the statute to Philip Morris, which has both affiliates that are subject to North Carolina's franchise tax and those that are not, violates the dormant commerce clause because "[t]he complained-of provision of the Franchise Tax treats [Philip Morris] differently based solely on the interstate element of its business." (R.248.)[12]

45. The Department argues that prohibiting it from applying the statute as written prevents it from administering the tax statute, something the ALJ lacks the authority to order. (Pet. Br. 11.) The Department observes that nowhere in the ALJ's listed powers did the General Assembly afford the ALJ the ability to render a portion of a statute inoperable, *see* N.C.G.S. § 150B-33 (enumerating the powers of an administrative law judge), nor did the legislature vest the ALJ with authority to

[12] As stated above, the ALJ recognized that the challenge was a facial one in footnote 6 of her opinion.

order injunctive relief, *see* N.C.G.S. § 105-241.19 (action for injunction is not permitted). (Pet. Br. 12.) Instead, the Department contends that under Section 105-241.17, Philip Morris' exclusive mechanism to challenge the constitutionality of a tax statute is to institute a civil action in the Superior Court of Wake County. Before it can do so, however, OAH is required to review the case, determine that the sole issue is the constitutionality of a tax statute, and dismiss the case for lack of jurisdiction. (Pet. Br. 14.)

46. Philip Morris responds that it did not ask OAH to determine whether the statute was generally enforceable, only whether it was constitutional "as applied" to it. (Resp. Br. 17.) However, Philip Morris' decision to request a remedy limited only to itself does not transform a facial challenge into an as-applied one.[13] The forum's jurisdiction does not turn on the taxpayer's characterization of the issue. *See Kelly*, 2022-NCCOA-675, at ¶ 23 ("a court is not restricted per se by a party's categorization of its challenge as facial or as-applied and may conduct its own review to determine whether the party's challenge is facial or as-applied"); *cf. Islamic Cmty. Ctr. for Mid Westchester v. City of Yonkers Landmark Pres. Bd.*, 258 F. Supp. 3d 405, 415 (2017) (a trial court may determine if the plaintiff's claims are facial or as applied despite the plaintiffs' assertions). If that were so, simply by labelling a constitutional

[13] Despite characterizing the issue as an as-applied challenge, Philip Morris writes in its summary judgment brief below: "[The] differential treatment between corporations doing business in North Carolina and those not doing business in the state is the epitome of the discrimination prohibited by the Commerce Clause." (Pet. Brief Supp. Mot. SJ 1, R.171.) Thus, Philip Morris' argument is not that the statute was misapplied only to it, but that it would be constitutionally impermissible to apply it to any corporation. The words of the statute itself are being challenged, not the manner of its application to Philip Morris.

challenge as one of misapplication, a taxpayer would be able to carve out, only for itself, a remedy from which other corporations comparably situated would not benefit simply because they had yet to challenge the statute's constitutionality themselves. The result would be an undesirable patch-work quilt of tax law at the administrative level. Nothing in the statutory scheme suggests that such an undesirable result was the General Assembly's intent. *See Ayers v. Board of Adjustment*, 113 N.C. App. 528, 531 (1994) (in giving the ordinary meaning to the words of a statute, the Court should "avoid interpretations that create absurd or illogical results").

47. In sum, determinations regarding the constitutionality of this statute are the province of the judiciary, and this Court does not read Section 105-241.17 to distinguish as-applied challenges from that general principle. Even if it did, as reflected in the remedy ordered by the ALJ, this case presents a facial constitutional challenge, not an as-applied one. Accordingly, the Court REVERSES the Final Decision and REMANDS the matter to OAH with instructions to DISMISS the case for lack of subject matter jurisdiction.[14]

V. PETITIONER'S MOTION TO STRIKE

48. The Scheduling Order in this case required the parties to brief the issue of whether OAH had subject matter jurisdiction to render the decision below. Both parties submitted briefs with attached exhibits. Included in Philip Morris'

[14] In reaching this determination, the Court does not express an opinion regarding whether the tax statute in question is, or is not, constitutional. This is a determination for another day should Philip Morris opt to proceed as provided by statute.

submission were exhibits 13–16, which contain tax information about taxpayers that are not parties and that cover years not at issue in this case.

49. The Department complains that exhibits 13–16 were never introduced to the tribunal below and are not part of the official record filed with this Court. It moves to strike the exhibits as an improper unilateral attempt to expand the record. (Pet. Br. Mot. Strike 2–5, ECF No. 29.)

50. Philip Morris responds that the motion comes too late, and, in any event, supplementation of the record in this manner is permissible. It contends that the information contained in exhibits 13–16 did not exist until after the date of the ALJ's hearing, and it argues that if it were not permitted to present the exhibits for the Court's consideration, it would be left without a way to respond to the Department's argument regarding the ALJ's remedy. Finally, Philip Morris argues that Business Court Rule 7 permits it to include exhibits with a brief. (Resp. Motion Strike 4, ECF No. 30.)

51. The Court has discretion to determine whether to allow the exhibits. *See, e.g.*, *N.C. State Board of Educ. v. N.C. Learns, Inc.*, 231 N.C. App. 270, 285 (2013) ("[T]he Court may require or permit subsequent corrections or additions to the record when deemed desirable.") (cleaned up). It is persuaded to do so because the information contained within them developed after the hearing below, Philip Morris deems the information important to its position, and counsel has professed confusion

over the applicability of BCR 7.[15] Accordingly, the Court determines that the interests of justice and fairness are advanced by permitting the exhibits.

52. Therefore, given the circumstances presented, the Court DENIES the Petitioner's Motion to Strike, and it has considered exhibits 13–16 when making its determination with respect to the Department's Petition.

VI. CONCLUSION

53. For the reasons stated herein, OAH's Final Decision is REVERSED and this matter is REMANDED to OAH with instructions to DISMISS this action for lack of subject matter jurisdiction. Petitioner's Motion to Strike is DENIED.

IT IS SO ORDERED, this the 3rd day of May, 2023.

/s/ Julianna Theall Earp

Julianna Theall Earp
Special Superior Court Judge
for Complex Business Cases

[15] The Court first observes that it is BCR 13, rather than BCR 7, that governs appeals from OAH to this Court.