

portion of the income from the sale of the [two divisions in other states] because the divisions were not part of Taxpayer's unitary business, a claim which Taxpayer raised for the first time at the administrative hearing, the Assistant Secretary stated that "[i]t would be inappropriate to close the record now and render a final decision with [certain] questions unanswered." Final Decision Docket No. 2000-5 (Issues I and II), at 30. The Assistant Secretary ordered Taxpayer to provide certain documents to the Department no later than June 30, 2001 or by a later date if requested by the Taxpayer upon a proper showing of why such extension was necessary. The Assistant Secretary then ruled that Taxpayer's request for refund based upon its claim that the [two divisions in the other state] were not part of its unitary business (Issue III) was to be "taken under advisement pending further proceedings as stated herein." *Id.* at 32.

This final decision, Final Decision Docket No. 2000-5 (Issue III), addresses the third and final issue regarding Taxpayer's claim for a refund of corporate income tax for tax year ended December 31, 1991. Final Decision Docket No. 2000-5 (Issues I and II) is incorporated herein by reference.

EVIDENCE

Exhibits D-1 through D-53 and T-1 through T-10 are incorporated herein by reference. In addition, the following items are introduced as exhibits and made part of the record:

- D-54 Letter from Bobby L. Weaver, Jr. to [one of Taxpayer's Attorneys] dated August 8, 2000.
- D-55 Power of Attorney submitted by [Taxpayer's Attorneys] dated August 16, 2000.
- D-56 Final Decision Docket No. 2000-5 (Issues I and II).
- D-57 Letter from Bobby L. Weaver, Jr. to [one of Taxpayer's Attorneys] dated August 28, 2001.

FINDINGS OF FACT

Findings of Fact 1 through 52 are incorporated herein by reference. In addition, the Assistant Secretary makes the following findings of fact:

- 53. The headquarters division of Taxpayer performed many corporate functions for the entire company, including the [divisions in North Carolina and two other states].
- 54. The headquarters division of Taxpayer managed and controlled Taxpayer's operating divisions, including the [divisions in North Carolina and two other states].
- 55. The [divisions in North Carolina and the two other states] were engaged in the same line of business.
- 56. Taxpayer has failed to comply with the Secretary's order to produce the requested documents.
- 57. Taxpayer has neither requested an extension nor provided any explanation for its failure to comply with the Secretary's order.

CONCLUSIONS OF LAW

Conclusions of Law 1 through 44 are incorporated herein by reference. In addition, the Assistant Secretary makes the following conclusions of law:

45. Taxpayer's argument that the unitary business principle requires exclusion of the income from the sale of [its two divisions in other states] from its apportionable income raises a constitutional issue.
46. The Secretary has no authority to rule on constitutional issues.
47. The Secretary has no authority under G.S. 105-266.1 to order the refund of an allegedly unconstitutional tax, since questions of constitutionality are for the courts.
48. The Secretary has no authority under G.S. 105-266.1 to order a refund based on Taxpayer's claim that inclusion of the income from the sale of the two divisions in its apportionable income is unconstitutional.
49. G.S. 105-267 provides the exclusive remedy for Taxpayer to seek a refund based on its constitutional claim.
50. Taxpayer has failed to comply with the mandatory provisions of G.S. 105-267.
51. Final Decision Docket No. 2000-5 (Issues I and II) did not finally determine Taxpayer's liability for corporate income tax for its 1991 tax year.
52. The Assistant Secretary in Final Decision Docket No. 2000-5 (Issues I and II) held the record open, ordered Taxpayer to produce certain documents, and held that Issue III regarding Taxpayer's liability for corporate income tax for 1991 was to be taken under advisement pending further proceedings as stated therein.
53. Taxpayer's failure to comply with the Secretary's order and produce the documents was unjustified.
54. In order to exclude certain income from the apportionable base, the taxpayer has the distinct burden of showing by clear and cogent evidence that the income was derived from unrelated business activity which constitutes a discrete business enterprise.
55. The constitutional question is whether the [two divisions in the other states] were unrelated to [Taxpayer] as a whole, and whether they were discrete business enterprises from that of Taxpayer as a whole.
56. Taxpayer has failed to satisfy its "distinct burden" of providing "clear and cogent evidence" that the [two out-of-state divisions] divisions were unrelated to Taxpayer's business activity and constituted discrete business enterprises from that of [Taxpayer] as a whole.
57. The amended return filed by Taxpayer was not a lawful return.
58. The Secretary has no authority to issue a refund based upon an unlawful return.
59. The denial of the refund claim is proper under the law and the facts.
60. The Secretary has an obligation and an implied power to enforce its rules and orders.
61. Dismissal of Taxpayer's refund claim is an appropriate sanction for Taxpayer's failure to comply with a formal order of the Secretary.

62. Dismissal of Taxpayer's refund claim is proper under the law and the facts.
63. Taxpayer's liability for corporate income tax for its 1991 tax year is hereby finally determined.

DECISION

At the administrative hearing, Taxpayer advanced, for the first time, the claim that it is entitled to a refund of the corporate income tax at issue on the grounds that the United States Constitution prohibits North Carolina from including the income from the sale of the [two out-of-state] divisions in its apportionable base because the divisions were not part of its unitary business.

Taxpayer's argument that the unitary business principle requires exclusion of the income from its apportionable income raises a constitutional issue. See *Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458, 461 (2000) (the income of which a state taxes a percentage is constitutionally limited to a corporation's "unitary" income); *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992) (the unitary business principle remains an appropriate device for ascertaining whether a state has transgressed constitutional limitations in taxing a nondomiciliary corporation).

A refund based on this theory thus requires a ruling or declaration by the Secretary that inclusion of the income in the apportionable base is unconstitutional, and this I am without authority to do. The Secretary has no authority to rule on the constitutionality of a statute or to pass on constitutional questions. *Gulf Oil Corp. v. Clayton*, 267 N.C. 15, 147 S.E.2d 522 (1966); *Great American Insurance Co. v. Gold*, 254 N.C. 168, 118 S.E.2d 792 (1961). More specifically, the Secretary has no authority under G.S. 105-266.1 to order the refund of an invalid or illegal tax, since questions of constitutionality are for the courts. *Coca-Cola Co. v. Coble*, 293 N.C. 565, 238 S.E.2d 780 (1977). G.S. 105-266.1 does not provide a remedy whereby unconstitutional taxes may be recovered by the taxpayer. *Coca-Cola Co. v. Coble*, 33 N.C.App. 124, 234 S.E.2d 477, *aff'd*, 293 N.C. 565, 238 S.E.2d 780 (1977).

Rather, G.S. 105-267 is the appropriate procedure for a taxpayer who seeks to test the constitutionality of a statute or its application to him. *Gulf Oil Corp. v. Clayton*, 267 N.C. 15, 147

S.E.2d 522; see also *Coca-Cola Co. v. Coble*, 293 N.C. 565, 238 S.E.2d 780. In fact, G.S. 105-267 is “the sole resort for a taxpayer seeking to challenge the legality of a state tax. By contrast, the immediately preceding section of the state tax code, § 266.1, provides the avenue for recovering an excessive amount paid because of a clerical or mathematical error.” *Swanson v. Faulkner*, 55 F.3d 956 (4th Cir. 1995), *cert. denied*, 516 U.S. 964 (1995).

I therefore hold that the Secretary has no authority under G.S. 105-266.1 to order a refund based on the claim that inclusion of the income from the sale of the two divisions in Taxpayer’s apportionable income is unconstitutional. I further hold that G.S. 105-267 sets forth the exclusive remedy for Taxpayer to pursue its constitutional claim. Finally, I hold that Taxpayer has failed to comply with the mandatory provisions of G.S. 105-267. For these reasons, Taxpayer’s refund claim is hereby denied.

In Final Decision Docket No. 2000-5 (Issues I and II), Taxpayer was ordered to provide certain documents and other information to evaluate the factual basis for its belated claim that the [two out-of-state] divisions were not part of Taxpayer’s unitary business. To date, Taxpayer has failed to comply with the Secretary’s order to produce the requested documents. Taxpayer has neither requested an extension nor provided any explanation for its failure to comply with the Secretary’s order.

In order to exclude certain income from the apportionable base under the unitary business principle, the taxpayer always has the “distinct burden of showing by ‘clear and cogent evidence’ that [the state tax] results in extraterritorial values being taxed.” *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 175 (1983) (citations omitted; brackets in original). “Unitary income normally includes all income from a corporation’s business activities, but excludes income that ‘derives from unrelated business activity which constitutes a discrete business enterprise.’” *Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458, 461 (2000) (quoting *Allied-Signal*, 504 U.S. at 773).

Thus, in order to prevail in its claim, and exclude the income from the sale of the two divisions from its apportionable base, Taxpayer bears the “distinct burden” of proving “by clear and

cogent evidence” that the [two out-of-state] divisions were unrelated to Taxpayer’s business activity and constituted discrete business enterprises from that of [Taxpayer] as a whole. Where Taxpayer has failed to comply with an order of the Secretary to produce documents so that all facts relevant to the claim may be considered, it cannot meet its “distinct burden” of providing “clear and cogent evidence” to support its claim. Regardless of the nature of a taxpayer’s request for refund, it always bears the burden to substantiate and document its claim, including all the factual underpinnings. For this additional and independent reason, Taxpayer’s refund claim is hereby denied.

The Taxpayer made no effort to comply with the Secretary’s order and offered no explanation for its refusal to comply. Instead, Taxpayer simply ignored the order. The Secretary has an obligation and an implied power to enforce its rules and orders. Dismissal of Taxpayer’s refund claim is an appropriate sanction for Taxpayer’s failure to comply with an order of this tribunal. See *In re Appeal of Fayetteville Hotel Assoc.*, 117 N.C.App. 285, 288, 450 S.E.2d 568, 570 (1994) (“without implicit authority to enforce its rules by dismissal, the [Property Tax] Commission’s effectiveness as a quasi-judicial body would be fatally compromised”). Taxpayer’s refund claim is hereby dismissed for failure to comply with the Secretary’s order.

Finally, as the first final decision in this matter concludes, the amended return filed by Taxpayer was not a lawful return. The Secretary has no authority to issue a refund based upon an unlawful return. For this additional and independent reason, Taxpayer’s refund claim is hereby denied.

Accordingly, for each of the foregoing alternative and independent reasons, Taxpayer’s request for refund based upon its claim that North Carolina is constitutionally prohibited from including the income from the sale of the [two out-of-state] divisions in its apportionable base is denied. In addition, Taxpayer’s refund claim is hereby dismissed. The record in this matter is now closed. The Secretary’s decision denying [Taxpayer’s] claim for a refund of corporate income tax for its tax year ending December 31, 1991 is now final and [Taxpayer’s] corporate income tax liability for its 1991 tax year is hereby finally determined.

Made and entered this 19th day of November, 2001.

Signature _____

Eugene J. Cella
Assistant Secretary of Revenue