



## EVIDENCE

*Submitted by the Division:*

- D-1 Taxpayer's North Carolina Franchise and Corporate Income Tax Return for the 1996 Tax Year.
- D-2 Taxpayer's North Carolina Franchise and Corporate Income Tax Return for the 1997 Tax Year.
- D-3 Taxpayer's North Carolina Franchise and Corporate Income Tax Return for the 1998 Tax Year.
- D-4 Taxpayer's Amended North Carolina Franchise and Corporate Income Tax Return for the 1996 Tax Year.
- D-5 Taxpayer's Amended North Carolina Franchise and Corporate Income Tax Return for the 1997 Tax Year.
- D-6 Taxpayer's Amended North Carolina Franchise and Corporate Income Tax Return for the 1998 Tax Year.
- D-7 Informational Brochures on Taxpayer.
- D-8 Copy of a Letter Dated July 10, 2000 from [a representative from an accounting firm] to William H. Daniel, (former) Director, Corporate, Excise, and Insurance Tax Division.
- D-9 Copy of a Letter Dated July 25, 2000 from [a representative from an accounting firm] to Bobby L. Weaver, Jr.
- D-10 Copy of a Memorandum Dated July 25, 2000 from [three representatives from an accounting firm].
- D-11 Copy of a Letter Dated August 21, 2000 from Bobby L. Weaver, Jr. to [a representative from an accounting firm].
- D-12 Copy of a Letter Dated December 7, 2000 from [a representative from an accounting firm] to Bobby L. Weaver, Jr. and William H. Daniel.
- D-13 Copy of a Letter Dated January 5, 2001 from Bobby L. Weaver, Jr. to [a representative from an accounting firm].
- D-14 Copy of a Letter Dated April 13, 2001 from [a representative from an accounting firm] to William H. Daniel.
- D-15 Copy of a Letter Dated April 24, 2001 from Bobby L. Weaver, Jr. to [a representative from an accounting firm].
- D-16 Hearing Information Sheet from Taxpayer Dated May 22, 2001.

- D-17 Copy of a Letter Dated May 25, 2001 from Bobby L. Weaver, Jr. to [a representative from an accounting firm].
- D-18 Copy of a Letter Dated June 7, 2001 from Eugene J. Cella to [a representative from an accounting firm].
- D-19 Copy of a Letter Dated June 18, 2001 from Bobby L. Weaver, Jr. to [a representative from an accounting firm].
- D-20 Copy of a Letter Dated August 16, 2001 with Attachments #1 through #15 from [a representative from an accounting firm] to Bobby L. Weaver, Jr.
- D-21 [Taxpayer's] Unsigned Board Meeting Minutes Dated June 17, 1996. Attachment # 1 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-22 Taxpayer's Unsigned Board Meeting Minutes Dated July 17, 1996. Attachment # 2 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-23 Taxpayer's Unsigned Board Meeting Minutes Dated September 13, 1996. Attachment # 3 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-24 1999 Report of Independent Public Accountants. Attachment # 4 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-25 1998 Report of Independent Public Accountants. Attachment # 5 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-26 1997 Report of Independent Public Accountants. Attachment # 6 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-27 Taxpayer's Program Overview. Attachment # 7 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-28 Taxpayer's Agreement for "Underinsured" Patients. Attachment # 8 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-29 Taxpayer Funding Agreement. Attachment # 9 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-30 Administrative and Technical Services Agreement between [an unrelated third-party healthcare consulting firm] and Taxpayer. Attachment # 10 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-31 Distribution System Agreement between [an unrelated third-party service provider] and Taxpayer. Attachment # 11 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-32 Certificate of Incorporation of [Taxpayer under Taxpayer's former name]. Attachment # 12 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].

- D-33 Bylaws of [Taxpayer when operating under Taxpayer's former name]. Attachment # 13 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-34 Certificate of Amendment for Taxpayer. Attachment # 14 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-35 Bylaws of Taxpayer. Attachment # 15 in [a] Letter Dated August 16, 2001 [from a representative from an accounting firm].
- D-36 North Carolina Department of Revenue Hearing Brief Submitted by the Corporate, Excise, and Insurance Tax Division to Eugene J. Cella, Assistant Secretary of Revenue, on August 27, 2001.

*Submitted by the Taxpayer:*

- T-1 Taxpayer's Brief for Tax Administrative Hearing Dated August 27, 2001 with Exhibits A through P.
- T-2 Exhibit A - Original Articles of Incorporation.
- T-3 Exhibit B - Original Bylaws.
- T-4 Exhibit C - Amended Articles of Incorporation.
- T-5 Exhibit D - Amended Bylaws.
- T-6 Exhibit E - Board of Directors Meeting Minutes - Taxpayer (June 17, 1996; July 17, 1996; September 13, 1996).
- T-7 Exhibit F - Program Overview - Taxpayer.
- T-8 Exhibit G - Diagram of Payment Procedures.
- T-9 Exhibit H - Program Adoption Agreement between Taxpayer and [drug manufacturer].
- T-10 Exhibit I - Funding Agreement between Taxpayer and [drug manufacturer].
- T-11 Exhibit J - Administrative and Technical Services Agreement between Taxpayer And [an unrelated third-party healthcare consulting firm].
- T-12 Exhibit K - Distribution System Agreement between Taxpayer and [an unrelated third-party service provider].
- T-13 Exhibit L - Process Design Document for Taxpayer.
- T-14 Exhibit M - Report of Independent Public Accountants - April 2, 1999.
- T-15 Exhibit N - Report of Independent Public Accountants - April 1, 1998.
- T-16 Exhibit O - Report of Independent Public Accountants - March 27, 1997.

- T-17 Exhibit P - Department of Revenue letter dated August 21, 2000 denying the refund claims.
- T-18 Copy of a Letter Dated September 24, 2001 from [a representative from an accounting firm] to Eugene J. Cella.

### **FINDINGS OF FACT**

Based on the foregoing evidence of record, the Assistant Secretary for Administrative Tax Hearings makes the following findings of fact:

1. [Taxpayer] was organized in [another state] on September 28, 1994 as a non-stock, not-for-profit, sub-chapter C corporation.
2. Taxpayer amended its articles of incorporation and officially changed its name to its current name on October 7, 1994.
3. Article III of the original Certificate of Incorporation states that "The [Taxpayer] is a nonprofit organization organized and operated exclusively for charitable and educational purposes within the meaning of Sec. 501(c)(3) of the Internal Revenue Code of 1986, as amended...."
4. Taxpayer's Bylaws specifically state that Taxpayer "... (a) shall not carry on any other activities not permitted to be carried on by a Corporation exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986 ... and (b) shall not (i) engage in any act of self-dealing (as defined in Section 4941 (d) of the Internal Revenue Code of 1986 ... ), (ii) retain any excess business holdings..., (iii) make any investments in such manner as to subject the Corporation to tax under Section 4944 of the Internal Revenue Code of 1986..., and from making any taxable expenditures...." The Bylaw also provides that Taxpayer was established to provide assistance to individuals who could not otherwise afford the cost of [a particular drug] for the treatment of [a disease].
5. Taxpayer provides the [drug] based on the patient's ability to pay. In most cases, the cost of the drug is covered by the patient's insurance company. However, in certain cases, the drug may be provided free to the patient. Taxpayer is authorized to solicit, receive, and administer funds for this purpose.
6. Funding of Taxpayer comes from the following sources: (i) interest income (2%); (ii) patient participation payments which operate similar to medical co-payments (5%); and (iii) private insurance carriers such as [an insurance company] (93%).
7. Taxpayer has an exclusive funding agreement with the [manufacturer of the drug, a corporation], whereby [the manufacturer] provides financial assistance to the taxpayer.
8. Under the terms of this agreement, Taxpayer agreed to take on administrative responsibilities for two charitable programs formerly run by [the manufacturer] in exchange for [the manufacturer's] commitment to make the [drug] available to patients of these two programs. [The manufacturer] also agreed to make funds available to Taxpayer to assist with operations.

9. Taxpayer has no tangible personal or real property and no employees.
10. All operations and administrative functions of Taxpayer are carried out by [an unrelated third-party healthcare consulting firm].
11. [The unrelated third-party healthcare consulting firm] is located in [a city in] North Carolina.
12. [The unrelated third-party healthcare consulting firm] specializes in providing technical and administrative services to charitable medical foundations.
13. Taxpayer's documents, including the organization's bylaws and all agreements with the unrelated third-party healthcare consulting firm], [the drug manufacturer] and [an unrelated third-party service provider], list a [North Carolina address] as either the principal office or the contact address of [Taxpayer].
14. Taxpayer has a "Dispensing Agreement" with [an unrelated third-party service provider].
15. [The unrelated third-party service provider] is responsible for various aspects of product handling.
16. [The unrelated third-party service provider] purchases the [drug] from [the drug manufacturer] at a price that is discounted from wholesale (\$5.00 per dose).
17. The local pharmacies order the drug from [the unrelated third-party service provider], and [this provider] places the order with [the drug manufacturer]. The [drug] is shipped directly to the pharmacy from [the drug manufacturer].
18. Taxpayer does not take possession of the drug as inventory for resale and it does not incur cost of goods sold. Instead, it incurs an annual expense related to the dispensing service provided by [the unrelated third-party service provider].
19. This expense is reflected on Taxpayer's federal return as "Other Deductions-Distributions" (line 26, page 1, statement 2). This expense, according to Taxpayer, is its payment to [the unrelated third-party service provider] for the drugs [this provider] purchases from [the drug manufacturer].
20. [The unrelated third-party service provider's] charge for all other services related to the "Dispensing Agreement" (e.g., patient qualification, screening procedures, maintenance of program files) is captured as "Other Deductions-Product Handling" (line 26, page 1, statement 2).
21. For federal and state income tax purposes, Taxpayer elected to be treated as a "C" corporation.
22. During the June 17, 1996 meeting of Taxpayer's Board of Directors, [an accounting firm] made a presentation concerning the potential tax exempt status of Taxpayer.
23. At the board meeting, an attorney with [a law firm] noted the following consequences of requesting tax exempt status for Taxpayer: (i) [the drug manufacturer] would not be allowed to loan money to Taxpayer; (ii) Taxpayer could solicit funding from sources other

than [the drug manufacturer]; (iii) [the drug manufacturer] could not sell the [drug] to Taxpayer; and (iv) [the drug manufacturer] could contribute the drug to Taxpayer and take a charitable contribution deduction since Taxpayer would have tax-exempt status.

24. In a meeting of Taxpayer's Board of Directors on September 13, 1996, the Board unanimously agreed not to seek the exempt status based on "the concerns raised by representatives from [the drug manufacturer]."
25. Taxpayer has never applied for nor qualified as a tax exempt entity for federal income tax purposes.
26. In tax years 1996, 1997 and 1998, Taxpayer had federal taxable income in the amounts of \$1,976,734, \$2,270,589 and \$778,199, respectively, and paid federal income tax in the amounts of \$672,090, \$772,000 and \$264,588, respectively.
27. On July 7, 2000, Taxpayer filed amended North Carolina Franchise and Corporate Income Tax returns for the tax years ending December 31, 1996 through December 31, 1998, claiming exemptions from the franchise and corporate income tax under G.S. 105-125(a)(1) and 105-130.11(a)(3), respectively, and seeking a total refund of \$418,430.
28. Taxpayer submitted a letter on July 10, 2000 presenting facts pertaining to Taxpayer to the Division and requested a ruling as to whether Taxpayer qualified for exemption from North Carolina corporate franchise and income tax under the provisions of G.S. 105-125(a)(1) and 105-130.11(a)(3).
29. The Division ruled in a letter dated August 21, 2000 that Taxpayer was not entitled to exemption from North Carolina franchise and corporate income tax because it was not organized and operated for "charitable" purposes since it did not operate for a public purpose, but rather served a private interest.
30. The Division denied the request for a refund by letter dated January 5, 2001.
31. Taxpayer timely protested the Division's denial of the refund and requested a hearing before the Secretary of Revenue pursuant to G.S. 105-266.1 by letter dated April 13, 2001.

### **CONCLUSIONS OF LAW**

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. G.S. 105-125(a)(1) provides an exemption from the franchise tax for corporations that are organized and operated as a charitable, religious, fraternal, benevolent, scientific, or educational corporation not operated for profit.
2. G.S. 105-130.11(a)(3) provides an exemption from the corporate income tax imposed under G.S. 105-130.3 for a corporation that is organized as a charitable corporation not operated for profit, no part of the organization's net earnings of which inure to the benefit of a shareholder or person.

3. G.S. 105-228.90(1b) defines “Code” as the Internal Revenue Code as enacted as of a specified date, including any provisions enacted as of that date which become effective either before or after that date.
4. IRC § 501(c)(3) provides for the exemption from taxation of: “corporations...organized and operated exclusively for...charitable...purposes...no part of the net earnings of which inures to the benefit of any private shareholder or individual.”
5. Pursuant to Federal Tax Regulation Section 1.501(a)-1, the words ‘private shareholder or individual’ as used in Section 501 of the Code refer to persons having a personal and private interest in the activities of the organization.
6. Section 1.501(c)(3)-1(d)(1)(ii) of the Federal Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest.
7. G.S. 105-130.11 and 105-125 prohibit against private inurement.
8. A Section 501(c)(3) organization is classified as either a public charity or a private foundation.
9. In order to receive public charity status, an organization must be either: (i) a public charity, according to IRC § 509(a)(1); (ii) a publicly supported organization, according to IRC § 509(a)(2); or (iii) a supporting organization, according to IRC § 509(a)(3).
10. Under IRC § 509(a)(1), a public charity must receive at least one-third (33 1/3%) of its support, excluding income received in the exercise or performance by such organization of its charitable purpose, from the general public or a governmental unit.
11. All of Taxpayer’s funding during the relevant period, with the exception of fees received from the sale of [the drug], came from [the drug manufacturer]. Taxpayer would not have qualified as a public charity under IRC § 509(a)(1).
12. Under IRC § 509(a)(2), a publicly supported organization must receive more than one-third (33 1/3%) of its support from the general public and must not receive more than one-third of its support from investment income.
13. Taxpayer received a minimal amount of investment income in the form of interest income and, for the past three years, has received more than one-third of its support from the general public. However, as stated above, [a drug manufacturer] provided significant contributions to Taxpayer. These contributions would not be included as public support and would most likely have disqualified Taxpayer as an IRC § 509(a)(2) entity for the relevant period.
14. Supporting organizations as defined in IRC § 509(a)(3) are those that are not publicly supported, but which are organized and operated solely for the benefit of an organization described in IRC § 509(a)(1) or (a)(2).
15. Taxpayer is not related to or operated to support any organization described in IRC § 509(a)(1) or (a)(2). Therefore, it would not have qualified for tax-exempt status under IRC § 509(a)(3).



16. Taxpayer may have qualified for tax exemption as a private foundation under IRC § 509(c)(3) had it applied.
17. Under the private foundation rules, various transactions, described in IRC § 4941(d), between a foundation and a disqualified person trigger the self-dealing excise tax.
18. Under IRC § 4946(a)(1), a disqualified person includes a substantial contributor as defined in IRC § 507(d).
19. IRC § 507(d)(2)(A) defines a substantial contributor as “any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by Taxpayer before the close of the taxable year of Taxpayer in which the contribution or bequest is received by Taxpayer from such person.”
20. [The drug manufacturer] has contributed millions to Taxpayer and would be considered a substantial contributor under IRC § 507(d) and a disqualified person for purposes of the self-dealing rules.
21. If Taxpayer had been granted exemption as a private foundation under IRC § 509(c)(3) by the Internal Revenue Service, Taxpayer, its managers, and [the drug manufacturer] (a “disqualified person”) would have been subject to excise taxes.
22. According to IRC § 4941(d)(1)(A), the “sale or exchange, or leasing, of property between a private foundation and a disqualified person” is an act of self-dealing.
23. [The drug manufacturer] sells [the drug] regularly to Taxpayer for a nominal price. These sales of [the drug] to Taxpayer constitute an act of self-dealing, subject to the taxes imposed under IRC § 4941.
24. The “lending of money or other extension of credit between a private foundation and a disqualified person” is an act of self-dealing pursuant to IRC § 4941(d)(1)(B).
25. Any loans between [the drug manufacturer] and Taxpayer would, therefore, also be considered acts of self-dealing, subject to the taxes under IRC § 4941.
26. The self-dealing excise tax has two potential levels of taxation.
27. The first level of the self-dealing excise tax is the initial tax in IRC § 4941(a). The Internal Revenue Service can impose an initial tax of 5 or 10 percent of the amount involved on the self-dealer or private foundation. A first-tier tax of 2 1/2 percent of the amount involved, up to \$10,000, can also be assessed against an organization’s managers. The initial tax is always assessed on a self-dealing transaction.
28. The second-tier tax of 200 percent on the self-dealer and 50 percent on the foundation manager can also be imposed. In the case of a prohibited taxable expenditure, the second-tier tax equals 200 percent of the amount involved. The second level occurs only if the self-dealing transaction is not corrected within a prescribed time.

29. In order for a self-dealing transaction to be corrected, IRC § 4941(e)(3) requires the undoing of the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.
30. There is no evidence that Taxpayer attempted to correct any self-dealing transactions that occurred during the refund period.
31. Under Reg. 1.507-1(c)(4), repeated and willful self-dealing by a private foundation will result in the revocation of the organization's tax exempt status.
32. The purchase and distribution of the [drug] under the circumstances present in the instant case is incident to a commercial operation and does not constitute "charitable" within the meaning of G.S. 105-125 and 105-130.11.
33. The taxpayer is subject to the general business franchise tax in accordance with G.S. 105-122.
34. The taxpayer is subject to income taxation in this State in accordance with G.S. 105-130 *et. seq.*
35. Under G.S. § 105-130.3 for the 1996, 1997, and 1998 tax years, the income tax is imposed on the State net income of every C corporation doing business in this State at 7.75%, 7.5% and 7.25%, respectively, of the corporation's State net income.
36. T17 NCAC 5C.0102 defines "doing business" in pertinent part as "[t]he maintenance of an office or other place of business in North Carolina."
37. "State net income" means the taxpayer's federal taxable income as determined under the Code, adjusted as provided in G.S. 105-130.5 and, in the case of a corporation that has income from business activity that is taxable both within and without this State, allocated and apportioned to this State as provided in G.S. 105-130.4.
38. G.S. 105-130.4(a)(2) defines "commercial domicile" as the principal place from which the trade or business of the taxpayer is directed or managed.
39. Taxpayer's "commercial domicile" is in North Carolina because it is directed and managed by [an unrelated third-party healthcare consulting firm] in [a city located in] North Carolina.
40. For purposes of allocation and apportionment, a corporation is taxable in another State if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless whether that state exercises its jurisdiction.
41. Pursuant to G.S. 105-130.4(b), "business activity" is defined to include any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code Section 381.

42. 15 United States Code Section 381, more commonly known as Public Law 86-272, restricts a state from imposing a net income tax on income derived within its borders from interstate commerce when the only activity within a state is the solicitation of orders of tangible property, the order is sent out of the state for approval or rejection, and the goods are shipped from a point outside the state.
43. Solicitation of orders for purposes of Public Law 86-272 includes the entire process associated with inviting an order, not just those activities absolutely essential to solicitation.
44. Taxpayer does not have any taxable business activities outside of North Carolina pursuant to Public Law 86-272 and is therefore not entitled to the apportionment provisions of G.S. 105-130.4(b).
45. The denial of the refunds requested on the amended returns and the proposed assessment of corporate franchise tax were proper under the laws and the facts.

### **DECISION**

This case presents three issues for resolution, namely (i) whether Taxpayer qualifies for exemption from North Carolina franchise and corporate income tax under the provisions of G.S. 105-125(a)(1) and 105-130.11(a)(3), (ii) whether Taxpayer, if deemed a taxable entity, is doing business in North Carolina, and (iii) whether Taxpayer, if deemed to be doing business in North Carolina, is entitled to apportion its income to North Carolina as a multistate corporation pursuant to G.S. 105-130.4(b).

#### I. NORTH CAROLINA CORPORATE INCOME AND FRANCHISE TAX EXEMPTION.

In its brief and at the administrative hearing, Taxpayer argued that the Division's denial of its refund claim as an exempt organization should have been based on the requirements set forth in G.S. 105-130.11 and 105-125, which are: (i) the organization must be charitable; (ii) the organization must not be operated for profit; and (iii) no part of the net earnings of the organization must inure to the benefit of any private stockholder or individual. Taxpayer contends that both the language and construction of the statute support its exemption from the corporate income and franchise tax and that the Division erred in relying upon federal law to amplify the meaning of the term "charitable."

The Division argued that Taxpayer did not qualify as a tax exempt organization under the statutes because it operated outside of the parameters prescribed for state and federal tax exemption. The Division asserts that an organization does not qualify for exemption from income and franchise taxation under G.S. 105-130.11 and 105-125 simply by incorporating as a non-stock, not-for-profit corporation. Its activities and purpose are important determinants as to whether the corporation qualifies for tax exemption. Both State and federal statutes contain similar restrictive provisions pertaining to the operations of a not-for-profit corporation. If a corporation violates either of these restrictions, it is not exempted from North Carolina franchise and corporate income taxation.

In this case, Taxpayer violated the prohibition against the private inurement of net earnings to individuals or shareholders because it regularly and systematically engaged in activities which resulted in the private inurement of benefits to [the drug manufacturer]. Although Taxpayer argued that it would have qualified for federal income tax exemption under IRC § 501(c)(3) had it applied, I find that the evidence submitted suggests otherwise.

A § 501(c)(3) organization is classified as either a public charity or a private foundation. [The drug manufacturer] provided significant contributions to Taxpayer during the relevant period. These contributions would not be included as public support and would have disqualified Taxpayer as a public charity under IRC §§ 509(a)(1) and 509(a)(2) for the relevant period. Taxpayer may have qualified for tax exemption as a private foundation under IRC § 509(c)(3); however, Taxpayer acknowledges that its directors elected not to pursue federal income tax exemption in order to avoid the punitive excise taxes imposed on “self-dealing” transactions by the Internal Revenue Service.

Assuming *arguendo* that Taxpayer had applied and qualified for tax exemption as a private foundation, Taxpayer, its manager, and [the drug manufacturer] would have been subject to severe punitive sanctions from the IRS for participating in prohibited transactions, including excise taxes imposed under IRC § 4941 and potential revocation of the exempt status.

[The drug manufacturer] sold the [drug] regularly to Taxpayer and lent money to Taxpayer during the relevant period -- transactions which constitute acts of self-dealing under IRC § 4941(d)(1). There is no evidence in the record that Taxpayer attempted to correct any self-dealing transactions that occurred during the refund period in accordance with IRC § 4941(e)(3). In addition, the evidence shows that [the drug manufacturer] continues to sell the [drug] to Taxpayer. Under Reg. 1.507-1(c)(4), repeated and willful self-dealing by a private foundation will result in the revocation of the organization's tax exempt status. Thus, had Taxpayer qualified for tax exemption as a private foundation, its exemption would have been revoked for repeated instances of self-dealing. Therefore, for the reasons stated above, I find that Taxpayer did not qualify for an exemption from franchise and corporate income taxation in North Carolina under G.S. 105-130.11 and 105-125.

## II. IS TAXPAYER "DOING BUSINESS" IN NORTH CAROLINA?

Taxpayer argued that it was not "doing business" in the State of North Carolina during the relevant period and therefore should be entitled to a refund of taxes paid. In support of this argument, Taxpayer alluded to the fact that it does not have any property or employees in this State and argued that the Department is prohibited from imposing tax on its income by the Commerce Clause of the Constitution because it lacks substantial nexus in North Carolina. The Division rejected this argument because Taxpayer's agent manages and conducts its business affairs in North Carolina.

It should be noted that 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. Furthermore, G.S. 105-266.1 does not provide an exception to the general rule that voluntary payments of unconstitutional tax are not refundable.

Nevertheless, the record of evidence clearly shows that Taxpayer's operations are principally managed and directed in North Carolina through its contractual relationship with the [unrelated third-party healthcare consulting firm] in [a city located in] North Carolina. (Exhibit D-

8) At least four documents, including the organization's bylaws and the agreements with the [unrelated third-party healthcare consulting firm], [the drug manufacturer] and [an unrelated third-party service provider], were submitted by Taxpayer as exhibits to its brief for administrative hearing. Each document listed a [North Carolina address] as either the principal office or the contact address of the [Taxpayer]. (Exhibits T-3, T-5, T-11, and T-12) This activity clearly constitutes "doing business" under the Department of Revenue's rule, T17 NCAC 5C. 0102, which defines "doing business" in pertinent part as "[t]he maintenance of an office or other place of business in North Carolina." Taxpayer, itself, formerly took the position that it was located and doing business in this State when it filed its original North Carolina corporate tax returns and paid taxes on 100% of its income. Based on this evidence and the absence of any evidence presented by Taxpayer that would indicate that it is located somewhere other than North Carolina, I find that Taxpayer is doing business in this State.

### III. IS TAXPAYER ENTITLED TO APPORTION ITS INCOME?

The final question is whether Taxpayer is entitled to apportion its income under G.S. 105-130.4. Taxpayer argued that a determination that Taxpayer was "doing business" in North Carolina because of its relationship with [an unrelated third-party healthcare consulting firm], should, using the same criteria, result in a finding that the [Taxpayer] has nexus in [another state] because of its relationship with [an unrelated third-party service provider]. Taxpayer further argued that such a finding should entitle it to apportion its income to North Carolina under the provisions of G.S. 105-130.4. I am not persuaded by Taxpayer's argument.

The activities of the two entities and their relationships with Taxpayer are fundamentally different. [The unrelated third-party healthcare consulting firm] is the contractual administrator of the [Taxpayer] and is responsible for managing the daily operations of the [Taxpayer], including certain transactions with [an unrelated third-party service provider]. In contrast, [the unrelated third-party service provider] is merely a service provider that Taxpayer contracted to deliver the [drug] through its distribution system. [The unrelated third-party service provider]

does not make any operational decisions on behalf of Taxpayer. As stated above, Taxpayer was “doing business” in North Carolina because this State is the principal place from which it is directed and managed. None of the services provided by [the unrelated third-party service provider] on behalf of Taxpayer are sufficient to establish that Taxpayer has business activity taxable in [another state]. Since Taxpayer has not established that it has taxable business activities in [another state], it is not permitted to apportion its income under G.S. 105-130.4(b).

**CONCLUSION**

After considering the arguments presented at the hearing and the briefs filed by both parties, I find that Taxpayer is a taxable organization that is located and principally managed entirely in North Carolina. Taxpayer is therefore subject to the corporate income and franchise tax liabilities reported on its original returns. For this reason, the Division’s denial of the refunds requested on the amended returns is sustained.

Made and entered this 21<sup>st</sup> day of December, 2001.

Signature\_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Revenue