

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE PROPERTY TAX COMMISSION
SITTING AS THE STATE BOARD OF
EQUALIZATION AND REVIEW

86 PTC 295

In the matter of :)
The appeal of ELE, Inc. from)
the Denial of present use value)
treatment for certain of its)
real property by the Bertie)
County Board of Commissioners)
for 1986.)

FINAL DECISION

This matter was heard before the Property Tax Commission, sitting as the State Board of Equalization and Review in the City of Raleigh, Wake County, North Carolina, on September 23, 1987, pursuant to the appeal of the appellant, ELE, Inc., from the denial of its application for present use value assessment for certain of its real property by the Bertie County Board of Commissioners for the years 1984, 1985, and 1986.

STATEMENT OF CASE

The property under appeal consists of approximately 4,764.12 acres of land in Bertie County in approximately 24 parcels, more particularly described in Commission Exhibit 4, appellant's completed Application For Hearing (Form AV-14). The market value of the property for the years 1984, 1985, and 1986 is \$2,889,641, while the value based upon present use treatment is \$2,079,953.

Bertie County denied the application for present use treatment on the grounds that the subject property was owned by a corporation and had not been owned for the required four years. Appellant contends that there was a common thread of ownership as the property passed from one corporation to another. Since 1974

stock in the older corporation has been owned primarily by E. R. Evans and E. L. Evans. A small number of shares were held by their mother for a short period in 1974.

The appellant was represented at the hearings by Robert C. Jenkins, attorney at law; Bertie County was represented at the hearings by its County Attorney, Lloyd C. Smith, Jr.

ISSUE

The issue to be decided by the Commission is: whether the appellant, ELE, Inc., is entitled to assessment and taxation of its real property in Bertie County on the basis of its present use value for the years 1984, 1985, and 1986.

STIPULATIONS

The parties made the following stipulations:

(1) This appeal was timely taken pursuant to Section 105-324(b) of The North Carolina General Statutes.

(2) ELE, Inc., the taxpayer herein, is a North Carolina business corporation, and ELE, Inc. is the owner in fee simple of the real property located in Bertie County, described in the Application For Hearing.

(3) The taxpayer has made timely and proper applications to the Bertie County Tax Supervisor pursuant to N.C.G.S. 105-277.4(a) for taxation of its real property on the basis of its present use value for the years 1984, 1985 and 1986.

(4) Bertie County has denied the applications of the taxpayer, ELE, Inc., for taxation of its lands on the basis of its present use value for the years 1984, 1985 and 1986 on the alleged ground that it does not qualify for use value because of

the prior ownership of the taxpayer, ELE, Inc.

(5) All of the taxpayer's real property described in the Application For Hearing is agricultural land and forest land as defined in N.C.G.S. 105-277.2(1) and (2) and N.C.G.S. 105-277.3(a) which otherwise qualifies for taxation based upon its present use value for the years 1984, 1985 and 1986.

(6) The total market value assessment of the taxpayer's land for the years 1984, 1985 and 1986 is \$2,889,641.00, and the total possible use value of the taxpayer's land for the years 1984, 1985 and 1986 is \$2,079,953.00.

(7) At all times relevant to this appeal the principal business of E. R. Evans & Sons, Inc., was agriculture and farming.

(8) At all times relevant to this appeal the principal business of the taxpayer, ELE, Inc., has been agriculture and farming.

(9) At all times relevant to this appeal and until March 2, 1984 all of the shareholders of E. R. Evans and Sons, Inc., were natural persons actively engaged in the business of the corporation or relatives of a shareholder who was actively engaged in the business of the corporation within the meaning of N.C.G.S. 105-277.2(4)b.

(10) At all times since March 2, 1984, Ernest L. Evans and his children have been the owners of all of the shares of common stock of the taxpayer, ELE, Inc., and Ernest L. Evans has been actively engaged in the principal business of the corporation, which is agriculture and farming.

(11) The taxpayer's land which is the subject of this appeal was formerly owned by E. R. Evans, Sr., until 1963. In the year 1963, E. R. Evans, Sr. incorporated his agriculture and farming business which included farmland in the adjoining counties of Bertie and Hertford, under the name E. R. Evans & Sons, Inc. In connection with the incorporation E. R. Evans, Sr. conveyed his farmland in Bertie County and Hertford County to E. R. Evans & Sons, Inc., in exchange for capital stock of E. R. Evans & Sons, Inc. At the death of E. R. Evans, Sr. in 1974, E. R. Evans, Jr. and Ernest L. Evans, surviving sons of E. R. Evans, Sr., were the major stockholders of E. R. Evans & Sons, Inc., with their mother owning a small number of shares. By the year 1982, E. R. Evans, Jr. and Ernest L. Evans had acquired the remainder of the capital stock of E. R. Evans & Sons, Inc., and owned all of the issued and outstanding stock of the corporation in equal shares, with each brother owning fifty percent (50%) of the stock.

(12) During the year 1983 E. R. Evans, Jr. and Ernest L. Evans decided to separate and divide the agriculture and farming business of E. R. Evans & Sons, Inc., into two equal parts or divisions. Since approximately one-half of the corporation's farmland was located in each county most of the land in Bertie County was put in one division and most of the land in Hertford County was put in the second division. It was decided that this division would be carried out and accomplished through a plan of corporate reorganization and separation under Section 368(a)(1)(D) of the Internal Revenue Code, known as a "D" reorganization, with the assistance of Touche Ross & Company of Raleigh, N.C. In order to comply with the requirements for a

non-taxable corporate reorganization under Section 368(a)(1)(D) of the Internal Revenue Code, a controlled corporation, ELE, Inc., (the taxpayer herein) was formed and organized in December, 1983. Subsequently, by deed dated February 29, 1984, and recorded March 2, 1984, in Book 642, Page 746, of the Bertie County Registry, E. R. Evans & Sons, Inc., the distributing corporation in the corporate reorganization, transferred and conveyed the land in Bertie County which was included in one of the divisions to the controlled corporation, ELE, Inc., in exchange for one thousand (1,000) shares of the authorized capital stock of ELE, Inc. Thereafter, on March 2, 1984, the one thousand (1,000) shares of capital stock of ELE, Inc., the controlled corporation, were transferred by E. R. Evans & Sons, Inc., the distributing corporation, to E. L. Evans, in exchange for all of his fifty percent (50%) of the capital stock of E. R. Evans & Sons, Inc., the distributing corporation in the reorganization.

(13) Pursuant to N.C.G.S. 105-228.29, no excise tax stamps were required on the aforesaid deed of conveyance of the subject land by E. R. Evans & Sons, Inc., to ELE, Inc. by the Bertie Register of Deeds.

(14) At all times during the corporate reorganization, and specifically from December, 1983 through March 2, 1984, Ernest L. Evans remained the owner of fifty percent (50%) of the capital stock of E. R. Evans & Sons, Inc., the distributing corporation, and Ernest L. Evans continued to be actively engaged in the agriculture and farming business of E. R. Evans & Sons, Inc. E.

R. Evans & Sons, Inc., the distributing corporation, owned all of the issued and outstanding stock of ELE, Inc., the controlled corporation, from February 29, 1984 until March 2, 1984. Upon completion of the corporate reorganization on or about March 2, 1984 the subject real property was owned by the taxpayer, ELE, Inc., and all of the issued and outstanding capital stock of ELE, Inc. was then owned by Ernest L. Evans. The farmland and woodsland located in Hertford County and a few parcels of farmland and woodsland in Bertie County, which were included in the other division remained the property of the distributing corporation, E. R. Evans & Sons, Inc.

(14) The above-described corporate reorganization was successfully carried out and completed as a non-taxable transaction for income tax purposes with the approval of the Internal Revenue Service, which was confirmed by a letter ruling dated April 19, 1984.

(15) The land owned by the taxpayer, ELE, Inc., which is referred to in Paragraph 3 in Grounds Of Appeal and referred to and described in the Application For Hearing was acquired by ELE, Inc., in connection with and pursuant to an approved corporate reorganization and separation of E. R. Evans & Sons, Inc. under the provisions of Section 368(a)(1)(D) of the Internal Revenue Code, and the transaction was therefore not considered to be a purchase from a stranger or unrelated party or entity by the Internal Revenue Service.

(16) E. R. Evans & Sons, Inc. and ELE, Inc. are considered to be separate corporations under North Carolina corporation law.

EVIDENCE

The evidence presented by the appellant and considered by the Commission consisted of the following:

1. Appellant's Exhibit 1 - Copy of Minutes of the Board of Commissioners of Bertie County dated October 6, 1986.

2. Appellant's Exhibit 2 - Copy of letter from Lloyd C. Smith, Jr., Esq. to Mr. Ernest L. Evans, President, ELE, Inc., dated October 14, 1986.

3. Appellant's Exhibit 3 - Application For Hearing (Form AV-14) and copy of letter from Jack A. Williford, Bertie County Tax Supervisor, to Robert C. Jenkins, Esq., dated November 17, 1986.

4. Appellant's Exhibit 4 - Diagram of corporate reorganization of E. R. Evans & Sons, Inc. This exhibit is offered for illustrative purposes.

5. Appellant's Exhibit 5 - Copy of IRS letter ruling dated April 19, 1984. Pursuant to Section 6110 of the Internal Revenue Code this document is not used or cited as precedent, but is offered solely for the purpose of explanation of the corporate reorganizational transactions which are relevant to this appeal.

6. Appellant's Exhibit 6 - Copies of Agreement and Plan of Reorganization and Corporate Separation dated December 12, 1983 and Agreement and Proposal dated February 28, 1984.

7. Appellant's Exhibit 7 - Copy of Certificate for 1,000 shares of ELE, Inc. issued to E. R. Evans & Sons, Inc. dated February 29, 1984, with assignment and transfer on reverse to Ernest L. Evans dated March 2, 1984.

8. Appellant's Exhibit 8 - Copy of Certificate for 1,000 shares ELE, Inc. issued to Ernest L. Evans dated March 2, 1984.

9. Appellant's Exhibit 9 - Copy of Deed from E. R. Evans & Sons, Inc., dated February 29, 1984, recorded March 2, 1984 in Book 642, Page 746, of the Bertie County Registry.

10. Oral Testimony of Ernest L. Evans, shareholder in ELE, Inc.

11. Oral Testimony of C. Ray Pittman, Jr. of Touche Ross & Company, Certified Public Accountants.

The evidence presented by the county and considered by the Commission consisted of the following:

1. County Exhibit 1 - Copy of Articles of Incorporation of E. R. Evans & Sons, Inc.

2. County Exhibit 2 - Copy of Articles of Incorporation of ELE, Inc.

3. Oral testimony of Jack A. Williford, Bertie County Tax Supervisor.

In addition to the evidence presented by the parties, the Commission also considered the following Commission Exhibits:

C-1 Letter from appellant's attorney transmitting Notice of Appeal, dated November 6, 1986, received November 12, 1986.

C-2 Letter acknowledging Commission's receipt of C-1, dated November 13, 1987.

C-3 Letter transmitting Form AV-14, dated December 2, 1986.

C-4 Completed Form AV-14, dated December 2, 1986.

C-5 Letter acknowledging receipt of C-3 and C-4, dated December 4, 1986.

- C-6 Letter from appellant's attorney requesting hearing status, dated March 30, 1987.
- C-7 and C-8 Official Notice of Time and Date of Hearing, dated August 28, 1987.
- C-9 Letter transmitting Order on Final Pre-Hearing Conference, dated September 3, 1987.
- C-10 Order on Final Pre-Hearing Conference.
- C-11 Letter from Commission acknowledging C-9 and C-10, dated September 10, 1987.
- C-12 and C-13 Letter from Commission stating change in time and date of hearing, dated September 14, 1987.
- C-14 Order on Final Pre-Hearing Conference, filed 23 September 1987.
- C-15 Brief of Bertie County.
- C-16 Brief of Taxpayer.

FINDINGS OF FACT

The facts previously stated in the Statement of Case and in the Stipulations are hereby adopted by the Commission as its findings of fact. The Commission makes the following additional finding of fact:

1. During the year 1983, when E. R. Evans, Jr. and E. L. Evans decided to separate the agriculture and farming business of E. R. Evans & Sons, Inc. into two equal parts, both brothers were married and each had children. Their decision to divide the business into two separate corporations was motivated, at least in part, by the advantages the division would create in

planning their individual estates.

CONCLUSIONS, DECISION, AND ORDER

The facts in this case frame a very narrow question of law for resolution by the Commission. For simplicity, some of the relevant facts are summarized here. In 1982, E. R. Evans & Sons, Inc. was a corporation owned by two brothers, E. R. Evans, Jr. and E. L. Evans. Each brother owned 50% of the stock of the corporation (Stipulation 11). The corporation, E. R. Evans & Sons, Inc. received present use value treatment for its lands located in Hertford and Bertie Counties. Approximately one-half of the farm land owned by the corporation was located in each county.

The two brothers decided in 1983 to divide the assets and business of the corporation into two equal parts, which each brother would independently own and control. Each half was large enough to be operated as a separate business. Upon the advice of professional tax consultants, the brothers decided to accomplish this division through the device of a "D" reorganization pursuant to Section 368(a)(1)(D) of the Internal Revenue Code. Where its requirements are met, the "D" reorganization permits the "split-off" which the brothers desired without triggering the recognition of gain for federal income tax purposes.

In order to comply with the requirements of the "D" reorganization, the controlled corporation, ELE, Inc., was formed and organized in December, 1983 (Stipulation 12). By deed dated 29 February 1984 (recorded 2 March 1984), approximately one-half of the assets of E. R. Evans & Sons, Inc., including the property

under appeal, were transferred to ELE, Inc., in exchange for 1,000 shares (100%) of the common stock of ELE, Inc. On 2 March 1984, E. R. Evans & Sons, Inc. transferred the same 1,000 shares of ELE, Inc. common stock to E. L. Evans in exchange for his 50% of the common stock of E. R. Evans & Sons, Inc.

Following the exchange, E. L. Evans owned 100% of the common stock of ELE, Inc.; ELE, Inc., in turn, owned the assets which had been transferred to it by E. R. Evans & Sons, Inc. E. R. Evans, Jr., following the transfer, was the sole shareholder in E. R. Evans & Sons, Inc.; E. R. Evans & Sons, Inc. owned the assets it had not transferred to ELE, Inc. At the end of the reorganization, each brother was the 100% shareholder in his own corporation. Each corporation owned assets equal to approximately one-half of the assets owned by E. R. Evans & Sons, Inc. prior to the reorganization. Each corporation owned sufficient assets to allow it to operate as an independent agricultural corporation and each was so operated.

The county denied ELE, Inc.'s application for present use treatment because ELE, Inc. was, for a short period of time, owned by E. R. Evans & Sons, Inc., another corporation. This, in the county's view, violates the requirements of G.S. 105-277.2 and G.S. 105-277.3. In its Brief the county notes that before agricultural or forest land can qualify for present use value, it must be "individually owned"; G.S. 105-277.3(a)(1) and (3). Moreover, "[i]f owned by a corporation, the property must have been owned by the corporation or one or more of its principal shareholders as defined in G.S. 105-277.2(4)b for the four years immediately preceding January 1 of the year for which the benefit

of this section is claimed." G.S. 105.277.3(b)(2). For a corporation to be considered "individually owned" it must have"... as its principal business one of the activities described in Subsections (1), (2), and (3), and whose shareholders are all natural persons actively engaged in the business of the corporation or a relative of a shareholder who is actively engaged in the business of the corporation." G.S. 105-277.2(4). The county contends that because ELE, Inc. was wholly owned by another corporation during the period of reorganization its timely applications for present use treatment must be denied.

The corporate reorganization described above was successfully complete. The transaction was considered non-taxable for federal income tax purposes pursuant to an approved corporate reorganization under Section 368(a)(1)(D) of the Internal Revenue Code (Stipulation 14).

The Commission takes judicial notice of Section 368 of the Internal Revenue Code and the Treasury Regulations promulgated thereunder. Specifically, the Commission takes notice of the provisions of Treasury Regulation Sections 1.368-1, 1.368-2, and 1.368-3. These regulations provide that, in order to qualify as a bono fide "D" reorganization, there must be a legitimate business purpose for the transaction; there must also be either a continuity of the existing business enterprise or a continuity in the use of a significant portion of the business assets. The stated policy underlying this general rule is to ensure that

reorganizations are limited to readjustments of continuing interests in property under modified corporate form; Treas. Reg. 1.368-1(d)(2).

The parties stipulated that, prior to the reorganization, all of the property of E. R. Evans & Sons, Inc. was qualified for present use treatment, and it is clear that the one-half of the property retained by E. R. Evans & Sons, Inc. continued to qualify after the reorganization. The county asserts that a literal reading of G.S. 105-277.3 requires disqualification of ELE, Inc. until four years have elapsed. In the county's view this disparate treatment of the two corporations is unavoidable.

One of the leading cases interpreting the present use value statutes is W. R. Co. v. North Carolina Property Tax Commission, 48 N.C. App. 245, 269 S.E.2d 636 (1980), cert. denied, 301 N.C. 727, 276 S.E.2d 287 (1981). In that case Judge Vaughn, writing for the Court, examined the purpose and legislative history of these statutes. The Court noted that when the law was rewritten in 1975, "individually owned" was defined as follows:

"Individually owned" means owned by:

- a. A natural person or persons or
- b. A corporation having as its principal business one of the activities described in subdivisions (1), (2) and (3), above, the real owners of all of the shares of such corporation being natural persons actively engaged in such activities, or the spouse, siblings or parents of such persons.

G.S. 105-277.2(4). This amendment extended the present use treatment to certain "family corporations"; 48 N.C. App. 245, 258. "The amendment was enacted at a time when farm families were advised to incorporate for estate planning purposes." Id.

at 259. The Court noted that the North Carolina statutes are quite restrictive with regard to which corporate entities can receive the benefit of present use treatment. In order to qualify, the corporation must have as its principal business one of the three permitted activities, and each shareholder must be actively engaged in the business of the corporation. Id.

In the Commission's view, the narrow question presented in this case must be resolved in a manner consistent with the purposes expressed above. The Commission notes in Stipulation 11 that:

"[a]t the death of E. R. Evans, Sr. in 1974, E. R. Evans, Jr. and Ernest L. Evans, surviving sons of E. R. Evans, Sr. were the major stockholders of E. R. Evans & Sons, Inc., with their mother owning a small number of shares. By the year 1982, E. R. Evans, Jr. and E. L. Evans had acquired the remainder of the capital stock of E. R. Evans & Sons, Inc., and owned all of the issued and outstanding stock of the corporation in equal shares, with each brother owning fifty percent (50%) of the stock."

The reorganization was the device used by the two brothers to achieve the division of their interests into separate entities. One of the reasons for the division was that it would simplify estate planning for each brother; see Commission's Finding Of Fact paragraph 1.

The Commission concludes, based upon the specific facts presented in this case, that the appellant, ELE, Inc., qualifies for present use treatment for the years 1984, 1985, and 1986. While it is true, as the county contends, that the statute does not normally contemplate the ownership of one corporation by another, the facts in this case reveal that Ernest L. Evans, with his brother, owned the subject property prior to the reorganization through his 50% ownership of stock in E. R. Evans

& Sons, Inc. During the reorganization, Ernest L. Evans, with his brother, owned the subject property through his 50% ownership of stock in E. R. Evans & Sons, Inc.; E. R. Evans & Sons, Inc. owned 100% of ELE, Inc. during this brief period. After the reorganization, Ernest L. Evans owned 100% of ELE, Inc. and through that corporation gained exclusive ownership and control over the subject property.

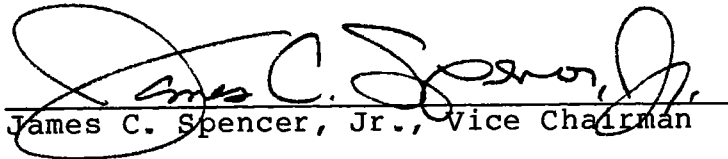
To deny present use treatment to ELE, Inc. under the circumstances of this case would be contrary to the legislative intent expressed in W. R. Co. v. Commission supra, to allow the use of family corporations as an estate planning device. The Commission, looking at the substance of these transactions rather than their form, finds no reason to deny present use treatment to the corporation owned by Ernest L. Evans where the statute clearly allows present use treatment for the corporation owned by E. R. Evans, Jr. The Commission concludes that the requirement of G.S. 105.277.3(b), that: "[i]f owned by a corporation, the property must have been owned by the corporation, or by one or more of its principal shareholders as defined in G.S. 105-277.2(4)b for the four years immediately preceding January 1 of the year for which the benefit of this section is claimed," is met. Ernest L. Evans, as the owner of a 50% interest in E. R. Evans & Sons, Inc. and later as the owner of a 100% interest in ELE, Inc., was the owner of the subject property for the four years immediately preceding January 1 of 1984, 1985, and 1986.

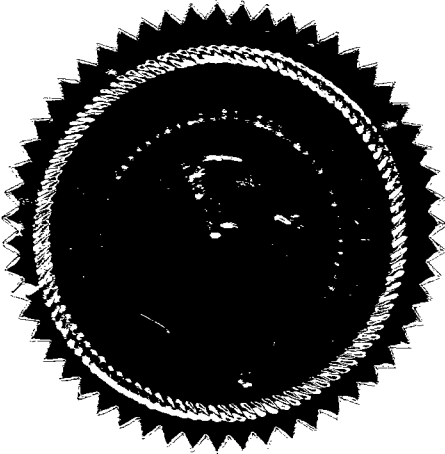
The ownership of a "small number" of shares in E. R. Evans & Sons, Inc. by the mother of the two brothers prior to 1982 does not affect this result.

WHEREFORE, IT IS ORDERED, ADJUDGED, AND DECREED that the decision of the Bertie County Board of Commissioners for 1986, denying present use value assessment and taxation to certain real property owned by the appellant for the years 1984, 1985 and 1986, is REVERSED. The county is instructed to revise its records accordingly.

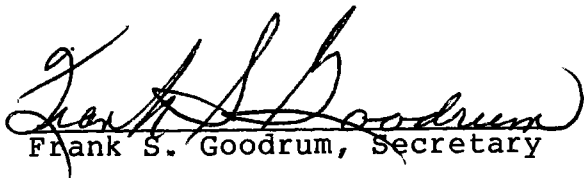
This the 10th day of March, 1988.

NORTH CAROLINA PROPERTY TAX COMMISSION


James C. Spencer, Jr., Vice Chairman



ATTEST:


Frank S. Goodrum, Secretary