North Carolina's Tax Assessment, Refund Review and Appeal Procedures

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The 2007 North Carolina General Assembly enacted sweeping reforms to the procedures for contesting State tax assessments and for claiming tax refunds. These changes affect assessments and refund claims for corporate income, franchise, individual income, sales and use, and other taxes imposed and collected by the State.

S.B. 242, 2007 Gen. Assem., enacted as S.L. 2007-491, establishes the procedures to be followed by the Department of Revenue and taxpayers to resolve both assessments and refund claims within the Department and provides for a prepayment appeal system under which a taxpayer may contest an assessment or a denial of a refund claim before an independent administrative law judge. The reform legislation also provides for new appeal procedures in the Business Court. Several technical changes to S.L. 2007-491 were accomplished through enactment of S.L. 2008-134 and S.L. 2008-107 during the 2008 session of the General Assembly. (Further technical changes are being considered by the Revenue Laws Committee for consideration during the 2010 session of the General Assembly.)

The reform legislation establishes a single unified procedure under which the procedure for reviewing tax refund claims and tax assessments is substantially identical. The procedures are set forth methodically and logically. Appeals are taken from a "final determination" of the Department of Revenue to the Office of Administrative Hearings ("OAH") where the record is set and a decision made by an administrative law judge. Action by the Secretary of Revenue on the OAH's decision results in the issuance of a "final decision" by the Secretary. Thereafter a taxpayer may request judicial review in Business Court, and, if necessary, in the appellate courts.

Requesting Refunds and Proposing Assessments

Refunds. The reform legislation establishes a limitations period for requesting a refund of an overpayment of tax, for any reason, of three years after the due date of the return or two years

after payment of the tax, whichever is later. *See* Appendix A for an outline of time periods. The due date of a return is considered to be the extended "due date." A 1975 Attorney General's opinion states that a claim for refund made within three years of the extended due date for filing a return is timely under former G.S. 105-266. *See* 44 N.C.A.G. 247 (1975). The Department concurs in and has followed this opinion and intends to continue to do so, according to Greg Radford, director of Corporate, Excise and Insurance Tax Division, NCDOR. Under former G.S. 105-267, when tax payments were made in installments, the statute of limitations for a refund request did not begin to run until after the last installment payment of a tax was paid. *See* **Rent-A-Car Co. v. Lynch**, 39 N.C. App. 709, 251 S.E.2d 917 (1979). While there is no North Carolina Supreme court case on this issue, federal cases cited in **Rent-A-Car Co.** support this decision in regard to federal estate tax. This precedent should continue to apply. If a taxpayer timely files a return reflecting a federal determination, the period for requesting a refund is the later of one year after such return is filed or three years after the original return was filed or due to be filed, whichever is later. Waiver of the statute of limitations by a taxpayer extends the time in which a taxpayer can obtain a refund to the end of the period extended by the waiver. *See* G.S. 105-241.6(b)(2).

A taxpayer may request a refund by filing an amended return reflecting an overpayment or by filing a claim for refund. Although the taxpayer must state the basis for the refund claim, the statement of the basis does not preclude the taxpayer from changing the basis for its claim thereafter. *See* G.S. 105-241.7(b). Within six months of the date of the filing of the refund claim, the Department must make the refund or partial refund (in which event the reason for the adjustment must be given), deny the refund and send a "notice of proposed denial," or request additional information concerning the requested refund. If the taxpayer provides the requested information, the Department must act on the request for refund within the later of the end of the six month period, 30 days after receiving the information requested, or a time period mutually agreed upon. If the taxpayer does not respond, the Department may deny the refund request and send the taxpayer a notice of proposed denial. *See* G.S. 105-241.7(c)(4).

The notice of proposed denial of the refund must state the basis for the proposed denial. However, statement of the basis for the denial does not limit the Department from changing the basis in the future. See G.S. 105-241.7(d). If the Department does not act on the request for refund within six months, the inaction is considered a proposed denial of the requested refund. *See* G.S. 105-241.7(c).

Assessments. S.L. 2007-491 provides that the Secretary may propose an assessment within the later of three years after the due date of the return or three years after the taxpayer filed the return. *See* G.S. 105-241.8(a)(1). The periods of time for making an assessment or requesting a refund after the taxpayer files a return reflecting a federal determination are identical. See G.S. 105-241.8(b) and G.S. 105-241.6(b)(1). The filing of an amended return does not extend the statute for making an assessment, except as discussed below relative to federal determinations.

The reform legislation made a significant change in the law regarding the ability of the Secretary to make assessments following federal determinations. Under the old law, a correction or final determination by the federal government for a tax year opened up the entire return for that year to audit and assessment for any reason. Under G.S. 105-241.10, a taxpayer will be liable for additional tax only if the additional tax is the result of adjustments related to the federal

determination. Similarly, the taxpayer will only be able to make a refund claim after a federal determination if the refund is the result of adjustments related to the federal determination. Except for adjustments related to the federal determination, this change to the law brings finality to tax years that under old G.S. 105-130.20 could remain open for audit and adjustment for extended periods of time - sometimes as much as six or seven years. The effective date for this change is for taxable years commencing on and after Jan. 1, 2007.

The reform legislation makes it clear that although a proposed assessment must set forth the basis for an assessment, the statement of that basis does not foreclose the Department from changing that basis. *See* G.S. 105-241.9(c)(1).

The difference in the periods of limitation between G.S. 105-241.6(a)(2), which provides a two year period after payment of tax for making a refund request, and G.S. 105-241.8(a)(2), which provides a three year period after the taxpayer files a return for making a proposed assessment, raises the possibility that a taxpayer, under audit, might discover that it had had a basis for a refund claim but the refund claim limitations period had expired. It has been Department policy to allow a taxpayer caught in such a situation to provide information which would justify a reduction in the assessment even though the time for filing a refund claim has passed. According to Greg Radford, director of Corporate, Excise and Insurance Tax Division, NCDOR, the Department intends to continue that policy of allowing an offset against an assessment although no refund will be allowed.

Decisions of the Secretary in making a proposed denial of a refund or in making a proposed assessment are presumed to be correct. *See* G.S. 105-241.7(f); G.S. 105-241.9(a).

Departmental Review of Proposed Assessments and Proposed Denials of Refunds
Under G.S. 105-241.11, a taxpayer who objects to a proposed denial of a refund or a proposed assessment may request a Departmental review of the proposed action. The request for review must be filed within forty five days of the date the proposed action was mailed to or delivered in person to the taxpayer. If no action is taken on a request for refund by the Department within six months, the request for review may be filed any time between the date that inaction by the Department was considered a proposed denial of the refund (six months after the date of filing of the amended return or claim for refund) and forty five days from the date a proposed denial is either mailed or delivered in person. A taxpayer whose refund request has been deemed denied by departmental inaction under GS 105-241.7(c) may request a Departmental review "at any time between the date that inaction by the Department on a request for refund is considered a proposed denial of the refund and the date the time periods set in the other subdivisions of this subsection expire." In other words, the taxpayer may file his request for Departmental review within the 45-day period from the date of the deemed denial or may wait and file his request for review at any time thereafter until 45 days from the date the notice of proposed denial is either mailed or delivered in person to the taxpayer.

Taxpayers who plan to use the mail or a delivery service to deliver requests for review must allow for adequate time - and proof of delivery - to file their requests for review. A request for review is considered filed only when the Department receives it, not when it is mailed. *See* G.S. 105-241.11(b). (The Revenue Laws Committee of the General Assembly is considering recommending

legislation which would provide that requests for review are also deemed filed when mailed by the USPS.)

If the taxpayer does not file a timely request for review of a proposed denial of a refund, the proposed denial is final and is expressly not subject to further administrative or judicial review. If the taxpayer does not file a timely request for review of a proposed assessment, the proposed assessment becomes final and is not subject to further administrative or judicial review. The taxpayer may, however, pay the tax and request a refund. *See* G.S. 105-241.12.

If the taxpayer does make a timely request for review, the Department must either grant the refund or remove the assessment, schedule a conference or request additional information from the taxpayer. If the refund is not granted or the assessment not removed, the Department must schedule a conference with the taxpayer, which may be by telephone or in person. Notice of the conference must be provided at least 30 days prior to the conference, unless the taxpayer agrees otherwise. *See* G.S. 105-241.13(b).

The conference is an informal proceeding designed to allow the Department and the taxpayer an opportunity to resolve the case, identical to the informal process followed under the old law. The taxpayer may designate a representative to appear for him at the conference. Failure of the taxpayer or a representative to attend the conference without prior notice to the Department results in a statutory determination that the parties are considered unable to resolve the taxpayer's objection and the issuance of a final determination by the Department. *See* G.S. 105-241.13(c)(3) and G.S. 105-241.14(a).

The taxpayer's representative at the informal conference need not be a lawyer. Under the Department's procedures, the taxpayer's representative will be required to present a power of attorney, which may be obtained from the Department's website (www.dor.state.nc.us), duly executed by the taxpayer and the representative.

According to the Department, most appeals have traditionally been resolved with the informal conference. It is the authors' experience that the directors, assistant directors and administration officers of the Divisions who conduct such conferences, (*e.g.* the Corporate, Excise and Insurance Tax, the Sales and Use Tax or the Personal Taxes Divisions) are unfailingly professional, courteous and knowledgeable, and will not hesitate to override the audit staff on a proposed assessment or to grant a refund if they are satisfied the taxpayer's position is correct.

Practice under the new law has shown that the Department makes heavy use of informal document requests to obtain documents and additional information from taxpayers during the review process. It is not uncommon for taxpayers to agree to extend the review period to accommodate the Department's information requests in the hope that free exchange of information will expedite resolution of cases.

Within nine months of the date the taxpayer files a request for review, unless the taxpayer and Department agree to an extension, a "final determination" must be issued by the Department. *See* G.S. 105-241.14(c). The final determination must state the basis for the determination, which does not limit the Department from changing the basis thereafter. During that nine month period, the

Department and the taxpayer may agree on a settlement, may agree that additional time is needed to negotiate or may fail to reach agreement, which will result in issuance of a final determination. *See* G.S. 105-241.13.

One potential weakness in the reform legislation is the failure by the General Assembly to address the situation in which the Department does not timely issue a final determination. G.S. 105-241.14(c) makes clear that failure to issue a notice of final determination within the required time does not affect the validity of a proposed assessment or proposed denial of a refund. However, the statute does not make clear what happens if the Department fails to issue a notice of final determination. Presumably, the Department will timely issue a final determination on a proposed assessment in order to expedite collection of the assessment. In the authors' experience, the Department is heedful of mandates of the General Assembly and takes seriously its responsibilities under the statutes it is charged with administering. Hopefully, concern over protection of the state's fisc will not slow down the issuance of final determinations on refund claims. This potential weakness may need to be corrected in a technical corrections bill, however, because a taxpayer's appeal rights are triggered by the issuance of a "notice of final determination". The legislation could be amended to provide that failure on the part of the Department to issue a final determination constitutes a "deemed" final determination. Query whether a taxpayer could seek judicial relief to compel issuance of a final determination. *See, e.g.* G.S. 150B-44.
Again, prudence indicates that taxpayers and practitioners should keep careful records of the time periods involved.

Appeals to the Office of Administrative Hearings
The Office of Administrative Hearings (OAH), established in 1985, has 10 administrative law judges (ALJ) who conduct hearings on appeals from administrative agencies, including, among many others, environmental, health and human services, personnel, health care certificate of need and licensing disputes. Most administrative appeals fall under the aegis of OAH. The disputes are often complex and frequently involve the use of expert witnesses. The Office of Administrative Hearings is an independent, quasi-judicial agency created by G.S. 7A-750, under authority of Article III, Section 11 of the N.C. Constitution. The Chief Administrative Law Judge, who serves as Director of the OAH, is appointed by the Chief Justice. The Chief Administrative Law Judge appoints additional administrative law judges as authorized by the General Assembly. He may designate certain ALJs as having the experience and expertise to preside at specific types of contested cases. *See* G.S. 7A-753.

One of the goals of advocates for reform of the tax appeal system was to attain both independence and expertise in the hearing officers assigned to tax appeals. The Office of Administrative Hearings was designed to provide both independence and expertise in contested administrative matters and has developed a reputation for both. As tax cases have been filed with the OAH, they have been distributed among the ALJs. According to Chief Administrative Law Judge, Julian Mann, as of Sept. 22, 2009, eighty appeals of DOR final determinations had been filed with the OAH, of which fifty five had been either withdrawn, not perfected or dismissed on procedural grounds. About half of the appeals have involved individual income tax. Of the pending open cases, eight relate to individual income tax, six to sales and use tax, five to unauthorized

substance tax and four to corporate income tax. Four of the pending individual income tax cases involved conservation easements. OAH has issued two decisions granting summary judgment to the DOR, both of which have been accepted by the Secretary.

Note: For an insightful discussion of proceedings before the OAH, see Chief Administrative Law Judge Julian Mann, III, Administrative Justice: No Longer Just A Recommendation, 79 N.C. L. REV. 1639 (2001). See also, Practice Before the Office of Administrative Hearings: An Overview, http://www.oah.state.nc.us/ .

S.L. 2007-491 provides that taxpayers who disagree with a notice of final determination issued by the Department may contest the determination by filing a petition for a contested case hearing at the OAH pursuant to Article 3 of Chapter 150B, but only after exhausting the prehearing remedy provided by the new legislation. The prehearing remedy is exhausted upon issuance by the Department of the final determination after conducting a review and a conference. *See* G.S. 105-241.15. The petition to the OAH must be filed within 60 days of service, by personal delivery or mailing, of the final determination. See G.S. 150B-23(f). Where the amount in controversy is $50,000 or greater, the petitioner must pay a filing fee of $125 to the OAH. *See* G.S. 150B-23.2 (effective Oct. 1, 2009).

The requirements for the petition are set forth in G.S. 150B-23(a). The taxpayer must allege facts tending to establish that the Department has deprived the taxpayer of property, ordered the taxpayer to pay a penalty or otherwise substantially prejudiced the taxpayer's rights and that the Department exceeded its authority or jurisdiction, acted erroneously, failed to use proper procedure, acted arbitrarily or capriciously, or failed to act as required by law or rule. See G.S. 150B-23(a). The OAH has promulgated a form petition which may be used in tax cases, a copy of which may be found at *http://www.oah.state.nc.us/forms* .

Although G.S. 150B-23(e) provides that all OAH hearings are open to the public, G.S. 150B-31.1 sets forth special provisions applicable to contested tax cases. G.S. 150B-31.1(e) provides that "the record, proceedings, and decision in a contested tax case [in the OAH] are confidential until the final decision is issued in the case," overriding the general provisions of G.S. 150B-23(e). As is discussed below, the final decision in the case is issued by the Secretary, so the proceedings will retain taxpayer confidentiality until that point. In recent years, pleadings filed in superior court by the Attorney General's staff representing the Department occasionally contained taxpayer information. Motion practice and trials of tax cases also resulted in taxpayer records being available in court files. The new procedures should alleviate taxpayers' confidentiality concerns because they can litigate their disputes with the Department, at least through the process before the OAH and before the Secretary through the final decision, without the concern of having their documents spread upon the public record.

Another goal of reform advocates was to develop a body of published precedent readily available to taxpayers. Although efforts have been made recently to increase publication of decisions of the Secretary, heretofore, decisions of the Secretary were published selectively. In the past, these decisions were sometimes published on the Department's Web site, but practitioners could never be certain that they had access to all of the Secretary's decisions relevant to a particular issue.

G.S. 105-256(a) now provides that the Secretary shall publish all final decisions of the Secretary in contested tax cases, but that identifying taxpayer information must be redacted prior to publication.

Hearings on all contested tax cases must be conducted in Wake County, unless the parties agree to hear the case in another county. See G.S. 150B-31.1(c). This provision overrides the more general provisions of G.S. 150B-24 as to venue.

Although G.S. 150B-31.1(b) provides for simplified procedures in contested tax cases involving taxpayers not represented by an attorney - thereby addressing a principal concern of the Department during the legislative proceedings - taxpayers other than individual taxpayers should be represented by attorneys. According to the OAH, in approximately 65% of its cases, individuals appear pro se; it is apparent that ALJs are accustomed to having unrepresented individuals appear before them. Given the formality of the quasi-judicial proceedings before the OAH, including the use of the Rules of Evidence and the use of discovery pursuant to the Rules of Civil Procedure, the fact that the record established before the ALJ will be the record for purposes of judicial review, and that the Department will be represented by the Attorney General's office, taxpayers are better protected by the involvement of competent counsel. *See* G.S. 150B-29; G.S. 150B-29; and 26 N.C.A.C. ? 03.0112 (for administrative procedures relating to discovery); and 26 N.C.A.C. 03.0122 (for administrative procedures relating to evidence).

G.S. 150B-28(b), which protected agencies from having to produce "records related solely to the internal procedures of the agency," was repealed by S.L. 2007-491. Taxpayers seeking discovery from the Department will be bound solely by the provisions of Rule 26(b) of the Rules of Civil Procedure, which broadly allows discovery "regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action...." The information sought in discovery need not itself be admissible "if the information sought appears reasonably calculated to lead to the discovery of admissible information." *See* G.S. 1A-1, Rule 26(b).

Several procedural points are worth mentioning. Taxpayers, who will have the burden of proof in contested cases, must establish the facts required by G.S. 150B-23(a) by a preponderance of the evidence. *See* G.S. 150B-29(a); G.S. 150B-34(a). Objections to evidence need not be raised at the hearing for a party to object to consideration of the evidence by the ALJ, the Secretary or by the superior court on judicial review. *See* G.S. 150B-29(a). ALJs may take official notice of all facts of which judicial notice may be taken, including "facts within the specialized knowledge of the agency." *See* G.S. 150B-30.

Motion practice before the OAH is governed by Rule 6 of the General Rules of Practice for the Superior and District Courts. See 26 N.C.A.C. ? 03.0115. The ALJ may dispose of cases on motions to dismiss under Rule 12(b) and on motions for summary judgment under Rule 56 of the Rules of Civil Procedure. *See* G.S. 150B-33(b) and G.S. 150B-36.

In tax cases brought under old G.S. 105-267, it was possible for several superior court judges to be involved with a tax case through its life unless the case was designated as "exceptional" or "complex business." *See* Rule 2.1 of the General Rules of Practice for the Superior and District Courts. A tax case assigned to the OAH will have one ALJ who will handle all proceedings

involving the case, which should promote judicial economy.

In issuing his decision, the ALJ must include findings of fact and conclusions of law. *See* G.S. 150B-34(a) and 26 N.C.A.C. ? 03.0127(c). The ALJ may receive proposed findings of fact and conclusions of law and written arguments after the contested hearing. *See* 26 N.C.A.C. ? 03.0127(a). Good practice would indicate that practitioners prepare to tender proposed findings of fact reflecting the evidence admitted. Counsel in proceedings before the OAH frequently submit orders reflecting the relief which they seek for consideration by the ALJ.

In making his decision, the ALJ shall give "due regard to the demonstrated knowledge and expertise of the agency with respect to the facts and inferences within the specialized knowledge of the agency." *See* G.S. 150B-34(a).

Final Agency Decision by Secretary

Upon rendering his decision, the ALJ must serve a copy of the decision on the taxpayer and the Department, and must promptly serve a copy of the official record on the Department so that the Secretary may make the final decision contemplated by G.S. 150B-36. *See* 26 N.C.A.C. ? 03.0127. The taxpayer will have the right to make exceptions to the decision of the ALJ and present written arguments to the Secretary, and may well want to do so to protect its interests. *See* G.S. 150B-36(a). The Secretary must adopt each finding of fact contained in the ALJ's decision "unless the finding is clearly contrary to the preponderance of the admissible evidence, giving due regard to the opportunity of the administrative law judge to evaluate the credibility of witnesses." *See* G.S. 150B-36(b). The Secretary may not hear new evidence. If the Secretary does not adopt the findings of fact, he must set forth in detail his reasons for not adopting the findings and the evidence he has relied upon in not adopting the findings. If the Secretary makes findings not contained in the ALJ's decision, he must similarly set out the basis in the evidence for his findings. Any finding the Secretary makes must be supported by the preponderance of the evidence in the record established before the ALJ. *Id.* The Secretary must adopt the decision of the ALJ unless the Secretary demonstrates that the decision is "clearly contrary to the preponderance of the evidence," and must set forth his reasoning. *Id.*

Judicial Review

A taxpayer aggrieved by a final decision in a contested tax case may seek judicial review of the decision under the provisions of Article 4 of Chapter 150B of the General Statutes, G.S. 150B-43 et seq. by filing a petition in superior court within 30 days after it has been served with the final decision. *See* G.S. 105-241.16 and G.S. 150B-45. Notwithstanding G.S. 150B-45, which provides that petitions seeking judicial review shall be filed in Wake County or in the superior court of the county where the person resides, under S.L. 2007-491 the petition in a tax case must be filed in the Wake County Superior Court, in accordance with the provisions for mandatory business cases set forth in G.S. 7A-45.4(b) through (f). *See* G.S. 105-241.16. Prior to filing the petition, the taxpayer must pay the amount of tax, penalties and interest the final decision states is due. (Although the intent of the legislation seemed clear enough, the Revenue Laws Committee is considering a recommendation to the 2010 session of the General Assembly to make it quite clear that these amounts be paid prior to filing the petition.) The option of posting a bond, previously provided by G.S. 105-241.3 in connection with judicial review of appeals of assessments, is no

longer available to taxpayers under the new law.

Advocates for reform of the tax appeal system sought expertise, not only in the hearing of tax appeals, where the record is set, but in the judicial review of final decisions of the Secretary in the courts. Tax cases are often complex and technical. The Business Court has developed a reputation for its highly competent judges, assisted by judicial clerks, accustomed to dealing with complex business cases. A study of the Business Court recognized that it might be appropriate to provide in the future for referral of tax cases to the Business Court. *See* Chief Justice's Commission on the Future of the North Carolina Business Court, Final Report and Recommendation (Oct. 28, 2004).

Assignment of complex tax cases to the Business Court should ultimately result in a greater degree of tax expertise in the judges handling these cases. As was contemplated when the Business Court was established, a body of reported case law is being developed by the Business Court upon which practitioners are relying. It seems probable that a body of tax law precedent will be developed by the Business Court which will provide guidance to taxpayers and practitioners.

One problem encountered by the drafters of S.L. 2007-491 was that, while it was thought desirable that many tax cases be reviewed in the Business Court, not all tax cases may be suitable for assignment to the Business Court. The Administrative Office of the Courts was particularly concerned that the resources of the Business Court not be unduly burdened by the assignment of tax cases which the Chief Justice or Chief Business Court Judge might not think appropriate for review by that court. The issue was resolved by the legislative decision to designate tax appeals as mandatory business cases upon filing, but to allow the Chief Justice and the Chief Business Court Judge to retain discretion as to which cases should be rejected by the Business Court and referred instead to the Wake County Superior Court. *See* G.S. 7A-45.4.

Once the petition and the notice of designation of a case as a mandatory complex business case have been filed, if the Chief Justice approves the assignment of the case to the Business Court, the Chief Judge of the Business Court then assigns the case to one of the three Business Court judges. An objection to designation of the tax appeal as a mandatory business case may be filed by the Department within thirty days after service of the notice of designation. In such event, the Chief Judge of the Business Court may determine that the case should not be designated as a mandatory complex business case and the case returned to the Wake County Superior Court. The court may also make such a decision on its own motion. If either the Department or the taxpayer disagrees with the decision, the party may appeal to the Chief Justice.

Although an adverse party has the right to object to the designation of a case as a mandatory complex business case, given that the objection must be made in good faith and that new G.S. 7A-45.4(a)(7) clearly provides that a tax appeal which has gone through the OAH process may be designated as a mandatory complex business case, such an objection by the Department would seem questionable.

As is discussed above, G.S. 150B-31.1(e) provides that "the record, proceeding, and decision in a contested tax case [in the OAH] are confidential until the final decision is issued in the case." G.S. 105-256(a)(9) provides that the Secretary shall publish final decisions of the Secretary in all

contested tax cases, with identifying taxpayer information redacted prior to publication. Query whether reading the two statutes together indicates legislative intent that the record and proceedings before the OAH should be held in confidence even after the final decision is entered, since their publication would render meaningless the protection of taxpayer confidentiality intended by G.S. 105-256(a)(9). The Department, which takes seriously its confidentiality obligations, should preserve the confidentiality of the record and proceedings transmitted to it by the OAH.

Once a petition seeking judicial review is filed, it is clearly available for public inspection. However, Business Court Rule 10.1 allows for the entry of protective orders for confidential or proprietary information. *See* Rule 10.1 of the General Rules of Practice and Procedure for the North Carolina Business Court. Rule 26(c) of the Rules of Civil Procedure allows for the entry of protective orders during discovery. *See* G.S. 1A-1, Rule 26(c). It seems reasonable that good cause could be shown for maintaining the confidentiality of the record established before the OAH during the judicial review process. In **Delhaize America, Inc. v. Reginald S. Hinton**, Secretary of Revenue, 07 CVS 20801, a case filed in the Business Court before Jan. 1, 2008, the effective date for S.B. 242, and thus brought under the old procedures for tax refund actions, the court entered an order protecting certain taxpayer records as confidential. See Confidentiality and Protective Order entered on June 9, 2008, accessible on the Web site of the Business Court, at *www.oah.state.nc.us* . As a possible analogy, the N.C. Supreme Court has held that the records of medical peer review committees, protected by statute, can be protected from public view at trial under both state and federal constitutional open courts guarantees. *See* **Virmani v. Presbyterian Health Servs. Corp.**, 350 N.C. 449, 515 S.E.2d 675 (1999).

Although, according to Chief Business Court Judge Ben Tennille, the Business Court plans to use electronic filing for tax cases, the rules of the Business Court allow parties to move to prevent electronic filing to protect confidential or proprietary information. *See* Rule 10.1 of the General Rules of Practice and Procedure of the North Carolina Business Court.

Scope and Standard of Review

The final decisions of the Secretary are subject to very different standards of judicial review, depending upon whether the Secretary adopts the decision of the ALJ or not. Under G.S. 150B-51(b), if the Secretary adopts the decision of the ALJ, the court may reverse or modify the Secretary's decision if the substantial rights of the taxpayer may have been prejudiced because the Secretary's findings, inferences, conclusion or decisions are (1) in violation of constitutional provisions, (2) in excess of the statutory authority or jurisdiction of the agency, (3) made upon unlawful procedure, (4) affected by other errors of law, (5) unsupported by substantial evidence admissible in view of the entire record as submitted, or (6) arbitrary, capricious or an abuse of discretion. *See* G.S. 150B-51(b).

On judicial review of an administrative agency's final decision, the substantive nature of each assignment of error dictates the standard of review. Questions of law receive de novo review, whereas fact-intensive issues such as sufficiency of the evidence to support an agency's decision are reviewed under the whole-record test. Under the de novo standard of review, the trial court consider(s) the matter anew and freely substitutes its own judgment for the agency's judgment. *See* **Luna v N.C. Dep't of Environment and Natural Resources**, 185 N.C. App. 291 (2007).

Appellate courts reviewing the decision of the superior court proceeding under G.S. 150B-51(b) will apply the same standard of review.

However, under G.S. 150B-51(c), if the agency substitutes its judgment for that of the ALJ, "the court shall review the official record, de novo, ... shall make findings of fact and conclusions of law[,]... shall not give deference to any prior decision in the case and shall not be bound by the findings of fact or the conclusions of law contained in the agency's final decision." *See* G.S. 150B-51(c). It is clear that the General Assembly, in rewriting the Administrative Procedures Act in 2000, intended to discourage agencies from overruling decisions of administrative law judges.

Appellate courts reviewing the decision of a superior court proceeding under G.S. 150B-51(c) will uphold the superior court's findings of fact "if supported by substantial evidence." *See* G.S. 150B-52 and **Donoghue v. N.C. Dep't of Correction**, 166 N.C. App. 612, 603 S.E.2d 360 (2004). Questions of law receive de novo review. *See* G.S. 150B-52 ("The scope of review to be applied by the appellate court under this section is the same as it is for other civil cases") and **Medina v. Div. of Soc. Servs.**, 165 N.C. App. 502, 598 S.E.2d 707 (2004) (the appellate standard for all questions of law is de novo review).

Direct Appeals to Superior Court Without Hearing in the OAH

In certain instances set forth in G.S. 150B-36(c), the decision of the ALJ, prior to a full evidentiary hearing, is a final decision appealable directly to superior court in accordance with the mandatory business case provisions. Those of principal interest to taxpayers include a decision by the ALJ that the OAH lacks jurisdiction and an order entered dismissing the contested case under Rule 12(b) in which all issues are disposed of. In addition, under G.S. 150B-36(d), if the ALJ grants summary judgment for the taxpayer or grants judgment on the pleadings under Rule 12(c), and the Secretary does not adopt the ALJ's decision, the taxpayer will be entitled to immediate judicial review in superior court.

If the taxpayer's petition to the OAH involves, as the sole issue, the unconstitutionality of a statute and not the application of the statute, then the OAH must dismiss the petition for lack of jurisdiction. Under North Carolina law, quasi-judicial bodies like the OAH do not have the authority to resolve claims of facial unconstitutionality, these claims being reserved for the judiciary. *See* **State ex rel. Utilities Com'n v. Carolina Utility Customers Ass'n, Inc.**, 336 N.C. 657, 673-74, 446 S.E.2d 332, 342 (1994) (citing **Great American Insurance Company v. Gold**, 254 N.C. 168, 118 S.E.2d 792 (1961)). Following such dismissal, the taxpayer may bring an action in Wake County Superior Court to challenge the statute following the procedures for a mandatory business case. However, the taxpayer must first pay the tax, penalties and interest the final determination states is due, and the action must be filed within two years of the dismissal. *See* G.S. 105-241.17.

If, however, the taxpayer's petition to the OAH raises statutory claims or alleges that a statute is unconstitutional as applied by the Department (that the application of a statute to a taxpayer's particular facts and circumstances is unconstitutional) in addition to a claim of facial unconstitutionality, the taxpayer must continue through the contested case process. The claim of facial unconstitutionality will then be reviewed with the taxpayer's other claims during the judicial review process in Superior Court. *See* G.S. 105-241.16.

The rules governing hearings before the OAH appear to anticipate as applied constitutional challenges. *See* 26 N.C.A.C. 03.0101 et seq. The administrative rules provide that an ALJ's decision shall fully dispose of all issues required to dispose of the case and shall contain "conclusions of law based on the findings of fact and applicable constitutional principles, statutes, rules or federal regulations." *See* 26 N.C.A.C. 03.0128(c)(6).

The General Assembly provided in 2007 that the provisions contained in SB 242 were to be the exclusive remedy for disputing the denial of a requested refund, a taxpayer's liability for a tax, or the constitutionality of a tax statute. *See* G.S. 105-241.19. In 2008 the General Assembly enacted legislation to deal with class actions. *See* G.S. 105-241.18.

To maintain a class action and to serve as a class representative, the taxpayer bringing the action must comply with all of the conditions of G.S. 105-241.17, i.e., the statute must be unconstitutional on its face and he must follow the steps outlined above to challenge a facially unconstitutional tax statute. He must also satisfy the requirements of Rule 23 of the North Carolina Rules of Civil Procedure.

G.S. 105-241.18 sets out the requirements to become a member of the class, tolling of the statute of limitations for filing a claim for refund for those eligible to become members of the class, and the effect of the class action on those who do not become a member of the class and their rights to pursue their remedies outside of the class action.

Conclusion

S.L. 2007-491, many of the provisions of which were long sought by tax practitioners, enhances the due process rights of taxpayers by providing a clear procedure for seeking refunds and a meaningful prepayment hearing therefore an independent administrative law on disputed assessments and refund claims. As such, it should enhance the regard of citizens for the fairness of North Carolina's tax procedures.

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