North Carolina’s New Tax Assessment, Refund and Appeal Procedures*
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The 2007 North Carolina General Assembly enacted sweeping reforms to the procedures for contesting 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.1

S.L. 2007-491 establishes new procedures to be followed by the Department of Revenue and taxpayers to resolve both assessments and refund claims within the Department and, for the first time, provides for a prepayment appeal system under which a taxpayer may contest an assessment before an independent administrative law judge. The reform legislation also provides for new appeal procedures in the Business Court.

History

Prior to adoption of S.L. 2007-491, depending on the circumstances, North Carolina law had three different procedures by which a taxpayer could contest its tax

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liability. The traditional remedy for contesting tax assessments or for seeking tax refunds was found in G.S. 105-267, which traced its antecedents to the 19th century. Under G.S. 105-267, taxpayers could pay a tax under protest and seek a refund in Superior Court. Although not usually sought, trial by jury was available.

In the mid 20th century, G.S. 105-241.1 et seq. was adopted to allow taxpayers to contest an assessment through an administrative process, involving an appeal of the assessment on a prepayment basis to the Secretary of Revenue ("the Secretary"), followed by an appeal to the Tax Review Board\(^2\) on the record set before the Secretary or his designee, with an appeal thereafter on the record to Superior Court. The taxpayer retained the right to forego this process, pay the tax, and sue under G.S. 105-267.\(^3\)

The third alternative, G.S. 105-266.1, was adopted to allow for the recovery of "excessive or incorrect" tax payments by the filing of a claim for refund, followed by a hearing before the Secretary, review of the Secretary's decision by the Tax Review Board and appeal thereafter to Superior Court. However, the courts made it clear that this remedy did not encompass constitutional challenges to the imposition of a tax,\(^4\) and that constitutional challenges must be pursued under G.S. 105-267.

The statutory schemes created by these three statutes included different periods of limitations and different procedural requirements. Practitioners often found the interplay among the statutes to be confusing, and sometimes a trap. This confusion was compounded by court rulings which made it unclear whether constitutional challenges

\(^2\) A three member board consisting of the State Treasurer, the Chairman of the Utilities Commission and a member appointed by the Governor.
\(^3\) G.S. 105-241.4.
could be brought under G.S. 105-241.1 *et seq.* or only under G.S. 105-267\(^5\) and what constituted a valid protest under G.S. 105-267.\(^6\)

Taxpayers and practitioners representing taxpayers were particularly troubled by the lack of an independent prepayment hearing of assessment appeals outside the Department. Under the appeals system set up by G.S. 105-241.1 *et seq.*, taxpayers’ appeals were taken to an Assistant Secretary appointed by the Secretary of Revenue\(^7\) whose office was located in the Secretary's suite. Hearings were not subject to the rules of evidence, nor were the rules of civil procedure applicable. Taxpayer representation by counsel was not required.\(^8\) The Department resisted discovery, taking the position that taxpayers were not entitled to discovery in these hearings. Appeals from the Secretary's decisions to the Tax Review Board and thereafter to Superior Court were on the record established before the Secretary and were entitled to the deference given to decisions made in administrative appeals under G.S. 150B-51(b), unless the taxpayer opted to pay

\(^5\) North Carolina cases are replete with statements that indicate that G.S. 105-267 is the only statute under which the constitutionality of a tax statute or the constitutionality of the Secretary's actions might be challenged. See, e.g., Coca-Cola v. Coble, supra; Bailey v. State, 330 N.C. 227, 235, 412 S.E.2d 295, 300 (1991) (Bailey I). However, in A&F Trademark, Inc v. Tolson, 167 N.C. App. 150, 605 S.E.2d 187 (2004), the Court of Appeals (in affirming a superior court decision in which the superior court affirmed a Tax Review Board decision sustaining an assessment) addressed the taxpayers' constitutional arguments in a case which had arisen under G.S. 105-241.1 *et seq.* and not under G.S. 105-267.

\(^6\) G.S. 105-267 provided that a taxpayer must "demand a refund of the tax paid in writing from the Secretary," and a long line of N.C. Supreme Court and Court of Appeals decisions made it clear that the law meant what it said. Kirkpatrick v. Currie, 250 N.C. 213, 216, 108 S.E.2d 209, 215 (1959); see also Buchan v. Shaw, 238 N.C. 522, 523, 78 S.E.2d 317, 317 (1953) (dismissing action because plaintiff had not followed the procedures prescribed by G.S. 105-267); Javurek v. Tax Rev. Bd., 165 N.C. App. 834, 840, 605 S.E.2d 317, 317 (2004) (holding that, because plaintiff did not comply with the procedure prescribed by G.S. 105-267, the superior court lacked subject matter jurisdiction); Salas v. McGee, 125 N.C. App. 255, 259, 480 S.E.2d 714, 717 (1997) (because plaintiffs did not comply with the statutory refund demand procedures in G.S. 105-267, the trial court was barred from hearing their action); 47th Street Photo, Inc v. Powers, 100 N.C. App. 746, 749, 398 S.E.2d 52, 54 (1990) (holding that, in challenging a tax, plaintiff must proceed according to the requirements of G.S. 105-267). However, the N.C. Supreme Court held in Bailey v. State, 348 N.C. 130, 500 S.E.2d 54 (1998) (Bailey II) that while claims of illegal or improper taxation are subject to the procedural requirements of G.S. 105-267, notice is only required to the extent necessary to provide the State with notice sufficient to protect the State’s fiscal stability.

\(^7\) Under authority of G.S. 105-260.1.

\(^8\) But see G.S. 84-1 *et seq.* governing the authorized practice of law.
the tax and proceed under G.S. 105-267 with a trial *de novo*. Even though the Department had worked in recent years to insulate its hearing officer from the Department’s influence, the statutory scheme did not lend itself to the independence taxpayers desired, nor did it provide for the statutory protections provided under the Administrative Procedures Act, G.S. 150B.

The Council of the Tax Section of the North Carolina Bar Association had for some years taken the position that the tax appeals system demanded reform. In 2007 the North Carolina Bar Association formally endorsed the reforms set out in S.B. 242 (subsequently enacted as S.L. 2007-491). In 2004, the Council on State Taxation (“COST”) had evaluated all 50 states' tax systems using a method that attempted to objectively analyze each state’s treatment in its statutes of significant procedural issues that reflect whether a state provided "fair, efficient, and customer-focused tax administration." The 2004 COST study had ranked North Carolina 43rd of 50 states. The 2007 COST study rated North Carolina even lower on the same criteria. CFO Magazine similarly ranked North Carolina “as having one of the least independent appeals processes in the country”. By 2006, North Carolina was one of only 15 states that did not provide an independent, prepayment appeals system.

Confronted with criticisms of the tax assessment and appeal system, the General Assembly in its 2006 Session directed its Revenue Laws Study Committee to study the

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9 Best and Worst of State Tax Administration: COST Scorecard on Appeals, Procedural Requirements, 11 MULTISTATE TAX REPORT, March 26, 2004 at 137.
10 Give and Take: As State Economic-Development Teams Offer Tax Breaks to Attract Companies, Revenue Departments Seek to Get That Money Back, CFO MAGAZINE, Jan. 10, 2007.
system and to make recommendations to the 2007 session. ¹² The Revenue Laws Study Committee made reform recommendations to the General Assembly as part of its report,¹³ and these recommendations formed the core of SB 242.¹⁴

The new legislation repeals the statutes governing the administration and judicial review of disputed tax matters (generally effective January 1, 2008, except as noted otherwise) and replaces them with a single unified procedure under which the procedure for handling tax refunds and reviewing tax assessments will be substantially identical. The new procedures are set forth methodically and logically. Appeals will be taken from a “final determination” of the Department to the Office of Administrative Hearings (“OAH”) where the record will be set and a decision made by an administrative law judge. Action by the Secretary on the OAH’s decision will result in the issuance of a “final decision” by the Secretary. Thereafter a taxpayer may request judicial review in Business Court.

One remedy lost by taxpayers in the change to a unified tax appeal system is the right to pay the tax and proceed directly to court in a refund action under G.S. 105-267. This was a trade-off in the give and take of the legislative process. This remedy is available in the federal system, under which a taxpayer may sue for a refund in federal

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¹⁴ SB 242 was introduced in the Senate by Senator Dan Clodfelter, D-Mecklenburg, who tenaciously led the reform effort. Significant portions of HB 2038, introduced in the House by Rep. Pryor Gibson, D-Anson, were incorporated into SB 242 while under consideration by the House Judiciary-1 Committee, chaired by Rep. Deborah Ross, D-Wake who, with Rep. Gibson, guided the bill through the House. The bill went through 21 drafts as legislative staff (Trina Griffin and Sabra Faires), representatives of the Department and the public commented on the evolving iterations, before the bill was presented to the Senate Finance Committee for consideration. In addition to COST and the North Carolina Bar Association, the bill was supported by the North Carolina Chamber of Commerce, the North Carolina Bankers Association and the North Carolina Retail Merchants Association.
district court or the United States Court of Federal Claims or proceed to Tax Court without payment of the tax.\textsuperscript{15}

**Requesting Refunds and Proposing Assessments**

**Refunds.** The new legislation establishes a limitations period for requesting a refund of an overpayment of tax, for any reason, of 3 years after the due date of the return\textsuperscript{16} or 2 years after payment of the tax,\textsuperscript{17} whichever is later.\textsuperscript{18} 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. As under current law,\textsuperscript{19} 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.\textsuperscript{20}

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

\textsuperscript{15} For a criticism of this and other aspects of SB 242, see Jasper L. Cummings, Jr., *New Procedures for Contested Tax Cases in North Carolina*, State Tax Notes, September 3, 2007 at 635-39; for another perspective, see Kay Miller Hobart, *Lawmakers Adopt New Procedures To Review Tax Disputes*, State Tax Notes, August 20, 2007 at 480.

\textsuperscript{16} 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 G.S. 105-266. 44 N.C.A.G. 247 (1975). The Department concurs in and has followed this opinion and intends to continue to do so. Telephone conference with Mr. Greg Radford, Director of Corporate, Excise and Insurance Tax Division, North Carolina Department of Revenue, September 12, 2007. See Corporate Tax Directive, CD-06-1.

\textsuperscript{17} Under 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 to the new statute.

\textsuperscript{18} See Appendix for an outline of time periods under S.L. 2007-491. The new limitations period is shorter than the former limitations period set forth in G.S. 105-267. Under G.S. 105-267, a taxpayer had three years from the date of payment of the tax to request a refund.

\textsuperscript{19} G.S. 105-266(c)(1) (current law, effective until January 1, 2008).

\textsuperscript{20} G.S. 105-241.6(b)(2). All statutory references to Chapter 105 hereafter are to the new law, unless indicated to the contrary.
changing the basis for its claim thereafter.21 Within 6 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 6 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.22

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.23 If the Department does not act on the request for refund within 6 months, the inaction is considered a proposed denial of the requested refund.24

Assessments. S.L. 2007-491 provides that the Secretary may propose an assessment within the later of 3 years after the due date of the return25 or 3 years after the taxpayer filed the return.26 The periods of time for making an assessment or requesting a refund after the taxpayer files a return reflecting a federal determination are identical.27

21 G.S. 105-241.7(b).
22 G.S. 105-241.7(c).
23 G.S. 105-241.7(d).
24 G.S. 105-241.7(c).
25 SL 2007-491 extended the due date of corporate income tax and franchise tax returns by one month. G.S. 105-122(a)1, G.S. 105-130.17(a).
26 G.S. 105-241.8(a)(1). The filing of an amended return does not extend the statute for making an assessment, except as discussed below relative to federal determinations. Telephone conference with Mr. Greg Radford, Director of Corporate, Excise and Insurance Tax Division, North Carolina Department of Revenue, September 12, 2007.
27 G.S. 105-241.8(b); G.S. 105-241.6(b)(1).
The new legislation makes 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 6 or 7 years. The effective date for this change is for taxable years commencing on and after January 1, 2007.

The new 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. 28

The difference in the periods of limitation between G.S. 105-241.6(a)(2), which provides a 2 year period after payment of tax for making a refund request, and G.S. 105-241.8(a)(2), which provides a 3-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

28 G.S. 105-241.9(c)(1).
time for filing a refund claim has passed. The Department intends to continue that policy of allowing an offset against an assessment although no refund will be allowed.\textsuperscript{29}

As under prior law,\textsuperscript{30} decisions of the Secretary in making a proposed denial of a refund or in making a proposed assessment are presumed to be correct.\textsuperscript{31}

\textbf{Departmental review of proposed assessments and proposed denials of refunds}

Under G.S. 105-241.11, a taxpayer who object 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 45 days of the date the proposed action was mailed to or delivered in person to the taxpayer. The old law had allowed only a 30-day protest period. If no action is taken on a request for refund by the Department within 6 months, the request for review must be filed within 45 days of the date that inaction by the Department was considered a proposed denial of the refund (6 months after the date of filing of the amended return or claim for refund).

Two points are worth noting. First, the potential for malpractice on the part of a practitioner and for loss of a refund claim on the part of the taxpayer exists if careful records are not kept of the date of filing the claim for refund, so that if the Department does not act, the taxpayer knows to make a timely request for review.\textsuperscript{32} Second, 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

\textsuperscript{29} Telephone conference with Greg Radford, Director Corporate, Excise and Insurance Tax Division, NCDOR, September 12, 2007.

\textsuperscript{30} Old G.S. 105-241.1(a).

\textsuperscript{31} G.S. 105-241.7(f); G.S. 105-241.9(a).

\textsuperscript{32} This issue is being studied by the Revenue Laws Committee of the General Assembly. The authors anticipate remedial legislation during 2008.
request for review is considered filed only when the Department receives it, not when it is mailed.  

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.

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. 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

33 G.S. 105-241.11(b).
34 G.S. 105-241.12.
35 G.S. 105-241.13(b).
36 Id.
resolve the taxpayer's objection and the issuance of a final determination by the
Department.37

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.

Within 9 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.38 The final determination must state the basis for the determination,
which does not limit the Department from changing the basis thereafter. During that 9-
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.39

37 G.S. 105-241.13(c)(3); G.S. 105-241.14(a).
38 G.S. 105-241.14(c).
One potential weakness in the new 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. 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.\(^{40}\)

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 ten 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

\(^{40}\) Query whether a taxpayer could seek judicial relief to compel issuance of a final determination. See, e.g. G.S. 150B-44.
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.  

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. It is the intention of the Chief Administrative Law Judge to see that members of the central panel of administrative law judges receive tax training. At the current time, he does not intend to assign cases to a single ALJ, but rather intends to develop expertise in at least several ALJs.

SL 2007-491 provides that taxpayers who disagree with a notice of final determination issued by the Department may contest the determination by filing a

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41 G.S. 7A-753.
42 As one example, ex parte communications with the ALJ, a concern of practitioners in appeals to the Secretary under the former procedure, are prohibited. G.S. 150B-35.
45 The Department of Revenue provided to the Revenue Law Study Committee the following statistics on 2006 appeals under the former system, which may provide some indication of appeal volume to the OAH under the new system: corporate, excise and franchise – 7; motor fuels – 4; personal tax – 10; sales & use – 5; and unauthorized substance - 131.
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.\textsuperscript{46} The petition to the OAH must be filed within 60 days of service, by personal delivery or mailing, of the final determination.\textsuperscript{47}

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.\textsuperscript{48}

Although G.S. 150B-23(e) provides that all OAH hearings are open to the public, new 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.

\textsuperscript{46} G.S. 105-241.15.
\textsuperscript{47} G.S. 150B-23(f).
\textsuperscript{48} G.S. 150B-23(a).
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 several years, these decisions were sometimes published on the Department's website, 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 now be conducted in Wake County, unless the parties agree to hear the case in another county. This new provision overrides the more general provisions of G.S. 150B-24 as to venue.

Although new 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 will require representation by attorneys. Given the increased formality of the quasi-judicial proceedings before the OAH when contrasted

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49 G.S. 150B-31.1(c).
50 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.
with the relative informality of proceedings before the Secretary, including the use of the Rules of Evidence and the use of discovery pursuant to the Rules of Civil Procedure, and the fact that the record established before the ALJ will be the record for purposes of judicial review, taxpayers are better protected by the involvement of competent counsel.

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."

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. 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. ALJs may take official notice of all facts of which judicial notice may be taken, including “facts within the specialized knowledge of the agency.”

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52 G.S. 150B-29. The standards for admissibility are liberalized in G.S. 150B-29(a).
53 G.S. 150B-28; G.S. 150B-33(b)(3) & (3a).
54 See also 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.
55 G.S. 1A-1, Rule 26(b).
56 G.S. 150B-29(a); G.S. 150B-34(a).
57 G.S. 150B-29(a).
58 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. 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.

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.” 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. The ALJ may receive proposed findings of fact and conclusions of law and written arguments after the contested hearing. 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."

59 26 N.C.A.C. § 03.0115.
60 G.S. 150B-33(b); G.S. 150B-36.
62 G.S. 150B-34(a); 26 N.C.A.C. § 03.0127(c).
63 26 N.C.A.C. § 03.0127(a).
64 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\(^65\) so that the Secretary may make the final decision contemplated by G.S. 150B-36. 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.\(^66\) 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."\(^67\) 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. \(\text{Id.}\) 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. \(\text{Id.}\)

**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

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\(^{65}\) 26 N.C.A.C. § 03.0127.
\(^{66}\) G.S. 150B-36(a).
\(^{67}\) G.S. 150B-36(b)
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.\textsuperscript{68} 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).\textsuperscript{69} Prior to filing the petition, the taxpayer must pay the amount of tax, penalties and interest the final decision states is due.\textsuperscript{70}

The Tax Review Board has been abolished by S.L. 2007-491, as its review functions have been eliminated with direct judicial review of final Secretary decisions.\textsuperscript{71}

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 recent study of the Business Court had recognized that it might be appropriate to provide in the future for referral of tax cases to the Business Court.\textsuperscript{72}

\textsuperscript{68} G.S. 105-241.16; G.S. 150B-45.
\textsuperscript{69} G.S. 105-241.16.
\textsuperscript{70} Id.
\textsuperscript{71} In addition to reviewing decisions of the Secretary, the Tax Review Board, augmented by the addition of the Secretary, was also responsible for hearing taxpayer requests for changes in the apportionment formula for corporate income and franchise tax purposes. Under the new law, decisions concerning alternate apportionment methods will be made by the Secretary. G.S. 105-122(c1); G.S. 105-130.4(t1). These decisions, as were those of the ATRB, are not appealable.
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.

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 30 days after service of the notice of designation. In such event, the Chief Judge of the Business Court may

73 G.S. 7A-45.4(7).
74 G.S. 7A-45.4.
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. Id.

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, new 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." New 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. Rule 26(c) of the Rules of Civil Procedure allows for the entry of protective orders during discovery. 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. 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.

Although 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.

**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.

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76 G.S. 1A-1, Rule 26(c).
78 Email from Chief Business Court Judge Ben Tennille of September 10, 2007.
80 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.\(^\text{81}\)

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."\(^\text{82}\) 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.”\(^\text{83}\) Questions of law receive de novo review.\(^\text{84}\)

**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

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\(^{81}\) Luna v N.C. Dep’t of Environment and Natural Resources, ___N.C. App. ___, 648 S.E.2d 280, 282 (Aug. 7, 2007).

\(^{82}\) G.S. 150B-51(c)

\(^{83}\) G.S. 150B-52; Donoghue v. N.C. Dep’t of Correction, 166 N.C. App. 612, 603 S.E.2d 360 (2004).

\(^{84}\) 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”); 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).
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.85 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 2 years of the dismissal.86

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

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86 G.S. 105-241.17.
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.\textsuperscript{87}

**Transition Rules**

The Department mailed letters to taxpayers outlining procedures in the transition from the old law to the new under the authority granted to the Secretary in G.S. 105-264.\textsuperscript{88}

The Department decided that the last date for hearings before the Assistant Secretary under G.S. 105-241.1 \textit{et seq.} would be October 31, 2007. Taxpayers who had hearings scheduled on or before that date could either proceed with a hearing before the Assistant Secretary with review thereafter by the Tax Review Board and the Superior Court under old G.S. 105-241.2 \textit{et seq.} or could decide to have their appeals heard by the Office of Administrative Hearings after January 1, 2008. Requests for hearings on proposed assessments or refund claims previously filed under old G.S. 105-266.1 are being treated as "requests for review" under new G.S. 105-241.11.\textsuperscript{89} That will trigger a review process under new G.S. 105-241.13, which will involve a conference on 30 days notice with the Department. If no resolution is reached at that stage, the Department must issue a notice of final determination within 9 months of the request for review. During that 9-month period, the Department may request additional information from the taxpayer. The Department has stated that the 9-month deadline for taxpayers who filed requests for hearing prior to January 1, 2008 began to run on January 1, 2008.\textsuperscript{90}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{87} G.S. 105-241.16.
\item \textsuperscript{88} Letters of Department to taxpayers dated September 7, 2007.
\item \textsuperscript{89} Id.
\item \textsuperscript{90} Telephone conference with Mr. Greg Radford, Director of Corporate, Excise and Insurance Tax Division, North Carolina Department of Revenue, September 12, 2007.
\end{itemize}
\end{footnotesize}
Upon issuance of the notice of final determination, the taxpayer will have 60 days to petition for a contested case hearing in the OAH, where an ALJ will try the case under the procedures set out in Chapter 150B of the General Statutes, as described above. We estimate the time for discovery, hearing preparation, hearing and issuance of a decision to be at least a year, perhaps more likely 18 months, although given the fact that these cases will be an entirely new type of case for the OAH, it could take longer. In addition, the Attorney General's staff believes that it will need five new lawyers to handle the new caseload and these lawyers will not be available, unless internal resources are shifted, until well after July 1, 2008, assuming the General Assembly authorizes them. S.L. 2007-491 directs the Revenue Laws Study Committee to study that issue.

CONCLUSION

SL 2007-491, many of the provisions of which have been long sought by tax practitioners, enhances the due process rights of taxpayers by providing a meaningful prepayment hearing on disputed assessments and a clear procedure for seeking refunds. As such, it should enhance the regard of citizens for the fairness of North Carolina’s tax procedures.
## APPENDIX
### TIMELINES UNDER S.L. 2007-491

<table>
<thead>
<tr>
<th>EVENT</th>
<th>PERIOD</th>
<th>REFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxpayer requests refund of overpayment</td>
<td>Later of 3 years after due date of return or 2 years after payment of tax</td>
<td>GS 105-241.6(a)</td>
</tr>
<tr>
<td>Taxpayer requests refund of overpayment after federal determination</td>
<td>Later of 1 year after return reflecting federal determination filed or 3 years after original return filed or due to be filed, whichever is later</td>
<td>GS 105-241.6(b)</td>
</tr>
<tr>
<td>DOR acts on refund request</td>
<td>6 months after refund claim filed or 30 days after taxpayer responds to DOR information request, whichever is later</td>
<td>GS 105-241.7(c)</td>
</tr>
<tr>
<td>DOR proposes assessment</td>
<td>Later of 3 years after due date of return or 3 years after taxpayer files return</td>
<td>GS 105-241.8(a)</td>
</tr>
<tr>
<td>DOR proposes assessment after federal determination</td>
<td>Later of 1 year after return reflecting federal determination filed or 3 years after original return filed or due to be filed, whichever is later</td>
<td>GS 105-241.8(b)(1)</td>
</tr>
<tr>
<td>Taxpayer requests review of proposed denial of refund or proposed assessment of tax</td>
<td>45 days after: (1) notice of denial or assessment mailed; (2) date notice delivered in person, or (3) the lapse of 6 months after the filing of a refund claim without action by the Department</td>
<td>GS 105-241.11</td>
</tr>
<tr>
<td>DOR sets conference to discuss request for review</td>
<td>30 days notice, unless taxpayer agrees to shorten notice</td>
<td>GS 105-241.13(b)</td>
</tr>
<tr>
<td>DOR issues notice of final determination</td>
<td>9 months after request for review filed, unless both parties agree to an extension of time</td>
<td>GS 105-241.14(c)</td>
</tr>
<tr>
<td>Taxpayer files petition with OAH</td>
<td>60 days after notice of final determination delivered or mailed</td>
<td>GS 105-241.15; GS105B-23(f)</td>
</tr>
<tr>
<td>Secretary issues final decision</td>
<td>60-120 days after receipt of official record from OAH</td>
<td>GS 150B-44</td>
</tr>
<tr>
<td>Taxpayer files petition for judicial review of Secretary’s final decision in Superior Court of Wake County in accordance with procedures for mandatory business court case</td>
<td>30 days after service of final decision on taxpayer</td>
<td>GS 105-241.16; GS 150B-45</td>
</tr>
<tr>
<td>Complaint filed challenging facial unconstitutionality of statute as sole basis for tax appeal</td>
<td>2 years after dismissal by OAH of petition</td>
<td>GS 105-241.17</td>
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</tbody>
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