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**WAKING A SLEEPING GIANT? ANALYZING THE JUST
AND EQUITABLE TAX CLAUSE AS A PROTECTION FOR
BUSINESS TAXPAYERS**

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I. INTRODUCTION

In Fiscal Year 2012 (“FY2012”),¹ businesses across America paid a total of \$649 billion in state and local taxes.² On average, the business sector shouldered 45.2% of the total state and local taxes collected by the fifty states and the District of Columbia.³ While these numbers may seem small compared to the \$2.45 trillion in revenue collected by the United States government in the same time frame,⁴ the importance of state-based taxation cannot be downplayed. These funds help pay for a variety of state needs, including education, healthcare, transportation, and social services.⁵

The ability to levy taxes is a strong power that must be respected. As famously noted by Justice Marshall in *McCulloch v. Maryland*, “the power to tax involves the power to destroy.”⁶ As a result, protections against the imposition of unreasonable or prohibitive taxes are an ongoing concern at both the state and federal level. With respect to taxes levied on businesses, proponents of restrained taxation policies touch upon issues such as the burden passed on to the consumer and the theoretical power of taxes to control the prosper or decline of different industries.⁷ Overall, balancing the freedom to raise necessary revenues with protections against unreasonable taxation is a delicate balance, with enormous consequences for the long-term welfare of both the government and its citizens.⁸

¹ See ANDREW PHILLIPS ET AL., TOTAL STATE AND LOCAL BUSINESS TAXES: STATE-BY-STATE ESTIMATES FOR FISCAL YEAR 2012, available at <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=84767> (last visited Mar. 7, 2014) (FY2012 for the large majority of states and D.C., including North Carolina, is June 2011 through July 2012).

² *Id.* at 1.

³ *Id.* at 14.

⁴ CONGRESSIONAL BUDGET OFFICE, MONTHLY BUDGET REVIEW: FISCAL YEAR 2012, available at <http://www.cbo.gov/publication/43656> (last visited Feb. 9, 2014).

⁵ See *Where Do Our State Tax Dollars Go?* CENTER ON BUDGET AND POLICY PRIORITIES, POLICY BASICS <http://www.cbpp.org/files/policybasics-statetaxdollars.pdf> (Mar. 27, 2014); see also *State v. Lockett*, 152 S.E. 693, 695–97 (N.C. 1930) (holding that licenses and fees collected by the government are necessary for the public health, safety, and welfare).

⁶ *McCulloch v. Maryland*, 17 U.S. 316, 431 (U.S. 1819).

⁷ See Rob Norton, *Corporate Taxation*, LIBRARY OF ECONOMICS AND LIBERTY, <http://www.econlib.org/library/Enc/CorporateTaxation.html> (last visited January 16, 2015).

⁸ *E. B. Ficklen Tobacco Co. v. Maxwell*, 199 S.E. 405, 408 (N.C. 1938) (arguing that “[t]he continued maintenance of government itself as a great communal activity in behalf of all the citizens of the State is dependent upon an adequate taxing power.”).

Today, state and federal governments have a vast array of revenue raising tax mechanisms at their disposal. Establishing different taxes for different business activities allows state governments to tailor a business' total tax bill to more closely mirror the governmental resources the entity consumes.⁹ For example, a property tax can generate revenues from real estate developers with large landholdings, while a corporate income tax can effectively source revenues from a locally-based Internet company, with a small footprint yet large profits.

In North Carolina, the State's taxing power is only limited by the North Carolina constitution.¹⁰ Along with the more common protections, such as uniformity and public purpose provisions that other states have,¹¹ North Carolina possesses a unique¹² constitutional protection against abuse of taxation, known as the "Just and Equitable Tax Clause."¹³

Despite the novelty of the Just and Equitable Tax Clause among state constitutions, it has received surprisingly little judicial and legislative attention since its implementation in 1935. However, after a nearly seventy-nine-year slumber, the Just and Equitable Tax Clause reemerged when the North Carolina Supreme Court issued its watershed application of the clause in *IMT, Inc. v. City of Lumberton*.¹⁴ Supported by all of the presiding Justices,¹⁵ this opinion represented the first direct interpretation of the Just and Equitable Tax Clause.¹⁶ More importantly, the court used this opportunity to develop

⁹ David Brunori & Joseph J. Cordes, *The State Corporate Income Tax: Recent Trends for a Troubled Tax*, AMERICAN INSTITUTE OF TAX POLICY (Aug. 15, 2005), http://www.americantaxpolicyinstitute.org/pdf/StateCorpTax%208-15-05%20_2_.pdf 23–25.

¹⁰ *Lenoir Fin. Co. v. Currie*, 118 S.E.2d 543, 545 (N.C. 1961) (arguing that "[t]he legislative power to tax is limited only by constitutional provisions.").

¹¹ See 2-18 BENDER'S STATE TAXATION: PRINCIPLES AND PRACTICE §18.10 (Charles W. Swenson ed., Matthew Bender, 2014) (noting that "[m]ost state constitutions contain uniformity provisions. These provisions differ as to the level of rigor they impose and the types of taxes to which they apply.").

¹² Dan Way, *City Argues That Courts Have No Power To Alter Tax Policies*, NC INSTITUTE FOR CONSTITUTIONAL LAW (Aug. 7, 2012), <http://www.ncicl.org/article/774> (stating that "[t]he just and equitable tax clause is an unusual taxpayer protection among the states.").

¹³ N.C. CONST. art. V, § 2(1).

¹⁴ *IMT, Inc. v. City of Lumberton*, 738 S.E.2d 156, 158 *reh'g denied*, 740 S.E.2d 478 (N.C. 2013)

¹⁵ See *id.* at 160 (Justice Beasley took no part in the case; all others joined the only opinion of the Court).

¹⁶ See *id.* at 156.

the Just and Equitable Tax Clause into a new constitutional protection for business taxpayers.¹⁷

This article will examine the Just and Equitable Tax Clause's effectiveness at protecting business taxpayers. In analyzing the Just and Equitable Tax Clause's evolution and newfound implications for North Carolina companies, this article first summarizes the history and application of the Just and Equitable Tax Clause. From there, it details the judicial treatment of the Just and Equitable Tax Clause, including a detailed summary of *IMT* and its fraternal twin *Smith v. City of Fayetteville*. Next, the article critiques the North Carolina Supreme Court's treatment of the Just and Equitable Tax Clause and notes how the Court chose to apply the clause in *IMT*. Finally, this article analyzes the shortcomings of the *IMT* decision, argues why the North Carolina Supreme Court missed a key opportunity for sound judicial policy by denying review of *Smith v. City of Fayetteville*,¹⁸ and proposes suggestions to improve the test in order to provide uniformity and direction to aid both the judiciary and the business community in evaluating the constitutionality of current and future taxes.

II. BACKGROUND

A. Evolution of the Just and Equitable Tax Clause

1. *The Common Law Standard*

Prior to the existence of the Just and Equitable Tax Clause, the 1868 North Carolina Constitution only contained a limited set of enumerated taxes that the state and local governments could employ.¹⁹ As a result of this constrained taxing power, legislative protections from oppressive or unreasonable taxes were scarce.²⁰ For example, the only constitutional protection was that taxes be levied in a uniform manner.²¹ However, common law protections sprouted out of the courts, affording protections from taxes on businesses that were

¹⁷ *See id.* at 158.

¹⁸ *Smith v. City of Fayetteville*, 743 S.E.2d 662 (N.C. Ct. App. 2013) (hereinafter *Smith II*)

¹⁹ Initial Appellant Brief at 11–12, *IMT, Inc. v. City of Lumberton*, 738 S.E.2d 156 (N.C. 2013) (No. 127A12), 2012 NC S. Ct. Briefs LEXIS at 53.

²⁰ Initial Appellant Brief at 12, *IMT, Inc. v. City of Lumberton*, 738 S.E.2d 156 (N.C. 2013) (No. 127A12), 2012 NC S. Ct. Briefs LEXIS at 53.

²¹ N.C. CONST. art. V, § 3 (1868) (stating that “[l]aws shall be passed taxing, by a uniform rule, all moneys, credits, investment in bonds, stocks, joint-stock companies or otherwise.”).

considered confiscatory,²² as well as tax classifications that were “arbitrary, unreasonable, or unjust.”²³ If the challenger could show that the tax was “so oppressive and unreasonable as to amount to confiscation, rather than taxation,” the court would invalidate the tax.²⁴

The most detailed evaluation of this common law analysis can be found in *State v. Dannenberg*.²⁵ In *Dannenberg*, the City of Charlotte had a privilege license tax of \$1,000 per year²⁶ to sell “near-beer” and related beverages.²⁷ The Defendant argued that the tax, which was fifty times the state annual license tax, was prohibitive and discriminatory.²⁸ In weighing the tax’s validity, the court examined a series of factors, including whether (1) the tax amounted to the prohibition of the business; (2) the evidence presented could rebut the presumption that the tax was reasonable; (3) the cost to the government in regulating the business class; and (4) the size of the municipality.²⁹ The court emphasized that the effect of the tax on businesses, rather than the amount of the tax, was a determining factor under common law.³⁰

Another case, *State v. Razook*, addressed a challenge to a privilege license tax as “discriminatory and unreasonable.”³¹ Building upon the precedent set forth in *Dannenberg*, the court held that a municipal tax was invalid if it was oppressive to the point of confiscation, but noted that “the courts will not review the action of the lawmakers unless an abuse of discretion is obvious.”³² The court also analogized the “size of the municipality” element from *Dannenberg*, and noted that the town in the present case was a “well known summer resort,” suggesting that the privilege license tax was permissible because the

²² Initial Appellant Brief, *supra* note 20, at 12 (stating that “[b]efore adoption of the Just and Equitable Tax Clause, courts applying common law could invalidate taxes if they were confiscatory.”).

²³ *Great Atl. & Pac. Tea Co. v. Maxwell*, 154 S.E. 838, 842 (N.C. 1930).

²⁴ *State v. Razook*, 103 S.E. 67, 69 (N.C. 1920) (citing *Minnesota v. Martin*, 145 N.W. 383 (1914)).

²⁵ See New Appellant Brief at 11, *IMT, Inc. v. City of Lumberton*, 738 S.E.2d 156 (N.C. 2013) (No. 127A12), 2012 NC S. Ct. Briefs LEXIS at 53 (stating that “[t]his Court’s most thorough analysis of that common-law claim was in *State v. Dannenberg*.”).

²⁶ Adjusted for inflation, this amount would be approximately \$25,000 today.

²⁷ *State v. Dannenberg*, 66 S.E. 301, 302 (N.C. 1909) (“Near-beer” contained as much as one-half of one per cent alcohol).

²⁸ *Id.* at 719, 721.

²⁹ *Id.* at 721–22.

³⁰ *Id.* at 722.

³¹ *Razook*, 103 S.E. at 68.

³² *Id.* at 69 (citing 17 WILLIAM M. MCKINNEY & BURDETT A. RICH, RULING CASE LAW 537 (1917)).

local tourism industry made it a more valuable location to operate a business.³³

2. *Introduction of the Just and Equitable Tax Clause*

The 1930's saw North Carolina state and local governments receive large increases in taxing power via amendments to the state constitution.³⁴ Many felt it necessary to balance this sharp expansion in constitutional tax authority by simultaneously providing expanded protections against potential abuse of these new taxing powers.³⁵ The North Carolina Constitutional Commission agreed, concluding that constitutional language ensuring "just and equitable" taxation would "provide adequate authorization for meeting the legitimate functions of government, *and adequate protection against abuse and oppression.*"³⁶ In 1936, the North Carolina citizenry officially approved an amendment to the state constitution that added the Just and Equitable Tax Clause.³⁷

3. *Implementation of the Just and Equitable Tax Clause*

The North Carolina State Constitution provides, in relevant part, that "[t]he power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended, or contracted away."³⁸ This section has been recognized to contain three separate clauses: the Just and Equitable Tax Clause; the Public Purpose Clause; and the Contracting Away Clause.³⁹ These three clauses were placed in the constitution to provide a "limitation upon the legislative power."⁴⁰ More specifically, "these constitutional provisions impose distinct and enforceable limitations on the manner in which government entities may exercise their taxing power."⁴¹ Judicial interpretation and analysis throughout the years has provided two of these clauses with more robust meaning: the Public Purpose Clause has been construed to limit the ability of the state to use public

³³ *Id.* at 68.

³⁴ Initial Appellant Brief, *supra* note 20, at 11–14.

³⁵ *See id.*

³⁶ *Id.*

³⁷ *See* Act of April 29, 1935, ch. 248, § 1, 1935 N.C. Sess. Law 270 (1935) (ratified by popular election and codified as amended at N.C. CONST. Art V, § 2(1)).

³⁸ N.C. CONST. art. V, § 2(1).

³⁹ *See IMT, Inc.*, 738 S.E.2d (providing a brief description of the three clauses and their general purposes).

⁴⁰ *Id.*

⁴¹ *Id.*

tax revenue for private enterprises,⁴² and the Contracting Away Clause has been read to curtail the ability of the state to delegate its taxing powers.⁴³ In contrast, the Just and Equitable Tax Clause has received only “sparse”⁴⁴ interpretation; as a result, the precise reach and power of the Just and Equitable Tax Clause has never been defined by the North Carolina courts.⁴⁵

4. *Pre-IMT Interpretation of the Just and Equitable Tax Clause*

Other than the recommendation from the North Carolina Constitutional Commission that the Just and Equitable Tax Clause be written to provide “protection against abuse and oppression,” there is “scant legislative history concerning the intent or intended scope of the ‘just and equitable’ language.”⁴⁶ In addition, the North Carolina courts have only addressed the Just and Equitable Tax Clause in a handful of cases, but no case has rested solely on its interpretation.⁴⁷

In *State v. Harris*, the North Carolina Supreme Court said that in order for a tax to be “just and equitable” it must apply equally to citizens across the state, and must not result in geographic disparity.⁴⁸ In *Nesbitt v. Gill*,⁴⁹ the Supreme Court added that while the government does not have to have a uniform privilege license tax across all professions, it must tax all members within those professions in a uniform manner.⁵⁰ The court also added that, when determining the amount of the tax, the government could look to the population of the municipality where the business will operate, the gross sales of the business, and the volume of product the business sells.⁵¹ The court also noted that the use of taxes and privilege taxes have historically been “nominal sums.”⁵² In *In re Assessment of Additional North*

⁴² See *Maready v. City of Winston-Salem*, 467 S.E.2d 615, 620 (N.C. 1996).

⁴³ See *Bailey v. State*, 500 S.E.2d 54, 64–65 (N.C. 1998).

⁴⁴ *IMT, Inc.*, 738 S.E.2d at 157.

⁴⁵ *Smith II*, 743 S.E.2d at 664 (stating that “[w]hile North Carolina precedent has thoroughly analyzed the Public Purpose Clause and Contracting Away Clause in Art. V, §2(1), until recently our courts had not defined the exact scope of the Just and Equitable Tax Clause.”).

⁴⁶ Initial Appellant Brief, *supra* note 20, at 12–13.

⁴⁷ In *State v. Harris*, 6 S.E.2d 854, 866 (N.C. 1939), the court declared a tax unconstitutional under the Just and Equitable Tax Clause because the tax did not apply equally to citizens of different counties.

⁴⁸ *Id.* at 859.

⁴⁹ 41 S.E.2d 646 (N.C. 1947).

⁵⁰ *Id.* at 650.

⁵¹ *Id.*

⁵² *Id.*

Carolina & Orange County Use Taxes Against Village Publishing Corp., the North Carolina Supreme Court further held that a tax would not violate the Just and Equitable Tax Clause if it was “founded upon a reasonable distinction and bears a substantial relation to the object of the legislation.”⁵³ It is upon this patchwork of legal reasoning that the Supreme Court initially fashioned protections under the Just and Equitable Tax Clause before reexamining the standard in *IMT*.

B. *IMT, Inc. v. City of Lumberton* – The North Carolina Supreme Court creates a New, Substantive Constitutional Protection

There are two cases that examine the Just and Equitable Tax Clause in the modern context—*IMT, Inc. v. City of Lumberton*⁵⁴ and *Smith v. City of Fayetteville*.⁵⁵ *IMT* preceded *Smith* by a short period of time, and was ultimately the case used by the North Carolina Supreme Court in defining the Just and Equitable Tax Clause as a protection for business taxpayers.⁵⁶ Plotting the procedural and factual evolution of this case paints a picture of how the Just and Equitable Tax Clause can be interpreted to protect businesses from abusive taxation.

1. Factual and Procedural Background

The legality of Internet sweepstakes businesses in North Carolina has been a heated and unresolved issue for many years. This cat-and-mouse game between legislators and business owners has caused tension between private industry and government policymakers, as well as persistent uncertainty within the marketplace.⁵⁷ Yet despite the changing regulatory foundation for the electronic sweepstakes industry, municipalities have continued to enjoy tax revenues from these businesses. For example, like forty-three other categories of businesses,⁵⁸ Internet sweepstakes businesses in the city of Lumberton,

⁵³ 322 S.E.2d 155, 157 (N.C. 1984).

⁵⁴ *IMT, Inc.*, 738 S.E.2d.

⁵⁵ *Smith II*, 743 S.E.2d.

⁵⁶ See *IMT, Inc.*, 738 S.E.2d at 157.

⁵⁷ Cory Howard, *Skill, Dumb Luck, and the Legal Ambiguity of North Carolina Sweepstakes Law: Why Municipal Ordinances and Not State Statutes Should Provide the Framework for Regulating Illegal Gambling*, 5 U. NEV.-LAS VEGAS GAMING L.J. 4 (Forthcoming 2015), available at <http://ssrn.com/abstract=2528055>. See also Joseph Kelly & Alex Igelman, *Internet Sweepstakes*, 16 GAMING L. REV. & ECON. 655, 670 (2012).

⁵⁸ *IMT, Inc. v. City of Lumberton*, 724 S.E.2d 588, 594 (N.C. Ct. App. 2012), *rev'd*, 738 S.E.2d 156, 157 (N.C. 2013).

North Carolina, pay a privilege license tax to operate physical locations within the city limits.

In *IMT*, the city was exercising its lawful power under North Carolina state law⁵⁹ and levying privilege license taxes upon companies operating within the city limits.⁶⁰ All electronic sweepstakes businesses within Lumberton, including IMT, Inc., were charged a uniform license tax.⁶¹ In the Fiscal Year 2009-2010, the tax was \$12.50.⁶² For the Fiscal Year 2010-2011, the city raised the tax on these sweepstakes businesses to “\$5,000 per business location and \$2,500 per gaming or computer terminal”⁶³ In comparison, the next highest privilege license tax imposed by the city was \$500 for “Circuses, Menageries, Wild West, [and] Dog and Pony Shows”⁶⁴

The effect of the change was an immediate minimum tax liability increase of at least \$7,487.50, or 59,900% per business location.⁶⁵ However, since this minimum increase only assumes one machine per business location, the effective tax increase for local Internet sweepstakes businesses was much higher, ranging from \$75,000 to \$137,500, or an increase of approximately 600,000% to 1,100,000%.⁶⁶

Following this unprecedented tax increase, two companies filed complaints against the city, while two others refused to pay the tax and were subsequently brought into court by the city.⁶⁷ These four cases were consolidated by the North Carolina Court of Appeals, which addressed the question of whether the tax amounted to a prohibition of the businesses’ operations.⁶⁸ The court affirmed the tax’s constitutionality,⁶⁹ adding that the Just and Equitable Tax Clause did not “permit relief for taxpayers who have been unreasonably taxed.”⁷⁰

⁵⁹ See N.C. GEN. STAT. §§ 105-109(e), 160A-211 (2013).

⁶⁰ *IMT, Inc.*, 738 S.E.2d at 157.

⁶¹ See *id.* (noting that the city charged a uniform privilege license tax on “[a]ny for-profit business or enterprise . . . where persons utilize electronic machines . . . to conduct games of chance, including . . . sweepstakes.”).

⁶² *IMT, Inc.*, 724 S.E.2d at 591.

⁶³ *Id.*

⁶⁴ *IMT, Inc.*, 738 S.E.2d at 157.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 158.

⁷⁰ Amicus Curiae Brief at 3, *IMT, Inc. v. City of Lumberton*, 738 S.E.2d 156 (N.C. 2013) (No. 127 A12).

2. *The Court of Appeals' Decision*

The Appellants' most salient argument⁷¹ was that the city was employing an “unjust and inequitable taxation scheme” meant to “deprive Appellants of all profit associated with their business.”⁷² The court looked to *Razook* for guidance:

If . . . it be conceded that the courts have power to declare a municipal ordinance levying a license tax on business invalid on the ground that the tax imposed is so oppressive and unreasonable as to amount to confiscation, rather than taxation, they will not determine the question by mere inspection of the amount of the tax imposed. All presumptions and intendments are in favor of the validity of the tax; . . . in other words, the mere amount of the tax does not prove its invalidity.⁷³

With this logic in mind, the court analyzed the rebuttable presumption standard for privilege license taxes and determined that positive proof is required to demonstrate the deprivation of a constitutional right.⁷⁴ Pulling from a handful of past cases, the court fashioned together an evidence-based test to rebut the presumption of constitutionality, considering such factors as the “value” the privilege license tax confers (as determined by the size and population of the city), the cost to the city in providing police protection to the businesses, and the revenues, expenses, and profits of the business compared to the amount of the tax.⁷⁵

Finding none of the suggested factors above within the evidentiary record, the court sided with the city and upheld the tax.⁷⁶ Yet, towards

⁷¹ Appellants also argued that the city lacked a requisite rational basis for imposing different privilege license tax amounts on different categories of businesses, but the Appellate Court discounted this argument by saying that comparing privilege license taxes across business types is “an invalid and misleading argument . . .” *IMT, Inc.*, 724 S.E.2d at 594–95 (noting that Appellants argued that a “discriminatory” tax that varied greatly from any other privilege license tax imposed by the city was unconstitutional without a rational basis).

⁷² *Id.* at 595.

⁷³ *Id.*

⁷⁴ *See id.* (stating that “[t]here does not appear to be a sufficient record of proof to show governmental action was taken to deprive Appellants of a constitutional right . . . in the absence of positive evidence to the contrary, [privilege license taxes] are presumed to be reasonable.”).

⁷⁵ *Id.* at 595–96.

⁷⁶ *Id.* at 596.

the end of its opinion the court noted that, but for the lack of supporting evidence, its conclusion may have been different:

The only evidence Appellants presented is the new amount of the privilege license tax on Appellants' businesses in comparison to the privilege license tax on Appellants' businesses in previous years as well as in comparison to the privilege license tax on other businesses. As stated in *Razook*, such evidence does not prove the tax's invalidity . . . We emphasize that this opinion does not stand for the proposition that a taxing mechanism similarly putative to the one at bar would pass constitutional muster if evidence of the prohibitive intent of the tax was shown. We find the City's privilege license tax here constitutional only because factual elements are missing to prove the City's privilege license tax is prohibitive.⁷⁷

3. *The Supreme Court Decision*

On appeal, the question before the North Carolina Supreme Court was distilled to whether “the City of Lumberton’s privilege license tax violates the Just and Equitable Tax Clause . . . of the North Carolina Constitution.”⁷⁸ Proceeding into a previously unexplored area of law,⁷⁹ the North Carolina Supreme Court embarked on two major endeavors: first, establishing the Just and Equitable Tax Clause as a substantive limitation on the taxing power of the state,⁸⁰ and second, determining “how the Just and Equitable Tax Clause operates to limit the taxing power.”⁸¹

Reviewing the decision *de novo*,⁸² the court first acknowledged that the Just and Equitable Tax Clause had, at best, a pockmarked

⁷⁷ *Id.*

⁷⁸ *IMT, Inc.*, 738 S.E.2d at 157.

⁷⁹ While previous cases have primarily focused on tangential aspects of the Just and Equitable Tax Clause, such as whether the tax was uniformly applied, no decision by the North Carolina Supreme Court has “rested solely” on an interpretation of the language in the Just and Equitable Tax Clause until *IMT*. The case is also unique because the challenge to the constitutionality of the tax rests primarily on the amount of the tax. *Id.* at 158–59.

⁸⁰ *Id.* at 158. (arguing that “[t]reating the Just and Equitable Tax Clause as mere precatory language, rather than as a substantive limitation . . . would create internal inconsistency within this constitutional provision.”).

⁸¹ *Id.* at 159.

⁸² *Id.* at 158 (stating that “[w]e review an appeal from summary judgment *de novo*.”).

legislative background compared to the Public Purpose and Contracting Away Clauses also found in Article V § 2(1).⁸³ However, the court declared that the Just and Equitable Tax Clause should be given the same weight as its sister clauses, and read the clause to impose a substantive limitation on the taxing power of the government.⁸⁴ Second, the court noted that a lack of case law on the Just and Equitable Tax Clause had forced both parties and the lower courts to turn to common law arguments that predated the implementation of the Just and Equitable Tax Clause.⁸⁵ The court concluded that the plain text of the constitution “did not incorporate the ‘unreasonable and prohibitory’ standard from the common law.”⁸⁶

After determining the existence of a substantive constitutional protection from unjust and unreasonable taxation separate from the common law, the court further continued into uncharted territory by assessing if the challenged tax violated the Just and Equitable Tax Clause. In order to do so, the court needed to determine the proper test to use for this new constitutional protection.⁸⁷ More specifically, the court noted that, “[t]he instant appeal . . . requires us to determine how the Just and Equitable Tax Clause operates to limit the taxing power.”⁸⁸ In making this determination, the court reached out to *Nesbitt v. Gill*⁸⁹ for relevant criteria in assessing the tax. The court used the factors discussed in *Nesbitt* as a non-exhaustive foundation for assessing tax’s validity under the clause.⁹⁰ From there, the court created new elements to consider, such as “the stark difference between the amount of tax levied . . . and the amounts levied against other economic activities”⁹¹ The North Carolina Supreme Court

⁸³ *Id.* (discussing how the Just and Equitable Tax Clause has “avoided a similarly thorough analysis” as the other two clauses).

⁸⁴ *Id.* (stating that the Public Purpose and Contracting Away Clauses “impose distinct and enforceable limitations on the manner in which government entities may exercise their taxing power” and concluding that denying the Just and Equitable Tax Clause the same power “would create internal inconsistency within this constitutional provision.”).

⁸⁵ *IMT, Inc.*, 738 S.E.2d at 157 (stating that “[s]everal cases relied upon by the parties and by the Court of Appeals were decided before the adoption of the Just and Equitable Tax Clause in 1935. Those cases concerned common law challenges to taxes.”).

⁸⁶ *Id.* at 159.

⁸⁷ *See id.* (stating that “[t]he instant appeal . . . requires us to determine how the Just and Equitable Tax Clause operates to limit the taxing power.”).

⁸⁸ *Id.*

⁸⁹ 41 S.E.2d 646 (N.C.), *aff’d per curiam* by 332 U.S. 749 (1947).

⁹⁰ *IMT, Inc.*, 738 S.E.2d at 160 (arguing that “[i]n cases arising under the Just and Equitable Tax Clause, trial courts should look to *Nesbitt* for guiding factors in assessing such claims. But those factors should not be viewed as exhaustive.”).

⁹¹ *Id.*

concluded that the minimum 59,900% tax increase lay outside the permissible bounds of the Just and Equitable Tax Clause, as it was “wholly detached from the moorings of anything reasonably resembling a just and equitable tax.”⁹² Yet, the court declined to “define the full parameters of the Just and Equitable Tax Clause’s limitations on the legislative taxing power.”⁹³

C. *Smith v. City of Fayetteville* – First Application of the IMT Test in the Lower Courts

Just two months after *IMT* was initially heard by the North Carolina District Court for Robeson County, the same court ruled on a second, factually similar case.⁹⁴ In *Smith v. City of Fayetteville*, the city of Fayetteville raised its privilege license tax on electronic sweepstakes operations from \$50 per license in FY2009-2010 to \$2,000 per business location and \$2,500 per machine in FY2010-2011.⁹⁵ Faced with a minimum tax rate increase of 8,900%, the plaintiffs sought a declaratory judgment to enjoin the city from enforcing the tax. After the superior court granted the city’s motion for summary judgment, the plaintiffs appealed,⁹⁶ arguing that the new privilege license tax was a de facto prohibition of their business and therefore unconstitutional.⁹⁷ The Court of Appeals acknowledged that it had just analyzed a similar case when deciding *IMT*, but decided to utilize a different test when analyzing *Smith*.⁹⁸

Similar to its *IMT* analysis, the court used a patchwork approach to assemble a legal standard for the Just and Equitable Tax Clause:

[W]e hold that this common law prohibition on unreasonable taxation schemes is the same or substantially the same as our Constitutional provision

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *IMT* was initially decided by the North Carolina District Court on June 6, 2011. *See* *IMT v. City of Lumberton*, No. 10 CVS 3508, 2011 WL 8971405 (N.C. Dist. June 6, 2011). *Smith* was decided by the North Carolina Superior Court on August 11, 2011. *See generally* *Smith v. City of Fayetteville*, No. 10 CVS 8712, 2011 WL 8908201 (N.C. Super. Aug. 11, 2011).

⁹⁵ *Smith v. City of Fayetteville*, 725 S.E.2d 405, 407 (N.C. Ct. App. 2012) (hereinafter *Smith I*). (detailing the amount of the tax increase and the businesses the tax applied to).

⁹⁶ *Id.*

⁹⁷ *Id.* at 409 (stating that “[p]laintiff’s argument [is] that the Ordinance is unconstitutional because it imposes an unjust and inequitable taxation scheme as it is so high it amounts to a prohibition of their businesses.”).

⁹⁸ *Id.* at 410.

requiring taxes to be exercised in a “just and equitable manner.” Accordingly, we refer not only to *Nesbitt* but to the common law decided before the 1936 amendment to inform us in analyzing this issue.⁹⁹

The court used this foundation to build out a technical, stepwise analysis to determine if the privilege license tax is reasonable rather than prohibitory:

The first step is to determine if the activity taxed is legal, and, if so, whether the city instituting the tax had the authority to do so. If so, the tax enjoys a presumption of reasonableness. To rebut this presumption, the plaintiff must present evidence of his business’s gross revenues, indicating that the tax is so high it prevented the plaintiff from conducting a profitable business. The plaintiff must also present evidence that the tax has prevented similarly situated businesses from being profitable. If the plaintiff successfully rebuts the presumption, the city instituting the tax may put forth evidence to show the tax is nevertheless reasonable and not prohibitory because either (1) the tax is reasonably related to the cost of increased police regulation of the taxed business or (2) the plaintiff’s inability to profit is due to his negligence in running his business and not because the tax is prohibitive. If the plaintiff successfully rebuts the presumption and the city presents evidence contradicting the plaintiff’s evidence, the issue of whether the privilege license tax is reasonable and not prohibitory becomes a material question of fact reserved for the fact-finder.¹⁰⁰

In applying its newly wrought test, the court quickly divided the plaintiffs into two camps: those who presented evidence of their business revenues, and those who presented merely “non-specific, widespread assertions that the tax would prohibit their businesses.”¹⁰¹ The Court of Appeals reversed in favor of the plaintiffs who presented evidence of their revenues, and held against the plaintiffs who failed to do so, even when those plaintiffs claimed that the tax bills were higher than their revenues received from business operations.¹⁰²

⁹⁹ *Id.* at 411.

¹⁰⁰ *Id.* at 413.

¹⁰¹ *Id.* at 413.

¹⁰² *Id.* at 414.

This ruling was short-lived, as the North Carolina Supreme Court's decision in *IMT* required the Court of Appeals to reconsider its *Smith* decision.¹⁰³ Beginning with a reading of *IMT*, the court noted the reluctance of the Supreme Court to define an adaptable methodology for analyzing cases under the Just and Equitable Tax Clause.¹⁰⁴ The court reiterated the need to protect the public from harmful taxation while simultaneously preserving legislative power.¹⁰⁵ Analogizing to the holding in *IMT*, where the North Carolina Supreme Court held that a 59,900% minimum tax increase was “wholly detached from the moorings of anything resembling a just and equitable tax”, the Court of Appeals declared that the 8,900% minimum tax increase in *Smith* also violated the Just and Equitable Tax Clause.¹⁰⁶ In overriding the previous decision, the Court of Appeals declined to follow the methodology it previously articulated in the original *Smith* decision, instead relying wholly on a factual comparison to *IMT*.¹⁰⁷ The North Carolina Supreme Court declined to grant an appeal of this decision.¹⁰⁸

III. ANALYSIS

A. The Supreme Court's *IMT* Decision

1. *The Just and Equitable Tax Clause as a Substantive Claim*

One of the most important aspects of the Supreme Court's decision was establishing the Just and Equitable Tax Clause as a substantive constitutional protection for North Carolina business taxpayers. The Court notes that N.C. Const. art. V, § 2(1) contains three enumerated limitations, but to date only two had been thoroughly analyzed by the courts.¹⁰⁹ While the City of Lumberton tried to argue that claims under the “just and equitable” language were not justiciable, the Court refused to accept this argument and declined to equate lack of judicial attention with lack of constitutional significance.¹¹⁰ Following the well-established precedent that every provision of the North Carolina

¹⁰³ *Smith II*, 743 S.E.2d at 664.

¹⁰⁴ *Id.* at 664–66.

¹⁰⁵ *Id.* at 665.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 665–66 (stating that “[w]ithout a fully-developed record and given the Supreme Court's reluctance to further define a methodology for evaluating just and equitable taxation claims, we are unwilling to articulate a methodology similar to the methodology previously adopted by this panel in *Smith I*.”).

¹⁰⁸ *Smith II*, 743 S.E.2d at 665–66 .

¹⁰⁹ *See generally IMT, Inc.*, 738 S.E.2d.

¹¹⁰ *Id.* at 158.

Constitution means “something,”¹¹¹ the court noted the language and construction of § 2(1) implied the presence of three distinct clauses that should be accorded equal treatment and weight of authority.¹¹²

Not only is this reasoning logically sound, it is also respectful of the history behind the Just and Equitable Tax Clause. The “just and equitable” language was originally proposed in the 1930s as a way to balance rising tax power with constitutional safeguards from abusive taxation.¹¹³ The language was deliberately placed in the Constitution by the people of North Carolina, and to dismiss the Just and Equitable Tax Clause as “mere precatory language” would not only create an “internal inconsistency” within this constitutional provision, but would also disrespect the actions and intents of the citizens of North Carolina.¹¹⁴

2. *Balancing Government Authority with Constitutional Protections*

By affirming the Just and Equitable Tax Clause as a substantive claim, the North Carolina Supreme Court faced a new policy dilemma: balancing the presumptive validity of taxes with the practice of liberally construing constitutional provisions designed to protect the “person and property” of North Carolina citizens.¹¹⁵ In *Dannenberg*, the North Carolina Supreme Court held that “in the absence of positive evidence to the contrary, [privilege license taxes] are presumed to be reasonable.”¹¹⁶ Despite the opportunity to challenge the reasonableness of a tax, the *Dannenberg* opinion notes that courts have soundly favored legislative discretion in determining tax rates.¹¹⁷ This line of reasoning is both logical and reasonable—legislators have the experience and knowledge to set the optimum tax rates for the state. In addition, legislators must balance numerous competing considerations. Therefore, courts should defer to their expertise when devising tax schemes and allow for some play in the joints of the tax

¹¹¹ *Galloway v. Jenkins*, 63 N.C. 147, 157 (N.C. Supp. Ct. 1869) (noting that “[i]t must also be admitted that the article of the Constitution means something.”).

¹¹² See *IMT, Inc.*, 738 S.E.2d at 158.

¹¹³ Appellants’ New Brief, *supra* note 25, at 12.

¹¹⁴ *IMT, Inc.*, 738 S.E.2d at 158 (arguing that “[t]he people of North Carolina placed the Just and Equitable Tax Clause in their Constitution, and we are not at liberty to selectively dismiss its relevance.”).

¹¹⁵ *Corum v. Univ. of N. C.*, 413 S.E.2d 276, 290 (N.C. 1992).

¹¹⁶ *IMT, Inc.*, 724 S.E.2d at 595 (citing *State v. Danneberg*, 66 S.E. 301 (1909)).

¹¹⁷ New Appellants’ Brief, *supra* note 25, at 9.

machine.¹¹⁸ The North Carolina Constitution grants the legislature taxing and spending powers, and the judiciary should respect this grant of authority by avoiding unnecessary judicial intrusion into this zone of control.

Despite the tendency of the courts to shy away from exerting overbearing control over legislative functions, the North Carolina courts are tasked with the duty to “give our constitution a liberal interpretation in favor of its citizens with respect to those provisions which were designed to safeguard the liberty and security of the citizens in regard to both person and property.”¹¹⁹ Not only are the constitutional protections for citizens under the North Carolina Constitution “more detailed and specific” than those found in the United States Constitution, for areas such as taxation, the North Carolina Constitution is the only source of protection for citizens by abusive state government practices.¹²⁰ As a result, the courts must exercise great care in remembering that the “power of government is vested in and derived from the people” and to protect their rights from allegedly abusive legislative decisions.¹²¹

Once the court declared the Just and Equitable Tax Clause to be a substantive constitutional protection, it was immediately vested with the duty to liberally construe the provision in order to protect the “person and property” of North Carolina citizens.¹²² This is an important standard to follow, since taxation, and particularly license taxation, has been recognized as an effective way of government to control the behavior of its citizens. As noted in *Dannenberg*:

One of the recognized methods of regulation is by license taxation, which will reduce the area and extent of the business, without annihilating it, and thus bring it more easily within municipal control...one of the most effective modes of restraining and limiting the number of [businesses] in any particular town or city is to require a heavy license tax on the keepers of them.¹²³

This represents not only a control on the types of businesses that can operate within the city, and the choices that the citizens and consumers have, but also directly impacts the potential livelihoods of small

¹¹⁸ *Village of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 265 (1977).

¹¹⁹ *Corum*, 413 S.E.2d at 290.

¹²⁰ *Id.*

¹²¹ N.C. CONST. art. I, § 2.

¹²² *Corum*, 413 S.E.2d at 290 (N.C. 1992).

¹²³ *Dannenberg*, 66 S.E. at 303.

business owners. The ability for individuals to choose a profession and to earn a livelihood is a deep-seated personal right that clearly falls within the “person and property” protections afforded by the North Carolina Constitution.

While municipalities can place taxes on businesses for the purpose of raising revenue and offsetting the burden those businesses place on local resources,¹²⁴ they cannot attempt to ban legal activities by placing unreasonably high taxes on their operations. Video sweepstakes businesses have been at odds with both state and local officials for quite some time.¹²⁵ Laws that curtail the use of video sweepstakes machines have faced two hurdles: they are either struck down by the courts,¹²⁶ or the companies change their machines and business models to exploit loopholes in the new laws.¹²⁷ Despite this exhausting legislative battle, a sudden and dramatic increase in privilege license taxes on electronic sweepstakes businesses cannot be permitted as a tactic by cities attempting to impose control over the behavior of citizens engaging in perfectly legal activities. The cities in both *IMT* and *Smith* argued that these particular businesses placed “unique burdens” on law enforcement and other city resources,¹²⁸ yet the significant gap between the business license taxes levied on video sweepstakes businesses and the next highest privilege license tax levied on other business shows a lack of correlation between tax level and resources used. The court nodded to this fact when it concluded that the “stark difference between the amount of tax levied on cyber-gaming establishments and the amount levied against other economic activities under the Ordinance” is evidence that the tax was unconstitutionally inequitable.¹²⁹ In addition, the court found that the tax increase was “wholly detached from the moorings of anything reasonably resembling a just and equitable tax.”¹³⁰ Simply put, the court held that the manipulative behavior of the cities was unconstitutionally unjust.¹³¹

¹²⁴ *Smith I*, 725 S.E.2d at 407.

¹²⁵ See *id.* at 413.

¹²⁶ See, e.g., *Hest Techs., Inc. v. State ex rel. Purdue*, 725 S.E.2d 10 (N.C. Ct. App. 2012) (concluding that the statute was an unconstitutional regulation of free speech).

¹²⁷ See, e.g., *Barber v. Jefferson County Racing Ass’n*, 960 So.2d 599, 615 (Ala. 2006) (noting that the owners of the game found a loophole in the patchwork of Alabama’s anti-gambling laws).

¹²⁸ *Smith I*, 725 S.E.2d at 408.

¹²⁹ *IMT, Inc.*, 738 S.E.2d at 160.

¹³⁰ *Id.*

¹³¹ *Id.*

B. Foundations of the *IMT* Test

1. *Rejecting the Common Law “Unreasonable and Prohibitory” Standard*

A key decision the North Carolina Supreme Court made was to reject the common law “unreasonable and prohibitory” standard and instead embrace the “just and equitable” standard enumerated in the Constitution.¹³² While this decision limits the ability of the court to consult an already sparse legislative history for the constitutionality of taxes, it legitimizes the strength of the Just and Equitable Tax Clause and provides a more concise foundation upon which the court can build an analysis for this clause.

Before *IMT*, courts that addressed the validity of burdensome taxes on businesses employed a patchwork of arguments. Some early cases interpolated the uniform tax requirements from the 1868 North Carolina Constitution to arrive at an “arbitrary, unreasonable, or unjust” standard,¹³³ while others looked to courts in other states for guidance.¹³⁴ A standard powerful and dynamic enough to unify the North Carolina courts failed to emerge.¹³⁵ Even after the Just and Equitable Tax Clause was added to the Constitution, its lack of judicial attention made the clause no more persuasive than the common law standard that preceded it.¹³⁶ In order to establish a clean break from this tangled past, the court rightly decided to abandon the old common law language in favor of the “just and equitable” standard that the drafters of the clause preferred.

¹³² *Id.* at 159 (observing that “the 1935 amendment to Article V did not incorporate the ‘unreasonable and prohibitory’ standard from the common law. Instead, the language ratified by the people stated ‘[t]he power of taxation shall be exercised in a just and equitable manner.’”).

¹³³ *Great Atl. & Pac. Tea Co.*, 154 S.E. at 842.

¹³⁴ *Dannenberg* cites cases in several states in its analysis, including Georgia (*Campbell v. Thomasville*, 64 S.E. 815 (1909)), Illinois (*Lauder v. Chicago*, 111 Ill. 291 (1884)), Alabama (*Railroad v. Attahala*, 24 So. 450 (1897)), Kansas (*Leavenworth v. Kansas*, 15 Kan. 627 (1875)), and the United States Supreme Court (*Dobbins v. Los Angeles*, 195 U.S. 223 (1904)). *Dannenberg*, 66 S.E. at 302–03..

¹³⁵ The courts used common elements, but continued to dictate different formulations for determining the validity of taxes on businesses. For example, *IMT, Inc.*, 724 S.E.2d at 595–96 and *Smith I*, 725 S.E.2d at 409–14 were two cases decided by the North Carolina Court of Appeals less than three months apart, yet the court created two different standards to analyze these factually-similar cases.

¹³⁶ *Smith I*, 725 S.E.2d at 411 (stating that the “common law prohibition on unreasonable taxation schemes is the same or substantially the same as our Constitutional provision” requiring just and equitable taxation).

Creating a new standard based on constitutional language provides businesses with a powerful protection against unjust taxation while indicating the court's desire to craft a new standard tailored to the exact language of the Just and Equitable Tax Clause.

2. *Defining the Scope of the Just and Equitable Tax Clause*

The Supreme Court declared the existence of a new substantive constitutional protection but declined to comment on its breadth.¹³⁷ The court claimed that both the “unusual” facts of the case and the “nearly universal deference” given to legislative taxation schemes precluded a broad proclamation of the bounds of the Just and Equitable Tax Clause.¹³⁸ It is true that the “unusual” facts of the case prevented the court from elaborating on the Just and Equitable Tax Clause’s hypothetical boundaries. However, citing legislative taxation schemes as a bar to determining the scope of the Just and Equitable Tax Clause actually undermined the logic in the rest of the opinion and diminished the power of this pivotal decision.

In *IMT* the facts were indeed unusual—the Appellants challenged a historically nominal¹³⁹ city tax that, for some Appellants, was raised by over one million percent.¹⁴⁰ It would be irresponsible to use such a factually anomalous case for delineating the boundaries of a key constitutional clause.¹⁴¹ The Just and Equitable Tax Clause will require both time and factually disparate scenarios to properly evolve. Future applications of the Just and Equitable Tax Clause will likely explore the complex core of the clause, which lies at the exact point where a tax crosses the line from permissible legislative authority to unjust tax-based abuse. *IMT* and *Smith* provide a strong argument for the necessity of the Just and Equitable Tax Clause’s protections; in both cases, the cities jeopardized the livelihoods of business owners without sound rationale or purpose. But the fact patterns in these cases are a poor tool to use when etching the fine distinction between the need for revenues and unjustified tax burdens, for clearly a tax increase of up to one million percent is not a nuanced issue. For this reason, the Supreme Court was wise in not using *IMT* to establish the full bounds of the Just and Equitable Tax Clause. As the state

¹³⁷ *IMT, Inc.*, 738 S.E.2d at 160 (stating that “[w]e do not attempt to define the full parameters of the Just and Equitable Tax Clause’s limitations on the legislative taxing power.”).

¹³⁸ *Id.* at 169.

¹³⁹ *Nesbitt*, 41 S.E.2d at 650. .

¹⁴⁰ *See IMT, Inc.*, 738 S.E.2d at 157.

¹⁴¹ *Id.* at 156.

constitution is the only safeguard against abusive taxation policies,¹⁴² the Just and Equitable Tax Clause will need to be liberally construed as broadly as possible in order to protect businesses and citizens alike. Refusing to delineate the outer bounds of the clause in *IMT* preserves the ability of the court to extend the clause to a wide range of scenarios that are not contemplated by the facts of the case.

The court's opinion acknowledged the existence of "constitutional tension between the government's taxing authority" and the new substantive protections of the Just and Equitable Tax Clause.¹⁴³ Yet the court refused to discuss the scope of the Just and Equitable Tax Clause because of the level of deference given to the government's tax classifications.¹⁴⁴ This reasoning suggests that the government's taxing power is both the reason why the Just and Equitable Tax Clause is necessary, yet also a controlling device that dampens the full power of the clause.

Case law reveals that while the government's taxing power is broad and powerful, the Just and Equitable Tax Clause retains ultimate power over legislative actions. First, the North Carolina State Constitution derives its power from the people, and therefore must be liberally construed in favor of the people when their liberty or property is threatened.¹⁴⁵ Its provisions, the Just and Equitable Tax Clause included, are clearly designed as safeguards to protect the citizens from the government they created. Second, the "pervading principle to be observed" by the government when exercising its taxing power is "equality and fair play," a policy which the North Carolina Supreme Court asserts is enforced by use of the Just and Equitable Tax Clause.¹⁴⁶ Finally, since the legislative power to tax is only limited by constitutional provisions, the constitutional protections against abusive taxation must command ultimate authority over and not be overshadowed by legislative power.¹⁴⁷

¹⁴² See BRADLEY LINGO ET AL., THE FEDERALIST SOCIETY, RECENT DECISIONS OF THE SUPREME COURT OF NORTH CAROLINA 3 (2014), http://www.fed-soc.org/library/doclib/20140915_WhyJudicialElectionsMatterRecentDecisionsoftheNorthCarolinaSupremeCourt.pdf.

¹⁴³ *IMT, Inc.*, 738 S.E.2d 156, 159.

¹⁴⁴ *Id.* at 160.

¹⁴⁵ See *State v. Harris*, 6 S.E.2d 854, 866 (N.C. 1940).

¹⁴⁶ *IMT, Inc.*, 738 S.E.2d at 159.

¹⁴⁷ *Currie*, 118 S.E.2d at 545.

C. The Current *IMT* Test – How the Just and Equitable Tax Clause Operates to Limit The Taxing Power

In applying the Just and Equitable Tax Clause to the facts in *IMT*, the court outlined a series of factors to consider when assessing the amount of a tax under the Just and Equitable Tax Clause. First, the test is colored by the expectation that the legislature will exercise equality and fair play.¹⁴⁸ Taxes enjoy a presumption of constitutionality, but businesses can use the Just and Equitable Tax Clause when they feel that the taxation scheme has lost this color of equality and fair play. Second, there is a non-exhaustive set of considerations derived from *Nesbitt*:

1. A tax is valid if it applies equally to all businesses in the class.¹⁴⁹ The tax on that class can differ from taxes on other classes of businesses.¹⁵⁰
2. When determining the appropriate tax level, the government may use factors including the size of the city, the gross sales of the business, the sales volume of the business, the business' profitability, and whether the business enjoys exemptions from other forms of taxation.¹⁵¹

Third, the court added several additional factors the court may examine when evaluating the constitutionality of a tax:

1. The presence of a “stark difference” between the tax levied on the class of businesses and the amount of tax levied on other classes of businesses.¹⁵²
2. Whether the tax increase is “wholly detached from the moorings of anything reasonably resembling a just and equitable tax.”¹⁵³ However, the presence of solely a high tax, or a high tax increase, may not be enough to violate the Just and Equitable Tax Clause.¹⁵⁴

¹⁴⁸ *IMT, Inc.*, 738 S.E.2d at 159 (quoting *Cnty. of Rockingham v. Bd. of Trs. of Elon Coll.*, S.E.2d 618, 620 (N.C. 1941).

¹⁴⁹ *Nesbitt*, 41 S.E.2d at 650.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *IMT, Inc.*, 738 S.E.2d at 160.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

1. *Protections Derived from IMT Test*

The *IMT* Test affords several key protections to businesses. First, if a class of businesses is being highly taxed compared to other classes of businesses, those companies can seek relief.¹⁵⁵ This serves as an effective balance that allows the government to exercise its expertise and discretion in spreading the tax burden, but prevents it from using its power to punish certain types of businesses. This logic is especially relevant to the determining factors such as the size of the city and the sales volume of the business. Clearly, it would be unfair to assign a flat tax rate to large and small companies alike, which would have different abilities to pay the fixed cost of the tax.¹⁵⁶ Second, the Just and Equitable Tax Clause offers protections from both high tax rates as well as high tax increases. Third, a tax can be unconstitutional if it is “wholly detached from the moorings of anything reasonably resembling a just and equitable tax.”¹⁵⁷ While this test was applied to a tax that was extremely high, there is the possibility that this phrase could evolve into a catchall provision that protects businesses from taxes that, for one reason or another, are gross deviations from the color of equality and fair play.

2. *Vulnerabilities Derived from the IMT Test*

A thorough reading of the *IMT* test reveals several potential vulnerabilities that could disparage a business taxpayer’s claim for relief. First, the *IMT* test permits the size of the municipality to be used as a factor in setting the tax rate. Under this logic, larger cities have more paying customers and therefore the local market is more valuable to operate in. However, the lurking danger is the possible harm to small businesses trying to operate in a larger city. If the minimum tax is so high that it frustrates the ability to operate a small-scale business or startup, it could discourage small business owners from participating in the local market.

The *IMT* test currently allows governments to graduate the tax rate based on the size or profitability of the business. Without additional protections, municipalities could manipulate this element to control the size of various businesses or industries.¹⁵⁸ In such a scenario, businesses can still run at a profit, but the taxation scheme makes

¹⁵⁵ See *id.* at 159–60.

¹⁵⁶ See *Nesbitt*, 41 S.E.2d at 650 (imposing the same tax on a large and a small business alike would be unequal).

¹⁵⁷ *IMT, Inc.*, 738 S.E.2d at 160.

¹⁵⁸ *Dannenberg*, 66 S.E. at 303.

investing capital into the business a poor return on investment, ultimately controlling the behavior of the citizenry.

Finally, the *IMT* Test contains two seemingly contradictory elements: the trap door for taxes that are “wholly detached from the moorings of anything reasonably resembling a just and equitable tax,” and the qualification that a high tax or tax increase alone may not be enough to rule the tax unconstitutional.¹⁵⁹ In *IMT* a 59,900% tax increase was high enough to be “wholly detached,”¹⁶⁰ and the 8,900% tax increase in *Smith* was invalidated for the same reason.¹⁶¹ However, nothing more than judicial discretion classified the taxes as such, rather than striking the challenge down for simply being high in their amount or increase.

D. What Could Have Been – The Supreme Court’s Shortcomings and How to Amend the *IMT* Test for Future Applications

While the Just and Equitable Tax Clause must be applied on a case-by-case basis, there remains the opportunity to establish a robust base standard to apply in all cases. The *IMT* test is the beginning of this standard, but additional key elements are needed to transform it into a clearer and more potent protection for businesses.

1. The Court Erred By Not Establishing A More Definitive Standard

The Supreme Court surrendered a key opportunity to establish a dynamic test for the Just and Equitable Tax Clause when deciding *IMT*. The court said that applying the Just and Equitable Tax Clause must be done on a case-by-case basis,¹⁶² yet there are three reasons why the Supreme Court should have clarified a broader foundational standard to apply across future cases. First, when the court decided to “resolve the substantive claim rather than remand the issue,” it should have accepted the responsibility of setting an example for the lower courts by laying out a detailed standard for analysis.¹⁶³ Second, the novelty of the issue and the act of creating a new substantive constitutional protection both warranted a more thorough test for the Just and Equitable Tax Clause. More specifically, *IMT* was the first

¹⁵⁹ *IMT, Inc.*, 738 S.E.2d at 160.

¹⁶⁰ *Id.*

¹⁶¹ *Smith II*, 743 S.E.2d at 665.

¹⁶² *IMT, Inc.*, 738 S.E.2d at 160 (arguing that “challenges under the Just and Equitable Tax Clause must be determined on a case-by-case basis.”).

¹⁶³ *Id.* at 160 (stating that “[i]n the instant case, we have chosen to resolve the substantive claim rather than remand the issue . . .”).

time that the Just and Equitable Tax Clause had ever been used to invalidate a tax because of the monetary burden on the businesses subjected to the tax.¹⁶⁴ Third, the Supreme Court dismissed the common law protections when creating its new standard.¹⁶⁵ By eliminating the majority of the previous case law on the topic, the Supreme Court should have constructed a more detailed analysis and rationale for lower courts to follow.

Without a more substantive guide, the lower courts have already struggled in applying the Just and Equitable Tax Clause.¹⁶⁶ For example, *Smith*, the first case to cite the new Supreme Court decision, overruled its previous decision in order to bring the case into conformity with *IMT*.¹⁶⁷ The court made this decision not because it believed that its original reasoning was flawed, but because the Supreme Court did not articulate a standard that could be applied to the case.¹⁶⁸

2. *Smith* was a Missed Opportunity to Reinforce the *IMT* Decision

The Supreme Court missed several key opportunities in emboldening the Just and Equitable Tax Clause by denying review of *Smith*¹⁶⁹ and neglecting to scan previous cases for additional factors to add to the *IMT* test. It is evident from the *Smith* opinion that the Court of Appeals was more concerned about mirroring the actions of the Supreme Court than understanding the application of the *IMT* test.¹⁷⁰ In fact, the court cites “the [North Carolina] Supreme Court’s reluctance to further define a methodology for evaluating just and equitable taxation claims” as a reason for failing to conduct a more thorough analysis.¹⁷¹

For a constitutional protection as important as the Just and Equitable Tax Clause, it is disturbing to see that the Supreme Court

¹⁶⁴ *Id.* at 158–59.

¹⁶⁵ *Id.* at 158–60.

¹⁶⁶ See *Smith II*, 743 S.E.2d at 666 (N.C.App. 2013) (stating that “given the Supreme Court’s reluctance to further define a methodology for evaluating just and equitable taxation claims, we are unwilling to articulate a methodology similar to the methodology previously adopted by this panel in *Smith I*.”).

¹⁶⁷ *Id.* at 664.

¹⁶⁸ *Id.* at 665–66.

¹⁶⁹ *Smith v. City of Fayetteville*, 748 S.E.2d 558, 559 (N.C. 2013) (dismissing appeal and denying discretionary review of the decision of the North Carolina Court of Appeals).

¹⁷⁰ See *Smith II*, 743 S.E.2d at 665.

¹⁷¹ *Id.* at 665–66.

created what it thought to be an introductory test for evaluating cases, and yet the Court of Appeals considers the test too undeveloped or insignificant to analyze or build upon. The Supreme Court Justices should have realized that the Court of Appeals' opinion was an indirect request for more guidance.

Prudential use of limited judicial resources suggests that the Supreme Court could make a more meaningful impact on North Carolina law by devoting time to other matters rather than reviewing a nearly identical case. However, the last *Smith* decision threatens to cloud the authority of the Just and Equitable Tax Clause and revert the state of the law back to a confusing pre-*IMT* environment. The Supreme Court should have used *Smith* as a chance to clarify its thinking, expand the *IMT* Test, and further evolve this nascent, but important protection.

The Court of Appeals decided that *Nesbitt* was the only case that provided “manageable standards” as to whether the challenged tax is just and equitable.¹⁷² While the Supreme Court clearly agreed with this argument, the inability of the Court of Appeals to thoroughly apply or understand the *IMT* test indicates that the Supreme Court needed to reexamine this issue.¹⁷³ If the Supreme Court wished to add clarity to the *IMT* test, this was a key opportunity to do so. But if the court merely wished to reiterate that *Nesbitt* was the only manageable foundation for the *IMT* test, it could have provided clarifying language to broaden the understanding of the logic used in its initial decision.

Examining the original *Smith* opinion from the Court of Appeals reveals several key elements that should be incorporated into the *IMT* Test. First, the *Smith* case contains a technical, stepwise analysis for evaluating just and equitable tax challenges.¹⁷⁴ Even if the elements of the test were invalidated by the *IMT* decision, the test nonetheless provides a convenient rubric that courts could use when applying the Just and Equitable Tax Clause. Ordering the elements of the test and creating threshold requirements allows businesses to easily examine the validity of the taxes imposed against them and provides the court the chance to show what factors in the *IMT* test are more or less important. The rubric is also helpful because it outlines specific requirements that both the city and the taxpayer must meet in order for the respective sides to present a valid claim or defense.¹⁷⁵

¹⁷² *Smith I*, 725 S.E.2d at 410.

¹⁷³ *See IMT, Inc.*, 738 S.E.2d.

¹⁷⁴ *See Smith I*, 725 S.E.2d at 411.

¹⁷⁵ *Id.*

The second *Smith* opinion notes that the actual tax imposed by the city is significantly higher than the minimum tax specified.¹⁷⁶ This fact is also true for *IMT*, yet the Supreme Court neglects to enumerate this possibility in the *IMT* Test. While cities are allowed to set variable or graduated tax rates, *Smith* and *IMT* both demonstrate that this can result in unconstitutionally-high taxes.¹⁷⁷ Incorporating this logic as an element of the *IMT* test would allow businesses to show that a seemingly innocent minimum tax is actually prohibitive when applied.

3. *Giving Equal Deference to Government and Businesses*

One of the reasons for giving deference to legislative tax classifications is the expertise of the government in setting tax rates and their ability to balance policy considerations during this process.¹⁷⁸ Interestingly, when the North Carolina Supreme Court examined the reasonableness of privilege license taxes in *Dannenberg*, one of the considerations of the court was that “evidence regarding the effect on the business of complying with the ordinance is typically unhelpful because negligence, incompetence, or other considerations could play into the success of the licensee’s business.”¹⁷⁹ These two policies, when read together, reveal a startling double standard: legislators are presumed to be reasonable and prudent in their decision-making, yet profit-minded business owners are not presumed to be equally reasonable and qualified in their decision-making.

Allowing for incorporation of an equal standard into the *IMT* test would balance these evaluations and provide business owners the equal deference they deserve. If the *Dannenberg* language were to be adopted again, it would imply that even if a tax strips away a large portion of profits from a business, the tax cannot be challenged as overbearing because the victim may not be savvy enough to generate more profits.¹⁸⁰ The structure of our economy is built on profit-seeking behavior. While businesses do fail, it is disingenuous to imply that all business owners have a negligent and incompetent streak in them. Even in the best managed business, if the industry has overall thin profit margins, the *Dannenberg* language would preclude these companies from challenging a crippling high tax, since the government could impose high taxes and claim that the businesses are

¹⁷⁶ *Id.* at 409.

¹⁷⁷ *Nesbitt*, 41 S.E.2d at 650.

¹⁷⁸ *IMT, Inc.*, 738 S.E.2d at 159.

¹⁷⁹ *Dannenberg*, 66 S.E. at 303.

¹⁸⁰ *See id.*

suffering not because the tax is punitive, but rather because the businesses are poorly run.¹⁸¹

This addition to the *IMT* Test should be two-fold. First, businesses should share an equal presumption of skill and deference in managing their affairs as the government is accorded in setting tax classifications. Second, businesses should be allowed to introduce evidence detailing their difficulty in complying with a high level of taxation. This would protect both smaller businesses with proportionally smaller profits as well as industries that are successful yet operate on thin margins.

IV. CONCLUSION

The North Carolina Supreme Court was correct in recognizing the importance of the Just and Equitable Tax Clause as a protection against unjustly high or abusive taxation. Its opinion in *IMT* demonstrates a respect for the drafters of the Just and Equitable Tax Clause and properly elevates the clause to its intended level of significance. However, in moving away from the common law standard and beginning to craft a new test for future cases, the court left ambiguities that have frustrated the lower courts and left businesses without some of the definitive protections they need. Fortunately, the *IMT* test establishes a broad and flexible foundation that can be cultivated and nurtured in subsequent decisions. Incorporating previously overlooked factors from cases such as *Smith*, *Dannenber*, and *Razook* would provide an immediate boost to the efficacy of the clause and prevent future false starts such as its application in *Smith*. The North Carolina Supreme Court must also be prudent in remembering that this constitutional protection should not be minimized by over-reliance on legislative deference. Moving forward, the North Carolina Supreme Court must take advantage of any possible opportunity to expand and clarify the test in order for the North Carolina Constitution to serve as a model form of protection for citizens against unjust taxation by both state and local government.

¹⁸¹ *Id.*