

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Additional)
Estate Tax by the Secretary of Revenue)
of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2003-231

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on August 4, 2003, upon an application for hearing by [Taxpayer's Attorney], wherein he protested the proposed assessment of additional estate tax against the [Taxpayer], hereinafter referred to as "Estate." The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by [Attorney]; [Executor]; [Wife of Executor and Daughter of the Decedent]; W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division; Patrick G. Penny, Administrative Officer in the Personal Taxes Division; and Alexandra M. Hightower, Assistant Attorney General.

[Decedent] died on January 14, 2002. Executor timely filed the North Carolina estate tax return for Estate. Line 6 of the estate tax return reflected tax of \$76,491.00; however, Lines 16 and 20 reflected estate tax of \$57,338.00, which was remitted with the return. Upon examination, the Department increased Estate's tax liability to \$76,491.00, the amount of estate tax reflected on Line 6 of the return. Pursuant to G.S. 105-241.1, a Notice of Estate Tax Assessment reflecting additional tax and interest of \$19,442.46 was mailed to Executor on December 9, 2002.

Attorney objected to the proposed assessment and timely requested a hearing before the Secretary of Revenue. Subsequent to receiving the hearing request, the Department determined that the estate tax liability had been overstated by \$40.00. Accordingly, the estate tax liability has been reduced to \$76,451.00.

ISSUE

The issue to be decided in this matter is as follows:

Is the assessment for additional estate tax proposed against Estate lawful and proper?

EVIDENCE

The evidence presented by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, consisted of the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Eugene J. Cella, Assistant Secretary for Administrative Tax Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.
2. Decedent's North Carolina estate tax return, a copy of which is designated as Exhibit PT-2.
3. Notice of Estate Tax Assessment dated December 9, 2002, a copy of which is designated as Exhibit PT-3.
4. Letter from Attorney to Ellen H. Clapp, Revenue Tax Auditor, dated January 9, 2003, a copy of which is designated as Exhibit PT-4.
5. Letter from Nancy R. Pomeranz, Director of the Personal Taxes Division, to Attorney dated February 6, 2003, a copy of which is designated as Exhibit PT-5.
6. Letter from Eugene J. Cella to Attorney dated May 14, 2003, a copy of which is designated as Exhibit PT-6.
7. Letter from Eugene J. Cella to Attorney dated June 26, 2003, a copy of which is designated as Exhibit PT-7.

At the hearing, Attorney presented a document entitled Memorandum of Authority in Support of Taxpayer's Protest of Assessment of Additional Estate Taxes and Interest along with two related exhibits, copies of which are collectively designated as Exhibit TP-1. At the conclusion of the hearing, the Assistant Secretary allowed Attorney until September 30, 2003, to submit additional information for the record in support of his objection to the proposed assessment. The Assistant Secretary received a letter from Attorney dated September 25, 2003, which included a document entitled Brief in Support of Taxpayer's Protest of Assessment of Additional Estate Taxes and Interest along with two related exhibits, copies of which are collectively designated as Exhibit TP-2.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. Decedent was a citizen and resident of North Carolina at the time of her death on January 14, 2002.
2. Executor timely filed Decedent's North Carolina estate tax return reflecting an estate tax liability of \$57,338.00, which was remitted with the return.
3. The state death tax credit allowed on Estate's federal estate tax return was \$57,338.00.

4. Upon examination, the Department determined that the North Carolina estate tax liability for Estate was \$76,491.00, the amount reflected on Line 6 of the North Carolina estate tax return.
5. Pursuant to G.S. 105-241.1, a Notice of Estate Tax Assessment reflecting additional tax and interest of \$19,442.46 was mailed to Executor on December 9, 2002. Attorney objected to the proposed assessment and timely requested a hearing before the Secretary of Revenue.
6. Subsequent to receiving the hearing request, the Department of Revenue determined that the estate tax liability had been overstated by \$40.00. Accordingly, the estate tax liability has been reduced to \$76,451.00.
7. The United States Congress enacted legislation in 2001 to phase out the federal state death tax credit over three years beginning with 2002. For 2002, the allowable credit was reduced by 25 percent for estates of decedents dying after December 31, 2001.
8. North Carolina law defines "Code" as the Internal Revenue Code as enacted on a certain date. On January 14, 2002, Decedent's date of death, North Carolina law defined "Code" as the Internal Revenue Code as enacted on January 1, 2001.
9. Effective September 30, 2002, G.S. 105-228.90(b)(1b) was amended to update the State's reference to the Internal Revenue Code from January 1, 2001 to May 1, 2002. In conjunction with the amendment to G.S. 105-228.90(b)(1b), G.S. 105-32.2(b) was amended to reflect the "decoupling" from the Internal Revenue Code with respect to the federal phase-out of the state death tax credit.
10. Attorney contends that the amendment of G.S. 105-32.2 in September 2002 retroactively increased the estate tax liability of Estate in violation of Article I, Section 16 of the North Carolina Constitution. Attorney also contends that Estate's North Carolina estate tax liability is limited to the amount of the state death tax credit allowed on Estate's federal estate tax return.

CONCLUSIONS OF LAW

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

1. Effective for decedents dying on or after January 1, 1999, North Carolina's former inheritance tax was repealed and replaced by a stand-alone estate tax predicated upon the federal state death tax credit.
2. For decedents dying on or after January 1, 1999, North Carolina imposes an estate tax upon the estate of a decedent when a federal estate tax is imposed on the estate under section 2001 of the Code and the decedent was a resident of this State at death.
3. At no point in time did the federal provision for the phase-out of the state death tax credit become applicable to North Carolina estate tax law.

4. For decedents dying on and after January 1, 2002 and before July 1, 2005, the amount of North Carolina's estate tax is the maximum credit for state death taxes allowed under section 2011 of the Code without regard to the phase-out and termination of that credit under subdivision (b)(2) and subsection (f) of that section.
5. A decedent's North Carolina estate tax liability is determined as of the date of death or the alternative valuation date, if elected.
6. The amendment to the estate tax statute (G.S. 105-32.2(b)) included in Session Laws 2002-126 reflects the North Carolina General Assembly's decision not to adopt the federal phase-out of the state death tax credit. This "decoupling" legislation was necessary since the General Assembly had also included legislation in Session Laws 2002-126 to update the reference date to the Internal Revenue Code from January 1, 2001 to May 1, 2002.
7. The Secretary of Revenue's duties includes administering the laws enacted by the North Carolina General Assembly relating to the assessment and collection of estate taxes. As an official of the Executive branch of the government, the Secretary lacks the authority to determine the constitutionality of legislative acts. The question of constitutionality of a statute is for the judicial branch.
8. The proposed assessment, modified to reduce the additional tax due by \$40.00, is lawful and proper.

DECISION

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary finds the proposed estate tax assessment, to the extent hereinafter modified, to be lawful and proper and is hereby affirmed.

One of the arguments offered by Attorney is that the amendment to G.S. 105-32.2(b) included in Session Laws 2002-126, which was enacted in September 2002, imposes a retrospective tax and is therefore unconstitutional. The Secretary of Revenue's duties includes administering the laws enacted by the North Carolina General Assembly relating to the assessment and collection of estate taxes. As an official of the Executive branch of the government, the Secretary lacks the authority to determine the constitutionality of legislative acts. The question of constitutionality of a statute is for the judicial branch. While the Assistant Secretary does not have jurisdiction to decide on the constitutionality of the amendment in question, the Assistant Secretary offers the following with respect to Attorney's retrospective

taxation argument. For estate tax purposes, North Carolina law defines “Code” as the Internal Revenue Code as enacted on a certain date. North Carolina law uses a fixed date as the reference date to the Internal Revenue Code for both a policy reason and a legal constraint. The policy reason for specifying a particular date is that, due to the many changes made to federal law from year to year, the North Carolina General Assembly may not wish to automatically adopt all federal changes, particularly when the changes result in large revenue losses or gains. More importantly, however, Section 2(1) of Article V of the North Carolina Constitution prohibits a delegation of the taxing power, thereby imposing an obstacle to a statute that automatically adopts any changes in federal law. The reference date to the Internal Revenue Code included in the definition of “Code” as defined by North Carolina estate tax law on Decedent’s date of death was January 1, 2001. Therefore, Decedent’s North Carolina estate tax liability must be determined using the Internal Revenue Code as enacted as of January 1, 2001. The maximum credit for state death taxes allowed to Estate under section 2011 of the Internal Revenue Code as enacted on January 1, 2001 is \$76,451.00. The fact that Estate was allowed a lesser amount of credit for state death taxes on its federal estate tax return due to an amendment to the Internal Revenue Code that was enacted after January 1, 2001, has no bearing on the Estate’s North Carolina estate tax liability as of Decedent’s date of death.

As part of Session Laws 2002-126, the General Assembly chose to update the definition of “Code” as referenced in North Carolina law to mean the Internal Revenue Code as enacted on May 1, 2002. Because the General Assembly also chose not to adopt the phase-out of the state death tax credit provisions enacted under 2001 federal legislation, it had to include in Session Laws 2002-126 an amendment to G.S.105-32.2(b) to reflect the decoupling from the Internal Revenue Code with respect to the phase-out provisions. Furthermore, the effect of the amendment to G.S. 105-32.2(b) was not to increase North Carolina estate tax, but rather to preserve the North Carolina estate tax as it was imposed under prior law. In effect, taxpayers continue to pay the same North Carolina estate tax as under prior State law but do not receive

full credit against their federal estate taxes for the payment. Since the amendment does not increase the North Carolina estate tax liability of any decedent dying prior to its enactment in September 2002, it cannot be viewed as a retrospective tax.

Attorney also argues that with the repeal of North Carolina's inheritance tax and the enactment of North Carolina's estate tax, the General Assembly intended to eliminate all death taxes in North Carolina except for the amount allowed as the federal state death tax credit on a decedent's federal return. Therefore, Attorney contends that Estate's North Carolina estate tax liability is limited to \$57,338.00, the amount of the state death tax credit allowed on Estate's federal estate tax return. While the General Assembly may have intended to accept the amount of the maximum state death tax credit as the North Carolina estate tax liability when they repealed the inheritance tax in 1998, the Assistant Secretary believes that with the passage of the amendment to G.S. 105-32.2(b) in September 2002, it is clear that the General Assembly did not intend to automatically adopt any changes to the federal computation of the state death tax credit for North Carolina estate tax purposes. Furthermore, the law does not define North Carolina estate tax as the maximum credit for state death taxes allowed on the decedent's federal estate tax return, but rather it defines North Carolina estate tax as the maximum credit for state death taxes allowed under section 2011 of the Internal Revenue Code as enacted on a certain date. At the time of Decedent's death on January 14, 2002, North Carolina law defined "Code" as the Internal Revenue Code as enacted on January 1, 2001. Therefore, Estate's North Carolina estate tax liability is \$76,451.00 even though the credit for state death taxes allowed on Estate's federal estate tax return was only \$57,338.00.

Attorney and Executor contend that the State has unconstitutionally imposed a retrospective tax. While the Assistant Secretary does not agree that a retrospective tax has been imposed, the Assistant Secretary is not empowered to address the constitutionality of the amendment in question. The Assistant Secretary may, however, render a decision on Attorney's other arguments. In that regard, the Assistant Secretary finds that the proposed

assessment for additional estate tax, modified to reduce the additional tax due by \$40.00, is hereby sustained in its entirety and is determined to be finally due and collectible, together with interest as allowed by law.

Made and entered this 15th day of December, 2003.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue