STATE OF NORTH CAROLINA **BEFORE THE SECRETARY OF REVENUE**

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessment of Additional Gift Tax for the Taxable Year 1996 by the Secretary of Revenue of North Carolina,	)	**FINAL DECISION**
vs.	)	Docket No. 2000-418
[Taxpayer]	)	

This matter was heard before the Assistant Secretary of Revenue, Michael A. Hannah, upon an application for a hearing by [Taxpayer], wherein she protested the proposed assessment of additional gift tax for the taxable year 1996. At the request of [Taxpayer's Representative] the hearing was conducted via written communication and the Assistant Secretary allowed Representative until November 6, 2000, to provide any arguments, documents, or other evidence in support of his objections to the proposed assessment. The hearing was conducted by the Assistant Secretary of Revenue under the provisions of G.S. 105-260.1.

Taxpayer owned a remainder interest in real estate located in [a county of] North Carolina. She timely filed a North Carolina gift tax return for the tax year 1996 to report a gift of the remainder interest to [Donee]. Taxpayer identified Donee as her stepfather.

Taxpayer reported $134,341.00 as the value of the gift. Taxpayer claimed the annual exclusion of $10,000.00 and the lifetime exemption of $100,000.00 in arriving at a taxable gift of $24,341.00. Taxpayer calculated gift tax of $386.82 and remitted payment of that amount with the return.

Upon examination, the Department of Revenue disallowed the annual exclusion because the gift was a gift of a future interest and disallowed the lifetime exemption because Donee was not a Class A donee. A Notice of Tax Assessment – Gift Tax reflecting additional gift tax plus interest of $17,187.13 was mailed to Taxpayer on December 28, 1999. Representative objected to the assessment on behalf of Taxpayer and timely requested a hearing.

ISSUE

The issues to be decided in this matter are as follow:

1) Should the annual exclusion of $10,000.00 be allowed because the gift, although a future interest to Taxpayer, is a present interest to Donee because Donee had immediate use, possession, and enjoyment of the gifted property?

2) Does the lifetime exemption apply to a stepparent?

EVIDENCE

The evidence presented by Gregory B. Radford, Assistant Director of the Personal Taxes Division, consisted of the following:

1) Memorandum dated April 18, 1996, from Muriel K. Offerman, Secretary of Revenue, to Michael A. Hannah, Assistant Secretary of Revenue, a copy of which is designated as Exhibit PT-1.

2) Taxpayer's North Carolina Gift Tax Return for the taxable year 1996, a copy of which is designated as Exhibit PT-2.

3) Notice of Tax Assessment – Gift Tax for the taxable year 1996 dated December 28, 1999, a copy of which is designated as Exhibit PT-3.

4) Letter from Representative to the North Carolina Department of Revenue dated January 31, 2000, a copy of which is designated as Exhibit PT-4.

5) Letter from Charles T. Hawks, former Administrative Officer in the Personal Taxes Division, to Representative dated February 24, 2000, a copy of which is designated as Exhibit PT-5.

6) Letter from Charles T. Hawks to Representative dated May 17, 2000, a copy of which is designated as Exhibit PT-6.

7) Letter from Representative to the Personal Taxes Division dated June 9, 2000, a copy of which is designated as Exhibit PT-7.

8) Letter from Representative to the Personal Taxes Division dated June 29, 2000, with Legal Memorandum attached, copies of which are collectively designated as Exhibit PT-8.

9) File Notes dated July 25, 2000, documenting a telephone conversation between Gregory B. Radford and Representative, a copy of which is designated as Exhibit PT-9.

10) Letter from Michael A. Hannah to Representative dated July 27, 2000, a copy of which is designated as Exhibit PT-10.

11) Letter from Representative to Michael A. Hannah dated September 26, 2000, a copy of which is designated as Exhibit PT-11.

12) Letter from Michael A. Hannah to Representative dated September 29, 2000, a copy of which is designated as Exhibit PT-12.

FINDINGS OF FACT

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

1) Taxpayer is and at all material times was a natural person, sui juris, and a citizen and resident of North Carolina.

2) Taxpayer owned a remainder interest in real estate located in [a county of] North Carolina. She gave the remainder interest to Donee in 1996.

3) At the time of the gift, Donee was also the life tenant in the property. As a result of the gift, Donee had total ownership of the real estate.

4) Taxpayer timely filed a North Carolina gift tax return for the tax year 1996 to report the gift. She reported $134,341.00 as the value of the gift. Taxpayer claimed the annual exclusion of $10,000.00 and the lifetime exemption of $100,000.00 in arriving at a taxable gift of $24,341.00. Taxpayer calculated gift tax of $386.82 and remitted payment of that amount with the return.

5) Upon examination, the Department of Revenue disallowed the annual exclusion because the gift was a gift of a future interest and disallowed the lifetime exclusion because Donee was not a Class A donee.

6) A Notice of Tax Assessment – Gift Tax reflecting additional gift tax plus interest of $17,187.13 was mailed to Taxpayer on December 28, 1999.

7) Representative objected to the assessment on behalf of Taxpayer and timely requested an administrative tax hearing.

CONCLUSIONS OF LAW

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

1) A gift tax is imposed on the transfer of property, real or personal, for less than full consideration.

2) The first $10,000.00 of present value gifts to each donee in a year is exempt from gift tax. This exclusion does not apply to gifts of future interests.

3) A donor is entitled to a lifetime exemption of $100,000.00 for gifts to Class A donees. A donor may not claim a lifetime exemption for gifts to Class B or Class C donees.

4) A Class A donee includes the lineal issue, lineal ancestor, adopted child, or stepchild of the donor. A Class B donee includes the brother or sister, descendant of the brother or sister, or uncle or aunt by blood of the donor. A Class C donee includes any other relative as well as any donee that is unrelated to the donor.

5) The gift tax return and payment of any tax liability are due on April 15 following the year of the gift.

6) Interest accrues on unpaid tax from the date the tax is due until the date the tax is paid.

7) The proposed assessment of additional gift tax and interest for the tax year 1996 is lawful and proper.

DECISION

This hearing addresses two issues with respect to the gift tax assessment proposed against Taxpayer for the tax year 1996. Taxpayer owned a remainder interest in real property. In 1996, she gave the remainder interest to her stepfather who, at the time of the gift, already owned the life interest in the property. At issue is whether Taxpayer's gift is a gift of a present interest and thus eligible for the annual $10,000 exclusion and whether Donee is a Class A beneficiary, thereby qualifying Taxpayer to claim the lifetime exclusion.

Representative argues that the annual exclusion of $10,000.00 should be allowed because the gift, although a future interest to Taxpayer, is a present interest to Donee because Donee had immediate use, possession, and enjoyment of the gifted property. Representative offers no legal

authority or case history in support of his argument. G.S. 105-188(d) provides that gifts of $10,000.00 or less to any one donee in a calendar year are not subject to the gift tax. If the value of the gifts to a donee during the calendar year exceeds $10,000.00, only the value of the gifts in excess of $10,000.00 is taxable. However, the $10,000.00 annual exclusion does not apply to gifts of future interests in property. Although North Carolina law does not define "future interests," federal gift tax law contains the identical prohibition of claiming the annual exclusion on a gift of a future interest (Code section 2503(b).) Regulation 25.2503-3 provides that "'Future interest' is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date or time…." The gift of the remainder interest by Taxpayer to Donee resulted in Donee having total ownership of the real estate because Donee was the life tenant in the property at the time of the gift. However, Taxpayer had only a remainder interest to give. A gift of a remainder interest is a gift of a future interest for purposes of the annual exclusion (*Hamilton, Robert v. U.S.*, 77-1 USTC ¶13196).

Representative also argues that the lifetime exclusion should apply to a stepparent. Pursuant to G.S. 105-188(f), the gift tax rate is determined based on the relationship between the donor and the donee. A donee who is the lineal issue, lineal ancestor, adopted child, or stepchild of the donor is subject to the tax rates in G.S. 105-188(f)(1). These donees are referred to as Class A donees. A donee who is the brother or sister, or descendant of the brother or sister, or the aunt or uncle by blood of the donor is subject to the tax rates in G.S. 105-188(f)(2). These donees are referred to as Class B donees. A donee other than the relations listed above is subject to the tax rates in G.S. 105-188(f)(3). These donees are referred to as Class C donees. The

classes of donees are the same as beneficiaries for inheritance tax, which was repealed effective for decedents dying on or after January 1, 1999.

Pursuant to G.S. 105-188(g), a donor is entitled to a lifetime exemption of $100,000 for gifts made to donees identified in G.S. 105-188(f)(1). A donor may not claim the lifetime exemption for gifts made to donees identified in G.S. 105-188(f)(2) or (3).

Representative correctly states that a gift from a donor to the donor's stepchild qualifies for the lifetime exemption, as statutorily mandated by G.S. 105-188(f)(1). Representative also correctly states that a gift from a donor to the donor's stepgrandchildren qualifies for the exemption just as a gift to the donor's grandchildren would qualify. This position was determined by the North Carolina Supreme Court's decision in *Ingram v. Johnson*, 260 NC 697 (1963).

Relying on *Ingram*, Representative argues that it is reasonable to conclude that the Legislature did not use the word "parent" in a technical or restricted sense but intended to place parents, natural or adoptive, in the same category. Representative also argues that it is not only inequitable to exclude stepparents from the ranks of Class A beneficiaries, but such an interpretation is inconsistent with the intent of the Legislature, the reasoning of our North Carolina courts, and the policy goals embedded in the statute.

As stated in *Ingram*, legislative intent is the test to be applied where a statute classifies persons for the purpose of measuring their tax liability. Interpretation is unnecessary where the words in the statute are so plain and unambiguous that no doubt can exist as to legislative intent and the proper application of the statutory language to a particular factual situation. When the words leave reasonable doubt as to what the Legislature intended, it is proper to look to legislative history, judicial interpretation of prior statutes dealing with the question, and any

changes made following a particular interpretation. The Court in *Ingram* looked at the legislative history of the inheritance tax statutes with respect to the classes of beneficiaries and determined that the progressive changes in the statute showed that the Legislature did not use the word "grandchildren" in a technical or restricted sense but intended to place grandchildren, natural, step, or adopted, in the same category. In arriving at its conclusion, the Court cited a 1925 legislative change and determined that the "amendment would appear to be superfluous if limited to natural grandchildren – they had been provided for in the previous provision – but essential to permit stepgrandchildren to take the exemption."

The same legislative history cited in *Ingram* shows that a lineal issue or lineal ancestor has been a Class A beneficiary since the inception of the inheritance tax in 1901. The Revenue Act of 1915 added "adopted child" to the list of Class A beneficiaries. In 1921, the list of Class A beneficiaries was enlarged to include "son-in-law or daughter-in-law or stepchild of the person who died…." Further amendments to the statute did not add superfluous language with respect to parents as the Court ruled had occurred with respect to grandchildren. In 1921, when the Legislature added the term "stepchild," it did not choose, for whatever reason, to add the term "stepparent." While the law provided for both parents and children, it provided only for stepchildren, not stepparents. The legislative history in this case supports the Department's contention that the language of the statute is clear and unambiguous with respect to the classification of a stepparent as a Class C donee.

The proposed assessment for the tax year 1996 is hereby sustained in its entirety and is determined to be final and collectible, together with interest as allowed by law.

Made and entered this 11th day of December, 2000.

Signature _____

Michael A. Hannah
Assistant Secretary of Revenue