

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Gift Tax for)
the Taxable Year 1996 by the Secretary)
of Revenue of North Carolina)

vs.)

[Donor])

FINAL DECISION
Docket No. 2001-607

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on November 19, 2001, upon an application for hearing by [Donor], wherein she protested the proposed assessment of gift tax for the taxable year 1996. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by [Donor's accountant] and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division. [Donor's accountant] is hereinafter referred to as "Representative."

On November 9, 2000, Donor filed a North Carolina gift tax return for the taxable year 1996 reflecting tax of \$17,540. Donor claimed credit on the 1996 return for the gift tax of \$20,000 paid with an application for extension for the taxable year 1995 and requested a refund for the difference of \$2,460. The examining auditor disallowed the \$20,000 payment and a Notice of Tax Assessment for the tax of \$17,540 plus penalties and interest was mailed to Donor on March 21, 2001.

Donor objected to the proposed assessment and filed a timely request for an administrative tax hearing before the Secretary of Revenue.

ISSUE

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

Is Donor barred by the statute of limitations from receiving credit on her 1996 gift tax return for gift tax paid with the application for extension to file her 1995 gift tax return?

Is there reasonable cause for waiver of the penalties asserted against Donor for the taxable year 1996?

Is the gift tax assessment proposed against Donor for the taxable year 1996 lawful and proper?

EVIDENCE

The evidence presented by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, included 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. Donor's North Carolina Application for Automatic Six-Month Extension of Time to File State Income Tax Return, dated April 15, 1996, for the taxable year 1995, a copy of which is designated as Exhibit PT-2.
3. Donor's North Carolina gift tax return for the taxable year 1996, a copy of which is designated as Exhibit PT-3.
4. Notice of Gift Tax Assessment for the taxable year 1996 dated March 21, 2001, a copy of which is designated as Exhibit PT-4.
5. Letter from W. L. Walser, Tax Auditor in the Office Examination Division, to Donor dated May 13, 1999, a copy of which is designated as Exhibit PT-5.
6. Letter from K. R. Biser, Tax Auditor in the Office Examination Division, to Representative dated March 9, 2000, a copy of which is designated as Exhibit PT-6.
7. Letter from K. R. Biser to Representative dated March 30, 2000, a copy of which is designated as Exhibit PT-7.
8. Letter from Representative to Glenn Cox, Supervisory Tax Auditor for the Central Examination Division, dated March 15, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from Glenn Cox to Representative dated March 20, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter from [Donor's attorney] to Nancy R. Pomeranz, Director of the Personal Taxes Division, dated April 12, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter from Representative to Nancy R. Pomeranz dated September 5, 2001, a copy of which is designated as Exhibit PT-11.
12. Letter from Eugene J. Cella to Representative dated October 5, 2001, a copy of which is designated as Exhibit PT-12.

At the hearing, Representative testified that he understood from telephone conversations with Department of Revenue employees that the \$20,000 paid with the 1995 extension would be applied to the gift tax due for the taxable year 1996. Representative contended that the statute of limitations provisions in G.S. 105-266(c) do not apply because Donor made no taxable gifts in 1995; was not required to file a return; and had no tax that year.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary 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. On April 15, 1996, Donor filed an application for an automatic six month extension of time to file a State gift tax return for the taxable year 1995 and included payment of \$20,000 with the application.
3. On November 9, 2000, Donor filed a North Carolina gift tax return for the taxable year 1996 and reported \$466,900 as the total fair market value of property at the time of the gift. Donor claimed the \$10,000 annual exclusion for each of the two donees and a total of \$26,242 of her lifetime exemption to arrive at total taxable gifts of \$420,658. The return reflected tax of \$17,540.
4. Donor claimed credit on the 1996 return for the gift tax of \$20,000 paid with the application for extension for the taxable year 1995 and requested a refund for the difference of \$2,460. The examining auditor disallowed the \$20,000 payment.
5. The auditor asserted the 10 percent late payment penalty, the 25 percent late filing penalty, and accrued interest.
6. A Notice of Tax Assessment for the tax of \$17,540 plus penalties and interest was mailed to Donor on March 21, 2001. Donor objected to the proposed assessment and filed a timely request for an administrative tax hearing before the Secretary of Revenue.

CONCLUSIONS OF LAW

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

1. Anyone who, during the calendar year, gives to a donee one or more taxable gifts whose total value exceeds the amount of the annual exclusion of \$10,000 must file a gift tax return. The tax is due on April 15th following the end of the calendar year in which the gift is made. A return must be filed on or before the due date of the tax.
2. A taxpayer may ask the Secretary for an extension of time to file a gift tax return. To obtain the extension, the taxpayer must file the request by the due date of the gift tax return and pay the tax expected to be due. Donor properly filed an application for an automatic extension of time to file a State gift tax return for the taxable year 1995 and paid the tax of \$20,000 expected to be due.
3. The State gift tax is levied on a calendar year basis.
4. An overpayment of tax shall not be refunded before the taxpayer has filed a final return for the tax period. No overpayment shall be refunded, whether upon discovery or receipt of written demand, if the discovery is not made or the demand is not received within

three years after the date set by the statute for the filing of the return or within six months after the payment of the tax alleged to be an overpayment, whichever is later.

5. Crediting an overpayment barred by the statute of limitations to a tax return for a subsequent year is the same as refunding the overpayment to the taxpayer. An overpayment barred by the statutory period for filing claims cannot be credited against a liability for another tax year (In re Fleishman, 264 N.C. 204, 141 S.E. (2d) 256 (1965)).
6. A penalty of five percent of the tax (maximum 25 percent) for each month is required for failure to file a gift tax return by the due date of the return. A penalty of ten percent of the tax is required for failure to pay the gift tax when due. Because Donor did not file the gift tax return for the tax year 1996 until November 9, 2000, nearly three and one half years after the due date, the late filing and late payment penalties are properly assessed.
7. The Secretary of Revenue is authorized to waive or reduce any penalties.
8. The proposed assessment for the taxable year 1996 was properly issued and is, under the facts, lawful and proper.

DECISION

Donor contends that the statute of limitations for refunds of tax should not apply to the \$20,000 paid with the application for extension of time to file the 1995 gift tax return because no taxable gifts were made, no tax was due, and no return would have been required. Donor further contends that the Department stated verbally that the payment could be credited against the gift tax for the taxable year 1996 and, consequently, should be allowed.

The law requires that no overpayment shall be refunded, whether upon discovery or receipt of written demand, if the discovery is not made or the demand is not received within three years after the date set by the statute for filing of the return or within six months after the payment of the tax alleged to be an overpayment, whichever is later. Also, an overpayment of tax shall not be refunded before the taxpayer has filed a final return for the tax period. Donor had until October 15, 1999, to make written demand for the refund of the gift tax paid for the tax year 1995 and there is no factual evidence indicating such written demand was ever made or that a return was filed requesting the refund. Alleged verbal statements made by Department personnel are not sufficient to meet the written demand requirements for refund. Moreover, the

letters (Exhibits PT-6 and PT-7) sent to Representative from Department personnel and construed by him to mean that the 1995 payment would be applied to the 1996 gift tax were mailed after the statute of limitations had expired for refunds for the taxable year 1995.

Donor's payment of \$20,000 was received with the application for an extension of time to file the gift tax return for the taxable year 1995. The State gift tax is levied on a calendar year basis; consequently, any refund of gift tax paid for the taxable year 1995 must be within the statute of limitations for that year. Whether or not Donor made any taxable gifts during that year does not preclude the requirement that the demand for refund be properly and timely made within the statute of limitations. Also, because the crediting of an overpayment of tax barred by the statute of limitations to a return for a subsequent year is the same as refunding the overpayment to the taxpayer, the tax paid for the taxable year 1995 may not be credited to the tax year 1996.

The Assistant Secretary finds reasonable cause for waiver of the penalties and hereby waives the late filing penalty of \$4,385.00 and the late payment penalty of \$1,754.00.

The proposed gift tax assessment for the taxable year 1996, modified to withdraw the penalties, is lawful and proper in every respect and is hereby determined to be immediately due and collectible as allowed by law.

Made and entered this 14th day of February, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue