

**STATE OF NORTH CAROLINA**  
**COUNTY OF WAKE**

**BEFORE THE**  
**SECRETARY OF REVENUE**

**IN THE MATTER OF:**

The Proposed Assessments of Gift Tax for )  
the Taxable Year 2002 by the Secretary )  
of Revenue of North Carolina )  
)  
vs. )  
)  
Taxpayers )  
)

**FINAL DECISION**  
Docket No. 2003-565

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, upon an application for a hearing by Taxpayers, hereinafter referred to collectively as "Donors," and separately as "Husband" and "Wife," respectively, wherein they protested proposed assessments of gift tax for the taxable year 2002. Grantees are hereinafter referred to as "Son" and "Daughter-In-Law," respectively. At the request of Donors' accountant, hereinafter referred to as "Accountant," the hearing was conducted via written communication and is based on all information presented for the record as of May 20, 2004. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1.

Notices of Gift Tax Assessment were mailed to Husband and Wife, respectively, on May 7, 2003, proposing assessments of additional gift tax and interest for the taxable year 2002. Donors objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.

**ISSUE**

The issues to be decided in this matter are:

1. Is the gift of real property by Donors properly divided between Son and Daughter-In-Law?
2. Are the gift tax assessments proposed against Husband and Wife for the taxable year 2002 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. Husband's North Carolina gift tax return for the taxable year 2002, a copy of which is designated as Exhibit PT-2.
3. Wife's North Carolina gift tax return for the taxable year 2002, a copy of which is designated as Exhibit PT-3.
4. Notice of Gift Tax Assessment proposed against Husband for the taxable year 2002 dated May 7, 2003, a copy of which is designated as Exhibit PT-4.
5. Notice of Gift Tax Assessment proposed against Wife for the taxable year 2002 dated May 7, 2003, a copy of which is designated as Exhibit PT-5.
6. Letter from Accountant to the Department dated May 27, 2003, with Donors' amended gift tax returns for the taxable year 2002, copies of which are collectively designated as Exhibit PT-6.
7. Facsimile letter dated July 18, 2003, from Accountant to Debra Hall, auditor in the Department's Central Examinations Division, with North Carolina General Warranty Deed reflecting Daughter-In-Law as grantor of real property in a North Carolina County to Son on June 18, 2003, copies of which are collectively designated as Exhibit PT-7.
8. Letter from Accountant to the Department dated August 8, 2003, a copy of which is designated as Exhibit PT-8.
9. North Carolina General Warranty Deed reflecting Donors as grantors of real property in a North Carolina County to Son and Daughter-In-Law on October 18, 2002, a copy of which is designated as Exhibit PT-9.
10. Letter from W. Edward Finch, Jr., Assistant Director in the Personal Taxes Division, to Accountant dated September 8, 2003, a copy of which is designated as Exhibit PT-10.
11. Letter from Accountant to W. Edward Finch, Jr., dated September 18, 2003, a copy of which is designated as Exhibit PT-11.

12. Letter with related attachments from Accountant to W. Edward Finch, Jr., dated October 3, 2003, copies of which are collectively designated as Exhibit PT-12.
13. Letter from W. Edward Finch, Jr., to Accountant dated November 3, 2003, a copy of which is collectively designated as Exhibit PT-13.
14. Letter from Accountant to W. Edward Finch, Jr., dated November 11, 2003, a copy of which is designated as Exhibit PT-14.
15. Letter from W. Edward Finch, Jr., to Accountant dated December 15, 2003, a copy of which is designated as Exhibit PT-15.
16. Letter from Eugene J. Cella to Accountant dated December 16, 2003, a copy of which is designated as Exhibit PT-16.
17. Letter from Accountant to Eugene J. Cella dated December 19, 2003, a copy of which is designated as Exhibit PT-17.
18. Letter from Eugene J. Cella to Accountant dated January 5, 2004, a copy of which is designated as Exhibit PT-18.
19. Letter from Eugene J. Cella to Accountant dated January 21, 2004, a copy of which is designated as Exhibit PT-19.
20. Letter from Accountant to Eugene J. Cella dated February 12, 2004, a copy of which is designated as Exhibit PT-20.
21. Letter from Eugene J. Cella to Accountant dated February 20, 2004, a copy of which is designated as Exhibit PT-21.

In lieu of appearing at the hearing, Accountant requested that the matter be resolved through written communication. The Assistant Secretary granted the request and allowed Accountant until May 20, 2004, to furnish information in support of Donors' objections to the assessments. Accountant submitted a letter dated May 17, 2004, summarizing his position, a copy of which is designated as Exhibit TP-1.

### **FINDINGS OF FACT**

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

1. Donors are and at all material times were natural persons, sui juris, and citizens and residents of North Carolina.

2. On October 18, 2002, Donors executed a warranty deed transferring real property located in a North Carolina County. The deed listed both Son and Daughter-In-Law as grantees. No excise stamp tax was paid on the transfer.
3. On March 20, 2003, Donors filed their respective North Carolina gift tax returns for the tax year 2002. Each return reported \$73,250 as the total fair market value of the property given by each Donor. Each return also reflected that the gift was divided equally between Son and Daughter-In-Law ( $\$73,250 / 2 = \$36,625$  to each donee). Husband and Wife claimed a \$10,000 annual exclusion for both donees on each of their returns (the correct annual exclusion for tax year 2002 is \$11,000). In error, the returns reflected Daughter-In-Law as a Class A donee and a portion (\$26,625) of Donors specific lifetime exemption was deducted from each of their gifts to her.
4. Upon examination, the auditor adjusted Donors returns to disallow the specific exemption of \$26,625 claimed for the gift to Daughter-In-Law. The auditor also increased the annual exclusion from \$10,000 to \$11,000.
5. Notices of Gift Tax Assessment reflecting the auditor's adjustments were mailed to Husband and Wife respectively on May 7, 2003. Donors objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
6. On June 4, 2003, Husband and Wife filed amended gift tax returns for the tax year 2002 indicating that no gift had been made to Daughter-in-law; that the property had been given solely to Son; and that no gift tax was due. The Department did not accept the amended returns as proper amendments of Donors' original returns.
7. On June 18, 2003, Daughter-In-Law deeded her share of the property to Son. No gift tax is due on that transfer because the gift tax does not apply to property passing from one spouse to the other spouse.
8. Accountant contends that although Donors included Daughter-in-law on the general warranty deed dated October 18, 2002, they did not intend to make a gift to her and that the transfer from Daughter-In-Law to Son by the deed dated June 18, 2003, was done ostensibly to rectify the alleged error.

### **CONCLUSIONS OF LAW**

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

1. North Carolina law imposes a gift tax on the transfer by gift of real property located in North Carolina or personal property that has acquired a taxing situs in North Carolina. The gift tax applies whether the gift is in trust or otherwise and whether the gift is direct or indirect.
2. If a gift is made in property, the fair market value of the property at the date of the gift is considered the amount of the gift. Where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration shall be deemed a gift.
3. Gifts, other than gifts of future interests, are subject to an exclusion of \$11,000.00 for tax year 2002.
4. "Class A" donees include the lineal issue, lineal ancestor, adopted child, or stepchild of the donor. A daughter-in-law is a "Class C" donee.
5. The gift tax rates are based on the relationship between the donor and the donee. Where the donee is the lineal issue of the donor ("Class A"), the gift tax rate is provided in G.S. 105-188(f)(1). Where the donee is the daughter-in-law of the donor ("Class C"), the gift tax rate is provided in G.S. 105-188(f)(3).
6. A donor is entitled to a lifetime exclusion of \$100,000.00 for gifts to "Class A" donees. Because Daughter-In-Law is a Class C donee, the auditor properly disallowed the lifetime exclusion claimed by Donors on the gift to her.
7. Nothing else appearing, a conveyance of real property to a husband and wife creates an estate by the entirety. The value of the conveyance is equally divided between husband and wife. An estate by the entirety is generally immune from the claims of judgment of creditors, except for obligations jointly incurred by the husband and wife.
8. Pursuant to G.S. 47-36.1, an obvious typographical or other minor error in a deed or other instrument recorded with the register of deeds may be corrected by rerecording the instrument and with a statement of explanation attached.
9. A party seeking reformation of a deed has the burden of showing by clear, cogent, and convincing evidence that the terms of the deed do not represent the original understanding of the parties. North Carolina law accords strong presumption in favor of the correctness of a deed or any other instrument of record. Hice v. Hi-Mil, Inc., 301 N.C. 647, 273 S.E.2d 268 (1981)
10. Donative intent is not an essential element in the application of the gift tax to a transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

11. Nothing on the warranty deed executed by Donors suggests that Donors did not intend for Daughter-In-Law to constitute a grantee upon such deed, or that Donors did not intend for Son and Daughter-In-Law to take title to the real property as tenants by the entirety. There is no indication on the deed that the property was to be held in trust or that the transfer was in any way revocable.

### **DECISION**

At issue is whether the transfer of the property by Donors in October 2002 was a gift to both Son and Daughter-In-Law or to Son only. There is no dispute that the warranty deed executed at the time of the transfer in 2002 reflects both Son and Daughter-In-Law as the grantees. Accountant argues that Donor intended to give the property solely to Son and that Daughter-In-Law's name was added to the deed in error. Accountant further contends that the subsequent transfer of the property from Daughter-In-Law to Son by the deed dated June 18, 2003, rectified the alleged error and, therefore, no gift tax is applicable on the initial transfer of the property by Donors.

The warranty deed executed by Donors on October 18, 2002, to transfer the property, listed Daughter-In-Law as one of the grantees. The deed does not mention any trust agreement and there is nothing in the deed to indicate that the deed is revocable or that Daughter-In-Law should not receive a beneficial interest in the property. After execution of the deed, any third party, upon review of the deed would have recognized Daughter-In-Law as an owner of the property. If the property were sold, Daughter-In-Law would have been entitled to one-half the proceeds. Daughter-In-Law's ownership is further evidenced by the second deed filed on June 18, 2003, reflecting her and Son as grantors of the property to Son. She could not have granted ownership if she did not own the property. The transfer from Daughter-In-Law to Son in 2003 was a new and separate

transaction and does not constitute a correction to the deed executed by Donors on October 18, 2002.

Even if Donors did not intend to make a gift of the property to Daughter-In-Law, the substance of the transaction is just that. To determine whether a gift has been made for North Carolina gift tax purposes, the facts and circumstances of the transaction must be examined. Treasury Regulation 26 CFR § 25.2511-1(g)(1) advises that donative intent is not an essential element in the application of the gift tax to a transfer and that the application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

It is the opinion of the Assistant Secretary that the facts and arguments presented by Accountant do not clearly and convincingly establish that Donors did not intend to give Daughter-In-Law beneficial interest in the property. Having made gifts to both Son and Daughter-In-Law, Donors must accept the resulting tax consequences whether contemplated by them or not, and may not change the transactions at a later date in order to obtain the tax advantages which would have been afforded by some other choice that could have been made by Donors but was not. *Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Company*, 417 U.S. 134 (1974). Also, because Daughter-In-Law is a Class C donee, Donors are not entitled to claim the lifetime exemption against the gift to her.

The Assistant Secretary finds that the gift of real property was properly divided between Son and Daughter-in-law and that the proposed assessments of gift tax for the taxable year 2002 are lawful and proper in every respect. The assessments are hereby affirmed to be immediately due and collectible as allowed by law.

Made and entered this 11th day of August, 2004.

Signature \_\_\_\_\_

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue