

STATE OF NORTH CAROLINA  
COUNTY OF WAKE

BEFORE THE  
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessments of )  
Additional Income Tax for the )  
Taxable Years 1997 and 1998 by the )  
Secretary of Revenue of North Carolina )  
vs. )  
[Taxpayers] )

**FINAL DECISION**  
Docket No. 2001-218

This matter was heard before the Acting Assistant Secretary of Administrative Hearings, Marilyn R. Mudge, upon an application for hearing by [Taxpayers, Husband and Wife], wherein they protested the proposed assessments of additional income tax, penalty, and interest for the taxable years 1997 and 1998. At Taxpayers' request, the hearing was conducted via written communication and the Acting Assistant Secretary allowed Taxpayers until May 14, 2001, to provide any arguments, documents, or other evidence in support of their objection to the assessments.

**ISSUE**

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

Are the additional income tax assessments proposed against Taxpayers for the taxable years 1997 and 1998 lawful and proper?

**EVIDENCE**

The evidence presented by W. Edward Finch, Jr., Administrative Officer in the Personal Taxes Division, consisted of the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Marilyn R. Mudge, Acting Assistant Secretary of Administrative Hearings, dated March 13, 2001, a copy of which is designated as Exhibit PT-1.
2. Taxpayers' North Carolina individual income tax return for the taxable year 1997, a copy of which is designated as Exhibit PT-2.
3. Taxpayers' North Carolina individual income tax return for the taxable year 1998, a copy of which is designated as Exhibit PT-3.

4. Notice of Individual Income Tax Assessment for the taxable year 1997 dated November 1, 2000, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for the taxable year 1998 dated November 1, 2000, a copy of which is designated as Exhibit PT-5.
6. Notice of Individual Income Tax Assessment for the taxable year 1997 dated January 3, 2001, a copy of which is designated as Exhibit PT-6.
7. Notice of Amended Individual Income Tax Assessment for the taxable year 1998 dated January 13, 2001, a copy of which is designated as Exhibit PT-7.
8. A paper extract of information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 1997, a copy of which is designated as Exhibit PT-8.
9. A paper extract of information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 1998, a copy of which is designated as Exhibit PT-9.
10. Letter from Husband to the Department of Revenue dated November 17, 2000, a copy of which is designated as Exhibit PT-10.
11. Letter from W. Edward Finch, Jr., Administrative Officer in the Personal Taxes Division, to Taxpayers dated December 21, 2000, a copy of which is designated as Exhibit PT-11.
12. Letter from Husband to the Department of Revenue dated January 9, 2001, a copy of which is designated as Exhibit PT-12.
13. Letter from Marilyn R. Mudge to Taxpayers dated March 5, 2001, a copy of which is designated as Exhibit PT-13.
14. Undated note from Taxpayers to the Department of Revenue and received by the Personal Taxes Division on March 20, 2001, a copy of which is designated as Exhibit PT-14.
15. Undated letter from Husband to the Department of Revenue and received by the Department on March 29, 2001, a copy of which is designated as Exhibit PT-15.

In lieu of appearing at the hearing, Taxpayers requested that the matter be resolved via written communication. The Acting Assistant Secretary granted the request and allowed Taxpayers until May 14, 2001, to submit for the record any additional arguments, documents, or other evidence in support of their objections to the proposed assessments. The Acting Assistant Secretary placed into the record the following:

1. Letter from Marilyn R. Mudge to Taxpayers dated April 11, 2001, a copy of which is designated as Exhibit S-1.

2. Undated letter with related attachments from Taxpayers to Marilyn R. Mudge, received by the Department on May 7, 2001, copies of which are collectively designated as Exhibit S-2.
3. Letter from Marilyn R. Mudge to Taxpayers dated May 15, 2001, a copy of which is designated as Exhibit S-3.

### **FINDINGS OF FACT**

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

1. Taxpayers are and at all material times were natural persons, sui juris, and citizens and residents of North Carolina.
2. Taxpayers timely filed their North Carolina individual income tax returns for the tax years 1997 and 1998.
3. Upon examination of the returns, the auditor disallowed the deduction for mortgage interest expense of \$13,172.00 and \$10,114.00 claimed by Taxpayers on line 39 of their 1997 and 1998 State returns, respectively. The interest was disallowed because Taxpayers had already deducted the interest in computing federal taxable income on their federal returns. In effect, Taxpayers claimed the deduction twice.
4. The auditor asserted the ten percent penalty for negligent failure to comply with the income tax laws. Pursuant to the Department's penalty policy, a taxpayer is presumed to be negligent if the amount of the deficiency is ten percent or more of the tax due. Taxpayers' deficiency is fifty-five percent and twenty-eight percent of the respective tax due for the tax years 1997 and 1998.
5. Pursuant to G.S. 105-241.1, Notices of Individual Income Tax Assessment for the taxable years 1997 and 1998 were mailed to Taxpayers on November 1, 2000. Taxpayers objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
6. In error, the auditor did not adjust the 1997 and 1998 returns to decrease the credit for children from \$240.00 to \$120.00 or to allow deductions for retirement benefits of \$373.00 and \$2,000.00, respectively. Subsequent to receiving Taxpayer's hearing request, the Department further adjusted the 1997 and 1998 returns to include these changes. A Notice of Individual Income Tax Assessment for the additional tax for the tax year 1997 was mailed to Taxpayers on January 3, 2001. A Notice of Amended Individual Income Tax Assessment for the total corrected balance due for the tax year 1998 was mailed to Taxpayers on January 13, 2001.

## **CONCLUSIONS OF LAW**

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

1. For residents of this State, North Carolina taxable income is defined as federal taxable income, adjusted for differences in State and federal law.
2. The Internal Revenue Code defines federal taxable income as gross income less either the standard deduction or itemized deductions, whichever is the greater, and the deduction for personal exemptions.
3. A deduction from federal taxable income is allowed for mortgage interest not deducted on the federal income tax return in those instances where a taxpayer does not claim mortgage interest as an itemized deduction because the taxpayer participated in the mortgage credit certificate program and claimed the mortgage interest tax credit on the federal return. Since North Carolina does not have a comparable credit, the law provides for a deduction from federal taxable income equal to the amount by which the taxpayer's federal deductions were reduced or disallowed because the taxpayer elected a federal tax credit in lieu of a deduction.
4. A taxpayer who claims mortgage interest as an itemized deduction on the federal return and who was not required to reduce the mortgage interest deduction for having claimed the federal mortgage interest credit is not entitled to again deduct the interest on the taxpayer's State return.
5. A deduction from federal taxable income of an amount not to exceed \$2,000.00 is allowed for retirement benefits received during the taxable year from one or more private retirement plans.
6. A tax credit of \$60.00 is allowed for each dependent child for whom an individual was allowed to deduct a personal exemption on the federal return if the individual's adjusted gross income is below certain thresholds.
7. A penalty of ten percent of the tax is required for negligent failure to comply with the income tax laws.
8. Assessments are presumed to be correct and the burden is on the taxpayer to establish that the assessment is in error. Taxpayers have not furnished any information to show that the assessments are in error.
9. The proposed assessments for the tax years 1997 and 1998 are lawful and proper in every respect.

## **DECISION**

It is the decision of the Acting Assistant Secretary that the proposed assessments of additional tax, penalty, and interest were properly issued, are lawful in every respect, and are

hereby sustained. Taxpayers have not offered any evidence to contradict the assessments or overcome the presumption of correctness.

Taxpayers contend that because they did not fully understand the purpose of line 39 on the State returns, they should be allowed to deduct home mortgage interest on that line.

Taxpayers' misunderstanding of the instructional verbiage on line 39 does not entitle them to claim a deduction twice. Because Taxpayers had already deducted the mortgage interest on their federal returns in arriving at federal taxable income and were not required to reduce their mortgage interest deduction on their federal returns for having claimed the federal mortgage interest credit, they are not entitled to again deduct the interest on the State returns.

Taxpayers claimed exemptions for two dependent children on their returns. They are entitled to a tax credit for children of \$120.00 (\$60.00 x 2). The adjustment to reduce tax credits claimed on the 1997 and 1998 returns from \$240.00 to \$120.00 is proper.

Because Taxpayers have not furnished any information that would tend to overcome the presumption of negligence, the ten percent negligence penalty was properly asserted for the tax years 1997 and 1998.

The proposed assessments for the taxable years 1997 and 1998 are sustained in their entirety and are declared to be final and immediately due and collectible together with interest as allowed by law.

Made and entered this 9<sup>th</sup> day of July, 2001.

Signature \_\_\_\_\_

Marilyn R. Mudge  
Acting Assistant Secretary of Administrative Hearings