

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Additional)
Income Tax for the Taxable Year)
1997 by the Secretary of Revenue of)
North Carolina)
vs.)
[Taxpayers])

FINAL DECISION
Docket No. 2001-285

This matter was heard before the Assistant Secretary of Revenue, Eugene J. Cella, in the city of Raleigh on July 9, 2001, upon an application for hearing by [Taxpayers], wherein they protested the proposed assessment of additional income tax for the taxable year 1997. At Taxpayers' request, the hearing was conducted via written communication and the Assistant Secretary allowed Taxpayers until July 9, 2001, to provide any arguments, documents, or other evidence in support of their objections to the assessment. The hearing was conducted by the Assistant Secretary under the provisions of G.S. 105-260.1.

Taxpayers timely filed their North Carolina individual income tax return for the taxable year 1997. The return reflected an overpayment of \$340.00, which was refunded to the Taxpayers.

Upon examination, the Department increased Taxpayers' North Carolina taxable income based on information obtained from the Internal Revenue Service. Pursuant to G.S. 105-241.1, a Notice of Individual Income Tax Assessment reflecting additional tax and interest of \$330.99 for the taxable year 1997 was mailed to Taxpayers on August 29, 2000. Taxpayers objected to the proposed assessment and submitted additional information to show that the assessment was in error. A Notice of Amended Individual Income Tax Assessment reflecting additional tax and interest of \$109.09 was mailed to Taxpayers on November 11, 2000. A Notice of Penalty Assessment assessing a late payment penalty of \$9.00 was mailed to Taxpayers on November 13, 2000.

Taxpayers filed a timely protest to the proposed amended assessment and requested a hearing before the Secretary of Revenue.

ISSUE

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

Is the assessment for additional income tax proposed against Taxpayers for the taxable year 1997 lawful and proper?

EVIDENCE

The evidence presented by Gregory B. Radford, 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 of Administrative Hearings, dated May 16, 2001, a copy of which is designated as PT-1.
2. Taxpayers' North Carolina individual income tax return for the taxable year 1997, a copy of which is designated as PT-2.
3. Notice of Individual Income Tax Assessment for the taxable year 1997 dated August 29, 2000, a copy of which is designated as PT-3.
4. Notice of Amended Individual Income Tax Assessment for the taxable year 1997 dated November 11, 2000, a copy of which is designated as PT-4.
5. Notice of Penalty Assessment for the taxable year 1997 dated November 13 2000, a copy of which is designated as PT-5.
6. Letter with attachments from Taxpayers to the Department of Revenue dated September 8, 2000, a copy of which is designated as PT-6.
7. Letter from Taxpayers to the Department of Revenue dated December 4, 2000, a copy of which is designated as PT-7.
8. Letter from Gregory B. Radford to Taxpayers dated January 17, 2001, a copy of which is designated as PT-8.
9. Letter from Gregory B. Radford to Taxpayers dated April 2, 2001, a copy of which is designated as PT-9.
10. Letter from Eugene J. Cella to Taxpayers dated May 21, 2001, a copy of which is designated as PT-10.
11. Letter from Eugene J. Cella to Taxpayers dated June 5, 2001, a copy of which is designated as PT-11.

FINDINGS OF FACT

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

1. Taxpayers are and at all material times were natural persons, sui juris.
2. Taxpayers timely filed their North Carolina individual income tax return for the tax year 1997.
3. Upon examination of the return, the Department increased Taxpayers' North Carolina taxable income by \$3,930.00 based on information obtained from the Internal Revenue Service which showed that federal taxable income reported by Taxpayers on the 1997 federal return exceeded the amount reported on the North Carolina return.
4. A Notice of Individual Income Tax Assessment for the additional tax and interest of \$330.99 was mailed to Taxpayers on August 29, 2000.
5. Taxpayers objected to the proposed assessment and provided additional information to establish that the unreported income was earned by wife in Florida prior to becoming a North Carolina resident. The Department determined from the additional information that 94 percent of the Taxpayers' total income was subject to North Carolina tax. The credit for children of \$120.00 was reduced accordingly.
6. A Notice of Amended Individual Income Tax Assessment reflecting the corrected additional tax and interest totaling \$109.09 was mailed to Taxpayers on November 11, 2000.
7. Taxpayers objected to the proposed amended assessment and timely requested a hearing before the Secretary of Revenue.
8. Taxpayers contended in a telephone conversation on April 2, 2001, that the liability should be abated because the Department of Revenue did not timely schedule a hearing.
9. Taxpayers were given additional time in which to furnish additional information but no additional information was provided.

CONCLUSIONS OF LAW

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

1. It is the duty of the North Carolina Department of Revenue to collect taxes due to the State.
2. North Carolina imposes an individual income tax upon the taxable income of (1) every resident of this State and (2) every nonresident individual deriving income from North Carolina sources attributable to the ownership of any interest in real or tangible personal property in this State or deriving income from a business, trade, profession, or occupation carried on in this State.

3. For part-year residents of this State, "North Carolina taxable income" is the taxpayer's taxable income as determined under the Internal Revenue Code, adjusted as statutorily mandated for differences in State and federal law. The numerator of the fraction includes gross income derived from all sources during the period the taxpayer was a resident of North Carolina and gross income derived while a nonresident from North Carolina sources and attributable to the ownership of any interest in real or tangible personal property in this State or deriving income from a business, trade, profession, or occupation carried on in this State.
4. A nonresident or part-year resident is allowed the credit for children in the proportion that federal taxable income is taxable to North Carolina.
5. A taxpayer who objects to a proposed assessment of tax must make a written request for a hearing within thirty days after the date the proposed assessment was mailed by the Department. The Department is required to set the time for the hearing and notify the taxpayer of the designated time within 60 days of the request and at least 10 days prior to the date set for the hearing. The date set for the hearing must be within 90 days after the timely request for a hearing was filed or at a later date mutually agreed upon by both parties.
6. If a taxpayer's federal taxable income is corrected or otherwise determined by the federal government, the taxpayer is required to file a return with the Secretary of Revenue reflecting the corrected or determined taxable income.
7. The Secretary of Revenue's duties include administering the laws enacted by the General Assembly relating to the assessment and collection of individual income 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 for the tax year 1997 is lawful and proper.

DECISION

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary of Revenue finds the proposed assessment for the tax year 1997 to be lawful and proper and is hereby affirmed.

Taxpayers contend that North Carolina's method of determining North Carolina taxable income for a part-year resident is flawed in that earnings derived from sources outside of North Carolina during a period of time that an individual is not a resident of North Carolina should have no effect on the individual's North Carolina income tax liability. G.S. 105-134.5(c) requires a part-year resident to determine North Carolina taxable income by multiplying federal taxable

income, as adjusted for differences in State and federal law, by a fraction, the numerator of which includes all income received while a resident of this State and any income derived from North Carolina sources while a nonresident. The denominator of the fraction includes total income from all sources. The Secretary of Revenue does not have the authority to use any other method of determining North Carolina taxable income. Whether the method used is constitutional is not an issue for the Secretary's consideration. The Secretary of Revenue's duties include administering the laws enacted by the General Assembly relating to the assessment and collection of individual income taxes. As an official of the executive branch of 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.

Taxpayers also contend that the assessment should be withdrawn because the Department did not timely schedule a hearing and notify Taxpayers of the hearing date within the time limits prescribed in G.S. 105-241.1. The Department does not deny that a hearing was not timely scheduled in response to Taxpayers' written request for a hearing. Instead, the Personal Taxes Division wrote to Taxpayers to more fully explain the assessment and asked Taxpayers to respond if they still wished to proceed to a hearing. In the correspondence, Taxpayers were advised that the Department would proceed with collection if no reply was received. Because Taxpayers did not respond, the Department resumed collection efforts. Even if a taxpayer could establish that he or she has been materially damaged by the Department's failure to timely schedule a hearing, G.S. 105-241.1(c) does not provide a penalty against the Department or a remedy to the taxpayer. The delay in scheduling the hearing did not affect Taxpayers' ability to present a defense to the proposed assessment of tax. In Administrative Decision 331, the Tax Review Board held that "[e]ven though an affirmative duty is placed upon the Secretary to satisfy the statute's guidelines, the legislature specifically elected not to couple this requirement with sanctions." Furthermore, Taxpayers have failed to provide any evidence of bad faith on the part of the Department regarding the delay in the

hearing. Therefore, the Board determined that the Assistant Secretary did not err in refusing to cancel an assessment because the hearing was not timely. As in this case, there is no bad faith on the Department's part in not timely scheduling Taxpayers' hearing. The Personal Taxes Division attempted to respond to Taxpayers' letter by providing the legal basis for its position and offered Taxpayers an opportunity to renew their request for a hearing if the explanation did not satisfy them. The Division also proceeded to schedule a hearing when Taxpayers contacted the Division in April and renewed their request.

Therefore, I find that the proposed assessment for tax year 1997 is lawful and proper. The assessment 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 28th day of August, 2001.

Signature_____

Eugene J. Cella
Assistant Secretary of Revenue