

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Individual)
Income Tax for the Taxable Year 2000 by)
the Secretary of Revenue of North Carolina)
)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2001-461

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on October 11, 2001, upon an application for hearing by [Taxpayer], wherein she protested the proposed assessment of additional income tax for the taxable year 2000. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division. Taxpayer's [former husband] is hereinafter referred to as "Spouse." Taxpayer owned 95 percent of [Partnership].

The Department adjusted Taxpayer's income tax return for the taxable year 2000 to disallow the credit claimed for estimated income tax paid of \$4,347.00. A Notice of Individual Income Tax Assessment for the additional tax plus accrued interest was mailed to Taxpayer on April 26, 2001. Taxpayer filed a timely objection to the proposed assessment and requested a hearing before the Secretary of Revenue.

ISSUE

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

Is the additional income tax assessment proposed against Taxpayer for the taxable year 2000 lawful and proper?

EVIDENCE

The evidence presented by W. Edward Finch, Jr., included the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Eugene J. Cella, Assistant Secretary for Administrative Tax Hearings, a copy of which is designated as Exhibit PT-1.

2. Taxpayer's North Carolina individual income tax return for the taxable year 2000, a copy of which is designated as Exhibit PT-2.
3. Individual Estimated Income Tax report for the first quarter 2000 and check for \$1,087.00, copies of which are collectively designated as Exhibit PT-3.
4. Individual Estimated Income Tax report for the second quarter 2000 and check for \$1,087.00, copies of which are collectively designated as Exhibit PT-4.
5. Individual Estimated Income Tax report for the third quarter 2000 and check for \$1,087.00, copies of which are collectively designated as Exhibit PT-5.
6. Individual Estimated Income Tax report for the fourth quarter 2000 and check for \$1,086.00, copies of which are collectively designated as Exhibit PT-6.
7. Notice of Individual Income Tax Assessment for the taxable year 2000 dated April 26, 2001, a copy of which is designated as Exhibit PT-7.
8. Letter from Taxpayer to the Department of Revenue dated May 21, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from Gregory B. Radford, former Assistant Director of the Personal Taxes Division, to Taxpayer dated June 14, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter with attachment from [a CPA] to the Department of Revenue dated June 25, 2001, copies of which are collectively designated as Exhibit PT-10.
11. Letter with attachments from Gregory B. Radford to [a CPA] dated July 6, 2001, copies of which are collectively designated as Exhibit PT-11.
12. Letter from [a CPA] to Gregory B. Radford dated July 10, 2001, a copy of which is designated as Exhibit PT-12.
13. Letter from Eugene J. Cella to [a CPA] dated August 7, 2001, a copy of which is designated as Exhibit PT-13.

The evidence presented by Taxpayer at the hearing consisted of the following:

1. Letter from Ann J. Hinkle, Manager of Professional Standards for the North Carolina State Board of Certified Public Accountant Examiners, to Taxpayer dated August 8, 2001, a copy of which is designated as Exhibit TP-1.
2. Consent Order dated October 2, 2000, and Separation Agreement And Property Settlement between Taxpayer and Spouse dated August 18, 2000, copies of which are collectively designated as Exhibit TP-2.
3. [Bank] deposit slip reflecting \$6,000.00 deposited into Taxpayer's and Spouse's joint account on March 15, 2000, a copy of which is designated as Exhibit TP-3.

4. Check dated March 14, 2000, for \$6,000.00 from Partnership, payable to Taxpayer, a copy of which is designated as Exhibit TP-4.
5. Check dated February 17, 2000, for \$46,000.00 from Partnership, payable to Taxpayer, a copy of which is designated as Exhibit TP-5.
6. [Bank] deposit slip reflecting \$46,001.50 deposit into Taxpayer's and Spouse's joint account, a copy of which is designated as Exhibit TP-6.
7. Check dated February 23, 2000, for \$5,000.00 from Partnership, payable to Taxpayer, a copy of which is designated as Exhibit TP-7.
8. [Bank] deposit slip reflecting \$5,000.00 deposit into Taxpayer's and Spouse's joint account on February 24, 2000, a copy of which is designated as Exhibit TP-8.

At the conclusion of the hearing, the Assistant Secretary allowed the Personal Taxes Division and Taxpayer thirty days to submit additional information for the record in support of their respective positions. Subsequent to the hearing, Taxpayer submitted a letter and related attachment to the Assistant Secretary dated November 5, 2001, copies of which are collectively designated as Exhibit TP-9. The Personal Taxes Division submitted a letter with related attachments from W. Edward Finch, Jr., to Taxpayer dated October 17, 2001, copies of which are collectively designated as Exhibit PT-14. The Personal Taxes Division also submitted a paper extract of Taxpayer's federal income tax return for the taxable year 2000 provided to the Department of Revenue by Internal Revenue Service, a copy of which is designated as Exhibit PT-15.

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. Taxpayer timely filed her North Carolina individual income tax return for the taxable year 2000 as married filing separately. Taxpayer owned 95 percent of Partnership and Spouse owned the remaining five percent. Taxpayer and Spouse separated on May 26, 2000, and entered into a written separation agreement and property settlement on August 18, 2000. The agreement stipulates that Spouse receives 100 percent of Partnership and that Taxpayer relinquishes title and interest in Partnership.
3. Taxpayer received a Form K-1, Partner's Share of Income, Credits, Deductions, Etc., from Partnership reporting \$63,303.00 as Taxpayer's distributive share of Partnership's ordinary income from trade or business activities for the taxable year 2000.
4. During the taxable year 2000, Taxpayer received payments from Partnership totaling \$57,000.00, which were deposited into a bank account held jointly with Spouse.
5. During the tax year 2000, Partnership remitted North Carolina estimated income tax payments of \$4,347.00. The payments were submitted with estimated income tax forms

reflecting the names of Taxpayer and Spouse; however, the Department of Revenue credited payments to Spouse's separate account only.

6. The Department obtained information from Partnership reflecting that the estimated income tax payments of \$4,347.00 remitted by Partnership reduced Spouse's capital account. In prior tax years, Taxpayer filed North Carolina individual income tax returns jointly with Spouse and paid estimated income tax into a joint account. Partnership continued this practice by remitting the estimated tax payments for the tax year 2000 on forms reflecting the names of both spouses.
7. Taxpayer claimed credit on her individual income tax return for payments of \$4,347.00 for estimated income tax. Because the Department had no record of Taxpayer paying estimated income tax, the return was adjusted to disallow the payments claimed.
8. A Notice of Individual Income Tax Assessment for the additional tax plus accrued interest was mailed to Taxpayer on April 26, 2001. Taxpayer filed a timely objection to the proposed assessment and requested a 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. A partner's distributive share of income, gain, loss, deduction, or credit is generally determined by the partnership agreement. In the case of a sale, exchange, or liquidation of a partner's entire interest in a partnership, the partner must include in taxable income for the tax year within which or with which his membership in the partnership ends his share of partnership income, deductions, credits, the other items described in Code Section 702(a), and any guaranteed payments for the partnership year ending with the date of sale, exchange, or liquidation.
2. Pursuant to section 705 of the Code, a partner's basis in a partnership is decreased by distributions by the partnership and by the sum of his distributive share of partnership losses and nondeductible partnership expenditures.
3. North Carolina uses federal taxable income as the starting point for computing State taxable income. Certain adjustments to federal taxable income are required for differences in State and federal law.
4. An individual is required to pay estimated income tax if the tax shown due on the income tax return for the taxable year, reduced by North Carolina tax withheld and allowable tax credits, is \$1,000.00 or more regardless of the amount of income the individual has that is not subject to withholding.
5. A husband and wife filing separate returns must each report their respective income, exemptions, credits (including payments of estimated income tax), and deductions on their individual returns.
6. The proposed assessment of additional income tax for the taxable year 2000 was properly issued and is, under the facts, lawful and proper.

DECISION

Taxpayer contends that because of unexplained discrepancies between the amounts reflected on the Schedule K-1 issued to Taxpayer by Partnership and the spreadsheet of Taxpayer's and Spouse's respective capital accounts obtained by the Department from Partnership, she is entitled to claim the estimated tax of \$4,347.00 paid by Partnership. Taxpayer further contends that because of these discrepancies, the \$63,303.00 reported by Partnership as her share of the ordinary income from business activities is questionable and that Spouse was the one who ultimately received the distributions she received from Partnership and deposited in a joint bank account.

While the reasons that certain discrepancies exist in information furnished by Partnership remain unclear, it is apparent that Partnership intended the four payments of estimated income tax to be on behalf of Spouse as evidenced by the reductions in his capital account. Consequently, the adjustment to disallow the estimated tax payments claimed on Taxpayer's 2000 income tax return is proper.

Taxpayer was a 95 percent owner of Partnership. Taxpayer reported her share of Partnership income of \$63,303.00 on her federal income tax return for the taxable year 2000. Since North Carolina uses federal taxable income as the starting point for computing State taxable income, that amount was also included on her North Carolina return. Taxpayer has not provided conclusive evidence to show that her percentage of ownership in Partnership is other than 95 percent; that any of the estimated tax payments by Partnership affected her capital account; or that her share of the ordinary income of \$63,303.00 from the operations of Partnership is in error. Any dispute regarding the disposition of Taxpayer's interest in Partnership pursuant to the separation agreement or which spouse ultimately received benefit of amounts withdrawn from the joint bank account is a matter between Taxpayer and Spouse.

The assessment is hereby sustained in its entirety and is finally determined and immediately due and collectible as allowed by law.

Made and entered this 24th day of January, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue