

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 1998 )  
and 1999 by the Secretary of Revenue )  
of North Carolina )  
vs. )  
[Taxpayer] )

**FINAL DECISION**  
Docket No. 2001-545

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on October 15, 2001, upon an application for hearing by [Taxpayer], wherein she protested the proposed assessments of additional income tax for the taxable years 1998 and 1999. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer and [her spouse]; Nancy R. Pomeranz, Director of the Personal Taxes Division; and Angela C. Quinn, Administrative Officer in the Personal Taxes Division.

Pursuant to G.S. 105-241.1, assessments proposing additional income tax and accrued interest for the tax years 1998 and 1999 were mailed to Taxpayer on February 21, 2001. Taxpayer filed a timely protest to the proposed assessments and requested a hearing before the Secretary of Revenue.

**ISSUE**

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

Are the assessments for additional income tax proposed against Taxpayer for the taxable years 1998 and 1999 lawful and proper?

**EVIDENCE**

The evidence presented by Nancy R. Pomeranz, 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 for Administrative Tax Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.

2. Taxpayer's North Carolina individual income tax return for the taxable year 1998, a copy of which is designated as Exhibit PT-2.
3. Taxpayer's North Carolina individual income tax return for the taxable year 1999, a copy of which is designated as Exhibit PT-3.
4. Federal income tax return detail 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-4.
5. Federal income tax return detail information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 1999, a copy of which is designated as Exhibit PT-5.
6. Notice of Individual Income Tax Assessment for the taxable year 1998 dated February 21, 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 April 20, 2001, a copy of which is designated as Exhibit PT-7.
8. Notice of Individual Income Tax Assessment for the taxable year 1999 dated February 21, 2001, a copy of which is designated as Exhibit PT-8.
9. Notice of Amended Individual Income Tax Assessment for the taxable year 1999 dated April 20, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter from Taxpayer to North Carolina Department of Revenue dated March 19, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter from Angela C. Quinn, Administrative Officer in the Personal Taxes Division, to Taxpayer dated April 20, 2001, a copy of which is designated as Exhibit PT-11.
12. Letter from Taxpayer to B. S. Blackmon, Tax Auditor, dated May 17, 2001, a copy of which is designated as Exhibit PT-12.
13. Letter from Angela C. Quinn to Taxpayer dated June 28, 2001, a copy of which is designated as Exhibit PT-13.
14. Letter from Taxpayer to Angela C. Quinn dated June 29, 2001, a copy of which is designated as Exhibit PT-14.
15. Electronic mail from Taxpayer to Angela C. Quinn dated August 29, 2001, a copy of which is designated as Exhibit PT-15.
16. North Carolina Administrative Code, Title 17, Subchapter 6B, Section .3900, Rule .3904, a copy of which is designated as Exhibit PT-16.
17. Excerpt from Federal Publication 501, a copy of which is designated as Exhibit PT-17.
18. Excerpt from Federal Publication 504, a copy of which is designated as Exhibit PT-18.

19. Letter from Eugene J. Cella, Assistant Secretary of Revenue, to Taxpayer dated August 31, 2001, a copy of which is designated as Exhibit PT-19.

Eugene J. Cella held the record open for thirty days to allow Taxpayer to respond to the evidence on record and to submit any additional evidence on her behalf. Taxpayer subsequently submitted a letter dated November 4, 2001, 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. 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 income tax returns for the taxable years 1998 and 1999.
3. Taxpayer's spouse is a nonresident military individual and earned no income from North Carolina sources for the tax years 1998 and 1999. Taxpayer filed a joint federal return for these years. For North Carolina purposes, Taxpayer calculated federal taxable income as a married person filing a separate federal return.
4. Taxpayer's 1998 and 1999 returns reflected North Carolina taxable income of \$7,166.00 and \$11,967.00, respectively. The Department issued refunds to Taxpayer of \$1,057.00 and \$1,188.11 as requested on the 1998 and 1999 returns, respectively.
5. Taxpayer claimed total itemized deductions from Taxpayer's joint federal return in arriving at separate federal taxable income for tax years 1998 and 1999. Upon examination, the Department recomputed Taxpayer's 1998 and 1999 separate federal taxable income by allowing Taxpayer a prorated portion of the total joint itemized deductions claimed on the federal return. Taxpayer's prorated portion of itemized deductions for tax year 1998 was determined by dividing Taxpayer's gross income by total gross income of Taxpayer and her spouse to arrive at an applicable prorated percentage. The percentage multiplied by the total joint itemized deductions result in allowable itemized deductions of \$5,239.00 for tax year 1998. Similarly, for tax year 1999, Taxpayer's prorated portion of itemized deductions was determined to be \$7,638.00. Taxpayer's North Carolina taxable income was determined to be \$18,534.00 and \$23,509.00 for tax years 1998 and 1999, respectively.
6. Pursuant to G.S. 105-159 and G.S. 105-241.1, Notices of Individual Income Tax Assessment proposing assessments of additional income tax and accrued interest for tax years 1998 and 1999 were mailed to Taxpayer on February 21, 2001.
7. Taxpayer objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.
8. Subsequent to the proposed assessments, the Department adjusted Taxpayer's additions to federal taxable income for tax years 1998 and 1999. The Department

reduced 1998 additions to federal taxable income from \$1,688.00 to \$661.00 and 1999 additions were reduced from \$2,146.00 to \$952.00. Notices of Amended Tax Assessment for tax years 1998 and 1999 were mailed to Taxpayer on April 20, 2001, reflecting corrected North Carolina taxable income of \$17,507.00 and \$23,509.00, respectively.

### **CONCLUSIONS OF LAW**

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

1. G.S. 105-152 (e) requires that a husband and wife shall file a joint return if their federal taxable income is determined on a joint federal return and both spouses are residents of this State or both spouses have North Carolina taxable income.
2. An individual who files a joint federal income tax return with his or her spouse but cannot qualify to file a joint North Carolina income tax return because the spouse is a nonresident and had no North Carolina taxable income, must calculate the individual's federal taxable income on a federal income tax form as a married person filing a separate federal income tax return and attach it to the individual's North Carolina return to show how separate federal taxable income was determined. The individual filing the separate federal return must report only the individual's income, exemptions and deductions (North Carolina Administrative Code, Title 17, Subchapter 6B, Section .3900, Rule .3904 (b)).
3. Federal Publications 501 and 504 specify that married individuals who file separate federal returns should each report only their individual income, exemptions, and deductions on their separate federal returns. Itemized nonbusiness deductions of husband and wife may be claimed by a spouse only if that spouse was obligated to pay the items and actually paid the amount during the year. In the case of a joint obligation (such as mortgage interest and real estate taxes), the deduction is allowable to the spouse who actually paid the item.
4. The proposed assessments are lawful and proper.

### **DECISION**

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary finds the proposed assessments for the tax years 1998 and 1999 to be lawful and proper, and they are hereby affirmed.

The allowance of deductions in the computation of taxable income is a privilege granted as a matter of legislative grace. Generally, deductions may be taken only by the individual to whom they accrue. Taxpayer argues that her income alone was used to pay all the expenses

that were claimed as itemized deductions on her joint federal income tax returns. However, no evidence has been presented by Taxpayer to show that only her income was used to pay these expenses. To the contrary, Taxpayer stated that mortgage interest, real estate taxes, and contributions were paid from a joint checking account and that Taxpayer and her spouse both deposit their respective earned incomes into this joint checking account. Expenses paid from a joint checking account are considered paid by both the Taxpayer and her spouse, which necessitates an appropriate method of allocation with respect to claiming a deduction for the expenses on Taxpayer's separate federal tax return. In the absence of evidence to the contrary, the only equitable and reasonable method of allocating the deductions is according to the respective adjusted gross incomes of Taxpayer and her spouse.

It is further noted that if Taxpayer's spouse had any North Carolina income and a joint federal return had been filed, Taxpayer and her spouse would be required to file a joint North Carolina return. In the calculation of North Carolina taxable income, any itemized deductions would be prorated based on the percentage of total income reported to North Carolina. The fact that Taxpayer's spouse is a nonresident and all his income is earned outside the State should not result in a windfall to Taxpayer by permitting her to deduct jointly paid expenses on a separate return against only one spouse's reported income.

The proposed assessments for the tax years 1998 and 1999 are hereby sustained in their entireties and are determined to be final and collectible, together with interest as allowed by law.

Made and entered this 6<sup>th</sup> day of December, 2001.

Signature \_\_\_\_\_

Eugene J. Cella  
Assistant Secretary for Administrative Tax Hearings