

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessments of Individual)
Income Tax, Penalties, and Interest for the)
Taxable Years 1995 and 1996 by the)
Secretary of Revenue of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2001-608

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, on February 26, 2002, upon an application for a hearing by [Taxpayer], wherein he protested the proposed assessments of individual income tax, penalties, and interest for the taxable years 1995 and 1996. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer; W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division; [Taxpayer's Representative]; and at Taxpayer's request, [a court reporter].

Notices of Individual Income Tax Assessment proposing assessments of income tax, penalties, and accrued interest for the taxable years 1995 and 1996 were mailed to Taxpayer on June 27, 2001. Taxpayer objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.

ISSUE

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

Are the individual income tax assessments proposed against Taxpayer for the taxable years 1995 and 1996 lawful and proper?

EVIDENCE

The evidence presented at the hearing by W. Edward Finch, Jr., 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 for Administrative Tax Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.

2. Notice of Individual Income Tax Assessment for the taxable year 1995 dated June 27, 2001, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for the taxable year 1996 dated June 27, 2001, a copy of which is designated as Exhibit PT-3.
4. A paper extract of information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 1995, a copy of which is designated as Exhibit PT-4.
5. Income Tax Examination Changes provided by the Internal Revenue Service for the taxable year 1996, a copy of which is designated as Exhibit PT-5.
6. Letter from Jeremy Huff, Revenue Field Auditor, to Taxpayer dated March 13, 2001, a copy of which is designated as Exhibit PT-6.
7. Letter with related attachments from Taxpayer to Jeremy Huff dated July 21, 2001, copies of which are collectively designated as Exhibit PT-7.
8. Letter from W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, to Taxpayer dated September 4, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter with related attachment from Taxpayer to W. Edward Finch, Jr., dated September 24, 2001, copies of which are collectively designated as Exhibit PT-9.
10. Letter from Eugene J. Cella to Taxpayer dated October 5, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter with related attachments from Taxpayer to Eugene J. Cella dated October 23, 2001, copies of which are collectively designated as Exhibit PT-11.
12. Letter from Eugene J. Cella to Taxpayer dated November 16, 2001, a copy of which is designated as Exhibit PT-12.
13. Letter from W. Edward Finch, Jr., to Taxpayer dated December 10, 2001, a copy of which is designated as Exhibit PT-13.
14. Letter from Eugene J. Cella to Taxpayer dated December 17, 2001, a copy of which is designated as Exhibit PT-14.

At the hearing Taxpayer presented an affidavit dated February 21, 2002, with related attachments, copies of which are collectively designated as Exhibit TP-1.

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 the following:

1. A document with related attachments titled Formal Demand For Production Of Precise Taxing Statute, dated February 27, 2002, copies of which are collectively designated as Exhibit TP-2.

2. A document with related attachments titled Memorandum Of Law In Support Of Respondent's Position, dated March 23, 2002, copies of which are collectively designated as Exhibit TP-3.
3. Letter and related attachments from Taxpayer to W. Edward Finch, Jr., dated February 18, 2002, copies of which are collectively designated as Exhibit TP-4.

The Personal Taxes Division submitted a letter from W. Edward Finch, Jr., to Taxpayer dated April 3, 2002, a copy of which is designated as Exhibit PT-15.

Taxpayer stated at the hearing that during the tax years at issue, he worked for the employers listed in the federal report (Exhibit PT-5) and that the social security number shown on that report is his correct number.

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 did not file North Carolina individual income tax returns for the tax years 1995 and 1996.
3. The Department of Revenue determined Taxpayer's North Carolina taxable income based on information received from the Internal Revenue Service. The federal information reflected federal taxable income of \$115,541.00 and \$72,870.00 for the tax years 1995 and 1996, respectively. These amounts were determined based on a filing status of married filing separate and allowing the standard deduction and one personal exemption.
4. The Department calculated Taxpayer's North Carolina taxable income by increasing Taxpayer's federal taxable income as reported by the Internal Revenue Service for the differences between the State and federal standard deduction and personal exemption allowances. North Carolina taxable income was determined to be \$116,536.00 for the tax year 1995 and \$74,270.00 for the tax year 1996.
5. Notices of Individual Income Tax Assessment proposing assessments of additional income tax, a twenty-five percent late filing penalty, a ten percent late payment penalty, a twenty-five percent negligence penalty, and accrued interest for each tax year were mailed to Taxpayer on June 27, 2001. The proposed assessment for the tax year 1996 also included a penalty of \$284.20 for underpayment of estimated income tax.
6. Taxpayer objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.
7. Information obtained from Taxpayer's employers subsequent to receiving his request for hearing indicates that Taxpayer is entitled to a credit for North Carolina tax withheld of \$3,751.46 for tax year 1995 and \$1,277.02 for tax year 1996.

CONCLUSIONS OF LAW

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

1. 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.
2. The term "taxpayer" is defined as an individual subject to the income tax. The term "individual" is defined as a human being.
3. For residents of this State, "North Carolina taxable income" is defined as the taxpayer's taxable income as determined under the Internal Revenue Code, adjusted for certain differences in State and federal law.
4. Federal taxable income is defined in section 63 of the Internal Revenue Code as gross income less deductions and personal exemptions. Gross income is defined in section 61 of the Code as all income from whatever source derived unless specifically excepted. Wages, salaries, commissions paid salesmen, compensation for services on the basis of a percentage of profits, tips, and bonuses are all includable in gross income.
5. An individual is required to file a federal income tax return if his gross income for the year equals or exceeds the allowable exemption amount (Code section 6012(a)(1)(A)). Because Taxpayer's gross income exceeded his allowable exemption amount, he was required to file federal returns.
6. A resident of this State is required to file a North Carolina individual income tax return if the individual is required to file a federal income tax return. The North Carolina return shall show the taxable income and adjustments to federal taxable income required by statute. An income tax return shall be filed as prescribed by the Secretary and must be in the form prescribed by the Secretary. For a calendar-year taxpayer, the return is due on or before the fifteenth of April of the calendar year following the tax year. Tax payable as shown on the return must be paid to the Secretary within the time allowed for filing the return.
7. 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.
8. Upon discovery that any tax is due from a taxpayer, G.S. 105-241.1 provides that an assessment may be proposed against the taxpayer. The Secretary must notify the taxpayer in writing of the kind and amount of tax due and of the Secretary's intent to assess the taxpayer for the tax. The notice must describe the basis for the proposed assessment and identify the amounts of any tax, interest, additions to tax, and penalties included in the proposed assessment. The proposed assessment must be made upon the basis of the best information available and, in the absence of information to the contrary, such assessment is deemed to be correct. The assessments proposed against Taxpayer for the tax years 1995 and 1996 meet all of these requirements.

9. For the failure to file any return on the date it is due, a penalty is required equal to five percent of the amount of the tax if the failure is for not more than one month, with an additional five percent for each additional month, or fraction thereof, during which the failure continues, not exceeding twenty-five percent in the aggregate, or five dollars (\$5.00), whichever is the greater.
10. For the failure to pay any tax when due, a penalty is required equal to ten percent of the tax, except that the penalty shall in no event be less than five dollars (\$5.00).
11. A twenty-five percent negligence penalty is required for a large individual income tax deficiency. A large income tax deficiency exists when a taxpayer understates taxable income by an amount equal to twenty-five percent or more of gross income.
12. 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 \$500 or more. A penalty is imposed for any underpayment of estimated income tax.
13. The Secretary of Revenue's duties includes 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.

DECISION

Taxpayer has presented various arguments, both procedural and constitutional, all of which I find to be frivolous and devoid of any merit. At the hearing, Representative attempted to discredit the proposed assessments by reciting his interpretation of the Internal Revenue Service's individual master file of Taxpayer. This tactic is a total red herring, designed to avert attention away from the core issue. Taxpayer admitted at the hearing that he was employed by the employers listed in the federal information received by the Department of Revenue from the Internal Revenue Service. It is clear from the evidence, corroborated by Taxpayer's own testimony, that Taxpayer had wages that far exceeded the minimum requirements for filing State income tax returns. Taxpayer further argues that the State is prohibited from proposing an assessment unless the Internal Revenue Service has also assessed the taxpayer. North Carolina uses federal taxable income as the starting point for computing State taxable income; however, the State predicate for income taxation is not dependent on the exclusive

determination of taxable income by the Internal Revenue Service. In fact, a hearing before the Secretary of Revenue with respect to a proposed assessment of North Carolina income tax is not the proper forum to determine if the Internal Revenue Code imposes an income tax or requires a return to be filed; those issues are between Taxpayer and the Internal Revenue Service.

Taxpayer has raised various other defenses as to whether he can be held liable for an income tax, including contentions that wages are not income and that the 16th amendment of the U. S. Constitution was never ratified. There is long list of cases where other taxpayers have made similar arguments which have been repeatedly rejected by the courts as frivolous and without merit. Also, the underlying principle behind these defenses is a taxpayer's constitutional rights. The question of the constitutionality of a statute is for the judicial branch as the Secretary of Revenue lacks the authority to determine the constitutionality of legislative acts [*Great America Insurance Co. v. Gold*, 254 NC 168, 118 SE2d 792 (1961)]. However, the Assistant Secretary notes that the 16th Amendment was ratified by 40 states, including Ohio, and was issued by proclamation in 1913. Shortly thereafter, two other states also ratified the Amendment. Under Article V of the Constitution, only three-fourths of the states are needed to ratify an amendment. There were enough states ratifying the 16th Amendment even without Ohio to complete the number needed for ratification. Furthermore, the U.S. Supreme Court upheld the constitutionality of the income tax laws enacted subsequent to ratification of the 16th Amendment in *Brushaber v. Union Pacific Railroad Company*, 240 U.S. 1, 36 S.Ct. 236 (1916). Since that time, the courts have consistently upheld the constitutionality of the federal income tax.

Taxpayer's defense that he does not receive a profit or gain, or engage in a taxpayer privilege is utter nonsense. The courts have consistently held for years that "compensation for labor or services," paid as wages or salary are subject to income taxes, and that a taxpayer "has

no basis in his or her labor.” *U.S. v. Buras*, 633 F.2d 1356 (9th Cir. 1980); *Beard v. Com’r.*, 793 F.2d 139 (6th Cir. 1986).

Taxpayer’s State income tax liability as amended to allow credit for North Carolina income tax withheld from his wages is as follows:

	<u>1995</u>	<u>1996</u>
Tax	\$ 8,550.29	\$ 5,275.00
Less: North Carolina tax withheld	<u>3,751.46</u>	<u>1,277.02</u>
Net tax	\$ 4,798.83	\$ 3,997.98
Failure to File Penalty	1,199.71	999.50
Failure to Pay Penalty	479.88	399.80
Underpayment of estimated tax penalty	-0-	208.00
Negligence Penalty	1,199.71	999.50
Interest to July 19, 2002	<u>2,479.39</u>	<u>1,706.79</u>
Total Due	<u>\$10,157.52</u>	<u>\$ 8,311.57</u>

The individual income tax assessments for the taxable years 1995 and 1996 as herein modified are hereby sustained in their entireties and are finally determined and immediately due and collectible as allowed by law.

Made and entered this 18th day of June, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue