

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

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

FINAL DECISION
Docket No. 2002-526

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on October 16, 2002, upon an application for a hearing by [Taxpayer], wherein he protested the proposed assessment of individual income tax and interest 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; Nancy R. Pomeranz, Director of the Personal Taxes Division; and Alexandra M. Hightower, Assistant Attorney General.

Upon examination, Taxpayer's 2000 individual income tax return was adjusted to disallow the deduction claimed for severance wages. A Notice of Individual Income Tax Assessment was mailed to Taxpayer on April 12, 2002. Taxpayer objected to the proposed assessment and timely requested a hearing before the Secretary of Revenue. [Taxpayer was employed by Employer. Employer was acquired by Buyer.]

ISSUES

The issues to be decided in this matter are as follows:

1. Has Taxpayer proved entitlement to the deduction for severance wages for the tax year 2000?
2. Is the individual income tax assessment proposed against Taxpayer for the taxable year 2000 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. Notice of Individual Income Tax Assessment for the taxable year 2000 dated April 8, 2002, 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. Taxpayer's North Carolina individual income tax return for the taxable year 2000, a copy of which is designated as Exhibit PT-4.
5. North Carolina Department of Revenue Directive PD-98-1 dated April 1, 1998, a copy of which is designated as Exhibit PT-5.
6. Cover letter, Incentive to Stay Agreement and Release, and Separation Agreement and Release from Employer to Gail H. Beamon, Administrative Officer in the Personal Taxes Division, dated March 15, 2001, copies of which are collectively designated as Exhibit PT-6.
7. Facsimile letter from Employer to Gail H. Beamon dated May 7, 2001, a copy of which is designated as Exhibit PT-7.
8. Letter from Nancy R. Pomeranz, Director of the Personal Taxes Division, to Employer dated May 18, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from Employer to Nancy R. Pomeranz dated June 6, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter from Nancy R. Pomeranz to Employer dated June 26, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter from Employer to Nancy R. Pomeranz dated July 23, 2001, a copy of which is designated as Exhibit PT-11.
12. Letter from Taxpayer to Jeffrey C. Davenport, Supervisor in the Examination Division, dated April 30, 2002, and letter from Employer to Thomas A. Sledge, Auditor in the Examination Division, dated April 17, 2002, copies of which are collectively designated as Exhibit PT-12.
13. Letter from Nancy R. Pomeranz to Taxpayer dated May 21, 2002, a copy of which is designated as Exhibit PT-13.
14. Letter from Taxpayer with addendum dated July 18, 2002, a copy of which is designated as Exhibit PT-14.

15. Letter from Gail H. Beamon to Taxpayer dated August 1, 2002, a copy of which is designated as Exhibit PT-15.
16. Letter from Taxpayer to Gail H. Beamon dated August 26, 2002, a copy of which is designated as Exhibit PT-16.
17. Letter from Eugene J. Cella to Taxpayer dated September 4, 2002, a copy of which is designated as Exhibit PT-17.
18. Letter from Taxpayer to Eugene J. Cella dated September 12, 2002, a copy of which is designated as Exhibit PT-18.
19. Letter from Eugene J. Cella to Taxpayer dated September 19, 2002, a copy of which is designated as Exhibit PT-19.

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 his North Carolina individual income tax returns for the tax years 1999 and 2000 and claimed a deduction of \$16,184 and \$15,996, respectively, for severance wages.
3. Taxpayer was employed by Employer at its facility located in [North Carolina]. Employer sold its business operation at that location to Buyer. Some of Employer's employees were not retained by Buyer and were paid severance wages under a Separation Agreement and Release. Other employees, including Taxpayer, were retained by Buyer and signed an Incentive to Stay Agreement and Release offered by Employer.
4. Under the terms of the Incentive to Stay Agreement and Release, the employee was to be paid one-half of an incentive to stay allowance as soon as practical after the employee signed the agreement, and the other half would be paid as soon as practical after the employee's last day of employment with Employer, provided the employee had started employment with Buyer. Taxpayer's last date of employment with Employer was at the end of tax year 1999. Effective January 1, 2000, Taxpayer transitioned to and was employed by Buyer at the same building location in [North Carolina]. Employer paid Taxpayer \$16,184 in the tax year 1999. Taxpayer received the second payment of \$15,996 in the tax year 2000.
5. The auditor did not disallow Employer's first payment to Taxpayer in 1999. The auditor adjusted the 2000 return to disallow a deduction of \$15,996 claimed by Taxpayer as severance wages.
6. A Notice of Individual Income Tax Assessment reflecting the auditor's adjustment for the taxable year 2000 was mailed to Taxpayer on April 12, 2002. Taxpayer objected to the assessment and timely requested an administrative tax hearing.

7. Directive PD-98-1 states that severance wages do not include a “stay bonus” paid to an employee as an incentive to continue working.
8. Taxpayer contends that since the wording “stay-on-pay” does not appear in the Individual Income Tax Bulletins until the 2001-2002 edition, it does not apply to the taxable year 2000.
9. Taxpayer contends that all payments received in 1999 and 2000 from Employer under both the Separation Agreement and Release and the Incentive to Stay Agreement and Release qualify for the severance wage deduction.
10. Pursuant to G.S. 105-134.6(b)(11), a deduction shall be made for “[s]everance wages received by a taxpayer from an employer as the result of the taxpayer’s permanent, involuntary termination from employment through no fault of the employee” to the extent such income is included in federal taxable income. “The amount of severance wages deducted as the result of the same termination may not exceed thirty-five thousand dollars (\$35,000) for all taxable years in which the wages are received.”

CONCLUSIONS OF LAW

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

1. Under G.S. 105-134.6(b)(11), a taxpayer is allowed to deduct severance wages as a result of the taxpayer’s permanent, involuntary termination from employment through no fault of the employee, not to exceed \$35,000 for all taxable years in which the wages are received. “Stay-on-pay” does not qualify as severance wages.
2. The first payment received by Taxpayer in 1999 qualifies for the severance wage deduction because it was contingent upon Taxpayer ceasing employment with Employer. The second payment, received in 2000, is considered “stay-on-pay” because receipt of this payment was contingent upon Taxpayer starting employment with Buyer.
3. The proposed assessment of additional tax and interest for the taxable year 2000 is lawful and proper.

DECISION

The Department of Revenue’s long-standing position has been that a “stay bonus” or “stay-on-pay” does not qualify for purposes of the deduction for severance wages. While the issue was not addressed in the Individual Income Tax Bulletins until the 2001-2002 edition, the Department communicated its written policy as early as April 1, 1998, as evidenced by Directive PD-98-1. The law in its present form was effective for tax years beginning on or after January 1,

1998. The Directive states that severance wages do not include a “stay bonus” paid to an employee as an incentive to continue working.

The issue before the Assistant Secretary is whether Taxpayer is in fact entitled to the deduction for severance wages claimed on his income tax return for the tax year 2000. The burden is on a taxpayer to show that he or she comes within an exemption or an exception. *Sabine v. Gill*, 229 N.C. 599, 51 S.E. 2d 1 (1948). According to the Incentive to Stay Agreement and Release, in order to qualify for receipt of the second payment issued in the taxable year 2000, Taxpayer was required to remain employed with Employer through the end of tax year 1999, and then report to work for Buyer on January 1, 2000. Severance wages do not include payments that represent compensation for past or future services.

“Taxation is the rule; exemption the exception.” *Odd Fellows v. Swain*, 217 N.C. 632, 637, 9 S.E. 2d 365, 368 (1940). “[S]tatutes providing exemption from taxation are strictly construed.” *Sale v. Johnson, Commissioner of Revenue*, 258 N.C. 749, 755, 129 S.E. 2d 465, 469 (1963). Consequently, the Assistant Secretary finds that Taxpayer has not carried his burden of proving entitlement to the deduction for severance wages for the taxable year 2000.

Based on the foregoing findings of fact and conclusions of law, the proposed assessment for taxable year 2000 is found to be lawful and proper in every respect and is hereby sustained.

Made and entered this 25th day of November, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue