

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 2000)
and 2001 by the Secretary of Revenue of)
North Carolina)
vs.)
[Taxpayers])

FINAL DECISION
Docket No. 2003-355

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on November 19, 2003, upon an application for hearing by [Taxpayers, Husband and Wife], wherein they protested the proposed assessments of additional income tax for the taxable years 2000 and 2001. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by [Taxpayers' representative], hereinafter referred to as "Accountant;" [Accountant's son and associate]; and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division.

Taxpayers timely filed their 2000 and 2001 North Carolina individual income tax returns. On each return, Taxpayers claimed a tax credit for premiums paid on long-term care insurance. Taxpayers also claimed a deduction for medical care expenses on Schedule A of their 2000 and 2001 federal income tax returns. Upon examination, the Department disallowed the tax credit for premiums paid on long-term care insurance on both the 2000 and 2001 returns. Pursuant to G.S. 105-241.1, Notices of Individual Income Tax Assessment reflecting additional tax, penalties, and interest of \$607.96 and \$571.75 for the tax years 2000 and 2001, respectively, were mailed to Taxpayers on May 27, 2003. Taxpayers objected to the proposed assessments and timely 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 Taxpayers for the taxable years 2000 and 2001 lawful and proper?

EVIDENCE

The evidence presented 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 of Administrative Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.
2. Taxpayers' North Carolina individual income tax return for the taxable year 2000, a copy of which is designated as Exhibit PT-2.
3. Taxpayers' North Carolina individual income tax return for the taxable year 2001, a copy of which is designated as Exhibit PT-3.
4. Notice of Individual Income Tax Assessment for the taxable year 2000 dated May 27, 2003, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for the taxable year 2001 dated May 27, 2003, a copy of which is designated as Exhibit PT-5.
6. Letter from Taxpayers to the Department of Revenue dated June 23, 2003, a copy of which is designated as Exhibit PT-6.
7. Letter from Robert R. Holland, Revenue Tax Auditor, to Taxpayers dated July 30, 2003, a copy of which is designated as Exhibit PT-7.
8. Letter from Eugene J. Cella to Taxpayers dated August 12, 2003, a copy of which is designated as Exhibit PT-8.
9. Facsimile letter from Wife to Eugene J. Cella dated September 23, 2003, a copy of which is designated as Exhibit PT-9.
10. Letter from Eugene J. Cella to Taxpayers dated September 24, 2003, a copy of which is designated as Exhibit PT-10.
11. Federal income tax return Schedule A detail information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 2000, a copy of which is designated as Exhibit PT-11.
12. Federal income tax return Schedule A detail information provided to the Department of Revenue on magnetic tape by the Internal Revenue Service for the taxable year 2001, a copy of which is designated as Exhibit PT-12.

At the hearing, Accountant presented a copy of page 2 and Form D400TC from Taxpayers' 2001 North Carolina individual income tax return reflecting his suggested method of calculating Taxpayers' North Carolina taxable income, 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. Taxpayers at all material times were natural persons, sui juris, and citizens and residents of North Carolina.
2. Taxpayers claimed a deduction on their federal income tax returns for medical care expenses under section 213 of the Internal Revenue Code ("Code") in each of the taxable years 2000 and 2001.
3. Taxpayers claimed a tax credit for premiums paid on long-term care insurance on their North Carolina individual income tax returns for the taxable years 2000 and 2001.
4. Upon examination, the Department disallowed the tax credits for premiums paid on long-term care insurance claimed on Taxpayers' 2000 and 2001 income tax returns.
5. A ten percent negligence penalty was assessed for each taxable year.
6. Notices of Individual Income Tax Assessment reflecting additional tax, penalties, and interest of \$607.96 and \$571.75 for the tax years 2000 and 2001, respectively, were mailed to Taxpayers on May 27, 2003. Taxpayers objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
7. Taxpayers argue that the provisions of the tax credit for premiums paid on long-term care insurance which preclude taxpayers who claim a deduction for medical care expenses under Code section 213 from claiming the credit is discriminatory. Taxpayers further argue that as long as they can show that they will not receive a double benefit by receiving a deduction in addition to the tax credit for the same insurance premium costs, they should be allowed to claim the tax credit.

CONCLUSIONS OF LAW

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

1. North Carolina law provides an individual income tax credit for premiums paid on long-term care insurance that is equal to 15% of the premium costs an individual pays during the taxable year on a qualified long-term care insurance contract. The credit may not exceed \$350.00 for each qualified long-term care insurance contract for which the credit is claimed.
2. The tax credit for premiums paid on long-term care insurance is not allowed to a taxpayer who claims a deduction for medical expenses under section 213 of the Code.
3. Taxpayers may not claim the tax credit for premiums paid on long-term care insurance contracts because they claimed a deduction for medical expenses under section 213 of the Code.

4. For residents of this State, North Carolina taxable income means the taxpayer's taxable income as determined under the Code, adjusted as provided in G.S. 105-134.6 and G.S. 105-134.7. There is no provision in G.S. 105-134.6 or G.S. 105-134.7 allowing an addition to federal taxable income for premiums paid on long-term care insurance.
5. Captions of a statute cannot control when the meaning of the text is clear.
6. Negligence is a failure to exercise reasonable care. For negligent failure to comply with any of the individual income tax laws and rules, the Secretary of Revenue shall assess a penalty equal to ten percent of the deficiency due to the negligence. The Secretary has the authority to waive or reduce any penalties assessed.
7. The disallowance of the claimed tax credits for premiums paid on long-term care insurance for the taxable years 2000 and 2001 is proper and lawful.

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 2000 and 2001, to the extent hereinafter modified, to be lawful and proper and are hereby affirmed.

Taxpayers allege that the statute at issue is discriminatory. Taxpayers believe that it is unfair to prohibit taxpayers that are able to claim medical care expenses as an itemized deduction on their federal return from claiming the tax credit for premiums paid for long-term care insurance while no such disqualification exists for those taxpayers that claim the standard deduction. Discriminatory arguments are constitutional in nature. The Secretary of Revenue's duties includes administering the laws enacted by the North Carolina 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 the constitutionality of a statute is for the judicial branch.

Taxpayers agree that they did receive a "double benefit" regarding the premium costs of their long-term care insurance on their 2000 and 2001 income tax returns as filed. However, Taxpayers argue that as long as they can show that they will not receive a double benefit by receiving a deduction in addition to the tax credit for the same insurance premium costs, they should be allowed to claim the tax credit. To illustrate Taxpayers' position, Accountant prepared

a calculation of Taxpayers' 2001 income tax liability whereby the long-term care insurance premiums were added back to federal taxable income as an "other additions to federal taxable income" on line 37 of Form D-400. Accountant then calculated the tax liability based on the increased North Carolina taxable income amount and claimed the tax credit for premiums paid on long-term care insurance. Under this method, Taxpayers would owe additional tax of \$195.00 for the taxable year 2001, significantly less than the additional tax of \$488.00 proposed by the Department.

While the method developed by Accountant may in whole or in part ensure that a "double benefit" is not realized with regard to the premium costs of the long-term care insurance, the Assistant Secretary cannot permit Taxpayers to use it. There is no provision in the law which allows the premium costs of long-term care insurance to be added back to federal taxable income, regardless of the purpose. More importantly, the unambiguous language of G.S. 105-151.28(b) clearly states that a taxpayer who claims a deduction for medical expenses under section 213 of the Code for the taxable year is not allowed to claim the credit. To permit Accountant to use his suggested method would require enabling retroactive legislation.

After considering the facts and circumstances, the Assistant Secretary finds reasonable cause to waive the ten percent negligence penalties assessed for each year. Therefore, the Assistant Secretary finds that the proposed assessments for the tax years 2000 and 2001, modified to exclude the ten percent negligence penalties, are hereby sustained in their entireties and are determined to be finally due and collectible, together with interest as allowed by law.

Made and entered this 17th day of February, 2004.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue