

**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 2000 and 2001 by the )  
Secretary of Revenue of North Carolina )  
vs. )  
Taxpayer 1 and Taxpayer 2, )  
Taxpayers )

**FINAL DECISION**  
Docket No. 2004-439

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, on December 7, 2004, upon an application for a hearing by Taxpayer 1 and Taxpayer 2, hereinafter referred to collectively as "Taxpayers," and separately as "Husband" and "Wife," respectively, wherein they protested the proposed assessments of individual income tax, penalties, and interest 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 Wife and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division. At Wife's request, the hearing was also attended by her mother.

**ISSUE**

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

1. Are the auditor's adjustments disallowing Taxpayers' itemized deductions, rental loss, and tax credits for the tax year 2000 proper?
2. Was Wife a resident of North Carolina for income tax purposes during the entire 2000 and 2001 taxable years?
3. Are the individual income tax assessments proposed against Taxpayers for the taxable years 2000 and 2001 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. Taxpayers' North Carolina individual income tax return for the taxable year 2000, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for the taxable year 2000 dated March 30, 2004, a copy of which is designated as Exhibit PT-3.
4. Notice of Individual Income Tax Assessment for the taxable year 2001 dated May 19, 2004, a copy of which is designated as Exhibit PT-4.
5. Field Auditor's Report for the taxable year 2000 dated March 19, 2004, a copy of which is designated as Exhibit PT-5.
6. Field Auditor's Report for the taxable year 2001 dated April 30, 2004, a copy of which is designated as Exhibit PT-6.
7. A paper extract of Taxpayers' federal income tax return for the taxable year 2000 provided to the Department of Revenue on magnetic tape by the Internal Revenue Service, a copy of which is designated as Exhibit PT-7.
8. A paper extract of Wife's North Carolina driver's license history and motor vehicle registration record obtained by the Department from the North Carolina Department of Transportation, a copy of which is designated as Exhibit PT-8.
9. Wife's County Board of Elections record of voting, a copy of which is designated as Exhibit PT-9.
10. Letter from Melissa S. Dann, Revenue Field Auditor, to Taxpayers dated February 20, 2004, a copy of which is designated as Exhibit PT-10.
11. Letter from Wife to the Department of Revenue dated April 29, 2004, a copy of which is designated as Exhibit PT-11.
12. Letter with related attachment from W. Edward Finch, Jr., to Taxpayers dated June 14, 2004, copies of which are collectively designated as Exhibit PT-12.

13. Letter from W. Edward Finch, Jr., to Taxpayers dated June 23, 2004, a copy of which is designated as Exhibit PT-13.
14. Letter with related attachments from Wife to W. Edward Finch, Jr., dated July 27, 2004, copies of which are collectively designated as Exhibit PT-14.
15. Letter from W. Edward Finch, Jr., to Taxpayers dated August 24, 2004, a copy of which is designated as Exhibit PT-15.
16. Letter from Wife to W. Edward Finch, Jr., dated September 19, 2004, a copy of which is designated as Exhibit PT-16.
17. Letter from Wife to Eugene J. Cella dated September 21, 2004, a copy of which is designated as Exhibit PT-17.
18. Letter with related attachments from the Virginia Department of Taxation, to W. Edward Finch, Jr., dated October 1, 2004, copies of which are collectively designated as Exhibit PT-18.
19. Letter from W. Edward Finch, Jr., to Wife dated October 12, 2004, a copy of which is designated as Exhibit PT-19.
20. Letter from Eugene J. Cella to Wife dated October 12, 2004, a copy of which is designated as Exhibit PT-20.
21. Letter from the Georgia Department of Revenue, dated October 13, 2004, a copy of which is designated as Exhibit PT-21.

Wife presented the following evidence at the hearing:

1. Information from the website of the Virginia Department of Taxation on residency status for Virginia individual income tax purposes, a copy of which is designated as Exhibit TP-1.
2. Information from the website of the North Carolina Department of Revenue on filing status for North Carolina individual income tax purposes, a copy of which is designated as Exhibit TP-2.

Subsequent to the hearing Wife submitted two letters from her to Eugene J. Cella dated December 21, 2004, and the Judgment of Divorce filed in the County District Court on January 8, 2004, dissolving the marriage between Taxpayers, copies of which are collectively designated as Exhibit TP-3.

## FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. During the taxable years at issue Husband worked in North Carolina. Wife worked both inside and outside of North Carolina during the tax year 2000. Wife worked outside of North Carolina during tax year 2001.
2. Taxpayers filed their North Carolina individual income tax return for the tax year 2000 on April 15, 2002, one year after the due date of April 15, 2001. Husband indicated on the return that he was a North Carolina resident for the entire tax year and Wife indicated that she was not a resident for the entire tax year. The return reflected an overpayment of \$3,131.00.
3. Taxpayers submitted Form D-400 TC with the return for the tax year 2000 reflecting tax credits for tax paid to another state; child and dependent care expenses; children; charitable contributions; and child health insurance premiums. The Department corrected various mathematical and procedural errors made by Taxpayers on the return when calculating the tax credits and a check for the resulting refund of \$3,416.00 was issued on June 3, 2002.
4. Taxpayers did not file a North Carolina individual income tax return for the tax year 2001.
5. By postal certified letter dated February 20, 2004, the Department asked Taxpayers to furnish documentation to substantiate all income and expenses claimed on their State and federal returns for the tax year 2000 and to file their State return for the tax year 2001. After two attempts to deliver the letter to Taxpayers, the Postal Service returned the letter to the Department marked "unclaimed" by the Postal Service.
6. Because Taxpayers did not furnish information to substantiate amounts claimed, the Department adjusted the 2000 return to disallow the following:

Taxes from federal Schedule A	\$ 7,186.00
Interest from federal Schedule A	\$10,973.00
Gifts to charity (Schedule A)	\$ 9,088.00
Miscellaneous deductions (Schedule A)	\$24,659.00
Rental loss	\$17,240.00
Credit for child and dependent care expenses	\$ 350.00
Credit for child health insurance premiums	\$ 100.00
Credit for charitable contributions	\$ 499.00
Credit for tax paid to another state	\$ 24.00

7. The Department also adjusted the 2000 return to allow the standard deduction; to compute the tax as full year residents; to disallow the tax credit for children of \$120.00; and, to increase the adjustment for the difference between the federal and State personal exemption amounts from \$1,200 to \$3,200. The Department also adjusted the 2000 State return to allow the \$2,000.00 deduction for private retirement benefits.

8. The Department determined Taxpayers' corrected North Carolina taxable as follows:

Federal adjusted gross income as corrected	\$115,521.00
Less: State standard deduction	5,000.00
State personal exemption (\$2,000.00 x 4)	8,000.00
State income tax refund	3,052.00
Deduction for private retirement benefits	<u>2,000.00</u>
North Carolina taxable income as corrected	\$ 97,469.00

9. The Department asserted the 25 percent late filing penalty and the 25 percent negligence penalty for the tax year 2000.

10. The Department obtained copies of Taxpayers' wage and tax statements for the tax year 2001 from Taxpayers' employers. Husband's employer reported wages of \$51,943.93 and North Carolina income tax withheld of \$3,095.19. Wife's employer reported total wages of \$42,946.69, Virginia income tax withheld of \$1,620.17, and Georgia income tax withheld of \$443.60.

11. In the absence of a return filed by Taxpayers, the Department determined their North Carolina taxable income for the tax year 2001 as follows:

Wages	\$94,891.00
Less: State standard deduction	5,000.00
State personal exemptions (\$2,500 x 4)	<u>10,000.00</u>
North Carolina taxable income	\$79,891.00

12. The Department allowed the credit for children of \$120.00 for the tax year 2001 and asserted the 25 percent late filing penalty, the 25 percent negligence penalty, and the 10 percent late payment penalty.

13. Notices of Individual Income Tax Assessment reflecting the Department's adjustments for the tax years 2000 and 2001 were mailed to Taxpayers on March 30 and May 19, 2004, respectively.

14. Taxpayers filed a timely protest to the proposed assessment for the tax year 2000 and requested a hearing before the Secretary of Revenue. Taxpayers did not file a timely protest to the 2001 assessment; however, that assessment was included in the hearing since similar issues are involved.
15. In support of Wife's contention that she was a resident of Virginia, she provided a copy of her wage and tax statement showing Virginia income tax withheld of \$1,887.56 from her wages for the tax year 2000; a mortgage interest statement showing interest of \$3,220.52 paid by Taxpayers in tax year 2000 to the Federal Credit Union and reflecting Taxpayers address; and a County Virginia Real Estate Tax Bill for 2002 of \$1,340.49 also reflecting the Virginia address.
16. The Department obtained a copy of Wife's Virginia income tax return for the tax year 2000 from the Virginia Department of Taxation. Wife signed the return on April 27, 2004, nearly three years after the original due date of May 1, 2001, and only after having been notified by the Department that she was deemed to be a North Carolina resident for income tax purposes. The Virginia return reflected Taxpayers' North Carolina address, as did their federal return for that year. According to information obtained by the Department from the Virginia Department of Taxation, Wife has not filed Virginia state income tax returns for any years after 2000. Wife is not entitled to a credit for income tax paid to Virginia for the tax year 2000 because the return she filed with Virginia indicates that her Virginia tax is zero.
17. Wife's wage and tax statements reflect her North Carolina address for the tax years 2000 and 2001.
18. Wife had a North Carolina driver's license during the years at issue. Wife owns two cars on which she continuously renewed her North Carolina registration during 2000 and 2001.
19. Wife is registered to vote in North Carolina and voted by absentee ballot in the 2000 general election and in person in the 2002 primary and general elections.
20. In tax year 2001, wife's employer withheld Virginia and Georgia income tax from her wages. According to information obtained by the Department from the Georgia Department of Revenue, Wife did not file a Georgia income tax return for the tax year 2001.
21. Federal Schedule E submitted with Taxpayers' 2000 federal return indicates that Taxpayers rented the Virginia property that Wife is claiming was her principal residence. Taxpayers deducted the mortgage interest of \$3,220.52 paid on the Virginia property as rental expense on federal Schedule E for the tax year 2000 and claimed rental depreciation expense on the property of \$1,704.00. The depreciation schedule attached to Taxpayers federal return reflects the cost or other basis of the property as \$86,500.00, which is equal to the beginning

principal amount of the loan on the Virginia property as reflected on Taxpayers' mortgage interest statement from the Federal Credit Union.

22. Taxpayers separated on or about March 1, 2000, and were granted an absolute divorce on January 8, 2004. The Judgment of Divorce states in the conclusions of law that Wife "has been a resident of the State of North Carolina for more than six months next preceding the institution of this action."

### **CONCLUSIONS OF LAW**

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

1. The term "resident" means an individual who is domiciled in North Carolina at any time during the taxable year or who resides in this State during the taxable year for other than a temporary or transitory purpose. An individual who lives in North Carolina for more than 183 days of a tax year is presumed to be a resident for income tax purposes in the absence of factual proof to the contrary; but the absence of an individual from the State for more than 183 days raises no presumption that the individual is not a resident. A resident who removes from the State during a taxable year is considered a resident until he has both established a definite domicile elsewhere and abandoned any domicile in this State.
2. The North Carolina Supreme Court in *Reynolds v. Cotton Mills*, 177 N.C. 412 (1919), defined domicile as "... the residence of a person at a particular place, with the intention to remain there permanently, or for an indefinite length of time, or until some unexpected event shall occur to induce him to leave the same." The Court further held that to effect a change of domicile, there must be an actual abandonment of the first domicile, coupled with the taxpayer's intention not to return to it. Actual residence must be established in a new locality with the intention of making the last acquired residence the taxpayer's home. The presumption of law is that an individual's domicile or origin exists until a change of domicile is proved.
3. Domicile is a question of fact and intention. The rule is well stated in 25 Am. Jur. 2d Domicil §91 (1966): "The weight to be given to the many facts and circumstances indicative or presumptive as to domicil depends upon the circumstances of each case. The determination of domicil depends upon no one fact or combination of circumstances, but upon the whole, taken together, showing a preponderance of evidence in favor of some particular place as the domicil." Declarations as to domicil may be contradicted by evidence of acts and conduct inconsistent with such declarations. Declarations as to an intention to acquire a domicil are of slight weight when they conflict with the facts. Where there is evidence which shows that the performance of acts ordinarily sufficient to

show a change of domicile were done without intent to change one's home, but with the intent to gain the legal advantage of having a domicile elsewhere, the inferences established by such acts are insufficient to establish a change. 25 Am. Jur. 2d Domicil §93 (1966).

4. Residence simply indicates a person's actual place of abode, whether permanent or temporary, whereas domicile denotes one's permanent established home as distinguished from a temporary, although actual place of residence. *Hall v. Board of Elections*, 280 N.C. 600 (1972) Mere residence, regardless of how prolonged it may be, is insufficient without the existence of an intention to make the place a permanent home.
5. Deductions are privileges, not matters of right, and are allowed as a matter of legislative grace. A taxpayer claiming a deduction must bring himself within the statutory provisions authorizing the deduction, *Ward v. Clayton* 5 N.C. App. 53, 167 S.E. 2d 808 (1969), aff'd, 276 N.C. 411, 172 S.E.2d 531 (1970). 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). In order to claim any deduction, a taxpayer must be able to prove that the expenses were in fact paid or incurred.
6. If a taxpayer does not provide adequate and reliable information upon which to compute his tax liability, an assessment may be made upon the basis of the best information available to the Department and, in the absence of information to the contrary, such assessment is deemed to be correct. The burden to show otherwise is upon the taxpayer.
7. Taxpayers' personal exemptions for State income tax purposes are the same as for federal purposes except that North Carolina does not increase the exemptions each year for inflation. Therefore, an addition is required on the State return for the amount each personal exemption has been increased for inflation. This amount is reduced by \$500.00 for each personal exemption if the taxpayers' adjusted gross income is less than a certain amount. For taxpayers filing jointly, the amount is \$100,000.00. Because Taxpayers' gross income as corrected exceeds that amount for the tax year 2000, an addition of \$800.00 is required for each exemption claimed. Because Taxpayers were allowed four exemptions, the correct addition for the personal exemption adjustment is \$3,200 rather than \$1,200 claimed on the return.
8. Married individuals filing jointly whose adjusted gross income is less than \$100,000.00 are allowed a tax credit equal to \$60.00 for each dependent child for whom they were entitled to deduct a personal exemption. Because Taxpayers' adjusted gross income as corrected exceeds \$100,000.00 for the tax year 2000, the Department's adjustment to disallow the credit for two children of \$120.00 is correct.



9. 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. Because Taxpayers understated their taxable income by 25 percent or more of gross income for the tax years 2000 and 2001, the 25 percent negligence penalty was properly asserted as required by law.
10. A penalty of five percent of the tax is imposed for each month or part of a month (maximum twenty five percent) the return is late. Because Taxpayers did not file the 2000 return until April 15, 2002, and did not file a 2001 return, the twenty five percent late filing penalty for each tax year is properly due.
11. A penalty of ten percent of the tax is required for failure to pay the tax when due. Because Taxpayers did not file a State income tax return for the tax year 2001, the ten percent penalty is properly applied for that year.

### **DECISION**

Wife contends that she was a part-year resident of North Carolina in tax year 2000 and a nonresident for the entire tax year 2001. To effect a change of domicile there must be an actual abandonment of the first domicile, coupled with the taxpayer's intention not to return to it. A long-standing principle in tax administration, repeatedly upheld by the courts, is that an individual can have but one domicile; and once established, it is not legally abandoned until a new one is established. The question of residency is dependent upon an analysis of all the various facts and circumstances in each case. The record reflects that although Wife worked in Virginia and Georgia during part of the tax periods at issue and although she may have established temporary places of abode in those states, her continued ties to this State demonstrate a lack of abandonment of her domicile in North Carolina. Accordingly, the Assistant Secretary finds that Wife has not carried her burden of proving abandonment of North Carolina as her State of domicile. Consequently, Wife was a resident of North Carolina for individual income tax purposes

for the tax years 2000 and 2001 and is subject to State income tax on her income from sources both inside and outside the State.

Taxpayers furnished no information prior to or during the hearing to substantiate the itemized deductions, rental loss, and tax credits claimed on their 2000 return. In order to claim any deduction, a taxpayer must be able to prove that the expenses were in fact paid or incurred and Taxpayers have not satisfactorily done so. Furthermore, Taxpayers have not met their burden of proof that the Department's adjustments are in error or that they are entitled to claim amounts greater than those allowed by the Department.

Therefore, based on the foregoing findings of fact and conclusions of law, the individual income tax assessments for the taxable years 2000 and 2001 are found to be lawful and proper, are sustained in their entireties, and are declared to be final and immediately due and collectible, together with interest as allowed by law.

Made and entered this 7<sup>th</sup> day of March, 2005.

Signature \_\_\_\_\_

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue