STATE OF NORTH CAROLINA **BEFORE THE SECRETARY OF REVENUE**

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessment of Additional Income Tax for the Taxable Year 2000 by the Secretary of Revenue of North Carolina	)	**FINAL DECISION** Docket No. 2004-62 (B)
vs.	)	
[Taxpayers]	)	

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, upon an application for hearing by [taxpayers]," wherein they protested the proposed assessment of additional income tax for the taxable year 2000. [Taxpayer] is hereinafter referred to separately as "Wife." At Wife's request, the hearing was conducted via written communication and the Assistant Secretary allowed Taxpayers until May 12, 2004, to provide any arguments, documents, or other evidence in support of their objections to the assessments. The hearing was conducted by the Assistant Secretary under the provisions of G.S. 105-260.1.

Pursuant to G.S. 105-241.1, an assessment proposing additional tax, penalties, and interest for the tax year 2000 was mailed to Taxpayers on October 14, 2003. Taxpayers objected to the proposed assessment and requested an administrative tax hearing before the Secretary of Revenue.

ISSUE

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

Is the assessment for additional income tax proposed against Taxpayers 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. 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 October 14, 2003, a copy of which is designated as Exhibit PT-3.

4. Internal Revenue Service Report of Income Tax Changes for tax year 2000, a copy of which is designated as Exhibit PT-4.

5. Letter from Eugene J. Cella to Taxpayers dated February 11, 2004, a copy of which is designated as Exhibit PT-5.

6. Letter from Wife to Eugene J. Cella dated February 17, 2004, a copy of which is designated as Exhibit PT-6.

7. Letter from Eugene J. Cella to Taxpayers dated March 2, 2004, a copy of which is designated as Exhibit PT-7.

Wife submitted a letter to Eugene J. Cella dated April 30, 2004 along with several exhibits, copies of which are collectively 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 are and at all material times were natural persons, sui juris, and citizens and residents of North Carolina.

2. Taxpayers timely filed their North Carolina individual income tax return for the tax year 2000. The return reflected federal taxable income of $(22,087) and North Carolina taxable income of $(19,638). The return also reflected an overpayment of $1,666, which was refunded to Taxpayers.

3. The Department of Revenue received a report from the Internal Revenue Service indicating that the Internal Revenue Service had audited Taxpayers' 2000 federal income tax return. The Internal Revenue Service determined Taxpayers' correct federal taxable income to be $35,302 for the tax year 2000.

4. Upon examination, the Department increased Taxpayers' North Carolina taxable income by $57,389 to reflect the increase in federal taxable income reflected on the federal report. After this increase, Taxpayers' corrected North Carolina taxable income for the tax year 2000 was $37,751.

5. Pursuant to G.S. 105-241.1, a Notice of Individual Income Tax Assessment reflecting additional tax, penalties, and interest of $2,924.96 was mailed to Taxpayers on October 14, 2003. Taxpayers objected to the proposed assessment and timely requested a hearing before the Secretary of Revenue.

6. Subsequent to receiving Taxpayers' hearing request, the Department determined that the twenty-five percent negligence penalty for a large individual income tax deficiency should have been asserted rather than the ten percent negligence penalty.

7. Taxpayers contend that the State has not identified the tax that they are "subject to." Taxpayers also contend that the report of income tax changes the Department obtained from the Internal Revenue Service is inaccurate and should not be used as a basis for adjusting their North Carolina income tax return.

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 every resident of this State. For residents of this State, "North Carolina taxable income" is the taxpayer's taxable income as determined under the Internal Revenue Code, adjusted as statutorily mandated for differences in State and federal law.

2. Federal taxable income is defined by the Internal Revenue Code as gross income less deductions and personal exemptions. Gross income is defined as all income from whatever source derived unless specifically excepted. Gross income includes compensation for services rendered and gross income derived from business. 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.

3. An addition to federal taxable income is required for the amount deducted from gross income under section 164 of the Code as state, local, or foreign income tax to the extent that the taxpayer's total itemized deductions deducted under the Code for the taxable year exceed the allowable State standard deduction.

4. An addition to federal taxable income is required for the amount by which each of the taxpayer's personal exemptions has been increased for inflation under section 151(d)(4)(A) of the Code.

5. Section 6103(d) of the Internal Revenue Code provides that federal income tax returns and return information are open to inspection by, or disclosure to, any State agency, body, or commission which is charged under the laws of that State with responsibility for the administration of the State's tax laws. Such inspection or disclosure is permitted only upon written request by the head of the agency or by an individual designated by the head of the agency. In 1982, the Department of Revenue and the Internal Revenue Service executed an Agreement on Coordination of Tax Administration that allows for the continuous sharing of tax information between the two agencies. The courts have consistently held that such standing agreement satisfies the written request requirement of Code section 6103(d).

6. If a taxpayer's federal taxable income is corrected or otherwise determined by the Internal Revenue Service, the taxpayer is required to file an income tax return with the State reflecting the corrected or determined taxable income within two years after being notified of the correction or final determination by the Internal Revenue Service. When the taxpayer does not file the required amended return and the Department obtains a copy of the Internal

Revenue Service report, an assessment may be proposed for any additional tax, penalties, and interest at any time within three years from the date the report is received from the Internal Revenue Service.

7. If a taxpayer does not provide adequate and reliable information upon which the Department can accurately compute his tax liability, an assessment may 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.

8. A twenty-five percent negligence penalty is imposed 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 taxable income by 25 percent or more of gross income, a penalty of $578 must be imposed.

9. The proposed assessment for the tax year 2000, modified to include the replacement of the ten percent negligence penalty with the twenty-five percent negligence penalty, is lawful and proper.

DECISION

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary finds the proposed assessment for the tax year 2000, to the extent hereinafter modified, to be lawful and proper and is hereby affirmed.

Wife contends that the State of North Carolina has not provided the statute and implementing regulations that identify the tax which the State claims Taxpayers are "subject to." Arguments similar to this one are often raised by taxpayers who object to the payment of income tax. Such arguments have consistently and uniformly been found to be completely lacking in legal merit and patently frivolous. Furthermore, the Department's Brief for Tax Hearing clearly identifies G.S. 105-134 as the North Carolina statute that imposes the individual income tax upon the taxable income of every resident of this State. Therefore, the Assistant Secretary finds Wife's contention to be unfounded.

Wife also attempts to discredit the proposed assessment through her interpretation of the Internal Revenue Service's individual master file for Taxpayers. This tactic is a total red herring, designed to avert attention away from the core issue. The Internal Revenue Service audited Taxpayers and made changes to Taxpayers' federal return as reflected in the federal

report received by the Department from the Internal Revenue Service. Taxpayers have presented no factual evidence to show that the Internal Revenue Service's examination changes are not warranted.

Wife questions the Department's authority to obtain the report of individual income tax changes from the Internal Revenue Service. Wife claims that the Department's only purpose for obtaining information from the Internal Revenue Service pursuant to Code section 6103(d) is to collect and share information from fuel transaction filings. Wife presents the Memorandum of Understanding Between the Internal Revenue Service and the State of North Carolina Department of Revenue for the Excise Summary Terminal Activity Reporting System signed by the Secretary of Revenue on August 25, 2001, in support of her claim. Wife's claim is simply incorrect. In 1982, the Department of Revenue and the Internal Revenue Service executed an Agreement on Coordination of Tax Administration that allows for the continuous sharing of tax information between the two agencies. Over the years, the Department of Revenue has approved several addendums to the Agreement on Coordination of Tax Administration as well as an implementing agreement and several memorandums of understanding on specific subject matters such as the Memorandum of Understanding Between the Internal Revenue Service and the State of North Carolina Department of Revenue for the Excise Summary Terminal Activity Reporting System cited by Wife. The Agreement on Coordination of Tax Administration does not limit the information available to the Department of Revenue to fuel transaction filings as Wife contends. In fact, pages 12-28 of Taxpayers' "Exhibit C" include the Implementing Agreement for the Federal/State Tax Exchange Program signed by the Secretary of Revenue on September 1, 1994. This document identifies most of the tax information available for sharing between the Department of Revenue and the Internal Revenue Service. In the present case, the Department obtained Taxpayers' Form 5278, Statement of Income Tax Changes from the Internal Revenue Service. Form 5278 is listed on page 15 of Taxpayers' "Exhibit C" as a report that is available to the Department from the Internal Revenue Service under the

Agreement on Coordination of Tax Administration. Once again, the Assistant Secretary finds Wife's contention to be unfounded.

The Assistant Secretary finds no merit in any of Taxpayers' arguments and defenses. Therefore, the proposed assessment for the tax year 2000, modified to include the replacement of the ten percent negligence penalty with the twenty-five percent negligence penalty, is hereby sustained in its entirety and is determined to be finally due and collectible.

Made and entered this *12th* day of *July,* 2004.

Signature_____
Eugene J. Cella
Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue