

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 2001)
and 2002 by the Secretary of Revenue)
of North Carolina)
vs.)
[Taxpayer 1], and [Taxpayer 2])
Taxpayers)

FINAL DECISION
Docket No. 2006-2

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on March 29, 2006, upon an application for hearing by [Taxpayer 1], and [Taxpayer 2], hereinafter referred to as “Taxpayers,” and separately as “Husband” and “Wife,” wherein they objected to the proposed assessments of additional income tax for the taxable years 2001 and 2002. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer’s attorney, hereinafter referred to as “Attorney;” Nancy R. Pomeranz, Director of the Personal Taxes Division; and Samuel L. McEwen, Assistant Director of the Personal Taxes Division.

Pursuant to G.S.105-241.1, assessments proposing additional tax, penalties, and interest for tax years 2001 and 2002 were mailed to Taxpayers. Taxpayers timely objected to the proposed assessments and 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 taxable years 2001 and 2002 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. Taxpayers' North Carolina Individual Income Tax Return for the taxable year 2001, a copy of which is designated as Exhibit PT-3.
4. Taxpayers' North Carolina Individual Income Tax Return for the taxable year 2002, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for taxable year 2001 dated October 4, 2005, a copy of which is designated as Exhibit PT-5.
6. Notice of Individual Income Tax Assessment for taxable year 2002 dated October 4, 2005, a copy of which is designated as Exhibit PT-6.
7. Various tax documents related to qualified business tax credits claimed on Taxpayer's 2000, 2001, and 2002 income tax returns, copies of which are collectively designated as Exhibit PT-7.
8. Letter from Rhonda R. Smith, Tax Auditor, to Taxpayers dated September 29, 2005, a copy of which is designated as Exhibit PT-8.
9. Letter from Attorney to Rhonda R. Smith dated October 26, 2005, a copy of which is designated as Exhibit PT-9.
10. Letter from Samuel L. McEwen, Assistant Director of the Personal Taxes Division, to Attorney dated December 1, 2005, a copy of which is designated as Exhibit PT-10
11. Letter from Attorney to Samuel L. McEwen, dated December 29, 2005, a copy of which is designated as Exhibit PT-11.
12. Letter from Eugene J. Cella to Attorney dated January 5, 2006, a copy of which is designated as Exhibit PT-12.
13. Letter from Attorney to Eugene J. Cella dated February 22, 2006, a copy of which is designated as Exhibit PT-13.

14. Letter from Eugene J. Cella to Attorney dated February 22, 2006, a copy of which is designated as Exhibit PT-14.

At the hearing, Attorney presented a memorandum to Eugene J. Cella dated March 29, 2006, a copy of which is designated as Exhibit TP-1.

FINDINGS OF FACT

1. Taxpayers were at all material times natural persons, sui juris, and were citizens and residents of North Carolina.
2. Husband was a partner in two pass-through entities, [Qualified Business 1] and [Qualified Business 2], (“Pass-Through Entities”).
3. The Pass-Through Entities made investments in qualified businesses in calendar year 1999.
4. The investments by the Pass-Through Entities qualified for the tax credit for qualified business investments and the entities passed the credits to their partners. Husband’s portion of the credits consisted of \$56,854 from Qualified Business 1 and \$34,207 from Qualified Business 2, for a total of \$91,061.
5. Taxpayers timely filed their North Carolina individual income tax return for tax year 2000 and claimed a tax credit of \$84,207 for investments in qualified businesses. The tax credit was limited on the return to \$50,000.
6. Taxpayers timely filed their North Carolina individual income tax return for tax year 2001 and carried over qualified business investment tax credits of \$34,569.
7. Taxpayers timely filed their North Carolina individual income tax return for tax year 2002 and carried over qualified business investment tax credits of \$6,478.
8. Upon examination, the Department disallowed the carryover of the qualified business investment tax credits because the amounts exceeded the maximum allowable credit of \$50,000 that was claimed on the income tax return for tax year 2000.
9. Notices of Individual Income Tax Assessment for taxable years 2001 and 2002 proposing additional tax, penalty, and interest were mailed to Taxpayers on October 4, 2005. Taxpayers objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
10. Attorney contends that while the amount of credit that can be claimed in one year is limited to \$50,000, a taxpayer is allowed to carryover credit amounts in excess of \$50,000 for up to five years. Attorney contends that the amounts in excess of \$50,000 are considered “unused credits” to which the \$50,000 limitation does not apply.

11. The Department contends that no matter the amount or number of investments in qualified businesses in a single year, the maximum credit an individual will ever be entitled to claim for those investments is \$50,000, whether in one year or in succeeding years.

CONCLUSIONS OF LAW

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

1. Pursuant to G.S. 105-163.011(b1), each individual who is the owner of a pass-through entity is allowed a credit for qualified business investments equal to the owner's allocated share of the credits for which the pass-through entity is eligible. The tax credit allowed to owners of pass-through entities is calculated and limited at the entity level and then allocated to the entity's owners.
2. Subject to the further limitations provided in G.S. 105-163.012, the credit is limited at the entity level to twenty-five percent (25%) of the amount invested and to a maximum of seven hundred fifty thousand dollars (\$750,000) for all investments in one year.
3. Pursuant to G.S. 105-163.011(b1), individual owners of pass-through entities are allocated the owner's share of the credit. If an individual owner cannot fully use the allocated credit, the credit may not be allocated to other owners.
4. After the entity level limitations are applied and an individual owner is allocated credit, a limitation applies at the owner level. Pursuant to G.S. 105-163.011(b1), the aggregate amount of credit allowed an individual for investments made in one year may not exceed fifty thousand dollars (\$50,000).
5. The further limitations provided in G.S. 105-163.012 reduce the credit to the amount of income tax imposed on a taxpayer less all other allowable credits except tax payments and, second, a global ceiling amount for credit taken by all taxpayers (i.e., \$6,000,000 ceiling in 2000).
6. G.S. 105-163.012(a) allows a carryover of "unused credit allowed under G.S. 105-163.011." The phrase "unused credit allowed under G.S. 105-163.011" means the credit allowed which is the credit subject to the limitations of G.S. 105-163.011 including the \$50,000 individual limit.
7. The final sentence of G.S. 105-163.012(a) states, "The fifty thousand dollar (\$50,000) limitation on the amount of credit allowed a taxpayer under G.S. 105-163.011 does not apply to unused amounts carried forward under this subsection." The unused credit amount is the amount potentially carried forward which is the credit available after the

- limitations found in G.S. 105-163.011 are applied (including the \$50,000 individual limit).
8. Taxpayers misinterpret this final sentence of G.S. 105-163.012(a) and erroneously read the sentence with G.S. 105-163.011(b1). The final sentence of G.S. 105-163.012(a) is expressly limited to “this subsection” which is G.S. 105-163.012(a) – not any subsection of section 105-163.011.
 9. The carryforward provision of G.S. 105-163.012(a) allows an individual taxpayer to carryforward any of the credit allowed in G.S. 105-163.011(b1) (i.e., \$50,000 maximum) which was limited by G.S. 105-163.012(a) due to other allowable credits or the amount of income tax imposed.
 10. The final sentence of G.S. 105-163.012(a) prevents the \$50,000 limit of G.S. 105-163.011(b1) from applying a second time to the same investment. Once the \$50,000 maximum of G.S. 105-163.011(b1) has been applied to investments made during a year, any carryovers under G.S. 105-163.012(a) are not subject to the \$50,000 limit in the carryover years. If a taxpayer made new investments every year and was limited by the \$50,000 for each year, the total carryover could theoretically buildup and exceed \$50,000, making a credit in excess of \$50,000 proper.
 11. Taxpayers were allocated investment credits from the Pass-Through Entities in only one tax year, 1999, making the \$50,000 limit of G.S. 105-163.011(b1) the absolute maximum benefit from that year’s investments.
 12. Taxpayers were not limited by G.S. 105-163.012(a) due to other allowable credits or the amount of their tax liability.
 13. Taxpayers have no carryover of the credit under G.S. 105-163.012(a) or under any other statute.
 14. The amount of computed credit for one or more investments in a single tax year that exceeds \$50,000 cannot be claimed in any tax year.
 15. Taxpayers’ argument for an unlimited carryover would result in an individual receiving a tax credit of more than \$50,000 for one or more qualified business investments in a single year which is expressly prohibited by G.S. 105-163.011(b1).
 16. For investments in qualified businesses, no matter the amount or number of investments in a single year, the maximum credit to which an individual will ever be entitled to claim for those investments is \$50,000. Taxpayers disregarded the statutory limitations and, in error, carried over to succeeding tax years amounts in excess of \$50,000. Because Taxpayers used the maximum \$50,000 credit, there was no “unused credit” available to be carried over to succeeding years.
 17. The Secretary of Revenue is authorized to waive or reduce penalties.

DECISION

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary finds the proposed assessments for tax years 2001 and 2002, modified to exclude the ten percent negligence penalties, to be lawful and proper. The assessments are, therefore, sustained in their entirety and are hereby declared to be finally due and collectible, together with interest as allowed by law.

Made and entered this 26th day of June, 2006

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue