

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessments of Additional)
Income Tax for Taxable Years 2001 through)
2005 by the Secretary of Revenue of)
North Carolina)
)
)
 vs.)
)
 [Taxpayer 1], Taxpayer)

FINAL DECISION
Docket No. 2006-242

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on October 26, 2006, upon an application for hearing by [Taxpayer 1], hereinafter referred to as "Taxpayer," wherein she objected to the proposed assessments of additional income tax for taxable years 2001 through 2005. 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; Edward S. Koonce, Administrative Officer in the Personal Taxes Division; and with Taxpayer's permission and at her request, [Taxpayer 2], Taxpayer's spouse.

ISSUE

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

Are the assessments for additional income tax proposed against Taxpayer for the taxable years 2001, 2002, 2003, 2004, and 2005 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 taxable year 2001, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for taxable year 2002, a copy of which is designated as Exhibit PT-3.
4. Notice of Individual Income Tax Assessment for taxable year 2003, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for taxable year 2004, a copy of which is designated as Exhibit PT-5.
6. Wage and Income Transcript from the Internal Revenue Service for taxable year 2001, a copy of which is designated as Exhibit PT-6.
7. Wage and Income Transcript from the Internal Revenue Service for taxable year 2002, a copy of which is designated as Exhibit PT-7.
8. Taxpayer's wage and tax information from Taxpayer's employer for taxable year 2003, a copy of which is designated as Exhibit PT-8.
9. Wage and Income Transcript from the Internal Revenue Service for taxable year 2004, a copy of which is designated as Exhibit PT-9.
10. Letter from Taxpayer to Department of Revenue dated July 7, 2006, a copy of which is designated as Exhibit PT-10.
11. Letter from Edward S. Koonce, Administrative Officer in the Personal Taxes Division, to Taxpayer dated July 26, 2006, a copy of which is designated as Exhibit PT-11.
12. Letter from Edward S. Koonce to Taxpayer's employer dated July 26, 2006, and subsequent responses, copies of which are collectively designated as Exhibit PT-12.
13. Undated letter from Taxpayer to Edward S. Koonce, a copy of which is designated as Exhibit PT-13.
14. Letter from Eugene J. Cella dated August 16, 2006, a copy of which is designated as Exhibit PT-14.
15. Undated letter from Taxpayer to Eugene J. Cella, a copy of which is designated as Exhibit PT-15.
16. Letter from Edward S. Koonce dated October 19, 2006, a copy of which is designated as Exhibit PT-16.

17. Notice of Individual Income Tax Assessment for taxable year 2005 dated October 24, 2006, a copy of which is designated as Exhibit PT-17.
18. Taxpayer's wage and tax statement for taxable year 2005, a copy of which is designated as Exhibit PT-18.

Taxpayer presented the following information at the hearing:

1. Statement by Taxpayer regarding due process, a copy of which is designated as Exhibit TP-1.
2. Validation and Verification of Requirement, Duty, Obligation, Debt or Liability Inquiry, and supporting documents, copies of which are collectively designated as Exhibit TP-2.
3. Requirement of the Paperwork Reduction Act and Demand for Compliance, and supporting documents, copies of which are collectively designated as Exhibit TP-3.
4. Demand for Correction of - Letter of Determination for Withholding Certificate, Form NC-4 sent October 9, 2006, a copy of which is designated as Exhibit TP-4.

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 did not file North Carolina individual income tax returns for tax years 2001, 2002, 2003, 2004, or 2005.
3. Wage income information from the Internal Revenue Service reflected wages of \$30,311.00, \$32,545.00, and \$34,064.00 for tax years 2001, 2002, and 2004, respectively.
4. Wage and tax information from Taxpayer's employer, reflected wages \$34,101.00 and \$35,557.76 for tax years 2003 and 2005 respectively.
5. An assessment proposing additional tax, penalties, and interest for tax year 2003 was mailed to Taxpayer on November 8, 2005. Proposed assessments for tax years 2001, 2002, and 2004 were mailed to Taxpayer on June 6, 2006.
6. Subsequent to the mailing of the proposed assessments, the Department determined that Taxpayer's filing status should be married filing separate. Corrected notices reflecting additional tax, penalties, and interest were mailed to Taxpayer on October 17, 2006.

7. An assessment proposing additional tax, penalties, and interest for tax year 2005 was delivered in person to Taxpayer at the hearing and accepted into the record.
8. The notices for tax years 2001, 2002, 2003, 2004 and 2005 proposed additional income tax, a twenty-five percent late filing penalty, a ten percent late payment penalty, a fifty percent underwithholding penalty, a twenty-five percent negligence penalty, and accrued interest.
9. Taxpayer objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
10. Taxpayer contends that Federal Form 1040 fails to comply with the Paperwork Reduction Act of 1995 and as such is a bootleg form.
11. Under the Paperwork Reduction Act, the Office of Management and Budget (“OMB”) is required to number each form required by an agency of the federal government for the collection of information and identify the law or regulation that requires that form to be filed. The Paperwork Reduction Act relates to forms for the collection of information.
12. Taxpayer contends that it has never been established that she is a taxpayer and to presume that she is violates the due process of law requirement contained in the Fifth Amendment of the United States Constitution.
13. Taxpayer contends that the Internal Revenue Code of 1939, which serves as the basis for the Internal Revenue Code of 1954 and the Internal Revenue Code of 1986, was repealed February 10, 1939.
14. Taxpayer claimed “exempt” from State withholding on a withholding exemption certificate, Form NC-4, filed with her employer and dated May 11, 2000.
15. The Department advised Taxpayer’s employer to ignore the allowance certificate filed by Taxpayer and to withhold on the basis of a single individual with no allowances.

CONCLUSIONS OF LAW

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

1. Division II of Article 4 in Chapter 105 of the North Carolina General Statutes imposes an individual income tax upon the taxable income of (1) every resident of this State and (2) every nonresident individual deriving income from North Carolina sources attributable to the ownership of any interest in real or tangible

personal property in this State or deriving income from a business, trade, profession, or occupation carried on in this State.

2. "Taxpayer" is defined as an individual subject to tax imposed by Division II of Article 4 in Chapter 105.
3. "North Carolina taxable income" is defined as a taxpayer's taxable income as determined under the Internal Revenue Code, adjusted as statutorily provided for the differences in State and federal law.
4. Federal taxable income is defined in 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 wages, which are subject to withholding.
5. Internal Revenue Code section 63 allows a taxpayer who does not claim itemized deductions to claim the standard deduction. The basic standard deduction for each filing status is set out in subdivision (c)(2). For married filing separate individuals, the basic standard deduction is \$3,000.00. Subdivision (c)(4) provides that the basic standard deduction is increased each year for inflation.
6. Internal Revenue Code section 151 allows a taxpayer to claim an exemption for himself and for each qualifying dependent. Subdivision (d)(1) provides that the basic exemption amount is \$2,000.00. Subdivision (d)(4) provides that the basic exemption amount is increased each year for inflation.
7. An individual is required to file a federal income tax return if his gross income for the year equals or exceeds the allowable amount.
8. A resident of this State is required under G.S. 105-152 to file a North Carolina individual income tax return. The North Carolina return must show the taxable income and adjustments to federal taxable income required by statute.
9. The Secretary of Revenue has the power to examine any books, papers, records, or other relevant data for the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the tax liability of a person, or collecting any such tax.
10. If a taxpayer does not provide adequate and reliable information upon which to compute his tax liability, G.S. 105-241.1 provides that 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.
11. Code section 1 (and Treasury Regulation § 1.1-1) imposes a tax on taxable income and provides the rates for calculating the tax but does not actually

require the collection of any information. The obligation to file the tax return is imposed by Code section 6012, and the regulations under that section describe the return that must be filed. Treasury Regulations § 602.101 (c) lists the various regulations that require returns and the OMB control numbers for IRS forms required by those regulations. The OMB control number assigned to the federal individual income tax return, Form 1040, is listed as a form required by a number of different regulations, including regulations under Code section 61 (“Gross Income Defined”), Code section 63 (“Taxable Income Defined”), and Code section 6012 (“Persons Required to Make Returns of Income”). The Internal Revenue Service has therefore complied with the Paperwork Reduction Act, and the regulations of the OMB, by identifying the regulations that require the collection of information in federal form 1040.

12. The Internal Revenue Code clearly defines “person” and sets forth which persons are subject to federal taxes. Section 7701(a)(14) defines “taxpayer” as any person subject to any internal revenue tax and section 7701(a)(1) defines “person” to include an individual, trust, estate, partnership, or corporation.
13. The Fifth Amendment to the United States Constitution provides that a person shall not be “deprived of life, liberty, or property, without due process of law...” The U.S. Supreme Court stated in Brushaber v. Union Pacific R.R. 240 U.S. 1, 24 (1916), that “it is ...well settled that [the Fifth Amendment] is not a limitation upon the taxing power conferred upon Congress by the Constitution.
14. The “repeal” language in section 4 of the Internal Revenue Code of 1939 is carefully qualified. It declares that when any particular provision of the Internal Revenue Title reflected in the Internal Revenue Code of 1939 takes effect, the provision of earlier law, which it represents, is then repealed, and until then, the original statute continues in force.
15. Pursuant to G.S. 105-163.5(b), an employee must furnish his or her employer with a signed withholding certificate informing the employer of the exemptions the employee claims, which may not exceed the amount of exemptions to which the employee is entitled.
16. A penalty is imposed for failure to file a return when due. The penalty is equal to five percent of the tax for each month, or fraction of a month, the return is late (minimum \$5.00, maximum twenty-five percent).
17. A penalty is imposed for failure to pay tax when due. The penalty is equal to ten percent of the tax (minimum \$5.00).
18. 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.

19. G.S. 105-163.5(f) provides that if an individual furnishes his or her employer with an exemption certificate that contains information which has no reasonable basis and that results in a lesser amount of tax being withheld than would have been withheld if the individual had furnished reasonable information, the individual is subject to a penalty of fifty percent (50%) of the amount not properly withheld.

20. Taxpayer is not exempt from State income tax withholding.

DECISION

Based on the foregoing findings of fact and conclusions of law, the proposed assessments of additional income tax, penalties, and interest for tax years 2001 through 2005 are found to be lawful and proper. The assessments are, therefore, sustained in their entireties and are determined to be finally due and collectible, together with interest as allowed by law.

Made and entered this 8th day of January, 2007

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue