

STATE OF NORTH CAROLINA

**BEFORE THE
SECRETARY OF REVENUE**

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessments of Additional)
Income Tax for the Taxable Years 2002)
and 2003 by the Secretary of)
Revenue of North Carolina)
))
vs.)
))
[Taxpayer 1], Taxpayer)

FINAL DECISION
Docket No. 2006-254

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the City of Raleigh on November 7, 2006, upon an application for hearing by [Taxpayer 1], hereinafter referred to as "Taxpayer," wherein he protested the proposed assessments of additional income tax for taxable years 2002 and 2003. 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; Samuel L. McEwen, Assistant Director of the Personal Taxes Division; Jeffrey C. Davenport, Administrative Officer in the Personal Taxes Division; and, with Taxpayer's permission and at his request, acquaintances of Taxpayer.

Pursuant to G.S. 105-241.1, assessments proposing additional tax, penalties, and interest for the tax years 2002 and 2003 were mailed to Taxpayer. Taxpayer filed a timely protest to the proposed assessments for tax years 2002 and 2003 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 Taxpayer for taxable years 2002 and 2003 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 2002 dated April 26, 2005, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for taxable year 2003 dated April 26, 2005, a copy of which is designated as Exhibit PT-3.
4. Statement of Financial Affairs, United States Bankruptcy Court, a copy of which is designated as Exhibit PT-4.
5. Undated letter from Taxpayer to the Department of Revenue with related attachments, copies of which are collectively designated as Exhibit PT-5.
6. Letter from Carl G. Hayes, former Administrative Officer in the Personal Taxes Division, to Taxpayer dated July 12, 2005, a copy of which is designated as Exhibit PT-6.
7. Letter from Taxpayer to Carl G. Hayes dated September 19, 2005, a copy of which is designated as Exhibit PT-7.
8. Letter from Jeffrey C. Davenport, Administrative Officer in the Personal Taxes Division, to Taxpayer dated September 1, 2006, a copy of which is designated as Exhibit PT-8.
9. Letter from Eugene J. Cella to Taxpayer dated September 7, 2006, a copy of which is designated as Exhibit PT-9.

At the hearing, the Assistant Secretary accepted the following evidence from Taxpayer:

1. Legal Notice of Denial of Domicile and Non-Tax Liability, a copy of which is designated as Exhibit TP-1.
2. Letter dated October 3, 2006 from the Correspondence Unit, North Carolina Secretary of State's Office, to Taxpayer acknowledging receipt of Legal Notice of Change in Domicile/Citizenship Records and Divorce from the "United States," a copy of which is designated as Exhibit TP-2.

FINDINGS OF FACT

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

1. Taxpayer is and at all times was a natural person, sui juris, and citizen and resident of North Carolina.
2. Taxpayer did not file individual income tax returns for taxable years 2002 and 2003.
3. The Department of Revenue obtained information from the Statement of Financial Affairs filed with Taxpayer's Chapter 13 bankruptcy petition reflecting income for 2003 of \$24,000.00. Taxpayer's income for 2002 was estimated to be \$24,000 based on this information.
4. The Department calculated Taxpayer's federal taxable income for tax years 2002 and 2003 to be \$17,075.00 and \$16,200.00, respectively, by allowing a standard deduction of \$3,925.00 for a married filing separate individual and the personal exemption of \$3,000.00 for 2002 and a standard deduction of \$4,750.00 for a married filing separate individual and the personal exemption of \$3,050.00 for 2003.
5. The Department calculated Taxpayer's North Carolina taxable income for each year by increasing Taxpayer's federal taxable income for the differences between the State and federal standard deduction and personal exemption allowances. North Carolina taxable income was determined to be \$19,000.00 for taxable year 2002 and \$18,750.00 for taxable year 2003.
6. Notices of Individual Income Tax Assessment proposing assessments of additional income tax, a twenty-five percent failure to file penalty, a ten-percent failure to pay penalty, and accrued interest for tax years 2002 and 2003 were mailed to Taxpayer on April 26, 2005.
7. Taxpayer objected to the proposed assessments and timely requested a hearing before the Secretary of Revenue.
8. Taxpayer contends that (1) he does not have income; (2) North Carolina has no jurisdiction over him; (3) he is not a citizen of the United States; (4) the Internal Revenue Service and the North Carolina Department of Revenue have no authority to determine his tax liability; and (5) income tax is voluntary.
9. Some of Taxpayer's contentions are based on constitutional issues.

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 every resident of 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 compensation for services rendered and gross income derived from business. Wages, salaries, commissions paid salesmen, compensation for services on the basis of the percentage of profits, tips, and bonuses are all includable in gross income.
5. Internal Revenue Code Section 63 allows a taxpayer who does not claim itemized deductions to claim a standard deduction. The basic standard deduction for each filing status is set out in subdivision (c)(2). The standard deduction for a married individual filing separately for tax years 2002 and 2003 is \$3,925.00 and \$4,750.00, respectively.
6. Internal Revenue Code section 151 allows taxpayers to claim an exemption for himself and for each qualified dependent. The personal exemption for tax year 2002 and 2003 is \$3,000.00 and \$3,050.00, respectively.
7. A resident of this State is required under G.S. 105-152 to file a North Carolina individual income tax return if the individual is required to file a federal income tax return. The North Carolina return must show the taxable income and adjustments to federal taxable income required by statute.
8. If the 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.
9. 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).

10. A penalty is imposed for failure to pay tax when due. The penalty is equal to ten percent of the tax (minimum \$5.00).
11. The term “income” is not defined in the Internal Revenue Code, nor is it defined in the North Carolina Revenue Laws. Blacks Law Dictionary defines income as the money or other form of payment one receives from employment, business, investments, and the like. Both federal and State law impose the individual income tax on the “taxable income” of every individual. The State’s definition of taxable income refers to the definition of taxable income in Code section 63. Taxable income for federal purposes means gross income less allowable deductions. Gross income is defined by Code section 61 as, except as otherwise provided, all income from whatever source derived, including compensation for services.
12. Taxpayer contends that income may be defined as the gain from capital. He states it can be unearned income, profit or gain, but it is not a tax on the wages and salaries of the ordinary citizen living and working in the several states. Taxpayer contends that income may be defined as the gain from capital, from labor, or from the both combined. Taxpayer cites *Eisner v. Macomber*, 252 U.S. 189 (1920), in support of his position. In *Eisner*, the court held that stock dividends are not income and hence are not taxable as such. The basis for the court’s decision is that the shareholder received nothing as a result of the stock dividend for his separate use and benefits; on the contrary, every dollar of his investment remained the property of the company. The court defined income as “the gain derived from capital, from labor, or from the both combined...” In *Commissioner of Internal Revenue v. Glenshaw Glass Co.*, 348 U.S. 426; 99 L.Ed. 483 (1955), the court concluded that *Eisner* was not meant to provide a touchstone to all future gross income questions. A taxpayer is taxable on “instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.” The statutory definition of gross income is “all-inclusive.” In *Merchant’s Loan and Trust Co. v. Smietanka*, 255 U.S. 509, the court found that the word income must be given the same meaning in all of the income tax acts of Congress that was given to it in the Corporation Excise Tax Act of 1909. However, that does not infer that income be solely a derivative of corporate activity. In *Merchant’s*, the plaintiff was a trust established at the death of a grantor. The trust sold stock and received sales proceeds in excess of the basis of the stock. The court held that a trust was a taxable person; therefore it is clear that income is not limited to corporate activities. The court also held that the gain from the sale of the stock was income stating that income may be defined as gain from capital, from labor, or from the both combined, including profit gained through sale or conversion of capital assets. The courts have consistently held that wages and other forms of compensation for services rendered are income.
13. Taxpayer contends that he is not a citizen of the United States because he was born in a jurisdiction foreign to the United States. The courts have consistently rejected this argument. In the *United States v. Cruikshank*, 92 U.S. 542 (1876), the court held that “the people of the United States resident within any State are subject to two

governments: one State, and the other National...” In the *United States v. Collins*, 920 F.2d 619, 629 (10th Cir. 1990), the court stated,” the tax code imposes a ‘ direct nonapportioned [income] tax upon United States citizens throughout the nation, not just in federal enclaves, ‘ such as postal offices and Indian reservations.”

14. The Secretary of Revenue’s duties include administering the laws enacted by the 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.
15. Taxpayer contends that the income tax is voluntary. Such is clearly not the case. While both the Internal Revenue Service and the Department of Revenue rely heavily on voluntary compliance by taxpayers, the filing of an income tax return and the payment of income tax are mandatory. Otherwise, the law would not impose penalties, both civil and criminal, for failure to do so. The law clearly imposes a State income tax on the Taxpayer and requires him to file a State income tax return.

DECISION

Based on the foregoing findings of fact and conclusions of law, the assessments proposed for tax years 2002 and 2003 are sustained in their entireties and are declared finally due and collectible, together with interest as allowed by law.

Made and entered this 25th day of January, 2007.

Signature _____

Eugene J. Cella
Assistant Secretary for Legal and Administrative Services
North Carolina Department of Revenue