

**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 1997, 1998, )  
1999, 2000, 2001, 2003, and 2004 by the )  
Secretary of Revenue of North Carolina )  
 )  
 )  
vs. )  
 )  
 )  
 )  
[Taxpayer 1], Taxpayer )

**FINAL DECISION**  
Docket No. 2006-3

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, upon an application for hearing by [Taxpayer 1], hereinafter referred to as "Taxpayer," wherein he objected to the proposed assessments of additional income tax for the taxable years 1997, 1998, 1999, 2000, 2001, 2003, and 2004. At Taxpayer's request, the hearing was conducted via written communication and the Assistant Secretary allowed Taxpayer until March 15, 2006, to provide any arguments, documents, or other evidence in support of his 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, assessments proposing additional income tax, penalties, and interest for tax years 1997, 1998, 1999, 2000, 2001, and 2003 were mailed to Taxpayer on October 4, 2005. The assessment for tax year 2004 was mailed on October 11, 2005. Taxpayer filed a timely objection to the proposed assessments and requested an administrative tax 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 the taxable years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, lawful and proper?

### **EVIDENCE**

The evidence presented by 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 the taxable year 1997 dated October 4, 2005, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for the taxable year 1998 dated October 4, 2005, a copy of which is designated as Exhibit PT-3.
4. Notice of Individual Income Tax Assessment for the taxable year 1999 dated October 4, 2005, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for the taxable year 2000 dated October 4, 2005, a copy of which is designated as Exhibit PT-5.
6. Notice of Individual Income Tax Assessment for the taxable year 2001 dated October 4, 2005, a copy of which is designated as Exhibit PT-6.
7. Notice of Individual Income Tax Assessment for the taxable year 2003 dated October 4, 2005, a copy of which is designated as Exhibit PT-7.
8. Notice of Individual Income Tax Assessment for the taxable year 2004 dated October 11, 2005, a copy of which is designated as Exhibit PT-8.
9. Letter from Carla R. Helms, Administrative Officer in the Personal Taxes Division, to Taxpayer's Employer, dated September 6, 2005, a copy of which is designated as Exhibit PT-9.
10. Taxpayer's 1997, 1998, 1999, 2000, 2001, 2003, and 2004 wage and tax information obtained from Taxpayer's Employer, a copy of which is designated as Exhibit PT-10.
11. Letter from Taxpayer to Department of Revenue dated October 27, 2005, a copy of which is designated as Exhibit PT-11.
12. Letter from Carla R. Helms to Taxpayer dated December 9, 2005, a copy of which is designated as Exhibit PT-12.

13. Letter from Taxpayer to Carla R. Helms dated January 2, 2006, a copy of which is designated as Exhibit PT-13.
14. Letter from Eugene J. Cella to Taxpayer dated January 9, 2006, a copy of which is designated as Exhibit PT-14.
15. Letter from Taxpayer to Eugene J. Cella not dated, a copy of which is designated as Exhibit PT-15.
16. Letter from Eugene J. Cella to Taxpayer dated January 20, 2006, a copy of which is designated as Exhibit PT-16.

Taxpayer submitted his response to the Department's position in his letter to Eugene J. Cella dated March 11, 2006, a copy of which is designated as TP-1.

### **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 the tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004.
3. Wage and tax information obtained from Taxpayer's Employer shows that Taxpayer had wages of at least \$59,322.00, \$41,269.00, \$37,116.00, \$75,232.00, \$70,741.00, \$63,025.00, and \$60,523.00, for the tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, respectively.
4. Upon examination, the Department calculated Taxpayer's federal taxable income to be \$52,522.00, \$34,319.00, \$30,066.00, \$68,757.00, \$63,291.00, \$55,225.00, and \$52,573.00, for the tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, respectively.
5. Taxpayer's North Carolina taxable income was determined to be \$53,822.00, \$35,769.00, \$31,616.00, \$70,732.00, \$65,741.00, \$58,025.00, and \$55,523.00, for tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, respectively, by increasing Taxpayer's federal taxable income for the difference between the amounts allowed for the federal standard deduction and personal exemption and the State standard deduction and personal exemption.
6. Notices of Individual Income Tax Assessment proposing additional income tax, a twenty-five percent failure to file penalty, a ten percent failure to pay penalty, a twenty-five percent negligence penalty, and accrued interest for tax years 1997, 1998, 1999, 2000, 2001, and 2003 were mailed to Taxpayer on October 4, 2005. A Notice of Individual Income Tax Assessment proposing additional income tax,

a twenty-five percent failure to file penalty, a ten percent failure to pay penalty, a twenty-five percent negligence penalty, and accrued interest for tax year 2004 was mailed to Taxpayer on October 11, 2005. The proposed assessments for tax years 1998, 1999, 2000, 2001, 2003, and 2004 also include the interest due for the underpayment of estimated income tax.

7. Taxpayer objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.
8. Subsequent to the mailing of the proposed assessments, the Department determined that the fifty percent penalty provided under G.S. 105-163.5(f) for furnishing an employer with an improper exemption certificate was, in error, not included in the proposed assessments.
9. Taxpayer has offered no defense directly addressing the calculation of the proposed assessments. Taxpayer contends that he is not required to file a North Carolina income tax return because he was not required to file a federal income tax return.
10. Taxpayer contends that he has never been engaged in a revenue taxable activity.
11. Taxpayer contends that the Department has never established that he is a “taxpayer.”
12. Taxpayer contends that he is not an “employee” as the Internal Revenue Code defines the word.
13. Taxpayer contends that he does not have income because the Internal Revenue Code does not define “income.”
14. Taxpayer contends that the 16<sup>th</sup> Amendment was never ratified and that the US Supreme Court has stated the amendment didn’t change anything nor did it create any new class of taxation.

### **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. Additions to federal taxable income are required for the amount by which the taxpayer's standard deduction has been increased for inflation under the Code and the amount by which each of the taxpayer's personal exemptions has been increased for inflation under the Code. The increase in the personal exemption for inflation is reduced by \$500.00 if the taxpayer's federal adjusted gross income is below the applicable threshold for the taxpayer's filing status. Additions of \$1,300.00, \$1,450.00, \$1,550.00, \$1,975.00, \$2,450.00, \$2,800.00, and \$2,950.00 were properly made for the tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, respectively.
4. 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). Because Taxpayer did not file his income tax returns when due, a failure to file penalty was properly assessed for each tax year at issue.
5. A penalty is imposed for failure to pay tax when due. The penalty is equal to ten percent of the tax (minimum \$5.00). Because Taxpayer did not pay the tax when due, a failure to pay penalty was properly assessed for each tax year at issue.
6. 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 Taxpayer understated taxable income by twenty-five percent or more of gross income for each tax year at issue, the negligence penalty was properly imposed.
7. An individual is required to pay estimated income tax if the tax shown due on the income tax return for the taxable year, reduced by North Carolina tax withheld and allowable tax credits, is \$1,000.00 or more. Interest is due for any underpayment of estimated income tax. Additional interest for the underpayment of estimated income tax was properly imposed for tax years 1998, 1999, 2000, 2001, 2003, and 2004.
8. 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 of the amount not properly withheld. Because Taxpayer has furnished his employer with improper exemption certificates, penalties of \$1,053.50, \$1,188.00, \$1,043.00, \$2,490.50, \$2,258.50, \$1,967.00, and \$1,879.50 are imposed for tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, respectively.

9. A “taxpayer” is an individual subject to the North Carolina individual income tax. An individual is a human being. Taxpayer is obviously a human being and based on the amount of wages earned during the years at issue, he is subject to the North Carolina individual income tax.
10. An individual is required to file a federal income tax return if his gross income for the year equals or exceeds the allowable exemption amount. A resident of this State is required 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. An income tax return must be filed as prescribed by the Secretary and in the form prescribed by the Secretary. Based on the amount of wages Taxpayer earned during the years at issue, he was required to file a federal income tax return as well as a North Carolina income tax return.
11. 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.
12. 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.
13. In *A. Ficalora*, CA-2, 85-1 USTC ¶ 9103, the Court held that Congress had the constitutional authority to impose an income tax on individuals. The court cited the United States Supreme Court’s decision in *Pollock* (157 U.S. 429), which explicitly stated that taxes on income from employment were not direct taxes and were not subject to the necessity of apportionment. In *United States v. Collins*, 920 F.2d 619, 629 (10<sup>th</sup> Cir. 1990), the court cited to *Brushaber v. Union Pacific R.R.*, 240 U.S. 1, 12-19 (1916), and noted that the U. S. Supreme Court has recognized that the “sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation.” Furthermore, the Sixteenth Amendment granted Congress the power to lay and collect taxes on incomes, from whatever source derived, without apportionment. In *United States v. Gerads*, 999 F.2d 1255 (8<sup>th</sup> Cir. 1993), the Court stated “we have rejected on numerous occasions, the tax-protester argument that the federal income tax is an unconstitutional direct tax that must be apportioned.” In *Connor v. Commissioner*, 770F.2d17, 20(2<sup>nd</sup> Cir.1985), the court held that “.... the taxpayer

argues that because wages are property, a tax on them is a property tax, and because the tax the Commissioner is attempting to collect is not apportioned, it is unconstitutional. However, as we and innumerable other courts have repeatedly explained, wages are income, and income taxes do not need to be apportioned.”

14. Internal Revenue Code section 3401(c) establishes the general rule that “wages” include all remuneration for services performed by an employee for his employer and that the employer has a responsibility to withhold tax from “wages.” Section 3401(c) further states that the term “employee” includes an officer, employee or elected official of the United States...” This language does not address how other employees’ wages are subject to withholding or taxation. Section 7701(c) states that the use of the word “includes” “shall not be deemed to exclude other things otherwise within the meaning of the term defined.” Thus, the word “includes” as used in the definition of “employee” is a term of enlargement, not of limitation. It clearly makes federal employees and officials a part of the definition of “employee”, which generally includes private citizens.
15. 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 constitutionality of a statute is for the judicial branch.

**DECISION**

Taxpayer's contentions are shopworn arguments characteristic of tax-protestor rhetoric that has been uniformly rejected by the courts. Therefore, based on the foregoing evidence of record, findings of fact, and conclusions of law, the proposed assessments for tax years 1997, 1998, 1999, 2000, 2001, 2003, and 2004, modified to include penalties for tax not properly withheld, are hereby sustained in their entirety and are determined to be finally due and collectible, together with interest as allowed by law.

Made and entered this 16th day of May, 2006

Signature\_\_\_\_\_

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue