

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 Years 2003 and)
2004 by the Secretary of Revenue of North)
Carolina)

FINAL DECISION

Docket No. 2007-181

vs.)

[Taxpayers])

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on October 31, 2007, upon an application for hearing by [Taxpayers], hereinafter referred to collectively as "Taxpayers" and separately as "Husband" and "Wife," respectively, wherein they objected to the proposed assessments of additional individual income tax for the taxable years 2003 and 2004. The hearing was held by the Assistant Secretary under the provisions of G. S. 105-260.1 and was attended by Taxpayers; Samuel L. McEwen, Assistant Director of the Personal Taxes Division; and Jeffrey C. Davenport, Administrative Officer in the Personal Taxes Division.

Pursuant to G.S. 105-241.1, assessments proposing additional income tax, penalties, and interest for tax years 2003 and 2004 were mailed to the Taxpayers on March 27, 2007. Taxpayers objected to the proposed assessments and timely requested an administrative tax hearing.

ISSUES

The issues to be decided in this matter are as follows:

1. Are Taxpayers entitled to the itemized deductions and Schedule C business expenses claimed on their 2003 and 2004 individual income tax returns?
2. Are the assessments for additional income tax proposed against Taxpayers for taxable years 2003 and 2004 lawful and proper?

EVIDENCE

The evidence presented by the Personal Taxes Division, consisted of the following:

1. Taxpayers' North Carolina individual income tax return for the tax year 2003, a copy of which is designated as Exhibit PT-1.
2. Taxpayers' North Carolina individual income tax return for the tax year 2004, a copy of which is designated as Exhibit PT-2.
3. Taxpayers' federal individual income tax return for the tax year 2003, a copy of which is designated as Exhibit PT-3.
4. Taxpayers' federal individual income tax return for the tax year 2004, a copy of which is designated as Exhibit PT-4.
5. Notice of Individual Income Tax Assessment for the tax year 2003 dated March 27, 2007, a copy of which is designated as Exhibit PT-5.
6. Notice of Individual Income Tax Assessment for the tax year 2004 dated March 27, 2007, a copy of which is designated as Exhibit PT-6.
7. Letter from Georgia Pope, Revenue Tax Auditor, to Taxpayers dated August 11, 2006, a copy of which is designated as Exhibit PT-7.
8. Letter from Georgia Pope to Taxpayers dated February 15, 2007, a copy of which is designated as Exhibit PT-8.
9. Letter from Taxpayers to the Department of Revenue dated April 24, 2007, a copy of which is designated as Exhibit PT-9.
10. Letter from Taxpayers to the Department of Revenue dated July 23, 2007, a copy of which is designated as Exhibit PT-10.
11. Letter from Taxpayers to Reginald S. Hinton, Secretary of Revenue, dated August 9, 2007, a copy of which is designated as Exhibit PT-11.
12. Letter from Eugene J. Cella to Taxpayers dated August 10, 2007, a copy of which is designated as Exhibit PT-12.
13. Letter from Nancy R. Pomeranz, Director of the Personal Taxes Division, to Taxpayers dated August 20, 2007, a copy of which is designated as Exhibit PT-13.

14. Letter from Reginald S. Hinton to Taxpayers dated September 5, 2007, a copy of which is designated as Exhibit PT-14.
15. Letter from Taxpayers to Nancy R. Pomeranz dated September 6, 2007, a copy of which is designated as Exhibit PT-15.
16. Letter from Jeffrey C. Davenport to Husband dated September 19, 2007, a copy of which is designated as Exhibit PT-16.
17. Letter from Eugene J. Cella to Taxpayers dated October 9, 2007, a copy of which is designated as Exhibit PT-17.
18. Department of Revenue document detail printout for taxable year 2003 dated October 26, 2007, a copy of which is designated as Exhibit PT-18.
19. Department of Revenue document detail printout for taxable year 2004 dated October 26, 2007, a copy of which is designated as Exhibit PT-19.

At the hearing, Husband submitted into evidence a document entitled NC Audit Timeline, which is designated as Exhibit TP-1.

Husband also submitted two compact discs of recorded telephone conversations with Jeffrey C. Davenport, which were designated as TP-2 and TP-3.

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 times were natural persons, sui juris, and citizens and residents of North Carolina.
2. Taxpayers filed their North Carolina individual income tax returns for the tax years 2003 and 2004, on June 29, 2004 and October 16, 2005, respectively.
3. Taxpayers claimed itemized deductions of \$13,872.00 and \$15,954.00 on their 2003 and 2004 federal income tax returns, respectively. These deductions were also claimed for purposes of North Carolina taxable income.
4. Taxpayers furnished documentation that substantiated itemized deductions of \$5,488.00 and \$6,946.00 on the 2003 and 2004 individual income tax returns, respectively.

5. The standard deduction of \$9,500.00 and \$9,700.00 for married filing jointly was allowed for tax years 2003 and 2004 because the standard deduction amounts exceeded the itemized deductions that were substantiated.
6. Taxpayers filed federal Schedules C for actor/writer, investments, and sales photo memorie claiming losses of \$20,110.00 and \$21,326.00 for tax years 2003 and 2004, respectively.
7. Taxpayers could not substantiate the Schedule C expenses.
8. Husband presented voluminous canceled checks, bank statements and receipts to the Department. Husband was unable to distinguish which records related to his Schedule C or to Wife's Schedule C expenses or if the expenses were business related.
9. Taxpayers did not establish that they were engaged in the activities listed on Schedules C for profit.
10. Taxpayers have not generated a profit from the Schedule C activities in the past five years.
11. Husband is retired and receives pension and social security benefits. Wife is employed. Taxpayers are not dependent on their Schedule C activities for their livelihood.
12. Taxpayers provided no evidence to support precisely how much time and effort were directed toward the Schedule C activities, nor did they maintain records showing business expenditures, the time and place of travel, or the business purpose.
13. Notices of Individual Income Tax Assessment reflecting the additional, tax, penalties, and interest were mailed to Taxpayers on March 27, 2007. Taxpayers objected to the proposed assessments and timely requested an administrative tax hearing.
14. With respect to the Schedule C losses, taxpayers contend that they are engaged in the activities for profit.
15. Taxpayers contend that the 2003 assessment was proposed after the statutory limits for making assessments had expired.
16. Taxpayers contend that the Department did not schedule a hearing in a timely manner.
17. The Department does not dispute the fact that in this case it did not meet the statutory timetable for scheduling the Taxpayers' hearing. However there was no

intent on the part of the Department to deny due process. At the time of the request, the Taxpayer was in the process of providing additional information in order to resolve the issues.

CONCLUSIONS OF LAW

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

1. Taxpayers have the burden to establish the facts which would entitle them to the deductions.
2. Taxpayers were properly allowed the standard deduction for 2003 and 2004 because Taxpayers failed to substantiate itemized deductions greater than the standard deduction.
3. A taxpayer is allowed to deduct the ordinary and necessary expenses paid during the income year in carrying on a trade or business or for the production or collection of income. A taxpayer must be able to prove that the expenses were in fact paid or incurred and were in fact business expenses or for the production of income.
4. For travel expenses, including meals and lodging, a taxpayer must substantiate each expenditure by adequate records or by sufficient corroborating evidence. A taxpayer must maintain timely records showing the amount of each expenditure, the time and place of travel, and the business purpose.
5. Taxpayers failed to establish the Schedule C activities had a profit motive.
6. An individual may not deduct losses arising from activities not entered into for a profit.
7. The Department gave Taxpayer multiple opportunities to present evidence to document the claimed itemized deductions and Schedule C expenses.
8. Taxpayers are not entitled to the Schedule C Losses.
9. Under G.S. 105-241.1(e), an assessment of tax or additional tax due may be made within three years after the date a return is filed or within three years from the date required by law for filing the return, whichever is later. Because the proposed notice of assessment was mailed to taxpayers on March 27, 2007, which was within three years of the return due date of April 15, 2004, the assessment was timely made.
10. The Secretary of Revenue is authorized to reduce or waive 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 2003 and 2004 to the extent hereinafter modified, to be lawful and proper and are hereby affirmed.

The Assistant Secretary finds reasonable cause to waive the penalties assessed. Therefore, the proposed assessments for tax years 2003 and 2004, modified to exclude the late filing and negligence penalties, 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 5th day of December, 2007.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department Of Revenue

