

**STATE OF NORTH CAROLINA**  
**COUNTY OF WAKE**

**BEFORE THE**  
**SECRETARY OF REVENUE**

**IN THE MATTER OF:**

The Proposed Assessments of Penalties for )  
the Taxable Years 2001 through 2004 by )  
the Secretary of Revenue of North Carolina )  
 )  
vs. )  
 )  
Taxpayer )

**FINAL DECISION**  
Docket No. 2007-88

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, upon an application for hearing by Taxpayer wherein they objected to the proposed assessments of penalties for the taxable years 2001, 2002, 2003, and 2004. Taxpayers are hereinafter referred to collectively as "Taxpayers" and Taxpayer separately as "Husband." At Husband's request, the hearing was conducted via written communication and the Assistant Secretary allowed Taxpayers until August 27, 2007, to provide arguments, documents, or other evidence in support of their objections to the assessments. The hearing was conducted by the Assistant Secretary of Revenue under the provisions of G.S. 105-260.1.

**ISSUE**

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

Are the penalties proposed against Taxpayers for the taxable years 2001 through 2004 lawful and proper?

**EVIDENCE**

The evidence submitted by the Personal Taxes Division and by Taxpayers consisted of the following:

1. Taxpayers' original 2001 North Carolina individual income tax return, with attachments, copies of which are collectively designated as Exhibit PT-1.

2. Taxpayers' corrected 2001 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-2.
3. Taxpayers' amended 2001 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-3.
4. Taxpayers' original 2002 North Carolina individual income tax return, with attachments, copies of which are collectively designated as Exhibit PT-4.
5. Taxpayers' corrected 2002 North Carolina individual income tax return, a copy of which is designated at Exhibit PT-5.
6. Taxpayers' amended 2002 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-6.
7. Taxpayers' original 2003 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-7.
8. Taxpayers' amended 2003 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-8.
9. Taxpayers' original 2004 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-9.
10. Taxpayers' amended 2004 North Carolina individual income tax return, a copy of which is designated as Exhibit PT-10.
11. Notice of Individual Income Tax Assessment for taxable year 2001, a copy of which is designated as Exhibit PT-11.
12. Notice of Amended Individual Income Tax Assessment for taxable year 2001, a copy of which is designated as Exhibit PT-12.
13. Notice of Individual Income Tax Assessment for taxable year 2002, a copy of which is designated as Exhibit PT-13.
14. Notice of Amended Individual Income Tax Assessment for taxable year 2002, a copy of which is designated as Exhibit PT-14.
15. Notice of Individual Income Tax Assessment for taxable year 2003, a copy of which is designated as Exhibit PT-15.
16. Notice of Amended Individual Income Tax Assessment for taxable year 2003, a copy of which is designated as Exhibit PT-16.

17. Notice of Individual Income Tax Assessment for taxable year 2004, a copy of which is designated as Exhibit PT-17.
18. Notice of Amended Individual Income Tax Assessment for taxable year 2004, a copy of which is designated as Exhibit PT-18.
19. Letter dated November 14, 2001, from Husband to (Husband's employer), with attachments, copies of which are collectively designated as Exhibit PT-19.
20. Assignment of Rights to Payment document dated November 26, 2002, from Husband to (Husband's employer), a copy of which is designated as Exhibit PT-20.
21. Contract between (Husband's employer) and (Husband's Corporation Sole) signed by Husband on November 26, 2002, a copy of which is designated as Exhibit PT-21.
22. Letter dated March 16, 2003, from (CPA) to Husband, a copy of which is designated as Exhibit PT-22.
23. Letter dated August 27, 2003, from Husband to North Carolina Department of Revenue, a copy of which is designated as Exhibit PT-23.
24. Letter dated September 9, 2003, from Husband to North Carolina Department of Revenue, a copy of which is designated as Exhibit PT-24.
25. Letter dated September 19, 2003, with attachments, from Husband to North Carolina Department of Revenue, copies of which are collectively designated as Exhibit PT-25.
26. Letter dated October 2, 2003, from Director of Criminal Investigations Division of the North Carolina Department of Revenue, to Husband, a copy of which is designated as Exhibit PT-26.
27. Letter dated October 16, 2003, from Husband to Director of Criminal Investigation Division, a copy of which is designated as Exhibit PT-27.
28. Form NC-4 signed by Husband on September 5, 2003, a copy of which is designated as Exhibit PT-28.
29. Form NC-4 signed by Husband on June 7, 2004, a copy of which is designated as Exhibit PT-29.
30. Withholding Exemption Certificate signed by Husband on June 7, 2004, a copy of which is designated as Exhibit PT-30.
31. Letter dated March 10, 2004, from Husband to (CPA), a copy of which is designated as Exhibit PT-31.

32. Affidavit of Corporate Formation and Operation signed by Husband on March 10, 2004, a copy of which is designated as Exhibit PT-32.
33. Letter dated March 14, 2004, from (CPA) to Husband, a copy of which is designated as Exhibit PT-33.
34. Letter dated July 21, 2004, with attachments, from Husband to North Carolina Attorney General, copies of which are collectively designated as Exhibit PT-34.
35. Letter dated September 16, 2004, with attachments, from Husband to E. K. Maxie, Tax Auditor, copies of which are collectively designated as Exhibit PT-35.
36. Document dated October 19, 2004, with attachments, from Husband to North Carolina Department of Revenue, copies of which are collectively designated as Exhibit PT-36.
37. Document dated October 19, 2004, from Husband to State of North Carolina and a County of North Carolina, a copy of which is designated as Exhibit PT-37.
38. Letter dated March 31, 2005, from Bryan Setzer, Special Agent, North Carolina Department of Revenue, to Husband, a copy of which is designated as Exhibit PT-38.
39. Letter dated April 7, 2005, from Husband to Bryan Setzer, a copy of which is designated as Exhibit PT-39.
40. Indictment issued by Wake County dated January 23, 2006, a copy of which is designated as Exhibit PT-40.
41. Order for Arrest issued by Wake County dated January 31, 2006, a copy of which is designated as Exhibit PT-41.
42. Bill of Information adding two charges of Failure to File returns, signed by Husband on August 17, 2006, a copy of which is designated as Exhibit PT-42.
43. Transcript of Plea dated August 17, 2006, a copy of which is designated as Exhibit PT-43.
44. Letter dated January 9, 2007, from (Husband's CPA) to Field Auditor, a copy of which is designated as Exhibit PT-44.
45. Letter dated March 27, 2007, from (Husband's CPA) to Field Auditor, a copy of which is designated as Exhibit PT-45.
46. Letter dated May 18, 2007, from Husband to Eugene J. Cella, a copy of which is designated as Exhibit PT-46.

47. Letter dated June 26, 2007, from Eugene J. Cella to Taxpayers, a copy of which is designated as Exhibit PT-47.
48. Letter dated July 25, 2007, from Eugene J. Cella to Husband, a copy of which is designated as Exhibit PT-48.
49. Letter and petition dated August 23, 2007, from Husband to Eugene J. Cella, copies of which are collectively designated as Exhibit TP-1.

### **FINDINGS OF FACT**

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

1. Prior to tax year 2001, Taxpayers timely filed self-prepared North Carolina individual income tax returns and paid the tax shown due thereon.
2. During November 2001, Husband directed his employer to cease withholding tax from his wages.
3. During September 2002, Husband established a corporation sole in another state.
4. Effective November 26, 2002, Husband directed his employer to cease issuing paychecks in his name and to remit all payment for services rendered by Husband to the corporation sole.
5. Taxpayers filed their tax year 2001 North Carolina individual income tax return during January 2003.
6. Husband's 2001 wage and tax statement reflects wages of \$291,059.50.
7. Taxpayers' 2001 North Carolina individual income tax return reflects federal adjusted gross income of \$413,742.00, federal taxable income of zero, North Carolina taxable income of zero, and North Carolina income tax withheld of \$13,913.00. Taxpayers requested a refund of \$13,913.00.
8. Taxpayers filed their 2002 North Carolina individual income tax return reflecting federal adjusted gross income of \$393,574.00, federal taxable income of zero, North Carolina taxable income of zero, North Carolina income tax withheld of zero, and North Carolina tax due of zero.
9. Taxpayers included frivolous statements with their 2001 and 2002 North Carolina individual income tax returns stating that they did not have any items of gross income from any taxable sources.

10. Taxpayers included with their tax year 2001 and 2002 North Carolina individual income tax returns a letter informing the Department that the return should not be construed as frivolous and that the amount of tax due is zero since they did not have any federal adjusted gross income.
11. Taxpayers did not timely file 2003 or 2004 North Carolina individual income tax returns.
12. CPA recommended on March 16, 2003 to Husband that he seriously reconsider the corporation sole and that, if examined, payments made to corporation sole would be re-characterized as payment of salary to Husband subject to all taxes.
13. Husband declared the use of corporation sole was reasonable as allowed by statute and was pursued in good faith.
14. In October 2003, the Director of the Department's Criminal Investigation Division advised Husband that courts of this country have considered and repeatedly rejected claims such as his. Husband was encouraged to seek advice from competent tax counsel or an attorney qualified to practice in North Carolina.
15. Husband claimed exempt status on multiple NC-4 forms.
16. Husband claimed exempt status on his Withholding Exemption Certificate.
17. In March 2004, CPA terminated his tax preparation relationship due to his disagreement with the position Husband had taken regarding the corporation sole.
18. Notices of Individual Income Tax Assessment proposing assessment of additional income tax, a twenty-five percent late filing penalty, a fifty percent fraud penalty, interest for underpayment of estimated income tax, and accrued interest for tax years 2001 and 2002 were mailed to Taxpayers on December 5, 2006.
19. Notices of Individual Income Tax Assessment proposing assessment of additional income tax, a twenty-five percent late filing penalty, a fifty percent fraud penalty, interest for underpayment of estimated income tax, and accrued interest for tax years 2003 and 2004 were mailed to Taxpayers on November 28, 2006.
20. The Department inadvertently failed to previously assert the mandatory penalty for filing a frivolous return.
21. Husband objected to the penalties and requested an administrative tax hearing.
22. Husband was indicted by a Wake County Grand Jury on seven counts of knowingly, willfully, and feloniously attempting to evade and defeat the North Carolina Individual Income Tax.

23. Husband entered an Alford plea in Wake County Superior Court to seven counts of violating G.S. 105-236(7) Attempt to Evade or Defeat Tax and two counts of violating G.S. 105-236(9) Willful Failure to File Return.
24. Husband attempts to discredit the proposed assessments through his interpretation of the Paperwork Reduction Act of 1995 and the links between federal and state requirements to file and pay taxes.
25. Husband states that he sought competent legal advice; however, all evidence of advice given to Husband takes a position contrary to the position maintained by Taxpayers.
26. Husband states his intent had more to do with charitable activities than any intent to evade payment of taxes. This is an indirect admission that his intent was to apply the money to other purposes rather than to apply it toward payment of taxes.

### **CONCLUSION OF LAW**

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

1. The Internal Revenue Code imposes an income tax on individuals and requires an individual to file a federal income tax return if his gross income for the year equals or exceeds the allowable exemption amount.
2. A resident of this State is required to file a North Carolina 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.
3. Based on the amount of gross income Husband received during tax years 2001, 2002, 2003, and 2004, Taxpayers were required to file a federal income tax return as well as a North Carolina income tax return.
4. If there is a deficiency or delinquency in payment of any tax because of fraud with intent to evade the tax, the Secretary shall assess a penalty equal to fifty percent of the total deficiency as a civil fraud penalty.
5. A taxpayer cannot avoid income tax or other financial responsibilities by purporting to be a religious leader and forming a corporation sole for tax avoidance purposes. Taxpayers' claims that such a corporation sole is described in section 501(c)(3), and that assignment of income and transfer of assets to such an entity will exempt an individual from income tax, are without merit. Courts repeatedly have rejected similar arguments as frivolous, imposed penalties for making such arguments, and upheld criminal tax evasion convictions against those making or promoting the use of such arguments.

6. The anticipatory assignment of income does not shift the incidence of taxation; the income remains taxable to the one who actually earned it.
7. North Carolina law defines “employee” as an individual, whether a resident or a nonresident of this State, who performs services in this State for wages or an individual who is a resident of this State and performs services outside this State for wages. As residents of North Carolina, all wages earned by Taxpayers are subject to North Carolina individual income tax.
8. In cases in which taxpayers fail to file any return on the date it is due, N.C. General Statute 105-236(3) authorizes the assessment of a penalty equal to five percent of the amount of the tax due for each full or partial month late, with a minimum of \$5.00 and a maximum of 25 percent.
9. N.C. General Statute 105-236(10a) imposes a nondiscretionary mandate that a penalty be assessed for filing a frivolous return. A frivolous return is one that fails to provide sufficient information to permit a determination that the return is correct or contains information which positively indicates the return is incorrect. It evidences an intention to delay, impede, or negate the revenue laws of this State or purports to adopt a position that is lacking in seriousness.
10. The returns and accompanying statements submitted by Taxpayers for tax years 2001 and 2002 are frivolous within the meaning of N.C. General Statute 105-236(10a).
11. The collateral consequences stemming from a guilty plea remain the same whether or not accompanied by an assertion of innocence. A taxpayer who is convicted of tax fraud is collaterally estopped from denying fraud in a subsequent civil proceeding with respect to the same taxes.
12. The imposition of the late-filing penalty and the frivolous return penalty in this case is lawful and proper.
13. The Department has carried its burden of proving fraud; therefore, the fraud penalty is lawful and proper.



**DECISION**

Based on the foregoing findings of fact and conclusions of law, the proposed assessments of penalties for tax years 2001 through 2004 are found to be lawful and proper, are sustained in their entirety, and are determined to be finally due and collectable, together with interest as allowed by law. The proposed assessments for tax years 2001 and 2002 are hereby modified to include the \$500.00 penalty for filing a frivolous North Carolina individual income tax return.

Made and entered this \_\_\_\_\_ 31st \_\_\_\_\_ day of \_\_\_\_\_ October \_\_\_\_\_, 2007.

Signature \_\_\_\_\_

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue