

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

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

**IN THE MATTER OF:**

The Proposed Assessment of Gift Tax for )  
the Taxable Year 2002 by the Secretary )  
of Revenue of North Carolina )  
vs. )  
Estate of [Taxpayer1], Taxpayer )

**FINAL DECISION**

Docket No. 2005-234

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on June 14, 2006, upon an application for hearing by the [Estate of Taxpayer 1], hereinafter referred to as "Estate," wherein it protested the proposed assessment of gift tax against [Taxpayer 1], hereinafter referred to as "Taxpayer," for the taxable year 2002. The hearing was held by the Assistant Secretary for Administrative Tax Hearings under the provisions of G.S. 105-260.1 and was attended by Taxpayer's lead attorney [Attorney 1], hereinafter referred to as "Attorney," and co-counsel [Attorney 2]; Michael J. Youth, Assistant Attorney General; Nancy R. Pomeranz, Director of the Personal Taxes Division; and C. Steven Cornwell, Administrative Officer in the Personal Taxes Division. At the conclusion of the hearing, Mr. Cella held the record open until July 17, 2006.

[Daughter1] is hereinafter referred to as "Daughter."

A Notice of Gift Tax Assessment for the 2002 tax year was mailed to Daughter, who is the Executrix of Estate, on January 27, 2006, proposing an assessment of gift tax and interest against Taxpayer. Estate objected to the proposed assessment and timely requested an administrative tax hearing before the Secretary of Revenue.

**ISSUES**

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

1. Did Taxpayer make taxable gifts by transferring to Daughter, in 2002, 99% interests in six parcels of real property, each of which was subject to a "reserved special power of appointment?"

2. If so, what is the taxable value of the gifts and at what rate should the gifts be taxed?

### **EVIDENCE**

The evidence presented by Nancy R. Pomeranz, included the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Eugene J. Cella dated May 16, 2001, a copy of which is designated as Exhibit PT-1.
2. Taxpayer's North Carolina Gift Tax Return for the taxable year 2002, a copy of which is designated as Exhibit PT-2.
3. Notice of Gift Tax Assessment for the taxable year 2002 dated February 2, 2005, a copy of which is designated as Exhibit PT-3.
4. Notice of Gift Tax Assessment for the taxable year 2002 dated June 1, 2005, a copy of which is designated as Exhibit PT-4.
5. Notice of Gift Tax Assessment for the taxable year 2002 dated January 27, 2006, a copy of which is designated as Exhibit PT-5
6. Taxpayer's United States Gift Tax Return for the taxable year 2002, a copy of which is designated as Exhibit PT-6.
7. Gift Deed made May 31, 2002 by Taxpayer, a copy of which is designated as Exhibit PT-7.
8. Gift Deed with Reserved Special Power of Appointment made August 14, 2002 by Taxpayer, a copy of which is designated as Exhibit PT-8.
9. Quitclaim Gift Deed made November 14, 2002 by Taxpayer, a copy of which is designated as Exhibit PT-9.
10. Quitclaim Gift Deed with Reserved Special Power of Appointment made November 26, 2002 by Taxpayer, a copy of which is designated as Exhibit PT-10.
11. Letter from Attorney to W. Edward Finch, Jr., former Assistant Director of the Personal Taxes Division, dated July 6, 2005, a copy of which is designated as Exhibit PT-11.
12. Letter from Attorney to C. Steven Cornwell dated October 11, 2005, a copy of which is designated as Exhibit PT-12.
13. Letter from Attorney to Nancy R. Pomeranz dated March 30, 2006, a copy of which is designated as Exhibit PT- 13.

14. AICPA (American Institute of Certified Public Accountants) Personal Financial Planning Resource titled "Residence Transfer Subject to Special Power of Appointment," copyright 2006, a copy of which is designated as PT -14.

Prior to the hearing, Attorney presented a Brief for Tax Hearing dated June 5, 2006, a copy of which is designated as Exhibit TP-1(a).

At the hearing, Attorney presented the following evidence:

1. Letter from Glenn B. Cox, Tax Auditor in the Examination Division, to Attorney dated April 8, 2005, a copy of which is designated as Exhibit TP-1(b).
2. Letter from Nancy R. Pomeranz, with attachment, to Attorney dated March 3, 2006, a copy of which is designated as Exhibit TP-2.
3. Letter from [Attorney 3], Attorney at Law, to Eugene J. Cella dated June 9, 2006, a copy of which is designated as TP-3.

Subsequent to the hearing, the following documents were entered into the record:

1. Letter from Michael J. Youth to Eugene J. Cella, along with Supplemental Brief for Tax Hearing and exhibit, dated June 29, 2006, copies of which are collectively designated as Exhibit PT-15.
2. Transcript of Proceedings held June 14, 2006 in Raleigh, North Carolina, a copy of which is designated as Exhibit PT-16.
3. Letter from Attorney to Eugene J. Cella dated July 14, 2006, along with Supplemental Brief for Tax Hearing and related attachments, copies of which are collectively designated as Exhibit TP-4.

### **FINDINGS OF FACT**

Based on the foregoing evidence of record, the Assistant Secretary for Administrative Tax Hearings makes the following findings of fact:

1. Taxpayer was at all relevant times a natural person, sui juris, and a citizen and resident of North Carolina.
2. In 2002, Taxpayer transferred to Daughter a 1% interest in six parcels of real property located in North Carolina ("the six parcels"). Specifically, on May 31, 2002, Taxpayer transferred a 1% interest in parcels 1 - 5. Additionally, on November 14, 2002, Taxpayer transferred a 1% interest in parcel 6. These transfers will hereinafter be referred to as "the 1% transfers."

3. In 2002, Taxpayer made thirteen distinct gifts of cash (“the cash gifts”) to Daughter totaling \$29,565.07.
4. In 2002, Taxpayer also transferred to his daughter a 99% interest in each of the six parcels. Specifically, on August 14, 2002, Taxpayer transferred a 99% interest in parcels 1 - 5. Additionally, on November 26, 2002, Taxpayer transferred a 99% interest in parcel 6. These transfers will hereinafter be referred to as “the 99% transfers.”
5. Daughter’s 99% interests resulting from the 99% transfers were subject to what is denominated in the transferring deeds as “reserved special powers of appointment.”
6. Under the “reserved special powers of appointment,” Taxpayer reserved the power to appoint, in whole or in part, the transferred 99% interests to or for the benefit of any one or more of the issue of Taxpayer’s parents (other than Taxpayer himself, his estate, or creditors of either himself or his estate) or any one or more I.R.C. Section 501(c) charitable organizations.
7. On April 15, 2003, Taxpayer timely filed a 2002 North Carolina gift tax return (“the return”).
8. In the return, Taxpayer reported total taxable gifts of \$106,423.07 made to Daughter. Taxpayer reported that the cash gifts had an aggregate taxable value of \$29,565.07, that the property gifted through the 1% transfers had an aggregate taxable value of \$2,608, and that one of the 99% interests transferred to Daughter had a taxable value of \$74,250.
9. In the return (and at hearing), Taxpayer contended that while the other five 99% transfers constituted gifts, they did not constitute “completed” gifts at the time of the transfers, and therefore were not taxable by the State until “completed” through exercise or release of the “reserved special powers of appointment.”
10. In the return, Taxpayer claimed an annual exclusion of \$11,000 for a number of the cash gifts made to Daughter.
11. In the return, Taxpayer also claimed a specific exemption of \$95,423.07 for the remainder of the cash gifts to Daughter, the aggregate taxable value of the 1% transfers, and for the transfer of the one 99% interest which Taxpayer contends constituted a “completed” gift.
12. The Department ultimately determined that, in the return, Taxpayer had properly reported the tax due on the cash gifts and the 1% transfers but had (1) improperly reported the tax due on the 99% transfers and (2) improperly applied the specific exemption.

13. Notices of Gift Tax Assessment for the 2002 tax year were mailed to Daughter as the Executrix of Estate on February 2, 2005, June 1, 2005, and January 27, 2006.
14. After the initial Notice of Gift Tax Assessment was sent out, and in response to Taxpayer's request, the Department informed Taxpayer that the "reserved special powers of appointment" and their gift tax ramifications were the information and evidence upon which the assessment was based.
15. The subsequent Notices of Gift Tax Assessment corrected errors in calculating the assessment.
16. The January 27, 2006 Notice of Gift Tax Assessment, the assessment at issue, was issued within the applicable statute of limitations.
17. The January 27, 2006 Notice of Gift Tax Assessment states that gift tax in the amount of \$21,819.20 plus interest is due.
18. In the January 27, 2006 Notice of Gift Tax Assessment, the Department set out that, in 2002, Taxpayer made total taxable gifts of \$290,365.07. Of the total taxable gifts, \$32,173.07 -- including the cash gifts and the 1% transfers -- was gifted to Daughter. According to the assessment, this amount was therefore taxable at the Class A donee tax rate and was eligible for application of the annual exclusion and the specific exemption. Of the total taxable gifts, \$258,192 -- including the 99% transfers -- was to be taxed as if it had been gifted to a Class B donee. According to the assessment, this amount was thus taxable at the Class B donee tax rate and was eligible for application of the annual exclusion but not for application of the specific exemption.
19. Having received the January 27, 2006 Notice of Gift Tax Assessment, Taxpayer timely requested a hearing before the Secretary.
20. Taxpayer had ample time within which to prepare for the hearing.
21. The hearing was held on June 14, 2006, at which both Taxpayer and the Department were allowed to present full argument on the issues, including live argument and two rounds of briefing.
22. It is uncontested that the 1% transfers constituted gifts made in calendar year 2002 to Daughter and were taxable by the State as such.
23. It is uncontested that the cash gifts constituted gifts made in calendar year 2002 to Daughter and were taxable by the State as such.
24. It is uncontested that the 99% transfers constituted transfers of property or interests therein.

25. It is uncontested that Taxpayer made the 99% transfers and received in return no consideration in money or money's worth.
26. As a result of the "reserved special powers of appointment," Daughter's 99% interests in the six parcels arising out of the 99% transfers were, at the time of the transfers, dependent upon a contingency or condition whereby they could have been wholly or in part defeated or abridged.
27. Taxpayer could have immediately exercised the "reserved special powers of appointment" in favor of a single Class B donee (i.e., a brother or sister or the descendant of a brother or sister). As a result, a single Class B donee could have taken a 99% fee simple interest in each of the six parcels.
28. The single Class B donee's potential fee simple interests in the six parcels were dependent upon a contingency or condition whereby they could have been wholly created.
29. Based on Taxpayer's accepted determination of the aggregate taxable value of the property gifted in the 1% transfers, the aggregate value of a 99% fee simple interest in the parcels gifted in the 99% transfers is \$258,192.

### **CONCLUSIONS OF LAW**

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

1. State law controls the disposition of this case.
2. State gift tax is imposed on the transfer by gift of real property located in North Carolina. The tax applies whether the gift is in trust or otherwise and whether the gift is direct or indirect.
3. G.S. 105-195 sets out that when property is transferred or otherwise limited, and the rights or interests of the transferees or beneficiaries are dependent upon contingencies or conditions whereby they may be wholly or in part created, defeated or abridged, a tax shall be imposed upon said transfer at the highest rate, within the discretion of the Secretary of Revenue, which on the happening of any of the said contingencies or conditions would be possible, and such tax so imposed shall be due and payable forthwith by the donor, and the Secretary of Revenue shall assess the tax on such transfers.
4. Because the 99% transfers involved (1) the transfer of property, and (2) rights or interests of a transferee and beneficiary which were dependent upon contingencies or conditions whereby they could have been wholly or in part created, defeated or abridged, the Department was obligated to assess the tax on the 99% transfers.

5. The gift tax rates are based on the relationship between the donor and the donee. Where the donee is the lineal issue of the donor by blood (i.e., a Class A donee), the gift tax rate is provided in G.S. 105-188(f)(1). Where the donee is the donor's brother or sister, or a descendant of the donor's brother or sister (i.e., a Class B donee), the gift tax rate is provided in G.S. 105-188(f)(2).
6. Because it was possible that Taxpayer could have immediately exercised the "reserved special powers of appointment" associated with the 99% transfers in favor of a single Class B donee, the Department was obligated to tax the 99% transfers at a Class B donee tax rate.
7. G.S. 105-189 sets out that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration, shall, for the purpose of the State gift tax, be deemed a gift and shall be included in computing the amount of gifts made during the calendar year.
8. Because Taxpayer made the 99% transfers and received in return no consideration in money or money's worth, and because the aggregate value of a 99% fee simple interest in the parcels gifted in the 99% transfers is \$258,192, the aggregate taxable value of the property gifted in the 99% transfers is \$258,192.
9. Gifts are subject to an annual exclusion of \$11,000 per donee as provided in G.S. 105-188(d).
10. Here, Taxpayer was allowed an annual exclusion in the amount of \$11,000 for the cash gifts and the 1% transfers to Daughter and an annual exclusion in the amount of \$11,000 for the 99% transfers taxable as if made to a single Class B donee.
11. As provided in G.S. 105-188(g), a donor is entitled to a total exemption of \$100,000 to be deducted from gifts made to Class A donees. No exemption is allowed to a donor for gifts made to Class B donees.
12. Here, Taxpayer is entitled to use this specific exemption as to the gifts made to Daughter. Taxpayer is not entitled to use this specific exemption for the 99% transfers taxable as if made to a single Class B donee.
13. The proposed assessment dated January 27, 2006 of gift tax and interest is lawful and proper and is sustained in its entirety.

Made and entered this 9th day of October 2006.

Signature \_\_\_\_\_  
Eugene J. Cella  
Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue