

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 2003 by the Secretary)
of Revenue of North Carolina)
vs.)
[Taxpayer 1], Taxpayer)

FINAL DECISION

Docket No. 2006-63

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on May 24, 2006, upon an application for hearing by [Taxpayer 1], hereinafter referred to as "Taxpayer," wherein Taxpayer protested the proposed assessment of gift tax for the taxable year 2003. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer's attorney, hereinafter referred to as "Attorney;" Gregory P. Roney, Assistant Attorney General; Nancy R. Pomeranz, Director of the Personal Taxes Division; and C. Steven Cornwell, Administrative Officer in the Personal Taxes Division. Assistant Secretary Cella held the record open until June 24, 2006.

[Taxpayer's Brother] is hereinafter referred to as "Brother." [Taxpayer's Certified Public Accountant], is hereafter referred to as "Accountant."

A Notice of Gift Tax Assessment for the 2003 tax year was mailed to Taxpayer on November 23, 2005, proposing an assessment of gift tax, penalties, and interest. Taxpayer 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. Whether Taxpayer transferred property in 2003 to Brother for less than adequate and full consideration.
2. Whether the fair market value of the property should be reduced by any mortgages.

3. Whether the assessment of gift tax, penalties, and interest proposed against Taxpayer for the taxable year 2003 is lawful and proper.

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. Notice of Gift Tax Assessment for the taxable year 2003 dated November 23, 2005, a copy of which is designated as Exhibit PT-2.
3. Auditor's Report - Gift Tax for the taxable year 2003 dated October 28, 2005, a copy of which is designated as Exhibit PT-3.
4. Letter from Accountant to the Department of Revenue dated December 30, 2005, a copy of which is designated as Exhibit PT-4.
5. Letter from Accountant to Glenn B. Cox, Tax Auditor in the Examination Division, dated January 20, 2006, a copy of which is designated as Exhibit PT-5.
6. Facsimile transmission from Accountant to C. Steven Cornwell dated January 27, 2006, a copy of which is designated as PT-6.
7. Letter from Eugene J. Cella to Accountant dated February 27, 2006, a copy of which is designated as Exhibit PT-7.
8. Warranty Deed made October 28, 2003, conveying the subject property by Taxpayer to Brother, a copy of which is designated as Exhibit PT-8.
9. Warranty Deed made November 17, 2005, conveying the subject property by Brother and his wife to Taxpayer, a copy of which is designated as Exhibit PT-9.
10. County real estate tax record for 2005, reflecting Brother as owner of the subject property, a copy of which is designated as Exhibit PT-10.
11. County real estate tax record for 2004, reflecting Brother as owner of the subject property, a copy of which is designated as Exhibit PT-11.
12. [Bank 1] Deed of Trust made August 1, 2001, reflecting Taxpayer as the borrower, a copy of which is designated as Exhibit PT-12.
13. [Bank 2] Deed of Trust made August 3, 2001, reflecting Taxpayer as the borrower, a copy of which is designated as Exhibit PT-13.

14. Internal Revenue Service file transcript from Taxpayer's 2003 Form 1040, a copy of which is designated as Exhibit PT-14.
15. Internal Revenue Service file transcript from Taxpayer's 2004 Form 1040, a copy of which is designated as Exhibit PT-15.
16. Letter from Attorney to Eugene J. Cella dated March 21, 2006, a copy of which is designated as Exhibit PT-16.
17. Letter with related attachment from Attorney to Nancy R. Pomeranz dated April 13, 2006, a copy of which is designated as Exhibit PT-17.
18. Letter from Eugene J. Cella to Attorney dated May 1, 2006, a copy of which is designated as Exhibit PT- 18.
19. Undated letter from Taxpayer to E. Norris Tolson, a copy of which is designated as Exhibit PT-19.

At the hearing, Attorney presented a Supplemental Brief for Tax Hearing, a copy of which is designated as Exhibit TP-1.

Subsequent to the hearing, the following evidence was entered into the record:

1. Letter to Eugene J. Cella from Gregory P. Roney dated June 16, 2006, a copy of which is designated as Exhibit PT-20.
2. Letter from Attorney to Eugene J. Cella dated June 23, 2006, with related attachments, copies of which are designated as Exhibit TP-2.

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 is and was at all times a natural person, sui juris, and a citizen and resident of North Carolina.
2. On October 28, 2003, Taxpayer executed a general warranty deed transferring real property (hereinafter referred to as "subject property") located in North Carolina to Brother.
3. The general warranty deed was recorded on December 3, 2003.
4. No excise stamp tax was paid on the transfer of the subject property.

5. Taxpayer transferred the subject property to Brother for no monetary consideration.
6. Taxpayer did not file a gift tax return for the 2003 tax year.
7. A Notice of Gift Tax Assessment for the 2003 tax year was mailed to Taxpayer on November 23, 2005, proposing an assessment of gift tax; a 25 percent late filing penalty; a 10 percent late payment penalty; and interest.
8. Taxpayer intended to transfer the subject property to Brother for no monetary consideration.
9. Taxpayer transferred the subject property free and clear of all encumbrances.
10. Taxpayer was obligated to repay the mortgages under the express terms of the deed.
11. Taxpayer transferred the subject property in contemplation of bankruptcy.
12. Taxpayer had full knowledge of the subject property's conveyance in 2003 and thereafter.
13. Taxpayer did not rescind the conveyance of the subject property.
14. The recording of the deed was not an error.
15. Taxpayer filed for bankruptcy on April 8, 2004.
16. The subject property is valued at \$356,434 for county ad valorem taxation.
17. Taxpayer included the subject property in his Voluntary Petition and valued it at \$356,000.
18. Based on the evidence in the record, the fair market value of the subject property was \$356,434 at the time of the transfer to Brother.
19. Taxpayer included two mortgage liabilities secured by the subject property in his Voluntary Petition: \$307,634 [Bank 1] and \$59,695 [Bank 2].
20. Taxpayer continued to pay the mortgages after he conveyed the subject property.
21. Taxpayer claimed itemized deductions for home mortgage interest from the mortgages in his federal Form 1040 for tax years 2003 and 2004.
22. Taxpayer claimed itemized deductions for the subject property's county real estate tax assessments in his federal Form 1040 for tax years 2003 and 2004.

23. The 2003 warranty deed was delivered to Brother upon its recordation.
24. Brother accepted the gift.
25. Brother did not assume the mortgage liabilities originated by Taxpayer and secured by the subject property.
26. Brother received the 2004 and 2005 County real estate tax bills.
27. Brother and his spouse executed a general warranty deed on November 17, 2005 transferring the subject property to Taxpayer.
28. The deed from Brother and his spouse transferred the subject property free and clear of all encumbrances.
29. Taxpayer contends that the deed to subject property was recorded in error and that he did not intend to make a gift to Brother.
30. The Department contends that Taxpayer deliberately transferred subject property to protect it from bankruptcy proceedings.

CONCLUSIONS OF LAW

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

1. North Carolina gift tax is imposed on the transfer by gift of real property located in North Carolina or personal property that has acquired a taxing situs in North Carolina. The gift tax applies whether the gift is in trust or otherwise and whether the gift is direct or indirect.
2. As provided in G.S. 105-195 if the gift is made in property, the fair market value of the property at the date of the gift is considered the amount of the gift.
3. Gifts, other than gifts of future interests, are subject to an annual exclusion of \$11,000.
4. The gift tax rates are based on the relationship between the donor and the donee. Where the donee is the brother of the donor by blood, the gift tax rate is provided in G.S. 105-188(f)(2).
5. Gift tax is due on April 15 of the calendar year following the calendar year in which the gift was made. The gift tax return is due on or before the date the tax is due.

6. A late filing penalty of five percent of the tax for each month, or fraction of a month, the return is late (minimum \$5.00, maximum 25 percent) is imposed if a gift tax return is not timely filed.
7. A late payment penalty is imposed for failure to pay tax when due. The penalty is equal to 10 percent of the tax (minimum \$5.00). Interest accrues on tax from the date the tax was due until the tax is paid.
8. Taxpayer transferred the subject property to Brother for less than adequate and full consideration.
9. A taxable gift occurred on October 28, 2003.
10. Taxpayer was obligated under the terms of the deed to pay any mortgages on the subject property.
11. The deed from Brother and his spouse does not rescind the first transfer from Taxpayer to Brother.
12. The fair market value of the subject property is not reduced by the mortgages when determining the taxable value of the gift.
13. The proposed assessment of gift tax, penalties, and interest is lawful and proper and is sustained in its entirety.

Wherefore, the assessment is sustained in its entirety and is declared to be final and immediately due and collectible.

Made and entered this 21st day of September 2006.

Signature _____

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