

STATE OF NORTH CAROLINA  
COUNTY OF WAKE

BEFORE THE  
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Individual )  
Income Tax and Interest for the Taxable )  
Year 2000 by the Secretary of Revenue )  
of North Carolina )  
vs. )  
[Taxpayers, Husband and Wife] )

**FINAL DECISION**  
Docket No. 2002-309

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, on June 25, 2002, upon an application for a hearing by [Taxpayers, Husband and Wife], wherein they protested the proposed assessment of individual income tax and interest for the taxable year 2000. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Nancy R. Pomeranz, Director of the Personal Taxes Division, and Alexandra M. Hightower, Assistant Attorney General. Neither Taxpayers nor anyone representing Taxpayers attended the hearing.

Upon examination, Taxpayers' 2000 individual income tax return was adjusted to disallow the deduction claimed for severance wages. A Notice of Individual Income Tax Assessment was mailed to Taxpayers on April 12, 2002. Husband objected to the proposed assessment and timely requested a hearing before the Secretary of Revenue. [Employer] is hereinafter referred to as "Employer." [Buyer] is hereinafter referred to as "Buyer."

**ISSUES**

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

1. Have Taxpayers proved entitlement to the deduction for severance wages for the tax year 2000?
2. Is the individual income tax assessment proposed against Taxpayers for the taxable year 2000 lawful and proper?

## EVIDENCE

The evidence presented by Nancy R. Pomeranz, Director of 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 2000 dated April 8, 2002, a copy of which is designated as Exhibit PT-2.
3. Notice of Individual Income Tax Assessment for the taxable year 2000 dated May 14, 2002, a copy of which is designated as Exhibit PT-3.
4. Taxpayers' North Carolina individual income tax return for the taxable year 1999, a copy of which is designated as Exhibit PT-4.
5. Taxpayers' North Carolina individual income tax return for the taxable year 2000, a copy of which is designated as Exhibit PT-5.
6. North Carolina Department of Revenue Directive Number PD-98-1 dated April 1, 1998, a copy of which is designated as Exhibit PT-6.
7. Cover letter, Incentive to Stay Agreement and Release, and Separation Agreement and Release from Employer to Gail H. Beamon, Administrative Officer in the Personal Taxes Division, dated March 15, 2001, copies of which are collectively designated as Exhibit PT-7.
8. Facsimile letter from Employer to Gail H. Beamon dated May 7, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from Nancy R. Pomeranz, Director of the Personal Taxes Division, to Employer dated May 18, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter from Employer to Nancy R. Pomeranz dated June 6, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter from Nancy R. Pomeranz to Employer dated June 26, 2001, a copy of which is designated as Exhibit PT-11.
12. Letter from Employer to Nancy R. Pomeranz dated July 23, 2001, a copy of which is designated as Exhibit PT-12.
13. Letter from Husband to Jeffrey C. Davenport, Supervisor in the Examination Division, dated April 24, 2002, a copy of which is designated as Exhibit PT-13.
14. Letter from Nancy R. Pomeranz to Husband dated May 16, 2002, a copy of which is designated as Exhibit PT-14.

15. Letter from Eugene J. Cella to Husband dated May 17, 2002, a copy of which is designated as Exhibit PT-15.

### **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 material times were natural persons, sui juris, and citizens and residents of North Carolina.
2. Taxpayers timely filed their North Carolina individual income tax returns for the tax years 1999 and 2000 and claimed deductions of \$26,294 and \$8,706, respectively, for severance wages pursuant to G.S. 105-134.6(6)(11).
3. Husband was employed by Employer at its facility located in [a city in] North Carolina. Employer sold its business operation at that location to Buyer. Some of Employer's employees were not retained by Buyer and were paid severance wages under a Separation Agreement and Release. Other employees, including Husband, were retained by Buyer and signed an Incentive to Stay Agreement and Release offered by Employer.
4. Under the terms of the Incentive to Stay Agreement and Release, the employee was to be paid one-half of an incentive to stay allowance as soon as practical after the employee signed the agreement and the remaining half would be paid as soon as practical after the employee's last day of employment with Employer, provided the employee's employment had started with Buyer. Husband's last date of employment with Employer was December 31, 1999. Effective January 1, 2000, Husband transitioned to and was employed by Buyer at the same building location in [a city in] North Carolina. Employer paid Husband \$26,294 in the tax year 1999. Husband received the second payment in the tax year 2000.
5. The auditor did not disallow Employer's first payment to Husband in 1999. The auditor adjusted the 2000 return to disallow the severance wage deduction of \$8,706 claimed as a result of the second payment received in 2000 by Husband from Employer. In error, the auditor also adjusted the amount of the personal exemption adjustment for the taxable year 2000.
6. A Notice of Individual Income Tax Assessment reflecting the auditor's adjustments for the taxable year 2000 was mailed to Taxpayers on April 12, 2002. Husband objected to the assessment and timely requested an administrative tax hearing.
7. Subsequent to receiving Husband's hearing request, the Department discovered that the auditor changed the personal exemption adjustment shown on Taxpayers' return in error. Because Taxpayers were allowed four exemptions and their federal adjusted gross income exceeded \$100,000, the correct addition for the personal exemption adjustment is \$3,200 rather than \$1,200 computed by the auditor. A corrected Notice of Individual Income Tax Assessment was mailed to Taxpayers on May 17, 2002.

8. Directive PD-98-1 states that severance wages do not include a “stay bonus” paid to an employee as an incentive to continue working.
9. On June 4, 2002, Taxpayers paid the amount of additional tax and interest shown on the corrected assessment notice. Taxpayers did not withdraw their request for an administrative tax hearing and the hearing proceeded in their absence.

### **CONCLUSIONS OF LAW**

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

1. A taxpayer is allowed to deduct severance wages as a result of the taxpayer’s permanent, involuntary termination from employment through no fault of the employee, not to exceed \$35,000 for all taxable years in which the wages are received. “Stay-on-pay” does not qualify as severance wages.
2. The first payment received by Husband in 1999 qualifies for the severance wage deduction because it was contingent upon Husband ceasing employment with Employer. The second payment, received in 2000, is considered “stay-on-pay” because receipt of this payment was contingent upon Husband starting employment with Buyer.
3. An addition is required on the North Carolina return for the difference in the State and federal personal exemptions. For taxable year 2000, the addition for taxpayers filing jointly with federal adjusted gross income of \$100,000 or more is \$800 for each exemption.
4. The corrected proposed assessment of additional tax and interest for the taxable year 2000 is lawful and proper.

### **DECISION**

Husband contends that since the wording “stay-on-pay” does not appear in the Individual Income Tax Bulletins until the 2001-2002 edition, it does not apply to the taxable year 2000.

Husband also contends that all payments received in 1999 and 2000 from Employer under both the Separation Agreement and Release and the Incentive to Stay Agreement and Release qualify for the severance wage deduction.

It has been the Department’s position since the statute’s inception that a “stay bonus” or “stay-on-pay” does not qualify for purposes of the deduction for severance wages. While the issue was not addressed in the Individual Income Tax Bulletins until the 2001-2002 edition, the Department of Revenue had communicated its written policy as early as April 1, 1998, as

evidenced by Directive PD-98-1. The law in its present form was effective for tax years beginning on or after January 1, 1998. The Directive states that severance wages do not include a “stay bonus” paid to an employee as an incentive to continue working.

The issue before the Assistant Secretary is whether Husband is in fact entitled to the deduction for severance wages claimed on his income tax return for the tax year 2000. The burden is on a taxpayer to show that he or she comes within an exemption or an exception. *Sabine v. Gill*, 229 N.C. 599, 51 S.E. 2d 1 (1948). According to the Incentive to Stay Agreement and Release, in order to qualify for receipt of the second payment issued in the taxable year 2000, Husband was required to remain employed with Employer through December 31, 1999, and then report to work for Buyer on January 1, 2000. While “severance wages” is not defined in the statute, the term does not include payments that represent compensation for past or future services.

“Taxation is the rule; exemption the exception.” *Odd Fellows v. Swain*, 217 N.C. 632, 637, 9 S.E. 2d 365, 368 (1940). “[S]tatutes providing exemption from taxation are strictly construed.” *Salé v. Johnson, Commissioner of Revenue*, 258 N.C. 749, 755, 129 S.E. 2d 465, 469 (1963). Consequently, the Assistant Secretary finds that Taxpayers have not carried their burden of proving entitlement to the deduction for severance wages for the taxable year 2000.

Based on the foregoing findings of fact and conclusions of law, the proposed assessment as amended for taxable year 2000, is found to be lawful and proper in every respect and is hereby sustained.

Made and entered this 19<sup>th</sup> day of July, 2002.

Signature \_\_\_\_\_

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings  
North Carolina Department of Revenue