

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Interest)
for the Taxable Year 1998 by the)
Secretary of Revenue of North Carolina)
)
)
vs.)
)
)
[Taxpayer])

FINAL DECISION
Docket No. 2001-502

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, on September 17, 2001, upon an application for a hearing by the attorney for the [Taxpayer], on behalf of the [executors of the estate]. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by [an attorney], and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division. [Taxpayer] is hereinafter referred to as "Donor" and [an executor of the estate] is hereinafter referred to as "Co-Executor."

Donor's North Carolina gift tax return for the tax year 1998 was filed on June 23, 1999, reflecting a tax liability of \$264,406.00. A Notice of Gift Tax Assessment for the tax plus accrued interest was mailed to Donor's estate on March 16, 2001. Donor's estate remitted payment of \$264,406.00 for the tax, but objected to the proposed assessment of interest and timely requested an administrative tax hearing before the Secretary of Revenue.

ISSUE

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

1. Is the gift tax assessment proposed against Donor's estate for the taxable year 1998 lawful and proper?
2. Is the Secretary of Revenue authorized to waive accrued interest on tax?

EVIDENCE

The evidence presented at the hearing by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, consisted of Exhibits PT-1 through PT-11.

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 Gift Tax Assessment for the taxable year 1998 dated March 16, 2001, a copy of which is designated as Exhibit PT-2.
3. Donor's North Carolina Application for Automatic Six-Month Extension of Time to File State Income and/or Gift Tax Return, dated April 15, 1999, for the taxable year 1998, a copy of which is designated as Exhibit PT-3.
4. Donor's North Carolina Application for Automatic Six-Month Extension of Time to File State Income and/or Gift Tax Returns, dated April 14, 1999, for the taxable year 1998, a copy of which is designated as Exhibit PT-4.
5. Donor's North Carolina individual income tax return for the taxable year 1998, a copy of which is designated as Exhibit PT-5.
6. Donor's North Carolina gift tax return for the taxable year 1998, a copy of which is designated as Exhibit PT-6.
7. Department of Revenue check number 0012134496 dated December 13, 1999, in the amount of \$274,551.04, a copy of which is designated as Exhibit PT-7.
8. Letter from Attorney to the Department of Revenue dated April 10, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from Gregory B. Radford, former Assistant Director of the Personal Taxes Division, to Attorney dated May 30, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter from Attorney to Gregory B. Radford dated June 21, 2001, a copy of which is designated as Exhibit PT-10.
11. Letter from Eugene J. Cella to Attorney dated August 14, 2001, a copy of which is designated as Exhibit PT-11.

At the hearing, Attorney submitted a Brief for Tax Hearing, a copy of which is designated as TP-1. At the conclusion of the hearing, the Assistant Secretary allowed the Personal Taxes Division and Attorney thirty days to submit additional information for the record in support of their respective positions. Subsequent to the hearing, Attorney submitted a Supplemental Brief for Tax Hearing dated October 15, 2001, with related exhibits, copies of which are collectively designated as Exhibit TP-2. The Personal Taxes Division submitted a copy of check number 1034 drawn on the account of the [Taxpayer], which is designated as PT-12.

FINDINGS OF FACT

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

1. Donor died on March 24, 1998. At the time of her death, Donor was a natural person, sui juris, and a citizen and resident of North Carolina.
2. Donor made taxable gifts during the tax year 1998. A timely application for an extension of time to file a gift tax return was filed on behalf of Donor and payment of \$264,406.00 was remitted with the application. In error, the Department applied the payment to Donor's individual income tax account for the taxable year 1998.
3. An extension of time to file Donor's individual income tax return for the taxable year 1998 was timely filed along with payment of \$9,265.00. The individual income tax return was subsequently filed reflecting additional tax due of \$295.00 and payment of \$305.00 was included with the return. As a result of the erroneous application of the gift tax extension payment to the individual income tax liability, Donor's income tax account reflected an overpayment of \$264,416.00. A refund of the overpayment plus interest of \$10,135.04 was mailed to Donor's estate on December 13, 1999. The refund included interest through December 23, 1999. The personal representative of Donor's estate deposited the check on December 30, 1999.
4. Donor's North Carolina gift tax return for the taxable year 1998 was filed on June 23, 1999, reflecting a liability of \$264,406.00, equal to the amount paid with the application for extension. Because the payment had been applied to the individual income tax account and refunded to the estate, a Notice of Gift Tax Assessment for the tax plus accrued interest of \$42,304.96 was mailed to Donor's estate on March 16, 2001. Donor's estate remitted payment of the tax of \$264,406.00, but objected to the proposed assessment of interest and timely requested an administrative tax hearing before the Secretary of Revenue.
5. In error, the interest shown due on the proposed assessment was calculated from April 15, 1999, the due date of the 1998 gift tax. Because the refund that created the underpayment was not made until December 23, 1999, the Department recalculated the interest on the amount refunded in error, \$274,551.04, from December 23, 1999, the date through which interest was included in the overpayment. By letter dated May 30, 2001, the Department notified Donor's estate that the correct interest due through that date was \$39,112.89 and that additional interest of \$8.51 accrues each day thereafter. Subsequent to January 1, 2002, interest of \$6.36 accrues each day.

CONCLUSIONS OF LAW

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

1. The principles and legislative history which gave rise to Internal Revenue Code section 6404(e)(2) do not apply in this case. State law controls and it requires accrued interest on all assessments of tax from the time the tax is due until it is paid.

2. Interest was properly charged on the unpaid gift tax. Unlike federal law, there is no provision in State law for an exception in this case.
3. The proposed assessment for the taxable year 1998 was properly issued and is, under the facts, lawful and proper.

DECISION

The amount of gift tax for the taxable year 1998 that was reflected in the proposed assessment notice equals the tax determined on Donor's return and such amount is not in dispute. Attorney contends that Donor's estate should not be held liable for the accrued interest on the tax.

Attorney contends that Donor's estate did not inquire as to the enormous windfall of \$274,551.04 because they assumed it was the result of substantial income tax deductions generated by charitable trusts established by Donor prior to her death. Donor's State individual income tax return for the taxable year 1998 was filed clearly reflecting a balance due of \$305.00. The individual return was signed by Co-Executor and by Attorney and a check for payment of that amount was included with the return. The check was drawn on Donor's estate and signed by Co-Executor. While Attorney and Co-Executor may not have been aware of the intimate details of the return as they suggest, they should have been aware, at the very least, that an additional tax liability of \$305.00 was in order, not a refund in excess of \$274,000.00. Attorney has made no indication that an amended State individual income tax return was filed for the taxable year 1998 to request a refund resulting from a substantial increase in the deduction for charitable contributions claimed on the original return. Apparently all available charitable contributions were deducted on the original income tax return to arrive at the additional tax due of \$305.00.

Notwithstanding that Donor's beneficiaries may have realized losses on their investments of the funds because of market declines, poor business decisions, etc., the fact remains that Donor's estate had full use of and the potential benefit of the funds from the time of

the erroneous refund until the date of repayment. Whether any economic gain was realized from the use of the funds is immaterial.

Attorney contends that the Department should be equitably estopped from charging interest on the erroneous refund. The Department cites *Henderson v. Gill*, 229 N.C. 313, 49 S.E. 2d 754 (1948) in which the North Carolina Supreme Court stated that "...facts, however potent in creating an estoppel in ordinary transactions between individuals, do not estop the State in the exercise of a governmental or sovereign right." *Id* at 316, 49 S.E. 2d at 756. The cases cited by Attorney indicate that the courts have, in certain limited circumstances, such as when necessary to prevent loss to another and only if it will not impair the exercise of government powers, applied the doctrine of equitable estoppel to government agencies. *Land-of-Sky Regional Council v. Henderson County*, 78 N.C. App. 85, 336 S.E.2d 653 (1985). The facts in the present case do not warrant estoppel. The accrual of interest on tax is required by G.S. 105-241.1(i). The fact that the tax had been erroneously refunded to Donor's estate does not preclude the accrual of interest on the assessed tax. Had the circumstances been reversed and Donor's estate had, through clerical error, paid the tax to the Department, the estate would have been entitled under the law to interest from the State on the tax not refunded within ninety days after the tax was paid. The requirement in the law that interest accrues on tax while a taxpayer has use and enjoyment of the funds does not constitute a loss to the taxpayer for purposes of applying the doctrine of estoppel.

Further, the Secretary of Revenue's authority at the hearing is limited to a determination of the validity of the proposed assessment. G.S. 105-241.1 (c). While G.S. 105-237 allows the Secretary to reduce or waive any penalties assessed, there is no statutory authority for him to reduce or waive interest. "When the right to do a thing depends on legislative authority and the Legislature has failed to authorize it, or has forbidden it, the approval of the doing of it by a ministerial officer cannot create a right to do that which is unauthorized or forbidden." *Glover v. Insurance Co.*, 228 N.C. 195, 198, 45 S.E. 2d 45, 47 (1947).

The North Carolina Court of Appeals held in *In re Petition of Jonas*, 70 N.C. App. 116, 318 S.E. 2d 869 (1984) that the Department's right to collect tax does not depend on its own due diligence even in instances where the Department's delay in assessing is unreasonable.

The Assistant Secretary is without authority to waive the interest assessed and finds that the proposed assessment for the taxable year 1998 is lawful and proper in every respect. The assessment is hereby sustained in its entirety and is finally determined and immediately due and collectible as allowed by law.

Made and entered this 14th day of January..., 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue