

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 2000 by the Secretary)
of Revenue of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2003-73

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on March 18, 2003, upon an application for hearing by [Taxpayer] wherein he protested the proposed assessment of gift tax 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 Taxpayer; [Taxpayer's attorney]; Alexandra M. Hightower, Assistant Attorney General; and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division.

[Taxpayer's uncle] is hereinafter referred to as "Uncle."

A Notice of Gift Tax Assessment was mailed to Taxpayer on August 28, 2002, proposing an assessment of gift tax; a 25 percent late filing penalty; a 10 percent late payment penalty; and accrued interest totaling \$41,178.06 for the tax year 2000. Taxpayer objected to the proposed assessment 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 Department's determination of the taxable value of the gift on the basis of county tax value proper?
2. Is the assessment of gift tax, penalties and interest proposed against Taxpayer for the taxable year 2000 lawful and proper?

EVIDENCE

The evidence presented by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, included 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 Gift Tax Assessment for the taxable year 2000 dated August 28, 2002, a copy of which is designated as Exhibit PT-2.
3. Notice of Gift Tax Assessment for the taxable year 2000 dated January 15, 2003, a copy of which is designated as Exhibit PT-3.
4. [A County District Court Order] granting summary judgment for the Department and Uncle dated September 16, 2002, a copy of which is designated as Exhibit PT-4.
5. North Carolina General Warranty Deed made on May 5, 2000, by and between Taxpayer and Uncle, filed July 3, 2000, with [Register of Deeds of a County], a copy of which is designated as Exhibit PT-5.
6. [A County Property Card] for tax year 2001, a copy of which is designated as Exhibit PT-6.
7. Letter with related attachment from Attorney to the Department of Revenue, dated May 30, 2001, copies of which are designated as Exhibit PT-7.
8. Letter from Attorney to the Department of Revenue, dated July 23, 2001, a copy of which is designated as Exhibit PT-8.
9. Letter from M. D. Wall, Tax Auditor with the Department of Revenue, to Attorney dated August 27, 2001, a copy of which is designated as Exhibit PT-9.
10. Letter with related attachment from Attorney to E. Norris Tolson, Secretary of Revenue, dated October 1, 2001, copies of which are designated as Exhibit PT-10.
11. Letter from E. Norris Tolson to Attorney dated November 2, 2001, a copy of which is designated as Exhibit PT-11.
12. Notice of Appeal from Gift Tax Assessment for the period 2000, dated September 13, 2002, a copy of which is designated as Exhibit PT-12.
13. Letter with related attachments from Attorney to W. Edward Finch, Jr., dated October 23, 2002, copies of which are designated as Exhibit PT-13.
14. Letter with related attachments from W. Edward Finch, Jr., to Attorney dated November 14, 2002, copies of which are designated as Exhibit PT-14.
15. Letter from Attorney to W. Edward Finch, Jr., dated November 22, 2002, a copy of which is designated as Exhibit PT-15.

16. Letter from Uncle to W. Edward Finch, Jr., dated January 2, 2003, a copy of which is designated as Exhibit PT-16.
17. Letter from Eugene J. Cella to Attorney dated January 16, 2003, a copy of which is designated as Exhibit PT-17.

Subsequent to the hearing, the Department entered into the record the Property Tax Rates and Revaluation Schedules For North Carolina Counties reflecting 2001 as the year of the next scheduled tax revaluation since 1993 a copy of which is designated as Exhibit PT-18.

At the hearing, Taxpayer presented the following evidence:

1. Purchase agreement between Taxpayer and a building contractor dated November 13, 1998, regarding improvements made by Taxpayer to the property at issue, a copy of which is designated as Exhibit TP-1.
2. Check stub reflecting pension payment to Taxpayer for the month of October 2002, a copy of which is designated as Exhibit TP-2.
3. Sales order dated November 20, 1998, reflecting various building materials purchased by Taxpayer from a metal roofing and siding manufacturer, a copy of which is designated as Exhibit TP-3.
4. Draftsman's sketch of a structure similar to one of the buildings erected by Taxpayer on the property at issue, a copy of which is designated as Exhibit TP-4.
5. Photographs of various buildings and other structures erected by Taxpayer on the property at issue, copies of which are designated as Exhibits TP-5 through TP-9.
6. Taxpayer's estimate of the fair market value of the property at issue at the time of the transfer to Uncle, a copy of which is designated as Exhibit TP-10.
7. Buyer's Closing Statement dated November 20, 1998, reflecting Taxpayer as buyer of the property at issue for a purchase price of \$95,000.00, a copy of which is designated as Exhibit TP-11.
8. Taxpayer's check for \$95,000.00 made payable to the trust account of the closing attorneys for the property at issue dated October 30, 1998, a copy of which is designated as Exhibit TP-12.
9. North Carolina General Warranty Deed recorded by [a County Register of Deeds] on March 2, 2000, regarding the sale by Taxpayer of seven acres of the property at issue to a third party, a copy of which is designated as Exhibit TP-13.
10. A billing statement to Taxpayer from Taxpayer's attorney for services rendered in connection with the transfer of the seven acres of the property at issue dated March 1, 2000, a copy of which is designated as Exhibit TP-14.

11. Letter from Uncle and his wife to Taxpayer dated December 31, 2002, a copy of which is designated as Exhibit TP-15.
12. A Notice of Lis Pendens filed by Attorney on December 27, 2000, in the [District Court of a County] on behalf of Taxpayer, a copy of which is designated as Exhibit TP-16.

Taxpayer stated at the hearing that soon after purchasing the property in 1998, he contracted with a building contractor for the construction of a large building on the property. The building was completed in about two weeks and consisted of only a "shell" with little or no interior work. Taxpayer completed the interior himself over a period of three years. During the fall of 1998, Taxpayer also constructed a shop building on the property which he testified cost approximately \$10,000. Taxpayer stated that he also constructed other structures on the property subsequent to the transfer to Uncle.

FINDINGS OF FACT

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

1. On October 30, 1998, Taxpayer purchased 29.82 acres of real property located in [a County] for \$95,000. On March 1, 2000, he sold seven acres of the property to a third party for \$21,000.
2. Taxpayer is identified as the grantor on a North Carolina General Warranty Deed executed on May 5, 2000. The deed reflects the transfer of the remaining 22.82 acres of real property from Taxpayer to Uncle. No excise stamp tax was paid on the transfer. Taxpayer purchased the property prior to his marriage. In an effort to protect the property from any type of marital distribution in his divorce proceedings, Taxpayer conveyed the property to Uncle. It was agreed between the two that Uncle would reconvey the property to Taxpayer upon his request.
3. A dispute arose between Taxpayer and Uncle resulting from Uncle's refusal to reconvey the property to Taxpayer. Taxpayer filed a complaint against Uncle in [a County District Court]. Included in the complaint was the issue of whether the transfer of the property from Taxpayer to Uncle constituted a gift. The Department was not named as a defendant in the matter. Judgment was filed on May 17, 2001, finding that Taxpayer had not made a gift of property and that no gift taxes were due on the conveyance. Taxpayer filed a motion on January 9, 2002, to set aside judgment and make the Department a defendant. The Department filed its Motion for Summary Judgment and Memorandum and the matter was heard in [a County District Court] on August 26, 2002. The Order granting Summary Judgment for the Department and ordering Taxpayer to pay gift taxes to the Department was entered on September 24, 2002. The case is currently on appeal in the North Carolina Court of Appeals.
4. Taxpayer submitted the 2000 [County] property tax card for the property at issue reflecting \$52,584.00 as the property value. Taxpayer also submitted page two of the 2003 property tax card reflecting the value of the land at \$86,380.00 plus improvements of \$106,100.00 in support of his initial contention that the improvements were made by Taxpayer subsequent to the transfer and that at the time of the transfer, the property consisted of "raw, unimproved land" with a fair market value of \$52,584.00.

5. On November 13, 1998, Taxpayer contracted with a building contractor for construction of a 36 ft. X 84 ft. building on the property for a cost of \$30, 783.00. According to Taxpayer's testimony at the hearing, the building was completed in about two weeks and consisted of only a "shell" with no interior work. During this same time, Taxpayer also constructed a shop building on the property which he testified to have cost approximately \$10,000.
6. [A County] conducted a property reevaluation for property tax purposes in 2001. The previous evaluation was in 1993. Consequently, the tax value of \$52,584 listed on the property tax card for the year 2000 is the value as of 1993 and does not reflect the actual fair market value in 2000 when the gift was made.
7. The permit history obtained by the Department from the [a County Tax Department] establishes that on December 10, 1998, Taxpayer was issued an electrical permit for new service for a garage and temporary service for construction work on a barn and garage on the property. The permit was to expire on June 10, 1999.
8. The 2001 [County] property tax card lists three improvements to the property with effective dates in 1999 indicating that the improvements were made prior to the date the property was given to Uncle.
9. Uncle furnished a notarized statement to the Department (Exhibit PT-16) describing in detail several buildings located on the land at the time of the transfer to him. The buildings described are consistent with the buildings listed on the 2001 property tax card.
10. The property tax cards for 2001 and 2003 values the land at \$86,380 and the improvements at \$106,100.00 for a total value of \$192,480.00.
11. Taxpayer estimates the fair market value of the property at the time of transfer to Uncle on May 5, 2000, including improvements at \$114,783.00 determined as follows:

<u>Date</u>	<u>Description</u>	<u>Amount</u>
October 30, 1998	Purchase Price of Land	\$ 95,000
November 13, 1998	Shell Barn (84ft. x 36ft.)	30,783
November 20, 1998	Shop Building (30ft. x 50ft.)	<u>10,000</u>
	Subtotal	\$ 135,783
March 1, 2000	Less: Sold 7 Acres	<u>21,000</u>
	Total Value	<u>\$114,783</u>

12. Upon examination of the transfer, the auditor determined that Taxpayer had made a gift to Uncle of \$317,000.00, based on the estimated fair market value of the property. Since Taxpayer had not filed a 2000 gift tax return, the auditor determined the taxable value of the gift to be \$307,000.00, equal to the estimated fair market value of the property less the \$10,000.00 annual gift tax exclusion.
13. A Notice of Gift Tax Assessment was mailed to Taxpayer on August 28, 2002, proposing an assessment of gift tax; a 25 percent late filing penalty; a 10 percent late payment penalty; and accrued interest totaling \$41,178.06 for the tax year 2000.

14. Taxpayer objected to the proposed assessment and timely requested an administrative tax hearing before the Secretary of Revenue.
15. Subsequent to receiving Taxpayer's hearing request, the auditor amended the proposed gift tax assessment to reduce the fair market value of the property to \$192,480.00 based on information obtained from the Polk County Property Tax Department. An amended Notice of Gift Tax Assessment reflecting tax, penalties, and accrued interest of \$22,630.06 for the tax year 2000 was mailed to Taxpayer on January 15, 2003.

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 exclusion of \$10,000.
4. The gift tax rates are based on the relationship between the donor and the donee. Where the donee is the uncle 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 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. 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.

DECISION

Taxpayer has two contentions regarding the transfer of the property at issue to Uncle. One issue is Taxpayer's contention that the transfer of the property to Uncle was not a gift; rather, it was a "non-taxable straw man or convenience transfer," arising from one party holding title to another party's property until a domestic case was settled. That issue is currently on appeal in the North Carolina Court of Appeals and, therefore, not within the Assistant

Secretary's purview. Taxpayer's other contention, and the only issue before the Assistant Secretary, is that the Department incorrectly determined the fair market value of the property for purposes of computing the gift tax.

The record shows that prior to the hearing Taxpayer took the position that at the time of transfer of the property to Uncle the property consisted of "raw, unimproved land" with a fair market value equal to the tax value of \$52,584.00 reflected on the 2000 [County] property tax card. At the hearing, however, Taxpayer allowed that some improvements had been made to the property prior to the transfer to Uncle and increased his estimate of the fair market value to \$114,783.00. [A County] conducted a property tax revaluation for property tax purposes in 2001. The previous evaluation was in 1993. The [County] property tax card for 2001 values the land at \$86,380.00 and the improvements at \$106,100.00 for a total value of \$192,480.00.

The Assistant Secretary finds that the Department's determination of the value of the property at issue based on the [County] property tax records is proper. The Assistant Secretary further finds that the proposed gift tax assessment for the tax year 2000, as amended, is lawful and proper and is hereby sustained in its entirety and is immediately due and collectible, together with interest as allowed by law.

Made and entered this 13th day of June, 2003.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue