TAX APPEAL BOARD OF THE STATE OF DELAWARE

RAYMOND M. & SHERRON H. RADULSKI,	)	
	)	
Petitioners,	)	
	)	
v.	)	Docket No. 1640
	)	
DIRECTOR OF REVENUE,	)	
	)	
Respondent.	)	

BEFORE: Todd C. Schiltz, Esq., Chairman, Steven R. Director, Esq., Vice-Chairman, Joan M. Winters, CPA, and Sindy Rodriquez and Robert Slavin, Members

Raymond M. and Sherron H. Radulski, *pro se*

Jennifer R. Noel, Esq., Deputy Attorney General, for Respondent.

DECISION AND ORDER

Petitioners Raymond M. and Sherron H. Radulski have appealed the Notice of Determination issued by the Director of Revenue ("DOR") wherein the DOR determined that the Petitioners could not (i) report their 2013 Delaware income taxes using a combined separate return, or (ii) split the income Mr. Radulski earned in 2013 between themselves for purposes of preparing their 2013 Delaware income tax return.

For the reasons set forth below, the Board concludes that the Petitioners were entitled to file a combined separate return, but that the Petitioners were not entitled to split Mr. Radulski's income between themselves for purposes of preparing their 2013 Delaware income tax return. Rather, because Petitioners elected to file a combined separate return, each Petitioner must report only his or her own income in their column of the 2013 combined separate return.

Statement of Facts

Petitioners reside at 3 Applewood Court, Hockessin, Delaware. Petitioners have been continuously married to one another for over forty years.

Mr. Radulski is an attorney and in 2013 he earned wages from the State of Delaware and a profit from his private law practice. The Petitioners also reported other income in 2013 consisting of dividend/interest income derived from jointly-owned property and a state tax refund, all of which totaled less than $1,000.[1]

In 2014, the Petitioners filed their Delaware Individual Resident Income Tax Return for 2013 (the "Return"). The Petitioners listed their filing status as "Married . . . & Filing Combined Separate" on the Return.[2] Although Mr. Radulski earned substantially all of the Petitioners' reportable income in 2013, the Return listed half of Mr. Radulski's federal adjusted gross income as being earned by him and half as being earned by Mrs. Radulski. The income reported by Mr. Radulski on the Return was substantially less than what was reflected on the form W-2 issued to him by the State of Delaware. The Return sought a refund of $319.

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[1] In addition to the Petitioners' joint income and Mr. Radulski's earned income, Mrs. Radulski received income in the form of a $15,000 IRA distribution in 2013. On the Return, the Petitioners claimed a "Pension/Retirement Exclusion" for the entire $15,000. (See Statement of Facts, Ex. A page 2 (listing two $7,500 subtractions on line 35)). As Mrs. Radulski is over 60 years of age, she was entitled to claim a maximum pension/retirement exclusion of $12,500. 30 *Del. C.* § 1106(b)(3)b.2.(A) and (B). The $2,500 difference is taxable and, for the reasons set forth below, must be included as part of Mrs. Radulski's income on the Return. Mrs. Radulski may also be entitled to an additional $2,000 over 60 exclusion as it appears she has not earned income in excess of $2,500. Mr. Radulski is also over 60 years of age and likewise is entitled to a pension/retirement exclusion to the extent he has retirement-eligible income up to $12,500. He is not entitled to the additional $2,000 over 60 exclusion as his earned income exceeded $2,500.

[2] An individual taxpayer filing a return in Delaware must select one of five filing status options: (1) single, divorced, widow(er), (2) married or entered into a civil union filing joint, (3) married or entered into a civil union filing separate, (4) married or entered into a civil union filing combined separate, or (5) head of household. The filing status selected by the taxpayer can impact, among other things, the number of exemptions, standard deductions and/or the tax rate applicable to the taxpayer.

Spousal taxpayers who select the filing status "married or entered into a civil union filing combined separate" file a single "combined" tax return, but list each spousal taxpayer's income, deductions, credits, etc. in a "separate" column on the return. Thus, the return is combined in the sense that it concerns more than one taxpayer, but separate in that each taxpayer's tax liability is calculated on an individual, separate basis.

After investigating the discrepancy between Mr. Radulski's reported income and the W-2 issued to him by the State of Delaware, the DOR's auditor issued a Notice of Assessment dated September 9, 2014. The Notice of Assessment changed the Petitioners' filing status from "Married . . . & Filing Combined Separate" to "Joint" and treated Mr. Radulski's income as jointly earned by the Petitioners (instead of splitting it evenly between the Petitioners).[3] The net effect of these changes was that Petitioners owed the State of Delaware an additional $616 in taxes for 2013, exclusive of interest.

The Petitioners appealed the Notice of Assessment. On January 15, 2015, the DOR's Tax Conferee issued a Notice of Determination denying the appeal, stating in pertinent part:

> . . . You filed your 2013 return on a "married or entered into a civil union & filing combined separate" basis, *i.e.*, filing status 4. An examination of the return shows that you were not entitled to file in this status, because Mr. Radulski earned all of the income of the family, yet it is divided equally on your return. The 2013 return instructions, page 5, pertaining to filing status provide: "For Filing status 3 or 4, you each report *only your own income, personal credits, deductions,* and one half of the income derived from securities, bank accounts, real estate, etc., which are titled or registered in joint names." (Emphasis supplied). Because Mrs. Radulski was reporting income that she did not realize, the Division of Revenue changed your filing status to "joint" and recomputed the return, which produce the changes in the September 9, 2014 notice of proposed assessment. The taxpayer bears the burden of proving that an assessment is incorrect. 30 *Del. C.* §526. You have not borne your burden of proof; accordingly, your protest is denied.

(emphasis in original).

The Petitioners appealed the Notice of Determination contending, among other things, that:

(i) "Petitioners are, and were at all applicable times, a married couple entitled to file a combined-separate return for tax year 2013,"

[3] The Board believes that changing the Petitioners' filing status from "Married . . . & Filing Combined Separate" to "Joint" benefitted the Petitioners. This is true because we believe that the Petitioners will pay less in taxes if they file a "Joint" return versus a "Married . . . & Filing Combined Separate" return in which the income earned by Mr. Radulski is attributed solely to him and the income earned by Mrs. Radulski is attributed solely to her.

(ii) "[t]he Director erroneously claims that Petitioners, who filed combined-separate for the year in question, improperly divided marital earned income equally between both Petitioners when only one Petitioner earned the bulk of the income,"

(iii) "[t]he couples' income is marital property under Delaware law. At all times the parties have considered all income to be joint," and

(iv) "[t]he Director has cited no statute or duly enacted rule or regulation which prohibits a married couple from dividing marital income and deductions equally. Indeed, any such rule or regulation would illegally discriminate against a 'traditional' married couple where the husband works outside the home and the wife maintains the home by subjecting the 'traditional' couple to a higher tax than would be applicable to a two-earner couple who earn the same income as that earned by the husband in the 'traditional' couple."

Analysis

I. Petitioners Were Entitled to File A Combined Separate Return.

The Notice of Determination stated that Petitioners were not entitled to utilize the "Married . . . & Filing Combined Separate" filing status. Notice of Determination at 1 ("You filed your 2013 return on a 'married or entered into a civil union & filing combined separate' basis, *i.e.*, filing status 4. An examination of the return shows that you were not entitled to file in this status . . . ."). In their petition to this Board, the Petitioners asserted that they "are . . . a married couple entitled to file a combined-separate return for tax year 2013."

Resident or non-resident spouses who file separate federal income tax returns must file separate Delaware returns. 30 *Del. C.* § 1162(a)(1). Resident or non-resident spouses who file a joint federal income tax return, in comparison, may choose whether to file a joint Delaware return or separate Delaware returns. 30 *Del. C.* § 1162(a)(2).

There is no evidence in the record as to whether the Petitioners filed separate or joint federal tax returns in 2013; however, regardless of the type of federal return Petitioners filed for 2013, they were either required to file separate Delaware returns or they had the right to elect to file separate Delaware returns for 2013. The Petitioners followed the statutory mandate or exercised their right to file a combined separate return in Delaware. As a result, the Board overturns and sets aside the Notice of Determination to the extent it concludes that the Petitioners were required to file their Return using a "Joint" filing status.[4]

II. Petitioners Were Not Entitled to Split Mr. Radulski's Income Between Themselves on the Combined Separate Return.

Although the Petitioners were entitled to file the Return using the "Married . . . & Filing Combined Separate" filing status, whether they can split Mr. Radulski's income between themselves on the Return is a separate issue.

The core questions that the Board must address are: (i) what income must be reported; and (ii) who must report and pay the tax on that income. As to what income must be reported, the Delaware Code provides that "[t]he entire taxable income of a resident of this State shall be the federal adjusted gross income as defined in the laws of the United States . . . ." 30 *Del. C.* § 1105. Section 61(a) of the Internal Revenue Code of 1986, as amended (the "Code"), in turn, defines an individual's gross income as "all income from whatever source derived, including (but not limited to) . . . (1) [c]ompensation for services including fees, commissions, fringe benefits, and similar items; [and] (2) [g]ross income derived from business." 26 *U.S.C.A.* § 61(a). "The definition [in Section 61(a) of the Code] extends broadly to all economic gains not otherwise

[4] The Board believes that the DOR changed the Petitioners' filing status to "Joint" in an effort to reduce the Petitioners' tax liability and we commend that effort. However, Petitioners' position on income splitting - that they can split the income earned by Mr. Radulski and attribute half to each spouse - requires Petitioners to file separate returns in Delaware. In light of this, and the fact Petitioners have a statutory right to file separate returns, which they seek to exercise, the Petitioners will be held to their choice and their 2013 Delaware taxes will be calculated using a combined separate return.

exempted." *Commissioner v. Banks*, 543 U.S. 426, 433 (2005). As no exemptions apply, all of the income Mr. Radulski earned in 2013 must be reported on the Return.

As to who must report and pay taxes on Mr. Radulski's income, "the first principle of income taxation [is] that income must be taxed to him that earns it." *Commissioner v. Culbertson*, 337 U.S. 733, 739-40 (1949) (citing *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930)). *See also Banks*, 543 U.S. at 433-34 ("gains should be taxed 'to those who earned them'") (citation omitted). In non-community property states, this principle requires the taxpayer who earned the income to report and pay taxes on the income and precludes income splitting.[5] Indeed, the United States Supreme Court has held that a husband employed as an attorney cannot split the income he earns with his unemployed, non-attorney wife and report half his income on his return and half his income on her return. *Lucas*, 281 U.S. at 113-15. This has been the law for the last eighty-five years, and it applies here.[6]

Mr. Radulski earned the vast majority of the Petitioners' income in 2013. As the Petitioners selected the combined separate filing status for their Return, any income Mr. Radulski earned must be reported as his income and cannot be shifted to or reported by Mrs. Radulski. Likewise, although Mrs. Radulski received less income than Mr. Radulski, she must report her income separately on the Return. According to the instructions for 2013 Delaware Resident Individual Income Tax Return, any joint income they received in 2013 related to jointly owned property must be split in half, with half listed in the column of the combined separate

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[5] "Income splitting permits couples with substantially disproportionate incomes to lower their taxes by dividing their aggregate income into two equal parts that are taxed separately, so that some of the higher earner's income may be taxed in a lower bracket." *The Innocent Spouse Problem: Joint and Several Liability for Income Taxes Should be Repealed*, Richard C.E. Beck, 43 Vand. L. Rev. 317, 369 (1990).

[6] In 1982, the DOR issued a tax ruling advising Delaware spousal taxpayers that "where taxpayers elect to file separate Delaware returns, the Federal adjusted gross income of each spouse . . . must be determined as if they had filed separate Federal returns in arriving at Federal adjusted gross income." *Division of Revenue Tax Ruling* 82-1 at 2. This tax ruling is consistent with *Lucas v. Earl*.

Return pertaining to Mr. Radulski (Column B) and half listed in the column of the combined separate Return pertaining to Mrs. Radulski (Column A).

To the extent Petitioners contend that the federal case law cited above does not apply to the state tax issue before the Board, the Board disagrees. As Petitioners correctly concede, "federal adjusted gross income is the statutory starting point for calculation of a taxpayer's Delaware income tax obligation . . . ." (Petitioners' Reply Brief at 2). By adopting federal adjusted gross income as the starting point for calculating Delaware income taxes, Delaware has necessarily adopted the methodologies used to calculate federal adjusted gross income, including the principle that income is taxable to the person who earns it recognized in *Lucas v. Earl* and its progeny. Moreover, while there do not appear to be any Delaware cases applying *Lucas v. Earl*, courts from other states adhere to it and its rationale when addressing state tax claims. *See Moseler v. Department of Revenue*, 2015 WL 1514460, at *2 (Or. T.C. Mar. 31, 2015) (for purposes of state income tax, "income is taxed to the individual who earns it"); *Luker v. State Tax Assessor*, 17 A.3d 1198, 1201 (Me. 2011) (same); *Lacey v. Indiana Department of State Revenue*, 948 N.E.2d 878, 880 n.6 (Ind. T.C. 2011) (same); *Fournier v. Commissioner*, 2008 WL 5102616, at *3 (Minn. T.C. Dec. 3, 2008) (same); *Subway Real Estate Corp. v. Director of Taxation*, 129 P.3d 528, 536 (Haw. 2006) (same); *Gerol v. Department of Revenue*, 1991 WL 121068, at *2 (Wis. Ct. App. May 22, 1991) (same); *VanderMeer v. Department of Revenue*, 352 So.2d 1147, 1149 (Ala. Civ. App. 1977) (same).

Petitioners further contend that their "income is marital property," suggesting that they believe each spouse has a fifty-percent interest in their collective income. While Petitioners may take this view between themselves, it is not how income is viewed as a matter of property law or

reported for purposes of income taxation in non-community property states like Delaware. *Lucas*, 281 U.S. at 113-14.[7]

Petitioners also argue that three sections of the Delaware tax code support their view that married couples can split spousal income on a Delaware combined separate income tax return. Specifically, Petitioners point to code sections that (i) allow one spouse to itemize deductions only if both elect to do so, 30 *Del. C.* § 1109(b), (ii) limit the state deductions of spouses who file a joint federal return to the deductions listed on the joint federal return, 30 *Del. C.* §1162(b)(1), and (iii) allow spouses who make joint estimated federal tax payments but who file separate state returns to divide the estimated payments between themselves as they elect, 30 *Del. C.* § 1169(c). None of the statutory sections identified by Petitioners resolves the issue before the Board. Indeed, these sections have no bearing on whether spouses who file a Delaware combined separate return can split one spouse's income on the return.

Petitioners' final argument is that it is unfair to preclude them, as members of a traditional marriage where the husband works and the wife maintains the home, from splitting Mr. Radulski's earned income on the Return. Petitioners contend that a two-earner couple who

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[7] In community property states, each spouse has an undivided one-half property interest in the income earned by both spouses and each spouse is liable for the tax due on one-half of the combined income. *See Poe v. Seaborn*, 282 U.S. 101, 111 (1930); *Commissioner v. Dunkin*, 500 F.3d 1065, 1069 (9th Cir. 2007) ("In *Poe v. Seaborn*, the Supreme Court . . . held that where community property laws of the state create . . . 'vested property right[s] in the . . . salaries or wages of either husband or wife, or both,' [then] each [spouse] has taxable income in the amount of one-half of such inflows.") (citations omitted). Under *Poe*, spousal taxpayers in community property states can split their income and reduce their overall tax liability. Delaware is a common law state, not a community property state, and this fact weighs heavily against allowing Petitioners to split Mr. Radulski's income on the Return.

Notably, the disparity between community property and common law states with respect to the reporting and payment of federal taxes was eliminated in 1948 when Congress adopted legislation permitting married taxpayers to file joint returns. *Fink v. United States*, 454 F.2d 1387, 1392 (Ct. Cl. 1972) ("Congress enacted the Revenue Act of 1948, c. 168, 62 Stat. 110, permitting husbands and wives to split income by filing joint returns, in order to eliminate unequal treatment between married taxpayers in community property states and non-community property states."). Common law states have followed the lead of the federal government and do not permit income splitting except when spousal taxpayers file a joint return. *See The Innocent Spouse Problem*, 43 Vand. L. Rev. at 389 ("No state apparently allows income splitting without joint return liability."). As the Petitioners have elected not to file a joint return, they are not permitted to split their income.

collectively earn the same income as Mr. Radulski pay less in taxes than the Petitioners and that this Board should remedy this disparity by allowing the Petitioners to evenly divide Mr. Radulski's income for purposes of preparing the Return. Assuming Petitioners are correct as to the disparate treatment among taxpayers, this is an issue that must be addressed by the Delaware General Assembly, not this Board.

Conclusion

For the reasons stated, the Board concludes that the Petitioners were entitled to file a combined separate return in 2013, but that the Petitioners were not entitled to split Mr. Radulski's income between them when preparing the Return.

The DOR is instructed to circulate a proposed form of order to the Petitioners for review within fourteen (14) days of the date of this opinion. The proposed form of order shall detail the total tax and interest that the Petitioners owe as of the date of this opinion. Tax Appeal Board Rules 19(e) and 20.

The DOR shall calculate the tax, penalty and interest the Petitioners owe using a combined separate return and attributing income to Mr. and Mrs. Radulski in the manner set forth above.

The proposed form of order also shall contain a per diem calculation for each additional day the amounts due pursuant to the order remain unpaid. Tax Appeal Board Rules 19(e) and

20. The parties shall file an agreed upon proposed order for signature by the Board, or, if necessary, separate proposed forms of order, within thirty (30) days of the date of this opinion. Tax Appeal Board Rule 20.

Date: Dec. 9, 2015