TAX APPEAL BOARD OF THE STATE OF DELAWARE

RICHARD and JANICE REULING,)
)
Petitioners,)
)
v.) Docket No. 1700
)
DIRECTOR OF REVENUE,)
)
Respondent.)

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

Richard and Janice Reuling, *pro se*, for Petitioners

Edward M. Black, Esq., Deputy Attorney General, for Respondent

DECISION AND ORDER

This case involves two issues. First, did the Director of Revenue ("Director") err when she determined that withdrawals from petitioner Richard Reuling's retirement account in 2014 and 2016 were not "lump-sum distributions?" Second, did the Director err when she determined that petitioners Richard and Janice Reuling (the "Taxpayers") failed to substantiate adequately the non-cash charitable contributions they claimed on their 2014 and 2016 tax returns?

For the reasons set forth below, the Board upholds the Director's determinations and concludes that: (i) the 2014 and 2016 retirement account withdrawals were not lump-sum distributions; and (ii) the Taxpayers have not adequately substantiated the non-cash charitable contributions they claimed on their 2014 and 2016 tax returns and, consequently, they are not allowed deductions in excess of the $5,000 per year deductions allowed by the Director. The parties are directed to submit a form of order within 30 days detailing the amount of tax, interest and penalty, if any, the Taxpayers owe as of the date of this opinion, as well as a per diem calculation for each additional day the amounts due pursuant to the order remain unpaid.

Legal Framework

Retirement Plan Lump-Sum Distributions

In order to attract and retain talented workers, many companies offer retirement benefits such as pension, 401(k) and profit sharing plans to their employees. Employees can withdraw funds from these plans, and they can minimize their Delaware tax burden if the withdrawal qualifies as a "lump sum distribution" from the plan.

The Internal Revenue Service describes a lump sum distribution as follows:

> A lump-sum distribution is *the distribution or payment within a single tax year of a plan participant's entire balance* from all of the employer's qualified plans of one kind (for example, pension, profit-sharing, or stock bonus plans). Additionally, a lump-sum distribution is a distribution that is paid:
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> - Because of the plan participant's death,

- After the participant reaches age 59½,
- Because the participant, if an employee, separates from service, or
- After the participant, if a self-employed individual, becomes totally and permanently disabled.

irs.gov/taxtopics/tc412 (emphasis added). The Internal Revenue Code of 1986, as amended (the "Code"), codifies the requirement that a lump-sum distribution be a distribution of the entire balance of a plan within one taxable year. 26 U.S.C. § 402(e)(4)(D) ("... the term '*lump sum distribution*' *means the distribution* or payment *within one taxable year* of the recipient *of the balance to* the credit of *an employee* ...") (emphasis added). Case law confirms this. *Powell v. CIR*, 129 F.3d 321, 326 (4th Cir. 1997) (the distribution "received by Powell did not constitute the entire balance of his account. Accordingly, it is not a 'lump sum distribution'"); *Cebula v. CIR*, 101 T.C. 70, 73 (July 21, 1993) ("A lump sum distribution is thus defined by statute as the distribution of an employee's entire plan balance in a tax-qualified retirement plan where the entire balance is distributed within a single tax year ....").

In order to calculate the state taxes due on withdrawals from retirement plans, Delaware has adopted the definition of lump-sum distribution set forth in the Code. 30 Del. C. § 1102(b)(6) ("For purposes of this subsection, the definition and special rules applying to the tax on lump-sum distributions as specified in §

402(e)(4) of the Internal Revenue Code … shall be applicable.”). *See also* 30 Del. C. § 1101 (“Any term used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States referring to federal income taxes, unless a different meaning is clearly required. Any reference to the laws of the United States shall mean the Internal Revenue Code of 1986 … and amendments thereto and other laws of the United States relating to federal income taxes, as the same may have been or shall become effective, for any taxable year.”)

Substantiating Non-Cash Charitable Contributions

Federal adjusted gross income is the starting point for determining a Delaware resident’s income that is subject to Delaware income tax. 30 Del. C. § 1105. By adopting federal adjusted gross income as the computational starting point, Delaware follows federal law with regard to itemized deductions, including the deductibility and substantiation of non-cash charitable contributions. *See* 30 Del. C. § 1109(a) (“a resident individual may elect to deduct the sum of the itemized deductions claimed on the federal income tax return as shall be permitted under the laws of the United States”).

The Code and Treasury Regulations adopted pursuant thereto impose “a series of increasingly rigorous substantiation requirements for larger [charitable contributions], especially when they consist of property rather than cash.” *Kunkle* *v. CIR*, T.C.M. 2015-71 (Apr. 8, 2015). These requirements build on each other and were summarized in *Kunkle*:

> Section 170 [of the Code] allows as a deduction any contribution made within the taxable year to a charitable organization such as those involved here. Sec. 170(a)(1), (c). Such deductions are allowed only if the taxpayer satisfies statutory and regulatory substantiation requirements. *See* sec. 170(a)(1); sec. 1.170A–13, Income Tax Regs. The nature of the required substantiation depends on the size of the contribution and on whether it is a gift of cash or property.
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> For all contributions of $250 or more, the taxpayer generally must obtain a contemporaneous written acknowledgment from the donee. Sec. 170(f)(8).....
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> Additional substantiation requirements are imposed for contributions of property with a claimed value exceeding $500. Sec. 170(f)(11)(B). Still more rigorous substantiation requirements, including the need for a "qualified appraisal," are imposed for contributions of property with a claimed value exceeding $5,000. Sec. 170(f)(11)(C). "Similar items of property" must be aggregated in determining whether gifts exceed the $500 and $5,000 thresholds. *See* sec. 170(f)(11)(F) ("For purposes of determining thresholds under this paragraph, property and all similar items of property donated to 1 or more donees shall be treated as 1 property."). The term "similar items of property" is defined to mean "property of the same generic category or type," such as clothing, jewelry, furniture, electronic equipment, household appliances, or kitchenware. Sec. 1.170A–13(c)(7)(iii), Income Tax Regs.
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> For non-cash contributions in excess of $500, taxpayers are required to maintain additional reliable written records with respect to each item of donated property. Sec. 1.170A–13(b)(2) and (3), Income Tax Regs.; *see Gaertner v. Commissioner,* T.C. Memo.2012–43. These records must include, among other things:

> (1) the approximate date the property was acquired and the manner of its acquisition; (2) a description of the property in detail reasonable under the circumstances; (3) the cost or other basis of the property; (4) the fair market value of the property at the time it was contributed; and (5) the method used in determining its fair market value. Sec. 170(f)(11)(B); sec. 1.170A–13(b)(2)(ii)(C) and (D), (3)(i)(A) and (B), Income Tax Regs.

Thus:

- for charitable contributions valued at $250 or more, "the taxpayer generally must obtain a contemporaneous written acknowledgment from the donee" organization;
- in addition to the doneee written acknowledgement, "[a]dditional substantiation requirements are imposed for contributions of property with a claimed value exceeding $500," including "(1) the approximate date the property was acquired and the manner of its acquisition; (2) a description of the property in detail reasonable under the circumstances; (3) the cost or other basis of the property; (4) the fair market value of the property at the time it was contributed; and (5) the method used in determining its fair market value";[1]

[1] *Kunkle* accurately summarizes the substantiation requirements for non-cash contributions that exceed $500. *See* Code § 170(f)(11)(B) ("In the case of contributions of property for which a deduction of more than $500 is claimed, the requirements of this subparagraph are met if the individual, partnership or corporation includes with the return for the taxable year in which the contribution is made a description of such property and such other information as the Secretary may require.") and Treas. Reg. 1.170A-13(b)(1), (b)(2)(ii)(D), 3(i)(A) and (B) (setting forth the information required by the Secretary, including requiring "any taxpayer who makes a charitable contribution of property … shall maintain … the following information: (i) The name of the

- in addition to the above, "[s]till more rigorous substantiation requirements, including the need for a 'qualified appraisal,' are imposed for contributions of property with a claimed value exceeding $5,000"; and,
- "'Similar items of property' must be aggregated in determining whether [contributions] exceed the $500 and $5,000 thresholds."

Statement of Facts[2]

Facts and Contentions Related to the Lump-Sum Distribution Issue

The Taxpayers are residents of Delaware and have been at all times relevant to this proceeding. In 2014, the Taxpayers withdrew $60,000 from Mr. Reuling's retirement account. This was not the entire balance in the account. In 2016, the Taxpayers withdrew $25,000 from Mr. Reuling's retirement account. This was not the entire balance in the account.

When filing their 2014 and 2016 Delaware income tax returns, the Taxpayers completed Form 329 (related to lump-sum distributions) and calculated

donee. (ii) The date and location of the contribution. (iii) A description of the property in detail reasonably sufficient under the circumstances." and "The written records … shall include …(D) The fair market value of the property at the time the contribution was made, the method utilized in determining the fair market value …" and "if a taxpayer … claims a deduction in excess of $500 … the taxpayer shall maintain written records that include … (A) The manner of acquisition … and the approximate date of acquisition of the property … [and] (B) The cost or other basis … of property …..").

[2] The facts set forth herein are derived from the parties' Stipulation of Facts and the exhibits and testimony introduced at the May 9, 2018 factual hearing. References to "Ex. __" refer to exhibits introduced at the factual hearing.

the state tax due on the premise that the withdrawals were lump-sum distributions. The Taxpayers paid $1,060 in Delaware income tax on the 2014 withdrawal and $120 in Delaware income tax on the 2016 withdrawal.

The Taxpayers contend that the Delaware Code and the instructions that accompany Form 329 are vague and fail to define lump-sum distribution as a distribution of all assets within an account in a single year, and contrast this form and its instructions to materials generated by the IRS. The Taxpayers further contend that they acted in good faith when completing Form 329 and that Delawareans should be able to use this form without ambiguity.

Upon review, the Director determined that the withdrawals from Mr. Reuling's retirement account were not "lump sum distributions" because the entire account balance was not distributed to Mr. Reuling in a single year. The notice of assessment and notice of determination increased the taxes due on the 2014 withdrawal by $8,390 and increased the taxes due on the 2016 withdrawal by $6,383, in both instances after allowing the Taxpayers a $12,500 pension exclusion based on Mr. Reuling's age. The Director contends the statutory language and case law cited above compel this result.

Facts and Contentions Related to the Charitable Contribution Issue

In their Delaware income tax returns for calendar years 2014 and 2016, the Taxpayers claimed non-cash charitable contributions in the following amounts:

2014 - $18,404 and 2016 - $22,102. The following charts summarize the charitable contributions by "property type" and list the value attributed to each property type by the Taxpayers:

2014

Property Type	Value
Baby Gear	$51
Bedding & Linen	$1,961
Books	$4
Clothing	$10,505
Computers	$613
Furniture	$2,484
Health & Beauty Supplies	$117
Kitchen Items	$658
Lawn/Patio Items	$190
Luggage	$88
Major Appliances	$212
Phones	$85
Portable Audio	$132
Sporting Goods	$937
Toys	$365

The Taxpayers introduced into evidence 39 receipts reflecting that they contributed this property to Goodwill Industries in 2014. Ex. 2.[3] Each receipt reflects that the Taxpayers contributed property valued at between $400 and $500 to Goodwill. Ex. 2. The Taxpayers calculated the value of the property using a TurboTax program called "ItsDeductible." Ex. 2. The Taxpayers testified that this program calculates the value of property based on resale values established using eBay and thrift shop prices. The Taxpayers entered information regarding the property they contributed to Goodwill into the "ItsDeductible" program and the program assigned a value to the property. The Taxpayers then used these values on their tax return.

The substantiating documents submitted by the Taxpayers did not include the approximate date the Taxpayers initially acquired the property, the manner of its acquisition or the cost or other basis of the property. *See* Ex. 2. The Taxpayers appear to contend that because each receipt reflects a contribution of property valued at less than $500, they need not submit this information.[4] The Taxpayers further contend that the IRS audited their 2008 tax return, the IRS accepted similar information to substantiate their non-cash charitable deductions for that year and, as a result, what they have submitted for 2014 is sufficient.

[3] In 2014, the Taxpayers did not contribute property to any charity other than Goodwill.

[4] Most of the 2014 Goodwill receipts state that the value of the property contributed is slightly less than $500. *See* Ex. 2.

2016

Property Type	Value
Automotive	$51
Bedding & Linen	$2,208
Books	$259
Clothing	$8,889
Computer	$1,288
Furniture	$5,363
Healthcare Items	$167
Housekeeping Items	$436
Kitchen Items	$1,799
Luggage	$43
Phones	$93
Portable Audio	$16
Sporting Goods	$480
Tools	$119
Toys	$891

The Taxpayers introduced into evidence 49 receipts reflecting that they contributed this property to Goodwill or The Salvation Army in 2016. Ex. 3. Each of the 48 Goodwill receipts reflects that the Taxpayers contributed property with a value of between $400 and $500. Ex. 3. The single Salvation Army receipt assigns no value to the property contributed. Ex. 3. The Taxpayers testified that, in 2016, they calculated the value of the property they contributed in the same manner they calculated value in 2014.

Like the 2014 substantiating documentation, the 2016 substantiating documents submitted by the Taxpayers did not include the approximate date the Taxpayers initially acquired the property, the manner of its acquisition or the cost or other basis of the property. *See* Ex. 3. The Taxpayers appear to contend that because each receipt reflects a contribution of property valued at less than $500, they need not provide this information.[5] The Taxpayers further contend that the IRS audited their 2008 tax return, the IRS accepted similar information to substantiate their non-cash charitable deductions for that year and, as a result, what they have submitted for 2016 is sufficient.

Upon review, the Director limited the Taxpayers' allowed charitable deductions to $5,000 for each year. The Director refused to allow a larger deduction on the ground that the Taxpayers had failed to substantiate their right to a larger deduction.

[5] Like in 2014, most of the 2016 Goodwill receipts state that the value of the property contributed is slightly less than $500. *See* Ex. 3.

Analysis

The Retirement Account Withdrawals Were Not Lump-Sum Distributions

As set forth above, in order for a withdrawal from a retirement account to be a lump-sum distribution, the entire balance in the account must be withdrawn in a single tax year. The Taxpayers did not withdraw the entire balance of Mr. Reuling's retirement account in either 2014 or 2016. Accordingly, the withdrawals cannot be treated as lump-sum distributions or receive the preferential tax treatment that can be afforded to such withdrawals.

The Taxpayers' counter-arguments, that the Delaware Code and the instructions related to Form 329 and lump-sum distributions are vague when compared to the comparable IRS form and that the Taxpayers acted in good faith, do not change this result. The Delaware Code is not vague on this issue. It expressly states that State of Delaware taxpayers are to use the federal definition of lump-sum distribution when determining if a withdrawal from a retirement account can receive the preferential tax treatment afforded to lump-sum distributions. The federal definition is clear that the entire balance of a retirement account must be withdrawn in order for the withdrawal to qualify as a lump-sum distribution. Likewise, the fact the Taxpayers believe Form 329 is vague, or even if it is vague, is of no moment as vague instructions on a form cannot replace, modify or draw into question clear statutory requirements. Finally, whether or not the Taxpayers acted in good faith is not part of the analysis and cannot change the result.

The Taxpayers Failed to Substantiate their Non-Cash Charitable Contributions

With regard to substantiation and deductibility of charitable contributions, the threshold question is whether to aggregate the value of similar items. Although the Taxpayers suggest this is not required because no single contribution exceeds $500, federal law is clear that taxpayers must aggregate the value of similar items when, as here, they are claiming large non-cash charitable contributions.[6]

As reflected in to above charts and Exhibits 2 and 3, the documents the Taxpayers submitted to substantiate their deductions, the Taxpayers essentially donated two types of property in 2014 and 2016: clothing and household items. 26 U.S.C. § 170(f)(16)(D) ("'household items' includes furniture, furnishings, electronics, appliances, linens and other similar items.").[7] The record demonstrates

[6] As stated in *Kunkle*, "'Similar items of property' must be aggregated in determining whether gifts exceed the $500 and $5,000 thresholds. *See* Code § 170(f)(11)(F) ('For purposes of determining thresholds under this paragraph, property and all similar items of property donated to 1 or more donees shall be treated as 1 property.')." The phrase "similar items of property means property of the same generic category or type ...." Treas. Reg. 1.170A-13(c)(7)(iii).

[7] The Taxpayers do not contest grouping the items in this manner. To the contrary, at page six of their opening brief, they stated "[t]he donations consist of typical 'used clothing' and 'used house hold items.'"

To the extent that items the Taxpayers contributed, *e.g.*, books or healthcare products, arguably do not fall within one of these two categories, and therefore should not be aggregated with other "similar items of property," the result here is no different. Even using the Taxpayers' valuations, such items do not have a collective value in excess of $5,000, the deduction the Director allowed that in 2014 and 2016, the Taxpayers contributed, in the aggregate, clothing and household items that the Taxpayers contend were worth more than $5,000.

To substantiate contributions/deductions of this size, the Taxpayers had to submit records reflecting, among other things, the approximate date they acquired the property they contributed, the manner of its acquisition and the cost or other basis of the property. *See Kunkel* at *5 (noting that with regard to non-cash contributions in excess of $500, the taxpayer must submit records showing "(1) the approximate date the property was acquired and the manner of its acquisition; ... [and] (3) the cost or other basis of the property ...."). It is undisputed that the substantiation records the Taxpayers submitted, Exs. 2 and 3, do not contain this information. The Taxpayers have failed to substantiate their non-cash charitable contributions for 2014 and 2016, and they are limited to claiming the $5,000 per year deduction previously allowed by the Director.[8]

The Taxpayers contend that the documentation they submitted is sufficient because the IRS accepted similar substantiation documentation when it audited the

the Taxpayers to take in both 2014 and 2016. Consequently, if anything, the Director has allowed the Taxpayers to claim a higher deduction than they otherwise are entitled to claim.

[8] The clothing and household items contributed by the Taxpayers in 2014 and 2016 exceeded $5,000 in claimed value. As a result, the Taxpayers also were required to submit a "qualified appraisal" to substantiate the value of the property. Treas. Reg. 1.170A-13(c)(2)(i)(A). Among other things, a qualified appraisal must be signed by the appraiser. Treas. Reg. 1.170A-13(c)(3)(i)(B). The TurboTax valuations generated through the "ItsDeductible" program are not signed. *See* Exs. 2 and 3. For this reason, and perhaps others, the TurboTax valuations are not a qualified appraisal.

Taxpayers' 2008 tax return.[9] Yet, what the IRS is willing to accept to resolve a dispute is not binding on the Director, particularly when the parties are addressing different tax years. The Taxpayers further contend that the Director is misreading the federal substantiation requirements or "cherry picking" them to support his position. We disagree. The Director has applied the substantiation requirements set forth in the Code and the regulations adopted pursuant thereto in accordance with their terms and found the Taxpayers' documentation lacking. The Director did not err when making this determination.

Conclusion

For the foregoing reasons, the Board upholds the Director's determinations and judgment is entered in her favor.

We order the Director to circulate a proposed form of order to the Taxpayers for review within fourteen (14) days of the date of this opinion. The proposed form of order shall detail the total tax, interest and penalty, if any, that the Taxpayers owe for each of 2014 and 2016 as of the date of this opinion, as well as 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 a joint proposed order for signature by the Board, or, if the parties are unable to

[9] *See* Taxpayer's reply brief at 4 ("In their audit, the IRS did not require appraisals, grouping of donations or the limitations as suggested by the Division for these donations.").

agree on a form of order, separate proposed forms of order, within thirty (30) days of the date of this opinion. Tax Appeal Board Rule 20.

Robert W. Sla

Joan M Winters

SO ORDERED this 2nd day of November, 2018.