

TAX APPEAL BOARD OF THE STATE OF DELAWARE

Estate of Richard P. Fox)
)
 Petitioner,)
)
 v.) Docket No. 573
)
 Director of Revenue,)
)
 Respondent.)

Jacqueline D. Fox)
)
 Petitioner,)
)
 v.) Docket No. 574
)
 Director of Revenue)
)
 Respondent.)

Before: Maurice A. Hartnett, III, Esquire, Chairman, Joseph S. Yucht, Esquire, Nettie C. Reilly, Cyric W. Cain, Jr., and Rhett McGriff, Members.

Edwin L. Kantor, C.P.A. and James McDonald of Frank A. Gunnip & Company, Certified Public Accountants for Petitioners

Stephen R. Spiller, Esquire, Special Counsel for Respondent.

DECISION AND ORDER

Joseph S. Yucht, Esquire, Member: The above cases were heard together by the Tax Appeal Board since the issues presented were the same. The issue involves the distribution of some \$67,000.00 from a Subchapter "S" corporation to its shareholders and the question is whether or not said

distribution is subject to Delaware Income Tax, during the year 1971.

The Facts

Richard P. Fox and Jacqueline D. Fox were, inter alia, shareholders in a corporation known as Richard Phillips Fox A.I.A. Inc. Said corporation was qualified as a Subchapter "S" corporation pursuant to the provisions of the Federal Internal Revenue Code. Both the said corporation and the individuals were on a cash basis for purposes of income tax accounting, and the corporate tax year commenced on September 1 of each year.

As of September 1, 1970, the start of the fiscal tax year for the corporation, said corporation's books indicated a balance of \$57,000.00 in undistributed funds in favor of Richard P. Fox and a balance of \$10,000.00 in undistributed funds in favor of Jacqueline D. Fox. Between September 1, 1970 and August 31, 1971, the date the final transitions were completed, it was established that pursuant to the Federal Internal Revenue Code, the transfers and/or distributions were not subject to additional taxation nor were they to be treated as taxable income to the individual tax payers (Petitioners). The distributions (rounded off

to even hundreds) were apparently as follows:

1. Between April and June, 1971, the sum of \$24,000.00 was distributed by paying cash to the petitioners and charging said sum against the undistributed taxed income account.

2. On August 31, 1971, two transactions were involved:

A. a journal entry was made reclassifying an entry made prior to September 1, 1970, in the amount of \$8,000.00, from a debit of a loan receivable account to a debit of the undistributed taxable income account , and

B. \$34,000.00 was distributed to taxpayers in cash and the undistributed taxable Income account was debited said amount.

The loan receivable account was in existence and on the corporations books since 1964.

The petitioners filed their 1971 State of Delaware personal Income tax form and did not include said amounts in computing adjusted gross income. The Director of Revenue, pursuant to the provisions of Chapter 11 of Title 30, Delaware Code, filed a Notice of Assessment against said taxpayers notifying them that the Division of Revenue had computed a proposed assessment of an income tax deficiency against each, including interest, and informed each of their right to protest said assessment by filing a petition for

review with the Tax Appeal Board.

The Law

On January 1, 1971, the Delaware "Piggy Back" tax law became effective. (57 Laws of Delaware Ch. 737). Said laws defined taxable income as follows:

"§1105 Taxable Income

The entire taxable income of a resident of this State shall be his federal adjusted gross income as defined in the Laws of the United States with the modifications and less the deductions and personal exemptions provided in this subchapter." (30 Del. C. §1105)

There were no modifications provided for in the Delaware Code that would cause the adjusted gross income as defined in the laws of the United States (federal income tax code), of these taxpayers, to be changed.

The distributions made by the corporation to taxpayers were not included in adjusted gross income under federal tax law and accordingly, Delaware adopted said provisions.

The Division of Revenue contended that 30 Del. C. §1902(b)(9), enacted as Section 2 of 57 Laws of Delaware Ch. 737 was applicable but the Board deemed said section not applicable because it became effective September 1, 1971 as to the corporation in question and in the case at bar,

the distribution had been concluded by that date.

The Division of Revenue further contended that Tax Newsgram 71-7, dated December 7, 1971 and pertaining to distributions to Subchapter "S" stockholders was a basis for the assessment. The Board found no basis in the Delaware Law to support said Tax Newsgram and accordingly deemed it to be invalid and of no effect.

The petitioners contended that the distributions were not includable in adjusted gross income under Federal Law and when Delaware adopted the piggy back provisions, Delaware Law then became whatever the federal law provided; and if a loophole developed, then so be it and said loophole could not be cured by a regulation (Tax Newsgram). This contention was adopted by the Tax Appeal Board.

Decision and Order

It is the view of the Board that when the General Assembly adopted the language of 30 Del. C. §1105, defining taxable income, as being the federal adjusted gross income, said General Assembly was aware of the possibility that certain distributions may be made and the effect would be that said income may not be taxable. The language is clear in the statutes that it is the federal adjusted gross income (30 Del. C. §1105) that is controlling and if income is not so includable in the federal tax law, then it will not

be so includable in said State law. There's nothing unconstitutional or unreasonable about such a decision and if a loophole exists, it is for the General Assembly to correct. An apparent deficiency, loophole or deficit in the law can not be remedied by a regulation enacted by the Division of Revenue.

Accordingly, Petitioners' prayers are granted and the deficiency assessments made by the Director of Revenue are reversed.

IT IS SO ORDERED.

Cyril W. Cain
James W. Bell
Joseph G. Guck
Nettie C. Reilly
Shett McGriff

Date 3/12/75

SYNOPSIS

DOCKET NOS. 573 and 574

TAX SEGMENT: PERSONAL INCOME TAX

ISSUE: The question in dispute is whether or not Subchapter "S" corporation distribution to shareholders of pre 1971 earnings are subject to tax during the year 1971.

TAB DECISION: The Tax Appeal Board held that when the distribution of pre 1971 earnings of the Subchapter "S" corporation was not reported by shareholders on their 1971 federal income tax return such earnings should not be included in determining 1971 Delaware adjusted gross income. The Board also held that the language of the statute (30 Del. C. § 1105) is controlling and if an apparent deficiency or loophole exists it cannot be remedied by administrative regulation by the Division of Revenue (Tax Newsgram 71-7).

DECISION: For Petitioner

DECISION DATE: March 12, 1975