SYNOPSIS

DOCKET NO. 755

TAX SEGMENT: DELAWARE CORPORATE INCOME TAX

ISSUE: Whether or not Petitioner is entitled to report and deduct a loss carryover from a subsidiary which loss carryover may be calculated by the computation of separate Federal tax returns for both merged subsisiary and the successor corporation of the merger.

TAB DECISION: The Tax Appeal Board held that pursuant to 30 Del. C., § 1903 (a) the starting point for the computation of Delaware Corporate income tax is the Federal taxable income.

As a result of filing Federal consolidated returns the net operating losses sustained by the constituent corporation of the Petitioner had been previously and completely utlized for Federal tax purposes as of December 31, 1977, the date of the merger. Therefore, since in the calendar year 1978 there was no additional net loss carryover that could be utilized for Federal taxable income, no loss existed to be utilized by the Petitioner for the calculation of Delaware Corporate income taxes.

DECISION: For Respondent

DECISION DATE: May 13, 1983

BEFORE THE TAX APPEAL BOARD

OF THE STATE OF DELAWARE

CLUETT, PEABODY, & CO., INC.,	:	
Petitioner,	:	
v.	:	Docket No. 755
DIRECTOR OF REVENUE,	:	
Respondent.	:	

Before: Joseph S. Yucht, Esquire, Chairman; James C. Eberly, Sr., Esquire, Vice-Chairman; Cyric W. Cain, Jr., Nettie C. Reilly, and Harry B. Roberts, Jr., Members.

Seymour F. Bernstein, Esquire of Deloitte Haskins & Sells, Attorney for Petitioner and John R. Ferrick, Esquire, Deputy Attorney General, Attorney for Respondent.

DECISION AND ORDER

James C. Eberly, Sr., Esquire, Vice-Chairman: The Board has before it for decision the issue of whether or not the Petitioner is entitled to report and deduct a loss carryover from a subsidiary which loss carryover may be calculated by the computation of separate federal tax returns for both the merged subsidiary and the successor corporation of the merger.

The facts that are pertinent in this decision and order have been stipulated by the parties, and include the following:

a. Petitioner has elected to file consolidated income tax returns with the Federal Internal Revenue Service on a

consistent basis for many years, including therein the income and losses of its several qualifying subsidiary corporations as members of an affiliated group of corporations.

b. On December 31, 1977, Van R Apparel Corporation, one of Petitioner's subsidiary corporations, and a member of its affiliated group of corporations, merged into Petitioner pursuant to the corporation laws of the respective states of incorporation.

c. For Federal income tax purposes, the merger of Van R Apparel Corporation into Petitioner qualified as a tax-free transaction in the nature of a complete liquidation of a wholly owned subsidiary corporation into its parent corporation pursuant to the provisions of section 332 of the Internal Revenue Code.

d. One of the consequences of a complete liquidation of Van R Apparel Corporation, as noted in subparagraph (c) above, is the fact that Petitioner would have been entitled to succeed to and take into account, as of the close of the date of the liquidation transfer, December 31, 1977, Van R Apparel Corporation's net operating loss carryover, if any, in accordance with sections 381(a)(1) and 381(c)(1) of the Internal Revenue Code, for the purpose of determining Petitioner's Federal taxable income.

e. As a result of the filing of Federal consolidated returns, Van R Apparel Corporation's net operating losses as

sustained in 1973, 1974 and 1975 were fully utilized as of December 31, 1977, the date of the merger, and, accordingly, Van R Apparel Corporation did not have any net operating loss carryover for Federal income tax purposes at the time of the merger.

It has further been stipulated and agreed by the parties that the State of Delaware does not have any provision for the filing of consolidated tax returns for corporations. The taxing statute that is in question in this instant appeal is Chapter 19, Title 30, Delaware Code. Petitioner advances the theory that they should be entitled to recompute their loss carryover from the constitutient corporation of the merger, by utilizing the arithmetic preparation of pro-forma tax returns for both constituent corporation and the survivor corporation of the merger for tax years prior to the merger, which both parties agreed took place on December 31, 1977. It should be noted that the constituent corporation of the merger was one of the subsidiaries of the Petitioner in this matter and was not, prior to the merger into the Petitioner, required to file any corporate tax return in the State of Delaware, it having done no business in the State of Delaware.

As recited above, it has been stipulated between the parties the consolidated tax returns of the Petitioner and other related corporations were filed for Federal purposes

during the years in which the loss carryover of the constituent corporation of the merger were generated. It has also been stipulated and agreed between the parties that the losses of the constituent corporation were completely utilized by December 31, 1977 for Federal tax purposes.

The Petitioner makes the argument that because Delaware does not have provision for the filing of consolidated returns, and recognizes, on a pro-forma basis, the separate filing of tax returns in the State of Delaware, based upon the income shown on the Federal pro-forma return, that the State of Delaware, subsequent to the merger between the Petitioner and its constituent corporation should allow the Petitioner and its constituent corporation to prepare separate returns thereby generating the loss carryover to be utilized by the Petitioner.

The Respondent's position is a simple one, and is the position that if a loss carryover were permitted to be taken on the Federal return, then it would also be permitted to be taken on the State of Delaware corporate tax return. The Respondent goes further and states that inasmuch as there was no loss to be utilized for Federal purposes, no loss exists to be utilized by the Petitioner in its State returns.

In reaching this decision and order, it should be noted that 30 Del. C., §1903(a) sets forth the starting point for the calculation of Delaware corporate income tax as the

Federal taxable income for such year as computed for purposes of Federal income tax. It has been stipulated and agreed between the parties, as above referred to, that all net operating losses of the constituent corporation with the Petitioner had previously been utilized on the Federal income tax return. Therefore, in the calendar year 1978 there was no additional net loss carryover to be utilized on the Federal income tax return for the Petitioner.

The statutory language of Chapter 19, 30 Del. C. is clear on its face, and we, as the Tax Appeal Board cannot enlarge upon the clear wording of the statute. The arguments advanced by the Petitioner in this matter are best addressed to the Legislature, which controls the statutory language of the applicable taxing statutes. To adopt the Petitioners position in this matter would be to, in effect, allow the Petitioner to take advantage of its constituent corporation's losses twice, they already having been utilized in the Federal tax returns in prior years.

Inasmuch as the computation of Delaware income tax for corporations uses as its starting point the Federal taxable income for the tax year in question, and inasmuch as there was no further loss carryovers that could be utilized for Federal purposes, we therefore affirm the decision of the Director of Revenue.

IT IS SO ORDERED on this 13th day of May, A.D. 1983.

Joseph S. Yacht

James C. Kelly

Mattie E. Kelly

Docket No. 755

SUPERIOR COURT
OF THE
STATE OF DELAWARE

ROBERT C. O'HARA
JUDGE

Submitted: August 22, 1984
Decided: January 22, 1985

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Gentlemen:

RE: Cluett, Peabody, & Co., Inc. v.
Director of Revenue, Division
of Revenue, State of Delaware
C. A. No. 83A-JN-4

This case comes before the Court on appeal from the Tax Appeal Board ("Board") pursuant to 29 Del. C. §10142.[1] The taxpayer-appellant, Cluett, Peabody & Co., Inc. ("taxpayer") appeals the decision of the Board affirming the assessment of an income tax deficiency in the amount of $34,354.42 by the Division of Revenue ("Division").

In 1979, taxpayer filed its 1978 income tax return with the State of Delaware. On May 8, 1980, the Division issued a Notice of Assessment, stating that it had disallowed an operating loss carry overdeducted by the taxpayer. The taxpayer requested a redetermination. When the Division's Director refused, the taxpayer appealed to the Tax Appeal Board.

Prior to the hearing before the Board, the taxpayer and the Division entered into a stipulation. The undisputed facts are set forth below.

For some years, taxpayer has elected to file consolidated income tax returns with the Federal Internal Revenue Service. These returns include the income and losses of taxpayer's several qualifying subsidiary corporations as members of an affiliated group of corporations.

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[1] A right of appeal also is provided by 30 Del. C. §331.

On December 31, 1977, the Van R Apparel Corporation, one of taxpayer's subsidiary corporations and a member of taxpayer's affiliated group of corporations, merged into taxpayer. For Federal income tax purposes, the merger qualified as a tax free transaction in the nature of a complete liquidation of a wholly-owned subsidiary corporation into its parent-corporation. One of the consequences of such a liquidation is that the taxpayer-parent is entitled to succeed to and take into account, as of the date of the liquidation transfer, the former subsidiary's net operating loss carry over, if any.

In the instant case, however, as a result of taxpayer's having filed consolidated Federal returns, the net operating losses sustained by the Van R Apparel Corporation in 1973, 1974 and 1975 had been fully utilized as of December 31, 1977, the date of the merger. Therefore, the Van R Apparel Corporation did not have any net operating loss carry over for Federal income tax purposes at the time of merger. If the taxpayer and the Van R Apparel Corporation had filed separate Federal returns for the years 1973 through 1977, Van R Apparel Corporation would have had a net operating loss carry over of $32,745,723 for Federal income tax purposes at the time of merger.

The State of Delaware, unlike the Federal government, does not permit the filing of consolidated corporate income tax returns. Accordingly, taxpayer filed its Delaware corporate income tax returns on a pro-forma basis as if it had prepared and filed separate Federal income tax returns.[2] Consequently, the Van R Apparel Corporation's accumulated net operating losses of $32,745,723 were not utilized for State income tax purposes prior to 1978.

In 1978, taxpayer reported a $32,745,723 net operating loss deduction in the computation of its pro-forma Federal taxable income which was reported in its Delaware corporate income tax return. The Division, however, disallowed the operating loss carry over. Citing 30 Del. C. §1903(a), the Division concluded that because Van R Apparel Corporation's losses had previously been offset against taxpayer's taxable income for Federal income tax purposes, the losses could not be utilized for State income tax purposes in 1978.

On May 13, 1983, the Board affirmed the Division's assessment. The Board stated:

> [i]n reaching this decision and order, it should be noted that 30 Del. C., §1903(a)

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2 The Van R Apparel Corporation never conducted business in the State of Delaware, and therefore, was not required to file a State income tax return.

> sets forth the starting point for the calculation of Delaware corporate income tax as the Federal taxable income for such year as computed for purposes of Federal income tax. It has been stipulated and agreed between the parties . . . that all net operating losses of the constituent corporation with the Petitioner had previously been utilized on the Federal income tax return. Therefore, in the calendar year 1978 there was no additional net loss carryover to be utilized on the Federal income tax return for the Petitioner.

The Board concluded that because the language of §1903 was clear on its face, the Board could not enlarge upon its meaning.

On appeal, taxpayer argues that the Board committed two errors of law: first, in violation of §1903, approving the Division's allegedly arbitrary practice of disregarding a corporate taxpayer's taxable income as determined under Federal law without providing a corresponding economic benefit to the taxpayer; and secondly, condoning the Division's use of a legal fiction (the separate return) when it benefits the Division but prohibiting the practice when it benefits the taxpayer. The taxpayer further argues that the taxing system implemented by the Division and upheld by the Board not only is arbitrary, capricious and unfair, but also violates Article VIII, §1 of the Delaware Constitution and §1903.

Pursuant to §1903, the Division argues that the starting point for computing State taxable income is Federal taxable income. Because taxpayer had no carry over loss for Federal income tax purposes in 1978, the Division argues that it did not have any such loss for State income tax purposes, and therefore, the carry over loss deduction should be disallowed.

The function of this Court on appeal from a decision of the Tax Appeal Board is to determine whether the Board's findings of fact and conclusions of law are supported by the record. If the Board's decision is supported by substantial evidence and free from legal error, it will be affirmed. State Tax Commissioner v. Publicker Industries, Inc., Del. Super., 267 A.2d 899 (1970); State Tax Commissioner v. Wilmington Trust Co., Del. Super., 266 A.2d 419 (1968); see generally Olney v. Cooch, Del. Supr., 425 A.2d 610 (1981); 29 Del. C. §10142. In the instant case, by the terms of the parties' stipulation, the

facts are undisputed. Therefore, the only question on appeal is whether the Board's interpretation of §1903 is correct as a matter of law.

Section 1903(a), in relevant part, provides that "[t]he 'entire net income' of a corporation for any income year means the amount of its federal taxable income for such year computed for purposes of the federal income tax . . . ." The language of the statute indicates that the starting point for the computation of State taxable income in any given year is the corporate taxpayer's Federal taxable income for the same year. For the tax year in question here, it is undisputed that there were no net operating loss carry overs for Federal income tax purposes.

In Decision of State Tax Board, Docket Nos. 238, 239 (July 27, 1962), the Board determined that a taxpayer could not utilize a net operating loss as a deduction unless such deduction was proper in connection with its Federal income tax computation for the year in question. The sole question in the case, which involved the application of 30 Del. C. §1903(a), was the deductibility (for State income tax purposes) of net operating losses incurred subsequent to January 1, 1958 (the date upon which the Delaware income tax upon corporations first became effective) where such losses had been exhausted by carrybacks to prior profitable years on the taxpayer's Federal return.

In the absence of any provisions specifically authorizing particular deductions, the Board concluded that Delaware law grants only those deductions which are allowable in computing a corporation's Federal taxable income for the particular year. The Board further noted the well-established principle that deductions are not matters of right, but matters of legislative grace, the right to which must be clearly set forth in the applicable taxing statute. See, e.g., Cagle v. C.I.R., 5th Cir., 539 F.2d 409 (1976); Fisher v. Commissioner of Internal Revenue, 7th Cir., 230 F.2d 79 (1956); 71 Am.Jur.2d State and Local Taxation §518 (1973).

Based on the language of §1903 and the Decision of the State Tax Board, Docket Nos. 238 and 239, supra, the Court finds that the decision of the Board is correct as a matter of law. Prior to the tax year in question, the taxpayer had exhausted the net operating losses of its subsidiary, the Van R Apparel Corporation, and therefore, in 1978, no net operating loss carry overs remained for the taxpayer to take advantage of in computing its Federal taxable income. The starting point for State taxable income being Federal taxable income, there was no net operating loss carry over for purposes of State income tax computation in 1978. Therefore, the deduction for such

losses was properly disallowed.

While the taxpayer's argument that the system created by §1903 and the separate filing requirement is unfair is not without merit, it is more properly addressed to the Legislature. As the Board stated in Decision of the State Tax Board, Docket Nos. 238 and 239, supra:

> [m]uch as we might wish to, we cannot interpret the plain provisions of the statute in order to cover a situation which, perhaps, was not envisioned when our law was adopted. To "interpret" the statute by applying the artificial concept taxpayers urge would not only ignore economic reality but in our opinion would supply by interpretation a statutory omission, if indeed there was any omission. It appears very clearly to us that the Legislature, rather than attempt to enact a comprehensive taxing statute, intended to "let the chips fall where they may" as to corporations, and to avoid the intricacies and administrative problems inherent in loss carryovers and carrybacks and in other types of deductions, by simply taking Federal taxable income, after Federal deductions, as the basis for Delaware tax. . . .

Furthermore, taxpayer's argument that a literal interpretation of §1903 results in the unequal application of the tax laws in violation of Article VIII, §1 is flawed in two respects. First, similarly situated taxpayers, that is those filing consolidated Federal returns, are treated equally. Secondly, and more importantly, taxpayers are not entitled to deductions as a matter of right.[3] Moreover, had taxpayer desired to take advantage of the losses of its subsidiary for State income tax purposes, it could have elected to file separate Federal returns.[4]

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[3] See supra, at page 3.

[4] In its reply brief, taxpayer argues that once it had commenced filing consolidated returns in 1966, it was required to continue such filing pursuant to I.R.S. Regulation 1.1502-75(a)(2) absent

For the reasons stated above, the decision of the Board should be affirmed.

IT IS SO ORDERED.

Respectfully yours,

RCOH:dm
xc: Prothonotary
Tax Appeal Board

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a showing of "good cause" for discontinuance. Taxpayer argues that under Regulation 1.1502-75(c)(ii), evidence of "good cause" has been defined as essentially the establishment of a substantial adverse change in Federal law affecting tax liability.

That argument, however, overlooks subsection (c)(iii)(a) of the Regulation. That subsection provides that in determining whether good cause exists, the Commissioner of Internal Revenue will take into account "[c]hanges in law or circumstances, including changes which do not affect Federal income tax liability. . . ." Pursuant to that subsection, taxpayer could have filed an application in 1971, alleging that Delaware's disallowance of consolidated returns constituted "good cause."

Supreme Ct. Form 9.

State of Delaware
Kent County } ss.

I, Thomas I. Barrows, Esq. Clerk of the Supreme Court of the State of Delaware, do hereby certify that the foregoing is a true and correct copy of Stipulation of Dismissal with Order dated May 28, 1985 in Cluett, Peabody & Co. v. Director of Revenue, No. 63, 1985

as the same remains on file and of record in said Court.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Court at Dover this 28th day of May, A.D. 1985

Thomas I. Barrows

Clerk of the Supreme Court.

Docket No. 7555

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Form 1

IN THE SUPREME COURT OF THE STATE OF DELAWARE

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TAX APPEAL BOARD

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PROTHONOTARY

CHETT vs DIR. REVENUE

No. 63, 1985
C.A. No. 83A-JN-4
Superior Court
New Castle County

The following docket entry has been made in the above cause.

13. May 23. Stipulation of voluntary dismissal by counsel.

14. May 28. Order dated 5-28-85, Clerk, granting dismissal. Certified copy of dismissal and record to clerk of court below. Case Closed.

cc: The Honorable Robert C. O'Hara
Charles Gruver, III, Esq.
J. Patrick Hurley, Jr., Esq.

Prothonotary
Received Above
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Date JUL 11 1985
TAX APPEAL BOARD

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Date: 5-28-85

Clerk

7637B

IN THE SUPREME COURT OF THE STATE OF DELAWARE

CLUETT, PEABODY & CO., INC., Petitioner Below, Appellant,	)	
v.	)	C. A. No.: 63, 1985
DIRECTOR OF REVENUE, Respondent Below, Appellee.	)	

STIPULATION OF VOLUNTARY DISMISSAL

The parties, having reached an amicable resolution of this controversy, hereby stipulate, subject to the approval of the Court, that the above-referenced matter be dismissed pursuant to Rule 29(a) of the Delaware Supreme Court Rules.

DELAWARE DIVISION OF REVENUE

By: J. Patrick Hurley
J. PATRICK HURLEY, JR., ESQ.
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BAYARD, HANDELMAN & MURDOCH, P.A.

By:
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Wilmington, De 19801
Attorneys for Appellant.

IT IS SO ORDERED THIS 28th DAY OF May, 1985.

For The Court
Thomas I. Barrows
~~Justice~~
Clerk