IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

LOUIS J. CAPANO, JR.,	)	
	)	
Appellant,	)	
	)	
v.	)	C.A. No. 01A-03-002 CHT
	)	
DIRECTOR OF REVENUE, STATE OF DELAWARE,	)	
	)	
Appellee.	)	

OPINION AND ORDER

On the Petitioner-Below's Appeal from the Decision of the Tax Appeal Board

Date Assigned: January 10, 2002
Date Decided: July 10, 2002

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Joseph Patrick Hurley, Jr., Deputy Attorney General, Department of Justice, State Office Building, 820 French Street, Wilmington, DE 19899, Attorney for Appellee.

TOLIVER, Judge

STATEMENT OF FACTS AND NATURE OF THE PROCEEDINGS

The matter before the Court arises from a tax credit claimed by the Appellant/Petitioner-Below, Louis J. Capano, Jr., on the Delaware personal income tax return he filed for the tax year 1989. The credit was taken pursuant to 30 Del. C. §1111[1] for taxes paid to the Commonwealth of Pennsylvania by a corporation, L & L Building Company (hereinafter "L & L"). Capano owned 90% of the shares in L & L. The facts relevant to this matter have been stipulated and/or agreed to by the parties in prior proceedings.[2]

During the tax year 1989, Mr. Capano was a resident of the State of Delaware. For Federal and Delaware state tax purposes, L & L was organized under the laws of Delaware as a Subchapter "S" corporation as opposed to a C corporation. For purposes of this litigation, it is important to understand the

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[1] All further references to Title 30 of the Delaware Code shall be by section only.

[2] As a result, no citations to the record other than to administrative proceedings below will be necessary.

significance between the designations. That distinction was outlined by the Supreme Court of Vermont in a case referred to by both of the instant parties captioned Tarrant v. Dept. of Taxes, 733 A.2d 733 (Vt. 1999), in the following manner:

> A traditional corporation, also known as a C corporation because its governing provisions are found in Subchapter C, Chapter 1, Subtitle A of the United States Internal Revenue Code (I.R.C.),is treated as a separate taxable entity by the federal government and is required to pay corporate income taxes based on or measured by its net income. When a C corporation distributes its earnings and profits to its shareholders, these distributions generally are taxable to the shareholders as dividends. Thus, a C corporation's income that is distributed to its shareholders is taxed twice: once at the corporate level and once at the personal level. . . .In 1958, Congress adopted Subchaper S of the I.R.C. primarily to curtail the impact of double taxation on small businesses. . . . Subchapter S permits small businesses, or S corporations, to receive the "non-tax advantages of incorporation such as continuity of existence, insulation from personal liability, and ease of transferability of ownership,. . . .which are also available to C corporations. There are, however, differences between S corporations and C corporations, most

> notably in their tax treatment. S corporations and their shareholders are for the most part statutorily exempt from double taxation. . . . Instead, S corporations and their shareholders are treated for tax purposes much like partnerships and their and respective partners. . . .The S corporation's income (or loss), deductions, and credits are passed through on a pro rata basis to the shareholders, who report them on their personal income tax returns. These pass-through items retain their character in the shareholder's hand. . . . Thus each shareholder reports the item on a personal income tax return as if the item were derived by the shareholder directly. . . .(Citations omitted.) Id. at 193-194.

Among other things, L & L owned a warehouse in Pennsylvania from which it received rental income. Pennsylvania did not recognize "S" corporation status for corporations that derived greater than twenty-five percent (25%) of their total income from rental activities. Notwithstanding L & L's Subchapter "S" status in Delaware, because L & L did in fact derive greater that this percentage from rental activities, Pennsylvania treated L & L as a "C" corporation for tax purposes.

For reasons that are not relevant to this litigation, L & L sold the Pennsylvania warehouse in 1989. Based upon the gain realized on the sale, L & L, as a C corporation, filed a corporate tax return and paid $183,135 in Pennsylvania state income tax. When he filed his 1989 individual tax return, Capano claimed a tax credit of $109,295 pursuant to §1111. This credit was based upon his pro rata share of the taxes assessed by the State of Pennsylvania on the aforementioned sale and paid by L & L.[3] The Delaware Division of Revenue disallowed the credit and issued a notice of deficiency on September 13, 1990. Capano filed a protest with the Director of the Division of Revenue. This protest was denied on January 23, 1991. The Division of Revenue also issued a "Notice of Assessment" seeking the imposition of penalties arising out the amount of taxes previously having been determined due.

Capano appealed the actions taken by the Division to the

[3] There is no evidence in the record that Capano himself paid any taxes in Pennsylvania or filed a tax return of any kind in that state.

Tax Appeal Board of the State of Delaware. Briefing was completed on September 26, 1996.[4] Following the submission of briefs by both parties, the Board issued its decision on February 9, 2001, denying Capano's petition.[5]

In reaching that decision, the Board accepted the argument made by the Director of Revenue argument that the statute was clear and unambiguous. It therefore refused to consider the legislative intent underlying the statute. The Board also relied on Sung v. Comm'n of Revenue Serv., Conn. Super., No. 548618, Blue, J. (Feb. 20, 1996), and held that the factual circumstances and the statutes in question there were more analogous to the circumstances and statutes at issue before it than the authority relied upon by Capano. Bd. Dec. at 2-3. In short, the Board found that Capano and L & L were distinct entities and that Capano could not claim credit for

[4] The parties agreed to stay the appeal to allow Capano to contest the designation of L & L as a C corporation in Pennsylvania. He was not successful in that effort and prosecution of the appeal resumed. The record is devoid of any information concerning the dates and/or substance of the Pennsylvania decision other than the aforementioned result.

[5] Hereinafter "Bd. Dec. at __".

taxes paid by L & L under the auspices of §1111.

On June 4, 2001 Capano filed the instant appeal from the decision of the Board. It is his contention that §1111 as it read at all times relevant to this appeal, was ambiguous, and that to properly apply it to the facts of this case requires one to look to the legislative history of the statute. Specifically, he asserts that the statute is ambiguous and that the Board "reconstructed" §1111 in a manner that contradicts the legislative intent in enacting that statute. That intent he contends, is for the Delaware Tax Code to "piggyback" or conform to the federal taxation system. DuPont v. Div. of Revenue, 347 A.2d 653, 655 (Del. Supr. 1975). The federal framework in turn allows a personal income tax credit to shareholders of "S" corporations for taxes paid by that corporation to foreign jurisdictions, regardless of whether that foreign jurisdiction recognizes the corporation's Subchapter "S" status in another state.

In support of his position, Capano relies on the alleged

ambiguity of §1111 and, as he did in the administrative proceedings below, Arundel Corp. v. United States, 102 F. Supp. 1019 (Ct. Cl. 1952) Because the federal system allows such a credit, Delaware's tax scheme must likewise permit the same type of credit where the "foreign" state does not recognize L & L's Subchapter "S" status, and the Board erred in failing to do so. Furthermore, the Board's decision is not supported by any Delaware case law and is contrary to the purpose of the statute, which is to prevent double taxation of income for resident individuals. As a result, the Board's strict construction of the statute is arbitrary and should be reversed.

The Director of Revenue's response to Capano's motion is that §1111 is unambiguous. As such, the Board was foreclosed from looking to any legislative intent and correctly applied the statute according to the plain meaning of its terms. The Director contends that this position is supported by decisions by courts in different jurisdictions when faced with analogous

situations. These decisions correctly focus on the distinction between the individual tax payer and the corporate entity as a taxpayer and require the conclusion that the one entity may not take a tax credit for taxes paid by the other.

DISCUSSION

The Delaware Administrative Procedures Act, specifically 29 Del. C. Ch. 101, includes the Tax Appeal Board as one of the agencies over which the Superior Court has appellate jurisdiction. Dir. of Revenue v. J. E. Rhoads & Sons, Inc., Del. Super., C. A. No. 92A-01-003, Gebelein, J. (Nov. 10, 1992), *rev'd on other grounds*, 628 A.2d 1388 (Del. 1993) (Mem. Op. at 1). When reviewing decisions of the administrative agencies over which it exercises that appellate jurisdiction, this Court must determine whether the decision is supported by substantial evidence and is free from legal error. Stoltz Management Co. v. Consumer Affairs Bd., 616 A.2d 1205, 1208

(Del. Supr. 1992); State, Dept. of Labor v. Medical Placement Services, Inc., 457 A.2d 382, 383 (Del. Super. 1982), aff'd 467 A.2d 454 (Del. Supr. 1983). "Substantial evidence is defined as such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Anchor Motor Freight v. Ciabattoni, 716 A.2d 154, 156 (Del. Super. 1998); and Streett v. State, 669 A.2d 9, 11 (Del. Supr. 1995). It is more than a scintilla and less than a preponderance. Olney v. Cooch, 425 A.2d 610, 614 (Del. Supr. 1981). It is not the function of this Court to weigh the evidence or to resolve conflicts in testimony or issues of credibility. Mooney v. Benson Mgmt., 451 A.2d 839 (Del. Super. 1982), *rev'd on other grounds*, 466 A.2d 1209 (Del. 1983); and Johnson v. Chrysler Corp., Del. Super., C. A. No. 84A-JL-18, Bifferato, J. (Nov. 26, 1985). In reviewing the record before it, the Court must consider the record in a light most favorable to the appellee. GMC v. Guy, Del. Super., C. A. No. 90A-JL-5, Gebelein, J. (Aug. 16, 1991).

When a statute is clear and unambiguous, the Court's "role is limited to an application of the literal meaning of the words." Coleman v. State, 729 A.2d 847, 851 (Del. Supr. 1999) (quoting Hudson Farms, Inc. v. McGrellis, 620 A.2d 215, 217 (Del. Supr. 1993)). However, when ambiguity is found, the Court should "ascertain and give effect to the intent of the legislature." Id. A statute is ambiguous when it is "reasonably susceptible of different conclusions or interpretations". Coastal Barge Corp. v. Coastal Zone Indus. Control Bd., 492 A.2d 1242, 1246 (Del. Supr. 1985). Ambiguity may also arise from a conclusion that the result produced by a literal reading of the statute is so unreasonable or absurd that the result could not have been intended by the legislature. Daniels v. State, 538 A.2d 1104, 1109 (Del. Supr. 1988).

Where there is ambiguity, the legislature's intent must be gleaned from a reading of the statute as a harmonious whole and such intent cannot be found by reading the statute's parts

or sections in isolation from the rest of the statute. Coastal Barge, 492 A.2d at 1245. Lastly, in construing statutes relating to taxation, the courts are not to concern themselves with legislative intent unless the clear meaning of the statute is in question. Doubts are to be resolved against the taxpayer. Id. See also Ebasco Service, Inc. v. Arizona State Tax Comm., 459 P.2d 719, 724 (Ariz. 1969).

Chapter 11 of Title 30 is entitled "Personal Income Tax".[6] Section 1101 states that the terms used in the chapter shall be interpreted consistent with federal law on the subject. However, such consistency is not required where the situations are not comparable or a different meaning is clearly intended. Where either of those exceptions is present, reason and common sense dictate that there be a divergence of interpretation.

In 1989, §1111 read:

> A resident individual shall be allowed a credit against the tax otherwise due

[6] The laws relating to the taxation of corporations are found in Chapter 19 of Title 30. S corporations are exempted from that genre of taxation by virtue of §1902(b)(9).

> under this chapter for the amount of any income tax imposed ***on him*** for the taxable year by another state of the United States, or the District of Columbia, on income derived from sources therein which is also subject to tax under this chapter. (Emphasis added.)

To take advantage of this language, Capano or any other taxpayer, must therefore:

> 1. Be a "resident individual";
>
> 2. Have income from the taxable year in question which was subjected to tax in both Delaware and another state; and
>
> 3. Which resulted in the imposition of a tax liability "on him" by that other state.

A resident individual is defined as an individual who is domiciled in Delaware or who has a residence and spends greater than 183 days of the taxable year in the state. §1103(2). Taxable income is defined as the taxpayer's federal adjusted gross income less deductions and the personal exemptions provided in Chapter 11. §1105. "On him" is not otherwise defined.

As indicated above, in order to reach Capano's arguments, the Court must first find an ambiguity in the statute in question. Barring such a finding, the Board's application of §1111 must be upheld. Unfortunately for Capano, nothing about the mandate of the statute is vague or indefinite, i.e., ambiguous.

The statutory mandate is in fact clear. At the risk of being repetitive, the taxpayer must be an individual who is a resident of Delaware having earned income subject to taxation in two jurisdictions, which, for present purposes, would be Delaware and another state. Of critical importance is the much highlighted additional requirement that taxes be imposed on the taxpayer him or herself, and not upon a separate entity. Then and only then is the taxpayer entitled to seek credit for the taxes paid to the other state or foreign jurisdiction.

Here, L & L was designated as a C corporation in the State of Pennsylvania. It was not an individual nor had it

been designated as an S corporation as Capano had urged that jurisdiction to do. That decision was unsuccessfully contested in that state for approximately five years while the proceedings in Delaware were stayed. L & L paid the tax assessed against the corporation. No Pennsylvania tax was imposed on or paid by Capano. Stated differently, L & L was a separate corporate entity which did not enjoy, at least in Pennsylvania, the status of an S corporation or any other symbiotic relationship with Capano sufficient for purposes of §1111. Nor was any tax otherwise imposed upon Capano by the State of Pennsylvania in connection with the activities of L & L. Given these facts about which there is no dispute, the only viable conclusion is that the Board acted in accordance the unambiguous language of §1111. The result was not absurd given the circumstances and there was no other basis upon which to premise a finding of any ambiguity. Any discussion of legislative intent was therefore unnecessary and the decision of the Board was correct as a matter of law.

To the extent that Capano complains that the Board's interpretation of §1111 is inconsistent with federal law in this area, a review of §1101 is in order. Consistency with federal law is not required where a different meaning was clearly intended when the General Assembly enacted the statute in question. The use of "on him" fits within that exception as it obviously reflects a legislative desire to allow a credit only where a tax burden had been imposed directly on the individual taxpayer not reflected in federal legislation covering the same subject. In addition, one can not include that the situations are analogous unless Pennsylvania considered L & L an S corporation and imposed the tax on that corporation which was ultimately assessed/paid by Capano in direct proportion to his ownership therein. Given Pennsylvania's refusal to grant S corporation status to L & L, Capano's quarrel is with that jurisdiction, not the State of Delaware.

While the cases cited by both sides are helpful in terms

of providing a basis for understanding the instant dispute, they are not controlling for several reasons.[7] First, none of the statutes involved contain "on him" or an equivalent designation specifically requiring the taxpayer be an individual upon whom the taxes were directly imposed. Second, each case reflects a factual background distinguishable from the instant situation. The question here is whether the individual taxpayer was subjected to taxation in a foreign jurisdiction and was also to be taxed on the same income in Delaware. Third, the courts which reached the question of legislative intent found ambiguity in construing the statutes in question. Here the language is unambiguous and a literal reading does not produce an absurd result.

The Court's view of §1111 is not affected by subsequent changes in the statute or the specter of double taxation. Amendments to the statute after that the operative events

[7] The primary cases discussed in this regard are Davis v. Arizona, 4 P.3d 1070 (Ariz. Ct. App. 2000); Sung v. Comm'r of Revenue Services, 691 A.2d 41 (Conn. Super. 1996); and Tarrant v. Dep't of Taxes, 733 A.2d 733 (Vt. Supr. 1999). However, the same conclusion applies to the other cases cited but not relied upon as extensively.

forming the basis of this litigation can be interpreted in favor of either interpretation being fostered here.[8] And, no authority has been presented to indicate that to subject both Capano and L & L to taxation is prohibited under the circumstances.[9] The fact that there was a common source of income is not significant apart and distinguishable from the initial determination that there was income subject to taxation in two states and/or jurisdictions. The critical point is that there was no tax obligation imposed on Capano in both Delaware and Pennsylvania arising out of that common income.

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[8] Capano refers to §1158, enacted in 1992, as an example of the legislative intent to treat S corporations in a manner contrary to that afforded him and L & L. See Op. Br. at 12. However, it can be argued with equal force if that was the intent of the Delaware General Assembly 1992, the legislature could have specifically addressed §1111 at that time as well.

[9] Capano did not contest the allegation made by the Board that L & L deducted the taxes paid to Pennsylvania when the corporation reported its taxable income for 1989. Ans. Br. at 3. Consequently, to the extent that L & L's income for that year was taxed twice, at least the deduction was used to offset some of that income.

CONCLUSION

Based upon the foregoing, the decision of the Tax Appeal Board is supported by substantial evidence in the record, is free from legal error. It must therefore be and hereby is, **affirmed.**

IT IS SO ORDERED.

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Toliver, Judge