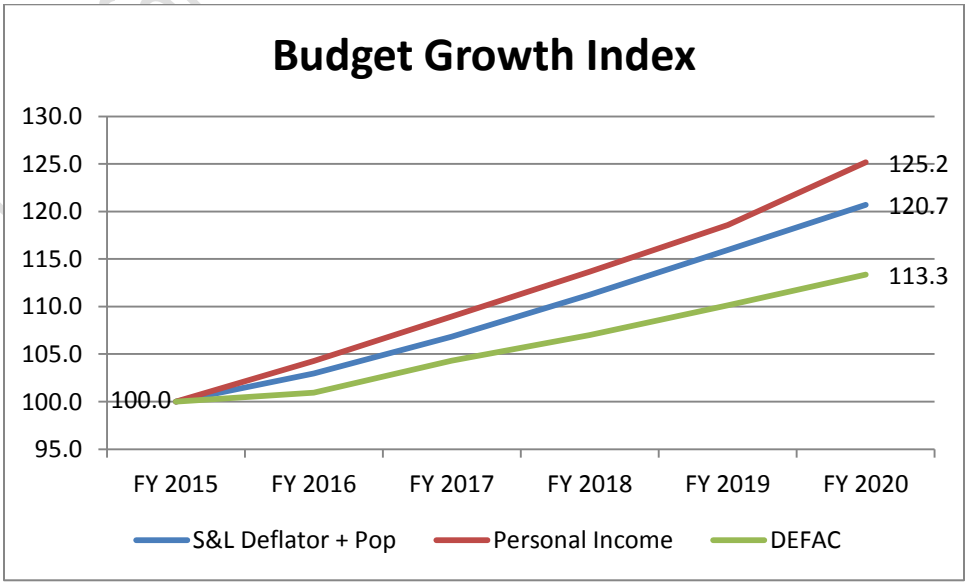
Framework for Recommendations

General Findings

- **Recent Performance:** For a decade or more, most of Delaware's General Fund revenue portfolio has failed to keep pace with fiscal pressures as measured by the following proxies:
  - Delaware Personal Income, and
  - Implicit Deflator for State and Local Government Purchases (CPI for states) plus Delaware population growth.
- **Unique Revenue Structure Conceals Underlying Issues:** This deficiency has been masked by the extraordinary growth in unclaimed property revenues over that same period. Unclaimed property revenues have peaked and, along with the state lottery, face external pressures that will likely prevent either source from returning to past growth trajectories.
- **Structural Concerns:** The failure of revenue growth to respond to recent upticks in the economy indicates that structural, and not cyclical, elements play the dominant role in the state's recent revenue performance.
- **The Connection between Revenues and Spending:** The Council did not explicitly examine the efficacy of current spending levels and priorities. From the Council's deliberations, though, it is clear that its members would likely fail to reach a consensus on the issue of the appropriate level of state spending. Regardless of the level of spending -- whether lower, higher or roughly the same as current levels – members do agree that the revenue system which supports that spending should embody sufficient elasticity to meet ordinary increases in the cost of providing services.

  To the extent that those ordinary cost increases are accurately reflected by inflation and population growth, the Council appeared to form a consensus on the use of a composite measure combining the Implicit Deflator for State and Local Government Purchases with Delaware population growth. Referring to the chart below, off of a given level of preferred state spending, the Council would appear to conclude that the revenues should grow on a trajectory similar to the S&L Deflator + Population (blue) line.



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- **Institutional Governors for Significant / Unexpected Surpluses:** The Council concluded that efforts to make Delaware's revenue portfolio more elastic should be combined with budget measures that ensure that large and/or unexpected surpluses are used judiciously. Like Delaware's other institutional governors, consideration should be given to adopting any new measure as a Constitutional Amendment.

Suggested Timeframe Definitions

- **Structural Reform:** Unlike most recent revenue legislation that focused on updates to tax rates, many of the policy "levers" presented to the Council involved more fundamental changes to various tax bases. In order to give taxpayers adequate time to digest and plan for such changes, the Council was urged to consider phasing-in certain changes over the course of a number of years.

- **Short-term:** Changes that address immediate budget shortfalls or surpluses. Such options must demonstrate that they can have a predictable effect on the FY 16 budget cycle.

- **Medium-term:** Fiscal Years 2017 – 2018.

- **Long-term:** Fiscal Years 2019 and beyond.

Personal Income Tax

- **Recent Performance:** Over the course of the new century, Delaware's Personal Income Tax has been consistent, economically responsive, and competitive relative to other parts of the tax portfolio. These characteristics are apparent as the Personal Income Tax ranks relatively well on measure such as:
    - Coefficient of Variation
    - Sharpe Ratio
    - Revenue-share Weighted Elasticity
    - Top Marginal Tax Rate
- **Demographic Dichotomy:** Since 2006, Delaware's total labor force and the number of resident Personal Income Tax filers have been relatively flat while civilian population has continued to grow. This is likely the result of the Baby Boomer generation beginning to retire. Delaware's Personal Income Tax has a variety of preferences favorable to elderly households and this demographic shift threatens to weaken the historical consistency and responsiveness of Delaware's Personal Income Tax.
- **Broadened the Base or Increase the Rate:** The Council's goal of increased portfolio elasticity and stability without harming tax competitiveness makes base broadening the preferred method of structural change.
    - Base broadening increases elasticity by reducing tax preferences that favor taxpayers who are generally well off and are the most likely to experience solid income gains. Depending on the form of base broadening, this may increase (elderly tax preferences) or decrease (changes to itemized deductions) stability and tax competitiveness. Likewise, the form of base broadening may simplify or complicate tax administration.
    - Rate hikes are more likely to affect Delaware's tax competitive position as Delaware's top marginal tax rate is currently just below the median for states with similar PIT structures and

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slightly above the median for all states. There may also be volatility concerns as higher income individuals also tend to have more volatile incomes.

- **Available Options:**
  - Simplify senior tax expenditures by unifying their trigger ages.
  - Means-testing tax-exempt retirement income.
  - Prohibiting, capping, or means-testing itemized deductions
  - Creating a new tax bracket.
  - Increasing some or all tax rates.

Corporate Income Tax

- **Recent Performance:** The Corporate Income Tax is one of the most volatile revenue sources in Delaware's portfolio while providing relatively moderate responsiveness to economic growth. Historically, the tradeoff between growth and volatility in the Corporate Income Tax has been relatively even. This balance has led the Council to focus on primarily on tax competition elements of the CIT.
- **Structural Volatility:** While the CIT is partially volatile because business income is volatile, Delaware's quarterly estimated payment schedule and the specific allocation of certain forms of business income have increased this volatility. Moving away from either of these structural elements would reduce volatility without seriously effecting responsiveness. However, doing so would certainly produce a one-time cost in the case of the estimated payment schedule, and would have varied costs and benefits in the case of specific allocation.
- **Trends in Tax Structure Point Away From Delaware Model:** Delaware's Corporate Income Tax apportionment formula is equally weighted on the share of a corporation's national sales, property, and payroll that occur in Delaware. Most states have moved towards an apportionment structure that weighs sales more heavily and a large minority of states have moved to apportioning based on sales alone. In addition, Delaware's CIT rate and CIT burden are high relative to other states. Thus the structure of Delaware's CIT maybe a competitive disadvantage, particularly in regards to corporate expansion.
- **Available Options:**
  - Evening out the quarterly payment schedule.
  - Changing apportionment formulas toward heavier weights on sales.
  - Limiting or ending specific allocation.
  - Reducing the tax rate.
  - Moving toward combined reporting.

Gross Receipts Tax

- **Recent Performance:** In recent history, the Gross Receipts Tax has been Delaware's most recession-proof revenue source experiencing the fewest years of negative growth in the period of consideration. The Gross Receipts Tax also boasts a large volatility-adjusted return above personal income growth relative to other revenue sources and is just behind the Personal Income Tax in terms of revenue-share weighted elasticity. While the Gross Receipts Tax scores well on volatility and responsiveness measure, there are competitiveness concerns raised by the business community mostly relating to the Gross Receipts Tax's relative uniqueness.

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- **Top Heavy Tax:** The Gross Receipts Tax is only paid by the top 10% of Delaware's business licensees and the top 1% of licensees provides 45% of the Gross Receipts Tax's revenue. Increases to the monthly exclusion over the past fifteen years have ensured that the Gross Receipts Tax's legal incidence continues to only fall on these large licensees.
- **License Categories Increase Complexity and Competitiveness:** A variety of license categories with different tax rates—representing a variety of competitive tax preferences towards certain industries—make tax administration and compliance more complicated. This issue is further convoluted by the Gross Receipts Tax's cascading nature where, for example, a firm that manufactures, wholesales, and retails some of its output must pay different rates on different portions of its receipts. The size of the Gross Receipts Tax's monthly exclusion is an attempt to reduce any distortionary effect of cascading.
- **Available Options:**
    - Collapsing the number of license categories.
    - Increasing rates generally or on specific industries.
    - Modifying the monthly exclusion amount.

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Video Lottery

	Amt Played	Amt Won	Net Proceeds	Track Share	Horsemen	Vendor Fees*	State Share
FY1996	$ 895.4	$ 818.7	$ 76.7	$ 39.5	$ 8.5	$ 9.5	$ 19.2
FY1997	$ 3,041.8	$ 2,788.0	$ 253.8	$ 128.2	$ 28.6	$ 31.9	$ 65.1
FY1998	$ 3,916.7	$ 3,591.0	$ 325.7	$ 161.9	$ 36.6	$ 37.8	$ 89.4
FY1999	$ 4,476.4	$ 4,099.8	$ 376.6	$ 185.6	$ 42.1	$ 28.7	$ 120.2
FY2000	$ 5,535.9	$ 5,085.9	$ 450.0	$ 219.9	$ 49.9	$ 25.3	$ 154.9
FY2001	$ 6,226.5	$ 5,725.5	$ 501.0	$ 243.7	$ 55.4	$ 25.6	$ 176.3
FY2002	$ 6,941.9	$ 6,376.4	$ 565.5	$ 273.9	$ 62.5	$ 28.9	$ 200.2
FY2003	$ 6,475.4	$ 5,950.9	$ 524.5	$ 254.4	$ 58.2	$ 27.7	$ 184.2
FY2004	$ 6,524.0	$ 5,994.0	$ 530.0	$ 253.8	$ 58.8	$ 29.9	$ 187.5
FY2005	$ 7,009.9	$ 6,436.2	$ 573.7	$ 273.9	$ 63.5	$ 32.2	$ 204.1
FY2006	$ 7,315.3	$ 6,713.6	$ 601.7	$ 286.7	$ 66.6	$ 33.9	$ 214.5
FY2007	$ 8,034.1	$ 7,401.9	$ 632.2	$ 300.6	$ 69.8	$ 37.3	$ 224.5
FY2008	$ 8,149.1	$ 7,528.4	$ 620.7	$ 295.4	$ 68.9	$ 36.9	$ 219.5
FY2009	$ 7,476.8	$ 6,900.1	$ 576.7	$ 266.1	$ 63.7	$ 34.5	$ 212.4
FY2010	$ 7,165.7	$ 6,619.3	$ 546.4	$ 221.0	$ 54.8	$ 32.9	$ 237.7
FY2011	$ 6,380.3	$ 5,881.0	$ 499.3	$ 202.4	$ 50.2	$ 29.5	$ 217.2
FY2012	$ 5,977.3	$ 5,504.9	$ 472.4	$ 190.6	$ 47.6	$ 28.7	$ 205.5
FY2013	$ 5,123.3	$ 4,720.3	$ 403.0	$ 163.5	$ 40.5	$ 24.6	$ 174.4
FY2014	$ 4,608.5	$ 4,253.2	$ 355.3	$ 141.8	$ 35.9	$ 23.9	$ 153.7
	$ 111,274.3	$ 102,389.1	$ 8,885.2	$ 4,102.9	$ 962.1	$ 559.7	$ 3,260.5

Sports Lottery

	Handle	Cashed	Vendor Fees*	Net Proceeds	Tracks	Retailers	Horsemen	State Share
FY1996								
FY1997								
FY1998								
FY1999								
FY2000								
FY2001								
FY2002								
FY2003								
FY2004								
FY2005								
FY2006								
FY2007								
FY2008								
FY2009								
FY2010	$ 10.8	$ 7.0	$ 0.6	$ 3.2	$ 1.3		$ 0.3	$ 1.6
FY2011	$ 12.9	$ 7.4	$ 0.9	$ 4.6	$ 1.9		$ 0.4	$ 2.3
FY2012	$ 17.8	$ 12.6	$ 0.8	$ 4.4	$ 1.8		$ 0.4	$ 2.2
FY2013	$ 25.4	$ 20.1	$ 0.9	$ 4.4	$ 1.4	$ 0.3	$ 0.4	$ 2.3
FY2014	$ 31.5	$ 20.3	$ 2.2	$ 9.0	$ 2.1	$ 0.6	$ 0.8	$ 5.5
	$ 98.4	$ 67.4	$ 5.4	$ 25.6	$ 8.5	$ 0.9	$ 2.3	$ 13.9

Table Games

	Drop	Win	Net Proceeds	Tracks	Horsemen	State Share
FY1996						
FY1997						
FY1998						
FY1999						
FY2000						
FY2001						
FY2002						
FY2003						
FY2004						
FY2005						
FY2006						
FY2007						
FY2008						
FY2009						
FY2010	$ 20.1	$ 17.1	$ 3.0	$ 2.0	$ 0.1	$ 0.9
FY2011	$ 388.3	$ 314.1	$ 74.2	$ 49.0	$ 3.4	$ 21.8
FY2012	$ 385.4	$ 310.4	$ 75.0	$ 49.6	$ 3.4	$ 22.0
FY2013	$ 340.7	$ 275.1	$ 65.6	$ 43.4	$ 2.9	$ 19.3
FY2014	$ 259.2	$ 206.8	$ 52.4	$ 34.6	$ 2.4	$ 15.4
	$ 1,393.7	$ 1,123.5	$ 270.2	$ 178.6	$ 12.2	$ 79.4

Implementation Schedule (Fiscal Impact)

Growth Target	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
**** EXAMPLE ****					
Fully Implemented FY 2018			ELASITICITY X VOLATILITY Y COMPETITIVENESS Z		
Revenue Neutral vs. DEFAC					
Fully Implemented FY 2019	Total 0.0	Total 0.0	Total 0.0	Total 0.0	ELASITICITY X VOLATILITY Y COMPETITIVENESS Z
Immediate FY16 Revenue Need					
Fully Implemented FY 2017	Total 0.0	Total 0.0	ELASITICITY X VOLATILITY Y COMPETITIVENESS Z		
Other					
Fully Implemented FY 20??					

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