CORPORATE INCOME TAX

- Statutory Provision

  Title 30, Delaware Code, Chapters 19 and 64.

- Collection/Administrative Agency

  The Department of Finance, Division of Revenue, administers this tax.

- General Liability

  Every domestic and foreign corporation doing business in Delaware is required, unless specifically exempt by law, to file a corporate income tax return regardless of the amount of its gross income or its taxable income. Corporations that maintain a statutory office in Delaware but that do not conduct business within the State are not required to file a corporate income tax return.

  Taxes for Delaware purposes are computed on whatever share of the corporation's federal taxable income is allocated and apportioned to Delaware. Delaware taxable income does not include interest on obligations of the United States, the State of Delaware, or its subdivisions. Dividends, interest, and royalties of foreign corporations that qualify for a foreign tax credit for federal purposes are excluded from Delaware taxable income. Additional deductions are allowed for any wages eliminated as a deduction in the calculation of the federal Jobs Credit and certain expenditures on building renovations that improve accessibility for handicapped persons.

  Income from rents and royalties, patents and copyright royalties, gains and losses from the sale or other disposition of real and tangible personal property, and from interest is allocated directly to the states where the property is physically located or the transactions took place, reduced by the applicable related expenses.

  Apportionment of unallocated income is based on a three-factor formula that averages the ratios of: (1) Delaware property to total property; (2) Delaware wages to total wages; and (3) Delaware gross receipts to total gross receipts for businesses that operate interstate. The apportionment formula is applied to a company's entire taxable income, excluding allocated and exempt income. The apportionment formula is as follows:

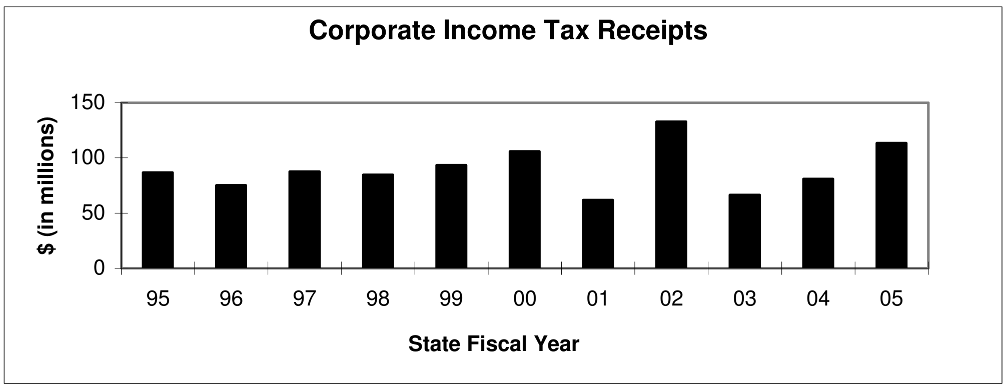
$$\frac{\text{Property Ratio} + \text{Salary Ratio} + \text{Sales Ratio}}{3} = \text{Apportionment Ratio}$$

- Tax Rate

8.7% of taxable income

- Tax Receipts, net of refunds (millions of dollars)

Fiscal Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total ($)	86.8	75.1	87.6	84.8	93.3	106.0	61.8	133.0	66.3	81.0	113.9



- Tax Preferences

The following items have been identified as corporate income tax preferences within the Delaware Code:

2.01 Exemption of Investment Holding Companies and Firms Managing Intangible Investments of Mutual Funds

1. Statutory Provision
   Title 30, Delaware Code, Chapter 19, §1902(b)(8)

2. Description
   Investment holding companies and corporations whose activities within this State are confined to the maintenance and management of the intangible investments of corporations or business trusts registered as investment companies under the Investment Company Act of 1940 are exempt from the corporate income tax.

3. Estimated Revenue Loss
FY 05: Unknown
FY 06: Unknown

4. Assessment
This provision is designed to spur economic development in the State. The tax preference is intended to strengthen the State's reputation as a major financial center, and to signal to the financial community that Delaware is a progressive state in terms of liberalizing its financial regulatory environment. Originally, this exemption applied only to investment holding companies. On July 1, 1990, this provision was extended to include corporations that invest the funds of a mutual fund.

Eligible firms file only information returns, establishing their eligibility for the exemption and, therefore, do not have to file a corporate income tax return. This makes an accurate assessment of the revenue impact of this provision little more than guesswork. As investment holding companies are established in Delaware primarily because of this tax exemption, it is likely that, given the inherent mobility of intangible assets, many of them would leave the State if the exemption were repealed or narrowed significantly. However, no data exist by which the Division of Revenue could make its own estimate of the revenue loss generated by this exemption.

5. Inadvertent Effects
None noted.

2.02 Exemption of Foreign Sales Corporations

1. Statutory Provision
Title 30, Delaware Code, Chapter 19, §1902(b)(11).

2. Description
Corporations that qualify as foreign sales corporations (FSC's) under the federal Internal Revenue Code (IRC) are exempt from corporate income tax. An FSC is a non-U.S. corporation, established by a single U.S. exporter, or jointly by a group of U.S. exporters (a "shared" FSC), to export U.S. goods and services abroad.

The Federal preference was dissolved by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (H.R. 4986), effective October 1, 2000. Short-term transition rules allow existing FSCs to continue these benefits through

December 31, 2001. Long-term benefits are also extended to long-term lease transactions, which will be allowed to maintain FSC tax benefits over the life of the lease.

3. Estimated Revenue Loss
FY 05: Unknown, Likely to be $0
FY 06: Unknown, Likely to be $0

4. Assessment
The primary rationale for exempting FSCs is to promote export opportunities for small- and medium-sized Delaware businesses. Such businesses face significant export barriers in the form, for example, of complex foreign legal and administrative requirements. By eliminating the tax liability on goods and services exported using an FSC, it may be argued that such barriers are more likely to be overcome, and Delaware's exports enhanced.

Historically, few firms claimed this exemption and, although FSC's were not required to file tax returns, analysts concluded that the provision cost the State little in terms of foregone revenue. Analysts also concluded that the exemption probably did little to improve Delaware's export base.

5. Inadvertent Effects
None Noted.

2.03 Exemption of Foreign Sales Service Corporations

1. Statutory Provision
Title 30, Delaware Code, Chapter 19, §1902(b)(12).

2. Description
Delaware exempts from its corporate income tax any corporation whose primary business is the sale of services to FSCs through the end of calendar year 2001. The Federal FSC Repeal and Extraterritorial Income Exclusion Act of 2001 will prohibit further use of this preference.

3. Estimated Revenue Loss
FY 05: Unknown, Likely to be $0
FY 06: Unknown, Likely to be $0

4. Assessment
This preference is also intended to encourage export growth and promote international trade by exempting FSSCs from corporate income tax. Like

FSCs, FSSCs only have to file information returns that prove their eligibility for the exemption--they do not have to file a corporate income tax return. Historically, very few firms have made use of this provision and it is very likely that this remains the case, especially in light of its repeal at the federal level.

As with the previous preference, the World Trade Organization found that such rules were effectively illegal export subsidies and encouraged the repeal of this preference.

5. Inadvertent Effects
None noted.

2.04 Exemption of Export Trading Companies

1. Statutory Provision
Title 6, Delaware Code, Chapter 74, §7401-§7404.
Title 30, Delaware Code, Chapter 19, §1902(b)(13).

2. Description
Any corporation that qualifies as an export trading company under federal law is exempt from corporate income tax. To qualify, a company must have an office in Delaware and, subject to the rules and regulations of the Delaware Economic Development Office, perform export trade services. In making its eligibility determinations, the Delaware Economic Development Office must consider:

(i) whether the firm's basic aim is to encourage and expand export trade;
(ii) whether its activities contribute significantly to encouraging export trade;
(iii) whether the exemption will serve as a significant incentive and aid in encouraging export trade; and
(iv) whether export trade opportunities will be expanded.

3. Estimated Revenue Loss
FY 05: Unknown, but likely to be negligible[1]
FY 06: Unknown, but likely to be negligible

4. Assessment
Although this provision was intended to promote export trade by Delaware corporations, very few firms have claimed the exemption since the provision

[1] Defined as less than $10,000.

became law in 1985. Historically this provision has gone largely unused. DEDO officials question its usefulness. As this provision is so little used, it seems reasonable to suggest that policymakers examine alternative methods of promoting Delaware's export trade.

This exemption appears to have provided no real impetus to the expansion of Delaware's export base. But this fact should not be misinterpreted to imply that these provisions are cost-effective approaches to export promotion. The cost is low, but the effectiveness appears to be minimal as well. Such provisions serve to further complicate the Delaware tax code, and could increase revenue losses if other factors cause exports to boom.

5. Inadvertent Effects
None noted.

2.05 Deduction of Interest from Affiliated Companies

1. Statutory Provision
Title 30, Delaware Code, Chapter 19, §1903(a)(2)

2. Description
Delaware allows firms (creditors) to deduct the amount of interest income (including discount) that they earn on inter-corporate obligations (usually in the form of advances, loans, or similar contractual transactions). In order to qualify for this deduction, the following requirements must be met:

(i) the debtor and creditor corporations are subject to taxation under Delaware law; and
(ii) the debtor corporation does not claim a deduction for such interest payments in determining its entire net income for Delaware corporation income tax purposes.

3. Estimated Revenue Loss
FY 05: Likely to be Negligible*
FY 06: Likely to be Negligible*

* Accounts for a very high probability of a sweeping behavioral effect. See discussion in Assessment, below.

4. Assessment
The corporate income tax deduction for interest from affiliated corporations allows related companies to shift interest income and related expenses among

members of a group that is eligible to file a federal consolidated return. The rational behind this provision is consistent with the idea behind the exemptions for investment holding companies (Item 2.01) and designated or qualified settlement funds (Item 1.16). By creating a tax advantage for the management of inherently mobile intangible assets, such as inter-company obligations, Delaware enhances its reputation as a financial center and may also produce a secondary effect in the form of relatively small employment gains for Delaware's financial and legal communities. Because the ease with which intangible assets could be moved from Delaware is so great, it is clear that a tax incentive's impact on the decision to locate such assets in Delaware is critical.

In fact, many argue that a business's decision to "locate" intangible assets in Delaware occurs solely due to the tax incentive. Unlike tangible business assets (e.g., a production or research facility), the location of intangible assets is not dependent upon the quality of public infrastructure, access to markets, a well-trained pool of labor, or quality of life considerations. In the event of its repeal, the vast majority of the intangible assets covered under this provision would leave the State drastically reducing any revenue loss estimate produced on a static basis.

When the deduction was enacted in 1957, Delaware permitted corporations to elect to file consolidated returns. Since most corporations at that time filed consolidated returns, there was little or no revenue impact resulting from the shift of income among related companies. Starting on August 1, 1971, however, corporations were not permitted to file consolidated returns and now must file a separate return for each corporation conducting business within Delaware. Interest may be excluded from State taxation to the extent that the creditor corporation (i.e., the corporation that receives the interest income) conducts a greater percentage of its business in Delaware than the debtor corporation (i.e., the corporation that pays the interest on its debt).

Affiliated finance companies (AFCs) present a special case under this tax preference. By purchasing receivables from their affiliate or "core business" (a large retailer, for example), the AFC acts as a creditor for its affiliate. The affiliate (retailer), usually has a very small apportionment percentage because sales in Delaware make up only a small part of its market. The AFC, however, usually has a very high apportionment percentage (frequently 100%). Therefore, the interest on a large loan from an AFC to the core business is often sufficient, when deducted from the AFC's net income, to totally eliminate its tax liability. The AFC's primary function is to enhance the financial position of the core business; correspondingly, large loans are not uncommon. It is evident that this preference is the reason behind the establishment of AFC's in Delaware. The fact that so many AFC's were established in Delaware in response to this provision suggests that its elimination would cause many or all AFC's to move to other states.

As mentioned above, estimates of the revenue loss for this tax preference are confounded by unknown market responses to a change in this tax law. Although the elimination of this provision could cause a temporary, short-term increase in revenues, firms likely would move these operations out of the State as quickly as possible, erasing any long-term revenue gain.

5. Inadvertent Effects
None noted.

2.06 Handicapped Accessibility Deduction

1. Statutory Provision
Title 30, Delaware Code, Chapter 19, §1903(a)(6).

2. Description
Delaware offers a deduction from corporate income tax equal to the expenses that a corporation incurs (not to exceed $5,000) in a renovation project to remove design features in a building that restrict the full use of the building by physically handicapped persons. The term "building" means a building or structure, located in Delaware and open to the general public. This definition includes sidewalks, curbing, driveways, and entrances connected with, or related to, the use of the building structure. Also qualifying for the deduction are expenditures incurred in the removal of architectural barriers or physical design features for the purpose of making the building more accessible to, or usable by, handicapped individuals.

3. Estimated Revenue Loss
FY 05: Negligible
FY 06: Negligible

4. Assessment
The relatively low utilization of this deduction suggests that it is insufficient to encourage firms to undertake costly renovations. This is true despite the fact that the deduction may be claimed in addition to a deduction on depreciation for renovation projects. Moreover, corporations are also allowed to expense up to $15,000 of capital costs (in lieu of depreciation) to remove architectural and transportation barriers to handicapped individuals under §190 of the

federal IRC, which is adopted by Delaware law. As such, corporations may receive a Delaware tax benefit of up to $435 (8.7% of the capital project up to $5,000) in addition to expensing or depreciating the capital investment.

Small businesses may also claim the federal "disabled access tax credit" -- a credit equal to 50 percent of "eligible access expenditures" as exceed $250 (as defined under Section 44 of the IRC), but not exceeding $10,250. To be eligible, a small business must have gross receipts of less than $1 million, or no more than 30 full-time employees.

Despite these federal and state inducements, very few companies have responded to them. The primary policy tool in promoting handicapped accessibility is the Americans with Disabilities Act (ADA). Enforcement of the ADA depends primarily upon private lawsuits brought by persons who claim that a business is non-compliant. If companies respond to the threat of such lawsuits, then the number of businesses that claim these deductions could grow. Nonetheless, it is unlikely that these tax benefits alone will offer much incentive for firms to make their buildings accessible. The value of these benefits, capped at $435 for each firm, pales in comparison to the costs of actually performing accessibility improvements. For these reasons, it appears that utilization of this tax benefit will remain inconsequential and that this provision will do little to achieve its intended purpose. Moreover, as with other tax incentives that parallel regulatory provisions, it is unclear that the State should simultaneously subsidize actions that are mandated by other laws.

5. Inadvertent Effects
None noted.

2.07 Neighborhood Assistance Credit [2]

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter I, §2001-§2006.

[2] Previously the Neighborhood Assistance Deduction.

2. Description

Businesses that invest in community development programs approved by the Director of the Delaware Economic Development Office and the Tax Appeal Board are entitled to a tax credit equal to fifty percent (50%) of the amount invested by a business firm in a program or in a Community-Based Development Organization. The size of the tax credit is limited to the lesser of 50% of a firm's qualifying investment or $100,000. The aggregate amount of tax credits awarded in any one year may not exceed $500,000.

The term "Neighborhood Assistance" encompasses business contributions to neighborhood organizations, Community Development Corporations, Community-Based Development Organizations, or which fund the following activities: job training or education for individuals not employed by the business firm, community services, crime prevention, housing, or economic development in an impoverished area.

3. Estimated Revenue Loss

FY 05: $0
FY 06: Less than $25,000

4. Assessment

The goal of this credit is to encourage Delaware businesses to invest in job training, education, crime prevention, and other community services in designated impoverished areas. The credit offered for neighborhood assistance is allowed in addition to the deduction for any amounts qualifying as charitable contributions. Corporations can therefore reduce their tax liability by over 50% percent of any amount (subject to the aforementioned limits) that they contribute to neighborhood assistance programs and to charitable organizations.

Prior to tax year 2000, this incentive was a less valuable deduction of which few firms made use. The expansion of the deduction into the current Neighborhood Assistance Credit, was implemented January 1, 2000, in an attempt to encourage greater program participation. However, it is not clear that these program enhancements will increase the success of the program. The inability of this provision to elicit business participation in the past, rather than demonstrating that the value of the preference is insufficient, more likely demonstrates that the tax consequences of corporate giving are far from the only consideration involved in the selection of the type of corporate charity. In addition to charitable objectives, corporate charity is also motivated by business considerations. Though exceptions may exist, generally speaking, charitable activities which resonate with a firm's customers, management and shareholders[3] are probably more likely to receive funding than other causes which lack similar appeal but happen to provide a larger tax break. Corporate giving, to the extent that it occurs within impoverished areas, is no exception; it occurs because it provides benefits to both the neighborhood and the firm.

To the extent that the traditionally scant use of this deduction demonstrates an inherent "disconnect" between the goals of corporate charitable efforts and the very real needs of impoverished areas, there may be very little chance that any reasonably constructed tax incentive will provide meaningful support to these communities. If policymakers conclude that the present level of support (both public and private) for these communities is inadequate, it seems apparent that other, more reliable, funding mechanisms (e.g., a direct appropriation) would be preferable to the current deduction or the enhanced version thereof.

To the extent that firms do take this deduction in the future, and are motivated by the factors discussed above rather than the tax benefits of giving, the credit may represent a bonus for actions that would have taken place in its absence.

5. Inadvertent Effects
None noted.

2.08 Tax Credit for Creation of Employment and Qualified Investments in Business Facilities (Blue Collar Jobs Act)

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter II §2010, §2011.

2. Description
Any corporate taxpayer that makes a qualified investment ($200,000 or more) and that hires five or more qualified employees ($40,000 per employee) is entitled to receive a tax credit. Eligible corporations receive credits of $400 for each qualified employee and $400 for each $100,000 invested, not to exceed fifty percent of their tax liability in a given year. Unused credits may be carried forward. Qualified activities are defined as:

    1. Manufacturing;
    2. Wholesaling;
    3. Scientific, agricultural or industrial research development or testing;
    4. Computer processing, or data preparation and processing services;

[3] For example, support for the arts, or support for medical research efforts.

5. Engineering services;
6. Consumer credit reporting services, including adjustment and collection services and credit reporting services;
7. Telecommunications services;
8. Aviation services;
9. Non-custom computer software;
10. Any combination of the activities described above; or
11. The administration, management or support operations (including marketing) of any activity described above.

Instead of five employees and $40,000 of investment, telecommunication service businesses are required to hire at least 50 qualified employees and make a minimum investment of $15,000 per qualified employee (with a minimum aggregate investment of $750,000, rather than $200,000).

In July 1997, the application of these credits was expanded. The requirement that a taxpayer make a qualifying investment *and* employ the requisite number of new employees in the same tax year was loosened. The two events now need to occur within the same 12-month period.

An alternative investment tax credit of $300 per $100,000 of investment is available in cases where the qualified investment is at least the greater of $1 million, or 15% of the unadjusted basis of the qualified facility. The alternative credit is to be used by manufacturers, wholesalers or aviation service firms who do not meet the ordinary requirements for investment credits (i.e., the required number of new employees).

Eligibility for corporate income tax credits also means firms become eligible for gross receipts and public utility tax breaks.[4] Unused credits may be carried forward for use in future tax years.

The cost of this preference, like the tax itself, tends to fluctuate considerably from year to year. As a consequence, as corporate profits have increased in recent years, so too, has the cost of this preference.

Unless the program is extended, no new credits will be allowed for investments that occur on or after January 1, 2007.

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[4] A related type of investment credit can be used against the bank franchise tax (5 Del. C., Chapter 11, Section 1105(d)-(f)).

3. Estimated Revenue Loss [5]
FY 05: $2.4 million
FY 06: $2.5 - $5.0 million

4. Assessment
The first goal of these credits is to promote job creation and investment in Delaware by giving employers incentives to hire additional full-time employees or to expand business facilities. The second goal is to offer an incentive to firms that are considering whether to locate a facility in Delaware. Whether a $400 credit per $100,000 of investment offers enough incentive for firms to expand is an open question, but appears improbable. In the absence of increased demand for a firm's products or services, the promise of a relatively small tax subsidy will make little difference in the expansion decision.

These credits also attempt to create a competitive environment to attract new business to Delaware. State development officials have indicated that these credits serve a useful role as a marketing tool in recruiting new businesses to Delaware. On the margin, the existence of tax credits may tip a firm's location decision in Delaware's favor. Further, the credits may have value if they portray Delaware as being committed to economic development.

In general, though, the impact of taxes on business location decisions is often of secondary importance to other elements of a State's business climate. Access to markets, labor skill and supply, and infrastructure quality are typically more important considerations in a business's location decision. It is often unclear whether tax credits are a critical element, without which a firm would have chosen to locate elsewhere, or if they merely serve as a bonus to firms that would have chosen a particular state regardless of the credit. The size of the incentives suggests that they are unlikely to have a significant impact on businesses' location decisions. Despite this, proponents argue that such credits must be offered for businesses to even consider Delaware as a potential location. Even if the credits are not *the* deciding factor in the location

[5] This estimate only includes the fiscal impact of this provision with respect to the corporate income tax. No assessment is made of the extent to which these credits will be claimed against other eligible taxes. Given this limitation, the fiscal impact estimate does not reflect the full impact of this provision on state revenues. It also excludes any "dynamic" revenue effect the credit may have (i.e., economic improvements resulting from the credit which offset some of its cost). For example, to the extent that the qualified investment in new facilities and employees increases a firm's productivity (and profits) corporate income tax receipts -- and other state tax receipts -- could increase. Establishing and quantifying a causal effect, however, would be tenuous at best.

decision, they may be of enough importance to retain. They may even be considered a cost of doing business for State development efforts.

This provision has been modified incrementally over a number of years, and is the basis for other credits against corporate income and other taxes (see items 2.09, 2.11 and 2.12). This "layer-upon-layer" development, however, has compromised the potential benefits of these credits by making the entire program unwieldy for development officials and confusing for prospective participants. The credits are only useful as a marketing tool for development officials to the extent that they can be understood and effectively utilized. As such, consideration should be given to streamlining the complex system of business tax credits now in place.

An assessment of the fiscal impact of the credits depends on the ability to identify those business decisions that were influenced by the credits and those that were not. Fiscal impacts could then be calculated for both sets of decisions and weighed against each other. No data exist that would allow such a comparison to be conducted. The fiscal impacts of these provisions are therefore calculated on a static basis, with no assessment of the potential positive behavioral responses to the incentives.

5. <u>Inadvertent Effects</u>

These credits may indeed serve as a useful promotional tool for State development officials. But there is an equally strong probability that most firms are simply "rewarded" with a bonus for actions that they would have taken without the existence of a credit, rather than "earning" a credit for actions that would not have occurred without them.

Moreover, as mentioned above, a series of incremental changes have made the program extremely complex, potentially compromising any positive effects the credits may have. Consideration should be given to streamlining the existing program.

2.09 Tax Credit for Creation of Employment and Qualified Investments in Targeted Areas (Blue Collar Jobs Act)

1. Statutory Provision
   Title 30, Delaware Code, Chapter 20, Subchapter III §2020-§2023.

2. Description
   This provision allows employers engaged in qualified activities (as defined in §2010 -- see above) an extra credit of $250 (for a total credit of $650) for each additional full-time employee, and an extra credit of $250 (for a total of $650) for each $100,000 investment in qualified facilities located in "targeted areas" (as defined in §2020), in addition to the credits allowable under §2011 above.

   A related credit of $400 (the amount for investment in qualified facilities) is allowed for facilities engaged in "commercial or retail activity" within targeted areas. *Commercial activities* (as defined in §2020(3)) include all services except: amusement conductor, amusement park operator, auctioneer, automobile race operator, bowling alley operator, circus exhibitor, entertainment agent, finance or small loan agency, floor show operator, health spa or health club, junk dealer, motion picture theater, outdoor music festival promoter, pawnbroker, pool table operator, public bath keeper, salvage yard operator, and self-service laundry or dry cleaner. *Retail activities* (as defined in §2020(4)) include all retail trade except: eating and drinking places, automobile sales, or providing recreation or entertainment. Facilities meeting this expanded definition in targeted areas are treated as if they qualified for the credit described above in 2.08.

3. Estimated Revenue Loss [6]
   FY 05: See Item 2.08 above
   FY 06: See Item 2.08 above

4. Assessment
   These credits were established to further encourage economic development and employment in certain underdeveloped areas of the State, and to create a business environment that is competitive with other states in the region. It is likely that some of the financial benefit of these credits accrues to firms that would have made the same investments anyway. In many cases, the use of

[6] This figure is included in the fiscal impact estimate for tax credits for the creation of employment and qualified investment in business facilities (Item 2.08). The information available to the Division of Revenue did not allow for the separate impact of these provisions to be broken out.

credits does not reflect desired behavioral change induced by the tax benefit, but rather shows decisions are often of secondary importance to other elements of a state's business climate (e.g., access to markets, the skill and cost of labor, infrastructure, etc.). Given the size of the incentives and the characteristics of the targeted areas, they seem unlikely to have a significant impact on locational decisions of businesses.

5. Inadvertent Effects
Certain qualifying firms may be benefiting from a tax relief for actions that were largely unrelated to the existence of tax incentives.

2.10 Tax Credits for the Mitigation of Commuter Traffic During Peak Travel Periods (Travelink Credits)

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter IV, §2030-§2036.

2. Description
Employers that participate in a Travelink program certified by the Delaware Department of Transportation are entitled to a tax credit equal to 10 percent of the developing, implementing, and maintaining the Travelink program, or up to $250 for each employee taking part in traffic mitigation efforts. In addition to the corporate income tax, businesses may take the credits against the gross receipts tax, bank franchise tax, insurance premium tax, or public utility license fee. The total amount of credits that may be authorized in any one year may not exceed $100,000.

3. Estimated Revenue Loss [7]
FY 05: Negligible
FY 06: Negligible

4. Assessment
The 1990 Federal Clean Air Act Amendments (CAA) required states to develop regulations to reduce commuter traffic. To comply, Delaware drafted the employee commute options (ECO) regulations mandating that employers with 100 or more employees develop commuter plans to reduce the use of single-occupant vehicles.

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[7] As is the case with the credits described in items 2.08 and 2.09, these credits may be claimed against one of several taxes. The fiscal impact estimate for corporate income tax may, therefore, underestimate the full impact of this provision.

For a brief period while Delaware was in the process of developing its ECO regulations, it appeared that Travelink would become a very costly program. Travelink's tax credit would have been eligible for all firms meeting a regulatory mandate. In this sense, there would have been no doubt that a tax credit would have been a bonus rather than a true incentive.

After Delaware had drafted its ECO regulations, however, the provisions of the CAA that mandated employee commute options programs were overturned by an act of Congress. ECO programs are now voluntary.

In the absence a regulatory mandate, the Travelink program continues to go largely unused. The Travelink program was expanded under legislation adopted during the first session of the 140th General Assembly. It is possible that these program enhancements may someday increase participation in the program. Significant participation, however, remains unlikely as more important phenomenon (e.g., the price of gasoline, availability of desired mode of public transportation) will probably continue to exert a larger influence on commuting decisions.

5. Inadvertent Effects
None Noted.

2.11 Green Industries Tax Credits

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter V, §2040-§2045.

2. Description
The "Green Industries" provisions allow tax credits in the categories listed below:

(i) §2041 provides a $400 credit for each full 10 percent of waste reduction by manufacturers that voluntarily reduce the weight of wastes reported under the Toxic Release Inventory by at least 20% (50% for non-TRI chemicals). The credit may be taken in the year the waste reduction is achieved and in each of the four succeeding years provided the waste reduction is maintained.

(ii) §2042 provides a $250 credit (for a total of $650) for firms that:

- Make use of recycled materials or materials removed from Delaware's solid waste stream for 25% of their raw materials;
- Satisfy the eligibility requirements of the Blue Collar Jobs Act under §2011; and
- Use the materials in a qualified facility (as defined in §2011). If the facility is located in a targeted area, then the credit may be claimed on top of the additional credits under §2021, for a total credit of $900.

(iii) §2043 provides a $250 credit (for a total of $650) for firms that:

- Process waste materials removed from Delaware's solid waste stream for resale as raw materials to manufacturers;
- Satisfy the eligibility requirements of the Blue Collar Jobs Act under §2011; and
- Devote the qualified investment entirely to the processing and resale of waste materials. If the facility is located in a targeted area, then the credit may be claimed on top of the additional credits under §2021, for a total credit of $900.

(iv) §2044 provides a $250 credit (for a total of $650) for firms that:

- Collect materials for recycling and distribute recycled materials;
- Satisfy the eligibility requirements of the Blue Collar Jobs Act under §2011; and
- Devote the qualified investment entirely to the collection of materials for recycling and distribution of recycled materials. If the facility is located in a targeted area, then the credit may be claimed on top of the additional credits under §2021, for a total credit of $900.

These credits are exclusive of one another. No taxpayer may claim credits under more than one section. However, credits may be carried forward for four years in the case of toxic waste reduction (i.e., (i) above), and nine years in the case of recycling activities (i.e., (ii) - (iv) above).

3. Estimated Revenue Loss [8]
FY 05: See item 2.08 above
FY 06: See item 2.08 above

4. Assessment
Since the inception of the program in 1992, this credit has gone virtually unused.

The goal of the Green Industry Credits is to encourage waste reduction among Delaware manufacturers and to provide incentives for the collection, processing, and use of recycled materials. Source reduction credits depend solely on the level of a firm's capital investment in pollution control equipment and on its compliance with an established waste reduction standard. In contrast, the eligibility for the recycling credits depends not only on performance of one of three separate activities, but also on achievement of the job creation and capital investment requirements specified in the Blue Collar Jobs Act.

The qualification requirements for Green Industry recycling credits ensure a low probability that a firm in a specific industry would qualify in any given year. The likelihood that a firm coming from an unestablished industry, as many recycling ventures are, and qualifying for these credits is even more remote. Further diminishing the qualification prospects is the fact that the new firms that may be eligible for the Blue Collar Jobs credits are rarely immediately profitable. Because of this, they have no corporate income tax liability and are often small enough to be exempt from payment of the gross receipts tax. The offer of a non-refundable tax credit is irrelevant to a firm without any tax liability.

The fiscal impact of the Green Industries Credit Program should therefore continue to be negligible. Unfortunately, the impact is negligible, because *very few companies are using them*, not because they are inexpensive. It may be that the

[8] As is the case with the credits described in items 2.08, 2.09, and 2.10, these credits may be claimed against one of several taxes, the fiscal impact estimate for corporate income tax may underestimate the full impact of this provision. However, the importance of this consideration is diminished given the low level of participation in the program.

credits simply represent too small an incentive to encourage the scale of behavioral change necessary to qualify for them. It may also be the case that, for the foreseeable future, the demand for recycled products is simply not sufficient to justify investment under any circumstances. Many recycling industries are still in a fledgling stage of development, suffering from large expenses, uncertain demand for recycled products, and a fluctuating supply of valuable recyclable materials. Given this adversity, expanding the Blue Collar Jobs Act has not provided a significant incentive for firms to enter the recycling business. Similarly, the "source reduction" credit is too small to cause a significant behavioral response. A business that invests $50,000 in capital equipment and reduces its chemical use by 20%, receives a tax credit of $800 per year for five years, just 8% ([$800x5]/$50,000) of its capital costs.

5. Inadvertent Effects

Like many of the other tax preferences that intend to encourage behavioral change, it seems likely that the Green Industry credits will reward behavior which takes place *regardless of the credits*. Prior to the enactment of these credits, in 1988, Delaware firms invested an estimated $12.5 million in capital acquisitions and improvements for pollution abatement purposes. Firms invested these resources without any financial encouragement from the State. As with other such credits, the Green Industries Credits serve as a bonus for actions that occur without regard to the availability of credits.

However laudable the goals of economic development, job creation, and environmentally friendly activities, the Green Industries Credits are not achieving those aims. Other policy tools (e.g., direct grants of equivalent amounts, or regulatory mechanisms) might better serve these goals.

This preference is linked to the Blue Collar Jobs program (see (ii) - (iv) above). As such, it has amplified the inherently complex nature of state business tax credits, making it more difficult for state officials to administer them, and for prospective participants to understand and benefit from them.

2.12 Credits for Development At "Brownfield" Sites and Facilities

1. Statutory Provision

Title 30, Delaware Code, Chapter 20, §2011(l).
Title 30, Delaware Code, Chapter 20, §2021(d).

2. Description

Seeking to encourage the redevelopment of underutilized real property known as "brownfields," the General Assembly created an additional investment tax credit in June 1995. These properties are typically abandoned properties where some residual environmental contamination may still exist, or where fears of cleanup liability may be preventing re-use of the land. Piggybacked on the Blue Collar Jobs Act credits, the "brownfield" credits attempt to encourage redevelopment of these lands by offering reduced license fees and tax credits for firms that invest in these properties. Tax credits worth $650 for each qualified employee and $650 for each $100,000 in qualified investment in "brownfield" sites are now available. The value of these credits grows to $900 per qualified employee or $900 for each $100,000 in qualified investments if the "brownfield" is also located in a "targeted" area, as defined under §2020.

3. <u>Estimated Revenue Loss</u>
   FY 05: $0
   FY 06: Likely to be $0

3. <u>Assessment</u>
   Since the inception of this program in 1995, this program has gone unused.

   As with the Green Industry Credits, the "brownfield" credits may not offer enough incentive to outweigh the large potential cleanup liabilities that investment in, or ownership of, these properties may entail. Moreover, it is clear that the firms that would actually fund and oversee a brownfield clean up (i.e., those that specialize in environmental remediation or real estate development) typically are not the firms that would meet the Blue Collar Jobs Act employment, investment and qualified activity requirements. As mentioned above, Brownfield credits can only be awarded if the firm first qualifies for the Blue Collar Jobs Act credits.

   Further diminishing the qualification prospects is the fact that otherwise eligible firms may not be initially profitable. Because of this, they have no corporate income tax liability and are often small enough to be exempt from payment of the gross receipts tax. The offer of a non-refundable tax credit is irrelevant to a firm without any tax liability within the foreseeable future.

   This preference is linked to the Blue Collar Jobs program (see above). As such, it has amplified the inherently complex nature of state business tax credits, making it more difficult for state officials to administer them, and for prospective participants to understand and benefit from them.

5. Inadvertent Effects
Like many the other tax preferences that try to encourage behavioral change, it seems likely that the "brownfields" credits, if ever used, would reward some behavior which takes place, *regardless of the credits*. Despite the laudable goals of economic development, job creation, and environmentally friendly activities, it remains to be seen if these new credits will lead to redevelopment of "brownfields."

2.13 Research and Development Tax Credit

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, §§2070-2075.

2. Description
This preference, adapted from similar federal tax provisions allows a credit against tax for qualified research conducted within Delaware. The statewide cap on such credits is $5 million per year, to be granted first in December 2001, with regard to tax year 2000 expenses. Whenever statewide application exceed $5 million, receipts are to be allowed pro rata according to the approved amount so that the total approved credits do not exceed $5 million. This preference will sunset in 2010.[9] Unused credits may not be carried back, but may be carried forward fifteen years.

The cost of this preference, like the tax itself, tends to fluctuate considerably beneath the $5 million annual cap. As a consequence, as corporate profits have increased in recent years, so too, has the cost of this preference.

3. Estimated Revenue Loss
FY 05: $1.2 million - $2.0 million
FY 06: $2.0 million - $5.0 million

4. Assessment
The purpose of this preference is to enhance Delaware's reputation as a home for research intensive firms (e.g., pharmaceutical and biotechnology firms). Like all business tax incentives, it is difficult to isolate that portion which actually results in "new" economic activity from that part which merely serves

[9] House Bill 56 during the 142nd General Assembly extended the sunset date from December 31, 2005, to December 31, 2010.

as a bonus to firms that would have engaged in the desired activity in the absence of the incentive. Because the Research and Development Credit is used by many firms that already had significant research and development activity in Delaware prior to its enactment, it is likely that a large portion of the provision's costs does nothing to add to the level of research and development conducted in Delaware. On the other hand, as may be the case with the Blue Collar Jobs Credits, the Research and Development Credits may be considered an unavoidable cost of doing business for states, like Delaware, that hope to compete successfully in the area of high-tech economic development.

5. Inadvertent Effects
None noted.

2.14 Land and Historic Resource Tax Credit

1. Statutory Provision
Title 30, Delaware Code, Chapter 18, §§ 1801 -- 1807.

2. Description
This preference allows an income tax credit for permanent gifts of land or interest in land to public agencies and qualified private non-profit charitable organizations. Lands that qualify must either:

(1) meet the criteria for Open Space established by the Delaware Land Protection Act;

(2) Consists of natural habitat for the protection of Delaware's unique and rare biological and natural resources; or,

(3) Protect Delaware's important historic resources.

The tax credit is based on 40% of the appraised fair market value of the gift. The amount of credit that can be claimed is limited to $50,000. In any one tax year, the credit claimed cannot exceed the tax due, but unused portions of the $50,000 credit can be carried forward for up to five (5) consecutive years. The credit became available on January 1, 2000.

3. Estimated Revenue Loss
FY 05: Refer to Section 1.17
FY 06: Refer to Section 1.17

4. Assessment
This credit may not be effective in motivating some corporate donors. Tax credits only benefit those firms that have a tax liability. Due to fluctuations in net corporate income, some firms may have little or no tax liability and, therefore, would have little incentive to take advantage of the credit.
For further discussion, refer to Section 1.17.

5. Inadvertent Effects:
Refer to Section 1.17.

2.15 Historic Preservation Credit

1. Statutory Provision:
Title 30, Delaware Code, Chapter 18, §1813.

2. Description
Under this provision, a person who wishes to repair, or otherwise preserve a historic property may apply to the State Office of Historic Preservation, for a partial credit for qualified expenditures.

To qualify for the credit, an individual must first submit a rehabilitation proposal to the Office of Historic Preservation to ensure that the restoration, when completed, would meet federal and state guidelines. Credits are to be granted on a first come-first serve basis, not to exceed $5 million[10] in any one fiscal year. Moreover, $100,000 of the credits awarded in a given fiscal year must be reserved for distribution to qualified resident curators.

Upon project completion, a State Preservation Office must certify that the end product conforms with federal and state requirements. Then the Division of Revenue or the Office of the State Bank Commissioner will determine the appropriate value of the tax credit to be issued. Personal/ Corporate Income tax or Bank Franchise tax credits may be valued at:

- 20% (30% in the case of low income housing) of qualified expenditures made in the rehabilitation of any certified historic property eligible for a federal tax credit under §47 of the Internal Revenue Code (income producing properties), or

- 30% (40% in the case of low income housing) of qualified expenditures made in the rehabilitation of any certified historic property not eligible for

[10] The annual credit allocation was increased from $3 million to $5 million from Fiscal Year 2006 onward.

a federal tax credit under §47 of the Internal Revenue Code (non-income producing properties).

Rehabilitative efforts taking the following forms would not qualify for the Historic Preservation Credit:

1) The acquisition of real property or interest in real property,

2) Additions to existing structures when the square footage of all additions is greater than or equal to 20% of the total square footage of the historic portion of the property,

3) Paving or landscaping costs that exceed 10% of the total qualified expenditure,

4) Sales and marketing costs, or

5) Expenditures not properly charged to a capital account, or, in the case of owner occupied property, would not be charged to a capital account if the owner were using such property in a trade or business.

This credit became available as of July 1, 2000, though the first credits could not be claimed until July 1, 2002. Currently, this preference is scheduled to expire on June 30, 2010, unless otherwise extended by the State Legislature.

3. Estimated Revenue Loss:[11]
FY 05: $0
FY 06: Negligible, Likely to be $0

4. Assessment:
For a more complete discussion, refer to analysis in Section 1.18

5. Inadvertent Effects:
Refer to analysis in Section 1.18

[11] With the exception of credits owned by individuals (see section 1.18), all remaining Historic Preservation Credits appear to be owned by financial institutions. As such, there are approximately $14 million in credits available to immediately offset Bank Franchise Tax liabilities. Given the transferability of these credits, at any time the credits may be conveyed to corporate taxpayers and then used to immediately reduce corporate income tax liabilities.