

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 do not conduct business within the state are not required to file a corporate income tax return.

Tax liabilities for Delaware purposes are based on the share of the corporation's federal taxable income that 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 wages eliminated as a deduction in the calculation of the federal Jobs Credit and certain expenditures on 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 has historically been based on a three-factor formula (see below) that averages the ratios of: 1) Delaware property to total United States property; 2) Delaware wages to total United States wages; and 3) Delaware gross receipts to total United States gross receipts for interstate businesses. Non-U.S. corporations may not use property or payroll without the United States of America to dilute their payroll and property apportionment factors. The apportionment formula is applied to a company's entire taxable income, excluding its allocated and exempt income.

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As a result of the Delaware Competes Act, signed into law on January 27, 2016, the apportionment calculation is transitioning to a single factor based solely on gross receipts as reflected in the table below.

2016 and years prior	<i>Apportionment Ratio= .333*Property Ratio +.333*Salary Ratio +.333*Sales Ratio</i>
2017	<i>Apportionment Ratio= .25*Property Ratio +.25*Salary Ratio +.50*Sales Ratio</i>
2018	<i>Apportionment Ratio= .20*Property Ratio +.20*Salary Ratio +.60*Sales Ratio</i>
2019	<i>Apportionment Ratio= .125*Property Ratio +.125*Salary Ratio +.75*Sales Ratio</i>
2020 and beyond	<i>Apportionment Ratio= Sales Ratio</i>

- Tax Rate
8.7% of taxable income
- Tax Receipts, net of refunds (millions of dollars)

<u>Fiscal Year</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
<u>Total (\$)</u>	178.5	126.5	87.9	168.3	119.1	187.9	102.0	269.5	143.3	120.8

- Tax Preferences
The following table identifies corporate income tax preferences within the Delaware Code along with annual estimated costs. Links within the table navigate to more detailed analysis of each tax preference.

TAX PREFERENCE	FY 17 (EST)	FY 18 (EST)
2.01 Exemption of Investment Holding Companies, Firms Managing Intangible Investments of Mutual Funds.	Unknown	Unknown
2.02 Deduction of Interest from Affiliated Companies	Negligible	Negligible
2.03 Handicapped Accessibility Deduction	Negligible	Negligible
2.04 Neighborhood Assistance Credit	\$200-\$300k	\$250-\$350k
2.05 Tax Credit for Creation of Employment and Qualified Investments in Business Facilities (New Jobs Creation formerly Blue Collar Jobs Act)	\$1.8m	\$2-\$4m
2.06 Tax Credit for Creation of Employment and Qualified Investments in Targeted Areas (New Jobs Creation formerly Blue Collar Jobs Act)	\$1.8m	\$2-\$4m
2.07 Clean Energy Technology Device Manufacturing Tax Credits	\$0	Negligible
2.08 Credits for Development at “Brownfield” Sites and Facilities	\$0	Negligible
2.09 Research and Development Tax Credit	\$2.3m	\$2-5m
2.10 Land and Historic Resource Tax Credit	Negligible	Negligible
2.11 Historic Preservation Credit	\$75-\$100k	\$0-\$250k

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2.12 Headquarters Management Company	\$0	\$0
2.13 Asset Management Corporation	Negligible	Negligible
2.14 Business Finder's Fee Tax Credit	\$0	\$0
2.15 Veterans' Opportunity Credit	\$0	Negligible
2.16 Exemption of Out-of-State Resources During Declared Emergencies	Negligible	Negligible
2.17 New Economy Jobs Tax Credit	\$0	\$0
2.18 Vocational Rehabilitation Credit	\$0	Negligible
2.19 Apportionment Election Preference for Worldwide Headquarters and Telecommunications Companies	Unknown	Unknown

2.01 Exemption of Investment Holding Companies, 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 17: Unknown
FY 18: 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 informational returns establishing their eligibility for the exemption and 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. Investment holding companies are established in Delaware primarily because of this tax exemption, and it is likely that many of them would leave the state if the exemption were repealed or modified given the mobility of intangible assets. No data exist by which the Division of Revenue could make its own estimate of the revenue loss generated by this exemption.

In recent years, many states have passed legislation to effectively prevent companies from deducting expenses paid to Delaware Investment Holding Companies from corporate income. As the number of states which allow these payments to be deducted from corporate income decreases, the use of these companies may potentially decrease as well.

5. Inadvertent Effects
None noted.

2.02 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 17: Likely to be Negligible*
FY 18: 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 rationale 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 1.13). A tax advantage for the management of inherently mobile intangible assets, such as inter-company obligations, enhances Delaware's reputation as a financial center and may also produce 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, such as 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 (the corporation that receives the interest income) conducts a greater percentage of its business in Delaware than the debtor corporation (the corporation that pays the interest on its debt).

Affiliated finance companies (AFCs) present a special case under this tax preference. The AFC acts as a creditor by purchasing receivables from their affiliate or "core business" (a large retailer, for example). The affiliate 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%). The interest on a large loan from an AFC to the core business is often sufficient to totally eliminate its tax liability when deducted from the AFC's net income. The AFC's primary function is to enhance the financial position of the core business; 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.

2.03 Handicapped Accessibility Deduction

1. Statutory Provision
Title 30, Delaware Code, Chapter 19, §1903(a)(2).
2. Description
Delaware offers a deduction, not to exceed \$5,000, equal to the renovation expenses incurred removing design features in a building which restrict a physically handicapped person's full use of said building. For the purposes of this provision, Delaware Code defines "building" as 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. Expenditures incurred in the removal of architectural barriers or physical design features in order to make the building more accessible to handicapped individuals also qualify.
3. Estimated Revenue Loss
FY 17: Negligible
FY 18: Negligible
4. Assessment
This deduction is rarely utilized; in most years, no firms use the preference. This suggests that it is insufficient to encourage businesses 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" equal to 50 percent of "eligible access expenditures" (defined under Section 44 of the IRC) that exceed \$250 but not exceeding \$10,000. 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.

Given its history of limited use, it appears that utilization of this tax benefit will remain inconsequential and that this provision will do little to achieve its intended purpose. It is also unclear whether the state should subsidize actions that are already mandated by other laws.

5. Inadvertent Effects
None noted.

2.04 Neighborhood Assistance Credit

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter I, §2001 – §2007.
2. Description
Persons that invest in community development programs approved by the Director of the Delaware State Housing Authority and the Neighborhood Assistance Act Advisory Council 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 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 contributions to neighborhood organizations, Community Development Corporations, or Community-Based Development Organizations, 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.

Legislation enacted during the 147th General Assembly reduced the maximum annual award of Neighborhood Assistance Credits and capped the amount a firm may receive over a three year period in order to extend the availability of the credit to a greater number of firms.

3. Estimated Revenue Loss
FY 17: \$200,000 - \$300,000¹
FY 18: \$250,000 - \$350,000

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. Participants 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.

5. Inadvertent Effects
None noted.

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

1. Statutory Provision
Title 30, Delaware Code, Chapter 20, Subchapter II, §2010 – §2015.
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 \$500 for each qualified employee and \$500 for each \$100,000 invested, not to exceed fifty percent of their tax liability in a given year. Credits may be taken in the taxable year in which all eligibility conditions are met and for any of the 9 following taxable years. 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;
5. Engineering services;

¹ Includes revenue loss due to credits claimed under the personal income tax by pass-through entity partners/owners.

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.

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).

An alternative investment tax credit of \$375 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, such as 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.² Unused credits may be carried forward for use in future tax years.

Both corporate income tax receipts and the cost of this preference fluctuate considerably from year to year.

² A related type of investment credit can be used against the bank franchise tax (5 Del. C., Chapter 11, Section 1105(h)-(i)).

3. Estimated Revenue Loss³

FY 17: \$1.8 million

FY 18: \$2.0 – \$4.0 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 \$500 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. 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 critical to a firm's decision to establish or expand their operations in Delaware or if they merely serve as a bonus to firms that would have chosen to locate here 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. Although the credits often may not be *the* deciding factor in a location decision, they still may be an important consideration. The marginal

³ 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.

impact of the credits may be important enough to retain them; they may even be considered a cost of doing business for state development efforts.

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. However, no data exist that would allow such a comparison to be conducted.

5. Inadvertent Effects

These credits may indeed serve as a useful promotional tool for state development officials. However, 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.

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

1. Statutory Provision

Title 30, Delaware Code, Chapter 20, Subchapter III, §2020 – §2022.

2. Description

This provision provides employers engaged in qualified activities (as defined in §2010 – see above) an extra credit of \$250 (for a total credit of \$750) for each additional full-time employee, and an extra credit of \$250 (for a total of \$750) 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 \$500 (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(1)) 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(2)) include all retail trade except: providing retail food and beverage services (including eating and drinking places, but excluding grocery and convenience stores), engaging in 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 2.05.

3. Estimated Revenue Loss ⁴

FY 17: See Item 2.05 above

FY 17: See Item 2.05 above

4. Assessment

These credits were established to further encourage economic development and employment in 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 invested in these areas anyway. In these cases, the use of this preference does not reflect behavioral change induced by the tax benefit; the credits are of secondary importance to other elements of a state's business climate, such as access to markets, the skill and cost of labor, and infrastructure. Given the size of the incentives and the characteristics of the targeted areas, they seem unlikely to have a significant impact on business location decisions.

5. Inadvertent Effects

Certain qualifying firms may be benefiting from a tax incentive for actions that were largely unrelated to the existence of the preference.

2.07 Clean Energy Technology Device Manufacturing Tax Credits

1. Statutory Provision

Title 30, Delaware Code, Chapter 20, Subchapter V, §2040.

2. Description

Clean energy technology device manufacturers qualifying for the New Job Creation Credit (see Item 2.05) are entitled to increase the income tax credits established under that provision by \$250, from \$500 to \$750. Clean energy technology device manufacturers include makers of the following items:

- Solar power devices;
- Fuel cells;
- Wind power devices; and,
- Geothermal power devices.

⁴ This figure is included in the fiscal impact estimate for tax credits for the creation of employment and qualified investment in business facilities (Item 2.05).

3. Estimated Revenue Loss⁵

FY 17: \$0

FY 18: Likely Negligible

4. Assessment

At present this credit has not been claimed.

This credit was established to further encourage economic development and employment with respect to specific forms of manufacturing within the state. While this credit has not been used so far, it may potentially be utilized in the future should clean energy manufacturing become increasingly popular. Like all economic development credits, it is likely that some of the financial benefit of these credits will ultimately accrue to firms that would have made the investments regardless of the credit.

5. Inadvertent Effects

See Items 2.05 and 2.06.

2.08 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

Brownfield 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 New Job Creation 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 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. Estimated Revenue Loss

FY 17: \$0⁶

⁵ While these credits have not been used in previous years, their use may grow in the future as Delaware’s manufacturing landscape changes.

FY 18: Likely Negligible

4. Assessment

Since the inception of this program in 1995, this program has gone largely unused.

As with many tax preferences, 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, firms that would actually fund and oversee a brownfield clean up, such as those that specialize in environmental remediation or real estate development, would not typically meet the New Job Creation Credit employment, investment and qualified activity requirements. As mentioned above, Brownfield Credits can only be awarded if the firm first qualifies for the New Job Creation Credit.

Further diminishing the Brownfield credit's efficacy 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.

5. Inadvertent Effects

Like other tax preferences that try to induce behavioral change, it seems likely that the brownfields credits will reward behavior that would have occurred regardless of the preference.

2.09 Research and Development Tax Credit

1. Statutory Provision

Title 30, Delaware Code, Chapter 20, Subchapter VIII, §2070 – §2075.

2. Description

This preference, adapted from similar federal tax provisions, allows a credit against tax for qualified research conducted within Delaware. As a result of the Commitment to Innovation Act, signed into law March 17, 2016, this credit was amended to ensure that all companies receive the full research and development tax credit for which they qualify. Prior to tax year 2017, the statewide cap on such credits was \$5 million per year. If statewide credit applications exceeded \$5 million, receipts were allowed *pro rata* according to

⁶ When relevant estimates include revenue losses due to credits claimed under the personal income tax by pass-through entity partners/owners.

the approved amount so that the total approved credits would not exceed \$5 million. For tax years 2017 and beyond, the Commitment to Innovation Act removes the \$5 million cap and the full, approved amount of the credit will be granted.

This legislation also provides that credits issued for tax years 2017 and later will be refundable. Unused credits issued prior to tax year 2017, could not be carried back but could be carried forward fifteen years.

3. Estimated Revenue Loss

FY 17: \$2.3 million

FY 18: \$2.0 – \$5.0 million

4. Assessment

The purpose of this preference is to enhance Delaware's reputation as a home for research-intensive firms, such as 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 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 cost does not add to the level of research and development conducted in Delaware. On the other hand, as may be the case with the New Job Creation Credits, the Research and Development Credits may be considered an unavoidable cost of doing business for states that hope to compete successfully in the area of high-tech economic development.

Note that the FY 17 estimate reflects only the carry-forward credits issued prior to tax year 2017. While it is possible that some taxpayers will claim the newly refundable credit during FY 18, it is likely that the bulk of the taxpayers claiming these credits will file on extension in or after October 2018, with the revenue loss occurring in fiscal year 2019.

5. Inadvertent Effects

None noted.

2.10 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 40% of the appraised fair market value of the gift up to \$50,000. The credit is not refundable, but unused portions can be carried forward for up to five (5) consecutive years.

3. Estimated Revenue Loss
FY 17: Negligible
FY 18: Negligible
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, in any given year three-quarters of firms have little or no tax liability and would therefore have little incentive to take advantage of the credit.

For further discussion, refer to Section 1.14.
5. Inadvertent Effects:
Refer to Section 1.14.

2.11 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 Historic Preservation Office for a partial credit for qualified expenditures.

To qualify for the credit, an individual must first submit a rehabilitation proposal to the Historic Preservation Office to ensure that the restoration will meet federal and state guidelines. Credits are to be granted on a first-come, first-served basis, not to exceed \$5 million 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, the State Preservation Office must certify that the end product conforms to 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 Income Tax, 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);
- 30% (40% in the case of low income housing) of qualified expenditures made in the rehabilitation of any certified historic property not eligible for a federal tax credit under §47 of the Internal Revenue Code (non-income producing properties); or,
- 100% of the qualified expenditures made in the rehabilitation of a certified historic property qualifying for credit award as a resident curatorship property regardless of eligibility for a federal tax credit under § 47 of the Internal Revenue Code [26 U.S.C. § 47].

Rehabilitative efforts taking the following forms do 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.
3. Estimated Revenue Loss:⁷
FY 17: \$75,000-\$100,000
FY 18: \$50,000-\$250,000
4. Assessment:
For a more complete discussion, refer to analysis in Section 1.15
5. Inadvertent Effects:
Refer to analysis in Section 1.15

2.12 Headquarters Management Company

1. Statutory Provision: Title 30, Delaware Code, Chapter 64 and Chapter 20, §2061 – §2064
2. Description:

Headquarters Management Corporations (HMC's) are entities treated as a corporation under the Internal Revenue Code of the United States (Title 26 of the United States Code) that:

⁷ With the exception of credits owned by individuals (see section 1.16), it appears that most of the remaining Historic Preservation Credits are owned by financial institutions. As such, there are millions of dollars in credits available that could 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.

- a. Make an election to be taxed as a Headquarters Management Corporation; and,
- b. The activities of which in this state are certified by the Director of Revenue to be confined to investment activities and/or the provision of headquarters services to itself and members of its affiliated group.

Headquarters services include accounts receivable and payable, employee benefit plan, insurance, legal, payroll, data processing, purchasing, and tax, financial and securities accounting, reporting and compliance services provided by a Headquarters Management Corporation to itself and members of its affiliated group, and the maintenance and management of the intangible investments of other members of its affiliated group.

HMC's were developed as a complement to Delaware Investment Holding Companies (See Item 2.01.) Whereas even the most ardent supporters of Investment Holding Companies would admit that they provide little in the way of direct employment benefits, HMC's were designed with the goal of increasing employment in Delaware for firms which limit their activities in Delaware to providing certain services to entities within their affiliated group.

HMC's are entitled to generous tax credits, which, by adding as few as five employees, eliminate 99% of the corporate income tax otherwise due. These credits are available for ten years.

3. Estimated Revenue Loss:
FY 17: \$0
FY 18: \$0
4. Assessment:
HMC's were established in 2004. Since that time, fewer than twenty HMC applications have been approved. As is the case with Investment Holding Companies, there is a high likelihood that the HMC's would not have been formed were not for 99% tax exemption offered under this provision. The fact that in nine-years' time so few firms have opted to take advantage of the HMC statute calls into question its general effectiveness as an economic development incentive.
5. Inadvertent Effects:
None Noted.

2.13 Asset Management Corporation

1. Statutory Provision: Title 30, Delaware Code, Chapter 19, §1903(b)(7)

2. Description:

Asset Management Corporations (AMC's) are corporations that derive 90% or more of their federally-reported gross receipts from asset management services. Asset management services means, in each case with respect to intangible investments:

- a. Rendering investment advice, including investment analysis;
- b. Making determinations as to when sales and purchases are to be made;
- c. Selling or purchasing of intangible investments;
- d. Rendering administration services;
- e. Rendering distribution services; or,
- f. Managing contracts for sub-advisory services.

Rather than the three-factor apportionment used by other corporations, asset management corporations are entitled to use customer-based sourcing and single factor, receipts-based apportionment.

3. Estimated Revenue Loss:

FY 17: Negligible⁸

FY 18: Negligible

4. Assessment:

The legislation establishing asset management corporations was adopted in response to evolving business practices within the financial services industry. In the mutual fund industry, for example, firms are increasingly engaging in related activities, such as pension fund management, that would fall outside of the scope of Delaware's mutual fund exemption. Because Delaware's mutual fund exemption is an "all or nothing proposition" (to qualify, 100% of a firm's activities must be confined to the management of intangible investments of mutual funds) any activity outside this scope, no matter how small, results in the loss of the exemption.

This provision is designed to allow firms the flexibility to engage in a wider array of financial activities without risking the loss of their tax advantaged

⁸ Accounts for likelihood of sweeping behavioral affect. See Assessment.

status. The asset management corporation legislation was effective starting in tax year 2009. At present, fewer than five corporations have elected AMC status.

It is likely that any firms which are located in Delaware due to this distinction would not be located here in the absence of this preference. Therefore, the state would not likely stand to gain additional revenue if it were to eliminate the credit.

5. Inadvertent Effects:
None noted.

2.14 Business Finder's Fee Tax Credit

1. Statutory Provision: Title 30, Delaware Code, Chapter 20, §2090 – §2097

2. Description:

This tax credit's purpose is to create incentives for existing businesses to partner with the state in the effort to create new employment opportunities for Delaware citizens, and to stimulate the Delaware economy by expanding the tax base. A finder's fee, a tool used commonly by businesses, is an arrangement by which an intermediary finds, introduces, and brings together parties to a business opportunity.

This provision rewards each Sponsor Firm (the "finder") and each New Business Firm (the business which relocates to Delaware) with a \$500 annual tax credit per Delaware job created by the new business. The tax credit is available for three years. The program requires that the new business relocate to Delaware as a result of the efforts of the sponsor, and excludes those businesses, such as real estate agents, banks and commercial landlords, that already have an incentive to bring out-of-state business to Delaware.

3. Estimated Revenue Loss:

FY 17: \$0

FY 18: \$0

4. Assessment:

This provision became effective on October 1, 2010. Since its introduction, no businesses have applied for the Business Finder's Fee program.

5. Inadvertent Effects:

Like all economic development tax incentives, there is a good chance that some of the firms that eventually take advantage of this legislation would have located in Delaware in its absence. In such cases, this legislation would act as a “bonus” instead of an incentive.

2.15 Veterans’ Opportunity Credit

1. Statutory Provision

Title 30, Delaware Code, Chapter 20A, §20A-100 – §20A-104

2. Description

This preference provides an incentive for employers to hire veterans who fought in the War in Afghanistan or the Iraq War. Employers may claim a refundable credit against the bank franchise tax, corporate income tax, personal income tax, or insurance income tax equal to 10% of gross wages or \$1,500, whichever is lower, for each veteran they hire. Credits may be claimed in the year the veteran is hired and for two subsequent years.

This credit sunset on December 31st, 2015, however this assessment is included as credits generated in tax year 2015 could still be claimed through tax year 2017 (FY 2018 or 2019).

3. Estimated Revenue Loss

FY 17: \$0

FY 18: Likely Negligible

4. Assessment

Encouraging businesses to hire war veterans is a commendable goal. At least among employers subject to the corporate or personal income taxes, this credit appears to have provided little incentive to hire combat veterans.⁹

5. Inadvertent Effects

None noted.

⁹ The credit may also be taken against the bank franchise and insurance premiums taxes, which may have experienced different rates of use than experienced under the personal and corporate income taxes.

2.16 Exemption of Out-of-State Resources During Declared Emergencies

1. Statutory Provision
Title 30, Delaware Code, Chapter 31, §§ 3101 – 3105.
2. Description
Delaware does not consider equipment and personnel employed during a declared state of emergency by infrastructure companies based in other states to constitute legal presence in the state for tax purposes if those assets are employed in emergency related work.
3. Estimated Revenue Loss
FY 17: Negligible
FY 18: Negligible
4. Assessment
This preference may facilitate the response to future disasters by eliminating tax concerns of companies employing out-of-state resources. During a declared emergency period, Delaware does not consider out-of-state businesses, workers, and property to have legal presence in this state of tax purposes. Companies without prior nexus in the state will benefit from this preference as they will not have to file a corporate income tax return. Companies with prior nexus in the state will also benefit from this preference as they will not be required to consider out-of-state, emergency-related property and personnel in their apportionment formula.

The revenue lost from this preference is likely to be \$0 for two reasons. First, the probability of a declared disaster occurring during any given fiscal year is small and unpredictable. Second, enforcement would likely be low if Delaware chose to tax this activity.
5. Inadvertent Effects
None noted.

2.17 New Economy Jobs Credit

1. Statutory Provision: Title 30, Delaware Code, Chapter 20, §2080 – §2086
2. Description:
The purpose of this provision is to incentivize the creation of new, well-paying positions without regard to industry or occupation. Targeted economic incentives are frequently criticized as government’s attempt to “pick winners” by singling out a specific industry for tax preferences or direct assistance.

Instead, the logic behind this provision is that, in the long-run, labor markets will determine which skills and industries are most in demand. As such, the most effective incentive is one that implicitly accepts those results without limiting the incentive to a predetermined list of preferred activities.

During the 148th General Assembly, this credit expanded to include a benefit for retained jobs. A company involved in or resulting from a recent corporate restructuring which has its principal executive offices in Delaware and is focused on specific industries such as agricultural science, nutrition, biosciences, and safety may be eligible for a job retention credit. A program focused on job retention is founded on differing logic than one which targets new employment. Such a credit should be sufficiently narrow to continue to allow market forces to direct employment away from declining industries while still allowing the State to compete for retention of large employers in healthy industries considering leaving the State.

To qualify, a new employer must add at least 50 net new jobs with average annual salaries of at least \$100,000.¹⁰ This provision awards a refundable tax credit ranging from 25% to 40% of the qualified withholding taxes collected and paid on behalf of these new, qualified employees during the taxable year. Additional geographic-based credits are available to businesses that locate qualifying employees within targeted growth zones, incorporated municipalities, former brownfields and targeted growth counties.

The maximum aggregate credit is 65% of qualified withholding. Qualifying firms are eligible for credits over a ten year period. Eligibility in each year during that period is independently determined for new cohorts of employees.

Legislation enacted during the 147th General Assembly added additional ways a firm may qualify for this credit. Employers that create at least 200 jobs with an average salary of \$70,000 to Delaware will be entitled to a tax credit equal to 25% of the withholding paid by the employer for the new jobs. If employers create more than 200 jobs, the size of the tax credit increases and can reach 40% if the employer creates 500 or more new jobs.

For retained jobs, the certified employer must maintain 200 jobs with an average salary of \$70,000 in Delaware to earn a tax credit equal to 25% of the withholding paid by the employer on behalf of the retained employees. If

¹⁰ The \$100,000 salary threshold applies to calendar year 2007. In subsequent years it is adjusted for inflation (CPI growth) meaning that, in all likelihood, the threshold will increase.

employers retain more than 200 jobs, the size of the tax credit increases and can reach 40% if the employer retains 500 or more employees.

3. Estimated Revenue Loss:

FY 17: \$0

FY 18: \$0

4. Assessment:

This credit provides the Delaware Economic Development Office with a tool to recruit high-paying jobs to Delaware. Since its inception in 2007, no firms have made use of this credit. The possibility that this provision might go unused for several years is expected, because it is designed to help Delaware capitalize on rare, significant economic development opportunities, such as the potential relocation of a corporate headquarters. While estimates continue to be zero at this time, the likelihood that the retained jobs portion will be claimed in the next few years is very high.

5. Inadvertent Effects:

Like all economic development tax incentives, there is a good chance that some of the firms that take advantage of this legislation would have located or stayed in Delaware in its absence. In such cases, this legislation would act as a “bonus” instead of an incentive.

2.18 Vocational Rehabilitation Hiring Credit

1. Statutory Provision:

Title 30, Delaware Code, Chapter 20B, §20B-100 – §20B-104

2. Description:

This preference provides an incentive for employers to hire individuals with a state-certified physical or mental disability who are in the process of, or have completed, vocational rehabilitative services. Employers may claim a refundable credit against the bank franchise tax, corporate income tax, personal income tax, or insurance income tax equal to 10% of gross wages or \$1,500, whichever is lower, for each qualified disabled worker they hire. Credits may be claimed in the year the qualified disabled worker is hired and for two subsequent years.

3. Estimated Revenue Loss:

FY 17: \$0

FY 18: Negligible

4. Assessment:
The credit is available for employees hired on or after January 1st, 2017 and may be taken in the year of the hiring and up to two years thereafter. As a result the tax credit is not effective in FY 17 since credit would be applied to final returns (paid in FY 18). Estimated revenue loss for FY 18 is based on the fiscal note, which itself was generated as a portion of Delaware employees qualified for the federal Work Opportunity Credit (WOTC) under the “state vocational rehab” category.
5. Inadvertent Effects:
Refer to Section 1.18

2.19 Apportionment Election Preference for Worldwide Headquarters and Telecommunication Companies

1. Statutory Provision:
Title 30, Delaware Code, Chapter 19, §1901 – §1903
2. Description:
As part of legislation enacted in the 148th General Assembly to modernize Delaware’s apportionment of multi-state firms’ profits—moving from three factor apportionment to single sales factor apportionment over a five year period—Telecommunications Corporations (TCCs) and Worldwide Headquarters Corporations (WHCs) are allowed to annually elect their apportionment method between equally weighted three factors or a single sales factor beginning in tax year 2017.

TCCs are members “of a group of corporate and non-corporate entities, which group (a) consists of corporate and non-corporate entities that are affiliated through relationships described in § 267(b) of the Internal Revenue Code, (b) provides both intrastate mobile telecommunications services and other intrastate telephone services, as such terms are used in § 5501(8)a.3. of [Title 30], and (c) in the aggregate earns annual gross receipts in the United States from providing intrastate and interstate telephone and telecommunications services, and from providing Internet access, as such term is defined in § 5501(6) of [title 30], in excess of’ \$50 billion.

WHCs are corporations that (a) list the site of their principal executive offices as an address in Delaware in their Form 10-Q filing with the SEC for the

quarter immediately prior to January 1st, 2017, (b) employ at least 400 full-time employees at the corporate headquarters in Delaware as of January 1st, 2016, and (c) make or contract for a capital investment of not less than \$25 million to renovate or improve the corporate headquarters in Delaware between July 1st, 2014 and June 30th 2018.

3. Estimated Revenue Loss:

FY 17: Unknown

FY 18: Unknown

4. Assessment:

For both TCCs and WHCs, a more accurate assessment of how allowing these taxpayers to choose their own apportionments, subject to the above limitations, affects receipts will be available in future years. Although there was a cost associated with these preferences in FY 17, the precise data is not yet available. The preference was effective beginning in tax year 2017; final returns for this period have not yet been filed. At the time of enactment, the full impact of the Delaware Competes Act was projected to cost \$8.2m in FY 17 and \$17.6m in FY 18 for all corporate income taxpayers in Delaware. The costs associated with the TCC and WHC provisions are likely to be a very small portion of those estimated costs.

The WHC provisions may be attractive for a few large Delaware-based firms with the potential for growth. Single-sales factor apportionment removes any negative tax consequences for expanding property and payroll in the State. Accordingly, there is no need for WHCs to defer expansion decisions until 2020.

Because TCCs are less likely to have large property and payroll shares in Delaware, this incentive may have less significance for them. Should TCCs continue to utilize three factor apportionment, then the cost of the TCC preference will continue beyond the end of the single-sales apportionment phase-in.

5. Inadvertent Effects:

Providing a preference for firms in one sector of the economy may create an incentive for other firms to recharacterize their activities in such a way that they meet the legal requirements for eligibility. While the strict definitions and high barriers to entry in telecommunications industries likely prevent this issue, it is possible that some firms may be able to do so and create a basis for claiming the single-sales apportionment. To the extent they are successful, the

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cost of this provision rises with no benefit in terms of Delaware employment or property ownership. Such preferences may also increase administrative costs related to enforcing narrowly defined eligibility standards.