EXECUTIVE SUMMARY

This Report, required by §8305(6), Title 29, Delaware Code, assesses the impact of tax preferences on the personal income tax, corporate income tax, motor fuel/special fuel tax, and public utility tax codes.

Tax preferences are no different from additional state spending in terms of their budgetary implications and thus are sometimes referred to as "tax expenditures." A reduction in revenues has the same fiscal impact as a direct expenditure of equal magnitude -- both consume finite public resources. Since the last Tax Preference Report was issued in 2009, Delaware has created two new tax preference, eliminated one tax preference and extended or expanded two, bringing the total covered by this report to 45. The growth in State expenditures on tax preferences has continued to increase.

Tax preferences are often established to pursue public policies that are not directly related to the tax system itself. For example, the tax-exempt status of employer-provided health insurance is primarily a health care policy that is administered through the tax system. In these cases, the effectiveness of a tax preference should be subject to the same cost-benefit analysis that direct expenditures undergo.

Using cost-benefit analysis to evaluate tax preferences is more difficult than for comparable direct expenditures. The analysis must also weigh how the policy affects the tax system through which it operates. For example, the impacts of such policies are often in conflict with the goals of an "ideal" tax system. The proliferation of tax preferences can, if left unchecked, undermine the fairness of a tax system, erode the tax base, distort private economic incentives, and generate unnecessary complexity within the tax code.

Given their budgetary and policy equivalence to direct expenditures, the burden they may place on the tax system, and the upward trend in their use, tax preferences represent a significant component of Delaware's fiscal environment. As such, it is important that this report receive serious attention from State policy makers.

ACKNOWLEDGMENTS

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The revenue estimates and judgments expressed herein, however, are ultimately those of the Division of Revenue.

Patrick Carter
Director of Revenue

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INTRODUCTION

Legislative Background

Title 29, Delaware Code, §8305(6) requires that the Division of Revenue, under the supervision of the Secretary of Finance, prepare biennial reports that estimate the fiscal impact of all newly enacted and existing tax preferences within selected revenue sources. Reports are due in each odd-numbered year. This twelfth Tax Preference Report is submitted to meet the requirements of that provision for Calendar Year 2011.

The reporting of tax expenditures was incorporated into the federal budget process through the enactment of the *Congressional Budget and Impoundment Act* (CBIA) in 1974. CBIA requires the President to report on tax expenditures in the budget and requires Congressional committees to provide tax expenditure estimates for each tax bill that they report. Through this process, legislators must recognize the costs associated with tax expenditures and hopefully bring such spending under traditional budget scrutiny.

Delaware took similar steps to analyze preferences within its tax system. In November 1986, a tax preference report was submitted to meet the requirements of the original legislation. The report was the State of Delaware's first published effort to identify tax preferences arising from provisions of the Delaware Code. The second report, which the Department of Finance submitted to the General Assembly in November 1988, fulfilled the legislation's more comprehensive requirements by analyzing the impact of all State and federal tax preferences on Delaware revenues. Pursuant to Senate Bill No. 284 of the 136th General Assembly, beginning with the third Tax Preference Report -- published in November 1993 -- the reports have had a significantly narrower focus. Like the more recent reports, this twelfth Delaware Tax Preference Report examines statutory tax preferences within the categories of personal income tax, corporate income tax, motor fuel/special fuel tax, and public utility tax.

Purpose of the Tax Preference Report

The "Declaration of Policy" set forth in §8305(6)(a) acknowledges that state governmental policy objectives may be achieved through direct expenditures and indirectly through the use of tax preferences. Unlike direct expenditure programs, however, tax preferences do not receive regular review or require annual appropriations. As such, preferences may remain in place indefinitely, with no review of their effectiveness and no system to monitor their cost. The primary purpose of this Report is to identify all tax preferences within specified revenue sources, and assess them quantitatively and qualitatively.

A comprehensive review of tax preferences has value in its own right. Without thorough, long-term reviews, tax policy often becomes overly focused on immediate, short-term problems. In such an environment, more fundamental government goals may fall by the wayside. For example, day-to-day tax policy issues often involve the analysis of a single tax preference designed to address a particular perceived need. When viewed in isolation, a tax preference may have considerable merit and be motivated by the best of intentions. But ad hoc preferences incrementally add to the complexity of the tax code and may threaten its fairness, distort decision-making, and gradually erode the tax base. Before long, the fundamental objectives of a tax system -- equity, efficiency, simplicity and adequacy -- may become compromised.[1]

Periodic review is necessary because time can dramatically alter the complexion of tax preferences. Tax breaks for a select and small group of people can grow quickly into expensive entitlements as demographic and/or economic conditions change. Conversely, tax preferences can lose their usefulness if the income or business conditions on which the preference is based change over time.

Tax preference reports are useful tools in the annual budget process. They offer insight into revenue losses that could be slowed, allowing budget shortfalls to be closed without resorting to tax increases or direct expenditure cuts. The incorporation of tax preference reports directly into the budget process would enhance the visibility of these fiscal options.

The purpose of this report, however, is not to propose specific policy alternatives, but rather to assist the tax policy debate in the State of Delaware by objectively highlighting the potential advantages and disadvantages of various tax preferences. It is our hope that this report will help facilitate discussion of current tax preferences and the role they play in the tax system.

Components of the Tax Preference Report

As per the requirements of §8305(6), this report provides the following information for each of the four designated tax types:

1. A description of each tax preference, its statutory basis, and its purpose.

[1] See the section of this Report entitled "Incrementalism" below.

2. An estimate of the revenue loss to the state, or one of its subdivisions, caused by each tax preference for the last fiscal year (FY 2011), and the estimated revenue loss caused by each tax preference for the current fiscal year (FY 2012).

3. An assessment of whether each tax preference is the most fiscally effective means of achieving the purpose for which it was enacted, and whether or not each tax preference has been successful in meeting the purpose for which it was enacted.

4. An assessment of whether each tax preference benefits those taxpayers originally intended to benefit from it and, if not, a listing of those who do benefit.

5. A statement of any unintended or inadvertent effects, benefits, or harm caused by each tax preference, including whether each tax preference conflicts with any other state laws, regulations, or policies.

Definition of "Tax Preference"

An essential step in preparing tax expenditure reports is defining the term "tax preference." A provision of the tax code that one onlooker considers to be grossly unfair can be a provision that another observer considers absolutely equitable and fair.

Nevertheless, most commentators agree that a tax preference: 1) provides a benefit only to taxpayers; 2) operates through specific statutory provisions of the tax code; and 3) depends on certain criteria, such as age, income source, or expenditure decisions that not all taxpayers meet. In general, then, tax expenditures are tax code provisions that narrow the tax base or give credits to certain groups of taxpayers. The federal government uses the following definition, originally found in §3(a)(3) of the *Congressional Budget and Impoundment Act*:

> "those revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or other deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

The tax base for both the federal and State income tax is "net income" in the case of corporate income tax, or "adjusted gross income" in the case of personal income tax.

In either case, the base equals gross income less certain costs associated with earning income. Not all subtractions from "net income" can be called tax preferences. For example, costs of earning income are often deductible, but not considered tax preferences. These expenses are deductible by all taxpayers, so no preferential treatment occurs.

In addition, certain features of the tax code are considered to be integral parts of its basic structure and thus, are not considered tax preferences, even though they are subtractions from net income: among them, differential rates based on income level, the standard deduction, and personal exemptions. Only exceptions to these basic tax rules can be properly identified as tax preferences.

In defining "tax preference," this Report uses the following operational guidelines found in §8305(6):

> "Tax preference' means any law of the United States or of the State of Delaware which exempts, in whole or in part, certain persons, income, goods, services or property from the impact of established taxes, including, but not limited because of a failure of enumeration, to those devices known as tax deductions, tax exclusions, tax credits, tax deferrals, and tax exemptions. Tax preferences shall not include variations in the rate of income tax...standard deductions...or personal exemptions. [2]"

Review of Tax Preference Terminology

Tax systems are frequently evaluated according to several commonly accepted criteria and fundamental goals. Tax preferences should be assessed in the same terms, since they directly affect how well the basic tax system achieves these goals. These criteria characterize a system's: (i) ability to raise revenues in a reliable manner, known as *adequacy and stability*; (ii) fairness in terms of the distribution of the tax burden, known as *horizontal equity* (i.e., treating equals equally) and *vertical equity* (treating unequals fairly based on their ability-to-pay); (iii) ease of administration, enforcement, and return preparation, known as *simplicity*; (iv) amount of interference with individual decision-making, known as *economic efficiency*; and (v) potential to promote (or hinder) *economic growth*.

[2] The personal exemption was replaced by a personal credit effective January 1, 1996.

Adequacy and Stability

The impact of tax preferences on government revenues is the most obvious way that tax preferences affect the tax system. In fact, the term "tax expenditures" is often used interchangeably with "tax preferences" to indicate their negative effect on revenues. Producing steady revenues, even in economic downturns, is one of the most important roles of any tax system. Tax preferences affect the adequacy of tax systems because they narrow the tax base and reduce the liability of certain groups of taxpayers, thereby reducing the ability of a tax system to raise revenue in a *stable* and *reliable* manner through alternating economic cycles. Tax preferences linked to certain income sources or investment activities increase revenue instability because taxpayers can change their economic behavior in unpredictable ways.

A related concept, which is often discussed in connection with adequacy, is the *elasticity* of a particular revenue source. Tax elasticity refers to the percentage change in revenue attributable to a one-percent change in the income of taxpayers. Revenue sources are often assigned an elasticity value and rated accordingly. For example, an elasticity of 0.5 would mean that a one-percent change in income would result in a 0.5 percent change in tax revenue.

Elasticity is an important consideration in evaluating tax systems because it is desirable to have revenue sources in place which keep pace with inflation and the demand for public services. In most instances, an elasticity of at least 1 is desired -- this implies that a one percent increase in income will produce a one percent increase in tax revenue. The reader should note that, within a given revenue source, tax stability and sufficient tax elasticity are often difficult to achieve simultaneously (i.e., the more elastic a revenue source, the less stable and predictable it is likely to be). For this reason, a state's mix of taxes (or its "revenue portfolio") should be composed of a number of taxes allowing for proper balance between revenue growth and stability. For additional information on the tradeoff between the evaluative criteria discussed in this section, please refer to the summary below.

Horizontal Equity

Horizontal equity means that, all other things being equal, taxpayers with similar ability-to-pay should have similar net tax burdens. Generally speaking, for tax purposes, equal ability-to-pay is defined in terms of equal income. But income does not always equate with ability-to-pay. For example, if "Taxpayer A" and "Taxpayer B" have the same level of income, but "Taxpayer A" spends two-thirds of her income on unavoidable

medical expenses, "Taxpayer A" has less ability-to-pay than "Taxpayer B." Horizontal equity, therefore, does not necessarily imply one set of rules for all. Tax rules can be adjusted to take account of special circumstances and thereby maintain horizontal equity. The problem is determining *which* special circumstances justify special treatment for tax purposes. These special circumstances are typically unavoidable, catastrophic expenses that a taxpayer faces involuntarily. Large, voluntary, and common expenses are not usually considered in ability-to-pay calculations because of their controllability. When it is legitimate to deviate from a common definition of income, criteria defining these cases should be outlined, and tax preferences evaluated with respect to them.

Vertical Equity

Vertical equity is the principle that tax burdens should be distributed "fairly" among taxpayers with different abilities-to-pay. Vertical equity is a subjective concept that, at its core, is essentially a value judgement. Among policy makers and academics, however, there is general agreement that the tax system should not be regressive; i.e., that those with lower incomes should not pay a larger proportion of their income in taxes than do those with higher incomes. Some tax preferences are clearly intended to benefit low-income groups.

The intent of these preferences, with respect to their effect on tax burdens is different from horizontal equity. Tax preferences that improve horizontal equity are intended to equalize the tax treatment between individuals with similar incomes by recognizing differences in ability to pay. Typically, tax preferences that seek to address vertical equity are designed to increase the tax system's progressivity by reducing the tax burden on lower-income taxpayers relative to those with higher incomes. To the extent that they are successful, proponents of increased progressivity may claim that the tax preference improves vertical equity. However, several of Delaware's tax preferences provide significant tax benefits to middle- and upper-income taxpayers even though they were ostensibly established for the purpose of improving vertical equity.

Simplicity

Simplicity in tax systems is valued because it allows for lower taxpayer and administrative costs and enhances compliance with tax laws. Tax preferences may take the form of deductions, exemptions, credits, and exclusions, many of which make tax forms more difficult to understand, more time-consuming, and harder to complete accurately. Entitlement to special deductions often requires special recordkeeping by taxpayers and additional verification by revenue agents. Conversely, simple tax systems offer reduced

administrative and collection costs due to their transparent, straightforward definition of taxable income.

Simplicity can affect voluntary and involuntary compliance rates. The more deductions and subtractions that taxpayers make on their returns, the greater the possibility that they will make inadvertent mistakes in calculating their liability. Tax simplification can increase voluntary compliance rates. Fewer deductions and credits (which often are difficult to verify in the absence of an audit) provide fewer opportunities to shelter income. Reducing the number of tax preferences reassures taxpayers that other citizens are "paying their fair share" and enhances their willingness to comply voluntarily.

Economic Efficiency

An efficient tax system should be as neutral as possible with respect to economic decision-making. This requires that resources be allocated where they will receive the highest expected return. Tax preferences may interfere with economic decision making and, therefore, erode *economic efficiency*, because they explicitly favor certain allocative decisions over others.

Not only does society lose resources by limiting tax payments from certain taxpayers, but tax preferences also may shift economic resources towards less productive uses. Tax preferences can cause resources to be allocated where they can receive the most favorable tax treatment rather than where they can produce the goods and services most in demand by consumers, or earn the highest economic return.

Economic Growth

Many tax preferences are based on the argument that they will promote economic development by encouraging businesses to locate in Delaware or to invest in existing Delaware enterprises. Tax preferences can increase tax revenues if they attract investments that enlarge the economy. Whether preferences *do* enhance economic growth is up to question. On the downside, tax preferences may actually become growth impediments if they cause other, non-preferred activities to pay higher taxes. Higher rates impede economic growth because they reduce the after-tax return available on investments.

Other Criteria

Tax preferences are often established for reasons other than improving the tax system, and so should be measured against criteria in additional to those listed above. Many preferences are designed to provide incentives to certain investment activities or to serve specific constituencies, and not to enhance revenues or simplify tax administration. In these cases, the tax system is simply being used as a mechanism to achieve other public policy goals. For example, the purpose of some business tax credits is to increase business investment in certain industries, locations, or production methods, such as expenditures on pollution abatement equipment. Clearly, these external policy goals must be recognized in any assessment of a tax preference. The primary questions in these cases is whether the tax preference actually causes the behavioral change that society desires, and if another mechanism (aside from the Tax Code) is more appropriate in achieving the desired goal.

Summary

One final point to keep in mind is that, in practice, there is a tradeoff between these different criteria. For example, efforts to improve horizontal equity by instituting new tax deductions or credits to insulate taxpayers from unavoidable expenditures may erode simplicity. Tax structures designed to produce a more progressive distribution of tax burdens may violate the principal of economic efficiency. A tax system cannot achieve each of these goals to the same degree simultaneously. Ideally, these fundamental goals are balanced in a way that reflects the desires of state taxpayers as expressed through their elected representatives.

Readers will likely form more fundamental questions as they read this report. To list a few:

(i) Should the tax system go beyond its basic role of raising government revenues? If so, what are these roles?

(ii) If the tax code is being used to address a certain societal problem, would direct governmental expenditures or the imposition (or removal) of government regulations better address the problem?

(iii) To what degree should tax preferences be held to the traditional standards of tax administration (i.e., adequacy, equity, efficiency, and simplicity), even if a tax preference was not created for tax policy purposes?

Methodology -- Measurement of Revenue Impacts

The revenue impacts of Delaware tax preferences are analyzed using a variety of sources and techniques. Estimates of losses in the personal income tax system rely primarily on databases that include information from both state and federal personal income tax forms for Delaware residents. Because Delaware has a relatively small number of taxpayers, in many instances the Division of Revenue can analyze data for all resident and non-resident taxpayers, rather than resort to statistical samples of the population. The relatively small number of taxpayers, combined with modern relational database software packages, allows substantially more accurate analyses of the impacts of specific tax preferences on individual income tax revenues than might otherwise be possible. These advances in computing capacity overcome the analytic limitations of the early tax preference reports.

Other sources of information for this report include computerized data for corporate income and other tax sources; published and unpublished Department of Finance reports and fiscal notes; data and reports from other government agencies and private institutions; and, where necessary, direct sampling of Delaware tax returns.

Readers should be aware of several limitations with respect to the Report's fiscal impact calculations:

(i) Except where noted, revenue loss estimates for each tax preference are calculated in static terms without accounting for behavioral effects that may result from the elimination or modification of a specific tax preference. This limitation is most significant with respect to business tax credits, whose primary purpose is to encourage behavioral change (e.g., different patterns of business investment).

(ii) Revenue loss estimates are calculated separately for each tax preference. No assessment has been made of the cumulative effect of a number of tax preferences on lost revenues. Interrelationships between different tax preferences can result in situations where changing one preference has implications for the revenue loss estimates of other preferences. This limitation is most apparent with respect to tax preferences for the elderly. The elderly may claim up to four different, non-means-tested tax preferences. Due to Delaware's graduated rates structure, the revenue effect of claiming four tax breaks simultaneously is not necessarily the same as the sum of its parts. For example, an elderly couple that qualifies for three tax

preferences may avoid any tax liability by taking only one of the three preferences available to them.[3]

(iii) Revenue estimates assume no change in the taxpayer's decision to itemize deductions or to take the standard deduction. If several preferred itemized deductions were eliminated, more taxpayers would possibly claim the standard deduction instead. As a result, the revenue impacts of other itemized deductions would fall. Conversely, elimination of the additional standard deduction for the elderly might cause an increase in itemized deductions, which would affect the fiscal impact of other tax preferences.

(iv) The fiscal impact of a particular provision only examines the revenue losses related to a specific tax covered in this Report. This is significant for several of the business tax credits, which may be taken against taxes other than corporate income tax or public utility taxes. For example, while a firm may have no corporate income against which to claim credits, it may claim the credits against the gross receipts tax, which is not covered in this Report.

(v) Economic performance directly affects these revenue loss estimates, especially those for corporate income tax preferences. For example, in economic downturns, corporations may not have any taxable income due to net losses. Corporations with no liability cannot claim the tax credits to which they may be entitled. As such, estimates of tax expenditures depend on the predictability of changes in taxable income that result from changes in the national economy.

(vi) Changes in the Federal tax or regulatory system can also affect the revenue loss estimates for Delaware tax preferences. This is because changes at the Federal level may induce behavioral changes that affect the State revenues.

Despite these limitations, this Report's revenue loss estimates do provide useful information on the relative size and growth of various tax preferences. The estimates can show how widely a tax preference is being used and indicate the revenue implications associated with its repeal or modification.

Limitations of the Tax Preference Report -- Incrementalism

[3] See the section of this Report entitled "Incrementalism" below.

One of the shortcomings of the approach taken by this report (the examination of individual preferences within specific revenue categories) is that, in some instances, it fails to adequately convey the implications which can result from the cumulative effect of different tax preferences. The incremental nature with which some preferences develop can have unintended consequences on taxpayers and state revenues. Due to the efforts of state policymakers, Delaware has for the most part avoided this problem. Two areas where incrementalism has raised concerns are the complexity of the New Job Creation Credit (formerly, the "Blue Collar Jobs Act" credits) and personal income tax preferences based on age. The discussion below deals with personal income tax preferences based on age.

Over the past five decades, public policy makers at all levels of government have implemented proposals aimed at improving the welfare of elderly citizens. The creation of Medicare and indexing Social Security benefits are among the most notable federal policies aimed at assisting the elderly. Like other states, Delaware has enacted several personal income tax preferences to assist elderly taxpayers.

Evaluated individually, the unintended implications inherent in many of these preferences (see the Personal Income Tax section below) may not have sufficiently outweighed the perceived benefits to prevent their enactment. Taken together, however, serious equity implications can arise. Because elderly taxpayers can utilize more than one of these preferences at a time, the combined effect of these preferences can result in dramatically different tax treatment of individuals with the same ability to pay.

Cumulative Effect of Non-means Tested Preferences

An illustration of the equity problems caused by the cumulative effect of these tax preferences can be seen in the following example. Consider the following two households:

	Household A	Household B
Family size:	4	2
Both Spouses Age:	35	65
Number of Children:	2	0
Both Spouses Work:	Yes	No
Total Household Income:	**$74,400**	**$74,400**

"Household A" receives its income exclusively from wages and interest, while "Household B" receives its income primarily from Social Security and pension income. The differences in sources of income between these two households will have a dramatic impact on their tax liability.

Household A

	Husband	Wife
Pension:	$0	$0
Interest:	$500	$500
Dividends:	$0	$0
Wages:	$36,700	$36,700
Social Security:	$0	$0
Total Income:	**$37,200**	**$37,200**

Household B

	Husband	Wife
Pension:	$20,000	$20,000
Interest:	$7,200	$7,200
Dividends:	$0	$0
Wages:	$0	$0
Social Security:	$10,000	$10,000
Total Income:	**$37,200**	**$37,200**

In computing taxable income, each spouse in Household A can reduce his/her taxable income by $3,250 (a total of $6,500 - the amount of the standard deduction). In contrast, the couple in Household B, because of the sources of their income and their age, can eliminate taxable income almost completely. This reduction represents the exclusion of Social Security benefits, the pension and eligible retirement income exclusion, the low-income elderly exclusion, the standard deduction and the additional standard deduction for persons 65 and over. (See table below.)

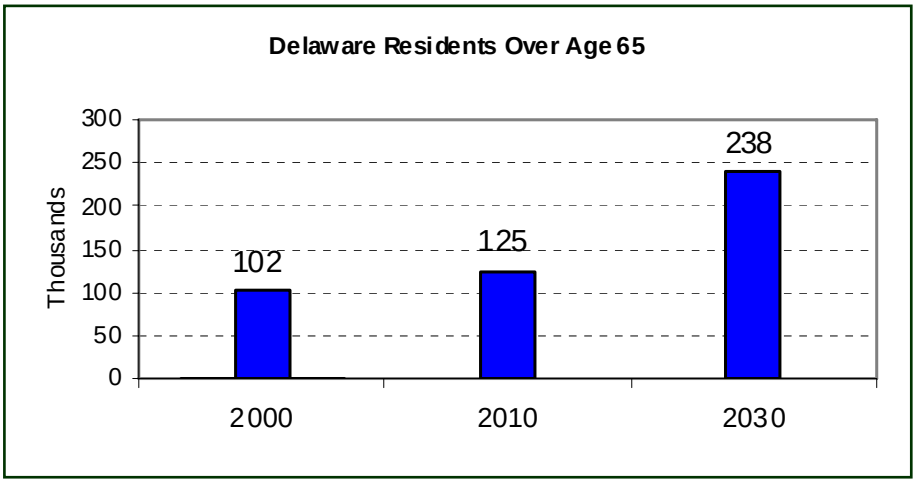
Tax Liability Comparison				
Two-earner Family of Four vs. Two Taxpayers Over 65				
	Household A		**Household B**	
Type of Income	Husband	Wife	Husband	Wife
Total Income	$37,200	$37,200	$37,200	$37,200
Wages	$36,700	$36,700	$0	$0
Social Security Exclusion	$0	$0	-$10,000	-$10,000
Pension Income	$0	$0	$20,000	$20,000
Dividend Income	$0	$0	$0	$0
Interest Income	$500	$500	$7,200	$7,200
Total Pension/Retirement Income	$0	$0	$27,200	$27,200
Pension Exclusion	$0	$0	-$12,500	-$12,500
Delaware AGI	$37,200	$37,200	$14,700	$14,700
Standard Deduction	-$3,250	-$3,250	-$3,250	-$3,250
Additional Standard Deduction	$0	$0	-$2,500	-$2,500
Taxable Income	$33,950	$33,950	$8,950	$8,950
Gross Tax Liability	$1,497	$1,497	$220	$220
Personal Credit	-$330	-$110	-$110	-$110
Additional Personal Credit	$0	$0	-$110	-$110
Child Care Credit	$0	-$250	$0	$0
Net Liability	$1,167	$1,137	$0	$0
Total Household Liability	**$2,304**		**$0**	

In the end, Household A has a gross liability of $2,994 which is reduced to $2,304 through the use of four $110 personal credits, and the child care credit.[4] Household B, on the other hand, has $440 in gross liability. This liability, however, is completely eliminated because the couple in Household B qualifies for four $110 personal credits – two regular credits plus two additional credits for persons age 60 or over. The retirees in Household B, despite having the same income and no dependents, pay no income tax, while the working family of four owes the state over $2,300.

This example is not unrepresentative of the radically different tax treatment of similarly situated taxpayers possible through the cumulative effect of non-means tested tax preferences.

Long-Term Effect on State Revenues

In addition, the cost of these preferences is expected to increase dramatically in future years. Over the next twenty years, the percentage of the population over age 65 will increase dramatically as the baby boom generation completes its transition into retirement. This will significantly increase the cost of these tax preferences as more and more elderly taxpayers become eligible to benefit from them. As can be seen in the accompanying chart, the number of Delaware residents over 65 is expected to increase to approximately 238,000 by the year 2030 -- a *90 percent increase* over 2010. The percentage of all Delawareans over age 65 is expected to increase from approximately 14 percent in 2010 to almost 24 percent in 2030.



urce: U.S. Census Bureau (http://www.census.gov/population/projections/PressTab5.xls)

[4] This couple can use four personal credits -- one personal credit for each spouse and one for each dependent.

LIST OF DELAWARE TAX PREFERENCES

Personal Income Tax

1.01 Low-Income Elderly Exclusion

1.02 Exclusion of Pension and Eligible Retirement Income

1.03 Exclusion of Taxable Social Security Benefits

1.04 Exclusion of Benefits Received Through the Travelink Program

1.05 Additional Standard Deduction for the Blind or Persons Age 65 or Over

1.06 Charitable Mileage Deduction

1.07 Additional Personal Credit for Persons Age 60 and Over

1.08 Volunteer Firefighter's Tax Credit

1.09 Child and Dependent Care Expense Tax Credit

1.10 Tax Credits for New Business Facilities, New Employees, Qualified Investments, and Green Industries

1.11 Military Action Exemption

1.12 Extension of Filing Deadline for Military Personnel Serving in a Combat Zone

1.13 Exemption for Early Retirement Distributions Used for Education

1.14 Exemption for Trusts Established as "Designated" or "Qualified" Settlement Funds

1.15 Land and Historic Resource Tax Credit

1.16 Historic Preservation Tax Credit

1.17 Earned Income Tax Credit

Corporate Income Tax

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

2.02 Deduction of Interest from Affiliated Companies

2.03 Handicapped Accessibility Deduction

2.04 Neighborhood Assistance Credit

2.05 Credits for Creation of Employment and Qualified Investments in Business Facilities

2.06 Credits for Creation of Employment and Qualified Investments in Targeted Areas

2.07 Credits for Mitigation of Commuter Traffic During Peak Travel Periods

2.08 Clean Energy Technology Device Manufacturing Credit ★

2.09 Credits for Development of "Brownfield" Sites

2.10 Research and Development Tax Credit

2.11 Land and Historic Resource Tax Credit

2.12 Historic Preservation Tax Credit

2.13 New Economy Jobs Credit

2.14 Headquarters Management Corporations

2.15 Asset Management Companies

2.16 Business Finder's Fee Tax Credit ★

Motor Fuel/Special Fuel Tax

3.01 Exemption for Ambulances, Veterans' Group Vehicles, and Volunteer Fire Companies

3.02 Refunds for Certain Non-Road Vehicles

3.03 Exemption for Special Fuels

Public Utility Tax

4.01 Exemption for Corporations Reorganizing Under Provisions of the Bankruptcy Code

4.02 Exemption of Electricity Used in Certain Manufacturing Processes

4.03 Refunds for Firms That Qualify for New Business Facilities Credit

4.04 Rate Reduction for Electricity used by Manufacturing Firms, Agribusiness and Food Processing Firms

4.05 Rate Reduction for Gas Used by Manufacturing Firms

4.06 Exemption for Electricity used by Automobile Manufacturing Firms

4.07 Exemption for Gas used by Automobile Manufacturing Firms

4.08 Rate Reduction for the Provision of Cable and Satellite Television Services

4.09 Exemption for Electronic Pager Service

★ New or recently implemented preference

DELAWARE TAX PROVISIONS NOT INCLUDED

The following items are listed in the Delaware Code in a manner similar to other tax preferences detailed in this report. Many of the items meet the criteria used to define a tax preference, which are highlighted above. However, these tax preferences have been excluded from the report for the reasons noted below.

Personal Income Tax

1. Modification for Fiduciary Adjustment
   Title 30, Delaware Code, Chapter 11, §1106(c).

   Rationale for exclusion from report:
   This modification is viewed as an appropriate adjustment to determine net income and, as such, should not strictly be defined as a tax preference.

2. Deduction of Interest or Dividends on U.S. Government Obligations
   Title 30, Delaware Code, Chapter 11, §1106(b)(1).

   Rationale for exclusion from report:
   This modification is required by the Supremacy Clause of the U.S. Constitution.

3. Deduction for Wages Paid for Which New Jobs Tax Credit is Claimed
   Title 30, Delaware Code, Chapter 11, §1106(b)(5).

   Rationale for exclusion from report:
   This provision is not technically a tax preference because a deduction is allowed for all wages paid, even when the taxpayer elects the federal preference of taking a credit for the same wages.

4. Credit for Income Taxes Paid to Another State
   Title 30, Delaware Code, Chapter 11, §1111.

   Rationale for exclusion from report:
   This credit avoids double taxation of Delaware residents.

5. Favorable Tax Treatment of Distributions from Qualified Tuition Savings Plans
Title 14, Delaware Code, §3483.

Rationale for exclusion from report:
This is a preference authorized under the federal Internal Revenue Code (IRC). Under §529 of the IRC, qualified distributions from such plans are taxed at the rate applicable to the beneficiary, not the contributor. State taxpayers benefit by virtue of Delaware's "piggybacking" on the federal tax system.

6. Deduction of Health Insurance Costs Paid by Self-Employed Persons
Title 30, Delaware Code, Chapter 11, §1109(a)(2)(b)

Rationale for exclusion from report:
This preference allows a State income tax deduction for amounts spent on health insurance over and above that which is allowed as a deduction on the taxpayer's federal return. Beginning in Tax Year 2003, the federal exclusion increased to 100% of qualified expenses and effectively eliminated any benefit associated with Delaware's "preference."

Corporate Income Tax

1. Deduction for Interest Received from U.S. Government Securities
Title 30, Delaware Code, Chapter 19, §1903(a)(3).

Rationale for exclusion from report:
This deduction is required by Constitutional provision.

2. Deductions for Gains or Losses From Sale of U.S. Government Securities
Title 30, Delaware Code, Chapter 19, §1903(a)(4).

Rationale for exclusion from report:
These deductions are required by Constitutional provision.

3. Deduction for Wages Paid for Which New Jobs Tax Credit is Claimed
Title 30, Delaware Code, Chapter 19, §1903(a)(6).

Rationale for exclusion from report:

As with the personal income tax exemption, this provision is not technically a tax preference because a deduction is allowed for all wages paid, even when the taxpayer elects the federal preference of taking a credit for the same wages.

4. Exemption of Foreign Interest, Dividends, and Royalties
Title 30, Delaware Code, Chapter 19, §1903(a)(1).

Rationale for exclusion from report:
These sources are not included due to Constitutional limitations.

5. Exemption for Homeowners' Associations
Title 30, Delaware Code, Chapter 19, § 1902(b)(17)

Rationale for exclusion from report:
These entities are not considered part of the base of the tax, and therefore the exemption is not defined as a tax preference.

Motor Fuel/Special Fuel Tax

1. Motor Fuel Tax and Special Rates
Title 30, Delaware Code, Chapter 51, §5110(c), §5132.

Rationale for exclusion from report:
This provision is not regarded as a tax preference because different tax rates are applied to technically different tax bases.

2. Exemption for Sales of Gasoline to the U.S. Government or Any of Its Subdivisions
Title 30, Delaware Code, Chapter 51, §5111.

Rationale for exclusion from report:
This exemption is required by Constitutional provision.

3. Exemption for Sales of Gasoline to Anyone Protected by the Interstate Commerce Clause
Title 30, Delaware Code, Chapter 51, §5111.

Rationale for exclusion from report:
This exemption is required by Constitutional provision.

4. Exemption for Sales of Gasoline to Delaware or Any of Its Subdivisions
Title 30, Delaware Code, Chapter 51, §5111.

Rationale for exclusion from report:
This exemption avoids the state needlessly taxing itself.

5. Exemption for Sales of Special Fuels to the U.S. Government or Any of Its Subdivisions
Title 30, Delaware Code, Chapter 51, §5133.

Rationale for exclusion from report:
This exemption is required by Constitutional provision.

6. Exemption for Sales of Special Fuels to Delaware or Any of Its Subdivisions
Title 30, Delaware Code, Chapter 51, §5133.

Rationale for exclusion from report:
This exemption avoids the state needlessly taxing itself.

7. Exemption of Fuel Used and All Vehicles of Any Other State Government Which Reciprocates
Title 30, Delaware Code, Chapter 51, §5133.

Rationale for exclusion from report:
This exemption is required by Constitutional provision.

Public Utility Tax

1. Exemption for Electricity, Gas and Telephone Sales and Services to Residential Users
Title 30, Delaware Code, Chapter 55, §5506(e).

Rationale for exclusion from report:

These users are not considered part of the base of the tax, and therefore the exemption is not defined as a tax preference.

2. Exempt Tax Receipts Received From the Sale of Public Utilities to the State of Delaware or Any of Its Subdivisions
Title 30, Delaware Code, Chapter 55, §5506(d).

Rationale for exclusion from report:
This exemption avoids the state needlessly taxing itself.

3. Exempt Internet Access Charges from Public Utility Tax
Title 30, Delaware Code, Chapter 55, § 5502

Rationale for exclusion from report:
This preference is effectively authorized under Delaware's own Tax Code. Authorization of this exemption became effective for Delaware taxpayers on January 1, 2005. As of November 1, 2005, however, an update to federal law effectively replicated Delaware's provision thereby eliminating any benefit associated with Delaware's "preference."

A SUMMARY OF TAX PREFERENCE CHANGES SINCE 2009

The adoption of new tax preferences has not abated since the publication of the last Tax Preference Report in 2009. In the intervening two years, the General Assembly spent resources on the creation, implementation, or expansion of one new tax preferences. Additionally, there has been the extension of one tax preference and the expansion of another. One tax preference has been eliminated. Below is a summary of the legislative changes affecting tax preferences since the completion of the 2009 Report.

Tax Preferences Created

Personal Income Tax:

None

Corporate Income Tax:

- Business Finder's Fee Tax Credit
- Clean Energy Technology Device Manufacturing Credit

Tax Preferences Expanded

Corporate Income Tax:

- New Jobs Creation Tax Credit (Blue Collar Jobs Act)

  Extended Sunset date to June 30, 2011.

Tax Preferences Extended

Personal Income Tax:

- Historic Preservation Tax Credit

Corporate Income Tax:

- Historic Preservation Tax Credit

Tax Preferences Eliminated

Corporate Income Tax:

- Green Industries Tax Credits