Time to close the door on the Delaware loophole

Suite 400 is located on the fourth floor of a modern building in an attractive office park next to a golf course on the outskirts of Wilmington, Delaware. It's a nice enough office, but you'd never know that it is the legal home of thousands and thousands of corporations – including many that do business in Pennsylvania.

These companies don't have factories or employees on Centreville Road in Wilmington, and they aren't there for the golf. They are there to take advantage of tax laws that make it easy to hide profits on income they earn in Pennsylvania. There's even a name for it: The Delaware loophole.

Here's how it works: A large multi-state corporation creates a shell company in a tax-haven state like Delaware. The subsidiary has no employees and is often nothing more than a post office box. The corporation then uses accounting gimmicks to funnel profits through the shell company, leaving no apparent income on the books in Pennsylvania. It may be legal, but it isn't fair.

In Pennsylvania, 71 percent of companies subject to the corporate net income tax pay no tax. Tens of thousands of companies are avoiding Pennsylvania state taxes because their home office is a file drawer in an office building somewhere in Delaware. And those that are paying are paying less. In 1994, 75 percent of corporations paid $1,000 or less in corporate income taxes. By 2003, 84 percent of all corporations were paying that much - less than a Pennsylvania family earning $36,000 a year pays in annual income taxes.

Twenty-three states – but not Pennsylvania – have enacted legislation to close the loopholes. The law, known as combined reporting, requires corporations and their affiliated shell companies to file together and pay taxes according to the amount of business activity done within the Commonwealth.

Closing the Delaware Loophole would bring hundreds of millions of dollars in corporate net income taxes back to Pennsylvania for profits earned here by multi-state corporations. Keeping that tax revenue where it belongs - in Pennsylvania - would allow the Commonwealth to take a more balanced approach to the state budget, preventing painful cuts to education, health care and services for families hard hit by the recession. Combined reporting could also allow the Commonwealth to reduce the corporate net income tax rate by as much as 10 percent.

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