

**DIVISION OF REVENUE**

**TECHNICAL INFORMATION MEMORANDUM 2004-01**

**DATE: February 6, 2004**

**SUBJECT: Legislation passed during the First Session of the 142<sup>nd</sup> Delaware General Assembly.**

During the First Session of Delaware's 142<sup>nd</sup> General Assembly, ended June 30, 2003, eight bills were enacted of interest to or having an impact on Delaware taxpayers and the state's Division of Revenue. The subjects of these bills range from the reorganization of debt-collection processes for Superior Court judgments to granting the option of renewing an occupational and business license for either one or three (3) years.

Legislation significant to Delaware's Division of Revenue has been summarized below and is divided into two categories for retrieval ease: (I) legislation implementing broad policy changes that affect tax procedures for businesses and individuals, but have no impact on Delaware tax rates and (II) House Bills relevant to the Division of Revenue's role assisting Delaware tobacco regulation.

Bills in their entirety may be viewed online through the Delaware Division of Revenue's website [<http://www.state.de.us/revenue>] by clicking "**Tax Regulations**" and then linking to "**General Assembly (Bill Tracking)**".

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This memorandum is intended for general notification and explanation of recently enacted Delaware laws and should not be relied upon exclusively in any pending or future audit or judicial review of an individual taxpayer or transaction. Taxpayers are advised to consult the particular bill, the Delaware Code, or Delaware regulations in all matters conflicting with any part of this memorandum.

Taxpayers with general questions about the application of Delaware law and procedures may call the Division of Revenue Help Line at (302) 577-8200, or visit the Division's website at [<http://www.state.de.us/revenue>] where information about tax topics and links to phone numbers for other information may be found.

**I. Legislation implementing broad policy changes that affect tax procedures for businesses and individuals, but have no impact on Delaware tax rates:**

**Senate Bill No. 3**

Introduced 01/15/2003

Signed 01/31/03

This Act exempts the sale of aircraft weighing 12,500 pounds or more from the Wholesalers' and Retailers' License and Gross Receipts tax.

**Senate Bill No. 84**

Introduced 04/17/2003

Signed 07/15/03

This Act allows the Director of Revenue to notify S Corporations of filing requirements by means of postcards. S corporations are corporations that, by virtue of their structure, are allowed to elect to pass their income or loss through to shareholders and thus are not taxed as an entity. In Delaware, S corporations must pay tax on behalf of non-resident shareholders. Very few S Corporation returns are produced other than by tax professionals or by software. There is no similar requirement to provide notification or to mail blank tax returns to "C" Corporations (corporations that do not elect S corporation treatment).

**Senate Bill No. 87**

Introduced 04/17/2003

Signed 07/15/03

This Bill makes several changes to streamline the administration and collection of taxes.

Section 1 amends Section 352 of Title 30 of the Delaware Code to permit the Director of Revenue to write off certain tax debts owed by bankrupt or deceased persons and dissolved businesses when there are not sufficient assets in their estates to pay the tax debt. The Director would continue to have discretion to write-off debts deemed impractical to collect after the lapse of 6 years. A write-off of an account would *not* extinguish the debt.

Section 2 amends provisions relating to the filing of Superior Court judgments for tax debts by permitting electronic filing of documents with the Prothonotary (the principle notary or clerk of the court) if and when such electronic filings are implemented by the Court.

Section 3 streamlines the process for collecting debt owed for taxes that have been reduced to Superior Court judgments.

Subsection (b) of the Act retains existing law in Title 30 of the Delaware Code § 556 with respect to collection of judgments from tangible property through Sheriff's sale.

*The remainder of the Act reorganizes the remaining concepts of § 556 as currently administered:*

Subsection (c) provides for garnishment of bank accounts as before, and may be issued by the Director.

Subsection (d), garnishment of other intangible assets such as wages and contract rights may be collected by a continuous levy issued by the Director. This could eliminate the necessity in some cases of filing multiple levies to collect the same judgment from payments due a judgment debtor in installments.

Subsection (e) sets forth the duties of a garnishee of bank accounts, wages, salaries, or other amounts of their duties when served with a notice of garnishment and holds such garnishee liable for failure of compliance. This provision codifies Superior Court practice for holding the garnishee liable for noncompliance with a notice of garnishment.

Sections 4 and 5 revise existing sections 2124 and 2125 of Title 30, Del. Code, relating to the revocation, denial, or non-renewal of business licenses for any company failing to pay their business license tax.

Under Section 4, the remedies to deny a business license extend, in addition to the offending taxpayer, to certain persons or entities who are closely related to that taxpayer (whose license has been denied), as well as in situations where the nature of the business is substantially the same as the revoked licensee's as to make them a virtual alter ego of the revoked business.

In practical effect, these provisions place the burden of proof on any similar businesses springing up from revoked businesses in instances where the seemingly new business is in the same line of work, is otherwise substantially the same, and is owned by a relative of the revoked business owner. The new business may carry the burden of proof by showing the business was acquired in an arms' length transaction and that no owner of 25% or more of the revoked business has an interest in the new business.

Under definitions in Section 5, related persons to the owner of a business whose business license was revoked, denied, or withheld (a "*revokee*") include natural persons who are siblings, spouses, children, grandchildren and parents and persons who own 25% or more of the equity of a revokee, or an entity in which the revokee owns 25% or more of the equity. The power to enjoin the conduct of business by a person whose business license was revoked or denied remains with the Court of Chancery, where the burden of proof, in such cases, lies with the revokee. Again, in such cases, the business owner may carry the burden of proof by showing the business was acquired in an arm's length transaction and that no owner of 25% or more of the revoked business has an interest in the new business.

## **House Bill No.146**

Introduced 04/29/2003

Signed 07/11/03

Section 1 retroactively corrects an unintentional omission from the law of an adjustment to the calculation of taxable income. Federal law requires refunds of state income taxes claimed as a deduction in a prior year, be included in federal taxable income. Since Delaware does not allow a deduction for Delaware income taxes paid, there should be no adverse consequence to Delaware taxpayers for receiving a refund of State taxes deducted on the federal return, nor has the Division of Revenue ever applied the law so as to create those consequences. However, this section has been amended to specify that the amount of any refund of Delaware State income taxes imposed under this Chapter exist, "to the extent included in federal adjusted gross income for the tax period."

This Act makes the statutes consistent with the manner in which the State personal income tax has been administered both presently and historically.

Sections 2 resolves an ambiguity regarding the interaction of Delaware and federal law. Under federal law (for tax years beginning after December 31, 1996), a trust may elect to be an "electing small business trust" (I.R.C. § 1361(e)(1)). An electing small business trust ("ESBT") is permitted to own stock in a Subchapter S corporation. The portion of an electing small business trust that consists of stock of one or more S corporations is treated as a separate trust in computing the tax attributable to the S corporation stock held by that trust (IRC § 641(c)). The income of the separate "S portion" is taxed at the highest rate imposed on trusts. Section 2. Under Delaware law, the starting point for calculating the tax on a trust is the amount of taxable income shown on the taxpayer's federal income tax return (Form 1041). The Internal Revenue Service did not materially redesign its tax return in response to the 1996 amendment to the tax code. Instead, without specific statutory direction, the instructions for IRS Form 1041 tell the taxpayer to separately calculate the tax on the S portion of an ESBT and then combine that tax with the tax calculated on the remainder of the trust income. To the left of the box for entry of the combined tax on the return the taxpayer is instructed to make an interline notation "Sec. 641(c)". The result is that the S portion is taxed for federal purposes at the highest rate, but it is not included in the amount of taxable income of the trust reported on line 22 of the return. Because of the way the Internal Revenue Service instructs taxpayers to calculate the tax on the S portion of an ESBT, some taxpayers contend this income is not taxable in Delaware.

Section 2 of this bill will clarify the intent of the Delaware Revenue Code to tax income received by an electing small business trust from its interest in an S corporation to the extent it constitutes Delaware source income. This section was later amended to explain that, in the case of an electing small business trust as defined in § 1361(e) of the Internal Revenue Code [26 U.S.C. § 1361(e)], there shall be added to the amount calculated the taxable income of the portion of the trust consisting of S corporation stock that is treated as a separate trust pursuant to § 641(c) of the Internal Revenue Code [26 U.S.C. § 641(c)].”

**House Bill No. 241**

Introduced 06/10/2003

Signed 06/30/03

This Act will allow procurement of occupational and business licenses for terms of up to three (3) years.

**II. House Bills concerning Delaware tobacco regulation:**

**House Bill No. 129**

Introduced 04/10/2003

Signed 07/08/03

This Act provides additional means to enforce the Tobacco Settlement Act of 1999 (29 Del. C. Chapter 60C) against a Non-Compliant Tobacco Manufacturer who is not a participant in the Master Settlement Agreement.

**House Bill No. 270**

Introduced 06/17/2003

Signed 06/19/03

This Act increases the tax on cigarettes from 24 cents to 55 cents per 20-cigarette pack.

Section 1 increases the cigarette tax rate.

Section 2 clarifies that the cigarette tax is rounded up in case it applies to any unit expressed in fractions of cents. The same concept presently applies to cigarettes sold in packs.

Section 3 makes the cigarette tax effective for possession within the state after midnight July 31, 2003. It also imposes a "floor tax" on inventories of cigarettes and requires that the difference between the new tax and the old tax be paid on

stamps purchased on or before midnight July 31, 2003, but not affixed to any cigarettes as of the effective date of this Act.

**House Bill No. 153**

Introduced 04/29/2003

Signed 06/30/03

This Bill provides certain terms and conditions to Internet sales of cigarettes in an effort to assure cigarettes do not get into the hands of children.

Section 1 amends Title 30 of the Delaware Code by inserting a new Chapter 53, Tobacco Product Tax, titled "Subchapter VI, Delivery Sales of Cigarettes".

Subsection § 5361 outlines the definitions for Subchapter VI as follows:

1. *Adult*: a person who is at least the legal minimum purchase age.
2. *Consumer*: an individual who is not licensed as a distributor or retail dealer pursuant to Subchapter II of this Chapter.
3. *Delivery Sale*: any sale of cigarettes to a consumer in this State where either (i) the purchaser submits the order for such sale by means of a telephonic or other method of voice transmission, the mails or any other delivery service, or the Internet or other online service; or (ii) the cigarettes are delivered by use of the mails or of a delivery service. A sale of cigarettes shall be a delivery sale regardless of whether the seller is located within or without this State. A sale of cigarettes not for personal consumption to a person who is a distributor or a retail dealer shall not be a delivery sale.
4. *Delivery Service*: any person who is engaged in the commercial delivery of letters, packages, or other containers.
5. *Department*: the Department of Finance.
6. *Legal Minimum Purchase Age*: the minimum age at which an individual may legally purchase cigarettes in this State.
7. *Mails or Mailing*: the shipment of cigarettes through the United States Postal Office.
8. *Person*: the same as defined in § 302(16) of Title 1.
9. *Shipping Container*: a container in which cigarettes are shipped in connection with a delivery sale.
10. *Shipping Documents*: bills of lading, airbills, or any other documents used to evidence the undertaking by a delivery service to deliver letters, packages, or other containers.

Subsection § 5362 details the requirements for delivery for Internet sales of cigarettes in Delaware. The ruling states that (a) no person shall make a delivery sale of cigarettes to any individual in Delaware who is under the legal minimum purchase age and (b) each person accepting a purchase order for a delivery sale shall comply with the requirements set forth in this Title, as well as all other laws

of this State that are generally applicable to sales of cigarettes occurring entirely within this State, including, but not limited to, those laws imposing: (i) excise taxes, (ii) sales taxes, (iii) license and revenue-stamping requirements, and (iv) escrow payment obligations as set forth in § 6082 of this Section.

Subsection § 5363 specifies the age verification requirements for delivery in Delaware of cigarette sales purchased on the Internet. No person shall mail, ship, or otherwise deliver cigarettes in connection with a delivery sale unless *prior* to the first delivery sale certain requirements are met. Persons accepting purchase orders for delivery sales may also request that prospective consumers provide their e-mail addresses.

Section 1 requires anyone mailing, shipping or otherwise delivering cigarettes to obtain reliable certification confirming that the consumer is at least the legal minimum purchase age. In addition, a statement in writing must be signed by the prospective consumer certifying the prospective consumer's address and that the consumer is at least eighteen (18) years of age.

Such statement must also confirm:

- (A) That the prospective consumer understands signing another person's name to such certification is illegal,
- (B) That the sale of cigarettes to individuals under the legal minimum purchase age is illegal,
- (C) That the purchase of cigarettes by individuals under the legal minimum purchase age is illegal under the laws of this State, and
- (D) That the prospective consumer wants to receive mailings from a tobacco company.

Section 2 requires any person making a delivery sale of cigarettes to produce a good faith effort to verify all information contained in the certification provided by the prospective consumer, pursuant to Subsection (1), against a commercially-available database; or to obtain a photocopy or other image of the valid, government-issued identification stating the date of birth or age of the individual placing the order.

Section 3 requires any person making a delivery sale of cigarettes to provide to the prospective consumer, via e-mail or other means, a notice meeting the requirements of § 5264 of this Title.

Section 4 states that, in the case of an order for cigarettes pursuant to an advertisement on the Internet, any individual engaged in the delivery service of cigarettes must receive payment for the delivery sale from the

prospective consumer by a credit or debit card issued in the consumer's name, or by check.

Subsection § 5364 outlines the necessary disclosure requirements for the delivery of cigarettes purchased on the Internet. The notice, required under § 5263(a)(3) of this Title, shall include a prominent and clearly legible statement that (a) cigarette sales to consumers below the legal minimum purchase age are illegal, (b) sales of cigarettes are restricted to those consumers who provide verifiable proof of age in accordance with § 5263 of this Title, and (c) cigarette sales are subject to tax under § 5305 of this Title, and an explanation of how such tax has been, or is to be, paid with respect to such delivery sale.

Subsection § 5365 details shipping requirements for delivery sales of Internet cigarettes in Delaware. Each person who mails, ships, or otherwise delivers cigarettes in connection with a delivery sale must meet certain requirements. If the person accepting a purchase order for a delivery sale delivers the cigarettes without using a delivery service, such person shall comply with all requirements of this Subchapter applicable to a delivery service and shall be in violation of the provisions of this Subchapter if he or she fails to comply with any such requirement.

Section 1 states that as part of the bill of lading or other shipping document, a clear and conspicuous statement must be included as follows: 'Cigarettes: Delaware Law Prohibits Shipping to Individuals Under 18, and Requires the Payment of all Applicable Taxes'.

Section 2 requires a method of mailing, shipping, or delivery be used which obligates the delivery service to require (i) the consumer placing the purchase order for the delivery sale, or another adult of legal minimum purchase age residing at the consumer's address, to sign to accept delivery of the shipping container, and (ii) proof – in the form of a valid, government-issued identification bearing a photograph of the individual who signs to accept delivery of the shipping container – demonstrating that he or she is either the addressee or another adult of legal minimum purchase age residing at the consumer's address. (However, proof of the legal minimum purchase age shall be required only if such individual appears to be under 27 years of age.)

Section 3 maintains that the delivery service retained for delivery sales must be provided with evidence of full compliance with § 5267 of this Title.

Subsection § 5366 outlines registration and reporting requirements. Prior to making delivery sales or mailing, shipping, or otherwise delivering cigarettes in connection with any such sales, every person shall file with the Department a statement setting forth such person's name, trade name, and the address of such

person's principal place of business and any other place of business. Not later than the tenth day of each calendar month, each person that has made a delivery sale or mailed, shipped, or otherwise delivered cigarettes in connection with any such sale during the previous calendar month, shall file with the Department a memorandum or a copy of the invoice that provides for each and every such delivery sale.

This invoice shall include:

- (A) The name and address of the consumer to whom such delivery sale was made,
- (B) The brand or brands of the cigarettes that were sold in such delivery sale, and
- (C) The quantity of cigarettes that were sold in such delivery sale.

Any person that satisfies the requirements of Section 376 of Title 15 of the United States Code shall be deemed to satisfy the requirements of this Section.

Subsection § 5367 requires the collection of taxes for each person accepting a purchase order for a delivery sale of cigarettes. All cigarette taxes imposed by this State with respect to such delivery sale shall be collected and remitted to the Department, except when such collection and remission shall not be required to the extent such person has obtained proof (in the form of the presence of applicable tax stamps or otherwise) that such taxes already have been paid to the State.

Subsection § 5368 outlines all penalties for violation of Subchapter VI. Except as otherwise provided in this Section, a first violation of any provision of Subchapter VI shall be punishable by a fine of \$1,000 or five (5) times the retail value of the cigarettes involved, whichever is greater. A second or subsequent violation of any provision of this Subchapter shall be punishable by a fine of \$5,000 or five (5) times the retail value of the cigarettes involved, whichever is greater.

Any person who knowingly violates any provision of this Subchapter, or who knowingly and falsely submits a certification under § 5263(a)(1) of this Title in another person's name, shall, for each such offense, be fined \$10,000 or five (5) times the retail value of the cigarettes involved, whichever is greater, or be imprisoned not more than five (5) years, or both.

Any person failing to collect or remit to the Department any tax required in connection with a delivery sale shall be assessed, in addition to any other penalty, a penalty of five (5) times the retail value of the cigarettes involved. Any cigarettes sold, or attempted to be sold, in a delivery sale that do not meet the requirements of this Subchapter shall be forfeited to the State and destroyed. And all fixtures, equipment, and all other materials and personal property on the

premises of any person who, with the intent to defraud the State, violates any of the requirements of this Subchapter, shall be forfeited to the State.

Subchapter § 5369. Enforcement. The Attorney General or his or her designee, or any person who holds a valid permit under 26 U.S.C. § 5712, may bring an action in the appropriate court in this State to prevent or restrain violations of this Subchapter by any person or any person controlling such person.

Patrick Carter  
Director of Revenue