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# Critics Call Delaware a Tax Haven

By [LYNNLEY BROWNING](#)

Wall Street, Sand Hill Road, LaSalle Street: Some corporate addresses scream money. Then there is North Orange Street, which whispers it.

North Orange, a ho-hum thoroughfare in Wilmington, Del., is, on paper, home to more than 6,500 companies. Many of them are empty shells. They make nothing and sometimes employ just a lone clerk. But all are there for the same reason: to help corporations avoid paying taxes in other states.

The Obama administration has riled corporate America by cracking down on secretive offshore tax havens. But now a big onshore refuge — Delaware — is drawing scrutiny, too.

Squeezed by hard times, states are pushing to collect taxes that corporations are avoiding through Delaware shell companies. Maryland has reclaimed \$267 million in such taxes, including interest and penalties, and has assessed an additional \$143 million.

About 20 states have adopted laws that would effectively keep companies from using the decades-old tax loopholes in Delaware. At stake are tens of billions of dollars in annual tax receipts, funds that states say they need during this [recession](#).

Critics of the arrangement in Delaware say it cheats state governments out of money. Delaware, these people say, has created its own onshore Cayman Islands. Even the Swiss are complaining, claiming that the United States is letting this homegrown haven flourish even as the I.R.S. pursues offshore shelters.

Defenders of the arrangement — corporate executives, tax lawyers and, unsurprisingly, Delaware officials — rebuff such criticism. Mailbox subsidiaries like the ones along North Orange Street do nothing to minimize companies' federal tax bills, they say. Corporations must still pay Uncle Sam. Moreover, these people say, many companies are drawn to Delaware for its business-friendly laws and courts, not to save on taxes.

That is certainly the view at 1209 North Orange Street, a nondescript low-slung building at the corner of West 13th Street. This address serves as a tax minimizer for dozens of brand-name companies, among them [Dillard's](#), the department store chain based in Little Rock, Ark., and Kentucky Fried Chicken, which is part of Yum Brands of Louisville, Ky. All of them, and nearly two-thirds of the Fortune 500, have tax-exempt subsidiaries at this address to reduce their state tax bills.

Jerry Daniel, the vice president for government relations at the Corporation Trust Company, which runs 1209 North Orange, does not see what all the fuss is about. After all, the arrangements are legal.

“The image of Delaware as a tax haven is totally unfair,” Mr. Daniel said. “Even if you incorporate here, you still have to pay a full federal tax bill.”

That argument does not sit well with David E. Brunori. A professor at [George Washington University](#) School of Law and a specialist in state taxes, Professor Brunori said the Delaware loophole was not harmless.

“It is a vehicle for avoiding otherwise legitimate tax liabilities at a time when states need money badly,” Professor Brunori said.

Shirley Sicilian, the general counsel of the Multistate Tax Commission, an intergovernmental state tax agency, said that “states increasingly want to make sure that income that’s earned in their state is actually taxed in their state, particularly in a bad fiscal situation like now.”

At the center of the dispute are legal entities known as Delaware holding companies, which have been around for decades but took off in the 1990s, when accountants began pushing them aggressively. Corporations are allowed to establish these shell companies in Delaware, as well as in Nevada and Wyoming.

Typically, they then transfer to these subsidiaries ownership of things like trademarks, patents and investments. Delaware does not tax holding companies set up to own and collect income from such lucrative intangible assets.

The parent companies of these shells usually pay royalties to the Delaware subsidiaries to lease back those assets. By doing so, they can claim income tax deductions in states where they actually do business. The shells also funnel profit, tax free, back to their parents, in the form of dividends and loans.

Some corporations have abused the system. Before WorldCom collapsed in 2002, it shifted \$19.4 billion in intellectual property tied to “management foresight” to a Delaware holding company.

Emboldened by recent court decisions that have challenged such arrangements, a growing number of states are moving aggressively to claim taxes that they say are rightfully theirs.

It will not be easy, tax experts say. Many corporations have found new ways to exploit the loophole, said Michael Mazerov, a senior fellow at the Center on Budget and Policy Priorities. The moves include creating “embedded royalty” companies, in which corporations set up Delaware holding companies that license their assets to other Delaware entities. The secondary Delaware entities buy goods or services from other parts of the company, add in the price of the royalty, and sell them back to the operating company, giving it a tax break on the royalty.

In recent months, the Delaware loophole has drawn heated criticism from the world’s leading offshore tax havens, including Switzerland and the Cayman Islands.

In April, a senior official of the Cayman Islands Financial Services Association asserted that Delaware, along with Nevada and Wyoming, promoted tax evasion and money laundering, thus qualifying the United States as a tax haven. Federal officials view the issue as a state matter and are not pushing for changes in Delaware, the home state of Vice President [Joseph R. Biden Jr.](#)

In any case, Delaware officials dismiss the idea that their state is some sort of shady tax haven. Richard J. Geisenberger, Delaware's assistant secretary of state, said that the loophole "is simply a state tax law." It does not enable tax evasion, he said.

Still, the loophole — and potential for companies to abuse it — worries Peter L. Faber, a prominent lawyer specializing in state tax at McDermott Will & Emery in Washington. In some cases, a single clerk may tend dozens of shell companies. Even the paperwork associated with these companies is back at the home office.

"I've seen a lot of companies with solid structures, and more with not," Mr. Faber said of the Delaware entities.

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