The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Dave Camp
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

January 16, 2014

Dear Chairmen and Ranking Members,

We, the undersigned organizations ask that **you refuse to extend two recently expired tax breaks that subsidize highly profitable corporations at the expense of ordinary Americans.** Congress has routinely kept egregious and expensive corporate tax breaks in place for companies that shift profits and jobs offshore. These corporate tax breaks are not free. And taxpayers have routinely had to shoulder their cost through cuts to programs or higher taxes.

Two rules in the tax code that allow U.S. multinational corporations to park their earnings offshore and avoid paying tax on them expired at the end of 2013. These rules are known as **the "active financing exception" and the "controlled foreign corporation (CFC) look-through rule."** If Congress refuses to extend these expired provisions, some U.S. companies will have much less incentive to send their profits and jobs offshore.

A U.S. multinational corporation generally cannot defer paying tax on the income of its foreign subsidiaries that is considered "passive" (even if it is not repatriated), such as interest, dividends, rents, and royalties. Congress has determined that deferral is not appropriate for this type of income because it is highly fungible and the entities that earn it are very mobile.

The "active financing exception" is an exception to this general rule that passive income earned by a foreign subsidiary must be recognized for tax purposes when earned. The "active financing exception" was repealed in the 1986 Tax Reform Act but reinstated in 1997 as a "temporary" measure after fierce lobbying by corporations. In 1998 it was expanded to include foreign captive insurance subsidiaries. These provisions have been extended every year since 1998, usually for only one or two years at a time.

The exception creates two harmful incentives. First it encourages American corporations to lend, invest and create jobs in foreign countries rather than in the U.S., because it provides a break from U.S. taxes on financial income generated offshore. Second, it encourages American corporations to engage in "financial engineering" to make their U.S. profits appear to be generated by a "captive" foreign financing subsidiary or other type of offshore subsidiaries, in order to avoid U.S. taxes.

The active financing exception is one of the primary reasons General Electric has paid, on average,

only a 1.8% effective U.S. federal income tax rate over the past ten years. G.E.'s federal tax bill is lowered dramatically with the use of the active financing exception provision by its subsidiary, G.E. Capital, which Forbes noted has an "uncanny ability to lose lots of money in the U.S. and make lots of money overseas."

In addition, this exception allows large U.S.-based financial institutions to pay low effective rates. As a group, the financial industry has one of the lowest effective rates of all corporations, averaging only 15.5% for the years 2008-2010.

The last two-year extension of the active financing exception was estimated by the Joint Committee on Taxation to have cost taxpayers $11.2 billion.

Another exception to the general rules requiring taxation of passive income, the CFC look- through rule, allows a U.S. multinational corporation to defer tax on passive income, such as royalties, earned by a foreign subsidiary (a "controlled foreign corporation" or "CFC") if it is paid to that subsidiary by a related CFC and can be traced to the active income of the payer CFC. (The check-the-box regulations allow similar tax planning with non-corporate entities.)

The CFC look-through rule allows multinationals to create transactions purely for "earnings stripping" – to create dividends, interest, rents, and royalties to strip active income out of high-tax countries and move it into low-tax or no-tax countries without incurring any U.S. tax liability (or any tax liability anywhere).

The last two-year extension of the CFC look-through rule was estimated by the Joint Committee on Taxation to have cost taxpayers $1.5 billion.

In summary, these rules allow U.S. multinationals to create "stateless income": income that is treated, for tax purposes, as earned in a (low- or no-tax) country instead of in the country where the employees and assets are located.

Transactions enabled by these rules are a reason for the low effective tax rates of companies with highly-valued intangibles. High-tech companies like Apple and Google and pharmaceutical companies like Pfizer and Forest Laboratories are easily able to shift income from the U.S. (or other countries with a meaningful corporate income tax) to low- or no-tax countries.

Public outcry against tax loopholes for large corporations has never been louder. News reports about the way companies such as G.E., Apple, Pfizer and Facebook are able to legally game the system continue to outrage your constituents and the country as a whole. These tax giveaways come at the expense of critical programs and the fiscal health of our government. Congress needs to stand up for ordinary taxpayers and stop giving these corporations a free pass.

Sincerely,