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

August 1, 2012

Dear Chairmen and Ranking Members,

Lawmakers on both sides of the aisle have publicly stated that Congress needs to thoughtfully and objectively evaluate tax expenditures, instead of just routinely passing them. We, the undersigned organizations ask that you take your tax writing committees to task and eliminate two egregious loopholes that subsidize highly profitable corporations at the expense of taxpayers.

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 2011. If Congress refuses to extend these expired provisions, some U.S. companies will have much less incentive to send their profits and jobs offshore. These are known as the "active financing exception" and the "controlled foreign corporation ("CFC") look-through rule."

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 the 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 The "active financing exception" was repealed in the 1986 Tax Reform Act but reinstated in 1997 as a "temporary" measure after fierce lobbying by corporations.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.

This exception allows multinationals to avoid tax on their worldwide income by creating "captive" foreign financing subsidiaries and makes it easier for multinationals to expand

overseas, making investments and creating jobs in foreign countries rather than here in the U.S. In addition to being highly fungible and highly mobile, financial products are also highly susceptible to manipulation or "financial engineering," allowing companies to manipulate their tax bill as well.

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.

Treasury has estimated the cost of extending the active financing exception for just one year, 2013, to be $3.2 billion.

Another exception to the general rules requiring taxation of passive income, the CFC look-through rules allow 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 rules allow 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).

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 the primary 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.

Treasury has estimated the cost of extending the CFC look-through rules for just one year, 2013, to be $690 million. Treasury estimated that repealing the check-the-box regulations would raise roughly $100 billion over ten years.

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. These tax giveaways come at the expense of critical programs; they come at the expense of fire fighters, safe roads, safe communities, teachers, clean energy, student loans and the fiscal health of our government.

The U.S. government has begun the process of holding foreign banks and individuals accountable for tax evasion, has offered a process for individuals who want to avoid legal prosecution through the amnesty program, and is actively investigating at least eleven Swiss financial institutions. We should follow suit and make sure that corporations are also held accountable for potentially abusive tax-avoidance schemes.

More importantly, the U.S. government should hold itself accountable for reforming the system that makes corporate tax avoidance not only possible, but legal. We call on you to respond to the repeated bi-partisan calls for a careful examination of tax expenditures and tax loopholes, and at a minimum, hold hearings with executives from some of the largest corporations paying the smallest of tax bills.

As Congress wrestles with critical decisions that will affect not only the government's budget, but the budgets and priorities of taxpayers nationwide, Congress should seek to plug the holes that enable corporations to pay shamefully low tax rates or even negative tax rates. When corporations are able to use these loopholes to avoid paying their fair share, other taxpayers pay through lost services or higher taxes.

Sincerely,

ActionAid USA
Americans for Tax Fairness
AFL-CIO - MN
Business and Investors Against Tax Haven Abuse
Citizens for Tax Justice
Financial Accountability and Corporate Transparency Coalition
Friends of the Earth U.S.
Global Financial Integrity
Growth & Justice
Jubilee Network USA
Main Street Alliance
National Education Association
New Rules for Global Finance
OMB Watch
SEIU
South Carolina Small Business Chamber of Commerce
Tax Justice Network USA
U.S. Public Interest Research Group
US Uncut
Wealth for the Common Good
Arizona PIRG (Arizona Public Interest Research Group)
CALPIRG (California Public Interest Research Group)
ConnPIRG (Connecticut Public Interest Research Group)
CoPIRG (Colorado Public Interest Research Group)
Florida PIRG (Florida Public Interest Research Group)
Georgia PIRG (Georgia Public Interest Research Group)

Illinois PIRG (Illinois Public Interest Research Group)
Iowa PIRG (Iowa Public Interest Research Group)
MASSPIRG (Massachusetts Public Interest Research Group)
Maryland PIRG (Public Interest Research Group)
MoPIRG (Missouri Public Interest Research Group)
New Jersey PIRG (New Jersey Public Interest Research Group)
NH PIRG (New Hampshire Public Interest Research Group)
NMPIRG (New Mexico Public Interest Research Group)
NC PIRG (North Carolina Public Interest Research Group)
Ohio PIRG (Ohio Public Interest Research Group)
OSPIRG (Oregon State Public Interest Research Group)
PennPIRG (Pennsylvania Public Interest Research Group)
PIRGIM (Public Interest Research Group in Michigan)
Rhode Island PIRG (Rhode Island Public Interest Research Group)
TexPIRG (Texas Public Interest Research Group)
WashPIRG (Washington Public Interest Research Group)
WisPIRG (Wisconsin Public Interest Research Group)
Chuck Denny, Jr, Retired CEO ADC Telecommunications, Inc
Richard McFarland, Retired CEO RBC Dain Rauscher
Roger Hale, Retired CEO Tenant Companies
Peter Heegaard, Retired founder and former managing principal of Lowry Hill, a subsidiary of Wells Fargo