

**Comments for the Financial Services Working Group  
Committee on Ways and Means  
Treatment of Global Active Financial Services Income**

**Comments of the Active Financing Working Group**

The Active Financing Working Group applauds the Committee on Ways and Means for its deliberative approach to U.S. tax reform and welcomes the opportunity to provide comments on the treatment of foreign financial services income of U.S.-based financial services companies in the context of tax reform.<sup>1</sup>

Pending international tax reform proposals, including the discussion draft released by House Ways and Means Committee Chairman Dave Camp in October 2011, have as their focal point the adoption of a competitive territorial system for taxation of global business income. Such a system would move the United States away from the existing system that provides for deferral of U.S. tax on the active business earnings of foreign subsidiaries of U.S. companies until that income is repatriated to the United States. A territorial system, as embodied in the Chairman's draft, would provide a dividend exemption for most of the earnings of foreign subsidiaries and foreign branches of U.S. companies, but would retain in some form the existing Subpart F rules to prevent, for example, passive investment income from benefiting from the dividend exemption.

It is critical that the active business income of financial services companies earned in global markets qualify for exemption under a territorial system.

As under current law, the definition of passive income is likely to be focused on interest, dividends, royalties, rents and annuities.<sup>2</sup> Importantly, the business income of financial services companies (whether banks, finance companies, insurance companies or securities firms) is largely the same type of income that would be passive in the hands of others and thus subject to current U.S. taxation under Subpart F. Thus, international tax reform requires the inclusion of rules similar to those that operate under current law that permit U.S. financial services companies to be taxed by the U.S. on active business income earned by their foreign subsidiaries only when the income is repatriated to the United States.<sup>3</sup> These rules, called the active financing rules, are necessary to distinguish financial services active business income from passive income.

With the active financing rules, the global active business income of U.S. financial services firms is given the same treatment as is provided for the active business income

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<sup>1</sup> The Active Financing Working Group is an ad hoc coalition of American financial services firms and supporting trade association. The members include banks, finance companies, insurance companies and securities firms.

<sup>2</sup> See section 954(c)(1)(A).

<sup>3</sup> Deferral for financial services active business income was repealed as part of the 1986 Tax Reform Act. However, the growth of global markets and the relative position of the U.S. corporate tax rate led Congress to reinstate deferral on a temporary basis in 1997. The active financing rules were significantly modified and further extended in 1998. They have been extended six times since then, most recently as part of the American Taxpayer Relief Act of 2012. They are scheduled to expire for taxable years beginning after December 31, 2013.

of other, non-financial U.S. companies doing business outside the United States. The active financing rules are not a special incentive. Thus, under current law, they simply apply the general rules of deferral to the financial services sector of our economy. The same should be true under a reformed system that replaces deferral with a dividend exemption. The active financing rules provide the blueprint for ensuring that foreign earnings of U.S. financial services companies are properly and appropriately treated under such a system. Otherwise, the U.S. financial services sector would be denied the benefits of an exemption regime.<sup>4</sup>

The active financing rules include both entity and item-by-item income tests that ensure that any U.S. financial services business that takes advantage of the rules has a significant local country presence and is indeed earning most of its income from local country customers. Thus, the active financing rules do not come at the expense of U.S. jobs. On the contrary, the current active financing rules embody the most stringent anti-U.S. base erosion rules in the existing tax system and reflect the fact that the provision of financial services is inherently a local business. To make loans, sell insurance, provide credit, or lease machinery, the business has to be where its customers are located. U.S. financial services companies cannot serve foreign markets without having an active foreign presence.

Not only do the active financial services rules not come at the expense of U.S. jobs, they actually support U.S. jobs. Absent these rules today, and absent inclusion of the rules in a dividend exemption system, U.S. financial services subsidiaries serving customers in foreign markets would be subject to immediate tax at the top U.S. rate. That, in turn, would place U.S. financial services at a decisive competitive disadvantage in global markets. Tens of thousands of jobs at U.S. headquarters and in U.S. service centers are directly attributable to supporting the business of serving global customers outside the United States. Further, U.S. manufacturers rely on the active financial services rule to promote their export of products made by American workers; the rule allows them to offer competitive financing through their foreign affiliates.

Today and under tax reform, the active financing rules are critical to the ability of U.S. financial services firms to win foreign business, compete in foreign jurisdictions to serve local customers, and to be global market leaders. The active financing rules, which have had broad bipartisan support, are necessary to maintain the competitiveness of the U.S.-based financial services industry and of manufacturing companies that rely on financial services arms to provide financing for large-ticket manufactured products.<sup>5</sup>

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<sup>4</sup> It is worth noting that the active financing rules do not permit deferral with respect to income from U.S. customers.

<sup>5</sup> On June 8, 2012, the Ways and Means Subcommittee on Select Revenues held a hearing on the extension of expired and expiring provisions. Select Revenues Chairman Tiberi noted in his opening statement that deferral for active financing income is “among the most important recently expired provisions that must be extended.” Select Revenue Ranking Member Neal agreed noting that it is “essential that the active financing rules . . . be extended.” Similarly, in testimony before the Senate Finance Committee in January 2012, Dr. Roseanne Altshuler, Professor and Chair, Department of Economics, Rutgers University, identified the active financing rules as one of the “fundamental policies of our current tax system” and called for the rules to be made permanent.

In summary, the Active Financing Working Group urges inclusion of the active financing or similar rules in a dividend exemption system and supports a continuation of these rules if tax reform deliberations continue beyond the end of 2013, when the current active financing rules expire. Continuation of the active financing rules is critical to the competitiveness of American financial services firms and the tens of thousands of U.S. jobs that are dependent on that competitiveness.