December 3, 2010

To Senator/Member of Congress
Senate/House Office Building
Washington, DC 20510/20515

Dear Senator/Representative:

As you sort through which provisions will be included in the final agreement on tax cuts for this session of Congress, we wanted to draw your attention to two specific “expired” tax provisions that, if enacted, could significantly benefit the economic health of our region. One is the extension of the R&D tax credit and the second is the reinstatement of the active financing exception in Subpart F of the tax code. Each of these provisions directly enhances the ability of major employers in our region to compete globally and expand locally.

The Importance of the R&D Tax Credit

Research and experimentation is the key to ensuring American competitiveness in the world market, and New England has long led the nation in terms of investing in the types of activities that create and retain high-paying, high-skilled jobs. Since 1981, the research and experimentation tax credit –more commonly known as the “R&D tax credit“ – has provided businesses of various sizes and specialties the capacity to recoup a portion of the financial investments they have made to create new or better products.

Although immensely popular with the business community, since its inception, the R&D tax credit has always been subject to short-term reauthorizations. In fact, the R&D tax credit has been renewed 13 times in its nearly 30-year history, and we respectfully call for an additional extension at this time. However, to avoid such annual concern regarding this provision of tax law, the New England Council believes the R&D tax credit should be permanently authorized, and also increased to even further encourage investment in productive business ventures.

When the R&D credit was first enacted, the United States was the world’s leader in R&D investment. Today, however, the Information Technology and Innovation Foundation (ITIF) places the US at 17th among developed nations in tax credit generosity – right between the Netherlands and Belgium. Even our NAFTA partners, Canada and Mexico, exceed the U.S. Expanding the tax credit will help the United States work towards “catching up” with other nations that have maintained their dedication to research and experimentation.

The R&D tax credit truly promotes American jobs. It can only be claimed for qualified research activities that occur in the United States, and the National Association of Manufacturers states that nearly three-fourths of the credit goes for salaries paid to men and women doing research work in the U.S. According to a 2008 study by the accounting firm Ernst & Young, nearly 18,000 companies across the nation utilize the credit, and a significant portion of R&D activity was cited as being generated in the New England region.

As we recover from one of the most dramatic economic downturns in our nation's history, there are few remedies at the government's disposal that will have a near immediate and positive impact on our overall financial situation. One such remedy is a robust R&D tax credit. According to a January 2010 report by the ITIF, raising the alternative simplified tax credit (ASC) from 14 percent to 20 percent would, in the short-term, produce $90 billion in GDP, add $17 billion to federal coffers, and create or retain more than 160,000 jobs. Moreover, should Congress permanently extend the R&D tax credit, it would provide the certainty investors need before committing financial resources to a new technology or untried product.

The Need to Reinstate the Active Financing Exception

Another expired tax provision that Congress needs to address is the "active financing exception," or, "deferral regime." For companies that are headquartered in the U.S., but earning certain types of banking or finance income in other countries, the active financing exception helps equalize tax treatment cross-nationally. Limited in scope, the active financing exception generally is meant to prevent situations where investment income that is earned by a U.S. company in another nation, and in connection with an active banking or insurance business, falls subject to immediate double taxation: taxed at one rate in the foreign country and another rate in the U.S. Indeed, this approach helps ensure qualified income from active banking and insurance businesses earned overseas is not subject to U.S. tax until it is repatriated (usually as dividends) to the United States.

The active financing exception is consistent with the U.S. taxation of other active businesses (e.g. manufacturing and other services industries). Since 1962, Congress has frequently recognized that certain types of active investment income earned in other countries should not be taxed in the U.S. until repatriated. Although the active financing exception was eliminated in 1986 due to concerns around the scope of its application, Congress temporarily re-enacted the provision in 1997 to include appropriate scope limitations and *subsequently extended it five additional times*. For 37 years of the 48-year history of exceptions to the deferral regime, active financing has been recognized as an important component in ensuring that U.S.-headquartered banking and insurance companies can compete globally.

Without the active financing exception, U.S. companies with a global reach operate at a disadvantage compared with their foreign competitors. For example, under the deferral regime, the interest earned on a loan made by a U.S. bank doing business overseas is taxed at the rate established in that foreign country. The U.S. bank is therefore able to compete with other domestic and international banks on an even playing field. Removing the active financing exception adds the U.S. rate on top of the foreign country's rate, making the U.S. bank's proposal more expensive and thus less competitive. Similarly for insurance companies, a deferral regime provides an ability to use investment income from premiums sold overseas to pay for such things as policy claims. Adding the U.S. tax rate to that income could hinder the insurer's ability to set competitive rates, ultimately affecting its ability to do business abroad.

Reinstating the active financing exception will reverse an impediment to our economic recovery and help key employers in the New England area compete fairly on a global basis. As a 2007 Bureau of Economic Analysis study noted, U.S. multinationals have an average of 2.2 jobs at the U.S. parent for every one job in overseas affiliates. Supporting global growth of New England-headquartered banking and insurance businesses also supports U.S. job growth. The New England Council urges Congress to include such a provision reinstating the active financing exception in whatever tax extenders package is considered in the last weeks of the 111th Congress.

While there are literally dozens of tax provisions that require Congressional attention, both the R&D tax credit and active financing exception provisions are targeted toward strengthening those employers which call New England home. As our nation emerges from this recession, it is vital that Congress provide the tools these companies need that will allow all aspects of their business to prosper. We recognize the tremendous scope of issues Congress faces as this session winds down, and urge you to at least extend these provisions on a temporary basis since they expired in 2009 and businesses are being adversely affected by the continued uncertainty.

Sincerely,

Michele M. Jalbert
Executive Director – Policy & Strategy