

PERMANENT ACTIVE FINANCING EXCEPTION ACT
 OF 2014

MAY 2, 2014.—Committed to the Committee of the Whole House on the State of the
 Union and ordered to be printed

Mr. CAMP, from the Committee on Ways and Means,
 submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 4429]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4429) to amend the Internal Revenue Code of 1986 to permanently extend the subpart F exemption for active financing income, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Permanent Active Financing Exception Act of 2014”.

SEC. 2. PERMANENT SUBPART F EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) **BANKING, FINANCING, OR SIMILAR BUSINESSES.**—Subsection (h) of section 954 of the Internal Revenue Code of 1986 (relating to special rule for income derived in the active conduct of banking, financing, or similar businesses) is amended by striking paragraph (9).

(b) **INSURANCE BUSINESSES.**—Subsection (e) of section 953 of such Code (relating to exempt insurance income) is amended by striking paragraph (10) and by redesignating paragraph (11) as paragraph (10).

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years of a foreign corporation beginning after December 31, 2013, and to taxable years of United States shareholders with or within which such taxable years of such foreign corporation end.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

Similar to a provision contained in the discussion draft of the “Tax Reform Act of 2014” released on February 26, 2014, the bill, H.R. 4429, reported by the Committee on Ways and Means, provides a permanent exemption from subpart F for active financing income. Under current law, that exemption expired for taxable years beginning after December 31, 2013.

B. BACKGROUND AND NEED FOR LEGISLATION

While the Committee continues actively to pursue comprehensive tax reform as a critical means of promoting economic growth and job creation, the Committee also believes that it is important to provide permanent, immediate tax relief to worldwide American employers in the manufacturing, financial services, and insurance sectors to help encourage economic growth and job creation here in the United States. By providing deferral of U.S. tax on their foreign business income, H.R. 4429 would deliver certainty and stability to these employers, allowing U.S. companies to price their products competitively against foreign multinationals.

C. LEGISLATIVE HISTORY

BACKGROUND

H.R. 4429 was introduced on April 8, 2014, and was referred to the Committee on Ways and Means.

COMMITTEE ACTION

The Committee on Ways and Means marked up H.R. 4429, the Permanent Active Financing Exception Act of 2014, on April 29,

2014, and ordered the bill, as amended, favorably reported (with a quorum being present).

COMMITTEE HEARINGS

The need for a permanent extension of the active financing exception was discussed at no fewer than five hearings during the 112th and 113th Congresses:

- Full Committee hearing on Fundamental Tax Reform (January 20, 2011);
- Full Committee hearing on the Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers (May 12, 2011);
- Select Revenue Measures Subcommittee hearing on Ways and Means International Tax Reform Discussion Draft (November 17, 2011);
- Full Committee hearing on Tax Havens, Base Erosion and Profit-Shifting (June 13, 2013); and
- Full Committee hearing on the Benefits of Permanent Tax Policy for America’s Job Creators (April 8, 2014).

II. EXPLANATION OF THE BILL

A. EXCEPTIONS FOR ACTIVE FINANCING INCOME (SECS. 953 AND 954 OF THE CODE)

PRESENT LAW

Under the subpart F rules,¹ 10-percent-or-greater U.S. shareholders of a controlled foreign corporation (“CFC”) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (i.e., income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and real estate mortgage investment conduits (“REMICs”); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC’s country of organization. Subpart F insurance income also includes income at-

¹ Secs. 951–965.

tributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.²

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Fur-

²Prop. Treas. Reg. sec. 1.953-1(a).

ther, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

The temporary exemptions for active financing income expire for taxable years of foreign corporations beginning after December 31, 2013 (and taxable years of U.S. shareholders ending with or within those taxable years).

REASONS FOR CHANGE

The Committee believes that it is appropriate to make permanent the temporary provisions to provide certainty, to facilitate business planning, and to help U.S. employers with overseas operations compete more effectively with foreign firms and increase employment in the United States.

EXPLANATION OF PROVISION

The proposal makes permanent the temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business.

EFFECTIVE DATE

The proposal is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 4429, the Permanent Active Financing Exception Act of 2014.

The bill, H.R. 4429, was ordered favorably reported as amended by a roll call vote of 21 yeas to 14 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	✓			Mr. Levin		✓	
Mr. Johnson	✓			Mr. Rangel		✓	
Mr. Brady	✓			Mr. McDermott		✓	
Mr. Ryan	✓			Mr. Lewis		✓	
Mr. Nunes	✓			Mr. Neal		✓	
Mr. Tiberi	✓			Mr. Becerra		✓	
Mr. Reichert	✓			Mr. Doggett		✓	
Mr. Boustany	✓			Mr. Thompson		✓	
Mr. Roskam	✓			Mr. Larson		✓	
Mr. Gerlach				Mr. Blumenauer		✓	
Mr. Price	✓			Mr. Kind			
Mr. Buchanan	✓			Mr. Pascrell		✓	
Mr. Smith	✓			Mr. Crowley		✓	
Mr. Schock	✓			Ms. Schwartz			
Ms. Jenkins	✓			Mr. Davis		✓	
Mr. Paulsen	✓			Ms. Sanchez		✓	
Mr. Marchant	✓						
Ms. Black	✓						
Mr. Reed	✓						
Mr. Young	✓						
Mr. Kelly	✓						
Mr. Griffin							
Mr. Renacci	✓						

IV. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATE OF BUDGETARY EFFECTS

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 4429, as reported.

The bill, as reported, is estimated to have the following effect on Federal budget receipts for fiscal years 2014–2024:

By fiscal years in billions of dollars—												
2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014–19	2014–24
–2.0	–5.2	–5.5	–5.6	–5.1	–5.4	–5.8	–5.9	–6.0	–6.1	–6.3	–28.8	–58.8

Note: Details do not add to totals due to rounding.

B. STATEMENT REGARDING NEW BUDGET AUTHORITY AND TAX EXPENDITURES BUDGET AUTHORITY

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing tax provisions involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. COST ESTIMATE PREPARED BY THE CONGRESSIONAL BUDGET OFFICE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, May 1, 2014.

Hon. DAVE CAMP,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4429, the Permanent Active Financing Exception Act of 2014.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Logan Timmerhoff.

Sincerely,

DOUGLAS W. ELMENDORF,
Director.

Enclosure.

H.R. 4429—Permanent Active Financing Exception Act of 2014

H.R. 4429 would amend the Internal Revenue Code to allow the deferral of tax on certain income earned in foreign companies when calculating taxable income. Under Subpart F rules in the Internal Revenue Code, U.S. shareholders that hold 10 percent or more of a controlled foreign corporation are subject to U.S. tax annually on certain income earned by that corporation, whether or not that income is distributed to shareholders. H.R. 4429 would make perma-

ment the temporary exceptions from Subpart F tax treatment for income from active banking, financing, insurance, or similar business that generally expired after December 31, 2013.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 4429 would reduce revenues, thus increasing federal budget deficits, by about \$59 billion over the 2014–2024 period.

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending and revenues. Enacting H.R. 4429 would result in revenue losses in each year beginning in 2014. The estimated increases in the deficit are shown in the following table.

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Logan Timmerhoff. The estimate was approved by David Weiner, Assistant Director for Tax Analysis.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 4429, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON APRIL 29, 2014

By fiscal year, in millions of dollars—													
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014– 2019	2014– 2024
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Effects	2,033	5,166	5,536	5,563	5,092	5,401	5,778	5,854	5,983	6,092	6,306	28,790	58,803

Source: Staff of the Joint Committee on Taxation.
Note: Components may not sum to totals because of rounding.

D. MACROECONOMIC IMPACT ANALYSIS

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: the effects of the bill on economic activity are so small as to be incalculable within the context of a model of the aggregate economy.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee’s review of the provisions of H.R. 4429 that the Committee concluded that it is appropriate to report the bill, as amended, favorably to the House of Representatives with the recommendation that the bill do pass.

B. STATEMENT OF GENERAL PERFORMANCE GOALS AND OBJECTIVES

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of gen-

eral performance goals and objectives for which any measure authorizes funding is required.

C. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104-4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. APPLICABILITY OF HOUSE RULE XXI 5(B)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that “A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present.” The Committee has carefully reviewed the bill, and states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (the “IRS Reform Act”) requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have “widespread applicability” to individuals or small businesses, within the meaning of the rule.

F. CONGRESSIONAL EARMARKS, LIMITED TAX BENEFITS, AND LIMITED TARIFF BENEFITS

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. DUPLICATION OF FEDERAL PROGRAMS

In compliance with Sec. 3(j)(2) of H. Res. 5 (113th Congress), the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any

report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111-139, or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Public Law 95-220, as amended by Public Law 98-169).

H. DISCLOSURE OF DIRECTED RULE MAKINGS

In compliance with Sec. 3(k) of H. Res. 5 (113th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * *

Subtitle A—Income Taxes

* * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * *

Subchapter N—Tax Based on Income From Sources Within or Without the United States

* * * * *

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

* * * * *

Subpart F—Controlled Foreign Corporations

* * * * *

SEC. 953. INSURANCE INCOME.

(a) * * *

* * * * *

(e) EXEMPT INSURANCE INCOME.—For purposes of this section—

(1) * * *

* * * * *

[(10) APPLICATION.—This subsection and section 954(i) shall apply only to taxable years of a foreign corporation beginning

after December 31, 1998, and before January 1, 2014, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after December 31, 2013 (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.】

【(11)】 (10) CROSS REFERENCE.—For income exempt from foreign personal holding company income, see section 954(i).

SEC. 954. FOREIGN BASE COMPANY INCOME.

(a) * * *

* * * * *

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) * * *

* * * * *

【(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2014, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.】

* * * * *

VII. DISSENTING VIEWS

These bills would add a combined \$310 billion to the deficit. Even though these bills were introduced individually with some bipartisan support, the opposition to these bills was based on the position that these tax provisions should not be made permanent by adding to the deficit without any revenue offset.

To put the combined cost (\$310 billion) into context, this total represents more than one-half of the entire federal deficit this year—the lowest it has been since President Obama took office. It represents nearly two-thirds of all non-defense domestic discretionary spending in 2014. It is more than three times what we spend annually on education, job training, and social services. It is five times more than we spend on veterans. And, it is five times more than we spend on medical research and public health.

We also opposed the manner in which Republicans were proceeding—selecting six to make permanent without any offset from the approximately 60 tax provisions that expired last year. This approach was both fiscally irresponsible and fundamentally hypocritical.

We found it hypocritical that, four months ago, Republicans let emergency unemployment insurance expire for more than 1.3 million Americans by arguing that an adequate offset had yet to be proposed. In early April, the Senate came to a bipartisan agreement on an offset after months of painstaking negotiations. Yet House Republicans still refuse to act.

Further, we found it also hypocritical that the Republicans were in favor of passing these six tax bills at a cost of \$310 billion without an offset at the same time that they were requiring an offset for a provision stripped from another bill under consideration at the markup that helped foster children at a cost of \$12 million.

The consideration of these six tax bills should have been part of the consideration of all the expired tax provisions commonly referred to as “tax extenders.” The Republicans did not take up other tax extenders that also are important to Democratic Committee Members. Left to an uncertain fate are provisions like the Work Opportunity Tax Credit, the New Markets Tax Credit, and the renewable energy tax credits, as well as the long-term status of the Earned Income Tax Credit, the Child Tax Credit, and the American Opportunity Tax Credit.

SANDER M. LEVIN,
Ranking Member.

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