



TAKING EXCEPTION TO THE “ACTIVE FINANCING EXCEPTION” CORPORATE TAX LOOPHOLE

The Active Financing Exception (AFE) tax loophole is an exception to an exception: an end run around rules meant to prevent the simplest form of offshore tax dodging. It allows big financial firms to indefinitely delay taxes on “passive” overseas income like interest and dividends even though these kinds of easily manipulated earnings are supposed to be ineligible for the tax-delaying break on offshore profits known as deferral. With this loophole, Wall Street banks, insurance companies and conglomerates with a big financing arm—General Electric has been a particular beneficiary over the years—can steer earnings to tax havens where little or no tax is due, while sending losses to the U.S., diminishing or even wiping out their domestic tax liability.

The AFE loophole is one of several dozen “temporary” tax breaks mostly benefitting corporations that have [routinely been extended every few years](#) by Congress.¹ GE, Wall Street investment banks and insurance firms have succeeded over the past two decades in getting this lucrative tax loophole included in those regular “tax extender” packages. The House Ways and Means Committee has voted to [make AFE permanent](#).² That would [cost \\$78 billion over 10 years](#), according to the Joint Committee on Taxation.³

DODGING TAXES BY OFFSHORING PROFITS

American corporations owe U.S. taxes on all their profits, wherever earned in the world, less a credit for any foreign taxes paid. But a big loophole called [“deferral” allows companies to avoid taxes on their offshore earnings](#) until they bring the money home.⁴ As a result, [U.S. companies have indefinitely stockpiled some \\$2 trillion offshore](#).⁵ Because certain kinds of income—like interest, dividends, rents and royalties—can be easily manipulated to disguise its actual origin, such [“passive” income is not eligible for deferral](#): taxes are due immediately, regardless of the income’s supposed country of origin.⁶ Such income is called “Subpart F income” after the section of the tax code designed to prevent its tax-avoidance abuse.

The active financing exception is an exception to Subpart F. Congress [eliminated the exception in the 1986 tax reform](#) that swept away many loopholes.⁷ But in 1997, Congress caved to pressure from corporate lobbyists and passed a “temporary” amendment to the tax code, bringing back the exception. Congress has “temporarily” extended this corporate tax break many times since then, usually for one or two years at a time as part of temporary tax-extendors legislation.

CASE STUDY: EXCEPTIONAL RETURNS FOR GENERAL ELECTRIC

Best known to most Americans as a manufacturer of light bulbs and dishwashers, GE has over the past few decades expanded to also be a major financial services company at the [center of the Wall Street economy](#).⁸ [About half of the company's profits](#) in recent years have come from its financing arm, GE Capital.⁹ It's also a leader in hiding profits offshore. GE had the second [most offshored profits of any American corporation—\\$119 billion](#)—at the end of 2014. GE has stashed much of its overseas profits in at least 18 tax havens, where it pays little if any taxes.¹⁰

The active financing exception has been a real moneymaker for GE. It's one of the primary reasons this highly profitable corporation [paid a negative 11.1% federal income tax rate between 2008 and 2012](#).¹¹ During those five years GE had profits of \$27.5 billion but got federal tax refunds totaling \$3.1 billion. The AFE has been so important to GE's bottom line that whenever the tax break neared expiration, the company has coordinated an extensive lobbying effort to preserve it, including [48 of its own lobbyists](#).¹²

The active financing exception loophole should be closed for both moral and practical reasons. Since working families and small businesses pay their taxes every year, it's not fair for huge multinational corporations to dodge their tax obligations using fancy accounting tricks. Plus, we need those billions of dollars in lost revenue to fix roads, build schools, find new medical cures, retrain the unemployed and provide many other useful services.

ENDNOTES

¹ Politico, "Meet the Tax Extenders" (October 2015). <http://www.politico.com/agenda/story/2015/10/congress-85-billion-extenders-tax-breaks-000283>

² House Ways and Means Committee, "H.R.961 - Permanent Active Financing Exception Act of 2015." The legislation was reported out of the committee on October 23, 2015. <https://www.congress.gov/bill/114th-congress/house-bill/961>

³ Congressional Budget Office, "Cost Estimate: H.R. 961, Permanent Active Financing Exception Act of 2015" (Sept. 22, 2015). <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr961.pdf>

⁴ U.S. Senate Permanent Subcommittee on Investigations (PSI), "EXHIBITS: Hearing on Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)" (May 21, 2013), p. 7. <https://info.publicintelligence.net/HSGAC-AppleOffshore.pdf>

⁵ Bloomberg, "U.S. Companies Are Stashing \$2.1 Trillion Overseas to Avoid Taxes" (May 4, 2015). <http://www.bloomberg.com/news/articles/2015-03-04/u-s-companies-are-stashing-2-1-trillion-overseas-to-avoid-taxes>

⁶ PSI, p. 12.

⁷ Citizens for Tax Justice (CTJ), "GE Just Lost a Tax Break - and Congress Will Probably Fix That" (Jan. 7, 2014). http://www.taxjusticeblog.org/archive/2014/01/ge_just_lost_a_tax_break_-_and.php#.VktOpniHbNo

⁸ Reuters, "Financial Risk Council Says AIG, GE Capital Are 'Too Big To Fail'" (July 9, 2013). http://www.huffingtonpost.com/2013/07/09/financial-risk-council-aig_n_3569517.html

⁹ Bloomberg, "GE Tumbles after Profit-Margin Forecast Trails Forecast" (Jan. 17, 2014).

<http://www.bloomberg.com/news/2014-01-17/ge-profit-matches-forecasts-on-jet-engine-sales.html>

¹⁰ CTJ, "Offshore Shell Games 2015: The Use of Offshore Tax Havens by Fortune 500 Companies" (October 2015), Table 2, p. 11. <http://ctj.org/pdf/offshoreshell2015.pdf>

¹¹ CTJ, "The Sorry State of Corporate Taxes: What Fortune 500 Firms Pay (or Don't Pay) in the USA and What They Pay Abroad—2008 to 2012" (February 2014). <http://www.ctj.org/corporatetaxdodgers/sorrystateofcorptaxes.pdf>

¹² Americans for Tax Fairness, “Corporate Lobbying on Tax Extenders and the GE Loophole” (March 2014).
<http://www.americansfortaxfairness.org/files/Corporate-Lobbying-on-Tax-Extenders-and-the-GE-Loophole-3.pdf>