



**Securities Industry Association**

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March 17, 2005

President's Advisory Panel on Federal Tax Reform  
1440 New York Avenue, N.W., #2100  
Washington, D.C. 20220

Dear Members of the President's Advisory Panel on Federal Tax Reform:

On behalf of the Securities Industry Association<sup>1</sup>, I am pleased to submit the following in response to the Panel's February 16, 2005 request for public comments. We applaud the Panel's efforts to identify unnecessary distortions, inefficiencies, and complexity in the current system as a precursor to exploring possible reform models.

SIA's comments are focused on four major areas: the importance of reducing distortions in the corporate tax code; the distortions caused by the temporary nature of the current law provision allowing deferral of active financial services income; complexities that drive down national savings; and the importance of reviewing any proposed reform / replacement system through a global prism.

**I. DOUBLE-TAXATION AND OTHER DISTORTIONS IN THE CORPORATE TAX CODE:**

By imposing multiple layers of taxation on corporate profits, the Tax Code distorts business behavior and decisions about business organization itself. In 2003, Congress reduced the distortions caused by the double-taxation of corporate profits by capping at 15% the top individual tax rate on dividends and long-term capital gains. As expected, this law has spurred more companies to offer larger dividends, enhanced the wealth of investors, and improved corporate governance by making businesses subject to the discipline of the dividend.

Those benefits, however, are limited by the temporary nature of the provision. In its recent "Budget Options" book, the Congressional Budget Office observed that:

[The 2003 tax cut on dividends and long-term capital gains] mitigated those distortions by reducing the extra tax burden—but only for a short interval. Because

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<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: [www.sia.com](http://www.sia.com).)

the lower rates expire at the end of 2008, investments made after that time will not benefit from them at all, and many investments made between 2003 and 2008 will benefit only partially.... Hence, many of the gains in efficiency that could result from the effects of the lower rates on the allocation of investment will not be realized unless [the rates are] perceived to be permanent.

These distortions caused by double-taxation impose real costs on the economy and should be addressed in any recommendations made by the Panel. In addition, SIA notes that other countries have successfully attracted investment and spurred economic growth by enacting broad-based reductions in corporate income taxes and encourages the Advisory Panel to consider whether a similar, broad-based reduction in U.S. corporate tax rates would strengthen our economy.

## **II. DISTORTIONS CAUSED BY TEMPORARY RULES IMPACTING FINANCIAL SERVICES FIRMS COMPETING ABROAD:**

Under current law, the active international income of foreign subsidiaries of American companies generally is not subject to U.S. tax until the funds are repatriated to the United States. This deferral is a long-standing, permanent feature of the Code for most businesses with international operations. It is correctly recognized as necessary to enable U.S.-based companies to compete with firms from countries with similar (or even more favorable) home country rules. The financial services industry, however, is uniquely disadvantaged, because the provision allowing deferral of their active income is only temporary. The current extension is set to expire at the end of 2006.

The temporary nature of current law injects costly distortions into firms' evaluations of business opportunities abroad and the resulting tax treatment of revenues from them, particularly with respect to multi-year transactions. Moreover, U.S.-based companies competing in international financial markets are selling a highly fungible commodity – money – and as a result find it particularly hard to make up elsewhere any tax costs that are not faced by their competitors.

## **III. SAVINGS RATE DRIVEN DOWN BY COMPLEXITY:**

In providing advice and financial planning services, our industry is on the front-line helping Americans save and invest for the future. We are increasingly concerned about the inadequate savings levels in American households. In 2004, aggregate personal saving, measured by the Bureau of Economic Analysis, averaged about one percent of disposable income in 2004, more than six percentage points lower than the average that has prevailed since the early 1970s.

Tax policy has a significant impact on whether or not workers are saving. For example, in the 1970s, the Individual Retirement Account (IRA) was expanded to permit any worker to qualify for a deduction for contributions to an IRA. Participation skyrocketed with contributions growing from \$4.8 billion in 1981 to \$38.2 billion by

1985. However, when this universal incentive was taken away in 1986, contributions fell to 14.1 billion in 1987, down from \$37.8 billion in 1986.<sup>2</sup>

Income eligibility limits, an increasing number of special purpose savings vehicles, and complex rules and regulations hurt middle-income and lower-income Americans efforts to save. The dramatic decrease in IRA contributions post 1986 demonstrates that taxpayers will not save for long-term goals unless the rules are clear, consistent, and universal.

Low or negative savings rates depress economic growth. Low savings rates reduce the pool of capital available for investment, the source of job creation and growth. Increased individual savings would directly improve economic growth by increasing the investment capital available for businesses and lowering the cost of capital.

To stimulate savings, SIA encourages the Commission to consider bold steps to simplify the current savings landscape. President Bush has proposed to expand savings opportunities through the creation of Retirement Savings Accounts (RSAs), Lifetime Savings Accounts (LSAs), and Employer Retirement Savings Accounts (ERSAs). These programs would provide all Americans with an easy, tax-preferred way to save for short-term goals such as education or purchasing a first home, as well as the long-term needs of their retirement years. No longer would families have to decide how much to save in one of the plethora of special purpose accounts, only to determine later that they had not saved enough in the appropriate account.

Providing greater flexibility, clarify, and simplification will encourage more Americans to save, thus promoting retirement security and U.S. economic growth.

#### **IV. REVIEWING REFORM PROPOSALS THROUGH A GLOBAL LENS**

In its request for comments, the Panel asked for submissions on “goals that the panel should try to achieve....” Without commenting on any specific reform proposal that might be considered by the Panel, the SIA believes that a key goal must be to ensure that we have a Tax Code, and a system of administering it, that does not hinder the ability of financial services companies to compete at home and around the world.

In the past two decades, profits from international operations have come to represent an increasingly large share of the total income earned by financial services companies. We strongly urge the Panel to ensure that any reform plan, whether it consists of revisions to the current code or a wholesale re-writing, ensures that it creates a level playing field, both at home and abroad, for financial services firms and our customers

Thank you for your consideration of our views as you evaluate proposals to reform the Tax Code. We stand ready to provide further information to you or your staff on these or other matters of concern.

Sincerely,

Marc E. Lackritz  
President  
Securities Industry Association

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<sup>2</sup> Investment Company Institute Perspective, February 2005, p. 4 & 5