

April 22, 2004

United States Senate

Dear Senator:

The Securities Industry Association¹ (SIA) supports S. 1637, the *Jumpstart Our Business Strength (JOBS) Act*. We are pleased that the recently reached unanimous-consent agreement moves this important legislation one step closer to final passage. At the same time, we wish to point out that the current bill includes several revenue-raising provisions SIA opposes. We hope our concerns can be favorably addressed as the measure progresses.

The growing interdependence of world financial markets has highlighted the need to rationalize U.S. tax rules that undermine the ability of American financial services industries to compete in the international arena. Creating a more competitive environment for firms is a critical element in helping to create jobs throughout our economy. SIA's member-firms provide access to global capital markets for U.S. businesses and help U.S. manufacturers obtain competitive financing to export their products to markets around the world. However, our ability to achieve these important objectives is undermined by a tax system that is in dire need of the types of reforms contained in S. 1637.

More specifically, the changes to the foreign tax credit regime included in the bill will help to ensure companies are not double-taxed (and sometimes triple-taxed) on the income earned from doing business in foreign countries. The credit has two general problems. First, companies have credits they simply cannot use because credits are isolated in separate "baskets" that prevent foreign taxes from active business income from being fully creditable in the United States. Second, U.S. expenses, mainly interest, are allocated to foreign source income for purposes of calculating the amount of foreign tax credits a U.S. company is allowed. This expense allocation rule artificially reduces net foreign source income and thereby foreign tax credits. Both problems lead to double taxation – taxation by the United States and the foreign country in which the income was earned – that the foreign tax credit was intended to eliminate. The bill contains important reforms that eliminate some of the barriers that prevent financial services firms from using these credits.

The *JOBS* bill also contains important modifications to current law to ensure that the rules providing for taxation of the active business income of overseas subsidiaries only when

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (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 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated \$209 billion in domestic revenue and \$278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com)

those funds are returned to the U.S. parent company appropriately treat the active business operations of financial services companies.

Despite SIA's support for these and other important provisions in the underlying bill, S. 1637 does contain several troubling revenue-raising provisions. In addition to other offsets of interest to some SIA member-firms, we wish to call your attention to three specific items that we hope can be addressed as the measure moves forward.

First, SIA is opposed to the proposal to deny businesses deductions for certain costs associated with settlements and other remedial steps taken in consultation with federal, state, or local government agencies. The tax code currently denies companies a deduction for any amount paid as a fine or penalty for a violation of any law. The *JOBS* bill would expand the scope of current law and deny businesses a deduction for amounts paid or incurred as a result of any government inquiry into a possible violation of law (other than restitution, which is narrowly defined). Under the terms of the provision, many routine business costs, such as a power plant installing pollution control equipment at the request of the EPA, would no longer be deductible. Similarly, financial services firms that voluntarily undertake programs such as investor education or enhanced disclosure at the suggestion of federal regulators will be denied a tax deduction for those costs. Moreover, the provision is retroactive. It is therefore particularly unfair to those companies that negotiated settlement agreements based on current law rules governing what costs would and would not be deductible.

Second, SIA opposes language changing the tax treatment of contingent payment convertible debt, instruments that may be converted, at the investor's option, into stock of the issuer and that also provide investors with additional interest payments in certain defined circumstances (so called contingent interest). Since 2001, more than \$73 billion in capital has been raised through almost 150 of these issuances by a broad array of American companies in numerous sectors, such as manufacturers, defense contractors, financial institutions, retailers, high-tech companies, drug and device manufacturers, other health care enterprises, hotels, and utilities. The change would create a "worst of both worlds" tax regime: companies could take less in interest deductions on these instruments than is currently allowed on contingent debt which has no conversion rights, while holders would be required to pay more in taxes on these bonds than they would on convertible debt which has no contingent interest feature. Enactment would have the effect of eliminating this important financing alternative for a broad range of businesses, one carefully studied and authorized by the Treasury in Revenue Ruling 2002-31.

Finally, recent modifications in the bill to the straddle rules would deny Qualified Covered Call (QCC) status to certain options sold over-the-counter (OTC). This modification would reverse a carefully researched and reviewed decision by the Treasury Department in April of 2002. Congress acknowledged covered call writing, a well-established strategy allowing shareholders to increase their yields, when it originally enacted the QCC provisions. SIA believes that maintaining QCC status for both OTC and listed options preserves choices and promotes competition for the benefit of investors. Specifically, listed options are only available with exercise prices in increments of \$5 if the exercise price is \$50 or above (and in increments of \$2.50 below that threshold). OTC options fill in the large gap within the \$5 (or \$2.50) increments. While listed "flex" options with customized exercise prices are available, they are

rarely used and thus may be more expensive than the competitively bid prices available from OTC options dealers. Investors should have the choice. Moreover, SIA is not aware of any tax policy reason to treat OTC options differently than listed flex options that would continue to be entitled to QCC status under the proposal.

Thank you for your consideration of these issues. We look forward to working with you on this important legislation.

Sincerely,

Steve Judge
Senior Vice President
Government Affairs

Richard Hunt
Senior Vice President
Federal Policy