NATIONAL FOREIGN TRADE COUNCIL, INC.
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October 18, 2005

M. Thierry Breton
Ministre de l'Economie, des Finances et de l'Industrie
Teledoc 151
139 rue de Bercy
75572 Paris Cedex 12

Dear Minister Breton:

On June 24, 2005, we wrote to you expressing concern about proposed changes to the thin capitalization rules of section 212 of the Fiscal Code. Since then a new draft proposal has been issued, and included in the draft 2006 Budget. While we very much appreciate some of the changes made to the proposal (in particular the change to the calculation of income under the interest cover test and the addition of a safe harbor clause), our members still have concerns about the proposal. We have been following the efforts of Mouvement des Entreprises de France ("MEDEF") on this legislation and we appreciate what they have achieved on behalf of both French and foreign investors in this matter – but we thought that it might be useful to reiterate our points to you directly.

Our members still have three principal concerns. First, as with last year's proposal, the restriction on the amount of interest that can be deducted on related-party borrowing is only 25% of net income ("resultat courant"). As we mentioned previously, the interest cover test is meant to measure a company's ability to support its debt. Even the U.S. rules, currently the strictest in the world, allow amounts up to 50% of income to qualify. We welcome the changes in the calculation of net income to something much closer to EBITDA, but our members still feel that 25% of even that new figure is far too low. While we support MEDEF's proposal to raise the allowable amount to 40%, we would actually request that you raise the percentage to the U.S. limit of 50%. In relation to the interest cover test, we would also request that interest be a "net" number, to take into account inflows as well as outflows of interest, rather than simply "gross" interest paid.

Our second point relates to the 5% reduction in the amount of disallowed interest that can be carried forward to a future year when the company's ratios may have changed to qualify under the new rules. Although reduced from 10%, there seems to be no logical policy reason for even a 5% reduction. We support MEDEF's proposal that requests that this reduction be removed.

Finally, our members have concerns about the safe harbor clause. While our members do very much appreciate the addition of the safe harbor, they would prefer it to much more explicitly follow customary transfer pricing practice and allow for an exception for loans made at arm's length rates. Should that not be possible, however, a number of our members have pointed out that the proposed safe harbor relating to the French company's ratio when compared to the group worldwide ratio, does not take account of a large group which may have several different lines of business. Therefore, if you decide not to adopt a transfer pricing approach, we would request that you consider changing the safe harbor to allow a comparison between the French company's ratio and other members of the group engaged in the same line of business. We would be happy to work with you on appropriate safeguards to prevent abuse of such a provision.

As we have noted before, the future economic health of the world relies upon the ability of firms to manage global enterprises in robust international markets, supported by tax policies that recognize the importance of the free flow of capital. We continue to be concerned that we are very close to a potentially damaging struggle that could curtail or even prevent the often very efficient debt-financing of foreign operations. In particular, we are concerned that the proposed changes to section 212 would adversely impact the debate on thin capitalization ("interest stripping" under section 163(j)) in the United States – to the further detriment of international capital flows.

Again we thank you for the improvements to the proposal made following our letter of June 24. Our members continue to be eager to work with you so that changes to France's thin capitalization rules will reflect the importance of continued investment in France. We respectfully ask you, therefore, to consider the further changes suggested in this letter, and to let us know how we can help.

Sincerely,

William A. Reinsch
President