NATIONAL FOREIGN TRADE COUNCIL, INC.

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July 31, 2006

Mr. Peer Steinbrueck
Federal Minister of Finance
Bundesministerium der Finanzen
Wilhelmstraße 97
10117 Berlin
GERMANY

Dear Mr. Finance Minister,

The National Foreign Trade Council, organized in 1914, is an association of some 350 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and our members have for many years been substantial investors in many foreign countries, among which one of the most significant is Germany.

Our members believe, however, that these mutually advantageous flows of investment may be damaged by some of the proposed "cornerstones" of your government's corporate tax reform announced in the past few weeks. While we welcome the lowering of tax rates, our members are concerned that some of the measures behind the headline rate cut may actually lead to an increased, rather than a reduced tax burden, particularly on foreign corporations. Proposals to restrict the deductibility of interest in determining the tax "base" of corporate income taxes under the new regime would be particularly damaging. Other proposals to restrict the deductibility of rental, lease, and royalty payments would also be damaging.

We understand and appreciate the general principle of "cutting the rate and broadening the base". However, "base broadening" generally refers to the removal of special privileges that are only available to a small group and which are economically distortive. Interest deductions and deductions for rents, leases, and royalties are not special interest provisions. Many businesses borrow to fund expansion (often, most efficiently by borrowing in their home country), or to better distribute funds throughout a group through a centralized funding structure. This is true across the full spectrum of industries. For example, financial services companies - and not just banks, but also finance and leasing companies - need to leverage highly to achieve sufficient volume. As another example, many manufacturing and service sector companies find it better from a cash flow point of view to rent or lease property rather than buying it outright. This clearly illustrates the simple, multiplier feature of leverage, which makes borrowing such an engine of economic expansion. This is not distortive, it is simple economics.

We are concerned, therefore, that restricting the deductibility of payments in the way proposed, would almost certainly raise taxes on any company that was not largely equity funded, and which did not own outright its plant and equipment. We would also mention that restricting deductions for royalties will inhibit innovation by technology-rich companies. In other words, whether we are talking about a bank, or a finance company, or a leasing company, or a technology company, or a manufacurer, these proposed restrictions on deductibility will raise the cost of doing business in Germany. And, this, in turn, will result either in higher costs to German consumers, or in less investment and business activity in Germany. Neither of these seems to be a desirable result for the future expansion of the German economy.

In addition, there is a specific U.S. tax problem with these proposals. As you may be aware, for a foreign tax to be creditable in the U.S., it must bear the hallmarks of an "income tax". That is to say it must be a "net" tax, where deductions for general business expenses are allowed against gross income. In general, under U.S. law, if a tax is calculated on a turnover (gross income) basis (rather than on net income) the U.S. may deny a foreign tax credit for that tax, leading to double taxation of that income. One example of a turnover tax that has been treated in this way is the IRAP in Italy. In that case, because certain deductions are denied in calculating the tax base, the IRAP is only creditable in part (and, it should be added, even that is only because of an exception made by the U.S. to the general rule that the entire tax should be non-deductible). U.S.-based multinationals have a long history of robust investment in the German economy, presently employing approximately 800,000 Germans. We would urge you to consider again the positive effects of U.S. investment on the German economy.

Our members would be very happy to work with you and your officials to help craft an outcome which can meet your goals, without damaging inward investment. Please do contact us to let us know how we can help.

Sincerely,

William A. Reinsch
President

cc: Mr. Karlheinz Weimar (Finance Minister State of Hessen)
Dr. Kurt Faltlhauser (Finance Minister State of Bayern)
Dr. Helmut Linssen (Finance Minister State of Nordrhein-Westfalen)
Mr. Gerhard Stratthaus (Finance Minister State of Baden-Württemberg)