THE PRESIDENT'S EXPORT COUNCIL
WASHINGTON, D.C. 20230

December 9, 2010

President of the United States of America
The White House
Washington, DC 20500

Dear Mr. President:

Our economy stands at an integral moment when growth is essential to our future. One of the best ways to ensure future growth is to expand our exports, particularly in fast growing economies. So that the United States might better compete, an important consideration of the National Export Initiative is to address the serious fiscal challenges that limit our country's ability to maximize the scale of our exports. Congress and the White House must work to develop a plan to meet those challenges. Current policy projections show unsustainable growth in government deficits and a key contributor to these deficits is federal non-interest spending. Our nation's economic security and American living standards depend on slowing the growth in federal spending and ensuring an annual balance between federal revenue and expenditures.

Critical reform of the corporate income tax system should be part of a fiscally responsible comprehensive tax reform and budget package. Critical action must be taken now to incent substantial private sector investment, which offers sustainable advantages over similar expenditures of public sector funds. U.S. companies have large capital reserves sitting on the sidelines due to the unprecedented uncertainty of the current public policy and political climate. A strong correlation exists between business investment and jobs, thus unlocking this capital for investment in the U.S. economy is in everyone's best interest. We respectfully submit the recommendations below for consideration:

- Reduce the combined (federal and state) corporate tax rate to the OECD average or less;
- Create an international tax system in which U.S. corporations can compete well with those in other OECD nations;
- Enact a permanent research and development credit that is competitive with other OECD incentives; and
- Create additional temporary tax incentives to invest in capital equipment.

Significant tax reform is needed to address these deficiencies and allow American workers and companies to compete effectively in domestic and international markets, to create jobs, and to achieve a higher standard of living for all Americans. As other nations pro-actively work to design tax systems to attract businesses and capital investment they improve the competiveness of their companies and workers. In the following portion we address these issues in more detail.

1. Corporate tax rate reduction – A significant corporate tax rate reduction is needed to both help US companies compete abroad and attract investment to the United States, encouraging foreign companies to invest here. Increased capital investment brings more

employment and higher wages for U.S. workers. Increased U.S. production expands exports around the world. A lower corporate rate would reduce the advantage of using debt financing over equity financing by reducing the benefits of interest deductions. It would reduce the incentive for businesses to operate in noncorporate form, such as partnerships or LLCs. It would also reduce pressure on transfer pricing because it would reduce the incentive to have income in low tax rate jurisdictions. In a 2008 report by economists at the OECD, who measured the relationship between different taxes and economic growth, they determined that the corporate income tax is *the most* harmful tax for long-term economic growth. This is because capital and income are the most mobile factors in the global economy and, thus, the most sensitive to high tax rates. Because capital is mobile but workers are not, labor bears a disproportionate share of the burden of corporate taxes – as much as 70% by some estimates.

In 2010, the average corporate tax rate in the OECD (excluding the U.S.) is 25.5 percent, including sub-central taxes. The corporate tax rate in the United States, including state income taxes, is 39.2 percent (calculated by the OECD as a 35 percent federal rate and a deductible state rate of 6.47 percent). Holding the state tax rate constant, the United States would need a federal corporate rate of approximately 20 percent to match the 2010 OECD level. Future tax reductions already announced in several OECD countries mean that our trading partners will continue to gain a competitive advantage in this area unless the United States undertakes a significant federal corporate tax rate reduction. Finally, it is worth noting that OECD countries that have lowered corporate rates have generally done so in combination with some broadening of the corporate income tax base.

2. Territorial-type tax system - The rest of the world increasingly uses territorial systems under which foreign earnings - taxed once in the foreign country – can be brought back for reinvestment in the domestic economy without incurring additional home country tax. Within the OECD, 25 countries use these territorial systems, with the United Kingdom and Japan adopting territorial systems in 2009. The United States, along with only five other OECD countries (Chile, Ireland, Korea, Mexico and Poland) use so-called worldwide tax systems in which foreign earnings are subject to domestic tax when remitted to the domestic economy. Importantly, all five nations have a much lower corporate tax rate than the U.S.

Expansion abroad by U.S. companies is vital for establishing export platforms for U.S.-produced goods and expanding the scope of domestic investments in research and other high-paying headquarters' operations. Economic analyses show that foreign operations of U.S. companies are complementary to their domestic operations – operations abroad expand domestic operations. A competitive territorial tax system for the United States should broadly follow the practice of our trading partners and should not be designed to raise new revenue, or to destabilize the U.S. corporate tax base, but rather to make the US tax system more competitive with its major trading partners.

3. Research and development incentives (R&D Tax Credit) - For U.S. companies to increase exports, they must be at the forefront of technology and intellectual property development. No longer can the U.S. claim sole superiority in this area, as a large

number of countries currently offer the critical operational pre-requisites for conducting research and development (R&D), including factors such as a strong customer base, educated workers, protection of intellectual property, and government support. The competition for these dollars is fierce, and the tax code is an effective instrument for encouraging the spending of these dollars. Unfortunately, the U.S. is falling behind. Even before the existing R&D credit expired, the U.S. tax incentive was only 24th among industrialized nations. Your Administration has proposed, and the U.S. should adopt, a permanent R&D tax credit that taxpayers can rely on. In addition, to encourage incremental investment in intellectual property development and ownership, many countries have recently enacted regimes providing advantaged treatment for intellectual property. These regimes offer reduced taxation of income from the exploitation of intellectual property created and owned in-country. The U.S. should consider a similar regime, expanded to include all intellectual property that is important to the U.S. economy.

4. **Additional Investment Incentives** – For five of the last eight years Congress has extended tax incentives to enhance first year depreciation on capital expenditures for small and large companies ('bonus' depreciation). While constructive and significant, these incentives alone have not increased business investment as much as desired given the economic downturn. Extending investment incentives until the economy more fully recovers or the corporate tax rate can be reduced would allow for advanced planning in corporate capital expenditure budgets and greatly enhance these incentives. In addition, a full expensing regime (as proposed by your Administration), or alternatively an investment tax credit of equal value, would significantly increase capital expenditures and GDP based on economic studies. This would encourage firms to make investments that would not be undertaken under today's tax code.

Finally, we appreciate the thoughtful considerations put forth by the bipartisan leaders of your deficit commission. Although this group opposes raising corporate taxes simply to raise revenue, we believe a full review of the tax code and responsible corporate tax reform that meets the objectives above is in order. We will continue to review the general proposals recently outlined and any additional recommendations published by the Commission.[1]

Sincerely,

Jim McNerney

[1] Please note that this letter has been prepared by the private-sector appointed members of the PEC.