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April 28, 2005

Hon. Connie Mack, Chairman
Hon. John Breaux, Vice Chairman
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW, Suite 2100
Washington, DC 20220

Dear Mr. Chairman and Vice Chairman,

The member companies of the Steel Manufacturers Association, that produce more than half of the steel made in the United States, are responding to your request of April 5, 2005 for ideas needed to reform the U.S. tax code.

Almost all industrial nations except for the United States rely on value-added taxes for a substantial portion of their tax revenues. However the U.S., the world's leading importer and a major world exporter, is inflicting both trade and capital-flight penalties upon itself through total dependence on its direct tax system. Other major nations have adopted indirect value-added tax systems, or like Japan and Canada, combinations of direct and indirect taxes providing favorable trade and capital investment effects.

In contrast, the United States is handicapping itself in international competition by its sole dependence on direct taxes on corporate profits, as well as continued direct taxes

PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM

on their after-tax distribution, while the rest of the world reaps both trade and capital investment benefits from their indirect tax systems.

Under the current U.S. direct tax regime incurred on corporate profits, domestic companies bear heavier tax liabilities than do foreign-based companies subject to indirect taxes since these same indirect taxes may also be imposed at the border on competing imports and rebated to these companies on their exports.

Moreover, "The U.S. marginal corporate income tax rate has become about 10 percentage points greater than Europe's over the past two decades – a substantial gap with effects on the location of new plant and equipment – made even more potent by capital's greater mobility and heightened company sensitivity to after-tax rates of return".[1]

Data publicly available shows that seventy percent of foreign firms importing goods into the United States pay either very little, or no taxes to the United States on their sales in U.S. markets. The U.S. has little ability to audit the accuracy of cost of goods sold data submitted to the U.S. by foreign exporting companies for determination of their U.S. tax liability.

U.S. companies, in contrast, receive no benefit at the border on their exports, or on competing imports under World Trade Organization rules, which permit indirect tax rebates on exports and comparable border taxes on imports, but not on direct taxes paid by U.S. corporations.

[1] MAPI Economic Report – ER-584e – March, 2005

For example, "European governments object to any relief from the "direct" U.S. corporate income tax as an "illegal subsidy" to U.S. exporters."…. The WTO rule's economically meaningless distinction between "direct" and "indirect" taxes still provides Europe the tools for turning the U.S. corporate income tax into a major disadvantage for U.S. exporters and their workers".[1] Over the last decade, Europe's export sector has outperformed the U.S. export sector, and by a wide margin. Europe's willingness to compete with lower taxes – and the United States' failure to meet that competition go a long way toward explaining the two very different levels of performance.

Thus U.S. manufacturers, including its steel producers, must compete not only with a U.S. dollar overvalued by at least 35 percent against several of its main Asian competitors, but also against tax preferences accorded by other governments to their companies; these benefits are not received by U.S. producers. Added to this burden, of course, are the social costs such as worker health care paid by U.S. producers that other governments routinely absorb.

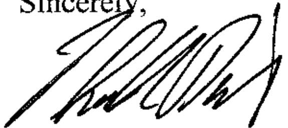
Is it any wonder, then, that U.S. companies, well aware that they are competing in world markets, are assessing the potential for outsourcing production to obtain the capital and labor cost advantages of production in foreign locations? But the U.S., through policy inaction, cannot stand by supinely while its core manufacturing industries hollow out. The U.S. negative balances on international trade and on current account, each

[1] MAPI Economic Report – ER-584e – March, 2005

approaching $600 billion annually, are a national disgrace, vastly exceeding those incurred by any other nation in history. They cannot continue without dire consequences for the U.S. economy. There is now an urgent need for U.S. tax policy to nurture U.S. international competitiveness to retain the U.S. manufacturing base.

Accordingly, we urge the Advisory Panel on Federal Tax Reform to recommend the elimination of double taxation of business profits and the adoption of border adjustable taxes. Under no circumstances should the incidence of corporate taxation be increased, as that would foster the expansion of U.S. flight capital investment in other countries. Instead, the U.S. should reduce direct U.S. corporate income taxes, achieving revenue neutrality through the adoption of a border-adjustable tax, benefiting all U.S. companies and their workers.

Sincerely,



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CC: SMA Board of Directors