Transmittal Supplement

TO: The Committee on Ways and Means
U. S. House of Representatives

FROM: Scott Salmon
General Manager, Governmental Affairs
United States Steel Corporation
901 K Street, NW, Suite 1250
Washington, DC 20001

(202) 783-6797

SRSalmon@uss.com

SUBJECT: Hearing on the Interaction of Tax and Financial Accounting on Tax Reform

Attached please find a written statement to be included in the official record of the full committee hearing held on February 8, 2012 on the Interaction of Tax and Financial Accounting on Tax Reform. Please direct questions concerning this statement to the name and address listed above.

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO:
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON THE INTERACTION OF
TAX AND FINANCIAL ACCOUNTING ON TAX REFORM

HEARING DATE: FEBRUARY 8, 2012

SUBMITTED BY GREGORY A. ZOVKO
VICE PRESIDENT & CONTROLLER
ON BEHALF OF
UNITED STATES STEEL CORPORATION

600 Grant Street
Pittsburgh, PA 15219

412-433-1166

GAZovko@uss.com

FEBRUARY 22, 2012

GREGORY A. ZOVKO
UNITED STATES STEEL CORPORATION

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United States Steel Corporation ("U. S. Steel") is an integrated steel producer of flat-rolled and tubular products with major production operations in North America and Europe. An integrated producer uses iron ore and coke as primary raw materials for steel production. According to World Steel Association's latest published statistics, we were the eighth largest steel producer in the world in 2010. U. S. Steel is also engaged in other business activities consisting primarily of railroad transportation services and real estate operations.

U. S. Steel appreciates the opportunity to add to the discussion on tax reform that occurred during the February 8, 2012 Hearing on the Interaction of Tax and Financial Accounting on Tax Reform. My written testimony is based on my experience as the Vice President and Controller for U. S. Steel. Among my current responsibilities, I am responsible for both the preparation of our financial statements and for the financial evaluation of capital projects.

Congress has the goal of making the United States a more attractive venue for investment, promoting economic growth and job creation, and simultaneously reducing the deficit. We are encouraged by proposals for a reduction in the corporate tax rate to induce new capital investment. Reducing the corporate tax rate to 25 percent would provide a substantial incentive for the expansion of business in the U.S. and help make our company more competitive internationally.

Furthermore, the retention or enhancement of accelerated depreciation when combined with a reduction in the corporate tax rate would be a powerful tool to promote investment in the U. S., something that the country sorely needs. While current tax deductions and credits will have to be carefully examined to determine if any should be changed or eliminated in order to achieve a lower tax rate, we believe that a reduction in the corporate tax rate should also be accompanied by the retention of accelerated depreciation to best encourage new capital investment, fostering economic growth and employment in the U.S.

While we would generally expect a tax rate reduction to increase net income and earnings per share in our financial statement, that impact will not necessarily translate into increased cash flows for capital intensive industries if accelerated depreciation is not retained. Cash flow is the lifeblood of a business and investors are very focused on cash flow generation and liquidity in addition to net income and earnings per share. Cash flow and liquidity considerations are major components of investment decisions and provide businesses with the confidence to continue to invest in projects that will grow America's manufacturing base. Corporations cannot focus solely on book earnings; cash flow is a critical measure of a company's financial viability and accelerated depreciation obviously increases cash flow in the early years of an investment.

U. S. Steel requires significant capital investments for its steel manufacturing and mining facilities in the United States. The net present value of future cash flows is the most important criterion in determining if a discretionary capital investment should be made. We evaluate the present value of future income taxes on earnings from the investment, as well as the present value of future income tax savings from depreciation on the investment. While a lower federal income tax rate will reduce the present value of tax on future earnings, that benefit may be more than offset by the reduced present value tax savings from future depreciation deductions. Accelerated depreciation has a substantial impact on all of U. S. Steel's investment decisions and is built into our models for evaluating the success of capital projects.

The availability of cash also determines how much we can invest and when we can invest it. Many job-creating, domestic investments may be delayed if cash flow is limited. Non-discretionary projects mandated by statute or regulation would by definition occur regardless of the cash flow analysis, but discretionary value added projects require an extensive analysis of the net present value cash flow. We are currently pursuing a promising large capital investment program with spending in 2011 and 2012 approaching $1 billion for each year. We are currently building new coking facilities in Pennsylvania and Indiana, and pipe mill facilities and a continuous annealing line in Ohio. We have also received all the permits required to expand and modernize an iron ore mine and pelletizing plant in Minnesota and have several dozen other projects under consideration for facilities in Michigan, Alabama and elsewhere. These planned investments will create thousands of construction jobs and hundreds of permanent jobs. These projects will result in billions in goods and services being bought from local and national suppliers. Some of these and future projects may not be as viable if accelerated depreciation is changed or eliminated. Some may view accelerated depreciation of less importance in the current low interest rate environment, but current interest rates may not be appropriate for judging long-term projects, especially for cyclical industries such as the steel manufacturing industry. Instead, we look at an "all-in" cost of capital that reflects both long-term interest rates and the cost of equity capital.

Making accelerated depreciation a constant tool for capital investment would enable companies to take this benefit into consideration when deciding what capital projects to undertake and when to undertake them. One reason some companies have responded to accelerated depreciation less enthusiastically than anticipated is due to the fact that recent proposals to further accelerate depreciation (the so-called "bonus depreciation" provisions) have been sporadic and enacted or extended very late in the year and thus have only provided an incentive for short term projects. Most large scale projects are planned for years ahead, where the one year at a time extension of bonus depreciation provides very little incentive due to its uncertainty.

Other countries with lower tax rates than the U.S. still encourage capital investment to fuel growth. For example, Canada has made investment more attractive by reducing the corporate tax rate and providing for accelerated depreciation. Canada has a lower federal corporate tax rate than the U.S. (the Canadian corporate rate in 2012 is 15%, which, when combined with provincial rates is approximately 25%), and they allow accelerated depreciation. For example, most machinery and equipment has a 30% depreciation rate applied against the unrecovered capital cost. At this rate, over 83% of the cost can be written off over 5 years. Even if the U.S. corporate income tax rate is reduced to be closer to the Canadian rate, if accelerated depreciation is eliminated in the

U.S., manufacturers with operations in both countries will still have a tax incentive to invest in Canada rather than in the U.S. Continuing or enhancing accelerated depreciation would help make the U.S. a more desired location for new capital investment.

A lower overall tax rate would benefit both old and new investment equally. However, accelerated depreciation provides a strong incentive to undertake new capital expenditures by providing a faster return on capital investment. Thus, to the extent that accelerated depreciation is repealed to reduce the tax rate, new investment is actually penalized since it bears the full burden of that cost while the corresponding "benefit" is split between new and existing investment.

A lower tax rate combined with accelerated depreciation provides a strong incentive for businesses like U. S. Steel to invest heavily in domestic capital projects, thus creating new jobs and expanding the U.S. economy.

As the Committee further analyzes the best way to structure corporate tax reform, I encourage you to consider the benefits of maintaining and further enhancing accelerated depreciation. Accelerated depreciation directly results in new capital investment, an essential part of economic recovery and job creation. We welcome the ability to further contribute to the tax reform discussion. Thank you for the opportunity to address the Committee.