Department of the Treasury

PRESS RELEASES

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 2, 2003
JS-445

Treasury Assistant Secretary for Tax Policy Pamela Olson Remarks to 2003 ICI/SIA Retirement Savings Conference

I very much appreciate the opportunity to be with you this morning. ICI, SIA, and the members of both organizations were instrumental in the passage of tax relief legislation last week. The support of both organizations, both in identifying the technical issues that had to be addressed and in educating the public and legislators on the significance of the President's proposal to end the double tax on corporate income, was invaluable. From those of us in the Treasury Department and the Administration who had the pleasure of working alongside you, I thank you. We simply could not have accomplished what we did without you.

I'd like to start this morning with the importance of the tax legislation that the President signed into law last week, then delve further into our tax system. That legislation addressed one of the most serious underlying problems in the tax code, but there are others that remain to be addressed.
The legislation the President signed into law last week - the Jobs & Growth Tax Relief Reconciliation Act of 2003 - was designed to give the economy the extra boost it needs to start growing at a faster rate.

The new law provides tax relief across the board. It increases the amount of income subject to tax at the lowest rate, ends the marriage penalty for lower and moderate income families, increases the child credit from $600 to $1000 per child, and guards middle income families against the AMT. It also accelerates to 2003 the reduction in the remainder of income tax rates that were delayed until 2004 and 2006.

Taken together, these changes mean that people will start seeing more money in their paychecks in the next few weeks. A married couple with two children and income of $40,000 will see their taxes decline by $1,133 (from $1,178 to $45) in 2003, a decline of 96 percent. Three million families will be taken off the tax rolls entirely. Eight million families who pay no income taxes will see their child credit refunds increase. In addition, families will not have to wait to see the benefits of the increase in the child credit. Next month, the IRS will begin cutting checks to families for the increase in the child credit.

What do the changes mean? They mean that families will get to decide what to do with their own money. Saving for college tuition. Preparing for retirement. Deciding how best to meet their families' needs using their own money.

The reduction in income tax rates and a significant increase in the amount of investment that small businesses can expense annually will benefit 23 million small business owners, leaving them with cash for further investments and to create new jobs. The critical role played by small businesses in the American economy is well known. As President Bush has noted, this law directly affects small business, because most small businesses pay taxes at the individual tax rates. Reducing the individual income tax rates helps the bottom line of most small businesses in America. It puts capital into the treasuries of small businesses across America. More capital means more investment. More investment means more jobs.

The centerpiece of the legislation is the significant reduction - to 5 and 15% rates -

in the double tax on corporate dividends and capital gains. While we did not win the complete end to the double tax, we made great strides. The change signed into law by President Bush last week is the most significant change to the structure of the income tax in decades. The President's goal was complete rationality - an end to the double tax. While we did not get to complete rationality - this is Washington after all! - we did get to an equal - and substantially reduced - tax rate on dividends and capital gains.

In reading the commentary and listening to the pundits over the last 10 days, it's clear that a lot of folks don't understand how positive this change is - so let me spend a minute on it. For decades now, we've been living with a system that diverges from our best economic interests as a country. We've had laws that favor debt, disfavor dividends, and enormously increase the tax costs of businesses growing through outside capital investments. The result of the decades of bias? Too much debt. Attempts to camouflage debt. Too much attention to manipulable earnings instead of unfakeable cash flow. Too many complicated transactions designed to produce capital gains. Transactions that coincidentally yielded enough shares to fulfill generous stock option grants without unacceptably diluting shareholder interests. Too many small business owners to whom the tax code presents a barrier to growth. Too long with an arbitrary allocation of the tax burden on the basis of the form in which a company does business.

With last week's legislative action, we've taken the first step to eliminating the tax code's decades old interference in the capital markets and misallocation of resources. Perhaps most important is that taxing dividends and capital gains alike removes the fig leaf of "tax inefficiency" behind which some less-than-stellar corporate managers have hidden decisions. Gone is any justification for retaining earnings without a satisfactory return on those earnings. That means a certain midwestern oracle, who, it must be noted, has played the tax code like a fiddle, is still safe retaining all his earnings. Perhaps, however, the equalization of tax on dividends and capital gains will even cause some of his shareholders to lose their complete affinity for capital gains!

Let me note two other significant benefits to the economy of the change in the taxation of corporate income. Did you know we were number one in the OECD? Yes, number one for highest tax on corporate income. This change ends that dubious distinction.
We operate in a global economy. We can no longer write rules as though what the rest of the world is doing is irrelevant to us. The second benefit is that it lowers the cost of capital for corporate investment. A lower cost of capital means more investment. More investment will encourage new job creation.

While we expect the change to have a positive effect on corporate behavior, it is likely that it will take some time for the change to undo decades of engrained practices. Dividend policy matters to the market because it is an indicator of the underlying health of a company - and, consequently, dividend policies are not changed lightly nor are they changed overnight. There are, however, already positive signs. Shortly after the President unveiled his proposal, Microsoft declared its first ever dividend. That was followed soon after by IHOP. As one economist observed, before the proposal was even enacted, it was changing behavior from PCs to pancakes. And that is why the President didn't waffle.

And the trend continues. Late last week, Sallie Mae increased its dividend pay out, citing the change in the tax law. As the economy improves, we are likely to see more of that. Over time, we may again see a time when cash dividends comprise an important part of shareholders' return. To my mind, that would be a welcome change. Lottery tickets are not a good investment strategy, but the investments in some cashless companies that our tax code encouraged are closely akin to it.

While the Jobs and Growth Act has better aligned our tax rules with our economic interests and our values, there are still ways in which our tax rules are inconsistent with the core values of American society. One of those is of special concern to those of you associated with today's Retirement Savings Conference: our tax code discourages saving.

Let's turn to the basics for a moment.

Our income tax system began as a system intended simply to fund the government. Over the years, successive Congresses and Administrations have proposed and enacted both minor changes and major overhauls. We have grafted on more and more components to the point that the system is nearing collapse.

To be sure, many of the components reflect an increasingly complicated world. But many do not. Often changes have been designed to hit a revenue target or to patch a hole, real or perceived. Whatever the case, changes have been made too frequently, without coherent or consistent policy design, with insufficient overall consideration of their effect on our country or its relation to the global economy, and without adequate thought to how each of the new components fits with the others.

In the tax world, we have done exactly the opposite of what the business world has done to increase productivity - a key to the incredible economic growth the county has experienced in the recent past. What is it the business world has done to increase productivity? They've simplified. They've taken every process down to its constituent parts and cut out the inefficiencies, the points of friction, the drags that prevent the most streamlined operation and the standardization of transactions.
In the tax world, instead of simplifying to increase productivity in compliance and administration, we keep adding complexity - more rules, more limitations, more terms, more conditions, more qualifiers, more provisos, more exceptions. The result is that our system gets slower and slower and more inefficient. We burn more fuel, and emit ever more heat and smoke, and yet with all that burning, there's less and less light to show for it.

Nowhere is this problem more evident than in the numerous savings vehicles we have in the Code. Instead of simplifying to increase saving, we keep adding complexity more rules, more limitations, more terms, more conditions, more qualifiers, more provisos, more exceptions. As a result Americans are increasingly disinclined to save, rather than trying to figure out the complex rules.

Two decades ago - before the '86 Tax Reform Act fixed all sorts of things that weren't broken there was one kind of IRA and it worked for everyone. As Matt Fink has noted, from 1980 to 1986, contributions to IRAs rose nearly ten-fold, from $4 billion to $38 billion. Even more significant, however, is that the median income of contributing workers declined from $41,000 in 1982 to $29,000 in 1986.

The '86 Act added provisos to the simple IRA that limited its availability. These provisos were based on income and pension plan availability. The result: participation dropped. Confusion over eligibility, deductibility, and the benefits of continuing to contribute sidelined many former participants who were still eligible to participate.

The complexity also sidelined our financial institutions whose marketing abilities coupled with the convenience of payroll deductions or automatic transfers - had made the IRA popular and successful. The limitations, qualifiers, and provisos made it impossible for them to standardize transactions. In short, we told simplicity and the efficiency and productivity simplicity brings - to take a hike. It has never returned. Instead of going back to basics to fix the decline in participation, we have added more complexity. We now have three versions of the IRA traditional, nondeductible, and Roth. All operate differently, including with different limitations, qualifiers, and provisos - and, of course, they are mutually exclusive.

Recognizing that more people would be willing to set aside cash for retirement if they knew they could withdraw it in certain circumstances, we made exceptions for certain kinds of withdrawals in certain situations and added more complexity.

As the list of sympathetic withdrawals lengthened, we added new savings accounts for the new purposes. ESAs, QSTPs, MSAs. Hardly a month goes by that someone doesn't propose yet another account for yet another purpose.

And so the complexity grows, the inability to standardize transactions grows, the cost of administration grows, and the confusion multiplies!

Implicit in all of these complicated provisions are two important points. First, we don't trust the American taxpayer to make the right decisions, and, second, our tax rules contradict our values.
If we did trust the American taxpayer to make the right decisions for him or herself and his or her family, we wouldn't need the long list of qualifiers, provisos, and exceptions, backed up by penalties. Penalties, incidentally, that particularly discourage participation by lower and moderate income families. It's hard enough for people to save today. The last thing we need is some scold hitting the virtuous saver with a penalty because they need the money for some purpose unsanctioned by Washington.

The rules contradict our values because our system penalizes those who save their money instead of spending it. We will only reduce the penalty for those who agree to save, and in fact do save, for the purposes dictated by us here in Washington. This contradiction of our values is so engrained that it has become second nature to us - we don't realize the effect it's having.

Take a simple example. Two families - identical except that one of them spends everything they make and the other saves some, whether to buy a new home, for continuing education, for a rainy day, for unexpected emergencies, for their children's future, or for their own retirement security. Over time, the family that saves will see its tax bill increase relative to the family that spends everything. We justify that on the basis that the family that saved has more income and a greater ability to pay. But the reason they have more income is because they chose to do the right thing. Like the ant in the parable, they worked and saved for their future. Virtue may be its own reward, but we're going to get less of it if we attach penalties to it. And, mind you, the additional taxes aren't limited to the tax owed on the savings income. Nor are the penalties for this virtue limited to the tax code.

We need to go back to the drawing board. We need to have faith that the American people know how to do the right thing. The President's budget proposals for retirement and lifetime savings accounts would do just that.

The proposed simplification of the retirement savings accounts and the addition of a lifetime savings account accessible to all Americans would bring significant simplification benefits. The lifetime savings account, or LSA, will allow everyone to contribute - with no limitations based on age or income status up to $7,500 per year of after-tax income. LSAs could be used to fund a college education, start a business, buy a first home, save for emergencies, or used for retirement. Earnings would not be subject to income tax and amounts could be withdrawn at any time for any purpose. Think medical savings accounts without losing unused cash at the end of the year. Think education savings accounts without the receipts. LSAs also could be established for children.

The retirement savings account, or RSA, would consolidate traditional IRAs, nondeductible IRAs, and Roth IRAs into a single simple account for retirement savings. Individuals could save up to $7,500 per year of after-tax compensation -- regardless of the level of that compensation for retirement, whether or not they also save in an LSA. Earnings in an RSA would not be subject to income tax provided the earnings are not distributed prior to the owner reaching age 58 or becoming disabled. Individuals would be able to convert existing tax-preferred savings into these new accounts in order to consolidate and simplify their savings.

Confusion and frustration are far too common among individuals trying to save. In 1982, the IRS publication explaining individual retirement accounts was 12 pages long. Now it is 104 pages long. People should not have to worry about the confusing alphabet soup of six different savings accounts and the endless maze of confusing rules. The two simple accounts will have one powerful goal making saving for everyday life and retirement security easier and more attractive.

Getting rid of the restrictions and qualifiers simplifies marketing and participation for everyone and for every purpose. But make no mistake about it: the real winners here are average Americans. In a matter of less than a decade, the accounts would permit all lower and moderate income Americans to enjoy the benefits of tax-free compounding and freedom from the complexity of Schedule B and Schedule D for all of their savings. This will give more hardworking Americans the chance to enrich their lives and strengthen their retirement security.

Besides simplifying savings for individuals, we need to simplify and rationalize the rules governing employer sponsored retirement plans. Each plan's purpose is to encourage retirement savings. But different sets of rules for different types of plans and different types of employers needlessly complicate and confuse employers and employees and make more difficult the standardization of transactions that reduces cost. Employer Retirement Savings Accounts, or ERSAs, would promote and vastly simplify employer sponsored retirement plans by consolidating 401(k), SIMPLE 401(k), 403(b), SIMPLE IRAs, SARSEPs, and 457 plans into a single type of plan that could be more easily established and maintained by any employer.

Less than 50% of the work force is covered by a retirement plan. Among small businesses, the coverage is even lower, with estimates ranging between 25 and 33% of the workforce. One look at the complexity of the rules and it is easy to understand why many small businesses would have opted out. We need to change that. We need to simplify the rules to make them accessible for all employers, regardless of size or sophistication.

I think you will find these proposals both sensible and constructive - they will simplify our tax code for employers and individuals, so that all Americans can save more for retirement, and for all their investment needs. We welcome your input on ways to make the proposals even more potent tools to encourage savings. Like the President's Jobs and Growth plan, and the Tax Relief Act of 2001, this will mean a long term boost for our economy, and greater prosperity and freedom for every American family.

Thank you.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 2, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $18,000 million to refund an estimated $6,000 million of publicly held 4-week Treasury bills maturing June 5, 2003, and to raise new cash of approximately $12,000 million.

Tenders for 4-week Treasury bills to be held on the book-entry records of *TreasuryDirect* will not be accepted.

The Federal Reserve System holds $15,145 million of the Treasury bills maturing on June 5, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders in this auction up to the balance of the amount not awarded in today's 13-week and 26-week Treasury bill auctions. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS 446

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED JUNE 5, 2003

June 2, 2003

Offering Amount........................ $18,000 million
Maximum Award (35% of Offering Amount)... $ 6,300 million
Maximum Recognized Bid at a Single Rate.. $ 6,300 million
NLP Reporting Threshold................. $ 6,300 million
NLP Exclusion Amount.................... $10,700 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NB 3
Auction date.......................June 3, 2003
Issue date.........................June 5, 2003
Maturity date......................July 3, 2003
Original issue date................January 2, 2003
Currently outstanding..............$42,304 million
Minimum bid amount and multiples....$1,000

Submission of Bids:
Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.
Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.
Competitive bids:
(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 4.215%.
(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:
Noncompetitive tenders:
Prior to 12:00 noon eastern daylight saving time on auction day
Competitive tenders:
Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date.

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TREASURY NEWS
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EMBARGOED UNTIL 11:00 A.M.
June 2, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS CASH MANAGEMENT BILLS

The Treasury will auction approximately $18,000 million of 8-day Treasury cash management bills to be issued June 5, 2003.

Tenders for Treasury cash management bills to be held on the book-entry records of *TreasuryDirect* will not be accepted.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The allocation percentage applied to bids at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS-447

HIGHLIGHTS OF TREASURY OFFERING
OF 8-DAY CASH MANAGEMENT BILLS

June 2, 2003

Offering Amount	$18,000 million
Maximum Award (35% of Offering Amount)	$ 6,300 million
Maximum Recognized Bid at a Single Rate	$ 6,300 million
NLP Reporting Threshold	$ 6,300 million
NLP Exclusion Amount	$ 1,400 million

Description of Offering:

Term and type of security	8-day Cash Management Bill
CUSIP number	912795 QF 1
Auction date	June 4, 2003
Issue date	June 5, 2003
Maturity date	June 13, 2003
Original issue date	May 28, 2003
Currently outstanding	$4,000 million
Minimum bid amount and multiples	$1,000

Submission of Bids:

Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 7.100%, 7.105%.

(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.

(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders:
Prior to 12:00 noon eastern daylight saving time on auction day

Competitive tenders:
Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 2-DAY BILLS

Term:	2-Day Bill
Issue Date:	June 03, 2003
Maturity Date:	June 05, 2003
CUSIP Number:	912795MQ1

High Rate: 1.175% Investment Rate 1/: 1.281% Price: 99.993

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 60.05%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 56,470,000	$ 24,002,600
Noncompetitive	0	0
FIMA (noncompetitive)	0	0
SUBTOTAL	56,470,000	24,002,600
Federal Reserve	0	0
TOTAL	$ 56,470,000	$ 24,002,600

Median rate 1.175%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.150%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 56,470,000 / 24,002,600 = 2.35

1/ Equivalent coupon-issue yield.

JS 448

PUBLIC DEBT NEWS

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TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	182-Day Bill
Issue Date:	June 05, 2003
Maturity Date:	December 04, 2003
CUSIP Number:	912795NZ0

High Rate: 1.095% Investment Rate 1/: 1.120% Price: 99.446

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 58.96%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 37,032,027	$ 16,823,747
Noncompetitive	1,051,545	1,051,545
FIMA (noncompetitive)	125,000	125,000
SUBTOTAL	38,208,572	18,000,292 2/
Federal Reserve	6,382,041	6,382,041
TOTAL	$ 44,590,613	$ 24,382,333

Median rate 1.085%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.065%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 38,208,572 / 18,000,292 = 2.12

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $827,386,000

JS-449

PUBLIC DEBT NEWS

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TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	91-Day Bill
Issue Date:	June 05, 2003
Maturity Date:	September 04, 2003
CUSIP Number:	912795NL1

High Rate: 1.110% Investment Rate 1/: 1.133% Price: 99.719

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 42.99%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 37,153,389	$ 16,424,534
Noncompetitive	1,455,553	1,455,553
FIMA (noncompetitive)	120,000	120,000
SUBTOTAL	38,728,942	18,000,087 2/
Federal Reserve	6,479,260	6,479,260
TOTAL	$ 45,208,202	$ 24,479,347

Median rate 1.100%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.080%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 38,728,942 / 18,000,087 = 2.15

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,163,850,000

http://www.publicdebt.treas.gov

JS 450

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 2, 2003
JS-451

Air Transportation Stabilization Board
Decision on Gemini Air Cargo, Inc.

WASHINGTON, DC The Air Transportation Stabilization Board (the Board) announced today that it has denied the application of Gemini Air Cargo, Inc. for a Federal guarantee of $29.7 million on a $33.0 million loan pursuant to the Air Transportation Safety and System Stabilization Act (Act) and implementing regulations promulgated by the Office of Management and Budget (Regulations). The Board concluded its review based on the standards set out in the Act and the Regulations and determined that Gemini's application did not meet the applicable standards for the reasons described in the attached letter. The vote to deny the application was unanimous.

Related Documents:

- Gemini Letter

Air Transportation Stabilization Board

Daniel Montgomery
Executive Director

June 2, 2003

Thomas A. Corcoran
President and Chief Executive Officer
Gemini Air Cargo, Inc.
44965 Aviation Drive
Washington Dulles International Airport
Dulles, VA 20166

Dear Mr. Corcoran:

In accordance with the Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (the "Act") and the regulations promulgated thereunder, 14 CFR Part 1300 (the "Regulations"), the Air Transportation Stabilization Board (the "Board") has considered the application of Gemini Air Cargo, Inc. ("Gemini") dated June 28, 2002, as supplemented (the "Application"), for a Federal loan guarantee of $29.7 million on a loan of $33 million.

During the process of reviewing the Application, the Board staff held telephone calls with you and your advisors and communicated additional requests for information. The Board staff met with you and your advisors on August 7, 2002, October 15, 2002, March 5, 2003 and April 15, 2003. Representatives of each Board member attended the meetings on October 15, 2002 and April 15, 2003. Following these meetings and communications, the Board staff and representatives of each Board member fully briefed the Board members on the Application.

The Board has carefully considered the Application under the standards set out under the Act and the Regulations. The Board's consideration included a review and analysis of the Application by the Board's staff and the Board's financial and industry consultants. Based on its review, the Board has determined that the Application did not meet the applicable standards, and, accordingly, the Board voted unanimously to deny the Application.

The Board determined that Gemini's proposal did not provide a reasonable assurance that Gemini would be able to repay the loan, an important evaluation criteria the Board is required to consider in assessing loan applications. The Board's financial consultant assigned Gemini's proposed financing a low credit rating. For all loan guarantee applications under the Act, a credit subsidy is computed, which represents the expected cost to the U.S. taxpayers of guaranteeing the loan. The calculations for Gemini implied a probability of default and related credit subsidy that the Board deemed to impose too high a risk to the U.S. taxpayers. Based on these considerations and other facts of record, the Board also was unable to determine that the loan would be prudently incurred by Gemini. Finally, the Board was unable to conclude that extension of the proposed loan guarantee to Gemini was a necessary part of maintaining a safe, efficient and viable commercial aviation system in the United States.

If you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

Daniel Montgomery

FROM THE OFFICE OF PUBLIC AFFAIRS

June 4, 2003
JS-452

Reconstruction in Iraq: Economic and Financial Issues
John B. Taylor
Under Secretary of the Treasury for International Affairs

Chairman Lugar, Ranking Member Biden, and other members of the Committee, thank you for inviting me to testify on the reconstruction of Iraq. I will discuss economic and financial issues, focusing on accomplishments since the end of major military operations and on our plans for the future.

The international community and the Iraqi people face an enormous task in the reconstruction of the Iraqi economy. A quarter century of repression and economic mismanagement under Saddam Hussein cut the size of the economy to only a small fraction of what it was before his regime took over. In 1979, GDP in Iraq was $128 billion in PPP (purchasing power parity) terms; by 2001, it had declined to about $40 billion. And income per capita has plummeted, impoverishing the Iraqi people. While the world economy expanded, the Iraqi economy shrunk. As a consequence, the Iraqi people fell way behind, from a rank of 76 in 1990 to a rank of 127 in 2001 on the UN Human Development Index.

While the reconstruction task is significant, the opportunities are great. Simply restoring the economy to what it was before Saddam will be a tremendous improvement in the well being of the Iraq people. Establishing a market economy based on clear property rights, a sound rule of law, and economic freedom will unleash a long tradition of entrepreneurship and build on the abundant human potential and natural resources of Iraq. I am confident that if these resources are used effectively, economic growth will soon be above, rather than well below, the world average.

Though there is much to do, I believe that we have already achieved important successes since the end of the major military operations, especially in the economic and financial areas. Over 1.5 million workers and pensioners have received salaries and emergency payments. Our financial experts in Baghdad report that Iraqis and other observers consider this act alone as a turning point in the mood of the city for many. These payments have enabled Iraqis to return to work to run the railroads, teach school children, or help in the payment of other Iraqis.

There are other successes. Since March 20, $1.7 billion of Saddam's assets have been vested; $1.2 billion have been frozen; and $0.9 billion in cash has been found in Iraq. Working with the international community, we have removed sanctions on the selling of Iraqi oil and we have agreed that the international financial institutions should provide needs assessments and technical assistance. Later this month in New York we will convene the first meeting of donors. I will provide more details on these and other accomplishments later in my testimony.

We have also achieved successes in avoiding catastrophic events that could have occurred; we were concerned about such events and took actions to prevent them. Instead of collapsing as many had feared, the Iraqi currency has recovered from its low levels at the start of the war. Hyperinflation has been avoided. Oil fields have been saved from destruction. There has been no humanitarian crisis. And the crippling burden of debt service payments has been lifted through the end of 2004 so that Iraq can focus on reconstruction needs.

These successes are due to the work of experienced and dedicated people and to the contingency plans laid out months in advance of the war. We began selecting members for our team of Treasury advisors back in January; the first wave was deployed to Kuwait in March and arrived in Baghdad in April. We have since sent over a dozen additional advisors with expertise in areas ranging from budgets, to payments systems, to monetary policy. Peter McPherson—former USAID Administrator and former Deputy Treasury Secretary—now serves as financial coordinator and adviser to Ambassador Bremer on economic and financial issues. He and his team have responsibility for working with Iraqis to get the Central Bank, the Finance Ministry, commercial banks and other financial institutions up and running. Their very first task on the ground was to assess conditions and evaluate the basic economic infrastructure, including the payments system. The work they are doing is similar to some of the tasks that we undertook in Afghanistan; indeed, while Treasury's work continues in Afghanistan, some of the same people who worked there have brought their experience to Iraq. I am in nearly constant contact with them through telephone and email, providing support and advice with the help of our Iraq Financial Task Force, Office of Technical Assistance, and others stationed here in Washington.

A Plan to Pay Workers and Pensioners

A top reconstruction priority from the start was to make emergency and salary payments to government workers and pensioners. Starting late last year we developed a contingency plan for such payments. The plan called for paying workers and pensioners in U.S. dollars on an interim basis. Making payments in dollars on an interim basis was not an attempt to dollarize the economy. On the contrary, the plan called for the continued use of dinars as an acceptable means of payment. Using dollars on an interim basis would create stability immediately after the war, as the dollar is a stable medium of exchange and a good store of value. By making sure that the spending on salaries was matched by the revenues available, the dollar payment plan also was a way to prevent inflationary financing.

To make this payment plan operational, financial resources were required. Hence, the first step in the plan was to vest the Iraqi regime assets that were frozen in the United States over a decade ago. The plan also required some functioning payroll system, so a high priority of our first wave of people on the ground was to assess the state of this system.

This plan is basically on track and has been successful thus far.

On March 20, President Bush vested $1.7 billion of assets and placed them in an account at the New York Fed to be used to support reconstruction. Treasury representatives, in close cooperation with the New York Fed and the Department of Defense, arranged the delivery of $199 million of these vested assets in three shipments from a storage facility in New Jersey to Andrews Air Force Base, where the currency was loaded on a transport and flown to the region. A fourth shipment of $358 million will be made shortly.

A mechanism for making emergency payments was quickly established on the ground, so that payments could commence for dock workers, rail workers, power plant workers, and others. At the same time, upon arriving in Iraq, our advisors conducted an assessment of the existing payroll system for salaries and pensions and found that adequate, functional procedures already existed. While this system will have to be updated over time, it provides the basic infrastructure for making salary and pension payments.

Despite tremendous logistical challenges, the system of payments has been a success. To date, over 1.5 million pensioners, civil servants, and workers crucial to the functioning of essential public services have received payments. Our advisors have played a key role, working closely with counterparts from the Defense Department and other agencies, in extending this initial financial life-line to the Iraqi people.

Establishing a Stable Currency

One of the most important objectives in the near-term is to promote the establishment of a stable, unified national currency. A currency that has the full faith and confidence of the Iraqi people, and which can be used as a store of value, is a prerequisite for establishing a vibrant economy.

The pre-existing currency situation in Iraq makes this a complex and difficult task. Iraq has not had a stable currency for some time; several currencies circulate widely in Iraq, including the Iraqi (or "Saddam") dinar in central and southern Iraq, the Old Iraqi (or "Swiss") dinar in the northern part of the country, and the U.S. dollar. The Saddam dinar has fallen dramatically in value over the past dozen years due to the policies of the Saddam Hussein regime. One dollar used to purchase only a third of a Saddam dinar under the official exchange rate; now, it will purchase about 1,200 dinars in the market.

One of our primary concerns was that the conflict and its aftermath would result in a massive depreciation of the Saddam dinar and hyperinflation. There were concerns about losing control over large warehouses of Saddam dinar notes and currency printing facilities.
And with the fall of the regime, there was the risk that the currency would cease to serve as an accepted means of exchange.

For these reasons, early action was taken to secure currency stocks and currency-printing facilities and stop the printing of the Saddam dinar. The military made public announcements that existing currencies in Iraq would continue to be accepted as means of payment. These measures helped stabilize the Saddam dinar and avert a monetary crisis. In fact, the Saddam dinar has actually strengthened in recent weeks—from a low of about 5,000 dinars per U.S. dollar during the conflict to approximately 1,200 per dollar today.

This achievement notwithstanding, a stable, unified currency system is essential for Iraq's long-run economic prospects. Several options exist for currency reform, including the introduction of a new currency or the replacement of Saddam dinars with Old Iraqi dinars. We stand ready to assist in the implementation of whichever option the people of Iraq choose through a representative, elected Iraqi government.

Development of an Iraqi Budget

Prior to the war, no Iraqi government budget was published. The lack of transparency and accountability in fiscal operations made it difficult to determine how resources were allocated or how revenues were raised.

Development of an integrated and transparent Iraqi government budget is necessary for ensuring that essential government services and reconstruction needs can be financed without resorting to printing money. Our advisors are working with personnel within the Ministry of Finance to develop an interim budget and to implement a centralized treasury mechanism for government spending. In addition, several Treasury advisors with expertise in tax systems will be working with Iraqi officials to revise the tax code and build the capacity of revenue agencies.

Initially, budgetary resources will derive primarily from returned Iraqi assets, oil sales, and donor contributions.

With the initiation of military action, the United States and its coalition partners acted to secure the Saddam Hussein regime's assets for the benefit of the Iraqi people. In addition to the rapid vesting of $1.7 billion of assets in the United States, we have spearheaded bilateral efforts that have led to the identification and freezing of about $1.2 billion of Iraqi assets outside of the United States since the beginning of the war. We are working with these countries to return them to the Iraqi people, as required by UNSCR 1483. The United States has deployed financial investigation teams to Iraq and other foreign jurisdictions to identify and recover additional Iraqi assets.

Efforts have also been made to secure assets inside of Iraq. Since the end of the conflict, approximately $900 million in currency has been found in various locations, in addition to $350 million of currency and gold discovered in vaults at the Central Bank of Iraq.

All of the vested assets in the United States, as well as the assets found in Iraq, will be used to assist the Iraqi people and support the reconstruction of Iraq.

Proceeds from the sale of Iraqi oil will be another critical source of funds. The Security Council resolution introduced by the U.S., Spain and the UK and approved unanimously last month provides immunity from attachment for Iraq's oil and proceeds from its sale through 2007. Oil revenues will be deposited in the Development Fund for Iraq, an account of the Central Bank of Iraq. The Coalition Provisional Authority now is working on the development of regulations to ensure transparency and accountability in the use and administration of oil proceeds and other revenues that will be deposited in the Development Fund for Iraq.

An important part of this effort will be the establishment of the International Advisory and Monitoring Board, which will be responsible for approving the auditors of the Development Fund for Iraq and reviewing their findings. Representatives from four international organizations—the IMF, the World Bank, the United Nations, and the Arab Fund for Social and Economic Development—will participate on this board. On May 24, Ambassador Bremer sent letters to the four organizations to initiate the process of constituting the board; I will chair a meeting later this month to finalize the terms of reference.

Role of the International Financial Institutions

Donor contributions will also play an important role in the reconstruction of Iraq. Active participation by the international financial institutions is important to mobilizing this international support.

I am pleased to report that the international financial institutions are intensifying their support for the process of reconstruction and recovery in Iraq. IMF and World Bank officials are traveling with the delegation of Sergio Vieira de Mello, the U.N. special representative for Iraq, on his trip to Iraq this week. In addition, IMF Managing Director Horst Köhler announced last week that he was prepared to send out a team to Baghdad for a fact-finding mission as early as this weekend. This team will work with the Coalition Provisional Authority and Iraqi officials to identify priority needs related to budget planning and execution, central bank functions, payments systems and banking sector reform, as well as the social safety net.

Later this month, the United Nations Development Program and the World Bank will co-host a donor meeting in New York to launch a coordinated, international effort to support Iraq's reconstruction needs and lay the groundwork for a donor conference in late summer after the World Bank has completed its needs assessment of Iraq.

Reforming the Banking Sector

Strengthening and modernizing the banking sector is central to achieving overall economic progress in Iraq. We are still in the early stages of assessing the banking system. We know, however, that Iraqi banks were oriented much more toward the fulfillment of Ba'athist political objectives than toward financial intermediation and other economic services that one normally associates with banks. Essentially, Iraqi banks were vehicles for storing and moving cash around the country, and in some cases outside the country.

Our overarching objective in this area is to help Iraq restore its banking sector and ensure that it begins to function in a commercially viable way. We want Iraq's banking sector to be a vehicle for sound economic growth, to meet the needs of the Iraqi people, and to reflect regional as well as international best practices. For example, we endorse the objective of Iraqis having access to financial products and services that are based on Islamic principles.

Creating a sound supervisory and regulatory regime is a critical step to establishing a sound financial system. We are working with the Iraqis to help them bring this about. To this end, we will be working with governments in the region that have strong systems and have offered technical assistance for the banking sector.

Iraq's Foreign Debt

An issue that has garnered much attention and will clearly have to be addressed is Iraq's capacity to address the potentially enormous burden of its existing financial obligations. Estimates of Iraqi external debt range from $60 billion to $130 billion. Whatever the precise level, Iraq's external obligations are significant and must be addressed in a comprehensive manner.

In the near-term, we have taken two important steps put to address this situation. First and foremost, we have worked with our G-8 partners to provide Iraq with some breathing room. We achieved agreement that given Iraq's precarious financial situation, creditors should not expect Iraq to make any payments on its debt for at least the next eighteen months. Secondly, we have put a lot of people to work on what could be described as data forensics. On the creditor side of the ledger, we proposed at the last meeting of the Paris Club, and creditor governments agreed, to report the amount of debt they are currently owed. We have also approached the IMF for its assistance in determining the amount of debt owed to non-Paris Club governments. To address the other side of the ledger, we have placed Treasury advisors in Baghdad to go through Iraqi government debt records.

In the medium-term, once we have a better estimate of the true level of Iraq's debt, we can move forward to develop a comprehensive strategy to deal with Iraq's official debt. To supplement these efforts, we are providing a Treasury advisor to work with Iraqi officials to develop a notional strategy for external debt treatment.

Conclusion

Achieving our economic objectives in Iraq is central to achieving our ultimate goal of a stable, unified, and prosperous Iraq—one which provides opportunities for all Iraqis to forge a better future for themselves and their children. The challenges are formidable. We have a tough job ahead. Our achievements to date can be attributed to careful planning, vigilance to potential problems, and early action by dedicated and talented professionals to prepare for them. We will bring the same spirit to our work in the coming months.

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 4, 2003
JS-453

Treasury Department Begins State Fiscal Relief Payment Process Under Jobs and Growth Tax Relief Act

The U.S. Treasury Department today began the process of distributing $10 billion in temporary fiscal relief payments to states under the Jobs and Growth Tax Relief Reconciliation Act signed into law by President Bush on May 28, 2003.

"The Treasury Department will ensure that payments are made available as quickly as possible," said Treasury Secretary John W. Snow in a letter sent today to state governors.

Under the Act, which provides for a $5 billion payment to states in each of fiscal years 2003 and 2004, payments will be made to the 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa.

The Treasury letter to the governors outlined the steps that states must take to receive payments, which are determined by a state population-based formula included in the Act. In order to receive a payment, states must provide the Treasury with a certification that the state's proposed uses of the funds are to 1) provide essential government services, or 2) cover the costs to the state of complying with federal intergovernmental mandates, if the federal government has not provided funds to cover the costs. In addition, a state may only use the funds for types of expenditures permitted under the most recently approved budget for the state.

The Treasury letter included a certification form that states are asked to use to certify compliance with the statutory requirements. The certification must be printed on state letterhead, signed by the state's governor and the certification must be attested by the state's secretary of state in accordance with state law. The form also requests electronic routing information for the payments, which will be made in a lump sum.

A state may use a single certification for both FY 2003 and 2004 funds, or it may provide separate certifications for FY 2003 and 2004 funds. Once the Treasury receives a properly executed state certification for FY 2003 (whether separately or together with its FY 2004 certification), the state's designated account will be credited with the FY 2003 payment within two business days. If a state sends the Treasury a single certification for both FY 2003 and 2004, the Treasury will process that state's payment for FY 2004 on October 1, 2003.

If a state delays sending its certification to the Treasury (either for FY 2003 or 2004, or both), that state's payment also will be delayed. The Treasury must receive a state's FY 2003 properly executed certification no later than September 30, 2003 because the Treasury's authority to make the FY 2003 payment legally expires after that date. Similarly, the Treasury must receive a state's FY 2004 certification no later than September 30, 2004 because the Treasury's authority to make the FY 2004 payment legally expires after that date.

Related Documents:

- Secretary Snow's letter to state governors
- Certification form in Microsoft Word format
- Certification form in WordPerfect format
- Table listing states and payment amounts

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

June 4, 2003

Dear [State Governor]:

On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Act). Section 401(b) of this Act provides $10 billion in payments to states, of which $5 billion is to be paid in each of Federal fiscal years 2003 and 2004 to provide temporary state fiscal relief. The Treasury Department is the agency responsible for making these payments.

The Treasury Department will ensure that the payments are made available as quickly as possible. Under the formula in the Act, each state has available its proportionate share of the $5 billion appropriated by Congress for each of FY 2003 and FY 2004 based on the relative population of each state using the 2000 census data, adjusted to provide minimum payment amounts to smaller population jurisdictions. I have enclosed a document showing the amount each state is eligible to receive and this same information is also posted at www.treasury.gov.

To receive the fiscal relief funds available for your state, you must sign and deliver to the Treasury Department a statement certifying that your state's proposed uses of the funds are consistent with the provisions of the Act. Enclosed is a certification form that we ask you to use for this purpose. As indicated on the form, the Secretary of State or other authorized official must attest its authenticity in accordance with state law. Your state may use a single certification for both FY 2003 and FY 2004 funds, or it may provide separate certifications. Once the Treasury Department receives a properly executed state certification for FY 2003 (whether separately or together with its FY 2004 certification), within two business days the state's designated account will be credited for the FY 2003 payment.

If your state sends the Treasury Department a single certification for both FY 2003 and 2004, we will make the FY 2004 payment on October 1, 2003. If your state chooses to send a separate certification for
FY 2004, payment will be processed when the certification is received or October 1, 2003, whichever is later.

If you have any question regarding these payments, please contact Ken Carfine, Deputy Assistant Secretary, Fiscal Operations and Policy, at ken.carfine@do.treas.gov or on 202-622-0570.

Sincerely,

John W. Snow

Enclosures

INSTRUCTIONS:

1. ***Produce this form on letterhead stationery of the State, Commonwealth, or District. You may download an MS Word or WordPerfect version of this form from*** **http://www.treasury.gov**
2. ***Fax the signed and sealed certification to (202) 874-7015***
3. ***Deliver the original signed and sealed certification by overnight courier or personal delivery to the following address: Financial Management Service, Risk Management Division, Room 423 Liberty Center Building, 401 14th Street SW, Washington, DC 20227, Attention: Stephen M. Vajs***

CERTIFICATION

I, [*insert name of signatory*], [*select correct title of signatory*]{Governor}/{Mayor [*in the case of D.C. only*]} of the [*select correct title*] {State}/{Commonwealth}/{District} of ________________ (the "State"), certify that:

1. The State's proposed uses of the funds to be provided under any Federal payment made under section 401(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003 for the fiscal years designated below are to:
   (A) provide essential government services; or
   (B) cover the costs to the State of complying with any Federal intergovernmental mandate (as defined in section 421(5) of the Congressional Budget Act of 1974) to the extent that the mandate applies to the State, and the Federal Government has not provided funds to cover the costs.

2. The State will only use funds provided under any Federal payment made under section 401(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003 for types of expenditures permitted under the most recently approved budget for the State.

3. This certification covers the Federal payment for [*select and initial one or both of the following*]:
   Federal fiscal year 2003 _____
   Federal fiscal year 2004 _____

4. The following is the correct information respecting the account of the State to which the Department of the Treasury may, under the laws of the State, make the FedWire payment to the State provided under section 401(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003:

Name of financial institution ________________________________
Address of financial institution ________________________________
ABA number of financial institution ________________________________
Account no. ________________________________
Account name ________________________________

[*select correct title*]
{STATE}/{COMMONWEALTH}/{DISTRICT} OF____________________

By:

Signature: ________________________
Title: {Governor}/{Mayor [*in the case of D.C. only*]}
Date: ________________________

Attest:

Signature: ________________________
Title: {Secretary of State}/{*title of other authorized official*}
Date: ________________________

(Seal)

State Fiscal Relief Fund Available Under Section 401(b) the Jobs and Growth Tax Relief Reconciliation Act of 2003

State	FY 2003	FY 2004	Total
Alabama	$75,612,289.50	$75,612,289.50	$151,224,579.00
Alaska	$25,000,000.00	$25,000,000.00	$50,000,000.00
Arizona	$87,234,114.84	$87,234,114.84	$174,468,229.68
Arkansas	$45,454,767.10	$45,454,767.10	$90,909,534.20
California	$575,906,288.27	$575,906,288.27	$1,151,812,576.54
Colorado	$73,132,646.44	$73,132,646.44	$146,265,292.88
Connecticut	$57,903,480.18	$57,903,480.18	$115,806,960.36
Delaware	$25,000,000.00	$25,000,000.00	$50,000,000.00
District of Columbia	$25,000,000.00	$25,000,000.00	$50,000,000.00
Florida	$271,742,077.38	$271,742,077.38	$543,484,154.76
Georgia	$139,191,035.56	$139,191,035.56	$278,382,071.12
Hawaii	$25,000,000.00	$25,000,000.00	$50,000,000.00
Idaho	$25,000,000.00	$25,000,000.00	$50,000,000.00
Illinois	$211,160,346.69	$211,160,346.69	$422,320,693.38
Indiana	$103,384,091.24	$103,384,091.24	$206,768,182.48
Iowa	$49,755,134.24	$49,755,134.24	$99,510,268.48
Kansas	$45,710,112.24	$45,710,112.24	$91,420,224.48
Kentucky	$68,720,606.18	$68,720,606.18	$137,441,212.36
Louisiana	$75,984,238.51	$75,984,238.51	$151,968,477.02
Maine	$25,000,000.00	$25,000,000.00	$50,000,000.00
Maryland	$90,054,065.07	$90,054,065.07	$180,108,130.14
Massachusetts	$107,951,195.26	$107,951,195.26	$215,902,390.52
Michigan	$168,979,448.39	$168,979,448.39	$337,958,896.78
Minnesota	$83,643,963.56	$83,643,963.56	$167,287,927.12
Mississippi	$48,366,599.41	$48,366,599.41	$96,733,198.82
Missouri	$95,133,168.57	$95,133,168.57	$190,266,337.14
Montana	$25,000,000.00	$25,000,000.00	$50,000,000.00
Nebraska	$29,095,930.69	$29,095,930.69	$58,191,861.38
Nevada	$33,975,576.62	$33,975,576.62	$67,951,153.24
New Hampshire	$25,000,000.00	$25,000,000.00	$50,000,000.00
New Jersey	$143,065,878.48	$143,065,878.48	$286,131,756.96
New Mexico	$30,928,522.58	$30,928,522.58	$61,857,045.16
New York	$322,649,223.19	$322,649,223.19	$645,298,446.38
North Carolina	$136,859,298.16	$136,859,298.16	$273,718,596.32
North Dakota	$25,000,000.00	$25,000,000.00	$50,000,000.00
Ohio	$193,032,967.21	$193,032,967.21	$386,065,934.42
Oklahoma	$58,670,110.68	$58,670,110.69	$117,340,221.37
Oregon	$58,172,699.44	$58,172,699.44	$116,345,398.88
Pennsylvania	$208,809,923.43	$208,809,923.43	$417,619,846.86
Rhode Island	$25,000,000.00	$25,000,000.00	$50,000,000.00
South Carolina	$68,214,659.63	$68,214,659.63	$136,429,319.26
South Dakota	$25,000,000.00	$25,000,000.00	$50,000,000.00
Tennessee	$96,732,637.73	$96,732,637.73	$193,465,275.46
Texas	$354,535,281.54	$354,535,281.54	$709,070,563.08
Utah	$37,969,692.82	$37,969,692.82	$75,939,385.64
Vermont	$25,000,000.00	$25,000,000.00	$50,000,000.00
Virginia	$120,353,202.19	$120,353,202.19	$240,706,404.38
Washington	$100,215,417.56	$100,215,417.56	$200,430,835.12
West Virginia	$30,746,560.69	$30,746,560.69	$61,493,121.38
Wisconsin	$91,196,453.17	$91,196,453.17	$182,392,906.34
Wyoming	$25,000,000.00	$25,000,000.00	$50,000,000.00
American Samoa	$5,000,000.00	$5,000,000.00	$10,000,000.00
Guam	$5,000,000.00	$5,000,000.00	$10,000,000.00
N. Mariana Islands	$5,000,000.00	$5,000,000.00	$10,000,000.00
Puerto Rico	$64,756,295.56	$64,756,295.56	$129,512,591.12
Virgin Islands	$5,000,000.00	$5,000,000.00	$10,000,000.00
Total	$5,000,000,000.00	$5,000,000,000.00	$10,000,000,000.00

FROM THE OFFICE OF PUBLIC AFFAIRS

June 4, 2003
JS-454

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $82,510 million as of the end of that week, compared to $82,908 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	May 23, 2003			May 30, 2003		
TOTAL	82,908			82,510		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	7,815	13,461	21,277	7,802	13,163	20,964
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,717	2,703	15,420	12,702	2,643	15,345
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			23,390			23,383
3. Special Drawing Rights (SDRs) [2]			11,778			11,775
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	May 23, 2003			May 30, 2003		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	May 23, 2003			May 30, 2003		

	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to the prior week's IMF data. IMF data for the latest week may be subject to revision. IMF data for the prior week are final.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 03, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term:	28-Day Bill
Issue Date:	June 05, 2003
Maturity Date:	July 03, 2003
CUSIP Number:	912795NB3

High Rate: 1.140% Investment Rate 1/: 1.164% Price: 99.911

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 45.74%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 40,270,500	$ 17,951,740
Noncompetitive	48,302	48,302
FIMA (noncompetitive)	0	0
SUBTOTAL	40,318,802	18,000,042
Federal Reserve	2,283,253	2,283,253
TOTAL	$ 42,602,055	$ 20,283,295

Median rate 1.130%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.110%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 40,318,802 / 18,000,042 = 2.24

1/ Equivalent coupon-issue yield.

JS-455

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 04, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 8-DAY BILLS

Term:	8-Day Bill
Issue Date:	June 05, 2003
Maturity Date:	June 13, 2003
CUSIP Number:	912795QF1

High Rate: 1.170% Investment Rate 1/: 1.190% Price: 99.974

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 45.75%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 52,225,000	$ 18,000,000
Noncompetitive	0	0
FIMA (noncompetitive)	0	0
SUBTOTAL	52,225,000	18,000,000
Federal Reserve	0	0
TOTAL	$ 52,225,000	$ 18,000,000

Median rate 1.150%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.130%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 52,225,000 / 18,000,000 = 2.90

1/ Equivalent coupon-issue yield.

JS 456

Bureau of the Public Debt
United States Department of the Treasury

Public Debt Announces Activity for Securities in the STRIPS Program for May 2003

FOR IMMEDIATE RELEASE

June 5, 2003

The Bureau of the Public Debt announced activity for the month of May 2003, of securities within the Separate Trading of Registered Interest and Principal of Securities program (STRIPS).

	In Thousands
Principal Outstanding (Eligible Securities)	$2,319,001,152
Held in Unstripped Form	$2,144,301,945
Held in Stripped Form	$174,699,207
Reconstituted in May	$28,765,014

The accompanying table, gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. These monthly figures are included in Table V of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form."

The STRIPS table, along with the new Monthly Statement of the Public Debt, is available on Public Debt's Internet site at: www.publicdebt.treas.gov. A wide range of information about the public debt and Treasury securities is also available at the site.

JS 457

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 6, 2003
JS-458

U.S. Designates 17 Individuals Linked to AL Qaida
Designation Supports Actions Taken by Italy and Germany

WASHINGTON, DC – Highlighting international cooperation in fighting the financing of terror, the U.S. Treasury Department today joined Italy in designating 16 individuals associated with the Algerian based Armed Islamic Group (GIA). In addition, Treasury designated Abdelghani Mzoudi, a member of the Hamburg, Germany, al Qaida cell that planned the September 11th attacks on America, in support of German action against Mzoudi. With the support of the United States, Italy and Germany have submitted these names to the United Nations 1267 Committee.

"These designations signal continued commitment and momentum within the international community to shut down the funding of terror. I applaud the Italians and Germans for taking action against these individuals," U.S. Treasury Secretary John Snow stated.

Today's action is one of many the U.S. has taken in collaboration with our international partners. Most recently, on May 29, the U.S. joined several European countries in designating the al-Aqsa International Foundation, a charity funding Hamas. In addition to Italy and Germany, we have taken joint actions with Saudi Arabia, Australia, the European Union, the G7, and others. If there are no objections from the UN 1267 committee, all UN member states will be required to designate these 17 individuals on Tuesday.

A list of those designated is attached. These designations prohibit transactions between U.S. persons and these individuals and freeze any assets in the United States. Additional background materials are available by calling Treasury Public Affairs.

INDIVIDUALS DESIGNATED

Designated Jointly with the Italian Government
ABDAOUI Youssef, alias Abu ABDULLAH, alias ABDELLAH, alias ABDULLAH.
AKLI Mohamed Amine, alias Mohamed Amine Akli, alias Killech Shamir (names also used in Spain), alias Kali Sami, alias Elias
AMDOUNI Mehrez, alias FUSCO Fabio, alias HASSAN Mohamed, alias ABU Thale
(name used in Spain)
AYARI Chiheb Ben Mohamed, alias HICHEM Abu Hchem
BAAZAOUI Mondher alias HAMZA
DUMONT Lionel, alias BILAL, alias HAMZA, alias BROUGERE Jacques
ESSAADI Moussa Ben Amor, alias DAH DAH, alias ABDELRAHMMAN, alias BECHIR
FETTAR Rachid, alias Amine del Belgio, alias Djaffar
HAMAMI Brahim Ben Hedili
JARRAYA Khalil alias YARRAYA Khalil, alias ABDEL' Aziz Ben Narvan, alias AMRO, alias OMAR, alias AMROU, alias AMR.
JARRAYA Mounir Ben Habib, alias YARRAYA.
JENDOUBI Faouzi, alias SAID, alias SAMIR.
MNASRI Fethi Ben Rebai, alias AMOR, alias ABU Omar, alias ALIC Fethi
OUAZ Najib

RARRBO Ahmed Hosni, alias ABDALLAH o ADDULLAH
SALEH Nedal, alias HITEM.

Designated in Support of the German Government

Abdelghani Mzoudi (alternate spelling Mazwati or Mazuti)

FROM THE OFFICE OF PUBLIC AFFAIRS

June 6, 2003
JS-459

Secretary Snow to Travel to Mexico

Secretary Snow will visit Mexico City, Mexico June 11 through 12. On Wednesday, June 11th, Secretary Snow will participate in a bilateral meeting with Mexican President Vicente Fox and Finance Minister Gil Diaz to discuss economic issues. On Thursday, June 12th, Secretary Snow will join President Fox in a ceremony to retire Mexico's "Brady Bonds."

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 6, 2003
JS-460

Treasury and IRS Propose Regulations for Incentive Stock Options

Today, the Treasury Department and the IRS issued proposed regulations on incentive stock options ("ISOs"). When finalized, these regulations will update the existing regulations to conform to current law, and will replace regulations proposed in 1984.

ISOs provide employees with the ability to acquire employer stock without realizing income when the option is exercised. If the employee holds the stock a required period, any gains on sale of the stock are capital. The exercise price for an ISO must be no less than the fair market value of the stock when the option is issued. An ISO plan must be approved by shareholders, and the amount of ISOs that can be granted to an employee is limited. The employer does not get a deduction.

In addition to restating the existing rules, the new proposed regulations include updated rules addressing current issues and practices, such as ISOs issued by limited liability companies and other entities that elect corporate tax treatment.

The proposed regulations will apply 180 days after publication of final regulations. Taxpayers may rely on these proposed regulations for any ISO granted after June 9, 2003.

The text of the proposed regulations is attached.

Related Documents:

- Statutory Options

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 14a

[REG-122917-02]

RIN 1545-BA75

Statutory Options

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; withdrawal of previous rulemaking; and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to statutory options. These proposed regulations affect certain taxpayers who participate in the transfer of stock pursuant to the exercise of incentive stock options and the exercise of options granted pursuant to an employee stock purchase plan (statutory options). These proposed regulations provide guidance to assist these taxpayers in complying with the law in addition to clarifying rules regarding statutory options. This document also withdraws a previous notice of proposed rulemaking.

DATES: Written and electronically submitted comments and requests to speak, with outlines of topics to be discussed at the public hearing scheduled for September 2, 2003, must be received by August 12, 2003.

ADDRESSES: Send submissions to CC:PA:RU (REG-122917-02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:PA:RU (REG-122917-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC or sent electronically, via the IRS Internet site www.irs.gov/regs. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Erinn Madden at (202) 622-6030 (not a toll-free number). To be placed on the attendance list for the hearing, please contact Guy Traynor at (202) 622-7180.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by August 8, 2003. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in 1.6039-1. Section 6039 of the Code requires all corporations that transfer stock to any person pursuant to the exercise of a statutory option to furnish that person with a written statement describing the transfer. Additionally, the corporation may be required to furnish the person a second written statement when the stock originally transferred pursuant to the exercise of the statutory option is subsequently disposed of by the person. The information on the statements required to be provided by the corporation will be used by recipients to complete their income tax returns in the year of the disposition of the statutory option stock. The likely respondents are for-profit corporations.

Estimated total annual reporting burden: 16,650 hours.

Estimated average annual burden hours per respondent; 20 minutes.

Estimated number of respondents: 50,000.

Estimated annual frequency of responses: annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to 26 CFR part 1 under sections 421, 422, and, 424 of the Internal Revenue Code (Code). Changes to the applicable tax law concerning section 421 were made by sections 11801 and 11821 of the Omnibus Budget Reconciliation Act of 1989, Public Law 101-508 (104 Stat. 1388). Changes to the applicable tax law concerning section 424 were made by section 1003 of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Public Law 100-647 (102 Stat. 3581), sections 11801 and 11821 of the Omnibus Budget Reconciliation Act of 1989 (OBRA 89), Public Law 101-508 (104 Stat. 1388), which included re-designating section 425 as section 424 of the Code, and section 1702(h) of the Small Business Job Protection Act of 1996, Public Law 104-188 (110 Stat. 1755). Changes concerning section 422 were made by section 251 of the Economic Recovery Tax Act of 1981 (95 Stat. 172), which added section 422A to the Code. Related changes to section 422A were made by section 102(j) of the Technical Corrections Act of 1982, Public Law 97-448, section 321(a) of Tax Reform Act of 1986 (96 Stat. 2365), Public Law 99-514 (100 Stat. 2807), section 1003(d) of TAMRA, and sections 11801 and 11821 of OBRA 89, which included re-designating section 422A as section 422 of the

Code.

Regulations under section 421 governing the requirements for restricted stock options and qualified stock options, as well as options granted under an employee stock purchase plan, were published in the **Federal Register** on December 9, 1957 (TD 6276), November 26, 1960 (TD 6500), January 18, 1961 (TD 6527), January 20, 1961 (TD 6540), December 12, 1963 (TD 6696), June 23, 1966 (TD 6887), July 24, 1978 (TD 7554), and November 3, 1980 (TD 7728). Temporary regulations under section 422A providing guidance and transitional rules related to incentive stock options were published in the **Federal Register** on December 17, 1981 (TD 7799) and September 18, 1992 (TD 8435). Final regulations under section 422 related to stockholder approval were published in the **Federal Register** on December 1, 1988 (TD 8235) and November 29, 1991 (TD 8374). Regulations under section 425 were published in the **Federal Register** on June 23, 1966 (TD 6887).

Proposed changes to the final regulations under sections 421, 424, and 6039 and proposed regulations under section 422A were previously published in the **Federal Register** at 49 FR 4504 on February 7, 1984 (the 1984 proposed regulations). With the exception of certain stockholder approval rules that were published in the **Federal Register** on June 23, 1966 (TD 6887) and amended by TD 7728 on October 31, 1980, the 1984 proposed regulations provided a comprehensive set of rules under section 422 of the Code. The 1984 proposed regulations are withdrawn.

In general, the income tax treatment of the grant of an option to purchase stock in connection with the performance of services and of the transfer of stock pursuant to the exercise of such option is determined under section 83 of the Code and the regulations thereunder. However, section 421 of the Code provides special rules for determining the income tax treatment of the transfer of shares of stock pursuant to the exercise of an option if the requirements of section 422(a) or 423(a), as applicable, are met. Section 422 applies to incentive stock options, and section 423 applies to options granted under an employee stock purchase plan (collectively, statutory options).

Under section 421, if a share of stock is transferred to an individual pursuant to the exercise of a statutory option, there is no income at the time of exercise of the option with respect to such transfer, and no deduction under section 162 is allowed to the employer corporation with respect to such transfer. However, pursuant to section 56(b)(3), section 421 does not apply with respect to the exercise of an incentive stock option for purposes of the individual alternative minimum tax.

Section 422(a) of the Code provides that section 421 applies to the transfer of stock to an individual pursuant to the exercise of an incentive stock option if (i) no disposition of the share is made within 2 years from the date of grant of the option or within 1 year from the date of transfer of the share, and (ii) at all times during the period beginning on the date of grant and ending on the day 3 months before the exercise of the option, the individual is an employee of either the corporation granting the option or a parent or subsidiary of such corporation, or a corporation (or a parent or subsidiary of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies. Section 422(b) provides several requirements that must be met for an option to qualify as an incentive stock option. Section 422(c) provides special rules applicable to incentive stock options, and section 422(d) provides a $100,000 limitation with respect to incentive stock options.

Section 424 of the Code provides special rules applicable to statutory options, including rules concerning the modification of statutory options and the substitution or assumption of an option by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation. Section 424 also contains definitions of certain terms, including disposition, parent corporation, and subsidiary corporation. Finally, section 424 provides special rules related to attribution of stock ownership and the effect of stockholder approval on the date of grant of a statutory option.

Explanation of Provisions

Overview

These proposed regulations would provide a set of comprehensive rules governing incentive stock options. These proposed regulations incorporate many of the rules contained in the 1984 proposed regulations, although these proposed regulations are re-numbered and re-organized. These proposed regulations would also make changes to the final regulations under sections 421 and 424 to provide additional guidance, as discussed below, in certain areas, to reflect the new organizational structure of the statutory option rules (including the re-designation of §1.425-1 as §1.424-1), and to remove obsolete rules and cross-references.

Section 421: General Rules

The proposed regulations under section 421 would remove obsolete provisions and update the cross-references to reflect amendments to the applicable statutes and re-organization of the regulations. These proposed regulations also incorporate many provisions of the 1984 proposed regulations. There are two sections of these proposed regulations under section 421: §1.421-1, which would provide rules concerning the meaning and use of terms, and §1.421-2, which would provide general rules regarding the application of section 421.

The terms defined in §1.421-1 of these proposed regulations are the same as those previously defined in §1.421-7, but these proposed regulations make changes to the definitions of certain terms. For example, §1.421-1(a) of these proposed regulations expands the definition of <u>option</u> to include warrants.

These proposed regulations would provide that an option must be evidenced in paper or in an electronic form. Under either form, however, the option must be enforceable under applicable law. Similarly, these proposed regulations provide that the plan pursuant to which incentive stock options are granted must be in paper or electronic form, provided that the paper or electronic form establishes an enforceable plan.

In addition, as with any taxpayer record, the form used for the option or plan, whether paper or electronic, must be one that provides adequate substantiation of the applicability of section 421. Thus, for example, the form must be one that provides adequate substantiation of the applicable requirements, such as the date on which the option is granted, the number of shares subject to the option, and the option price. In addition, the taxpayer must retain records relating to the option that are sufficient to comply with section 6001 and the regulations thereunder. If these records are kept electronically, the records must meet the requirements of Rev. Proc. 97-22 (1997-1 C.B. 652), or subsequent guidance, and if the records are kept in an ADP system, the records must meet the requirements of Rev. Proc. 98-25 (1998-11 I.R.B. 7), or subsequent guidance.

The definition of statutory option in §1.421-1(b) of these proposed regulations is revised to provide that a statutory option may include an option transferred to a trust if, under section 671 and applicable state law, the individual to whom the option was granted remains the beneficial owner. In contrast, these proposed regulations provide that a transfer of a statutory option incident to divorce will result in the option failing to qualify as a statutory option as of the date of transfer.

Section 1.421-1(i) of these proposed regulations defines corporation to have the same meaning prescribed by section 7701(a)(3) and §301.7701-2(b). Thus, for example, a corporation includes an S Corporation, a foreign corporation, and a limited liability corporation that is treated as a corporation for all Federal tax purposes. In addition, section 1.421-1(d) of these proposed regulations provides that stock includes ownership interests other than capital stock. Thus, under these proposed regulations, it would be permissible for any entity that is classified as a corporation for federal tax purposes pursuant to the provisions of §301.7701-2(b) to grant statutory stock options with respect to ownership interests in that entity.

Section 1.421-2 of these proposed regulations incorporates both the provisions of §1.421-8 and many of the related provisions of the 1984 proposed regulations. These proposed regulations also provide further revisions, including specifying that the deduction in connection with a disqualifying disposition is allowed only if otherwise allowable under sections 83(h) and 162 and if the reporting requirements under §1.83-6(a) are met.

Section 422: Incentive Stock Options

The proposed regulations under section 422 would provide a new set of comprehensive rules, with the exception of the rules regarding stockholder approval described in §1.422-5 of the final regulations (re-numbered as §1.422-3 by these proposed regulations). There are four sections under these proposed regulations: §1.422-1, general rules; §1.422-2, definition of incentive stock option; §1.422-4, the $100,000 limitation; and §1.422-5, permissible provisions.

1. Special rules regarding disqualifying dispositions

The 1984 proposed regulations provided rules concerning the consequences of disqualifying dispositions. The general disqualifying disposition rules for incentive stock options are provided in §§1.421-2(b)(1) and 1.422-1(b)(1) of these proposed regulations. In addition, §1.422-1(b)(2) of these proposed regulations clarifies the operation of the special rules applicable to a disqualifying disposition of an incentive stock option under section 422(c)(2) (section 422A(c)(2), prior to amendment by OBRA 89).

The general rules concerning disqualifying dispositions are described in §1.421-2(b) of these proposed regulations. Under these rules, if there is a disqualifying disposition of a share of stock, the special tax treatment provided by section 421 and §1.421-2(a) does not apply to the transfer of the share. Instead, the exercise of the option is treated as the exercise of a nonstatutory option under §1.83-7. Thus, in the taxable year in which the disqualifying disposition occurs, the individual must recognize compensation income equal to the fair market value of the stock on the date the stock is transferred less the exercise price (determined without reduction for any brokerage fees or other costs paid in connection with the disposition). A deduction attributable to the transfer of the share of stock pursuant to the exercise of the option is allowable for the taxable year in which such disqualifying disposition occurs, to the employer corporation, its parent or subsidiary corporation, or a corporation substituting or assuming an option in a transaction to which §1.424-1(a) applies, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met.

Section 422(c)(2), however, provides a special rule that is applicable if an individual makes a disqualifying disposition of stock acquired through the exercise of an incentive stock option and if the disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized by the individual. Under this special rule, the amount includible in gross income on the disqualifying disposition, and the amount deductible, as compensation attributable to the exercise of the option, shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of the share. Under section 422(c)(2), this special rule is not applicable if the disposition is a sale or exchange with respect to which a loss (if sustained) would not be recognized by the individual. Section 1.422A-1(b)(2) of the 1984 proposed regulations described these special rules concerning the disqualifying disposition of an incentive stock option and this description is incorporated into §1.422-1(b)(2) of these proposed regulations.

For example, if the disposition is a sale described in section 1091 (relating to a loss from wash sales of stock or securities), a gift, or a sale described in section 267(a)(1) (relating to sales between related parties), any loss sustained would not be recognized. Because a loss in any of these transactions would not be recognized, under §1.422-1(b)(2)(ii) of these proposed regulations, the special rule provided in §1.422-1(b)(2)(i) of these proposed regulations does not apply. Instead, the general rules for disqualifying dispositions described in §1.421-2(b) of these proposed regulations apply.

For example, assume E, an employee of Corporation X, is granted an incentive stock option to acquire X stock. The option price on the date of grant is $100 (the fair market value of X stock on the date of grant). E exercises the option and is transferred X stock when the fair market value of the stock is $200. E later sells the stock for $150 to M before the applicable holding periods expire. Because the sale is a disqualifying disposition that meets the requirements of §1.422-1(b)(2)(i) of these proposed regulations, in the taxable year of the disqualifying disposition, E is only required to include $50 (the excess of the amount realized on the sale, $150, over the adjusted basis of the share, $100) in gross income as compensation attributable to the exercise of the option. For its taxable year in which the disqualifying disposition occurs, X is allowed a compensation deduction of $50 attributable to E's exercise of the option, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met.

In this example, however, if 10 days after the sale to M, E purchases substantially identical stock, under section 1091, a loss would not be recognized on the sale to M. Thus, under §1.422-1(b)(2)(ii) of these proposed regulations, the special rule in § 1.422-1(b)(2)(i) does not apply. Instead of including $50 in gross income in the taxable year of the disqualifying disposition, E must include $100 (the difference between the fair market value of X stock on the date of transfer, $200, and the exercise price, $100) in gross income as compensation attributable to the exercise of the option. In the taxable year in which the disqualifying disposition occurs, X is allowed a compensation deduction of $100 attributable to E's exercise of the option if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met.

Since the 1984 proposed regulations were issued, there have been no changes in section 422(c)(2) (other than the redesignation of section 422A(c)(2) as 422(c)(2) by OBRA 89), and these proposed regulations do not make any substantive changes to the 1984 proposed regulations.

2. Stockholder approval of incentive stock option plan

Among other requirements, to qualify as an incentive stock option, the option must be granted pursuant to a plan which is approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted. See section 422(b). These proposed regulations would provide the same basic requirements for stockholder approval as those included in the 1984 proposed regulations.

These proposed regulations, however, would provide additional guidance concerning the circumstances in which stockholder approval is required. As under the 1984 proposed regulations, stockholder approval is required if there is a change in the aggregate number of shares or in the employees (or class or classes of employees) eligible to be granted options under the plan. In addition, while the standard for determining when stockholder approval is required is the same as under the 1984 proposed regulations, these proposed regulations clarify these requirements and provide a more complete list of situations that require new stockholder approval of the plan by specifically including a change in the shares with respect to which options are issued or a change in the granting corporation. Thus, for example, assume that S, a subsidiary of P, adopts an incentive stock option plan under which incentive stock options for S stock will be granted to S employees, and the plan is approved by the stockholders of S (in this case, P) within the applicable 24-month period. If S later amends the plan to provide for the grant of incentive stock options to acquire P stock (rather than S stock), S must obtain approval from the stockholders of S within 12 months before or after the date of the amendment to the plan because the amendment of the plan to allow the grant of options for P stock is considered the adoption of a new plan.

These proposed regulations also would provide additional guidance regarding the application of the stockholder approval requirements in the context of the substitution or assumption of an option by reason of a corporate transaction. For a discussion of these rules, see the "Substitution, assumption, and modification of options" portion of the preamble.

3. $100,000 limitation

Section 422(d)(1) provides that to the extent that the aggregate fair market value of stock with respect to which incentive stock options (determined without regard to section 422(d)) are exercisable for the first time by any individual during the calendar year (under all of plans of the employer corporation and any related corporation) exceeds $100,000, such options are not treated as incentive stock options. Under section 422(d)(2), options are taken into account in the order in which they are granted. Section 422(d)(3) provides that the fair market value of stock is determined at the time the option is granted.

The 1984 proposed regulations provided no rules concerning the operation of the $100,000 limitation because these provisions were enacted in 1986. However, Notice 87-49 (1987-2 C.B. 355) provides general guidance about the operation of the $100,000 limitation, including examples illustrating the application of this limitation.

Section 1.422-4 of these proposed regulations provides guidance on the operation of the $100,000 limitation that incorporates and expands on the guidance provided in Notice 87-49. Section 1.422-4(a)(1) of these proposed regulations provides that an option that otherwise qualifies as an incentive stock option nevertheless fails to be an incentive stock option to the extent the $100,000 limitation is exceeded.

To determine whether the $100,000 limitation has been exceeded, the rules provided in §1.422-4(b) of these proposed regulations would apply. Under these proposed regulations, an option that does not qualify as an incentive stock option when granted (including an option which contains terms providing that it will not be treated as an incentive stock option) is disregarded. Additionally, the fair market value of stock is determined on the date of grant of the option. Except as described in the following paragraph, options are taken into account in the order in which they are granted.

An option is considered to be first exercisable during a calendar year if the option will first become exercisable at any time during the year, assuming that any condition on the optionee's ability to exercise the option related to the performance of services is satisfied. If an optionee is able to exercise the option in a year only if an acceleration provision is satisfied, then the option is exercisable in that year only if the acceleration provision is triggered prior to the end of that year. After an acceleration provision is triggered, for purposes of applying the $100,000 limitation, the options subject to such provision and all other options first exercisable during a calendar year are then taken into account in the order in which granted. However, because an acceleration provision is not taken into account prior to its triggering, an incentive stock option that becomes exercisable for the first time during a calendar year by operation of such a provision does not affect the application of the $100,000 limitation with respect to an option (or portion thereof) exercised prior to such acceleration. An acceleration provision includes, for example, a provision that accelerates the exercisability of an option on a change in ownership or control or a provision that conditions exercisability on the attainment of a performance goal. See §1.422-4(d), Example 4 of these proposed regulations.

For example, assume that in 2006, E, an employee of Y Corporation, is granted Option 1 for stock of Y with a fair market value on the date of grant of $75,000. Option 1 is first exercisable in 2008, except that the option provides that it will become immediately exercisable in the event of a change in control. In 2007, E is granted Option 2 for stock of Y with a fair market value on the date of grant of $50,000. Option 2 is immediately exercisable, and E exercises Option 2. A change in control of Y occurs in 2007, after E has exercised Option 2, and Option 1 becomes immediately exercisable. Notwithstanding the fact that Option 1 was granted prior to Option 2, because the acceleration clause is not taken into account until it is triggered and because E exercised Option 2 prior to the change in control, Option 2 is an incentive stock option in its entirety. Option 1 is bifurcated into an incentive stock option to acquire stock with a fair market value of $50,000 on the date of grant and a nonstatutory option to acquire stock with a fair market value of $25,000 on the date of grant.

If the change in control instead occurred prior to E's exercise of Option 2, then Option 1, which was granted first, is treated as an incentive stock option in its entirety, and Option 2 is bifurcated into an incentive stock option to acquire stock with a fair market value of $25,000 on the date of grant and a nonstatutory option to acquire stock with a fair market value of $25,000 on the date of grant.

These proposed regulations also would provide that an option is disregarded for purposes of the $100,000 limitation if, prior to the calendar year during which it would have otherwise become exercisable for the first time, the option is modified and thereafter ceases to be an incentive stock option, is transferred in violation of the nontransferability requirements, or is canceled. In all other situations, a modified, transferred, or canceled option (or portion thereof) is treated as outstanding until the end of the calendar year during which it would otherwise have become exercisable for the first time.

Finally, under these proposed regulations, a disqualifying disposition has no effect on the determination of whether an option exceeds the $100,000 limitation. Thus, for example, assume Corporation X grants E, an employee of X, Option 1 to acquire X stock with a fair market value on the date of grant of $75,000. Option 1 is exercisable on January 1, 2005. On January 5, 2005, E exercises the option and sells the stock in a disqualifying disposition. On January 15, 2005, X grants E Option 2 to acquire X stock with a fair market value on the date of grant of $50,000. Option 2 is immediately exercisable. Under §1.422-4(b)(6) of the proposed regulations, the disqualifying disposition of Option 1 has no effect on the application of the $100,000 limitation. Thus, Option 2 is bifurcated into an incentive stock option to acquire stock with a fair market value of $25,000 on the date of grant and a nonstatutory option to acquire stock with a fair market value of $25,000 on the date of grant.

4. Permissible provisions

These proposed regulations also provide guidance on additional provisions that may be included in an incentive stock option. Because these provisions are not part of the requirements for an incentive stock option, they are addressed separately in §1.422-5 of these proposed regulations (many of these rules were previously in §1.422A-2(i) of the 1984 proposed regulations). Section 1.422-5 of these proposed regulations addresses provisions permitting cashless exercise, providing the right to receive additional compensation, and providing alternative rights. In each case, these proposed regulations essentially retain the rules described in the 1984 proposed regulations.

Section 424: Definitions and Special Rules

These proposed regulations re-designate the regulations under section 425 as regulations under section 424 and update the regulations. For example, these proposed regulations amend the definition of disposition to exclude a transfer of a share of stock acquired pursuant to the exercise of a statutory option if the transfer is described in section 1041(a) (concerning transfers between spouses or former spouses incident to divorce).

Substitution, Assumption, and Modification of Options

Section 424(h)(1) provides that if the terms of an option are modified, extended, or renewed, such modification, renewal, or extension is treated as the grant of a new option. Under section 424(h)(3), the term modification (with certain exceptions) means any change in the terms of an option which gives the optionee additional benefits under the option. One exception to this definition is that a change in the terms of an option attributable to a substitution or an assumption that meets the requirements of section 424(a) is not a modification of an option.

These proposed regulations would provide that an eligible corporation (as defined in §1.424-1(a)(2) of these proposed regulations) may by reason of a corporate transaction (as defined in §1.424-1(a)(3) of these proposed regulations) substitute a new statutory option (new option) for an outstanding statutory option (old option) or assume an old option without the substitution or assumption being considered a modification of the old option under section 424(h).

An eligible corporation is defined as a corporation that is the employer of an optionee or a related corporation of such corporation. The determination of whether a corporation is the employer of the optionee or a related corporation of such corporation is based upon the circumstances existing immediately after the corporate transaction.

Under the proposed regulations, a corporate transaction is (i) a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation; (ii) a distribution (excluding ordinary dividends), or change in the terms or number of outstanding shares of such corporation, such as a stock split or stock dividend (a change in capital structure); (iii) a change in the name of a corporation whose stock is purchasable under the old option; and (iv) such other corporate events as may be prescribed by the Commissioner in published guidance.

The definitions of eligible corporation and corporate transaction would be expanded under these proposed regulations. Specifically, these proposed regulations permit corporations with outstanding options to substitute or assume an option under §1.424-1(a) if there is a corporate transaction. Additionally, the definition of corporate transaction includes events, such as a stock dividend or stock split, that were previously addressed in §1.425-1(e) of the final regulations, and is otherwise expanded so that events or transactions with similar consequences are treated the same. Because of these changes, the rules in §1.425-1(e)(5)(ii) of the current regulations would be removed.

These proposed regulations also would eliminate the requirement contained in §1.425-1(a)(1)(ii) of the final regulations that the corporate transaction result in a significant number of employees being transferred to a new employer or discharged or in the creation or severance of a parent-subsidiary relationship. However, §1.424-1(a)(4) of these proposed regulations would continue to impose, and provide additional guidance concerning, the requirement that the substitution or assumption be "by reason of" the corporate transaction.

Under these proposed regulations, a change in an option or issuance of a new option is considered to be by reason of a corporate transaction unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction. For example, a change in an option or issuance of a new option is considered to be made for reasons unrelated to such a corporate transaction if there is an unreasonable delay between the corporate transaction and such change in the option or issuance of a new option or if the corporate transaction serves no substantial corporate business purpose independent of the change in options. A change in an option or issuance of a new option is not by reason of a distribution or change in the terms or number of outstanding shares unless the option as changed, or the new option, is issued on the stock of the same corporation, or if such class of stock is eliminated by the change in capital structure, on other stock of the same corporation. For purposes of a change in name of the corporation, the issuance of a new option is by reason of the change in name of the corporation only if the option issued is on stock of the successor corporation.

These proposed regulations do not otherwise revise the requirements that must be met for a change in an option to qualify as a substitution or an assumption. For example, no changes are proposed with respect to the requirements that no additional benefits be granted to the optionee in connection with a substitution or assumption or that certain spread and ratio tests must be met.

These proposed regulations also continue to impose the requirement contained in the final regulations that the new or assumed option must otherwise qualify as a statutory option. See §1.424-1(a)(5)(vi) of these proposed regulations. Thus, except as necessary to comply with the specific requirements regarding substitution or assumption, such as the restrictions on ratio and spread, the option must comply with the requirements of §1.422-2 of these proposed regulations or 1.423-2, as applicable. Accordingly, for example, the new option must be granted, or the old option must be assumed, under a plan approved by the stockholders of the corporation substituting or assuming the option.

The proposed regulations do not impose any additional stockholder approval requirement, however, merely because there is a corporate transaction. In Rev. Rul. 71-474 (1971-2 C.B. 215) involving qualified stock options,[1] the IRS held that qualified stock options assumed by a corporation in a merger with the granting corporation retained their status as qualified stock options without approval of the assuming corporation's stockholders. In the ruling, the IRS indicated that approval of the persons who owned stock of the granting corporation at the time the plan was approved was sufficient to satisfy the stockholder approval requirements. Similarly, the 1984 proposed regulations provided that the stockholders of the granting corporation must approve the plan within 12 months before or after its adoption without additional requirements.

Section 1.422-2(b)(2) of these proposed regulations would provide that the plan must be approved during the applicable 24-month period by the stockholders of the corporation granting the incentive stock option. There is no requirement that additional stockholder approval be obtained because of post-approval changes in the stockholders. For example, assume S, a subsidiary of P, adopts a plan under which incentive stock options for S stock will be granted to S employees. Under the proposed regulations, the stockholders of S must approve the plan within 12 months before or after the adoption of the plan. If P later completely disposes of its interest in S, outstanding S options and new grants of S options under the plan are treated as options granted under a plan that meets the stockholder approval requirement of

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[1] Qualified stock options are no longer permitted under section 422, but the stockholder approval provisions applicable to a plan under which qualified stock options were granted were the same as those that apply to a plan under which incentive stock options are granted.

§1.422-2(b)(2) of these proposed regulations without regard to whether S seeks approval of the plan from the stockholders of S after the spin-off. Assuming all other applicable requirements are met, the outstanding S options and new options granted by S pursuant to the plan with respect to S stock will be treated as incentive stock options.

These proposed regulations also would provide additional guidance with respect to when a change to an option constitutes a modification. Under these proposed regulations, as under the 1984 proposed regulations, both a provision under an option that provides that the optionee may receive an additional benefit at the future discretion of the granting corporation and the exercise of that discretion are considered modifications of the option. However, under these proposed regulations, it is not a modification for the granting corporation to exercise discretion related to the payment of a bonus at the time of the exercise of the option, the availability of a loan at exercise, or the right to tender previously-owned stock for the stock purchasable under the option. A change to an option adding such discretion, however, would be a modification.

In addition, these proposed regulations address more clearly changes related to an option, including changes not only to the option or the option plan, but also changes to any other related agreements. In the case of a change to the stock on which the option is granted that affects the value of the stock, there would be a modification unless a new option is substituted for the old option by reason of the change in the terms of the stock in accordance with the requirements of §1.424-1(a) of these proposed regulations.

<u>Section 6039</u>

These proposed regulations also would provide guidance on the statements required under section 6039 of the Code. Under these proposed regulations, §1.6039-1 of the final regulations would be deleted, and §1.6039-2 would be re-designated as §1.6039-1. These proposed regulations take the same approach toward providing notice as that taken in the 1984 proposed regulations.

Section 1.6039-1(f) of these proposed regulations states that the matter of furnishing statements in electronic form is reserved. Temporary and proposed regulations have been issued under sections 6041 and 6051 (relating to voluntary electronic furnishing of payee statements on Form W-2) and section 6050S (relating to voluntary electronic furnishing of statements to individuals for whom Forms 1098-T, "Tuition Payments Statement," and 1098-E, "Student Loan Interest Statement" are filed). See 66 FR 10191 and 10247 (Feb. 14, 2001). The preamble to those temporary and proposed regulations requested comments regarding, among other things, the extent to which the proposed method of electronic filing is appropriate for information statements required under other sections of the Code. In addition, section 401 of the Job Creation and Worker Assistance Act of 2002 authorized all statements required by sections 6041 through 6050T of the Code to be furnished electronically under certain conditions. The issue of electronic statements in general is under review, and comments are requested.

Proposed Effective Date

The regulations under sections 421, 422, and 424 are proposed to apply as of the date that is 180 days after publication of final regulations in the **Federal Register** and apply to any statutory option that is granted on or after that date. The regulations under section 6039 are proposed to apply to transfers on or after the date that is 180 days after publication of final regulations in the **Federal Register** of stock acquired pursuant to a statutory option. The 1984 proposed regulations are withdrawn. Taxpayers may rely on these proposed regulations for the treatment of any statutory option granted after June 9, 2003.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Section 1.6039-1 of these proposed regulations provides for the collection of information. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the provision of employee statements provided under these proposed regulations will impose a minimal paperwork burden on most small entities (see the discussion under the heading "Paperwork Reduction Act" earlier in this preamble). Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking is being submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 2, 2003, beginning at 10 a.m. in the IRS Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. All visitors must come to the Constitution Avenue entrance and present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by August 12, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Erinn Madden, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Parts 1 and 14a

Income taxes, Reporting, and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 14a is proposed to be amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§§1.421-1 through 1.421-6 [Removed]

Par. 2. Sections 1.421-1 through 1.421-6 are removed.

Par. 3. Section 1.421-7 is re-designated as §1.421-1 and is amended as follows:

1. In paragraph (a)(1), first sentence, the language "sections 421 through 425" is removed and "§§1.421-1 through 1.424-1" is added in its place.

2. In paragraph (a)(1), first sentence, the language "includes" is removed, and "means" is added in its place.

3. In paragraph (a)(1), removing the second sentence.

4. Removing the last sentence of paragraph (a)(1) and adding two sentences in its place.

5. Revising paragraph (a)(3).

6. Revising paragraphs (b)(1) and (b)(2).

7. In paragraph (b)(3)(i), third sentence, removing the language "1.425-1" and

inserting “1.424-1" in its place.

8. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly Designated Section	Remove	Add
1.421-1(b)(3)(ii), Example 1, first, second, third and fourth sentences	S-1	X
1.421-1(b)(3)(ii), Example 1, second sentence	1964	2004
1.421-1(b)(3)(ii), Example 1, third and fourth sentences	1965	2005
1.421-1(b)(3)(ii), Example 2, first and second sentences	1964	2004
1.421-1(b)(3)(ii), Example 2, first, third, and fourth sentences	S-1	X
1..421-1(b)(3)(ii), Example 2, third and fourth sentences	1965	2005

9. Revising the last sentence of paragraph (b)(3)(ii), Example 1.

10. Removing the last sentence of paragraph (b)(3)(ii), Example 2 and adding two sentences in its place.

11. Removing the first sentence of paragraph (c)(1) and adding two new sentences in its place.

12. In paragraph (c)(2), second sentence, the language "425" is removed and "424" is added in its place.

13. In paragraph (c)(3), second and last sentences, the language "1964" is removed and "2004" is added in its place.

14. In paragraph (c)(3), second sentence, the language "1965" is removed and "2005" is added in its place.

15. Revising paragraphs (d) and (e).

16. In paragraph (f), in the first sentence, the language "sections 421 through 425" is removed and "this section and §§1.421-2 through 1.424-1" is added in its place.

17. Revising the last sentence of paragraph (f).

18. In paragraph (g), first sentence, the language "sections 421 through 425" is removed and "this section and §§1.421-2 through 1.424-1" is added in its place.

19. Adding a new third sentence to paragraph (g).

20. Revising the first, second, and third sentences of paragraph (h)(1).

21. Revising paragraph (h)(2).

22. In paragraph (h)(3), first sentence, the language "425" is removed and "424" is added in its place.

23. In paragraph (h)(3), last sentence, the language "or assuming" is removed and "the option or substituting or assuming the option" is added in its place.

24. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly Designated Section	Remove	Add
1.421-1(h)(4), Example 1, first sentence	1964	2004
1.421-1(h)(4), Example 1, second and last sentences	1965	2005
1.421-1(h)(4), Example 2, first sentence	425	424
1.421-1(h)(4), Example 2, first sentence	issuing	substituting
1.424-1(h)(4), Example 2, last sentence	1965	2005
1.421-1(h)(4), Example 2, last sentence	for A is then employed by a corporation which issued an option under section 425(a).	to the transfer of the M stock because, at all times during the period beginning with the date of grant of the X option and ending with the date of exercise of the M option, A was an employee of the corporation granting the option or substituting or assuming the option under §1.424-1(a).
1.421-1(h)(4), Example 3, second sentence	1964	2004
1.421-1(h)(4), Example 3, third, fourth, and fifth sentences	1965	2005
1.421-1(h)(4), Example 4, first sentence	425(a)	424(a)

1.421-1(h)(4), <u>Example 5</u>, first sentence	qualified stock	statutory
1.421-1(h)(4), <u>Example 6</u>, first sentence	an employment contract with M which provides that upon the termination of any military duty E may be required to serve, E will be entitled to reemployment with M or a parent or subsidiary of M.	a right to reemploymnet with M or a related corporation on the termination of any military duty E may be required to serve.
1.421-1(h)(4), <u>Example 6</u>, third sentence	of M	of M or a related corporation
1.421-1(h)(4), <u>Example 6</u>, last sentence	can apply	applies
1.421-1(h)(4), <u>Example 7</u>, first and last sentences	a qualified stock	an incentive
1.421-1(h)(4), <u>Example 7</u>, first sentence	parent or subsidiary	related corporation
1.421-1(h)(4), <u>Example 7</u>, last sentence	its parent and subsidiary corporation	related corporations
1.421-1(h)(4), <u>Example 7</u>, last sentence	terminated	deemed terminated

25. Revising paragraph (i).

26. Adding paragraph (j).

The additions and revisions read as follows:

<u>§1.421-1 Meaning and use of certain terms.</u>

(a) * * * (1) * * * While no particular form of words is necessary, the option must express, among other things, an offer to sell at the option price, the maximum number of shares purchasable under the option, and the period of time during which the offer remains open. The term option includes a warrant that meets the requirements of this paragraph (a)(1).

* * * * *

(3) An option must be in writing (in paper or electronic form), provided that such writing is adequate to establish an option right or privilege that is enforceable under applicable law.

(b) Statutory options. (1) The term statutory option, for purposes of this section and §§1.421-2 through 1.424-1, means an incentive stock option, as defined in §1.422-2(a), or an option granted under an employee stock purchase plan, as defined in §1.423-2.

(2) An option qualifies as a statutory option only if the option is not transferable (other than by will or by the laws of descent and distribution) by the individual to whom the option was granted, and is exercisable, during the lifetime of such individual, only by such individual. See §§1.422-2(a)(2)(v) and 1.423-2(j). Accordingly, an option which is transferable or transferred by the individual to whom the option is granted during such individual's lifetime, or is exercisable during such individual's lifetime by another person, is not a statutory option. However, if the option or the plan under which the option was granted contains a provision permitting the individual to designate the person who may exercise the option after such individual's death, neither such provision, nor a designation pursuant to such provision, disqualifies the option as a statutory option. A

pledge of the stock purchasable under an option as security for a loan that is used to pay the option price does not cause the option to violate the nontransferability requirements of this paragraph (b). Also, the transfer of an option to a trust does not disqualify the option as a statutory option if, under section 671 and applicable State law, the individual is considered the sole beneficial owner of the option while it is held in the trust. If an option is transferred incident to divorce (within the meaning of section 1041) or pursuant to a qualified domestic relations order (within the meaning of section 414(p)), the option does not qualify as a statutory option as of the day of such transfer. For the treatment of nonstatutory options, see §1.83-7.

(3)(ii) * * * * *

Example 1. * * * Because X was a subsidiary of P on the date of the grant of the statutory option, the option does not fail to be a statutory option even though X ceases to be a subsidiary of P.

Example 2. * * * Because X was not a subsidiary of P on the date of the grant of the option, the option is not a statutory option even though S later becomes a subsidiary of P. See §§1.422-2(a)(2) and 1.423-2(b).

(c) Time and date of granting option. (1) For purposes of this section and §§1.421-2 through 1.424-1, the language "the date of the granting of the option" and "the time such option is granted," and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. A corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable. * * *

* * * * *

(d) Stock and voting stock. (1) For purposes of this section and §§1.421-2 through 1.424-1, the term stock means capital stock of any class, including voting or nonvoting common or preferred stock. Except as otherwise provided, the term includes both treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term stock as used in such sections, provided such stock otherwise possesses the rights and characteristics of capital stock.

(2) For purposes of determining what constitutes voting stock in ascertaining whether a plan has been approved by stockholders under §1.422-2(b) or 1.423-2(c) or whether the limitations pertaining to voting power contained in sections §§1.422-2(f) and 1.423-2(d) have been met, stock which does not have voting rights until the happening of an event, such as the default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Generally, stock which does not possess a general voting power, and may vote only on particular questions, is not voting stock. However, if such stock is entitled to vote on whether a stock option plan may be adopted, it is voting stock.

(3) In general, for purposes of this section and §§1.421-2 through 1.424-1, ownership interests other than capital stock are considered stock.

(e) Option price. (1) For purposes of this section and §§1.421-2 through 1.424-1, the term option price, price paid under the option, or exercise price means the consideration in cash or property which, pursuant to the terms of the option, is the price at which the stock subject to the option is purchased. The term option price does not include any amounts paid as interest under a deferred payment arrangement or treated as interest.

(2) Any reasonable valuation method may be used to determine whether, at the time the option is granted, the option price satisfies the pricing requirements of sections 422(b)(4), 422(c)(5), 422(c)(7), and 423(b)(6) with respect to the stock subject to the option. Such methods include, for example, the valuation method described in §20.2031-2 of this chapter (Estate Tax Regulations).

(f) Exercise. * * * An agreement or undertaking by the employee to make payments under a stock purchase plan does not constitute the exercise of an option to the extent the payments made remain subject to withdrawal by or refund to the employee.

(g) Transfer. * * * A transfer does not fail to occur merely because, under the terms of the arrangement, the individual may not dispose of the share for a specified period of time or the share is subject to a right of first refusal at the share's fair market value at the time of sale.

(h) Employment relationship. (1) An option is a statutory option only if, at the time the option is granted, the optionee is an employee of the corporation granting the option, or a related corporation of such corporation. If the option has been assumed or a new option has been substituted in its place under §1.424-1(a), the optionee must, at the time of such substitution or assumption, be an employee of the corporation so substituting or assuming the option, or a related corporation of such corporation. The determination of whether the optionee is an employee at the time the option is granted (or at the time of the substitution or assumption under §1.424-1(a)) is made in accordance with section 3401(c) and the regulations thereunder. * * *

(2) In addition, §1.421-2(a) is applicable to the transfer of a share pursuant to the exercise of the statutory option only if the optionee is, at all times during the period beginning with the date of the granting of such option and ending on the day 3 months before the date of such exercise, an employee of either the corporation granting such option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which §1.424-1(a) applies. For purposes of the preceding sentence, the employment relationship is treated as continuing intact while the individual is on military leave, sick leave, or other bona fide leave of absence (such as temporary employment by the Government) if the period of such leave does not exceed 90 days, or if longer, so long as the individual's right to reemployment with the corporation granting the option (or a related corporation of such corporation) or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which §1.424-1(a) applies, is guaranteed either by statute or by contract. If the period of leave exceeds 90 days and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship is deemed to terminate on the 91st day of such leave. Thus, if the option is not exercised before such deemed termination of employment, §1.421-2(a) applies to the transfer of a share pursuant to

an exercise of the option only if the exercise occurs within 3 months from the date the employment relationship is deemed terminated.

* * * *

(i) Additional definitions. (1) Corporation. For purposes of this section and §§1.421-2 through 1.424-1, the term corporation has the meaning prescribed by section 7701(a)(3) and §301.7701-2(b) of this chapter. For example, a corporation for purposes of the preceding sentence includes an S corporation (as defined in section 1361), a foreign corporation (as defined in section 7701(a)(5)), and a limited liability company that is treated as a corporation for all Federal tax purposes.

(2) Parent corporation and subsidiary corporation. For the definition of the terms parent corporation (and parent) and subsidiary corporation (and subsidiary), for purposes of this section and §§1.421-2 through 1.424-1, see §1.424-1(f)(i) and (ii), respectively. Related corporation as used in this section and in §§1.421-2 through 1.424-1 means either a parent corporation or subsidiary corporation.

(j) Effective date. This section applies to any statutory option granted on or after the date that is 180 days after publication of final regulations in the **Federal Register**. Taxpayers can rely on these regulations for the treatment of any statutory option granted on or after June 9, 2003.

Par. 4. Section 1.421-8 is re-designated as 1.421-2 and is amended by:

1. Revising paragraphs (a)(1), (b), and (c)(1).

2. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly Designated Section	Remove	Add
1.421-2(c)(2), second sentence	, or 424(c)(1)	
1.421-2(c)(2), third sentence	or 424(c)(1)	
1.421-2(c)(3)(i), first, second, and third sentences	422(c)(1), 423(c), or 424(c)(1)	423(c)
1.421-2(c)(3)(ii), Example, first sentence	1964	2004
1.421-2(c)(3)(ii), Example, third, fifth, and sixth sentences	1966	2006

3. In paragraph (c)(2), first sentence, add the phrase "for purposes of section 423(c)" at the end of the first sentence.

4. Removing paragraph (c)(4)(i) and redesignating paragraphs (c)(4)(ii) through (c)(4)(iv) as paragraphs (c)(4)(i) through (c)(4)(iii), respectively.

5. In newly designated paragraph (c)(4)(i)(a), first sentence, removing the phrase "In the case of an employee dying after December 31, 1956" and adding "In the case of the death of an optionee" in its place.

6. Removing Example (1) in newly designated paragraph (c)(4)(iii) and redesignating Examples (2) through (5) as Examples (1) through (4), respectively.

7. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly Designated Section		
	1.421-2(c)(4)(i)(a), last	sentence

Remove	Add	
422(c)(1), 423(c), or 424(c)(1)	423(c)	1.421-2(c)(4)(i)(b), first, second, and last sentences
422(c)(1), 423(c), or 424(c)(1)	423(c)	1.421-2(c)(4)(i)(c), first sentence
422(c)(1), 423(c), or 424(c)(1)	423(c)	1.421-2(c)(4)(iii), Example 1, first sentence
1964	2005	1.421-2(c)(4)(iii), Example 1, eighth sentence
subdivision (ii)(b) of this subparagraph	paragraph (c)(4)(i)(b) of this section	1.421-2(c)(4)(iii), Example 1, third and fifth sentences
1966	2006	1.421-2(c)(4)(iii), Example 1, ninth sentence
subdivision (ii)(c) of this subparagraph	paragraph (c)(4)(i)(c) of this section	1.421-2(c)(4)(iii), Example 2, second and fifth sentences
subdivision (ii)(a) of this subparagraph	paragraph (c)(4)(i)(a) of this section	1.421-2(c)(4)(iii), Example 2, fifth sentence
subdivision (ii)(b) of this subparagraph	paragraph (c)(4)(i)(b) of this section	1.421-2(c)(4)(iii), Example 2, first sentence
example (2)	Example 1	

1.421-2(c)(4)(iii), Example 3, first sentence	example (2)	Example 1
1.421-2(c)(4)(iii), Example 3, second and fourth sentences	subdivision (ii)(a) of this subparagraph	paragraph (c)(4)(i)(a) of this section
1.421-2(c)(4)(iii), Example 3, fourth sentence	subdivision (ii)(c) of this subparagraph	paragraph (c)(4)(i)(c) of this section
1.421-2(c)(4)(iii), Example 4, first sentence	example (2)	Example 1
1.421-2(c)(4)(iii), Example 4, first sentence	1966	2006
1.421-2(c)(4)(iii), Example 4, first and second sentences	1967	2007
1.421-2(c)(iii), Example 4, third, fifth, and sixth sentences	subdivision (ii)(a) of this subparagraph	paragraph (c)(4)(i)(a) of this section
1.421-2(c)(4)(iii), Example 4, fifth and sixth sentences	subdivision (ii)(b) of this subparagraph	paragraph (c)(4)(i)(b) of this section
1.421-2(c)(4)(iii), Example 4, sixth sentence	subdivision (ii)(c) of this subparagraph	paragraph (c)(4)(i)(c) of this section

8. Revising paragraph (d).

9. Adding paragraph (f).

The revisions read as follows:

§ 1.421-2 General rules.

(a) Effect of qualifying transfer. (1) If a share of stock is transferred to an individual pursuant to the individual's exercise of a statutory option, and if the requirements of §1.422-1(a) (relating to incentive stock options) or §1.423-1(a) (relating to employee stock purchase plans) whichever is applicable, are met, then--

(i) No income results at the time of the transfer of such share to the individual upon the exercise of the option with respect to such share (in addition, no income results upon grant of the option, see §1.83-7);

(ii) No deduction under section 162 or the regulations thereunder (relating to trade or business expenses) is allowable at any time with respect to the share so transferred; and

(iii) No amount other than the price paid under the option is considered as received by the employer corporation, a related corporation of such corporation, or a corporation substituting or assuming a stock option in a transaction to which §1.424-1(a) (relating to corporate reorganizations, liquidations, etc.) applies, for the share so transferred.

* * * * *

(b) Effect of disqualifying disposition. (1)(i) The disposition (as defined in §1.424-1(c)) of a share of stock acquired by the exercise of a statutory option before the expiration of the applicable holding periods as determined under §1.422-1(a) or 1.423-1(a) is a disqualifying disposition and makes paragraph (a) of this section inapplicable to the transfer of such share. See §1.83-7 for the treatment of nonstatutory options. The income attributable to such transfer (determined without reduction for any brokerage fees or other costs paid in connection with the disposition) is treated by the individual as compensation income received in the taxable year in which such disqualifying disposition occurs. Similarly, if otherwise allowable under sections 83(h) and 162, a deduction attributable to such transfer is allowable for the taxable year in which such disqualifying disposition occurs to the employer corporation, or a related corporation of such corporation, or a corporation substituting or assuming an option in a transaction to which §1.424-1(a) applies. Additionally, an amount is allowed as a deduction only if the requirements of §1.83-6(a) are satisfied. No amount is treated as income, and no amount is allowed as a deduction, for any taxable year other than the taxable year in which the disqualifying disposition occurs. If the amount realized on the disposition exceeds (or is less than) the sum of the amount paid for the share and the amount of compensation income recognized as a result of such disposition, the extent to which the difference is treated as gain (or loss) is determined under the rules of section 302 or 1001, as applicable.

(ii) The following examples illustrate the principles of this paragraph (b):

Example 1. On June 1, 2006, X Corporation grants an incentive stock option to A, an employee of X, entitling A to purchase 100 shares of X stock at $10 per share. On August 1, 2006, A exercises the option when the fair market value of X stock is $20 per share, and 100 shares of X stock are transferred to A on that date. On December 15, 2007, A sells the stock. Because A disposed of the stock before June 2, 2008, A did not satisfy the holding period requirements of §1.422-1(a). Under paragraph (b)(1)(i) of this section, A made a disqualifying disposition of the stock. Thus, paragraph (a) of this section is inapplicable to the transfer of the shares, and A must include the compensation income attributable to the transfer of the shares in gross income. The amount of compensation income A must include in income under §1.83-7 in the year of the disqualifying disposition is $1,000 (($20, the fair market value of X stock on transfer less $10, the exercise price per share) times 100 shares)). If otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X is allowed a deduction of $1,000 for its taxable year in which the disqualifying disposition occurs.

Example 2. Y Corporation grants an incentive stock option for 100 shares of its stock to E, an employee of Y. The option has an exercise price of $10 per share. E exercises the option and is transferred the shares when the fair market value of a share of Y stock is $30. Before the applicable holding periods expire, Y redeems the shares for $70 per share. Because the holding period requirements of §1.422-1(a) are not met, the redemption of the shares is a disqualifying disposition of the shares. Under paragraph (b)(1)(i) of this section, A made a disqualifying disposition of the stock. Thus, paragraph (a) of this section is inapplicable to the transfer of the shares, and E must include the compensation income attributable to the transfer of the shares in gross income. Under §1.83-7, the amount of compensation income attributable to E's purchase of the share that E must include in gross income in the year of the disqualifying disposition is $2,000 ($3,000, the fair market value of Y stock on transfer, less $1,000, the exercise price paid by E). The character of the additional gain that is includible in E's income as a result of the redemption is determined under the rules of section 302. If otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, Y is allowed a deduction for the taxable year in which the disqualifying disposition occurs for the compensation income of $2,000. Y is not allowed a deduction for the additional gain includible in E's income as a result of the redemption.

(2) If an optionee transfers stock acquired through the optionee's exercise of a statutory option prior to the expiration of the applicable holding periods, paragraph (a) of this section continues to apply to the transfer of the stock pursuant to the exercise of the option if such transfer is not a disposition of the stock as defined in §1.424-1(c) (for example, a transfer from a decedent to the decedent's estate or a transfer by bequest or inheritance). Similarly, a subsequent transfer by the executor, administrator, heir, or legatee is not a disqualifying disposition by the decedent. If a statutory option is exercised by the estate of the optionee or by a person who acquired the option by bequest or inheritance or by reason of the death of such optionee, see paragraph (c) of this section. If a statutory option is exercised by the individual to whom the option was granted and the individual dies before the expiration of the holding periods, see paragraph (d) of this section.

(3) For special rules relating to the disqualifying disposition of a share of stock acquired by exercise of an incentive stock option, see §§1.422-5(b)(2) and 1.424-1(c)(3).

(c) Exercise by estate. (1) If a statutory option is exercised by the estate of the individual to whom the option was granted (or by any person who acquired such option by bequest or inheritance or by reason of the death of such individual), paragraph (a) of this section applies to the transfer of stock pursuant to such exercise in the same manner as if the option had been exercised by the deceased optionee. Consequently, neither the estate nor such person is required to include any amount in gross income as a result of a transfer of stock pursuant to the exercise of the option. Paragraph (a) of this section applies even if the executor, administrator, or such person disposes of the stock so acquired before the expiration of the applicable holding periods as determined under §1.422-1(a) or 1.423-1(a). This special rule does not affect the applicability of section 423(c), relating to the estate's or other qualifying person's recognition of compensation income, or section 1222, relating to what constitutes a short-term and long-term capital gain or loss. Paragraph (a) of this section also applies even if the executor, administrator, or such person does not exercise the option within three months after the death of the individual or is not employed as described in §1.421-1(h), either when the option is exercised or at any time. However, paragraph (a) of this section does not apply to a transfer of shares pursuant to an exercise of the option by the estate or by such person unless the individual met the employment requirements described in §1.421-1(h) either at the time of the individual's death or within three months before such time (or, if applicable, within the period described in §1.422-1(a)(3)). Additionally, paragraph (a) of this section does not apply if the option is exercised by a person other than the executor or administrator, or other than a person who acquired the option by bequest or inheritance or by reason of the death of such deceased individual. For example, if the option is sold by the estate, paragraph (a) of this section does not apply to the transfer of stock pursuant to an exercise of the option by the buyer, but if the option is distributed by the administrator to an heir as part of the estate, paragraph (a) of this section applies to the transfer of stock pursuant to an exercise of the option by such heir.

* * * * *

(d) <u>Option exercised by the individual to whom the option was granted if the individual dies before expiration of the applicable holding periods</u>. If a statutory option is exercised by the individual to whom the option was granted and such individual dies before the expiration of the applicable holding periods as determined under §1.422-1(a) or 1.423-1(a), paragraph (a) of this section does not become inapplicable if the executor or administrator of the estate of such individual, or any person who acquired such stock by bequest or inheritance or by reason of the death of such individual, disposes of such stock before the expiration of such applicable holding periods. This rule does not affect the applicability of section 423(c), relating to the individual's recognition of compensation income, or section 1222, relating to what constitutes a short-term and long-term capital gain or loss.

* * * * *

(f) Effective date. This section is applies to any statutory option granted on or after the date that is 180 days after publication of final regulations in the **Federal Register**. Taxpayers can rely on these regulations for the treatment of any statutory option granted on or after June 9, 2003.

Par. 5. Section 1.422-1 is added to read as follows:

§1.422-1 Incentive stock options; general rules.

(a) Applicability of section 421(a). (1)(i) Section 1.421-2(a) applies to the transfer of a share of stock to an individual pursuant to the individual's exercise of an incentive stock option if the following conditions are satisfied--

(A) The individual makes no disposition of such share before the later of the expiration of the 2-year period from the date of grant of the option pursuant to which such share was transferred, or the expiration of the 1-year period from the date of transfer of such share to the individual; and

(B) At all times during the period beginning on the date of grant of the option and ending on the day 3 months before the date of exercise, the individual was an employee of either the corporation granting the option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which §1.424-1(a) applies.

(ii) For rules relating to the disposition of shares of stock acquired pursuant to the exercise of a statutory option, see §1.424-1(c). For rules relating to the requisite employment relationship, see §1.421-1(h).

(2)(i) The holding period requirement of section 422(a)(1), described in paragraph (a)(1)(i)(A) of this section, does not apply to the transfers of shares by an insolvent individual described in this paragraph (a)(2). If an insolvent individual holds a share of stock acquired pursuant to the individual's exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of the individual's creditors in such proceeding is a disposition of such share for purposes of this paragraph (a). For purposes of this paragraph (a)(2), an individual is insolvent only if the individual's liabilities exceed the individual's assets or the individual is unable to satisfy the individual's liabilities as they become due. See section 422(c)(3).

(ii) A transfer by the trustee or other fiduciary that is not treated as a disposition for purposes of this paragraph (a) may be a sale or exchange for purposes of recognizing capital gain or loss with respect to the share transferred. For example, if the trustee transfers the share to a creditor in an insolvency proceeding, capital gain or loss must be recognized by the insolvent individual to the extent of the difference between the amount realized from such transfer and the adjusted basis of such share.

(iii) If any transfer by the trustee or other fiduciary (other than a transfer back to the insolvent individual) is not for the exclusive benefit of the creditors in an insolvency proceeding, then whether such transfer is a disposition of the share by the individual for purposes of this paragraph (a) is determined under §1.424-1(c). Similarly, if the trustee or other fiduciary transfers the share back to the insolvent individual, any subsequent transfer of the share by such individual which is not made in respect of the insolvency proceeding may be a disposition of the share for purposes of this paragraph (a).

(3) If the employee exercising an option ceased employment because of permanent and total disability, within the meaning of section 22(e)(3), 1 year is used instead of 3 months in the employment period requirement of paragraph (a)(1)(i)(B) of this section.

(b) Failure to satisfy holding period requirements--(1) General rule. For general rules concerning a disqualifying disposition of a share of stock acquired pursuant to the exercise of an incentive stock option, see §1.421-2(b)(1).

(2)(i) Special rule. If an individual makes a disqualifying disposition of a share of stock acquired by the exercise of an incentive stock option, and if such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to the individual, then, under this paragraph (b)(2)(i), the amount includible in the gross income of such individual, and deductible from the income of the employer corporation (or a related corporation of such corporation, or of a corporation substituting or assuming the option in a transaction to which §1.424-1(a) applies) as compensation attributable to the exercise of such option, shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share. Subject to the special rule provided by this paragraph (b)(2)(i), the amount of compensation attributable to the exercise of the option is determined under §1.83-7; see §1.421-2(b)(1)(i).

(ii) Limitation to special rule. The special rule described in paragraph (b)(2)(i) of this section does not apply if the disposition is a sale or exchange with respect to which a loss (if sustained) would not be recognized to the individual. Thus, for example, if a disqualifying disposition is a sale described in section 1091 (relating to loss from wash sales of stock or securities), a gift (or any other transaction which is not at arm's length), or a sale described in section 267(a)(1) (relating to sales between related persons), the special rule described in paragraph (b)(2)(i) of this section does not apply because a loss sustained in any such transaction would not be recognized.

(3) Examples. The following examples illustrate the principles of this paragraph (b):

Example 1. On June 1, 2006, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase one share of X Corporation stock. On August 1, 2006, A exercises the option and the share of X Corporation stock is transferred to A on that date. The option price is $100 (the fair market value of a share of X Corporation stock on June 1, 2006) and the fair market value of a share of X Corporation stock on August 1, 2006 (the date of transfer) is $200. The share transferred to A is transferable and not subject to a substantial risk of forfeiture. A makes a disqualifying disposition by selling the share on June 1, 2007, for $250. Under §1.83-7(a) (relating to options to which section 421 does not apply), the amount of compensation attributable to A's exercise is $100 (the difference between the fair market value of the share at the date of transfer, $200, and the amount paid for the share, $100). Because the amount realized ($250) is greater than the value of the share at transfer ($200), paragraph (b)(2)(i) of this section does not apply and thus does not affect the amount includible as compensation in A's gross income and deductible by X. A must include in gross income for the taxable year in which the sale occurred $100 as compensation and $50 as capital gain ($250, the amount realized from the sale, less A's basis of $200 (the $100 paid for the share plus the $100 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option)). For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a deduction of $100 for compensation attributable to A's exercise of the incentive stock option.

Example 2. Assume the same facts as in Example 1, except that the share of X Corporation stock transferred to A is subject to a substantial risk of forfeiture and not transferable for a period of six months after such transfer. Assume further that the fair market value of X Corporation stock is $225 on February 1, 2005, the date on which the six-month restriction lapses. Under section 83(a) and §1.83-7(a), the amount of compensation attributable to A's exercise of the option and disqualifying disposition of the share is $125 (the difference between the fair market value of the share on the date that the restriction lapsed, $225, and the amount paid for the share, $100). A must include $125 of compensation income and $25 of capital gain in gross income for the taxable year in which the disposition occurs ($250, the amount realized from the sale, less A's basis of $225 (the $100 paid for the share plus the $125 increase in basis resulting from the inclusion of that amount of compensation in A's gross income)). For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a deduction of $125 for the compensation attributable to A's exercise of the option.

Example 3. (i) Assume the same facts as in Example 1, except that A sells the share for $150 to M.

(ii) If the sale to M is a disposition that meets the requirements of paragraph (b)(2)(i) of this section, instead of $100 which otherwise would have been includible as compensation under §1.83-7, under paragraph (b)(2)(i) of this section, A must include only $50 (the excess of the amount realized on such sale, $150, over the adjusted basis of the share, $100) in gross income as compensation attributable to the exercise of the incentive stock option. Because A's basis for the share is $150 (the $100 which A paid for the share, plus the $50 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option), A realizes no capital gain or loss as a result of the sale. For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a deduction of $50 for the compensation attributable to A's exercise of the option.

(iii) Assume the same facts as in paragraph (i) of this Example 3, except that 10 days after the sale to M, A purchases substantially identical stock. Because under section 1091(a) a loss (if it were sustained on the sale) would not be recognized on the sale, under paragraph (b)(2)(ii) of this section, the special rule described in paragraph (b)(2)(i) of this section does not apply. Under §1.83-7, A must include $100 (the difference between the fair market value of the share on the date of transfer, $200, and the amount paid for the share, $100) in gross income as compensation attributable to the exercise of the option for the taxable year in which the disqualifying disposition occurred. A recognizes no capital gain or loss on the transaction. For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a $100 deduction for compensation attributable to A’s exercise of the option.

(iv) Assume the same facts as in paragraph (ii) of this Example 3, except that A sells the share for $50. Under paragraph (b)(2)(i) of this section, A is not required to include any amount in gross income as compensation attributable to the exercise of the option. A is allowed a capital loss of $50 (the difference between the amount realized on the sale, $50, and the adjusted basis of the share, $100). X Corporation is not allowed any deduction attributable to A's exercise of the option and disqualifying disposition of the share.

(c) Failure to satisfy employment requirement. Section 1.421-2(a) does not apply to the transfer of a share of stock pursuant to the exercise of an incentive stock option if the employment requirement, as determined under paragraph (a)(1)(i)(B) of this section, is not met at the time of the exercise of such option. Consequently, the effects of such a transfer are determined under the rules of §1.83-7. For rules relating to the employment relationship, see §1.421-1(h).

Par. 6. Section 1.422-2 is added to read as follows:

§1.422-2 Incentive stock options defined.

(a) Incentive stock option defined--(1) In general. The term incentive stock option means an option that meets the requirements of paragraph (a)(2) of this section on the date of grant. An incentive stock option is also subject to the $100,000 limitation described in §1.422-4. An incentive stock option may contain a number of permissible provisions that do not affect the status of the option as an incentive stock option. See §1.422-5 for rules relating to permissible provisions of an incentive stock option.

(2) Option requirements. To qualify as an incentive stock option under this section, an option must be granted to an individual in connection with the individual's employment by the corporation granting such option (or by a related corporation), and granted only for stock of any of such corporations. In addition, the option must meet all of the following requirements --

(i) It must be granted pursuant to a plan that meets the requirements described in paragraph (b) of this section;

(ii) It must be granted within 10 years from the date of the adoption of the plan or the date such plan is approved by the stockholders, whichever is earlier (see paragraph (c) of this section);

(iii) It must not be exercisable after the expiration of 10 years from the date of grant (see paragraph (d) of this section);

(iv) It must provide that the option price per share is not less than the fair market value of the share on the date of grant (see paragraph (e) of this section);

(v) By its terms, it must not be transferrable by the individual to whom the option is granted other than by will or the laws of descent and distribution, and must be exercisable, during such individual's lifetime, only by such individual (see §§1.421-1(b)(2) and 1.421-2(c)); and

(vi) Except as provided in paragraph (f) of this section, it must be granted to an individual who, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation employing such individual or of any related corporation of such corporation.

(3) Amendment of option terms. Except as otherwise provided in §1.424-1, the amendment of the terms of an incentive stock option may cause it to cease to be an option described in this section. If the terms of an option that has lost its status as an incentive stock option are subsequently changed with the intent to re-qualify the option as an incentive stock option, such change results in the grant of a new option on the date of the change. See §1.424-1(e).

(4) Terms provide option not an incentive stock option. If the terms of an option,

when granted, provide that it will not be treated as an incentive stock option, such option is not treated as an incentive stock option.

(b) Option plan--(1) In general. An incentive stock option must be granted pursuant to a plan that meets the requirements of this paragraph (b). The authority to grant other stock options or other stock-based awards pursuant to the plan, where the exercise of such other options or awards does not affect the exercise of incentive stock options granted pursuant to the plan, does not disqualify such incentive stock options. The plan must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan. See §1.422-5 for rules relating to permissible provisions of an incentive stock option.

(2) Stockholder approval. (i) The plan required by this paragraph (b) must be approved by the stockholders of the corporation granting the incentive stock option within 12 months before or after the date such plan is adopted. Ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action.

(ii) For purposes of paragraph (b)(2)(i) of this section, the stockholder approval must comply with the rules described in §1.422-3.

(iii) The provisions relating to the maximum aggregate number of shares to be issued under the plan (described in paragraph (b)(3) of this section) and the employees (or class or classes of employees) eligible to receive options under the plan (described in paragraph (b)(4) of this section) are the only provisions of a stock option plan that must be approved by stockholders for purposes of section 422(b)(1). Any increase in the maximum aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split), or change in the designation of the employees (or class or classes of employees) eligible to receive options under the plan is considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. In addition, a change in the granting corporation or the stock available for purchase or award under the plan is considered the adoption of a new plan requiring new stockholder approval within the prescribed 24-month period. Any other changes in the terms of an incentive stock option plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(3) Maximum aggregate number of shares. (i) The plan required by this paragraph (b) must designate the maximum aggregate number of shares that may be issued under the plan through incentive stock options, nonstatutory options, and all other stock-based awards to be granted thereunder. If nonstatutory options or other stock-based awards may be granted, the plan may separately designate terms for each type of option and other stock-based award and designate the maximum number of shares that may be issued under such option or other stock-based award. Unless otherwise specified, all terms of the plan apply to all options and other stock-based

awards that may be granted under the plan.

(ii) A plan that merely provides that the number of shares that may be issued under options and other stock-based awards granted under such plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under such plan does not satisfy the requirement that the plan state the maximum aggregate number of shares that may be issued under the plan. However, the maximum aggregate number of shares that may be issued under the plan may be stated in terms of a percentage of the authorized, issued or outstanding shares at the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued or outstanding shares at the date of the adoption of the plan. A plan which provides that the maximum aggregate number of shares that may be issued under the plan may change based on any other specified circumstances satisfies the requirements of this paragraph (b)(3) only if the stockholders approve an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event.

(iii) It is permissible for the plan to provide that shares purchasable under the plan may be supplied to the plan through acquisitions of stock on the open market, that shares purchased under the plan and forfeited back to the plan are available for re-issuance under the plan, or that shares surrendered in payment of the exercise price of an option are available for re-issuance under the plan.

(iv) If there is more than one plan under which incentive stock options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares that are available for issuance under such plans, the stockholder approval requirements described in paragraph (b)(2) of this section are not satisfied. A separate maximum aggregate number of shares must be approved for each plan.

(4) Designation of employees. The plan described in this paragraph (b), as adopted and approved, must indicate the employees (or class or classes of employees) eligible to receive the options or other stock-based awards to be granted under the plan. This requirement is satisfied by a general designation of the classes of employees eligible to receive options or other stock-based awards under the plan. Designations such as "key employees of the grantor corporation"; "all salaried employees of the grantor corporation and its subsidiaries, including subsidiaries which become such after adoption of the plan;" or "all employees of the corporation" meet this requirement. This requirement is considered satisfied even though the board of directors, another group, or an individual is given the authority to select the particular employees who are to receive options or other stock-based awards from a described class and to determine the number of shares to be optioned or granted to each such employee. If individuals other than employees may be granted options or other stock-based awards under the plan, the plan must separately designate the employees or classes of employees eligible to receive incentive stock options.

(5) Conflicting option terms. An option on stock available for purchase or grant under the plan is treated as having been granted pursuant to a plan even if the terms of the option conflict with the terms of the plan, unless such option is granted to an

employee who is ineligible to receive options under the plan, options have been granted on stock in excess of the aggregate number of shares which may be issued under the plan, or the option provides otherwise.

(6) The following examples illustrate the principles of this paragraph (b):

Example 1. Stockholder approval. (i) S Corporation is a subsidiary of P Corporation, a publicly traded corporation. On January 1, 2006, S adopts a plan under which incentive stock options for S stock are granted to S employees.

(ii) To meet the requirements of paragraph (b)(2) of this section, the plan must be approved by the stockholders of S (in this case, P) within 12 months before or after January 1, 2004.

(iii) Assume the same facts as in paragraph (i) of this Example 1. Assume further that the plan was approved by the stockholders of S (in this case, P) on March 1, 2006. On January 1, 2008, S changes the plan to provide that incentive stock options for P stock will be granted to S employees under the plan. Because there is a change in the stock available for grant under the plan, the change is considered the adoption of a new plan that must be approved by the stockholders within 12 months before or after January 1, 2008.

Example 2. Stockholder approval. (i) Assume the same facts as in paragraph (i) of Example 1, except that on March 15, 2007, P completely disposes of its interest in S. Thereafter, S continues to grant options for S stock to S employees under the plan.

(ii) The new S options are granted under a plan that meets the stockholder approval requirements of paragraph (b)(2) of this section without regard to whether S seeks approval of the plan from the stockholders of S after P disposes of its interest in S.

(iii) Assume the same facts as in paragraph (i) of this Example 2, except that under the plan as adopted on January 1, 2006, only options for P stock are granted to S employees. Assume further that after P disposes of its interest in S, S changes the plan to provide for the grant of options for S stock to S employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (b)(2)(iii) of this section, the stockholders of S must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (b) of this section.

Example 3. Maximum aggregate number of shares. X Corporation maintains a plan under which statutory options and nonstatutory options may be granted. The plan designates the number of shares that may be used for incentive stock options.

Because the maximum aggregate number of shares that will be used for both statutory and nonstatutory options is not designated in the plan, the requirements of paragraph (b)(3) of this section are not satisfied.

Example 4. Maximum aggregate number of shares. Y Corporation adopts an incentive stock option plan on November 1, 2006. On that date there are two million outstanding shares of Y Corporation stock. The plan provides that the maximum aggregate number of shares that may be issued under the plan may not exceed 15% of the outstanding number of shares of Y Corporation on November 1, 2006. Because the maximum aggregate number of shares under the plan is designated in the plan, the requirements of paragraph (b)(3) of this section are met.

Example 5. Maximum aggregate number of shares. (i) B Corporation adopts an incentive stock option plan on March 15, 2005. The plan provides that the maximum aggregate number of shares available under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares.

(ii) Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (b)(3) of this section are not met.

(iii) Assume the same facts as in paragraph (i) of this Example 5, except that the plan provides that the maximum aggregate number of shares available under the plan is the lesser of (a) 50,000 shares increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares or (b) 200,000 shares. Because the maximum aggregate number of shares under the plan is designated as the lesser of one of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (b)(3) of this section are met.

(c) Duration of option grants under the plan. An incentive stock option must be granted within 10 years from the date that the plan under which it is granted is adopted or the date such plan is approved by the stockholders, whichever is earlier. To grant incentive stock options after the expiration of the 10-year period, a new plan must be adopted and approved.

(d) Period for exercising options. An incentive stock option, by its terms, must not be exercisable after the expiration of 10 years from the date such option is granted, or 5 years from the date such option is granted to an employee described in paragraph

(f) of this section. An option that does not contain such a provision when granted is not an incentive stock option.

(e) Option price. (1) Except as provided by paragraph (e)(2) of this section, the option price of an incentive stock option must not be less than the fair market value of the stock subject to the option at the time the option is granted. The option price may be determined in any reasonable manner, including the valuation methods permitted under §20.2031-2 of this chapter (Estate Tax Regulations), so long as the minimum price possible under the terms of the option is not less than the fair market value of the stock on the date of grant. For general rules relating to the option price, see §1.421-1(e). For rules relating to the determination of when an option is granted, see §1.421-1(c).

(2)(i) If a share of stock is transferred to an individual pursuant to the exercise of an option which fails to qualify as an incentive stock option merely because there was a failure of an attempt, made in good faith, to meet the option price requirements of paragraph (e)(1) of this section, the requirements of such paragraph are considered to have been met. Whether there was a good-faith attempt to set the option price at not less than the fair market value of the stock subject to the option at the time the option was granted depends on the relevant facts and circumstances.

(ii) For publicly held stock that is actively traded on an established market at the time the option is granted, determining the fair market value of such stock by the appropriate method described in §20.2031-2 of this chapter (Estate Tax Regulations) establishes that a good-faith attempt to meet the option price requirements of this paragraph (e) was made.

(iii) For non-publicly traded stock, if it is demonstrated, for example, that the fair market value of the stock at the date of grant was based upon an average of the fair market values as of such date set forth in the opinions of completely independent and well-qualified experts, such a demonstration generally establishes that there was a good-faith attempt to meet the option price requirements of this paragraph (e). If the stock is non-publicly traded, the optionee's status as a majority or minority stockholder may be taken into consideration.

(iv) Regardless of whether the stock offered under an option is publicly traded, a good-faith attempt to meet the option price requirements of this paragraph (e) is not demonstrated unless the fair market value of the stock on the date of grant is determined with regard to nonlapse restrictions (as defined in §1.83-3(h)) and without regard to lapse restrictions (as defined in §1.83-3(i)).

(v) Amounts treated as interest and amounts paid as interest under a deferred payment arrangement are not includible as part of the option price. See §1.421-1(e)(1). An attempt to set the option price at not less than fair market value is not regarded as made in good faith where an adjustment of the option price to reflect amounts treated as interest results in the option price being lower than the fair market value on which the option price was based.

(3) Notwithstanding that the option price requirements of paragraphs (e)(1) and (2) of this section are satisfied by an option granted to an employee whose stock ownership exceeds the limitation provided by paragraph (f) of this section, such option

is not an incentive stock option when granted unless it also complies with paragraph (f) of this section. If the option, when granted, does not comply with the requirements described in paragraph (f) of this section, such option can never become an incentive stock option, even if the employee's stock ownership does not exceed the limitation of paragraph (f) of this section when such option is exercised.

(f) Options granted to certain stockholders. (1) If, immediately before an option is granted, an individual owns (or is treated as owning) stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation employing the optionee or of any related corporation of such corporation, then an option granted to such individual cannot qualify as an incentive stock option unless the option price is at least 110 percent of the stock's fair market value on the date of grant and such option by its terms is not exercisable after the expiration of 5 years from the date of grant. For purposes of determining the minimum option price for purposes of this paragraph (f), the rules described in paragraph (e)(2) of this section, relating to the good-faith determination of the option price, do not apply.

(2) For purposes of determining the stock ownership of the optionee, the stock attribution rules of §1.424-1(d) apply. Stock that the optionee may purchase under outstanding options is not treated as stock owned by the individual. The determination of the percentage of the total combined voting power of all classes of stock of the employer corporation (or of its related corporations) that is owned by the optionee is made with respect to each such corporation in the related group by comparing the voting power of the shares owned (or treated as owned) by the optionee to the aggregate voting power of all shares of each such corporation actually issued and

outstanding immediately before the grant of the option to the optionee. The aggregate voting power of all shares actually issued and outstanding immediately before the grant of the option does not include the voting power of treasury shares or shares authorized for issue under outstanding options held by the individual or any other person.

(3) Examples. The rules of this paragraph (f) are illustrated by the following examples:

Example 1. (i) E, an employee of M Corporation, owns 15,000 shares of M Corporation common stock, which is the only class of stock outstanding. M has 100,000 shares of its common stock outstanding. On January 1, 2005, when the fair market value of M stock is $100, E is granted an option with an option price of $100 and an exercise period of 10 years from the date of grant.

(ii) Because E owns stock possessing more than 10 percent of the total combined voting power of all classes of M Corporation stock, M cannot grant an incentive stock option to E unless the option is granted at an option price of at least 110 percent of the fair market value of the stock subject to the option and the option, by its terms, expires no later than 5 years from its date of grant. The option granted to E fails to meet the option-price and term requirements described in paragraph (f)(1) of this section and, thus, the option is not an incentive stock option.

(iii) Assume the same facts as in paragraph (i) of this Example 1, except that E's father and brother each owned 7,500 shares of M Corporation stock, and E owned no M stock in E's own name. Because under the attribution rules of §1.424-1(d), E is treated as owning stock held by E's parents and siblings, M cannot grant an incentive stock option to E unless the option price is at least 110 percent of the fair market value of the stock subject to the option, and the option, by its terms, expires no later than 5 years from the date of grant.

Example 2. Assume the same facts as in paragraph (i) of this Example 1. Assume further that M is a subsidiary of P Corporation. Regardless of whether E owns any P stock and the number of P shares outstanding, if P Corporation grants an option to E which purports to be an incentive stock option, but which fails to meet the 110-percent-option-price and 5-year-term requirements, the option is not an incentive stock option because E owns more than 10 percent of the total combined voting power of all classes of stock of a related corporation of P Corporation (i.e., M Corporation). An individual who owns (or is treated as owning) stock in excess of the ownership specified in paragraph (f)(1) of this section, in any corporation in a group of corporations consisting of the employer corporation and its related corporations, cannot be granted an incentive stock option by any corporation in the group unless such option meets the

110-percent-option-price and 5-year-term requirements of paragraph (f)(1) of this section.

Example 3. (i) F is an employee of R Corporation. R has only one class of stock, of which 100,000 shares are issued and outstanding. F owns no stock in R Corporation or any related corporation of R Corporation. On January 1, 2005, R grants a 10-year incentive stock option to F to purchase 50,000 shares of R stock at $3 per share, the fair market value of R stock on the date of grant of the option. On April 1, 2005, F exercises half of the January option and receives 25,000 shares of R stock that previously were not outstanding. On July 1, 2005, R grants a second 50,000 share option to F which purports to be an incentive stock option. The terms of the July option are identical to the terms of the January option, except that the option price is $3.25 per share, which is the fair market value of R stock on the date of grant of the July option.

(ii) Because F did not own more than 10% of the total combined voting power of all classes of stock of R Corporation or any related corporation on the date of the grant of the January option and the pricing requirements of paragraph (e) of this section are satisfied on the date of grant of such option, the unexercised portion of the January option remains an incentive stock option regardless of the changes in F's percentage of stock ownership in R after the date of grant. However, the July option is not an incentive stock option because, on the date that it was granted, F owned 20 percent (25,000 shares owned by F divided by 125,000 shares of R stock issued and outstanding) of the total combined voting power of all classes of R Corporation stock and, thus the pricing requirements of paragraph (f)(1) of this section were not met.

(iii) Assume the same facts as in paragraph (i) of this Example 3 except that the partial exercise of the January incentive stock option on April 1, 2003, is for only 10,000 shares. Under these circumstances, the July option is an incentive stock option, because, on the date of grant of the July option, F does not own more than 10 percent of the total combined voting power (10,000 shares owned by F divided by 110,000 shares of R issued and outstanding) of all classes of R Corporation stock.

§1.422-4 [Removed]

Par. 7. Section 1.422-4 is removed.

§1.422-5 [Redesignated]

Par. 8. Section 1.422-5 is re-designated as §1.422-3.

Par. 9. New §1.422-4 is added to read as follows:

§1.422-4 $100,000 limitation for incentive stock options.

(a) $100,000 per year limitation--(1) General rule. An option that otherwise qualifies as an incentive stock option nevertheless fails to be an incentive stock option to the extent that the $100,000 limitation described in paragraph (a)(2) of this section is exceeded.

(2) $100,000 per year limitation. To the extent that the aggregate fair market value of stock with respect to which an incentive stock option (determined without regard to this section) is exercisable for the first time by any individual during any calendar year (under all plans of the employer corporation and related corporations) exceeds $100,000, such option is treated as a nonstatutory option. See §1.83-7 for rules applicable to nonstatutory options.

(b) Application. To determine whether the limitation described in paragraph (a)(2) of this section has been exceeded, the following rules apply.

(1) An option that does not meet the requirements of §1.422-2 when granted (including an option which, when granted, contains terms providing that it will not be treated as incentive stock option) is disregarded. See §1.422-2(a)(4).

(2) The fair market value of stock is determined as of the date of grant of the option for such stock.

(3) Except as otherwise provided in paragraph (b)(4) of this section, options are taken into account in the order in which they are granted.

(4) For purposes of this section, an option is considered to be first exercisable during a calendar year if the option will become exercisable at any time during the year assuming that any condition on the optionee's ability to exercise the option related to

the performance of services is satisfied. If the optionee's ability to exercise the option in the year is subject to an acceleration provision, then the option is considered first exercisable in the calendar year in which the acceleration provision is triggered. After an acceleration provision is triggered, the options subject to such provision are then taken into account in accordance with paragraph (b)(3) of this section for purposes of applying the limitation described in paragraph (a)(2) of this section to all options first exercisable during a calendar year. However, because an acceleration provision is not taken into account prior to its triggering, an incentive stock option that becomes exercisable for the first time during a calendar year by operation of such a provision does not affect the application of the $100,000 limitation with respect to any option (or portion thereof) exercised prior to such acceleration. For purposes of this paragraph (b)(4), an acceleration provision includes, for example, a provision that accelerates the exercisability of an option on a change in ownership or control or a provision that conditions exercisability on the attainment of a performance goal. See paragraph (d), Example 4 of this section.

(5)(i) An option (or portion thereof) is disregarded if, prior to the calendar year during which it would otherwise have become exercisable for the first time, the option (or portion thereof) is modified and thereafter ceases to be an incentive stock option described in §1.422-2, is canceled, or is transferred in violation of §1.421-1(b)(2).

(ii) If an option (or portion thereof) is modified, canceled, or transferred at any other time, such option (or portion thereof) is treated as outstanding according to its original terms until the end of the calendar year during which it would otherwise have become exercisable for the first time.

(6) A disqualifying disposition has no effect on the determination of whether an option exceeds the $100,000 limitation.

(c) Bifurcation of options. The application of the rules described in paragraph (b) of this section may result in an option being treated, in part, as an incentive stock option and, in part, as a nonstatutory option. In such a case, a corporation can issue a separate certificate for incentive option stock and designate such stock as incentive stock option stock in the corporation's transfer records. In the absence of such a designation, a pro rata portion of each share of stock purchased under the option is treated as incentive stock option stock and nonstatutory option stock. See §1.83-7 for the treatment of nonstatutory options.

(d) Examples. The following examples illustrate the principles of this section. In each of the following examples E is an employee of X Corporation. The examples are as follows:

Example 1. General rule. Effective January 1, 2004, X Corporation adopts a plan under which incentive stock options may be granted to its employees. On January 1, 2004, and each succeeding January 1 through January 1, 2013, E is granted immediately exercisable options for X Corporation stock with a fair market value of $100,000 determined on the date of grant. The options qualify as incentive stock options (determined without regard to this section). On January 1, 2014, E exercises all of the options. Because the $100,000 limitation has not been exceeded during any calendar year, all of the options are treated as incentive stock options.

Example 2. Order of grant. X Corporation is a parent corporation of Y Corporation, which is a parent corporation of Z Corporation. Each corporation has adopted its own separate plan, under which an employee of any member of the corporate group may be granted options for stock of any member of the group. On January 1, 2004, X Corporation grants E an incentive stock option (determined without regard to this section) for stock of Y Corporation with a fair market value of $100,000 on the date of grant. On December 31, 2004, Y Corporation grants E an incentive stock option (determined without regard to this section) for stock of Z Corporation with a fair market value of $75,000 as of the date of grant. Both of the options are immediately exercisable. For purposes of this section, options are taken into account in the order in which granted using the fair market value of stock as of the date on the option is granted. During calendar year 2004, the aggregate fair market value of stock with respect to which E's options are exercisable for the first time exceeds $100,000. Therefore, the option for Y Corporation stock is treated as an incentive stock option, and the option for Z Corporation stock is treated as a nonstatutory option.

Example 3. Acceleration provision. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $150,000 on the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Date of Grant	Fair Market Value of Stock	First Exercisable
Option 1	April 1, 2004	$60,000	2004
Option 2	May 1, 2004	$50,000	2006
Option 3	June 1, 2004	$40,000	2004

(ii) In July of 2004, a change in control of X Corporation occurs, and, under the terms of its option plan, all outstanding options become immediately exercisable. Under the rules of this section, Option 1 is treated as an incentive stock option in its entirety; Option 2 exceeds the $100,000 aggregate fair market value limitation for calendar year 2004 by $10,000 (Option 1's $60,000 + Option 2's $50,000 = $110,000) and is, therefore, bifurcated into an incentive stock option for stock with a fair market value of $40,000 as of the date of grant and a nonstatutory option for stock with a fair market value of $10,000 as of the date of grant. Option 3 is treated as a nonstatutory option in its entirety.

Example 4. Exercise of option and acceleration provision. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $120,000 on the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Option 1	Option 2	Option 3

Date of Grant	Fair Market Value of Stock	First Exercisable
April 1, 2004	$60,000	2005
May 1, 2004	$40,000	2006
June 1, 2004	$20,000	2005

(ii) On June 1, 2005, E exercises Option 3. At the time of exercise of Option 3, the fair market value of X stock (at the time of grant) with respect to which options held by E are first exercisable in 2005 does not exceed $100,000. On September 1, 2005, a change of control of X Corporation occurs, and, under the terms of its option plan, Option 2 becomes immediately exercisable. Under the rules of this section, because E's exercise of Option 3 occurs before the change of control and the effects of an acceleration provision are not taken into account until it is triggered, Option 3 is treated as an incentive stock option in its entirety. Option 1 is treated as an incentive stock option in its entirety. Option 2 is bifurcated into an incentive stock option for stock with a fair market value of $20,000 on the date of grant and a nonstatutory option for stock with a fair market value of $20,000 on the date of grant because it exceeds the $100,000 limitation for 2003 by $20,000 (Option 1 for $60,000 + Option 3 for $20,000 + Option 2 for $40,000 = $120,000).

(iii) Assume the same facts as in paragraph (ii) of this Example 4, except that the change of control occurs on May 1, 2005. Because options are taken into account in the order in which they are granted, Option 1 and Option 2 are treated as incentive stock options in their entirety. Because the exercise of Option 3 (on June 1, 2005) takes place after the acceleration provision is triggered, Option 3 is treated as a nonstatutory option in its entirety.

Example 5. Cancellation of option. (i) In 2004, X Corporation grants E three incentive stock options (determined without regard to this section) to acquire stock with an aggregate fair market value of $140,000 as of the date of grant. The dates of grant, the fair market value of the stock (as of the applicable date of grant) with respect to which the options are exercisable, and the years in which the options are first exercisable (without regard to acceleration provisions) are as follows:

	Date of Grant	Fair Market Value of Stock	First Exercisable
Option 1	April 1, 2004	$60,000	2005
Option 2	May 1, 2004	$40,000	2005
Option 3	June 1, 2004	$40,000	2005

(ii) On December 31, 2004, Option 2 is canceled. Because Option 2 is canceled before the calendar year during which it would have become exercisable for the first time, it is disregarded. As a result, Option 1 and Option 3 are treated as incentive stock options in their entirety.

(iii) Assume the same facts as in paragraph (ii) of this Example 5, except that Option 2 is canceled on January 1, 2005. Because Option 2 is not canceled prior to the calendar year during which it would have become exercisable for the first time (2005), it is treated as an outstanding option for purposes of determining whether the $100,000 requirement for 2005 has been exceeded. Because options are taken into account in the order in which granted, Option 1 is treated as an incentive stock option in its entirety. Because Option 3 exceeds the $100,000 limitation by $40,000 (Option 1 for $60,000 + Option 2 for $40,000 + Option 3 for $40,000 = $140,000), it is treated as a nonstatutory options in its entirety.

(iv) Assume the same facts as in paragraph (i) of this Example 5, except that on January 1, 2005, E exercises Option 2 and immediately sells the stock in a disqualifying disposition. A disqualifying disposition has no effect on the determination of whether the underlying option is considered outstanding during the calendar year during which it is first exercisable. Because options are taken into account in the order in which granted, Option 1 is treated as an incentive stock option in its entirety. Because Option 3 exceeds the $100,000 limitation by $40,000 (Option 1 for $60,000 + Option 2 for $40,000 + Option 3 for $40,000 = $140,000), it is treated as a nonstatutory option in its entirety.

Example 6. Designation of stock. On January 1, 2004, X grants E an immediately exercisable incentive stock option (determined without regard to this section) to acquire X stock with a fair market value of $150,000 on that date. Under the rules of this section, the option is bifurcated and treated as an incentive stock option for X stock with a fair market value of $100,000 and a nonstatutory option for X stock with a fair market value of $50,000. In these circumstances, X may designate the stock that is treated as stock acquired pursuant to the exercise of an incentive stock option by issuing a separate certificate (or certificates) for $100,000 of stock and identifying such certificates as Incentive Stock Option Stock in its transfer records. In the absence of such a designation, two-thirds ($100,000 / $150,000) of each share of stock is treated as acquired pursuant to the exercise of an incentive stock option and one-third ($50,000 / $150,000) as stock acquired pursuant to the exercise of a nonstatutory option.

Par. 10. Section 1.422-5 is added to read as follows:

§1.422-5 Permissible provisions.

(a) General rule. An option that otherwise qualifies as an incentive stock option does not fail to be an incentive stock option merely because such option contains one or more of the provisions described in paragraphs (b), (c), and (d) of this section.

(b) Cashless exercise. (1) An option does not fail to be an incentive stock option merely because the optionee may exercise the option with previously acquired stock of the corporation that granted the option or stock of the corporation whose stock is being offered for purchase under the option. For special rules relating to the use of statutory option stock to pay the option price of an incentive stock option, see §1.424-1(c)(3).

(2) All shares acquired through the exercise of an incentive stock option are individually subject to the holding period requirements described in §1.422-1(a) and the disqualifying disposition rules of §1.422-1(b), regardless of whether the option is exercised with previously acquired stock of the corporation that granted the option or stock of the corporation whose stock is being offered for purchase under the option. If an incentive stock option is exercised with such shares, and the exercise results in the basis allocation described in paragraph (b)(3) of this section, the optionee's

disqualifying disposition of any of the stock acquired through such exercise is treated as a disqualifying disposition of the shares with the lowest basis.

(3) If the exercise of an incentive stock option with previously acquired shares is comprised in part of an exchange to which section 1036 (and so much of section 1031 as relates to section 1036) applies, then:

(i) The optionee's basis in the incentive stock option shares received in the section 1036 exchange is the same as the optionee's basis in the shares surrendered in the exchange, increased, if applicable, by any amount included in gross income as compensation pursuant to sections 421 through 424 or section 83. Except for purposes of §1.422-1(a), the holding period of the shares is determined under section 1223. For purposes of §1.422-1 and sections 421(b) and 83 and the regulations thereunder, the amount paid for the shares purchased under the option is the fair market value of the shares surrendered on the date of the exchange.

(ii) The optionee's basis in the incentive stock option shares not received pursuant to the section 1036 exchange is zero. For all purposes, the holding period of such shares begins as of the date that such shares are transferred to the optionee. For purposes of §1.422-1(b) and sections 421(b) and 83 and the regulations thereunder, the amount paid for the shares is considered to be zero.

(c) <u>Additional compensation</u>. An option does not fail to be an incentive stock option merely because the optionee has the right to receive additional compensation, in cash or property, when the option is exercised, provided such additional compensation is includible in income under section 61 or section 83. The amount of such additional compensation may be determined in any manner, including by reference to the fair market value of the stock at the time of exercise or to the option price.

(d) Option subject to a condition. (1) An option does not fail to be an incentive stock option merely because the option is subject to a condition, or grants a right, that is not inconsistent with the requirements of §§1.422-2 and 1.422-4.

(2) An option that includes an alternative right is not an incentive stock option if the requirements of §1.422-2 are effectively avoided by the exercise of the alternative right. For example, an alternative right extending the option term beyond ten years, setting an option price below fair market value, or permitting transferability prevents an option from qualifying as an incentive stock option. If either of two options can be exercised, but not both, each such option is a disqualifying alternative right with respect to the other, even though one or both options would individually satisfy the requirements of §§1.422-2, 1.422-4, and this section.

(3) An alternative right to receive a taxable payment of cash and/or property in exchange for the cancellation or surrender of the option does not disqualify the option as an incentive stock option if the right is exercisable only when the then fair market value of the stock exceeds the exercise price of the option and the option is otherwise exercisable, the right is transferable only when the option is otherwise transferable, and the exercise of the right has the same economic and tax consequences as the exercise of the option followed by an immediate sale of the stock. For this purpose, the exercise of the alternative right does not have the same economic and tax consequences if the payment exceeds the difference between the then fair market value of the stock and the exercise price of the option.

(e) Examples. The principles of this section are illustrated by the following examples:

Example 1. On June 1, 2004, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase 100 shares of X Corporation common stock at $10 per share. The option provides that A may exercise the option with previously acquired shares of X Corporation common stock. X Corporation has only one class of common stock outstanding. Under the rules of section 83, the shares transferable to A through the exercise of the option are transferable and not subject to a substantial risk of forfeiture. On June 1, 2005, when the fair market value of an X Corporation share is $25, A uses 40 shares of X Corporation common stock, which A had purchased on the open market on June 1, 2002, for $5 per share, to pay the full option price. After exercising the option, A owns 100 shares of incentive stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), 40 of the shares have a $200 aggregate carryover basis (the $5 purchase price x 40 shares) and a three-year holding period for purposes of determining capital gain, and 60 of the shares have a zero basis and a holding period beginning on June 1, 2005, for purposes of determining capital gain. All 100 shares have a holding period beginning on June 1, 2005, for purposes of determining whether the holding period requirements of §1.422-1(a) are met.

Example 2. Assume the same facts as in Example 1. Assume further that, on September 1, 2005, A sells 75 of the shares that A acquired through exercise of the incentive stock option for $30 per share. Because the holding period requirements were not satisfied, A made a disqualifying disposition of the 75 shares on September 1, 2005. Under the rules of paragraph (b)(3) of this section, A has sold all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, under paragraph (b)(3) of this section and section 83(a), the amount of compensation attributable to A's exercise of the option and subsequent disqualifying disposition of 75 shares is $1,500 (the difference between the fair market value of the stock on the date of transfer, $1,875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). In addition, A must recognize a capital gain of $675. Accordingly, A must include in gross income for the taxable year in which the sale occurs $1,500 as compensation and $675 as capital gain. For its taxable year in which the disqualifying disposition occurs, if otherwise allowable under section 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a deduction of $1,500 for the compensation paid to A.

Example 3. Assume the same facts as in Example 2, except that, instead of selling the 75 shares of incentive stock option stock on September 1, 2005, A uses those shares to exercise a second incentive stock option. The second option was granted to A by X Corporation on January 1, 2005, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. As in Example 2, A has made a disqualifying disposition of the 75 shares of stock pursuant to §1.424-1(c). Under paragraph (b)(1) of this section, A has disposed of all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, pursuant to paragraph (b)(3) of this section and section 83(a), the amount of compensation attributable to A's exercise of the first option and subsequent disqualifying disposition of 75 shares is $1,500 (the difference between the fair market value of the stock on the date of transfer, $1,875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). Unlike Example 2, A does not recognize any capital gain as a result of exercising the second option because, for all purposes other than the determination of whether the exercise is a disposition pursuant to section 424(c), the exercise is considered an exchange to which section 1036 applies. Accordingly, A must include in gross income for the taxable year in which the disqualifying disposition occurs $1,500 as compensation. For its taxable year in which the disqualifying disposition occurs, if otherwise alllowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are met, X Corporation is allowed a deduction of $1,500 for the compensation paid to A. After exercising the second option, A owns a total of 125 shares of incentive stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), the 100 "new" shares of incentive stock option stock have the following bases and holding periods: 15 shares have a $75 carryover basis and a three-year-and-three-month holding period for purposes of determining capital gain, 60 shares have a $1,500 basis resulting from the inclusion of that amount in income as compensation and a three-month holding period for purposes of determining capital gain, and 25 shares have a zero basis and a holding period beginning on September 1, 2005, for purposes of determining capital gain. All 100 shares have a holding period beginning on September 1, 2005, for purposes of determining whether the holding period requirements of §1.422-1(a)are met.

Example 4. Assume the same facts as in Example 2, except that, instead of selling the 75 shares of incentive stock option stock on September 1, 2005, A uses those shares to exercise a nonstatutory option. The nonstatutory option was granted to A by X Corporation on January 1, 2005, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. Unlike Example 3, A has not made a disqualifying disposition of the 75 shares of stock. After exercising the nonstatutory option, A owns a total of 100 shares of incentive stock option stock and 25 shares of nonstatutory stock option stock. Under section 1036 (and so much of section 1031 as relates to section 1036), the 75 new shares of incentive stock option stock have the same basis and holding period as the 75 old shares used to exercise the nonstatutory option. The additional 25 shares of stock received upon exercise of the nonstatutory option are taxed under the rules of section 83(a). Accordingly, A must include in gross income for the taxable year in which the transfer of such shares occurs $750 (25 shares at $30 per share) as compensation. A's basis in such shares is the same as the amount included in gross income. For its taxable year in which the transfer occurs, X Corporation is allowed a deduction of $750 for the compensation paid to A to the extent allowable under sections 83(h) and 162 and if the requirements of §1.83-6(a) are satisfied.

Example 5. Assume the same facts in Example 1, except that the shares transferred pursuant to the exercise of the incentive stock option are subject to a substantial risk of forfeiture and not transferable (substantially nonvested) for a period of six months after such transfer. Assume further that the shares that A uses to exercise the incentive stock option are similarly restricted. Such shares were transferred to A on January 1, 2005, through A's exercise of a nonstatutory stock option which was granted to A on January 1, 2004. A paid $5 per share for the stock when its fair market value was $22.50 per share. A did not file a section 83(b) election to include the $700 spread (the difference between the option price and the fair market value of the stock on date of exercise of the nonstatutory option) in gross income as compensation. After exercising the incentive stock option with the 40 substantially-nonvested shares, A owns 100 shares of substantially-nonvested incentive stock option stock. Section 1036 (and so much of section 1031 as relates to section 1036) applies to the 40 shares exchanged in exercise of the incentive stock option. However, pursuant to section 83(g), the stock received in such exchange, because it is incentive stock option stock, is not subject to restrictions and conditions substantially similar to those to which the stock given in such exchange was subject. For purposes of section 83(a) and §1.83-1(b)(1), therefore, A has disposed of the 40 shares of substantially-nonvested stock on June 1, 2005, and must include in gross income as compensation $800 (the difference between the amount realized upon such disposition, $1,000, and the amount paid for the stock, $200). Accordingly, 40 shares of the incentive stock option stock have a $1,000 basis (the $200 original basis plus the $800 included in income as compensation) and 60 shares of the incentive stock option stock have a zero basis. For its taxable year in which the disposition of the substantially-nonvested stock occurs, X Corporation is allowed a deduction of $800 for the compensation paid to A, provided that the requirements of §1.83-6 are satisfied.

(f) Effective date. This section applies to any statutory option granted on or after the date that is 180 days after publication of final regulations in the **Federal Register**. Taxpayers can rely on these regulations for the treatment of any statutory option granted on or after June 9, 2003.

§1.423-1 [Amended]

Par. 11. Section 1.423-1 is amended as follows:

1. In paragraph (a)(2), the language "425(a)" is removed and "424(a)" is added in its place.

2. In paragraph (b), first sentence, the language "§1.421-7" is removed and

“§1.421-1" is added in its place.

3. In paragraph (b), second sentence, the language “§1.421-8" is removed and §1.421-2" is added in its place.

4. In paragraph (b), last sentence, the language “425(c)” is removed and “424(c)” is added in its place.

5. In paragraph (b), last sentence, the language “§1.425-1" is removed and “§1.424-1" is added in its place.

§1.423-2 [Amended]

Par. 12. Section 1.423-2 is amended by:

1. In paragraph (b), last sentence, the language “§1.421-7" is removed and “§1.421-1" is added in its place.

2. In paragraph (d)(1), second sentence, the language “425(d)” is removed and “424(d)” is added in its place.

3. In paragraph (d)(3), Example 3, fourth sentence, the language “425(d)” is removed and “424(d)” is added in its place.

4. In paragraph (e)(2), the language “§1.421-7" is removed and “§1.421-1" is added in its place.

5. In paragraph (g)(1), the first sentence of the concluding text, the language “§1.421-7" is removed and “§1.421-1" is added in its place.

6. In paragraph (g)(1), the third sentence of the concluding text, the language “§1.421-7" is removed and “§1.421-1" is added in its place.

7. In paragraph (j), second sentence, the language “§1.421-7" is removed and “§1.421-1" is added in its place.

8. In paragraph (j), last sentence, the language “425" is removed and “424" is added in its place.

9. In paragraph (k)(2), second sentence, the language “§1.421-8" is removed and “§1.421-2" is added in its place.

§1.425-1 [Redesignated]

Par. 13. Section 1.425-1 is redesignated as §1.424-1 and is amended by:

1. Revising paragraphs (a)(1) through (a)(6).

2. Redesignating paragraph (a)(7) as paragraph (a)(9).

3. Adding paragraph (a)(7).

4. Revising paragraph (a)(8).

5. Adding paragraph (a)(10).

6. In paragraph (b)(1), first, second, and last sentences, the language “425" is removed wherever it appears, and “424" is added in their places.

7. In paragraph (c)(1), first sentence, the language “425" is removed and “424" is added in its place.

8. In paragraph (c)(1), first sentence, the language “disposition” is removed and “disposition of stock” is added in its place.

9. Adding paragraph (c)(1)(iv).

10. Redesignating paragraph (c)(3) as (c)(4).

11. Adding new paragraph (c)(3).

12. Adding newly designated paragraph (c)(4), Examples 7 through 9.

13. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly Designated Section	Remove	Add
1.424-1(c)(4), Example 1, first sentence	1964	2004
1.424-1(c)(4), Example 1, first sentence	qualified stock option	statutory option
1.424-1(c)(4), Example 1, second and fourth sentences	1965	2005
1.424-1(c)(4), Example 1, third sentence	1968	2006
1.424-1(c)(4), Example 2, first sentence	1968	2006
1.424-1(c)(4), Example 2, last sentence	long-term	
1.424-1(c)(4), Example 3, first sentence	1968	2006
1.424-1(c)(4), Example 4, first sentence	1968, two years and 11 months after the transfer of shares to him	2006

1.424-1(c)(4), Example 4, last sentence	three years from the date	two years from the date the options were granted and within one year of the date that
1.424-1(c)(4), Example 5, first sentence	1965	2005
1.424-1(c)(4), Example 5, first sentence	qualified stock option	statutory option
1.424-1(c)(4), Example 6, first sentence	1965	2005
1.424-1(c)(4), Example 6, third sentence	three years	2 years
1.424-1(c)(4), Example 6, last sentence	income	compensation income
1.424-1(c)(4), Example 6, third sentence	a qualified stock option	the option
1.424-1(c)(4), Example 6, last sentence	paragraph (b)(2) of §1.421-8	§1.421-2(b)(2)

14. Revising paragraph (d).

15. Revising paragraphs (e)(1) and (e)(2).

16. In paragraph (e)(3), first sentence, remove the phrase "Except as otherwise provided in subparagraph (4)" and add "If section 423(c) applies to an option then,".

17. In paragraph (e)(3), first sentence, remove the language ", and 424(b)(1)."

18. Removing paragraph (e)(4).

19. Redesignating paragraph (e)(5) as paragraph (e)(4).

20. Revising newly designated paragraph (e)(4).

21. Redesignating paragraph (e)(6) as paragraph (e)(5) and removing the

second and third sentences.

22. Adding a new paragraph (e)(6).

23. In list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Section	Remove	Add
1.424-1(e)(7) Example 1, first sentence	1964	2004
1.424-1(e)(7) Example 1, first sentence	1966	2006
1.424-1(e)(7) Example 1, third, fourth, fifth, sixth and last sentences	1965	2005
1.424-1(e)(7) Example 1, fifth sentence	425(h)	424(h)
1.424-1(e)(7) Example 1, last sentence	The exercise of such	Because the requirements of §1.424-1(e)(3) and §1.423-2(g) have not been met, the exercise of such
1.424-1(e)(7) Example 2, first, second, and fifth sentences	1964	2004
1.424-1(e)(7) Example 2, first, third, fourth, and fifth sentences, wherever it appears	1965	2005

1.424-1(e)(7) Example 2, first and third sentences	1966	2006
1.424-1(e)(7) Example 2, fifth sentence	425(h)	424(h)
1.424-1(e)(7) Example 2, last sentence	The exercise of such	Because the requirements of §1.424-1(e)(3) and §1.423-2(g) have not been met, the exercise of such
1.424-1(e)(7) Example 3, first, second, and last sentences	1965	2005

24. In paragraph (e)(7), remove Example 4.

25. Adding paragraphs (f) and (g).

The additions and revisions are as follows:

§ 1.424-1 Definitions and special rules applicable to statutory options.

(a) Substitutions and assumptions of options--(1) In general. (i) This paragraph (a) provides rules under which an eligible corporation (as defined in paragraph (a)(2) of this section) may, by reason of a corporate transaction (as defined in paragraph (a)(3) of this section), substitute a new statutory option (new option) for an outstanding statutory option (old option) or assume an old option without such substitution or assumption being considered a modification of the old option. For the definition of modification, see paragraph (e) of this section.

(ii) For purposes of §§1.421-1 through 1.424-1, the phrase "substituting or assuming a stock option in a transaction to which section 424 applies," "substituting or assuming a stock option in a transaction to which §1.424-1(a) applies," and similar phrases means a substitution of a new option for an old option or an assumption of an old option that meets the requirements of this paragraph (a). For a substitution or assumption to qualify under this paragraph (a), the substitution or assumption must meet all of the requirements described in paragraphs (a)(4) and (a)(5) of this section.

(2) Eligible corporation. For purposes of this paragraph (a), the term eligible corporation means a corporation that is the employer of the optionee or a related corporation of such corporation. For purposes of this paragraph (a), the determination of whether a corporation is the employer of the optionee or a related corporation of such corporation is based upon all of the relevant facts and circumstances existing immediately after the corporate transaction.

(3) Corporate transaction. For purposes of this paragraph (a), the term corporate transaction includes--

(i) A corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation;

(ii) A distribution (excluding ordinary dividends) or change in the terms or number of outstanding shares of such corporation (e.g., a stock split or stock dividend);

(iii) A change in the name of the corporation whose stock is purchasable under the old option; and

(iv) Such other corporate events prescribed by the Commissioner in published guidance.

(4) By reason of. (i) For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), the change must be

made by an eligible corporation (as defined in paragraph (a)(2) of this section) and occur by reason of a corporate transaction (as defined in paragraph (a)(3) of this section).

(ii) Generally, a change in an option or issuance of a new option is considered to be by reason of a corporate transaction, unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction. For example, a change in an option or issuance of a new option will be considered to be made for reasons unrelated to a corporate transaction if there is an unreasonable delay between the corporate transaction and such change in the option or issuance of a new option, or if the corporate transaction serves no substantial corporate business purpose independent of the change in options. Similarly, a change in the number or price of shares purchasable under an option merely to reflect market fluctuations in the price of the stock purchasable under an option is not by reason of a corporate transaction.

(iii) A change in an option or issuance of a new option is by reason of a distribution or change in the terms or number of the outstanding shares of a corporation (as described in paragraph (a)(3)(ii) of this section) only if the option as changed or the new option issued is an option on the same stock as under the old option (or if such class of stock is eliminated in the change in capital structure, on other stock of the same corporation).

(iv) A change in an option or issuance of a new option is by reason of a change in the name of a corporation (as defined in paragraph (a)(3)(iii) of this section) only if the option as changed or the new option issued is an option on stock of the successor corporation.

(5) Other requirements. For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), all of the requirements described in this paragraph (a)(5) must be met.

(i) In the case of an issuance of a new option (or a portion thereof) in exchange for an old option (or portion thereof), the optionee's rights under the old option (or portion thereof) must be canceled, and the optionee must lose all rights under the old option (or portion thereof). There cannot be a substitution of a new option for an old option within the meaning of this paragraph (a) if the optionee may exercise both the old option and the new option. It is not necessary to have a complete substitution of a new option for the old option. However, any portion of such option which is not substituted or assumed in a transaction to which this paragraph (a) applies is an outstanding option to purchase stock or, to the extent paragraph (e) of this section applies, a modified option.

(ii) The excess of the aggregate fair market value of the shares subject to the new or assumed option immediately after the change in the option or issuance of a new option over the aggregate option price of such shares must not exceed the excess of the aggregate fair market value of all shares subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option over the aggregate option price of such shares.

(iii) On a share by share comparison, the ratio of the option price to the fair market value of the shares subject to the option immediately after the change in the option or issuance of a new option must not be more favorable to the optionee than the ratio of the option price to the fair market value of the stock subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option. The number of shares subject to the new or assumed option may be adjusted to compensate for any change in the aggregate spread between the aggregate option price and the aggregate fair market value of the shares subject to the option immediately after the change in the option or issuance of the new option as compared to the aggregate spread between the option price and the aggregate fair market value of the shares subject to the option immediately before the change in the option or issuance of the new option.

(iv) The new or assumed option must contain all terms of the old option, except to the extent such terms are rendered inoperative by reason of the corporate transaction.

(v) The new option or assumed option must not give the optionee additional benefits that the optionee did not have under the old option.

(vi) The new or assumed option must otherwise comply with the requirements of §1.422-2 or §1.423-2. Thus, for example, the old option must be assumed or the new option must be issued under a plan approved by the stockholders of the corporation changing the option or issuing the new option as described in §1.422-2(b)(2) or §1.423-2(c), as applicable.

(6) Obligation to substitute or assume not necessary. For a change in the option or issuance of a new option to meet the requirements of this paragraph (a), it is not necessary to show that the corporation changing an option or issuing a new option is under any obligation to do so. In fact, this paragraph (a) may apply even when the

option that is being replaced or assumed expressly provides that it will terminate upon the occurrence of certain corporate transactions. However, this paragraph (a) cannot be applied to revive a statutory option which, for reasons not related to the corporate transaction, expires before it can properly be replaced or assumed under this paragraph (a).

(7) Issuance of stock without meeting the requirements of this paragraph (a). A change in the terms of an option resulting in a modification of such option occurs if an optionee's new employer (or a related corporation of the new employer) issues its stock (or stock of a related corporation) upon exercise of such option without satisfying all of the requirements described in paragraphs (a)(4) and (5) of this section.

(8) Date of grant. For purposes of applying the rules of this paragraph (a), a substitution or assumption is considered to occur on the date that the optionee would, but for this paragraph (a), be considered to have been granted the option that the eligible corporation is substituting or assuming. A substitution or an assumption that occurs by reason of a corporate transaction may occur before or after the corporate transaction.

* * * * *

(10) Examples. The principles of this paragraph (a) are illustrated by the following examples:

Example 1. Eligible corporation. X Corporation acquires a new subsidiary, Y Corporation, and transfers some of its employees to Y. Y Corporation wishes to grant to its new employees and to the employees of X Corporation new options for Y shares in exchange for old options for X shares that were previously granted by X Corporation. Because Y Corporation is an employer with respect to its own employees and a related corporation of X Corporation, Y Corporation is an eligible corporation under paragraph (a)(2) of this section with respect to both the employees of X and Y Corporations.

Example 2. Corporate transaction. (i) On January 1, 2004, Z Corporation grants E, an employee of Z, an option to acquire 100 shares of Z stock. At the time of grant, the fair market value of Z stock is $200 per share. E's option price is $200 per share. On July 1, 2005, when the fair market value of Z stock is $400, Z declares a stock dividend that causes the fair market value of Z stock to decrease to $200 per share. On the same day, Z grants to E a new option to acquire 200 shares of Z stock in exchange for E's old option. The new option has an exercise price of $100 per share.

(ii) A stock dividend is a corporate transaction under paragraph (a)(3)(ii) of this section. Generally, the issuance of a new option is considered to be by reason of a corporate transaction. None of the facts in this Example 2 indicate that the new option is not issued by reason of the stock dividend. In addition, the new option is issued on the same stock as the old option. Thus, the substitution occurs by reason of the corporate transaction. Assuming the other requirements of this section are met, the issuance of the new option is a substitution that meets the requirements of this paragraph (a) and is not a modification of the option.

(iii) Assume the same facts as in paragraph (i) of this Example 2. Assume further that on December 1, 2005, Z declares an ordinary cash dividend. On the same day, Z grants E an new option to acquire Z stock in substitution for E's old option. Under paragraph (a)(3)(ii) of this section, an ordinary cash dividend is not a corporate transaction. Thus, the exchange of the new option for the old option does not meet the requirements of this paragraph (a) and is a modification of the option.

Example 3. Corporate transaction. On March 15, 2004, A Corporation grants E, an employee of A, an option to acquire 100 shares of A stock at $50 per share, the fair market value of A stock on the date of grant. On May 2, 2005, A Corporation transfers several employees, including E, to B Corporation, a related corporation. B Corporation arranges to purchase some assets from A on the same day as E's transfer to B. Such purchase is without a substantial business purpose independent of making the exchange of E's old options for the new options appear to be by reason of a corporate transaction. The following day, B Corporation grants to E, one of its new employees, an option to acquire shares of B stock in exchange for the old option held by E to acquire A stock. Under paragraph (a)(3)(i) of this section, the purchase of assets is a corporate transaction. Generally, the substitution of an option is considered to occur by reason of a corporate transaction. However, in this case, the relevant facts and circumstances demonstrate that the issuance of the new option in exchange for the old option occurred by reason of the change in E's employer rather than a corporate transaction and that the sale of assets is without a substantial corporate business purpose independent of the change in the options. Thus, the exchange of the new option for the old option is not by reason of a corporate transaction that meets the requirements of this paragraph (a) and is a modification of the old option.

Example 4. Additional benefit. On June 1, 2004, P Corporation acquires 100 percent of the shares of S Corporation and issues a new option to purchase P shares in exchange for an old option to purchase S shares that is held by E, an employee of S. On the date of the exchange, E's old option is exercisable for 3 more years, and, after the exchange, E's new option is exercisable for 5 years. Because the new option is exercisable for an additional period of time beyond the time allowed under the old option, the effect of the exchange of the new option for the old option is to give E an additional benefit that E did not enjoy under the old option. Thus, the requirements of paragraph (a)(5) of this section are not met, and this paragraph (a) does not apply to the exchange of the new option for the old option. Therefore, the exchange is a modification of the old options.

<u>Example 5</u>. <u>Spread and ratio tests</u>. E is an employee of S Corporation. E holds an old option that was granted to E by S to purchase 60 shares of S at $12 per share. On June 1, 2005, S Corporation is merged into P Corporation, and on such date P issues a new option to purchase P shares in exchange for E's old option to purchase S shares. Immediately before the exchange, the fair market value of an S share is $32; immediately after the exchange, the fair market value of a P share is $24. The new option entitles E to buy P shares at $9 per share. Because, on a share-by-share comparison, the ratio of the new option price ($9 per share) to the fair market value of a P share immediately after the exchange ($24 per share) is not more favorable to E than the ratio of the old option price ($12 per share) to the fair market value of an S share immediately before the exchange ($32 per share) (9/24 = 12/32), the requirements of paragraph (a)(5)(iii) of this section are met. The number of shares subject to E's option to purchase P stock is set at 80. Because the excess of the aggregate fair market value over the aggregate option price of the shares subject to E's new option to purchase P stock, $1,200 (80 x $24 minus 80 x $9), is not greater than the excess of the aggregate fair market value over the aggregate option price of the shares subject to E's old option to purchase S stock, $1,200 (60 x $32 minus 60 x $12), the requirements of paragraph (a)(5)(ii) of this section are met.

<u>Example 6</u>. <u>Ratio test and partial substitution</u>. Assume the same facts as in <u>Example 5</u>, except that the fair market value of an S share immediately before the exchange of the new option for the old option is $8, that the option price is $10 per share, and that the fair market value of a P share immediately after the exchange is $12. P sets the new option price at $15 per share. Because, on a share-by-share comparison, the ratio of the new option price ($15 per share) to the fair market value of a P share immediately after the exchange ($12) is not more favorable to E than the ratio of the old option price ($10 per share) to the fair market value of an S share immediately before the substitution ($8 per share) (15/12 = 10/8), the requirements of paragraph (a)(5)(iii) of this section are met. Assume further that the number of shares subject to E's P option is set at 20, as compared to 60 shares under E's old option to buy S stock. Immediately after the exchange, 2 shares of P are worth $24, which is what 3 shares of S were worth immediately before the exchange (2 x $12 = 3 x $8). Thus, to achieve a complete substitution of a new option for E's old option, E would need to receive a new option to purchase 40 shares of P (*i.e.*, 2 shares of P for each 3 shares of S that E could have purchased under the old option (2/3 = 40/60)). Because

E's new option is for only 20 shares of P, P has replaced only ½ of E's old option, and the other ½ is still outstanding.

Example 7. Partial substitution. X Corporation forms a new corporation, Y Corporation, by a transfer of certain assets and, in a spin-off, distributes the shares of Y Corporation to the stockholders of X Corporation. E, an employee of X Corporation, is thereafter an employee of Y. Y wishes to substitute a new option to purchase some of its stock for E's old option to purchase 100 shares of X. E's old option to purchase shares of X, at $50 a share, was granted when the fair market value of an X share was $50, and an X share was worth $100 just before the distribution of the Y shares to X's stockholders. Immediately after the spin-off, which is also the time of the substitution, each share of X and each share of Y is worth $50. Based on these facts, a new option to purchase 200 shares of Y at an option price of $25 per share could be granted to E in complete substitution of E's old option. It would also be permissible to grant E a new option to purchase 100 shares of Y, at an option price of $25 per share, in substitution for E's right to purchase 50 of the shares under the old option.

Example 8. Stockholder approval requirements. (i) X Corporation, a publicly traded corporation, adopts an incentive stock option plan that meets the requirements of §1.422-2. Under the plan, options to acquire X stock are granted to X employees. X Corporation is acquired by Y Corporation and becomes a subsidiary corporation of Y Corporation. Y Corporation maintains an incentive stock option plan that meets the requirements of §1.422-2. Under the plan, options for Y stock may be granted to employees of Y or its related corporations. After the acquisition, X employees remain employees of X. In connection with the acquisition, Y Corporation substitutes new options for Y stock for old options for X stock that were previously granted to the employees of X. As a result of this substitution, on exercise of the new options, X employees receive Y Corporation stock.

(ii) Because Y Corporation has a plan that meets the requirements of §1.422-2 in existence on the date it acquires X, the new options for Y stock are granted under a plan approved by the stockholders of Y. The stockholders of Y do not need to approve the X plan. If the other requirements of paragraphs (a)(4) and (5) of this section are met, the issuance of new options for Y stock in exchange for the old options for X stock meets the requirements of this paragraph (a) and is not a modification of the old options.

(iii) Assume the same facts as in paragraph (i) of this Example 8, except that Y Corporation does not maintain an incentive stock option plan on the date of the acquisition of X. The Y options will only be incentive stock options if they are granted under a plan that meets the requirements of §1.422-2(b). Therefore, Y must adopt a plan that provides for the grant of incentive stock options, and the plan must be approved by the stockholders of Y in accordance with §1.422-2(b). If the stockholders of Y approve the incentive stock option plan within 12 months before or after the date of the adoption of a plan by Y and the other requirements of §1.422-2 and the requirements of this paragraph (a) are met, the issuance of the new options for Y stock in exchange for the old options for X stock meets the requirements of this paragraph (a) and is not treated as a modification of the old options for X stock. The result is the same if Y Corporation assumes the old options instead of issuing new options.

(iv) Assume the same facts as in paragraph (i) of this Example 8, except that there is no exchange of options. Instead, as part of the acquisition, X amends its plan to allow future grants under the plan to be grants to acquire Y stock. Because the amendment of the plan to allow options on a different stock is considered the adoption of the new plan, the stockholders of X must approve the plan within 12 months before or after the date of the amendment of the plan. If the stockholders of X timely approve the plan, the future grants to acquire Y stock will be incentive stock options (assuming the other requirements of §1.422-2 have been met).

Example 9. Modification. X Corporation merges into Y Corporation. Y Corporation retains employees of X who hold old options to acquire X Corporation stock. When the former employees of X exercise the old options, Y Corporation issues Y stock to the former employees of X. Under paragraph (a)(7) of this section, because Y issues its stock on exercise of the old options for X stock, there is a change in the terms of the old options for X stock. Thus, the issuance of Y stock on exercise of the old options is a modification of the old options.

* * * * *

(c) * * * (1) * * *

(iv) A transfer between spouses or incident to divorce (described in section 1041(a)). The special tax treatment of §1.421-2(a) with respect to the transferred stock applies to the transferee. However, see §1.421-1(b)(2) for the treatment of the transfer of a statutory option incident to divorce.

* * * * *

(3) If an optionee exercises an incentive stock option with statutory option stock and the applicable holding period requirements (under §1.422-1(a) or §1.423-1(a)) with respect to such statutory option stock are not met before such transfer, then sections 354, 355, 356, or 1036 (or so much of 1031 as relates to 1036) do not apply to determine whether there is a disposition of those shares. Therefore, there is a

disposition of the statutory option stock, and the special tax treatment of § 1.421-2(a) does not apply to such stock.

(4) * * *

Example 7. On January 1, 2004, X Corporation grants to E, an employee of X Corporation, an incentive stock option to purchase 100 shares of X Corporation stock at $100 per share (the fair market value of an X Corporation share on that date). On January 1, 2005, when the fair market value of a share of X Corporation stock is $200, E exercises half of the option, pays X Corporation $5,000 in cash, and is transferred 50 shares of X Corporation stock with an aggregate fair market value of $10,000. E makes no disposition of the shares before January 2, 2006. Under §1.421-2(a), no income is recognized by E on the transfer of shares pursuant to the exercise of the incentive stock option, and X Corporation is not entitled to any deduction at any time with respect to its transfer of the shares to E. E's basis in the shares is $5,000.

Example 8. Assume the same facts as in Example 7, except that on December 1, 2005, one year and 11 months after the grant of the option and 11 months after the transfer of the 50 shares to E, E uses 25 of those shares, with a fair market value of $5,000, to pay for the remaining 50 shares purchasable under the option. On that day, X Corporation transfers 50 of its shares, with an aggregate fair market value of $10,000, to E. Because E disposed of the 25 shares before the expiration of the applicable holding periods, §1.421-2(a) does not apply to the January 1, 2005, transfer of the 25 shares used by E to exercise the remainder of the option. As a result of the disqualifying disposition of the 25 shares, E recognizes compensation income under the rules of §1.421-2(b).

Example 9. On January 1, 2005, X Corporation grants an incentive stock option to E, an employee of X Corporation. The exercise price of the option is $10 per share. On June 1, 2005, when the fair market value of an X Corporation share is $20, E exercises the option and purchases 5 shares with an aggregate fair market value of $100. On January 1, 2006, when the fair market value of an X Corporation share is $50, X Corporation is acquired by Y Corporation in a section 368(a)(1)(A) reorganization. As part of the acquisition, all X Corporation shares are converted into Y Corporation shares. After the conversion, if an optionee holds a fractional share of X Corporation stock, Y Corporation will purchase the fractional share for cash equal to its fair market value. After applying the conversion formula to the shares held by E, E has 10 Y Corporation shares and one-half of a share of X Corporation stock. Y Corporation purchases E's one-half share for $25, the fair market value of one-half of an X Corporation share on the conversion date. Because E sells the one-half share prior to expiration of the holding periods described in §1.422-1(a), the sale is a disqualifying disposition of the one-half share. Thus, in 2006, E must recognize compensation income of $5 (one-half of the fair market value of an X Corporation share on the date of exercise of the option, or $10, less one-half of the exercise price per share, or $5). For purposes of computing any additional gain, E's basis in the one-half share increases to \$10 (reflecting the \$5 included in income as compensation). E recognizes an additional gain of \$15 (\$25, the fair market value of the one-half share, less \$10, the basis in such share). The extent to which the additional \$15 of gain is treated as a redemption of X Corporation stock is determined under section 302.

(d) Attribution of stock ownership. To determine the amount of stock owned by an individual for purposes of applying the percentage limitations relating to certain stockholders described in §§1.422-2(f) and 1.423-2(d), shares of the employer corporation or of a related corporation that are owned (directly or indirectly) by or for the individual's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants, are considered to be owned by the individual. Also, for such purposes, if a domestic or foreign corporation, partnership, estate, or trust owns (directly or indirectly) shares of the employer corporation or of a related corporation, the shares are considered to be owned proportionately by or for the stockholders, partners, or beneficiaries of the corporation, partnership, estate, or trust. The extent to which stock held by the optionee as a trustee of a voting trust is considered owned by the optionee is determined under all of the facts and circumstances.

(e) Modification, extension, or renewal of option. (1) This paragraph (e) provides rules for determining whether a share of stock transferred to an individual upon the individual's exercise of an option after the terms of the option have been changed is transferred pursuant to the exercise of a statutory option.

(2) Any modification, extension, or renewal of the terms of an option to purchase shares is considered the granting of a new option. The new option may or may not be

a statutory option. To determine the date of grant of the new option for purposes of section 422 or 423, see §1.421-1(c).

* * * * *

(4)(i) For purposes of §§1.421-1 through 1.424-1 the term modification means any change in the terms of the option (or change in the terms of the plan pursuant to which the option was granted or in the terms of any other agreement governing the arrangement) that gives the optionee additional benefits under the option regardless of whether the optionee in fact benefits from the change in terms. In contrast, for example, a change in the terms of the option shortening the period during which the option is exercisable is not a modification. However, a change providing an extension of the period during which an option may be exercised (such as after termination of employment) or a change providing an alternative to the exercise of the option (such as a stock appreciation right) is a modification regardless of whether the optionee in fact benefits from such extension or alternative right. Similarly, a change providing an additional benefit upon exercise of the option (such as the payment of a cash bonus) or a change providing more favorable terms for payment for the stock purchased under the option (such as the right to tender previously acquired stock) is a modification.

(ii) If an option is not immediately exercisable in full, a change in the terms of the option to accelerate the time at which the option (or any portion thereof) may be exercised is not a modification for purposes of this section. Additionally, no modification occurs if a provision accelerating the time when an option may first be exercised is removed prior to the year in which it would otherwise be triggered. For example, if an acceleration provision is timely removed to avoid exceeding the

$100,000 limitation described in §1.422-4, a modification of the option does not occur.

(iii) A change to an option which provides, either by its terms or in substance, that the optionee may receive an additional benefit under the option at the future discretion of the grantor, is a modification at the time that the option is changed to provide such discretion. In addition, the exercise of discretion to provide an additional benefit is a modification of the option. However, it is not a modification for the grantor to exercise discretion reserved under an option with respect to the payment of a cash bonus at the time of exercise, the availability of a loan at exercise, or the right to tender previously acquired stock for the stock purchasable under the option. An option is not modified merely because an optionee is offered a change in the terms of an option if the change to the option is not made.

(iv) A change in the terms of the stock purchasable under the option that affects the value of the stock is a modification of such option, except to the extent that a new option is substituted for such option by reason of the change in the terms of the stock in accordance with paragraph (a) of this section.

(v) If an option is amended solely to increase the number of shares subject to the option, the increase is not considered a modification of the option but is treated as the grant of a new option for the additional shares.

(vi) Any change in the terms of an option made in an attempt to qualify the option as a statutory option grants additional benefits to the optionee and is, therefore, a modification.

(vii) An extension of an option refers to the granting by the corporation to the optionee of an additional period of time within which to exercise the option beyond the time originally prescribed. A renewal of an option is the granting by the corporation of the same rights or privileges contained in the original option on the same terms and conditions. The rules of this paragraph apply as well to successive modifications, extensions, and renewals.

* * * * *

(6) [Reserved.]

* * * * *

(f) Definitions. The following definitions apply for purposes of §§1.421-1 through 1.424-1:

(1) Parent corporation. The term parent corporation, or parent, means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(2) Subsidiary corporation. The term subsidiary corporation, or subsidiary, means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in an unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(g) Effective date. This section applies to any statutory option granted on or after the date that is 180 days after publication of final regulations in the **Federal Register**.

Taxpayers can rely on these regulations for the treatment of any statutory option granted on or after June 9, 2003.

§1.6039-1 [Removed]

Par. 14. Section 1.6039-1 is removed.

§1.6039-2 [Redesignated]

Par. 15. Section 1.6039-2 is redesignated as 1.6039-1 and revised to read as follows:

§1.6039-1 Statements to persons with respect to whom information is furnished.

(a) Requirement of statement with respect to incentive stock options under section 6039(a)(1). Every corporation which transfers stock to any person pursuant to such person's exercise of an incentive stock option described in section 422(b) must furnish to such transferee, for each calendar year in which such a transfer occurs, a written statement with respect to the transfer or transfers made during such year. This statement must include the following information--

(1) The name, address, and employer identification number of the corporation transferring the stock;

(2) The name, address, and identifying number of the person to whom the share or shares of stock were transferred;

(3) The name and address of the corporation the stock of which is the subject of the option (if other than the corporation transferring the stock);

(4) The date the option was granted;

(5) The date the shares were transferred to the person exercising the option;

(6) The fair market value of the stock at the time the option was exercised;

(7) The number of shares of stock transferred pursuant to the option;

(8) The type of option under which the transferred shares were acquired; and

(9) The total cost of all the shares.

(b) Requirement of statement with respect to stock purchased under an employee stock purchase plan under section 6039(a)(2). (1) Every corporation which records, or has by its agent recorded, a transfer of the title to stock acquired by the transferor pursuant to the transferor's exercise on or after January 1, 1964, of an option granted under an employee stock purchase plan which meets the requirements of section 423(b), and with respect to which the special rule of section 423(c) applied, must furnish to such transferor, for each calendar year in which such a recorded transfer of title to such stock occurs, a written statement with respect to the transfer or transfers containing the information required by paragraph (b)(2) of this section.

(2) The statement required by paragraph (b)(1) of this section must contain the following information--

(i) The name and address of the corporation whose stock is being transferred;

(ii) The name, address and identifying number of the transferor;

(iii) The date such stock was transferred to the transferor;

(iv) The number of shares to which title is being transferred; and

(v) The type of option under which the transferred shares were acquired.

(3) If the statement required by this paragraph is made by the authorized transfer agent of the corporation, it is deemed to have been made by the corporation.

The term transfer agent, as used in this section means any designee authorized to keep the stock ownership records of a corporation and to record a transfer of title of the stock of such corporation on behalf of such corporation.

(4) A statement is required by reason of a transfer described in section 6039(a)(2) of a share only with respect to the first transfer of such share by the person who exercised the option. Thus, for example, if the owner has record title to a share or shares of stock transferred to a recognized broker or financial institution and the stock is subsequently sold by such broker or institution (on behalf of the owner), the corporation is only required to furnish a written statement to the owner relating to the transfer of record title to the broker or financial institution. Similarly, a written statement is required when a share of stock is transferred by the optionee to himself and another person (or persons) as joint tenants, tenants by the entirety or tenants in common. However, when stock is originally issued to the optionee and another person (or persons) as joint tenants, or as tenants by the entirety, the written statement required by this paragraph shall be furnished (at such time and in such manner as is provided by this section) with respect to the first transfer of the title to such stock by the optionee.

(5) Every corporation which transfers any share of stock pursuant to the exercise of an option described in this paragraph shall identify such stock in a manner sufficient to enable the accurate reporting of the transfer of record title to such shares. Such identification may be accomplished by assigning to the certificates of stock issued pursuant to the exercise of such options a special serial number or color.

(c) Time for furnishing statements -- (1) In general. Each statement required by this section to be furnished to any person for a calendar year must be furnished to such person on or before January 31 of the year following the year for which the statement is required.

(2) Extension of time. For good cause shown upon written application of the corporation required to furnish statements under this section, the Director, Martinsburg Computing Center, may grant an extension of time not exceeding 30 days in which to furnish such statements. The application must contain a full recital of the reasons for requesting an extension to aid the Director in determining the period of the extension, if any, which will be granted and must be sent to the Martinsburg Computing Center (Attn: Extension of Time Coordinator). Such a request in the form of a letter to the Martinsburg Computing Center signed by the applicant (or its agent) will suffice as an application. The application must be filed on or before the date prescribed in paragraph (c)(1) of this section for furnishing the statements required by this section, and must contain the employer identification number of the corporation required to furnish statements under this section.

(3) Last day for furnishing statement. For provisions relating to the time for performance of an act when the last day prescribed for performance falls on Saturday, Sunday, or a legal holiday, see §301.7503-1 of this chapter (Regulations on Procedure and Administration).

(d) Statements furnished by mail. For purposes of this section, a statement is considered to be furnished to a person if it is mailed to such person's last known address.

(e) Penalty. For provisions relating to the penalty provided for failure to furnish a statement under this section, see section 6722.

(f) Electronic furnishing of statements [Reserved]

(g) Effective date. This section applies as of the date that is 180 days after publication of final regulations in the **FEDERAL REGISTER** to transfers of stock acquired pursuant to a statutory option on or after that date. Taxpayers can rely on these regulations with respect to the transfer of stock acquired pursuant to a statutory option on or after June 9, 2003.

PART 14a--TEMPORARY INCOME TAX REGULATIONS RELATING TO INCENTIVE STOCK OPTIONS

Part 14a [Removed]

Par. 16. Part 14a is removed.

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 6, 2003
JS-461

Media Advisory
Bush, Fox Administrations look to Further Economic Ties
Two Countries Sponsor Entrepreneurial Workshop
San Francisco, CA - June 9th and 10th

Furthering the commitments made by U.S. President George W. Bush and the Mexican President Vicente Fox during their historic summit in September 2001, the United States and Mexico will jointly sponsor the 'Partnership for Prosperity' Entrepreneurial Workshop in San Francisco June 9-10 to encourage U.S. and Mexican private sector involvement in Mexico's economic future.

U.S. Commerce Secretary Don Evans and Mexico's Secretary of the Economy Fernando Canales will host the conference and U.S. Treasurer Rosario Marin will be the mistress of ceremonies and the moderator for the entire conference, which will promote contact between the U.S. and Mexican business communities.

Investors and business owners from both countries will meet with university leaders, leading non-governmental organizations and government experts to discuss investment and financing opportunities in Mexico. There will also be an opportunity for networking among the Mexican and U.S. private sector participants. Business sectors represented will include information and environmental technology, housing finance and construction, agribusiness and food processing, infrastructure, and the automotive industry.

Other panels will explore enterprise financing; regulations, taxes and procedures required for doing business in North America; and the enhancement of human capital on economic development in Mexico. Senior U.S. and Mexican corporate and government leaders also will discuss the competitiveness of the North American market and corporate citizenship.

WHAT: PARTNERSHIP FOR PROSPERITY ENTREPRENEURIAL WORKSHOP
*** See Attached Press Schedule for Details ***

WHERE: THE WESTIN ST FRANCIS HOTEL, SAN FRANCISCO, CA
335 POWELL STREET

WHEN: MONDAY, JUNE 9TH TUESDAY, JUNE 10TH

WHO: DON EVANS, Secretary of Commerce, US
FERNANDO CANALES, Secretary of Economy, Mexico

Other senior U.S. government participants in the conference include Tim Hauser, Deputy Under Secretary of Commerce for International Trade, and Alan P Larson, Under Secretary of State for Economic, Business and Agricultural Affairs, Small Business Administrator Hector Baretto and Overseas Private Investment Corporation President Peter Watson.

Mexican government participants will include Agustin Carstens, Deputy Secretary of Finance and Public Credit; Lourdes Dieck, Under Secretary of Economic Relations and International Cooperation; Angel Villalobos, Under Secretary of International

Trade Negotiations; and Eduardo Sojo, Chief Economic Advisor to President Fox. Rosario Marin, Treasurer of the United States, will moderate the conference. Also taking part are the private sector U.S. Council on Competitiveness and its Mexican counterpart, the Mexican Institute for Competitiveness.

Interested media, please register at www.partnershipworks2003.com or contact Bobby Peede at peede@eventstrategies.com or via phone at 703-684-0025. There is no registration fee, and only credentialed media will be admitted. Media may also register on-site.

PARNTERSHIP FOR PROSPERTIY
PRESS SCHEDULE
St. Francis Hotel, San Francisco, CA
June 9-10, 2003
- All Open Press Events are Tentative Until Day of Event -

Pre-Conference - Sunday, June 8, 2003

11:00am-5:00pm Media and Conference Registration Open TBD

************************* NO PUBLIC ACTIVITIES**********************************

Day 1 - Monday, June 9, 2003

8:00am-5:00pm Media and Conference Registration Open Mezzanine Level

9:00am-10:00am Opening Session - OPEN PRESS Grand Ballroom
` Rosario Marin, US Treasurer, Mistress of Ceremonies
Willie L. Brown, Mayor of San Francisco
Eduardo Sojo, Advisor to President Fox
Tim Hauser, Deputy Under Secretary, U.S. Department of Commerce

10:00am-10:15am Break Italian Foyer Room

10:15am-12:15pm Concurrent Cross-Sector Panels - OPEN PRESS
Panel 1: Investing in Mexico Tower Salon A
(Enterprise Investment Financing)
Panel 2: Doing Business in California East
North America (Promoting Exports)
Panel 3: Human Capital and California West
Innovation Enterprises

12:30pm-2:15pm Lunch - OPEN PRESS Grand Ballroom
Rosario Marin, US Treasurer, Mistress of Ceremonies
Fernando Canales, Secretary of Economy, Mexico
John Morgridge, Chairman of Cisco Systems

2:20pm-3:00pm Overseas Private Investment Corporation OPEN
PRESS TBD
Signing Ceremony

2:30pm-4:15pm Concurrent Business Opportunity Panels OPEN PRESS
Panel 4: Information Technology Tower Salon A
Panel 5: Housing Finance and Construction Victorian
Panel 6: Agribusiness and Food Processing Olympic
Panel 7: Infrastructure and Environmental Technology Oxford
Panel 8: Automotive Sector California East

3:00pm-5:00pm Senior Executive Roundtable 2: OPEN PRESS Colonial Room
Corporate Citizenship
Announcement of Good Partner Award PRINCIPAL MEDIA AVAIL

4:15pm-4:30pm Break Mezzanine Level

5:00pm-6:30pm Signing Ceremony – OPEN PRESS TBD
University of Arizona and CONACYT; Georgetown University and CONACYT; Georgetown University and USAID; University of Texas/El Paso; USAID/TIES announcements.

7:00pm-8:00pm Remarks at San Francisco City Hall OPEN PRESS
San Francisco City Hall
Willie L. Brown, Mayor of San Francisco - Welcoming Remarks
Donald Evans, U.S. Secretary of Commerce
Fernando Canales, Secretary of Economy, Mexico
Hector Barreto, Administrator, Small Business Administration

Day 2 - Tuesday, June 10, 2003

8:00am-10:00am Media and Conference Registration Open Mezzanine Level

9:00am-9:45am Signing Ceremonies - OPEN PRESS TBD
9:00am-9:20am Peace Corps with CONACYT
9:20am-10:45am USAID/Aid to Artisans/CONACYT; Iowa State/CONACYT; Fogarty/NIH/CONACYT

10:00am-11:30am Off-Site Press Event and Media Availability
OPEN PRESS
Donald L. Evans, Secretary of Commerce, U.S.
Fernando Canales, Secretary of Economy, Mexico
Transportation will be provided to and from event site

9:45am-11:45am Concurrent Cross-Sector Panels - OPEN PRESS
Panel 9: Venture Capital
Victorian RM
Panel 10: SME Trade Financing
Oxford RM

Panel 11: Secure and Competitive Remittances
California East

12:00pm-1:30pm Lunch – OPEN PRESS
Grand Ballroom
Rosario Marin, US Treasurer, Mistress of Ceremonies
Donald L. Evans, Secretary of Commerce, United States
Hector Rangel, President of the Business Coordinating Council, Mexico

1:30pm-2:00pm Closing Session – OPEN PRESS
Grand Ballroom
Rosario Marin, US Treasurer, Mistress of Ceremonies
Al Larson, Under Secretary, U.S. Department of State
Lourdes Dieck, Under Secretary, Mexican Ministry of Foreign Affairs

FROM THE OFFICE OF PUBLIC AFFAIRS

June 9, 2003
JS-462

Fact Sheet:
Timetable for Additional Child Tax Credit Checks

The process for issuing checks for the advance payment of the child tax credit takes 6-8 weeks. The IRS begins by running a program to search more than 130 million 2002 tax returns filed earlier this year to identify taxpayers eligible for the advance payment. A calculation is performed for those eligible for the credit to determine the amount of the check and the data is transmitted to Financial Management Service (FMS), the agency in Treasury which issues all federal government checks like Social Security, government employee and Military pay checks. A testing process is also performed to minimize errors.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 provides for the issuance of checks to approximately 25 million eligible taxpayers. As a result, checks are scheduled to be issued beginning July 25, 2003 in the following manner:

Last 2 Digits of SSN	Date Check Mailed from FMS	Estimated Volume	Estimated Dollars
00-33	7/25/03	8.6 million	$4.42 billion
34-66	8/1/03	8.4 million	$4.29 billion
67-99	8/8/03	8.4 million	$4.29 billion

The Senate has passed a bill that provides for approximately 7 million additional advance child tax credit checks to be issued. Many press reports have inaccurately reported a time frame for which these additional checks proposed by the Senate-passed legislation would be issued.

If the additional checks were to be included with those provided for by the Jobs and Growth Act, that would cause a delay of nearly one month for the 25 million taxpayers scheduled to receive checks beginning in late July. This is because IRS would be required to restart the identification and calculation process begun last month. Alternatively, the process for the additional round of checks can begin only after the first round of checks is issued.

In order to not create any significant delay in issuing the 25 million checks provided for by the Jobs and Growth Act, a second round of checks could not be issued until mid-September.

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DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 9, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS 4-YEAR 11-MONTH 2 5/8% NOTES

The Treasury will auction $15,000 million of 4-year 11-month 2 5/8% notes to raise new cash.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The auction will be conducted in the single-price auction format. All competitive and noncompetitive awards will be at the highest yield of accepted competitive tenders. The allocation percentage applied to bids awarded at the highest yield will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

The notes being offered today are eligible for the STRIPS program.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the security are given in the attached offering highlights.

oOo

Attachment

JS 463

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF
4-YEAR 11-MONTH 2 5/8% NOTES TO BE ISSUED JUNE 16, 2003

June 9, 2003

Offering Amount	$15,000 million
Maximum Award (35% of Offering Amount)	$ 5,250 million
Maximum Recognized Bid at a Single Rate	$ 5,250 million
NLP Reporting Threshold	$ 5,250 million
NLP Exclusion Amount	$ 6,300 million

Description of Offering:

Term and type of security	4-year 11-month 2 5/8% notes (reopening)
Series	F-2008
CUSIP number	912828 AZ 3
Auction date	June 11, 2003
Issue date	June 16, 2003
Dated date	May 15, 2003
Maturity date	May 15, 2008
Interest rate	2 5/8%
Amount outstanding	$18,339 million
Yield	Determined at auction
Interest payment dates	November 15 and May 15
Minimum bid amount and multiples	$1,000
Accrued interest payable by investor	$2.28261 per $1,000 (from May 15 to June 16, 2003)
Premium or discount	Determined at auction

STRIPS Information:

Minimum amount required	$1,000
Corpus CUSIP number	912820 HW 0
Due date(s) and CUSIP number(s) for additional TINT(s)	Not applicable

Submission of Bids:

Noncompetitive bids: Accepted in full up to $5 million at the highest accepted yield.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a yield with three decimals, e.g., 7.123%.

(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position equals or exceeds the NLP reporting threshold stated above.

(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders: Prior to 12:00 noon eastern daylight saving time on auction day.

Competitive tenders: Prior to 1:00 p.m. eastern daylight saving time on auction day.

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date, or payment of full par amount with tender. *TreasuryDirect* customers can use the Pay Direct feature which authorizes a charge to their account of record at their financial institution on issue date.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 9, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $22,000 million to refund an estimated $6,000 million of publicly held 4-week Treasury bills maturing June 12, 2003, and to raise new cash of approximately $16,000 million.

Tenders for 4-week Treasury bills to be held on the book-entry records of *TreasuryDirect* will not be accepted.

The Federal Reserve System holds $15,284 million of the Treasury bills maturing on June 12, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders in this auction up to the balance of the amount not awarded in today's 13-week and 26-week Treasury bill auctions. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS-464

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED JUNE 12, 2003

June 9, 2003

Offering Amount........................$22,000 million
Maximum Award (35% of Offering Amount)...$ 7,700 million
Maximum Recognized Bid at a Single Rate..$ 7,700 million
NLP Reporting Threshold.................$ 7,700 million
NLP Exclusion Amount....................$10,500 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NC 1
Auction date.......................June 10, 2003
Issue date.........................June 12, 2003
Maturity date......................July 10, 2003
Original issue date................January 9, 2003
Currently outstanding..............$40,260 million
Minimum bid amount and multiples....$1,000

Submission of Bids:
Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.
Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.
Competitive bids:
(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 4.215%.
(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:
Noncompetitive tenders:
Prior to 12:00 noon eastern daylight saving time on auction day
Competitive tenders:
Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 09, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	182-Day Bill
Issue Date:	June 12, 2003
Maturity Date:	December 11, 2003
CUSIP Number:	912795PA3

High Rate: 0.980% Investment Rate 1/: 1.000% Price: 99.505

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 65.24%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 31,193,655	$ 17,027,055
Noncompetitive	898,269	898,269
FIMA (noncompetitive)	75,000	75,000
SUBTOTAL	32,166,924	18,000,324 2/
Federal Reserve	6,225,749	6,225,749
TOTAL	$ 38,392,673	$ 24,226,073

Median rate 0.965%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.950%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 32,166,924 / 18,000,324 = 1.79

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $653,977,000

JS 465

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 09, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	91-Day Bill
Issue Date:	June 12, 2003
Maturity Date:	September 11, 2003
CUSIP Number:	912795NM9

High Rate: 1.005% Investment Rate 1/: 1.024% Price: 99.746

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 92.76%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 33,567,439	$ 16,369,054
Noncompetitive	1,450,950	1,450,950
FIMA (noncompetitive)	180,000	180,000
SUBTOTAL	35,198,389	18,000,004 2/
Federal Reserve	6,203,776	6,203,776
TOTAL	$ 41,402,165	$ 24,203,780

Median rate 0.990%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.970%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 35,198,389 / 18,000,004 = 1.96

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,154,372,000

JS 466

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 5, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS 13-WEEK AND 26-WEEK BILLS

The Treasury will auction 13-week and 26-week Treasury bills totaling $36,000 million to refund an estimated $31,618 million of publicly held 13-week and 26-week Treasury bills maturing June 12, 2003, and to raise new cash of approximately $4,382 million. Also maturing is an estimated $6,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced June 9, 2003.

The Federal Reserve System holds $15,284 million of the Treasury bills maturing on June 12, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders either in these auctions or the 4-week Treasury bill auction to be held June 10, 2003. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of each auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

TreasuryDirect customers have requested that we reinvest their maturing holdings of approximately $1,050 million into the 13-week bill and $594 million into the 26-week bill.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about each of the new securities are given in the attached offering highlights.

oOo

Attachment

JS 467

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS
TO BE ISSUED JUNE 12, 2003

June 5, 2003

Offering Amount	$18,000 million	$18,000 million
Maximum Award (35% of Offering Amount)	$ 6,300 million	$ 6,300 million
Maximum Recognized Bid at a Single Rate	$ 6,300 million	$ 6,300 million
NLP Reporting Threshold	$ 6,300 million	$ 6,300 million
NLP Exclusion Amount	$ 5,900 million	None

Description of Offering:

Term and type of security	91-day bill	182-day bill
CUSIP number	912795 NM 9	912795 PA 3
Auction date	June 9, 2003	June 9, 2003
Issue date	June 12, 2003	June 12, 2003
Maturity date	September 11, 2003	December 11, 2003
Original issue date	March 13, 2003	June 12, 2003
Currently outstanding	$22,559 million	---
Minimum bid amount and multiples	$1,000	$1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 7.100%, 7.105%.

(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.

(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders..... Prior to 12:00 noon eastern daylight saving time on auction day

Competitive tenders........ Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date, or payment of full par amount with tender. *TreasuryDirect* customers can use the Pay Direct feature, which authorizes a charge to their account of record at their financial institution on issue date.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 10, 2003
JS-468

Statement from Treasury Secretary John W. Snow

I am saddened to learn of the death of Don Regan. Don will be remembered as a great Treasury Secretary and an innovative leader of the American business community. Many at Treasury will miss him, and our thoughts today are with his wife and family.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 10, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term:	28-Day Bill
Issue Date:	June 12, 2003
Maturity Date:	July 10, 2003
CUSIP Number:	912795NC1

High Rate: 1.075% Investment Rate 1/: 1.099% Price: 99.916

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 27.11%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 55,320,400	$ 21,954,725
Noncompetitive	46,137	46,137
FIMA (noncompetitive)	0	0
SUBTOTAL	55,366,537	22,000,862
Federal Reserve	2,854,887	2,854,887
TOTAL	$ 58,221,424	$ 24,855,749

Median rate 1.065%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.050%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 55,366,537 / 22,000,862 = 2.52

1/ Equivalent coupon-issue yield.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 10, 2003
JS-470

UNITED STATES AND JAPAN INITIAL NEW INCOME TAX TREATY

The Treasury Department announced today that the United States and Japan have reached an agreement in principle on the text of a new income tax treaty. Formal negotiations to replace the current tax treaty between the two countries began in October 2001. The two governments now are moving forward, as quickly as possible, to formal signature of the proposed treaty.

The proposed treaty is a complete modernization of the existing treaty between the two countries, which is now over 30 years old. The new agreement reflects the deepening economic ties between the United States and Japan and the globalization of the two economies. Most significantly, the proposed treaty provides for substantial reductions in the withholding taxes imposed on cross-border dividends, interest, royalties and other income, including the complete elimination of source-country withholding taxes on royalties, certain interest, and certain intercompany dividends. The new agreement also incorporates modern rules to ensure that the benefits of the treaty are enjoyed as intended by the businesses and residents of the two countries and to prevent improper exploitation of the treaty.

Speaking at a dinner of the Japan Society this evening, Treasury Secretary John Snow welcomed the new agreement. "I am very pleased to announce tonight that the United States and Japan have reached an agreement in principle on the text of a new income tax treaty. The proposed treaty reflects both the deepening economic ties between the United States and Japan and the globalization of our two economies. The proposed treaty reduces barriers to trade and investment between the United States and Japan through substantial reductions in the source-country withholding taxes imposed on cross-border dividends, interest, royalties and other income. Most significantly, the agreement includes the complete elimination of withholding taxes on royalties, on certain interest, and on certain intercompany dividends.

"Achieving a new and improved tax treaty with Japan has been a priority. We are pleased to have worked together with our Japanese partners to achieve an agreement that will benefit the economies of both our countries, and I look forward to signing this important agreement without delay. Finance Minister Shiokawa is announcing this agreement on our new tax treaty right now in Tokyo, where it is early Wednesday morning," Secretary Snow concluded.

After signature, the proposed treaty is subject to ratification according to the procedures of each of the two countries. In the United States, the signed treaty will be transmitted to the Senate for its advice and consent to ratification.

The text of the treaty will be made public after signature.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 10, 2003
JS-471

Keynote Address by Treasury Secretary John W. Snow to the Japan Society Annual Dinner, New York, NY

Good evening. I am pleased to join the Japan Society tonight, to talk about our hopes for a great ally and economic partner. The longstanding and strong friendship between our nations is a bulwark of global stability, and has been an engine of global prosperity.

As an example of our partnership, I am very pleased to announce tonight that the United States and Japan have reached an agreement in principle on the text of a new income tax treaty. The proposed treaty reflects both the deepening economic ties between the United States and Japan and the globalization of our two economies.

The proposed treaty reduces barriers to trade and investment between the United States and Japan through substantial reductions in the source-country withholding taxes imposed on cross-border dividends, interest, royalties and other income.

Most significantly, the agreement includes the complete elimination of withholding taxes on royalties, on certain interest, and on certain inter-company dividends. Given the importance of this agreement, its announcement is being simultaneously released by Minister Shiokawa in Tokyo at this very moment.

Achieving a new and improved tax treaty with Japan has been a priority. We are pleased to have worked together with our Japanese partners to achieve an agreement that will benefit the economies of both our countries, and I look forward to signing this important agreement without delay.

This new proposed treaty agreement also makes a larger point. There was a time, not long ago, when powerful and emerging economies alike were seen foremost as competitors, as if domestic economic growth in one had to come, to some degree, at the expense of growth in another. Today we know that such a view is not only false, but counterproductive. Economic growth in one nation drives growth in its trading partners. Individual firms may compete at the expense of each other, but such inter-firm competition is the wrong model for countries where of course the operative principle is comparative, not absolute advantage.

Through trade all nations benefit from each other's prosperity and in turn create more prosperity. Thus, improving opportunities for trade benefits all. Likewise, reducing trade barriers helps the citizens of all participating nations and is a powerful driver of future growth. For hundreds of millions of poor in the developing world, escaping from poverty requires more robust growth in the world economy and more free trade. That won't happen unless leaders of the industrialized nations take steps to strengthen their own economies and shun the temptation to restrict trade.

Today the industrialized nations of the world are growing far too slowly and everyone suffers as a consequence. This was one of President Bush's key messages at the G8 summit last week: that the United States wishes economic success for all its partners, and that the developing world in particular needs faster growth from all of the more advanced economies. It has been the policy of his administration to encourage economic growth at home and abroad.

Nowhere is this more important than in the leading industrialized nations, which through their trade and investment activities support growth throughout the rest of the world. Our challenge today is that the leading economies are suffering from a growth deficit – their potential far exceeds their performance. Returning these economies to high growth performance was a focus of the G8 meeting.

In the United States, we have taken aggressive steps to get our economy on a stronger growth path. We have focused on reducing the tax burdens on consumers who wish to spend or save, and on encouraging companies to invest in new jobs and equipment. With the President's Jobs and Growth plan now in place, I am confident we are going to see steadily increasing growth here in the United States in the coming year, and with it, more jobs higher productivity, and performance much closer to our long term potential. The developing economies have the potential to perform much better as well, and we need to find the keys to unlock that potential.

In the developing world, the President's visionary Millennium Challenge Account will sharply increase aid to countries that promote policies for good governance, economic freedom, and investment in health care, education, and infrastructure. Under this program, we will reward governments that produce results for their people and empower the private sector to drive growth.

The plain fact is that development assistance has not been accompanied by a proportionate pickup in the prosperity and living standards of poorer countries. We can do better with development aid. Today, our aid programs are falling far short of their objectives of lifting poor countries out of the terrible blight of poverty. We can and must do better. That begins by changing the focus from in puts – the amounts of aid – to outcomes – the results of that aid. Such an approach promises a much brighter future for the poor peoples of the world and as we know so well today based on decades of experience, good policies precede economic success.

The reconstruction of Iraq, while it is a unique case, illustrates many of these principles. The Coalition Provisional Authority is working to create a national infrastructure in a country that has lacked any semblance of modern economic or political institutions for at least twenty-five years. The Coalition is laying the foundation for representative government, rule of law, and a market economy.

I said at the beginning of this speech that the relationship between the United States and Japan has been an engine of global prosperity. The world needs that engine running on all cylinders. Japan remains the world's second-largest economy, and by far the largest economy in Asia. Japan has also been an active partner in humanitarian projects worldwide, such as the reconstruction of Afghanistan and Iraq.

Japan's economy, however, has struggled for a decade, following four decades of awesome growth. We all know the diagnosis by now: a distressed banking system with too many non-performing borrowers; persistent deflation; and a rigid and overly regulated economic structure that discourages risk-taking, competition, and innovation.

The prescriptions for the ailments are well known, too. And the needed action is not unprecedented. The U.S., for example, had trouble with economic rigidity in the past. Our transportation industry was bound-up in antiquated regulations for decades, as I know well. Economists talked about the problems for almost as long, until the government finally acted to deregulate transportation in the late 70s and early 80s. The benefits of that deregulation have only increased over the years in the greater flexibility of the American economy, its competitiveness, and its resistance to shocks.

The U.S. has also encountered the problem of misalignment between real asset values and the book values of those assets. The savings and loan crisis of the 1980s had the potential to throttle our economy. For a long time, no one wanted to admit the extent of the damage. No one wanted to take responsibility for it. But in retrospect, one of the best choices policymakers made was to bite the bullet, gather up the overvalued assets, and put them on the market. We got over that hump, and bounced back.

Economies stumble. Over the past few years, the United States suffered from a notable slowdown, following many years of high growth. In our case, exogenous factors such as September 11, the bursting of the stock market bubble, and corporate scandals dragged us down. But because of the flexibility of our system, along with swift fiscal and monetary responses, we have been able to keep moving forward, keep growing, under what might otherwise seem an impossible situation.

Flexibility matters because no one can predict the future with certainty – so the best policy is usually to allow markets to work. The flexibility that we've hailed today is owed in large part to the policymakers who decided, for example, to deregulate transportation and liquidate nonperforming S&L assets so many years ago.

In some ways, Japan today reminds me of the picture of the United States that emerged in the late 70s. Growth was slow. Our companies were inefficient. Our economic system seemed brittle and stagnant. Many critics were writing off the U.S. economy entirely, believing that the U.S. would be permanently eclipsed by Japan's ascendance.

Yet during the stagnation, during the criticism, quietly at first, the American economy was evolving. Managers and investors were studying Japan's success, for example, and beginning to learn from Japanese quality control practices. We were adopting new technologies, and new production processes such as just-in-time delivery. We overcame our pride and our "not invented here" syndrome. We learned from others, and we learned especially from the Japanese.

We did not remake ourselves as Japan. But we incorporated Japanese practices within American institutions, and we were better for it. I say "we," but I should be more specific. Businesses that learned and adapted survived and prospered. Those that refused to change have failed and vanished.

Winston Churchill said something to the effect of, "America always finds the right answer – after it has exhausted all the alternatives."

The fact is, the one and only constant of economic life is change. To maintain success, an economic system must accommodate change, even as it maintains institutions of stability. It must allow failures, and then it must allow and even encourage entrepreneurs and businesses to learn from those failures. At times, the medicine is painful – but I believe it works.

The United States is hardly alone as a nation that reversed a period of economic stagnation and decline. Britain, New Zealand, the Netherlands, and no doubt others have done the same, each in its own way, but with the commonality that all adapted to change while preserving their national character.

I'm not here to preach American answers to Japanese problems. I'm here to say that we believe in Japan, and that we believe that Japan will take actions to overcome these obstacles, and return to a position of economic leadership and growth in the world.

Japan must find Japanese solutions, not through isolation, but through openness, leadership, and a legendary will. The solutions must meet the needs of Japan's unique society and institutions to win broad public support. Without that combination of leadership and broad-based support, reform cannot happen, nor can it hold.

And amid the criticism and all the well-documented problems, there are signs that Japan has been changing. This is a hopeful time.

In banking, Japan has created a basis for corporate restructuring, the Industrial Revitalization Corporation. I am encouraged by the work of the Financial Services Agency under the leadership of Minister Takenaka. I am especially heartened by the Japanese Government's action to preserve the stability of the financial system in the recent case of Resona Bank. The accelerated resolution of bad loans will provide a useful model as the Japanese Government considers a new framework this summer.

I am also encouraged that the Bank of Japan, under the leadership of Governor Fukui, is now working more closely with the government and improving communication with the market. We have high expectations for stronger monetary growth as a means to eliminate deflation.

Prime Minister Koizumi has stated that there can be no growth without structural and regulatory reform, and he has committed to opening the Japanese economy to competition and efficiency. I believe the Japanese economy will get a tremendous boost from policies that open up sectors to new entry and competition, and that make it easier to move labor and assets to where they are most productive.

Japanese companies have shown that they can compete in world markets to the benefit of consumers in virtually every nation. Their competition brings benefits such as lower prices, higher quality, and newer technology. Japanese consumers should have the same opportunity to benefit from competition at home.

Let me close with a story from my personal experience with Japan, one that illustrates how our nations can address similar questions in different, valid ways and then learn from each other. When I was the chairman of the Business Roundtable, a group of American corporate leaders from our largest firms, we launched a dialogue with our counterparts of Japan's Keidanren, to learn from each other, and foster mutual understanding.

For our very first meeting, each was to prepare a list of national priorities for discussion. The usual subjects appeared – trade, global warming, pensions and deregulation were among the topics. But the number one priority for both groups was education. We said to the Japanese, "we want to learn from your educational system— how do you achieve such universal literacy, competence, numeracy and achievement?" To which the Japanese business leaders replied: "No, we want to learn from your educational system—how do you produce so many Nobel Prize winners, so much creativity, so much innovation? How do you preserve opportunities for so many to get a second and third chance?"

Clearly, we have much to learn from each other. The United States welcomes a vibrant, rejuvenated Japanese economy, and we will support our friend and ally's efforts to restore full growth. The world has much still to learn from Japan, and Japan has much to contribute to global growth and security.

Thank you.

Related Documents:

- U.S.-Japan Income Tax Treaty Initialization

FROM THE OFFICE OF PUBLIC AFFAIRS

June 10, 2003
JS-472

U.S. Treasury Secretary John W. Snow Remarks to the Japan Society Annual Dinner, New York, NY

Good evening. I am pleased to join the Japan Society tonight, to talk about our hopes for a great ally and economic partner. The longstanding and strong friendship between our nations is a bulwark of global stability, and has been an engine of global prosperity.

As an example of our partnership, I am very pleased to announce tonight that the United States and Japan have reached an agreement in principle on the text of a new income tax treaty. The proposed treaty reflects both the deepening economic ties between the United States and Japan and the globalization of our two economies.

The proposed treaty reduces barriers to trade and investment between the United States and Japan through substantial reductions in the source-country withholding taxes imposed on cross-border dividends, interest, royalties and other income.

Most significantly, the agreement includes the complete elimination of withholding taxes on royalties, on certain interest, and on certain inter-company dividends. Given the importance of this agreement, its announcement is being simultaneously released by Minister Shiokawa in Tokyo at this very moment.

Achieving a new and improved tax treaty with Japan has been a priority. We are pleased to have worked together with our Japanese partners to achieve an agreement that will benefit the economies of both our countries, and I look forward to signing this important agreement without delay.

This new proposed treaty agreement also makes a larger point. There was a time, not long ago, when powerful and emerging economies alike were seen foremost as competitors, as if domestic economic growth in one had to come, to some degree, at the expense of growth in another. Today we know that such a view is not only false, but counterproductive. Economic growth in one nation drives growth in its trading partners. Individual firms may compete at the expense of each other, but such inter-firm competition is the wrong model for countries where of course the operative principle is comparative, not absolute advantage.

Through trade all nations benefit from each other's prosperity and in turn create more prosperity. Thus, improving opportunities for trade benefits all. Likewise, reducing trade barriers helps the citizens of all participating nations and is a powerful driver of future growth. For hundreds of millions of poor in the developing world, escaping from poverty requires more robust growth in the world economy and more free trade. That won't happen unless leaders of the industrialized nations take steps to strengthen their own economies and shun the temptation to restrict trade.

Today the industrialized nations of the world are growing far too slowly and everyone suffers as a consequence. This was one of President Bush's key messages at the G8 summit last week: that the United States wishes economic success for all its partners, and that the developing world in particular needs faster growth from all of the more advanced economies. It has been the policy of his administration to encourage economic growth at home and abroad.

Nowhere is this more important than in the leading industrialized nations, which through their trade and investment activities support growth throughout the rest of the world. Our challenge today is that the leading economies are suffering from a growth deficit – their potential far exceeds their performance. Returning these economies to high growth performance was a focus of the G8 meeting.

In the United States, we have taken aggressive steps to get our economy on a stronger growth path. We have focused on reducing the tax burdens on consumers who wish to spend or save, and on encouraging companies to invest in new jobs and equipment. With the President's Jobs and Growth plan now in place, I am confident we are going to see steadily increasing growth here in the United States in the coming year, and with it, more jobs higher productivity, and performance much closer to our long term potential. The developing economies have the potential to perform much better as well, and we need to find the keys to unlock that potential.

In the developing world, the President's visionary Millennium Challenge Account will sharply increase aid to countries that promote policies for good governance, economic freedom, and investment in health care, education, and infrastructure. Under this program, we will reward governments that produce results for their people and empower the private sector to drive growth.

The plain fact is that development assistance has not been accompanied by a proportionate pickup in the prosperity and living standards of poorer countries. We can do better with development aid. Today, our aid programs are falling far short of their objectives of lifting poor countries out of the terrible blight of poverty. We can and must do better. That begins by changing the focus from in puts – the amounts of aid – to outcomes – the results of that aid. Such an approach promises a much brighter future for the poor peoples of the world and as we know so well today based on decades of experience, good policies precede economic success.

The reconstruction of Iraq, while it is a unique case, illustrates many of these principles. The Coalition Provisional Authority is working to create a national infrastructure in a country that has lacked any semblance of modern economic or political institutions for at least twenty-five years. The Coalition is laying the foundation for representative government, rule of law, and a market economy.

I said at the beginning of this speech that the relationship between the United States and Japan has been an engine of global prosperity. The world needs that engine running on all cylinders. Japan remains the world's second-largest economy, and by far the largest economy in Asia. Japan has also been an active partner in humanitarian projects worldwide, such as the reconstruction of Afghanistan and Iraq.

Japan's economy, however, has struggled for a decade, following four decades of awesome growth. We all know the diagnosis by now: a distressed banking system with too many non-performing borrowers; persistent deflation; and a rigid and overly regulated economic structure that discourages risk-taking, competition, and innovation.

The prescriptions for the ailments are well known, too. And the needed action is not unprecedented. The U.S., for example, had trouble with economic rigidity in the past. Our transportation industry was bound-up in antiquated regulations for decades, as I know well. Economists talked about the problems for almost as long, until the government finally acted to deregulate transportation in the late 70s and early 80s. The benefits of that deregulation have only increased over the years in the greater flexibility of the American economy, its competitiveness, and its resistance to shocks.

The U.S. has also encountered the problem of misalignment between real asset values and the book values of those assets. The savings and loan crisis of the 1980s had the potential to throttle our economy. For a long time, no one wanted to admit the extent of the damage. No one wanted to take responsibility for it. But in retrospect, one of the best choices policymakers made was to bite the bullet, gather up the overvalued assets, and put them on the market. We got over that hump, and bounced back.

Economies stumble. Over the past few years, the United States suffered from a notable slowdown, following many years of high growth. In our case, exogenous factors such as September 11, the bursting of the stock market bubble, and corporate scandals dragged us down. But because of the flexibility of our system, along with swift fiscal and monetary responses, we have been able to keep moving forward, keep growing, under what might otherwise seem an impossible situation.

Flexibility matters because no one can predict the future with certainty – so the best policy is usually to allow markets to work. The flexibility that we've hailed today is owed in large part to the policymakers who decided, for example, to deregulate transportation and liquidate nonperforming S&L assets so many years ago.

In some ways, Japan today reminds me of the picture of the United States that emerged in the late 70s. Growth was slow. Our companies were inefficient. Our economic system seemed brittle and stagnant. Many critics were writing off the U.S. economy entirely, believing that the U.S. would be permanently eclipsed by Japan's ascendance.

Yet during the stagnation, during the criticism, quietly at first, the American economy was evolving. Managers and investors were studying Japan's success, for example, and beginning to learn from Japanese quality control practices. We were adopting new technologies, and new production processes such as just-in-time delivery. We overcame our pride and our "not invented here" syndrome. We learned from others, and we learned especially from the Japanese.

We did not remake ourselves as Japan. But we incorporated Japanese practices within American institutions, and we were better for it. I say "we," but I should be more specific. Businesses that learned and adapted survived and prospered. Those that refused to change have failed and vanished.

Winston Churchill said something to the effect of, "America always finds the right answer – after it has exhausted all the alternatives."

The fact is, the one and only constant of economic life is change. To maintain success, an economic system must accommodate change, even as it maintains institutions of stability. It must allow failures, and then it must allow and even encourage entrepreneurs and businesses to learn from those failures. At times, the medicine is painful – but I believe it works.

The United States is hardly alone as a nation that reversed a period of economic stagnation and decline. Britain, New Zealand, the Netherlands, and no doubt others have done the same, each in its own way, but with the commonality that all adapted to change while preserving their national character.

I'm not here to preach American answers to Japanese problems. I'm here to say that we believe in Japan, and that we believe that Japan will take actions to overcome these obstacles, and return to a position of economic leadership and growth in the world.

Japan must find Japanese solutions, not through isolation, but through openness, leadership, and a legendary will. The solutions must meet the needs of Japan's unique society and institutions to win broad public support. Without that combination of leadership and broad-based support, reform cannot happen, nor can it hold.

And amid the criticism and all the well-documented problems, there are signs that Japan has been changing. This is a hopeful time.

In banking, Japan has created a basis for corporate restructuring, the Industrial Revitalization Corporation. I am encouraged by the work of the Financial Services Agency under the leadership of Minister Takenaka. I am especially heartened by the Japanese Government's action to preserve the stability of the financial system in the recent case of Resona Bank. The accelerated resolution of bad loans will provide a useful model as the Japanese Government considers a new framework this summer.

I am also encouraged that the Bank of Japan, under the leadership of Governor Fukui, is now working more closely with the government and improving communication with the market. We have high expectations for stronger monetary growth as a means to eliminate deflation.

Prime Minister Koizumi has stated that there can be no growth without structural and regulatory reform, and he has committed to opening the Japanese economy to competition and efficiency. I believe the Japanese economy will get a tremendous boost from policies that open up sectors to new entry and competition, and that make it easier to move labor and assets to where they are most productive.

Japanese companies have shown that they can compete in world markets to the benefit of consumers in virtually every nation. Their competition brings benefits such as lower prices, higher quality, and newer technology. Japanese consumers should have the same opportunity to benefit from competition at home.

Let me close with a story from my personal experience with Japan, one that illustrates how our nations can address similar questions in different, valid ways and then learn from each other. When I was the chairman of the Business Roundtable, a group of American corporate leaders from our largest firms, we launched a dialogue with our counterparts of Japan's Keidanren, to learn from each other, and foster mutual understanding.

For our very first meeting, each was to prepare a list of national priorities for discussion. The usual subjects appeared – trade, global warming, pensions and deregulation were among the topics. But the number one priority for both groups was education. We said to the Japanese, "we want to learn from your educational system— how do you achieve such universal literacy, competence, numeracy and achievement?" To which the Japanese business leaders replied: "No, we want to learn from your educational system—how do you produce so many Nobel Prize winners, so much creativity, so much innovation? How do you preserve opportunities for so many to get a second and third chance?"

Clearly, we have much to learn from each other. The United States welcomes a vibrant, rejuvenated Japanese economy, and we will support our friend and ally's efforts to restore full growth. The world has much still to learn from Japan, and Japan has much to contribute to global growth and security.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 11, 2003
JS-473

Treasury Under Secretary John B. Taylor
Testimony before the House Subcommittee on Domestic and International Monetary Policy, Trade and Technology of the House Financial Services Committee

Chairman King, Representative Maloney, Members of the Committee, thank you for the opportunity to testify today on the Millennium Challenge Account (MCA). My statement will focus on the economic rationale behind the MCA and how it fits within the Administration's overall approach to economic development.

Today there are more than three billion people living in extreme poverty. Last year 3 million people died for lack of immunization, 1 million died from malaria, 3 million died from water-related diseases, and 2 million died from exposure to stove smoke inside their own homes. In addition, HIV/AIDS has ravaged the populations of developing nations, killing 3 million people in 2002 alone.

The United States is helping in many ways to combat poverty and deal with these related problems. Under President Bush's leadership the Administration has developed a new economic growth agenda aimed at reducing poverty around the world. The MCA is one part of this agenda. The agenda focuses on channeling more funds to countries that follow pro-growth policies, and on structuring our contributions to create incentives for specific measurable results. These principles are the driving force behind Treasury's reform strategy at the Multilateral Development Banks (MDBs) as this committee is well aware. And I want to underscore the importance that the Administration attaches to the authorization requests related to the MDBs that are pending with this Committee. I look forward to working with this Committee and the Congress, to help make the MDBs strong and effective institutions. These same principles are the driving force behind the MCA. The MCA operates on the principle that aid is more likely to promote economic growth and raise living standards in countries that are pursuing sound political, economic and social policies. It also seeks to integrate measurement and evaluation into the design of activities to ensure that aid is working.

In a similar vein, I want to emphasize how transparent the Millennium Challenge Corporation (MCC) intends to be. The selection of countries will be based on an objective and transparent assessment of their policy performance on 16 indicators that are key to increasing economic growth. All contracts, activity implementation plans, and measurement and evaluation reports will be posted on the web. The United States is the leading force for increased transparency in the MDBs, and working in collaboration with this committee, we think we have come up with a robust agenda for even greater transparency that we will continue to pursue vigorously.

Treasury will play a vital role in the implementation of the MCA. The Secretary of the Treasury brings to the Board of MCC expertise in policies that promote economic growth and enhance productivity. Furthermore, as the U.S. Governor in the international financial institutions, the Secretary of the Treasury is in a unique position to ensure coordination of MCA programs with the World Bank, the regional development banks and other international financial institutions.

Removing Impediments to Productivity Growth

Sustainable poverty reduction can only be achieved via productivity growth. Productivity is the amount of goods and services that a worker produces per unit of time with the skills and tools available. If you want to reduce the number of countries with low per capita incomes, then you have no choice but to increase productivity in those countries. And the higher the rate of productivity growth, the faster poverty will decline. Simply put, the ticket out of poverty is higher productivity jobs.

Productivity depends on two things: capital per worker and the level of technology. If there are no impediments to the flow and accumulation of capital and technology, then countries that are behind in productivity should have a higher productivity growth rate. They should catch up, and we have seen many countries catching up over the years – such as South Korea, Chile, and Botswana. However, many of the poorest nations still have had low and stagnant productivity and income, and they are not catching up. More and more evidence has been accumulating that this is due to significant impediments to investment and the adoption of technology.

These impediments can be grouped into three areas. First, poor governance — the lack of rule of law or enforceable contracts and the prevalence of corruption — creates disincentives to invest, start up new firms, and expand existing firms with high-productivity jobs. This has a negative impact on capital formation and entrepreneurial activity. Second, weak health and education systems impede the development of human capital. Workers without adequate education do not have the skills to take on high-productivity jobs or to increase the productivity of the jobs they do have. Third, too many restrictions on economic transactions prevent people from trading goods and services or adopting new technologies.

Poor economic policies, state monopolies, excessive regulation, and the lack of openness to trade are all examples of restrictions that reduce the incentives for innovation and investment that are needed to boost productivity.

The Administration's approach to assisting developing nations to increase their productivity growth is to increase aid to countries that are taking actions to remove these impediments by following pro-growth policies.

Measuring Pro-Growth Policies

President Bush speaks of three types of pro-growth policies: governing justly, investing in people, and encouraging economic freedom. Note that these three categories correspond to the three types of impediments holding back productivity growth.

To implement President Bush's vision, the Administration chose a set of quantitative indicators of these pro-growth policies. We worked intensively for several months evaluating a wide range of possible indicators. As part of this process, we met with representatives from other donor countries, developing countries, charitable organizations, universities, think tanks, the private sector, and other interested parties to gather their ideas.

Ultimately, we selected 16 indicators based on their relationship to economic growth, the number of countries they cover, their transparency and availability, and their relative soundness and objectivity. These indicators are not set in stone and may change in the future if problems with them emerge or better indicators become available. To qualify, a country will have to be above the median on half of the indicators in each of the three policy areas.

Governing Justly: There are six indicators in this category. The first two are from Freedom House and the latter four are from the World Bank Institute.

1) Civil Liberties: An indicator based on a survey of freedom of expression, association and organizational rights, rule of law and human rights, and personal autonomy and economic rights.

2) Political Rights: An indicator based on a survey of free and fair elections of officials; elected representatives have real power; the right of citizens to form political parties; freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies and economic oligarchies; and the political rights of minority groups.

3) Voice and Accountability: An aggregate index of existing quantitative indices of governance. One of these indices, for example, measures protection of civil liberties, citizen participation in the selection of governments, and the independence of the media.

4) Government Effectiveness: An aggregate index of such items as the provision of quality public services, competent and independent civil servants, and credible governments.

5) Rule of Law: An aggregate index of the extent to which people have confidence in and abide by rules of society, the incidence of violent and non-violent crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.

6) Control of Corruption: An aggregate index that measures corruption among public officials including, for example, bribery, patronage, nepotism, and secret party funding. With respect to this indicator, President Bush made it clear that MCA funds should only go to the most transparent and least corrupt countries. To meet the President's concerns, we have determined that those countries which fall below the median on this indicator will be considered ineligible for MCA funds, absent material change in their circumstances.

Investing in People: Our proposal includes two input measures and two output measures.

1) Public expenditure on health as a percent of GDP.

2) Immunization rate for DPT and measles: The World Health Organization publicly compiles and annually releases data on immunization rates for nearly all member countries.

3) Total public expenditure on primary education as a percent of GDP.

4) Primary Completion Rate: The World Bank, using UNESCO data, compile data that measure whether children are attaining minimum education levels. A higher level of education increases labor productivity.

Encouraging Economic Freedom: There are six indicators in this category covering both macroeconomic and microeconomic policies.

1) Country Credit Rating: Institutional Investor magazine produces a semi-annual survey of bankers' and fund managers' perceptions of a country's risk. A good credit rating reflects good overall economic policy conducive to growth.

2) Inflation: The rate of increase in prices over 1 year. Of the 16 indicators, this is the only one where performance is not judged relative to the median. Instead, a country must have inflation of less than 20% in order to pass the indicator.

3) Budget Deficit/GDP: A country's overall budget deficit is averaged over a three-year period.

4) Days to start a business: Compiled by the Private Sector Advisory Service of the World Bank Group, which works with local lawyers and other professionals.

5) Trade Policy: The Heritage Foundation's Index of Economic Freedom measures a country's openness to international trade based on average tariff rates and non-tariff barriers to trade.

6) Regulatory Quality Rating: The World Bank Institute measures the burden on business arising from, among others, licensing requirements, labor regulations, and bureaucratic corruption.

I should emphasize that none of these indicators is without some problem. There may be gaps or lags in the data, or trends not reflected in the data, which may be material for assessing performance. The MCC Board of Directors will have ultimate responsibility to exercise judgment and look behind the numbers to make a final recommendation to the President on qualifying countries.

Eligible Countries

The MCA aims to reduce poverty and is aimed at poor countries. In FY'04, countries eligible to borrow from the International Development Association (IDA), and which have per capita incomes below $1,435 (the historical IDA cutoff), will be considered. This is currently 74 countries.

In FY'05, all countries with incomes below $1,435 will be considered, which adds another 13 countries. In FY'06, all countries with incomes between $1,435 and $2,975 will be eligible to compete as a separate pool. This group currently consists of 29 countries. It is important to note that countries prohibited from receiving assistance by current statutory restrictions will not be eligible.

Measuring Results

The success of any foreign aid program requires that we measure results. This is a core component of the Administration's development strategy and is one that we have pushed in the Multilateral Development Banks (MDBs). For example, the United States made part of its financial commitment to the IDA-13 replenishment in the form of an incentive contribution that calls for making progress towards a set of development indicators in health, education, and private sector development. The agreement also called for the initiation of a performance measurement system which will develop ultimately into a common set of outcome indicators that can be compared across countries.

The MCA furthers this focus on measuring results by making sure that every MCA contract states in quantitative terms the expected outcomes. We will require a clear strategy for gathering baseline data and measuring progress toward stated results and assessing the reasons for success and failure. We will require projects to be structured in a way that steps up or cuts back funding contingent on achieving results. Evaluation of results will allow the MCA to incorporate lessons learned into ongoing and future operations. All measurement and evaluation reports, as well as the terms of each contract, will be made public in the United States and in the host country.

In addition to coordinating with USAID, coordination of assistance with other donors will be vital to the success of the MCA. Each recipient country will be responsible for managing coordination among the MCA and other donors to maximize impact and avoid duplication of efforts.

Conclusion

In summary, the MCA is an operational action plan to use taxpayer resources to help increase economic growth and reduce poverty around the world. I urge your favorable consideration of the "Millennium Challenge Act of 2003."

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 11, 2003
JS-474

President's Working Group on Financial Markets' Letter on Energy Bill Amendment

LETTER TO CRAPO AND MILLER

Related Documents:

- LETTER TO CRAPO AND MILLER

Department of the Treasury
Board of Governors of the Federal Reserve System
U.S. Securities and Exchange Commission
Commodity Futures Trading Commission

June 11, 2003

The Honorable Michael D. Crapo
United States Senate
111 Russell Senate Office Building
Washington, DC 20510

The Honorable Zell B. Miller
United States Senate
257 Dirken Senate Office Building
Washington, DC 20510

Dear Senators Crapo and Miller:

Thank you for your letter of June 10, 2003, requesting the views of the President's Working Group on Financial Markets (PWG) on proposed Senate Amendment #876 to S.14, the pending energy bill. As this amendment is similar to a proposed amendment on which you sought the views of the PWG last year, we reassert the positions expressed in the PWG's response dated September 18, 2002, a copy of which is enclosed. The proposed amendment could have significant unintended consequences for an extremely important risk management market -- serving businesses, financial institutions, and investors throughout the U.S. economy. For that reason, we believe that adoption of this amendment is ill-advised.

We would also point out that, since we wrote that letter last year, various federal agencies have initiated actions against wrongdoing in the energy markets. As you note, the CFTC has brought formal actions against Enron, Dynegy, and El Paso for market manipulation, wash (or roundtrip) trades, false reporting of prices, and operation of illegal markets. The Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Department of Justice have also initiated formal actions in the energy sector. Some of these actions have already resulted in substantial monetary penalties and other sanctions. These initial actions alone make clear that wrongdoers in the energy markets are fully subject to the existing enforcement authority of federal regulators.

The Commodity Futures Modernization Act of 2000 brought important legal certainty to the risk management marketplace. Businesses, financial institutions, and investors throughout the economy rely upon derivatives to protect themselves from market volatility triggered by unexpected economic events. This ability to manage risks makes the economy more resilient and its importance cannot be underestimated. In our judgment, the ability of private counterparty surveillance to effectively regulate these markets can be undermined by inappropriate extensions of government regulation.

Yours truly,

John W. Snow
Secretary
Department of the Treasury

Alan Greenspan
Chairman
Board of Governors of the
Federal Reserve System

William H. Donaldson
Chairman
U.S. Securities and Exchange
Commission

James E. Newsome
Chairman
Commodity Futures Trading
Commission

Enclosure

Department of the Treasury
Board of Governors of the Federal Reserve System
U.S. Securities and Exchange Commission
Commodity Futures Trading Commission

September 18, 2002

The Honorable Michael D. Crapo
United States Senate
111 Russell Senate Office Building
Washington, DC 20510

The Honorable Zell B. Miller
United States Senate
257 Dirksen Senate Office Building
Washington, DC 20510

Dear Senators Crapo and Miller:

In response to your letter of September 13, we write to express our serious concerns about the legislative proposal to expand regulation of the over-the-counter (OTC) derivatives markets that has recently been proposed by Senators Harkin and Lugar.

We believe that the OTC derivatives markets in question have been a major contributor to our economy's ability to respond to the stresses and challenges of the last two years. This proposal would limit this contribution, thereby increasing the vulnerability of our economy to potential future stresses.

The proposal would subject market participants to disclosure of proprietary trading information and new capital requirements. We do not believe a public policy case exists to justify this governmental intervention. The OTC markets trade a wide variety of instruments. Many of these are idiosyncratic in nature. These customized markets generally do not serve a significant price discovery function for non-participants, nor do they permit retail investors to participate. Public disclosure of pricing data for customized OTC transactions would not improve the overall price discovery process and may lead to confusion as to the appropriate pricing for other transactions, as terms and conditions can vary by contract. The rationale for imposing capital requirements is unclear to us, and the proposal's capital requirements also could duplicate or conflict with existing regulatory capital requirements.

The trading of these instruments arbitrages away inefficiencies that exist in all financial and commodities markets. If dealers had to divulge promptly the proprietary details and pricing of these instruments, the incentive to allocate capital to developing and finding markets for these highly complex instruments would be lessened. The result would be that the inefficiencies in other markets that derivatives have arbitraged away would reappear.

It is also unclear who would benefit from the proposed disclosures and regulations other than whoever simply copied existing products and instruments for their own short-term advantage. Weakening the protection of proprietary intellectual property rights in the market arena would undercut a complex of highly innovative markets that is among this nation's most valuable assets.

While the derivatives markets may seem far removed from the interests and concerns of consumers, the efficiency gains that these markets have fostered are enormously important to consumers and to our economy. We urge Congress to protect these markets' contributions to the economy, and to be aware of the potential unintended consequences of current legislative proposals.

Yours truly,

Paul H. O'Neill
Secretary
Department of the Treasury

Alan Greenspan
Chairman
Board of Governors of the
Federal Reserve System

Harvey L. Pitt
Chairman
U.S. Securities and Exchange
Commission

James E. Newsome
Chairman
Commodity Futures Trading
Commission

cc: Senator Daschle
Senator Feinstein
Senator Gramm
Senator Harkin
Senator Lugar
Senator Lott
Senator Sarbanes

FROM THE OFFICE OF PUBLIC AFFAIRS

June 11, 2003
JS-476

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $82,566 million as of the end of that week, compared to $82,510 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	May 30, 2003			June 6, 2003		
TOTAL	82,510			82,566		
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	7,802	13,163	20,964	7,769	13,238	21,007
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,702	2,643	15,345	12,631	2,658	15,289
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			23,383			23,429
3. Special Drawing Rights (SDRs) [2]			11,775			11,778
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	May 30, 2003			June 6, 2003		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	May 30, 2003			June 6, 2003		

	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to the prior week's IMF data. IMF data for the latest week may be subject to revision. IMF data for the prior week are final.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 12, 2003
JS-477

U.S. Treasury Secretary John Snow Remarks at the Brady Bond Retirement Ceremony, Mexico City, Mexico

Good Morning. I am pleased to join President Fox, Secretary Gil Diaz, IMF Managing Director Koehler and World Bank President Wolfensohn for this historic occasion in the economic development of our friend, our ally, our partner Mexico.

The early retirement of the last of Mexico's dollar-denominated Brady bonds is an occasion for celebration. These bonds, named for Nicholas Brady – one of my predecessors in the office of United States Treasury Secretary – were devised to meet the needs of Latin America in a difficult economic period. We are here today to formally recognize the resilience of the Mexican economy, in particular, as it has finished repaying these debts ahead of schedule, and is clearly on a path to a bright future.

Brady Bonds represent the long-standing spirit of cooperation between our nations and the international financial institutions as we have worked together to overcome our challenges. That spirit of cooperation is still present today, even as the Mexican economy has strengthened and progressed to a new stage.

Since 1990, Mexico has taken many important measures to strengthen its economy: floating its exchange rate, opening markets, privatizing enterprises, resolving its banking crisis and strengthening its financial sector, as well as providing a sound fiscal and monetary framework.

Today, Mexico and the United States are working together more than ever before. In the fall of 2001, our two Presidents agreed on a new "Partnership for Prosperity," to ensure that the economic benefits from our close ties reach all regions of Mexico. Lowering the costs of remittance flows from the United States to Mexico has been one goal of the program. Remittance flows account for over one percent of Mexican GDP, and the cost of these remittances, thanks in part to the Partnership for Prosperity, have fallen by half. Remittance flows have more than doubled since the mid-1990s, reaching $10 billion last year.

Trade has also been an important part of our relationship for many years, with the Mexican government taking important strides in liberalizing trade through NAFTA and integrating Mexico with the global economy. These measures have been enormously successful – exports have increased four-fold since 1990, while trade has risen to over half of Mexico's GDP. Reflecting Mexico's strengthened economy and the rewards for these efforts, growth has accelerated in the 1990s to double the average rate of the decade before.

The retirement of these bonds is a measure of their success. Much more, however, this retirement is a symbol of Mexico's success, and the success of the global marketplace. Today's occasion is possible in part because of advances in the international financial system which allows nations such as Mexico to borrow funds, if needed, with a cost that accurately reflects national creditworthiness and market competition.

The recent history of other nations has shown us that crises do still occur. Recognizing that debt restructurings may occur again, the United States, the multilateral development banks and our international partners for development have been working to create new, market-oriented procedures for restructuring sovereign debts. Bonds with collection action clauses, for example, will be easier and less costly for all parties to renegotiate.

Implementing such market-oriented reforms will allow nations to recover from economic stumbles more quickly, and with less shock to their citizens and the global financial system. There will, we hope, not be a need for a new round of Brady Bonds.

And just as Mexico was the first of 17 countries to reach agreement on the Brady Bond program, in March of 1990, the new bonds that Mexico has issued to pay off the Brady Bonds are among the first to incorporate collective action clauses. These new bonds are simpler, more efficient, more liquid, and less costly to the people of Mexico.

Mexico's leadership in these and other matters is a sign of the kind of flexibility and innovation that promises to keep the country moving forward.

In closing, let me underscore this: Mexico is an important partner to the Untied States. Our relationship is wide ranging, and we intend on strengthening it. My visit here represents the historic nature of our partnership. We are committed to Mexico's success, and we will continue to work together to support our mutual agenda.

Mexico and the United States are truly partners for prosperity, and the people of America applaud your success on today's economic milestone.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 13, 2003
JS-478

Treasury Secretary John Snow to Help Launch Health Coverage Tax Credit Registration in Pittsburgh on Monday

Treasury Secretary John Snow will launch Pennsylvania's registration process for the Health Coverage Tax Credit Program (HCTC) that will help cover the cost of health insurance premiums for many Pennsylvania residents.

WHAT:
Treasury Secretary Snow Launches Pennsylvania's Health Insurance Registration

WHEN:
Monday, June 16, 2003 at 4:00 p.m.

WHERE:
Robert Morris University, Sewall Center, Center Suite
6001 University Blvd., Moon Township, PA 15108

INVITED PARTICIPANTS:
President Edward A. Nicholson, Ph.D., Robert Morris University
Secretary Stephen M. Schmerin, Pennsylvania Department of Labor and Industry
Senator Rick Santorum, United States Senate
Senator Arlen Specter, United States Senate

The Trade Adjustment Assistance Act President Bush signed into law last year includes the new Health Coverage Tax Credit (HCTC). This program provides an advanced payment of 65% of the premium cost for a qualified health plan for individuals who are eligible to receive Trade Adjustment Assistance (TAA) benefits or certain individuals who receive pension benefit payments from the Pension Benefit Guaranty Corporation (PBGC). Approximately 21,000 workers and their families in Pennsylvania are estimated to qualify for the program.

The registration period for eligible Pennsylvanians commences with this event and the HCTC advance payments will be begin August 2003. For more information on a particular state and the health insurance programs that qualify, please visit the HCTC website at www.irs.gov and enter IRS Keyword: HCTC.

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 16, 2003
JS-479

United States Treasury Secretary John W. Snow
Remarks Regarding the Health Coverage Tax Credit
Pittsburgh, PA

Good afternoon. It is a pleasure to be here with you. President Nicholson, let me begin by thanking you and Robert Morris University for hosting this event.

Let me also thank all of you here today for your participation in this event calling attention to the President's Health Coverage Tax Credit. We think it's going to provide important help to people in Pennsylvania and across America. Of course, the very best help for those who are out of work or insecure about their job is to create conditions in which companies and entrepreneurs invest to create new jobs and make existing jobs more secure.

That's why President Bush's Jobs and Growth plan is so important. By lowering tax rates on workers and small businesses, reducing the marriage penalty, and increasing the child tax credit, taxpayers will keep more of what they earn and use it as they see fit. That is what the President's Jobs and Growth Plan does. Now that the President's plan has been signed into law, I am confident that we are going to see a pick-up in economic growth and investment, and that is going to lead to new and better jobs here in Western Pennsylvania and all across America. When the new tax plan takes effect – which will be soon – I am confident we're going to see those "help wanted" signs go up again in greater and greater numbers.

I am delighted to be here today with Pennsylvania's two outstanding senators, Arlen Specter and Rick Santorum. Pennsylvania is fortunate to have two such extremely effective members of the U.S. Senate. They are both great public servants and a great credit to the Commonwealth in all they do. I want to publicly thank Senator Specter and Senator Santorum for their strong support of President Bush's Jobs and Growth plan. The people of the state of Pennsylvania and President Bush alike have been able to count on these senators to do the right thing for the American economy and for the citizens of Pennsylvania.

But we also know that for families lacking health coverage, especially when the breadwinner is out of work and looking, finding a new job can seem a long way off. Family health care needs can't wait for a change in the business cycle. We know that and we care about helping Americans get the health care they need right now.

That is why the Congress passed and the President signed the Health Coverage Tax Credit, which helps folks who are eligible to receive Trade Adjustment Assistance or pension benefit payments from the Pension Benefit Guaranty Corporation. People in Pennsylvania eligible for these two programs – that's about 21,000 across the state – now can obtain a tax credit covering 65% of qualified health insurance premiums. They can get this assistance in two ways. First, they can claim it on their tax forms in a lump sum next year on April 15th. Better yet, beginning in August, the Health Coverage Tax Credit program will allow eligible individuals and their families to directly apply the credit to their health insurance premiums every month. This advance payment option could make a big difference for families that are just getting by month-to-month or week-to-week.

I'm pleased to note that Pennsylvania is one of the first states to authorize participating health plans in the program, and the first where we will launch an early registration program. Your leaders are on the forefront of innovative health care policy and Pennsylvanians, especially Pennsylvanians who need some extra help right now, are going to be the beneficiaries. I want to recognize the state Insurance Commissioner, the Secretary of Labor and Industry, the Steelworkers Unions as well as Pennsylvania's Blue Cross and Blue Shield's participating health plans – thank you all for working together to bring the Health Coverage Tax Credit Program to Pennsylvania.

Today's event is the first on-site registration for the Health Coverage Tax Credit in Pennsylvania. Starting tomorrow, there will be registration sites, including Robert Morris University, out across Pennsylvania, and we hope to reach out to all eligible Pennsylvanians by August. This program is a real innovation in tax policy, one that we hope will lead the way for other innovations that help real people obtain the health care coverage that they need in a flexible and reliable way.

In fact, the President's budget proposes $89 billion over ten years for new health tax credits to make private health insurance more affordable for Americans who do not have employer-provided insurance or public insurance. This is a serious proposal to deal with a serious concern, and it's gaining bipartisan support. I know a lot of folks here today have worked in the steel industry, and you've helped build this country, to make it as strong as it is. The Health Coverage Tax Credit is one way we can give back to you. It's a bold step in the direction of affordable health care for all Americans.

Thank you.

Related Documents:

- PA Program Kit
- PA Registration Form
- Letter Penn
- PA Session Letter

HCTC | Health Coverage Tax Credit
Federal • State • Private Industry

The new Health Coverage Tax Credit (HCTC) could pay 65% of the eligible premium you pay for a qualified health plan. This federal tax credit was passed by Congress and signed into law by President George W. Bush on August 6, 2002.

Am I Eligible?

We believe you may be eligible because you receive either Trade Adjustment Assistance (TAA) benefits or pension benefit payments from the Pension Benefit Guaranty Corporation (PBGC). However, you must meet additional requirements to be eligible to receive the HCTC. One of these requirements is that you be enrolled in a qualified health plan. Only certain types of health plans qualify for the HCTC. Review **page 6** of the enclosed Program Kit to determine if your current health plan is qualified. In addition, a list of health plans currently qualified for HCTC by the state of Pennsylvania is provided on the next page. This list is updated on a regular basis. For the most current list, visit our website or call the HCTC Customer Contact Center.

Two Options

If you are eligible and are enrolled in a qualified health plan, you have two options for claiming the credit:

1. Claim the HCTC on your federal tax return for eligible payments you made directly to a qualified health plan during the year. (This is also the way to obtain the tax credit for any eligible premiums you paid for a qualified health plan before you registered in the HCTC program.)
2. Claim and receive the HCTC in advance by registering for the HCTC program. This program combines your share of your health plan premium for each month with a 65% **advance** payment of the federal tax credit. The combined payment will then be sent to the health plan each month on your behalf.

Register Now for the Advance Payment Option

If you meet the eligibility criteria and are enrolled in a qualified plan, complete the enclosed HCTC Registration Form using the Program Kit as a guide. **You can bring your completed Registration Form to an HCTC Registration Session in late June or early July.** You will receive a separate letter from us that provides details about these sessions.

If You Cannot Attend a Registration Session

If you cannot attend an HCTC Registration Session, we recommend you mail your Registration Form to the HCTC program in the enclosed postage-paid envelope **by August 1**.

Until you receive your first invoice from the HCTC program, you should continue paying 100% of your health plan premium directly to your health plan administrator.

For information on the HCTC program or the enclosed materials, please visit the IRS.gov website at www.irs.gov and enter IRS Keyword: HCTC. You may also call the HCTC Customer Contact Center at 1-866-628-HCTC (TDD/TTY: 1-866-626-HCTC).

Highmark Blue Cross Blue Shield

For individuals who are currently not Highmark Blue Cross Blue Shield members	1-800-876-7639
For current Highmark Blue Cross Blue Shield members:	1-800-544-6679
For written requests for information:	Highmark Blue Cross Blue Shield Direct Pay Programs 120 Fifth Avenue Place Pittsburgh, PA 15222

Counties Served: Allegheny, Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Potter, Somerset, Venango, Warren, Washington, Westmoreland

Highmark Blue Shield

For individuals who are currently not Pennsylvania Blue Shield members	1-888-269-8412
For current Pennsylvania Blue Shield members:	1-877-986-4571
For written requests for information:	Highmark Blue Shield Direct Pay Programs 120 Fifth Avenue Place Pittsburgh, PA 15222

Counties Served: Adams, Berks, Centre, Columbia, Cumberland, Dauphin, Franklin, Fulton, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montour, Northampton, Northumberland, Perry, Schuylkill, Snyder, Union, York

Independence Blue Cross

Within the five-county Philadelphia area:	215-569-8189
Outside of the five-county Philadelphia area:	1-800-556-5455
For written requests for information:	Independence Blue Cross P.O. Box 41452 Philadelphia, PA 19101-8822

Counties Served: Bucks, Chester, Delaware, Montgomery, Philadelphia

Blue Cross of Northeastern Pennsylvania

Weekdays, 8am to 5pm:	1-800-829-8599
TDD – weekdays, 8am to 5pm:	1-866-280-0486
For written requests for information:	Blue Cross of Northeastern Pennsylvania 19 North Main Street Wilkes-Barre, PA 18711

Counties Served: Bradford, Carbon, Clinton, Lackawanna, Luzerne, Lycoming, Monroe, Pike, Sullivan, Susquehanne, Tioga, Wayne, Wyoming

Capital Blue Cross

All Callers:	1-800-962-2242
For written requests for information:	Capital BlueCross P.O. Box 779519 Harrisburg, PA 17177-9519

Counties Served: Adams, Berks, Centre, Columbia, Cumberland, Dauphin, Franklin, Fulton, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montour, Northampton, Northumberland, Perry, Schuylkill, Snyder, Union, York

HCTC | Health Coverage Tax Credit
Federal • State • Private Industry

June 12, 2003

The Health Coverage Tax Credit (HCTC)
is coming to Pennsylvania and registration starts next week!

What is the HCTC?

The HCTC is a federal tax credit that was passed by Congress and signed into law by President George W. Bush on August 6, 2002. We believe you may be eligible because you have received either Trade Adjustment Assistance (TAA) benefits or pension benefit payments from the Pension Benefit Guaranty Corporation (PBGC).

How do I benefit from the HCTC?

If you meet certain requirements, the HCTC could pay 65% of the eligible premium you pay for a qualified health plan.

Register Now for the Advance Payment Option

Watch for a mailing from the HCTC program. This mailing will include a HCTC Program Kit and Registration Form. Important information about the program is also included to assist you in claiming the credit. To claim the credit:

1) Complete the HCTC Registration Form to find out if you are eligible, using the Program Kit as a guide. If you believe you are eligible, bring the form to one of the on-site registration sessions in Pennsylvania listed on the next page. These sessions are designed to:
   - Provide information about the HCTC program,
   - Help you determine if you are eligible to receive the credit,
   - Provide answers to your questions about the HCTC Registration Form and process,
   - Provide you with the opportunity to learn about and enroll in a state qualified health plan.

   If you are not enrolled in a qualified health plan, but meet all of the other requirements for the HCTC, you may still benefit from attending a registration session. The state of Pennsylvania has approved certain health plans for the HCTC program (listed on page 3). Representatives from these plans will be available to assist you at the on-site registration sessions.

2) **Attendance is not required at an on-site registration session.** If you are unable to attend, but believe you meet the eligibility criteria and are enrolled in a qualified plan, complete the HCTC Registration Form using the Program Kit as a guide. Mail your completed Registration Form to the HCTC program in the postage-paid envelope included in your HCTC Program Kit.

What do I do if I still have questions?

For general information about the HCTC program, please visit the IRS web site at *www.irs.gov* and enter IRS Keyword: HCTC. You may also call the HCTC Customer Contact Center at 1-866-628-HCTC (TDD/TTY: 1-866-626-HCTC). If you do not register for the advance HCTC, you still may be eligible to claim the tax credit using IRS Form 8885 when you file your federal tax return, even if you do not owe any federal income tax.

HCTC Federal • State • Private Industry | Health Coverage Tax Credit

HCTC On-site Registration Sessions

Below is a list of locations, dates and times for scheduled on-site registration sessions. To help us serve you better, we encourage you to attend during the time allotted based on the first letter of your last name. Make-up sessions will take place as indicated. For directions, please call the number listed for the location you wish to attend.

On-site Registration Session:	Dates:	Times:	Last Name Beginning With:
Pittsburgh	June 17, 2003	1:00 PM – 6:00 PM	A – J
Robert Morris University	June 18, 2003	9:00 AM – 6:00 PM	K – Q
John Jay Center (Ballroom) 6001 University Blvd. Moon Township, PA 15108	June 19, 2003	9:00 AM – 5:00 PM	R – Z; Make-up
412-262-8264			
Johnstown	June 23, 2003	1:00 PM – 6:00 PM	A – E
Westside Elementary School	June 24, 2003	9:00 AM – 6:00 PM	F – M
196 Westgate Drive Johnstown, PA 15905	June 25, 2003	9:00 AM – 6:00 PM	N – U
814-535-7621	June 26, 2003	9:00 AM – 5:00 PM	V – Z; Make-up
Steelton	June 23, 2003	1:00 PM – 6:00 PM	A – E
USWA Local 1688	June 24, 2003	9:00 AM – 6:00 PM	F – M
200 Gibson Street Steelton, PA 17113	June 25, 2003	9:00 AM – 6:00 PM	N – U
717-939-9366	June 26, 2003	9:00 AM – 5:00 PM	V – Z; Make-up
Bethlehem	July 8, 2003	1:00 PM – 6:00 PM	A – J
USWA Local 2599	July 9, 2003	9:00 AM – 6:00 PM	K – Q
53 East Lehigh Street Bethlehem, PA 18018	July 10, 2003	9:00 AM – 5:00 PM	R – Z; Make-up
610-867-3772			
Coatesville	July 7, 2003	1:00 PM – 6:00 PM	A – E
USWA Local 1165	July 8, 2003	9:00 AM – 6:00 PM	F – M
750 Charles Street Coatesville, PA 19320	July 9, 2003	9:00 AM – 6:00 PM	N – U
610-384-9180	July 10, 2003	9:00 AM – 5:00 PM	V – Z; Make-up
Erie	July 15, 2003	1:00 PM – 6:00 PM	A – J
Gannon University	July 16, 2003	9:00 AM – 6:00 PM	K – Q
Palumbo Academic Center, 2nd floor 824 Peach Street Erie, PA 16541-0003	July 17, 2003	9:00 AM – 5:00 PM	R – Z; Make-up
814-871-7000			
Wilkes-Barre	July 14, 2003	1:00 PM – 8:00 PM	A – M
Luzerne County Community College Conference Center 1333 South Prospect St. Nanticoke, PA 18634-3899	July 15, 2003	9:00 AM – 8:00 PM	N – Z; Make-up
570-740-0476			

HCTC Federal • State • Private Industry | Health Coverage Tax Credit

Pennsylvania Qualified Health Plans

Below is a list of the health plans that have been qualified by the state of Pennsylvania. Representatives from these plans will be on-site to answer questions and enroll you in a state qualified health plan.

State Qualified Health Plan:	Counties Served:	Contact Information:
Blue Cross of Northeastern Pennsylvania	Bradford, Carbon, Clinton, Lackawanna, Luzerne, Lycoming, Monroe, Pike, Sullivan, Susquehanna, Tioga, Wayne, Wyoming	19 North Main Street Wilkes-Barre, PA 18711 1-800-829-8599 TDD 1-866-280-0486
Capital Blue Cross	Adams, Berks, Centre, Columbia, Cumberland, Dauphin, Franklin, Fulton, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montour, Northampton, Northumberland, Perry, Schuylkill, Snyder, Union, York	P.O. Box 779519 Harrisburg, PA 17177-9519 1-800-962-2242
Highmark Blue Cross Blue Shield	Allegheny, Armstrong, Beaver, Bedford, Blair, Butler, Cambria, Cameron, Centre, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Huntingdon, Indiana, Jefferson, Lawrence, McKean, Mercer, Potter, Somerset, Venango, Warren, Washington, Westmoreland	Direct Pay Programs 120 Fifth Avenue Place Pittsburgh, PA 15222 1-800-876-7639 (Non Members) 1-800-544-6679 (Current Members)
Highmark Blue Shield	Adams, Berks, Centre, Columbia, Cumberland, Dauphin, Franklin, Fulton, Juniata, Lancaster, Lebanon, Lehigh, Mifflin, Montour, Northampton, Northumberland, Perry, Schuylkill, Snyder, Union, York	Direct Pay Programs 120 Fifth Avenue Place Pittsburgh, PA 15222 1-800-269-8412 (Non Members) 1-877-986-4571 (Current Members)
Independence Blue Cross	Bucks, Chester, Delaware, Montgomery, Philadelphia	P.O. Box 41452 Philadelphia, PA 19101-8822 215-569-8189 (Within the five-county Philadelphia area) 1-800-556-5455 (Outside of the five-county Philadelphia area)

In addition, some COBRA continuation coverage, individual coverage or spousal coverage may qualify for the tax credit. Please review the HCTC Program Kit and Registration Form carefully to determine if your health coverage qualifies.

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 18, 2003
JS-480

Treasury and IRS Mail New Lower Tax Withholding Tables To Small Businesses

Today, the Treasury Department and the Internal Revenue Service mailed the new lower tax withholding tables to small businesses. Approximately 8.5 million copies of IRS Publication 15-T, "New Withholding Tables for 2003" are being mailed to small businesses. The new withholding tables were posted on Treasury and IRS websites on May 28, 2003, when the President signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003.

The new withholding tables tell employers and payroll administrators how much less in federal income taxes to withhold from workers' wages. Employers should use these new tables as soon as they can work them into their payroll systems, but not later than July 1, 2003. In the next few weeks, workers will begin to see more money in their paychecks.

These withholding changes alone are expected to reduce workers' taxes and put $22 billion into the economy this year, and $35 billion next year. Under the Jobs and Growth Act, a family of four making $40,000 will see their taxes reduced by $1,133 in 2003, a reduction of 96%.

Among other things, the Jobs and Growth Tax Relief and Reconciliation Act immediately in 2003:

- expands the 10-percent bracket from $6,000 to $7,000 for single filers and from $12,000 to $14,000 for married taxpayers filing joint returns, meaning the lowest tax rate will apply to a larger portion of workers' incomes;
- lowers the tax rate for married taxpayers filing jointly from 27% to 15% on taxable incomes between $47,450 and $56,800;
- lowers the 27% rate to 25% on taxable income up to $68,800 for single taxpayers ($114,650 for married taxpayers filing joint returns);
- lowers the 30% rate to 28% on taxable income up to $143,500 for single taxpayers ($174,700 for married taxpayers filing jointly);
- lowers the 35% rate to 33% on taxable income up to $311,950;
- lowers the 38.6% rate to 35% on taxable income over $311,950;
- reduces the marriage penalty by expanding the standard deduction from $7,950 to $9,500 for married individuals; and
- lowers tax rates for millions of small businesses. Twenty-three million small business owners would benefit from the tax act (including all the provisions in the bill).

-30-

Related Documents:

- Publication 15-T "New Withholding Tables for 2003"

Department of the Treasury
Internal Revenue Service

Publication 15-T
(Rev. June 2003)
Cat. No. 32112B

New Withholding Tables

(For Wages Paid Through December 2004)

Get forms and other information faster and easier by:

Computer • www.irs.gov or **FTP** • ftp.irs.gov

FAX • 703-368-9694 (from your fax machine)

EFTPS
Electronic Federal Tax Payment System

IRS e-file for Business
www.irs.gov/efile

Contents

Introduction

This publication contains revised withholding rates and tables. Employers should begin using the withholding tables in this publication as soon as possible. The change is a result of the Jobs and Growth Tax Relief Reconciliation Act of 2003. This publication is a supplement to **Circular E (Pub. 15)**, Employer's Tax Guide, **Pub. 15-A,** Employer's Supplemental Tax Guide, and **Circular A (Pub. 51)**, Agricultural Employer's Tax Guide.

CAUTION *Because this publication combines withholding tables from both Circular E (Pub. 15) and Pub. 15-A, your applicable table may be on a* **different page** *from that shown in those publications.*

Notice to Employers

Make the notice on page 63 available to employees so that they will be aware of how the new law affects their withholding. A copy of **Form W-4,** Employee's Withholding Allowance Certificate, is included on pages 61 and 62. Employees may submit a new Form W-4 to ensure that the correct amount of tax is being withheld from their pay.

Note: *The 2003 Advance Earned Income Credit Payment Tables and the 2003 Form W-4 are not being revised.*

Other 2003 Withholding Rate Changes

Supplemental wages. Effective for wages paid after May 28, 2003 (or as soon as possible thereafter), the supplemental wage flat withholding rate is decreased to 25%. See Circular E (Pub. 15) for more information on supplemental wages.

Backup withholding. Effective for payments after May 28, 2003 (or as soon as possible thereafter), the backup withholding rate is decreased to 28%. See the **General Instructions for Forms 1099, 1098, 5498, and W-2G,** for more information on backup withholding.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 18, 2003
JS-481

Treasury Officials in Ohio to Salute Financial Education Program

U.S. Treasurer Rosario Marin and Treasury Assistant Secretary for Financial Institutions Wayne Abernathy will be in Columbus, OH on Monday, June 23, 2003 to formally salute the Ohio Credit Union League's Latino Financial Literacy Program with an honorary certificate of recognition for its efforts in teaching financial education to Columbus' Hispanic community.

Following the presentation of the certificate, Treasurer Marin and Assistant Secretary Abernathy will assist in teaching a Spanish-language financial education class where students are learning about saving, managing money and handling credit. Representing the fastest growing ethnic population in the United States, Hispanics have a combined purchasing power of more than $450 billion. Yet research and surveys reveal that 43 percent of Hispanics in the United States report knowing little about retirement planning, and as many as 25 percent do not have a bank account.

The Treasury presentation will take place before the class begins, at 6:45 pm at the Shepard Church of the Nazarene, 425 South Hamilton Rd., Gahanna. Treasury officials and Ohio Credit Union League representatives will be available for media interviews at that location from 6:30-6:45 pm.

The Latino Financial Literacy Program, now in its second year, is a four-session course providing instruction on financial goals and spending; developing a budget; establishing and maintaining a good credit history; and managing a bank account and other financial instruments. In its first year, 225 people attended the course and received a certificate of graduation. The program is sponsored by the Ohio Credit Union League in partnership with the Ohio State University Extension Office.

The Treasury Department in 2002 established the Office of Financial Education to strengthen the financial literacy of all Americans, and to provide guidance to organizations providing financial education programs. The Office works to ensure that people can gain the practical knowledge and skills that they need to make informed financial choices throughout various life stages. It focuses on four key areas: basic savings, credit management, homeownership and retirement planning. More information can be found at www.treasury.gov.

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 17, 2003
JS-482

IMF Concludes Article IV Consultation with the United States

The Treasury Department is releasing today the concluding statement by the staff of the International Monetary Fund following this year's Article IV Consultation with the United States. This statement represents IMF staff's independent judgment and assessment of U.S. economic performance and policies.

Release of this statement is consistent with the United States' longstanding, strong support for enhanced transparency of the IMF. The United States also plans to release the IMF staff report and Public Information Notice on the U.S. Article IV review following the Executive Board's discussion of the mission later this summer.

Report(s):

- IMF 2003 Article IV Consultation Statement of the Fund Mission

INTERNATIONAL MONETARY FUND

2003 Article IV Consultation with the United States of America

Statement of the Fund Mission

June 16, 2003

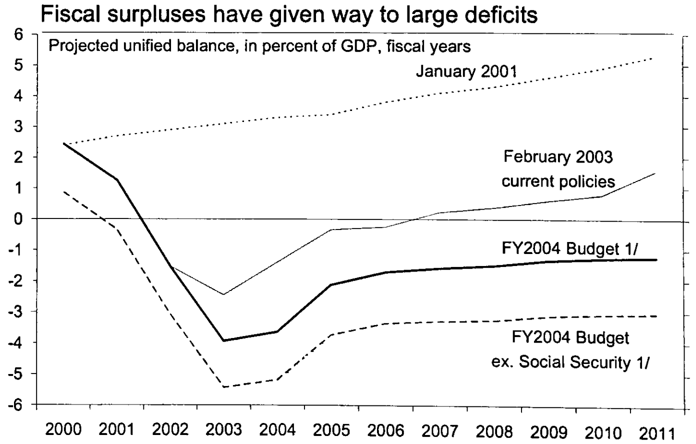
Overall assessment

1. ***The U.S. economy has continued to provide valuable support for global growth, despite being hit by substantial shocks in recent years.*** Following the bursting of the stock market bubble in 2000, the economy was further shaken by the September 11 attacks, corporate failures, and spillovers from geopolitical uncertainties. Nonetheless, the remarkable resilience and flexibility of the U.S. economy and financial system, as well as the exceptional stimulus provided by monetary and fiscal policies, helped make the 2001 downturn relatively short and shallow. Productivity growth has remained robust, and final domestic demand has begun to recover.

2. ***However, the recovery has been uneven, and short-term prospects remain uncertain.*** We expect growth to rise above its potential rate in the latter half of 2003 and into 2004, with the relatively quick resolution of the Iraq war, lower oil prices, and continued support from monetary and fiscal policies. Even so, it remains to be seen whether the adjustments associated with the unwinding of the equity price bubble have fully run their course, and downside risks remain a concern given the continued weakness of industrial activity and employment conditions.

3. ***Medium-term growth prospects generally appear favorable, but recent tax cuts heighten concern regarding the long-term fiscal problem.*** To be sure, fiscal policies have provided valuable support to the recovery so far, but the tax package leaves the fiscal position even less prepared to cope with the retirement of the baby-boom generation later this decade. Sustained fiscal deficits would eventually crowd out investment and erode U.S. productivity growth. They would also tend to boost the already large U.S. current account deficit, imposing a further drain on global saving and increasing the risk of disorderly exchange market conditions.

Fiscal surpluses have given way to large deficits



1/ Fund staff estimates, based on the FY2004 Budget and the Jobs and Growth Reconciliation Act of 2003.

4. ***Against this background, the challenge is to manage short-term risks to the outlook, while establishing a credible approach to coping with longer-term fiscal pressures.*** In the IMF staff's view, responding effectively to this challenge will help promote growth as well as domestic and external sustainability, in line with the G7 finance ministers' commitment to cooperate to promote global economic growth.

- Monetary policy remains best placed to respond if the recovery falters, especially given the low inflation environment.
- The fiscal policy priorities are to establish a framework to balance the budget, excluding Social Security, over the next five to ten years and to begin reforms of entitlement programs that would allow them to meet impending demographic pressures.
- Growth—both at home and abroad—would also benefit from U.S. leadership to promote trade liberalization and development, as well as from continued efforts to strengthen corporate governance and accounting standards.

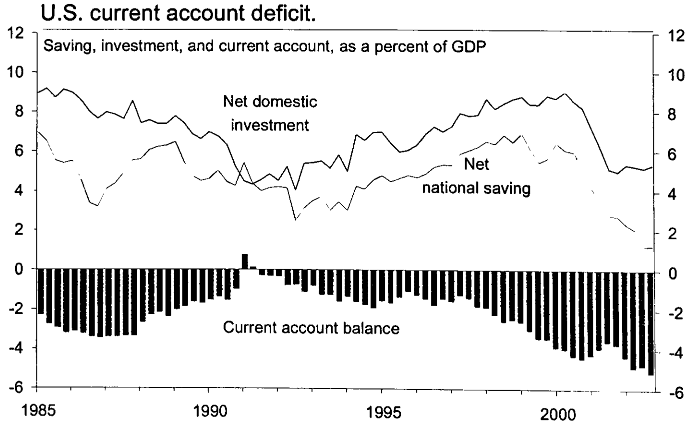
Monetary policy and the exchange rate

5. ***While monetary policy has responded aggressively to the economic slowdown, further easing may still be required if the recovery does not regain momentum.*** With inflation having fallen to near post-war lows and interest rates close to the zero bound, the appropriate bias is toward aggressive and preemptive action to support a healthy recovery. Although deflation risks in the United States appear modest, the FOMC's strong signal of its readiness to act, and its willingness to use a broader range of policy instruments should deflationary pressures intensify, is welcome.

6. ***A quantified statement of the Federal Reserve's longer-term inflation objective would further anchor inflation expectations and help guard against deflation risks.*** Aiming for an inflation rate in the range of 2 percent would still leave room for countercyclical policy responses consistent with the Federal Reserve's dual mandate to achieve price stability and full employment. Making this objective explicit would seem especially helpful now that interest rates have moved close to zero and deflation is a concern.

7. ***The dollar's recent weakness has added to uncertainty and may pose challenges for short-term macroeconomic policy management among partner countries.*** The authorities have correctly emphasized that exchange rates have responded to market forces and that foreign exchange market intervention has little enduring influence. Indeed, the dollar's depreciation

Boosting saving will facilitate the smooth adjustment of the U.S. current account deficit.

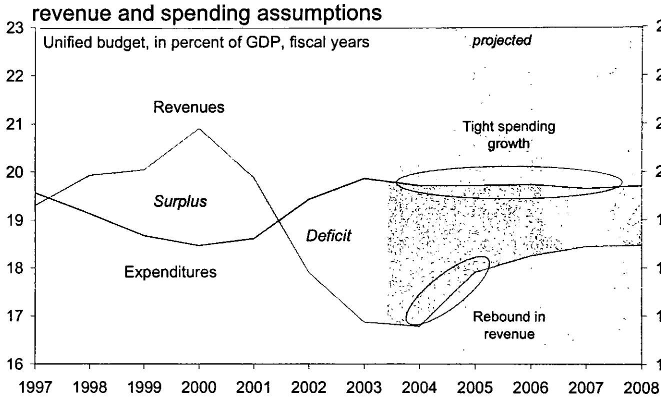


represents a step toward bringing the U.S. current account deficit to a more sustainable position. However, an abrupt weakening of investor sentiment and turbulent exchange market conditions would have adverse consequences both domestically and abroad. A firm commitment to reducing the U.S. fiscal deficit over the medium term, as well as strong growth among partner countries, would help ensure that the eventual adjustment of the U.S. current account deficit is orderly and rests on a strengthening of national saving rather than weaker U.S. investment and growth.

Fiscal policies

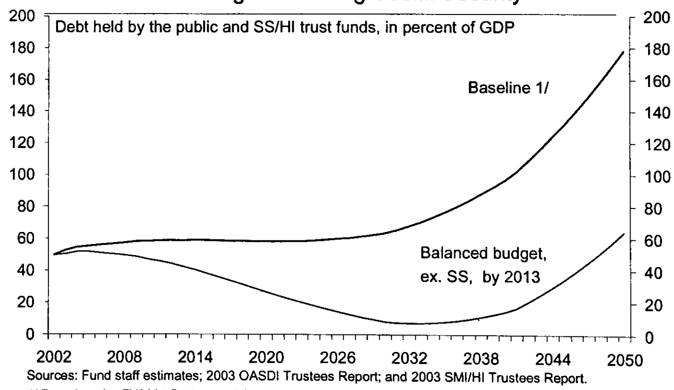
8. ***The priority for fiscal policy should be to establish a credible framework for returning the budget to balance, excluding Social Security, over the medium term and to place retirement and health care systems on a sound financial footing.*** Although the deficit/GDP ratio is projected to narrow somewhat in coming years, these projections are based on assumptions—including a sharp improvement in tax receipts and strict limits on discretionary outlays, excluding defense and homeland security—that may prove optimistic, especially since supporting policies to ensure strict limits on discretionary spending have yet to be defined. Moreover, the retirement of the baby-boom generation will place increasing pressure on the Social Security and Medicare systems in coming decades, potentially causing debt and deficits to rise rapidly. The unfunded actuarial liability of these programs is estimated at around 180 percent of GDP if measured over a 75-year horizon and even higher if measured over longer periods. Balancing the budget, excluding Social Security, over the next five to ten years would enable a substantial reduction in the debt ratio ahead of this demographic shift and provide greater room to implement the needed reform of entitlement programs.

Fiscal deficits remain significant, even on optimistic revenue and spending assumptions



Source: FY2004 Budget of the U.S. Government.

Long-term fiscal pressures can be moderated by measures to balance the budget excluding Social Security



Sources: Fund staff estimates; 2003 OASDI Trustees Report; and 2003 SMI/HI Trustees Report.
1/ Based on the FY2004 Budget and the Jobs and Growth Reconciliation Act of 2003.

9. ***Tax and expenditure policies will need to be geared toward ensuring a sustainable fiscal position.*** In this context, the recent tax package has added to uncertainty about the future paths of tax rates and—as recently illustrated in a study by the Congressional Budget Office—is unlikely to boost output in a sustained manner unless its adverse budgetary impact

is offset over the medium term. Meeting the fiscal costs of population aging will eventually require revenue increases—preferably through base broadening measures that focus on eliminating corporate and personal income tax preferences—and sustained spending restraints.

10. ***The Budget Enforcement Act (BEA) disciplines could provide a credible framework for ensuring that these medium-term trade-offs are faced squarely and that policies are consistent with fiscal sustainability.*** The federal budget is highly transparent and represents best practice in many areas, but recent developments have raised questions about the adequacy of fiscal discipline. In addition to the sharp increase in discretionary spending that has occurred, recent tax cuts have been phased-in and subjected to sunsets in a manner that leaves their longer–term budgetary consequences unclear. The caps on discretionary outlays and pay-as-you-go requirements applied under the BEA contributed to the successful fiscal consolidation during the 1990s. If restored and strengthened further, these disciplines could usefully support the fiscal adjustment that is needed in the period ahead, particularly if accompanied by broader efforts to re-establish a political consensus for budget balance.

11. ***Steps also should be initiated soon to strengthen the financial position of the Social Security and Medicare systems.*** In the case of the Social Security system, relatively modest changes in the system—including amendments to indexation formulas, increases in the retirement age, or hikes in contributions rates—would be sufficient to close projected shortfalls. However, these measures take considerable time to phase-in, and larger and more painful adjustments will be required the longer decisions are delayed. The financial position of the Medicare system is considerably worse, given the rapid growth of health care costs and the modest share of benefits that are covered by individual contributions. In these circumstances, any measures to enrich benefits, including for prescription drugs, should be accompanied by credible measures to address the system's longer-term financial problems.

12. ***Energy policies that operate on the demand-side—as well as the supply-side—would help support both environmental and fiscal objectives.*** Current proposals embodied in the Energy Bill aim to boost U.S. energy production and reduce emissions intensity, principally through tax and other incentives for businesses. Measures that directly target consumers—including energy-related taxes—also could be effective in aligning energy demand and supply and achieving emissions goals, while contributing to longer-term budgetary objectives.

13. ***Fiscal pressures at the state and local government levels are a growing concern.*** Recent federal initiatives have devolved greater responsibility and accountability for programs to the states, including by shifting funding for programs from a cost-sharing to a block grant basis. Although this approach has merit, the burden on states—including for welfare, education initiatives, and homeland security—has increased at a time when state revenues have been severely affected by the economic slowdown. Proposed reforms to Medicaid funding will need to take into account the growing pressures on the system from population aging and spillovers from the Medicare system.

Financial sector and corporate governance

14. ***Financial sector balance sheets have held up well, and corporate profitability seems to be recovering.*** However, care will be needed to ensure that banks are well-positioned to absorb the effect on balance sheets of an eventual turnaround in interest rates or a possible cooling of conditions in the real estate market. The rapid growth and systemic importance of Fannie Mae and Freddie Mac suggest the possible need for measures to further limit these agencies' special status, especially in view of the implicit government guarantee that markets attach to their liabilities.

15. ***Considerable progress has been made toward strengthening the oversight of accounting and corporate governance.*** The remaining challenge is to ensure that the responsible agencies are provided with the resources and the support to complete the reform agenda. Key tasks will be to improve the accounting of stock options; ensure the independence of corporate boards; and achieve greater harmony between U.S. and international accounting standards. In addition, the significant underfunding of defined-benefit corporate pension plans that has emerged in recent years points to the need to strengthen the accounting and transparency of these plans, as well as the finances of the Pension Benefit Guaranty Corporation.

Trade policies and development assistance

16. ***The United States will need to continue to play an important leadership role in promoting trade liberalization.*** A more open and liberal trade system has enormous potential for fostering growth in all countries, and the United States has already made helpful proposals for moving the Doha Round forward. As it is essential to reinvigorate the momentum toward a successful completion of the Round, it will be important for the United States to find common ground with partner countries in a range of difficult areas, such as the public health exemption on TRIPs. The authorities are also encouraged to take early action to comply with recent WTO rulings. Ongoing negotiations of bilateral and regional free-trade agreements have the potential to bring substantial benefits to the partner countries involved. In this context, it will be important to ensure that such initiatives complement, rather than substitute for, broader multilateral efforts toward liberalization and that they are designed to limit trade diversion and administrative complexities.

17. ***There are also important opportunities to better align U.S. trade and other domestic policies with the broader commitment to development.*** Recent efforts to improve access to U.S. markets for countries in Africa and the Andean region, and to boost overseas development assistance (ODA)—including in the context of the Millennium Challenge Account, are welcome. However, U.S. development assistance as a share of GNP would still remain among the lowest among the industrial countries, and larger increases in foreign assistance would still be desirable. There also remains scope for improving the complementarities between development and trade policies, including by reducing subsidies to U.S. agricultural producers and by more ambitious efforts to eliminate remaining non-tariff barriers to imports from developing countries.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 17, 2003
JS-483

Remarks of Greg Zerzan Deputy Assistant Secretary for Financial Institutions at the Homeland Education Resource Organization Conference 2003

Las Vegas, Nevada

Thank you for inviting me to speak with you today regarding the Terrorism Risk Insurance Program. It is a great pleasure to be able to come to Las Vegas and discuss this important program with some of America's leaders in the tourism and travel industry.

Those in the gaming industry are familiar with the principles of calculating odds, taking risks, and hedging against those risks. I doubt there would still be a casino open in this town if it wasn't possible to estimate, with an acceptable degree of proximate certainty, what the given losses and gains of the casino would be for any given time period. But for the insurance industry, September 11th was akin to having every slot machine in the casino come up triple lemons.

As we know, the cowardly attacks by the terrorists on September 11th were a despicable act of murder unprecedented in their cruelty and scope. As well as the loss of the lives of scores of heroic firefighters, police, and people who had simply gone to work expecting to put in another day at the office, 9-11 wreaked havoc on our economy and financial markets. For the insurance industry, it was the day that separate catastrophic insurable events occurred almost simultaneously: four large passenger planes, both World Trade Center buildings and most of the surrounding real estate was destroyed. Clearly this was a loss on a scale that was not anticipated, or even thinkable.

After 9-11 it was clear that insureds faced a new type of risk: the potential for loss due to massive catastrophic terror. The difficulty this presented was that, as a first of its kind risk, it was difficult to immediately quantify. And being unable to quantify it, no insurance company could reasonably insure against it without obtaining reinsurance. And reinsurers made it clear that if they were to provide terror coverage at all, it would be prohibitively expensive.

President Bush immediately recognized the chilling effect this placed on our economy. Most of commercial America would be unable to find insurance against this new and profound threat. Without insurance, American companies faced serious financing difficulties. The cost of this lack of insurance had the potential to put a massive brake on the engine of the economy which was already sputtering because of the attacks.

The President and the Congress began to work on creating a Federal program to provide a backstop for terrorism risk insurance. On November 26, 2002 President Bush signed into law the Terrorism Risk Insurance Act of 2002. This act, known as TRIA, provides a temporary program of shared Federal and private coverage for commercial property and casualty losses resulting from acts of terror. TRIA became effective immediately, and it pre-empted all existing policies and exclusions while mandating that policy holders be given access to terrorism risk coverage.

The first thing to remember about TRIA is that it is a temporary program. It sunsets, or ceases to be law, on December 31, 2005. Until that date, the program provides a government backstop for terrorism reinsurance.

It is important that policyholders understand that the government's backstop for terrorism reinsurance is not on a policy-by-policy basis, but rather it operates through a private insurance company deductible, with excess losses being shared with the Federal government. If an insurance company suffers a loss resulting from an act of terrorism equal to its deductible, the Treasury will cover 90% of the losses beyond that threshold. This is an important feature of the program, for it requires that an insurance company retain a portion of terror risk and thus ensures that such companies will exercise normal due diligence in their underwriting and risk allocation. Additionally, throughout the life of the program an insurance company's deductible increases so that the potential share of losses paid by the taxpayers decreases proportionally. By increasing the amount of the deductible every year, the Federal government phases itself out of the reinsurance business while private companies develop their own market means of calculating and insuring against terror risk. From the first year of the program, which is this year, the insurance company deductible increases from 7% of premiums, to 10%, and finally 15% in the program's final year.

To further protect the taxpayers, the Program provides the Treasury with the authority to recoup Federal payments from policyholder payments paid to the insurers. Finally, the government's total liability under the program is limited to $100 billion.

As I stated a few moments ago, TRIA mandates that all insurers offer terror insurance as part of their property and casualty policies. This coverage must be made available on terms and conditions that do not materially differ from the terms and conditions generally applicable to other types of insured losses. This does not mean that the price of terror policies must be the same as for other types of property and casualty insurance, but rather that the type and amount of coverage cannot be significantly different.

Under TRIA, an act of terrorism is defined as an act committed on behalf of a foreign power which is violent or dangerous to life, property or infrastructure. This means that the law does not apply to domestic terrorism, or to acts committed in the course of a war that has been declared by Congress. Nor does it apply to acts of terrorism where the aggregate losses from the attack are less than $5 million.

The provision that requires that losses total $5 million before an event can be certified as an act of terrorism has caused some confusion among policyholders. We have heard that some policyholders have looked at this provision and concluded that because they do not have $5 million in exposure they have little need for the coverage offered under TRIA. In this regard I think that it is important that policyholders understand that the $5 million threshold is not on a policy-by-policy basis, but rather the threshold is related to aggregate property and casualty insurance losses associated with a particular act of terrorism. For example, if $7 million in aggregate property and casualty insurance losses from a certified act of terrorism were distributed among 10 policyholders, those losses could contribute to an insurance companies ability to access the TRIA backstop, and in turn policyholders should derive some benefit from the TRIA backstop.

TRIA mandates that insurers clearly and conspicuously disclose the premium which they are charging for terror coverage, and the Federal share of losses under the program. The program is limited to commercial property and casualty losses, and it provides specific procedures for processing claims in order to manage any potential litigation which might follow an act of terrorism. The program requires the Treasury Department to conduct a study to determine whether the coverage should be applied to group life insurance policies as well as property and casualty policies. The Secretary continues to review the comments we have received on this issue, and the Treasury is continuing its work on that study.

As with any new law, implementing TRIA requires a great deal of regulatory work. Already the Treasury has issued interim guidance and regulations regarding various aspects of the proposal. The regulations issued by Treasury are subject to the normal notice and comment procedures, and the whole series interim guidance notices and regulations can be found on Treasury's website - www.treasury.gov/trip. In addition, we will shortly be completing certain aspects of the rulemaking process, such as issuing a final rule on the definitions and other requirements in the statute. The infrastructure for processing claims under the program has also been created as a separate office within the Treasury, and that office continues to solidify the administrative application of the program.

The Treasury Department continues to monitor the effectiveness of the Terrorism Risk Insurance Program. The key goal of the law is to make sure not only that terrorism insurance is available, but also to improve insurance companies' ability to price such coverage, and in turn improve the affordability of such coverage for commercial entities. This is ultimately the idea behind the Act. By creating a Federal role in being the insurer of last resort for terror risk, TRIA aims to improve the availability of terror coverage while the private marketplace can assess risk and create pricing models that reasonably accommodate their own risks.

And that is why TRIA is temporary. The Federal government cannot and should not be in the business of attempting to do what market forces can do better. Ultimately the insurance industry should have the opportunity to provide terror coverage to all of its policyholders on the terms and conditions that the market and events require. We will ultimately realize the success of this law when, on January 1, 2006, it no longer exists.

Having covered the basics of TRIA, I will now turn to a question I am often asked: does my business need to purchase terror insurance? It is a question I cannot answer. Each commercial entity must evaluate its own operations and sense of risk to determine whether terror insurance is right for that enterprise.

But the great success of TRIA is that, if the business determines it should purchase terror insurance, businesses will have the opportunity to purchase such coverage.

In some places there still exists some uncertainty about how TRIA works, but this is to be expected with any program of its kind. Although it is still early in the implementation of the law, we have received initial data indicating that pricing is stabilizing in the terror insurance market. The insurance industry, policyholders and the National Association of Insurance Commissioners have all played a crucial role in helping Treasury make TRIA work. We are grateful for the support and input they have given, and we look forward to continuing to work with them throughout the duration of the program. Likewise, leaders in Congress not only helped create the law, but continue to provide invaluable guidance and suggestions. All of this support is certainly helpful in ensuring the program responds to the needs and desires of those who seek terror coverage.

Let me conclude on this note. September 11th was a dark day for America. But it was a turning point not only in that it awoke us to the new realization that there are many in the world who hate us and despise our way of life. It was a turning point in that it inspired us to hold dear those ideals which are most a part of our country and our character: freedom and the rule of law, the rights to speak and worship as we see fit. It was these values which were attacked, and these values which we defend.

As President Bush has said, September 11 was not the beginning of a war against our ideals; it was the beginning of the end for those who oppose them. Already the nations of Afghanistan and Iraq have been freed; those who sought our downfall found in the terrorists' cowardly deeds their own downfall instead.

The War on Terror, the creation of the Homeland Security Agency, the Terrorism Risk Insurance Act and a host of other actions since 9-11 are only a part of America's response to the terrible events of that day. Like all of you, I look forward to the day when the thought of the need for terror insurance seems absurd.

Thank you very much for inviting me to speak with you today, and I will be around after the program if I can answer any questions.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 17, 2003
JS-484

Opening Remarks by Treasury Secretary John Snow at Money Magazine's Money Summit New York, New York Tuesday, June 17, 2003

Good afternoon. Before Lou and I begin our dialogue with you, I would like to make a few opening comments about the current state of the U.S.
economy, and where I think we're going.

Here's the landscape: GDP rose by 1.9% in the first quarter of 2003, better than the growth late last year. But I think the real pick-up is going to happen in the second half of this year, as the President's jobs and growth provisions kick-in. In fact, I think we're going to see annualized growth rates near 3.5% by the later part of this year.

I know a lot of people in the investment community have been heartened by the passage of President Bush's Jobs and Growth plan. We're starting to see an impact in the markets, as higher tax-adjusted returns on dividends and capital gains are factored into stock prices.

In many ways, the focus of the President's plan is on reducing the cost of capital for businesses, small and large. We've tried to create conditions for higher potential growth in the long-term, and I think the plan has succeeded in that.

Thanks to the plan, all businesses now qualify for greater expensing of new equipment investments, which is lowering the cost of making those investments. While it's too early to be definitive there are signs that new incentive is cracking the ice in terms of capital spending decisions.

Small businesses that are taxed as pass-through entities are going to see more disposable income for new investment and new jobs, thanks to marginal rate cuts.

Larger businesses that pay dividends will be able to raise equity capital more cheaply, as dividend paying stocks become more attractive to shareholders. A lower cost of capital means more capital formation, more investment, and more jobs.

Obviously, the tax plan does a lot for the demand side as well, with lower marginal rates for all taxpayers and immediate child tax credits for families, for example. Americans are going to see lower withholding from their paychecks right away - money they can save or spend right now with the new withholding tables going out this week.

I'm confident that the plan is going to have a serious impact on overall economic growth and job creation in the United States this year. Bottom line is: I am confident we're going to see those `help wanted' signs go up again in greater and greater numbers.

Conditions for this recovery are looking better and better. Let me put it in a way that those living through the Northeastern weather this year can appreciate: this recovery has been soggy, but it's definitely drying up.

Our trade deficit has narrowed, consumer sentiment is up with the end of the war, interest rates have stayed low keeping the housing market strong, and corporate profits are rebounding. Productivity has stayed strong, which bodes well for future income growth and living standards. There are signs of renewed capital spending too.

Another reason for increasing confidence in the markets is the SEC's steady hand, which has been routing out the vestiges of bubble-era malfeasance, and setting a tone of accountability for public companies and investment firms. We're proud of their work. With the SEC setting clear rules of the road, businessmen can get back to focusing on running their businesses, producing good returns for shareholders, opening up new markets, developing new products, serving customers well and making the big and important decisions that are so critical to the future success of their enterprises.

Of course, the most important economic indicator for the President is employment. Stock indices are not jobs, but companies that are doing well, that are making investments, are going to start hiring.

I think the markers are all there for a strengthening labor market as growth accelerates this year.

We've also taken steps to help folks who are out of work, looking for those new jobs to come through. We've extending unemployment coverage, and put forward some exciting, innovative programs like the Health Coverage Tax Credit, which I introduced in Pittsburgh yesterday. This program has great potential for aiding the uninsured.

Before I take your questions, a word about global growth prospects. Today the industrialized nations of the world are growing far too slowly and everyone suffers as a consequence. This was one of President Bush's key messages at the G8 summit earlier this month: that the United States wishes economic success for all its partners, and that the developing world in particular needs faster growth from all of the more advanced economies. It has been the policy of his administration to encourage economic growth at home and abroad.

Nowhere is this more important than in the leading industrialized nations, which through their trade and investment activities support growth throughout the rest of the world. Our challenge today is that the leading economies are suffering from a growth deficit - their potential far exceeds their performance. Returning these economies to high growth performance has been and will continue to be our focus. We expect others to take bold actions themselves - including fundamental structural reforms where necessary - to spur growth, create jobs and contribute to global prosperity.

That's my quick take on the economy - we've come a long way from the beginning of this year, and we've seen a big victory on the home front. This is a hopeful time for America.

I'm looking forward to your questions.

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FROM THE OFFICE OF PUBLIC AFFAIRS

June 19, 2003
JS-485

Statement of Gregory F. Jenner
Deputy Assistant Secretary (Tax Policy)
United States Department of the Treasury

Before the House Ways and Means Subcommittee on Select Revenue Measures

Mr. Chairman, Ranking Member McNulty, and distinguished Members of the Subcommittee:

I am pleased to appear before you today to discuss the various proposals to reform Subchapter S of the Internal Revenue Code.

The Benefits of Subchapter S

There is little dispute that small businesses are the cornerstone of the American economy. The millions of individuals who spend their time, energy, and resources pursuing ideas, taking risks, and creating value are instrumental to job creation and the growth of our economy. The entire Administration, including the IRS and the Department of the Treasury, is committed to working closely with the small business community and its representatives to help small businesses and the self-employed understand their tax obligations, ease unnecessary restrictions, and reduce their compliance burdens.

Subchapter S is an important tool for small businesses. Enacted in 1958, Subchapter S was designed to provide small businesses organized as state law corporations with a single-layer tax system similar to that enjoyed by partnerships.

Major reforms in 1982 and 1996 moved the tax treatment of S corporations closer to that of partnerships while easing restrictions on S corporation eligibility. Among the 1996 reforms were: (1) increasing the number of S corporation shareholders from 35 to 75; (2) allowing S corporations to own subsidiaries; (3) allowing certain types of tax-exempt organizations and trusts to own S corporation stock; (4) allowing banks to elect S corporation status; (5) allowing an S corporation to create an employee stock ownership plan; (6) allowing the IRS to provide relief for late or invalid S corporation elections; and (7) exempting S corporations from the unified audit and litigation procedures.

The 1982 and 1996 reforms appear to have enabled a greater number of businesses to operate as S corporations. Between 1982 and 2000, the percentage of non-farm businesses taxed as S corporations rose from less than 4 percent to more than 11 percent. Although this trend is, in all likelihood, due in part to the significant lowering of individual tax rates, S corporation reforms certainly played an important role.

S corporations are not, however, the predominant form of entity used by small businesses. As of 2000, less than 8 percent of non-farm businesses with gross receipts under $250,000 were operating in S corporation form. The vast majority (79 percent) were operating as sole proprietorships, while the remaining 13 percent were operating as C corporations, partnerships, and limited liability companies taxed as partnerships. We believe that this is due in no small measure to the relative simplicity of operating as a sole proprietorship rather than as a partnership or S corporation.

Conversely, it also appears that the S corporation form is more attractive to larger business than to small businesses. More than 37 percent of non-farm businesses with gross receipts over $1 million are S corporations and more than 25 percent of non-farm businesses with gross receipts over $50 million are S corporations.

The relative attractiveness of S corporations will, in all likelihood, have diminished somewhat as a result of the recently-enacted Jobs and Growth bill. Doing business as an S corporation, for those businesses that qualified, offered the advantage of a single layer of tax at the shareholder level. In contrast, C corporations were taxed on their income at the corporate level, while their shareholders were taxed a second time on dividends distributed by the C corporation. By reducing the rate of tax on dividends to 15 percent, the Jobs and Growth bill has lessened (but not eliminated) the double tax on corporate income, thereby reducing (but again not eliminating) the tax advantage offered by S corporations.

Recognizing that small businesses may choose a variety of organizational forms, the Administration has chosen to focus on broad-based tax initiatives that are not dependent on organizational structure. It is our belief that tax should not play a significant role in the selection of the form in which a business chooses to operate. As a result, the President and Congress have worked together to reduce income tax rates by 3 to 5 percent and to increase the amount of investment that may be immediately deducted by small businesses from $25,000 to $100,000. In the 2001 Act, Congress phased out the death tax, allowing innovative entrepreneurs to pass the fruits of their lives' work to their children rather than the government. These changes will benefit 23 million small business owners, approximately 2 million of which are S corporations, providing cash for further investment and job creation. In addition, several regulatory changes have been made to ease the burdens on small businesses.[1]

Although these legislative and regulatory reforms have provided much needed tax relief and simplification to small businesses, the complexity of the tax laws continues to plague small business owners. Our tax laws have become devastatingly complex in recent years. Many small business owners are unprepared to deal with this complexity and do not have the resources to hire sophisticated tax counsel to advise them. Tax law compliance drains the time, energy, and financial resources of small business owners and diverts their attention from the more important goal of building a business.

It is our belief that Subchapter S remains a relatively simple, yet flexible, system in which small businesses can operate and thrive. We recognize the importance of enhancing its flexibility wherever and whenever possible. We are also concerned, however, that such flexibility should not be achieved at the cost of greater complexity. As a result, we analyze proposed changes to Subchapter S by asking whether the proposal would increase the complexity of Subchapter S and, if so, is such increased complexity more than offset by the benefits of the proposed change.

It is important to remember that Subchapter S is no longer the only way small businesses can achieve limited liability while paying only a single layer of tax. As a result of regulations issued in 1995, state law limited liability companies can now be taxed as partnerships. Many practitioners now tout the benefits of the more flexible limited liability company entity over the more restrictive S corporation entity.

Interestingly, however, between 1996 and 2000, growth in the number of S corporations has exceeded growth in the number of limited liability companies taxed as partnerships. We believe this is due in no small measure to the complexity of the partnership system compared with S corporations. Although S corporations must meet eligibility restrictions that do not apply to limited liability companies, these eligibility restrictions allow for a much simpler system of taxing S corporation income. In particular, the inordinately complex systems for determining a partner's shares of partnership income do not apply to S corporations. In short, despite eligibility restrictions, an S corporation is perhaps the only organizational form available to small multi-member businesses that offers relative simplicity. Consequently, we hesitate to support proposals that would add additional complexity to Subchapter S.

H.R. 714, H.R. 1498, and H.R. 1896

Because of the large number of proposals included in the bills under consideration today, our testimony does not set out Treasury's views on each provision. Instead, our testimony identifies the provisions that the Administration would not oppose on substance, and sets out our views on those provisions. To reiterate, our basic goal is to preserve the relative simplicity of Subchapter S while offering additional flexibility to businesses taxed as S corporations. We believe that these provisions are either consistent with, or not contrary to, that basic goal. We would also point out the need to exercise fiscal discipline in considering additional tax measures, and that any tax bill inclusive of these or other tax provisions should not increase the deficit further.

Allow shareholders of an S corporation to obtain the full benefit of a charitable contribution of appreciated property by the corporation (Section 11 of H.R. 714 and section 205 of H.R. 1896). In cases where an S Corporation donates appreciated property to charity, a shareholder's basis in their S corporation stock reflects the basis of that appreciated property, whereas the amount contributed is the fair market value of the appreciated property. Under current law, an S corporation shareholder's charitable deduction is limited to his or her stock basis. As a result, current law prevents some S corporation shareholders from obtaining the full benefit of the charitable contribution deduction. The proposal would allow an S corporation shareholder to increase the basis of their S corporation stock by the difference between the shareholder's share of the charitable contribution deduction and the shareholder's share of the basis of the appreciated property. This treatment is already provided to partnerships and limited liability companies. Therefore, this proposal would accomplish the twin goals of encouraging charitable giving and equalizing the treatment of S corporations and partnerships.

Permit a bank corporation's eligible shareholders to include an IRA and allow shares held in an IRA to be purchased by the IRA owner (Section 103 of H.R. 1896). A corporation cannot elect S corporation status if its stock is held by an IRA, and income of an S corporation that is allocable to a tax-exempt entity generally is treated as unrelated business taxable income. The only exception is for employee stock ownership plans (ESOPs) which are themselves subject to special strict rules mandated by EGTRRA. In addition, an IRA owner cannot purchase assets held by the IRA without a special exemption. The proposal would permit an IRA to be a permissible shareholder of a bank S corporation. In addition, an IRA owner would be permitted to purchase S corporation shares held by the IRA without the need for a special exemption. These changes would only apply to shares held prior to enactment of the provision. This proposal would result in some additional complexity that it would be preferable to avoid. However, on balance, we believe that this complexity is outweighed by the flexibility that would be provided to IRAs currently owning bank shares. Our support, however, is explicitly conditioned on the S Corporation income earned in the IRA being treated as unrelated business taxable income. We are concerned that, if enacted, subsequent efforts will be made that would make such income not subject to UBIT (as was done in the case of ESOPs), thus eliminating any and all tax on such income.

Allow S corporation shareholders to transfer suspended losses on a divorce (Section 302 of H.R. 1896). Under current law, losses that exceed the shareholder's basis in S corporation stock are suspended and may be carried over indefinitely and used when the shareholder acquires sufficient basis in the S corporation stock. The losses, though, cannot be transferred to another person. If, as a result of a divorce, a shareholder must transfer S corporation stock to his or her former spouse, the suspended losses associated with that stock are lost. Section 302 would remedy this unduly harsh result by allowing suspended losses to be transferred along with the S corporation stock transferred incident to divorce.

Allow beneficiaries of qualified subchapter S trusts (QSSTs) to use passive activity losses and at-risk amounts (Section 303 of H.R. 1896). Generally, the current income beneficiary of a QSST is taxed on S corporation income. Losses that flow through to the beneficiary from the S corporation may be limited under the passive activity loss or at risk rules. For most S corporation shareholders, losses that are limited under the passive activity loss or at risk rules carry over until the shareholder disposes of the activity generating the passive loss or at risk amount. At that time, the shareholder may take any remaining suspended passive activity and at-risk losses. Unfortunately, the S corporation rules provide that the QSST and not the income beneficiary is treated as the owner of the S corporation stock for purposes of determining the tax consequences of a disposition of the S corporation stock. Because the beneficiary is treated as the owner of the S corporation stock for income reporting purposes, but not for purposes of gain or loss on the disposition of S corporation stock, it is unclear whether losses flowing through to a QSST beneficiary that are suspended under the passive activity loss or at risk rules may be used on the disposition of the S corporation stock. This proposal would clarify that, for purposes of applying the passive activity loss and at risk rules, the disposition of S corporation stock by a QSST will be treated as the disposition of the stock by the income beneficiary of the QSST.

Permit an electing small business trust (ESBT) to claim an income tax deduction for any interest incurred to purchase S stock (Section 304 of H.R. 1896). This proposal would eliminate an existing distinction between an individual purchaser of S corporation stock and a trust purchaser, and would make the ESBT more attractive. Under current law, the only permissible deductions against an ESBT's income are its administrative expenses, such as costs incurred in the management and preservation of the trust's assets; interest incurred to acquire S corporation stock is not deductible. Treasury does not oppose this proposal, but we believe that the interest deduction should be no more generous to an ESBT purchaser of S corporation stock than the interest deduction available to an individual purchaser of that stock. We would be pleased to work with the Subcommittee to achieve that result.

Disregard unexercised powers of appointment in determining the potential current beneficiaries of an ESBT (Section 305 of H.R. 1896). This proposal would significantly improve the ESBT rules by removing a technical impediment that currently prevents many trusts from making the ESBT election. Many existing trusts grant to an individual the ability to name additional persons and entities as trust beneficiaries (for example, as substitute beneficiaries in the event of the death of a current beneficiary, or a change in circumstances that renders a current beneficiary "unworthy" of receiving benefits from the trust). Usually, the group of permissible appointees is described as an identified class of persons or entities, such as the descendants of the grantor's grandparents or any charitable organizations. Such a class of permissible appointees has an almost unlimited number of members. Current law limits the number of shareholders of an S corporation to 75, and all of the members of the class of potential appointees count toward that 75-person limit. As a result, if an ESBT election is made for a trust that grants such a power of appointment, the S election of the corporation will be terminated, even though that power of appointment may never be exercised. This proposal would disregard such powers so long as they were not exercised.

Allow the S corporation's charitable contributions to be deducted from its gross income (Section 307 of H.R. 1896). Under current law, an individual S corporation shareholder may claim an income tax charitable deduction for his or her share of a charitable contribution made by the S corporation. However, because of the rules regarding charitable deductions of trusts, a shareholder whose S corporation stock is held in a trust will receive no comparable tax benefit from that contribution. Section 307 would explicitly add charitable contributions to the items that can be deducted in computing the ESBT's income tax on its S corporation income. This proposal would encourage charitable giving by S corporations and would eliminate a significant difference in the tax treatment of an S corporation's individual and non-individual shareholders. We suggest that this Subcommittee consider expanding the application of this provision to other pass-through entities making charitable contributions. This could be accomplished by amending the trust rules to provide that trusts may deduct charitable contributions made by all types of pass-through entities in a way that is comparable to the charitable deduction available to individuals (and subject to the same limitations).

Allow banks to exclude investment securities income from passive investment income (Section 3 of H.R. 714 and section 401 of H.R. 1896). S corporations with accumulated C corporation earnings and profits are subject to a corporate-level tax on passive investment income that exceeds 25 percent of the corporation's gross receipts for any year. Additionally, a corporation's S corporation status is terminated if the 25 percent limit is exceeded for three consecutive years. Gross receipts derived in the ordinary course of a banking business are not considered passive investment income for this purpose. Income from investment assets, however, is treated as derived in the ordinary course of a banking business only if the investment assets are needed for liquidity or loan demand. The amount of investment assets needed for liquidity or loan demand may be subject to disagreement. This provision would eliminate this uncertainty by providing that passive investment income would not include any interest income earned by a bank, bank holding company, or qualified subchapter S subsidiary (in the case of H.R. 1896 only) or dividends on assets required to be held by such bank, bank holding company, or qualified subchapter S subsidiary (in the case of H.R. 1896 only) to conduct a banking business. We recommend that this proposal be clarified to apply only to a bank, bank holding company, or a qualified subchapter S subsidiary of a bank or a bank holding company.

Allow a bank to recapture its bad debt reserves on either its first S corporation or its last C corporation return (Section 6 of H.R. 714 and section 403 of H.R. 1896). Under current law, banks that use the reserve method of accounting are ineligible to make the S corporation election. If a bank makes an S corporation election, the bank is automatically switched to the specific charge-off method of accounting for bad debts. This change in accounting method results in recapture of the bad debt reserve over four years. The recapture of the reserve by the bank S corporation is treated as built-in gain subject to a special corporate-level tax. Under the built-in gain provisions, tax on the built-in gain must be paid both at the corporate and shareholder level in the year of recognition. In contrast, a C corporation would pay tax on the recapture amount at the corporate level but the shareholders would not have to pay tax on that amount until the C corporation paid dividends. By allowing banks to take the recapture of the bad debt reserves into account in the last C corporation year, rather than the first S corporation year, the proposal would eliminate the current imposition of a second layer of tax. This provision is similar to a provision of the Code designed to recapture LIFO reserves on the conversion of a C corporation to an S corporation. Under that provision, the LIFO recapture amount is taken into account in the year before the conversion to S corporation status, but the corporation is allowed to pay the tax on the recapture amount over 4 years. We recommend that similar principles be applied to address the recapture of bad debt reserves and would be happy to work with this Subcommittee to draft an appropriate provision.

Allow the IRS to provide relief for inadvertently invalid qualified Subchapter S subsidiary (QSub) elections and terminations (Section 501 of H.R. 1896). Section 1362(f) authorizes the Secretary to provide relief for inadvertent invalid S corporation elections and inadvertent terminations of S corporation elections. This provision has saved hundreds of taxpayers from the consequence of procedural mistakes; invalid elections and inadvertent terminations are common because S corporations and their shareholders are often unfamiliar with the technical requirements of eligibility. Under current law, however, there is no comparable relief available for QSubs. Allowing the Secretary to grant relief for inadvertent invalid QSub elections and terminations would prevent shareholders from suffering significant negative consequences for mere procedural errors.

Provide that a sale of an interest in a QSub is treated as a sale of a pro rata share of the QSub's assets, followed by a contribution of those assets to a corporation (Section 503 of H.R. 1896). A QSub must be wholly owned by a single S corporation. Under current law, if an S corporation sells more than 20 percent of the stock of a QSub, the S corporation will recognize gain and loss on all of the assets of the QSub. The proposal would change this to align the treatment of the sale of an interest in a QSub with the treatment of the sale an interest in a limited liability company that is treated as a disregarded entity.

Eliminate the earnings and profits earned by a corporation as an S corporation prior to 1983 (Section 601 of H.R. 1896). Prior to 1983, income earned by an S corporation gave rise to earnings and profits. Concluding that it was inconsistent with the modern view of S corporations to continue to view pre-1983 S corporation income as giving rise to earnings and profits, in 1996 Congress eliminated pre-1983 earnings and profits for any corporation that was an S corporation prior to 1983, but only if the corporation was an S corporation in its first taxable year beginning after December 31, 1996. Section 601 would eliminate pre-1983 earnings and profits arising during an S corporation year, regardless of whether the corporation was an S corporation in its first taxable year beginning after December 31, 1996. In our view, relief from pre-1983 S corporation earnings and profits should not be dependent on whether the corporation continued to be an S corporation after 1996.

Allow charitable contribution carryforwards and foreign tax credit carryforwards to offset the corporate-level tax on built-in gains (Section 603 of H.R. 1896). Under current law, an S corporation may use net operating loss carryforwards and capital loss carryforwards to offset the tax on built-in gains under section 1374. It is our view that charitable contribution carryforwards and foreign tax credit carryforwards should also be available to offset section 1374 built-in gains.

Expand the number of permissible S Corporation shareholders (Section 4 of H.R.. 714 and section 104 of H.R. 1896). These proposals would increase the number of permissible S Corporation shareholders from 75 to 150. Treasury cannot support such a dramatic increase, which we believe would run counter to the goal of maintaining Subchapter S as the simplest of systems for businesses with more than one owner. Increasing the number of shareholders will, inevitably, bring increased pressure to liberalize other facets of Subchapter S which will, in turn, increase the complexity of the provisions. It is important to keep in mind that the number of permissible shareholders was more than doubled, from 35 to 75, just a few years ago. For these reasons, we urge this Subcommittee to refrain from dramatic expansion of these rules.

* * *

We believe that the proposals outlined here could provide solid technical reforms that would be faithful to the spirit of subchapter S. Consistent with the goal of subchapter S to provide simple rules for small business, these rules would decrease taxpayer burden, while offering increased flexibility. We would be pleased to work with the Committee to develop these or other S corporation reform proposals.

This concludes my prepared statement. I would be pleased to answer any questions the Subcommittee may have.

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(1) The Administration's efforts to decrease burdens on small business are not limited to legislative initiatives. For example, last year, the IRS and Treasury issued a revenue procedure permitting certain businesses with gross receipts of less than $10 million to use the cash method of accounting. We expect that the revenue procedure will eliminate most disputes concerning the use of the cash method by small business taxpayers, allowing those taxpayers to focus on growth, not tax compliance. Other recently implemented burden reduction projects benefiting small businesses include:

1. Exempting 2.6 million small corporations from filing Schedules L, M-1 & M-2, reducing burden by 61 million hours annually. (April 2002)
2. Reducing the number of lines on Schedules D, Forms 1040 and 1041, resulting in estimated burden reduction of 9.5 million hours for 22.4 million taxpayers. (January 2002)
3. Eliminating the requirement for filing Part III of Schedule D (capital gains), Form 1120S for 221,000 S-Corporation taxpayers, reducing burden by

almost 600,000 hours. (November 2002)

The IRS has also streamlined many of its procedures to make compliance less burdensome for small business taxpayers. A few examples include:

1. The establishment of a permanent special group to work with payroll services to resolve problems before notices are issued and penalties are assessed against the individual small businesses serviced by these bulk and batch filers. (October 2002)
2. Business filers can now e-file employment tax and fiduciary tax returns, and at the same time, pay the balance due electronically by authorizing an electronic funds withdrawal.
3. Business preparers can now e-file their clients' employment tax returns.
4. The IRS has continued to improve its Web site to offer its customers the ability to both order, and in many cases, utilize its Small Business Products online.

It is the long-term and continuing goal of the IRS and the Treasury to ease the burden of small businesses to the greatest extent practical, consistent with the law as enacted by Congress. We look forward to working with this committee on those efforts.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 15, 2004
2004-6-15-12-40-16-20409

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $82,581 million as of the end of that week, compared to $82,728 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	June 4, 2004			June 11, 2004		
TOTAL		**82,728**			**82,581**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	10,107	14,136	24,243	10,165	14,387	24,552
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,668	2,841	14,509	11,366	2,891	14,257
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			20,268			20,142
3. Special Drawing Rights (SDRs) [2]			12,663			12,585
4. Gold Stock [3]			11,045			11,045
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	June 4, 2004			June 11, 2004		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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III. Contingent Short-Term Net Drains on Foreign Currency Assets

	June 4, 2004			June 11, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, a deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 19, 2003
JS-487

Media Advisory
Briefing on Today's John Doe Summons Enforcement Action Today at 4:30 pm

Treasury Assistant Secretary for Tax Policy Pam Olson, IRS Commissioner Mark W. Everson, and IRS Chief Counsel B. John Williams will hold a briefing on Thursday, June 19, 2003 at 4:30 pm in room 3108 (Tax Policy conference room). This session will provide a briefing on a John Doe summons that is being served to Jenkens & Gilchrist, asking the law firm to identify taxpayers who may have invested in listed transactions or other potentially abusive transactions organized or sold by the firm's Chicago office. This will also allow for a Question and Answer session with Tax Policy staff. No cameras will be admitted-- this is a "pen and pad" only briefing.

Media without Treasury or White House press credentials planning to attend should contact Treasury's Office of Public Affairs at (202) 622-2960 with the following information: name, social security number and date of birth. This information may also be faxed to (202) 622-1999.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 19, 2003
JS-488

Assistant Secretary Quarles's remarks at the Brazil-U.S. Private Sector Summit
Creating a Bilateral Partnership for Economic Growth
Afternoon Keynote Address
"Expanding Access to Credit: Opportunities for Bilateral Partnership"
Hosted by the U.S. Chamber of Commerce

Introduction

I am pleased to join you today in a discussion of a critical component of any growth strategy mobilizing financing for private investment. This is a subject of considerable interest to the U.S., and at Treasury in particular, as we analyze key challenges for raising growth in both countries. And it is fitting that we consult closely with those who know best the barriers to access to credit - you, the private sector. We see problems with financial intermediation being at the heart of growth outcomes that are currently well below their potential.

Any investor or bank lender wants both a stable macroeconomic environment and a predictable, competitive business environment at the microeconomic level. Brazil's authorities face challenges on both fronts. But I want to take a moment to highlight real progress on macroeconomic stability in recent months.

Macroeconomic Outlook

Macroeconomic conditions have turned the corner following a particularly challenging period beginning last year and continuing into 2003. This Brazilian government, like its predecessor, has already established a well-deserved, solid reputation for making effective use of fiscal and monetary tools in pursuit of a stable macroeconomic environment. Financial markets have reacted positively to policy actions of the Lula administration, as well as to strong fiscal and external performance. The real has strengthened 20% on the year-to-date while spreads on Brazilian bonds have narrowed more than 700 basis points. And thanks to the support by the Lula Administration of the Central Bank's continuing efforts to meet inflation targets, general inflation is falling rapidly. Clearly, recent good news on inflation justified yesterday's decision by the Central Bank to cut the overnight rate by 50 basis points to 26%.

Brazil's export sector has outperformed even the most optimistic expectations: Exports have grown 43.5% over the past year, resulting in an $8 billion trade surplus for the first five months of 2003 and a $19 billion trade surplus over the last twelve months. Even more compelling is the fact that these results have been achieved largely through export expansion rather than import contraction.

The Finance Ministry's Economic Policy and Structural Reform Agenda released earlier this year calls for primary surpluses sufficient to reduce Brazil's debt-to-GDP ratio. The authorities have clearly put that agenda into practice. Brazil far exceeded first quarter fiscal targets - generating a primary surplus of nearly 6% through March of this year. As the Finance Ministry's Policy and Reform Agenda highlights, reducing Brazil's debt-to-GDP ratio will, in itself, be growth-promoting. Other measures, such as the Government's announced plans to reduce the share of foreign exchange-linked public debt and extend average debt maturities will enhance stability.

Recent progress may very well represent the start of a "virtuous cycle" - one that rewards sound fiscal and monetary policies with price and exchange rate stability, which in turn, feeds back into lower debt levels. Such stability will allow for the gradual reduction in interest rates, which in turn will fuel growth and further improve Brazil's outlook.

This period of rising confidence creates a window of opportunity for looking beyond short term financial concerns and focus on longer-term priorities, in particular, economic growth. Despite the strong performance of Brazil's export sector and favorable financial market conditions, overall economic activity remains depressed. Real GDP growth this year is expected to reach only 1.9%, following 1.5% growth last year. A sustained and consistent effort to establish conditions necessary for private sector investment and productivity growth will allow Brazil to achieve the sustained, high growth of which it is capable.

A key vulnerability, not just in Brazil but in emerging markets globally, has been an imbalance in sources of affordable credit. Businesses that are able to do so actively tap external sources of financing, but domestic financial intermediation has not played the role it should in financing investment and growth. My comments today are focused on domestic sources of credit, in particular, bank credit.

Bank Credit

Bank credit plays a critical role for firms, especially in countries where capital markets aren't fully developed. If access to bank loans is restricted, potentially profitable projects cannot be undertaken and economic activity will suffer.

While Brazilian bank assets are roughly three times that of Mexican banks, the two banking systems provide the same amount of direct lending to the private sector. The relatively low level of lending is coupled with high intermediation spreads and high lending rates to businesses and individuals. Intermediation spreads have declined substantially since the beginning of the Real Plan, and again since the floating of the exchange rate; however, bank credit remains prohibitively expensive for most small and medium-sized firms and even large companies. Current spreads are 56% for loans to individuals and 24% for loans to firms; this compares roughly with intermediation spreads of 1-2% for loans to firms in the U.S. With such high rates, firms are frequently forced to finance investment through retained earnings and/or the savings of family and friends, delaying if not eliminating larger scale or longer term projects.

In recent years, Brazil's Central Bank has made active efforts to lower lending rates and improve financial intermediation. With the establishment of the new payments system in 2002, the Central Bank began publishing basic information on loan rates to improve data-sharing. The Accounting Statements of Financial Institutions were revised to be consistent with international norms. And the scope of the Credit Risk Data Center was widened, lowering the threshold of loan size that banks are required to report from $50,000 real to $5,000. All of these measures work to strengthen reporting in the banking sector and enhance the sector's stability as a result.

Nonetheless, high interest rates persist. Both macroeconomic and microeconomic factors are clearly in play.

- Government borrowing from banks crowds out loans to the private sector. Balance sheet data indicate that large banks are more invested in securities - mostly government debt - than loans. Brazil's top 20 banks hold roughly one-quarter of their assets in public debt.

- To fight inflation, reserve requirements are high. Reserve requirements of 60% on demand deposits and 10% on time deposits reduce potential income for the banking sector, making it necessary for banks to charge higher rates on capital that is put to productive use.

- Furthermore, Brazil's history of high real interest rates which averaged

11% in recent years reflects an uncertain macroeconomic environment. Persistent fears of high inflation force banks to raise interest margins a priori to offset potential erosion of capital.

But we are not convinced that macroeconomics tells the whole story.

- High operating expenses and taxes absorb a significant portion of intermediation income. Overhead costs at Brazilian banks have been double the average for Latin America, and triple the average for upper middle income countries. High payroll costs stem, in part, from the need to maintain substantial collection and legal departments given cumbersome legal and judicial processes. And finally, taxes on banks have historically been more than double the Latin American and upper-middle income country average.
- Public ownership in the banking sector and directed lending may also play a role in the preservation of high intermediation spreads. Public banks have lower returns on assets, higher non-performing loans and higher operating expenses than private banks. This means higher average interest rates across all loans. Directed lending is on a declining trend but remains as high as 40% of total credit.
- A weak bankruptcy code and inadequate judicial infrastructure also lead to higher interest rates. Creditor rights are considered weak. Court judgments can take as long as five years due to case backlogs and generous rights to appeal. There is also considerable variation in court decisions across Brazil, increasing the risk to lenders. Creditors or creditor committees have little to no role in the process of liquidation. And once proceedings are completed, tax claims, wage arrears, and administrative expenses are paid first, leaving little for creditors. There is no legislation which facilitates informal workout procedures to reduce the burden on the court system.
- I should add that a law designed to modernize the bankruptcy code and address many of these issues has been in discussion in the Brazilian Congress since 1993. Congress recently began debating amendments to the legislation, which is a significant step forward. I understand an informal commission is reviewing whether the legislation can be sent to a vote in the House, which could happen in the near future. Passage of bankruptcy legislation would represent significant progress toward increasing creditor rights and lowering intermediation spreads.

The significant public sector presence and weak bankruptcy law result in high credit costs and lower asset quality. For the six months ending December 2002, allowance for bad credits was 30% of net interest revenues, and Brazil's historical rate of write-offs is 4% to 5% of total credits, compared with 0.4% to 1.4% in developed countries. The majority of non-performing loans are in public bank loans to industry and housing, and private bank loans to individuals. One conclusion is that substantial directed public lending to riskier borrowers, combined with the inability to seize on those loans, is an important source of inefficiency in the banking system.

To summarize, high bank spreads clearly stem from macroeconomic factors, including crowding out. But they also follow from a raft of microeconomic factors, including high operating expenses, the burden of inefficient public sector banks, and weak creditor rights.

The Lula Administration is already tackling a number of these areas, and these efforts should result in increased access to affordable credit for the private sector. No single factor will have a greater impact in spurring growth than lower interest rates. And no single factor will have a greater impact on interest rates than a stable macroeconomic environment. A sound fiscal picture will allow for the gradual reduction of public sector debt and free-up bank resources for private sector lending. The Lula Administration has already announced intentions to lower debt-to-GDP; continued strong fiscal performance, combined with passage of key tax and pension reforms, should make this attainable.

Furthermore, a commitment to meet inflation targets, as has been demonstrated by the Central Bank, will eventually lead to lower inflation expectations. Eliminating persistent fears of high inflation will result in lower lending rates.

But, in addition to this macroeconomic progress, the agenda must include steps to address microeconomic and structural problems. Certain provisions of the pending tax legislation, if passed, would lower banks' overhead costs by reducing their payroll burden. Likewise, reducing the amount of directed lending and under-performing loans by public banks would free up capacity for more productive uses of bank resources at lower rates of interest. Finally, passage of bankruptcy reform legislation will go far in boosting banks' willingness to lend, and would help banks streamline collection and legal departments.

Conclusion

The United States has one of the most open and, therefore, competitive banking sectors in the world. The access to capital that it provides to the private sector and individuals alike has been a key driver of economic growth in the U.S. Small businesses are the primary driver of economic growth in the U.S., and in most other countries. They provide roughly three out of every four new jobs and about half of the nation's private sector output. Small businesses also represent 99% of all employers and employ 50% of the private work force.

The ability of small businesses to get financing is critical to their success. Commercial banks are the most important source of financing for small businesses, and the competitive and deep banking system in the United States ensures sufficient credit for small businesses across a wide range of sizes, industries, and locations.

We want to engage with Brazil's authorities and with you in the private sector on these issues. We all seek the policy, legal and regulatory environments that make it possible to expand access to affordable financing to creditworthy, productive borrowers. I am looking forward to an informed and spirited panel discussion and to ongoing engagement on these issues in the future.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 20, 2003
JS-489

Statement by
Treasury Assistant Secretary for Tax Policy Pam Olson
on John Doe Summons issued to Jenkens and Gilchrist

Treasury has been working hand in hand with the IRS to have the right policies and rules to effectively address the problem of abusive tax avoidance transactions. The best policies mean little unless they are enforced, and today's action represents another important step by the IRS, Chief Counsel and the Justice Department in bringing these transactions, and their promoters, into the light.

The John Doe summons initiative is an important step in our efforts to ensure that the IRS has the information necessary for it to fully and fairly enforce the tax laws.

For the first time, a summons is being issued to a law firm requesting the identification of taxpayers who may have invested in listed transactions or other potentially abusive transactions organized or sold by the firm.

We are working to create a new climate of respect by going after conduct that represents the most troublesome forms of potentially abusive tax avoidance.

Attached:

Tax Shelter Backgrounder

Statements by IRS Commissioner Everson and IRS Chief Counsel B. John Williams

BACKGROUND INFORMATION
STRATEGY TO COMBAT ABUSIVE AVOIDANCE TRANSACTIONS

Today, the Internal Revenue Service received approval from the United States District Court, Northern District of Illinois to serve a John Doe summons on Jenkens & Gilchrist, asking the law firm to identify taxpayers who may have invested in listed transactions or other potentially abusive transactions organized or sold by the firm's Chicago office.

The key features of a John Doe summons are that the IRS must seek court approval to serve it and, if there are objections to the summons, the statute of limitations for assessing tax deficiencies for the unknown parties (the "John Does", in this case, the investors) is automatically suspended beginning six months after the service of the summons, while objections to the summons are resolved.

This is the latest step in a comprehensive strategy to ensure all taxpayers pay their fair share. The Treasury Department, the Internal Revenue Service and the Department of Justice are moving aggressively to combat abusive tax avoidance transactions.

This multi-pronged strategy includes requiring prompt disclosure of potentially abusive transactions by taxpayers and promoters, providing more timely analyses of these transactions and publishing legal guidance as early as possible. It also involves auditing taxpayers and promoters to ensure that they have complied with their obligations under the tax rules. In particular, the IRS conducts promoter examinations to determine whether a promoter has complied with regulations requiring identification of potentially abusive tax avoidance transactions by registering such transactions and maintaining and providing investor lists to the IRS upon request, and to determine whether the promoter may be liable for penalties if they have failed to comply with the registration and list maintenance requirements. Some promoters have cooperated by giving the IRS the information to which it is entitled; however, others have not.

Among the key steps taken:

- The IRS is investigating 92 promoters (some of which are related) including law firms, investment banks and accounting firms.

- Since the beginning of 2002, the IRS has issued 268 summonses to 35 promoters (some of which are related) to examine their compliance with the registration and list maintenance requirements, by requesting information and investor lists.

- This is the first action which seeks permission, as required by statute, to issue a summons for the primary purpose of obtaining the identities of the investors in what the IRS has determined are potentially abusive tax shelters.

- Of these summonses, 78 involving seven promoters have been referred to the Department of Justice for enforcement.

- The Justice Department has filed summons enforcement actions against four promoters.

In addition to these efforts to ensure promoters comply with the law, the IRS and Treasury Department have also taken the following steps:

- The IRS and Treasury have identified 25 abusive transactions through formal guidance.

- The IRS is auditing taxpayers to determine whether they invested in abusive transactions, using information derived from promoter audits, a disclosure initiative (described below), public information and other sources.

- The Large and Mid-Size Business Division (LMSB) conducted a disclosure initiative from December 2001 to April 2002 that resulted in 1,664 disclosures from 1,206 taxpayers. Taxpayers disclosed transactions in which they claimed deductions or losses amounting to billions of dollars. Agents continue to investigate the leads generated by information provided by the taxpayers who came forward.

- IRS teams have been assembled to implement a comprehensive strategy to deal with questionable transactions. Teams are headed by an LMSB executive and include representatives from Chief Counsel, technical advisors and field specialists. The Chief Counsel has also created new senior executive position within the Office of Chief Counsel to focus on potentially abusive tax avoidance transactions.

- LMSB launched additional settlement initiatives involving three types of abusive transactions in October 2002 to offer an equitable alternative to protracted enforcement and litigation. The last of these settlement initiatives ended in March 2003.

- The President's budget proposes an additional $100 million to support this effort to pursue high-income individuals and businesses. This request is awaiting action by Congress.

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Statement of IRS Commissioner Mark W. Everson

"Today's action represents an important step in enforcing the tax law. The promoters of potentially abusive tax avoidance transactions know the tax code requires them to keep investor lists and to provide those lists to the IRS on request. We are seeking nothing more or less than adherence to the law."

Statement of IRS Chief Counsel B. John Williams

"Our efforts to curb potentially abusive tax avoidance transactions depend on our ability to obtain and use a web of information about these transactions and those who invest in and promote them. As part of our efforts, we have, and will, issue summonses to law firms, accounting firms, investment banks and others who may have been involved in the promotion of questionable transactions."

"We will use all tools available to us to ensure that promoters and investors are complying with the tax laws and will not hesitate to serve John Doe summonses, in addition to regular summonses, to make sure that we preserve the statute of limitations for investors. We will not allow investors and promoters to use stalling tactics to circumvent our compliance efforts."

FROM THE OFFICE OF PUBLIC AFFAIRS

June 20, 2003
JS-490

Press Announcement
On the Group for Growth
June 20, 2003

Secretary John Snow and Minister Antônio Palocci share a commitment to accelerate economic growth in both countries to create jobs, raise living standards, and fight poverty. Higher growth in each economy will provide important benefits not only for the US and Brazil but for the rest of the Hemisphere as well. The two agree on the benefits of in-depth discussions on pro-growth strategies to share experience and best practices in addressing challenges common to their large economies with complex federal systems.

In this context, Secretary Snow and Minister Palocci will launch a Group for Growth designed to examine policy topics key for raising productivity growth. They have agreed on an initial set of topics for consultations: fiscal policy and tax reform, reducing impediments to the creation and expansion of small and medium-sized companies, increasing investment and business credit, promoting trade, developing infrastructure, strengthening domestic competition. Both may also invite representatives of the private sector and society at large to share views on key impediments and needed reforms to spur growth.

John Taylor, Under Secretary for International Affairs at the U.S. Treasury, will chair the inter-agency delegation to meetings of the Group for Growth for the U.S. side. Joaquim V. Levy, Secretary of the National Treasury, and Marcos Lisboa, Secretary for Economic Policy, both at the Brazilian Ministry of Finance, will co-chair the inter-agency delegation for the Brazilian side. The first meeting of the Group for Growth is expected in the early fall of this year.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 20, 2003
JS491

Statement by G7 Finance Ministers

Revision of the Financial Action Task Force 40 Recommendations

We welcome the Financial Action Task Force (FATF) revision of its 40 recommendations, which set the international standard in the fight against money laundering and terrorist financing.

This new standard represents a crucial step forward in the international fight against financial crime. The revision of the FATF 40 recommendations significantly enhances the standard for customer due diligence, broadens the scope of the money laundering offence, improves transparency of legal persons and arrangements and strengthens international cooperation and suspicious transactions reporting. It also enlarges the scope of non-financial professions and businesses involved in this collective effort.

We strongly endorse these new recommendations and reaffirm our commitment to taking early steps towards complying with this revised standard and to promoting its world-wide implementation.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 20, 2003
JS-492

Statement By Treasury General Counsel David Aufhauser On DC Court Of Appeals Ruling Upholding Designation Of The Holy Land Foundation For Relief And Development

“We are pleased that the DC Court of Appeals has upheld Treasury's ability to employ a vital tool in the war on terrorist financing. The power to freeze the assets of terrorists and those who support them is one of our most effective weapons in preventing future acts of terror.”
- Treasury General Counsel David Aufhauser

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 23, 2003
JS-493

Treasury Issues Guidance on Partnership Abuses

Today the Treasury Department and the Internal Revenue Service issued regulations dealing with a tax shelter commonly known as "Son of Boss." The regulations address the tax treatment of the assumption of certain obligations by a partnership from a partner. The regulations ensure that temporary or permanent non-economic tax losses cannot be created by transferring these obligations to partnerships.

"These regulations are part of our increased efforts to shut down abusive tax shelter transactions," stated Treasury Assistant Secretary for Tax Policy Pam Olson. "In Notice 2000-44, we warned that these Son of Boss transactions didn't work. Nevertheless, we understand that some promoters have continued to pitch them. The regulations will remove any question that the transactions do not produce the results claimed by the promoters of the transactions."

In one variation of a 'Son of Boss' transaction, a taxpayer purchases and writes economically offsetting options and then purports to create substantial positive basis by transferring those option positions to a partnership. On the disposition of the partnership interest, the liquidation of the partnership, or the taxpayer's sale or depreciation of distributed partnership assets, the taxpayer claims a tax loss, even though the taxpayer has incurred no corresponding economic loss.

For example, assume that taxpayer A issues and purchases options to acquire stock in Corporation X. A pays $100 for the option to acquire X stock and receives $100 on the issuance of the option to acquire X stock. A then contributes to a partnership the $100 A received on the sale of the option, and the partnership assumes A's obligation to satisfy the option that A has issued. The value of A's interest in the partnership is $0. However, some taxpayers have argued that A's basis in the partnership is $100, because A's basis in the partnership interest is not reduced by the amount of the option obligation assumed by the partnership. A then sells his partnership interest for $0 and claims a $100 loss.

The regulations address this transaction by requiring A to reduce his basis in the partnership by the amount of the assumed option obligation. In accordance with legislation granting Treasury authority to issue these regulations, the regulations apply to assumptions by partnerships occurring on or after October 19, 1999.

The temporary and proposed regulations are attached.

Related Documents:

- 358H Temporary Reg
- 358 H Proposed Reg

[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9062]

RIN 1545-BB83

Assumption of Partner Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations regarding a partnership's assumption of a partner's liabilities in a transaction occurring after October 18, 1999, and before June 24, 2003. These temporary regulations affect partners and partnerships and clarify the tax treatment of an assumption by a partnership of a partner's liability. The text of these temporary regulations also serves as the text of the proposed regulations set forth in a notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective June 24, 2003.

Applicability Date: For date of applicability, see _1.752-6T(d).

FOR FURTHER INFORMATION CONTACT: Horace Howells (202) 622-3050

(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

With certain exceptions, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock of the corporation, and, immediately after the exchange, the transferors control the corporation. If, however, the transferee corporation assumes a liability of the transferor, then, under section 358(d), the transferor's basis in the stock received in the exchange is reduced by the amount of that liability. If the amount of the liability exceeds the transferor's basis in the property transferred to the corporation, then the transferor recognizes gain under section 357(c)(1). Under section 357(c)(3), a liability the payment of which would give rise to a deduction or that would be described in section 736(a) (regarding payments to a retiring partner) is not taken into account in applying section 357(c)(1), unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property.

Under section 752(a) and (b), similar rules apply where a partnership assumes a liability from a partner or a partner contributes property to a partnership subject to a liability. The difference between the amount of the liability and the partner's share of that liability after the partnership's assumption is treated as a distribution of money, which reduces the partner's basis in the partnership interest and may cause the partner to recognize gain. There is no statutory or regulatory definition of liabilities for purposes of section 752. Case law and revenue rulings, however, have established that, as under section 357(c)(3), the term liabilities for this purpose does not include liabilities the payment of which would give rise to a deduction, unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of property. Rev. Rul. 88-77 (1988-2 C.B. 128); Salina Partnership LP, FPL Group, Inc. v. Commissioner, T.C. Memo 2000-352.

On December 21, 2000, as part of the Community Renewal Tax Relief Act of 2000 (Appendix G of H.R. 4577, Consolidated Appropriations Act, 2001) Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) (the Act), Congress enacted section 358(h) to address certain situations where property was transferred to a corporation in exchange for both stock and the corporation's assumption of certain obligations of the transferor. In these situations, transferors took the position that the obligations were not liabilities within the meaning of section 357(c) or that they were described in section 357(c)(3), and, therefore, the obligations did not reduce the basis of the transferor's stock. These assumed obligations, however, did reduce the value of the stock. The transferors then sold the stock and claimed a loss. In this way, taxpayers attempted to duplicate a loss in corporate stock and to accelerate deductions that typically are allowed only on the economic performance of these types of obligations.

Section 358(h) addresses these transactions by requiring that, after application of section 358(d), the basis in stock received in an exchange to which section 351, 354, 355, 356, or 361 applies be reduced (but not below the fair market value of the stock) by the amount of any liability assumed in the exchange. Exceptions to section 358(h) are provided where: (1) the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the exchange; or (2) substantially all of the assets with which the liability is associated are transferred to the person assuming the liability as part of the exchange. The term liability for purposes of section 358(h) includes any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code (Code).

Congress recognized that taxpayers were attempting to use partnerships to carry out the same types of abuses that section 358(h) was designed to deter. Therefore, in section 309(c) and (d)(2) of the Act, Congress directed the Secretary to prescribe rules to provide "appropriate adjustments under subchapter K of chapter 1 of the Code to prevent the acceleration or duplication of losses through the assumption of (or transfer of assets subject to) liabilities described in section 358(h)(3) . . . in transactions involving partnerships." This statutory provision does not specify whether the exceptions in section 358(h)(2) should apply. The only cross-reference to section 358(h) in this statutory provision is to section 358(h)(3), which defines the term liability. Under the statute, these rules are to "apply to assumptions of liability after October 18, 1999, or such later date as may be prescribed in such rules."

In response to this directive, these temporary regulations provide rules to prevent the duplication and acceleration of loss through the assumption by a partnership of a liability of a partner in a nonrecognition transaction. Section 1.752-6T adopts the approach of section 358(h), with some modifications, for transactions involving partnership assumptions of partners' liabilities occurring after October 18, 1999, and before June 24, 2003. The modifications made to the approach of section 358(h) were to provide rules to conform the application of section 358(h) to partnerships and, as discussed below, to prevent abuse.

Prior to the enactment of Code section 358(h) and section 309(c) and (d)(2) of the Act, the lack of specific rules addressing the treatment of liabilities upon the transfer of property to a corporation or a partnership led to interpretations of then existing law that failed to reflect the true economics of certain transactions. In some cases, taxpayers continued to assert these interpretations even after the enactment of these statutory provisions. For example, in a transaction addressed in Notice 2000-44 (2000-2 C.B. 255), a taxpayer purchases and writes economically offsetting options and then purports to create substantial positive basis by transferring those option positions to a partnership. On the disposition of the partnership interest, the liquidation of the partner's interest in the partnership, or the taxpayer's sale or depreciation of distributed partnership assets, the taxpayer claims a tax loss, even though the taxpayer has incurred no corresponding economic loss.

Treasury and the IRS believe that it is appropriate to prohibit partners and partnerships engaging in transactions described in, or transactions that are substantially similar to the transactions described in, Notice 2000-44 from relying on the exception in section 358(h)(2)(B). The exceptions to section 358(h) were intended to exclude from the application of section 358(h) ordinary business transactions. They were not intended to allow taxpayers to engage in transactions that create noneconomic tax losses.

The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register** (_1.752-6 of the proposed Income Tax Regulations). As part of that notice of proposed rulemaking, §1.752-7 of the proposed Income Tax Regulations is being issued to carry out the directive of section 309(c) of the Act with respect to assumptions of liabilities occurring on or after June 24, 2003. The proposed regulations conform the application of section 358(h) to partnerships by providing a basis reduction upon an event that separates the partner from the liability rather than on assumption of the liability by the partnership and by adopting certain exceptions. Section 1.752-7(j) of the proposed Income Tax Regulations allows a partnership to elect to apply _1.752-7 of the proposed Income Tax Regulations and related proposed provisions to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003, in lieu of applying _1.752-6T of the temporary Income Tax Regulations to this period.

Explanation of Provisions

Under these temporary regulations, if a partnership assumes a liability of a partner (other than a liability to which section 752(a) and (b) apply) in a transaction described in section 721(a), then, after application of section 752(a) and (b), the partner's basis in the partnership is reduced (but not below the adjusted value of such interest) by the amount (determined as of the date of the exchange) of the liability. For this purpose, the term liability includes any fixed or contingent obligation to make payment, without regard to whether the obligation is otherwise taken into account for federal tax purposes. The adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under __1.752-1 through 1.752-5.

The exceptions under section 358(h) applicable to corporate assumptions of shareholder liabilities generally apply for purposes of these temporary regulations. Therefore, a reduction in a partner's basis generally is not required, under these regulations, after an assumption of a liability by a partnership from that partner if: (1) the trade or business with which the liability is associated is transferred to the partnership assuming the liability as part of the transaction, or (2) substantially all of the assets with which the liability is associated are contributed to the partnership assuming the liability.

However, in the case of a partnership transaction described in, or a partnership transaction that is substantially similar to the transactions described in, Notice 2000-44, the exception for contributions of "substantially all of the assets with which the liability is associated" does not apply.

Effective Date

In accordance with the directive in section 309(c) and (d)(2) of the Act, these temporary regulations apply to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003. Under section 7805(b)(6), the Secretary may provide that any regulation may take effect in accordance with a legislative grant from Congress authorizing the Secretary to prescribe the effective date for such regulation. In addition, under section 7805(b)(3), the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse. The Secretary has determined that a later effective date is inappropriate.

Therefore, these regulations are being applied retroactively in accordance with the directive from Congress in section 309(d)(2) of the Act and to prevent abuse.

Special Analyses

These temporary regulations are necessary to prevent abusive transactions of the type described in the Notice 2000-44. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3).

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the notice of proposed rulemaking on this subject published in the Proposed Rules section of this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these temporary regulations is Horace Howells, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.752-6T also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2000). * * *

Par. 2. Section 1.752-6T is added to read as follows:

1.752-6T Partnership assumption of partner's section 358(h)(3) liability after October 18, 1999, and before June 24, 2003.

(a) In general. If, in a transaction described in section 721(a), a partnership assumes a liability (defined in section 358(h)(3)) of a partner (other than a liability to which section 752(a) and (b) apply), then, after application of section 752(a) and (b), the partner's basis in the partnership is reduced (but not below the adjusted value of such interest) by the amount (determined as of the date of the exchange) of the liability. For purposes of this section, the adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under __1.752-1 through 1.752-5.

(b) Exceptions--(1) In general. Except as provided in paragraph (b)(2) of this section, the exceptions contained in section 358(h)(2)(A) and (B) apply to this section.

(2) Transactions described in Notice 2000-44. The exception contained in section 358(h)(2)(B) does not apply to an assumption of a liability (defined in section 358(h)(3)) by a partnership as part of a transaction described in, or a transaction that is substantially similar to the transactions described in, Notice 2000-44 (2000-2 C.B. 255). See §601.601(d)(2) of this chapter.

(c) Example. The following example illustrates the principles of paragraph (a) of this section:

Example. In 1999, A and B form partnership PRS. A contributes property with a value and basis of $200, subject to a nonrecourse debt obligation of $50 and a fixed or contingent obligation of $100 that is not a liability to which section 752(a) and (b) applies, in exchange for a 50% interest in PRS. Assume that, after the contribution, A's share of partnership liabilities under __1.752-1 through 1.752-5 is $25. Also assume that the $100 liability is not associated with a trade or business contributed by A to PRS or with assets contributed by A to PRS. After the contribution, A's basis in PRS is $175 (A's basis in the contributed land ($200) reduced by the nonrecourse debt assumed by PRS ($50), increased by A's share of partnership liabilities under __1.752-1 through 1.752-5 ($25)). Because A's basis in the PRS interest is greater than the adjusted value of A's interest, $75 (the fair market value of A's interest ($50) increased by A's share of partnership liabilities ($25)), paragraph (a) of this section operates to reduce A's basis in the PRS interest (but not below the adjusted value of that interest) by the amount of liabilities described in section 358(h)(3) (other than liabilities to which section 752(a) and (b) apply) assumed by PRS. Therefore, A's basis in PRS is reduced to $75.

(d) Effective dates--(1) In general. This section applies to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003.

(2) Election to apply §1.752-7. The partnership may elect, under the provisions of REG-106736-00 (2003-28 IRB) (see §601.601(d)(2) of this chapter) to apply those provisions and related proposed Income Tax Regulations to all assumptions of liabilities by the partnership occurring after October 18, 1999, and before June 24, 2003. The provisions of REG-106736-00 (2003-28 IRB) (see §601.601(d)(2) of this chapter) describes the manner in which the election is made.

David A. Mader

Assistant Deputy Commissioner of Internal Revenue.

Approved: 5/07/03

Gregory Jenner

Deputy Assistant Secretary of the Treasury.

[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-106736-00]

RIN 1545-AX93

Assumption of Partner Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of proposed rulemaking by cross-reference to temporary regulations; and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the definition of liabilities under section 752 of the Internal Revenue Code. These regulations provide rules regarding a partnership's assumption of certain fixed and contingent obligations in exchange for a partnership interest and provide conforming changes to certain regulations. These regulations also provide rules under section 358(h) for assumptions of liabilities by corporations from partners and partnerships. In addition, this document provides notice that the IRS and Treasury intend to issue supplemental guidance that may apply certain of the rules outlined in these proposed regulations to transactions involving corporations. This document also provides notice of public hearing on the

proposed regulations.

DATES: Written or electronic comments and requests to speak at the public hearing scheduled for Tuesday, October 14, 2003, must be received by September 22, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG-106736-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG-106736-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC or sent electronically, via the IRS Internet site at: www.irs.gov/regs. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Horace Howells at (202) 622-3050; concerning submissions, the hearing, and/or placement on the building access list to attend the hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP Washington, DC 20224. Comments on the collection of information should be received by August 25, 2003. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §1.752-7(e), (f), (g), and (h). This information is required for a former or current partner of a partnership to take deductions attributable to the economic performance of certain fixed or contingent obligations assumed from the partner by a partnership. This information will be used by the partner to permit the partner to take a deduction. An additional collection of information in this proposed regulation is in _1.752-7(j)(2). This information is required to inform the IRS of partnerships making the designated election and to report income appropriately. The collection of information is required to obtain a benefit, i.e., to elect to apply the provisions of _1.752-7 of the proposed regulations in lieu of _1.752-6T of the temporary regulations. The likely respondents are individuals, business or other for-profit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 125 hours.

The estimated annual burden per respondent varies from 20 to 40 minutes, depending on individual circumstances, with an estimated average of 30 minutes.

Estimated number of respondents: 250

Estimated annual frequency of responses: On occasion

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

With certain exceptions, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock of the corporation, and, immediately after the exchange, the transferors control the corporation. If, however, the transferee corporation assumes a liability of the transferor, then, under section 358(d), the transferor's basis in the stock received in the exchange is reduced by the amount of that liability. If the amount of the liability exceeds the transferor's basis in the property transferred to the corporation, then the transferor recognizes gain under section 357(c)(1). Under section 357(c)(3), a liability the payment of which would give rise to a deduction or that would be described in section 736(a) (regarding payments to a retiring partner) is not taken into account in applying section 357(c)(1), unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property.

Under section 752(a) and (b), similar rules apply where a partnership assumes a liability from a partner or a partner contributes property to a partnership subject to a liability. The difference between the amount of the liability and the partner's share of that liability after the partnership's assumption is treated as a distribution of money, which reduces the partner's basis in the partnership interest and may cause the partner to recognize gain. There is no statutory or regulatory definition of liabilities for purposes of section 752. Case law and revenue rulings, however, have established that, as under section 357(c)(3), the term liabilities for this purpose does not include liabilities the payment of which would give rise to a deduction, unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of property. Rev. Rul. 88-77 (1988-2 C.B. 128); Salina Partnership LP, FPL Group, Inc. v. Commissioner, T.C. Memo 2000-352.

On December 21, 2000, as part of the Community Renewal Tax Relief Act of 2000 (Appendix G of H.R. 4577, Consolidated Appropriations Act, 2001) Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) (the Act), Congress enacted section 358(h) to address certain situations where property was transferred to a corporation in exchange for both stock and the corporation's assumption of certain obligations of the transferor. In these situations, transferors took the position that the obligations were not liabilities within the meaning of section 357(c) or that they were described in section 357(c)(3), and, therefore, the obligations did not reduce the basis of the transferor's stock. These assumed obligations, however, did reduce the value of the stock. The transferors then sold the stock and claimed a loss. In this way, taxpayers attempted to duplicate a loss in corporate stock and to accelerate deductions that typically are allowed only on the economic performance of these types of obligations.

Section 358(h) addresses these transactions by requiring that, after application of section 358(d), the basis in stock received in an exchange to which section 351, 354, 355, 356, or 361 applies be reduced (but not below the fair market value of the stock) by the amount of any liability assumed in the exchange. Exceptions to section 358(h) are provided where: (1) the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the exchange; or (2) substantially all of the assets with which the liability is associated are transferred to the person assuming the liability as part of the exchange. The term liability for purposes of section 358(h) includes any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code (Code).

Congress recognized that taxpayers were attempting to use partnerships and S corporations to carry out the same types of abuses that section 358(h) was designed to deter. Therefore, in section 309(c) and (d)(2) of the Act, Congress directed the Secretary to prescribe rules to provide "appropriate adjustments under subchapter K of chapter 1 of the Code to prevent the acceleration or duplication of losses through the assumption of (or transfer of assets subject to) liabilities described in section 358(h)(3) . . . in transactions involving partnerships" and to prescribe similar rules for S corporations. Under the statute, these rules are to "apply to assumptions of liability after October 18, 1999, or such later date as may be prescribed in such rules."

In response to this directive, these proposed regulations provide rules to prevent the duplication and acceleration of loss through the assumption by a partnership of a §1.752-7 liability from a partner. For this purpose, a partnership that takes property subject to a liability is generally treated as assuming the liability. A _1.752-7 liability is any fixed or contingent obligation to make payment that is not described in _1.752-1(a)(1), without regard to whether the obligation is otherwise taken into account for purposes of the Code.

The proposed regulations also provide that section 704(c) principles shall apply to a §1.752-7 liability assumed by a partnership from a partner. Accordingly, the §1.752-7 liability is treated under section 704(c) principles as having a built-in loss equal to the amount of such liability at the time of its assumption by the partnership. The amount of the §1.752-7 liability is the amount that a willing assignor would pay to a willing assignee to assume the §1.752-7 liability in an arm's-length transaction.

In addition, the proposed regulations make conforming amendments to §§1.704-1(b)(2)(iv)(b) (by providing that a partner's capital account be reduced by the §1.752-7 liabilities that the partnership assumes from the partner), 1.704-2(b)(3) (by treating a §1.752-7 liability as a nonrecourse liability for purposes of the partnership allocation rules), and 1.705-1 (by directing taxpayers to §1.358-7(b) and _1.752-7 for basis adjustments necessary to coordinate section 705 with section 358(h) and _1.752-7).

Moreover, the proposed regulations provide rules under section 358(h) for assumptions of liabilities by corporations from partners and partnerships. In addition, in the Explanation of Provisions section of this preamble, the IRS and Treasury are alerting taxpayers that they are considering adopting the definition of liability proposed in these regulations as an appropriate interpretation of the term liability for purposes of subchapter C of chapter 1 of the Code. The IRS and Treasury are also considering issuing regulations to conform the exceptions to section 358(h) to the exceptions described in these regulations. These regulations will be retroactive to the extent necessary to prevent abuse.

Section 358(h) applies to S corporations. The Act states that the Secretary may prescribe comparable rules which provide appropriate adjustments under subchapter S. These proposed regulations do not address the assumption of liabilities by S corporations; however, any rules applicable to assumptions of liabilities by corporations would, in the absence of provisions to the contrary, apply equally to S corporations. Comments regarding the assumption of liabilities by S corporations are requested.

Explanation of Provisions

1. <u>Addition of §1.752-1(a)(1)--Definition of Liability</u>

The question of what constitutes a liability for purposes of section 752 was addressed in Rev. Rul. 88-77 (1988-2 C.B. 128). Rev. Rul. 88-77 holds that partnership liabilities include an obligation only if, and to the extent that, incurring the obligation creates or increases the basis to the partnership of any of the partnership's assets (including cash attributable to borrowings), gives rise to an immediate deduction to the partnership, or, under section 705(a)(2)(B) (relating to noncapital, nondeductible expenditures of a partnership) currently decreases a partner's basis in the partner's partnership interest. Section 1.752-1T(g) (1989-1 C.B. 180), included a definition of a liability for purposes of section 752 that reaffirmed the position of the IRS in Rev. Rul. 88-77. This definition was removed from the final version of those regulations in response to comments that the definition was redundant and therefore unnecessary. The Service continues to follow the definition of liability set forth in Rev. Rul. 88-77. See Rev. Rul. 95-26 (1995-1 C.B. 131).

Because these proposed regulations define a §1.752-7 liability as a fixed or contingent obligation to make payment to which section 752 does not apply, Treasury and the IRS believe that it is appropriate to describe in these regulations the liabilities to which section 752 does apply. Therefore, following the principles set forth in §1.752-1T(g) and Rev. Rul. 88-77, the proposed regulations provide that an obligation is a liability if and to the extent that incurring the obligation: (A) creates or increases the basis of any of the obligor's assets (including cash); (B) gives rise to an immediate deduction to the obligor; or (C) gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. An obligation for this purpose is any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Code. Obligations include, but are not limited to, debt obligations, environmental obligations, tort obligations, contract obligations, pension obligations, obligations under a short sale, and obligations under derivative financial instruments such as options, forward contracts, and futures contracts. The definition of a liability contained in these proposed regulations does not follow <u>Helmer v. Commissioner</u>, T.C. Memo 1975-160. (The Tax Court, in <u>Helmer</u>, held that a partnership's issuance of an option to acquire property did not create a partnership liability for purposes of section

752.)

Treasury and the IRS are considering adopting the definition of liability proposed in these regulations as an appropriate interpretation of the term liability for purposes of subchapter C of chapter 1 of the Code. Treasury and the IRS request comments on the scope and substance of such regulations, which will be retroactive to the extent necessary to prevent abuse.

2. §1.752-7--Partnership Assumption of Partner's §1.752-7 Liability

In the corporate context, section 358(h) prevents the duplication and acceleration of loss with respect to obligations not encompassed by section 358(d) by reducing the transferor shareholder's basis in corporate stock received in the exchange. Treasury and the IRS do not believe that this is the best approach for partnerships given their passthrough nature. Ultimately, the partners' shares of a partnership's deductions are limited by the partners' bases in their partnership interests (their outside bases). If, at the time of an assumption of a §1.752-7 liability by a partnership from a partner (the _1.752-7 liability partner), the partner's outside basis were reduced by the amount of the §1.752-7 liability, then the partner would not have sufficient outside basis to absorb any deduction with respect to the §1.752-7 liability that passed through the partnership.

For this reason, these proposed regulations do not reduce the outside basis of the §1.752-7 liability partner upon the partnership's assumption of the §1.752-7 liability. If the partnership satisfies the §1.752-7 liability while the §1.752-7 liability partner is a partner in the partnership, then the deduction with respect to the portion of the §1.752-7 liability assumed by the partnership from the §1.752-7 liability partner (the built-in loss associated with the §1.752-7 liability) is allocated to the §1.752-7 liability partner, reducing that partner's outside basis. If, instead, one of three events occur that separate the §1.752-7 liability partner from the §1.752-7 liability, then the §1.752-7 liability partner's outside basis is reduced at that time. These events are: (1) a disposition (or partial disposition) of the partnership interest by the §1.752-7 liability partner, (2) a liquidation of the §1.752-7 liability partner's partnership interest, and (3) the assumption (or partial assumption) of the §1.752-7 liability by a partner other than the §1.752-7 liability partner. Immediately before the occurrence of one of these events, the §1.752-7 liability partner's basis in the partnership interest generally is reduced by the lesser of: (1) the excess of the §1.752-7 liability partner’s basis in the partnership interest over the adjusted value of that interest, or (2) the remaining built-in loss associated with the §1.752-7 liability (the §1.752-7 liability reduction). For this purpose, the adjusted value of a partner’s interest in a partnership is the fair market value of that interest increased by the partner’s share of partnership liabilities under __1.752-1 through 1.752-5. In the case of a partial disposition of the §1.752-7 liability partner’s partnership interest or a partial assumption of the §1.752-7 liability by another partner, the §1.752-7 liability reduction is pro rated based on the portion of the interest sold or the portion of the §1.752-7 liability assumed.

After the occurrence of such an event, the partnership (or the assuming partner) is not entitled to any deduction or capital expense on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. If, however, the partnership (or the assuming partner) notifies the §1.752-7 liability partner of the partial or complete economic performance of the §1.752-7 liability, then the §1.752-7 liability partner is entitled to a deduction or loss. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the §1.752-7 liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

The proposed regulations further provide that, solely for purposes of section 705 (adjustments to the basis of a partnership interest) and _1.704-1(b)(2)(iv)(b) (partnership capital accounting rules), the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expense to the partnership. Therefore, the remaining partners' bases in their partnership interests and capital accounts are not reduced by the remaining built-in loss associated with the §1.752-7 liability.

If the _1.752-7 liability is assumed by a partner other than the _1.752-7 liability partner, then, on economic performance of the _1.752-7 liability, the assuming partner is treated as contributing cash to the partnership in the amount of the lesser of: (1) the amount paid to satisfy the _1.752-7 liability; or (2) the remaining built-in loss associated with the _1.752-7 liability as of the time of the assumption. Adjustments as a result of this deemed cash contribution may include adjusting the basis of the partnership interest, any assets (other than cash, accounts receivable, or inventory) distributed by the partnership to the partner, or gain or loss on the disposition of the partnership interest or of property distributed by the partnership, as the case may be. However, the assuming partner cannot take into account any adjustments to depreciable basis, reduction in gain, or increase in loss until economic performance of the _1.752-7 liability. Any adjustment to the basis of an asset under this provision is taken into account over the recovery period of that asset.

3. Exceptions

Certain exceptions apply to these rules. In the corporate context, section 358(h) does not apply in the following two situations:(1) where the trade or business with which the liability is associated is transferred to the corporation assuming the liability; and (2) where substantially all of the assets with which the liability is associated are transferred to the corporation assuming the liability. Section 358(h)(2) authorizes the Secretary to limit the application of these exceptions.

The statutory provision relating to partnerships does not specify whether the exceptions in section 358(h)(2) should apply. The only cross-reference to section 358(h) in this statutory provision is to section 358(h)(3), which defines the term liability. Treasury and IRS believe it is appropriate to provide for a variation on one of the two exceptions to section 358(h), as well as an additional exception that is not included in section 358(h), in these proposed regulations. Treasury and the IRS request comments on these exceptions and on whether additional exceptions should be included in the final regulations.

The first exception applies where the partnership assumes the §1.752-7 liability as part of the contribution of the trade or business with which the liability is associated and the partnership continues to conduct that trade or business after the contribution. For this purpose, a trade or business is a specific group of activities carried on by a person for the purpose of earning income or profit if the activities included in that group include every operation that forms a part of, or a step in, the process of earning income or profit.

The proposed regulations provide that the activity of acquiring, holding, or disposing of financial instruments constitutes a trade or business for this purpose if and only if the activity is conducted by an entity registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended. Treasury and the IRS are concerned that certain activities involving acquiring, holding, or disposing of financial instruments could be structured to accomplish the types of transactions that section 309(c) of the Act was designed to prevent. Nonetheless, Treasury and the IRS recognize that many persons contribute such activities to partnerships for substantial business purposes. For example, mutual funds often contribute substantially all of their assets to a master partnership to save administrative costs. Under some circumstances, such a mutual fund may transfer portfolio positions (including hedge positions that could be considered _1.752-7 liabilities under the proposed regulations) to the master partnership. Because a contribution by a mutual fund to a master partnership is not the type of abusive loss duplication transaction that section 309(c) of the Act was designed to address, the proposed regulations treat this type of contribution as a contribution of a trade or business. Treasury and the IRS request comments on additional types of activities that should be treated as trades or businesses for purposes of these regulations.

The proposed regulations do not include the section 358(h) exception for situations in which substantially all of the assets with which the liability is associated are transferred to the partnership assuming the liability. Treasury and the IRS are concerned that taxpayers would rely on that exception to facilitate transactions of the type that section 309(c) of the Act was designed to prevent.

An additional de minimis exception, not present in section 358(h), is included in the proposed regulations. Under this exception, the proposed regulations do not apply where, immediately before the disposition of the partnership interest by the §1.752-7 liability partner, the liquidation of the §1.752-7 liability partner's partnership interest, or the assumption of the §1.752-7 liability by another partner, the amount of the remaining built-in loss with respect to all §1.752-7 liabilities assumed by the partnership (other than §1.752-7 liabilities that are assumed by the partnership with an associated trade or business) is less than the lesser of 10% of the gross value of the partnership's assets or $1,000,000. This exception was added in recognition of the fact that loss acceleration and duplication strategies typically are engaged in only if the accelerated or duplicated loss is substantial.

4. Advanced Notice of Proposed Rulemaking Under Section 358(h)(2)

Treasury and the IRS are considering exercising their regulatory authority under section 358(h)(2) to limit the exceptions to section 358(h)(1) to follow the exceptions set forth in these proposed regulations (other than the de minimis exception). Treasury and the IRS request comments on the scope and substance of such regulations, which will be retroactive to the extent necessary to prevent abuse.

5. Rules Applicable to Tiered Structures

Proposed §1.752-7(e) and (i) provide rules to address a contribution of a partnership interest to another partnership. First, under §1.752-7(e)(3), a transfer by a partner of an interest in a partnership (lower-tier partnership) to another partnership (upper-tier partnership) is not treated as a transfer of a partnership interest for purposes of applying these rules. Therefore, the partner does not have to reduce the basis of the partnership interest before such a transfer. However, look-through rules in §1.752-7(i) apply to treat the transfer of the partnership interest as a transfer of the partner's share of the assets and §1.752-7 liabilities of the partnership. Therefore, a transfer of a partnership interest to another partnership may be treated as an assumption of a §1.752-7 liability by a partnership under these proposed regulations. Under proposed _1.358-7(a), similar rules apply to a contribution of a partnership interest to a corporation.

Also, §1.752-7(i)(2) provides a limitation on the trade or business exception where a partnership (upper-tier partnership) assumes a §1.752-7 liability from a partner, and then another partnership (lower-tier partnership) assumes the §1.752-7 liability from the upper-tier partnership. In such a case, the trade or business exception does not apply on the assumption of the §1.752-7 liability by the lower-tier partnership from the upper-tier partnership unless it applied on the assumption of the §1.752-7 liability by the upper-tier partnership from the §1.752-7 liability partner. Section 1.358-7(c) of these proposed regulations provide for similar rules where a corporation assumes an obligation described in section 358(h)(3) from a partnership that the partnership had previously assumed from a partner. In addition, _1.358-7(b) of these proposed regulations provide special rules for adjusting the partners' bases in a partnership when a corporation assumes a §1.752-7 liability from the partnership.

Additional rules are provided for look-through treatment where a partnership is a §1.752-7 liability partner in another partnership. The proposed regulations also provide special rules for situations in which the §1.752-7 liability partner disposes of the partner's interest in the partnership and then another partnership (or a corporation) assumes the §1.752-7 liability from the partnership.

Effective Date

The regulations described above are proposed to apply to assumptions of §1.752-7 liabilities occurring on or after June 24, 2003. In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations (_1.752-6T) that apply to liabilities assumed by a partnership after October 18, 1999, and before June 24, 2003 . The text of those temporary regulations published in the Rules and Regulation section of this issue of the **Federal Register** serves as the text of _1.752-6 of these regulations. In lieu of applying _1.752-6T of the temporary Income Tax Regulations, partnerships may elect to be subject to the proposed rules of __1.358-7 and 1.752-7 and the proposed revisions of __1.704-1(b)(2)(iv)(b), 1.704-2(b)(3), 1.705-1(a)(7), and 1.752-1, published as part of this Notice of Proposed Rulemaking, with respect to all liabilities (including §1.752-7 liabilities) assumed by the partnership after October 18, 1999 and before June 24, 2003. The election must be filed with the first Federal income tax return filed by the partnership on or after September 22, 2003. The election will be valid only if the partnership and its partners promptly amend any returns for open taxable years that would be affected by the election.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that few partnerships engage in the type of transactions that are subject to these regulations (assumptions of liabilities not described in section 752(a) and (b) from a partner). In addition, available data indicates that most partnerships that engage in the type of transactions that are subject to these regulations are large partnerships. Certain broad exceptions to the application of these regulations (including a de minimis exception) further limit the economic impact of these regulations on small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. Comments are sought as to the number of legitimate business transactions that will be affected by the proposed regulations.

Drafting Information

The principal author of these regulations is Horace Howells, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 continues to read in part as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.752-1(a) also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-6 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-7 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Par. 2. Section 1.358-7 is added to read as follows:

§1.358-7 Transfers by partners and partnerships to corporations.

(a) Contributions of partnership interests. For purposes of section 358(h), a transfer of a partnership interest to a corporation is treated as a transfer of the partner's share of each of the partnership's assets and an assumption by the corporation of the partner's share of partnership liabilities (including section 358(h) liabilities, as defined in paragraph (d) of this section). See paragraph (e), Example 1 of this section.

(b) Contributions by partnerships. If a corporation assumes a section 358(h) liability from a partnership in an exchange to which section 358(a) applies, then, for purposes of applying section 705 (determination of basis of partner's interest) and §1.704-1(b), any reduction, under section 358(h)(1), in the partnership's basis in corporate stock received in the transaction is treated as an expenditure of the partnership described in section 705(a)(2)(B). See paragraph (e), Example 2 of this section. This expenditure must be allocated among the partners in accordance with section 704(b) and (c) and §1.752-7(c). If a partner's share of the reduction, under section 358(h)(1), in the partnership's basis in corporate stock exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess, which is treated as gain from the sale or exchange of a partnership interest. This paragraph does not apply to the extent that §1.752-7(i)(4) applies to the assumption of the §1.752-7 liability by the corporation.

(c) Assumption of section 358(h) liability by partnership followed by transfer of partnership interest or partnership property to a corporation--trade or business exception. Where a partnership assumes a section 358(h) liability from a partner and, subsequently, the partner transfers all or part of the partner's partnership interest to a corporation in an exchange to which section 358(a) applies, the section 358(h) liability is treated as associated only with the contribution made to the partnership by that partner. Similar rules apply where a partnership assumes a section 358(h) liability of a partner and a corporation subsequently assumes that section 358(h) liability from the partnership in an exchange to which section 358(a) applies. See paragraph (e), Example 1 of this section.

(d) Section 358(h) liabilities defined. For purposes of this section, section 358(h) liabilities are liabilities described in section 358(h)(3).

(e) Examples. The following examples illustrate the provisions of this section. Assume, for purposes of these examples, that the obligation assumed by the corporation does not reduce the shareholder's basis in the corporate stock under section 358(d). The examples are as follows:

Example 1. Contribution of partnership interest to corporation. In 2004, A contributes undeveloped land with a value and basis of $4,000,000 in exchange for a 50% interest in PRS and an assumption by PRS of $2,000,000 of pension liabilities from a separate business that A conducts. A's basis in the PRS interest immediately after the contribution is A's basis in the land, $4,000,000, unreduced by the amount of the pension liabilities. PRS develops the land as a landfill. Before PRS has economically performed with respect to the pension liabilities, A contributes A's interest in PRS to Corporation X, in an exchange to which section 351 applies. At the time of the exchange, the value of A's PRS interest is $2,000,000, A's basis in PRS is $4,000,000, and A has no share of partnership liabilities other than the pension liabilities. For purposes of applying section 358(h), the contribution of the PRS interest to Corporation X is treated as a contribution to Corporation X of A's share of PRS assets and of A's share of the pension liabilities of PRS ($2,000,000). Because the pension liabilities were not assumed by PRS from A in an exchange in which either the trade or business associated with the liability or substantially all of the assets associated with the liability were transferred to PRS, the contribution of the PRS interest to Corporation X is not excepted from section 358(h) under section 358(h)(2). Under section 358(h), A's basis in the Corporation X stock is reduced by the $2,000,000 of pension liabilities.

Example 2. Contribution of partnership property to corporation. In 2004, in an exchange to which section 351(a) applies, PRS, a cash basis taxpayer, contributes $2,000,000 cash to Corporation X, also a cash basis taxpayer, in exchange for Corporation X shares and the assumption by Corporation X of $1,000,000 of accounts payable incurred by PRS. At the time of the exchange, PRS has two partners, A, a 90% partner, who has a $2,000,000 basis in the PRS interest, and B, a 10% partner, who has a $50,000 basis in the PRS interest. Assume that, under section 358(h)(1), PRS's basis in the Corporation X stock is reduced by the accounts payable assumed by Corporation X ($1,000,000). Under paragraph (b) of this section, A's and B's bases in PRS must be reduced, but not below zero, by their respective shares of the section 358(h)(1) basis reduction. If either partner's share of the section 358(h)(1) basis reduction exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess. A's share of the section 358(h) basis reduction is $900,000 (90% of $1,000,000). Therefore, A's basis in the PRS interest is reduced to $1,100,000 ($2,000,000 - $900,000). B's share of the section 358(h) basis reduction is $100,000 (10% of $1,000,000). Because B's share of the section 358(h) basis reduction ($100,000) exceeds B's basis in the PRS interest ($50,000), B's basis in the PRS interest is reduced to $0 and B recognizes $50,000 of gain. This gain is treated as gain from the sale of the PRS interest.

(f) Effective date. This section applies to assumptions of liabilities by a corporation occurring on or after June 24, 2003.

§1.704-1 [Amended]

Par. 3. Section 1.704-1 is amended as follows:

1. Paragraph (b)(1)(ii) is amended by removing the language "The" at the beginning of the first sentence and adding "Except as otherwise provided in this section, the" in its place.

2. Paragraph (b)(2)(iv)(b)(2) is amended by removing the language "secured by such contributed property" in the parenthetical.

3. Paragraph (b)(2)(iv)(b)(2) is further amended by removing the language "under section 752" in the parenthetical.

4. Paragraph (b)(2)(iv)(b)(5) is amended by removing the language "secured by such distributed property" in the parenthetical.

5. Paragraph (b)(2)(iv)(b)(5) is further amended by removing the language "under section 752" in the parenthetical.

6. Paragraph (b)(2)(iv)(b) is further amended by adding a sentence at the end of the paragraph.

The addition reads as follows:

§1.704-1 Partner's distributive share.

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(b) * * * For liabilities assumed before June 24, 2003, references to liabilities in this paragraph (b)(2)(iv)(b) shall include only liabilities secured by the contributed or distributed property that are taken into account under section 752(a) and (b).

* * * * *

§1.704-2 [Amended]

Par. 4. In §1.704-2, paragraph (b)(3) is amended by adding the language "or a §1.752-7 liability (as defined in §1.752-7(b)(2)(i)) assumed by the partnership from a partner on or after June 24, 2003" at the end of the sentence.

Par. 5. Section 1.705-1 is amended by adding paragraph (a)(8) to read as follows:

§1.705-1 Determination of basis of partner's interest.

(a) * * *

(8) For basis adjustments necessary to coordinate sections 705 and 358(h), see §1.358-7(b). For certain basis adjustments with respect to a §1.752-7 liability assumed by a partnership from a partner, see §1.752-7.

* * * * *

§1.752-0 [Amended]

Par. 6. Section 1.752-0 is amended as follows:

1. The section heading and introductory text of §1.752-0 are revised.

2. The entries for §1.752-1(a)(1) through (a)(3) are redesignated as §1.752-1(a)(2) through (a)(4).

3. A new entry for §1.752-1(a)(1) is added.

4. The entries for _1.752-1(a)(1)(i), (ii), (iii), and (iv) are added.

5. The entries for §§1.752-6 and 1.752-7 are added.

The revision and additions read as follows:

§1.752-0 Table of contents.

This section lists the major captions that appear in §§1.752-1 through 1.752-7.

(4) Remaining built-in loss associated with a §1.752-7 liability.
(5) §1.752-7 liability reduction.
(i) In general.
(ii) Partial dispositions and assumptions.
(6) §1.752-7 liability transfer.
(7) Testing date.
(8) Trade or business.
(i) In general.
(ii) Trading and investment partnerships.
(A) In general.
(B) Financial instruments.
(iii) Examples.
(9) Adjusted value.
(c) Application of section 704(c) to assumed §1.752-7 liabilities.
(1) In general.
(2) Example.
(d) Special rules for sales of partnership interests, distributions of partnership assets, and assumptions of the §1.752-7 liability after a §1.752-7 liability transfer.
(1) In general.
(2) Exceptions.
(i) In general.
(ii) Examples.
(e) Transfer of §1.752-7 liability partner's partnership interest.
(1) In general.
(2) Examples.
(3) Exception for nonrecognition transactions.
(i) In general.
(ii) Examples.
(f) Distribution in liquidation of §1.752-7 liability partner's partnership interest.
(1) In general.
(2) Example.
(g) Assumption of §1.752-7 liability by a partner other than §1.752-7 liability partner.
(1) In general.
(2) Consequences to §1.752-7 liability partner.
(3) Consequences to partnership.
(4) Consequences to assuming partner.
(5) Example.
(h) Notification by the partnership (or successor) of the economic performance of the §1.752-7 liability.
(i) Tiered partnerships.

(1) Look-through treatment.
(2) Trade or business exception.
(3) Partnership as a §1.752-7 liability partner.
(4) Transfer of §1.752-7 liability by partnership to another partnership or corporation after a transaction described in paragraphs (e),(f), or (g).
(i) In general.
(ii) Subsequent transfers.
(5) Example.
(j) Effective date.
(1) In general.
(2) Election to apply this section to assumptions of liabilities occurring after October 18, 1999 and before June 24, 2003.
(i) In general.
(ii) Manner of making election.
(iii) Filing of amended returns.
(iv) Time for making election.

Par. 7. In §1.752-1, paragraphs (a)(1) through (a)(3) are redesignated as paragraphs (a)(2) through (a)(4) and a new paragraph (a)(1) is added to read as follows:

§1.752-1 Treatment of Partnership Liabilities.

(a) Definitions--(1) Liability defined--(i) In general. An obligation is a liability for purposes of section 752 and the regulations thereunder, only if and to the extent that incurring the obligation--

(A) Creates or increases the basis of any of the obligor's assets (including cash);

(B) Gives rise to an immediate deduction to the obligor; or

(C) Gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital.

(ii) Obligation. For purposes of this paragraph and _1.752-7, an obligation is any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code. Obligations include, but are not limited to, debt obligations, environmental obligations, tort obligations, contract obligations, pension obligations, obligations under a short sale, and obligations under derivative financial instruments such as options, forward contracts, and futures contracts.

(iii) Other liabilities. For obligations that are not liabilities as defined in paragraph (a)(1)(i) of this section, see §§1.752-6 and 1.752-7.

(iv) Effective date. This paragraph (a)(1) applies to liabilities that are incurred or assumed by a partnership on or after June 24, 2003 .

* * * * *

§1.752-5(a) [Amended]

Par. 8. Section 1.752-5 is amended as follows:

1. Paragraph 1.752-5(a) is amended by removing the language "Unless" at the beginning of the first sentence and adding "Except as otherwise provided in __1.752-1 through

1.752-4, unless" in its place.

Par. 9. Section 1.752-6 is added to read as follows:

§1.752-6 Partnership assumption of partner's section 358(h)(3) liability after October 18, 1999, and before June 24, 2003.

The text of proposed _1.752-6 is the same as the text of _1.752-6T published elsewhere in this issue of the **Federal Register.**

Par. 10. Section 1.752-7 is added to read as follows:

1.752-7 Partnership assumption of partner's §1.752-7 liability on or after June 24, 2003 .

(a) General rules--(1) Purpose and structure. The purpose of this section is to prevent the acceleration or duplication of loss through the assumption of obligations not described in §1.752-1(a)(1) in transactions involving partnerships. Under paragraph (c) of this section, any such obligation that is assumed by a partnership from a partner in a transaction governed by section 721(a) must be taken into account by applying principles under section 704(c). Paragraphs (e), (f), and (g) of this section provide rules for situations where a partnership assumes such an obligation from a partner and, subsequently, that partner sells or exchanges all or part of the partnership interest, that partner receives a distribution in liquidation of the partnership interest, or another partner assumes part or all of that obligation from the partnership. These rules prevent the duplication of loss by prohibiting the partnership and any person other than the partner from whom the obligation was assumed from claiming a deduction or capital expense to the extent of the built-in loss associated with the obligation. These rules also prevent the acceleration of loss by deferring the partner's deduction or loss attributable to the obligation (if any) until economic performance occurs. Paragraph (d) of this section provides a number of exceptions to paragraphs (e), (f), and (g) of this section, including a de minimis exception. Paragraph (i) of this section provides special rules for tiered partnership transactions.

(2) Exception from disguised sale rules. The assumption of a §1.752-7 liability is not treated as an assumption of a liability or as a transfer of cash for purposes of section 707(a)(2)(B).

(b) Definitions. For purposes of this section, the following definitions apply--

(1) Assumption. A person that takes property subject to a §1.752-7 liability of another person is treated as assuming the §1.752-7 liability, but only to the extent of the fair market value of the property taken subject to the §1.752-7

liability.

(2) §1.752-7 liability--(i) In general. A §1.752-7 liability is an obligation (as defined in _1.752-1(a)(1)(ii)) that is not described in §1.752-1(a)(1)(i).

(ii) Amount and share of §1.752-7 liability. The amount of a §1.752-7 liability is the amount of cash that a willing assignor would pay to a willing assignee to assume the §1.752-7 liability in an arm's-length transaction. A partner's share of a partnership's §1.752-7 liability is the amount of deduction that would be allocated to the partner with respect to the §1.752-7 liability if the partnership disposed of all of its assets, satisfied all of its liabilities (other than §1.752-7 liabilities), and paid an unrelated person to assume all of its §1.752-7 liabilities in a fully taxable arm's-length transaction (assuming such payment would give rise to an immediate deduction to the partnership).

(3) §1.752-7 liability partner. A §1.752-7 liability partner is a partner from whom a partnership assumes a §1.752-7 liability as part of a §1.752-7 liability transfer or any person who acquires a partnership interest from the §1.752-7 liability partner in a transaction described in paragraph (e)(3) of this section. If a partnership (lower-tier partnership) assumes a §1.752-7 liability from another

partnership (upper-tier partnership), then both the upper-tier partnership and the partners of the upper-tier partnership are §1.752-7 liability partners. Therefore, paragraphs (e) and (f) of this section apply on a sale or liquidation of any partner's interest in the upper-tier partnership and on a sale or liquidation of the upper-tier partnership's interest in the lower-tier partnership. See paragraph (i)(3) of this section.

(4) Remaining built-in loss associated with a §1.752-7 liability. The remaining built-in loss associated with a §1.752-7 liability equals the amount of the §1.752-7 liability as of the time of the assumption of the §1.752-7 liability by the partnership, reduced by the portion of the §1.752-7 liability previously taken into account by the §1.752-7 liability partner under paragraph (i)(4) of this section and adjusted as provided in paragraph (c) of this section and §1.704-3 for--

(i) Partnership allocations of loss or deduction with respect to the §1.752-7 liability on or prior to the testing date; and

(ii) Any assumption of all or part of the §1.752-7 liability by the §1.752-7 liability partner (including any assumption that occurs on the testing date).

(5) §1.752-7 liability reduction--(i) In general. The

§1.752-7 liability reduction is the amount by which the §1.752-7 liability partner is required to reduce the basis in the partner's partnership interest by operation of paragraphs (e), (f), and (g) of this section. The §1.752-7 liability reduction is the lesser of--

(A) The excess of the §1.752-7 liability partner's basis in the partner's partnership interest over the adjusted value of that interest (as defined in paragraph (b)(9) of this section); or

(B) The remaining built-in loss associated with the §1.752-7 liability.

(ii) Partial dispositions and assumptions. In the case of a partial disposition of the §1.752-7 liability partner's partnership interest or a partial assumption of the §1.752-7 liability by another partner, the §1.752-7 liability reduction is pro rated based on the portion of the interest sold or the portion of the §1.752-7 liability assumed.

(6) §1.752-7 liability transfer. A §1.752-7 liability transfer is any assumption of a §1.752-7 liability by a partnership from a partner in a transaction governed by section 721(a).

(7) Testing date. The testing date is--

(i) For purposes of paragraph (e) of this section, the date of the sale, exchange, or other disposition of part or all of the §1.752-7 liability partner's partnership interest;

(ii) For purposes of paragraph (f) of this section, the date of the partnership's distribution in liquidation of the §1.752-7 liability partner's partnership interest; and

(iii) For purposes of paragraph (g) of this section, the date of the assumption (or partial assumption) of the §1.752-7 liability by a partner other than the §1.752-7 liability partner.

(8) Trade or business--(i) In general. A trade or business is a specific group of activities carried on by a person for the purpose of earning income or profit if the activities included in that group include every operation that forms a part of, or a step in, the process of earning income or profit. Such group of activities ordinarily includes the collection of income and the payment of expenses. Subject to paragraph (b)(8)(ii) of this section, the group of activities must constitute the carrying on of a trade or business under section 162(a) (determined as though the activities were conducted by an individual).

(ii) Trading and investment partnerships--(A) In general. The activity of acquiring, holding, or disposing of financial instruments constitutes a trade or business for purposes of this paragraph (b)(8) if and only if the activity is conducted by an entity registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended (15 U.S.C. 80a).

(B) Financial instruments. For purposes of paragraph (b)(8)(ii) of this section, financial instruments include stock in corporations; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, stock, securities, currencies, or commodities, including options, forward or futures contracts, or short positions; or any similar financial instrument.

(iii) Examples. The following examples illustrate the provisions of paragraph (b)(8) of this section:

Example 1. Corporation Y owns, manages, and derives rental income from an office building and also owns vacant land that may be subject to environmental liabilities. Corporation Y contributes the land subject to the environmental liabilities to PRS in a transaction governed by section 721(a). PRS plans to develop the land as a landfill. The contribution of the vacant land does not constitute the contribution of a trade or business because Corporation Y did not conduct any significant business or development activities with respect to the land prior to the contribution.

Example 2. For the past 5 years, Corporation X has owned and operated gas stations in City A, City B, and City C. Corporation X transfers all of the assets associated with the operation of the gas station in City A to PRS for interests in PRS and the assumption by PRS of the §1.752-7 liabilities associated with that gas station. PRS continues to operate the gas station in City A after the contribution. The contribution of the gas station to PRS constitutes the contribution of a trade or business.

Example 3. For the past 7 years, Corporation Z has engaged in the manufacture and sale of household products. Throughout this period, Corporation Z has maintained a research department for use in connection with its manufacturing activities. The research department has 10 employees actively engaged in the development of new products. Corporation Z contributes the research department to PRS in exchange for a PRS interest and the assumption by PRS of pension liabilities with respect to the employees of the research department. PRS continues the research operations on a contractual basis with several businesses, including Corporation Z. The contribution of the research operations to PRS constitutes a contribution of a trade or business.

(9) Adjusted value. The adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under __1.752-1 through 1.752-5.

(c) Application of section 704(c) to assumed §1.752-7 liabilities--(1) In general. Any §1.752-7 liability assumed by a partnership in a §1.752-7 liability transfer is treated under section 704(c) principles as having a built-in loss equal to the amount of the §1.752-7 liability as of the date of the partnership's assumption of the §1.752-7 liability. Thus, items of deduction or loss with respect to the §1.752-7 liability, if any, must be allocated, first, to the §1.752-7 liability partner to the extent of the built-in loss. Deductions or losses with respect to the §1.752-7 liability that exceed the built-in loss are shared among the partners in accordance with section 704(b) and the regulations thereunder.

(2) Example. The following example illustrates the provisions of this paragraph (c):

Example--(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value and basis of $400X, subject to a §1.752-7 liability of $100X, for a 25% interest in PRS. B contributes $300X cash for a 25% interest in PRS, and C contributes $600X cash for a 50% interest in PRS. Assume that the partnership complies with the substantial economic effect safe harbor of §1.704-1(b)(2). Under §1.704-1(b)(2)(iv)(b), A's capital account is credited with $300X (the fair market value of Property 1, $400X, less the §1.752-7 liability assumed by PRS, $100X). In 2005, PRS earns $200X of income and uses it to satisfy the §1.752-7 liability. Assume that the cost to PRS of satisfying the §1.752-7 liability is deductible by PRS. The $200X of partnership income is allocated according to the partnership agreement, $50X to A, $50X to B, and $100X to C.

(ii) Analysis. Pursuant to paragraph (c) of this section, $100X of the deduction attributable to the economic performance of the §1.752-7 liability is specially allocated to A, the §1.752-7 liability partner, under section 704(c)(1)(A) and the regulations thereunder. No book item corresponds to this tax allocation. The remaining $100X of deduction attributable to economic performance of the §1.752-7 liability is allocated, for both book and tax purposes, according to the partnership agreement, $25X to A, $25X to B, and $50X to C. If the partnership, instead, satisfied the §1.752-7 liability over a number of years, the first $100X of deduction with respect to the §1.752-7 liability would be allocated to A, the §1.752-7 liability partner, before any deduction with respect to the §1.752-7 liability would be allocated to the other partners. For example, if PRS were to satisfy $50X of the §1.752-7 liability at a time when PRS reasonably believed that it would cost $200X to satisfy the §1.752-7 liability in full, the $50X deduction with respect to the §1.752-7 liability would be allocated to A for tax purposes only. No deduction would arise for book purposes. If PRS later paid a further $100X in satisfaction of the §1.752-7 liability, $50X of the deduction with respect to the

§1.752-7 liability would be allocated, solely for tax purposes, to A and the remaining $50X would be allocated, for both book and tax purposes, according to the partnership agreement.

(d) Special rules for sales of partnership interests, distributions of partnership assets, and assumptions of the §1.752-7 liability after a §1.752-7 liability transfer--(1) In general. Except as provided in paragraph (d)(2) of this section, paragraphs (e), (f), and (g) of this section apply to certain partnership transactions occurring after a §1.752-7 liability transfer.

(2) Exceptions--(i) In general. Paragraphs (e), (f), and (g) of this section do not apply--

(A) If the partnership assumes the §1.752-7 liability as part of a contribution to the partnership of the trade or business with which the liability is associated, and the partnership continues to carry on that trade or business after the contribution (for the definition of a trade or business see paragraph (b)(8) of this section); or

(B) If, immediately before the testing date, the amount of the remaining built-in loss with respect to all §1.752-7 liabilities assumed by the partnership (other than §1.752-7 liabilities assumed by the partnership with an associated trade or business) in one or more §1.752-7 liability transfers is less than the lesser of 10% of the gross value of partnership assets or $1,000,000.

(ii) Examples. The following examples illustrate the principles of this paragraph (d)(2):

Example 1. For the past 5 years, Corporation X, a C corporation, has been engaged in Business A and Business B. In 2004, Corporation X contributes Business A, in a transaction governed by section 721(a), to PRS in exchange for a PRS interest and the assumption by PRS of pension liabilities with respect to the employees engaged in Business A. PRS plans to carry on Business A after the contribution. Because PRS has assumed the pension liabilities as part of a contribution to PRS of the trade or business with which the liabilities are associated, paragraphs (e), (f), and (g) of this section do not apply to any transaction occurring after the §1.752-7 liability transfer.

Example 2--(i) Facts. The facts are the same as in Example 1, except that PRS also assumes from Corporation X certain pension liabilities with respect to the employees of Business B. At the time of the assumption, the amount of the pension liabilities with respect to the employees of Business A is $3,000,000 (the A liabilities) and the amount of the pension liabilities associated with the employees of Business B (the B liabilities) is $2,000,000. Two years later, Corporation X sells its interest in PRS to Y for $9,000,000. At the time of the sale, the remaining built-in loss associated with the A liabilities is $2,100,000, the remaining built-in loss associated with the B liabilities is $900,000, and the gross value of PRS's assets (excluding §1.752-7 liabilities) is $20,000,000. Assume that PRS has no §1.752-7 liabilities other than those assumed from Corporation X.

(ii) Analysis. The only liabilities assumed by PRS from Corporation X that were not assumed as part of Corporation X's contribution of Business A were the B liabilities. Immediately before the testing date, the remaining built-in loss associated with the B liabilities ($900,000) was less than the lesser of 10% of the gross value of PRS's assets ($2,000,000) or $1,000,000. Therefore, paragraph (d)(2)(i)(B) of this section applies to exclude Corporation X's sale of the PRS interest to Y from the application of paragraph (e) of this section.

(e) Transfer of §1.752-7 liability partner's partnership interest--(1) In general. Except as provided in paragraphs (d)(2) and (e)(3) of this section, immediately before the sale, exchange, or other disposition of all or a part of a §1.752-7 liability partner's partnership interest, the §1.752-7 liability partner's basis in the partnership interest is reduced by the §1.752-7 liability reduction. No deduction or capital expense is allowed to the partnership on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. For purposes of section 705(a)(2)(B) and _1.704-1(b)(2)(ii)(b) only, the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expenditure of the partnership. Therefore, the remaining partners' capital accounts and bases in their partnership interests are not reduced by the remaining built-in loss associated with the §1.752-7 liability. If the partnership (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a loss or deduction. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(2) Examples. The following examples illustrates the principles of paragraph (e)(1) of this section:

Example 1--(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value of $5,000,000 and basis of $4,000,000 subject to a §1.752-7 liability of $2,000,000 in exchange for a 25% interest in PRS. B contributes $3,000,000 cash in exchange for a 25% interest in PRS, and C contributes $6,000,000 cash in exchange for a 50% interest in PRS. In 2006, when PRS has a section 754 election in effect, A sells A's interest in PRS to D for $3,000,000. At the time of the sale, the basis of A's PRS interest is $4,000,000, the remaining built-in loss associated with the §1.752-7 liability is $2,000,000, and PRS has no liabilities (as defined in §1.752-1(a)(1)). Assume that none of the exceptions of paragraph (d)(2) of this section apply and that economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2007, PRS pays $3,000,000 to satisfy the liability.

(ii) Sale of A's PRS interest. Immediately before the sale of the PRS interest to D, A's basis in the PRS interest is reduced (to $3,000,000) by the §1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the

PRS interest ($4,000,000) over the adjusted value of that interest ($3,000,000), $1,000,000, or the remaining built-in loss associated with the §1.752-7 liability, $2,000,000. Therefore, A recognizes no gain or loss on the sale of the PRS interest to D. D's basis in the PRS interest is $3,000,000. D's share of the adjusted basis of partnership property equals D's interest in the partnership's previously taxed capital of $2,000,000 (the amount of cash that D would receive on a liquidation of the partnership, $3,000,000, increased by the amount of tax loss that would be allocated to D in the hypothetical transaction, $0, and reduced by the amount of tax gain that would be allocated to D in the hypothetical transaction, $1,000,000). Therefore, the basis adjustment under section 743(b) is $1,000,000.

(iii) Satisfaction of §1.752-7 liability. Neither PRS nor any of its partners is entitled to a deduction for the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability ($2,000,000). PRS is entitled to a deduction, however, for the amount by which the cost of satisfying the §1.752-7 liability exceeds the remaining built-in loss associated with the §1.752-7 liability. Therefore, in 2007, PRS may deduct $1,000,000 (cost to satisfy the §1.752-7 liability, $3,000,000, less the remaining built-in loss associated with the §1.752-7 liability, $2,000,000). If PRS notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2007 of $1,000,000 (the §1.752-7 liability reduction).

Example 2-- The facts are the same as in Example 1 except that, at the time of A's sale of the PRS interest to D, PRS has a nonrecourse liability of $4,000,000, of which A's share is $1,000,000. A's basis in PRS is $5,000,000. At the time of the sale of the PRS interest to D, the adjusted value of A's interest is $4,000,000 (the fair market value of the interest ($3,000,000), increased by A's share of partnership liabilities ($1,000,000)). The difference between the basis of A's interest ($5,000,000) and the adjusted value of that interest ($4,000,000) is $1,000,000. Therefore, the §1.752-7 liability reduction is $1,000,000 (the lesser of this difference or the remaining built-in loss associated with the §1.752-7 liability, $2,000,000). Immediately before the sale of the PRS interest to D, A's basis is reduced from $5,000,000 to $4,0000,000. A's amount realized on the sale of the PRS interest to D is $4,000,000 ($3,000,000 paid by D, increased under section 752(d) by A's share of partnership liabilities, or $1,000,000). Therefore, A recognizes no gain or loss on the sale. D's basis in the PRS interest is $4,000,000. Because D's share of the adjusted basis of partnership property is $3,000,000 (D's share of the partnership's previously taxed capital, $2,000,000, plus D's share of partnership liabilities, $1,000,000), the basis adjustment under section 743(b) is $1,000,000.

(3) Exception for nonrecognition transactions--(i) In general. Paragraph (e)(1) of this section does not apply where a §1.752-7 liability partner transfers all or part of the partner's partnership interest in a transaction in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the transferor's basis in the partnership interest. In addition, paragraph (e)(1) of this section does not apply to a distribution of an interest in the partnership that has assumed the §1.752-7 liability by a partnership that is the §1.752-7 liability partner.

(ii) Examples. The following examples illustrate the provisions of this paragraph (e)(3):

Example 1--(i) Facts. In 2004, X contributes undeveloped land with a value and basis of $2,000,000 and subject to environmental liabilities of $1,500,000 to partnership LTP in exchange for a 50% interest in LTP. LTP develops the land as a landfill. In 2005, in a transaction governed by section 721(a), X contributes the LTP interest to UTP in exchange for a 50% interest in UTP. In 2008, X sells the UTP interest to A for $500,000. At the time of the sale, X's basis in UTP is $2,000,000, the remaining built-in loss associated with the environmental liability is $1,500,000, and the gross value of UTP's assets is $2,500,000. The environmental liabilities were not assumed by LTP as part of a contribution by X to LTP of a trade or business with which the liabilities were associated. (See paragraph (b)(8)(iii), Example 1 of this section.)

(ii) Analysis. Because UTP's basis in the LTP interest is determined by reference to X's basis in the LTP interest, X's contribution of the LTP interest to UTP is exempted from the rules of paragraph (e)(1) of this section. Under paragraph (i)(1) of this section, X's contribution of the LTP interest to UTP is treated as a contribution of X's share of the assets of LTP and UTP's assumption of X's share of the LTP liabilities (including §1.752-7 liabilities). Therefore, X's transfer of the LTP interest to UTP is a §1.752-7 liability transfer. The §1.752-7 liabilities deemed transferred by X to UTP are not associated with a trade or business transferred to UTP for purposes of paragraph (d)(2)(i)(A) of this section, because they were not associated with a trade or business transferred by X to LTP as part of the original §1.752-7 liability transfer. See paragraph (i)(2) of this section. Because none of the exceptions described in paragraph (d)(2) of this section apply to X's taxable sale of the UTP interest to A in 2008, paragraph (e)(1) of this section applies to that sale.

Example 2. The facts are the same as in Example 1, except that, rather than transferring the LTP interest to UTP in 2005, X contributes the LTP interest to Corporation Y in an exchange to which section 351 applies. Because Corporation Y's basis in the LTP interest is determined by reference to X's basis in that interest, X's contribution of the LTP interest is exempted from the rules of paragraph (e)(1) of this section. But see section 358(h) and _1.358-7.

(f) Distribution in liquidation of §1.752-7 liability partner's partnership interest--(1) In general. Except as provided in paragraph (d)(2) of this section, immediately before a distribution in liquidation of a §1.752-7 liability partner's partnership interest, the §1.752-7 liability partner's basis in the partnership interest is reduced by the

§1.752-7 liability reduction. This rule applies before section 737. No deduction or capital expense is allowed to the partnership on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. For purposes of section 705(a)(2)(B) and _1.704-1(b)(2)(ii)(b) only, the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expenditure of the partnership. Therefore, the remaining partners' capital accounts and bases in their partnership interests are not reduced by the remaining built-in loss associated with the §1.752-7 liability. If the partnership (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a loss or deduction. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(2) Example. The following example illustrates the provision of this paragraph (f):

Example--(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value and basis of $5,000,000 subject to a §1.752-7 liability of $2,000,000 for a 25% interest in PRS. B contributes $3,000,000 cash for a 25% interest in PRS, and C contributes $6,000,000 cash for a 50% interest in PRS. In 2012, when PRS has a section 754 election in effect, PRS distributes Property 2, which has a basis and fair market value of $3,000,000, to A in liquidation of A's PRS interest. At the time of the distribution, the fair market value of A's PRS interest is $3,000,000, the basis of that interest is $5,000,000, and the remaining built-in loss associated with the §1.752-7 liability is $2,000,000. Assume that none of the exceptions of paragraph (d)(2) of this section apply to the distribution and that the economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2013, PRS pays $1,000,000 to satisfy the entire §1.752-7 liability.

(ii) Redemption of A's PRS interest. Immediately before the distribution of Property 2 to A, A's basis in the PRS interest is reduced (to $3,000,000) by the §1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the PRS interest over the adjusted value of that interest ($2,000,000) or the remaining built-in loss associated with the §1.752-7 liability ($2,000,000). Therefore, A's basis in Property 2 under section 732(b) is $3,000,000. Because this is the same as the partnership's basis in Property 2 immediately before the distribution, the partnership's basis adjustment under section 734(b) is $0.

(iii) Satisfaction of §1.752-7 liability. PRS is not entitled to a deduction for the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability ($2,000,000). Because this amount exceeds the amount paid by PRS to satisfy the §1.752-7 liability ($1,000,000), PRS is not entitled to any deduction for the §1.752-7 liability in 2013. If, however, PRS notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2013 of $1,000,000 (the amount paid in satisfaction of the §1.752-7 liability) and a capital loss of $1,000,000 (the remaining §1.752-7 liability reduction).

(g) Assumption of §1.752-7 liability by a partner other than §1.752-7 liability partner--(1) In general. Except as provided in paragraph (d)(2) of this section, section 704(c)(1)(B) does not apply to an assumption of a §1.752-7 liability from a partnership by a partner other than the §1.752-7 liability partner. Instead, this paragraph (g) applies. The rules of paragraph (g)(2) of this section apply only if the §1.752-7 liability partner is a partner in the partnership at the time of the assumption of the §1.752-7 liability. The rules of paragraphs (g)(3) and (4) of this section apply to any assumption of the §1.752-7 liability by a partner other than the §1.752-7 liability partner, whether or not the §1.752-7 liability partner is a partner in the partnership at the time of the assumption.

(2) Consequences to §1.752-7 liability partner. If, at the time of an assumption of a §1.752-7 liability from a partnership by a partner other than the §1.752-7 liability

partner, the §1.752-7 liability partner remains a partner in the partnership, then the §1.752-7 liability partner's basis in the partnership interest is reduced by the §1.752-7 liability reduction. If the assuming partner (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a deduction or loss. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(3) Consequences to partnership. Immediately after the assumption of the §1.752-7 liability from the partnership by a partner other than the §1.752-7 liability partner, the

partnership must reduce the basis of partnership assets by the remaining built-in loss associated with the §1.752-7 liability. The reduction in the basis of partnership assets must be allocated among partnership assets as if that adjustment were a basis adjustment under section 734(b).

(4) Consequences to assuming partner. No deduction or capital expense is allowed to an assuming partner (other than the §1.752-7 liability partner) on the economic performance of a §1.752-7 liability assumed from a partnership to the extent of the remaining built-in loss associated with the §1.752-7 liability. Instead, on economic performance of the _1.752-7 liability, the assuming partner must adjust the basis of the partnership interest, any assets (other than cash, accounts receivable, or inventory) distributed by the partnership to the partner, or gain or loss on the disposition of the partnership interest, as the case may be. These adjustments are determined as if the assuming partner's basis in the partnership interest at the time of the assumption were increased by the lesser of the amount paid to satisfy the _1.752-7 liability or the remaining built-in loss associated with the _1.752-7 liability. However, the assuming partner cannot take into account any adjustments to depreciable basis, reduction in gain, or increase in loss until economic

performance of the _1.752-7 liability. Any adjustment to the basis of an asset under this provision is taken into account over the recovery period of that asset.

(5) Example. The following example illustrates the provisions of this paragraph (g):

Example--(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1, a nondepreciable capital asset with a fair market value and basis of $5,000,000, in exchange for a 25% interest in PRS and assumption by PRS of a §1.752-7 liability of $2,000,000. B contributes $3,000,000 cash for a 25% interest in PRS, and C contributes $6,000,000 cash for a 50% interest in PRS. PRS uses the cash contributed to purchase Property 2. In 2007, PRS distributes Property 1, subject to the §1.752-7 liability to B in liquidation of B's interest in PRS. At the time of the distribution, A's interest in PRS has a value of $3,000,000 and a basis of $5,000,000, and B's interest in PRS has a value and basis of $3,000,000. Also at that time, Property 1 has a value and basis of $5,000,000, Property 2 has a value and basis of $9,000,000, and the remaining built-in loss associated with the §1.752-7 liability is $2,000,000. Assume that none of the exceptions of paragraph (d)(2)(i) of this section apply to the assumption of the §1.752-7 liability by B and that economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2010, B pays $1,000,000 to satisfy the entire §1.752-7 liability. At that time, B still owns Property 1, which has a basis of $3,000,000.

(ii) Assumption of §1.752-7 liability by B. Section 704(c)(1)(B) does not apply to the assumption of the §1.752-7 liability by B. Instead, A's basis in the PRS interest is reduced (to $3,000,000) by the §1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the PRS interest over the adjusted value of that interest ($2,000,000), or the remaining built-in loss associated with the §1.752-7 liability as of the time of the assumption ($2,000,000). PRS's basis in Property 2 is reduced (to $7,000,000) by the $2,000,000 remaining built-in loss associated with the §1.752-7 liability. B's basis in Property 1 under section 732(b) is $3,000,000 (B's basis in the PRS interest). This is $2,000,000 less than PRS's basis in Property 1 before the distribution of Property 1 to B. If PRS has a section 754 election in effect for 2007, PRS may increase the basis of Property 2 under section 734(b) by $2,000,000.

(iii) Satisfaction of §1.752-7 liability. B is not entitled to a deduction for the economic performance of the §1.752-7 liability in 2010 to the extent of the remaining built-in loss associated with the §1.752-7 liability as of the time of the assumption ($2,000,000). As this amount exceeds the amount paid by B to satisfy the §1.752-7 liability, B is not entitled to any deduction for the §1.752-7 liability in 2010. B may, however, increase the basis of Property 1 by the lesser of the remaining built-in loss associated with the §1.752-7 liability ($2,000,000) or the amount paid to satisfy the §1.752-7 liability ($1,000,000). Therefore, B's basis in Property 1 is increased to $4,000,000. If B notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2010 of $1,000,000 (the amount paid in satisfaction of the §1.752-7 liability) and a capital loss of $1,000,000 (the remaining §1.752-7 liability reduction).

(h) Notification by the partnership (or successor) of the economic performance of the §1.752-7 liability. For purposes of paragraphs (e), (f), and (g) of this section, notification by the partnership (or successor) of the economic performance of the §1.752-7 liability must be attached to the §1.752-7 liability partner's return for the year in which the loss is being claimed and must include--

(1) The amount paid in satisfaction of the §1.752-7 liability, and whether the amounts paid were in partial or complete satisfaction of the §1.752-7 liability;

(2) The name and address of the person satisfying the

§1.752-7 liability;

(3) The date of the payment on the §1.752-7 liability; and

(4) The character of the loss with respect to the §1.752-7 liability.

(i) Tiered partnerships--(1) Look-through treatment. For purposes of this section, a contribution by a partner of an interest in a partnership (lower-tier partnership) to another partnership (upper-tier partnership) is treated as a contribution of the partner's share of each of the lower-tier partnership's assets and an assumption by the upper-tier partnership of the partner's share of the lower-tier partnership's liabilities (including §1.752-7 liabilities). See paragraph (e)(3)(ii), Example 1 of this section. In addition, a partnership is treated as having its share of any §1.752-7 liabilities of the partnerships in which it has an interest.

(2) Trade or business exception. If a partnership (upper-tier partnership) assumes a §1.752-7 liability of a partner, and, subsequently, another partnership (lower-tier partnership) assumes that §1.752-7 liability from the upper-tier partnership, then the §1.752-7 liability is treated as associated only with any trade or business contributed to the

upper-tier partnership by the _1.752-7 liability partner. The same rule applies where a partnership assumes a §1.752-7 liability of a partner, and, subsequently, the _1.752-7 liability partner transfers that partnership interest to another partnership. See paragraph (e)(3)(ii), Example 1 of this section.

(3) Partnership as a §1.752-7 liability partner. If a transaction described in paragraph (e), (f), or (g) of this section occurs with respect to a partnership (upper-tier partnership) that is a §1.752-7 liability partner of another partnership (lower-tier partnership), then such transaction will also be treated as a transaction described in paragraph (e), (f), or (g) of this section, as appropriate, with respect to the partners of the upper-tier partnership, regardless of whether the upper-tier partnership assumed the §1.752-7 liability from those partners. (See paragraph (b)(3) of this section for rules relating to the treatment of transactions by the partners of the upper-tier partnership). In such a case, the §1.752-7 liability reduction with respect to each partner in the upper-tier partnership is equal to that partner's share of the §1.752-7 liability. The partners of the upper-tier partnership at the time of the transaction described in paragraph (e), (f), or (g) of this section, and not the upper-

tier partnership, are entitled to the loss or deduction on the economic performance of the §1.752-7 liability. Similar principles apply where the upper-tier partnership is itself owned by one or a series of partnerships. This paragraph does not apply to the extent that _1.752-7(i)(4) applies to the assumption of the §1.752-7 liability by the lower-tier partnership.

(4) Transfer of §1.752-7 liability by partnership to another partnership or corporation after a transaction described in paragraphs (e),(f), or (g)--(i) In general. If, after a transaction described in paragraphs (e),(f), or (g) of this section with respect to a §1.752-7 liability assumed by a partnership (the upper-tier partnership), another partnership or a corporation assumes the §1.752-7 liability from the upper-tier partnership (or the assuming partner) in a transaction in which the basis of property is determined, in whole or in part, by reference to the basis of the property in the hands of the upper-tier partnership (or assuming partner), then--

(A) The upper-tier partnership (or assuming partner) must reduce its basis in any corporate stock or partnership interest received by the remaining built-in loss associated with the §1.752-7 liability (but the partners of the upper-tier partnership do not reduce their bases or capital accounts in the upper-tier partnership); and

(B) No deduction or capital expense is allowed to the assuming partnership or corporation on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability.

(ii) Subsequent transfers. Similar rules apply to subsequent assumptions of the §1.752-7 liability in transactions in which the basis of property is determined, in whole or in part, by reference to the basis of the property in the hands of the transferor. If, subsequent to an assumption of the §1.752-7 liability by a partnership in a transaction to which paragraph (i)(4)(i) of this section applies, the §1.752-7 liability is assumed from the partnership by a partner other than the partner from whom the partnership assumed the §1.752-7 liability, then the rules of paragraph (g)(4) of this section apply.

(5) Example. The following example illustrates the provisions of paragraphs (i)(3) and (i)(4) of this section.

Example--(i) Assumption of §1.752-7 liability by UTP and transfer of §1.752-7 liability partner's interest in UTP. In 2004, A, B, and C form partnership UTP. A contributes Property 1 with a fair market value and basis of $5,000,000 subject to a §1.752-7 liability of $2,000,000 in exchange for a 25% interest in UTP. B contributes $3,000,000 cash in exchange for a 25% interest in UTP, and C contributes \$6,000,000 cash in exchange for a 50% interest in UTP. UTP invests the \$9,000,000 cash in Property 2. In 2006, A sells A's interest in UTP to D for \$3,000,000. At the time of the sale, the basis of A's UTP interest is \$5,000,000, the remaining built-in loss associated with the §1.752-7 liability is \$2,000,000, and UTP has no liabilities other than §1.752-7 liabilities. Assume that none of the exceptions of paragraph (d)(2) of this section apply and that economic performance of the §1.752-7 liability would give rise to a deductible expense to the payor. Under paragraph (e) of this section, immediately before the sale of the UTP interest to D, A's basis in UTP is reduced to \$3,000,000 by the \$2,000,000 §1.752-7 liability reduction. Therefore, A recognizes no gain or loss on the sale of the UTP interest to D. D's basis in the UTP interest is \$3,000,000.

(ii) <u>Assumption of §1.752-7 liability by LTP from UTP</u>. In 2008, at a time when the estimated amount of the §1.752-7 liability has increased to \$3,500,000, UTP contributes Property 1 and Property 2, subject to the §1.752-7 liability, to LTP in exchange for a 50% interest in LTP. At the time of the contribution, Property 1 still has a value and basis of \$5,000,000 and Property 2 still has a value and basis of \$9,000,000. UTP's basis in LTP under section 722 is \$14,000,000. Under paragraph (i)(4) of this section, UTP must reduce its basis in LTP by the \$2,000,000 remaining built-in loss associated with the §1.752-7 liability (as of the time of the sale of the UTP interest by A). The partners in UTP are not required to reduce their bases in UTP by this amount.

(iii) <u>Sale by UTP of LTP interest</u>. In 2010, UTP sells its interest in LTP to E for \$10,500,000. At the time of the sale, Property 1 still has a value and basis of \$5,000,000, Property 2 still has a value and basis of \$9,000,000, and the remaining built-in loss associated with the §1.752-7 liability is still \$3,500,000. Under paragraph (e) of this section, immediately before the sale, UTP must reduce its basis in the LTP interest by the §1.752-7 liability reduction. Under paragraph (a)(4) of this section, the remaining built-in loss associated with the §1.752-7 liability is \$1,500,000 (remaining built-in loss associated with the §1.752-7 liability, \$3,500,000, reduced by the amount of the §1.752-7 liability taken into account under paragraph (i)(4) of this section, \$2,000,000). The difference between the basis of the LTP interest held by UTP (\$12,000,000) and the adjusted value of that interest ($10,500,000) is also $1,500,000. Therefore, the _1.752-7 liability reduction is $1,500,000 and UTP's basis in the LTP interest must be reduced to $10,500,000. In addition, UTP's partners must reduce their bases in their UTP interests by their proportionate shares of the §1.752-7 liability reduction. Thus, the basis of each of B's and D's interest in UTP must be reduced by $375,000 and the basis of C's interest in UTP must be reduced by $750,000. In 2011, D sells the UTP interest to F.

(iv) Economic performance of §1.752-7 liability by LTP. In 2012, LTP pays $3,500,000 to satisfy the §1.752-7 liability. Under paragraphs (e) and (i)(4) of this section, LTP is not entitled to any deduction with respect to the §1.752-7 liability. Under paragraph (i)(3) of this section, UTP also is not entitled to any deduction with respect to the §1.752-7 liability. If LTP notifies A, B, C and D of the economic performance of the §1.752-7 liability, then A is entitled to a deduction in 2012 of $2,000,000, B and D are each entitled to deductions in 2012 of $375,000, and C is entitled to a deduction in 2012 of $750,000.

(j) Effective date--(1) In general. This section applies to §1.752-7 liability transfers occurring on or after June 24, 2003.

(2) Election to apply this section to assumptions of liabilities occurring after October 18, 1999 and before June 24, 2003--(i) In general. A partnership may elect to apply this section to assumptions of liabilities (including §1.752-7

liabilities) occurring after October 18, 1999, and before June 24, 2003. Such an election is binding on the partnership and all of its partners. A partnership making such an election must apply all of the provisions of these proposed regulations (other than _1.752-6).

(ii) Manner of making election. A partnership makes an election under this paragraph (j)(2) by attaching the following statement to its timely filed return: "[Insert name and employer identification number of electing partnership] elects under _1.752-7 of the Income Tax Regulations to be subject to the rules of __1.358-7, 1.752-7 and 1.704-1(b)(2)(iv)(b), 1.704-2(b)(3), 1.705-1(a)(7), and 1.752-1, on June 24, 2003, with respect to all liabilities (including §1.752-7 liabilities) assumed by the partnership after October 18, 1999 and before June 24, 2003. In the statement, the partnership must list, with respect to each liability (including each §1.752-7 liability) assumed by the partnership after October 18, 1999 and before June 24, 2003--

(A) The name, address, and taxpayer identification number of the partner from whom the liability was assumed;

(B) The date on which the liability was assumed by the partnership;

(C) The amount of the liability as of the time of its assumption; and

(D) A description of the liability.

(iii) Filing of amended returns. An election under this paragraph (j)(2) will be valid only if the partnership and its partners promptly amend any returns for open taxable years that would be affected by the election.

(iv) Time for making election. An election under this paragraph (j)(2) must be filed with the first Federal income tax return filed by the partnership on or after September 24, 2003.

David A. Mader,

Assistant Deputy Commissioner of Internal Revenue.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 23, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $12,000 million to refund an estimated $25,000 million of publicly held 4-week Treasury bills maturing June 26, 2003, and to pay down approximately $13,000 million.

Tenders for 4-week Treasury bills to be held on the book-entry records of *TreasuryDirect* will not be accepted.

The Federal Reserve System holds $14,905 million of the Treasury bills maturing on June 26, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders in this auction up to the balance of the amount not awarded in today's 13-week and 26-week Treasury bill auctions. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS - 494

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED JUNE 26, 2003

June 23, 2003

Offering Amount.........................$12,000 million
Maximum Award (35% of Offering Amount)...$ 4,200 million
Maximum Recognized Bid at a Single Rate..$ 4,200 million
NLP Reporting Threshold.................$ 4,200 million
NLP Exclusion Amount....................$10,200 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NE 7
Auction date.......................June 24, 2003
Issue date.........................June 26, 2003
Maturity date......................July 24, 2003
Original issue date................January 23, 2003
Currently outstanding..............$40,363 million
Minimum bid amount and multiples....$1,000

Submission of Bids:
Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.
Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.
Competitive bids:
(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 4.215%.
(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:
Noncompetitive tenders:
Prior to 12:00 noon eastern daylight saving time on auction day
Competitive tenders:
Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 23, 2003
2003-6-23-9-38-43-27333

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $82,961 million as of the end of that week, compared to $82,566 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	June 6, 2003			June 13, 2003		
TOTAL	82,566			82,961		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	7,769	13,238	21,007	7,883	13,391	21,274
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,631	2,658	15,289	12,782	2,689	15,471
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			23,429			23,401
3. Special Drawing Rights (SDRs) [2]			11,798			11,770
4. Gold Stock [3]			11,043			11,044
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	June 6, 2003			June 13, 2003		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	June 6, 2003			June 13, 2003		

	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to the prior week's IMF data. IMF data for the latest week may be subject to revision. IMF data for the prior week are final.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 23, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS 2-YEAR NOTES

The Treasury will auction $25,000 million of 2-year notes to refund $21,098 million of publicly held notes maturing June 30, 2003, and to raise new cash of approximately $3,902 million.

In addition to the public holdings, Federal Reserve Banks hold $6,700 million of the maturing notes for their own accounts, which may be refunded by issuing an additional amount of the new security.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

TreasuryDirect customers requested that we reinvest their maturing holdings of approximately $621 million into the 2-year note.

The auction will be conducted in the single-price auction format. All competitive and noncompetitive awards will be at the highest yield of accepted competitive tenders. The allocation percentage applied to bids awarded at the highest yield will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

The notes being offered today are eligible for the STRIPS program.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS 495

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF
2-YEAR NOTES TO BE ISSUED JUNE 30, 2003

June 23, 2003

Offering Amount	$25,000 million
Maximum Award (35% of Offering Amount)	$ 8,750 million
Maximum Recognized Bid at a Single Rate	$ 8,750 million
NLP Reporting Threshold	$ 8,750 million

Description of Offering:

Term and type of security	2-year notes
Series	M-2005
CUSIP number	912828 BC 3
Auction date	June 25, 2003
Issue date	June 30, 2003
Dated date	June 30, 2003
Maturity date	June 30, 2005
Interest rate	Determined based on the highest accepted competitive bid
Yield	Determined at auction
Interest payment dates	December 31 and June 30
Minimum bid amount and multiples	$1,000
Accrued interest payable by investor	None
Premium or discount	Determined at auction

STRIPS Information:

Minimum amount required	$1,000
Corpus CUSIP number	912820 HZ 3
Due date(s) and CUSIP number(s) for additional TINT(s)	June 30, 2005 - - 912833 ZJ 2

Submission of Bids:

Noncompetitive bids:

Accepted in full up to $5 million at the highest accepted yield.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a yield with three decimals, e.g., 7.123%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all yields, and the net long position equals or exceeds the NLP reporting threshold stated above.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders:

Prior to 12:00 noon eastern daylight saving time on auction day

Competitive tenders:

Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date, or payment of full par amount with tender. *TreasuryDirect* customers can use the Pay Direct feature which authorizes a charge to their account of record at their financial institution on issue date.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 23, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	183-Day Bill
Issue Date:	June 26, 2003
Maturity Date:	December 26, 2003
CUSIP Number:	912795PC9

High Rate: 0.840% Investment Rate 1/: 0.858% Price: 99.573

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 44.73%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 26,212,803	$ 17,134,150
Noncompetitive	816,113	816,113
FIMA (noncompetitive)	50,000	50,000
SUBTOTAL	27,078,916	18,000,263 2/
Federal Reserve	6,417,177	6,417,177
TOTAL	$ 33,496,093	$ 24,417,440

Median rate 0.815%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.790%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 27,078,916 / 18,000,263 = 1.50

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $619,516,000

JS 496

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 23, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	91-Day Bill
Issue Date:	June 26, 2003
Maturity Date:	September 25, 2003
CUSIP Number:	912795NP2

High Rate: 0.815% Investment Rate 1/: 0.830% Price: 99.794

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 32.92%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 28,235,689	$ 15,488,564
Noncompetitive	1,376,510	1,376,510
FIMA (noncompetitive)	135,000	135,000
SUBTOTAL	29,747,199	17,000,074 2/
Federal Reserve	6,131,549	6,131,549
TOTAL	$ 35,878,748	$ 23,131,623

Median rate 0.795%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.750%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 29,747,199 / 17,000,074 = 1.75

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,090,061,000

JS 497

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 24, 2003
JS-498

Remarks of Peter R. Fisher
Under Secretary for Domestic Finance
to
American Securitization Forum
New York, NY

Our credit markets are adjusting to the prospect of price stability. We can now better observe real rates across time and among different borrowers. As a consequence, we can also better observe the shortcomings of current investor disclosures in providing the information needed to portray accurately risk-reward prospects in a world of derivatives and of structured credit products.

Some attention has recently been given to the risks of deflation. While a sustained decline in the general price level is a possibility, it is still one to which a rather low probability should be attached. A higher probability should be attached to the "risk" that we will see a period of sustained price stability. Recognizing the modest upward bias and the inevitable noise in our measures of inflation, we now appear to be at effective price stability.

The question for monetary policy, which I will *not* address, is how to sustain effective price stability. The question for our credit markets, which I intend to address, is how to adjust to a world of price stability in which attention is more clearly focused on credit quality.

An environment of price stability, if sustained, will be characterized by low variance in the general price level and by expectations for more symmetric deviations from the current price level than we have experienced over the last thirty years. If such an environment takes hold, credit market participants will come to expect that prices are as likely to rise modestly as to fall modestly, within a narrow range. One consequence is that we will more readily observe both movements in aggregate real rates and the variance in real borrowing costs experienced by different borrowers.

While we have all understood that real rates change over time, during the recent decades of rising and falling inflation we have tended to focus on the movements in nominal rates as explained by changes in inflation and inflation expectations. We have also fallen into the bad habit of assuming that changes in inflation are the principle source of volatility in real asset values.

We should have known all along that real rates can also move around. But now that we seem to have entered a period of price stability the observed variance in real rates is slapping us in the face. While an imperfect measure of real rates, the Treasury's inflation-protected ten-year note provides some evidence of recent changes in aggregate real rates. The real yield on the 10-year TIPS peaked at 4.4 percent in early 2000 and now, just three years later, has fallen in recent weeks to between 1.4 and 1.6 percent, while implied inflation expectations moved in a narrower range.

Those of us inclined to make the simplifying assumption of a constant 2 or 3 percent long-run, real cost of capital, as suggested by economic historians, will need to think about the meaning of a greater than 50 percent decline in observed real rates in the space of a few years. Those of you with risk management responsibilities will need to think carefully about your efforts to achieve 4 or 5 percent risk-adjusted, real returns in a world that may only be offering a riskless, real rate of less than 2 percent.

Removing aggregate inflation from the list of uncertainties allows investors to identify more clearly good managerial decisions from poor ones, sustainable cash flows from unsustainable ones. Managers who are able to identify and expand markets where their firms have pricing power will enjoy persistently lower real costs of borrowing; whereas firms that face stiff competition will tend to face higher real borrowing costs.

With greater attention focused on credit quality, securitized assets should be able to perform well, given the *relative* simplicity and clarity of their cash flows and risk characteristics compared to the complexities and uncertainties associated with major corporate balance sheets. However, if our traded credit markets are going to prosper in a world of increased attention to credit quality, *all* issuers of credit instruments will need to provide investors with disclosures that accurately portray the risk-reward characteristics of the non-linear and probabilistic claims on cash flows that are now routinely embedded in the structured products that investors hold both directly and indirectly.

Our existing disclosure paradigm is not adequate for this task.

The mindset that dominates current disclosure and accounting practices continues to focus on *identifying facts (about the past) that are precisely comparable between different firms and credits.* The risk management mindset – which inspired the development of our exchange-traded and over-the-counter derivative markets and still dominates financial management today – focuses on *comprehending the probabilities of likely and unlikely future deviations from particular desired or expected outcomes.* As a consequence, our disclosure regime is inadequate for the task of informing investors about the financial underpinnings of the products in which they invest.

There are "just" two topics that need to be addressed to come up with a new disclosure paradigm: first, the non-linear nature of contingent financial claims; and, second, the subjective nature of risk.

Before even turning to the complexity of derivatives, we should acknowledge that there is no single perspective from which to consider accounting and disclosure. Shareholders and creditors have different interests. Generally accepted accounting principles are different from regulatory accounting principles and regulatory capital is different from shareholder equity. There is also the additional perspective of tax accounting. So we must be careful to avoid the assumption of a single "right" answer.

The non-linear nature of optionality drives much of the complexity of derivative instruments and poses a significant but manageable challenge for disclosure practices. For example, investors need to understand different facts about an option at different stages in an option's life cycle. To prevent too many eyes from glazing over at the mention of non-linearity, let me try an analogy.

Turning to biology, imagine a short list of attributes needed to describe a caterpillar: length, width, color and number of legs. Perfectly adequate to the task of portraying caterpillars, these four attributes will not portray very well the features of butterflies. Precise comparisons of caterpillars and butterflies using just these few attributes may well mislead and confuse. To describe the non-linear process of metamorphosis we need something more than a precise comparison of key facts about caterpillars or even key facts about butterflies.

More importantly, we are not just interested in observing facts. To carry the analogy to investors forward, we are going to be keenly interested in whether these particular caterpillars are likely to turn into butterflies or whether they are likely to become moths. We are not principally interested in comparing caterpillars to caterpillars. We *are* interested in those attributes of caterpillars which help us comprehend the probability of the hoped for transformation into butterflies.

This brings up the subjective nature of risk. Risk is deviation from a particular goal or objective. You cannot understand risk without first articulating an objective. The "intended", the "desired" or the "expected" path must be identified before you can think clearly about likely and unlikely deviations.

In the world of derivative accounting and disclosure, this issue is frequently boiled down to the question: Is it the asset or is it the hedge? Without a clear statement of objective it is difficult to answer that question. But if you have a clear understanding of the objective (or, at least, of the expected outcome) then you can articulate the risks being managed and, therefore, identify which is the asset and which is the hedge.

The particular challenge for accounting and disclosure of derivatives is that this hinges on something as subjective as *intention* and *expectation*. This poses a host of problems about "changing our minds". But for the present purpose, I want to draw attention to the problem of framing disclosures to investors that will help them better understand the probability of deviations from particular *desired* outcomes.

Compared with this, coming up with formats for disclosing the non-linearity of options and related exposures is just a technical challenge of identifying those features that best foreshadow the probabilities of different outcomes and those that best summarize the course of the transformation.

The subjective nature of risk poses two significant challenges for disclosure practices. First, it suggests that there is no single, correct way to account for or disclose a particular set of sliced and spliced contingent cash flows; we must look to the objective to understand the significance of particular assets and liabilities. Second, accurate disclosure will require borrowers to be specific about their objectives and to be transparent about deviations from their objectives – that is, to be transparent about their failures or, perhaps we should more kindly say, their "un-successes".

The comparisons that we need to see are not principally between the simple facts about Borrower A and Borrower B. Rather, we want to understand the relative success of Borrower A at managing deviation from *his* objective compared with the success of Borrower B at managing deviation from *his* objective. Their objectives may be quite different but we ought to be able to compare their "risk management acumen".

This is a major hurdle for improving disclosure practices. I used to think that improvements in investor disclosures were principally held back by a "first mover" problem. Upon reflection, I now think that it is the double hurdle of the first mover problem and the reluctance to be clear about "un-successes" that make it so difficult to achieve improvements in disclosure practices.

This is where you come in. You have the opportunity to overcome this hurdle.

You can compete with one another on the basis of the quality of the information you provide investors without it reflecting on the capabilities of any individuals. Securitized assets don't have "intent". Structured pools of mortgages, credit card receivables and auto loans don't have their own "objectives" and they can't be embarrassed when they experience unlikely outcomes. They have only expected outcomes and likely and unlikely deviation from those expected outcomes. So it is much easier for issuers of securitized assets to provide more detailed information about expected outcomes and the probabilities of deviations from those expectations.

In addition, you have already gotten over the first mover problem. To compete with one another, and with other credit products, issuers in your industry already do compete on the basis of the information you provide about the pools of assets you securitize. You need only reinvigorate your efforts to improve disclosures to present more accurately the non-linear and probabilistic attributes of the claims on cash flows embedded in your products.

In closing let me note that the pressure on all issuers of credit instruments to disclose more and more information of marginal utility to investors is a function of investor discomfort with an inadequate disclosure paradigm. Until the paradigm is shifted to one that better reflects the characteristics of the risks that investors face, our credit markets will continue to hear demands for *more* disclosure when what is needed is *better* disclosure.

You can continue to let the costs mount – the burdens of both additional, unhelpful disclosures and of unhappy investors – or you can try to give investors the information they need to understand your products on the same terms that you do. I do not mean to suggest that this will be easy, but I do think it's important.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 24, 2003
JS-499

U.S. Treasurer Salutes Columbus, OH Financial Education Program

U.S. Treasurer Rosario Marin today formally recognized the Ohio Credit Union League's Latino Financial Literacy Program with an honorary certificate of recognition from the Treasury Department for the program's efforts in teaching financial education to Columbus' Hispanic community.

"The Ohio Credit Union League's Latino Financial Literacy Program is doing an outstanding job of educating Columbus-area Hispanics about the basic building blocks of personal finance," said Treasurer Marin. "A strong foundation of financial literacy is key to helping these families succeed in their pursuit of the American Dream."

Following the presentation of the certificate, Treasurer Marin assisted in teaching a Spanish-language financial education class where students are learning about saving, managing money and handling credit. Representing the fastest growing ethnic population in the United States, Hispanics have a combined purchasing power of more than $450 billion. Yet research and surveys reveal that 43 percent of Hispanics in the United States report knowing little about retirement planning, and as many as 25 percent do not have a bank account.

The Latino Financial Literacy Program, now in its second year, is a four-session course providing instruction on financial goals and spending; developing a budget; establishing and maintaining a good credit history; and managing a bank account and other financial instruments. In its first year, 225 people attended the course and received a certificate of graduation. The program is sponsored by the Ohio Credit Union League in partnership with the Ohio State University Extension Office.

The Treasury Department in 2002 established the Office of Financial Education to strengthen the financial literacy of all Americans, and to provide guidance to organizations providing financial education programs. The Office works to ensure that people can gain the practical knowledge and skills that they need to make informed financial choices throughout various life stages. It focuses on four key areas: basic savings, credit management, homeownership and retirement planning. More information can be found at www.treasury.gov.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 24, 2003
JS-500

U.S. Treasury Secretary John W. Snow
Statement regarding the death of IRS employee LaToya Taylor
June 24 2003
Washington, DC

I would like to convey the sadness that everyone in the United States Treasury Department feels on learning of the loss of LaToya Taylor. Ms. Taylor was a dedicated mother and public servant, and her passing is all the more heartbreaking for coming so early in her career. Our sincere condolences go to her family on this day.

federal financing bank NEWS
WASHINGTON, D.C. 20220

FEDERAL FINANCING BANK

2003 PRESS RELEASE

June 2003

Brian Jackson, Chief Financial Officer, Federal Financing Bank (FFH) announced the following activity for the month of June 2003.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $36.4 billion on June 30, 2003, posting a decrease of $21.8 million from the level on May 31, 2003. This net change was the result of a decrease in holdings of government-guaranteed loans of $21.8 million. The FFB made 47 disbursements and received 14 prepayments during the month of June. The FFB also extended the maturities of 157 loans guaranteed by the Rural Utilities Service ("RUS") during the month of June.

Below are tables presenting FFB June loan activity and FFB holdings as of June 30, 2003.

FEDERAL FINANCING BANK
June 2003 ACTIVITY

Borrower	2003	Amt. Of Advance	Final Maturity Century 2000	Int. Rate	Semi-Annual or Quarterly
GOVERNMENT-GUARANTEED LOANS					

JS 501

GENERAL SERVICES ADMINISTRATION					
San Francisco OH	6/13	$132,507.93	8/1/2005	1.284%	Semi-Annually
ICTC Building	6/23	$359,121.74	11/2/2026	4.111%	Semi-Annually
San Francisco OB	6/23	$132,507.93	8/1/2005	1.380%	Semi-Annually
Foley Services Contract	6/25	$6,381.80	7/31/2025	3.935%	Semi-Annually
ICTC Building	6/25	$497,084.00	11/2/2026	4.004%	Semi-Annually
San Francisco Bldg Lease	6/26	$1,499,249.17	8/1/2005	1.449%	Semi-Annually
DEPARTMENT OF EDUCATION					
Barber-Scotia College	6/13	$659,914.75	3/1/2030	3.898%	Semi-Annually
Livingstone College	6/13	$67,310.00	7/1/2031	3.943%	Semi-Annually
Virginia Union Univ.	6/13	$29,695.86	1/2/2032	3.959%	Semi-Annually
Lincoln University	6/16	$417,753.13	1/2/2015	2.686%	Semi-Annually
Tuskegee Univ.	6/16	$977,046.65	1/2/2032	3.908%	Semi-Annually
RURAL UTILITIES SERVICE					
Associated Electric #894	6/02	$513,000.00	1/3/2033	4.147%	Quarterly
Deep East Texas Electric #872	6/02	$5,200,000.00	12/31/2036	4.237%	Quarterly
Jackson Purchase #755	6/03	$2,668,000.00	9/30/2005	1.405%	Quarterly
Karnes Elec. #203	6/04	$2,000,000.00	6/30/2004	1.074%	Quarterly
South Miss. Elec. #691	6/04	$1,235,000.00	12/31/2030	4.065%	Quarterly
Butler Rural Elec. #578	6/05	$1,028,554.00	1/3/2034	4.125%	Quarterly
Cornbelt Power #565	6/05	$3,746,000.00	1/3/2028	3.895%	Quarterly
Georgia Trans. Corp. #849	6/05	$20,319,000.00	12/31/2025	3.820%	Quarterly
Lake Region Elec. #737	6/05	$350,000.00	12/31/2030	4.033%	Quarterly
Carbon Power & Light #533	6/06	$401,000.00	10/1/2018	3.798%	Quarterly
S. Illinois Power #202	6/06	$6,907,000.00	1/3/2033	4.152%	Quarterly
Tri-State #202	6/06	$86,782,000.00	1/3/2033	4.154%	Quarterly
West Plains Elec. #501	6/06	$2,246,000.00	9/30/2003	1.158%	Quarterly
Darien Telephone Co. #719	6/09	$388,000.00	9/30/2003	1.038%	Quarterly
Habersham Electric Mem. #200	6/09	$4,400,000.00	9/30/2003	1.037%	Quarterly
Kankakee Valley Elec. #857	6/09	$1,200,000.00	12/31/2036	4.259%	Quarterly
Mid-Yellowstone Elec. #745	6/09	$518,000.00	12/31/2035	4.237%	Quarterly
Owen Electric #525	6/09	$3,263,000.00	9/30/2004	1.126%	Quarterly
Red River Valley #484	6/09	$1,000,000.00	1/3/2033	4.286%	Quarterly
South Texas Electric #845	6/11	$9,000,000.00	12/31/2024	3.666%	Quarterly
Irwin Electric #715	6/12	$324,000.00	1/2/2035	4.061%	Quarterly

McLennan County Elec. #784	6/12	$2,000,000.00	12/31/2035	3.928%	Quarterly
Sac Osage Electric Coop. #815	6/12	$1,182,000.00	12/31/2036	4.106%	Quarterly
Burt County Public #669	6/16	$256,000.00	1/2/2035	3.971%	Quarterly
Midstate Communications #780	6/16	$496,242.00	12/31/2018	3.091%	Quarterly
Navopache Electric #202	6/17	$10,000,000.00	6/30/2004	0.957%	Quarterly
Sumter Elec. #203	6/17	$4,800,000.00	12/31/2037	4.094%	Quarterly
Wild Rice Elec. #806	6/17	$888,000.00	12/31/2035	4.048%	Quarterly
Harrison County #799	6/18	$700,000.00	12/31/2035	4.131%	Quarterly
Rock County Electric #202	6/18	$734,000.00	12/31/2037	4.174%	Quarterly
Farmers Telephone #476	6/20	$7,257,000.00	9/30/2003	0.940%	Quarterly
Swan's Island Electric #203	6/20	$194,000.00	12/31/2036	4.255%	Quarterly
Southside Electric #786	6/23	$1,200,000.00	12/31/2035	4.276%	Quarterly
W. Farmers Elec. #701	6/23	$2,249,000.00	12/31/2025	3.913%	Quarterly
Canoochee Elec. #461	6/24	$1,801,000.00	12/31/2031	4.227%	Quarterly
Big Horn Rural Elec. #631	6/26	$550,000.00	1/3/2034	4.215%	Quarterly
*Amicalola Electric #664	6/30	$6,819,365.57	9/30/2003	0.871%	Quarterly
*Atlantic Telephone Mem. #805	6/30	$5,931,000.00	9/30/2003	0.871%	Quarterly
*Bailey County Elec. #856	6/30	$1,896,000.00	9/30/2003	0.871%	Quarterly
*Basin Electric #425	6/30	$12,913,671.12	9/30/2003	0.996%	Quarterly
*Big Sand Elec. #540	6/30	$764,209.79	9/30/2003	0.871%	Quarterly
*Big Sand Elec. #540	6/30	$573,157.33	9/30/2003	0.871%	Quarterly
*Big Sand Elec. #540	6/30	$958,194.61	9/30/2003	0.871%	Quarterly
*Big Sand Elec. #540	6/30	$2,228,508.17	9/30/2003	0.871°s	Quarterly
*Blue Grass Energy #674	6/30	$1,962,705.10	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$2,444,996.64	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,870,746.12	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,524,824.46	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,151,037.82	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,523,403.78	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$195,531.71	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,749,600.67	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,636,082.19	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$409,464.71	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$833,906.82	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$13,573.98	9/30/2003	0.871%	Quarterly

*Brazos Electric #917	6/30	$358,916.66	9/30/2003	0.871°s	Quarterly
*Brazos Electric #917	6/30	$336,676.37	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$2,819,037.97	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$746,790.11	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$819,671.04	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,252,097.74	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$315,224.59	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$727,084.76	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$949,347.43	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$632,205.65	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$363,484.26	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$679,563.31	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$827,154.23	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$266,731.44	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$193,583.18	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$1,715,601.82	9/30/2003	0.871%	Quarterly
*Brazos Electric #917	6/30	$2,003,726.66	9/30/2003	0.871%	Quarterly
*Brazos Electric #844	6/30	$4,614,000.00	9/30/2003	0.871%	Quarterly
*Brazos Electric #844	6/30	$5,000,000.00	9/30/2003	0.871%	Quarterly
*Brazos Electric #844	6/30	$5,000,000.00	9/30/2003	0.871%	Quarterly
*Brazos Electric #844	6/30	$5,000,000.00	9/30/2003	0.871%	Quarterly
*Brazos Electric #844	6/30	$5,000,000.00	9/30/2003	0.871%	Quarterly
*Brown County Elec. #687	6/30	$243,891.96	9/30/2003	0.871%	Quarterly
*Brown County Elec. #687	6/30	$585,340.72	9/30/2003	0.871%	Quarterly
*Brown County Elec. #687	6/30	$292,717.54	9/30/2003	0.871%	Quarterly
*Brown County Elec. #687	6/30	$637,811.22	1/2/2035	4.409%	Quarterly
*Citizens Elec. #742	6/30	$2,676,990.72	9/30/2003	0.871%	Quarterly
*Citizens Elec. #878	6/30	$3,000,000.00	9/30/2003	0.871%	Quarterly
*Clark Energy Coop. #611	6/30	$2,874,583.80	9/30/2003	0.871%	Quarterly
*Clark Energy Coop. #611	6/30	$1,910,233.35	9/30/2003	0.871%	Quarterly
*Clark Energy Coop. #611	6/30	$4,263,062.02	9/30/2003	0.871%	Quarterly
*Clark Energy Coop. #611	6/30	$3,565,180.71	9/30/2003	0.871%	Quarterly
*Clark Energy Coop. #611	6/30	$2,582,418.29	9/30/2003	0.871%	Quarterly
*Cumberland Valley #668	6/30	$4,097,385.03	9/30/2003	0.871%	Quarterly
*Cooper Valley Tel. #648	6/30	$976,864.44	9/30/2003	0.871%	Quarterly

*Darien Telephone Co. #719	6/30	$1,827,077.47	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$420,888.83	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$202,860.84	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$239,830.80	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$174,422.39	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$258,789.75	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$213,100.77	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$1,448,146.75	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$270,168.67	9/30/2003	0.871%	Quarterly
*Darien Telephone Co. #719	6/30	$533,112.73	9/30/2003	0.871%	Quarterly
*Delaware County Elec. #682	6/30	$356,027.15	1/2/2035	4.409%	Quarterly
*Delaware County Elec. #682	6/30	$908,279.41	1/2/2035	4.409%	Quarterly
*East River Power #453	6/30	$374,074.76	9/30/2003	0.996%	Quarterly
*East River Power #453	6/30	$184,482.28	9/30/2003	0.996%	Quarterly
*East River Power #601	6/30	$3,269,839..22	9/30/2003	0.871%	Quarterly
*East River Power #601	6/30	$4,334,934.98	9/30/2003	0.871%	Quarterly
*East River Power #793	6/30	$628,751.10	9/30/2003	0.871%	Quarterly
*Fairfield Elec. #684	6/30	$3,154,731.02	9/30/2003	0.871%	Quarterly
*Farmer's Telephone #459	6/30	$21,390.87	9/30/2003	0.996%	Quarterly
*Farmer's Telephone #459	6/30	$204,282.23	9/30/2003	0.996%	Quarterly
*Federal Rural Elec. #728	6/30	$993,565.42	6/30/2033	4.408%	Quarterly
*Fleming-Mason Energy #644	6/30	$2,491,305.95	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$1,341,472.42	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$1,437,291.89	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$2,108,028.11	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$1,341,472.42	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$2,906,741.04	9/30/2003	0.871%	Quarterly
*Fleming-Mason Energy #644	6/30	$2,880,605.31	9/30/2003	0.871%	Quarterly
*Freeborn-Mower Coop. #736	6/30	$735,936.01	9/30/2003	0.871%	Quarterly
*Freeborn-Mower Coop. #736	6/30	$490,638.42	9/30/2003	0.871%	Quarterly
*Freeborn-Mower Coop. #736	6/30	$197,436.62	9/30/2003	0.871%	Quarterly
*Freeborn-Mower Coop. #736	6/30	$198,701.29	9/30/2003	0.871%	Quarterly
*FTC Communications #709	6/30	$2,559,392.09	9/30/2003	0.871%	Quarterly
*FTC Communications #709	6/30	$3,273,226.37	9/30/2003	0.871%	Quarterly
*Grady Electric #690	6/30	$3,110,690.90	9/30/2003	0.871%	Quarterly

*Grady Electric #746	6/30	$3,209,438.33	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$1,149,833.52	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$574,916.77	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$958,194.61	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$1,241,370.59	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$980,554.79	9/30/2003	0.871%	Quarterly
*Grayson Rural Elec. #619	6/30	$2,483,276.80	9/30/2003	0.871%	Quarterly
*Greenbelt Elec. #743	6/30	$I,728,020.36	9/30/2003	0.871%	Quarterly
*Greenbelt Elec. #743	6/30	$498,830.49	9/30/2003	0.871%	Quarterly
*Grundy Elec. Coop. #744	6/30	$1,234,399.36	9/30/2003	0.871%	Quarterly
*Grundy Elec.Coop. #744	6/30	$987,652.44	9/30/2003	0.871%	Quarterly
*Harrison County #532	6/30	$954,297.91	9/30/2003	0.871%	Quarterly
*Harrison County #532	6/30	$858,868.13	9/30/2003	0.871%	Quarterly
*Harrison County #532	6/30	$960,736.24	9/30/2003	0.871%	Quarterly
*Harrison County #532	6/30	$1,566,634.65	9/30/2003	0.871%	Quarterly
*Harrison County #532	6/30	$1,686,673.36	9/30/2003	0.871%	Quarterly
*Hudson Valley Datanet #833	6/30	$5,000,000.00	9/30/2003	0.871%	Quarterly
*Hudson Valley Datanet #833	6/30	$2,000,000.00	9/30/2003	0.871%	Quarterly
*Inter-County Energy #592	6/30	$1,431,446.86	9/30/2003	0.087%	Quarterly
*Inter-County Energy #592	6/30	$1,908,595.83	9/30/2003	0.871%	Quarterly
*Inter-County Energy #592	6/30	$2,487,854.65	9/30/2003	0.871%	Quarterly
*Inter-County Energy #592	6/30	$211,761.00	9/30/2003	0.871%	Quarterly
*Inter-County Energy #85C	6/30	$4,000,000.00	9/30/2003	0.871%	Quarterly
*Inter-County Energy #850	6/30	$2,000,000.00	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$3,974,744.94	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$2,981,058.70	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$4,670,325.31	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$1,987,372.48	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$2,484,215.60	9/30/2003	0.871%	Quarterly
*Jackson Energy #794	6/30	$1,987,432.76	9/30/2003	0.871%	Quarterly
*Johnson County Elec. #482	6/30	$1,532,176.62	9/30/2003	0.996%	Quarterly
*Licking Valley Elec. #522	6/30	$2,623,364.96	9/30/2003	0.871%	Quarterly
*Licking Valley Elec. #854	6/30	$2,000,000.00	9/30/2003	0.871%	Quarterly
*Magnolia Electric #560	6/30	$4,777,660.79	9/30/2003	0.996%	Quarterly
*McLeod Coop. Power #554	6/30	$1,291,375.91	1/3/2034	4.383%	Quarterly

*Medina Electric #622	6/30	$2,796,530.60	6/30/2004	1.095%	Quarterly
*North Carolina RSA 3 Tele #200	6/30	$9,600,000.00	9/30/2003	0.871%	Quarterly
*New Horizon Elec. #791	6/30	$2,051,000.00	9/30/2003	0.871%	Quarterly
*Nolin Rural Elec. #528	6/30	$l,806,485.94	9/30/2003	0.871%	Quarterly
*Nolin Rural Elec. #577	6/30	$2,464,951.52	9/30/2003	0.871%	Quarterly
*Nolin Rural Elec. #577	6/30	$2,464,951.52	9/30/2003	0.871%	Quarterly
*Nolin Rural Elec. #840	6/30	$4,000,000.00	9/30/2003	0.871%	Quarterly
*Northstar Technology #811	6/30	$1,833,492.00	9/30/2003	0.871%	Quarterly
*Northstar Technology #811	6/30	$1,000,000.00	9/30/2003	0.871%	Quarterly
*Owen Electric #525	6/30	$1,911,260.56	9/30/2003	0.871%	Quarterly
*Owen Electric #525	6/30	$1,907,400.73	9/30/2003	0.871%	Quarterly
*Owen Electric #525	6/30	$962,318.27	9/30/2003	0.871%	Quarterly
*Owen Electric #525	6/30	$l,940,623.60	9/30/2003	0.871%	Quarterly
*Pennyrile Elec. #513	6/30	$5,845,008.43	9/30/2003	0.996%	Quarterly
*PRTCommunications #798	6/30	$4,802,000.00	9/30/2003	0.871%	Quarterly
*PRTCommunications #798	6/30	$1,800,000.00	9/30/2003	0.871%	Quarterly
*Rio Grand Electric #615	6/30	$340,555.32	l/03/2034	4.383%	Quarterly
*San Miguel Electric #919	6/30	$7,432,136.80	9/30/2003	0.871%	Quarterly
*San Miguel Electric #919	6/30	$7,803,830.61	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$941,534.40	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$941,534.40	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$470,767.20	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$941,534.40	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$941,534.40	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$956,971.40	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$963,201.28	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$2,225,082.62	9/30/2003	0.871%	Quarterly
*Surry-Yadkin Elec.	6/30	$1,000,000.00	9/30/2003	0.871%	Quarterly
*Tri-County Electric Ass. #830	6/30	$838,000.00	6/30/2033	4.451%	Quarterly
*United Elec. Coop. #870	6/30	$12,000,000.00	9/30/2003	0.871%	Quarterly
*Upsala Coop. Tele.	6/30	$277,268.51	l/02/2018	3.478%	Quarterly
*Webster Electric #705	6/30	$2,171,381.43	9/30/2003	0.871%	Quarterly

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FEDERAL FINANCING BANK HOLDINGS JUNE 2003

(in millions of dollars)

Program	*FEDERAL FINANCING June 30, 2003*	*BANK HOLDINGS May 31, 2003*	*Monthly Net Change 6/1/03- 6/30/03*	*Fiscal Year Net Change 10/1/02- 6/30/03*
Agency Debt:				
U. S. Postal Service	$7,273.4	$7,273.4	$0.0	($3,840.6)
Subtotal*	$7,273.4	$7,273.4	$0.0	($3,840.6)
Agency Assets:				
FmHA-RDIF	$950.0	$950.0	$0.0	$0.0
FmHA-RHIF	$82,530.0	$2,530.0	$0.0	$375.0
Rural Utilities Service-CBO	$42,702.0	$4.270.2	$0.0	$0.0
Subtotal*	$7,750.2	$7,750.2	$0.0	$375.0
Govt-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,751.9	$1,790.1	$38.2	$170.6
DoEd-HBCU+	$78.4	$76.2	$2.2	$9.7
DHUD-Comm. Dev. Block Grant	$3.8	$3.8	$0.0	$1.3
DHUD-Public Housing Notes	$1,133.2	$1,133.2	$0.0	$74.1
General Services Administration+	$2,150.4	$2,168.8	($18.4)	($55.2)
DOI-Virgin Islands	$10.1	$10.1	$0.0	($1.3)
DON-Ship Lease Financing	$705.3	$705.3	$0.0	($75.4)
Rural Utilities Service	$15,418.7	$15,383.4	$35.3	$1,360.4
SBA-State/Local Devel. Cos.	$82.6	$85.3	($2.7)	($19.8)
DOT-Section 511	$3.1	$3.2	$0.0	($0.1)
Subtotal*	$21,337.5	$21,359.3	$21.8	$972.4
Grand total*	**$36,361.1**	**$36,383.0**	**($21.8)**	**$3,243.2**

**figures may not total due to rounding; +does not include capitalized interest*

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 24, 2003
JS-502

U.S. Designates 55 Most Wanted Iraqi Officials
Part of Ongoing Effort to Secure and Return Iraqi Assets to the Iraqi People

WASHINGTON, DC – The U.S. Treasury Department has today designated 55 former senior Iraqi officials, the Department of Defense's 55 most wanted Iraqis or the so-called "deck of cards," in an effort to secure and return their assets to the Iraqi people. These names have been added to the Office of Foreign Assets Control's Specially Designated Nationals (SDN) list, freezing any accounts in U.S. jurisdiction and prohibiting transactions with U.S. persons. According to the Department of Defense, 32 of the 55 designated today have been captured or have surrendered to coalition forces.

Additionally, the United States will submit these names to the United Nations for designation under UNSCR 1483 which requires all member states to freeze without delay funds or other financial assets or economic resources of Iraqi state bodies, corporations, or agencies located outside of Iraq, as well as funds or economic resources removed by Saddam Hussein, senior officials of the former Iraqi regime, and their immediate families. Any assets belonging to these individuals must be returned to the Development Fund for Iraq and used for the good of the Iraqi people as required under the resolution.

"Today's designation is yet another step in Treasury's effort to locate the assets plundered by Saddam Hussein and his cronies and return them to their rightful owners – the Iraqi people. As with any assets of the former Iraqi regime, any funds found will be used to help the people of Iraq as they rebuild their country after more than two decades of tyranny," Secretary Snow stated.

This action continues Treasury's effort to find, secure and return assets of the former Iraqi regime to the Iraqi people. The Treasury Department has already returned over $660 million dollars in Iraqi assets previously frozen in the U.S. to Iraq where it has been used to pay civil servants and pensioners and to provide capital for Iraqi Ministries as they resume operation. Additionally, the Treasury Department, working with allies, has located well over $1.2 billion dollars in previously unknown Iraqi assets and is working to facilitate the return of those assets to the Iraqi people through the Development Fund for Iraq.

A list of those designated is attached.

Former Senior Iraqi Officials Designated June 24, 2003

Saddam Hussein al-Tikriti
DOB 28 Apr 1937, POB al-Awja, near Tikrit, Iraq; President since 1979; nationality Iraqi.
a.k.a. Abu Ali

Qusay Saddam Hussein al-Tikriti
DOB1965; alt. DOB 1966; POB Baghdad, Iraq; Saddam's second son; oversaw Special Republican Guard, Special Security Organization, and Republican Guard; nationality Iraqi.

Uday Saddam Hussein al-Tikriti

DOB 1964; alt. DOB 1967; POB Baghdad, Iraq; Saddam's eldest son; leader of paramilitary organization Fedayeen Saddam; nationality Iraqi.

Abid Hamid Mahmud al-Tikriti
DOB circa 1957; POB al-Awja, near Tikrit, Iraq; Saddam's presidential secretary and key advisor; nationality Iraqi.
a.k.a. Abid Hamid bid Hamid Mahmud
a.k.a. Col. Abdel Hamid Mahmoud
a.k.a. Abed Mahmoud Hammud

Ali Hassan al-Majid al-Tikriti
DOB 1943; POB al-Awja, near Tikrit, Iraq; presidential advisor and senior member of Revolutionary Command Council; nationality Iraqi.
a.k.a. al-Kimawi

Izzat Ibrahim al Duri
DOB circa 1942; POB al-Dur, Iraq; deputy commander-in-chief of Iraqi military; deputy secretary, Ba'th party regional command; vice chairman, Revolutionary Command Council; nationality Iraqi.
a.k.a. Abu Brays

Hani abd-al-Latif Tilfah al-Tikriti
DOB circa 1962; POB al-Awja, near Tikrit, Iraq; #2 in Special Security Organization; nationality Iraqi.

Aziz Salih al-Numan
DOB 1941; alt. DOB 1945; POB An Nasiriyah, Iraq; Ba'th party regional command chairman; nationality Iraqi.

Muhammad Hamza Zubaidi
DOB 1938; POB Babylon, Babil Governorate, Iraq; former prime minister; nationality Iraqi.

Kamal Mustafa Abdallah
DOB 1952; alt. DOB 4 May 1955; POB Tikrit, Iraq; Republican Guard Secretary; led Special Republican Guard and commanded both Republican Guard corps; nationality Iraqi.
a.k.a. Kamal Mustafa Abdallah Sultan al-Tikriti

Barzan abd al-Ghafur Sulaiman Majid al-Tikriti
DOB 1960; POB Salah al-Din, Iraq; commander, Special Republican Guard; nationality Iraqi.
a.k.a. Barzan Razuki abd al-Ghafur

Muzahim Sa'b Hassan al-Tikriti
DOB circa 1946; alt. DOB 1949 al-Awja, near Tikrit, Iraq; led Iraq's Air Defense Forces; Deputy Director, Organization of Military Industrialization; nationality Iraqi.

Ibrahim Ahmad abd al-Sattar Muhammed al-Tikriti
DOB 1943; alt. DOB 1950; alt. DOB 1952; POB Ba'qubah or al-Sumayda/Shirqat, Iraq; armed forces chief of staff; nationality Iraqi.

Saif-al-Din Fulayyih Hassan Taha al-Rawi
DOB 1953; POB Ar Ramadi, al-Anbar Governorate, Iraq; Republican Guard chief of staff; nationality Iraqi.
a.k.a. Ayad Futayyih al-Rawi

Rafi abd-al-Latif Tilfah al-Tikriti
DOB circa 1954; POB Tikrit, Iraq; Director, Directorate of General Security; nationality Iraqi.

Tahir Jalil Habbush al-Tikriti
DOB 1950; POB Tikrit, Iraq; director of Iraqi Intelligence Service; nationality Iraqi.

Hamid Raja Shalah al-Tikriti
DOB 1950; POB Bayji, Salah al-Din Governorate, Iraq; air force commander; nationality Iraqi.

a.k.a. Hamid Raja-Shalah Hassan al-Tikriti
a.k.a. Hamid Raja-Shalah Hassum al-Tikriti

Latif Nusayyif Jasim al-Dulaymi
DOB circa 1941; POB Ar-Rashidiya suburb of Baghdad, Iraq; Ba'ath party military bureau deputy chairman; nationality Iraqi.

Abd-al-Tawab Mullah Huwaysh
DOB 1957; alt. DOB 14 March 1942; POB Mosul or Baghdad, Iraq; deputy prime minister; director, Organization of Military; nationality Iraqi.

Taha Yassin Ramadan al-Jizrawi
DOB circa 1938; vice president since 1991; nationality Iraqi.

Rukan Razuki abd-al-Ghafur Sulaiman al-Tikriti
DOB 1956; POB Tikrit, Iraq; head of Tribal Affairs Office in presidential office; nationality Iraqi.
a.k.a. Rukan abdal-Ghaffur Sulayman al-Majid
a.k.a. Rukan abd al-Gafur al-Majid
a.k.a. Rukan abd al-Ghaffur al-Majid al-Tikriti
a.k.a. Rukan Razuqi abd al-Gahfur al-Majid
a.k.a. Rukan 'abd al-Ghaffur al-Majid al-Tikriti
a.k.a. Abu Walid

Jamal Mustafa Abdallah Sultan al-Tikriti
DOB 4 May 1955; POB al-Samnah, near Tikrit, Iraq; deputy head of tribal affairs in presidential office; nationality Iraqi.

Mizban Khadr Hadi
DOB 1938; POB Mandali District, Diyala, Iraq; member, Ba'th party regional command and Revolutionary Command Council since 1991; nationality Iraqi.

Taha Muhyi-al-Din Ma'ruf
DOB 1924; POB Sulaymaniyah, Iraq; Vice President; member of Revolutionary Command Council; nationality Iraqi.

Tariq Aziz
DOB 1 Jul 1936; POB Mosul or Baghdad, Iraq; Deputy Prime Minister; NO34409/129 (July 1997); nationality Iraqi.
a.k.a. Tariq Mikhail Aziz

Walid Hamid Tawfiq al-Tikriti
DOB circa 1950; POB Tikrit, Iraq; Governor of Basrah; nationality Iraqi.
a.k.a. Walid Hamid Tawfiq al-Nasiri

Sultan Hashim Ahmad al-Tai
DOB circa 1944; POB Mosul, Iraq; Minister of Defense; nationality Iraqi.

Hikmat Mizban Ibrahim al-Azzawi
DOB 1934; POB Diyala, Iraq; Deputy Prime Minister and Finance Minister; nationality Iraqi.

Mahmud Dhiyab al-Ahmad
DOB 1953; POB Mosul or Baghdad, Iraq; Minister of Interior; nationality Iraqi.

Ayad Futayyih Khalifa al-Rawi
DOB 1942; POB Rawah, Iraq; Quds Force Chief of Staff; nationality Iraqi.

Zuhair Talib abd-al-Sattar al-Naqib
DOB circa 1948; Director, Military Intelligence; nationality Iraqi.

Amir Hamudi Hassan al-Sa'di
DOB 5 Apr 1938; POB Baghdad, Iraq; presidential scientific advisor; Passport No. NO33301/862, issued 17 October 1997, expires 1 October 2005; Passport No. M0003264580; Passport No. H0100009, issued 1 May 2002; nationality Iraqi.

Amir Rashid Muhammad al-Ubaidi

DOB 1939; POB Baghdad, Iraq; Minister of Oil; nationality Iraqi.

Husam Muhammad Amin al-Yassin
DOB 1953; alt. DOB 1958; POB Tikrit, Iraq; head, National Monitoring Directorate; nationality Iraqi.

Muhammad Mahdi al-Salih
DOB 1947 alt. DOB 1949, al-Anbar Governorate, Iraq; Minister of Trade; nationality Iraqi.

Sab'awi Ibrahim Hassan al-Tikriti
DOB 1947; POB Tikrit, Iraq; presidential advisor; half-brother of Saddam Hussein; nationality Iraqi.

Watban Ibrahim Hassan al-Tikriti
DOB 1952; POB Tikrit, Iraq; presidential advisor; half-brother of Saddam Hussein; nationality Iraqi.
a.k.a. Watab Ibrahim al-Hassan

Barzan Ibrahim Hassan al-Tikriti
DOB 1951; POB Tikrit, Iraq; presidential advisor; half-brother of Saddam Hussein; Passport No. M0001666/970; Passport No. NM0000860/114; Passport No. M0009851/1; nationality Iraqi.

Huda Salih Mahdi Ammash
DOB 1953; POB Baghdad, Iraq; member, Ba'ath party regional command; nationality Iraqi.

Abd-al-Baqi abd-al-Karim Abdallah al-Sad'un
DOB 1947; Ba'th party regional command chairman, Diyala; nationality Iraqi.

Muhammad Zimam abd-al-Razzaq al-Sa'dun
DOB 1942; POB Suq ash-Shuyukh District, Dhi-Qar, Iraq; Ba'th party regional chairman, at-Tamim nationality Iraqi.

Samir abd al-Aziz al-Najim
DOB 1937; POB 1938, Baghdad, Iraq; Ba'th party regional command chairman, East Baghdad; nationality Iraqi.

Humam abd-al-Khaliq abd-al-Ghafur
DOB 1945; POB ar-Ramadi, Iraq; Minister of Higher Education and Research; M0018061/104, issued 12 September 1993; nationality Iraqi.
a.k.a. Humam 'abd al-Khaliq 'abd al-Rahman
a.k.a. Humam 'abd al-Khaliq Rashid

Yahia Abdallah al-Ubaidi
Ba'th party regional command chairman, al-Basrah; nationality Iraqi.

Nayif Shindakh Thamir Ghalib
Ba'th party regional command chairman, an-Najaf; member; Iraqi National Assembly; nationality Iraqi.

Saif-al-Din al-Mashhadani
DOB 1956; POB Baghdad, Iraq; Ba'th party regional command chairman, al-Muthanna; nationality Iraqi.

Fadil Mahmud Gharib
DOB 1944; POB Dujail, Iraq; Ba'th party regional command chairman, Babil; chairman, General Federation of Iraqi Trade Unions; nationality Iraqi.
a.k.a. Gharib Muhammad Fazel al-Mashaikhi

Muhsin Khadr al-Khafaji
Ba'th party regional command chairman, al-Qadisiyah; nationality Iraqi.

Rashid Taan Kazim
Ba'th party regional command chairman, al Anbar; nationality Iraqi.

Ugla Abid Saqar al-Kubaysi
DOB 1944; POB Kubaisi, al-Anbar Governorate, Iraq; Ba'th party regional command chairman, Maysan; nationality Iraqi.
a.k.a. Saqr al-Kabisi abd Aqala

Ghazi Hammud al-Ubaidi
DOB 1944; POB Baghdad, Iraq; Ba'th party regional command chairman, Wasit; nationality Iraqi.

Adil Abdallah Mahdi
DOB 1945; POB al-Dur, Iraq; Ba'th party regional command chairman, Dhi Qar; nationality Iraqi.

Hussein al-Awadi
Ba'th party regional command chairman, Ninawa; nationality Iraqi.

Khamis Sirhan al-Muhammad
Ba'th party regional command chairman, Karbala; nationality Iraqi.
a.k.a. Dr. Khamis

Sa'd abd-al-Majid al-Faysal al-Tikriti
DOB 1944; POB Tikrit, Iraq; Ba'th party regional command chairman, Salah al-Din; nationality Iraqi.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-503

Wayne A. Abernathy Assistant Secretary for Financial Institutions U.S. Department of The Treasury Before The Subcommittee on Financial Institutions and Consumer Credit Of The Committee On Financial Services U.S. House of Representatives

Chairman Bachus, Ranking Member Sanders, and members of the Sub-Committee, I appreciate the opportunity to appear before you this morning to talk about an important issue: expanding access to mainstream financial institutions, such as banks, thrifts, and credit unions, for all individuals. Mr. Chairman, I commend you for focusing a national spotlight on this critical issue by convening today's hearing. I look forward to updating you this morning on the Treasury Department's efforts in this area.

The Treasury Department strongly believes that everyone should have the opportunity to establish a banking relationship with a regulated and insured financial institution. An account at an insured depository institution is a basic tool for individuals to build their own financial security.

While most Americans already have the comfort of keeping their money in insured accounts, other Americans use financial services of a different sort. They cash checks at a neighborhood storefront and pay bills in cash or with money orders. There may be a variety of reasons for this, but it is usually expensive, occasionally dangerous, and rarely the best option.

There are few reliable statistics available regarding the true size of the U.S. population who have no accounts with insured financial institutions. Some estimates indicate, however, that as many as one in ten families, or approximately ten million households, may not have bank accounts.

Given the size of the population without mainstream financial institution relationships, the obvious question is why do so many people remain outside of the mainstream. Are they shut out of the system or have they made a conscious choice not to do business at traditional financial institutions? Surveys on this issue reveal varied responses to these questions. Some individuals cite financial reasons for not maintaining a bank, thrift, or credit union account; they say that bank fees or minimum balance requirements are too high. Other individuals suggest that they choose to use non-bank financial services because the types of accounts offered by traditional financial institutions do not meet their needs. For example, a person may not write enough checks or have enough month-to-month savings to make it worthwhile to maintain an account. Attitudes toward banks also appear to be a factor as a large number of people surveyed indicated that they are not comfortable dealing with banks or letting them know their personal financial information.

It is clear that there is no single reason that applies to all of the many people in the United States who do not have a relationship with a mainstream financial institution. It also seems clear that there is no single solution. Yet, because there are significant advantages to establishing an account at a bank, thrift, or credit union, the Treasury Department is committed to efforts whereby people have the knowledge to choose and the ability to access the financial services that in their view serve them best. Such choice, however, is illusory if people do not have accurate and adequate information, together with sufficient understanding of how to use that information, that will enable them to make educated decisions and access a range of financial services providers.

Consumers using non-bank financial services typically pay higher costs in the form of transaction fees for financial services than individuals with banking relationships. Recent Treasury research indicates that a worker can pay an average of $18 per month for cashing paychecks at a non-bank check casher. A Social Security recipient would pay an average of $9-16 a month to cash his or her government check. Relying on alternative service providers as a source of credit is similarly more expensive. The costs of loans from pawnshops, car-title lenders, payday lenders, and small loan companies can be very high as relative to the amounts borrowed.

Individuals also face heightened safety and security risks as a result of conducting financial transactions in cash. Carrying large amounts of cash is dangerous and keeping cash at home is not a whole lot safer. There have been a number of news stories describing how criminals have specifically targeted immigrants for robbery as they leave check cashing outlets because of the likelihood that these individuals are carrying a significant amount of cash. And we are all familiar with tragic cases of people losing their life savings in fires because they kept it hidden in their homes in the form of cash. Unlike traditional depository institutions, alternative financial services providers cannot offer their customers insured deposit account products. Deposit accounts at insured financial institutions offer a safe place to keep money until the depositor is ready to spend or invest it.

It is not that we question the validity of products offered by alternative service providers. They can offer the advantages of immediacy and convenience, or other specialized services for specialized circumstances, for which the providers charge a premium. But America is in the choice business. Rather than seek to close down legitimate alternative services providers, we would like to continue the progress in this nation of expanding the choices available to consumers, as well as consumers' ability to understand and make use of those choices.

Establishing a banking relationship is taking a key step toward building a promising financial future. Individuals lacking basic financial services may have a reduced ability to manage their finances, and may be limited in planning and saving for the future. Without a banking account, it is nearly impossible to establish a strong credit record, which in turn is necessary to qualify for a good car loan, home mortgage, or small business loan at reasonable rates. A traditional banking relationship offers the account holder an opportunity to become familiar with fundamental financial concepts that are critical in asset building, and bank accounts are tools to help families establish and fulfill their savings goals and manage their money. And saving is the foundation for investment.

Greater use of mainstream banking services also aids in our country's fight against money laundering. As individuals move their money from informal financial services providers and rely more upon safer, insured depository institutions, the funds are removed from paths more likely to be frequented by those engaged in illegal activity.

The Treasury Department's most visible initiative to provide greater access to financial services is the First Accounts program. Through this program, Treasury has funded projects to connect low- and moderate-income individuals with mainstream financial services. The paramount goal of First Accounts is to assist a maximum number in establishing accounts with insured depository institutions. The fifteen First Accounts pilot programs provide an opportunity for Treasury to evaluate a variety of experiments intended to increase participation in mainstream financial institutions.

Additional goals of the program include the provision of financial education to the individuals served by the pilot programs to enhance the sustainability of the new financial relationships. Having relatively recently completed award allocation, our next step is to undertake research to evaluate the success of the funded projects and to understand what products, services, educational initiatives, marketing techniques, or incentives are most effective in achieving the goals of the First Accounts program. Although it is too early to predict because many of the projects have not yet reached their midway point, the Treasury Department has great hope that the pilot programs funded through First Accounts will provide a wealth of practical insight on how to develop replicable, self-sustaining programs for assisting a significant number of individuals to establish banking relationships with insured depository institutions.

Let me also highlight some other initiatives that Treasury is working on related to this effort. First, we have a number of activities underway that are aimed at improving financial education. A key function of the Office of Financial Education is to identify sound, effective financial education programs around the country and highlight their efforts. Many of the individuals who need these programs do not even know about them. The attention that the Treasury Department can bring to the programs will help connect individuals in need to good financial education programs. In addition, these financial education programs will then serve as examples for other programs. For instance, earlier this week, Treasurer Rosario Marin was in Columbus, Ohio, to recognize the Ohio Credit Union League's Latino Financial Literacy Program, which has provided classes for more than 200 Hispanics in the Columbus area. The program includes many of the criteria that we have identified for effective programs, especially the inclusion of tools to measure results, and hopefully this program will expand throughout Ohio.

Our financial education initiatives at the Treasury Department are an important component of a larger, government-wide effort. We have been privileged to partner with some of the other agencies and departments engaged in financial education efforts, including the Department of Education and the Federal Reserve Board. And, when testifying on the subject of financial education last year, we provided information about no fewer than 10 federal departments and agencies, including the Treasury Department, the Federal Deposit Insurance Corporation, the Social Security Administration, the Department of Housing and Urban Affairs, and the Department of Labor, that do an excellent job in offering a wide variety of financial education programs and resources.

An additional Federal program that is supported by the Administration and contributes to the goal of moving individuals into the mainstream financial services sector is the Electronic Transfer Account (ETA) program. The ETA program, which is administered by Treasury's Financial Management Service, provides low-cost electronic bank accounts to Federal benefits recipients. To date, the ETA is offered in every state, the District of Columbia, and Puerto Rico through approximately 600 banks with more than 18,000 branch locations. Treasury plans to continue to examine the benefits of the ETA programs and, if necessary, make recommendations to the Administration and Congress on how to coordinate its ETA efforts with First Accounts to ensure that the participants in the program receive valuable services in the most cost-effective manner.

Another topic that is might be overlooked in this discussion is the remittance activity of many people in this country. The Inter-American Development Bank estimates that Latin American immigrants living in the United States send an average of $200 to their native countries an average of seven to eight times per year. These remittances have reached a level that surpassed $32 billion last year approximately one third of total worldwide remittances. Many immigrants send remittances through a small number of alternative financial services providers. Limited competition in the remittance industry has contributed to high remittances costs. Although remittance charges have declined in the past two years, as we have encouraged greater competition, they still range from $15 to $26 for a typical $200 remittance. The cost varies depending on the type of institution used to send the money and the country where the money is being sent, but it can often exceed 20 percent, when transmission fees and exchange rate cost are both factored in.

But this is changing. With our encouragement and support, more and more traditional financial institutions and credit unions are recognizing that there is a concrete opportunity to attract a diverse consumer base by offering low cost remittance products. Offering remittance features as part of bank accounts can be an important marketing tool in reaching out to migrant workers. One important product that banks and credit unions can offer that money transmitters cannot is a federally insured checking or savings account. This can lay the foundation for new customers to save and build assets, establish a banking relationship, and learn about important tools in personal finance. At the same time, the increased competition will result in lower remittance costs. We support these and other efforts to make the process of sending remittances more affordable for the people who send them - most of whom are low-wage earners -- and those who receive them, people who often are in very great need.

Through our efforts in the Partnership for Prosperity with Mexico, we have encouraged the entry of new providers into the US-Mexico remittance market. The results have been dramatic, with transfer costs falling by more than half on some new product offerings. We see an increasing range of financial institutions entering the market, with innovative product ideas.

In closing, I would like to commend the efforts of the many banks, credit unions, and community- and consumer-based entities and groups - some of whom are represented on the panel that follows me this morning who have recognized the problems faced by the segment of the population who do not have relationships with depository institutions and which institutions have undertaken innovative initiatives to bring these individuals and families into the financial mainstream.

Expanding access to financial services is a non-partisan issue that contributes to improved financial well being, particularly among many low- and moderate-income individuals. Opening an account at an insured depository institution provides the account holder with a number of benefits: the opportunity for wealth building; lower costs for financial services; security; knowledge of and familiarity with the fundamentals of personal finance; and the chance to build a credit history and qualify for credit on better terms. Because of these benefits, Treasury is committed to promoting policies that will encourage individuals to establish traditional account relationships with insured banks and credit unions.

To accomplish this goal, Treasury has focused on both educating individuals about the benefits of opening and maintaining deposit account and persuading depository institutions to expand and tailor services for this segment of the population. Thank you for the opportunity to appear here today. I look forward to working with Committee on these issues in the future.

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i. James T. Moser, Fostering Mainstream Financial Access: www.chicagofed.org/unbanked, Chicago Fed Letter, Number 162, (Feb. 2001) (http://www.chicagofed.org/publications/fedletter/2001/cflfeb2001_162.pdf).

ii. John P. Caskey, Bringing Unbanked Households Into the Banking System, Capital Xchange (Jan. 2002) (http://www.brook.edu/dybdocroot/es/urban/capitalxchange/article10.htm).

iii. Moser, supra note i.

iv. Caskey, supra note ii.

v. CUs Testify Provisions of the Patriot Act Could Harm Immigrants, Credit Union Journal (Feb. 25, 2002).

vi. Angela Shah, Money in the Bank: Accounts Helping Wary Immigrants Park Cash Safely, Send It Home, The Dallas Morning News (Aug. 19, 2001).

vii. Remittances to Latin America and the Caribbean, Multilateral Investment Fund/Inter-American Investment Bank (Feb. 2002) (http://www.iadb.org/mif/website/static/en/study3.doc).

viii. Sending Money Home: An International Comparison of Remittance Markets, Multilateral Investment Fund/Inter-American Investment Bank (Feb. 2003) (http://www.iadb.org/exr/prensa/images/RoundTablesFEB2003.pdf)

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-504

Iraqi Economic Reconstruction Randal Quarles, Assistant Secretary of the Treasury for International Affairs Cato Institute Washington, DC June 25, 2003

Thank you for inviting me here today to speak about the economic and financial aspects of Iraqi reconstruction. Progress in these areas is critical to achieving the broader goal of building a stable, prosperous, and democratic Iraq. As you can imagine, this is a daunting task.

It is a task, however, that is incredibly important. After living under decades of misrule by Saddam Hussein, the Iraqi people at last have an opportunity to forge a better future for themselves and for their children. We are committed to assisting in this effort. Our work is guided by a set of principles that are fundamental to creating the foundation for sustained economic growth. These principles include open markets, the rule of law, established property rights, transparent and accountable governance, and a sound currency.

It is with these principles in mind that we are confronting the many challenges on the economic front that we have faced since the end of the war. Government ministries were largely destroyed by fighting and looting; the Iraqi dinar had depreciated severely and we feared a monetary crisis and hyperinflation; basic economic statistics were non-existent; and the lack of a secure environment restricted commerce and the work that our staff could do in Iraq. We continue to deal with lawlessness, limited communication capabilities, and the loss of technical expertise in government ministries.

I would like to stress, however, that the reconstruction task is not solely, or even primarily, to rebuild from the consequences of several weeks of war, but from several decades of misrule. The Iraqi economy has deteriorated under years of sanctions, conflict, and economic mismanagement. Income per capita plummeted, impoverishing the Iraqi people, and other measures of wellbeing also declined. The infant mortality rate, for instance, increased from 50 per 1,000 live births in 1990 to 121 per 1,000 live births in 2000.

Although the reconstruction task is significant, Iraq has several advantages that will facilitate efforts to improve the prospects for the Iraqi people. The country has a long tradition of entrepreneurship and diverse commercial activity; already, the streets of Baghdad are bustling with commerce. In addition, Iraq has abundant human potential and natural resources. In combination with a market economy based on rule of law, established property rights, and economic freedom, these advantages can lead the way to a brighter, more prosperous future for all Iraqis.

In helping Iraqis achieve such a future, it will be important to draw on lessons learned from previous post-conflict experiences. One such lesson is that rebuilding societies and economies requires time, patience, and a sustained commitment. Reconstruction is not amenable to easy solutions or quick exits. The nature of our engagement will necessarily evolve over time as Iraqis choose their own government and reconstruction tasks are completed, but we are committed to ensuring that the people of Iraq have brighter prospects for their future.

While we are still confronted with serious problems, our initial efforts in Iraq have already resulted in some success. Credit is due in part to a group of extremely dedicated technical experts that Treasury has sent who, in spite of all of the difficulties, are working hard to assist Iraqis in revitalizing the country's economy. They have been involved in all facets of our initial efforts. I would like to focus now on some of the principal steps we have taken so far, as well as on our priorities for future action.

One of the foremost priorities at the end of the war was to make emergency and salary payments to government workers and pensioners. This has been an enormous undertaking. The first step was to obtain the financial resources required to make payments. On March 20, President Bush vested $1.7 billion of Iraqi regime assets that had been frozen in the United States over a decade ago and placed them in an account at the New York Fed to be used to support reconstruction. So far, nearly half of these assets have been delivered to Iraq to finance payments. A mechanism for emergency payments was quickly established on the ground so that payments could begin for dock workers, power plant workers, and others. Despite tremendous logistical challenges, the system of payments has been a success, placing money in the hands of consumers and helping to spur commerce.

A second priority is to promote the establishment of a stable, unified national currency, which is a prerequisite for establishing a vibrant economy. The pre-existing currency situation in Iraq makes this a difficult task. Several currencies circulate widely, including the Iraqi, or "Saddam," dinar in central and southern Iraq; the Old Iraqi, or "Swiss," dinar in the northern part of the country; and the U.S. dollar. One of our main concerns following the end of the war was that there would be a large devaluation of the Saddam dinar and hyperinflation. In addition, there were concerns about losing control of currency printing facilities, and fears that the currency would cease to serve as an accepted means of exchange.

We took early action to address these concerns. We secured currency stocks and printing facilities, and the military made public announcements that existing currencies would continue to be accepted as means of payment. Although little price data is available to make assessments about inflation, the information we have received on exchange rates indicates that the value of the Saddam dinar against the dollar, while very volatile, has strengthened of late. We stand ready to assist in the implementation of whichever long-term currency reform the people of Iraq choose through a representative Iraqi government.

A third area on which we have placed a great deal of attention is the development of an integrated and transparent Iraqi government budget. Before the war, the Iraqi budget was a state secret. The lack of transparency and accountability made it difficult to determine how resources were allocated. Enhanced transparency will be essential in future budget operations, particularly in the area of oil revenues, if enhanced standards of governance are to be achieved and the Iraqi people are to hold their elected officials accountable.

Strengthening and modernizing the banking sector is also central to achieving economic progress in Iraq. We are still in the early stages of assessing the banking system, but we do know that Iraqi banks were dominated by the state and oriented more toward the fulfillment of political objectives than the provision of economic services or financial intermediation. Our objective is to ensure that the banking sector begins to function in a commercially viable way and that it reflects regional as well as international best practices. For example, we endorse the objective of Iraqis having access to financial products and services that are based on Islamic principles. We are also working with Iraqis to help them create a sound supervisory and regulatory regime in the banking sector. After closing their doors during the war, financial institutions are now beginning to revive. The Central Bank has reopened, as have many of the branches of the largest banks in Iraq.

In addition, we are evaluating options to establish a "trade credit authority" that will begin laying the groundwork for commercial activity independent of central authority. Such a financing mechanism will help stimulate the Iraqi economy by facilitating foreign trade.

An issue that has received much attention and will clearly have to be addressed is Iraq's capacity to address the potentially enormous burden of its existing financial obligations. In the near-term, we have taken two important steps to address this situation. First, we secured agreement from G-7 creditors not to expect Iraq to service its debt for at least the next eighteen months. Second, we have been working to determine how much debt Iraq owes. In the medium-term, once we have a better estimate of the true level of Iraq's debt and its underlying payment capacity, we can move forward to develop a comprehensive strategy to deal with Iraq's official debt.

Donor contributions will also play an important role in the reconstruction of Iraq. Active participation by the international financial institutions is important to mobilizing this support. Indeed, I am pleased to report that these institutions are already intensifying their engagement in the process of reconstruction and recovery in Iraq. The U.S. also welcomes the commitment of the UN and the international community for a donor reconstruction conference for Iraq in October.

We have been guided in all of our actions by the goal of creating a stable and prosperous Iraq and releasing the shackles that have constrained the potential of the Iraqi people. The challenges are still formidable, but we remain committed to achieving an environment in which all Iraqis will have the opportunity to forge a better future for themselves and their children.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-505

Chart Presentation of Deputy Assistant Secretary for Federal Finance Timothy S. Bitsberger To the Bond Market Association's Inflation-Linked Securities Conference New York, NY

Why Treasury Issues TIPS

[Chart 2]

There is one message I have given over the past year. It has been very simple. We are committed to the TIPS market.

My message today is just as simple. Growing the market will be a collaborative effort between all of us: Treasury, the buy-side and the sell-side.

This is still a very young market. Just about six years old. In fact two years ago the future of the TIPS program was in jeopardy. The growth and success of the TIPS market over the past year is exceptional.

Future growth of the market will depend on how well we work together.

But it is not the nominal coupon market.

The first point I want to make is that we view TIPS as a separate liability class just as you should think about TIPS as a separate asset class.

A separate liability class makes sense for us in the same way that a separate asset class makes sense for you.

By developing this different asset class we increase the pool of potential investors. Broadening our investor base diversifies our funding sources. Additionally, by diversifying our borrowing, we reduce exposure to a single adverse shock and both lower and smooth our borrowing costs.

[Chart 3]

I just said that TIPS represent a different liability class, but that does not mean we manage them differently. We issue TIPS the same way we do nominal bonds.

At Treasury, we are committed to issuing large, liquid securities. We increased the number of 10-year note auctions from two to three to our current policy of four/year. We now auction a new security in July and April and reopen it respectively in October and January.

Reopenings can sometimes cost Treasury money because we do not capture the on-the-run premium often associated with new issuance. However, the benefits of large and predictable issuance --and a more stable and liquid secondary market--

outweigh the cost of reopening.

We have become the world's largest TIPS issuer with more than $150 billion par amount outstanding.

I believe that commitment means growth. We hope to continue to expand the TIPS calendar in the future.

But it is important that we expand the auction calendar without moving too fast and getting too far ahead of the market. We know we must lead, but we don't want to move too fast and create illiquid market conditions.

[Chart 4]

I am often asked what percentage of our issuance in TIPS. We do not plan to target our issuance as a percentage of gross issuance. We look to increase supply in line with increasing demand, but that will depend on your collective actions and our ability to interpret those actions. As an aside, the advice that many of you freely provide Treasury on market conditions is crucial to our assessment of market growth.

Even though we strive to be regular and predictable, we cannot limit our flexibility as debt managers by committing to specific issuance percentages in the future. Our borrowing needs, driven by outlays and receipts that are enormous by any standard, are unknown - as any of you who have tried to forecast our fiscal position know. Targeted issuance would not have been sustainable.

That being said, TIPS represents approximately more than 25% of our recent 10-year note issuance.

[Chart 5]

Liquidity has markedly improved since Treasury reaffirmed its commitment last year.

Market data and anecdotal evidence is fairly conclusive. More investors are purchasing TIPS.

I want to add that no market compares to the depth and liquidity of the nominal coupon treasury market. The 24-hour liquidity available to traders and investors is remarkable. Daily volume, which averaged around $100 billion in 1998, is now over $500 billion/day.

So, we must be careful how we judge TIPS. TIPS will never trade with the liquidity of nominal Treasuries, but by any other measure, liquidity is good and promises to get better.

[Chart 6]

I am encouraged by signs that many dealers are committing more capital TIPS. A few have actively committed personnel and capital in the past few months. Because Treasury is committed, because their customers are asking for market making, many more dealers are committing trading capital to TIPS.

I do not expect every primary dealer to take a leadership role and help expand the TIPS market the ways many firms here have demonstrated, but I am hopeful we are well on our way to reaching a critical mass of dealers that will be needed to support what I expect to be a very large market.

[Chart 7]

One comment I occasionally hear is that "the market is too small". Compared to other markets the TIPS market is not small. I understand the frustrations of those who need a larger market and are accustomed to the liquidity of the nominal Treasury market. My response is that the more support you show our current issuance, the faster we will be able to increase auction size and frequency.

But we need sponsorship. I encourage everyone on the buy side to view TIPS as an evolving asset category and manage their expectations. Great strides have been made over the past year, but the market-making infrastructure (often taken for granted in the nominal market) will take time to fully develop. I believe that the increasing awareness that as TIPS are truly a different class-and the product is better understood markets will deepen.

As the primary seller of TIPS, I am frustrated where I talk to private and public funds that view TIPS as the long-term panacea for their ills, but then trade them with a short-term, opportunistic bias. Growth depends on long-term commitment to this market; arbitraging break-evens and carry versus nominals increases one-way liquidity and does nothing to create long-term sponsorship.

[Charts 8 and 9]

A much higher percentage of auction awards are allocated to investment funds, a further indication that the market has come to believe that we are committed to TIPS.

Diversifying our investor base should lower our costs over time.

[Chart 10]

Returns and risk stand out. Now that TIPS have reached their 5-year threshold for returns and the outstanding volume exceeds that of many other market, I am hopeful that the consultant community will consider recommending TIPS as a strategic asset allocation.

[Chart 11]

I am often asked why not include TIPS in the Lehman Ag. Because of the low or negative correlation to nominal bonds, TIPS should be a separate asset class. Inclusion in the Lehman Ag would provide a short-term benefit to existing TIPS holders, but I am not sure it is the appropriate place for a security with different cash flow characteristics than nominal fixed income securities.

TIPS are a very different asset than nominal bonds and are much less risky because their value will not be eroded by inflation. This allows for meaningful diversification and will help insulate portfolios from both higher inflation and higher inflationary expectations.

[Chart 12]

I think the recent high beta can be explained by very low inflation risk and a general move in real rates. As the fed has diffused any short-term inflation risk, real and nominal yields have moved together.

[Chart 13]

Good summary chart for perspective investors.

[Chart 14]

Structure.

Debt Management

[Chart 15]

Since I joined treasury in the fall of 2001, we have strived to become more transparent about what we do and why. I believe the better you can understand our analysis and decision making, the better you will be able to foresee changes in our issuance calendar.

If we continuously surprised the market, traders and investors alike would have difficulty adjusting their expectations as well as their portfolios. In other words an ad hoc approach to issuance would hurt Treasury in the primary market.

I believe that more transparency on our part will mean better-prepared investors and traders, resulting in a more robust primary market.

Many of the following charts and concepts are new-some are under one-year old. We have attempted to develop a framework for future debt managers --as well as investors-for years to come. It is important for Treasury to quantify as best we can our decision-making and for lack of another word-performance.

I would like to start by talking about our objective-lowest cost financing over time. We strive to meet this objective through regular and predictable issuance of our debt. We are not market timers-that is we do not make a judgment on interest rates.

You all know with a high degree of certainty when our auctions will be. You know that auction frequency or issuance has nothing to do with market conditions or the level of rates. We will not adjust size or frequency as rates or the yield curve change. That is, that we do not issue more long debt when rates are perceived to be low nor do we issue more short term debt when rates are perceived to be high.

But developing a regular and predictable issuance pattern is difficult. It is difficult because we face tremendous uncertainty.

[Chart 15]

In it's simplest form lowest cost financing means borrowing at the lowest rate without over funding our cash balances. We try to limit the fluctuations in our cash balances for two reasons. First we face a negative funding spread. Second, our balances are collateralized in the private sector. Big swings can cause market dislocations.

Forecasting is very difficult. Every one misses. We strive to do a much better job of forecasting. But as the old saying goes, "if you are going to forecast, you better do it often."

By way of illustration, total federal tax receipts are $1.8 trillion. The federal budget is over $2 trillion. A small miss on those two numbers -and they are usually correlated over time--will result in a change in the budget deficit of tens of billions of dollars.

[Chart 16]

We know we face uncertainty. It is not our job to project long-term deficits or surpluses. That is the job of OMB and CBO.

What is our job is to make sure our auction calendar can handle a range of reasonable outcomes. Our calendar must be able to handle changes on the margin. We must have flexibility in our calendar. This slide highlights this point quite well.

This chart of financing residuals (+/- one standard deviation) was one we considered before the May refunding when we announced significant increases to our frequency of coupon issuance.

- Lines: central and 1 standard deviation forecasts of deficits
- Bars: residual financing if base case issuance were carried forwards

Financing residuals (one-sided) Forward looking scenario analysis

We believe our calendar was well set up to handle lower deficits. We had and have the ability to reduce auction sizes and pay down issuance. Currently we have over $1trillion in outstanding bills and annualized we issue $300B in 2-yr notes.

But what concerned us was the more pessimistic outlook, higher deficits. Though we believed we could continue to increase auction sizes, we concluded that increased auction frequency would spread out the effects of increased issuance and still give us flexibility if deficits turn out to be smaller than forecasted.

[Chart 17]

Last year we issued over $3 trillion in bills, notes and TIPS.

The fiscal balance is hugely important on the margin and determines the structure of our issuance, but our refinancing dominates our daily debt management decision-making. In other words we rollover our debt, but contrary to many market analysts that interests us but it does not concern us.

I would like to take a moment to talk about rollover risk. The distinction between debt management at Treasury and within the CFO's office of a corporation are vast, and in my opinion, not necessarily understood by the marketplace. Our risk is not that we cannot rollover our debt; it is in doing so we incur large changes in interest costs. Though we have work to do in this area, we feel a regular and predictable issuance calendar-not one based on rates or market timing-can best mitigate the the risk of volatile interest costs.

[Chart 18]

In a nutshell, our job is to figure out what to auction and when. What security should we sell at what size and in what frequency? The tricky part is to incorporate changes to the calendar in transparent manner within the regular and predictable framework.

We want to issue at the lowest cost over time. The changes must be transparent, we want flexibility and we want to minimize any market dislocation.
This next chart plots our issuance calendar versus different deficit outcomes. The inputs are deficits and borrowing generated from our coupon calendar. The output is bills as a percentage of marketable debt.

The deficits are based off the current (last January) OMB forecast. The inputs are our current issuance calendar. Most analysts are forecasting higher deficits for this year, so the slope of the green line may be too steep. A return to that projection would mean a fast bill pay down.

The red line has no policy implications it is merely a reference point.

[Chart 19]

This chart shows another way of looking at distribution. It highlights how long dated issuance is market timing and significantly reduces flexibility. This is not a chart that shows rollover risk. Rather it demonstrates the costs Treasury faces once it locks itself into longer dated issuance decisions.

[Chart 20]

Soft measure of cost--one observation over 50 yrs. But it implies it is cheaper for treasury to fiancé in the front end of the curve over time. It also shows how hard it is too market time.

Related Documents:

- Charts

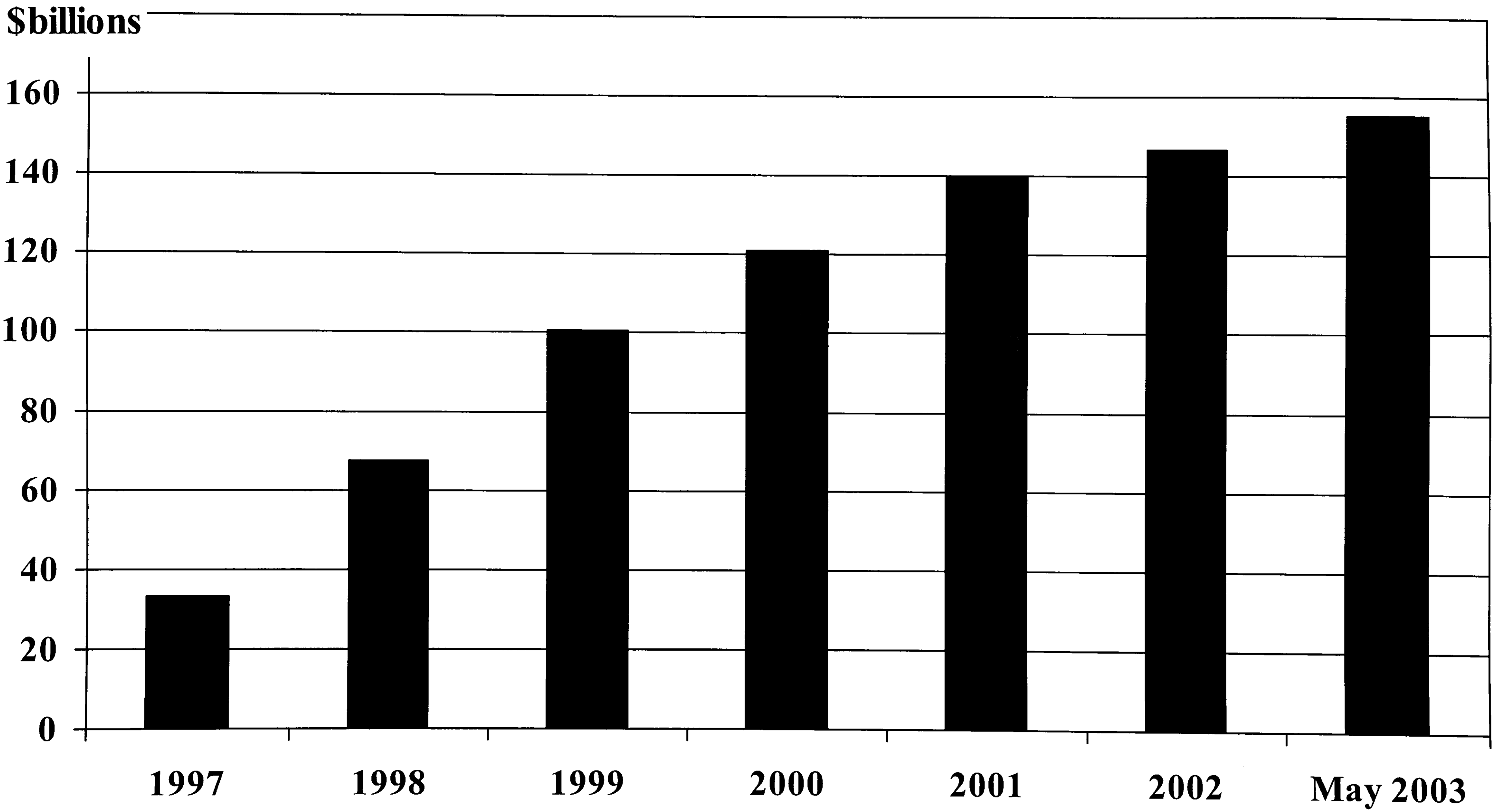
Treasury Debt Management

Timothy Bitsberger
Deputy Assistant Secretary
U.S. Treasury Department

Summary

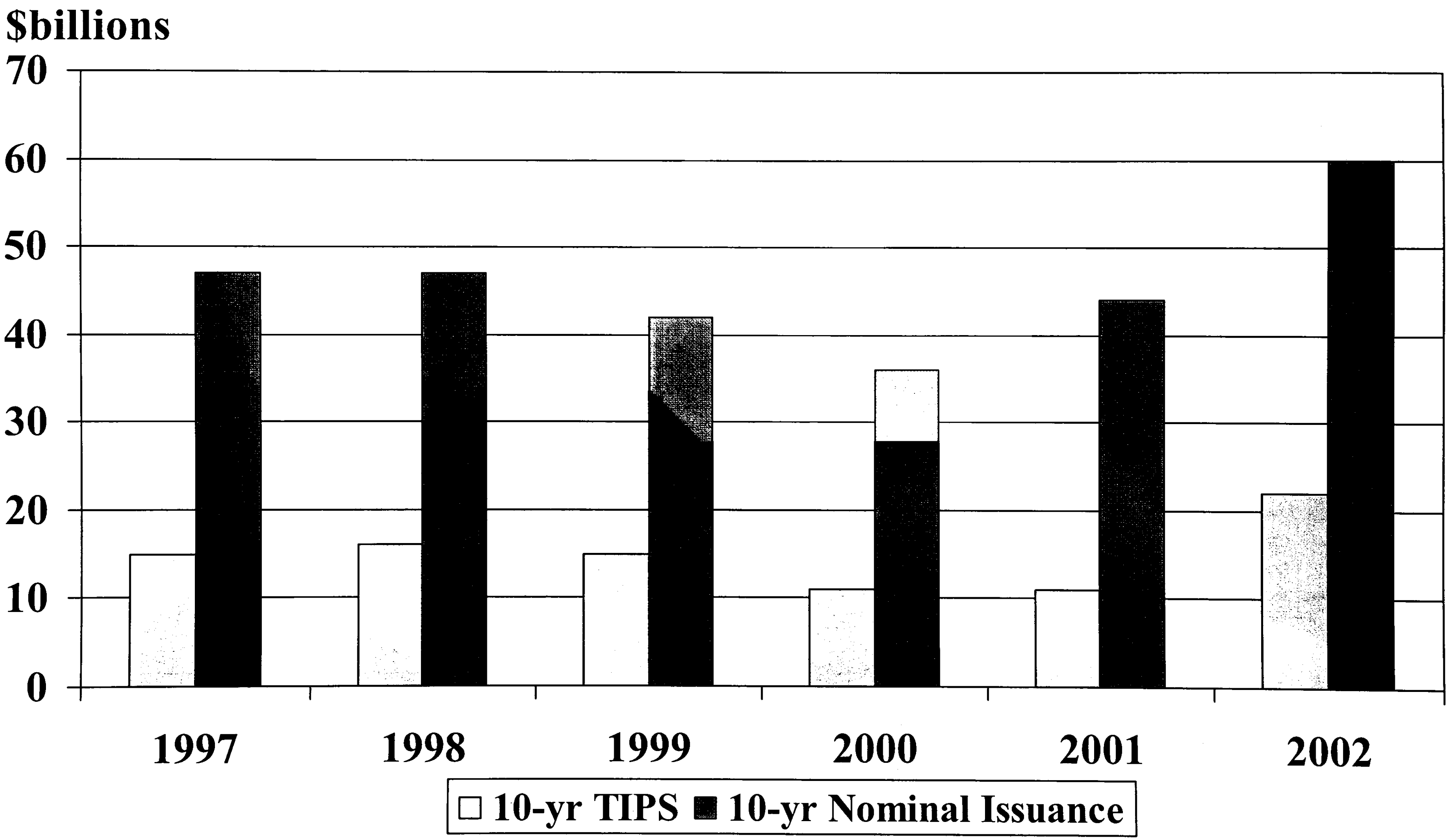
- Treasury is committed because TIPS reduce cost
- Closest thing to a risk free asset for long-term investors.
- Highest credit quality
- Improve portfolio diversification
- Better match to inflation than real estate, commodities, or other real assets
- TIPS market is young but growing fast

TIPS Outstanding



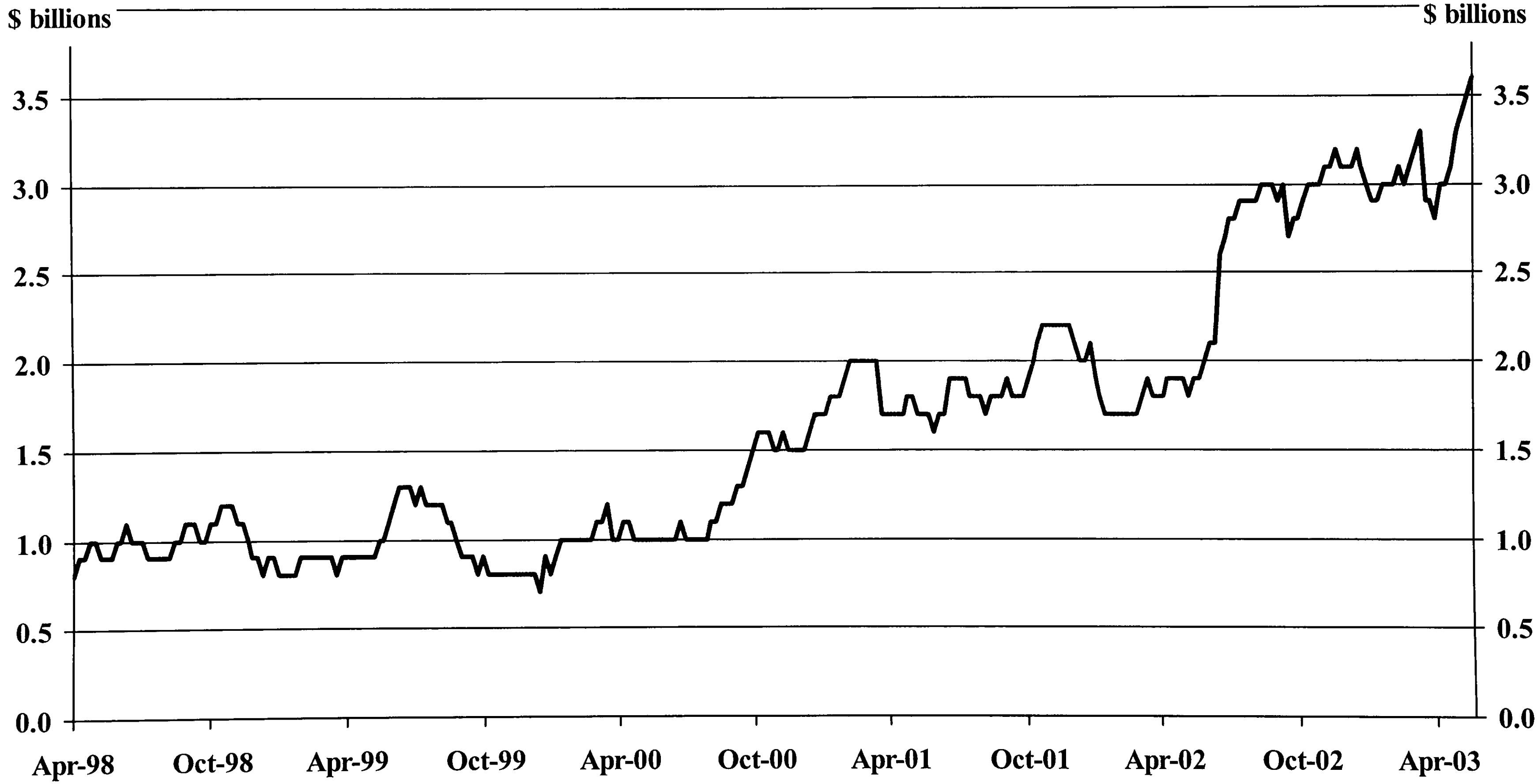
Source: US Treasury

10-year TIPS Issuance Represents More Than a Quarter of Treasury's Total 10-year Note Issuance

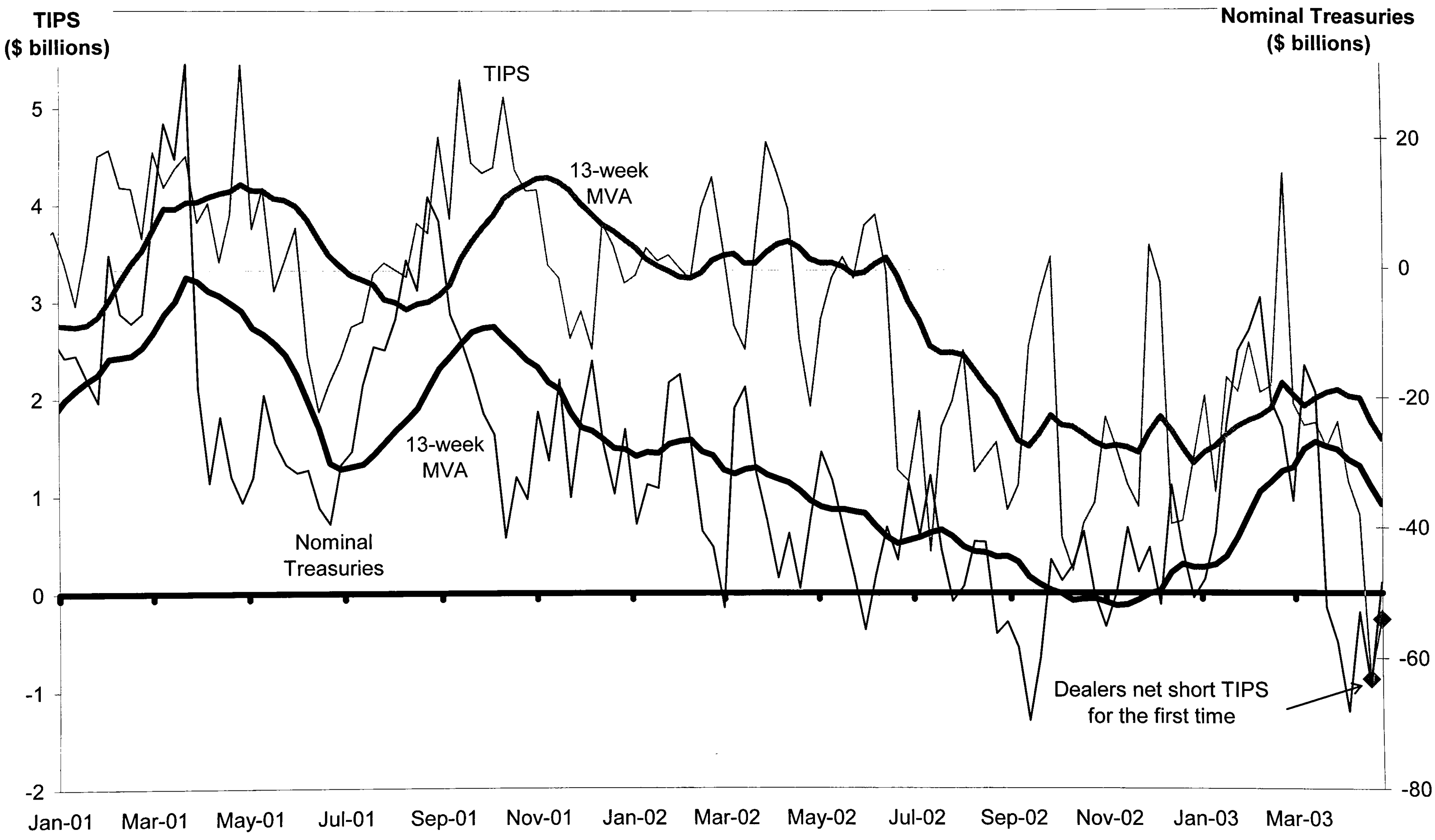


TIPS Liquidity Increasing

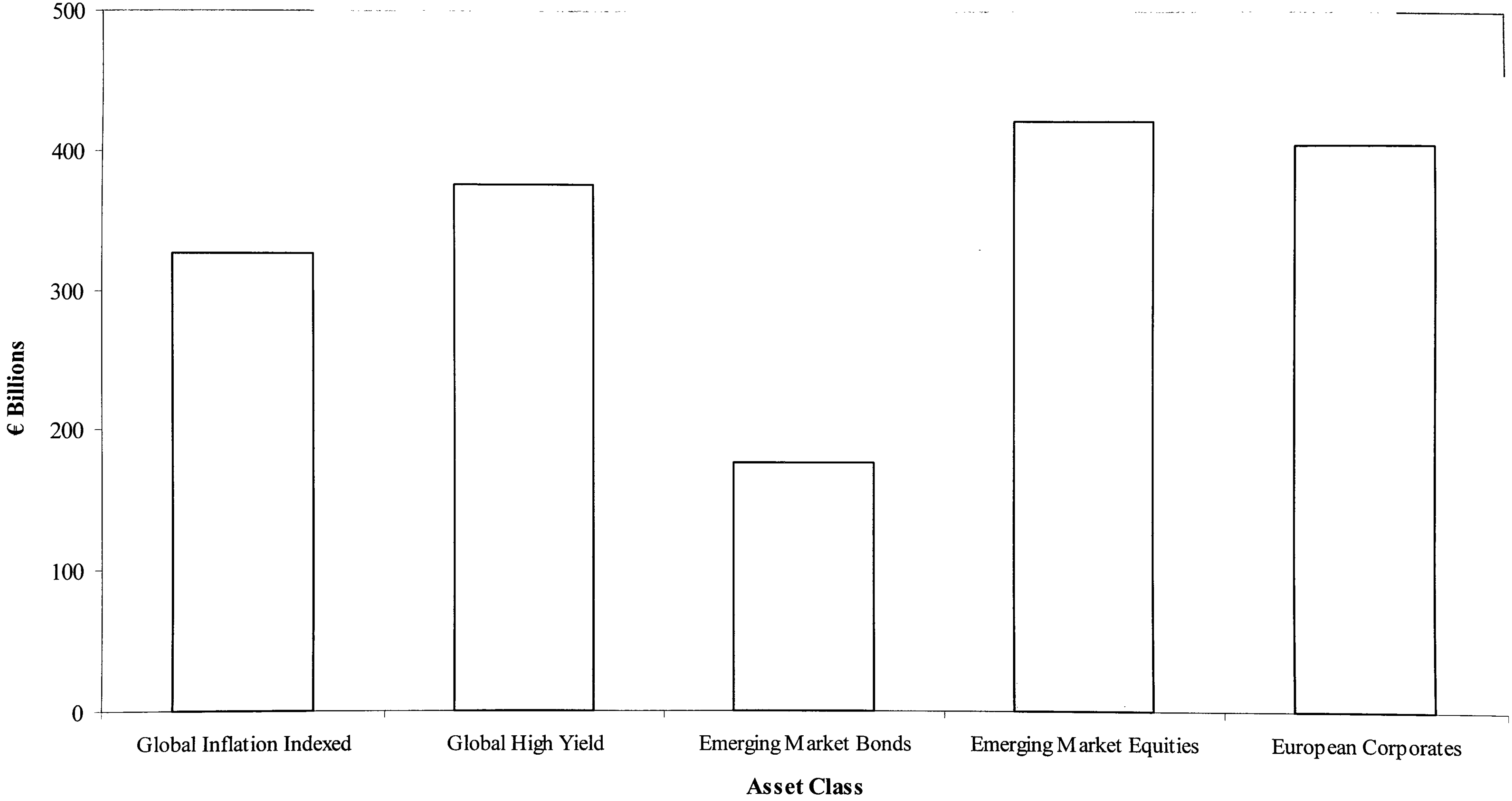
3-Month Moving Average of Daily TIPS Transactions by Primary Dealers



Net Dealer Positions in Treasuries



SIZE OF GLOBAL INFLATION-INDEXED BOND MARKET VS. OTHER ASSET CLASSES

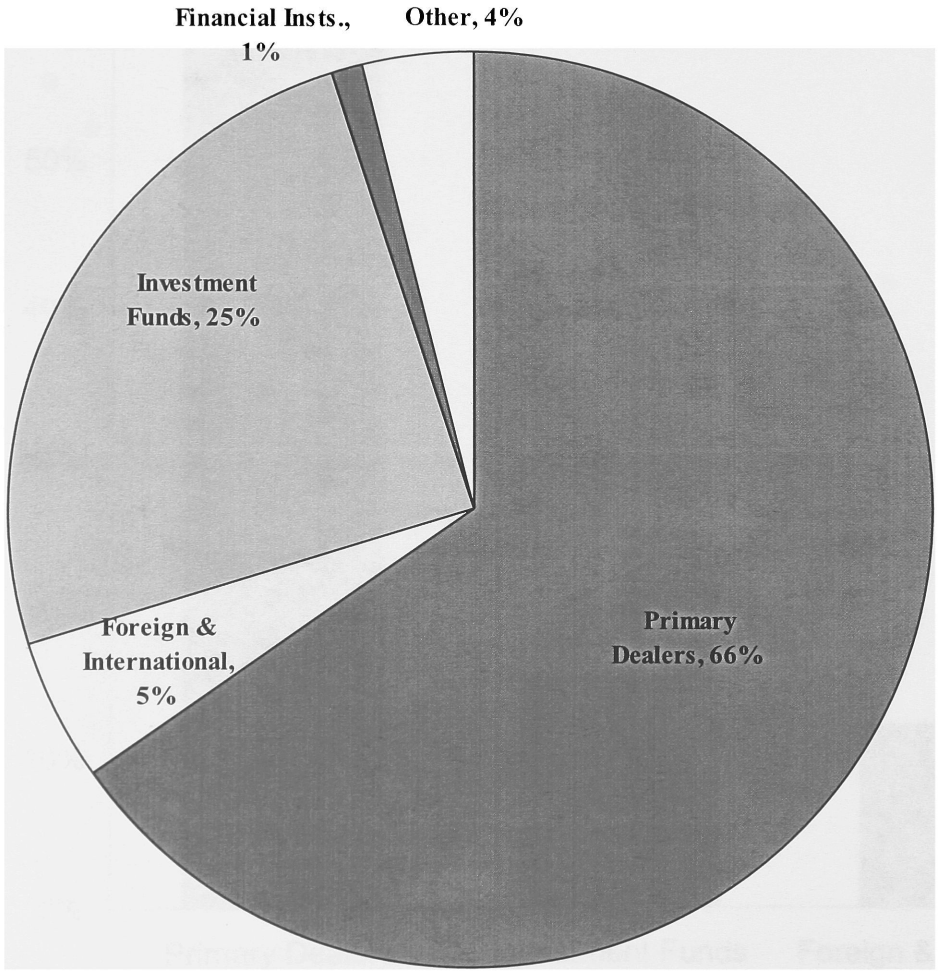


Source: Bridgewater Associates

Distribution of Competitive Auction Awards of 10-Year Treasury Notes

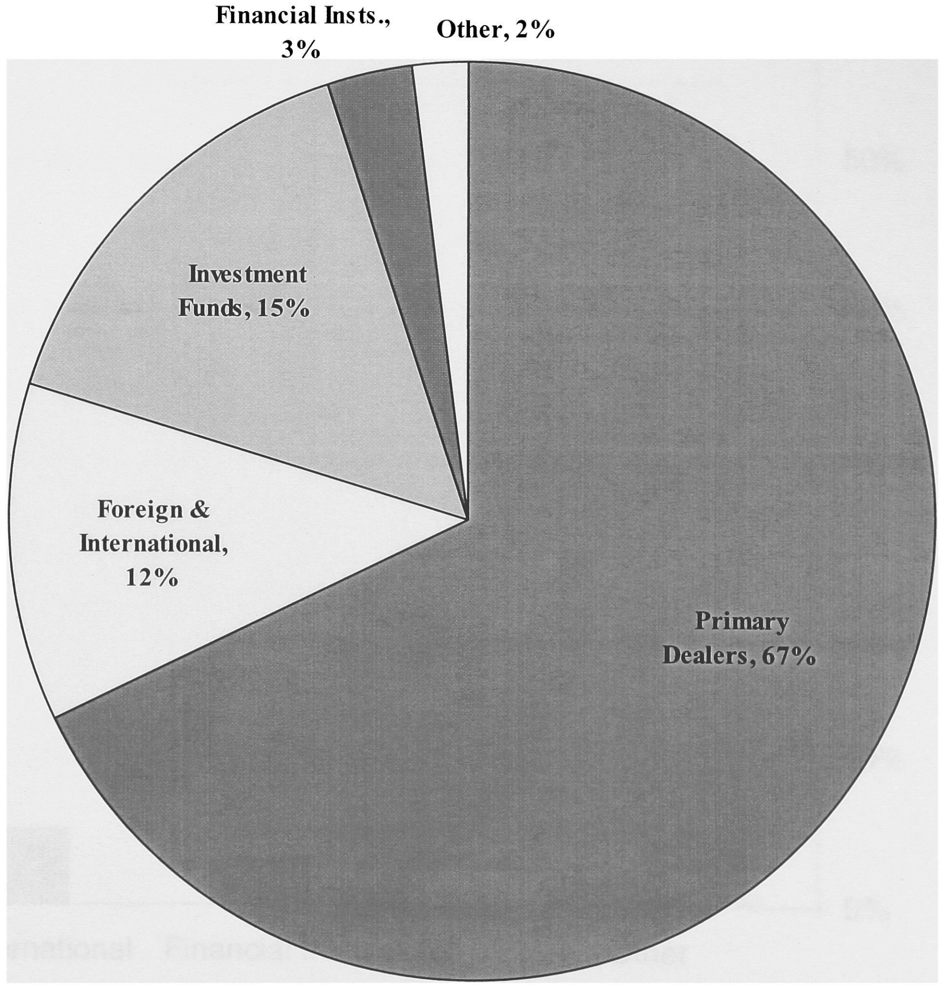
10-Year Inflation-Indexed Notes

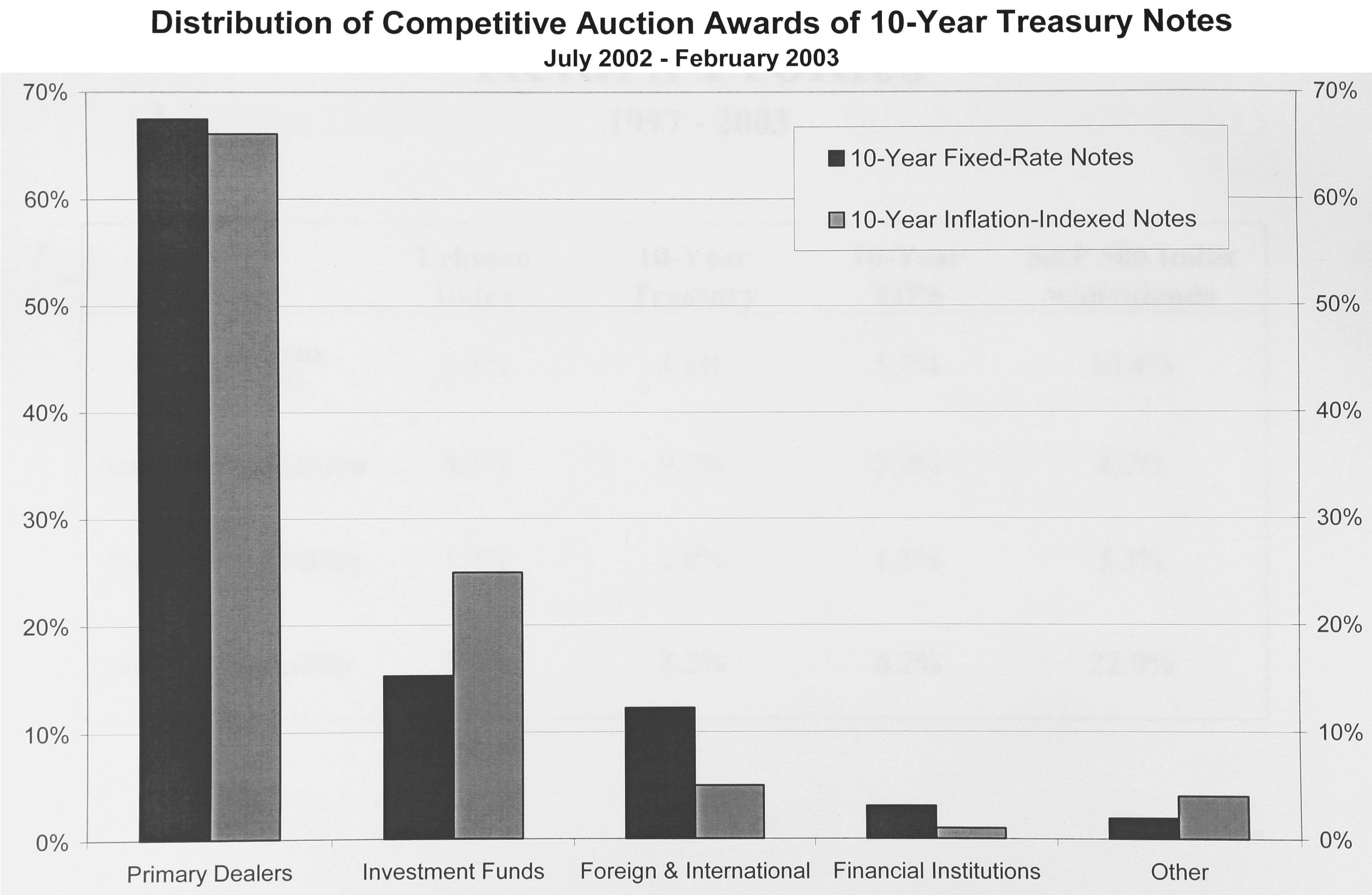
July 2002, October 2002 & January 2003



10-Year Fixed-Rate Notes

August 2002, November 2002 & February 2003





Distribution of Competitive Auction Awards of 10-Year Treasury Notes
July 2002 - February 2003
70%
60%
50%
40%
30%
20%
10%
0%
10-Year Fixed-Rate Notes
10-Year Inflation-Indexed Notes
Primary Dealers
Investment Funds
Foreign & International
Financial Institutions
Other

Return Profiles

1997 - 2003

	Lehman Index	10-Year Treasury	10-Year TIPS	S&P 500 Index w/dividends
2003 Returns (Thru May 2003)	4.3%	5.8%	5.7%	10.4%
Annualized Return	8.4%	9.2%	7.9%	4.7%
Monthly Volatility	1.3%	2.0%	1.1%	5.3%
Annual Volatility	5.7%	8.2%	6.2%	22.0%

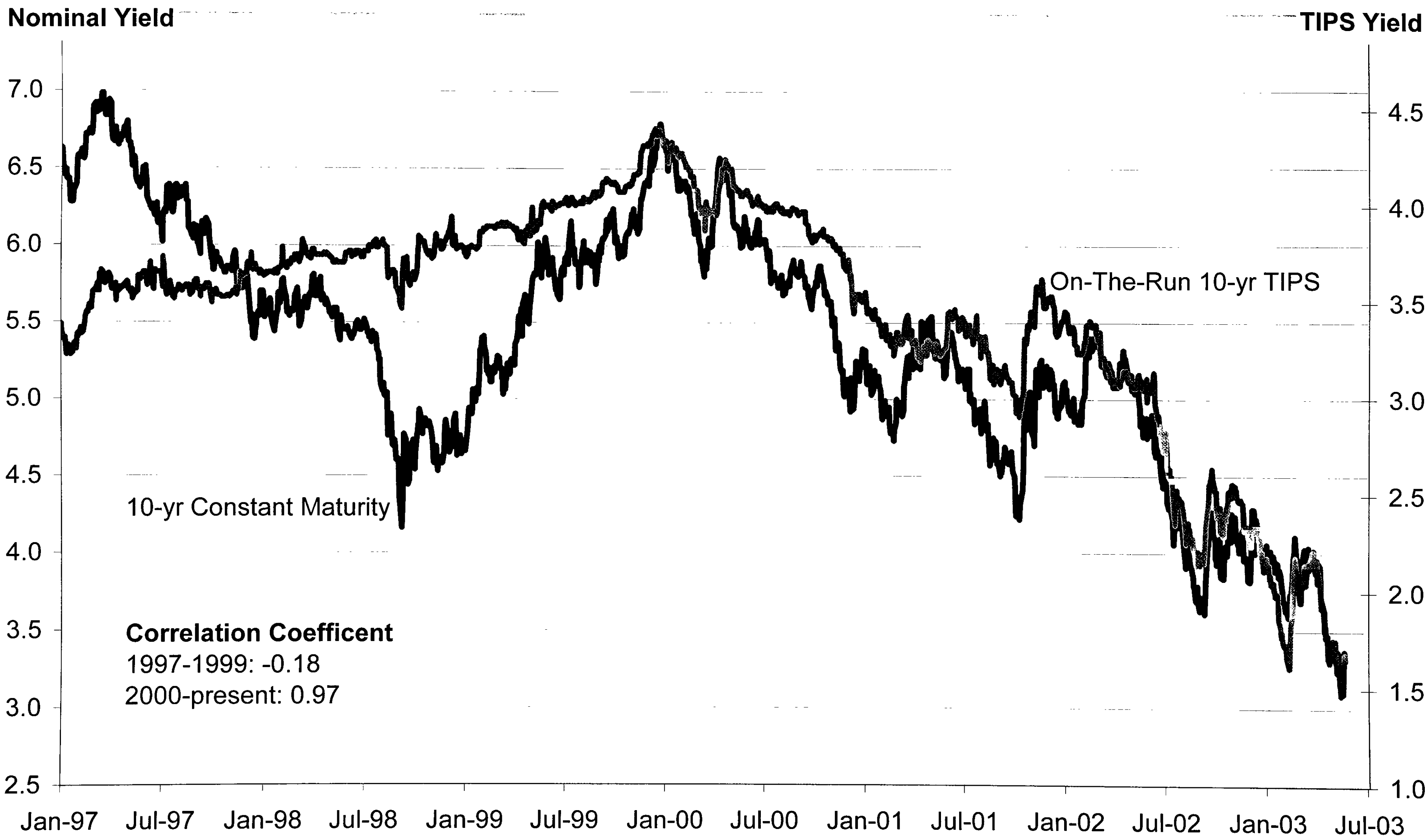
Source: Barclays Capital

I/I BOND CORRELATION TO OTHER ASSETS AND INFLATION

Correlation of TIPS (10 Yr Duration) to

1970 to Present	CPI	Equities S&P 500	Nominal Bonds 10 Yr Duration
1 Month	0.18	0.11	0.57
3 Month	0.27	0.02	0.64
1 Year	0.51	-0.18	0.29
3 Year	0.84	-0.47	-0.33
5 Year	0.91	-0.53	-0.35

10-Year TIPS and Nominal Yields



TIPS Characteristics

- Fixed real coupon, paid semi-annually on inflation adjusted principal
- Deflation-protected principal at maturity
- Principal adjusted for inflation daily, but paid at maturity
- Inflation accretion is referenced to the CPI-U NSA, set with a 3-month lag
- First issue January 1997; 10 issues ranging from 2007 to 2032
- $155 billion market capitalization; total Treasury market capitalization $3.3 trillion
- Four 10-year TIPS auctions per year, increased issuance
- Average daily trading volume over $3.5 billion

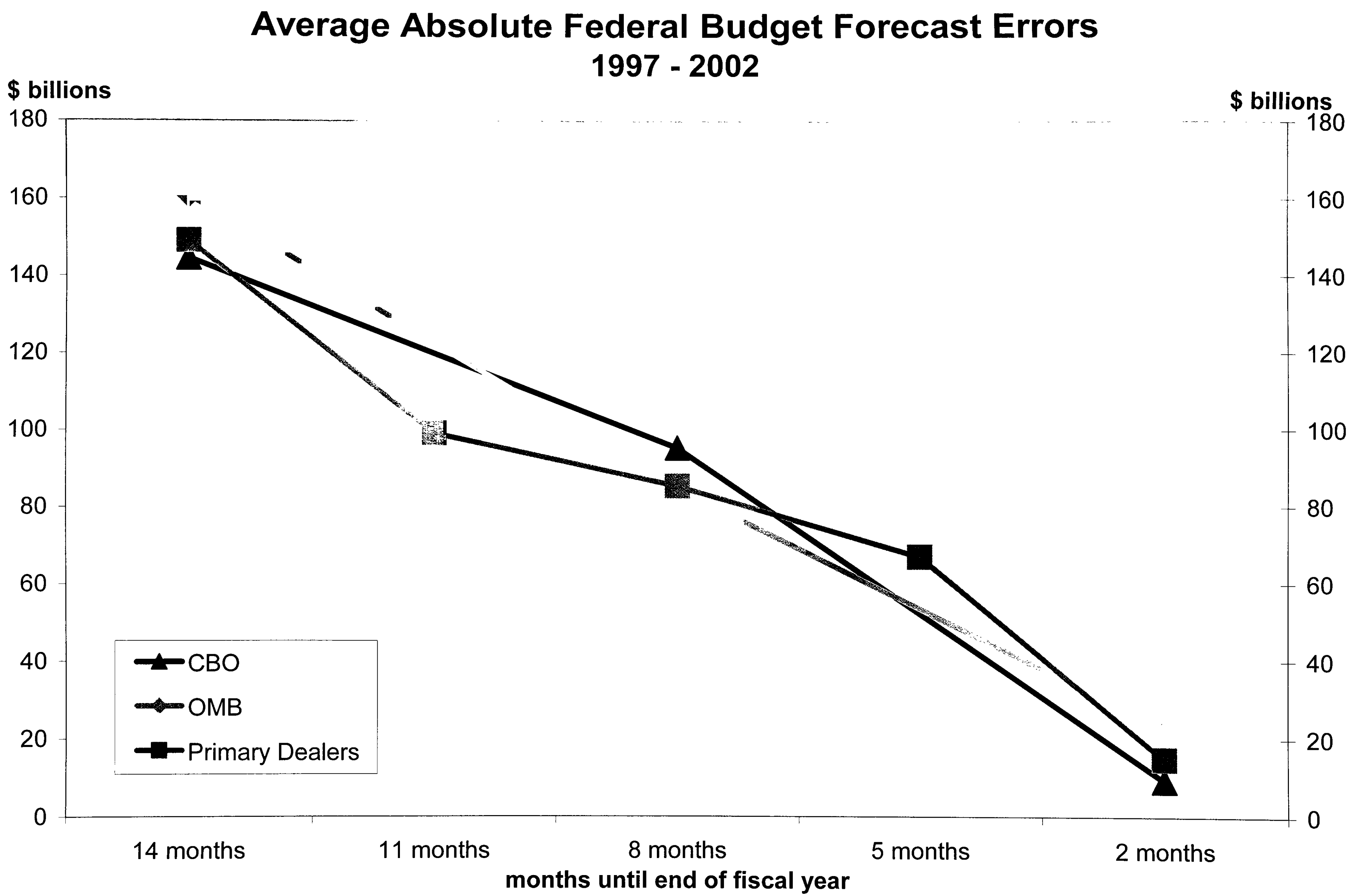
Structure

- Principal value is adjusted for inflation by multiplying the value at issuance by an index ratio which changes daily. Inflation adjustment is paid at maturity.

- Coupon payments are a fixed percentage, determined at auction, of the inflation-adjusted value of the principal.

- The index ratio for a particular valuation date is the index number for that date divided by the index number for the issue date.

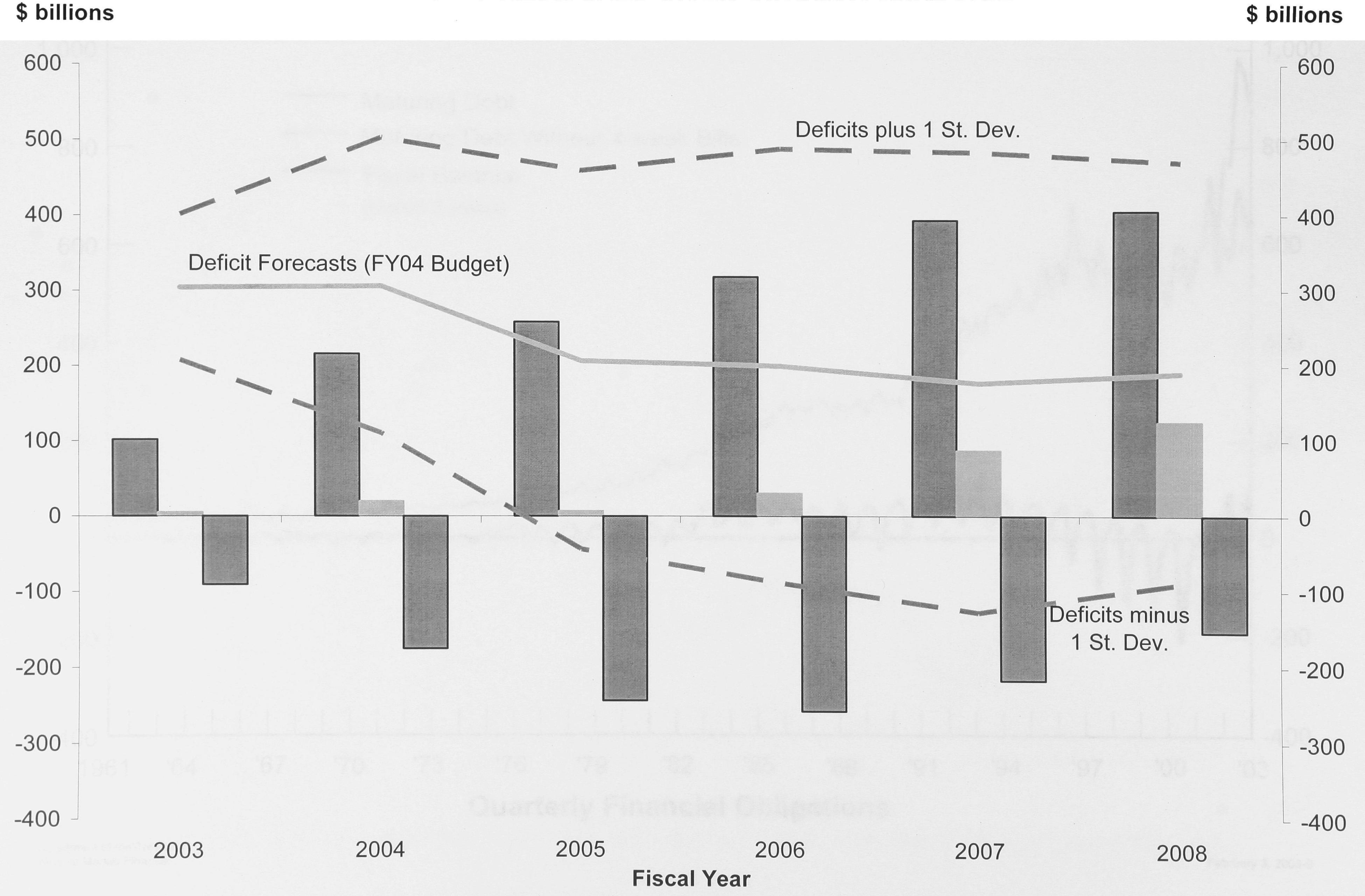
- $$\text{Index Ratio}_{\text{Date}} = \frac{\text{Index number for value date}}{\text{Index number for dated date}}$$



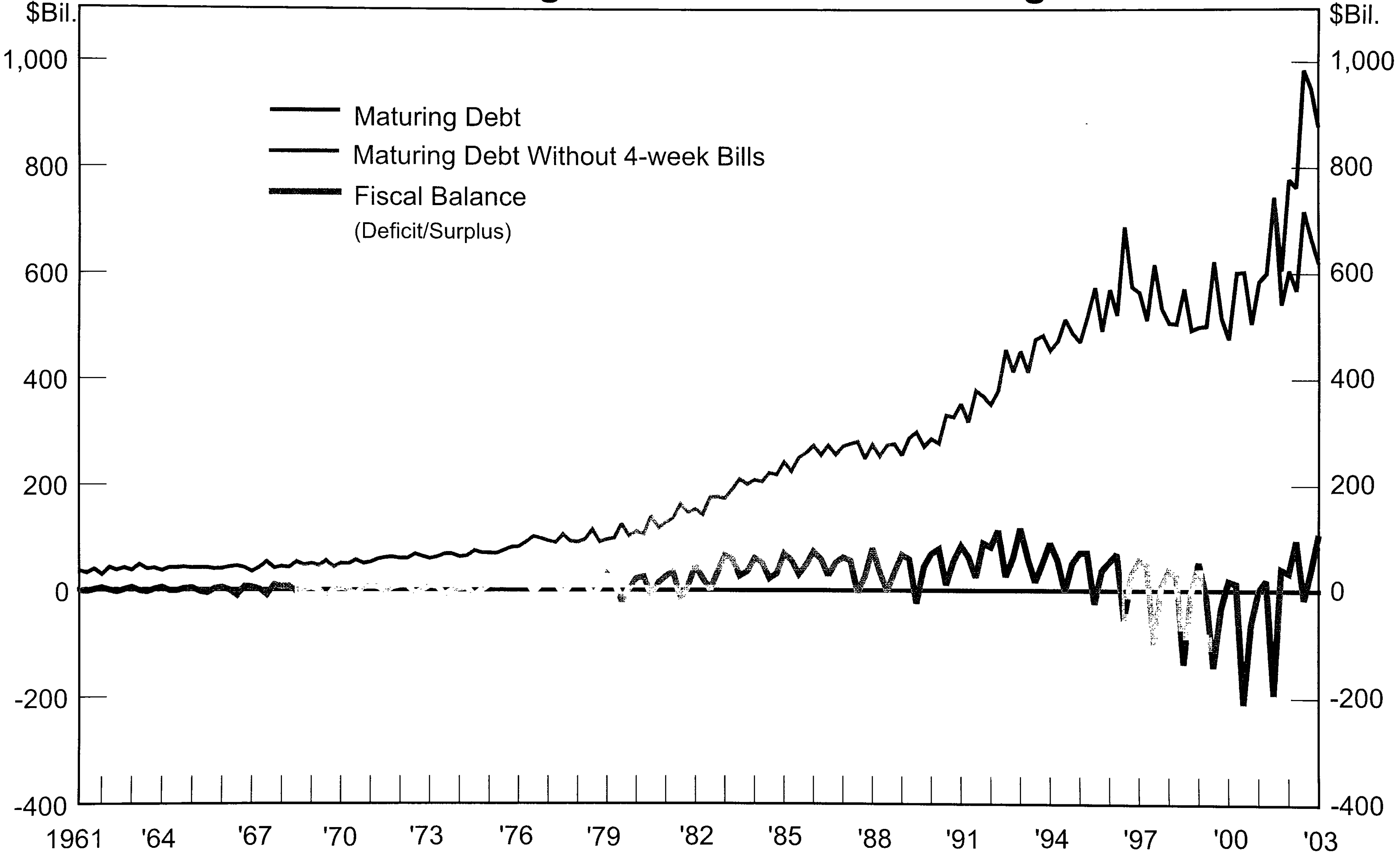
Office of Market Finance
Department of the Treasury

Source: Primary Dealer forecasts provided to Treasury at quarterly dealer interviews
OMB – U.S. Budget and Mid-Session Review
CBO – Budget Outlook and Update

FINANCING RESIDUALS GIVEN CURRENT ISSUANCE

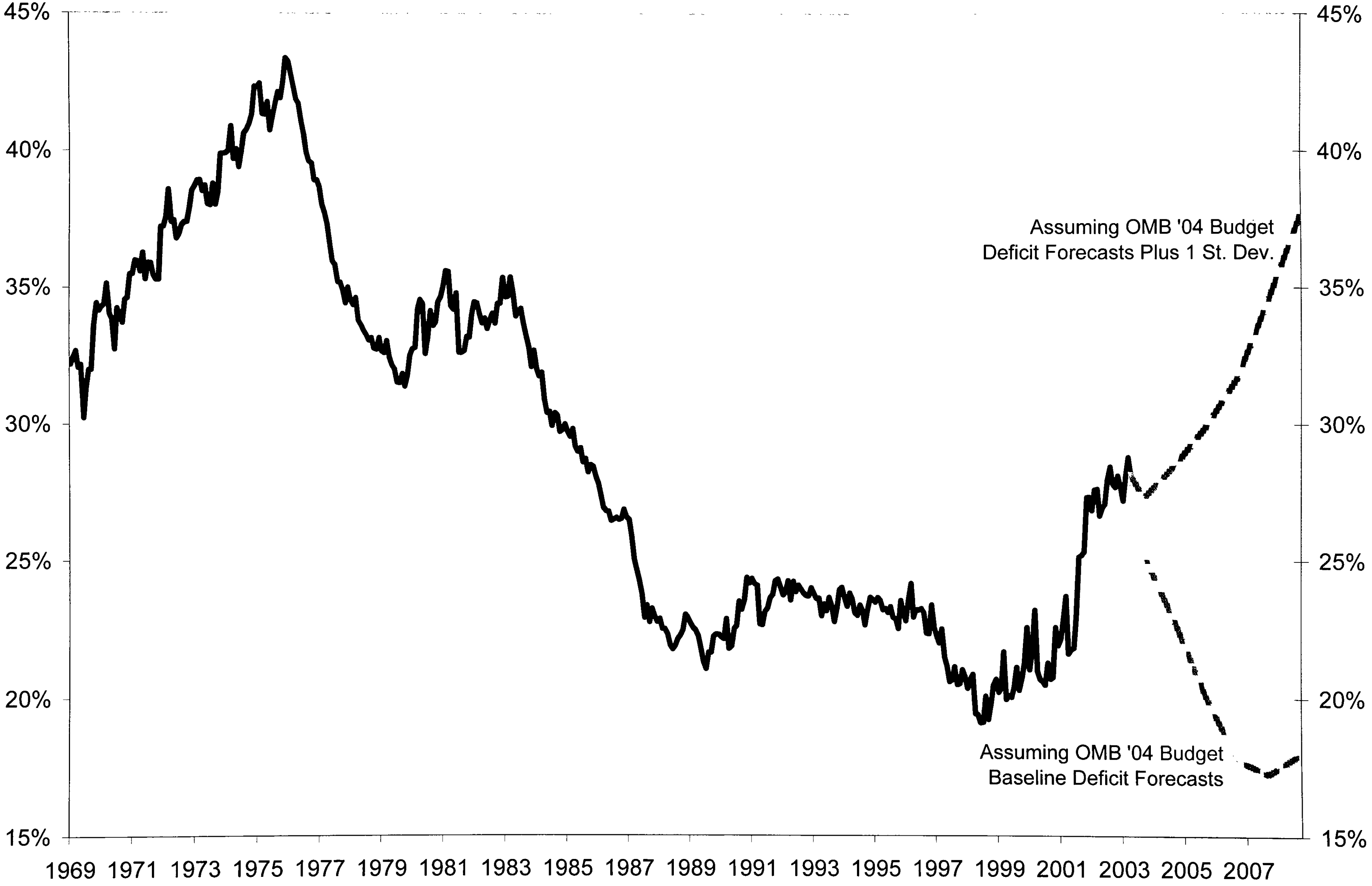


Refinancing dominates new financing

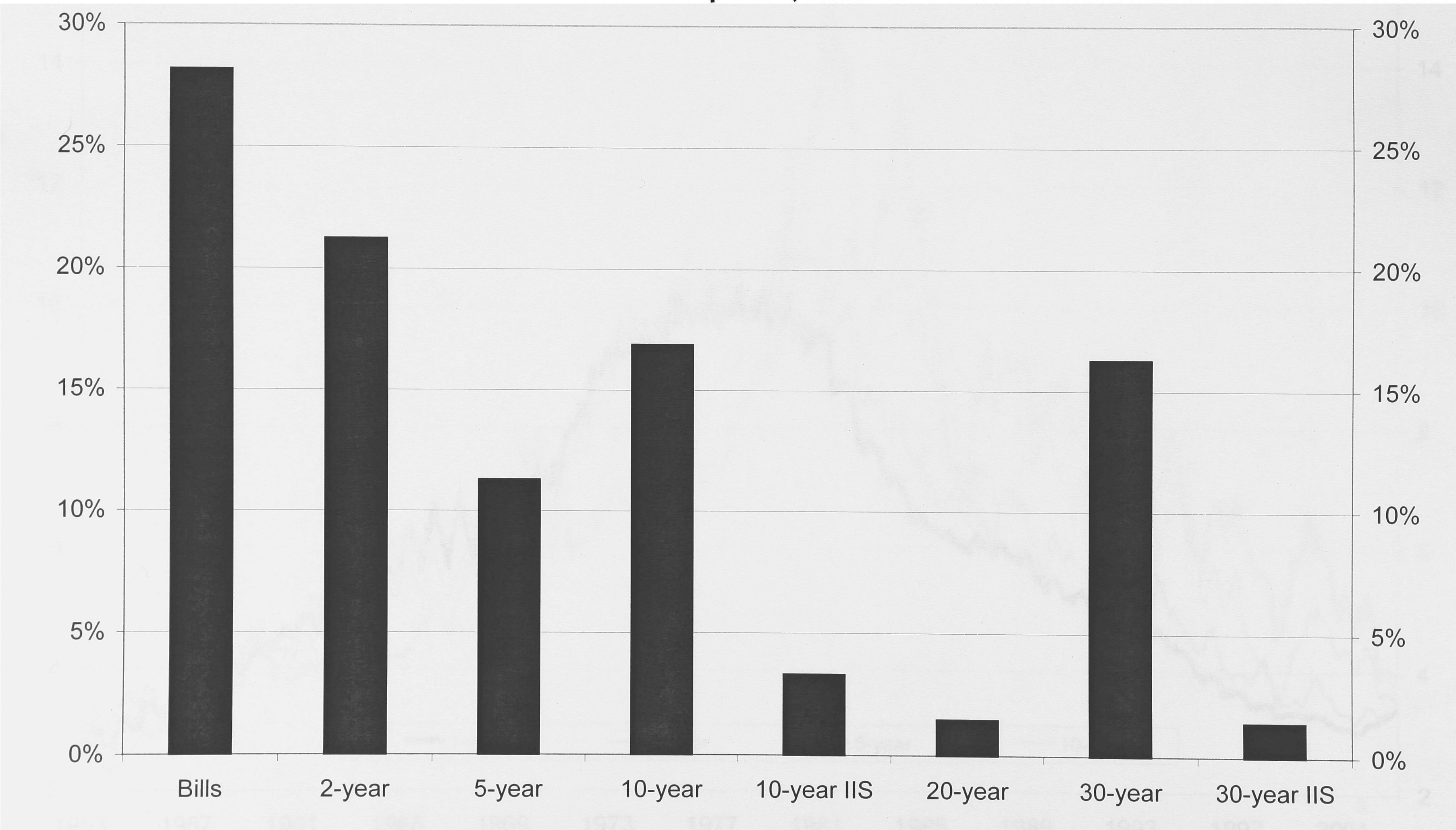


Quarterly Financial Obligations

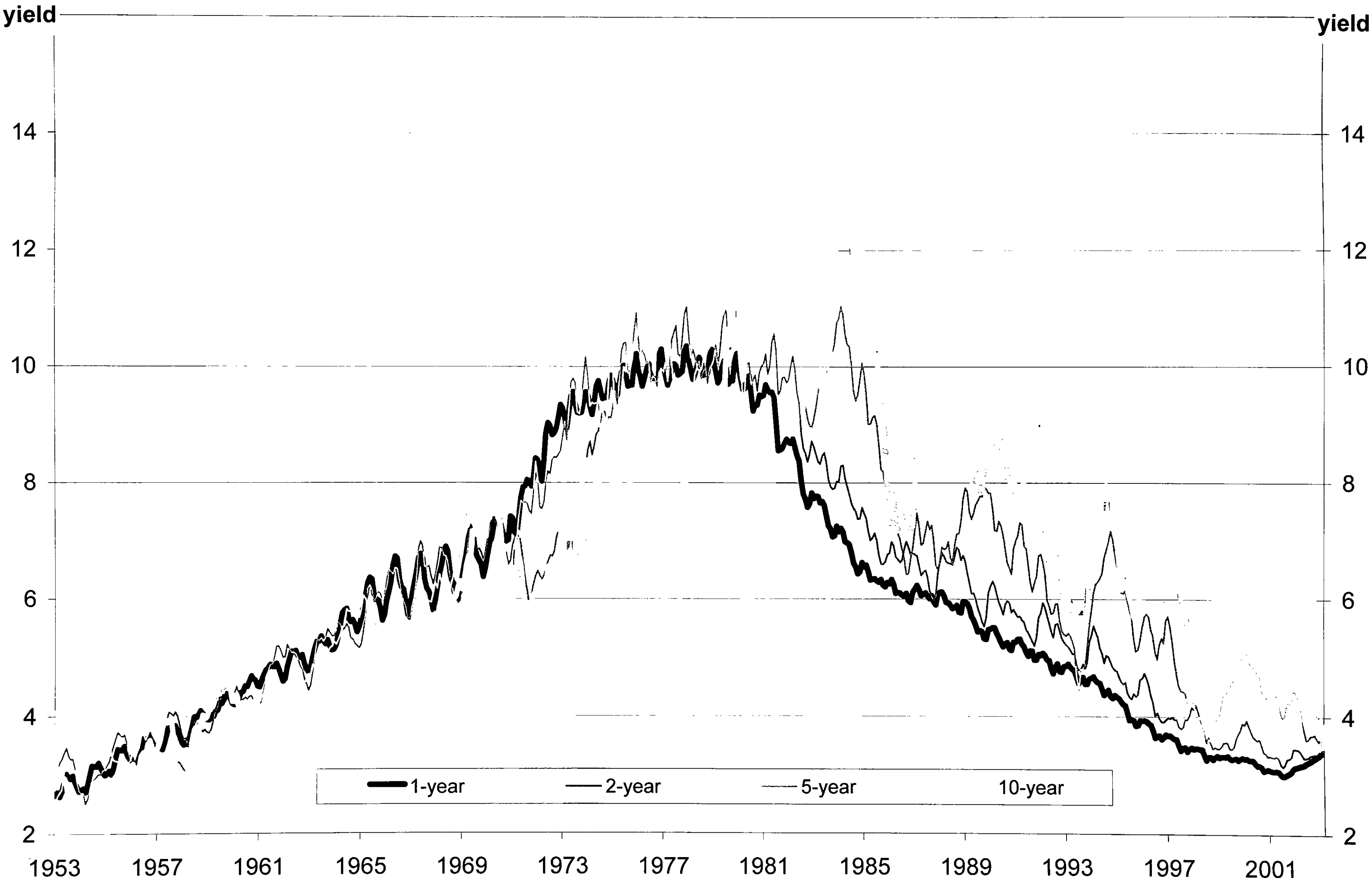
BILLS AS A PERCENTAGE OF TREASURY'S MARKETABLE DEBT[1]



Distribution of Treasury's Marketable Debt Outstanding By Security
As of April 30, 2003



Realized 10-Year Borrowing Cost for Treasury Securities



1/ The interest cost for borrowing a fixed amount with a given security over a 10-year period was calculated using Treasury constant maturity yields.

Includes Forward Rates as of May 21, 2003

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-506

Remarks of Assistant Secretary for Financial Markets Brian C. Roseboro To the Bond Market Association's Inflation-Linked Securities Conference New York, NY

Finding a Better Way

A wise man once said, "*The great enemy of the truth is very often not the lie – deliberate, contrived, and dishonest – but the myth – persistent, persuasive, and unrealistic*".

In my brief time in Washington, I've found the worst myth to be the belief that the debt ceiling imposes any control on government spending. The plain truth is that the debt limit does not affect the deficits or surpluses; the critical revenue and spending decisions are made during the congressional budget process.

The "debt limit" myth bears special attention today because in spite of a recent increase in the debt limit, mythically characterized by some as "the largest increase ever"- not true - this issue will confront the Congress, the Treasury and the fixed income market yet again in the not too distant future. It is imprudent and unwise to risk the United State's privileged standing in the capital markets with this all too frequent self imposed political imbroglio. The challenge and necessity before us is clear: we must maintain Congress's constitutional granted authority for borrowing on "the full faith and credit of the U.S." but better align it with the practical necessity of the Treasury's responsibility to finance the gap between congressionally approved changes to revenues and expenditures. An active financial market community voice must not be mute in urging a solution to this problem.

Definition & history

The authority to borrow on the full faith and credit of the United States is vested in Congress by the Constitution: Article I, Section 8, and Clause 2 –"*The Congress shall have power to borrow money on the credit of the United States*". It is an important and critical pillar of our government's balance of powers. In 1917, in the face of more frequent government financing needs – World War I - the 65th Congress, in conjunction with the Second Liberty Bond Act, delegated authority to the Treasury Department to borrow, subject to a limit. This action replaced the necessity of having to seek congressional authority on each issuance thus providing an operational convenience. Through the years, the format of the debt limit has changed. Initially, different types of government debt had their own limits. The debt limit essentially achieved its modern form in the early 1940s.

The debt limit currently stands at $7.384 trillion. Debt subject to limit, as of June 20th, was $6.598 trillion in combined publicly held and intra-governmental debt outstanding. The current definition of debt subject to limit lacks economic coherence. As stated, the debt limit applies not just to debt held by the public, but to the notional credits in the government trust funds, of which Social Security is the largest. An impartial party to the issue might logically prefer to alternatively define the debt limit as applying just to debt actually held by the public which is only 58% of the current limit. They may just as likely think it more reasonable to define it as a full measure of the government's unfunded liabilities, in which case the current debt subject to limit is massively understated. Today's debt limit is a halfway house, neither here nor there. Further, despite the debt limit's conceptual emptiness, the steady growth of the trust funds - from less than 25 percent of total federal debt in 1990 to 43 percent in 2002 and projected to rise to 55 percent by 2007 - guarantees perennial debt limit strife no matter how frugal Congress chooses to be in the budget process.

This well intended "operational convenience" of 1917 has evolved to at best – an operational inconvenience or - at worst - a threat to the high credit and financial standing of the United States government.

Risking the U.S.'s privileged standing in the capital markets

During the most recent episode, lasting from February 20 – May 23, 2003, Treasury was forced to use – as have all the administrations before us - what's becoming euphemistically know as its' "bag of tricks" to technically stay under the debt limit. All of these devices are provided for in statute. Most are "harmless" accounting "conveniences". However, there always comes a point where use of other authorized devices, along with implementing unexpected alterations or opaque changes to Treasury's "regular and predictable" issuance, have imposed costs on US taxpayers - and worse – short-term disruptive effects on the efficiency of the US fixed income market.

For example: (1) the June 2002 2-year note auction was delayed due to last year's debt limit impasse (in which the US was placed on "credit watch" by Moody's) and following a sloppy "snap" auction ended up costing the Treasury –taxpayers – an estimated $20-$30 million in higher interest cost, and (2) this year, T-bill issuance sizes were affected by $30-$40 billion in April, May and June as Treasury swung "compensating balances" in and out of the banking system to avoid the debt limit. This undoubtedly contributed to unusual tightness in the bill market in May.

The bill issuance adjustments during the recent debt limit episode still have some lingering market effects as we continue to work to "clean up after the party". As the Wall Street Journal said in a recent editorial, "*It would be worse than ironic if, while trying to hold down the level of debt, Congress actually raises the cost of borrowing*". The United States government enjoys unparalleled access to the capital markets in large part due to its regular and predictable policy. The market rewards Treasury for regular and predictable auction cycles with low cost financing. A higher cost of borrowing is likely to be realized when Treasury is seen to have deviated from its policy and introduced uncertainty into the market. While difficult to estimate, a move or a "risk premium" as small as 1 basis point would cost taxpayers $50 million/quarter or $200 million per year based on our projected issuance calendar.

It is critical that there be no doubt either here or abroad that the federal government will honor its financial obligations. In 1919, Moody's Investor's Service gave its first review and rating to U.S. Government securities – "Aaa." The full faith and credit of the United States of America is one of the most precious assets that the American taxpayers have entrusted to any Congress and any Administration. Neither Congress nor the Administration wants to be blamed for losing this standing or much less default. However, the risks of a miscalculation inherent in the "political theater" of raising the debt limit, "getting it done only when it *must* be done", may be more significant than all parties realize.

Is there a better way?

The U.S. capital markets are the envy of the world. The liquidity and transparency that exist makes our markets a role model for developing markets everywhere. However, as we watch that emulation take place, noticeably absent from the blueprint of any other government's financing plan is the adoption of the *debt limit* concept as we entertain it. Varied voices in private and government sectors have questioned the usefulness of the debt limit. They are convinced that Congress, through its regular budget process, already has ample opportunity to vote on overall revenues, outlays and deficits. Still, it is critical and appropriate for Congress to maintain and exercise its constitutional granted authority and control for borrowing on "the full faith and credit of the U.S." Yet there must be a more appropriate alternative mechanism to provide Congress a "check" on its delegation of borrowing authority to the Treasury. There must be an alternative to Treasury being periodically undermined of its ability to efficiently execute the assigned responsibility to manage the government's cash and debt management needs.

Finding those alternatives is today's challenge – "we need to fix the roof while it's not raining." Proposals to raise or repeal the debt ceiling are easy targets for demagoguery. Unless carefully explained – maybe even if carefully explained – these proposals are likely to seem profligate to many voters. A reform proposal will be most likely to succeed and deflect unfair attacks if it self-evidently bolsters fiscal discipline. As examples, alternatives to the current debt limit for consideration could include: (1) simply apply the limit to only debt held by the public or (2) tie a notional debt limit to a new metric, such as publicly held debt as percentage of Gross Domestic Product, now 32%. Or (3) Congress could also replace or redefine the debt limit. To serve as a genuine limit, a replacement should tie raising the debt ceiling directly to fiscal decisions, and define "debt" in a fiscally meaningful way. In an accrual based budget rule, Congress would have to raise the debt ceiling before making fiscal decisions projected to breach it – especially if debt subject to limit were calculated on an accrual basis. Under an accrual-based rule, expenditures are recorded, in whole, as soon as Congress approves them. Or (4) Congress could do away with a notional debt limit and grant the Treasury "evergreen" borrowing authority, that is, the authority to borrow as needed to fund congressionally approved expenditures subject to a periodic review. Congress could vote to renew this authority every 4 or 5 years. Any of these approaches, while still with drawbacks of their own, are far superior to the current status quo.

An active financial market community voice must not be mute in urging a solution to this problem

We at Treasury have worked especially hard over the past two years to make our deliberations more open and transparent and ourselves more accessible to dialogue with market participants – sell side, buy side, analyst and academia. Your input and feedback into our decision making process is wanted and critical to achieving our goal of "lowest cost financing over time." The Treasury's management of the government's finances, as well as legislative policy affecting the execution of Treasury financing, should not be a spectator sport. It matters to you how our decisions on debt issuance – size, term, frequency, and distribution between nominal & TIPs - affect the efficiency of the market. It should matter just as much, if not more, that there not be counterproductive, obsolete legislative constraints which only serve to induce inefficiency and uncertainty into that same market.

Conclusion

Congress's constitutional authority over borrowing is sacred but so too is the premier position of US Treasury securities in the world market place. A better way to maintain both must be found so that neither is compromised. Two hundred and twelve years ago, Alexander Hamilton's idea of unitary government financing began Treasury's responsibility of debt management with a portfolio of $75 million. One hundred and six years later –1897 - the national debt stood at $1.8 billion. And now, one hundred and six years after that, it stands at $6.6 trillion. In the face of this rising debt, the United States has witnessed unrivaled economic growth and development during those 212 years. The issue is misplaced. It's not about debt and debt limits. It's about economic growth. There – another myth exposed to the truth.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-507

Oral And Written Testimony of David D. Aufhauser General Counsel, Department of the Treasury Judiciary Subcommittee on Terrorism, Technology and Homeland Security

Mr. Chairman, I want to thank you for holding this hearing on an issue central to the war on terrorism. I hope that my presence here will aid in your inquiries.

When I joined the Department of the Treasury two and a half years ago, I was already well aware of a deficit of hope in much of the Islamic world, the most visible symbol of which has been the failure to resolve the question of Palestine. I had traveled in the Middle East on behalf of the World Bank and my assignments at that time were straight-forward, but a forensic challenge - try to figure out why rivers of money intended to build dams, to irrigate land, or to establish an effective stock market in the Gulf had failed in their mission, with much left unaccounted for.

When Paul O'Neill asked me to join him, he gave me a related challenge - help the President make every dollar of development aid count, not only because we are stewards of the taxpayer's money, but because effective aide is the most promising tonic to hate. Despair is hate's crucible, and our ambition was to eliminate it, not with any romantic notion of changing minds, but by changing opportunity. No man kills who sees a future for his family.

Others, however, have sought to exploit despair and to teach people how to kill.

They have financed the venture by defiling charitable purpose. And they have found a convenient means to do so in the Middle East and, particularly, in the theocracy of Saudi Arabia.

I want to be clear. We are not at war with a faith, nor with any particular sect. The war is with those who would seek to compromise faith, who counterfeit it, who champion the death of innocents in the name of faith. And here, the austere and uncompromising literal Salafist Wahabi view of the Quran has been wrongly invoked by would be false prophets like Osama Bin Laden to legitimize terror.

Still, it is a very important factor to be taken into account when discussion terrorist financing. The principal of charity is central to Islam, and with unimaginable oil wealth has come a commensurate amount of zakat that has flowed into prominent Saudi based NGOs. Those NGOs have offices disbursed in the outposts of the world populated by the Islamic diaspora - places where need is infinite and where hopelessness preys on the night's sleep. There are, moreover few financial or human resource controls on those frontiers, and little sophistication for dealing with the diversion of charitable money for violent purpose.

It is a combustible compound when mixed with religious teachings in thousands of madrassahs that condemn pluralism and mark nonbelievers as enemies. Fundamentalism is too easily morphed into a chilling mission of hate and terror. And it needs to be dealt with.

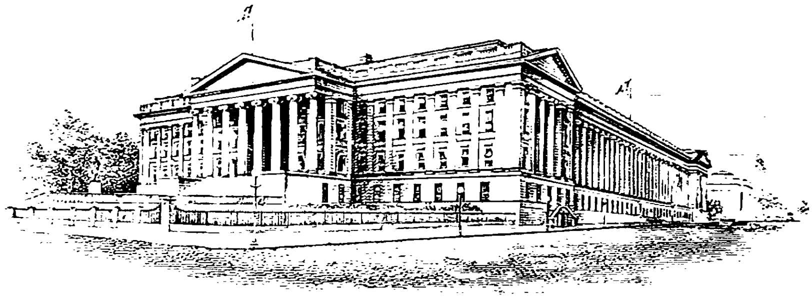
Much of our dialogue with the Saudi government on terrorist financing has focused on the misuse of these religious and charitable missions and the need to tighten controls. The result has been a far reaching charities initiative that bars all cross border giving absent Saudi government oversight and vetting; the closing of 10 offices of the largest and most far reaching Saudi NGO - al Haramain - each office demonstrated to be underwriters for terror in the Balkans, East Africa, Indonesia, and Pakistan; the reconstitution of al Haramain's board of directors; the arrest of a significant number of prominent fundraisers known to us; an on going dialogue on additional NGOs and donors; and work towards establishing a framework for sharing more financial intelligence on a near real time basis.

This last development is critical. Much of the evidence in this shadow war is suspect, the product of interrogation, rewards, betrayals, deceits. But a financial record doesn't lie. It has integrity. And it is enormously useful - helping to identify, locate and capture bad guys, mapping out a network of connections that tie an anonymous banker to a suicide bomber, helping to evaluate the credibility and immediacy of a threat, and preventing a calamity by starving the enterprise of terror of its fuel.

This brings us back, ironically, to why I came to Treasury. As I told you, I did not know then whether my words or advocacy could change people's minds. I did, as I told you, believe that a dollar well deployed could enhance opportunity and thereby diminish antipathy to our values. But I now know that preventing a dollar from being misapplied can be of equal service and is, perhaps, the surest weapon we have to make the homeland secure and to let our kids go to schools that teach tolerance and respect for people of all faiths.

Related Documents:

- Written Testimony



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

Contact: Taylor Griffin
(202) 622-2960

Written Testimony of David D. Aufhauser

General Counsel, Department of the Treasury

Before the Senate Judiciary Committee

Subcommittee on Terrorism, Technology and Homeland Security

June 26, 2003 2:00 p.m.

The United States Senate

The Threat of Terrorist Financing

Chairman Kyl and distinguished Members of the Subcommittee on Terrorism, Technology and Homeland Security, thank you for inviting me to testify today about the threat posed by those who fund terrorism and what can be done to keep that money from getting into the hands of terrorists.

I want to take a moment to emphasize that the terrorist financing strategy of the United States government does not target any particular faith or sect. We are not at war with a religion, but rather with terrorists who sometimes masquerade as its champion. It is a difficult challenge to distinguish between an austere, uncompromising and intolerant view of faith from extremism and fanaticism that purposely seeks the blood of children.

This is a profoundly uncommon war. There is no known sovereign; no uniformed army; no road to take; and, as far as terrorists are concerned, no target that is out-of-bounds. Indeed, terrorists obscenely place a premium upon death and the maiming of innocents. It is shadow warfare. The primary source of the stealth and mobility necessary to wage it is money. It is the fuel for the enterprise of terror. But money is also the Achilles' heel of a terrorist. It leaves a signature, an audit trail which, once discovered, has proven to be the best single means of identification, prevention and capture. Books and records are literally diaries of terror and they can tell us much about the wrongful, criminal hijacking of religion.

How Terrorists Raise and Move Money

Terrorist financing is a unique form of financial crime. Unlike money laundering, which is finding dirty money that is trying to hide; terrorist financing is often clean money being used for lethal purposes. The source of the money used to put a bomb in the hand of a terrorist is often legitimate -- as in the case of charitable donations or profits from store-front businesses diverted from their ostensible use -- and the ultimate goal is not necessarily the attainment of more funds. The ultimate goal of terrorist financing is destruction.

Terrorists employ a wide range of terrorist financing mechanisms, both to raise and move money, and the means used by particular terrorist organizations vary from group to group. Some terrorist groups, such as those in Europe, East Asia, and Latin America, rely on common criminal activities including extortion, kidnapping, narcotics trafficking, counterfeiting, and fraud to support their terrorist acts. Other groups, such as those in the Middle East, rely on commercial enterprises, donations, and funds skimmed from charitable organizations to not only fund their activities but also to move materiel and personnel. Still other groups rely on state sponsors for funding.

But both terrorist financing and traditional financial crimes have one thing in common – they leave a financial footprint that allows us to trace financial flows, unravel terrorist financing networks, and uncover terrorist sleeper cells. The following is a basic summary of the principal sources of funding and the means used to move money that terrorist organizations and their supporters use to plan attacks and to support their networks.

1. Gaming the Banking System

As the United States government sought the sources of support to terrorists in the wake of September 11th, the focuswas on the formal international banking system – the most visible conduit for terrorist financing. Terrorists exploited the openness of the international financial system by storing funds in shell banks and front companies and by using wire transfers to move funds through multiple jurisdictions.

Over the past twenty-one months, we – the Treasury Department, State, Justice, the FBI and other agencies, have conducted an intensive campaign to counter this threat. Through the broad powers of the USA PATRIOT Act (Patriot Act)and sustained international engagement, we have greatly improved the transparency and accountability of financial institutions around the world. These improvements have allowed us to identify and unravel terrorist financing networks embedded in the international financial system. We have also increased the costs for terrorists seeking to use the formal banking system as a means of storing and moving funds.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-508

Economic Policies and Investment Risk in Africa John B. Taylor Under Secretary of Treasury for International Affairs U.S.-Africa Business Summit Washington, DC June 26, 2003

The reason we are here today is to discuss financial mechanisms that are able to mitigate some of the risks of doing business in Africa. Risk—both real and perceived—is the primary reason more capital is not flowing to Africa. Africa represents incredible potential. While capital flows have occurred quite successfully elsewhere, most notably in Asia, Africa has been left behind. Despite Africa's enormous potential, low cost labor, and vast natural resources, investors, quite frankly, remain wary. They are afraid of putting their money in a place which all too often is perceived (however true or not) as a continent wracked by war, famine, AIDS, and corruption.

Although specific financial mechanisms are necessary, they can not address all the risks that confront businesses in Africa. We in the United States have been working with African countries and our donor partners to reduce this risk. The key areas of focus are: (1) challenging African governments to rapidly and significantly improve their investment environments; (2) facilitating new ways to engage the private sector with Africa; and, (3) working with the IFIs to strengthen the financial systems of Africa to support productive investment.

I. Challenging Africa's Governments

First and foremost, the strongest way to mitigate investment risk requires African governments to change their investment environments. The Millennium Challenge Account focuses on improving the investment environment by directing more resources to countries committed to ruling justly, investing in people, and encouraging economic freedom. The Administration's intention is to provide an additional $5 billion a year by 2006 to strong-performing poor countries.

Ruling Justly
In Africa, poor governance – including corruption, limited rule of law, and lack of enforcement of contracts -- scares off domestic and foreign investors. Ruling justly is critical to reversing that trend. Actions African governments must take include effective anti-corruption initiatives, and strengthening of the courts. Another important step is to reduce opportunities for rent-seeking—such as ad hoc tax exemptions and investment incentives, trade quotas, and dual exchange rates.

To be sure, there are already African countries taking these steps. The Zambian Government's recently-established Task Force on Corruption has seized property improperly acquired with public funds and re-channeled those funds to education and agriculture programs. The Kenyan Parliament recently passed two anti-corruption bills which had been pending for many years. In South African, the government has worked since the onset of majority rule to ensure that the benefits of growth are shared more equitably, fiscal management is more transparent and accountable, and the rule of law is reinforced.

Investing in People

For high and sustained economic growth, the composition of government spending in Africa needs to be slanted much more towards investment in people and infrastructure. Creating a better-educated and more productive workforce requires sufficient public investment in schools and teachers, and a commitment from businesses to train their workers. Let us look to Mauritius. In 1999, the secondary school enrollment ratio was 58% while the average for Africa is 31%. The average manufacturing wage is $336 per month, compared with $54 per month in other parts of Africa. This means a more skilled workforce and rising productivity.

Investing in people also means investing in health. In countries with HIV/AIDS rates of 10%, economic growth is reduced by up to one-third and a 20% rate may reduce productivity and growth by more than half.

The African Development Bank has specifically targeted investment in the education and health sectors. Bank lending in these sectors reached 15% of total loans last year. In May 2003, President Bush signed legislation aimed at providing $15 billion to prevent new infections, treating HIV-infected people and providing care for HIV-infected individuals and AIDS orphans. Close to 20 million Africans will benefit. Here again, the U.S. is committed to reducing the real investment risk that HIV/AIDS is casting over the continent.

Economic Freedom

The third MCA pillar is an environment conducive to private sector investment and entrepreneurship. All too often, excessive regulation, state monopolies, and lack of openness to trade result in productivity-enhancing investment going elsewhere.

Macroeconomic stability and trade liberalization are keys to attracting productive investment. Keeping inflation levels low, developing domestic financial markets, limiting the claims of governments on domestic savings, and a sustainable foreign exchange rate regime also are among the requirements for a vibrant economy conducive to private investment.

Botswana is an example of a stable, market-oriented African economy. There are few non-tariff barriers and no foreign exchange controls, price controls, or price subsidies. Contracts and property rights are respected. Moody's and Standard and Poor's call it the best credit risk in Africa despite the macroeconomic challenges presented by the HIV/AIDS epidemic.

Ghana took a very systematic approach to reforming its financial sector in the early 1990s. In the first phase of those reforms, the government placed ceilings on net bank credit to the government to avoid crowding out the private sector. While administrative controls on interest rates remained in place, they were gradually relaxed. The second phase of reform focused on liberalizing controls on interest rates and bank credit. In the third phase, there was a gradual shift from a direct system of monetary controls to an indirect system that utilized market-based policy instruments.

As part of the process, the Bank of Ghana rationalized the minimum reserve requirements for banks, introduced new financial instruments, and absorbed excess liquidity from open market operations. These policies were complemented by strengthening the soundness of the banking system by improving the regulatory framework, strengthening bank supervision, and improving the efficiency and profitability of banks, including the replacement of their non-performing assets. In the final stage of this process, Ghana has embarked on the privatization of the major publicly owned banks.

II. Engaging the Private Sector with Africa

The second way the U.S. is working to help mitigate investment risk in Africa is by working to create ways to promote private sector led growth. As one example, last year, the U.S. launched a project to fund a number of sub-Saharan African countries to get their initial sovereign credit ratings. This promotes several benefits. First, the process of getting a rating helps countries focus on things international investors care about, perhaps most importantly, timely and high quality data.

Sovereign credit ratings can help investors even in non-debt investments evaluate the economic environment and distinguish among markets. Changes in ratings provide useful market-based feedback to governments about their policies. And ratings can serve as benchmarks for private companies that want to access international capital markets. Prior to this initiative, only four Sub-Saharan African countries had received sovereign credit ratings (Botswana, Mauritius, Senegal, and South Africa). This project could add up to 20 countries to this list over the next several years. To date, ratings have been completed for Lesotho and Gambia.

The African Growth and Opportunity Act (AGOA) is another example of support to encourage the private sector. AGOA's purpose is to stimulate closer trade and investment between sub-Saharan Africa and the U.S., thereby boosting market-led growth in the region. AGOA's most important benefit is to provide duty-free treatment for an enhanced list of products plus duty-free imports of textiles and apparel up to a predetermined cap. To qualify, countries must meet requirements with respect to economic reform, trade liberalization, poverty alleviation, attacking corruption, and civil and worker rights.

To date, 38 countries have qualified for AGOA, and total non-oil U.S. imports from AGOA-eligible countries rose to $1.9 billion in 2002 from $1.6 billion in 2000, despite an adverse global economy. The U.S. is also working to create regional trade hubs in Botswana, Ghana and Kenya and is working to achieve a free trade agreement with the five members of the Southern African Customs Union.

III. Financial Strengthening

My third point concerns strengthening financial systems in Africa, including their capacity to manage risk. In most Sub-Saharan countries, SMEs and micro-enterprises have limited access to financial services, yet they make up the vast majority of businesses in Sub-Saharan Africa. In recent years, multilateral development banks, governments, and NGOs have developed numerous programs to finance micro-enterprises. SMEs, on the other hand, would best be served by the local financial sector, which could provide working capital loans and other financial products in local currency. We are convinced that such lending to small and medium businesses has significant potential for generating economic growth and creating jobs and reducing poverty. All of this would mitigate the overall investment risk climate. If these businesses can grow and demonstrate success, I believe private investment capital will follow.
The problem is, however, that this needed financial sector is underdeveloped in many countries.

But we are working to change that. The Bush Administration has long encouraged a small and medium-sized business loan program in Africa. It would be a vital tool for creating economic growth in sub-Saharan Africa. The initiative would mark the first time that the World Bank has combined the resources of its concessional lending arm, the International Development Association (IDA), with those of its private sector affiliate, the International Finance Corporation (IFC).

About eight countries will take part in the $225 million pilot program over the next three to four years, drawing $130 million from new or existing IDA credits, $60 million from IFC, and other commercial investors, and $35 million from other sources. The program's focus will be on three areas:

• Access to Financial Services—establishment of viable new microfinance institutions, improvement of the ability of local banks to lend profitably, and development of innovative vehicles to supply risk capital to small businesses.

• Capacity Building and Business Development Services—strengthening of managerial and technical capacity of small businesses by stimulating both demand and supply within the business development market. The program will also focus on industry-specific programs to link these enterprises with large corporates through integration of supply-chain activities.

• Investment Climate and Enabling Environment —introduction of reforms that facilitate dialogue between the public and the private sectors and improve the functioning and advocacy role of business associations.

While specific country programs will be unique to each local environment, the Bank will ensure that there will be a regional management structure to ensure the sharing of approaches and instruments, and to provide the overall monitoring and evaluation of the program. In the end, we expect the investment climate will strongly improve, and risk will finally begin to drop as financial services are strengthened.

Conclusion
Much work lies ahead for donors, development partners, the private sector, and the governments of Africa if we are to assist Africa reduce its high levels of real and perceived investment risk. The broadening and deepening of financial markets to facilitate financial instruments that mitigate risk is an important element. However, Africa itself must begin the turnaround. The U.S. is doing and will continue to do what it can to reinforce that effort by emphasizing development effectiveness and working in partnership with African nations that rule justly, invest in people, and promote economic freedom.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 22, 2003
JS-509

Remarks before the Israel-America Chamber of Commerce
John B. Taylor
Under Secretary for International Affairs
United States Treasury
June 22, 2003

Thank you very much. It is a pleasure to be in Israel and an honor to speak before such a distinguished group from the business community.

The United States has enjoyed a close economic relationship with Israel since the first days of Israeli statehood. Following the establishment of the U.S.-Israel Free Trade Agreement in 1985 this relationship has become even closer. The United States is now the largest export market for Israel. America invests more in Israel than does any other country.

Recent Trends in Historical Perspective

Like many economies in the world, the Israeli economy suffered substantial setbacks in the past 2½ years. After reaching a peak in the third quarter of 2000, real GDP fell in 2001 and in 2002 by about 1 percent per year. As in my home in Northern California, Israel's high tech industry was hard-hit by the slowdown in the IT sector. After rising by 23 percent in 2000, exports fell by 7 percent in 2001. The domestic security situation has also significantly harmed Israel's growth. Over the longer term, I believe structural policy problems have also been holding back economic growth in Israel. Except for the 1999-2000 export boom, economic growth declined steadily in the second half of the 1990s. This was in contrast to the stronger growth in the first half of the 1990s.

Israel has a history of success in overcoming economic crisis. In the 1980s, economic growth also slowed down. Israel was plagued by triple-digit inflation and large budget deficits. But the introduction of fiscal and monetary policy changes addressed these problems. The budget deficit was reduced. Money growth was brought under control. Structural reforms were implemented, especially trade liberalization and more competition, as in mobile phones.

These policies laid the groundwork for the favorable economic performance in the early 1990s. Growth rose to an average of over 6 percent. Inflation came down sharply. However, as reforms lagged, growth slowed again in the second half of the 1990s.

Today Israel faces another turning point, and again, with the right measures, Israel is destined for success. The government has embarked on an important reorientation of economic policy. It is interesting that Germany, France, and Japan are also starting to address long-term structural impediments to growth. As the global economy recovers, I believe these structural policy changes will have significant payoffs.

The Importance of Productivity Growth

I have long argued that economic policy should focus on increasing productivity growth because that is the driving force behind rising living standards in any country. Simply put, productivity is a function of the pace at which capital is accumulated and the efficiency of resource allocation. While Israel's strong investment in human capital has led to one of the world's most highly skilled workforces, private capital accumulation has been crowded out by excessive government spending. Resource allocation has also been distorted by inefficiencies in the highly-concentrated financial sector, generous social transfers and high taxes that led to low labor market participation rates.

Finance Minister Netanyahu's economic recovery program, passed by the Knesset three weeks ago, is crucial for achieving higher productivity growth in the Israeli economy. Under this plan the government will undertake fiscal policies and structural reforms in order to reduce government expenditures and keep the budget deficit on a downward path.

Israel's general government revenues and expenditures stand at roughly 42 percent and 48 percent of GDP respectively, compared to an OECD average of 38 percent and 41 percent of GDP in 2001. Finance Minister Netanyahu's economic recovery plan therefore rightly focuses its efforts on reducing spending growth. The recent efforts to trim Israeli government ministry budgets and limit the growth of social transfers are important first steps in implementing this plan. These efforts will reduce the government's claim on real and financial resources.

In addition, the reduction in marginal tax rates will help encourage the Israeli private sector to make productivity-enhancing investments. Under this plan, the top marginal tax rate will fall from 60 percent to 49 percent. This will increase the incentives to work and spur growth.

As President Bush has said, "Government spends a lot of money, but it doesn't build factories, it doesn't invest in companies, or do the work that makes the economy go.
The role of government is not to manage or control the economy... but to remove obstacles standing in the way for faster economic growth."

In Israel, getting government out of the direct provision of commercial goods and services is a critical part of the government's plan. Last week's successful offering of El Al shares on the Tel Aviv Stock Exchange is very significant. This will pave the way for further privatizations. I look forward to successful offerings of Bank Leumi, Israel Discount Bank and Bezeq Ltd. Boosting the privatization program will strengthen Israeli competitiveness in the global marketplace and will create generous returns to the Israeli people.

I also agree with Finance Minister Netanyahu that wider financial sector reform should be a top priority for the government. A more efficient banking sector is essential to ensuring that resources are allocated to their most productive use. As the economy begins to pick up, the inefficiencies associated with Israel's highly-concentrated banking sector could eventually present a roadblock to restoring high growth. Recent reforms to make the pension system more market-oriented by shifting pension investments away from preferred government bonds and into the regular bond and equity markets will also help to create a deeper, more liquid capital market.

Labor market reforms would also help boost productivity by increasing labor market participation. At only 54 percent, labor market participation in Israel is among the lowest in the industrialized world.

These are all bold steps in the direction of restoring robust economic growth in Israel, a goal that the U.S. strongly supports. The people of the United States are providing $9 billion in loan guarantees to help the Israeli economy weather regional shocks and thereby create the conditions for the Israel government to put in place reforms that will lead to higher and sustainable growth. In negotiating the agreement, both sides agreed that the guarantees should be linked to progress in implementing the economic reform plan.

In conclusion, let me mention that I am visiting Israel at the end of a trip to Kuwait, Iraq, Afghanistan and Jordan. Freed of the threat of Saddam Hussein and the Taliban, we now have an historic opportunity for sustained economic, political and social progress. The U.S. is committed to doing its part to seize this opportunity. Success in the long-term project of reconstructing Iraq will serve as a powerful example in the region. Moreover, progress in implementing the roadmap will promote greater economic cooperation between Israel and its neighbors, with substantial benefits for all parties. With a successful recovery plan and increasing regional integration, Israel can serve as both an economic engine and an example for the region. Prosperity can in turn reinforce peace and security.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 26, 2003
JS-510

Treasury and IRS to Withdraw "Extraordinary Transaction" Rule of Proposed Regulations

Today, the Treasury Department and the IRS issued a Notice announcing it will withdraw the so-called "extraordinary transaction" rule of proposed regulations issued on November 29, 1999. The rule would have would have operated to change the classification of a foreign entity for tax purposes if certain transactions occurred within a year of the date the entity elected disregarded-entity status. Most commentators on the proposed regulations criticized the approach as overly broad and expressed concern that it would undermine the increased certainty and simplification promoted by the entity classification regulations issued in 1996.

"Withdrawing the proposed extraordinary transaction rule preserves the certainty in tax results that taxpayers need to organize their international business operations," stated Treasury Assistant Secretary for Tax Policy Pamela Olson. "We are continuing to examine certain categories of transactions to ensure that the substantive rules of particular statutory and treaty provisions reach appropriate results notwithstanding changes in entity classification. To the extent we conclude they do not, we intend to propose changes to the rules that are narrow and focused on correcting inappropriate results."

The Notice also states that portions of the proposed regulations other than the extraordinary transaction rule have received minimal comments and that the Treasury Department and IRS intend to finalize those portions of the proposed regulations promptly.

Related Documents:

- Notice 2003-46

Part III - Administrative, Procedural, and Miscellaneous

Notice 2003-46

On November 29, 1999, the IRS and Treasury issued proposed regulations (Reg-110385-99, 64 FR 66591) addressing certain transactions that occur within a specified period of time before or after a change in entity classification. The proposed regulations generally would provide that if an "extraordinary transaction," as defined in the proposed regulations, occurred either one day before or within 12 months after the date a foreign entity changed its classification to disregarded-entity status, then the entity would not be treated as a disregarded entity but instead would be classified as an association taxable as a corporation for all purposes. In addition to this extraordinary transaction rule, the proposed regulations also address "grandfathered" pass-through entities and the determination of relevance of the classification of a foreign entity for U.S. federal income tax purposes.

A public hearing on the proposed regulations was held on January 31, 2000. In addition, written comments were received. Most commentators criticized the approach adopted in the proposed regulations as overly broad and expressed concern that it would mitigate the increased certainty promoted by the entity classification regulations issued in 1996.

After considering the comments received, the IRS and Treasury have decided to withdraw the extraordinary transaction rule of the proposed regulations. Therefore, the IRS and Treasury will withdraw proposed section 301.7701-3(h). The IRS and Treasury received minimal comments on the portions of the proposed regulations addressing grandfathered entities and the relevancy of classification status, and intend to finalize those portions of the proposed regulations.

The IRS and Treasury remain concerned about cases in which a taxpayer, seeking to dispose of an entity, makes an election to disregard it merely to alter the tax consequences of the disposition. The IRS will continue to pursue the application of other principles of existing law (such as the substance over form doctrine) to determine the proper tax consequences in such cases. As the Supreme Court has noted: "To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945).

In addition, the IRS and Treasury are continuing to examine the potential use of the entity classification regulations to achieve results inconsistent with the policies and rules of particular Code provisions or of U.S. tax treaties. In contrast to the approach of the extraordinary transaction rule, which would operate to change the classification of an entity if certain conditions are met, this examination will focus on ensuring that the substantive rules of particular Code provisions and U.S. tax treaties reach appropriate results notwithstanding changes in entity classification.

One category of transactions that the IRS and Treasury are considering is the acquisition of the assets of one controlled foreign corporation (the acquired CFC) by a second controlled foreign corporation (the acquiring CFC) that involves the acquisition of the stock in the acquired CFC followed by its liquidation into the acquiring CFC (through an actual liquidation or by electing to treat the acquired CFC as a disregarded entity). Such a transaction typically would be treated as an asset reorganization under section 368(a)(1)(C) or (D), provided that the transaction meets the other requirements generally applicable to reorganizations, including the requirements that the transaction have a valid business purpose and continuity of business enterprise. See §1.368-1. Although the regulations under section 367(a) would require certain U.S. shareholders of the acquired corporation to enter into a gain recognition agreement if the acquiring CFC had acquired the stock of the acquired CFC, the regulations do not require a gain recognition agreement in an asset reorganization. §1.367(a)-3(a) and (b)(1)(ii). A gain recognition agreement generally requires former U.S. shareholders of the acquired corporation to recognize gain on their original transfers if the acquiring corporation disposes of the stock or substantially all of the assets of the acquired corporation (including a disposition of substantially all of the assets following a liquidation of the acquired corporation) during the five-year period following the initial transaction. The IRS and Treasury are considering whether to extend the gain recognition agreement requirement for nonrecognition treatment under the section 367 regulations to asset reorganizations.

Another category of transactions that the IRS and Treasury are considering is the disposition of a controlled foreign corporation by liquidating the corporation (through an actual liquidation or by electing to treat the corporation as a disregarded entity) and selling its assets rather than by selling the stock of the controlled foreign corporation. For purposes of subpart F, section 954(c)(1) generally characterizes gain on the sale of assets based on the type of income produced by such assets. Thus, section 954(c)(1) distinguishes between gain from the sale of stock, which generally is characterized as subpart F income because stock gives rise to dividend income, and gain from the sale of the underlying assets of the corporation, which is characterized as subpart F income or other income based on the types of income produced by such assets. The IRS and Treasury are continuing to consider the proper treatment of these transactions under the substantive rules of subpart F.

Written comments concerning this Notice may be submitted to CC:PA:RU (Notice 2003-46), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 am and 4 pm to: CC:PA:RU (Notice 2003-46), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically to: notice.comments@irscounsel.treas.gov.

FOR FURTHER INFORMATION CONTACT: Concerning the notice, Aaron A. Farmer or Ronald M. Gootzeit at (202) 622-3860; concerning submissions of comments, Lanita Van Dyke, (202) 622-7180 (not toll-free numbers).

FROM THE OFFICE OF PUBLIC AFFAIRS

June 25, 2003
JS-511

Treasury Applauds New Lending Program for Small and Medium Businesses in Africa

Program is part of Bush Administrationstrategy for economic growth in Africa.

The Treasury Department applauded today's announcement by the World Bank Group that two of its institutions would join in a pilot project to begin lending to small and medium business enterprises in Africa. The Bush Administration proposed this approach last year as part of its strategy for creating economic growth in sub-Saharan Africa. (See Taylor: Finding New Business Models at the Multilateral Development Banks; http://www.treas.gov/press/releases/po3495.htm).

"We're very pleased with today's announcement," said John Taylor, Treasury Under Secretary for International Affairs. "We have strongly advocated this idea for Africa for some time, so it's gratifying to see it get underway. Lending to small and medium businesses has significant potential for generating economic growth and creating jobs and reducing poverty."

The $225 million pilot program will combine the resources of the World Bank's concessional lending arm, the International Development Association (IDA), with those of its private sector affiliate, the International Finance Corporation (IFC).

During the past year, Treasury Department staff has worked closely with IDA and IFC, as well as other shareholder governments, to encourage adoption of such a program.

"Today small and medium businesses in Africa have very few if any options for financing their growth," said Taylor. "This program will help these businesses to invest in productivity enhancements and growth. And if these businesses can grow and demonstrate success, I believe private investment capital will follow. I appreciate the work of the World Bank Group for overcoming challenges to implement this idea."

Taylor credited reforms achieved in last year's IDA replenishment negotiations where the U.S. secured international agreement that IDA resources, which have traditionally gone only to the public sector, could also be used for private sector development in IDA-eligible countries. Collaboration between the IFC and IDA is essential to removing obstacles to private sector led-growth.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 27, 2003
JS-512

Address of Wayne A. Abernathy Assistant Secretary of the Treasury for Financial Institutions to the 2003 Graduating Class of Mynderse Academy Seneca Falls, NY

Congratulations Graduates! Thank you for welcoming me back to Mynderse Academy. Twenty-nine years and four days ago, I sat where you are sitting today. I don't know why it has taken you four more days to graduate than it took us in the Class of 1974—maybe we were in a hurry, or maybe we just had fewer snow days.

As I say, I sat where you are, so I know that I am on borrowed time. I have some recent experience with graduations. My daughter, Cindy, graduated just last week from Chantilly High School, in northern Virginia. There were present for her graduation just shy of 600 students, some 13 beach balls, and one inflatable floating ring—but the ring didn't toss around as well as the beach balls.

Today is a day of celebration. So rather than give a long speech, let me celebrate with you, and help us all understand what we celebrate.

First of all, we are celebrating your achievement. Whether you got to this point on your own steam, or with a lot of pushing, pulling, coaxing and coercion—and I suspect that a combination of all of that brought you here—you are here today, here as graduates. You will receive a diploma that has your name on it, because you met the standards, you earned it. It took you thirteen years—maybe some of you more than thirteen years. But you finished, and we recognize that, and we salute you for it.

But who are you, and what do you represent? Here I find something else to celebrate. As I prepared for today, it struck me that I might be speaking to the sons and daughters of some of my classmates who joined me in that procession nearly 30 years ago. Some of the last names on the list of graduates are very familiar. But there are new names, names that were not found on the list of the Class of 1974. Last week, as those 600 graduates at Chantilly walked up and received their diplomas, I was impressed by the names, and the story behind the names. There were names like Andrews, Baxter, Cohen, and Davenport, Eslinger, Falletti, Larson, and O'Connor. They were joined by classmates with names like Abawi, El-Oyoun, Borkowski, and Gonzalez, Katebi, Kim, Nguyen, and Zafar, names from all parts of the world. They and their parents had all come to America, because all around the world, America means opportunity, after nearly 400 years, it still means opportunity. And they had seized that opportunity, and all were there, together, each and all graduating from high school in America, where else but in America. I see that here today. And that is something to celebrate.

Now, a third great thing to celebrate today: you are graduating from Mynderse Academy! You join the ranks of a great tradition. In Washington alone, I have known graduates from Mynderse Academy working in senior counsels of the White House, in the halls of Congress, in public policy organizations, major national newspapers, and two of us from the Class of 1974 have now served as Assistant Secretaries of the Treasury. Sometimes in conversation the subject of high school comes up. "Where did you go to high school?" Someone replies, "Well, I went to Springfield High School," or "East High School," or "Millard Fillmore High School." "Where did you go to high school?" they ask. I went to Mynderse Academy. I am proud to say it still.

I am proud to say it, because it sounds great: Mynderse Academy. But I am proudest to say it because of what it means to me, because of what I picked up at Mynderse Academy. You have picked up a lot of things during your time at Mynderse, much of which will be of value, some things that may not.

For the remaining few minutes that I have with you this evening, let me share with you some of the things that I picked up, that I brought away with me from Mynderse Academy, things that have worked for me.

Number one, you can date the girls from Waterloo. In fact, I married one of the girls from Waterloo, in fact the Valedictorian of the Waterloo High School Class of 1978. I have often told her that as Valedictorian at Waterloo, she probably would have done well at Mynderse, probably graduated in the top ten. I really believe that.

Something else that I picked up at Mynderse was the knowledge that, while your real failures are all your own, your successes involve a lot of helping hands. In a recent magazine interview I was asked the following question: you spent more than twenty years working for the United States Senate; what would you say was your greatest achievement? I replied that I couldn't name one, not because I was not involved in a lot of successes over that time. I was involved in many. I said that I couldn't name one, because accomplishing anything in the Congress requires the participation of many people, 51 Senators to begin with. No achievement was mine alone. Success comes in working together with a lot of people.

Sometimes you are a leader, sometimes an effective assistant, but always you are working together. A team won't succeed without its members, but there is always a team. Your success here today is yours, but don't forget the team. And something else that I have learned since: there's no limit to the good you can do if you don't worry about who gets the credit.

The next of my acquisitions from Mynderse is closely related: your failures, your real failures, come when you stop trying. No one from the Class of 1974 will remember me as an athlete. I usually got picked last for football, basketball, even dodge ball—and I was pretty good at dodge ball: hard to hit a small target. But one year, I got gymnastics into my blood, not that I was good at it, I wasn't. It is that fact that I was so poor at it that is the point. I wanted to do a hand spring. I couldn't do a handspring. I tried and tried and couldn't do it. Some might say that wisdom is knowing when to quit. I didn't quit. I kept at it. For study halls, I went to the gym and practiced; after school, I went to the gym and practiced. At last I did it. It wasn't pretty, but it was a hand spring. Then I quit. But first I succeeded. I learned from that to keep at it. One of those successes in the Senate that I participated in was a major change to our banking laws that Congress had been working on for 20 years. You keep at it, and you will succeed.

Another gem that I picked up at Mynderse: In the end, it does not matter how hard you try, it is what you produce. A 100 on the Chemistry Regents Exam is a 100, whether it was easy or hard, and a 60 won't pass. Why is that? Why isn't it good enough just to do your best? There are two reasons. First of all, when you are paying the bill, you aren't interested in how hard the man tries, but whether he gets the job done. You are not going to be happy if the dentist says, "I didn't finish filling the cavity, but I did my best. That'll be $100 dollars. Try not to chew on that side. Have a nice day." You are not going to have a nice day, whether the dentist did his best or not.

The second reason why what you do is more important than how hard you try, is because it makes you try harder. I have achieved many things in my life that I couldn't do, or at least that I did not know that I could do. If my standard was just do my best, I might never have done those things. But the standard for the hard things in life—and most of the worthwhile things are the hard things—is get them done. And doing them brings out the real "best that I can do." When you think about it, every great accomplishment was once an impossible task.

This December, people will gather together on a sand dune on the Outer Banks of North Carolina, celebrating the one-hundredth anniversary of the flight of the Wright

Brothers. One hundred years ago today, and for thousands of years before that, it was impossible for man to fly. Today and every day, millions will fly. The Wright Brothers didn't settle for doing their best. They kept at it until they flew. What might you achieve that will be celebrated for a hundred years to come if you aren't satisfied with just doing your best?

The next gold nugget I will share with you came from a Mynderse Social Studies teacher. He taught, you'll never get rich working for your money; you have to get your money to work for you. As Assistant Secretary of the Treasury, I spend a great deal of time teaching that same rule to people all over the country. Today as you graduate from high school, I feel very certain that you are not thinking much about retiring. You are thinking more of your first paycheck than you are of your last.

Do you know what Albert Einstein called "the greatest mathematical discovery of all time"? Compound interest. Why would Einstein say something like that, and why should you be interested? Oh, please be interested—it will be worth your while. I was asked to be inspirational in my speech, and this is the inspirational part, so pay close attention. When you earn money, don't spend it all. Save some, invest some. And what you save and invest will earn interest. Save that, too. Over time, good times and bad, an investment in the stock market will earn you about 7% a year. If you let that ride, and earn interest on your interest, in about 10 years, you will double your money. That means—and here is the power—$1,000 that you invest today, at age 18, will be worth $32,000 when you retire at about age 68. If you wait until you are 28 to invest that $1,000, it will only be worth $16,000 when you retire. It doubles every 10 years, but you can't add years at the end, only at the beginning.

There is much more that I brought with me from Mynderse Academy. My basket was full. These are a few. Let me finish by talking about finishing.

A great American religious leader, Thomas S. Monson, noted a small sign in the sales window of a furniture store as one day he walked the streets of his home town, Salt Lake City. The sign said, "Finishers Wanted" In the furniture business, a finisher is the person who puts the final touches on a piece of furniture to get it ready for sale, to make it attractive and useful to customers. Bishop Monson thought how that sign is in the window of every business, of every walk of life. The world has many starters, but it's the finishers who are in demand. Without them, nothing is ever quite done.

Today, there will be tears in you parents' eyes, even your dad's (though he may try to hide it). Your parents today are finishers. They look on you today with pride, with pride for your achievement, for what you have finished, but also with some pride or satisfaction for what they have finished. You see, it is no big deal to START a family. In fact, one of the curses in our country is the person who merely starts a family with no goal or plans in mind about finishing one, about raising the children and seeing them through into strong, honorable, productive adulthood. Today, with regard to you, your parents have finished something, an important something that they started and to which they have devoted great effort and time and perseverance.

And you join them today as finishers. You are all finishers here today. You all can look with satisfaction upon what you have finished. And it is that finishing that qualifies you now for a beginning in the next stage of your life.

But remember, being a graduating Senior only qualifies you for becoming a Freshman in the Fall, but at a newer, a higher level. So let today also be a beginning, a beginning of something new. Let it be something worthwhile, something that you might not think you can do but that needs to be done. Go forward from here, don't settle for just your best. Continue on until it is finished.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 27, 2003
JS-513

U.S. Calls on Allies to Return Iraqi Assets the Iraqi People

WASHINGTON, DC – U.S. Treasury Secretary John Snow today wrote to Finance Ministers in 38 countries formally requesting their support in identifying, securing, and returning Iraqi assets to the Iraqi people.

Secretary Snow reiterated the obligations of all UN member states under UN Security Counsel Resolution 1483 to transfer any frozen assets of the Iraqi regime to the Development Fund for Iraq (DFI) and to freeze and transfer to the DFI any assets belonging to Iraqi state entities, corporations, or former senior regime officials.

Finally, Snow informed the Ministers that the United States has agreed to help the Coalition Provisional Authority (CPA) and the Central Bank of Iraq seek out the assets of certain individuals and entities, including front companies, that may have acted on behalf of the former Iraqi regime. He added that Treasury General Counsel David D. Aufhauser would be in contact to provide additional information about this effort.

Today's formal communications with Finance Ministers follows the designation and submission to the UN of 55 former senior Iraqi officials on Tuesday. Once final, the UN designation requires that all member states freeze and transfer to the DFI the assets of these individuals.

Since March 20, 2003, the U.S. Treasury Department has been engaged in an effort to locate, secure and return assets of the former Iraqi regime for the good of the Iraqi people. The United States has already returned over $681 million dollars of the $1.7 billion in Iraqi assets previously frozen in the U.S. to Iraq where it is being used to pay civil servants and pensioners, to provide working capital for government ministries, and to purchase equipment for local police forces. Additionally, the Treasury Department, working with allies, has located over $1.2 billion dollars in previously unknown Iraqi assets and is working to facilitate the return of those assets to the Iraqi people through the Development Fund for Iraq.

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 27, 2003
JS-514

Treasury Letter and Report to Congress on G-Fund Restoration

Related Documents:

- Letter to Congress
- Letter to G-Fund
- Report

June 27, 2003

The Honorable J. Dennis Hastert
Speaker of the House
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

Section 8438 of Title 5 of the United States Code requires the Secretary of the Treasury to report to Congress on the operation and status of the Government Securities Investment Fund of the federal employees' Thrift Savings Plan (the "G-Fund") during any debt issuance suspension period. As required by statute, enclosed is the report covering the operation and status of the G-Fund during the most recent debt issuance suspension period. As explained in the report, Treasury has fully restored the G-Fund to the condition in which it would have been had there not been a debt issuance suspension period. An additional report covering the operation and status of the Civil Service Retirement and Disability Fund during the recent debt issuance suspension period will be transmitted to Congress, as required by 5 U.S.C. § 8348, no later than thirty days after June 30, 2003, the first normal interest payment date for that fund.

Sincerely,

Brian C. Roseboro

Assistant Secretary for
Financial Markets

Attachment

Letter sent to:

Rep. Hastert - Speaker of the House

Rep. DeLay - House Majority Leader

Rep. Pelosi - House Minority Leader

Rep. Thomas - Ways & Means Committee, Chairman

Rep. Rangel - Ways & Means Committee, Ranking Member

Rep. Nussle - Budget Committee, Chairman

Rep. Spratt - Budget Committee, Ranking Member

Rep. Oxley - Financial Services Committee, Chairman

Rep. Frank - Financial Services Committee, Ranking Member

Rep. Davis - Government Reform Committee, Chairman

Rep. Waxman - Government Reform Committee, Ranking Member

Sen. Frist - Senate Majority Leader

Sen. Daschle - Senate Minority Leader

Sen. Stevens - President Pro Tempore of the Senate

Sen. Grassley - Finance Committee, Chairman

Sen. Baucus - Finance Committee, Ranking Member

Sen. Shelby - Banking, Housing, and Urban Affairs Committee, Chairman

Sen. Sarbanes - Banking, Housing, and Urban Affairs Committee, Ranking Member

Sen. Nickles - Budget Committee, Chairman

Sen. Conrad - Budget Committee, Ranking Member

Sen. Collins - Governmental Affairs Committee, Chairman

Sen. Lieberman - Governmental Affairs Committee, Ranking Member

June 27, 2003

Mr. Gary A. Amelio
Executive Director
Federal Retirement Thrift Investment Board
1250 H Street, N.W.
Washington, D. C. 20005

Dear Mr. Amelio:

Section 8438 of Title 5 of the United States Code requires the Secretary of the Treasury to report to Congress on the operation and status of the Government Securities Investment Fund of the federal employees' Thrift Savings Plan (the "G-Fund") during any debt issuance suspension period. The Secretary of the Treasury is also required to send a copy of this report to the Executive Director of the Federal Retirement Thrift Investment Board. As required by statute, enclosed is a copy of the report covering the operation and status of the G-Fund during the most recent debt issuance suspension period. This report was transmitted to Congress on June 27, 2003. As explained in the report, Treasury has fully restored the G-Fund to the condition in which it would have been had there not been a debt issuance suspension period.

Sincerely,

Brian C. Roseboro

Assistant Secretary for
Financial Markets

Attachment

Report on the Operation and Status of the
Government Securities Investment Fund
February 20 to May 28, 2003
Pursuant to 5 U.S.C. § 8438(h)

June 27, 2003

On February 20, 2003, Treasury's outstanding debt reached the statutory limit of $6,400 billion. In order to protect the full faith and credit of the United States, the Secretary of the Treasury employed statutory authority to suspend investments in the Government Securities Investment Fund (G-Fund) of the federal employees' Thrift Savings Plan. On May 27, 2003, the debt issuance suspension period ended when President Bush signed legislation increasing the statutory debt limit to $7,384 billion (P.L. 108-24). The G-Fund was fully restored on May 28, 2003.

Legal authority: Section 8438(g)(1) of Title 5, United States Code, authorizes the Secretary of the Treasury to "suspend the issuance of additional amounts of obligations of the United States [in the G-Fund], if such issuances could not be made without causing the public debt of the United States to exceed the public debt limit, as determined by the Secretary of the Treasury." The statute defines the period of this suspension as a "debt issuance suspension period." § 8438(g)(6)(B).

Reporting requirement: Section 8438(h)(1) requires submission of a report to Congress on the operation and status of the G-Fund during this period. The report is to be made "as soon as possible after the expiration of such period, but not later than 30 days after the first business day after the expiration of such period." This document fulfills the reporting requirement of 5 U.S.C. § 8438(h). A copy of this report is being concurrently transmitted to the Executive Director of the Federal Retirement Thrift Investment Board.

Restoration requirement: Section 8438(g) requires the Secretary to make the G-Fund whole upon expiration of a debt issuance suspension period. Treasury must immediately issue obligations sufficient to ensure that the G-Fund's portfolio replicates what it would have been if the suspension had not occurred. § 8438(g)(3). Treasury must also pay the G-Fund, on the first business day after the expiration of the debt issuance suspension period, the interest that the fund would have earned. § 8438(g)(4).

Status and operations: As shown on Attachment 1, throughout this period, all or a portion of the G-Fund's holdings could not be re-invested without exceeding the debt limit. Treasury has now replicated the portfolio the G-Fund would have held but for the suspension, and has paid the G-Fund $362,478,377.37 for interest it would have earned, accounting for receipts and withdrawals.

The table included as Attachment 1 details the daily and cumulative amounts of G-Fund principal and interest that were suspended and restored. With the restoration of $50,048,937,000 in principal on May 27 and of $362,478,377.37 in interest on May 28, the G-Fund was fully restored to the condition it would have been in had there not been a debt issuance suspension period.

Brian C. Roseboro
Assistant Secretary of the Treasury
for Financial Markets

Attachment 1

Status of the
Government Securities Investment Fund
February 20, 2003 - May 28, 2003

Date	Principal: Daily (Suspension) or Restoration	Principal: Cumulative (Suspension)	Interest: Daily (Suspension) or Restoration	Interest: Cumulative (Suspension)
February 20, 2003	($8,507,443,000)	($8,507,443,000)	($974,811)	($974,811)
February 21, 2003	$397,848,000	($8,109,595,000)	($2,788,008)	($3,762,820)
February 24, 2003	($335,035,000)	($8,444,630,000)	($968,045)	($4,730,865)
February 25, 2003	($3,547,031,000)	($11,991,661,000)	($1,374,587)	($6,105,451)
February 26, 2003	$984,291,000	($11,007,370,000)	($1,261,961)	($7,367,412)
February 27, 2003	($14,596,304,000)	($25,603,674,000)	($2,934,599)	($10,302,011)
February 28, 2003	($6,673,262,000)	($32,276,936,000)	($11,098,738)	($21,400,749)
March 3, 2003	($2,984,737,000)	($35,261,673,000)	($3,797,831)	($25,198,580)
March 4, 2003	($7,339,309,000)	($42,600,982,000)	($4,588,235)	($29,786,815)
March 5, 2003	$16,072,419,000	($26,528,563,000)	($2,858,711)	($32,645,526)
March 6, 2003	($9,620,343,000)	($36,148,906,000)	($3,894,542)	($36,540,068)
March 7, 2003	$2,750,777,000	($33,398,129,000)	($10,796,612)	($47,336,680)
March 10, 2003	($2,287,809,000)	($35,685,938,000)	($3,846,290)	($51,182,970)
March 11, 2003	($3,135,587,000)	($38,821,525,000)	($4,184,215)	($55,367,185)
March 12, 2003	$3,356,617,000	($35,464,908,000)	($3,823,363)	($59,190,548)
March 13, 2003	($11,266,785,000)	($46,731,693,000)	($5,036,519)	($64,227,067)
March 14, 2003	$325,049,000	($46,406,644,000)	($15,006,219)	($79,233,286)
March 17, 2003	$27,630,889,000	($18,775,755,000)	($2,029,530)	($81,262,816)
March 18, 2003	($7,589,594,000)	($26,365,349,000)	($2,846,684)	($84,109,500)
March 19, 2003	$5,244,850,000	($21,120,499,000)	($2,282,441)	($86,391,941)
March 20, 2003	($16,769,399,000)	($37,889,898,000)	($4,087,726)	($90,479,666)
March 21, 2003	($169,192,000)	($38,059,090,000)	($12,319,132)	($102,798,798)
March 24, 2003	($1,564,821,000)	($39,623,911,000)	($4,276,139)	($107,074,937)
March 25, 2003	($4,290,755,000)	($43,914,666,000)	($4,738,451)	($111,813,389)
March 26, 2003	$3,013,849,000	($40,900,817,000)	($4,414,554)	($116,227,943)
March 27, 2003	($5,379,948,000)	($46,280,765,000)	($4,994,121)	($121,222,063)
March 28, 2003	$2,932,503,000	($43,348,262,000)	($14,037,021)	($135,259,085)
March 31, 2003	($6,053,892,000)	($49,402,154,000)	($5,332,152)	($140,591,237)
April 1, 2003	$9,563,765,000	($39,838,389,000)	($4,442,109)	($145,033,346)
April 2, 2003	($7,025,734,000)	($46,864,123,000)	($5,223,240)	($150,256,585)
April 3, 2003	($2,928,151,000)	($49,792,274,000)	($5,549,170)	($155,805,756)
April 4, 2003	$0	($49,792,274,000)	($16,643,012)	($172,448,767)
April 7, 2003	$0	($49,792,274,000)	($5,548,130)	($177,996,897)
April 8, 2003	$1,475,810,000	($48,316,464,000)	($5,384,858)	($183,381,755)
April 9, 2003	($1,550,787,000)	($49,867,251,000)	($5,561,181)	($188,942,936)
April 10, 2003	$0	($49,867,251,000)	($5,515,848)	($194,458,784)
April 11, 2003	$0	($49,867,251,000)	($16,597,893)	($211,056,677)

Date	Principal		Interest	
	Daily (Suspension) or Restoration	Cumulative (Suspension)	Daily (Suspension) or Restoration	Cumulative (Suspension)
April 14, 2003	$0	($49,867,251,000)	($5,527,147)	($216,583,823)
April 15, 2003	$19,017,925,000	($30,849,326,000)	($3,426,218)	($220,010,041)
April 16, 2003	$731,954,000	($30,117,372,000)	($3,370,820)	($223,380,862)
April 17, 2003	$7,217,009,000	($22,900,363,000)	($2,569,305)	($225,950,167)
April 18, 2003	($896,630,000)	($23,796,993,000)	($8,007,648)	($233,957,815)
April 21, 2003	($2,946,019,000)	($26,743,012,000)	($2,997,441)	($236,955,256)
April 22, 2003	($3,584,406,000)	($30,327,418,000)	($3,396,042)	($240,351,297)
April 23, 2003	($1,794,693,000)	($32,122,111,000)	($3,595,829)	($243,947,126)
April 24, 2003	$9,320,325,000	($22,801,786,000)	($2,560,637)	($246,507,764)
April 25, 2003	($674,531,000)	($23,476,317,000)	($7,907,608)	($254,415,372)
April 28, 2003	($1,513,052,000)	($24,989,369,000)	($2,804,865)	($257,220,237)
April 29, 2003	($1,085,503,000)	($26,074,872,000)	($2,925,788)	($260,146,025)
April 30, 2003	($14,434,585,000)	($40,509,457,000)	($4,529,956)	($264,675,981)
May 1, 2003	$15,090,042,000	($25,419,415,000)	($2,853,788)	($267,529,769)
May 2, 2003	$8,763,731,000	($16,655,684,000)	($5,641,071)	($273,170,840)
May 5, 2003	($3,417,862,000)	($20,073,546,000)	($2,260,746)	($275,431,587)
May 6, 2003	($4,725,667,000)	($24,799,213,000)	($2,786,072)	($278,217,658)
May 7, 2003	$327,536,000	($24,471,677,000)	($2,749,988)	($280,967,647)
May 8, 2003	$5,980,883,000	($18,490,794,000)	($2,085,751)	($283,053,398)
May 9, 2003	$378,412,000	($18,112,382,000)	($6,131,812)	($289,185,210)
May 12, 2003	($882,019,000)	($18,994,401,000)	($2,142,621)	($291,327,831)
May 13, 2003	($8,480,583,000)	($27,474,984,000)	($3,085,146)	($294,412,976)
May 14, 2003	$2,973,063,000	($24,501,921,000)	($2,755,148)	($297,168,125)
May 15, 2003	($25,408,653,000)	($49,910,574,000)	($5,578,638)	($302,746,763)
May 16, 2003	$0	($49,910,574,000)	($16,736,580)	($319,483,343)
May 19, 2003	$0	($49,910,574,000)	($5,580,870)	($325,064,213)
May 20, 2003	$8,562,323,000	($41,348,251,000)	($4,630,368)	($329,694,581)
May 21, 2003	($1,074,472,000)	($42,422,723,000)	($4,750,269)	($334,444,850)
May 22, 2003	($7,626,214,000)	($50,048,937,000)	($5,598,154)	($340,043,004)
May 23, 2003	$0	($50,048,937,000)	($22,395,103)	($362,438,106)
May 27, 2003	$50,048,937,000	$0	($40,271)	($362,478,377)
May 28, 2003	$0	$0	$362,478,377	$0

FROM THE OFFICE OF PUBLIC AFFAIRS

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June 30, 2003
JS-515

United States Treasury Secretary John W. Snow
Remarks Advocating the Renewal of the Fair Credit Reporting Act
June 30 2003
The Treasury Department, Cash Room
Washington, DC

Good afternoon, and thanks for joining us at the Treasury. I'd like to thank the Women in Housing and Finance for their attendance and support today. I'd also like to thank Treasury Under Secretary Peter Fisher and Assistant Secretary Wayne Abernathy for spearheading our efforts to improve the Fair Credit Reporting Act.

The Administration also owes a special thanks to Chairman Oxley, Chairman Bachus, and Ranking Member Frank of the House Financial Services Committee along with Chairman Shelby and Ranking Member Sarbanes of the Senate for their very constructive hearings on the Fair Credit Reporting Act and consumer protections. Since April, Chairman Bachus alone has held 6 hearings and called 75 witnesses before his subcommittee. We appreciate their attention to this issue.

The uniform national standards in the Fair Credit Reporting Act expire soon. Since their passage in 1996, these national standards for consumer credit information have become a pillar of our economy. Millions of Americans have access to credit today because of these standards and millions more get credit on better terms because of them. They have lead to the democratization of credit and the miracle of modern credit markets, which do so much for average citizens. The widespread availability of credit on reasonable terms helps to keep this economy strong. It is important that the uniform national standards of the Fair Credit Reporting Act be extended and made permanent. The reason for today's event is to express the Administration's strong support for doing just that – renewing the standards and strengthening the consumer protections in them.

A hallmark of our country is readily available credit. In fact, it would not be too much to say that credit is as American as apple pie. Great advances in financial services over the past few decades have opened the doors to credit for Americans across the board. It seems so basic that we take it for granted, but as integral part of what makes our economy so successful is our confidence in financial services such as credit cards, mortgages, and auto loans.

If there is any question on that score, just consider how all three have helped the American economy withstand the serious shocks we've experienced over the last three years – a recession, 9-11, homeland security, war in Iraq and so on.

The availability of credit improves peoples' lives greatly and gives them a degree of economic freedom that is otherwise unimaginable. Because of these credit products, Americans have an unprecedented level of economic freedom and that freedom – the ready availability of credit – depends on business's instant nationwide access to accurate, reliable consumer information.

The national uniform standards of the Fair Credit Reporting Act serve consumer interests in two ways. First, they expand the opportunity for every consumer to access credit and financial services – essentially, they make your reputation as a borrower portable, so that you don't have to establish your good name from scratch in every city you visit, or every store where you shop. Second, the national uniform standards work to ensure that the consumer's personal information is more accurate and secure. The accuracy allows lenders to price credit fairly, and to extend credit to those who might not have been approved in the past. The security limits the ability of the unscrupulous to abuse private data.

As Congress begins to consider the permanent renewal of the national uniform standards of the Fair Credit Reporting Act, we would like to suggest a few ways to make these standards even stronger. With the right additions, we can better protect consumer financial data from fraud and abuse, while enhancing the quality and integrity of that information.

The first priority for the renewed national standards is security, because the greatest threat to consumers today is the growing menace of identity theft. Identity theft is far more insidious and harmful to our national welfare than many realize. It attacks the trust and confidence that nurture our open economy, even as it destroys individual lives. Identity thieves routinely prey on the vulnerable – families of the recently deceased, seniors, veterans, and men and women serving our nation overseas.

The wretched depravity of some identity crimes defies the imagination. In a ring stretching from New Jersey to California, a healthcare worker in cahoots with bank insiders and mortgage brokers got the names of terminally ill hospital patients, forged their identities, drained their bank accounts, and then bought houses and cars in their names – stealing their identify and looting their finances.

Another recent case involved a rash of scammers posing in military uniforms who visited the wives of soldiers deployed in Iraq. They falsely informed the wives that their husbands had been seriously wounded. The con artists then tried to collect personal information about the soldiers from the distraught wives, to enable the scammers to use the solders' identities and steal the families' savings.

In other cases, thieves have impersonated representatives from well-known charities, or used names that sound like well-known charities to collect donor information – all for the purpose of emptying the accounts of the duped donors.

One of the worst aspects of these crimes is that they are often far-advanced by the time they are discovered – with an unexpected failed charge, a surprising negative bank balance, or a rejected job application – but the consequences of these crimes for the victims can linger for years, or even a lifetime. Extensive damage to a person's credit can be as hard to cure as it is to prevent. How do you prove you are the real you, after someone else has stolen and ruined your name? Recovering one's identity is a long, stressful and painful process. We need to make it more difficult to take one's identity and much easier to reestablish one's identity.

It is important to realize that such crimes exact a heavy toll on our economy. Every such crime weighs on our entire system of credit, raising the cost of doing business and subtly but surely impeding economic growth.

Fighting identity theft requires taking the crime as seriously as its consequences. That is what we hope to achieve with permanent national standards for the Fair Credit Reporting Act. The reforms we are seeking will give law enforcement more tools to fight identity crimes. For example, we would direct the bank regulators to be on the watch for patterns followed by identity thieves and alert the banks that they supervise to be on the watch for these patterns. These reforms will also empower individual consumers to protect themselves, and will help victims rebuild their financial lives more easily.

There are several ways that the renewed Fair Credit Reporting Act standards should go further to protect individuals against identity theft, and help victims of theft rebuild their financial lives. For one, we recommend that the uniform standards include a national security alert system. Under such a system we will allow consumers who have been victimized or are in danger of being victimized to put banks and merchants on their guard against any further efforts to impersonate the consumer, thus making it much harder to steal one's identity. The Fair Credit Reporting Act should promote best practices for the sharing of credit information – things like blocking fraudulent account information and doing it immediately before bad information becomes built into the system. And the standards should codify a policy for credit bureaus to share information immediately when a theft is discovered

Another goal of the uniform standards of the Fair Credit Reporting Act is to help consumers learn how to manage their credit to obtain the best outcomes for their personal finances. In the modern American economy, smart credit management is an elementary lesson in financial literacy. Every consumer should know the consequences of poor credit scores and how to raise those scores.

A reformed, pro-consumer FCRA will expand consumer access to free annual credit reports upon request. Consumers should be offered the right to review their credit reports for accuracy and completeness. Consumers also should be provided more information about their credit scores, and instructed on how they can improve their credit profiles.

We believe that the FCRA should also be amended to direct the Federal Trade Commission and bank regulators to make it easier for consumers to say no to unsolicited credit offers. Too often, consumers' rights are hidden from view, and that should be fixed when Congress reauthorizes the Act.

Ultimately, these reforms strike a balance between consumer protection and the overall cost of credit to consumers and businesses in our society. We know that the gains to the economy and to individual consumers are very large because of our uniform national standards. We need to make sure that we are also providing the maximum consumer protection consistent with achieving those economic gains. Better, uniform standards for information sharing allow more people to obtain credit when they need it, wherever and whoever they may be. Our goal is to do so while respecting peoples' privacy and protecting their identity.

For example, more than two-thirds of Americans now own their own home, and 9 out of 10 homes are purchased with a mortgage. The Council of Economic Advisers estimates that without the national uniform standards of the Fair Credit Reporting Act, 280,000 home mortgage applications that are now approved each year would be denied – that's $22 billion in new mortgages annually. Access to financial information that is known to be accurate and reliable is especially important for approving loans to first-time buyers.

The benefits are most pronounced for lower income and minority families, because national standards for credit information give lenders the hard facts they need to make lending decisions they might have walked away otherwise. The percentage of minorities holding mortgages increased dramatically between 1983 and 2001, at a rate much higher than for families overall. At the same time the percentage of minority families with credit cards has risen dramatically as well. One study found that lender utilization of credit scores made possible by national information standards improved minority borrower approval rates by 29%.

With national uniform standards, folks who earn their good reputations can take them along wherever they go. That's especially important for immigrants to this country, who are just starting to put down roots.

No other nation compares with the United States in the breadth, diversity and depth of financial services available to the public.

Secure, reliable information is the lifeblood of all financial services, among which consumer credit is fundamental. It is not an overstatement to suggest that preserving the integrity and availability of consumer credit in this economy is preserving prosperity itself.

We urge Congress to enact this package of reforms, to ensure that the Fair Credit Reporting Act becomes an even more effective tool for meeting the financial interests of American consumers. This proposal is vital to the future of our economy. With improved national standards, we can make great strides to protect our citizens against identity theft, while holding open the doors of credit to many more American families of every income and background.

Thank you.

Related Documents:

- FCRA Factsheet

Fact Sheet on the Administration's Position on FCRA

All consumers of financial services have two basic, closely related interests that are at the foundation of the Fair Credit Reporting Act and that should guide any review of the Act's provisions:

- ► *Security and accuracy of their personal financial information*
- ► *Access to credit and other financial services*

The Administration proposes a package of changes to the FCRA that appropriately balance these two interests for the benefit of consumers:

- Enlisting consumers in improving the accuracy of credit reports by expanding access to free annual credit reports, so that every consumer has free access each year to his or her credit report.
- Directing the FTC and bank regulators to make opt-out notices for pre-screened credit offers simpler and easier to execute.
- Providing consumers with information as to how their individual credit scores were derived and how they can act to improve them.
- Granting the FTC specific authority to require notices to consumers when their credit scores caused them to be offered less favorable rates than for which they applied.
- Requiring credit bureaus to reinvestigate consumer disputes forwarded by intermediaries who consolidate credit reports.

In particular, changes to the law should target the primary concern of financial consumers—*identity theft*. Reforms should work together to help prevent identity theft, apprehend the thieves, and facilitate the restoration of the reputations of victims. For this effort the Administration proposes the following:

- Placing into law a national security alert system, to employ FCRA information sharing procedures to fight identity theft.
- On the basis of a police report or similar document, blocking fraudulent account information on credit reports immediately.
- Establishing in the law the "one-call-for-all" policy whereby an identity theft call to one bureau would be immediately shared with others.
- As a foundation for these measures, as well as to preserve credit market benefits of the national information system, removing the sunsets from the FCRA uniform national standards scheduled to expire at the end of the year.

Outside of the FCRA, changes should be made to banking statutes and the Fair Debt Collection Practices Act that would further the fight against identity theft. The Administration proposes the following:

- Directing the bank regulators to identify and maintain a list of "red flag" indicators of identity theft and provide the list to financial institutions.
- Directing bank regulators to examine banks for use of "red flag" indicators, with authority to assess fines where losses occur due to failure of banks to follow designated procedures.
- Truncating credit and debit card account numbers, and eliminating expiration dates, on receipts.
- Authorizing debt collectors and creditors to share with identity theft victims the information upon which they are basing their collections.
- Discouraging reintroduction of fraudulent information relating to identity theft. Debt collectors who learn that an account is fraudulent would be required to notify the creditor. Creditors thereby would be required to stop the reintroduction of fraudulent information on to credit reports.
- Prohibiting creditors, once they learn that a debt was caused by identity theft, from selling or transferring the debt for collection.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 27, 2003
JS-516

Assistant Secretary for International Affairs Randal Quarles United States Policy Enforcement in the Global Economy Remarks to the Marriott School of Management, Brigham Young University, Provo, Utah, June 27, 2003

Thank you, Dean Hill. It's a pleasure to be back home in Utah and to be able to share with you today my thoughts on the global economy and US engagement in international economic affairs.

The Role of Economics in Foreign Policy
From the outset of this Administration, President Bush has stressed that his foreign policy is based on three essential, interdependent building blocks --military, political, and economic--with economics by no means in third place. In fact, the first National Security Presidential Directive named the Secretary of the Treasury – for the first time -- as a formal member of the National Security Council, together with the Secretaries of Defense and State.

This formal inclusion of economics into foreign policy has certainly resulted in an elevation of economic issues. But it has also led to a government inter-agency mechanism--from the cabinet, to their deputies, to technical staff--that allows for increased coordination between economic and military/political issues.

This increased coordination has been evident in many areas, from the Reconstruction of Iraq to a heightened emphasis on business-like input-output performance measures used in policy evaluation, even in areas where quantitative information is difficult to find or measure.

Overall Economic Policy Goals
So, from the outset of the Administration, international economic policy has been central to foreign policy. Two goals have guided the international economic policy agenda: (1) increasing economic growth, as measured by improvements in productivity and higher income per capita, and (2) improving economic stability, as measured by a reduction in the severity, length, and frequency of economic downturns and crises.
Perhaps the best illustration of how economic policy is formulated is to discuss how these core principles are applied in every day policy-making. I'd like to turn now to a brief overview of current conditions, and then continue with an examination of applied economics – how our principles help guide policy towards developed, emerging and developing countries around the world.

An Overview of Current Conditions
The most important thing any country can do for global economic policy is to get its own domestic economic policies right – promoting growth is critical and the US is doing its part. The President took this message to the recent G8 Summit in Evian, France, and the Finance Ministers underscored it with their own pronouncements from Deauville.

So let me start with an overview of where we are at the moment in the US. In the United States, GDP rose by 1.4% in each of the last two quarters. Most analysts, however, expect a significant pick-up in the second half of this year and over 4% in 2004, as the President's jobs and growth provisions kick-in. In fact, Treasury economists are currently expecting annualized growth rates near 3.5% by the later part of this year. We're starting to see an impact in the markets from the Jobs and Growth plan, as higher tax-adjusted returns on dividends and capital gains are factored into stock prices. In many ways, the focus of the plan is on reducing the cost of capital for businesses, creating conditions for higher potential growth in the long-term. A lower cost of capital means more capital formation, more investment, and more jobs. Obviously, the tax plan does a lot for the demand side as well, with lower marginal rates for all taxpayers and immediate child tax credits for families, for example.

And there is other good news. Consumer sentiment is up with the end of The war, interest rates have stayed low keeping the housing market strong, and corporate profits are rebounding. Productivity has stayed strong, which bodes well for future income growth and living standards.

The Industrialized Nations: Structural Changes
On the international front, the industrialized nations are growing far too slowly and everyone suffers as a consequence. Growth in the G-7 countries outside the United States has been disappointing. Our neighbor Canada continues to do well, closely linked as it is to our own economy. But in Europe the outlook for the Continental countries is decidedly weak, and some forecasters doubt whether the upturn expected in the second half of this year will occur on schedule. Japan remains on a path of very low growth, continuing the weak performance of the past decade.

So, among the developed nations of the world, we expect relatively strong performance by the United States over the next year and a half, and relatively weak performance by Japan and Europe. But a healthy world economy needs multiple engines of growth, so we remain concerned about weakness in the Euro Area and in Japan. These countries need to take action, appropriate for their own situations, to move onto a sustained upward path. For both Europe and Japan, structural changes will be especially important. In Germany, reform emphasizing more flexible labor markets, is an important first step. For the French, public sector pension reform is key. Japan also needs to act decisively – to clean up its banking system, to end deflation, to undertake structural reforms and deregulation of product markets, and to adopt a credible medium-term fiscal consolidation program.

Emerging Markets: Fostering Growth and Stability
Financial crises in recent years have threatened the progress made by many emerging markets. Successive crises have constrained global capital flows and helped leave growth well below its potential. With the central goal of increasing economic growth and stability, we must provide strong support for policy reforms.

Latin America and Asia
In Latin American prospects look distinctly better this year. The effects of Argentina's massive financial crisis and political uncertainty in Brazil in the run-up to presidential elections were among the factors that heightened regional uncertainty in 2002 and contributed to negative growth. With Argentina now recovering, Brazil's new president providing a positive confidence shock through support for strong policies, and other countries also improving their policy frameworks, the outlook for 2003 has improved and positive growth is expected this year. Significant challenges remain, however, if the region is to improve on the disappointing growth it has seen over a long period.

As we look at the region, we see new leaders – including three I met on my recent trip with the Secretary to Latin America, Lula, Uribe, and Gutierrez – who are setting a courageous and far-sighted economic course. They have focused on cutting deficits, lowering the cost of capital and freeing up resources for private sector-led growth, promoting trade integration, and upholding the rule of law. Throughout the region, we see more convergence on core policy imperatives: stability, more emphasis on markets and the private sector, and a focus on better governance and reduced corruption.

In East Asia, despite a slowing of growth in the second quarter, mainly due to the impact of SARS, prospects are good that growth will rebound during the rest of the year. The risk of balance of payments crisis has declined significantly as the lessons of the Asian Financial crisis are absorbed (though to varying degrees) and most countries have built up foreign exchange reserves and reduced short-term external debt. China's impressive expansion reflects foreign investment and low-cost labor, as well as strengthening domestic demand. The good news for the global economy is that China's imports are growing rapidly, along with its exports. Many Asian countries rely more and more on sales to China. Continued growth in China will be a great opportunity for the world economy: producers in Asia, the U.S. and elsewhere can benefit greatly from growing exports to China, while consumers continue to enjoy China's exports.

Crisis Prevention

So, the emerging market countries are doing much better, but the experience of the last 20 years tells us that we must be vigilant about the risk of instability or crisis in these markets. Reducing the frequency of crises and improving emerging markets' access to private capital flows means preventing crises before they erupt – to do this, we need to better understand potential vulnerabilities and encourage countries to take early action. Second, we must reduce the spread of crises from one country to others. Third, we are working to make clear that official sector finance is limited – and not available in large sums that might encourage excessive risk-taking or provide an escape for policy-makers facing difficult choices. Finally, we are seeking to create a more orderly and predictable process for debt restructuring through the introduction of collective action clauses in sovereign bonds.

No one wants to support the bail out of investors that take risky bets, or of governments that avoid responsible policies. The first step to avoiding a request for emergency assistance from a country is to be able to better spot trouble on the horizon. To this end, one of our primary tools is the International Monetary Fund, which has a mandate for surveillance of countries' policies and of financial market trends. The Fund has made important strides in bolstering its own understanding of risks, and its own capacity for analysis. We have also made good progress in sharing the benefits of the Fund's work with market participants -- the Fund now has a comprehensive web site (www.imf.org) that is a conduit for the public to get access to real-time financial and economic information on countries, and in many cases to see the full staff papers that inform the Fund's decision.

When financial crises cannot be averted, policy makers need to consider how to respond. In the face of recent challenges in Latin America, the international community demonstrated active but calibrated responses. The United States and the international financial institutions acted quickly and decisively to pressures on Brazil in August 2002 as the country headed into presidential elections. We bet that the new government would continue a strong emphasis on stabilization, and accordingly, we supported an IMF program that spanned the election, though resources were back loaded to maintain an incentive for solid implementation. Our support for Brazil has turned out to be a good bet.

The United States encouraged Argentina and the IMF to negotiate a short, transitional program to support and strengthen stabilization progress through the election period. The idea was to lock-in fiscal and monetary policy progress during this period and in the immediate aftermath of the elections to build confidence and give the new government a chance to formulate its policies. Both policy outcomes and economic performance suggest that in macroeconomic terms this IMF program was a good decision by the international community.

In Uruguay, we found a good performer with a strong desire to honor its obligations. But it was hit hard by Argentina's severe crisis. The United States and the international financial institutions formulated a financial package aimed at avoiding banking sector collapse and a multi-year depression. In addition, the recent debt exchange may well turn out to be a model in cases where debt restructuring is needed.

Finally, the United States was determined to help Colombian President Uribe meet security needs as well as the economic and financial challenges the country was facing at the same time. Support from the international financial institutions helped generate renewed access to markets.

These four country cases demonstrate our willingness to help those committed to sound policies. We are not, prepared, however, to back countries that lack a strong commitment to policy performance.

To further strengthen incentives for strong policies and prudent risk-taking, the United States has sought to make clear the limits on official finance. The Administration has emphasized and will continue to insist that the IMF be the key source of emergency support in the face of financial crises. Creating a more orderly and predictable process for debt restructuring has also been a priority in recent months. There can at times be "collective action" problems that prevent a prompt, orderly resolution of a sovereign debt crisis. It is our strong view that collective action clauses offer a practical vehicle to mitigate this problem. We have seen excellent progress in developing and incorporating collective action clauses in external sovereign bond contracts. An initial offering by Mexico incorporated these clauses and was followed by Brazil, South Africa, Korea and others. Emerging markets that regularly access international financing need to assume rightful ownership of these issues and help assure a more stable and orderly international financial system.

The Developing World: Economic Growth is the Key to Poverty Reduction
The persistence of poverty is one of the most difficult challenges the world faces. Yet we are committed to tackling it. The Administration's strategy in developing countries centers on increasing productivity growth, thereby raising living standards and reducing poverty. Creating economic opportunities is vital not only to the daily lives of individuals and the economic development of their countries but also to stability for all of the world's citizens.

The President's commitment to tackling poverty is exemplified by his proposed Millennium Challenge Account (MCA), which represents a tremendous innovation in the delivery of development assistance. The MCA brings together the lessons we have learned about development over the past 50 years: 1) Aid is more likely to result in successful sustainable economic development in countries that are pursuing sound political, economic and social policies. 2) Development plans formulated by a broad range of stakeholders engender country ownership and are more likely to succeed and 3) Integrating monitoring and evaluation into the design of activities ensures that aid is going where it's most effective. The MCA will place a clear focus on results. Funds will only go to well designed programs that have clear objectives, measure baseline data, and set benchmarks for both intermediate outputs and final outcome goals.

President Bush has also set out a new economic growth agenda for the multilateral development banks that focuses on raising productivity growth, introducing measurable results, and structuring our contributions to create incentives for specific outcomes. He called on the development banks to increase the use of grants, rather than loans, to the poorest countries, and the banks are already responding. Grants help poor countries make productive investments without saddling them with ever larger debt burdens. Recipients perceive grants to be more valuable than loans, permitting higher performance hurdles and thus enhancing development effectiveness and results. With strong U.S. urging, both the World Bank's concessional window – IDA – and the African Development Fund have agreed to increase sharply the share of resources provided in the form of grants to the poorest countries, so that 18-21 percent of total assistance over the next three years will be provided in this form. The poorest countries are eligible for 100% grant financing for efforts to counter HIV/AIDS. Donors likewise committed to increase grants in the International Fund for Agricultural Development to 10 percent of total assistance. This year we will seek to expand the use of grants at other MDBs, particularly the Asian Development Bank through its facility for the poorest countries, the Asian Development Fund.

The Primacy of Trade and Investment in an Integrated Economic Policy Strategy
One issue that is of fundamental importance to each category of country – the industrialized nations, the emerging markets and the developing world – is trade. Trade liberalization is a fundamental step that all countries around the world can take to raise growth and reduce poverty. We are pursuing this objective at a global level in the World Trade Organization, regionally through the Free Trade Area of the Americas agreement, and bilaterally through recently signed agreements with Singapore and Chile, as well as continuing negotiations with the Southern Africa Customs Union, Morocco, Australia and several Central American nations.

Multilateral trade liberalization is a global tax cut for all consumers and exporters and an engine for growth, in association with sound macroeconomic, structural policies. The IMF and World Bank estimate that the gains to developing countries from eliminating global barriers to merchandise trade alone would be well in excess of annual aid flows to these countries. To realize these benefits, developing countries need to reduce their own trade barriers substantially. The World Bank found that liberalization within the developing world is key to their economic growth, development, and poverty elimination. Developing countries collect most of their tariffs on trade with other developing countries. Indeed, 67-80 percent of the projected income gains from global trade liberalization for developing countries (some $121 billion in a static model and $424 billion in a dynamic model) are expected to come from liberalization of their own barriers.

An open investment climate both here and abroad contributes to the widening and deepening of capital markets, improves the risk profile of developing and emerging markets, and complements trade liberalization as an engine of growth. For developing and emerging markets, in particular, an open investment climate, whereby foreign investors have broad market access and are treated in a fair, equitable, and non-discriminatory manner is critical to lowering the cost of capital in these countries. Inflows of foreign capital can improve productivity, induce the transfer of technology and management skills, create jobs, expand exports, and enhance import competitiveness. These benefits are not limited to developing and emerging economies, however. They are important to our own economy, and the President is committed to maintaining the U.S. Government's long-standing policy welcoming foreign investment in this country.

The President is also committed to a vigorous negotiating agenda to ensure open investment policies abroad. The passage of TPA has enhanced the President's ability to pursue negotiation of international investment agreements. His administration has launched one of the most sweeping initiatives to encourage open investment policies abroad ever undertaken by United States. The effort is both bilateral and multilateral. The investment chapters in the recently concluded Chile and Singapore FTAs reflect this vigorous agenda.

Rebuilding Iraq

One area in which we are being called upon to apply these principles in a particularly dramatic way is the reconstruction of Iraq. Rebuilding Iraq and Afghanistan are clear priorities for the United States. After living under decades of misrule by Saddam Hussein, the Iraqi people at last have an opportunity to forge a better future for themselves and for their children. We are committed to assisting in this effort. Our work is guided by a set of principles that are fundamental to creating the foundation for sustained economic growth. These principles include open markets, the rule of law, established property rights, transparent and accountable governance, and a sound currency.

With these principles in mind we are confronting the many challenges on the economic front that we have faced since the end of the war. Government ministries were largely destroyed by fighting and looting; the Iraqi dinar had depreciated severely and we feared a monetary crisis and hyperinflation; basic economic statistics were non-existent; and the lack of a secure environment restricted commerce and the work that our staff could do in Iraq. We continue to deal with lawlessness, limited ability to communicate, and the loss of technical expertise in government ministries.

I would like to stress, however, that the reconstruction task is not just, or even primarily, to rebuild from the consequences of several weeks of war, but rather from several decades of misrule. The Iraqi economy deteriorated under years of sanctions, conflict, and economic mismanagement. Income per capita plummeted, and other measures of wellbeing also declined. The infant mortality rate, for instance, increased from 50 per 1,000 live births in 1990 to 121 per 1,000 live births in 2000.

Although the reconstruction task is significant, Iraq has several advantages that will facilitate efforts to improve the country's prospects. Iraq has a long tradition of entrepreneurship and diverse commercial activity; already, the streets of Baghdad are bustling with commerce. In addition, it has abundant human potential and natural resources. In combination with a market economy based on rule of law, established property rights, and economic freedom, these advantages can lead the way to a brighter, more prosperous future for all Iraqis.

In helping Iraqis achieve such a future, it will be important to draw on lessons learned from previous post-conflict experiences. One such lesson is that rebuilding societies and economies requires time, patience, and a sustained commitment.

Reconstruction is not amenable to easy solutions or quick exits. The nature of our engagement will necessarily evolve over time as Iraqis choose their own government and reconstruction tasks are completed, but we are committed to ensuring that the people of Iraq have brighter prospects for their future.

Let me review briefly some of the principal steps we have taken, as well as priorities for future action.

A critical early priority is to promote the establishment of a stable, unified national currency, which is a prerequisite for establishing a vibrant economy. The pre-existing currency situation makes this a difficult task. Several currencies circulate widely, including the Iraqi, or "Saddam," dinar in central and southern Iraq; the Old Iraqi, or "Swiss," dinar in the northern part of the country; and the U.S. dollar. One of our main concerns following the end of the war was that there would be a large devaluation of the Saddam dinar followed by hyperinflation. In addition, there were concerns about losing control of currency printing facilities, and fears that the currency would cease to serve as an accepted means of exchange.

We took action early to address these concerns. We secured currency stocks and printing facilities, and the military made public announcements that existing currencies would continue to be accepted as means of payment. Although little price data is available to make assessments about inflation, the information we have received on exchange rates indicates that the value of the Saddam dinar against the dollar, while very volatile, has strengthened of late. We stand ready to assist in the implementation of whichever long-term currency reform the people of Iraq choose through a representative Iraqi government.

Another area on which we have placed a great deal of attention is the development of an integrated and transparent Iraqi government budget. Before the war, the Iraqi budget was a state secret. The lack of transparency and accountability made it difficult to determine how resources were allocated. Enhanced transparency will be essential in future budget operations, particularly in the area of oil revenues, if enhanced standards of governance are to be achieved and the Iraqi people are to hold their elected officials accountable.

In addition, we are evaluating options to establish a "trade credit authority" that will begin laying the groundwork for commercial activity independent of central authority. Such a financing mechanism will help stimulate the Iraqi economy by facilitating foreign trade.

An issue that has received much attention and will clearly have to be addressed is Iraq's capacity to address the potentially enormous burden of its existing financial obligations. In the near-term, we have taken two important steps to address this situation. First, we secured agreement from G-7 creditors not to expect Iraq to service its debt for at least the next eighteen months. Second, we have been working to determine how much debt Iraq owes. In the medium-term, once we have a better estimate of the true level of Iraq's debt and its underlying payment capacity, we can move forward to develop a comprehensive strategy to deal with Iraq's official debt.

We have been guided in all of our actions by the goal of creating a stable and prosperous Iraq and releasing the shackles that have constrained the potential of the Iraqi people. The challenges are still formidable, but we remain committed to achieving an environment in which all Iraqis will have the opportunity to forge a better future for themselves and their children.

A Few Words on the Financing of Terrorism

Money is the fuel for the enterprise of terror, but it also can be its Achilles' heel. Conventional wisdom has it that terror is cheap, but this is only based on the most visible of operating costs. Terrorism is an enterprise involving numerous activities – recruiting, transporting, training, arming, targeting, concealing, executing, and escaping. It takes a great deal of money. Al-Qai'da paid the Taliban $20 million each year for safe harbor in Afghanistan. If we stop the money, we stop the killing.

The Treasury Department has been a key agency in the fight against the financing of terrorism. Our approach to the problem is multifaceted. Our most public tactic is the designation and freezing of financial assets. This impedes operations and dries up the financing pipeline, and has already netted us $138 million worldwide. But this is only one activity. We also spend many hours on the vitally important work of developing and strengthening international standards related to identifying wire transfers, reporting on suspicious bank activities, and overseeing charitable donations among other things. Besides standard setting, we are working to institutionalize the protection of the world's formal and informal financial systems by ensuring that the International Financial Institutions look hard at countries' safeguards against terrorist finance as part of routine oversight. All of this involves extensive diplomatic outreach, both bilaterally and multilaterally.

Conclusion
As you can see, we have set for ourselves a challenging agenda. But we are committed to working through the key issues of our times and to developing a set of policies that ensures continued growth while laying the foundation for financial stability. We will continue to work with our partners around the globe in attempting to lay the foundation for increased prosperity and improved economic conditions around the world.

I would be happy to take your questions.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 27, 2003
2003-6-27-12-57-9-6972

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $82,961 million as of the end of that week, compared to $82,566 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	June 13, 2003			**June 20, 2003**		
TOTAL	**82,961**			**82,350**		
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	7,883	13,391	21,274	7,724	13,286	21,010
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,782	2,689	15,471	12,556	2,668	15,224
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			23,401			23,335
3. Special Drawing Rights (SDRs) [2]			11,770			11,737
4. Gold Stock [3]			11,044			11,044
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	June13, 2003			**June 20, 2003**		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	June 13, 2003			**June 20, 2003**		

	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to the prior week's IMF data. IMF data for the latest week may be subject to revision. IMF data for the prior week are final.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 30, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	91-Day Bill
Issue Date:	July 03, 2003
Maturity Date:	October 02, 2003
CUSIP Number:	912795NQ0

High Rate: 0.885% Investment Rate 1/: 0.903% Price: 99.776

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 50.67%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 31,308,506	$ 15,460,914
Noncompetitive	1,389,108	1,389,108
FIMA (noncompetitive)	150,000	150,000
SUBTOTAL	32,847,614	17,000,022 2/
Federal Reserve	5,313,764	5,313,764
TOTAL	$ 38,161,378	$ 22,313,786

Median rate 0.870%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.840%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 32,847,614 / 17,000,022 = 1.93

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,073,005,000

JS 517

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY SECURITY AUCTION RESULTS
BUREAU OF THE PUBLIC DEBT - WASHINGTON DC

FOR IMMEDIATE RELEASE
June 30, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	183-Day Bill
Issue Date:	July 03, 2003
Maturity Date:	January 02, 2004
CUSIP Number:	912795PD7

High Rate: 0.950% Investment Rate 1/: 0.971% Price: 99.517

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 41.37%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 28,042,764	$ 16,687,494
Noncompetitive	1,037,625	1,037,625
FIMA (noncompetitive)	275,000	275,000
SUBTOTAL	29,355,389	18,000,119 2/
Federal Reserve	6,286,079	6,286,079
TOTAL	$ 35,641,468	$ 24,286,198

Median rate 0.925%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.890%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 29,355,389 / 18,000,119 = 1.63

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $806,927,000

JS-518

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 30, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $17,000 million to refund an estimated $18,000 million of publicly held 4-week Treasury bills maturing July 3, 2003, and to pay down approximately $1,000 million.

Tenders for 4-week Treasury bills to be held on the book-entry records of *TreasuryDirect* will not be accepted.

The Federal Reserve System holds $14,027 million of the Treasury bills maturing on July 3, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders in this auction up to the balance of the amount not awarded in today's 13-week and 26-week Treasury bill auctions. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of the auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about the new security are given in the attached offering highlights.

oOo

Attachment

JS 519

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED JULY 3, 2003

June 30, 2003

Offering Amount	$17,000 million
Maximum Award (35% of Offering Amount)	$ 5,950 million
Maximum Recognized Bid at a Single Rate	$ 5,950 million
NLP Reporting Threshold	$ 5,950 million
NLP Exclusion Amount	$10,700 million

Description of Offering:

Term and type of security	28-day bill
CUSIP number	912795 NF 4
Auction date	July 1, 2003
Issue date	July 3, 2003
Maturity date	July 31, 2003
Original issue date	January 30, 2003
Currently outstanding	$42,079 million
Minimum bid amount and multiples	$1,000

Submission of Bids:

Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 4.215%.
(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders:
Prior to 12:00 noon eastern daylight saving time on auction day

Competitive tenders:
Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGOED UNTIL 11:00 A.M.
June 26, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS 13-WEEK AND 26-WEEK BILLS

The Treasury will auction 13-week and 26-week Treasury bills totaling $35,000 million to refund an estimated $30,560 million of publicly held 13-week and 26-week Treasury bills maturing July 3, 2003, and to raise new cash of approximately $4,440 million. Also maturing is an estimated $18,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced June 30, 2003.

The Federal Reserve System holds $14,027 million of the Treasury bills maturing on July 3, 2003, in the System Open Market Account (SOMA). This amount may be refunded at the highest discount rate of accepted competitive tenders either in these auctions or the 4-week Treasury bill auction to be held July 1, 2003. Amounts awarded to SOMA will be in addition to the offering amount.

Up to $1,000 million in noncompetitive bids from Foreign and International Monetary Authority (FIMA) accounts bidding through the Federal Reserve Bank of New York will be included within the offering amount of each auction. These noncompetitive bids will have a limit of $100 million per account and will be accepted in the order of smallest to largest, up to the aggregate award limit of $1,000 million.

TreasuryDirect customers have requested that we reinvest their maturing holdings of approximately $991 million into the 13-week bill and $756 million into the 26-week bill.

The allocation percentage applied to bids awarded at the highest discount rate will be rounded up to the next hundredth of a whole percentage point, e.g., 17.13%.

This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular for the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes, and Bonds (31 CFR Part 356, as amended).

Details about each of the new securities are given in the attached offering highlights.

oOo

Attachment

JS-520

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS
TO BE ISSUED JULY 3, 2003

June 26, 2003

Offering Amount	$17,000 million	$18,000 million
Maximum Award (35% of Offering Amount)	$ 5,950 million	$ 6,300 million
Maximum Recognized Bid at a Single Rate	$ 5,950 million	$ 6,300 million
NLP Reporting Threshold	$ 5,950 million	$ 6,300 million
NLP Exclusion Amount	$ 5,800 million	None
Description of Offering:		
Term and type of security	91-day bill	183-day bill
CUSIP number	912795 NQ 0	912795 PD 7
Auction date	June 30, 2003	June 30, 2003
Issue date	July 3, 2003	July 3, 2003
Maturity date	October 2, 2003	January 2, 2004
Original issue date	April 3, 2003	July 3, 2003
Currently outstanding	$22,916 million	---
Minimum bid amount and multiples	$1,000	$1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.

Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order of size from smallest to largest with no more than $100 million awarded per account. The total noncompetitive amount awarded to Federal Reserve Banks as agents for FIMA accounts will not exceed $1,000 million. A single bid that would cause the limit to be exceeded will be partially accepted in the amount that brings the aggregate award total to the $1,000 million limit. However, if there are two or more bids of equal amounts that would cause the limit to be exceeded, each will be prorated to avoid exceeding the limit.

Competitive bids:

(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 7.100%, 7.105%.

(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold stated above.

(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Receipt of Tenders:

Noncompetitive tenders..... Prior to 12:00 noon eastern daylight saving time on auction day

Competitive tenders........ Prior to 1:00 p.m. eastern daylight saving time on auction day

Payment Terms: By charge to a funds account at a Federal Reserve Bank on issue date, or payment of full par amount with tender. *TreasuryDirect* customers can use the Pay Direct feature, which authorizes a charge to their account of record at their financial institution on issue date.