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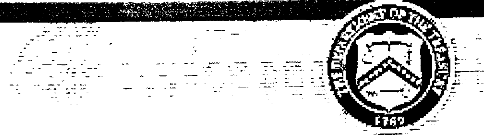
Department of the Treasury

PRESS RELEASES

The following numbers were not used:

JS-690 and 767

Some numbers were used twice.



FROM THE OFFICE OF PUBLIC AFFAIRS

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September 2, 2003
JS-688

Treasury Issues Regulations On Consolidated Attributes

Today the Treasury Department and the IRS issued temporary regulations that provide rules for reducing tax attributes (e.g., net operating losses, tax credit carryovers) when the debt of a member of a consolidated group is forgiven.

"These regulations are an important clarification of how consolidated groups are to treat debt forgiveness in bankruptcy," stated Pam Olson, Assistant Secretary for Tax Policy.

Under current law, the discharge of indebtedness is generally income to a debtor corporation. There is an exception to this rule, however, when the debtor corporation is in bankruptcy. In lieu of including the amount of indebtedness discharged in income, the bankrupt corporation must reduce its "tax attributes" by the amount of debt discharged. The reduction of attributes prevents corporations from avoiding taxable income in bankruptcy while retaining tax attributes that can reduce future tax liability.

Because consolidated attributes could later be used to reduce the tax liability of the bankrupt member, the temporary regulations clarify that all of the consolidated attributes of the group are available for reduction when the debt of a member of the group is discharged. In addition, they provide a methodology for reducing attributes. The temporary regulations apply immediately.

The text of the regulations is attached.

-30-

Related Documents:

- The Text of The Regulations

[4830-01-p]

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9089]

RIN 1545-BC39

Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 1502 that govern the application of section 108 when a member of a consolidated group realizes discharge of indebtedness income. These temporary regulations affect corporations filing consolidated returns. 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 in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective August 29, 2003.

FOR FURTHER INFORMATION CONTACT: Amber Renee Cook or Marie C. Milnes-Vasquez at (202) 622-7530 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 61(a)(12) of the Internal Revenue Code provides that gross income includes income from the discharge of indebtedness, except as provided by law. Section 108(a) provides

that gross income of a C corporation does not include any amount that would otherwise be includible in gross income by reason of the discharge, in whole or in part, of indebtedness of the taxpayer if the discharge occurs in a title 11 case (section 108(a)(1)(A)), the discharge occurs when the taxpayer is insolvent, but only to the extent of the insolvency (section 108(a)(1)(B)), or the indebtedness discharged is qualified farm indebtedness (section 108(a)(1)(C)).

Although section 108 does not require certain taxpayers to include discharge of indebtedness income in gross income, it does require the reduction of tax attributes. Section 108(b)(1) provides that if a taxpayer excludes an amount from gross income under section 108(a)(1)(A), (B), or (C), the taxpayer must reduce its tax attributes by the amount excluded. Absent an election under section 108(b)(5) (described below), pursuant to section 108(b)(2), tax attributes are reduced in the following order: net operating losses and net operating loss carryovers, general business credits under section 38, minimum tax credits under section 53(b), net capital losses and capital loss carryovers, asset basis, passive activity loss and credit carryovers under section 469(b), and foreign tax credits and foreign tax credit carryovers. Section 108(b)(5) provides that the taxpayer may elect to apply any portion of excluded discharge of indebtedness income to first reduce basis in depreciable assets under the rules of section 1017. Any amount of debt discharge that remains after attribute reduction is not includible in income. See H.R. Rep. 96-833 at 11 (1980); S. Rep. No. 96-1035 at 12 (1980).

These provisions are designed to "preserve the debtor's 'fresh start' after bankruptcy." H.R. Rep. 96-833 at 9 (1980); see S. Rep. No. 96-1035 at 10 (1980). In addition, they are intended to "carry out the Congressional intent of deferring, but eventually collecting within a reasonable period, tax on ordinary income realized from debt discharge." H.R. Rep. 96-833 at 9

(1980); see S. Rep. No. 96-1035 at 10 (1980). By making attributes unavailable to offset income in later years, the provisions offer the debtor a temporary, rather than a permanent, deferral of tax.

Questions have arisen regarding the application of section 108 when the taxpayer with discharge of indebtedness income that is excluded from gross income is a member of a consolidated group. In particular, questions have arisen regarding the determination of the attributes that are available for reduction in a consolidated group and the method for reducing those attributes. These regulations provide guidance regarding those questions.

Explanation of Provisions

A. Application of Section 108(a)(1)(B)

As described above, pursuant to section 108(a)(1)(B), gross income of an insolvent C corporation does not include any amount that would otherwise be includible in gross income by reason of the discharge, in whole or in part, of indebtedness of the taxpayer, but only to the extent of the insolvency. The IRS and Treasury believe that computing the amount of the insolvency for purposes of section 108(a)(1)(B) with respect to only the debtor member reflects that, without an agreement that provides otherwise, the assets of members other than the debtor member will not be available to satisfy claims of the creditors of the debtor member. Therefore, these temporary regulations provide that the amount of discharge of indebtedness income excluded from gross income in the case in which the debtor is insolvent is determined based on the assets and liabilities of only the member with discharge of indebtedness income.

B. Application of Section 108(b)

1. Consolidated approach

The IRS and Treasury Department have considered a separate entity approach and various consolidated approaches to the application of the attribute reduction rules of section 108(b) in the consolidated group context. As explained below, these regulations adopt a consolidated approach that reduces all attributes that are available to the debtor.

The IRS and Treasury Department have rejected a separate entity approach. Such an approach would reduce only the attributes attributable to the member with excluded discharge of indebtedness income. The IRS and Treasury Department have rejected this approach because it fails to take into account the fact that consolidated attributes that are attributable to other members will be available to offset income of the debtor member as long as the debtor is a member of the group. A separate entity approach could result in the permanent exclusion of discharge of indebtedness income when there are other attributes available to the debtor member.

In the view of the IRS and Treasury Department, the policies underlying section 108 require a consolidated approach that reduces all attributes that are available to the debtor. An approach that does not reduce all of such attributes is inconsistent with Congressional intent that income realized from debt discharge generally be deferred and not permanently eliminated. Furthermore, reducing all of the consolidated attributes available to the debtor member reflects the principle enunciated by the Supreme Court in United Dominion Indus., Inc. v. United States, 532 U.S. 822 (2001), that, in general, the only net operating loss of a consolidated group or its members for a consolidated return year is the consolidated net operating loss. Consistent with United Dominion, the tax attributes subject to reduction under section 108(b) when the debtor is a member of a consolidated group include the group's consolidated attributes in their entirety. Therefore, these temporary regulations provide for the reduction of consolidated net operating

losses and all other consolidated tax attributes, including consolidated tax attributes that are attributable to members other than the debtor member.

When the debtor is a member of a consolidated group, consolidated tax attributes attributable to other members may be used to offset income of the debtor member. That ability may enable the debtor member to offset future income with the consolidated attributes attributable to other members. As a result, unless such other attributes are reduced, discharge of indebtedness income that is excluded from gross income may never result in taxable income.

Unlike consolidated attributes, the basis of assets held by members other than the debtor member is not directly available to offset income of the debtor member. In fact, the basis of assets held by members other than the debtor member may never give rise to an attribute that could be directly available to offset income of a member of the group for a consolidated return year. Therefore, as explained below, these temporary regulations provide for a reduction of basis of assets of members other than the debtor member only in limited circumstances.

2. Ordering rule

Under these temporary regulations, the attributes attributable to the debtor member are first subject to reduction. For this purpose, attributes attributable to the debtor member include (1) consolidated attributes attributable to the debtor member, (2) attributes that arose in separate return limitation years of the debtor member, and (3) the basis of property of the debtor member. The amount of a consolidated attribute attributable to the debtor member is determined pursuant to the principles of §1.1502-21(b). To the extent that the excluded discharge of indebtedness income exceeds the attributes attributable to the debtor member, these temporary regulations require the reduction of consolidated attributes attributable to other members and attributes

attributable to members other than the debtor member that arose (or are treated as arising) in a separate return limitation year to the extent that the debtor member is a member of the separate return limitation year subgroup with respect to such attribute.

The availability of tax attributes attributable to other members of a consolidated group to reduce the future income of the debtor member creates the possibility of shifting the location of tax attributes and future tax liability. Preserving the location of tax items within the group is a fundamental policy underlying the consolidated return regulations which is reflected in a number of such regulations. See, e.g., §1.1502-13 (regarding intercompany transactions); §1.1502-21 (regarding the use of attributes that arise in separate return limitation years). Location is particularly important when a member leaves the group and no longer shares the attributes attributable to it with, or uses the attributes attributable to, the other members. This sharing of tax attributes can shift the location of items within the group, affecting the amount of consolidated tax attributes that a member takes with it when it leaves the group.

The IRS and Treasury Department did not adopt an alternative consolidated approach that would require the reduction of consolidated attributes attributable to other members prior to the reduction of all of the attributes attributable to the debtor member. Such an approach would not preserve the location of income in the debtor member resulting from the reduction of attributes as effectively as the approach adopted in these temporary regulations. For example, a reduction of the consolidated attributes attributable to each member before the reduction of all of the attributes attributable to the debtor member could cause a shifting of the tax burden if the debtor member subsequently leaves the group. In that case, the debtor member may take with it a larger portion of the consolidated attributes than it otherwise would, while a portion of the

consolidated attributes attributable to other members would be reduced. The larger portion of the consolidated attributes that the debtor member would take with it would be available to offset future income of the debtor member, while the remaining members of the group would bear a higher tax burden as a result of the unavailability of those consolidated attributes.

These temporary regulations achieve the dual objectives of subjecting the entire amount of consolidated attributes to reduction and preserving the location of future income that is deferred by first reducing attributes attributable to the debtor member, including consolidated attributes, in the order prescribed in section 108(b) and then reducing the remaining amount of consolidated attributes. This ordering rule reduces the potential to shift the location of attributes within the group.

3. Look-through rule

The adopted approach include a look-through rule that applies if the attribute of the debtor member reduced is the basis of stock of another member of the group. In these cases, corresponding adjustments must be made to the attributes attributable to the lower-tier member. To effect those corresponding adjustments, these temporary regulations treat the lower-tier member as a debtor member that has discharge of indebtedness income that is excluded from gross income in the amount of the stock basis reduction for purposes of the rules relating to the reduction of the attributes attributable to a debtor member. For this purpose, the consolidated attributes attributable to the lower-tier member (determined pursuant to the principles of §1.1502-21(b)) as well as the lower-tier member's separate attributes (including attributes that arose in separate return limitation years and asset basis) are available for reduction. The look-through rule is consistent with the treatment of a group as a single taxpayer under a number of

the consolidated return regulations, including the provisions allowing the consolidated tax attributes attributable to one member of a group to offset income of other members of the group and the investment adjustment rules that adjust the basis of subsidiary stock to reflect the income and absorbed losses of the subsidiary.

C. Corresponding Amendments

Included in these temporary regulations are amendments to certain provisions of the consolidated return regulations that reflect the attribute reduction rules that apply when the debtor is a member of a consolidated group. The following paragraphs describe these amendments.

1. The investment adjustment rules

Under §1.1502-32(b)(3)(ii)(C), discharge of indebtedness income of a subsidiary that is excluded from gross income is treated as tax-exempt income for purposes of the investment adjustment rules only to the extent it is applied to reduce attributes. For this purpose, a discharge of indebtedness is treated as applied to reduce tax attributes only to the extent the attribute reduction is taken into account as a noncapital, nondeductible expense under §1.1502-32. The investment adjustment rules of §1.1502-32 do not apply to affect the basis of the stock of the common parent of a group. Therefore, to the extent that discharge of indebtedness income reduces consolidated attributes that are attributable to the common parent, no positive basis adjustment is made to the stock of the subsidiary. Furthermore, because the reduction of a tax credit is not a noncapital, nondeductible expense, to the extent that the discharge of indebtedness income reduces a tax credit, no positive basis adjustment is made to the stock of the subsidiary.

The IRS and Treasury Department believe that a positive basis adjustment should be

made to the basis of the stock of a debtor subsidiary even if the discharge of indebtedness income reduces an attribute that is attributable to the common parent. This position is consistent with the approach of §1.1502-32 that income of a subsidiary that is offset by net operating losses generated by the common parent results in an increase in the basis of the subsidiary stock. In addition, the IRS and Treasury Department believe that a positive basis adjustment should be made to the basis of the stock of a debtor subsidiary even if the discharge of indebtedness income reduces a credit of any member. Accordingly, these temporary regulations treat as tax-exempt income discharge of indebtedness income that is excluded from gross income to the extent that such excluded income reduces tax attributes, including tax attributes attributable to the common parent and any other attribute the reduction of which is not treated as a noncapital, nondeductible expense, such as a credit.

2. The excess loss account rules

Under §1.1502-19, an excess loss account attributable to subsidiary stock must be included in income when an indebtedness of that subsidiary is discharged and any part of the amount discharged is not included in gross income and is not treated as tax-exempt income under §1.1502-32. This rule may require inclusion of an excess loss account in income in an amount that is substantially greater than the amount discharged that is not treated as tax-exempt income.

The IRS and Treasury Department believe that requiring the inclusion of the excess loss account in income only to the extent of the amount discharged that is not treated as tax-exempt income is consistent with the policies underlying section 108 and the consolidated return regulations. Accordingly, these temporary regulations modify the rules of §1.1502-19 to provide that the excess loss account must be included in income only to the extent that any amount

discharged that is excluded from gross income is not treated as tax-exempt income.

3. Rules governing apportionment of net operating losses

The temporary regulations also include modifications to the rules of §1.1502-21 relating to the amount of consolidated net operating losses apportioned to a subsidiary when a consolidated net operating loss is absorbed and when a subsidiary departs from the group. These modifications take into account the reduction of the net operating losses attributable to that member that occurs as a result of discharge of indebtedness.

D. Request for Comments

The IRS and Treasury Department are considering adopting rules under section 1502 (and possibly other Code sections) to address the effect of transitory transactions and other transactions designed to avoid the application of the rules concerning attribute reduction. Comments are requested regarding whether such a rule should be adopted and the appropriate scope of such a rule. Even in the absence of such a rule, such transactions may be challenged under existing law. If the IRS and Treasury Department determine such a rule is necessary to protect the policies underlying section 108 and the consolidated return regulations, the IRS and Treasury Department are prepared to promulgate such a rule with retroactive effect to discharges of indebtedness that occur after August 29, 2003.

Effective Dates

The temporary regulations related to the application of section 108(b) when a member of a consolidated group realizes discharge of indebtedness income that is excluded from gross income apply to discharges of indebtedness that occur after August 29, 2003. The amendments to the investment adjustment rules apply with respect to determinations of stock basis in

consolidated return years the original return for which is due (without extensions) after August 29, 2003. The amendments to the excess loss account rules apply to dispositions of subsidiary stock after August 29, 2003. However, taxpayers may apply the amendments to the investment adjustment rules and the excess loss account rules retroactively. Finally, the amendments to the net operating loss rules apply only to taxable years the original return for which the due date (without extensions) is after August 29, 2003.

Special Analyses

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. These temporary regulations are necessary to provide taxpayers with immediate guidance regarding the application of section 108 when a member of a consolidated group has discharge of indebtedness income that is excluded from gross income. Current circumstances have made the application of section 108 in the consolidated group context an issue that needs to be addressed at this time. In addition, consolidated groups may be taking positions that are inconsistent with the policies underlying section 108 and the principle enunciated by the Supreme Court in United Dominion Indus., Inc. v. United States, 532 U.S. 822 (2001). Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(3). For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue 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

Various personnel from the IRS and Treasury Department participated in the development of the regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 is amended by removing the two entries for §1.1502-32T and adding the following entries in numerical order to read in part as follows:

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

Section 1.1502-19T also issued under 26 U.S.C. 1502. * * *
Section 1.1502-28T also issued under 26 U.S.C. 1502. * * *
Section 1.1502-32T also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502-19 is amended as follows:

1. Paragraph (b)(1) is revised.

2. The headings for paragraphs (h)(2) and (h)(2)(i) are revised.

3. Paragraph (h)(2)(ii) is redesignated as paragraph (h)(2)(iii).

4. New paragraph (h)(2)(ii) is added.

The revisions and addition read as follows:

§1.1502-19 Excess loss accounts.

* * * * *

(b) * * * (1) [Reserved]. For further guidance, see §1.1502-19T(b)(1).

* * * * *

(h) * * *

(2) Dispositions of stock--(i) Dispositions of stock before effective date. * * *

(ii) Application of special limitation. [Reserved]. For further guidance, see §1.1502-19T(h)(2)(ii).

* * * * *

Par. 3. Section 1.1502-19T is added to read as follows:

§1.1502-19T Excess loss accounts (temporary).

(a) [Reserved]. For further guidance, see §1.1502-19(a).

(b) Excess loss account taken into account as income or gain--(1) Operating rules--(i) General rule. Except as provided in paragraph (b)(1)(ii) of this section, if P is treated under §1.1502-19 as disposing of a share of S's stock, P takes into account its excess loss account in the share as income or gain from the disposition.

(ii) Special limitation on amount taken into account. Notwithstanding paragraph (b)(1)(i) of this section, if P is treated as disposing of a share of S's stock as a result of the application of §1.1502-19(c)(1)(iii)(B), the aggregate amount of its excess loss account in the shares of S's stock that P takes into account as income or gain from the disposition shall not exceed the amount of S's indebtedness that is discharged that is neither included in gross income nor treated as tax-exempt income under §1.1502-32T(b)(3)(ii)(C)(1). If more than one share of S's stock has an excess loss account, such excess loss accounts shall be taken into account pursuant to the preceding sentence, to the extent possible, in a manner that equalizes the excess loss accounts in S's shares that have an excess loss account.

(iii) Treatment of disposition. Except as provided in §1.1502-19(b)(4), the disposition is treated as a sale or exchange for purposes of determining the character of the income or gain.

(b)(2) through (h)(2)(i) [Reserved]. For further guidance, see §1.1502-19(b)(2) through (h)(2)(i).

(h)(2)(ii) Application of special limitation. If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of §1.1502-19(c)(1)(iii)(B) after August 29, 2003 and in a consolidated return year beginning on or after January 1, 1995, the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount, are determined or redetermined with regard to paragraph (b)(1)(ii) of this section. If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of §1.1502-19(c)(1)(iii)(B) on or before August 29, 2003 and in a consolidated return year beginning on or after January 1, 1995, the group may determine or redetermine the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount with regard to paragraph (b)(1)(ii) of this section.

(h)(2)(iii) through (h)(3) [Reserved]. For further guidance, see §1.1502-19(h)(2)(iii) through (h)(3).

Par. 4. Section 1.1502-21 is amended as follows:

1. Paragraphs (b)(2)(iv) and (c)(2)(vii) are revised.

2. Paragraphs (h)(6) and (h)(7) are redesignated as paragraphs (h)(7) and (h)(8), respectively.

3. New paragraph (h)(6) is added.

4. Newly designated paragraph (h)(8) is revised.

The revision and additions read as follows:

§1.1502-21 Net operating losses.

* * * * *

(b) * * *

(2) * * *

(iv) [Reserved]. For further guidance, see §1.1502-21T(b)(2)(iv).

* * * * *

(c) * * *

(2) * * *

(vii) [Reserved]. For further guidance, see §1.1502-21T(c)(2)(vii).

* * * * *

(h) * * *

(6) [Reserved]. For further guidance, see §1.1502-21T(h)(6).

* * * * *

(8) [Reserved]. For further guidance, see §1.1502-21T(h)(8).

Par. 5. Section 1.1502-21T is amended as follows:

1. Paragraphs (b)(1) through (b)(3)(ii)(B) are revised.

2. Paragraphs (c) through (h)(7) are revised.

3. Paragraph (h)(8) is added.

The revisions and addition read as follows:

§1.1502-21T Net operating losses (temporary).

* * * * *

(b) * * *

(1) Carryovers and carrybacks generally. The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. In addition, the amount of any CNOL absorbed by the group in any year is apportioned among members based on the percentage of the CNOL attributable to each member as of the beginning of the year. The percentage of the CNOL attributable to a member is determined pursuant to paragraph (b)(2)(iv)(B) of this section. Additional rules provided under the Internal Revenue Code or regulations also apply. See, e.g., section 382(l)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not subject to limitation under section 382). See §1.1502-21(c)(1)(iii), Example 2, for an illustration of pro rata absorption of losses subject to a SRLY limitation. See paragraph (b)(3)(v) of this section regarding the treatment of any loss that is treated as expired under §1.1502-35T(f)(1).

(2)(i) through (iii) [Reserved]. For further guidance, see §1.1502-21(b)(2)(i) through (iii).

(iv) Operating rules--(A) Amount of CNOL attributable to a member. The amount of a CNOL that is attributable to a member shall equal the product of the CNOL and the percentage of the CNOL attributable to such member.

(B) Percentage of CNOL attributable to a member--(1) In general. Except as provided in

paragraph (b)(2)(iv)(B)(2) of this section, the percentage of the CNOL attributable to a member shall equal the separate net operating loss of the member for the year of the loss divided by the sum of the separate net operating losses for that year of all members having such losses. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss, including the member's losses and deductions actually absorbed by the group in the taxable year (whether or not absorbed by the member).

(2) Special rule. If during a taxable year either a member realizes discharge of indebtedness income that is excluded from gross income under section 108(a) and such amount reduces any portion of the CNOL attributable to such member pursuant to section 108 and §1.1502-28T, or a member that had a separate net operating loss for the year of the CNOL ceases to be a member, the percentage of the CNOL attributable to each member as of the first day of the following taxable year shall be recomputed. In addition, if a portion of the CNOL attributable to a member for a taxable year is carried back to a separate return year, the percentage of the CNOL attributable to each member as of the first day of the taxable year following the taxable year of the CNOL shall be recomputed. In each case, such recomputed percentage shall equal the unabsorbed CNOL attributable to the member on the first day of the following taxable year divided by the sum of the unabsorbed CNOL attributable to all of the members on the first day of the following taxable year. For purposes of the preceding sentence, a CNOL that is reduced pursuant to section 108 and §1.1502-28T or that is otherwise permanently disallowed or eliminated shall be treated as absorbed.

(b)(2)(v) through (b)(3)(ii)(B) [Reserved]. For further guidance, see §1.1502-21(b)(2)(v)

through (b)(3)(ii)(B).

* * * * *

(c)(1) through (c)(2)(vi) [Reserved]. For further guidance, see §1.1502-21(c)(1) through (c)(2)(vi).

(vii) Corporations that leave a SRLY subgroup. If a loss member ceases to be affiliated with a SRLY subgroup, the amount of the member's remaining SRLY loss from a specific year is determined pursuant to the principles of §1.1502-21(b)(2)(ii)(A) and §1.1502-21T(b)(2)(iv).

(c)(2)(viii) through (h)(5) [Reserved]. For further guidance, see §1.1502-21(c)(2)(viii) through (h)(5).

(6) Certain prior periods. Paragraphs (b)(1), (b)(2)(iv), and (c)(2)(vii) of this section shall only apply to taxable years the original return for which the due date (without extensions) is after August 29, 2003. For taxable years the original return for which the due date (without extensions) is on or before August 29, 2003, see paragraphs (b)(1), (b)(2)(iv), and (c)(2)(vii) of §1.1502-21 and paragraph (b)(1) of §1.1502-21T as contained in 26 CFR part 1 revised April 1, 2003.

(7) [Reserved]. For further guidance, see §1.1502-21(h)(7).

(8) Losses treated as expired under §1.1502-35T(f)(1). Paragraph (b)(3)(v) of this section is effective for losses treated as expired under §1.1502-35T(f)(1) on and after March 7, 2002, and no later than March 11, 2006. Par. 6. Section 1.1502-28T is added to read as follows:

§1.1502-28T Consolidated section 108 (temporary).

(a) In general. This section sets forth rules for the application of section 108(a) and the

reduction of tax attributes pursuant to section 108(b) when a member of the group realizes discharge of indebtedness income that is excluded from gross income under section 108(a) (excluded COD income).

(1) Application of section 108(a). Section 108(a)(1)(B) is applied separately to each member that realizes excluded COD income. Therefore, the limitation of section 108(a)(3) on the amount of discharge of indebtedness income that is treated as excluded COD income is determined based on the assets (including stock and securities of other members) and liabilities (including liabilities to other members) of only the member that realizes excluded COD income.

(2) Reduction of tax attributes attributable to the debtor--(i) In general. With respect to a member that realizes excluded COD income in a taxable year, the tax attributes attributable to that member (and its direct and indirect subsidiaries to the extent required by section 1017(b)(3)(D) and paragraph (a)(3) of this section), including basis of assets and losses and credits arising in separate return limitation years, shall be reduced as provided in sections 108 and 1017 and this section. Basis of subsidiary stock, however, shall not be reduced below zero.

(ii) Consolidated tax attributes attributable to a member. For purposes of this section, the amount of a consolidated tax attribute that is attributable to a member shall be determined pursuant to the principles of §1.1502-21T(b)(2)(iv). In addition, if the member is a member of a separate return limitation year subgroup, the amount of a tax attribute that arose in a separate return limitation year that is attributable to that member shall also be determined pursuant to the principles of §1.1502-21T(b)(2)(iv).

(3) Look-through rules--(i) Priority of section 1017(b)(3)(D). If a member treats stock of a subsidiary as depreciable property pursuant to section 1017(b)(3)(D), the basis of the

depreciable property of such subsidiary shall be reduced pursuant to section 1017(b)(3)(D) prior to the application of paragraph (a)(3)(ii) of this section.

(ii) Application of additional look-through rule. If the basis of stock of a member (the lower-tier member) that is owned by another member is reduced pursuant to section 108, section 1017, and paragraph (a)(2) of this section (but not as a result of treating subsidiary stock as depreciable property pursuant to section 1017(b)(3)(D)), solely for purposes of sections 108 and 1017 and this section other than paragraphs (a)(4) and (b)(1) of this section, the lower-tier member shall be treated as realizing excluded COD income. The amount of such excluded COD income shall be the amount of such basis reduction. Accordingly, the tax attributes attributable to such lower-tier member shall be reduced as provided in sections 108 and 1017 and this section. To the extent that the excluded COD income realized by the lower-tier member pursuant to this paragraph (a)(3) does not reduce a tax attribute attributable to the lower-tier member, such excluded COD income shall not be applied to reduce tax attributes attributable to any member under paragraph (a)(4) of this section.

(4) Reduction of certain tax attributes attributable to other members. To the extent that, pursuant to paragraph (a)(2) of this section, the excluded COD income is not applied to reduce the tax attributes attributable to the member that realizes the excluded COD income, after the application of paragraph (a)(3) of this section, such amount shall be applied to reduce the remaining consolidated tax attributes of the group as provided in section 108 and this section. Such amount also shall be applied to reduce the tax attributes attributable to members that arose (or are treated as arising) in a separate return limitation year to the extent that the member that realizes excluded COD income is a member of the separate return limitation year subgroup with

respect to such attribute. The reduction of each tax attribute pursuant to the two preceding sentences shall be made in the order prescribed in section 108 and pursuant to §1.1502-21T(b)(1). Except to the extent that the member that realizes excluded COD income is a member of the separate return limitation year subgroup with respect to a tax attribute that arose (or is treated as arising) in a separate return limitation year, such attribute is not subject to reduction pursuant to this paragraph (a)(4). In addition, basis in assets is not subject to reduction pursuant to this paragraph (a)(4). Finally, to the extent that the realization of excluded COD income by a member pursuant to paragraph (a)(3) does not reduce a tax attribute attributable to such lower-tier member, such excess shall not be applied to reduce tax attributes attributable to any member pursuant to this paragraph (a)(4).

(b) Special rules--(1) Multiple debtor members--(i) Reduction of tax attributes attributable to debtor members prior to reduction of consolidated tax attributes. If in a single taxable year multiple members realize excluded COD income, paragraphs (a)(2) and (3) of this section shall apply with respect to the excluded COD income of each such member prior to the application of paragraph (a)(4) of this section.

(ii) Reduction of higher-tier debtor's tax attributes. If in a single taxable year multiple members realize excluded COD income and one such member is a higher-tier member of another such member, paragraphs (a)(2) and (3) of this section shall be applied with respect to the excluded COD income of the higher-tier member before such paragraphs are applied to the excluded COD income of the other such member. A member (the first member) is a higher-tier member of another member (the second member) if the first member is the common parent or investment adjustments under §1.1502-32 or §1.1502-32T with respect to the stock of the second

member would affect investment adjustments with respect to the stock of the first member.

(iii) Reduction of additional tax attributes. If more than one member realizes excluded COD income that has not been applied to reduce a tax attribute attributable to such member (the remaining COD amount) and the remaining tax attributes available for reduction under paragraph (a)(4) of this section are less than the aggregate of the remaining COD amounts, after the application of paragraph (a)(2) of this section, each such member's remaining COD amount shall be applied on a pro rata basis (based on the relative remaining COD amounts), pursuant to paragraph (a)(4) of this section, to reduce such remaining available tax attributes.

(2) Election under section 108(b)(5). Any member that realizes excluded COD income may make the election described in section 108(b)(5). The election is made separately for each member. Therefore, an election may be made for one member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section) while another election, or no election, may be made for another member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section). See §1.108-4 for rules relating to the procedure for making an election under section 108(b)(5).

(3) Limitation of section 1017(b)(2). The limitation of section 1017(b)(2) on the reduction in basis of property shall be applied by reference to the aggregate of the basis of the property held by the member that realizes excluded COD income, not the aggregate of the basis of the property held by all of the members of the group, and the liabilities of such member, not the aggregate liabilities of all of the members of the group.

(c) Examples. The principles of paragraphs (a) and (b) of this section are illustrated by the following examples. Unless otherwise indicated, no election under section 108(b)(5) has

been made. The examples are as follows:

Example 1. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 80 percent of the stock of S1 and 100 percent of the stock of S2. In Year 1, the P group sustained a $250 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $125 was attributable to P and $125 was attributable to S1. On Day 1 of Year 2, S2 joined the P group. As of the beginning of Year 2, S2 had a $50 net operating loss carryover from Year 1, a separate return limitation year. In Year 2, the P group sustained a $200 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $90 was attributable to P, $70 was attributable to S1, and $40 was attributable to S2. In Year 3, S2 realized $200 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S2 had no liabilities. In that same year, the P group sustained a $50 consolidated net operating loss, of which $40 was attributable to S1 and $10 was attributable to S2 under the principles of §1.1502-21T(b)(2)(iv). As of the beginning of Year 4, S2 had Asset A with a basis of $40 and a fair market value of $10.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S2 must first be reduced to take into account its excluded COD income in the amount of $200.

(1) Reduction of net operating losses. Pursuant to section 108(b)(2)(A), the net operating loss and the net operating loss carryovers of S2 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S2 under the principles of §1.1502-21T(b)(2)(iv) are reduced first. Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable to S2, to $40. Then, again pursuant to section 108(b)(4)(B), S2's net operating loss carryover of $50 from its separate return limitation year is reduced to $0. Finally, the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S2, to $160.

(2) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S2 reduces its basis in Asset A by $40, from $40 to $0.

(B) Reduction of remaining consolidated tax attributes. The remaining $60 of excluded COD income then reduces consolidated tax attributes pursuant to paragraph (a)(4) of this section. In particular, the remaining $40 consolidated net operating loss for Year 3 is reduced to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20 from $250 to $230. Pursuant to paragraph (a)(4) of this section, a pro rata amount of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced. Therefore, $10 of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced.

Example 2. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1 and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year. In Year 1, the P group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $10 was attributable to P, $20 was attributable to S1, and $20 was attributable to S2. In Year 2, the P group sustained a $70 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $30 was attributable to P, $30 was attributable to S1, and $10 was attributable to S2. In Year 3, S1 realized $170 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S1 and S2 had no liabilities. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1 and $40 was attributable to S2 under the principles of §1.1502-21T(b)(2)(iv). As of the beginning of Year 4, S1's sole asset was the stock of S2, and S1 had a $80 basis in the S2 stock. In addition, at the beginning of Year 4, S2 had an asset with a $0 basis and a $10 value.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of $170.

(1) Reduction of net operating losses. Pursuant to section 108(b)(2)(A), the net operating loss and the net operating loss carryovers of S1 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of §1.1502-21T(b)(2)(iv) are reduced first. Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss for Year 3 attributable to S1, to $40. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20, the portion of that consolidated net operating loss carryover attributable to S1, to $30, and the consolidated net operating loss carryover from Year 2 is reduced by $30, the portion of that consolidated net operating loss carryover attributable to S1, to $40.

(2) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by $80, from $80 to $0.

(3) Tiering down of stock basis reduction. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing $80 of excluded COD income. Accordingly, the consolidated net operating loss for Year 3 is reduced by an additional $40, the portion of the consolidated net operating loss for Year 3 attributable to S2, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20, the portion of that consolidated net operating loss carryover attributable to S2, to $10. Then, the consolidated net operating loss carryover from Year 2 is reduced by $10, the portion of that consolidated net operating loss carryover attributable to S2, to $30. S2's remaining $10 of excluded COD income does not reduce consolidated tax attributes attributable to P or S1 under

paragraph (a)(4) of this section.

(B) Reduction of remaining consolidated tax attributes. Finally, pursuant to paragraph (a)(4) of this section, S1's remaining $30 of excluded COD income reduces the remaining consolidated tax attributes. In particular, the remaining $10 consolidated net operating loss carryover from Year 1 is reduced by $10 to $0, and the remaining $30 consolidated net operating loss carryover from Year 2 is reduced by $20 to $10.

Example 3. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1, S1 owns 100 percent of the stock of S2, and S2 owns 100 percent of the stock of S3. In Year 1, the P group sustained a $150 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $50 was attributable to S2, and $100 was attributable to S3. In Year 2, the P group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $40 was attributable to S1 and $10 was attributable to S2. In Year 3, S1 realized $170 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S1, S2, and S3 had no liabilities. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1, $20 was attributable to S2, and $20 was attributable to S3 under the principles of §1.1502-21T(b)(2)(iv). At the beginning of Year 4, S1's only asset was the stock of S2, with a basis of $120, and S2's only asset was the stock of S3 with a basis of $180 and a value of $10. None of P, S1, or S2 had a separate return limitation year.

(ii) Analysis--Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of $170.

(A) Reduction of net operating losses. Pursuant to section 108(b)(2)(A), the net operating loss and the net operating loss carryovers of S1 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of §1.1502-21T(b)(2)(iv) are reduced first. Pursuant to section 108(b)(4)(B), S1's net operating loss for the taxable year of the discharge is reduced first. Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable to S1, to $40. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S1, to $10.

(B) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by $120, from $120 to $0.

(C) Tiering down of stock basis reduction to S2. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing $120 of

excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and net operating loss carryovers of S2 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S2 under the principles of §1.1502-21T(b)(2)(iv) are reduced. Pursuant to section 108(b)(4)(B), S2's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S2, to $20. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by $50, the portion of that consolidated net operating loss carryover attributable to S2, to $100. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is further reduced by $10, the portion of that consolidated net operating loss carryover attributable to S2, to $0. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S2 reduces its basis in its S3 stock by $40 to $140.

(D) Tiering down of stock basis reduction to S3. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing $40 of excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and the net operating loss carryovers of S3 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S3 under the principles of §1.1502-21T(b)(2)(iv) are reduced. Pursuant to section 108(b)(4)(B), S3's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S3, to $0. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by $20, the lesser of the portion of that consolidated net operating loss carryover attributable to S3 and the remaining excluded COD income, to $80.

Example 4. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of each of S1 and S2. Each of S1 and S2 owns stock of S3 that represents 50 percent of the value of the stock of S3. In Year 1, the P group sustained a $160 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $10 was attributable to P, $50 was attributable to S2, and $100 was attributable to S3. In Year 2, the P group sustained a $110 consolidated net operating loss. Under the principles of §1.1502-21T(b)(2)(iv), of that amount, $40 was attributable to S1 and $70 was attributable to S2. In Year 3, S1 realized $200 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 realized $270 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S1, S2, and S3 had no liabilities. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1, $20 was attributable to S2, and $20 was attributable to S3 under the principles of §1.1502-21T(b)(2)(iv). At the beginning of Year 4, S1's basis in its S3 stock was $60, S2's basis in its S3 stock was $120, and S3 had one asset with a basis of $200 and a value of $10. None of P, S1, S2, or S3 had a separate return limitation year.

(ii) Analysis--Reduction of tax attributes attributable to debtors. Pursuant to paragraph (b)(1)(i) of this section, the tax attributes attributable to each of S1 and S2 are reduced pursuant to paragraph (a)(2) of this section, and the tax attributes attributable to S3 are reduced pursuant to paragraph (a)(3) of this section so as to reflect a reduction of S1's and S2's basis in the stock of S3 prior to the application of paragraph (a)(4) to reduce additional tax attributes. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 and S2 must be reduced to take into account their excluded COD income.

(A) Reduction of net operating losses generally. Pursuant to section 108(b)(2)(A), the net operating losses and the net operating loss carryovers of S1 and S2 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating losses and the net operating loss carryovers attributable to S1 and S2 under the principles of §1.1502-21T(b)(2)(iv) are reduced first.

(B) Reduction of net operating losses attributable to S1. Pursuant to section 108(b)(4)(B), S1's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable to S1, to $40. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S1, to $70.

(C) Reduction of net operating losses attributable to S2. Pursuant to section 108(b)(4)(B), S2's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S2, to $20. Then, pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by $50, the portion of that consolidated net operating loss carryover attributable to S2, to $110. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is further reduced by $70, the portion of that consolidated net operating loss carryover attributable to S2, to $0.

(D) Reduction of basis. Following the reduction of the net operating losses and the net operating loss carryovers attributable to S1 and S2, S1 and S2 must reduce their basis in their assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by $60, from $60 to $0, and S2 reduces its basis in the stock of S3 by $120, from $120 to $0.

(E) Tiering down of basis reduction. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing $180 of excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and the net operating loss carryovers of S3 are reduced, in the order indicated by section 108(b)(4)(B). Pursuant to paragraph (a)(2) of this section the consolidated net operating loss and any consolidated net operating loss carryovers that are attributable to S3 under the principles of §1.1502-21T(b)(2)(iv) are reduced. Accordingly, the consolidated net operating loss for Year 3

is further reduced by $20, the portion of the consolidated net operating loss attributable to S3, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $100, the portion of that consolidated net operating loss carryover attributable to S3, to $10. Following the reduction of the net operating loss and the net operating loss carryover attributable to S3, S3 reduces its basis in its asset pursuant to section 1017 and §1.1017-1. Accordingly, S3 reduces its basis in its asset by $60, from $200 to $140.

(F) Reduction of remaining consolidated tax attributes. Finally, pursuant to paragraph (a)(4) of this section, the remaining $90 of S1's excluded COD income and the remaining $10 of S2's excluded COD income reduce the remaining consolidated tax attributes. In particular, the remaining $10 consolidated net operating loss carryover from Year 1 is reduced by $10 to $0. Because that amount is less than the aggregate amount of remaining excluded COD income, such income is applied on a pro rata basis to reduce the remaining consolidated tax attributes. Accordingly, $9 of S1's remaining excluded COD income and $1 of S2's remaining excluded COD income is applied to reduce the remaining consolidated net operating loss carryover from Year 1. Consequently, of S1's excluded COD income of $200, only $119 is applied to reduce tax attributes, and, of S2's excluded COD income of $270, only $261 is applied to reduce tax attributes.

(d) Effective date. This section applies to discharges of indebtedness that occur after August 29, 2003.

Par. 7. Section 1.1502-32 is amended as follows:

1. Paragraphs (b)(3)(ii)(C)(1) and (b)(3)(iii)(A) are revised.

2. Paragraph (b)(4)(vii) is added.

3. Paragraph (b)(5)(ii), Example 4, paragraphs (a), (b), and (c), are revised.

4. Paragraph (h)(7) is added.

The revisions and additions read as follows:

§1.1502-32 Investment adjustments.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(C) * * *

(1) [Reserved]. For further guidance, see §1.1502-32T(b)(3)(ii)(C)(1).

* * * * *

(iii) * * *

(A) [Reserved]. For further guidance, see §1.1502-32T(b)(3)(iii)(A).

* * * * *

(4) * * *

(vii) [Reserved]. For further guidance, see §1.1502-32T(b)(4)(vii).

(5) * * *

(ii) * * *

Example 4(a), (b), and (c) [Reserved]. For further guidance, see §1.1502-32T(b)(5)(ii), Example 4(a), (b), and (c).

* * * * *

(h) * * *

(7) [Reserved]. For further guidance, see §1.1502-32T(h)(7).

Par. 8. Section 1.1502-32T is amended as follows:

1. Paragraphs (b) through (b)(3)(iii)(B) are revised.

2. Add and reserve paragraph (b)(3)(iv) and revise paragraphs (b)(4) through (b)(4)(iv).

3. Add and reserve paragraphs (b)(5) and revise paragraphs (c) through (h)(5)(ii) are revised.

4. Paragraph (h)(7) is added.

The revisions and addition read as follows:

§1.1502-32T Investment adjustments (temporary).

* * * * *

(b) through (b)(3)(ii)(B) [Reserved]. For further guidance, see §1.1502-32(b) through (b)(3)(ii)(B).

(C) Discharge of indebtedness income--(1) In general. Discharge of indebtedness income of S that is excluded from gross income under section 108 is treated as tax-exempt income only to the extent the discharge is applied to reduce tax attributes attributable to any member of the group under section 108, section 1017, or §1.1502-28T. If S is treated as realizing discharge of indebtedness income that is excluded from gross income pursuant to §1.1502-28T(a)(3), S shall not be treated as realizing excluded COD income for purposes of the preceding sentence.

(b)(3)(ii)(C)(2) through (b)(3)(ii)(D) [Reserved]. For further guidance, see §1.1502-32(b)(3)(ii)(C)(2) through (b)(3)(ii)(D).

(iii) Noncapital, nondeductible expenses--(A) In general. S's noncapital, nondeductible expenses are its deductions and losses that are taken into account but permanently disallowed or eliminated under applicable law in determining its taxable income or loss, and that decrease, directly or indirectly, the basis of its assets (or an equivalent amount). For example, S's Federal taxes described in section 275 and loss not recognized under section 311(a) are noncapital, nondeductible expenses. Similarly, if a loss carryover (e.g., under section 172 or 1212) attributable to S expires or is reduced under section 108(b) and §1.1502-28T, it becomes a noncapital, nondeductible expense at the close of the last tax year to which it may be carried. However, when a tax attribute attributable to S is reduced as required pursuant to §1.1502-28T(a)(3), the reduction of the tax attribute is not treated as a noncapital, nondeductible expense

of S. Finally, if S sells and repurchases a security subject to section 1091, the disallowed loss is not a noncapital, nondeductible expense because the corresponding basis adjustments under section 1091(d) prevent the disallowance from being permanent.

(b)(3)(iii)(B) [Reserved]. For further guidance, see §1.1502-32(b)(3)(iii)(B).

* * * * *

(b)(3)(iv) through (b)(4)(iv) [Reserved]. For further guidance, see §1.1502-32(b)(3)(iv) through (b)(4)(iv).

* * * * *

(b)(5)(i) through (b)(5)(ii), Example 3 [Reserved]. For further guidance, see §1.1502-32(b)(5)(i) through (b)(5)(ii), Example 3.

Example 4. Discharge of indebtedness. (a) Facts. P forms S on January 1 of Year 1 and S borrows $200. During Year 1, S's assets decline in value and the P group has a $100 consolidated net operating loss. Of that amount, $10 is attributable to P and $90 is attributable to S under the principles of §1.1502-21T(b)(2)(iv). None of the loss is absorbed by the group in Year 1, and S is discharged from $100 of indebtedness at the close of Year 1. P has a $0 basis in the S stock. P and S have no attributes other than the consolidated net operating loss. Under section 108(a), S's $100 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and §1.1502-28T, the consolidated net operating loss is reduced to $0.

(b) Analysis. Under §1.1502-32(b)(3)(iii)(B), the reduction of $90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense in Year 1 because that loss is permanently disallowed by section 108(b) and §1.1502-28T. Under paragraph (b)(3)(ii)(C)(1) of this section, all $100 of S's discharge of indebtedness income is treated as tax-exempt income in Year 1 because the discharge results in a $100 reduction to the consolidated net operating loss. Consequently, the loss and the cancellation of the indebtedness result in a net positive $10 adjustment to P's basis in its S stock.

(c) Insufficient attributes. The facts are the same as in paragraph (a) of this Example 4, except that S is discharged from $120 of indebtedness at the close of Year 1. Under section 108(a), S's $120 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and §1.1502-28T, the consolidated net operating loss is reduced to $0 at the close of Year 1. Under §1.1502-32(b)(3)(iii)(B), the reduction of $90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense. Under paragraph (b)(3)(ii)(C)(1) of this section, only $100 of the discharge is treated as tax-exempt income because only that amount is applied to reduce tax attributes. The remaining $20 of discharge income excluded under section 108(a) has no effect on P's basis in S's stock.

(b)(5)(ii), Example 4(d) through (h)(5)(ii) [Reserved]. For further guidance, see §1.1502-32(b)(5)(ii), Example 4(d) through (h)(5)(ii).

* * * * *

(h)(7) Rules related to discharges of indebtedness excluded from gross income. Paragraphs (b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c), of this section apply with respect to determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without extensions) after August 29, 2003. For determinations in consolidated return years the original return for which is due (without extensions) on or before August 29, 2003, groups may apply paragraphs (b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c), of this section without regard to the references to §1.1502-28T or, alternatively, apply paragraphs (b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c), of §1.1502-32 as contained in 26 CFR part 1 edition revised as of April 1, 2003.

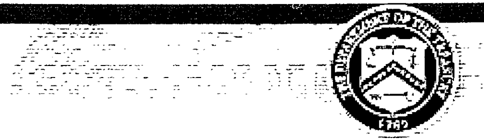
Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

Approved: August 28, 2003.

Gregory F. Jenner,

Deputy Assistant Secretary of the Treasury.



FROM THE OFFICE OF PUBLIC AFFAIRS

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September 2, 2003
JS-689

Treasury and IRS Issue Proposed Regulations Providing Guidance for Partnerships Engaged in a U.S. Trade or Business

Today, the Treasury Department and the IRS issued proposed regulations that provide guidance on the withholding tax obligation of partnerships that have one or more foreign partners and that are engaged in a U.S. trade or business. A foreign person that conducts a trade or business in the United States generally is subject to U.S. tax on the income that is effectively connected with that trade or business. Similar rules apply to income earned by a foreign person through a partnership that is engaged in a U.S. trade or business. To ensure collection of the tax owed by the foreign partner, section 1446 of the Internal Revenue Code requires a partnership that is engaged in a U.S. trade or business to withhold and pay over tax to the extent that its net income that is effectively connected with its U.S. trade or business is allocable to a foreign partner. The amount of the tax due is computed by applying the highest marginal income tax rate to the amount of the partnership's effectively connected income that is allocable to its foreign partners.

The proposed regulations issued today update and elaborate on guidance currently provided in Revenue Procedure 89-31 (as modified by Revenue Procedure 92-66) concerning a partnership's obligation to withhold tax on the income allocated to its foreign partners. The proposed regulations provide guidance on the information a partnership may rely on in determining if its partners are foreign partners, the computation of the tax due, and the payment of the tax on a quarterly basis in the case of estimated tax payments. The proposed regulations also provide rules on reporting the amount of tax withheld for direct and indirect foreign partners. In addition, the proposed regulations provide special rules regarding the withholding tax obligation for partnerships that are publicly traded. The proposed regulations generally are consistent with the rules in Revenue Procedures 89-31 and 92-66 and will replace those revenue procedures when the proposed regulations are finalized.

Related Documents:

- The text of the proposed regulations

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG-108524-00]

RIN 1545-AY28

Section 1446 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the obligation of a partnership to pay a withholding tax on effectively connected taxable income allocable under section 704 to a foreign partner. The regulations will affect partnerships engaged in a trade or business in the United States that have one or more foreign partners.

DATES: Written or electronic comments and requests to speak, with outlines of topics to be discussed at the public hearing scheduled for December 4, 2003, must be received by November 13, 2003.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-108524-00), room 5203, 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 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-108524-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at 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 proposed regulations, David J. Sotos, at (202) 622-3860, or to be placed on the attendance list for the hearing, LaNita Van Dyke at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have 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 collections 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 collections of information should be received by November 3, 2003. Comments are specifically requested concerning:

Whether the proposed collections of information are 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 collections 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 collections 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 collections of information in this proposed regulation are in §§1.871-10, 1.1446-1, 1.1446-3, and 1.1446-4. This information is required to determine whether a partnership is required to pay a withholding tax with respect to a foreign partner and provide information concerning the tax paid on such partner's behalf, and to determine the foreign person required to report the effectively connected taxable income earned by such partnership and entitled to claim credit for the withholding tax paid by the partnership. This information will be used in issuing refunds to foreign persons claiming credit for withholding tax paid on their behalf, as well as for audit and examination purposes. The reporting requirements in §§1.871-10 and 1.1446-3 are mandatory. The reporting requirement in §1.1446-1 and 1.1446-4 are voluntary. The likely respondents include individuals, business or other for profit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 7,805 hours.

Estimated average annual burden hours per respondent: 0.5 hours.

Estimated number of respondents: 15,775.

Estimated annual frequency of responses: on occasion and quarterly.

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 section 1446 of the Internal Revenue Code (Code). Section 1446 was added to the Code by section 1246(a) of the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2085, 2582 (1986 Act)), to impose withholding at a rate of 20 percent on distributions to a foreign partner by a partnership that was engaged in a U.S. trade or business. Section 1012(s)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647, 102 Stat. 3342, 3526 (1988 Act)) revised section 1446 to require that a withholding tax (1446 tax) be imposed on effectively connected taxable income (ECTI) allocable to a partner that is a foreign person (foreign partner) at the highest tax rate applicable to such person. Finally, section 7811(i)(6) of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239, 103 Stat. 2106, 2410 (1989 Act)), made certain technical amendments to section 1446.

Treasury and the IRS issued Rev. Proc. 88-21 (1988-1 C.B. 777) to provide guidance on the operation of the withholding tax imposed under section 1446 as enacted by the 1986 Act. After the 1988 Act, which revised the withholding approach to apply to a partner's allocable share of ECTI instead of to distributions, Treasury and the IRS published Rev. Proc. 89-31

(1989-1 C.B. 895), which made Rev. Proc. 88-21 obsolete. Rev. Proc. 89-31 was modified by Rev. Proc. 92-66 (1992-2 C.B. 428). Rev. Proc. 89–31, as modified by Rev. Proc. 92-66, provides current guidance to partnerships for calculating, paying over, and reporting the 1446 tax.

Explanation of Provisions

A. In General

Prior to the enactment of section 1446, a partnership generally was not required to withhold on income that was effectively connected with the conduct of a trade or business within the United States (a U.S. trade or business) and allocated or distributed to its foreign partners. Congress enacted section 1446 because it was concerned that passive foreign investors could escape U.S. tax on their partnership income. See S. Rep. No. 99-313, 99th Cong., 2d Sess. 414 (1986). As originally enacted, section 1446 generally required both domestic and foreign partnerships with any income, gain, or loss that was effectively connected with the conduct of a U.S. trade or business to withhold a tax equal to 20 percent of any amount distributed to a foreign partner. Through a series of modifications and refinements discussed below, this withholding tax regime evolved from its original structure of withholding on distributions to foreign partners to its present form of, generally, withholding on an installment basis on partnership ECTI (whether distributed or not distributed), apart from special provisions for publicly traded partnerships.

In response to the enactment of section 1446, Treasury and the IRS issued Rev. Proc. 88-21 to provide guidance for partnerships to comply with section 1446. After Rev. Proc. 88-21

was issued, the 1988 Act amended section 1446 retroactively and provided that no withholding was required under section 1446 for partnership taxable years beginning before January 1, 1988.

Section 1446, as revised by the 1988 Act, shifted from imposing a withholding tax on partnership distributions to imposing a withholding tax on the amount of ECTI allocable to the partnership's foreign partners. More specifically, section 1446(a) requires partnerships that have ECTI in any taxable year, any portion of which is allocable under section 704 to a foreign partner, to pay the 1446 tax at such time and in such manner as prescribed in regulations. The amount of withholding tax payable by a partnership under section 1446 is equal to the applicable percentage of the partnership's ECTI allocable under section 704 to foreign partners. The applicable percentage for ECTI allocable to a foreign corporation is the highest rate of tax specified in section 11(b), and the applicable percentage for ECTI allocable to a non-corporate foreign partner is the highest rate of tax specified in section 1. Further, section 1446(d), as amended by the 1988 Act, provides that a foreign partner is entitled to a credit under section 33 for such partner's share of the 1446 tax, and, except as provided in regulations, such partner's share of the 1446 tax paid by the partnership is treated as distributed to such partner on the last day of the taxable year for which such tax was paid. The credit under section 33 is applied against the partner's U.S. tax liability for the taxable year in which the partner includes its allocable share of the partnership's effectively connected income.

Treasury and the IRS issued Rev. Proc. 89-31 to provide guidance to partnerships under section 1446, as amended by the 1988 Act. This revenue procedure made Rev. Proc. 88-21 obsolete. In general, Rev. Proc. 89-31 provides guidance concerning the requirement to pay a withholding tax, the determination of whether a partner is a foreign person, the calculation of

partnership ECTI, the amount of the withholding tax, and the procedures for reporting and paying over the 1446 tax. The revenue procedure generally follows the regime set forth in section 6655 for estimated tax payments by corporations, and requires a partnership to annualize its ECTI and pay over the 1446 tax in quarterly installments. Further, the revenue procedure provides special rules for publicly traded partnerships and tiered partnership structures. A partnership subject to section 1446 must continue to comply with Rev. Proc. 89-31, as modified by Rev. Proc. 92-66 (discussed below), until the partnership's first taxable year beginning after the date these regulations are issued in final form.

Section 7811(i)(6) of the 1989 Act amended section 1446 in three respects. First, the amendment provides that, except as provided in regulations, a foreign partner's share of the 1446 tax paid by a partnership is treated as distributed to such partner on the earlier of the day on which such tax is paid by the partnership or the last day of the partnership's taxable year for which such tax is paid. Second, the amendment grants Treasury and the IRS regulatory authority to apply the addition to tax under section 6655 to a partnership as if it were a corporation. Third, the amendment clarifies that the applicable percentage for a foreign corporate partner is the highest rate of tax specified in section 11(b)(1). The changes made by the 1989 Act are effective for partnership taxable years beginning after December 31, 1987, as if originally included as part of the 1988 Act amendments.

In 1992, Treasury and the IRS issued Rev. Proc. 92-66, which modified Rev. Proc. 89-31 in three respects. First, Rev. Proc. 92-66 provides that the applicable percentage to be used by publicly traded partnerships in calculating the 1446 tax is the highest rate of tax imposed under section 1, which at that time was 31 percent. Second, the revenue procedure allows a partnership

to seek a refund from the IRS in certain circumstances for amounts it has paid under section 1446. Third, the revenue procedure provides that a foreign partnership subject to withholding under section 1445(a) during a taxable year is allowed to credit the amount withheld under section 1445(a), to the extent such amount is allocable to foreign partners, against its liability to pay the 1446 tax for that year.

B. Structure of the Proposed Regulations

In general, the proposed regulations follow the approach in Rev. Proc. 89-31 for computing, paying over and reporting the 1446 tax. The proposed regulations are set forth in six sections. Section 1.1446-1 contains rules regarding a partnership's requirement to pay a withholding tax, and how a partnership should determine the status of its partners (i.e., domestic or foreign, corporate or non-corporate). Section 1.1446-2 contains rules for calculating partnership ECTI allocable to each foreign partner. Section 1.1446-3 contains rules pertaining to a partnership's obligation to pay the 1446 tax on an installment basis, including guidance on calculating the 1446 tax, reporting and paying over the 1446 tax, and penalties for underpayment of the 1446 tax. Section 1.1446-4 contains special rules applicable to publicly traded partnerships. These rules generally implement a withholding regime based upon the distribution of effectively connected income to foreign partners. These regulations also permit publicly traded partnerships to elect to withhold and pay over the 1446 tax based upon the general rules set forth in §§1.1446-1 through 1.1446-3 (withholding based upon ECTI allocable under section 704 to foreign partners). Section 1.1446-5 contains rules applicable to tiered partnership structures, including rules for looking through certain upper-tier foreign partnerships to

determine the 1446 tax obligation of a lower-tier partnership. Finally, §1.1446-6 contains the proposed effective date of the regulations.

In addition to the proposed regulatory amendments under section 1446, these regulations also include proposed amendments to §§1.871-10, 1.1443-1, 1.1461-1 through 1.1461-3, 1.1462-1, 1.1463-1, 301.6109-1, and 301.6721-1, to coordinate the section 1446 withholding regime with existing regulations.

C. Determining the Status and Classification of Partners--§1.1441-1

Section 1446 applies only to partnerships with ECTI allocable under section 704 to one or more foreign partners. Section 1446(e) defines a foreign partner as any partner who is not a United States person. Section 7701(a)(30) defines a United States person to include a citizen or resident of the United States, a domestic partnership, a domestic corporation, any estate other than a foreign estate within the meaning of section 7701(a)(31), and any trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. Section 1446 and the legislative history are silent as to how a partnership is to determine the domestic or foreign status of its partners.

Rev. Proc. 89-31 contains rules for determining whether a partner is a foreign partner for purposes of section 1446. Under the revenue procedure, a partnership may determine a partner's status by relying upon a certification of non-foreign status provided by the partner, or by relying on any other means. See Rev. Proc. 89-31, §5.02 and §5.03.

In order to reduce the paperwork burden imposed on taxpayers and avoid conflicting information, the proposed regulations reflect an approach different from the approach taken in

Rev. Proc. 89-31 for determining whether a partner is a foreign partner. The proposed regulations generally require a partnership to comply with the paperwork requirements used under section 1441 to determine the status (domestic or foreign) and the tax classification (corporate or non-corporate) of its partners. Under the proposed regulations, a partnership should obtain either a Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding," Form W-8IMY, "Certificate of Foreign Intermediary, Flow Through Entity, or Certain U.S. Branches for United States Tax Withholding," or Form W-9, "Request for Taxpayer Identification Number and Certification," from each of its partners. Additionally, special rules are provided with respect to domestic and foreign trusts all or a portion of which are treated as owned by a grantor or another person under subpart E of subchapter J of the Code. The documentation requirement set forth in the proposed regulations will allow a partnership required to withhold under both section 1441 and section 1446 to receive one form instead of two from each of its partners, and thus will reduce the paperwork and recordkeeping burden imposed upon partners and partnerships. Further, the required documentation will also serve to establish a uniform basis for determining the foreign or non-foreign status of partners and to reduce the instances where a partnership receives inconsistent documentation.

In the absence of a valid Form W-8BEN, Form W-8IMY, or Form W-9 from a partner (or upon the receipt of a form that the partnership has actual knowledge or reason to know is incorrect or unreliable), the proposed regulations contain a presumption that the partner is a foreign person and that the partnership must pay 1446 tax on ECTI allocable to the partner. However, this presumption does not apply, and the partnership shall not be liable for 1446 tax

with respect to a partner, to the extent the partnership relies on other means to ascertain the non-foreign status of a partner, and the partnership is correct in its determination that such partner is a U.S. person. This approach is similar to Rev. Proc. 89-31, which permitted partnerships to rely on other means to ascertain the non-foreign status of a partner. See Rev. Proc. 89-31, §5.03. Under the proposed regulations, when the presumption of foreign status applies, the following rules apply for purposes of determining the applicable rate that will apply in computing the 1446 tax. If the partnership knows that the partner is an individual and not an entity, the partnership shall compute the 1446 tax with respect to such partner using the highest rate in section 1. If the partnership knows that the partner is an entity that is a corporation under §301.7701-2(b)(8) (included on the per se list of entities under the entity classification regulations), the partnership shall treat the partner as a foreign corporation and compute the 1446 tax with respect to such partner using the highest rate in section 11(b)(1). In all other cases, including where the partnership cannot reliably determine the status of the partner, the proposed regulations presume that the partner is either a corporate or non-corporate partner, based upon whichever classification results in a higher 1446 tax being due. This presumption is necessary to prevent a partner from obtaining a more favorable withholding result than would have been achieved if the partner complied with the documentation requirements. The duration and validity of the forms required for purposes of section 1446 is intended to be consistent with the standards applicable when these forms are submitted in the context of sections 1441, 1442, and 3406. These forms and their instructions will be modified as necessary to facilitate their use under section 1446.

D. <u>Determining a Foreign Partner's Allocable Share of Partnership ECTI--§1.1446-2</u>

The proposed regulations contain rules for computing partnership ECTI allocable to foreign partners. Consistent with Rev. Proc. 89-31, the partnership determines its ECTI allocable to a foreign partner using an aggregate approach. The partnership first determines the effectively connected partnership items allocable to each of the partnership's foreign partners. Partnership ECTI allocable to all foreign partners then is computed by combining all of the foreign partners' allocable shares of partnership ECTI.

The proposed regulations also provide guidance concerning capital losses, suspended losses, and loss carryovers and carrybacks when determining a foreign partner's allocable share of partnership ECTI. The proposed regulations permit capital losses allocable to a foreign partner to offset such partner's allocable share of capital gains consistent with section 1211(a). Solely for purposes of section 1446, the proposed regulations do not permit the partnership to consider section 1211(b), which permits an individual to use capital losses in excess of capital gains to the extent of $3,000 per taxable year. Further, the proposed regulations do not permit the partnership to take into account in determining a foreign partner's allocable share of partnership ECTI any losses of a partner that are carried over or back or are suspended.

A number of issues arise under section 1446 where the partnership has cancellation of indebtedness income under section 61(a)(12), including difficulties arising because the exclusion of cancellation of indebtedness income under section 108 is applied at the partner level rather than at the partnership level. See section 108(d)(6). These proposed regulations do not specifically address the treatment of cancellation of indebtedness income of a partnership under section 1446. Comments are requested concerning the appropriate treatment under section 1446 of such income allocable to a foreign partner.

E. Calculating, Paying Over, and Reporting the 1446 Tax--§1.1446-3

Section 1446(f)(2) provides that the Secretary shall prescribe such regulations as may be necessary to carry out the purposes of section 1446, including regulations providing (1) that, for purposes of section 6655, the withholding tax imposed under section 1446 be treated as a tax imposed by section 11 and any partnership required to pay such tax be treated as a corporation, and (2) appropriate adjustments in applying section 6655 with respect to such withholding. Section 6655 generally requires a corporation to make estimated tax payments throughout its taxable year, and determines an addition to tax for any underpayment of the required installments.

Rev. Proc. 89-31 generally requires a partnership, other than a publicly traded partnership, to determine its ECTI allocable to foreign partners, and, ultimately, its 1446 tax obligation, by annualizing its effectively connected items under one of the three options generally available to corporations under section 6655 when paying estimated taxes. As an alternative, Rev. Proc. 89-31 permits a partnership to determine its 1446 tax obligation based upon a safe harbor. Under both the safe harbor and the annualization methods, a partnership must pay the 1446 tax on an installment basis.

The proposed regulations adopt, with some modifications, the estimated tax payment rules set forth in section 6655, including the imposition of an addition to tax for an underpayment of the 1446 tax. Consistent with Rev. Proc. 89-31, the proposed regulations require a partnership to pay its 1446 tax obligation on an installment basis, and pay its 1446 tax either based upon annualizing its income or based upon a safe harbor. The proposed regulations broaden the approaches available in Rev. Proc. 89-31 in certain circumstances. Under the

proposed regulations, a partnership that chooses to annualize its income may use certain methods in section 6655 that address the seasonality of income earned by a partnership. See section 6655(e). Further, the proposed regulations modify the safe harbor set forth in Rev. Proc. 89-31 so that a partnership does not need to have filed Form 1065, "U.S. Return of Partnership Income," and Form 8804, "Annual Return for Partnership Withholding Tax (Section 1446)," at the time it makes an installment payment. Instead, it is sufficient if the partnership timely files these forms (taking into account extensions).

F. Special Rule for Tiered Trust or Estate Structures-- §1.1446-3(d)(2)(iii)

Treasury and the IRS are concerned about the potential abuse of tiered trust structures to claim inappropriate refunds of the 1446 tax, to avoid reporting by a beneficiary of ECTI earned by a partnership, or to avoid section 1446 entirely. Existing provisions contemplate that entitlement to a credit or refund of any section 1446 withholding tax follows the liability for tax. Section 1446(d) provides that each foreign partner of a partnership shall be allowed a credit under section 33 for such partner's share of the 1446 tax paid by the partnership. A foreign partner's share of any 1446 tax paid by the partnership is treated as distributed to the partner by such partnership. Section 1462 provides that income on which any tax is required to be withheld at the source under chapter 3 of the Code, including section 1446, shall be included in the return of the recipient of such income, and any amount of tax so withheld may be credited against the amount of income tax as computed in such return. The regulations under section 1462 explain that an amount withheld on a payment to a fiduciary, partnership, or intermediary is deemed to have been paid by the taxpayer ultimately liable for the tax upon such income. See §1.1462-1(b). Sections 702(b), 652(b), and 662(b) ensure that the character of income (e.g., income that

is effectively connected income) of a partnership allocated to a trust (whether domestic or foreign) is preserved in the hands of a beneficiary (see Rev. Rul. 85-60 (1985-1 C.B. 187)).

The proposed regulations include clarification of the regulations under section 1462 to coordinate with section 1446(d) to provide that a foreign trust's or estate's allocable share of ECTI is deemed to have been paid by the taxpayer ultimately liable for tax upon such income. In the case of a foreign grantor trust, the taxpayer ultimately liable for the tax upon such income is the grantor of such trust.

Further, §1.1446-3 of the proposed regulations includes two rules and several examples pertaining to tiered trust or estate structures. The rules are intended to match the credit claimed under section 33 with the taxpayer that reports and pays tax on the ECTI upon which the credit is based. The first rule applies where a foreign trust or estate is a partner in a partnership required to pay the 1446 tax and the beneficiary of the foreign trust or estate is either another foreign trust (with a foreign person as a beneficiary of such trust) or a foreign person. In such a circumstance, the proposed regulations provide that the foreign trust or estate is only entitled to claim the portion of the credit under section 33 that corresponds to the portion of the associated effectively connected income on which it bears the tax liability.

The second rule addresses the use of a domestic trust. The second rule applies where a partnership knows or has reason to know that a foreign person that is the ultimate beneficial owner of the effectively connected income holds its interest in the partnership through a domestic trust, and such domestic trust was formed or availed of with a principal purpose of avoiding the 1446 tax. The use of a domestic trust in a tiered trust structure may have a principal purpose of avoiding the 1446 tax even though the tax avoidance purpose is outweighed by other

purposes when taken together. Where applicable, this rule allows the IRS to impose the 1446 tax obligation on such partnership as if each domestic trust in the chain is a foreign trust.

G. Publicly Traded Partnerships--§1.1446-4

Section 1446(f)(1) provides that the Secretary shall prescribe regulations to apply section 1446 in the case of publicly traded partnerships. In this regard, the legislative history to section 1446 specifically notes that special rules may be necessary in identifying a publicly traded partnership's partners as U.S. or foreign. See H.R. Rep. No. 100-795, 100th Cong., 2d Sess. 291 (1988); S. Rep. No. 100-445, 100th Cong., 2d Sess. 305 (1988).

Rev. Proc. 89-31 provides special rules for publicly traded partnerships. Under Rev. Proc. 89-31, the term publicly traded partnership means a regularly traded partnership within the meaning of the regulations under section 1445(e)(1), but not a publicly traded partnership treated as a corporation under the general rules of section 7704(a). Generally, publicly traded partnerships with effectively connected income, gain or loss are required to withhold based upon distributions made to foreign partners. Rev. Proc. 92-66 modified the applicable percentage for withholding on distributions to the highest rate of tax imposed under section 1, and applied that percentage to both corporate and non-corporate partners.

Under Rev. Proc. 89-31, a publicly traded partnership generally determines the tax status of its partners by receiving either a certificate of non-foreign status, a Form W-8, or a Form W-9 from its partners, or by relying on other means. Further, nominees that hold interests in a publicly traded partnership on behalf of one or more foreign partners may be responsible for the 1446 tax liability for foreign partners under certain circumstances. Finally, Rev. Proc. 89-31 permits publicly traded partnerships to elect to apply the general rules that determine the 1446

tax based on a foreign partner's allocable share of partnership ECTI rather than on distributions to foreign partners. Under Rev. Proc. 89-31, the publicly traded partnership makes this election by complying with the payment and reporting requirements of the general rules and attaching a statement to its annual return of withholding tax indicating that the election is being made.

The proposed regulations modify several of the rules for publicly traded partnerships set forth in Rev. Proc. 89-31. First, the proposed regulations define publicly traded partnership solely by reference to the definition in section 7704. Second, the proposed regulations provide that the documentation requirements and presumptions of §1.1446-1 apply to publicly traded partnerships, thereby requiring such partnerships to obtain a Form W-8BEN, Form W-8IMY, or Form W-9 from each of their partners if they do not rely on other means to determine the status of their partners. Third, the proposed regulations provide that the applicable percentage for withholding on distributions is the rate applicable under section 1446(b).

Comments are requested as to whether the special rules applicable to publicly traded partnerships should be extended to other partnerships. Specifically, Treasury and the IRS are considering whether these special rules should apply to partnerships that make an election under section 775 of the Code or partnerships with a specified minimum number of partners.

H. Tiered Partnership Structures--§1.1446-5

Special concerns arise when a foreign partnership (upper-tier partnership) is a partner in a second partnership (lower-tier partnership) that is subject to section 1446. Section 1446(f) provides the Secretary with regulatory authority to prescribe rules necessary to carry out the purposes of the section. The legislative history to section 1446 notes that in the context of tiered partnership structures, "rules may be necessary to prevent the imposition of more tax than will be

properly due (for example, rules to prevent the tax from being imposed on more than one partnership and rules to determine the applicable percentages)." H.R. Rep. No. 100-795, 100th Cong., 2d Sess. 291 (1988); S. Rep. No. 100-445, 100th Cong., 2d Sess. 305 (1988).

Rev. Proc. 89-31 employs an entity approach in computing the 1446 tax obligation of a partnership that has a foreign partnership as one of its partners. Under the entity approach, a lower-tier partnership must pay a 1446 tax at the highest rate in section 1 on an upper-tier foreign partnership's allocable share of ECTI, regardless of the composition of the upper-tier partnership. Rev. Proc. 89-31 provides the upper-tier partnership a credit for a portion of the 1446 tax paid by the lower-tier partnership to avoid multiple application of the 1446 tax. This approach may result in a partnership paying a 1446 tax that is greater in amount than would have been required if the partners of the upper-tier partnership had been direct partners of the lower-tier partnership, for example, where some of the partners of the upper-tier partnership are U.S. persons.

The proposed regulations modify the rules in Rev. Proc. 89-31 with respect to certain tiered partnership structures to address this situation. The proposed regulations provide that if a partner in a partnership that is required to pay the 1446 tax is a foreign partnership, it may submit a completed Form W-8IMY to the lower-tier partnership. If the upper-tier foreign partnership completes and submits Form W-8IMY to the lower-tier partnership, and passes along the Form W-8BEN, Form W-8IMY, or Form W-9 it received for some or all of its partners, as well as information describing how effectively connected items are allocated among its partners, the lower-tier partnership shall look through the upper-tier partnership to the partners of the upper-tier partnership (to the extent that it has received the appropriate documentation and

allocation information and can reliably associate the allocation of its effectively connected items to the partners of the upper-tier partnership) to determine its 1446 tax obligation. To the extent the lower-tier partnership receives a valid Form W-8IMY from the upper-tier partnership but cannot reliably associate the upper-tier partnership's allocable share of effectively connected partnership items with a withholding certificate for each of the upper-tier partnership's partners, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b).

Therefore, in appropriate circumstances, the lower-tier partnership may determine its 1446 tax obligation based on the status of its indirect partners. This approach generally is consistent with the paperwork requirements under section 1441 applicable to a nonwithholding foreign partnership and will ensure that the 1446 tax paid by the partnership more closely approximates the actual tax liability of the beneficial owner of the income in the case of a tiered partnership structure. An upper-tier foreign partnership with foreign partners remains obligated to file and report with respect to its 1446 tax obligation. Accordingly, the upper-tier partnership must comply with the general rules of section 1446, including requiring payment in installments, and reporting and passing along the credit under section 33 to its partners, which in these situations will also include the tax paid at the lower-tier partnership level.

Comments are requested on the general approach taken in these proposed regulations for situations involving two or more tiers of partnerships. Further, comments are requested as to the desirability and administrability of an alternative approach that allows a domestic upper-tier partnership with foreign partners to elect to pass information regarding its partners to the lower-

tier partnership and have the lower-tier partnership pay the 1446 tax based upon the composition of the partners of the upper-tier partnership.

I. Withholding in Excess of Partner's Actual Tax Liability

Since the enactment of section 1446, Treasury and the IRS have received and considered several comments regarding the potential for section 1446 to require a partnership to pay a withholding tax in an amount that exceeds a foreign partner's actual tax liability for a taxable year. This situation may occur for several reasons, including that: (1) section 1446 does not take into account a partner's losses from outside the partnership during the year, or a partner's loss carryovers; and (2) section 1446 requires withholding at the maximum statutory rates generally applicable to a foreign partner with effectively connected income. Section 1446 does not contain provisions for reducing or eliminating the general withholding obligation like the provisions contained in section 1445 (which impose a withholding tax in the case of the disposition of an interest in United States real property). See section 1445(c). Rev. Proc. 89-31 provides that section 1446 applies instead of section 1445(e)(1) where the two sections overlap, and, accordingly, partnerships owning U.S. real property are not permitted to reduce withholding on gains from the disposition of such property through the use of the procedures available under section 1445. See also §8.01 of Rev. Proc. 2000-35 (2000-2 C.B. 211).

Treasury and the IRS considered comments regarding alternative approaches for adjusting the withholding tax obligation under section 1446 to more closely approximate a foreign partner's actual U.S. tax liability. These proposed regulations contain provisions aimed at mitigating the potential for withholding in excess of the partner's actual tax liability (see e.g., §1.1446-5). These proposed regulations do not contain other provisions that have been

suggested because, among other reasons, of concerns regarding the administrability of such approaches. Comments are requested with respect to approaches that would permit an adjustment to the amount of 1446 tax obligation that are consistent with the statute and legislative history and administrable by partnerships, partners and the IRS. In particular, comments are requested on whether the rules coordinating sections 1445 and 1446 should be modified to address these concerns.

J. Effective Date

These regulations are proposed to apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register.**

Effect on Other Documents

The following publications will be obsolete for partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register:**

Rev. Proc. 89-31 (1989-1 C.B. 895)

Rev. Proc. 92-66 (1992-2 C.B. 428)

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations. With respect to the collections of information contained in §1.871-10, §1.1446-1 (pertaining to domestic grantor trusts), and §1.1446-3 (pertaining to foreign trusts), it is hereby certified that these collections of information will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that only limited

small entities are impacted by these collections and the burden associated with such collections is .5 hours. With respect to the collections of information in §§1.1446-3 (pertaining to a partnership required to notify its foreign partners of an installment payment of 1446 tax paid on behalf of such partner) and 1.1446-4, it is hereby certified that these sections will not impose a significant economic impact on a substantial number of small entities. This certification is based upon the fact that while approximately 15,000 small entities will be impacted by these sections, the estimated annual burden associated with these sections is only .5 hours per respondent. Moreover, the information collection in §1.1446-4 is voluntary. 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 and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet Site at www.irs.gov/regs. All comments will be available for public inspection and copying. The Treasury Department and IRS request comments on the clarity of the proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for December 4, 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 electronic or 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 November 13, 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 David J. Sotos, Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and Recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are 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 * * *
§1.1446-3 also issued under 26 U.S.C. 1446(f).
§1.1446-4 also issued under 26 U.S.C. 1446(f).* * *

Par. 2. In §1.871-10, paragraph (d)(3) is amended by adding a sentence at the end of that paragraph, and paragraph (e) is amended by revising the first sentence to read as follows:

§1.871-10 Election to treat real property income as effectively connected with U.S. business.

* * * * *

(d) * * *

(3) Election by partnership. * * * If the nonresident alien or foreign corporation makes an election, such person must provide the partnership a Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for U.S. Withholding," and must indicate that the nonresident alien or foreign corporation has made the election under this section to treat real property income as effectively connected income.

(e) Effective date. This section shall apply for taxable years beginning after December 31, 1966, except the last sentence of paragraph (d)(3) shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.* * *

Par. 3. In §1.1443-1 is amended by:

1. Revising the first sentence of paragraph (a) and adding a sentence at the end of the paragraph.

2. Revising paragraph (c)(1).

The revision and additions read as follows:

§1.1443-1 Foreign tax-exempt organizations.

(a) Income includible in computing unrelated business taxable income. In the case of a foreign organization that is described in section 501(c), amounts paid or effectively connected taxable income allocable to the organization that are includible under section 512 in computing the organization's unrelated business taxable income are subject to withholding under §§1.1441-1, 1.1441-4, 1.1441-6, and 1.1446-1 through 1.1446-5, in the same manner as payments or allocations of effectively connected taxable income of the same amounts to any foreign person that is not a tax-exempt organization.*** See also §1.1446-3(c)(3).

* * * * *

(c)* * *

(1) In general. This section applies to payments made after December 31, 2000, except that the references in paragraph (a) of this section to effectively connected taxable income and withholding under section 1446 shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 4. Sections 1.1446-0 through 1.1446-6 are added to read as follows.

§1.1446-0 Table of contents. This section lists the captions contained in §§1.1446-1 through 1.1446-6.

§1.1446-1 Withholding tax on foreign partners' share of effectively connected taxable income.

(a) In general.
(b) Steps in determining 1446 tax obligation.
(c) Determining whether a partnership has a foreign partner.
(1) In general.
(2) Forms W-8BEN, W-8IMY, and W-9.
(i) In general.
(ii) Effect of Forms W-8BEN, W-8IMY, W-9, and statement.
(iii) Requirements for certificates to be valid.
(A) When period of validity expires.
(B) Required information for Forms W-8BEN and W-8IMY.
(iv) Partner must provide new withholding certificate when there is a change in circumstances.
(v) Partnership must retain withholding certificates.
(3) Presumption of foreign status in absence of valid Form W-8BEN, Form W-8IMY, Form W-9, or statement.
(4) Consequences when partnership knows or has reason to know that Form W-8BEN, Form W-8IMY, or Form W-9 is incorrect or unreliable and does not withhold.

§1.1446-2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.
(a) In general.
(b) Computation.
(1) In general.
(2) Income and gain rules.
(i) Application of the principles of section 864.
(ii) Income treated as effectively connected.
(iii) Exempt income.
(3) Deduction and losses.
(i) Oil and gas interests.
(ii) Charitable contributions.
(iii) Net operating losses and other suspended or carried losses.
(iv) Interest deductions.
(v) Limitation on capital losses.
(vi) Other deductions.
(vii) Limitations on deductions.
(4) Other rules.
(i) Exclusion of items allocated to U.S. partners.
(ii) Partnership credits.
(5) Examples.

§1.1446-3 Time and manner of calculating and paying over the 1446 tax.

(a) In general.

(1) Calculating 1446 tax.
(2) Applicable percentage.
(b) Installment payments.
(1) In general.
(2) Calculation.
(i) General application of the principles of section 6655.
(ii) Annualization methods.
(iii) Partner's estimated tax payments.
(iv) Partner whose interest terminates during the partnership's taxable year.
(v) Exceptions and modifications to the application of the principles under section 6655.
(A) Inapplicability of special rules for large corporations.
(B) Inapplicability of special rules regarding early refunds.
(C) Period of underpayment.
(D) Other taxes.
(E) 1446 tax treated as tax under section 11.
(F) Prior year tax safe harbor.
(3) 1446 tax safe harbor.
(i) In general.
(ii) Permission to change to standard annualization method.
(c) Coordination with other withholding rules.
(1) Fixed or determinable, annual or periodical income.
(2) Real property gains.
(i) Domestic partnerships.
(ii) Foreign partnerships.
(3) Coordination with section 1443.
(d) Reporting and crediting the 1446 tax.
(1) Reporting 1446 tax.
(i) Reporting of installment tax payments, installment tax payment due dates, and notification to partners of installment tax payments.
(ii) Payment due dates.
(iii) Annual return and notification to partners.
(iv) Information provided to beneficiaries of foreign trusts and estates.
(v) Attachments required of foreign trusts and estates.
(vi) Attachments required of beneficiaries of foreign trusts and estates.
(vii) Information provided to beneficiaries of foreign trusts and estates that are partners in certain publicly traded partnerships.
(2) Crediting 1446 tax against a partner's U.S. tax liability.
(i) In general.
(ii) Substantiation for purposes of claiming the credit under section 33.
(iii) Tiered structures including trusts or estates.
(A) Foreign estates and trusts.
(B) Use of domestic trusts to circumvent section 1446.
(iv) Refunds to withholding agent.
(v) 1446 tax treated as cash distribution to partners.

(vi) Examples.
(e) Liability of partnership for failure to withhold.
(1) In general.
(2) Proof that tax liability has been satisfied.
(3) Liability for interest and penalties.
(f) Effect of withholding on partner.

§1.1446-4 Publicly traded partnerships.

(a) In general.
(b) Definitions.
(1) Publicly traded partnership.
(2) Applicable percentage.
(3) Nominee.
(4) Qualified notice.
(c) Time and manner of payment.
(d) Rules for designation of nominees to withhold tax under section 1446.
(e) Determining foreign status of partners.
(1) In general.
(2) Presumptions regarding payee's status in absence of documentation.
(f) Distributions subject to withholding.
(1) In general.
(2) In-kind distributions.
(3) Ordering rule relating to distributions.
(4) Coordination with section 1445.
(g) Election to withhold based upon ECTI allocable to foreign partners instead of withholding on distributions.

§1.1446-5 Tiered partnership structures.

(a) In general.
(b) Reporting requirements.
(1) In general.
(2) Publicly traded partnerships.
(c) Look through rules for foreign upper-tier partnerships.
(d) Examples.

§1.1446-6 Effective date.

§1.1446-1 Withholding tax on foreign partners' share of effectively connected taxable income.

(a) In general. If a domestic or foreign partnership has effectively connected taxable income as computed under §1.1446-2 (ECTI), for any partnership tax year, and any portion of such taxable income is allocable under section 704 to a foreign partner, then the partnership must pay a withholding tax under section 1446 (1446 tax) at the time and in the manner set forth in this section and §§1.1446-2 through 1.1446-5.

(b) Steps in determining 1446 tax obligation. In general, a partnership determines its 1446 tax as follows. The partnership determines whether it has any foreign partners in accordance with paragraph (c) of this section. If the partnership does not have any foreign partners (including any person presumed to be foreign under paragraph (c) of this section and any domestic trust treated as foreign under §1.1446-3(d)) during its taxable year, it generally will not have a 1446 tax obligation. If the partnership has one or more foreign partners, it then determines under §1.1446-2 whether it has ECTI any portion of which is allocable to one or more of the foreign partners. If the partnership has ECTI allocable to one or more of its foreign partners, the partnership computes its 1446 tax, pays over 1446 tax, and reports the amount paid in accordance with the rules in §1.1446-3. For special rules applicable to publicly traded partnerships, see §1.1446-4. For special rules applicable to tiered partnership structures, see §1.1446-5.

(c) Determining whether a partnership has a foreign partner--(1) In general. Except as otherwise provided in §1.1446-3, only a partnership that has at least one foreign partner during the partnership's taxable year can have a 1446 tax liability. The term foreign partner means any partner of the partnership who is not a U.S. person within the meaning of section 7701(a)(30). Thus, a partner of the partnership is a foreign partner if the partner is a nonresident alien

individual, foreign partnership, foreign corporation, foreign estate or trust, as those terms are defined under section 7701 and the regulations thereunder, or a foreign government within the meaning of section 892 and the regulations thereunder. For purposes of this section, a partner that is treated as a U.S. person for all income tax purposes (by election or otherwise, see e.g., sections 953(d), 1504(d)) will not be a foreign partner, provided the partner has provided the partnership a valid Form W-9, "Request for Taxpayer Identification Number and Certification," or if the partnership uses other means to determine that the partner is not a foreign partner (see paragraph (c)(3) of this section). A partner that is treated as a U.S. person only for certain specified purposes is considered a foreign partner for purposes of section 1446, and a partnership must pay a withholding tax on the portion of ECTI allocable to that partner. For example, a partnership must generally pay 1446 tax on ECTI allocable to a foreign corporate partner that has made an election under section 897(i).

(2) Forms W-8BEN, W-8IMY, and W-9--(i) In general. Except as otherwise provided in this paragraph (c)(2) or paragraph (c)(3) of this section, a partnership must determine whether a partner is a foreign partner, and the partner's tax classification (e.g., corporate or non-corporate), by obtaining from the partner a Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding," Form W-8IMY, "Certificate of Foreign Intermediary, Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding," or a Form W-9, as applicable. Specifically, a foreign partner that is a nonresident alien individual, a foreign estate or trust (other than a grantor trust described in this paragraph

(c)(2)), a foreign corporation, or a foreign government should provide a valid Form W-8BEN. A partner that is a foreign partnership should provide a valid Form W-8IMY. A partner that is a U.S. person (other than a grantor trust described in this paragraph (c)(2)), including a domestic partnership, should provide a valid Form W-9. An entity that is disregarded as an entity separate from its owner under §301.7701-3 of this chapter may not submit a Form W-8BEN, W-8IMY, or Form W-9. See §§301.7701-1 through 301.7701-3 of this chapter for determining the U.S. Federal tax classification of a partner. To the extent that a grantor or another person is treated as the owner of any portion of a trust under subpart E of subchapter J of the Internal Revenue Code, such trust shall not provide a Form W-8BEN or Form W-9 to the partnership, except to the extent that such trust is providing documentation on behalf of the grantor or other person treated as the owner of a portion of such trust as required by this paragraph (c)(2). Instead, if such trust is a foreign trust, the trust shall submit Form W-8IMY to the partnership identifying itself as a grantor trust and shall provide such documentation (e.g., Forms W-8BEN, W-8IMY, or W-9) and information pertaining to its owner(s) to the partnership that permits the partnership to reliably associate (within the meaning of §1.1441-1(b)(2)(vii)) such portion of the trust's allocable share of partnership ECTI with the grantor or other person that is the owner of such portion of the trust. If such trust is a domestic trust, the trust shall furnish the partnership a statement under penalty of perjury that the trust is, in whole or in part, a grantor trust and identifying that portion of the trust that is treated as owned by a grantor or another person under subpart E of subchapter J of the Internal Revenue Code. The trust shall also provide such documentation and information (e.g., Forms W-8BEN, W-8IMY, or W-9) pertaining to its owner(s) to the partnership that permits the partnership to reliably associate such portion of the

trust's allocable share of partnership ECTI with the grantor or other person that is the owner of such portion of the trust. With respect to nominees, only nominees described in §1.1446-4(b)(3) holding interests in publicly traded partnerships subject to §1.1446-4 may submit a Form W-9. See §1.1446-4 for additional documentation that may be submitted by such a nominee. In all other cases where a nominee holds an interest in a partnership, the beneficial owner of the partnership interest, not the nominee, shall submit Form W-8BEN, Form W-8IMY, or Form W-9. A partnership that has obtained a valid Form W-8BEN, Form W-8IMY, or Form W-9 from a partner, nominee, or beneficial owner prior to the due date for paying any 1446 tax may rely on it to the extent provided in this paragraph (c)(2).

(ii) Effect of Forms W-8BEN, W-8IMY, W-9, and Statement. In general, for purposes of this section, a partnership may rely on a valid Form W-8BEN, Form W-8IMY, Form W-9, statement described in §1.1446-4(e)(1), or statement described in this paragraph (c)(2) from a partner, nominee, beneficial owner, or grantor trust to determine whether that person, beneficial owner, or the owner of a grantor trust, is a domestic or foreign partner or a nominee, and if such person is a foreign partner, to determine whether or not such person is a corporation for U.S. tax purposes. To the extent a partnership receives a Form W-8IMY from a foreign grantor trust or a statement described in this paragraph (c)(2) from a domestic grantor trust, but does not receive a Form W-8BEN, Form W-8IMY, or Form W-9 identifying such grantor or other person, the rules of paragraph (c)(3) of this section shall apply. Further, a partnership may not rely on a Form W-8BEN, Form W-8IMY, Form W-9, or statement described in §1.1446-4(e)(1) or this paragraph (c)(2), and such form or statement is therefore not valid, if the partnership has actual knowledge

or has reason to know that any information on the withholding certificate or statement is incorrect or unreliable and, if based on such knowledge or reason to know, it should pay a 1446 tax in an amount greater than would be the case if it relied on the information or certifications. A partnership has reason to know that information on a withholding certificate or statement is incorrect or unreliable if its knowledge of relevant facts or statements contained on the form or other documentation is such that a reasonably prudent person in the position of the withholding agent would question the claims made. See §§1.1441-1(e)(4)(viii) and 1.1441-7(b)(1) and (2). If the partnership does not know or have reason to know that a Form W-8BEN, Form W-8IMY, Form W-9, or statement received from a partner, nominee, beneficial owner, or grantor trust contains incorrect or unreliable information, but it subsequently determines that it does contain incorrect or unreliable information, and, based on such knowledge the partnership should pay 1446 tax in an amount greater than would be the case if it relied on the information or certification, the partnership will not be subject to penalties for its failure to pay the 1446 tax in reliance on such form or statement for any installment payment date prior to the date that the determination is made. See §§1.1446-1(c)(4) and 1.1446-3 concerning penalties for failure to pay the withholding tax when a partnership knows or has reason to know that the form or statement is incorrect or unreliable.

(iii) Requirements for certificates to be valid. Except as otherwise provided in this paragraph (c), for purposes of this section, the validity of a Form W-9 shall be determined under section 3406 and §31.3406(h)-3(e) of this chapter which establish when such form may be reasonably relied upon. A Form W-8BEN, or Form W-8IMY is only valid for purposes of this

section if its validity period has not expired, the partner submitting the form has signed it under penalties of perjury, and it contains all the required information.

(A) When period of validity expires. For purposes of this section, a Form W-8BEN or W-8IMY submitted by a partner shall be valid until the end of the period of validity determined for such form under §1.1441-1(e). With respect to a foreign partnership submitting Form W-8IMY, the period of validity of such form shall be determined under §1.1441-1(e) as if such foreign partnership submitted the form required of a nonwithholding foreign partnership. See §1.1441-1(e)(4)(ii).

(B) Required information for Forms W-8BEN and W-8IMY. Forms W-8BEN and W-8IMY submitted under this section must contain the partner's name, permanent address and Taxpayer Identification Number (TIN), the country under the laws of which the partner is formed, incorporated or governed (if the person is not an individual), the classification of the partner for U.S. federal tax purposes (e.g., partnership, corporation), and any other information required to be submitted by the forms or instructions to Form W-8BEN or Form W-8IMY, as applicable.

(iv) Partner must provide new withholding certificate when there is a change in circumstances. The principles of §1.1441-1(e)(4)(ii)(D) shall apply when a change in circumstances has occurred (including situations where the status of a U.S. person changes) that requires a partner to provide a new withholding certificate.

(v) Partnership must retain withholding certificates. A partnership or nominee who has responsibility for paying the withholding tax under this section or §1.1446-4, must retain each withholding certificate and other documentation received from its direct and indirect partners

(including nominees) for as long as it may be relevant to the determination of the withholding agent's tax liability under section 1461 and the regulations thereunder.

(3) Presumption of foreign status in absence of valid Form W-8BEN, Form W-8IMY, Form W-9, or statement. Except as otherwise provided in this paragraph (c)(3), a partnership that does not receive a valid Form W-8BEN, Form W-8IMY, Form W-9, statement described in §1.1446-4(e)(1), or statement required by paragraph (c)(2) of this section from a partner, nominee, beneficial owner, or grantor trust, or a partnership that receives a withholding certificate or statement but has actual knowledge or reason to know that the information on the certificate or statement is incorrect or unreliable, must presume that the partner is a foreign person. If the partnership knows that the partner is an individual and not an entity, the partnership shall treat the partner as a nonresident alien individual. If the partnership knows that the partner is an entity, the partnership shall treat the partner as a corporation if the entity is a corporation as defined in §301.7701-2(b)(8) of this chapter. In all other cases, the partnership shall treat the partner as either a nonresident alien individual or a foreign corporation, whichever classification results in a higher 1446 tax being due, and shall pay the 1446 tax in accordance with this presumption. The presumption set forth in this paragraph (c)(3) that a partner is a foreign person (either because a Form W-9 was not furnished by such partner or the partnership determines that such form is incorrect or unreliable) shall not apply to the extent that the partnership relies on other means to ascertain the non-foreign status of a partner and the partnership is correct in its determination that such partner is a U.S. person. A partnership is in no event required to rely upon other means to determine the non-foreign status of a partner and

may demand that a partner furnish a Form W-9. If a certification is not provided in such circumstances, the partnership may presume that the partner is a foreign partner, and for purposes of sections 1461 through 1463, will be considered to have been required to pay 1446 tax on such partner's allocable share of partnership ECTI.

(4) Consequences when partnership knows or has reason to know that Form W-8BEN, Form W-8IMY, or Form W-9 is incorrect or unreliable and does not withhold. If a partnership knows or has reason to know that a Form W-8BEN, Form W-8IMY, Form W-9, statement described in §1.1446-4(e)(1), or statement required by paragraph (c)(2) of this section submitted by a partner, nominee, beneficial owner, or grantor trust contains incorrect or unreliable information (either because the certificate or statement when given to the partnership contained incorrect information or because there has been a change in facts that makes information on the certificate or statement incorrect), and the partnership pays less than the full amount of withholding tax due on ECTI allocable to that partner, the partnership shall be fully liable under section 1461 and §1.1461-3 (§1.1461-1 for publicly traded partnerships subject to §1.1446-4), §1.1446-3, and for all applicable penalties and interest, for any failure to pay the 1446 tax for the period during which the partnership knew or had reason to know that the certificate contained incorrect or unreliable information and for all subsequent installment periods. If a partner, nominee, beneficial owner, or grantor trust, submits a new valid Form W-8BEN, Form W-8IMY, Form W-9, or statement, as applicable, the partnership may rely on that form for paying installments of 1446 tax beginning with the installment period during which such form is received.

§1.1446-2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.

(a) In general. A partnership's effectively connected taxable income (ECTI) is generally the partnership's taxable income as computed under section 703, with adjustments as provided in section 1446(c) and this section, and computed with consideration of only those partnership items which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States. For purposes of determining the section 1446 withholding tax (1446 tax) under §1.1446-3, partnership ECTI allocable under section 704 to foreign partners is the sum of the allocable shares of ECTI of each of the partnership's foreign partners as determined under paragraph (b) of this section. The calculation of partnership ECTI allocable to foreign partners as set forth in paragraph (b) of this section, and the determination of the partnership's withholding tax obligation, is a partnership-level computation solely for purposes of determining the 1446 tax. Therefore, any deduction that is not taken into account in calculating a partner's allocable share of partnership ECTI (e.g., percentage depletion), but which is a deduction that under U.S. tax law the foreign partner is otherwise entitled to claim, can still be claimed by the foreign partner when computing its U.S. tax liability and filing its U.S. income tax return, subject to any restriction or limitation that otherwise may apply.

(b) Computation--(1) In general. A foreign partner's allocable share of partnership ECTI for the partnership's taxable year that is allocable under section 704 to a particular foreign partner is equal to that foreign partner's distributive share of partnership gross income and gain for the partnership's taxable year that is effectively connected and properly allocable to the partner under section 704 and the regulations thereunder, reduced by the foreign partner's

distributive share of partnership deductions for the partnership taxable year that are connected with such income under section 873 or 882(c) and properly allocable to the partner under section 704 and the regulations thereunder, in each case, after application of the rules of this section. For these purposes, a foreign partner's distributive share of effectively connected gross income and gain and the deductions connected with such income shall be computed by considering allocations that are respected under the rules of section 704 and §1.704-1(b)(1), including special allocations in the partnership agreement (as defined in §1.704-1(b)(2)(ii)(h)), and adjustments to the basis of partnership property described in section 743 pursuant to an election by the partnership under section 754 (see §1.743-1(j)). The character of effectively connected partnership items (capital versus ordinary) shall be separately considered only to the extent set forth in paragraph (b)(3)(v) of this section.

(2) Income and gain rules. For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules with respect to partnership income and gain shall apply.

(i) Application of the principles of section 864. The determination of whether a partnership's items of gross income are effectively connected shall be made by applying the principles of section 864 and the regulations thereunder.

(ii) Income treated as effectively connected. A partnership's items of gross income that are effectively connected includes any income that is treated as effectively connected income, including partnership income subject to a partner's election under section 871(d) or section 882(d), any partnership income treated as effectively connected with the conduct of a U.S. trade or business pursuant to section 897, and any other items of partnership income treated as

effectively connected under another provision of the Code, without regard to whether those amounts are taxable to the partner.

(iii) Exempt income. A foreign partner's allocable share of partnership ECTI does not include income or gain exempt from U.S. tax by reason of a provision of the Internal Revenue Code. A foreign partner's allocable share of partnership ECTI also does not include income or gain exempt from U.S. tax by operation of any U.S. income tax treaty or reciprocal agreement. In the case of income excluded by reason of a treaty provision, such income must be derived by a resident of an applicable treaty jurisdiction, the resident must be the beneficial owner of the item, and all other requirements for benefits under the treaty must be satisfied. The partnership must have received from the partner a valid withholding certificate, that is Form W-8BEN or Form W-8IMY (see §1.1446-1(c)(2)(iii) regarding when a Form W-8BEN or Form W-8IMY is valid for purposes of this section), containing the information necessary to support the claim for treaty benefits required in the forms and instructions to those forms. In addition, for purposes of this section, the withholding certificate must contain the beneficial owner's taxpayer identification number.

(3) Deduction and losses. For purposes of computing a foreign partner's allocable share of partnership ECTI under this paragraph (b), the following rules with respect to deductions and losses shall apply.

(i) Oil and gas interests. The deduction for depletion with respect to oil and gas wells shall be allowed, but the amount of such deduction shall be determined without regard to sections 613 and 613A.

(ii) Charitable contributions. The deduction for charitable contributions provided in section 170 shall not be allowed.

(iii) Net operating losses and other suspended or carried losses. The net operating loss deduction of any foreign partner provided in section 172 shall not be taken into account. Further, the partnership shall not take into account any suspended losses (e.g., losses in excess of a partner's basis in the partnership, see section 704(d)) or any capital loss carrybacks or carryovers available to a foreign partner.

(iv) Interest deductions. The rules of this paragraph (b)(3)(iv) shall apply for purposes of determining the amount of interest expense that is allocable to income which is (or is treated as) effectively connected with the conduct of a trade or business for purposes of calculating the foreign partner's allocable share of partnership ECTI. In the case of a non-corporate foreign partner, the rules of §1.861-9T(e)(7) shall apply. In the case of a corporate foreign partner, the rules of §1.882-5 shall apply by treating the partnership as a foreign corporation and using the partner's pro-rata share of the partnership's assets and liabilities for these purposes. For these purposes, the rules governing elections under §1.882-5(a)(7) shall be made at the partnership level.

(v) Limitation on capital losses. Losses from the sale or exchange of capital assets allocable under section 704 to a partner shall be allowed only to the extent of gains from the sale or exchange of capital assets allocable under section 704 to such partner.

(vi) Other deductions. No deduction shall be allowed for personal exemptions provided in section 151 or the additional itemized deductions for individuals provided in part VII of subchapter B of the Internal Revenue Code (section 211 and following).

(vii) Limitations on deductions. Except as provided in paragraph (b)(3) or (4) of this section, any limitations on losses or deductions that apply at the partner level when determining ECTI allocable to a foreign partner shall not be taken into account.

(4) Other rules--(i) Exclusion of items allocated to U.S. partners. In computing ECTI allocable to a foreign partner, the partnership shall not take into account any item of income, gain, loss, or deduction to the extent allocable to any partner that is not a foreign partner, as that term is defined in §1.1446-1(c) of this section.

(ii) Partnership credits. See §1.1446-3(a) providing that the 1446 tax is computed without regard to a partner's distrubutive share of the partnership's tax credits.

(5) Examples. The following examples illustrate the application of this section:

Example 1. Limitation on capital losses. PRS partnership has two equal partners, A and B. A is a nonresident alien individual and B is a U.S. citizen. A provides PRS with a valid Form W-8BEN, and B provides PRS with a valid Form W-9. PRS has the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business and are allocated equally between A and B: $100 of long-term capital gain, $400 of long-term capital loss, $300 of ordinary income, and $100 of ordinary deductions. Assume that these allocations are respected under section 704(b) and the regulations thereunder. Accordingly, A's allocable share of PRS's effectively connected items includes $50 of long-term capital gain, $200 of long-term capital loss, $150 of ordinary income, and $50 of ordinary deductions. In determining A's allocable share of partnership ECTI, the amount of the long-term capital loss that may be taken into account pursuant to paragraph (b)(3)(v) of this section is limited to A's allocable share of gain from the sale or exchange of capital assets. The amount of partnership ECTI allocable under section 704 to A is $100 ($150 of ordinary income less $50 of ordinary deductions, plus $50 of capital gains less $50 of capital loss).

Example 2. Limitation on capital losses--special allocations. PRS partnership has two equal partners, A and B. A and B are both nonresident alien individuals. A and B each provide PRS with a valid Form W-8BEN. PRS has the following annualized tax items for the relevant installment period, all of which are effectively connected with its U.S. trade or business: $200 of long-term capital gain, $200 of long-term capital loss, and $400 of ordinary income. A and B have equal shares in the ordinary income, however, pursuant to the partnership agreement, capital gains and losses are subject to special allocations. The long-term capital gain is allocable to A, and the long-term capital loss is allocable to B. It is assumed that all of the partnership's allocations are respected under section 704(b) and the regulations thereunder. Pursuant to

paragraph (b)(3)(v) of this section, A's allocable share of partnership ECTI is $400 ($200 of ordinary income plus $200 of long-term capital gain), and B's allocable share of partnership ECTI is $200 ($200 of ordinary income).

Example 3. Withholding tax obligation where partner has net operating losses. PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. FC and DC provide a valid Form W-8BEN and Form W-9, respectively, to PRS. Both FC and PRS are on a calendar taxable year. PRS is engaged in the conduct of a trade or business in the United States and for its first installment period during its taxable year has $100 of annualized ECTI that is allocable to FC. As of the beginning of the taxable year, FC had an unused effectively connected net operating loss carryover in the amount of $300. The net operating loss carryover is not taken into account in determining PRS's withholding tax liability for ECTI allocable under section 704 to FC. PRS must pay 1446 tax with respect to the $100 of ECTI allocable to FC.

§1.1446-3 Time and manner of calculating and paying over the 1446 tax.

(a) In general--(1) Calculating 1446 tax. This section provides rules for calculating, reporting, and paying over the section 1446 withholding tax (1446 tax). A partnership's 1446 tax is equal to the amount determined under this section and shall be paid in installments during the partnership's taxable year (see paragraph (d)(1) of this section for installment payment due dates), with any remaining tax due paid with the partnership's annual return required to be filed pursuant to paragraph (d) of this section. For these purposes, a partnership shall not take into account either a partner's liability for any other tax imposed under any other provision of the Internal Revenue Code (e.g., section 55 or 884) or a partner's distributive share of the partnership's tax credits when determining the amount of the partnership's 1446 tax.

(2) Applicable percentage. In the case of a foreign partner that is a corporation, the applicable percentage is the highest rate of tax specified in section 11(b)(1) for such taxable year. Except to the extent provided in §1.1446-5, in the case of a foreign partner that is not taxable as a corporation (e.g., partnership, individual, trust or estate), the applicable percentage is the highest rate of tax specified in section 1.

(b) Installment payments--(1) In general. Except as provided in §1.1446-4 for certain publicly traded partnerships, a partnership must pay its 1446 tax by making installment payments of the 1446 tax based on the amount of partnership ECTI allocable under section 704 to its foreign partners, without regard to whether the partnership makes any distributions to its partners during the partnership's taxable year. The amount of the installment payments are determined in accordance with this paragraph (b), and the tax must be paid at the times set forth in paragraph (d) of this section. Subject to paragraph (b)(3) of this section, in computing its first installment of 1446 tax for a taxable year, a partnership must choose whether it will pay its 1446 tax for the entire taxable year by using the safe harbor set forth in paragraph (b)(3) of this section, or by using one of several annualization methods available under paragraph (b)(2)(ii) of this section for computing partnership ECTI allocable to foreign partners. In the case of any underpayment of an installment payment of 1446 tax by a partnership, the partnership shall be subject to an addition to tax equal to the amount determined under section 6655, as modified by this section, as if such partnership were a domestic corporation, as well as any other applicable interest and penalties. See §1.1446-3(f). Section 6425 (permitting an adjustment for an overpayment of estimated tax by a corporation) shall not apply to a partnership with respect to the payment of its 1446 tax.

(2) Calculation--(i) General application of the principles of section 6655. Installment payments of 1446 tax required during the partnership's taxable year are based upon partnership ECTI for the portion of the partnership taxable year to which they relate, and, except as set forth in this paragraph (b)(2) or paragraph (b)(3) of this section, shall be calculated using the

principles of section 6655. Under the principles of section 6655, the partnership's effectively connected items are annualized to determine each foreign partner's allocable share of partnership ECTI under §1.1446-2. Each foreign partner's allocable share of partnership ECTI is then multiplied by the applicable percentage for each foreign partner. This computation will yield an annualized 1446 tax with respect to such partner. The installment of 1446 tax due with respect to a foreign partner's allocable share of partnership ECTI equals the excess of the section 6655(e)(2)(B)(ii) percentage of the annualized 1446 tax for that partner (or, if applicable, the adjusted seasonal amount) for the relevant installment period, over the aggregate of any amounts paid under section 1446 with respect to that partner in prior installments during the partnership's taxable year.

(ii) Annualization methods. A partnership that chooses to annualize its income for the taxable year shall use one of the annualization methods set forth in section 6655(e) and the regulations thereunder, and as described in the forms and instructions for Form 8804, "Annual Return for Partnership Withholding Tax (Section 1446)," Form 8805, "Foreign Partner's Information Statement of Section 1446 Withholding Tax," and Form 8813, "Partnership Withholding Tax Payment Voucher."

(iii) Partner's estimated tax payments. In computing its installment payments of 1446 tax, a partnership may not take into account a partner's estimated tax payments.

(iv) Partner whose interest terminates during the partnership's taxable year. With respect to a partner whose interest in the partnership terminates prior to the end of the period for which the partnership is making an installment payment, the partnership shall take into account the

income that is allocable to the partner for the portion of the partnership taxable year that the person was a partner.

(v) Exceptions and modifications to the application of the principles under section 6655. To the extent not otherwise modified in §§1.1446-1 through 1.1446-6, or inconsistent with those rules, the principles of section 6655 apply to the calculation of the installment payments of 1446 tax made by a partnership, except that:

(A) Inapplicability of special rules for large corporations. The principles of section 6655(d)(2), concerning large corporations (as defined in section 6655(g)(2)), shall not apply.

(B) Inapplicability of special rules regarding early refunds. The principles of section 6655(h), applicable to amounts excessively credited or refunded under section 6425, shall not apply. See paragraph (b)(1) of this section providing that section 6425 shall not apply for purposes of the 1446 tax.

(C) Period of underpayment. The period of the underpayment set forth in section 6655(b)(2) shall end on the earlier of the 15th day of the 4th month following the close of the partnership's taxable year (or, in the case of a partnership described in §1.6081-5(a)(1) of this chapter, the 15th day of the 6th month following the close of the partnership's taxable year), or with respect to any portion of the underpayment, the date on which such portion is paid.

(D) Other taxes. Section 6655 shall be applied without regard to any references to alternative minimum taxable income and modified alternative minimum taxable income.

(E) 1446 tax treated as tax under section 11. The principles of section 6655(g)(1) shall be applied to treat the 1446 tax as a tax imposed by section 11.

(F) Prior year tax safe harbor. The safe harbor set forth in section 6655(d)(1)(B)(ii) shall not apply and instead the safe harbor set forth in paragraph (b)(3) of this section applies.

(3) 1446 tax safe harbor--(i) In general. The addition to tax under section 6655 shall not apply to a partnership with respect to a current installment of 1446 tax if--

(A) The average of the amount of the current installment and prior installments during the taxable year is at least 25 percent of the total 1446 tax that would be payable on the amount of the partnership's ECTI allocable under section 704 to foreign partners for the prior taxable year;

(B) The prior taxable year consisted of twelve months;

(C) The partnership timely files (including extensions) an information return under section 6031 for the prior year; and

(D) The amount of ECTI for the prior taxable year is not less than 50 percent of the ECTI shown on the annual return of section 1446 withholding tax that is (or will be) timely filed for the current year.

(ii) Permission to change to standard annualization method. Except as otherwise provided in this paragraph (b)(3), if a partnership chooses to pay its 1446 tax for the first installment period based upon the safe harbor method set forth in this paragraph (b)(3), the partnership must use the safe harbor method for each installment payment made during the partnership's taxable year. Notwithstanding the foregoing, if a partnership paying over 1446 tax during the taxable year pursuant to this paragraph (b)(3) determines during an installment period (based upon the standard option annualization method set forth in section 6655(e) and the regulations thereunder, as modified by the forms and instructions to Forms 8804, 8805, and

8813) that it will not qualify for the safe harbor in this paragraph (b)(3) because the prior year's ECTI will not meet the 50-percent threshold in paragraph (b)(3)(i)(D) of this section, then the partnership is permitted, without being subject to the addition to tax under section 6655, to pay over its 1446 tax for the period in which such determination is made, and all subsequent installment periods during the taxable year, using the standard option annualization method. A change pursuant to this paragraph shall be disclosed in a statement attached to the Form 8804 the partnership files for the taxable year and shall include information to allow the Service to determine whether the change was appropriate.

(c) Coordination with other withholding rules--(1) Fixed or determinable, annual or periodical income. Fixed or determinable, annual or periodical income subject to tax under section 871(a) or section 881 is not subject to withholding under section 1446, and such income is independently subject to the withholding requirements of sections 1441 and 1442 and the regulations thereunder.

(2) Real property gains--(i) Domestic partnerships. A domestic partnership that is otherwise subject to the withholding requirements of sections 1445 and 1446 will be subject to the payment and reporting requirements of section 1446 only and not section 1445(e)(1) and the regulations thereunder, with respect to partnership gain from the disposition of a U.S. real property interest (as defined in section 897(c)), provided that the partnership complies fully with the requirements under section 1446 and the regulations thereunder, including any reporting obligations, with respect to dispositions of U.S. real property interests. A partnership that has complied with such requirements will be deemed to satisfy the withholding requirements of section 1445 and the regulations thereunder. In the event that amounts are withheld under

section 1445(a) at the time of the disposition of a U.S. real property interest, such amounts may be credited against the section 1446 tax.

(ii) Foreign partnerships. A foreign partnership that is subject to withholding under section 1445(a) during its taxable year may credit the amount withheld under section 1445(a) against its section 1446 tax liability for that taxable year only to the extent such gain is allocable to foreign partners.

(3) Coordination with section 1443. A partnership that has ECTI allocable under section 704 to a foreign organization described in section 1443(a) shall be required to withhold under this section.

(d) Reporting and crediting the 1446 tax--(1) Reporting 1446 tax. This paragraph (d) sets forth the rules for reporting and crediting the 1446 tax paid by a partnership. To the extent that 1446 tax is paid on behalf of a domestic trust (including a grantor or other person treated as an owner of a portion of such trust) or a grantor or other person treated as the owner of a portion of a foreign trust, the rules of this paragraph (d) applicable to a foreign trust or its beneficiaries shall be applied to such domestic or foreign trust and its beneficiaries or owners, as applicable, so that appropriate credit for the 1446 tax may be claimed by the trust, beneficiary, grantor, or other person.

(i) Reporting of installment tax payments and notification to partners of installment tax payments. Each partnership required to make an installment payment of 1446 tax must file Form 8813, "Partnership Withholding Tax Payment Voucher (Section 1446)," in accordance with the instructions of that form. When making a payment of 1446 tax, a partnership must notify each foreign partner of the 1446 tax paid on its behalf. A foreign partner generally may credit a 1446

tax paid by the partnership on the partner's behalf against the partner's estimated tax that the partner must pay during the partner's own taxable year. No particular form is required for a partnership's notification to a foreign partner, but each notification must include the partnership's name, the partnership's Taxpayer Identification Number (TIN), the partnership's address, the partner's name, the partner's TIN, the partner's address, the annualized ECTI estimated to be allocated to the foreign partner, and the amounts of tax paid on behalf of the partner for the current and prior installment periods during the partnership's taxable year.

(ii) Payment due dates. The 1446 tax is calculated based on partnership ECTI allocable under section 704 to foreign partners during the partnership's taxable year, as determined under section 706. Payments of the 1446 tax generally must be made during the partnership's taxable year in which such income is derived. A partnership must pay to the Internal Revenue Service a portion of its estimated annual 1446 tax in installments on or before the 15th day of the fourth, sixth, ninth, and twelfth months of the partnership's taxable year as provided in section 6655. Any additional amount determined to be due is to be paid with the filing of the annual return of tax required under this section and clearly designated as for the prior taxable year. Form 8813 should not be submitted for a payment made under the preceding sentence.

(iii) Annual return and notification to partners. Every partnership (except a publicly traded partnership that has not elected to apply the general withholding tax rules under section 1446) that has effectively connected gross income for the partnership's taxable year allocable under section 704 to one or more of its foreign partners (or is treated as having paid 1446 tax under §1.1446-5(a)), must file Form 8804, "Annual Return for Partnership Withholding Tax (Section 1446)." Additionally, every partnership that is required to file Form 8804 also must file

Form 8805, "Foreign Partner's Information Statement of Section 1446 Withholding Tax," and furnish this form to the Internal Revenue Service and to each of its partners with respect to which the 1446 tax was paid. Forms 8804 and 8805 are separate from Form 1065, "U.S. Return of Partnership Income," and the attachments thereto, and are not to be filed as part of the partnership's Form 1065. A partnership must generally file Forms 8804 and 8805 on or before the due date for filing the partnership's Form 1065. See §1.6031(a)-1(c) for rules concerning the due date of a partnership's Form 1065. However, with respect to partnerships described in §1.6081-5(a)(1), Forms 8804 and 8805 are not due until the 15th day of the sixth month following the close of the partnership's taxable year. Any additional tax owed under section 1446 for the prior taxable year of the partnership must be paid to the Internal Revenue Service with the Form 8804.

(iv) Information provided to beneficiaries of foreign trusts and estates. A foreign trust or estate that is a partner in a partnership subject to withholding under section 1446 shall be provided Form 8805 by the partnership. The foreign trust or estate must provide to each of its beneficiaries a copy of the Form 8805 furnished by the partnership. In addition, the foreign trust or estate must provide a statement for each of its beneficiaries to inform each beneficiary of the amount of the credit that may be claimed under section 33 (as determined under this section) for the 1446 tax paid by the partnership. Until an official IRS form is available, the statement from a foreign trust or estate that is described in this paragraph (d)(1)(iv) shall contain the following information--

(A) Name, address, and TIN of the foreign trust or estate;

(B) Name, address, and TIN of the partnership;

(C) The amount of the partnership's ECTI allocated to the foreign trust or estate for the partnership taxable year (as shown on the Form 8805 provided to the trust or estate);

(D) The amount of 1446 tax paid by the partnership on behalf of the foreign trust or estate;

(E) Name, address, and TIN of the beneficiary of the foreign trust or estate;

(F) The amount of the partnership's ECTI allocated to the trust or estate for purposes of section 1446 that is to be included in the beneficiary's gross income; and

(G) The amount of 1446 tax paid by the partnership on behalf of the foreign trust or estate that the beneficiary is entitled to claim on its return as a credit under section 33.

(v) Attachments required of foreign trusts and estates. The statement furnished to each foreign beneficiary under this paragraph (d)(1) must also be attached to the foreign trust or estate's U.S. Federal income tax return filed for the taxable year including the installment period to which the statement relates.

(vi) Attachments required of beneficiaries of foreign trusts and estates. The beneficiary of the foreign trust or estate must attach the statement provided by the trust or estate, along with a copy of the Form 8805 furnished by the partnership to such trust or estate, to its U.S. income tax return for the year in which it claims a credit for the 1446 tax. See §1.1446-3(d)(2)(ii) for additional rules regarding a partner or beneficial owner claiming a credit for 1446 tax.

(vii) Information provided to beneficiaries of foreign trusts and estates that are partners in certain publicly traded partnerships. A statement similar to the statement required by paragraph (d)(1)(iv) of this section shall be provided by trusts or estates that hold interests in publicly traded partnerships subject to §1.1446-4.

(2) Crediting 1446 tax against a partner's U.S. tax liability--(i) In general. A partnership's payment of 1446 tax on the portion of ECTI allocable to a foreign partner relates to the partner's U.S. income tax liability for the partner's taxable year in which the partner is subject to U.S. tax on that income. Subject to paragraphs (d)(2)(ii) and (iii) of this section, a partner may claim as a credit under section 33 the 1446 tax paid by the partnership with respect to ECTI allocable to that partner. The partner may not claim an early refund of these amounts under the estimated tax rules.

(ii) Substantiation for purposes of claiming the credit under section 33. A partner may credit the amount paid under section 1446 with respect to such partner against its U.S. income tax liability only if it attaches proof of payment to its U.S. income tax return for the partner's taxable year in which the items comprising such partner's allocable share of partnership ECTI are included in the partner's income. Except as provided in the next sentence, proof of payment consists of a copy of the Form 8805 the partnership provides to the partner (or in the case of a beneficiary of a foreign trust or estate, the statement required under paragraph (d)(1)(iv) of this section to be provided by such trust or estate and the related Form 8805 furnished to such trust or estate), but only if the name and TIN on the Form 8805 (or the statement provided by a foreign trust or estate) match the name and TIN on the partner's U.S. tax return, and such form (or statement) identifies the partner (or beneficiary) as the person entitled to the credit under section 33. In the case of a partner of a publicly traded partnership that is subject to withholding on distributions under §1.1446-4, proof of payment consists of a copy of the Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," provided to the partner by the partnership.

(iii) Tiered structures including trusts or estates--(A) Foreign trusts and estates. Section 1446 tax paid on the portion of ECTI allocable under section 704 to a foreign trust or estate that the foreign trust or estate may claim as a credit under section 33 shall bear the same ratio to the total 1446 tax paid on behalf of the trust or estate as the total ECTI allocable to such trust or estate and not distributed (or treated as distributed) to the beneficiaries of such trust or estate, and, accordingly not deducted under section 651 or section 661 in calculating the trust or estate's taxable income, bears to the total ECTI allocable to such trust or estate. Any 1446 tax that a foreign trust or estate is not entitled to claim as a credit under this paragraph (d)(2) may be claimed as a credit by the beneficiary or beneficiaries of such trust or estate that includes the partnership's ECTI (distributed or deemed distributed) allocated to the trust or estate in gross income under section 652 or section 662 (with the same character as effectively connected income as in the hands of the trust or estate). The trust or estate must provide each beneficiary with a copy of the Form 8805 provided to it by the partnership and prepare the statement required by paragraph (d)(1)(iv) of this section.

(B) Use of domestic trusts to circumvent section 1446. This paragraph (d)(2)(iii)(B) shall apply if a partnership knows or has reason to know that a foreign person that is the ultimate beneficial owner of the ECTI holds its interest in the partnership through a domestic trust (and possibly other entities), and such domestic trust was formed or availed of with a principal purpose of avoiding the 1446 tax. The use of a domestic trust in a tiered trust structure may have a principal purpose of avoiding the 1446 tax even though the tax avoidance purpose is outweighed by other purposes when taken together. In such case, a partnership is required to pay 1446 tax under this paragraph as if the domestic trust was a foreign trust for purposes of section

1446 and the regulations thereunder. Accordingly, all applicable penalties and interest shall apply to the partnership for its failure to pay 1446 tax under this paragraph (d)(2)(iii)(B), commencing with the installment period during which the partnership knew or had reason to know that this paragraph (d)(2)(iii)(B) applied.

(iv) Refunds to withholding agent. A partnership (or nominee pursuant to §1.1446-4) may apply for a refund of the 1446 tax paid only to the extent allowable under section 1464 and the regulations thereunder.

(v) 1446 tax treated as cash distribution to partners. Amounts paid by a partnership under section 1446 with respect to a partner are treated as distributed to that partner on the earliest of the day on which such tax was paid by the partnership, the last day of the partnership taxable year for which the tax was paid, or, the last day during the partnership's taxable year on which the partner owned an interest in the partnership. Thus, for example, 1446 tax paid by a partnership after the close of a partnership taxable year that relates to ECTI allocable to a foreign partner for the prior taxable year will be considered distributed by the partnership to the respective foreign partner on the last day of the partnership's prior taxable year.

(vi) Examples. The following examples illustrate the application of this section:

Example 1. Simple trust that reports entire amount of ECTI. PRS is a partnership that has two partners, FT, a foreign trust, and A, a U.S. person. FT is a simple trust under section 651. FT and A each provide PRS with a valid Form W-8BEN and Form W-9, respectively. FT has one beneficiary, NRA, a nonresident alien individual. In computing its installment obligation during the 2004 taxable year, PRS has $200 of annualized income, all of which is ordinary ECTI. The $200 of income will be allocated equally to FT and A under section 704 and it is assumed that such an allocation will be respected under section 704(b) and the regulations thereunder. FT's allocable share of ECTI is $100. PRS withholds $35 under section 1446 with respect to the $100 of ECTI allocable to FT. FT's only income for its tax year is the $100 of income from PRS. Pursuant to the terms of the trust's governing instrument and local law, the $100 of ECTI is not included in FT's fiduciary accounting income and the deemed distribution of the $35 withholding tax paid under paragraph (d)(2)(v) of this section is not included in FT's

fiduciary accounting income. Accordingly, the $100 of ECTI is not income required to be distributed by FT, and FT may not claim a deduction under section 651 for this amount. FT must report the $100 of ECTI in its gross income and may claim a credit under section 33 in the amount of $35 for the 1446 tax paid by PRS. NRA is not required to include any of the ECTI in gross income and accordingly may not claim a credit for any amount of the $35 of 1446 tax paid by PRS.

Example 2. Simple trust that distributes a portion of ECTI to the beneficiary. Assume the same facts as in Example 1, except that PRS distributes $60 to FT, which is included in FT's fiduciary accounting income under local law. FT will report the $100 of ECTI in its gross income and may claim a deduction for the $60 required to be distributed under section 651(a) to NRA. Pursuant to paragraph (d)(2)(iii) of this section, FT may claim a credit under section 33 in the amount of $14 for the 1446 tax paid by PRS ($40/$100 multiplied by $35). NRA is required to include the $60 of the ECTI in gross income under section 652 (as ECTI) and may claim a credit under section 33 in the amount of $21 for the 1446 tax paid by PRS ($35 less $14 or $60/$100 multiplied by $35).

Example 3. Complex trust that distributes entire ECTI to the beneficiary. Assume the same facts as in Example 1, except that FT is a complex trust under section 661. PRS distributes $60 to FT, which is included in FT's fiduciary accounting income. FT distributes the $60 of fiduciary accounting income to NRA and also properly distributes an additional $40 to NRA from FT's principal. FT will report the $100 of ECTI in its gross income and may deduct the $60 required to be distributed to NRA under section 661(a)(1) and may deduct the $40 distributed to NRA under section 661(a)(2). FT may not claim a credit under section 33 for any of the $35 of 1446 tax paid by PRS. NRA is required to include $100 of the ECTI in gross income under section 662 (as ECTI) and may claim a credit under section 33 in the amount of $35 for the 1446 tax paid by PRS ($35 less $0).

(e) Liability of partnership for failure to withhold--(1) In general. Every partnership required to pay a 1446 tax is made liable for that tax by section 1461. Therefore, a partnership that is required to pay a 1446 tax but fails to do so, or pays less than the amount required under this section, is liable under section 1461 for the payment of the tax required to be withheld under

chapter 3 of the Internal Revenue Code and the regulations thereunder unless the partnership can demonstrate pursuant to paragraph (e)(2) of this section, to the satisfaction of the Commissioner or his delegate, that the full amount of effectively connected taxable income allocable to such partner was included in income on the partner's U.S. Federal income tax return and the full amount of tax due on such return was paid by such partner to the Internal Revenue Service. See paragraph (e)(3) of this section and section 1463 regarding the partnership's liability for penalties and interest even though a foreign partner has satisfied the underlying tax liability. See §1.1461-3 for applicable penalties when a partnership fails to pay 1446 tax. See paragraph (b) of this section for an addition to tax under section 6655 when there is an underpayment of 1446 tax.

(2) Proof that tax liability has been satisfied. Proof of payment of tax may be established for purposes of paragraph (e)(1) of this section on the basis of a Form 4669, "Statement of Payments Received," or such other form as the Internal Revenue Service may prescribe in published guidance (see §601.601(d)(2) of this chapter), establishing the amount of tax, if any, actually paid by the partner on the income. Such partnership's liability for tax, and the requirement that such partnership file Forms 8804 and 8805 shall be deemed to have been satisfied with respect to such partner as of the date on which the partner's income tax return was filed and all tax required to be shown on the return is paid in full.

(3) Liability for interest and penalties. Notwithstanding paragraph (e)(2) of this section, a partnership that fails to pay over tax under section 1446 is not relieved from liability under section 6655 or for interest under section 6601. See §1.1463-1. Such liability may exist even if there is no underlying tax liability due from a foreign partner on its allocable share of partnership

ECTI. The addition to tax under section 6655 or the interest charge under section 6601 that is required by those sections shall be imposed as set forth in those sections, as modified by this section. For example, under section 6601, interest shall accrue beginning on the last date for paying the tax due under section 1461 (which is the due date, without extensions, for filing the Forms 8804 and 8805). The interest shall stop accruing on the 1446 tax liability on the date, and to the extent, that the unpaid tax liability under section 1446 is satisfied. A foreign partner is permitted to reduce any addition to tax under section 6654 or 6655 by the amount of any section 6655 addition to tax paid by the partnership with respect to its failure to pay adequate installment payments of the 1446 tax on ECTI allocable to the foreign partner.

(f) Effect of withholding on partner. The payment of the 1446 tax by a partnership does not excuse a foreign partner to which a portion of ECTI is allocable from filing a U.S. tax or informational return, as appropriate, with respect to that income. Information concerning installment payments of 1446 tax paid during the partnership's taxable year on behalf of a foreign partner shall be provided to such foreign partner in accordance with paragraph (d) of this section and such information may be taken into account by the foreign partner when computing the partner's estimated tax liability during the taxable year. Form 1040NR, "U.S. Nonresident Alien Income Tax Return," Form 1065, "U.S. Return of Partnership Income," Form 1120F, "U.S. Income Tax Return of a Foreign Corporation," or such other return as appropriate, must be filed by the partner, and any tax due must be paid, by the filing deadline (including extensions) generally applicable to such person. Pursuant to §1.1446-3(d), a partner may generally claim a credit under section 33 for its share of any 1446 tax paid by the partnership against the amount of

income tax (or 1446 tax in the case of tiers of partnerships) as computed in such partner's return.

§1.1446-4 Publicly traded partnerships.

(a) In general. This section sets forth rules for applying the section 1446 withholding tax (1446 tax) to publicly traded partnerships. A publicly traded partnership (as defined in paragraph (b) of this section) that has effectively connected gross income, gain or loss must pay 1446 tax by withholding from distributions to a foreign partner. Publicly traded partnerships that withhold on distributions must pay over and report any 1446 tax as provided in paragraph (c), and generally are not to pay over and report the 1446 tax under the rules in §1.1446-3. However, under paragraph (g) of this section, a publicly traded partnership may elect not to apply the rules of this section, and instead, to pay the 1446 tax based on the effectively connected taxable income (ECTI) allocable under section 704 to foreign partners under the general rules of §§1.1446-1 through 1.1446-3. The amount of the withholding tax on distributions, other than distributions excluded under paragraph (f) of this section, that are made during any partnership taxable year, equals the applicable percentage (defined in paragraph (b)(2) of this section) of such distributions.

(b) Definitions--(1) Publicly traded partnership. For purposes of this section, the term publicly traded partnership has the same meaning as in section 7704 (including the regulations thereunder), but does not include a publicly traded partnership treated as a corporation under that section.

(2) Applicable percentage. For purposes of this section, applicable percentage shall have the meaning as set forth in §1.1446-3(a)(2).

(3) Nominee. For purposes of this section, the term nominee means a domestic person that holds an interest in a publicly traded partnership on behalf of a foreign person.

(4) Qualified notice. For purposes of this section, a qualified notice is a notice given by a publicly traded partnership regarding a distribution that is attributable to effectively connected income, gain or loss of the partnership, and in accordance with the notice requirements with respect to dividends described in 17 CFR 240.10b-17(b)(1) or (3) issued pursuant to the Securities Exchange Act of 1934, 15 U.S.C. section 78(a).

(c) Time and manner of payment. The withholding tax required under this section is to be paid pursuant to the rules and procedures of section 1461, §§1.1461-1, 1.1461-2, and 1.6302-2. However, the reimbursement and set-off procedures set forth in those regulations shall not apply. A publicly traded partnership must use Form 1042, "Annual Withholding Tax Return for U.S. Source Income of Foreign Persons," and Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," to report withholding from distributions under this section. See §1.1461-1(b). See §1.1446-3(d)(1)(vii) requiring a foreign trust or estate that holds an interest in a publicly traded partnership to provide a statement to the beneficiaries of such foreign trust or estate with respect to the credit to be claimed under section 33. For penalties and additions to the tax for failure to comply with this section, see §§1.1461-1 and 1.1461-3.

(d) Rules for designation of nominees to withhold tax under section 1446. A nominee that receives a distribution from a publicly traded partnership subject to withholding under this section, and which is to be paid to (or for the account of) any foreign person, may be treated as a withholding agent under this section. A nominee is treated as a withholding agent under this section only to the extent of the amount specified in the qualified notice (as defined in paragraph

(b)(4) of this section) that the nominee receives. Where a nominee is designated as a withholding agent with respect to a foreign partner of the partnership, then the obligation to withhold on distributions to such foreign partner in accordance with the rules of this section shall be imposed solely on the nominee. A nominee under this section shall identify itself as a nominee by providing Form W-9, "Request for Taxpayer Identification Number and Certification," to the partnership, along with the statement required by paragraph (e)(1) of this section. If a nominee furnishes Form W-9 and the statement required by paragraph (e)(1) of this section to the partnership, but a qualified notice is not received by the nominee from the partnership, the nominee shall not be a withholding agent subject to the rules of this section and the partnership shall presume that such nominee is a nonresident alien individual or foreign corporation, whichever classification results in a higher 1446 tax being due, and pay a withholding tax consistent with such presumption. A nominee responsible for withholding under the rules of this section shall be subject to liability under sections 1461 and 6655, as well as for all applicable penalties and interest, as if such nominee was a partnership responsible for withholding under this section.

(e) Determining foreign status of partners--(1) In general. Except as provided in paragraph (d) of this section permitting nominees to submit a Form W-9 to a publicly traded partnership, the rules of §1.1446-1 shall apply in determining whether a partner of a publicly traded partnership is a foreign partner for purposes of the 1446 tax (see §1.1446-4(a)) and a nominee obligated to withhold under this section shall be entitled to rely on a Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding," Form W-8IMY, "Certificate of Foreign Intermediary, Flow-Through Entity, or Certain U.S. Branches

for United States Tax Withholding," or Form W-9, "Request for Taxpayer Identification Number," received from persons on whose behalf it holds interests in the partnership to the same extent a partnership is entitled to rely on such forms under those rules. In addition to the rules stated in §§1.1446-1 through 1.1446-3 with respect to certificates establishing a partner as a domestic or foreign person, a nominee shall attach a brief statement to the Form W-9 that it furnishes to the partnership, informing the partnership that the nominee holds interests in the partnership on behalf of one or more foreign persons, including information that permits the partnership to determine the partnership interest held on behalf of such foreign persons. A statement furnished by a nominee pursuant to §1.6031(c)-1T satisfies the requirements of the previous sentence.

(2) Presumptions regarding payee's status in absence of documentation. The rules of §1.1446-1(c)(3) shall apply to determine a partner's status in the absence of documentation.

(f) Distributions subject to withholding--(1) In general. Except as provided in this paragraph (f)(1), a publicly traded partnership must withhold at the applicable percentage with respect to any actual distribution made to a foreign partner. The amount of a distribution subject to 1446 tax includes the amount of any 1446 tax required to be withheld on the distribution and, in the case of a partnership that receives a partnership distribution from another partnership in which it is a partner (i.e., a tiered structure described in §1.1446-5), any 1446 tax that was withheld from such distribution. For example, a foreign publicly traded partnership, UTP, owns an interest in domestic publicly traded partnership, LTP. UTP does not provide LTP any documentation with respect to its domestic or foreign status. LTP and UTP each have a calendar

taxable year. LTP makes a distribution subject to section 1446 of $100 to UTP during its taxable year beginning January 1, 2004, and withholds 35 percent (the highest rate in section 1) of that distribution under section 1446. UTP receives a net distribution of $65 which it immediately redistributes to its partners. UTP has a liability to pay 35 percent of the total actual and deemed distribution it makes to its foreign partners as a section 1446 withholding tax. UTP may credit the $35 withheld by LTP against this liability as if it were paid by UTP. When UTP distributes the $65 it actually receives from LTP to its partners, UTP is treated for purposes of section 1446 as if it made a distribution of $100 to its partners ($65 actual distribution and $35 deemed distribution). UTP's partners (U.S. and foreign) may claim a credit against their U.S. income tax liability for their allocable share of the $35 of 1446 tax paid on their behalf.

(2) In-kind distributions. If a publicly traded partnership distributes property other than money, the partnership shall not release the property until it has funds sufficient to enable the partnership to pay over in money the required 1446 tax.

(3) Ordering rule relating to distributions. Distributions from publicly traded partnerships are deemed to be paid out of the following types of income in the order indicated--

(i) Amounts attributable to income described in section 1441 or 1442 that are not effectively connected, without regard to whether such amounts are subject to withholding because of a treaty or statutory exemption;

(ii) Amounts attributable to recurring dispositions of crops and timber that are subject to withholding under §1.1445-5(c)(3)(iv) of the regulations, which continue to be subject to the rules of §1.1445-5(c)(3);

(iii) Amounts effectively connected with a U.S. trade or business, but not subject to withholding under section 1446 (e.g., exempt by treaty);

(iv) Amounts subject to withholding under section 1446; and

(v) Amounts not listed in paragraphs (f)(3)(i) through (iv) of this section.

(4) Coordination with section 1445(e)(1). Except as otherwise provided in this section, a publicly traded partnership that complies with the requirements of withholding under section 1446 and this section will be deemed to have satisfied the requirements of section 1445(e)(1) and the regulations thereunder. Notwithstanding the excluded amounts set forth in paragraph (f)(3) of this section, distributions subject to withholding at the applicable percentage shall include the following--

(i) Amounts subject to withholding under section 1445(e)(1) upon distribution pursuant to an election under §1.1445-5(c)(3) of the regulations; and

(ii) Amounts not subject to withholding under section 1445 because the distributee is a partnership or is a foreign corporation that has made an election under section 897(i).

(g) Election to withhold based upon ECTI allocable to foreign partners instead of withholding on distributions. A publicly traded partnership may elect to comply with the requirements of §§1.1446-1 through 1.1446-3 (relating to withholding on ECTI allocable to foreign partners) and §1.1446-5 (relating to tiered partnership structures) instead of the rules of this section. A publicly traded partnership shall make the election described in this paragraph (g) by complying with the payment and reporting requirements of §§1.1446-1 through 1.1446-3 and by complying with the information reporting requirements of this paragraph (g). The election is made by attaching a statement to a timely filed Form 8804, "Annual Return for

Partnership Withholding Tax (Section 1446)," that is required to be filed by the partnership for the taxable year, indicating that the partnership is a publicly traded partnership that is electing to pay the 1446 tax under section 1446 based upon ECTI allocable under section 704 to its foreign partners. Once made, an election under this paragraph (g) may be revoked only with the consent of the Commissioner.

§1.1446-5 Tiered partnership structures.

(a) In general. The rules of this section shall apply in cases where a partnership (lower-tier partnership) that has effectively connected taxable income (ECTI), has a partner that is itself a partnership (upper-tier partnership). A partnership that directly or indirectly (through a chain of partnerships) owns a partnership interest in a lower-tier partnership shall be allowed a credit against its own section 1446 withholding tax (1446 tax) for the tax paid by the lower-tier partnership on its behalf. If an upper-tier domestic partnership directly owns an interest in a lower-tier partnership, the lower-tier partnership is not required to pay a withholding tax with respect to the upper-tier partnership's allocable share of effectively connected taxable income (ECTI), regardless of whether the upper-tier domestic partnership's partners are foreign.

(b) Reporting requirements--(1) In general. To the extent that an upper-tier partnership that is a foreign partnership is a partner in a lower-tier partnership, and the lower-tier partnership has made 1446 tax installment payments on ECTI allocable to the upper-tier partnership, the upper-tier partnership shall receive a copy of the statements and forms filed by the lower-tier partnership allocable to its partnership interest in the lower-tier partnership under §§1.1446-1 through 1.1446-3 (e.g., Form 8805, "Foreign Partner's Information Statement of Section 1446 Withholding Tax"). The upper-tier partnership may treat the 1446 tax paid by the lower-tier

partnership on its behalf as a credit against its liability to pay 1446 tax, as if the upper-tier partnership actually paid over the amounts at the time that the amounts were paid by the lower-tier partnership. See §1.1462-1(b). However, the upper-tier partnership may not obtain a refund for the amounts paid by the lower-tier partnership, but instead, must file such forms as prescribed by §1.1446-3 and this section to allow the credits under section 33 to be properly claimed by the beneficial owners of such income. See §1.1462-1. The upper-tier partnership must file Form 8804, "Annual Return for Partnership Withholding Tax (Section 1446)," and Form 8805, "Foreign Partner's Information Statement of Section 1446 Withholding Tax," with respect to its 1446 tax obligation, passing the credit for 1446 tax paid by the lower-tier partnership to its partners.

(2) Publicly traded partnerships. In the case of an upper-tier foreign partnership that is a publicly traded partnership, the rules of §1.1446-4(c) shall apply.

(c) Look through rules for foreign upper-tier partnerships. For purposes of computing the 1446 tax obligation of a lower-tier partnership, if an upper-tier partnership owns an interest in the lower-tier partnership, the upper-tier partnership's allocable share of the lower-tier partnership's ECTI shall be treated as allocable to the partners of the upper-tier partnership (as if they were direct partners in the lower-tier partnership) to the extent that--

(1) The upper-tier partnership furnishes the lower-tier partnership with a valid Form W-8IMY, "Certificate of Foreign Intermediary, Flow Through Entity, or Certain U.S. Branches for United States Tax Withholding," indicating that it is a look-through foreign partnership for purposes of section 1446, and

(2) The lower-tier partnership can reliably associate (within the meaning of §1.1441-1(b)(2)(vii)) the effectively connected partnership items allocable to the upper-tier partnership with a Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding," Form W-8IMY, or Form W-9, "Request for Taxpayer Identification Number and Certification," for each of the upper-tier partnership's partners. The principles of §1.1441-1(b)(2)(vii) shall apply to determine whether a lower-tier partnership can reliably associate effectively connected partnership items allocable to the upper-tier partnership to the partners of the upper-tier partnership. The upper-tier partnership shall provide the lower-tier partnership with a withholding certificate for each partner in the upper-tier partnership and information regarding the allocation of effectively connected items to the respective partners of the upper-tier partnership. To the extent the lower-tier partnership receives a valid Form W-8IMY from the upper-tier partnership but cannot reliably associate the upper-tier partnership's allocable share of effectively connected partnership items with a withholding certificate for each of the upper-tier partnership's partners, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b). If a lower-tier partnership has not received a valid Form W-8IMY from the upper-tier partnership, the lower-tier partnership shall withhold at the higher of the applicable percentages in section 1446(b). See §1.1446-1(c)(3). The approach set forth in this paragraph (c) shall not apply to partnerships whose interests are publicly traded. See §1.1446-4.

(d) Examples. The following examples illustrate the provisions of §1.1446-5:

Example 1--Sufficient documentation--tiered partnership structure. (i) Nonresident alien (NRA) and foreign corporation (FC) are partners in PRS, a foreign partnership, and share profits and losses in PRS 70 and 30 percent, respectively. All of PRS's partnership items are allocated based upon each partner's respective ownership interest and it is assumed that these

allocations are respected under section 704(b) and the regulations thereunder. NRA and FC each furnish PRS with a valid Form W-8BEN establishing themselves as a foreign individual and foreign corporation, respectively. PRS holds a 40 percent interest in the profits, losses and capital of LTP, a lower-tier partnership. NRA holds the remaining 60 percent interest in profits, losses and capital of LTP. LTP has $100 of annualized ECTI for the relevant installment period. PRS has no income other than the income allocated from LTP. PRS provides LTP with a valid Form W-8IMY indicating that it is a foreign partnership and attaches the valid Form W-8BENs executed by NRA and FC, as well as a statement describing the allocation of PRS's effectively connected items among its partners. Further, NRA provides a valid Form W-8BEN to LTP.

(ii) LTP must pay 1446 tax on the $60 allocable to its direct partner NRA using the highest rate in section 1.

(iii) With respect to the effectively connected partnership items that LTP can reliably associate with NRA through PRS (70 percent of PRS's allocable share, or $28), LTP will pay 1446 tax on NRA's allocable share of LTP's partnership ECTI (as determined by looking through PRS) using the applicable percentage for non-corporate partners (the highest rate in section 1).

(iv) With respect to the effectively connected partnership items that LTP can reliably associate with FC through PRS (30 percent of PRS's allocable share, or $12), LTP will pay 1446 tax on FC's allocable share of LTP's ECTI (as determined by looking through PRS) using the applicable percentage for corporate partners.

(v) LTP's payment of the 1446 tax is treated as a distribution to NRA and PRS, its direct partners, that those partners may credit against their respective tax obligations. PRS will report its 1446 tax obligation with respect to its direct foreign partners, NRA and FC, on the Form 8804 and Form 8805 that it files with the Internal Revenue Service and will credit the amount withheld by LTP. Thus, PRS will pass along to NRA and FC the credit for the 1446 tax withheld by LTP which will be treated as a distribution to them.

Example 2--Insufficient documentation--tiered partnership structure. PRS is a domestic partnership that has two equal partners A and UTP. A is a nonresident alien individual and UTP is a foreign partnership that has two equal foreign partners, C and D. Neither A nor UTP provide PRS with a valid Form W-8BEN, Form W-8IMY, or Form W-9. Neither C nor D provide UTP with a valid Form W-8BEN, Form W-8IMY, or Form W-9. PRS must presume that UTP is a foreign person subject to withholding under section 1446 at the higher of the highest rate under section 1 or 11(b)(1). PRS has also not received any documentation with respect to A. PRS must presume that A is a foreign person, and, if PRS knows that A is an individual, compute and pay 1446 tax based on that knowledge.

§1.1446-6 Effective date.

Sections 1.1446-1 through 1.1446-5 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 5. Section 1.1461-1 is amended as follows:

1. Paragraph (a)(1) is amended by adding three sentences at the end of the paragraph.

2. The second sentence of paragraph (c)(1)(i) is removed and two sentences are added in its place.

3. Paragraph (c)(1)(ii)(A)(8) is redesignated as paragraph (c)(1)(ii)(A)(9), and a new paragraph (c)(1)(ii)(A)(8) is added.

4. The first sentence of paragraph (c)(2)(i) is removed and two sentences are added in its place.

5. The first sentence of paragraph (c)(3) is removed and two sentences are added in its place.

6. Paragraph (i) is revised.

The additions and revisions read as follows:

§1.1461-1 Payment and returns of tax withheld.

(a) * * *

(1) * * * With respect to withholding under section 1446, this section shall only apply to publicly traded partnerships that have not made an election under §1.1446-4(g). See §1.1461-3 for penalties applicable to partnerships that fail to withhold under section 1446 on effectively connected taxable income allocable to foreign partners, including a publicly traded partnership that has made an election under §11446-4(g). The previous two sentences shall apply to

partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(c) * * *

(1) * * *

(i) * * * Notwithstanding the preceding sentence, any person that withholds or is required to withhold an amount under sections 1441, 1442, 1443, or §1.1446-4(a) must file a Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," for the payment withheld upon whether or not that person is engaged in a trade or business and whether or not the payment is an amount subject to reporting. The reference in the previous sentence to withholding under §1.1446-4 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.*** * *

(ii) * * *

(A) * * *

(8) A partner receiving a distribution from a publicly traded partnership subject to withholding under section 1446 and §1.1446-4. This paragraph (c)(1)(ii)(A)(8) shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.**

* * * * *

(2) Amounts subject to reporting--(i) In general. Subject to the exceptions described in paragraph (c)(2)(ii) of this section, amounts subject to reporting on Form 1042-S are amounts paid to a foreign payee or partner (including persons presumed to be foreign) that are amounts

subject to withholding as defined in §1.1441-2(a) or §1.1446-4(a). The reference in the previous sentence to withholding under §1.1446-4 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.** * * *

* * * * *

(3) Required information. The information required to be furnished under this paragraph (c)(3) shall be based upon the information provided by or on behalf of the recipient of an amount subject to reporting (as corrected and supplemented based on the withholding agent's actual knowledge) or the presumption rules of §§1.1441-1(b)(3), 1.1441-4(a); 1.1441-5(d) and (e); 1.1441-9(b)(3), 1.1446-1(c)(3) or 1.6049-5(d). The reference in the previous sentence to presumption rules applicable to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.** * * *

* * * * *

(i) Effective date. Unless otherwise provided in this section, this section shall apply to returns required for payments made after December 31, 2000.

Par. 6. Section 1.1461-2 is amended by:

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

2. Revising paragraphs (b) and (d).

The revisions and addition read as follows:

§1.1461-2 Adjustments for overwithholding or underwithholding of tax.

(a) Adjustments of overwithheld tax--(1) In general. Except for partnerships or nominees required to withhold under section 1446, a withholding agent that has overwithheld under

chapter 3 of the Internal Revenue Code, and made a deposit of the tax as provided in §1.6302-2(a) may adjust the overwithheld amount either pursuant to the reimbursement procedure described in paragraph (a)(2) of this section or pursuant to the set-off procedure described in paragraph (a)(3) of this section. References in the previous sentence excepting from this section certain partnerships withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.** * * *

* * * * *

(b) Withholding of additional tax when underwithholding occurs. A withholding agent may withhold from future payments (or a partner's allocable share of ECTI under section 1446) made to a beneficial owner the tax that should have been withheld from previous payments (or paid under section 1446 with respect to a partner's allocable share of ECTI) to such beneficial owner under chapter 3 of the Internal Revenue Code. In the alternative, the withholding agent may satisfy the tax from property that it holds in custody for the beneficial owner or property over which it has control. Such additional withholding or satisfaction of the tax owed may only be made before the date that the annual return (e.g. Form 1042, Form 8804) is required to be filed (not including extensions) for the taxable year in which the underwithholding occurred. See §1.6302-2 for making deposits of tax or §1.1461-1(a) for making payment of the balance due for a calendar year. See also §§1.1461-1, 1.1461-3, and 1.1446-1 through 1.1446-5 for rules relating to withholding under section 1446. References in this paragraph (b) to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.**

* * * * *

(d) Effective date. Unless otherwise provided in this section, this section applies to payments made after December 31, 2000.

Par. 7. Section 1.1461-3 is added to read as follows.

§1.1461-3 Withholding under section 1446.

For rules relating to the withholding tax liability of a partnership or nominee under section 1446, see §§1.1446-1 through 1.1446-6. For penalties and additions to the tax for failure to timely pay the tax required to be paid under section 1446, see sections 6655 (in the case of publicly traded partnerships that have not made an election under §1.1446-4(g), see section 6656), 6672, and 7202 and the regulations under those sections. For penalties and additions to the tax for failure to file returns or furnish statements in accordance with the regulations under section 1446, see sections 6651, 6662, 6663, 6721, 6722, 6723, 6724(c), 7201, 7203, and the regulations under those sections. This section shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.**

Par. 8. Section 1.1462-1 is amended by revising paragraphs (b) and (c) to read as follows:

§1.1462-1 Withheld tax as credit to recipient of income.

* * * * *

(b) Amounts paid to persons who are not the beneficial owner. Amounts withheld at source under chapter 3 of the Internal Revenue Code on payments to (or effectively connected taxable income allocable to) a fiduciary, partnership, or intermediary is deemed to have been paid by the taxpayer ultimately liable for the tax upon such income. Thus, for example, if a

beneficiary of a trust is subject to the taxes imposed by section 1, 2, 3, or 11 upon any portion of the income received from a foreign trust, the part of any amount withheld at source which is properly allocable to the income so taxed to such beneficiary shall be credited against the amount of the income tax computed upon the beneficiary's return, and any excess shall be refunded. See §1.1446-3 for examples applying this rule in the context of a partnership interest held through a foreign trust or estate. Further, if a partnership withholds an amount under chapter 3 of the Internal Revenue Code with respect to the distributive share of a partner that is a partnership or with respect to the distributive share of partners in an upper-tier partnership, such amount is deemed to have been withheld by the upper-tier partnership. See §1.1446-5 for rules applicable to tiered partnership structures. References in this paragraph (b) to withholding under section 1446 shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.**

(c) Effective date. Unless otherwise provided in this section, this section applies to payments made after December 31, 2000.

Par. 9. Section 1.1463-1 is amended by:

1. Adding two sentences at the end of paragraph (a).

2. Revising paragraph (b).

The addition and revision read as follows:

§1.1463-1 Tax paid by recipient of income.

(a) * * * See §1.1446-3(f) for additional rules where the tax was required to be withheld under section 1446. The reference in the previous sentence to withholding under section 1446

shall apply to partnership taxable years beginning after the date that these regulations are published as final regulations in the **Federal Register.**

(b) Effective date. Unless otherwise provided in this section, this section applies to failures to withhold occurring after December 31, 2000.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 10. The authority for 26 CFR part 301 continues to read in part as follows:

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

Par. 11. In §301.6109-1 is amended as follows:

1. In paragraph (b)(2)(vi), remove the word "and".

2. In paragraph (b)(2)(vii), remove the period at the end of the paragraph and add "; and" in its place.

3. Paragraph (b)(2)(viii) is added.

4. In paragraph (c), the first three sentences are revised and a sentence is added at the end of the paragraph.

The amendments and additions read as follows:

§301.6109-1 Identifying numbers.

* * * * *

(b) * * *

(2) * * *

(viii) A foreign person that furnishes a withholding certificate described in §1.1446-1(c)(2) or (3) of this chapter. This paragraph (b)(2)(viii) shall apply to partnership taxable years

beginning after the date these regulations are published as final regulations in the **Federal Register.**

(c) Requirement to furnish another's number. Every person required under this title to make a return, statement, or other document must furnish such taxpayer identifying numbers of other U.S. persons and foreign persons that are described in paragraph (b)(2)(i), (ii), (iii), (vi), (vii), or (viii) of this section as required by the forms and the accompanying instructions. The taxpayer identifying number of any person furnishing a withholding certificate referred to in paragraph (b)(2)(vi) or (viii) of this section shall also be furnished if it is actually known to the person making a return, statement, or other document described in this paragraph (c). If the person making the return, statement, or other document does not know the taxpayer identifying number of the other person, and such other person is one that is described in paragraph (b)(2)(i), (ii), (iii), (vi), (vii), or (viii) of this section, such person must request the other person's number. * * * References in this paragraph (c) to paragraph (b)(2)(viii) of this section shall apply to partnership taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 12. In §301.6721-1, paragraph (g)(4) is revised to read as follows:

§301.6721-1 Failure to file correct information returns.

* * * * *

(g) ***

(4) Other items. The term information return also includes any form, statement, or schedule required to be filed with the Internal Revenue Service with respect to any amount from

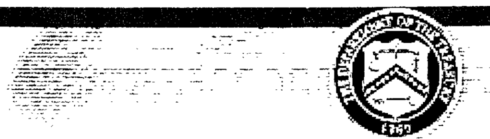
which tax is required to be deducted and withheld under chapter 3 of the Internal Revenue Code (or from which tax would be required to be so deducted and withheld but for an exemption under the Internal Revenue Code or any treaty obligation of the United States), generally Forms 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," and 8805, "Foreign Partner's Information Statement of Section
1446 Withholding Tax." The provisions of this paragraph
(g)(4) referring to Form 8805, shall apply to partnership
taxable years beginning after the date these regulations are

published as final regulations in the **Federal Register.**

* * * * *

Robert E. Wenzel

Deputy Commissioner for Services and Enforcement.



FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the Microsoft Word content on this page, download the free Microsoft Word Viewer.

September 2, 2003
JS-691

Statement by Secretary of the Treasury John Snow on the Departure of General Counsel David Aufhauser

"David Aufhauser has served our nation with superb leadership and vision during a time of great challenge. As Chairman of the National Security Council's Policy Coordinating Committee on Terrorist Financing, he has helped direct the U.S. government's efforts to halt the flow of money that funds terror. Since the September 11th attacks, the U.S. has designated more than 290 individuals and entities as terrorists and terrorist supporters and, along with our international partners, has frozen over $136 million in assets worldwide. Under David's leadership, new alliances have been forged internationally to fight the financing of terror and more than 80 nations have implemented laws that will help keep money out of the hands of terrorists.

"Additionally, David has led Treasury's efforts to secure the nation's financial system against money laundering and the financing of terror through implementation of the Patriot Act. He has also worked to restore integrity and confidence to the financial markets as Treasury's representative on the Justice Department's Corporate Fraud and Abuse Task Force. Finally, he has spearheaded the hunt for assets belonging to the former Iraqi regime and has worked tirelessly to secure their return to Iraq for the good of the Iraqi people. President Bush and I are grateful for his outstanding service to the Treasury Department and to our nation."

Related Documents:

- Letter from David Aufhauser to President Bush

September 2, 2003

The President
The White House
Washington, D.C. 20500

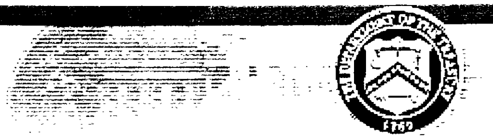
Dear Mr. President:

It is with both pride and regret that I respectfully submit my resignation as General Counsel of the Department of the Treasury effective September 30, 2003. Pride because it has been a privilege and an honor to serve in an Administration governed by principle, clarity and unquestioned purpose. Regret in that I cannot imagine working with a finer group of people than my friends at Treasury and the many colleagues throughout the government that banded together to marshal your campaign against the financing of terror.

Although I have had many responsibilities, it is the latter that has defined a significant amount of my work. Your leadership in this area has altered the international legal landscape, secured our financial borders and substantially reduced the threat of harm or death to many innocents. The chance to be a part of that endeavor will leave me forever in your debt.

Sincerely,

David D. Aufhauser



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 3, 2003
JS-692

Press Roundtable Transcript with Treasury Secretary Snow in Beijing, China on September 3, 2003."

SNOW: Thank you very much Mr. Ambassador. Thank you very much for all your kindness and hospitality during our visit. The ambassador and I have been spending a great deal of time together, as we have called upon the economic and political leaders of your great country.

Let me say that we have had a series of very good meetings, very important meetings and, to me, very encouraging meetings. So, let me begin by thanking my hosts for inviting me to Beijing – me and my colleagues from the Treasury Department – to discuss issues of mutual interest to our two countries. I've been to China many times in the past in a private capacity, as a businessman. This is my first opportunity to be here in my new capacity as a representative of the United States government. I want to state how much I appreciate the hospitality and the warmth and the friendship that has been extended to us, to me and to the Treasury delegation, throughout the course of our discussions. I am honored this afternoon to have the opportunity to continue those discussions with the premier, with Premier Wen. In all of these discussions I have found the Chinese leaders open, frank and encouraging of the close ties and the close working relationship between our two countries.

Early last year when President Bush visited China and met with President Jiang Zemin, President Bush said, and I want to quote him here because I think his quote sets the foundation for this relationship. He said, "China and the United States, both with significant influence in the world, should step up dialogue and cooperation, properly handle their differences, and work together to move the constructive and cooperative relations between us further forward." Our talks this week are fully in keeping with the spirit of President Bush's comments.

One thing is clear and that is economic engagement and extending the engagement between the United States and China will promote prosperity in both of our countries and, in addition, for all of our trading partners. Our trade with you makes your economy stronger. Your trade with us makes our economy stronger. As our economies are stronger, benefits are extended to the rest of our trading partners. So just as China benefits from our market, U.S. businesses and consumers should benefit from China's growth. Clearly, investments and technology from the United States help to sustain high growth in China.

In recent years, China has made historic strides in reforming its economy and moving to a market-based system. We applaud that and urge continued progress.

It's been our view for some time that the best international economic system, the best for China, and the best for the United States, and the best for the whole trading world is one based on the principle of free trade, open markets, free capital flows, and market-based exchange rates, among the major economies. China is now clearly one of the major economies of the world. It's with these principles in mind, these ideas in mind, that I am here to discuss our economic relationship with the Chinese leaders and to encourage China to continue to take advantage of its strong growth to accelerate progress in all of these areas. The growth which China has enjoyed makes it easier to move further in the direction of open markets and floating exchange rates and free capital flows and to advance these ideas within the economy of China for the benefit of the Chinese people.

It's important to recognize that the United States is committed to a growing, healthy

and mutually beneficial trade relationship with China. In that regard, it's very important that China continue its efforts to fully implement the commitments it made to the World Trade Organization. Progress on market opening should be made for products such as soy beans, which is important to the United States, of course, but important to the citizens of China as well. We also encourage further relaxation of the ownership rules in the area of financial services.

Another area of concern for me is that U.S. companies continue to lose billions of dollars because of the piracy of intellectual property. Enforcement of the good intellectual property laws which China has put in place is essential to our continued economic relationship.

Another area that is important is the free flow of capital. The free flow of capital is a fundamental component of our global system of international trade and international finance. While I applaud and welcome the recent policy changes that allow for greater capital mobility, it's in China's interest to accelerate these efforts. For example, it would be beneficial to expand the qualified institutional investor programs, to increase both portfolio inflows and portfolio outflows. It would also be advantageous to liberalize the long-term debt transactions, and overall to create open capital markets. As we talked to the Chinese economic leaders we emphasized over and over the necessity to develop open capital markets. They really are the key to the success of a market-based economy.

Finally, let me turn to the subject of exchange rates, because the subject of exchange rates has also been much in discussion among us. The establishment of flexible exchange rates, of a flexible exchange rate regime, would benefit both our nations as well as our regional and global trading partners. Market-determined floating currencies are really the key to a well-functioning international financial system. For the world's major traders, only freely floating currencies bring the accuracy and the efficiency necessary for the proper pricing account settlement in capital flows. That's really our central point, that floating rates, market-based, flexible exchanges create the signals for a well-functioning flow of resources on a global basis. There's ultimately no substitute for that.

We've learned over the years that rigidities of all kinds, including rigidities in exchange rate mechanisms, tend to distort the proper functioning of markets. Open competitive markets with little or no interference are essential. They are really needed to insure that people and investment capital can seek out the best ideas and opportunities.

How do economies grow? How do they prosper? They grow and prosper by bringing people with ideas together with people with capital. Then, seeing those ideas flower in the marketplace, with new products and new services. That's the engine of growth, and it requires the availability of capital and it requires markets that make capital available to those entrepreneurs and businesses that generate the ideas and will employ people and bring people and capital together.

So progress on each of these issues, in our view, will yield long-term benefits for the peoples of China, the peoples of the United States and the peoples of the world. This is clearly a win-win situation for China and the United States; a win-win situation brought about by embracing these ideas of open markets, capital flows, floating exchange rates.

During my meetings this week I expressed these views with the Chinese economic leaders. On the need for currency flexibility, in particular, I was encouraged. I was encouraged to hear the reaffirmation of China's longstanding goal to move toward greater flexibility. In the course of those discussions I was repeatedly assured that interim steps are now being taken and progress in this area will continue.

In order to continue this dialogue, in order to further communications and understanding between our nations on this issue and other important economic, financial and trade issues, I yesterday extended an open invitation to host the Vice-Premier, Huang Ju, and other officials to come to Washington to continue the work on these important matters.

We also intend to appoint a Treasury Attaché at the U.S. Embassy in Beijing where the Ambassador tells me that that Treasury person will be well cared for, and looked after, and will an important part of the Ambassador's team. Let me conclude

by saying that I look forward to our continued discussions as we cooperate to enhance our economic relationship.

So I thank you very much and now look forward to your questions:

QUESTION: When you talk about these interim measures on the currency, what measures specifically are you talking about, and what concretely do you expect to leave here with?

SNOW: Well, we have in mind things like expanding the opportunities for capital flows, expanding the opportunities for ownership of financial assets. We have in mind things that are underway already, being expanded and accelerated, removing some of the burdensome capital requirements in the banking system, capital asset ratio requirements; and ownership rules, relaxation of ownership rules; a variety of things in this area.

QUESTION: On currency though, specifically? Interim measures?

SNOW: Right, well these are interim measures that prepare the economy for a floating exchange rate system, that get it ready for a floating-exchange system. That was the nature of a lot of our dialogue, the interim steps, putting in place the interim steps that prepare the way for an effective floating regime.

QUESTION: Do you have a timetable for these interim measures?

SNOW: Well they're underway right now, and we're pleased to see them underway. We want to see them accelerate. Our conversation yesterday with the economic leaders indicated that more is coming, and we urged that on, we urged them on with doing more.

QUESTION: And could you tell us were the Chinese receptive to your ideas, I mean the incentives for them to adopt these moves?

SNOW: The incentives are their own advantage. It's in China's advantage to open its system up. It's in China's advantage to encourage greater flows both in and out. It's in China's interest to secure a more market-based set of financial institutions. And, as China moves down this path, it prepares the way to move to floating rates. That was the essence; that was an important part of our discussion yesterday.

QUESTION: Could I ask you to be a little specific about this? Was it in essence these interim measures attempted to rebalance the demand between the renminbi and the dollar? Specifically was it to allow more Chinese companies to invest in U.S. Treasuries, and do they also mention allowing domestic Chinese companies or funds to invest in stock markets abroad?

SNOW: Yes. It's not. No further actions need to be taken to allow foreign investment in the United States bond market. It's an open market, so any restrictions would be local restrictions not U.S. restrictions of course. But we had that discussion of opening up opportunities for investments going both ways, in both the financial arena and in the non-financial arena.

QUESTION: I'd like to ask a question about the trade relations between the two sides. The American trade deficit with China has attracted much attention from your side for a long time. As we know, with the development of trade liberalization and economic globalization, I think that it's not so important to just talk about bilateral trade surplus or deficit. For example, China has several thousand billion dollar U.S. trade surplus with the United States, but she also has an approximately forty billion U.S. dollar trade deficit with the other Asian countries like Japan and Malaysia and the Republic of Korea. And this offsets the surplus with the U.S. At the same time, China has a trade surplus with the United States. She also purchases a large amount of American debt, which offer a great support to the American economy. So can we say that the trade relations between the U.S. and China are not only just bilateral trade relations, but are also multiparty and mutually beneficial relations on the global trading system? What we should do is to develop this win-win or multi-win trade relations. Do you agree with that?

SNOW: I'm not sure I fully understand the question, but let me try and respond as best I do understand it. The United States and China have a good trade relationship. We benefit from the opportunity to have low-cost goods from China in the United States and you benefit from the opportunity to take advantage of U.S. exports. We'd like to see that trade deficit narrowed though. I think it's unsustainably large at current levels. One way for it to narrow is for the domestic economy of China to strengthen. Because as it strengthens, then with more disposable income in China, there will be an increase in the propensity to buy U.S. goods, and that would be healthy. So we are urging the Chinese officials to continue with their reform strategies, because those reform strategies, if persisted in, if continued, will clearly create a stronger domestic economy. That's in China's interest and it's very much in the U.S. interest as well. We're interested in selling more products and services in China. China will benefit from that, just as you benefit from access to our markets.

QUESTION: I take it from your choice of language that you would say that China is not at this moment ready for a free floating currency. Am I correct in that assumption, and if they're not ready now, what specifically do they have to do? How long will it take?

SNOW: Well, the objective here is to get a commitment to move to a free-floating currency. That's what we want. We'd like to see China operating in a regime of market-based, floating, flexible exchange rates. And as I said in my comments, I was encouraged to see the Chinese officials reaffirm that objective, that policy goal. I was also pleased to see them making strides on the interim steps that have to be put in place. I don't think it's helpful for us to try to talk about a timetable. I do think it's helpful though to see that reaffirmation of the policy direction, and to see the progress that's being made in the commitment to further progress on these interim steps.

QUESTION: Mr. Secretary could you tell us if you discussed at all any specific sectors of trade, U.S. sectors of trade, textiles, furniture, or shoes or any of the other sectors where there's been some political pressure in the Unites States to do something about China trade? Did any of your Chinese hosts discuss any specific measures that they might take to address any concerns in those specific sectors?

SNOW: Well our discussions were more general I would say than sector-specific, although the financial sector did receive a good deal of specific attention, because a focal point of our conversations was moving towards flexibility in exchange rates. It's the freeing up and opening up of the financial sector which is part and parcel of moving to fluctuating rates. But we did talk generally about opening up markets in other areas, about the intellectual property rights and better enforcement there; about making the market more open for soybeans; and, as I say, financial services; and agriculture in general. So there was a general discussion of other areas and a more specific discussion of financial services.

QUESTION: The National Association of Manufacturers says that China maintains an artificially low exchange rate that is the single biggest factor in manufacturing job loss in the U.S. and I'm wondering if you consider the Yuan undervalued. If so by how much? And what relationship does that have to the loss of jobs in the U.S.?

SNOW: What we're seeking is broad movement to flexibility so that markets can be allowed to set values. We're placing our confidence in markets. The only way ultimately to know the answer is to place your confidence in markets. Therefore I'm encouraged by what I heard. We want to make sure that you use markets so that there isn't any artificial propping up of one sector or another, so the U.S. manufacturers will have a fair opportunity to compete on a level playing field.

QUESTION: I would like to ask: you are going to have a meeting with Premier Wen Jiabao this afternoon. What are the topics that you are especially interested in during your meeting with the Premier?

SNOW: It'll be a continuation of the subjects we've reviewed here. I will commend the Premier on the enormous progress that 's being made in this economy. I will commend him on the reforms that are underway. I will reaffirm the importance of this relationship. I will let him know that we want to see a win-win relationship between China and the United States. I will tell him that we have an enormous amount to gain together, working together. I will urge him on with the reforms and indicate specifically our interest in seeing a movement to more open capital flows;

applauding China's WTO commitment, open banking and insurance markets, to foreign services; indicate that some problems remain. We'd like to see continuing progress in this area. I'll suggest to him that it's in China's interest to adopt flexible, risk-based capital requirements for the banking sector. I will indicate our interest in seeing China move forward and honor the commitments it's made to allowing branching by non-life insurance companies, financial services companies. I will urge, as well, continued progress on securities and asset-management, including importantly allowing a majority ownership by foreign firms.

We see more robust capital markets, more market-based capital markets as an essential component of the China of the future. In saying that, our position is it's in China's interest to move in that direction. I will suggest to him our interest in seeing China move towards a floating rate, a flexible regime of international currencies.

In addition, at some point our conversation will turn to terrorist finance, and I will commend the Premier for China's cooperation in dealing with the threat of terrorist finance. The United States, with China and other nations of the civilized world, are committed to dealing with the terrorist threat. An important component of dealing with terrorism is dealing with terrorist finance. I want to reaffirm our mutual commitments to do that. And of course I will thank the Premier on behalf of the President for the leadership China is showing in dealing with the threat of nuclear arms on the Korean Peninsula.

QUESTION: I have two questions. One is: many analysts blame this round of the Japanese economic recession on the Plaza Accord 1985. I want to know: do you agree with that? Meanwhile I would like to know your opinion on how the foreign exchange rate influence could be used to resolve the trade deficit.

SNOW: Fluctuating exchange rates, if they're really used, provide a mechanism for the adjustments that need to be made so that imbalances aren't sustained in the world economy. That's really why we want to use flexible exchange rates. If a country has a surplus, and it goes on for quite a while, the fluctuating exchange rate mechanism will provide for an adjustment process as currencies change values. If a country is in long-term deficit, the exchange rate mechanism will provide for an adjustment of currencies which will correct it. The virtue of fluctuating rates is that the price signals are working to create a healthy and efficient, continuous adjustment process. Where fluctuating rates, market-based rates, are impeded, imbalances develop in individual economies and they develop in the world trading system. So the world trading system is more efficient. It works better. It works better under a regime of fluctuating exchange rates. So that's why we will be urging the authorities to move in that direction, and to take the steps that prepare the way for the implementation of a fluctuating, market-based regime of currencies.

I thank you very much for this opportunity to be with you and respond to your questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 3, 2003
JS-693

Remarks of Peter R. Fisher
Under Secretary for Domestic Finance
To
American Enterprise Institute Conference
Washington, DC
Can Nonfinancial Indicators Succeed Where GAAP Fails?

To improve corporate behavior and to reward corporate performance we need to improve the quality and utility of the information that all corporations disclose to investors. Our existing disclosure framework is not adequate.

Peter Wallison and AEI are to be congratulated for bringing together – once again – so much talent on such an important topic. I certainly hope that non-financial indicators of business performance can succeed in providing investors the information they need and deserve, where GAAP has failed. But I also hope that we can improve the state of financial disclosure and, by doing so, provide stronger incentives for companies to disclose business performance measures.

To succeed, I believe that we must acknowledge the insufficiency of the accountant's mindset, which animates our existing disclosure framework, and focuses on identifying facts (about the past) that are precisely comparable between firms. Investors have a different mindset and focus on comprehending the probabilities of likely and unlikely future deviations from particular desired or expected outcomes. We need to remedy this mismatch between what investors are looking for and what our disclosure regime provides.

There has always been an asymmetry between the information available to corporate insiders and to outside investors. A principle purpose of any regime of minimum disclosure standards is to redress this imbalance. The computing, communications and data management revolution of the last two decades has significantly increased the information advantage of insiders, giving them access to timely and detailed data about near-term company prospects in customer order flow, cost management, revenues and other indicators of performance.

This information needs to be organized and presented to investors on a systematic basis. Some companies are doing this. More need to do this. To provide stronger incentives for companies to make these business value disclosures we need to improve the clarity of financial disclosures.

To do this we need to move beyond the false dichotomy between on- and off-balance sheet. Shareholders and creditors need to know the real economic leverage being employed, whether through on- or off-balance devices. We need a measure of all the contractually obligated liabilities – both on and off-balance sheet – and a parallel measure of all of the firm's contractually obligated revenues. Tying these together will give us the firm's contractually-obligated net-present value, a true indictor of the firm's leverage.

Clearly disclosing this number – which will not include hoped-for or anticipated revenues, but only those for which there is a customer contract – would create a strong incentive for companies to disclose more clearly how they plan to generate the cash flow to close the gap between expenses and revenues and to disclose the measures of business performance that will indicate the extent of their plan's success.

To move in this direction, there are two challenges that I think deserve our

attention. The non-linear nature of contingent claims, particularly reflected in options, poses a significant but manageable technical problem for financial disclosures. A more general challenge, affecting both financial and non-financial disclosures, is to squarely confront the subjective nature of risk.

To measure accurately the present value of the future contractually obligated cash flows we need to deal with the contingent nature of various assets and liabilities, particularly options exposures. Simply put, investors need different facts about an option at different stages in an option's life cycle. This does not come naturally to the accountant's mindset – of looking for discrete facts directly comparable between firms – but properly understood it need not be at odds with it either. However, this information is vital for investors.

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 butter flies.

We are not, however, just interested in observing facts. To carry the analogy to investors forward, we are 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.

To deal with contingent values, financial disclosures useful to investors need to include those features that best foreshadow the probabilities of different outcomes and those that summarize the course of the transformation.

The broader challenge for our disclosure regime is 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. For our disclosure regime premised on the accountant's mindset this is a challenge because it suggests that there is no single correct way to disclose a particular set of contingent cash flows.

Applied to non-financial measures the subjective nature of risk is not complicated but it may be awkward.

While investors are interested in some absolute financial comparisons between firms (such as earnings per share), they are keenly interested in the performance of the particular business – that is, of the relative success of one company at managing deviation from their stated objective compared with the success of other companies at managing deviation from their stated objectives. The objectives may be quite different but we ought to be able to compare their ability to manage relative to their own objectives.

It should be self-evident that investors need information about whether a company is growing its business as planned or whether it is failing to do so. Accurate disclosure – of useful financial and non-financial indicators – will require companies to be more transparent about their objectives and about their deviations from objectives – that is, to be transparent about their failures – or their "un-successes".

As awkward as this may be for individual companies, for the health of our economy it is vital that we do an even better job of rewarding good corporate performance. In

our system of investor-based capitalism this must involve improving the quality and utility of the information provided to investors.

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
September 03, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term:	28-Day Bill
Issue Date:	September 04, 2003
Maturity Date:	October 02, 2003
CUSIP Number:	912795NQ0

High Rate: 0.950% Investment Rate 1/: 0.968% Price: 99.926

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 55.47%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 39,691,900	$ 16,957,760
Noncompetitive	42,333	42,333
FIMA (noncompetitive)	0	0
SUBTOTAL	39,734,233	17,000,093
Federal Reserve	3,451,634	3,451,634
TOTAL	$ 43,185,867	$ 20,451,727

Median rate 0.945%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.920%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 39,734,233 / 17,000,093 = 2.34

1/ Equivalent coupon-issue yield.

JS 694

FROM THE OFFICE OF PUBLIC AFFAIRS

September 3, 2003
JS-695

Treasury and IRS Announce over-the-counter Drugs to be covered by Health Care Flexible Spending Accounts

Today, the Treasury Department and the IRS announced over-the-counter drugs can be paid for with pre-tax dollars through health care flexible spending accounts. Treasury and IRS issued guidance clarifying that reimbursements for nonprescription drugs by an employer health plan are excluded from income. Thus, reimbursements by health flexible spending arrangements (FSAs) and other employer health plans for the cost of over-the-counter drugs available without prescription are not subject to tax if properly substantiated by the employee.

“Flexible Spending Accounts are an important tool in helping people meet their health care costs," stated Treasury Secretary John Snow. “Since many prescription drugs have moved to the over-the-counter market, this action today makes paying for them a little bit easier to swallow."

"Flexible Spending Accounts were established under the tax code to provide incentives for better health care," said IRS Commissioner Mark W. Everson. "This action is a sensible expansion and simplification of the program consistent with existing law."

Drugs are increasingly becoming available over-the-counter without prescription. Many health plans no longer cover the cost of these drugs as over-the-counter. While an over-the-counter drug is less expensive than the prescription drug, the cost to many consumers increases because the price paid by the consumer for the over-the-counter drug is greater than the co-payment by the consumer when the drug was covered by insurance. This is especially an issue for individuals who remedy chronic health problems by regularly taking an over-the-counter medicine.

Revenue Ruling 2003-102 explains that the statutory exclusion for reimbursements of employee health expenses is broader than the itemized deduction for medical expenses (which does not apply to nonprescription drugs). Thus, the guidance clarifies that employer reimbursements of
employee health expenses that are nonprescription drugs, including reimbursements through health FSAs and Health Reimbursement Arrangements (HRAs), are excluded from income like other employer reimbursements of employee health expenses. This will result in savings to consumers with access to employer plans who may purchase nonprescription drugs. However, for purposes of the itemized medical expenses deduction, the cost of such over-the-counter drugs continues to be non-deductible. In addition, the cost of dietary supplements that are merely beneficial to the employee's health are not excluded from income.

The text of Revenue Ruling 2003-102 follows:

Part 1

Section 105. Amounts Received Under Accident and Health Plans
(Also Section 213. - Medical, Dental, etc., Expenses)

Rev. Rul. 2003-102

ISSUE

Are reimbursements by an employer of amounts paid by an employee for medicines, drugs, or dietary supplements purchased by the employee without a physician's prescription excludable from gross income under § 105(b) of the Internal Revenue Code?

FACTS

Employer N sponsors a health flexible spending arrangement (health FSA). The health FSA provides for the reimbursement of participating employees' medical care expenses that are not covered by other insurance. Employee A is a participating employee in Employer N's health FSA.

Employee A purchases an antacid, an allergy medicine, a pain reliever, and a cold medicine from a pharmacy, none of which are purchased with a physician's prescription. Employee A purchases these items for personal use, or for the use of Employee A's spouse or dependents, to alleviate or treat personal injuries or sickness. Employee A also purchases dietary supplements (e.g., vitamins) without a physician's prescription to maintain the general health of Employee A, or Employee A's spouse or dependents. Employee A submits substantiated claims for all of these expenses, which have been incurred during the current plan year, to Employer N's health FSA for reimbursement. Employee A is not compensated for these expenses by insurance or otherwise.

LAW AND ANALYSIS

Section 61(a)(1) provides that, except as otherwise provided in subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 105(a) provides that amounts received by an employee through accident or health insurance for personal injuries or sickness are included in gross income to the extent such amounts (1) are attributable to contributions by the employer that were not includible in the gross income of the employee or (2) are paid by the employer.

However, § 105(b) provides an exception to the general rule requiring inclusion in income. Section 105(b) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in § 213(d)) of the taxpayer or the taxpayer's spouse or dependents (as defined in § 152).

Section 105(e) states that amounts received under an accident or health plan for employees are treated as amounts received through accident or health insurance for purposes of § 105. Section 1.105-5(a) of the Income Tax Regulations provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Section 213(d)(1) defines "medical care" to include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body.

Section 1.213-1(e)(1)(ii) states that an expenditure that is merely beneficial to the general health of an individual, such as an expenditure for a vacation, is not an expenditure for medical care. Section 1.213-1(e)(1)(ii) also states that expenditures for "medicines and drugs" are expenditures for medical care.

Section 1.213-1(e)(2) states that the term "medicine and drugs" includes only items that are legally procured and generally accepted as falling within the category of medicine and drugs. Section 1.213-1(e)(2) further provides that toiletries (e.g., toothpaste), cosmetics (e.g., face creams) and sundry items are not "medicines and drugs" and that amounts expended for these items are not expenditures for "medical care."

Rev. Rul. 2003-58, 2003-22 I.R.B. 959, considers whether amounts paid by an individual for medicines that may be purchased without a prescription of a physician

are deductible under § 213. The ruling notes that § 213(b) permits an amount paid for a medicine or drug to be taken into account for the purposes of the § 213 deduction for medical care expenses only if the medicine or drug is a prescribed drug or insulin. Section 213(d)(3) defines a "prescribed drug" as a drug or biological that requires a prescription of a physician for its use by an individual. The ruling concludes that amounts paid for medicines or drugs that may be purchased without a prescription of a physician are not taken into account pursuant to § 213(b) and are therefore not deductible under § 213.

Section 105(b) specifically refers to "expenses incurred by the taxpayer for . . . medical care," as defined in § 213(d). There is no requirement in § 105(b) that the expense be allowed as a deduction for medical care under § 213(a) or that only medicines or drugs that require a physician's prescription be taken into account.

Accordingly, the amount expended by Employee A to purchase the antacid, allergy medicine, pain reliever, and cold medicine without a physician's prescription is an expenditure for medical care. Employer N's health FSA reimbursement of Employee A's cost for these items is therefore excludable under § 105(b), even though the cost would not have been deductible under § 213(a). However, the dietary supplements (e.g., the vitamins) are merely beneficial to Employee A or Employee A's spouse or dependents' general good health. Therefore, the cost of the dietary supplements is not an expense for medical care and is not reimbursable or excludable under § 105(b).

HOLDING

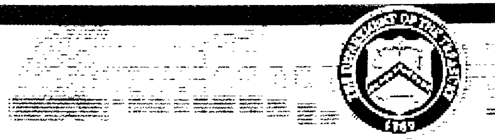
Reimbursements by an employer of amounts paid by an employee for medicines and drugs purchased by the employee without a physician's prescription are excludable from gross income under § 105(b). However, amounts paid by an employee for dietary supplements that are merely beneficial to the general health of the employee or the employee's spouse or dependents, are not reimbursable or excludable from gross income under § 105(b).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 2003-58 is distinguished.

DRAFTING INFORMATION

The principal author of this revenue ruling is Barbara E. Pie of the Office of Division Counsel/Associated Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Pie at (202) 622-6080 (not a toll-free call).



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 3, 2003
JS-696

Statement of
Assistant Secretary for Financial Institutions Wayne Abernathy
on the Federal Trade Commission's Identity Theft Survey Report

"The report issued today by the Federal Trade Commission gives vivid evidence of the serious national problem of identity theft. It is the latest demonstration of the need for passing legislation this fall to fight this crime. On June 30, 2003, Treasury Secretary John Snow outlined the Administration's program to give important new tools to consumers and law enforcers. The House of Representatives is poised to approve this package, and we are encouraged that the Senate will soon take up similar legislation.

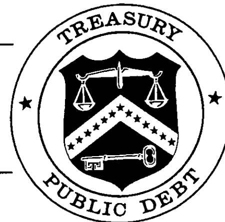
"As the FTC survey shows, identity theft is a major and growing national problem, affecting as many as 10 million people during the last year. The financial costs are alarming, with over $10,000 stolen in the average fraud, American businesses losing upwards of $50 billion, and the innocent victims spending $5 billion cleaning up the mess that others have created.

"The Administration has called for legislation that, among other provisions, would establish a national fraud alert system, improve the accuracy of credit reports, identify the tell tale signs—or red flags—to alert lenders so they can thwart identity theft attempts, and put more information in the hands of consumers—including annual free copies of their credit reports. The proposals would also make it easier for victims to restore their credit histories and impose penalties if a company puts false information on credit records.

"The problem is so great, and its impact on consumers so terrible, that we should not delay giving consumers and law enforcers these important new tools to fight identity theft."

The FTC report can be found at www.ftc.gov

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
September 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term: 91-Day Bill
Issue Date: September 04, 2003
Maturity Date: December 04, 2003
CUSIP Number: 912795NZ0

High Rate: 0.970% Investment Rate 1/: 0.988% Price: 99.755

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 98.82%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 35,421,324	$ 14,353,046
Noncompetitive	1,422,250	1,422,250
FIMA (noncompetitive)	225,000	225,000
SUBTOTAL	37,068,574	16,000,296 2/
Federal Reserve	5,695,076	5,695,076
TOTAL	$ 42,763,650	$ 21,695,372

Median rate 0.965%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.940%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 37,068,574 / 16,000,296 = 2.32

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,154,501,000

http://www.publicdebt.treas.gov

JS-697

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
September 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	182-Day Bill
Issue Date:	September 04, 2003
Maturity Date:	March 04, 2004
CUSIP Number:	912795PN5

High Rate: 1.040% Investment Rate 1/: 1.063% Price: 99.474

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 91.36%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 34,054,590	$ 14,939,086
Noncompetitive	910,921	910,921
FIMA (noncompetitive)	150,000	150,000
SUBTOTAL	35,115,511	16,000,007 2/
Federal Reserve	5,777,302	5,777,302
TOTAL	$ 40,892,813	$ 21,777,309

Median rate 1.030%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 1.000%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

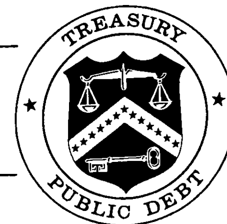
Bid-to-Cover Ratio = 35,115,511 / 16,000,007 = 2.19

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $678,873,000

http://www.publicdebt.treas.gov

JS 698

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
September 02, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 12-DAY BILLS

Term: 12-Day Bill
Issue Date: September 03, 2003
Maturity Date: September 15, 2003
CUSIP Number: 912795QG9

High Rate: 0.980% Investment Rate 1/: 1.007% Price: 99.967

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 23.45%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

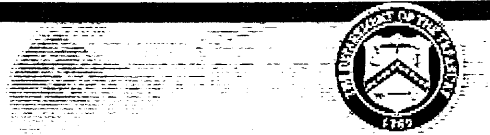
Tender Type	Tendered	Accepted
Competitive	$ 57,214,000	$ 23,000,400
Noncompetitive	12	12
FIMA (noncompetitive)	0	0
SUBTOTAL	57,214,012	23,000,412
Federal Reserve	0	0
TOTAL	$ 57,214,012	$ 23,000,412

Median rate 0.970%: 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 = 57,214,012 / 23,000,412 = 2.49

1/ Equivalent coupon-issue yield.

JS - 699



FROM THE OFFICE OF PUBLIC AFFAIRS

September 5, 2003
JS-700

Snow Announces Designation of 10 Jemaah Islamiyah (JI) Terrorists

In a press conference at the APEC Meeting in Phuket, Thailand, U.S. Treasury Secretary John Snow announced that the United States is today designating 10 members of Jemaah Islamiyah, or JI, a South Asian terrorist group with significant links to al-Qaida, as Specially Designated Global Terrorists (SDGTs) under Executive Order 13224. The U.S. is also submitting these individuals to the United Nations for designation by all UN member states as al-Qaida terrorists.

"This designation is yet another important step in the ongoing effort by the international community to shut down JI terrorist operations in Southeast Asia," Secretary Snow stated. "Today's action identifies 10 individuals at the heart of the JI network. These terrorists have worked to achieve al-Qaida's terrorist goals in Southeast Asia. They have plotted to assassinate international leaders, they have planned and supported attacks such as the Bali bombing – a horrific act that took the lives of 200 people and wounded 300. We look forward to working with our allies in the region to dismantle JI -- to shut down their sources of financing and support, and to eliminate the threat they present to the people of Southeast Asia."

Today's action follows the previous designation by the U.S. and the United Nations of JI as a terrorist organization; the designation and recent capture of key JI figure Nurjaman Riduan Isamuddin (a.k.a Hambali); and the designation of Mohamad Iqbal Aburrabman (a.ka. Abu Jibril).

The designation today will immediately freeze all assets belonging to these terrorists in the U.S. and prohibit transactions with U.S. persons. Within 72 hours, if there are no objections by the UN 1267 committee, all UN member states will be required to take similar actions.

Since September 11th 2001, the United States and our allies have designated 305 individuals and entities as terrorists and supporters of terrorism and have frozen over $136.7 million in assets worldwide.

Further details, including the list of those designated, are provided in the attached fact sheet.

FACT SHEET

DESIGNATION OF JEMAAH ISLAMIYAH MEMBERS

Jemaah Islamiyah ("JI") is an al-Qaida linked terrorist group with cells operating in several countries in Southeast Asia. The JI's stated goal is to create an Islamic state comprising Malaysia, Singapore, Indonesia, and the southern Philippines. Members of JI have been trained, funded and directed by the al-Qaida leadership to pursue al-Qaida's terrorist agenda across the region. In December 2001, Singapore authorities arrested 13 JI members, eight of whom had trained in al-Qaida camps in Afghanistan, who planned to bomb the U.S. and Israeli Embassies, British and Australian diplomatic buildings, and U.S. and Singapore defense targets in Singapore. Members of the group had conducted videotaped surveillance of the potential targets, and had already acquired explosives in preparation for the attacks. Singapore police discovered tampered passports, forged immigration stamps, bomb making manuals, and al-Qaida-related material in several suspects' homes. In addition, a copy of a videotape made by certain members of the group and showing intended targets in Singapore was found in the wreckage of an al-Qaida leader's house in Afghanistan in December 2001. In April 2003, Indonesian

authorities arrested 19 additional members of JI as suspects in the Bali bombings of October 2002. In the home of one of the suspects, police reportedly discovered documents with plans for the bombings.

The United States designated JI as a Specially Designated Global Terrorist (SDGT) under Executive Order 13224, "Blocking Property and Prohibiting Transactions with Persons who Commit, or Support Terrorism," on October 23, 2002. On January 24, 2003, two senior JI leaders, Nurjaman Riduan Isamuddin (most commonly known as Hambali) and Mohamad Iqbal Abdurrabman, a.k.a. Abu Jibril, were also designated as SDGTs under E.O. 13224. JI and the two leaders have been added to the UN 1267 Committee sanctions list. The United States government has credible evidence that the following JI members support and/or commit acts of terrorism on behalf of JI.

• Yassin Sywal. "Yassin," is an operative who provides support to JI and al-Qaida in Southeast Asia. Yassin received training in the al-Qaida-operated Chaldun Camp in Afghanistan in the l980s or l990s. When he returned to Southeast Asia, he became involved in sectarian conflicts occurring in Sulawesi, Indonesia. Yassin, who is the son-in-law of JI co-founder Abdullah Sungkar, collaborated with individuals associated with JI and al-Qaida in Southeast Asia, such as suspected al-Qaida operative Umar Faruq, to recruit and train Muslims for combat in Sulawesi. Yassin also assisted in importing weapons from the Philippines for use in conflicts in Indonesia. In addition, Yassin participated in planning and facilitating al-Qaida terrorist plots in Southeast Asia. In 1999, Yassin attended a planning session with Faruq to select assassination targets. The targets selected included Indonesian President Megawati Sukarnoputri and other Indonesian figures. Yassin's role in the plot was to procure weapons for use in the assassinations. Ultimately, the plot was aborted.

• Mukhlis Yunos. An explosives expert, Yunos is the leader of the Special Operations Group of the Philippines-based Moro Islamic Liberation Front (MILF). Yunos has acted on behalf of and materially assisted JI on several occasions. Yunos assisted JI member Fathur Rohman Al-Ghozi in procuring explosives and weapons for shipment to Indonesia and elsewhere. Yunos also carried out the December 30, 2000, bombings in Manila, known as the "Rizal Day Bombings," on behalf of JI. Yunos received financial assistance from JI figures Faiz bin Abu Bakar Bafana and Fathur Rohman A1-Ghozi to conduct the Rizal Day bombings, which killed 22 people and injured more than 100. Yunos also assisted JI operations chief Riduan Isomuddin, a.k.a. Hambali, and JI Singapore cell leader Faiz bin Abu Bakar Bafana in conducting surveillance of the U.S. and Israeli embassies in the Philippines. Yunos studied in Pakistan and received military training in Afghanistan.

• Imam Samudra. An Indonesian national, Samudra was arrested on November 21, 2002, in connection with the October 12, 2002, bombings in Bali. Indonesian authorities have identified Samudra as a member of JI. Samudra moved to Malaysia in 1990, received military training in Afghanistan between 1991 and 1993, and took an oath of allegiance, or "bai'at," to JI leader Abu Bakar Bashir in 1998. Samudra has provided support and assistance to JI in at least three bomb attacks. Samudra assisted JI operations chief Hambali in organizing and financing the bombings of 24 churches in Indonesia, on December 24, 2000, which killed 19 people and injured more than 100. Samudra participated in the bomb attack on a Jakarta shopping mall on August 1, 2001, by providing explosives and detonators to two men who carried out the attack. Samudra also played a central role in the Bali bomb attacks that killed 202 people. Samudra initiated the Bali bomb plot and selected the target and time of the bombings. He also recruited and commanded the team that executed the Bali blasts. Indeed, Indonesian police found the following message on Samudra's computer:

We are responsible for the incident in Legian St. Kuta Bali, at Saturday night, October 12, 2002 also near General Consulate building in Jalan Hayman Wuruk 188, Denpasar, Bali at the same night.

• Huda bin Abdul Haq (a.k.a. and hereafter referred to as, "Mukhlas"). Mukhlas is a senior and influential JI leader with ties to Usama bin Laden. He was reportedly named head of JI's "Mantiqi One", or regional network, covering Sumatra, Singapore, Malaysia and southern Thailand. Mukhlas co-founded a religious school in Malaysia used as a training ground for JI operatives and was involved extensively in the Bali bombings. Mukhlas was detained and charged by Indonesian authorities with planning and supervising the terrorist attacks that occurred in Bali

on October 12, 2002, killing at least 202 people. A 1,046- page case file cites reports of 200 witnesses linking Mukhlas with the attacks. Mukhlas himself admitted to being present and in command at the planning meetings for the Bali bombings, and recruited two of his brothers to help assemble and transport the bombs used in the Bali attacks. A significant sum of money, amounting to approximately US $35,000 was contributed to the Bali bombings by Wan Mm Wan Mat, a leader of the JI network in Malaysia. The money came from senior JI leader Hambali through Wan Mm and was channeled to Mukhlas. The money was provided in cash, and according to claims by Mukhlas, the money was not just used for the bombings in Bali, but also in other places in Indonesia. Mukhlas admitted that he met with Usama bin Laden in Afghanistan in 1987 and fought the Soviet Union in Afghanistan as a member of Usama bin Laden's "International Brigade". According to Mukhlas "he and other top JI personnel were careful to nurture ties to bin Laden and al-Qaida in the years that followed."

• Parlindungan Siregar. 'Parlin Siregar" is an Indonesian engineer identified by Spanish authorities as a close associate of an al-Qaida cell in Spain. Siregar has also been involved in al-Qaida training activities in Indonesia, according to the same authorities. Siregar, who studied engineering in Spain, was associated with the Spanish al-Qaida cell led by Barakat Yarkas. Spanish authorities arrested 11 members of that cell in November 2001. During the course of their investigation, Spanish authorities uncovered evidence indicating that Siregar led an al-Qaida training camp in Sulawesi, Indonesia. Siregar is alleged by Spanish authorities to have arranged for several hundred al-Qaida operatives from Europe, including Yarkas, to travel to Indonesia for training.

• Julkipli Salim Y Salamuddin. Salamuddin led combined JI-MILF elements in late 2002, along with MILF leader Solamain Esmael. They were suspected of planning attacks on US companies, government facilities, and shopping malls in the South Central Mindanao area.

• Aris Munandar. Munandar facilitates and provides support to JI activities in Southeast Asia. Munandar, a native of Indonesia, is reported to be between 34 and 40 years old. He is a close associate of JI leader Abu Bakar Bashir. Munandar is a graduate of Bashir's Islamic boarding school, Pondok Ngruki, and a member of Majelis Mujahidin Indonesia (MMI), an organization that Bashir helped found and later directed. He is also the head of KOMPAK, a non-governmental organization that produced videos used in the recruitment of JI members. Munandar is considered to be Bashir's assistant. As such, Munandar provided direct support and assistance to activities authorized by Bashir. On one occasion, Munandar procured explosives at the request of Bashir for use in Ambon. Munandar also facilitated recruitment and training for JI and al-Qaida activities in Indonesia. Munandar, working with al-Qaida operative Umar Faruq, is suspected of providing military training for recruits to join sectarian fighting in Sulawesi.

• Fathur Rohman Al-Ghozi. Al-Ghozi is a JI member and explosives expert who received military training at an al-Qaida camp on the Afghan-Pakistani border. Al-Ghozi was involved in conducting surveillance and procuring explosives for the Hambali-approved JI plan to attack U.S. and other Western interests in Singapore. He admitted to helping plan and finance a series of bombings in the Philippines on December 30, 2000, that killed 22 people and injured more than 100. He also served as a JI trainer and conducted bomb-making courses in Malaysia and the Philippines attended by JI members. Al-Ghozi was detained by Philippine authorities on January 15, 2002, pled guilty to explosives charges in April 2002, and was sentenced to 10-12 years in jail. While under detention, he gave police information that led to the discovery of more than a ton of explosives, 300 detonators and other bomb-making materials in the Southern Philippines. In an affidavit, A1-Ghozi admitted he was working with Hambali (an SDGT designated under E.O. 13224 on January 24, 2003). Al-Ghozi escaped from prison on July 14, 2003 and is currently at large.

• Agus Dwikarna. Dwikarna is a JI member and facilitator for al-Qaida in Indonesia. Dwikarna acted as a guide for two al-Qaida leaders during their visit to Indonesia in June 2002, and reportedly set up an al-Qaida training camp in Indonesia. Dwikarna was arrested on March 13, 2002, while attempting to board a flight at the international airport in Manila, the Philippines. Security personnel discovered bomb-making equipment in his suitcase. Dwikarna was sentenced to 17 years in jail for illegal possession of explosives.

- Abdul Hakim Murad. Murad, a Pakistani national, is a licensed commercial pilot who trained in flight schools in the U.S. He was arrested in Manila, the Philippines in January 1995 in a raid that resulted in the seizure of a laptop computer, a large quantity of chemicals and other paraphernalia used in the manufacture of explosives. He was turned over to the U.S. and indicted for conspiring to simultaneously blow up 12 U.S. commercial airliners while airborne, a project codenamed Bojinka. According to Philippines and U.S. law enforcement officials, the key planners of the Bojinka plot were al-Qaida operations directors Khalid Shaikh Mohammad and Ramzi Yousef. Khalid Shaikh Mohammed was indicted as a co-conspirator of the Bojinka plot in 1996, but avoided standing trial by eluding law authorities. Mohammed was designated as an SDGT pursuant to E.O. 13224 on October 12, 2001, and was arrested on March 1, 2003, in Pakistan. Murad also told the FBI, in step-by-step details, of his involvement in preparing the Bojinka plot. On September 5, 1996, Abdul Hakim Murad, along with co-defendants Ramzi Yousef and Wail Khan Main Shah, were convicted on all counts related to the Bojinka bombing conspiracy.

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.
September 2, 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 $17,000 million of publicly held 4-week Treasury bills maturing September 4, 2003.

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 $14,924 million of the Treasury bills maturing on September 4, 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-701

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

September 2, 2003

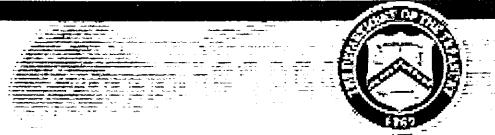
Offering Amount.........................$17,000 million
Maximum Award (35% of Offering Amount)...$ 5,950 million
Maximum Recognized Bid at a Single Rate..$ 5,950 million
NLP Reporting Threshold.................$ 5,950 million
NLP Exclusion Amount....................$11,700 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NQ 0
Auction date.......................September 3, 2003
Issue date.........................September 4, 2003
Maturity date......................October 2, 2003
Original issue date................April 3, 2003
Currently outstanding..............$45,233 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

September 5, 2003
JS-702

Statement by John Snow, U.S. Secretary of the Treasury
Meeting of the Asia-Pacific Economic Cooperation Forum
Finance Ministers Phuket, Thailand September 5, 2003

In my first meeting with the finance ministers of the Asia-Pacific Economic Cooperation Forum I come away impressed with the serious interest expressed by my colleagues on the important issues we came to discuss. I thank our hosts from Thailand for their hospitality and for providing this beautiful setting for our meetings.

Both in group discussions and in bilateral meetings, I took the opportunity to address issues important to our prosperity and our security. I stressed our view that the best international economic system – for the United States, for the Asia-Pacific region, and for the world – is one based on the principles of free trade, the free flow of capital, and market-based exchange rates. I also stressed the need for each of us to take steps to increase economic growth in our domestic economies. Raising productivity through structural reform and private investment is the most direct route to raising living standards for our people. I reported that the U.S. economy is returning to higher levels of growth, but that the global economy requires Europe and Asia – and Japan in particular – to attain higher levels of growth as well.

Throughout my meetings we had extensive discussions on the issue of currencies. I expressed my long-held view that market-determined floating currencies, with interventions kept to a minimum, are essential to a well-functioning international financial system. Only freely floating currencies bring the accuracy and efficiency necessary for proper pricing, account settlement and capital flows among our economies. Furthermore, rigid currency systems, rather than promoting stability, instead increase the risk that economies cannot properly adjust, thereby escalating the impact of economic shocks. The management of currencies at unnatural rates distorts markets, tending toward beggar-thy-neighbor policies, and encourages protectionism. These are paths we must avoid.

I was pleased with the reception of this view from my colleagues. Our agreement that flexible exchange rates are necessary to promote orderly and balanced external adjustments is significant. This principle is an essential first step toward the universal acceptance of market-based, freely floating currencies. We should move quickly to build upon this initial foundation of agreement.

The free flow of capital is also a fundamental component of our global system of international trade and finance. Barriers raise the cost and limit the freedom of investment capital to seek out the best opportunities. We should continue to eliminate restraints on investment capital in order to maximize our growth opportunities.

Trade among our nations has risen significantly in recent years, and this is to the benefit of all our economies, but I emphasized that we must continue to press for further trade liberalization in the Doha Round WTO negotiations. Our prosperity is enhanced when all nations have the freedom to bring to global, competitive markets the best goods and services their talents and abilities can produce, in compliance with the laws of international trade.

We also discussed our collective actions to halt the flow of funds to the

agents of terror. I announced that the United States is designating 10 members of Jemaah Islamiyah, or JI, as terrorists, freezing any assets in the United States and prohibiting transactions with these individuals. We will also be submitting these names to the United Nations for action by all UN member states. I am encouraging my colleagues to take bold action against this terrorist organization and I look forward to working with our allies in the region to shut down JI's sources of financing and support, and to eliminate the threat they pose to the people of Southeast Asia.

We have had a successful series of meeting this week. We have broken new ground on important issues concerning our economic relations. I look forward to continue to work with my counterparts in the region as we work to put in place the building blocks of strong, sustainable economic growth.

FROM THE OFFICE OF PUBLIC AFFAIRS

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September 5, 2003
JS-703

Treasury and IRS Issue Guidance on the Additional Bonus Depreciation Allowance

Today the Treasury Department and the Internal Revenue Service issued temporary regulations providing detailed rules on the additional first-year or "bonus" depreciation allowance.

As a result of recent amendments to the Internal Revenue Code, taxpayers may deduct an additional 30- or 50-percent first-year depreciation allowance for certain depreciable property. This depreciation allowance is in addition to the amount of depreciation otherwise allowable in the first year.

In general, the regulations provide the requirements that must be met for depreciable property to qualify for the additional first-year depreciation deduction. Further, the regulations instruct taxpayers how to calculate the additional first-year depreciation deduction and the amount of depreciation otherwise allowable for the property.

The regulations are effective for property that is acquired by a taxpayer after September 10, 2001 (for purposes of the additional 30-percent first-year depreciation allowance), or acquired after May 5, 2003 (for purposes of the additional 50-percent first-year depreciation allowance), and placed in service before January 1, 2005 (or, in the case of certain property, placed in service before January 1, 2006.) The regulations are also effective for New York Liberty Zone property that is acquired by a taxpayer after September 10, 2001, and placed in service before January 1, 2007 (or, in the case of certain real property, placed in service before January 1, 2010.)

Related Documents:

- The text of the temporary regulations

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9091

RIN 1545-BC19

Special Depreciation Allowance

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property) and the depreciation of computer software subject to section 167. Specifically, these regulations provide guidance regarding the additional first year depreciation allowance provided by sections 168(k) and 1400L(b) for certain MACRS property and computer software. The regulations reflect changes to the law made by the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. The text of these 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 in this issue of the **Federal Register**.

DATES: Effective Dates: These regulations are effective September 8, 2003.

Applicability Dates: For dates of applicability, see §§1.167(a)-14T(e), 1.168(d)-1T(d), 1.168(k)-1T(g), 1.169-3T(g), and 1.1400L(b)-1T(g).

FOR FURTHER INFORMATION CONTACT: Douglas Kim, (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 to provide regulations under sections 168(k) and 1400L(b) of the Internal Revenue Code (Code). Sections 168(k) and 1400L(b) were added to the Code by, respectively, sections 101 and 301(a) of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21), and were modified by section 201 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 (117 Stat. 752).

Explanation of Provisions

Background

Section 167 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear of property used in a trade or business or held for the production of income. The depreciation allowable for tangible, depreciable property placed in service after 1986 generally is determined under section 168 (MACRS property). The depreciation allowable for computer software that is placed in service after August 10, 1993, and is not an amortizable section 197 intangible is determined under section 167(f)(1).

Section 168(k)(1) allows a 30-percent additional first year depreciation deduction for qualified property acquired after September 10, 2001, and, in most cases, placed in service before January 1, 2005. Section 168(k)(4) allows a 50-percent additional first

year depreciation deduction for 50-percent bonus depreciation property acquired after May 5, 2003, and, in most cases, placed in service before January 1, 2005. Section 1400L(b) allows a 30-percent additional first year depreciation deduction for qualified New York Liberty Zone property (Liberty Zone property) acquired after September 10, 2001, and placed in service before January 1, 2007 (January 1, 2010, in the case of qualifying nonresidential real property and residential rental property).

Scope

The regulations provide the requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by sections 168(k) and 1400L(b). Further, the regulations instruct taxpayers how to determine the additional first year depreciation deduction and the amount of depreciation otherwise allowable for this property.

Property Eligible for the Additional First Year Depreciation Deduction

The regulations provide that depreciable property must meet four requirements to be qualified property under section 168(k)(2) (property for which the 30-percent additional first year depreciation deduction is allowable) or 50-percent bonus depreciation property under section 168(k)(4) (property for which the 50-percent additional first year depreciation deduction is allowable). These requirements are: (1) the depreciable property must be of a specified type; (2) the original use of the depreciable property must commence with the taxpayer after September 10, 2001, for qualified property or after May 5, 2003, for 50-percent bonus depreciation property; (3) the depreciable property must be acquired by the taxpayer within a specified time

period; and (4) the depreciable property must be placed in service by a specified date. These requirements are more fully discussed below.

Property of a Specified Type

The regulations provide that qualified property or 50-percent bonus depreciation property must be one of the following: (1) MACRS property that has a recovery period of 20 years of less; (2) computer software as defined in, and depreciated under, section 167(f)(1); (3) water utility property as defined in section 168(e)(5) and depreciated under section 168; or (4) qualified leasehold improvement property depreciated under section 168. Because the additional first year depreciation deduction applies to MACRS property that is depreciated under the general depreciation system (GDS) or would be depreciated under the GDS but for an alternative depreciation system (ADS) election made by the taxpayer, the regulations provide that for purposes of determining the eligibility of MACRS property as qualified property or 50-percent bonus depreciation property, the recovery period applicable for the MACRS property under section 168(c) of the GDS is used regardless of any election made by the taxpayer to depreciate the class of property under the ADS of section 168(g). Further, with respect to qualified leasehold improvement property, the regulations define those improvements specified in section 168(k)(3)(B) that are not considered as qualified leasehold improvement property.

The regulations also provide that qualified property or 50-percent bonus depreciation property does not include: (1) property excluded from the application of section 168 as a result of section 168(f); (2) property that is required to be depreciated

under the ADS; (3) any class of property for which the taxpayer elects not to deduct the 30-percent or 50-percent additional first year depreciation; or (4) qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c).

Property is required to be depreciated under the ADS if the property is described under section 168(g)(1)(A) through (D) or if other provisions of the Code require depreciation for the property to be determined under the ADS (for example, section 263A(e)(2)(A) or section 280F(b)(1)). Thus, MACRS property for which the taxpayer makes an election under section 168(g)(7) to depreciate the property under the ADS is eligible for the additional first year depreciation deduction (assuming all other requirements are met).

With respect to the election out of the additional first year depreciation deduction, a taxpayer may elect out of the 30-percent additional first year depreciation deduction for any class of qualified property. For any class of 50-percent bonus depreciation property, a taxpayer may elect either to deduct the 30-percent, instead of the 50-percent, additional first year depreciation deduction or to deduct no additional first year depreciation deduction. The regulations provide the rules for making these elections and also define what is a class of property for purposes of the elections.

Original Use

Pursuant to section 168(k)(2)(A)(ii), the regulations provide that qualified property is property the original use of which commences with the taxpayer after September 10, 2001. Further, pursuant to section 168(k)(4)(B)(i), the regulations provide that 50-percent bonus depreciation property is property the original use of which commences

with the taxpayer after May 5, 2003. The regulations provide that the original use generally means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Thus, new property initially used by a taxpayer for personal use and then subsequently converted by the taxpayer for use in its trade or business satisfies the original use requirement. However, new property acquired by a taxpayer for personal use and then subsequently acquired by a different taxpayer for use in its trade or business does not satisfy the original use requirement.

Likewise, additional capital expenditures incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer satisfies the original use requirement. However, the cost of reconditioned or rebuilt property acquired by the taxpayer does not satisfy the original use requirement. The question of whether property is reconditioned or rebuilt property is a question of fact. The regulations provide a safe harbor that property containing used parts will not be treated as reconditioned or rebuilt if the cost of the used parts is not more than 20 percent of the total cost of the property. See Rev. Rul. 68-111 (1968-1 C.B. 29).

The regulations also provide special rules for certain sale-leaseback transactions and syndication transactions. If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a person and the property is involved in a sale-leaseback transaction described in section 168(k)(2)(D)(ii), the taxpayer-lessor is considered the original user of the property. Likewise, if qualified property is originally placed in service

by a lessor after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service by a lessor after May 5, 2003, and is sold by the lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor, and the user of the property does not change during this three-month period, the purchaser of the property in the last sale is considered the original user of the property.

The regulations also provide that if in the ordinary course of its business a taxpayer sells fractional interests in qualified property or 50-percent bonus depreciation property to unrelated third parties, each first fractional owner of the property is considered as the original user of its proportionate share of the property. Furthermore, if a taxpayer uses the qualified property or the 50-percent bonus depreciation property before all of the fractional interests are sold and the property continues to be held primarily for sale by the taxpayer, the original use of any fractional interest sold to an unrelated third party subsequent to the taxpayer's use begins with the first purchaser of that interest.

Acquisition of Property

Pursuant to section 168(k)(2)(A)(iii), the regulations provide that qualified property is property: (1) acquired by the taxpayer after September 10, 2001, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before September 11, 2001; or (2) acquired by the taxpayer pursuant to a written binding contract that was entered into after September 10, 2001, and before January 1, 2005. Further, pursuant to section 168(k)(4)(B)(ii), the regulations provide

that 50-percent bonus depreciation property is property acquired by the taxpayer after May 5, 2003, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before May 6, 2003.

The regulations define a binding contract as any contract that is enforceable under State law against the taxpayer or a predecessor, and does not limit damages to a specified amount. However, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount. Further, the fact that there will be little or no damages because the contract price does not significantly differ from the fair market value will not be taken into account in determining whether a contract limits damages.

The regulations also provide that a contract is binding even if the contract is subject to a condition, as long as the condition is not within the control of either one of the parties or a predecessor. Further, an option to either acquire or sell property is not treated as a binding contract.

The regulations also provide that a binding contract does not include a supply agreement or similar agreement, if the amount and design specifications of the property to be purchased have not been specified. In this case, the contract is not treated as a binding contract until both the amount and design specifications are specified.

With respect to self-constructed property, the regulations provide that the property acquisition requirement is met if a taxpayer manufactures, constructs, or produces qualified property or 50-percent bonus depreciation property for its own use and such manufacturing, construction, or production began after, respectively,

September 10, 2001, or May 5, 2003, and before January 1, 2005. Further, property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into before the manufacture, construction, or production of the property begins is considered to be manufactured, constructed, or produced by the taxpayer.

The regulations also define when construction begins. Construction of qualified property or 50-percent bonus depreciation property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature has begun depends on the facts and circumstances. The regulations, however, provide a safe harbor that physical work of a significant nature has begun when the taxpayer incurs or pays more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities).

The regulations also provide rules for a contract to acquire, or for the manufacture, construction, or production of, a component of the larger self-constructed property. If a binding contract to acquire a component was in effect, or the manufacture, construction, or production of a component began, before September 11, 2001, for qualified property or before May 6, 2003, for 50-percent bonus depreciation property, the component does not qualify for the additional first year depreciation deduction. Similarly, if a binding contract to acquire a component was in effect, or the manufacture, construction, or production of a component began, before September 11, 2001, for qualified property or before May 6, 2003, for 50-percent bonus depreciation

property, but the manufacture, construction, or production of the larger self-constructed property began after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, the larger self-constructed property qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the component does not. Additionally, if the manufacture, construction, or production of the larger self-constructed property began before September 11, 2001, for qualified property or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any acquired or self-constructed component related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction. However, if the binding contract to acquire the component was entered into, or the manufacture, construction, or production of the component began, after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property begins after December 31, 2004, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

The regulations provide rules for when certain acquired or self-constructed property will not meet the acquisition date requirement (disqualified transactions). When the user of property as of the date on which the property was originally placed in service, or a related party to the user, acquired, or had a written binding contract in effect for the acquisition of, the property at any time before September 11, 2001, or

before May 6, 2003, as applicable, the property does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. Similarly, property manufactured, constructed, or produced for the taxpayer or a related party does not qualify for the 30-percent or 50-percent additional first year depreciation deduction if the manufacture, construction, or production began at any time before September 11, 2001, or before May 6, 2003, as applicable. For this purpose, persons are related if they have a relationship specified in section 267(b) or 707(b).

Placed-in-service Date

Pursuant to section 168(k)(2)(A)(iv) and 168(k)(4)(B)(iii), the regulations provide that qualified property or 50-percent bonus depreciation property is property that is placed in service by the taxpayer before January 1, 2005. However, the placed in service date of January 1, 2005, is extended for one year to January 1, 2006, for property described in section 168(k)(2)(B).

The regulations also provide special rules for sale-leaseback transactions and syndication transactions. If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a person and is involved in a sale-leaseback transaction described in section 168(k)(2)(D)(ii), the property is treated as originally placed in service by the taxpayer-lessor not earlier than the date on which the property is used by the lessee under the sale-leaseback. Likewise, if qualified property is originally placed in service by a lessor after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service by a lessor after May 5, 2003, and is sold by the

lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor, and the user of the property does not change during this three-month period, the property is treated as originally placed in service not earlier than the date of the last sale by the purchaser of the property in the last sale.

Special rules also are provided for certain nonrecognition transactions. In the case of a technical termination of a partnership under section 708(b)(1)(B), qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination is treated as originally placed in service by the new partnership on the date the qualified property or the 50-percent bonus depreciation property is contributed by the terminated partnership to the new partnership. Additionally, qualified property or 50-percent bonus depreciation property transferred in a "step-in-the-shoes" transaction described in section 168(i)(7) in the taxable year the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor is treated as originally placed in service on the date the transferor placed the qualified property or the 50-percent bonus depreciation property in service.

Liberty Zone Property

Generally, the requirements for determining the eligibility of property for the additional first year depreciation deduction for Liberty Zone property provided by section 1400L(b) are similar to the requirements for the 30-percent additional first year depreciation deduction for qualified property provided by section 168(k)(1). There are, however, some differences that are discussed below.

The regulations provide that Liberty Zone property includes the same property that is described as qualified property or 50-percent bonus depreciation property for purposes of section 168(k). In addition, Liberty Zone property includes nonresidential real property or residential rental property to the extent such property rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the terrorist attacks of September 11, 2001. Property is treated as replacing destroyed or condemned property if, as part of an integrated plan, the property replaces real property that is included in a continuous area that includes real property destroyed or condemned. Real property is considered to have been destroyed or condemned only if an entire building or structure was destroyed or condemned as a result of the terrorist attacks of September 11, 2001.

While Liberty Zone property includes the same property that is described as qualified property or 50-percent bonus depreciation property for purposes of section 168(k), only one additional first year depreciation deduction is allowable for the property. Thus, pursuant to section 1400L(b)(2)(C)(i), the regulations provide that if the 30-percent or 50-percent additional first year depreciation deduction under section 168(k) applies to the property, it is not Liberty Zone property.

Pursuant to section 1400L(b)(2)(A)(ii), property is Liberty Zone property if substantially all of the use of the property is in the Liberty Zone and the property is used in the active conduct of a taxpayer's trade or business in the Liberty Zone. The regulations provide that the term substantially all means 80 percent or more.

In addition to the application of the original use rules for qualified property, the

regulations provide that used property will satisfy the original use requirement for Liberty Zone property if the used property has not been previously used within the Liberty Zone.

Pursuant to section 1400L(b)(2)(A)(iv), the regulations provide that Liberty Zone property is property that is acquired by the taxpayer by purchase after September 10, 2001, but only if no written binding contract for the acquisition of the property was in effect before September 10, 2001. The term by purchase is defined in section 179(d) and §1.179-4(c). The regulations also provide that the binding contract rules and the disqualified transactions rules for qualified property apply to Liberty Zone property. The self-construction rules for qualified property also apply to self-constructed Liberty Zone property except that the requirement to begin the manufacture, construction, or production of the qualified property before January 1, 2005, does not apply to Liberty Zone property.

Finally, the regulations provide that Liberty Zone property generally must be acquired by a taxpayer after September 10, 2001, and placed in service by the taxpayer before January 1, 2007. However, qualifying nonresidential real property and residential rental property must be acquired by a taxpayer after September 10, 2001, and placed in service by the taxpayer before January 1, 2010.

Computation of Additional First Year Depreciation Deduction and Otherwise Allowable Depreciation

The allowable additional first year depreciation deduction for qualified property or Liberty Zone property is equal to 30 percent of the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the property. The allowable additional first year

depreciation deduction for 50-percent bonus depreciation property is equal to 50 percent of the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the property. For qualified property or 50-percent bonus depreciation property described in section 168(k)(2)(B) (property having a longer production period), the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the property is limited to the property's basis attributable to manufacture, construction, or production of the property before January 1, 2005.

The additional first year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. However, for alternative minimum tax purposes, the amount of the additional first year depreciation deduction is based on the unadjusted depreciable basis of the property for alternative minimum tax purposes. The amount of the additional first year depreciation deduction is not affected by a taxable year of less than 12 months for either regular or alternative minimum tax purposes.

Before determining the amount of depreciation otherwise allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property, the taxpayer must first reduce the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the property by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater (the remaining adjusted depreciable basis). Then, the remaining adjusted depreciable basis is depreciated using the applicable depreciation provisions of the Code for the property (that is, section 168 for MACRS property and section 167(f)(1) for computer software). This amount of depreciation is allowed for both regular tax and alternative minimum tax purposes, and is affected by a

taxable year of less than 12 months. However, for alternative minimum tax purposes, the amount of depreciation allowed is determined by calculating the remaining adjusted depreciable basis of the property for alternative minimum tax purposes and using the same depreciation method, recovery period, and convention that applies to the property for regular tax purposes. If a taxpayer uses the optional depreciation tables in Rev. Proc. 87-57 (1987-2 C.B. 687) to compute depreciation for qualified property, 50-percent bonus depreciation property, or Liberty Zone property that is MACRS property, the regulations also provide that the remaining adjusted depreciable basis of the property is the basis to which the annual depreciation rates in those tables apply.

Special Rules

The regulations also provide rules for the following situations: (1) qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year; (2) redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (3) recapture of additional first year depreciation for purposes of section 1245 and section 1250; (4) a certified pollution control facility that is qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (5) like-kind exchanges and involuntary conversions of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (6) a change in use of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (7) the computation of earnings and profits; (8) the increase in the limitation of the amount of depreciation for passenger automobiles; and (9) the step-up in basis due to a section 754 election.

With respect to qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year, the regulations provide that the additional first year depreciation deduction is not allowed. This rule is consistent with the general rule in §1.168(d)-1(b)(3)(ii) for MACRS property placed in service and disposed of in the same taxable year. However, as previously discussed, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a terminated partnership in the same taxable year in which a technical termination of the partnership occurs. In this case, the new partnership, and not the terminated partnership, claims the additional first year depreciation deduction. Similarly, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a transferor in the same taxable year in which the property is transferred in a step-in-the-shoes transaction described in section 168(i)(7). In this case, the additional first year depreciation deduction for the transferor's taxable year in which the property is placed in service is allocated between the transferor and the transferee on a monthly basis. The allocation shall be made in accordance with the rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee.

The regulations also provide rules for a redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property (for example, due to a contingent purchase price or a discharge of indebtedness). If the unadjusted depreciable basis of the property is redetermined by the date on which the

property must be last placed in service to meet the placed-in-service date requirement in section 168(k)(2)(A)(iv), 168(k)(4)(B)(iii), or 1400L(b)(2)(A)(v), the additional first year depreciation deduction allowable for the property is redetermined. If the redetermination of basis occurs after that date, the additional first year depreciation deduction is not redetermined. The regulations instruct taxpayers how to determine the depreciation adjustment for an increase or decrease in basis. If there is an increase in basis, the taxpayer claims the additional first year depreciation deduction attributable to the increase in the taxable year in which the increase occurs. If there is a decrease in basis, the taxpayer includes in its income the excess additional first year depreciation deduction attributable to the decrease in the taxable year in which the decrease occurs.

Because the additional first year depreciation deduction is not a ratable method of computing depreciation, the regulations provide that the additional first year depreciation deduction is not a straight line method for purposes of section 1250. Thus, the additional first year depreciation deduction is an accelerated depreciation method for purposes of determining recapture under section 1250. For purposes of section 1245, all depreciation deductions are subject to recapture.

With respect to a certified pollution control facility that is qualified property, 50-percent bonus depreciation property, or Liberty Zone property, the regulations provide that the additional first year depreciation deduction is allowable in the facility's placed in service year even if the taxpayer elects to amortize the basis of the facility under section 169 in the placed-in-service year. The regulations also amend the regulations under section 169 to provide that the amortizable basis under section 169 must be reduced by

the additional first year depreciation deduction allowed or allowable, whichever is greater, applicable to the facility.

With respect to MACRS property or computer software acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033, the regulations provide that the carryover basis and the excess basis, if any, of the acquired MACRS property or acquired computer software are eligible for the additional first year depreciation deduction if the acquired MACRS property or acquired computer software is qualified property, 50-percent bonus depreciation property, or Liberty Zone property. However, if qualified property, 50-percent bonus depreciation property, or Liberty Zone property is placed in service and then disposed of in an exchange or involuntary conversion in the same taxable year, the unadjusted depreciable basis of the exchanged or involuntarily converted property is not eligible for the additional first year depreciation deduction.

The regulations also provide rules when the use of qualified property, 50-percent bonus depreciation property, or Liberty Zone property changes in the hands of the same taxpayer during the placed-in-service year or a subsequent taxable year. The regulations provide that no additional first year depreciation deduction is allowed for qualified property, 50-percent bonus depreciation property, or Liberty Zone property converted to personal use in the placed-in-service year. However, property converted to business or income-producing use is eligible for the additional first year depreciation deduction in the taxable year the property is converted to business or income-producing use (assuming all the requirements are met). With respect to a change in the use of

depreciable property subsequent to the placed-in-service year, the regulations provide that the change in the use will not affect the determination of whether the property was eligible for the additional first year depreciation deduction in the taxable year the property was originally placed-in-service. Thus, if property is not qualified property in its placed-in-service year and a change in the use in a subsequent taxable year would result in the property being qualified property, no additional first year depreciation deduction is allowed for the property. Likewise, if property is qualified property in its placed-in-service year and a change in the use in a subsequent taxable year would result in the property no longer being qualified property, the additional first year depreciation deduction allowable for the property in its placed-in-service year is not redetermined.

Furthermore, the regulations provide that the additional first year depreciation deduction is not allowable for purposes of computing earnings and profits. Pursuant to section 168(k)(2)(E) and (4)(D), the regulations also provide the increase in the limitation under section 280F(a)(1) of the amount of depreciation for certain passenger automobiles that are qualified property or 50-percent bonus depreciation property. Finally, the regulations provide that any increase in basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property due to a section 754 election generally is not eligible for the additional first year depreciation deduction because any such increase in basis of property does not satisfy the original use requirement.

Special Analyses

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. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. 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 its impact on small business.

Drafting Information

The principal author of these regulations is Douglas H. Kim, Office of Associate Chief Counsel (Passthroughs and Special Industries). 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 * * *

Par. 2. Section 1.167(a)-14 is amended by:

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

2. Revising paragraph heading (e).

3. Adding paragraph (e)(3).

The additions and revisions read as follows:

§1.167(a)-14 Treatment of certain intangible property excluded from section 197.

* * * * *

(b) * * *

(1) In general. [Reserved]. For further guidance, see §1.167(a)-14T(b)(1).

* * * * *

(e) Effective dates * * *

(2) Change in method of accounting. [Reserved]. For further guidance, see §1.167(a)-14T(e)(2).

(3) Qualified property, 50-percent bonus depreciation property, qualified New York Liberty Zone property, or section 179 property. [Reserved]. For further guidance, see §1.167(a)-14T(e)(3).

Par. 3. Section 1.167(a)-14T is added to read as follows:

§1.167(a)-14T Treatment of certain intangible property excluded from section 197 (temporary).

(a) For further guidance, see §1.167(a)-14(a).

(b) Computer software--(1) In general. The amount of the deduction for computer software described in section 167(f)(1) and §1.197-2(c)(4) is determined by amortizing the cost or other basis of the computer software using the straight line

method described in §1.167(b)-1 (except that its salvage value is treated as zero) and an amortization period of 36 months beginning on the first day of the month that the computer software is placed in service. Before determining the amortization deduction allowable under this paragraph (b), the cost or other basis of computer software that is section 179 property, as defined in section 179(d)(1)(A)(ii), must be reduced for any portion of the basis the taxpayer properly elects to treat as an expense under section 179. In addition, the cost or other basis of computer software that is qualified property under section 168(k)(2) or §1.168(k)-1T, 50-percent bonus depreciation property under section 168(k)(4) or §1.168(k)-1T, or qualified New York Liberty Zone property under section 1400L(b) or §1.1400L(b)-1T, must be reduced by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, under section 168(k) or section 1400L(b) for the computer software. If costs for developing computer software that the taxpayer properly elects to defer under section 174(b) result in the development of property subject to the allowance for depreciation under section 167, the rules of this paragraph (b) will apply to the unrecovered costs. In addition, this paragraph (b) applies to the cost of separately acquired computer software if the cost to acquire the software is separately stated and the cost is required to be capitalized under section 263(a).

(b)(2) through (e)(1) For further guidance, see §1.167(a)-14(b)(2) through (e)(1).

(e)(2) Change in method of accounting. See §1.197-2(l)(4) for rules relating to changes in method of accounting for property to which §1.167(a)-14T applies. However, see §1.168(k)-1T(g)(4) or 1.1400L(b)-1T(g)(4) for rules relating to changes in

method of accounting for computer software to which the third sentence in §1.167(a)-14T(b)(1) applies.

(3) Qualified property, 50-percent bonus depreciation property, qualified New York Liberty Zone property, or section 179 property. This section also applies to computer software that is qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to computer software that is 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003. This section also applies to computer software that is section 179 property placed in service by a taxpayer in a taxable year beginning after 2002 and before 2006. This section expires on September 7, 2006.

Par. 4. Section 1.168(d)-1 is amended by:

1. Revising paragraph (b)(3)(ii).

2. Paragraph heading (d) is revised and the text of paragraph (d) is redesignated as paragraph (d)(1).

3. Adding paragraph (d)(2).

The additions and revisions read as follows:

§1.168(d)-1 Applicable conventions--half-year and mid-quarter conventions.

* * * * *

(b) * * *

(3) * * *

(ii) [Reserved]. For further guidance, see §1.168(d)-1T(b)(3)(ii).

* * * * *

(d) Effective dates--(1) In general. * * *

(2) Qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property. [Reserved]. For further guidance, see §1.168(d)-1T(d).

Par. 5. Section 1.168(d)-1T is added to read as follows:

§1.168(d)-1T Applicable conventions--half-year and mid-quarter conventions (temporary).

(a) through (b)(3)(i) For further guidance, see §1.168(d)-1(a) through (b)(3)(i).

(b)(3)(ii) The applicable convention, as determined under this section, applies to all depreciable property (except nonresidential real property, residential rental property, and any railroad grading or tunnel bore) placed in service during the taxable year, excluding property placed in service and disposed of in the same taxable year. No depreciation deduction is allowed for property placed in service and disposed of during the same taxable year. However, see §1.168(k)-1T(f)(1) for qualified property or 50-percent bonus depreciation property, and §1.1400L(b)-1T(f)(1) for qualified New York Liberty Zone property, that is placed in service in the same taxable year in which either a partnership is terminated as a result of a technical termination under section 708(b)(1)(B) or the property is transferred in a transaction described in section 168(i)(7).

(b)(3)(iii) through (d)(1) For further guidance, see §1.168(d)-1(b)(3)(iii) through (d)(1).

(d)(2) Qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property. This section also applies to qualified property under

section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003. This section expires on September 7, 2006.

Par. 6. Section 1.168(k)-0T is added to read as follows:

§1.168(k)-0T Table of contents (temporary).

This section lists the headings that appear in §1.168(k)-1T.

§1.168(k)-1T Additional first year depreciation deduction (temporary).
(a) Scope and definitions.
(1) Scope.
(2) Definitions.
(b) Qualified property or 50-percent bonus depreciation property.
(1) In general.
(2) Description of qualified property or 50-percent bonus depreciation property.
(i) In general.
(ii) Property not eligible for additional first year depreciation deduction.
(A) Property that is not qualified property.
(B) Property that is not 50-percent bonus depreciation property.
(3) Original use.
(i) In general.
(ii) Conversion to business or income-producing use.
(iii) Sale-leaseback and syndication transactions.
(A) Sale-leaseback transaction.
(B) Syndication transaction.
(C) Sale-leaseback transaction followed by a syndication transaction.
(iv) Fractional interests in property.
(v) Examples.
(4) Acquisition of property.
(i) In general.
(A) Qualified property.
(B) 50-percent bonus depreciation property.
(ii) Definition of binding contract.
(A) In general.
(B) Conditions.
(C) Options.
(D) Supply agreements.
(E) Components.

(iii) Self-constructed property.
(A) In general.
(B) When does construction begin.
(C) Components of self-constructed property.
(1) Acquired components.
(2) Self-constructed components.
(iv) Disqualified transactions.
(A) In general.
(B) Related party defined.
(v) Examples.
(5) Placed-in-service date.
(i) In general.
(ii) Sale-leaseback and syndication transactions.
(A) Sale-leaseback transaction.
(B) Syndication transaction.
(C) Sale-leaseback transaction followed by a syndication transaction.
(iii) Technical termination of a partnership.
(iv) Section 168(i)(7) transactions.
(c) Qualified leasehold improvement property.
(1) In general.
(2) Certain improvements not included.
(3) Definitions.
(d) Computation of depreciation deduction for qualified property or 50-percent bonus depreciation property.
(1) Additional first year depreciation deduction.
(i) In general.
(ii) Property having a longer production period.
(iii) Alternative minimum tax.
(2) Otherwise allowable depreciation deduction.
(i) In general.
(ii) Alternative minimum tax.
(3) Examples.
(e) Election not to deduct additional first year depreciation.
(1) In general.
(i) Qualified property.
(ii) 50-percent bonus depreciation property.
(2) Definition of class of property.
(3) Time and manner for making election.
(i) Time for making election.
(ii) Manner of making election.
(4) Special rules for 2000 or 2001 returns.
(5) Failure to make election.
(f) Special rules.
(1) Property placed in service and disposed of in the same taxable year.

(i) In general.
(ii) Technical termination of a partnership.
(iii) Section 168(i)(7) transactions.
(iv) Examples.
(2) Redetermination of basis.
(i) Increase in basis.
(ii) Decrease in basis.
(iii) Definition.
(iv) Examples.
(3) Section 1245 and 1250 depreciation recapture.
(4) Coordination with section 169.
(5) Like-kind exchanges and involuntary conversions.
(i) Scope.
(ii) Definitions.
(iii) Computation.
(A) In general.
(B) Year of disposition and year of replacement.
(iv) Sale-leasebacks.
(v) Examples.
(6) Change in use.
(i) Change in use of depreciable property.
(ii) Conversion to personal use.
(iii) Conversion to business or income-producing use.
(A) During the same taxable year.
(B) Subsequent to the acquisition year.
(iv) Depreciable property changes use subsequent to the placed-in-service year.
(v) Examples.
(7) Earnings and profits.
(8) Limitation of amount of depreciation for certain passenger automobiles.
(9) Section 754 election.
(g) Effective date.
(1) In general.
(2) Technical termination of a partnership or section 168(i)(7) transactions.
(3) Like-kind exchanges and involuntary conversions.
(4) Change in method of accounting.
(i) Special rules for 2000 or 2001 returns.
(ii) Like-kind exchanges and involuntary conversions.

Par. 7. Section 1.168(k)-1T is added to read as follows:

§1.168(k)-1T Additional first year depreciation deduction (temporary).

(a) Scope and definitions--(1) Scope. This section provides the rules for

determining the 30-percent additional first year depreciation deduction allowable under section 168(k)(1) for qualified property and the 50-percent additional first year depreciation deduction allowable under section 168(k)(4) for 50-percent bonus depreciation property.

(2) Definitions. For purposes of section 168(k) and this section, the following definitions apply:

(i) Depreciable property is property that is of a character subject to the allowance for depreciation as determined under section 167 and the regulations thereunder.

(ii) MACRS property is tangible, depreciable property that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143) and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.

(iii) Unadjusted depreciable basis is the basis of property for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations thereunder (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease,

see section 167(c)(2).

(iv) <u>Adjusted depreciable basis</u> is the unadjusted depreciable basis of the property, as defined in §1.168(k)-1T(a)(2)(iii), less the adjustments described in section 1016(a)(2) and (3).

(b) <u>Qualified property or 50-percent bonus depreciation property</u>--(1) <u>In general</u>. Qualified property or 50-percent bonus depreciation property is depreciable property that--

(i) Meets the requirements in §1.168(k)-1T(b)(2) (description of property);

(ii) Meets the requirements in §1.168(k)-1T(b)(3) (original use);

(iii) Meets the requirements in §1.168(k)-1T(b)(4) (acquisition of property); and

(iv) Meets the requirements in §1.168(k)-1T(b)(5) (placed-in-service date).

(2) <u>Description of qualified property or 50-percent bonus depreciation property</u>--(i) <u>In general</u>. Depreciable property will meet the requirements of this paragraph (b)(2) if the property is--

(A) MACRS property (as defined in §1.168(k)-1T(a)(2)(ii)) that has a recovery period of 20 years or less. For purposes of this paragraph (b)(2)(i)(A) and section 168(k)(2)(B)(i)(II) and 168(k)(4)(C), the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7);

(B) Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations thereunder;

(C) Water utility property as defined in section 168(e)(5) and depreciated under

section 168; or

(D) Qualified leasehold improvement property as defined in paragraph (c) of this section and depreciated under section 168.

(ii) Property not eligible for additional first year depreciation deduction--(A) Property that is not qualified property. For purposes of the 30-percent additional first year depreciation deduction, depreciable property will not meet the requirements of this paragraph (b)(2) if the property is--

(1) Described in section 168(f);

(2) Required to be depreciated under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A) through (D) or other provisions of the Internal Revenue Code (for example, property described in section 263A(e)(2)(A) or section 280F(b)(1));

(3) Included in any class of property for which the taxpayer elects not to deduct the 30-percent additional first year depreciation (for further guidance, see paragraph (e) of this section); or

(4) Qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2).

(B) Property that is not 50-percent bonus depreciation property. For purposes of the 50-percent additional first year depreciation deduction, depreciable property will not meet the requirements of this paragraph (b)(2) if the property is--

(1) Described in paragraph (b)(2)(ii)(A)(1), (2), or (4) of this section; or

(2) Included in any class of property for which the taxpayer elects the 30-percent,

instead of the 50-percent, additional first year depreciation deduction or elects not to deduct any additional first year depreciation (for further guidance, see paragraph (e) of this section).

(3) Original use--(i) In general. For purposes of the 30-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(3) if the original use of the property commences with the taxpayer after September 10, 2001. For purposes of the 50-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(3) if the original use of the property commences with the taxpayer after May 5, 2003. Except as provided in paragraph (b)(3)(iii) and (iv) of this section, original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Thus, additional capital expenditures incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer satisfies the original use requirement. However, the cost of reconditioned or rebuilt property acquired by the taxpayer does not satisfy the original use requirement. The question of whether property is reconditioned or rebuilt property is a question of fact. For purposes of this paragraph (b)(3)(i), property that contains used parts will not be treated as reconditioned or rebuilt if the cost of the used parts is not more than 20 percent of the total cost of the property.

(ii) Conversion to business or income-producing use. If a taxpayer initially acquires new property for personal use and subsequently uses the property in the taxpayer's trade or business or for the taxpayer's production of income, the taxpayer is

considered as the original user of the property. If a person initially acquires new property for personal use and a taxpayer subsequently acquires the property from the person for use in the taxpayer's trade or business or for the taxpayer's production of income, the taxpayer is not considered the original user of the property.

(iii) Sale-leaseback and syndication transactions--(A) Sale-leaseback transaction. If new property is originally placed in service by a person after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and is sold to a taxpayer and leased back to the person by the taxpayer within three months after the date the property was originally placed in service by the person, the taxpayer-lessor is considered the original user of the property.

(B) Syndication transaction. If new property is originally placed in service by a lessor (including by operation of paragraph (b)(5)(ii)(A) of this section) after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and is sold by the lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor, and the user of the property after the last sale during the three-month period remains the same as when the property was originally placed in service by the lessor, the purchaser of the property in the last sale during the three-month period is considered the original user of the property.

(C) Sale-leaseback transaction followed by a syndication transaction. If a sale-leaseback transaction that satisfies the requirements in paragraph (b)(3)(iii)(A) of this section is followed by a syndication transaction that satisfies the requirements in

paragraph (b)(3)(iii)(B) of this section, the original user of the property is determined in accordance with paragraph (b)(3)(iii)(B) of this section.

(iv) Fractional interests in property. If, in the ordinary course of its business, a taxpayer sells fractional interests in property to unrelated third parties, each first fractional owner of the property is considered as the original user of its proportionate share of the property. Furthermore, if the taxpayer uses the property before all of the fractional interests of the property are sold but the property continues to be held primarily for sale by the taxpayer, the original use of any fractional interest sold to an unrelated third party subsequent to the taxpayer's use of the property begins with the first purchaser of that fractional interest. For purposes of this paragraph (b)(3)(iv), persons are not related if they do not have a relationship described in section 267(b) or 707(b) and the regulations thereunder.

(v) Examples. The application of this paragraph (b)(3) is illustrated by the following examples:

Example 1. On August 1, 2002, A buys from B for $20,000 a machine that has been previously used by B in B's trade or business. On March 1, 2003, A makes a $5,000 capital expenditure to recondition the machine. The $20,000 purchase price does not qualify for the additional first year depreciation deduction because the original use requirement of this paragraph (b)(3) is not met. However, the $5,000 expenditure satisfies the original use requirement of this paragraph (b)(3) and, assuming all other requirements are met, qualifies for the 30-percent additional first year depreciation deduction, regardless of whether the $5,000 is added to the basis of the machine or is capitalized as a separate asset.

Example 2. C, an automobile dealer, uses some of its automobiles as demonstrators in order to show them to prospective customers. The automobiles that are used as demonstrators by C are held by C primarily for sale to customers in the ordinary course of its business. On September 1, 2002, D buys from C an automobile that was previously used as a demonstrator by C. D will use the automobile solely for business purposes. The use of the automobile by C as a demonstrator does not

constitute a "use" for purposes of the original use requirement and, therefore, D will be considered the original user of the automobile for purposes of this paragraph (b)(3). Assuming all other requirements are met, D's purchase price of the automobile qualifies for the 30-percent additional first year depreciation deduction for D, subject to any limitation under section 280F.

Example 3. On April 1, 2000, E acquires a horse to be used in E's thoroughbred racing business. On October 1, 2003, F buys the horse from E and will use the horse in F's horse breeding business. The use of the horse by E in its racing business prevents the original use of the horse from commencing with F. Thus, F's purchase price of the horse does not qualify for the additional first year depreciation deduction.

Example 4. In the ordinary course of its business, G sells fractional interests in its aircraft to unrelated parties. G holds out for sale eight equal fractional interests in an aircraft. On January 1, 2003, G sells five of the eight fractional interests in the aircraft to H, an unrelated party, and H begins to use its proportionate share of the aircraft immediately upon purchase. On June 1, 2003, G sells to I, an unrelated party to G and H, the remaining unsold 3/8 fractional interests in the aircraft. H is considered the original user as to its 5/8 fractional interest in the aircraft and I is considered the original user as to its 3/8 fractional interest in the aircraft. Thus, assuming all other requirements are met, H's purchase price for its 5/8 fractional interest in the aircraft qualifies for the 30-percent additional first year depreciation deduction and I's purchase price for its 3/8 fractional interest in the aircraft qualifies for the 50-percent additional first year depreciation deduction.

(4) Acquisition of property--(i) In general--(A) Qualified property. For purposes of the 30-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(4) if the property is--

(1) Acquired by the taxpayer after September 10, 2001, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before September 11, 2001; or

(2) Acquired by the taxpayer pursuant to a written binding contract that was entered into after September 10, 2001, and before January 1, 2005.

(B) 50-percent bonus depreciation property. For purposes of the 50-percent additional first year depreciation deduction, depreciable property will meet the

requirements of this paragraph (b)(4) if the property is acquired by the taxpayer after May 5, 2003, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before May 6, 2003.

(ii) Definition of binding contract--(A) In general. A contract is binding only if it is enforceable under State law against the taxpayer or a predecessor, and does not limit damages to a specified amount (for example, by use of a liquidated damages provision). For this purpose, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount. In determining whether a contract limits damages, the fact that there may be little or no damages because the contract price does not significantly differ from fair market value will not be taken into account. For example, if a taxpayer entered into an irrevocable written contract to purchase an asset for $100 and the contract contained no provision for liquidated damages, the contract is considered binding notwithstanding the fact that the asset had a fair market value of $99 and under local law the seller would only recover the difference in the event the purchaser failed to perform. If the contract provided for a full refund of the purchase price in lieu of any damages allowable by law in the event of breach or cancellation by the seller, the contract is not considered binding.

(B) Conditions. A contract is binding even if subject to a condition, as long as the condition is not within the control of either party or a predecessor. A contract will continue to be binding if the parties make insubstantial changes in its terms and conditions or because any term is to be determined by a standard beyond the control of

either party. A contract that imposes significant obligations on the taxpayer or a predecessor will be treated as binding notwithstanding the fact that insubstantial terms remain to be negotiated by the parties to the contract.

(C) Options. An option to either acquire or sell property is not a binding contract.

(D) Supply agreements. A binding contract does not include a supply or similar agreement if the amount and design specifications of the property to be purchased have not been specified. The contract will not be a binding contract for the property to be purchased until both the amount and the design specifications are specified. For example, if the provisions of a supply or similar agreement state the design specifications of, and the pricing for, the property to be purchased, a purchase order under the agreement for a specific number of assets is treated as a binding contract.

(E) Components. A binding contract to acquire one or more components of a larger property will not be treated as a binding contract to acquire the larger property. If a binding contract to acquire the component does not satisfy the requirements of this paragraph (b)(4), the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable.

(iii) Self-constructed property--(A) In general. If a taxpayer manufactures, constructs, or produces property for use by the taxpayer in its trade or business (or for its production of income), the acquisition rules in paragraph (b)(4)(i) of this section are treated as met for qualified property if the taxpayer begins manufacturing, constructing, or producing the property after September 10, 2001, and before January 1, 2005, and for 50-percent bonus depreciation property if the taxpayer begins manufacturing,

constructing, or producing the property after May 5, 2003, and before January 1, 2005. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in paragraph (b)(4)(ii) of this section) that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income) is considered to be manufactured, constructed, or produced by the taxpayer.

(B) When does construction begin. For purposes of paragraph (b)(4)(iii) of this section, construction of property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature begins depends on the facts and circumstances. For purposes of this paragraph (b)(4)(iii)(B), physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). For example, if a retail motor fuels outlet is to be constructed on-site, construction begins when physical work of a significant nature commences at the site; that is, when work begins on the excavation for footings, pouring the pads for the outlet, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings) does not constitute the beginning of

construction. However, if a retail motor fuels outlet is to be assembled on-site from modular units constructed off-site and delivered to the site where the outlet will be used, construction begins when physical work of a significant nature commences at the off-site location.

(C) Components of self-constructed property--(1) Acquired components. If a binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire a component does not satisfy the requirements of paragraph (b)(4)(i) of this section, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. A binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire one or more components of a larger self-constructed property will not preclude the larger self-constructed property from satisfying the acquisition rules in paragraph (b)(4)(iii)(A) of this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not satisfy the requirements of paragraph (b)(4)(i) of this section. If the manufacture, construction, or production of the larger self-constructed property begins before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any acquired components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. If a binding contract to acquire the component is

entered into after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

(2) Self-constructed components. If the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. However, if the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of paragraph (b)(4)(iii)(A) of this section, the larger self-constructed property qualifies for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met) even though the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. If the manufacture, construction, or production of the

larger self-constructed property began before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any self-constructed components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. If the manufacture, construction, or production of a component begins after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

(iv) Disqualified transactions--(A) In general. Property does not satisfy the requirements of this paragraph (b)(4) if the user of the property as of the date on which the property was originally placed in service (including by operation of paragraph (b)(5)(ii), (iii), and (iv) of this section), or a related party to the user, acquired, or had a written binding contract (as defined in paragraph (b)(4)(ii) of this section) in effect for the acquisition of, the property at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for 50-percent bonus depreciation property). In addition, property manufactured, constructed, or produced for the taxpayer or a related party does not satisfy the requirements of this paragraph (b)(4) if the manufacture, construction, or production of the property for the taxpayer or a related party began at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for

50-percent bonus depreciation property).

(B) Related party defined. For purposes of this paragraph (b)(4)(iv), persons are related if they have a relationship specified in section 267(b) or 707(b) and the regulations thereunder.

(v) Examples. The application of this paragraph (b)(4) is illustrated by the following examples:

Example 1. On September 1, 2001, J, a corporation, entered into a written agreement with K, a manufacturer, to purchase 20 new lamps for $100 each within the next two years. Although the agreement specifies the number of lamps to be purchased, the agreement does not specify the design of the lamps to be purchased. Accordingly, the agreement is not a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section.

Example 2. Same facts as Example 1. On December 1, 2001, J placed a purchase order with K to purchase 20 new model XPC5 lamps for $100 each for a total amount of $2,000. Because the agreement specifies the number of lamps to be purchased and the purchase order specifies the design of the lamps to be purchased, the purchase order placed by J with K on December 1, 2001, is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, the cost of the 20 lamps qualifies for the 30-percent additional first year depreciation deduction.

Example 3. Same facts as Example 1 except that the written agreement between J and K is to purchase 100 model XPC5 lamps for $100 each within the next two years. Because this agreement specifies the amount and design of the lamps to be purchased, the agreement is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, because the agreement was entered into before September 11, 2001, any lamp acquired by J under this contract does not qualify for the additional first year depreciation deduction.

Example 4. On September 1, 2001, L began constructing an electric generation power plant for its own use. On November 1, 2002, L ceases construction of the power plant prior to its completion. Between September 1, 2001, and November 1, 2002, L incurred $3,000,000 for the construction of the power plant. On May 6, 2003, L resumed construction of the power plant and completed its construction on August 31, 2003. Between May 6, 2003, and August 31, 2003, L incurred another $1,600,000 to complete the construction of the power plant and, on September 1, 2003, L placed the power plant in service. None of L's total expenditures of $4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A)

of this section, L began constructing the power plant before September 11, 2001.

Example 5. Same facts as Example 4 except that L began constructing the electric generation power plant for its own use on October 1, 2001. L's total expenditures of $4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A) of this section, L began constructing the power plant after September 10, 2001, and placed the power plant in service before January 1, 2005. Accordingly, the additional first year depreciation deduction for the power plant will be $1,380,000, computed as $4,600,000 multiplied by 30 percent.

Example 6. On August 1, 2001, M entered into a written binding contract to acquire a new turbine. The new turbine is a component part of a new electric generation power plant that is being constructed on M's behalf. The construction of the new electric generation power plant commenced in November 2001, and the new electric generation power plant was completed in November 2002. Because M entered into a written binding contract to acquire a component part (the new turbine) prior to September 11, 2001, pursuant to paragraph (b)(4)(iii)(C) of this section, the component part does not qualify for the additional first year depreciation deduction. However, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, the new plant constructed for M will qualify for the 30-percent additional first year depreciation deduction because construction of the new plant began after September 10, 2001, and before May 6, 2003. Accordingly, the unadjusted depreciable basis of the new plant that is eligible for the 30-percent additional first year depreciation deduction must not include the unadjusted depreciable basis of the new turbine.

Example 7. Same facts as Example 6 except that M entered into the written binding contract to acquire the new turbine on September 30, 2002, and construction of the new plant commenced on August 1, 2001. Because M began construction of the new plant prior to September 11, 2001, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, neither the new plant constructed for M nor the turbine will qualify for the additional first year depreciation deduction because self-construction of the new plant began prior to September 11, 2001.

Example 8. On September 1, 2001, N began constructing property for its own use. On October 1, 2001, N sold its rights to the property to O, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible for the additional first year depreciation deduction because N and O are related parties and construction of the property by N began prior to September 11, 2001.

Example 9. On September 1, 2001, P entered into a written binding contract to acquire property. On October 1, 2001, P sold its rights to the property to Q, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible for the additional first year depreciation deduction because P and Q are related parties and a written binding contract for the acquisition of the property was in

effect prior to September 11, 2001.

Example 10. Prior to September 11, 2001, R began constructing an electric generation power plant for its own use. On May 1, 2003, prior to the completion of the power plant, R transferred the rights to own and use this power plant to S, an unrelated party, for $6,000,000. Between May 6, 2003, and June 30, 2003, S, a calendar-year taxpayer, incurred another $1,200,000 to complete the construction of the power plant and, on August 1, 2003, S placed the power plant in service. Because R and S are not related parties, the transaction between R and S will not be a disqualified transaction pursuant to paragraph (b)(4)(iv) of this section. Accordingly, S's total expenditures of $7,200,000 for the power plant qualify for the additional first year depreciation deduction. S's additional first year depreciation deduction for the power plant will be $2,400,000, computed as $6,000,000 multiplied by 30 percent, plus $1,200,000 multiplied by 50 percent. The $6,000,000 portion of the total $7,200,000 unadjusted depreciable basis qualifies for the 30-percent additional first year depreciation deduction because that portion of the total unadjusted depreciable basis was acquired by S after September 10, 2001, and before May 6, 2003. However, because S began construction to complete the power plant after May 5, 2003, the $1,200,000 portion of the total $7,200,000 unadjusted depreciable basis qualifies for the 50-percent additional first year depreciation deduction.

Example 11. On September 1, 2001, T acquired and placed in service equipment. On October 15, 2001, T sells the equipment to U, an unrelated party, and leases the property back from U in a sale-leaseback transaction. Pursuant to paragraph (b)(4)(iv) of this section, the equipment does not qualify for the additional first year depreciation deduction because T, the user of the equipment, acquired the equipment prior to September 11, 2001.

(5) Placed-in-service date--(i) In general. Depreciable property will meet the requirements of this paragraph (b)(5) if the property is placed in service by the taxpayer before January 1, 2005, or, in the case of property described in section 168(k)(2)(B), is placed in service by the taxpayer before January 1, 2006.

(ii) Sale-leaseback and syndication transactions--(A) Sale-leaseback transaction. If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a person and sold to a taxpayer and leased back to the person by the taxpayer within

three months after the date the property was originally placed in service by the person, the property is treated as originally placed in service by the taxpayer-lessor not earlier than the date on which the property is used by the lessee under the leaseback.

(B) Syndication transaction. If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a lessor (including by operation of paragraph (b)(5)(ii)(A) of this section) and is sold by the lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor, and the user of the property after the last sale during this three-month period remains the same as when the property was originally placed in service by the lessor, the property is treated as originally placed in service by the purchaser of the property in the last sale during the three-month period but not earlier than the date of the last sale.

(C) Sale-leaseback transaction followed by a syndication transaction. If a sale-leaseback transaction that satisfies the requirements in paragraph (b)(5)(ii)(A) of this section is followed by a syndication transaction that satisfies the requirements in paragraph (b)(5)(ii)(B) of this section, the placed-in-service date of the property is determined in accordance with paragraph (b)(5)(ii)(B) of this section.

(iii) Technical termination of a partnership. For purposes of this paragraph (b)(5), in the case of a technical termination of a partnership under section 708(b)(1)(B), qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination is treated as originally placed in service by the new partnership on the date the qualified property or the 50-

percent bonus depreciation property is contributed by the terminated partnership to the new partnership.

(iv) Section 168(i)(7) transactions. For purposes of this paragraph (b)(5), if qualified property or 50-percent bonus depreciation property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor, the transferred property is treated as originally placed in service on the date the transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable. In the case of multiple transfers of qualified property or 50-percent bonus depreciation property in multiple transactions described in section 168(i)(7) in the same taxable year, the placed in service date of the transferred property is deemed to be the date on which the first transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable.

(c) Qualified leasehold improvement property--(1) In general. For purposes of section 168(k), qualified leasehold improvement property means any improvement, which is section 1250 property, to an interior portion of a building that is nonresidential real property if--

(i) The improvement is made under or pursuant to a lease by the lessee (or any sublessee) of the interior portion, or by the lessor of that interior portion;

(ii) The interior portion of the building is to be occupied exclusively by the lessee (or any sublessee) of that interior portion; and

(iii) The improvement is placed in service more than 3 years after the date the

building was first placed in service by any person.

(2) Certain improvements not included. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to:

(i) The enlargement of the building;

(ii) Any elevator or escalator;

(iii) Any structural component benefiting a common area; or

(iv) The internal structural framework of the building.

(3) Definitions. For purposes of this paragraph (c), the following definitions apply:

(i) Building has the same meaning as that term is defined in §1.48-1(e)(1).

(ii) Common area means any portion of a building that is equally available to all users of the building on the same basis for uses that are incidental to the primary use of the building. For example, stairways, hallways, lobbies, common seating areas, interior and exterior pedestrian walkways and pedestrian bridges, loading docks and areas, and rest rooms generally are treated as common areas if they are used by different lessees of a building.

(iii) Elevator and escalator have the same meanings as those terms are defined in §1.48-1(m)(2).

(iv) Enlargement has the same meaning as that term is defined in §1.48-12(c)(10).

(v) Internal structural framework has the same meaning as that term is defined in §1.48-12(b)(3)(i)(D)(iii).

(vi) Lease has the same meaning as that term is defined in section 168(h)(7). In

addition, a commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee. However, a lease between related persons is not considered a lease. For purposes of the preceding sentence, related persons are--

(A) Members of an affiliated group (as defined in section 1504 and the regulations thereunder); and

(B) Persons having a relationship described in section 267(b) and the regulations thereunder. For purposes of applying section 267(b), the language "80 percent or more" is used instead of "more than 50 percent."

(vii) Nonresidential real property has the same meaning as that term is defined in section 168(e)(2)(B).

(viii) Structural component has the same meaning as that term is defined in §1.48-1(e)(2).

(d) Computation of depreciation deduction for qualified property or 50-percent bonus depreciation property--(1) Additional first year depreciation deduction--(i) In general. Except as provided in paragraph (f)(5) of this section, the allowable additional first year depreciation deduction for qualified property is determined by multiplying the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the qualified property by 30 percent. Except as provided in paragraph (f)(5) of this section, the allowable additional first year depreciation deduction for 50-percent bonus depreciation property is determined by multiplying the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of the 50-percent bonus depreciation property by 50 percent.

Except as provided in paragraph (f)(1) of this section, the 30-percent or 50-percent additional first year depreciation deduction is not affected by a taxable year of less than 12 months. See paragraph (f)(1) of this section for qualified property or 50-percent bonus depreciation property placed in service and disposed of in the same taxable year. See paragraph (f)(5) of this section for qualified property or 50-percent bonus depreciation property acquired in a like-kind exchange or as a result of an involuntary conversion.

(ii) Property having a longer production period. For purposes of paragraph (d)(1)(i) of this section, the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of qualified property or 50-percent bonus depreciation property described in section 168(k)(2)(B) is limited to the property's unadjusted depreciable basis attributable to the property's manufacture, construction, or production after September 10, 2001 (for qualified property), or May 5, 2003 (for 50-percent bonus depreciation property), and before January 1, 2005.

(iii) Alternative minimum tax. The 30-percent or 50-percent additional first year depreciation deduction is allowed for alternative minimum tax purposes for the taxable year in which the qualified property or the 50-percent bonus depreciation property is placed in service by the taxpayer. The 30-percent or 50-percent additional first year depreciation deduction for alternative minimum tax purposes is based on the unadjusted depreciable basis of the property for alternative minimum tax purposes.

(2) Otherwise allowable depreciation deduction. Before determining the amount otherwise allowable as a depreciation deduction for the qualified property or the 50-

percent bonus depreciation property for the placed-in-service year and any subsequent taxable year, the taxpayer must determine the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property. This remaining adjusted depreciable basis is equal to the unadjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property reduced by the amount of the additional first year depreciation allowed or allowable, whichever is greater. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is then depreciated using the applicable depreciation provisions under the Internal Revenue Code for the qualified property or the 50-percent bonus depreciation property. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property that is MACRS property is also the basis to which the annual depreciation rates in the optional depreciation tables apply (for further guidance, see section 8 of Rev. Proc. 87-57 (1987-2 C.B. 687) and §601.601(d)(2)(ii)(b) of this chapter). The depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is affected by a taxable year of less than 12 months.

(ii) Alternative minimum tax. For alternative minimum tax purposes, the depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is based on the remaining adjusted depreciable basis for alternative minimum tax purposes. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciable property for alternative minimum tax purposes is depreciated using the

same depreciation method, recovery period (or useful life in the case of computer software), and convention that apply to the qualified property or the 50-percent bonus depreciation property for regular tax purposes.

(3) Examples. This paragraph (d) is illustrated by the following examples:

Example 1. On March 1, 2003, V, a calendar-year taxpayer, purchased and placed in service qualified property that costs $1 million and is 5-year property under section 168(e). V depreciates its 5-year property placed in service in 2003 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. For 2003, V is allowed a 30-percent additional first year depreciation deduction of $300,000 (the unadjusted depreciable basis of $1 million multiplied by .30). Next, V must reduce the unadjusted depreciable basis of $1 million by the additional first year depreciation deduction of $300,000 to determine the remaining adjusted depreciable basis of $700,000. Then, V's depreciation deduction allowable in 2003 for the remaining adjusted depreciable basis of $700,000 is $140,000 (the remaining adjusted depreciable basis of $700,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

Example 2. On June 1, 2003, W, a calendar-year taxpayer, purchased and placed in service 50-percent bonus depreciation property that costs $126,000. The property qualifies for the expensing election under section 179 and is 5-year property under section 168(e). W did not purchase any other section 179 property in 2003. W makes the election under section 179 for the property and depreciates its 5-year property placed in service in 2003 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. For 2003, W is first allowed a $100,000 deduction under section 179. Next, W must reduce the cost of $126,000 by the section 179 deduction of $100,000 to determine the unadjusted depreciable basis of $26,000. Then, for 2003, W is allowed a 50-percent additional first year depreciation deduction of $13,000 (the unadjusted depreciable basis of $26,000 multiplied by .50). Next, W must reduce the unadjusted depreciable basis of $26,000 by the additional first year depreciation deduction of $13,000 to determine the remaining adjusted depreciable basis of $13,000. Then, W's depreciation deduction allowable in 2003 for the remaining adjusted depreciable basis of $13,000 is $2,600 (the remaining adjusted depreciable basis of $13,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(e) Election not to deduct additional first year depreciation--(1) In general. If a taxpayer makes an election under this paragraph (e), the election applies to all qualified

property or 50-percent bonus depreciation property, as applicable, that is in the same class of property and placed in service in the same taxable year. The rules of this paragraph (e) apply to the following elections provided under section 168(k):

(i) Qualified property. A taxpayer may make an election not to deduct the 30-percent additional first year depreciation for any class of property that is qualified property placed in service during the taxable year. If this election is made, no additional first year depreciation deduction is allowable for the property placed in service during the taxable year in the class of property.

(ii) 50-percent bonus depreciation property. For any class of property that is 50-percent bonus depreciation property placed in service during the taxable year, a taxpayer may make an election--

(A) To deduct the 30-percent, instead of the 50-percent, additional first year depreciation. If this election is made, the allowable additional first year depreciation deduction is determined as though the class of property is qualified property under section 168(k)(2); or

(B) Not to deduct any additional first year depreciation. If this election is made, no additional first year depreciation deduction is allowable for the class of property.

(2) Definition of class of property. For purposes of this paragraph (e), the term class of property means:

(i) Except for the property described in paragraphs (e)(2)(ii) and (iv) of this section, each class of property described in section 168(e) (for example, 5-year property);

(ii) Water utility property as defined in section 168(e)(5) and depreciated under section 168;

(iii) Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations thereunder; or

(iv) Qualified leasehold improvement property as defined in paragraph (c) of this section and depreciated under section 168.

(3) Time and manner for making election--(i) Time for making election. Except as provided in paragraph (e)(4) of this section, any election specified in paragraph (e)(1) of this section must be made by the due date (including extensions) of the Federal tax return for the taxable year in which the qualified property or the 50-percent bonus depreciation property, as applicable, is placed in service by the taxpayer.

(ii) Manner of making election. Except as provided in paragraph (e)(4) of this section, any election specified in paragraph (e)(1) of this section must be made in the manner prescribed on Form 4562, "Depreciation and Amortization," and its instructions. The election is made separately by each person owning qualified property or 50-percent bonus depreciation property (for example, for each member of a consolidated group by the common parent of the group, by the partnership, or by the S corporation). If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(4) Special rules for 2000 or 2001 returns. For the election specified in paragraph (e)(1)(i) of this section for qualified property placed in service by the taxpayer during the taxable year that included September 11, 2001, the taxpayer should refer to

the guidance provided by the Internal Revenue Service for the time and manner of making this election on the 2000 or 2001 Federal tax return for the taxable year that included September 11, 2001 (for further guidance, see sections 3.03(3) and 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

(5) Failure to make election. If a taxpayer does not make the applicable election specified in paragraph (e)(1) of this section within the time and in the manner prescribed in paragraph (e)(3) or (4) of this section, the amount of depreciation allowable for that property under section 167(f)(1) or under section 168, as applicable, must be determined for the placed-in-service year and for all subsequent taxable years by taking into account the additional first year depreciation deduction. Thus, any election specified in paragraph (e)(1) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer=s method of accounting).

(f) Special rules--(1) Property placed in service and disposed of in the same taxable year--(i) In general. Except as provided in paragraphs (f)(1)(ii) and (iii) of this section, the additional first year depreciation deduction is not allowed for qualified property or 50-percent bonus depreciation property placed in service and disposed of during the same taxable year.

(ii) Technical termination of a partnership. In the case of a technical termination of a partnership under section 708(b)(1)(B), the additional first year depreciation deduction is allowable for any qualified property or 50-percent bonus depreciation

property placed in service by the terminated partnership during the taxable year of termination and contributed by the terminated partnership to the new partnership. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property shall not be claimed by the terminated partnership but instead shall be claimed by the new partnership for the new partnership's taxable year in which the qualified property or the 50-percent bonus depreciation property was contributed by the terminated partnership to the new partnership. However, if qualified property or 50-percent bonus depreciation property is both placed in service and contributed to a new partnership in a transaction described in section 708(b)(1)(B) by the terminated partnership during the taxable year of termination, and if such property is disposed of by the new partnership in the same taxable year the new partnership received such property from the terminated partnership, then no additional first year depreciation deduction is allowable to either partnership.

(iii) Section 168(i)(7) transactions. If any qualified property or 50-percent bonus depreciation property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor, the additional first year depreciation deduction is allowable for the qualified property or the 50-percent bonus depreciation property. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property for the transferor's taxable year in which the property is placed in service is allocated between the transferor and the transferee on a monthly basis. This allocation shall be made in accordance with the

rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee. However, if qualified property or 50-percent bonus depreciation property is both placed in service and transferred in a transaction described in section 168(i)(7) by the transferor during the same taxable year, and if such property is disposed of by the transferee (other than by a transaction described in section 168(i)(7)) during the same taxable year the transferee received such property from the transferor, then no additional first year depreciation deduction is allowable to either party.

(iv) Examples. The application of this paragraph (f)(1) is illustrated by the following examples:

Example 1. X and Y are equal partners in Partnership XY, a general partnership. On February 1, 2002, Partnership XY purchased and placed in service new equipment at a cost of $30,000. On March 1, 2002, X sells its entire 50 percent interest to Z in a transfer that terminates the partnership under section 708(b)(1)(B). As a result, terminated Partnership XY is deemed to have contributed the equipment to new Partnership XY. Pursuant to paragraph (f)(1)(ii) of this section, new Partnership XY, not terminated Partnership XY, is eligible to claim the 30-percent additional first year depreciation deduction allowable for the equipment for the taxable year 2002 (assuming all other requirements are met).

Example 2. On January 5, 2002, BB purchased and placed in service new office desks for a total amount of $8,000. On August 20, 2002, BB transferred the office desks to Partnership BC in a transaction described in section 721. BB and Partnership BC are calendar-year taxpayers. Because the transaction between BB and Partnership BC is a transaction described in section 168(i)(7), pursuant to paragraph (f)(1)(iii) of this section the 30-percent additional first year depreciation deduction allowable for the desks is allocated between BB and Partnership BC in accordance with the rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee. Accordingly, the 30-percent additional first year depreciation deduction allowable for the desks for 2002 of $2,400 (the unadjusted depreciable basis of $8,000 multiplied by .30) is allocated between BB and Partnership BC based on the number of months that BB and Partnership BC held the desks in service. Thus, because the desks were held in service by BB for 7 of 12 months, which includes the month in which BB placed the desks in service but does not include the month in which the desks were

transferred, BB is allocated $1,400 (7/12 x $2,400 additional first year depreciation deduction). Partnership BC is allocated $1,000, the remaining 5/12 of the $2,400 additional first year depreciation deduction allowable for the desks.

(2) Redetermination of basis. If the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of qualified property or 50-percent bonus depreciation property is redetermined (for example, due to contingent purchase price or discharge of indebtedness) by January 1, 2005 (or January 1, 2006, for property described in section 168(k)(2)(B)), the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property is redetermined as follows:

(i) Increase in basis. For the taxable year in which an increase in basis of qualified property or 50-percent bonus depreciation property occurs, the taxpayer shall claim an additional first year depreciation deduction for qualified property by multiplying the amount of the increase in basis for this property by 30 percent or, for 50-percent bonus depreciation property, by multiplying the amount of the increase in basis for this property by 50 percent. For purposes of this paragraph (f)(2)(i), the 30-percent additional first year depreciation deduction applies to the increase in basis if the underlying property is qualified property and the 50-percent additional first year depreciation deduction applies to the increase in basis if the underlying property is 50-percent bonus depreciation property. To determine the amount otherwise allowable as a depreciation deduction for the increase in basis of qualified property or 50-percent bonus depreciation property, the amount of the increase in basis of the qualified property or the 50-percent bonus depreciation property must be reduced by the additional first year depreciation deduction allowed or allowable, whichever is greater,

for the increase in basis and the remaining increase in basis of--

(A) Qualified property or 50-percent bonus depreciation property (except for computer software described in paragraph (b)(2)(i)(B) of this section) is depreciated over the recovery period of the qualified property or the 50-percent bonus depreciation property, as applicable, remaining as of the beginning of the taxable year in which the increase in basis occurs, and using the same depreciation method and convention applicable to the qualified property or 50-percent bonus depreciation property, as applicable, that applies for the taxable year in which the increase in basis occurs; and

(B) Computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is qualified property or 50-percent bonus depreciation property is depreciated ratably over the remainder of the 36-month period (the useful life under section 167(f)(1)) as of the beginning of the first day of the month in which the increase in basis occurs.

(ii) Decrease in basis. For the taxable year in which a decrease in basis of qualified property or 50-percent bonus depreciation property occurs, the taxpayer shall include in the taxpayer's income the excess additional first year depreciation deduction previously claimed for the qualified property or the 50-percent bonus depreciation property. This excess additional first year depreciation deduction for qualified property is determined by multiplying the amount of the decrease in basis for this property by 30 percent. The excess additional first year depreciation deduction for 50-percent bonus depreciation property is determined by multiplying the amount of the decrease in basis for this property by 50 percent. For purposes of this paragraph (f)(2)(ii), the 30-percent additional first year depreciation deduction applies to the decrease in basis if the

underlying property is qualified property and the 50-percent additional first year depreciation deduction applies to the decrease in basis if the underlying property is 50-percent bonus depreciation property. Also, if the taxpayer establishes by adequate records or other sufficient evidence that the taxpayer claimed less than the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property before the decrease in basis or if the taxpayer claimed more than the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property before the decrease in basis, the excess additional first year depreciation deduction is determined by multiplying the amount of the decrease in basis by the additional first year depreciation deduction percentage actually claimed by the taxpayer for the qualified property or the 50-percent bonus depreciation property, as applicable, before the decrease in basis. To determine the amount includible in the taxpayer's income for the excess depreciation previously claimed (other than the additional first year depreciation deduction) resulting from the decrease in basis of the qualified property or the 50-percent bonus depreciation property, the amount of the decrease in basis of the qualified property or the 50-percent bonus depreciation property must be adjusted by the excess additional first year depreciation deduction includible in the taxpayer's income (as determined under this paragraph) and the remaining decrease in basis of--

(A) Qualified property or 50-percent bonus depreciation property (except for computer software described in paragraph (b)(2)(i)(B) of this section) is included in the taxpayer's income over the recovery period of the qualified property or the 50-percent

bonus depreciation property, as applicable, remaining as of the beginning of the taxable year in which the decrease in basis occurs, and using the same depreciation method and convention of the qualified property or 50-percent bonus depreciation property, as applicable, that applies in the taxable year in which the decrease in basis occurs; and

(B) Computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is qualified property or 50-percent bonus depreciation property is included in the taxpayer's income ratably over the remainder of the 36-month period (the useful life under section 167(f)(1)) as of the beginning of the first day of the month in which the decrease in basis occurs.

(iii) Definition. For purposes of this paragraph (f)(2)--

(A) An increase in basis occurs in the taxable year an amount is taken into account under section 461; and

(B) A decrease in basis occurs in the taxable year an amount would be taken into account under section 451.

(iv) Examples. The application of this paragraph (f)(2) is illustrated by the following examples:

Example 1. (i) On May 15, 2002, CC, a cash-basis taxpayer, purchased and placed in service qualified property that is 5-year property at a cost of $200,000. In addition to the $200,000, CC agrees to pay the seller 25 percent of the gross profits from the operation of the property in 2002. On May 15, 2003, CC paid to the seller an additional $10,000. CC depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.

(ii) For 2002, CC is allowed a 30-percent additional first year depreciation deduction of $60,000 (the unadjusted depreciable basis of $200,000 multiplied by .30). In addition, CC's depreciation deduction for 2002 for the remaining adjusted depreciable

basis of $140,000 (the unadjusted depreciable basis of $200,000 reduced by the additional first year depreciation deduction of $60,000) is $28,000 (the remaining adjusted depreciable basis of $140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, CC's depreciation deduction for the remaining adjusted depreciable basis of $140,000 is $44,800 (the remaining adjusted depreciable basis of $140,000 multiplied by the annual depreciation rate of .32 for recovery year 2). In addition, pursuant to paragraph (f)(2)(i) of this section, CC is allowed an additional first year depreciation deduction for 2003 for the $10,000 increase in basis of the qualified property. Consequently, CC is allowed an additional first year depreciation deduction of $3,000 (the increase in basis of $10,000 multiplied by .30). Also, CC is allowed a depreciation deduction for 2003 attributable to the remaining increase in basis of $7,000 (the increase in basis of $10,000 reduced by the additional first year depreciation deduction of $3,000). The depreciation deduction allowable for 2003 attributable to the remaining increase in basis of $7,000 is $3,111 (the remaining increase in basis of $7,000 multiplied by .4444, which is equal to 1/remaining recovery period of 4.5 years at January 1, 2003, multiplied by 2). Accordingly, for 2003, CC's total depreciation deduction allowable for the qualified property is $50,911.

Example 2. (i) On May 15, 2002, DD purchased and placed in service qualified property that is 5-year property at a cost of $400,000. To purchase the property, DD borrowed $250,000 from Bank2. On May 15, 2003, Bank2 forgives $50,000 of the indebtedness. DD makes the election provided in section 108(b)(5) to apply any portion of the reduction under section 1017 to the basis of the depreciable property of the taxpayer. DD depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.

(ii) For 2002, DD is allowed a 30-percent additional first year depreciation deduction of $120,000 (the unadjusted depreciable basis of $400,000 multiplied by .30). In addition, DD's depreciation deduction allowable for 2002 for the remaining adjusted depreciable basis of $280,000 (the unadjusted depreciable basis of $400,000 reduced by the additional first year depreciation deduction of $120,000) is $56,000 (the remaining adjusted depreciable basis of $280,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, DD's deduction for the remaining adjusted depreciable basis of $280,000 is $89,600 (the remaining adjusted depreciable basis of $280,000 multiplied by the annual depreciation rate of .32 for recovery year 2). However, pursuant to paragraph (f)(2)(ii) of this section, DD must include in its taxable income for 2003 the excess depreciation previously claimed for the $50,000 decrease in basis of the qualified property. Consequently, DD must include in its taxable income for 2003 the

excess additional first year depreciation of $4,500 (the decrease in basis of $50,000 multiplied by .30). Also, DD must include in its taxable income for 2003 the excess depreciation attributable to the remaining decrease in basis of $45,500 (the decrease in basis of $50,000 reduced by the excess additional first year depreciation of $4,500). The amount includible in taxable income for 2003 for the remaining decrease in basis of $45,500 is $20,222 (the remaining decrease in basis of $45,500 multiplied by .4444, which is equal to 1/remaining recovery period of 4.5 years at January 1, 2003, multiplied by 2). Accordingly, for 2003, DD's total depreciation deduction allowable for the qualified property is $64,878 ($89,600 minus $4,500 minus $20,222).

(3) Section 1245 and 1250 depreciation recapture. For purposes of section 1245 and the regulations thereunder, the additional first year depreciation deduction is an amount allowed or allowable for depreciation. Further, for purposes of section 1250(b) and the regulations thereunder, the additional first year depreciation deduction is not a straight line method.

(4) Coordination with section 169. The additional first year depreciation deduction is allowable in the placed-in-service year of a certified pollution control facility (as defined in §1.169-2(a)) that is qualified property or 50-percent bonus depreciation property, even if the taxpayer makes the election to amortize the certified pollution control facility under section 169 and the regulations thereunder in the certified pollution control facility's placed-in-service year.

(5) Like-kind exchanges and involuntary conversions--(i) Scope. The rules of this paragraph (f)(5) apply to acquired MACRS property or acquired computer software that is eligible for the additional first year depreciation deduction under section 168(k) at the time of replacement provided the time of replacement is after September 10, 2001, and before January 1, 2005, or, in the case of acquired MACRS property or acquired computer software that is qualified property, or 50-percent bonus depreciation property,

described in section 168(k)(2)(B), the time of replacement is after September 10, 2001, and before January 1, 2006.

(ii) Definitions. For purposes of this paragraph (f)(5), the following definitions apply:

(A) Acquired MACRS property is MACRS property in the hands of the acquiring taxpayer that is acquired in a transaction described in section 1031(a), (b), or (c) for other MACRS property or that is acquired in connection with an involuntary conversion of other MACRS property in a transaction to which section 1033 applies.

(B) Exchanged or involuntarily converted MACRS property is MACRS property that is transferred by the taxpayer in a transaction described in section 1031(a), (b), or (c), or that is converted as a result of an involuntary conversion to which section 1033 applies.

(C) Acquired computer software is computer software (as defined in paragraph (b)(2)(i)(B) of this section) in the hands of the acquiring taxpayer that is acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033.

(D) Exchanged or involuntarily converted computer software is computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is transferred by the taxpayer in a like-kind exchange under section 1031 or that is converted as a result of an involuntary conversion under section 1033.

(E) Time of disposition is when the disposition of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable, takes place.

(F) Time of replacement is the later of:

(1) when the property received in the exchange or involuntary conversion is placed in service; or

(2) the time of disposition of involuntarily converted property.

(G) Carryover basis is the lesser of:

(1) the basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder; or

(2) the adjusted depreciable basis of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable.

(H) Excess basis is any excess of the basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder, over the carryover basis as determined under paragraph (f)(5)(ii)(G) of this section.

(I) Remaining carryover basis is the carryover basis as determined under paragraph (f)(5)(ii)(G) of this section reduced by--

(1) The percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income); and

(2) Any adjustments to basis provided by other provisions of the Code and the regulations thereunder (including section 1016(a)(2) and (3)) for periods prior to the disposition of the exchanged or involuntarily converted property.

(J) Remaining excess basis is the excess basis as determined under paragraph (f)(5)(ii)(H) of this section reduced by--

(1) The percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income);

(2) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179; and

(3) Any adjustments to basis provided by other provisions of the Code and the regulations thereunder.

(iii) Computation--(A) In general. Assuming all other requirements are met, the remaining carryover basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the acquired MACRS property or the acquired computer software, as applicable, are eligible for the additional first year depreciation deduction. The 30-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after September 10, 2001, and before May 6, 2003, or if the taxpayer made the election provided in paragraph (e)(1)(ii)(A) of this section. The 50-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer

software if the time of replacement is after May 5, 2003, and before January 1, 2005, or before January 1, 2006, for 50-percent bonus depreciation property described in section 168(k)(2)(B). The additional first year depreciation deduction is computed separately for the remaining carryover basis and the remaining excess basis. Rules similar to the rules provided in paragraph (d) of this section apply to property described in section 168(k)(2)(B) and for alternative minimum tax purposes.

(B) Year of disposition and year of replacement. The additional first year depreciation deduction is allowable for the acquired MACRS property or acquired computer software in the year of replacement. However, the additional first year depreciation deduction is not allowable for the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software if the MACRS property or computer software, as applicable, is placed in service and disposed of in an exchange or involuntary conversion in the same taxable year.

(iv) Sale-leaseback transaction. For purposes of this paragraph (f)(5), if MACRS property or computer software is sold to a taxpayer and leased back to a person by the taxpayer within three months after the time of disposition of the MACRS property or computer software, as applicable, the time of replacement for this MACRS property or computer software, as applicable, shall not be earlier than the date on which the MACRS property or computer software, as applicable, is used by the lessee under the leaseback.

(v) Examples. The application of this paragraph (f)(5) is illustrated by the following examples:

Example 1. (i) In December 2002, EE, a calendar-year corporation, acquired for $200,000 and placed in service Canopy V1, a gas station canopy. Canopy V1 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). EE depreciated Canopy V1 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. EE elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. On January 1, 2003, Canopy V1 was destroyed in a fire and was no longer usable in EE's business. On June 1, 2003, in a transaction described in section 1033(a)(2), EE acquired and placed in service Canopy W1 with all of the $160,000 of insurance proceeds EE received due to the loss of Canopy V1. Canopy W1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e).

(ii) For 2002, EE is allowed a 30-percent additional first year depreciation deduction of $60,000 for Canopy V1 (the unadjusted depreciable basis of $200,000 multiplied by .30), and a regular MACRS depreciation deduction of $28,000 for Canopy V1 (the remaining adjusted depreciable basis of $140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals $56,000 (.50 of Canopy W1's remaining carryover basis of $112,000 (Canopy V1's remaining adjusted depreciable basis of $140,000 minus 2002 regular MACRS depreciation deduction of $28,000).

Example 2. (i) Same facts as in Example 1, except EE elected not to deduct the additional first year depreciation for 5-year property placed in service in 2002. EE deducted the additional first year depreciation for 5-year property placed in service in 2003.

(ii) For 2002, EE is allowed a regular MACRS depreciation deduction of $40,000 for Canopy V1 (the unadjusted depreciable basis of $200,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals $80,000 (.50 of Canopy W1's remaining carryover basis of $160,000 (Canopy V1's unadjusted depreciable basis of $200,000 minus 2002 regular MACRS depreciation deduction of $40,000) .

Example 3. (i) In December 2001, FF, a calendar year corporation, acquired for $10,000 and placed in service Computer X2. Computer X2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). FF depreciated Computer X2 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. FF elected to use the optional depreciation tables to compute the

depreciation allowance for Computer X2. On January 1, 2002, FF acquired Computer Y2 by exchanging Computer X2 and $1,000 cash in a transaction described in section 1031(a). Computer Y2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e).

(ii) For 2001, FF is allowed a 30-percent additional first year depreciation deduction of $3,000 for Computer X2 (unadjusted basis of $10,000 multiplied by .30), and a regular MACRS depreciation deduction of $1,400 for Computer X2 (the remaining adjusted depreciable basis of $7,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Computer Y2 is allowable for the remaining carryover basis of $5,600 (Computer X2's unadjusted depreciable basis of $10,000 minus additional first year depreciation deduction allowable of $3,000 minus 2001 regular MACRS depreciation deduction of $1,400) and for the remaining excess basis of $1,000 (cash paid for Computer Y2). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis equals $1,680 ($5,600 multiplied by .30) and for the remaining excess basis equals $300 ($1,000 multiplied by .30), which totals $1,980.

Example 4. (i) In September 2002, GG, a June 30 year-end corporation, acquired for $20,000 and placed in service Equipment X3. Equipment X3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). GG depreciated Equipment X3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment X3. In December 2002, GG acquired Equipment Y3 by exchanging Equipment X3 and $5,000 cash in a transaction described in section 1031(a). Equipment Y3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e).

(ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to §1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3.

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Equipment Y3 is allowable for the remaining carryover basis of $20,000 (Equipment X3's unadjusted depreciable basis of $20,000) and for the remaining excess basis of $5,000 (cash paid for Equipment Y3). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis equals $6,000 ($20,000 multiplied by .30) and for the remaining excess basis equals $1,500 ($5,000 multiplied by .30), which totals $7,500.

Example 5. (i) Same facts as in Example 4. GG depreciated Equipment Y3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment Y3. On July 1, 2003, GG acquired Equipment Z1 by exchanging Equipment Y3 in a transaction described in section 1031(a). Equipment Z1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e).

(ii) For the taxable year ending June 30, 2003, the regular MACRS depreciation deduction allowable for the remaining carryover basis of Equipment Y3 is $2,800 (the remaining carryover basis of $14,000 multiplied by the annual depreciation rate of .20 for recovery year 1) and for the remaining excess basis of Equipment Y3 is $700 (the remaining excess basis of $3,500 multiplied by the annual depreciation rate of .20 for recovery year 1), which totals $3,500.

(iii) For the taxable year ending June 30, 2004, pursuant to paragraph (f)(5)(iii)(A) of this section, the 50-percent additional first year depreciation deduction allowable for Equipment Z1 is $7,000 (.50 of Equipment Z1's remaining carryover basis of $14,000 (Equipment Y3's total unadjusted depreciable basis of $25,000 minus the total additional first year depreciation deduction of $7,500 minus the total regular MACRS depreciation deduction of $3,500).

(6) Change in use--(i) Change in use of depreciable property. The determination of whether the use of depreciable property changes is made in accordance with section 168(i)(5) and regulations thereunder.

(ii) Conversion to personal use. If qualified property or 50-percent bonus depreciation property is converted from business or income-producing use to personal use in the same taxable year in which the property is placed in service by a taxpayer, the additional first year depreciation deduction is not allowable for the property.

(iii) Conversion to business or income-producing use--(A) During the same taxable year. If, during the same taxable year, property is acquired by a taxpayer for personal use and is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for

the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.

(B) Subsequent to the acquisition year. If property is acquired by a taxpayer for personal use and, during a subsequent taxable year, is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). For purposes of paragraphs (b)(4) and (5) of this section, the property must be acquired by the taxpayer for personal use after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and converted by the taxpayer from personal use to business or income-producing use by January 1, 2005. See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.

(iv) Depreciable property changes use subsequent to the placed-in-service year--(A) If the use of qualified property or 50-percent bonus depreciation property changes in the hands of the same taxpayer subsequent to the taxable year the qualified property or the 50-percent bonus depreciation property, as applicable, is placed in service and, as a result of the change in use, the property is no longer qualified property or 50-percent bonus depreciation property, as applicable, the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation

property, as applicable, is not redetermined.

(B) If depreciable property is not qualified property or 50-percent bonus depreciation property in the taxable year the property is placed in service by the taxpayer, the additional first year depreciation deduction is not allowable for the property even if a change in the use of the property subsequent to the taxable year the property is placed in service results in the property being qualified property or 50-percent bonus depreciation property in the taxable year of the change in use.

(v) Examples. The application of this paragraph (f)(6) is illustrated by the following examples:

Example 1. (i) On January 1, 2002, HH, a calendar year corporation, purchased and placed in service several new computers at a total cost of $100,000. HH used these computers within the United States for 3 months in 2002 and then moved and used the computers outside the United States for the remainder of 2002. On January 1, 2003, HH permanently returns the computers to the United States for use in its business.

(ii) For 2002, the computers are considered as used predominantly outside the United States in 2002 pursuant to §1.48-1(g)(1)(i). As a result, the computers are required to be depreciated under the alternative depreciation system of section 168(g). Pursuant to paragraph (b)(2)(ii)(A)(2) of this section, the computers are not qualified property in 2002, the placed-in-service year. Thus, pursuant to (f)(6)(iv)(B) of this section, no additional first year depreciation deduction is allowed for these computers, regardless of the fact that the computers are permanently returned to the United States in 2003.

Example 2. (i) On February 8, 2002, II, a calendar year corporation, purchased and placed in service new equipment at a cost of $1,000,000 for use in its California plant. The equipment is 5-year property under section 168(e) and is qualified property under section 168(k). II depreciates its 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. On June 4, 2003, due to changes in II's business circumstances, II permanently moves the equipment to its plant in Mexico.

(ii) For 2002, II is allowed a 30-percent additional first year depreciation

deduction of $300,000 (the adjusted depreciable basis of $1,000,000 multiplied by .30). In addition, II's depreciation deduction allowable in 2002 for the remaining adjusted depreciable basis of $700,000 (the unadjusted depreciable basis of $1,000,000 reduced by the additional first year depreciation deduction of $300,000) is $140,000 (the remaining adjusted depreciable basis of $700,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, the equipment is considered as used predominantly outside the United States pursuant to §1.48-1(g)(1)(i). As a result of this change in use, the adjusted depreciable basis of $560,000 for the equipment is required to be depreciated under the alternative depreciation system of section 168(g) beginning in 2003. However, the additional first year depreciation deduction of $300,000 allowed for the equipment in 2002 is not redetermined.

(7) Earnings and profits. The additional first year depreciation deduction is not allowable for purposes of computing earnings and profits.

(8) Limitation of amount of depreciation for certain passenger automobiles. For a passenger automobile as defined in section 280F(d)(5), the limitation under section 280F(a)(1)(A)(i) is increased by--

(i) $4,600 for qualified property acquired by a taxpayer after September 10, 2001, and before May 6, 2003; and

(ii) $7,650 for qualified property or 50-percent bonus depreciation property acquired by a taxpayer after May 5, 2003.

(9) Section 754 election. In general, for purposes of section 168(k) any increase in basis of qualified property or 50-percent bonus depreciation property due to a section 754 election is not eligible for the additional first year depreciation deduction. However, if qualified property or 50-percent bonus depreciation property is placed in service by a partnership in the taxable year the partnership terminates under section 708(b)(1)(B), any increase in basis of the qualified property or the 50-percent bonus depreciation

property due to a section 754 election is eligible for the additional first year depreciation deduction.

(g) Effective date--(1) In general. Except as provided in paragraphs (g)(2) and (3) of this section, this section applies to qualified property under section 168(k)(2) acquired by a taxpayer after September 10, 2001, and to 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003. This section expires on September 7, 2006.

(2) Technical termination of a partnership or section 168(i)(7) transactions. If qualified property or 50 percent bonus depreciation property is transferred in a technical termination of a partnership under section 708(b)(1)(B) or in a transaction described in section 168(i)(7) for a taxable year ending on or before September 8, 2003, and the additional first year depreciation deduction allowable for the property was not determined in accordance with paragraph (f)(1)(ii) or (iii) of this section, as applicable, the Internal Revenue Service will allow any reasonable method of determining the additional first year depreciation deduction allowable for the property in the year of the transaction that is consistently applied to the property by all parties to the transaction.

(3) Like-kind exchanges and involuntary conversions. If a taxpayer did not claim on a federal tax return for a taxable year ending on or before September 8, 2003, the additional first year depreciation deduction for the remaining carryover basis of qualified property or 50-percent bonus depreciation property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not to deduct the additional first year depreciation

deduction for the class of property applicable to the remaining carryover basis, the Internal Revenue Service will treat the taxpayer's method of not claiming the additional first year depreciation deduction for the remaining carryover basis as a permissible method of accounting and will treat the amount of the additional first year depreciation deduction allowable for the remaining carryover basis as being equal to zero, provided the taxpayer does not claim the additional first year depreciation deduction for the remaining carryover basis in accordance with paragraph (g)(4)(ii) of this section.

(4) Change in method of accounting--(i) Special rules for 2000 or 2001 returns. If a taxpayer did not claim on the Federal tax return for the taxable year that included September 11, 2001, any additional first year depreciation deduction for a class of property that is qualified property and did not make an election not to deduct the additional first year depreciation deduction for that class of property, the taxpayer should refer to the guidance provided by the Internal Revenue Service for the time and manner of claiming the additional first year depreciation deduction for the class of property (for further guidance, see section 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

(ii) Like-kind exchanges and involuntary conversions. If a taxpayer did not claim on a federal tax return for any taxable year ending on or before September 8, 2003, the additional first year depreciation deduction allowable for the remaining carryover basis of qualified property or 50-percent bonus depreciation property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not to deduct the additional first year

depreciation deduction for the class of property applicable to the remaining carryover basis, the taxpayer may claim the additional first year depreciation deduction allowable for the remaining carryover basis in accordance with paragraph (f)(5) of this section either:

(A) by filing an amended return (or a qualified amended return, if applicable (for further guidance, see Rev. Proc. 94-69 (1994-2 C.B. 804) and §601.601(d)(2)(ii)(b) of this chapter)) on or before December 31, 2003, for the year of replacement and any affected subsequent taxable year; or,

(B) by following the applicable administrative procedures issued under §1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002-9 (2002-1 C.B. 327) and §601.601(d)(2)(ii)(b) of this chapter).

Par. 8. Section 1.169-3 is amended by:

1. Revising paragraphs (a) and (b)(2).
2. Adding paragraph (g).

The additions and revisions read as follows:

§1.169-3 Amortizable basis.

* * * * *

(a) [Reserved]. For further guidance, see §1.169-3T(a).

* * * * *

(b) * * *

(2) [Reserved]. For further guidance, see §1.169-3T(b)(2).

* * * * *

(g) Effective date for qualified property, 50-percent bonus depreciation property, and qualified New York Liberty Zone property. [Reserved]. For further guidance, see §1.169-3T(g).

Par. 9. Section 1.169-3T is added to read as follows:

§1.169-3T Amortizable basis (temporary).

(a) In general. The amortizable basis of a certified pollution control facility for the purpose of computing the amortization deduction under section 169 is the adjusted basis of the facility for purposes of determining gain (see part II (section 1011 and following), subchapter O, chapter 1 of the Internal Revenue Code), as modified by paragraphs (b), (c), and (d) of this section. The adjusted basis for purposes of determining gain (computed without regard to these modifications) of a facility that performs a function in addition to pollution control, or that is used in connection with more than one plant or other property, or both, is determined under §1.169-2(a)(3). For rules as to additions and improvements to such a facility, see paragraph (f) of this section. Before computing the amortization deduction allowable under section 169, the adjusted basis for purposes of determining gain for a facility that is placed in service by a taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or §1.168(k)-1T, 50-percent bonus depreciation property under section 168(k)(4) or §1.168(k)-1T, or qualified New York Liberty Zone property under section 1400L(b) or §1.1400L(b)-1T must be reduced by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, under section 168(k)

or section 1400L(b), as applicable, for the facility.

(b) Limitation on post-1968 construction, reconstruction, or erection. (1) For further guidance, see §1.169-3(b)(1).

(2) If the taxpayer elects to begin the 60-month amortization period with the first month of the taxable year succeeding the taxable year in which the facility is completed or acquired and a depreciation deduction is allowable under section 167 (including an additional first-year depreciation allowance under former section 179; for a facility that is acquired by the taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or §1.168(k)-1T or qualified New York Liberty Zone property under section 1400L(b) or §1.1400L(b)-1T, the additional first year depreciation deduction under section 168(k)(1) or 1400L(b), as applicable; and for a facility that is acquired by the taxpayer after May 5, 2003, and that is 50-percent bonus depreciation property under section 168(k)(4) or §1.168(k)-1T, the additional first year depreciation deduction under section 168(k)(4)) with respect to the facility for the taxable year in which it is completed or acquired, the amount determined under paragraph (b)(1) of this section shall be reduced by an amount equal to the amount of the depreciation deduction allowed or allowable, whichever is greater, multiplied by a fraction the numerator of which is the amount determined under paragraph (b)(1) of this section, and the denominator of which is the facility's total cost. The additional first-year allowance for depreciation under former section 179 will be allowable only for the taxable year in which the facility is completed or acquired and only if the taxpayer elects to begin the amortization deduction under section 169 with the taxable year succeeding the taxable

year in which such facility is completed or acquired. For a facility that is acquired by a taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or §1.168(k)-1T or qualified New York Liberty Zone property under section 1400L(b) or §1.1400L(b)-1T, see §1.168(k)-1T(f)(4) or §1.1400L(b)-1T(f)(4), as applicable, with respect to when the additional first year depreciation deduction under section 168(k)(1) or 1400L(b) is allowable. For a facility that is acquired by a taxpayer after May 5, 2003, and that is 50-percent bonus depreciation property under section 168(k)(4) or §1.168(k)-1T, see §1.168(k)-1T(f)(4) with respect to when the additional first year depreciation deduction under section 168(k)(4) is allowable.

(c) through (f) For further guidance, see §1.169-3(c) through (f).

(g) Effective date for qualified property, 50-percent bonus depreciation property, and qualified New York Liberty Zone property. This section applies to a certified pollution control facility. This section also applies to a certified pollution control facility that is qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to a certified pollution control facility that is 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003. This section expires on September 7, 2006.

Par. 10. Section 1.1400L(b)-1T is added to read as follows:

§1.1400L(b)-1T Additional first year depreciation deduction for qualified New York Liberty Zone property (temporary).

(a) Scope. This section provides the rules for determining the 30-percent

additional first year depreciation deduction allowable under section 1400L(b) for qualified New York Liberty Zone property.

(b) Definitions. For purposes of section 1400L(b) and this section, the definitions of the terms in §1.168(k)-1T(a)(2) apply and the following definitions also apply:

(1) Building and structural components have the same meanings as those terms are defined in §1.48-1(e).

(2) New York Liberty Zone is the area located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan in the City of New York, New York.

(3) Nonresidential real property and residential rental property have the same meanings as those terms are defined in section 168(e)(2).

(4) Real property is a building or its structural components, or other tangible real property except property described in section 1245(a)(3)(B) (relating to depreciable property used as an integral part of a specified activity or as a specified facility), section 1245(a)(3)(D) (relating to single purpose agricultural or horticultural structure), or section 1245(a)(3)(E) (relating to a storage facility used in connection with the distribution of petroleum or any primary product of petroleum).

(c) Qualified New York Liberty Zone property--(1) In general. Qualified New York Liberty Zone property is depreciable property that--

(i) Meets the requirements in §1.1400L(b)-1T(c)(2) (description of property);

(ii) Meets the requirements in §1.1400L(b)-1T(c)(3) (substantial use);

(iii) Meets the requirements in §1.1400L(b)-1T(c)(4) (original use);

(iv) Meets the requirements in §1.1400L(b)-1T(c)(5) (acquisition of property by purchase); and

(v) Meets the requirements in §1.1400L(b)-1T(c)(6) (placed-in-service date).

(2) Description of qualified New York Liberty Zone property--(i) In general. Depreciable property will meet the requirements of this paragraph (c)(2) if the property is--

(A) Described in §1.168(k)-1T(b)(2)(i); or

(B) Nonresidential real property or residential rental property depreciated under section 168, but only to the extent it rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the terrorist attacks of September 11, 2001. Property is treated as replacing destroyed or condemned property if, as part of an integrated plan, the property replaces real property that is included in a continuous area that includes real property destroyed or condemned. For purposes of this section, real property is considered as destroyed or condemned only if an entire building or structure was destroyed or condemned as a result of the terrorist attacks of September 11, 2001. Otherwise, the real property is considered damaged real property. For example, if certain structural components (for example, walls, floors, and plumbing fixtures) of a building are damaged or destroyed as a result of the terrorist attacks of September 11, 2001, but the building is not destroyed or condemned, then only costs related to replacing the damaged or destroyed structural components qualify under this paragraph (c)(2)(i)(B).

(ii) Property not eligible for additional first year depreciation deduction. Depreciable property will not meet the requirements of this paragraph (c)(2) if --

(A) Section 168(k) or §1.168(k)-1T applies to the property; or

(B) The property is described in section §1.168(k)-1T(b)(2)(ii).

(3) Substantial use. Depreciable property will meet the requirements of this paragraph (c)(3) if substantially all of the use of the property is in the New York Liberty Zone and is in the active conduct of a trade or business by the taxpayer in New York Liberty Zone. For purposes of this paragraph (c)(3), “substantially all” means 80 percent or more.

(4) Original use. Depreciable property will meet the requirements of this paragraph (c)(4) if the original use of the property commences with the taxpayer in the New York Liberty Zone after September 10, 2001. The original use rules in §1.168(k)-1T(b)(3) apply for purposes of this paragraph (c)(4). In addition, used property will satisfy the original use requirement in this paragraph (c)(4) so long as the property has not been previously used within the New York Liberty Zone.

(5) Acquisition of property by purchase--(i) In general. Depreciable property will meet the requirements of this paragraph (c)(5) if the property is acquired by the taxpayer by purchase (as defined in section 179(d) and §1.179-4(c)) after September 10, 2001, but only if no written binding contract for the acquisition of the property was in effect before September 11, 2001. For purposes of this paragraph (c)(5), the rules in §1.168(k)-1T(b)(4)(ii) (binding contract), the rules in §1.168(k)-1T(b)(4)(iii) (self-constructed property), and the rules in §1.168(k)-1T(b)(4)(iv) (disqualified transactions)

apply. For purposes of the preceding sentence, the rules in § 1.168(k)-1T(b)(4)(iii) shall be applied without regard to 'and before January 1, 2005.'

(ii) Exception for certain transactions. For purposes of this section, the new partnership of a transaction described in §1.168(k)-1T(f)(1)(ii) (technical termination of a partnership) or the transferee of a transaction described in §1.168(k)-1T(f)(1)(iii) (section 168(i)(7) transactions) is deemed to acquire the depreciable property by purchase.

(6) Placed-in-service date. Depreciable property will meet the requirements of this paragraph (c)(6) if the property is placed in service by the taxpayer on or before December 31, 2006. However, nonresidential real property and residential rental property described in paragraph (c)(2)(i)(B) of this section must be placed in service by the taxpayer on or before December 31, 2009. The rules in §1.168(k)-1T(b)(5)(ii) (relating to sale-leaseback and syndication transactions), the rules in §1.168(k)-1T(b)(5)(iii) (relating to a technical termination of a partnership under section 708(b)(1)(B)), and the rules in §1.168(k)-1T(b)(5)(iv) (relating to section 168(i)(7) transactions) apply for purposes of this paragraph (c)(6).

(d) Computation of depreciation deduction for qualified New York Liberty Zone property. The computation of the allowable additional first year depreciation deduction and the otherwise allowable depreciation deduction for qualified New York Liberty Zone property is made in accordance with the rules for qualified property in §1.168(k)-1T(d)(1)(i) and (2).

(e) Election not to deduct additional first year depreciation--(1) In general. A taxpayer may make an election not to deduct the 30-percent additional first year depreciation for any class of property that is qualified New York Liberty Zone property placed in service during the taxable year. If a taxpayer makes an election under this paragraph (e), the election applies to all qualified New York Liberty Zone property that is in the same class of property and placed in service in the same taxable year, and no additional first year depreciation deduction is allowable for the class of property.

(2) Definition of class of property. For purposes of this paragraph (e), the term class of property means--

(i) Except for the property described in paragraphs (e)(2)(ii), (iv), and (v) of this section, each class of property described in section 168(e) (for example, 5-year property);

(ii) Water utility property as defined in section 168(e)(5) and depreciated under section 168;

(iii) Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations thereunder;

(iv) Nonresidential real property as defined in paragraph (b)(3) of this section and as described in paragraph (c)(2)(B) of this section; or

(v) Residential rental property as defined in paragraph (b)(3) of this section and as described in paragraph (c)(2)(B) of this section

(3) Time and manner for making election--(i) Time for making election. Except as provided in paragraph (e)(4) of this section, the election specified in paragraph (e)(1) of

this section must be made by the due date (including extensions) of the federal tax return for the taxable year in which the qualified New York Liberty Zone property is placed in service by the taxpayer

(ii) Manner of making election. Except as provided in paragraph (e)(4) of this section, the election specified in paragraph (e)(1) of this section must be made in the manner prescribed on Form 4562, "Depreciation and Amortization," and its instructions. The election is made separately by each person owning qualified New York Liberty Zone property (for example, for each member of a consolidated group by the common parent of the group, by the partnership, or by the S corporation). If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(4) Special rules for 2000 or 2001 returns. For the election specified in paragraph (e)(1) of this section for qualified New York Liberty Zone property placed in service by the taxpayer during the taxable year that included September 11, 2001, the taxpayer should refer to the guidance provided by the Internal Revenue Service for the time and manner of making this election on the 2000 or 2001 federal tax return for the taxable year that included September 11, 2001 (for further guidance, see sections 3.03(3) and 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

(5) Failure to make election. If a taxpayer does not make the election specified in paragraph (e)(1) of this section within the time and in the manner prescribed in paragraph (e)(3) or (e)(4) of this section, the amount of depreciation allowable for that

property under section 167(f)(1) or under section 168, as applicable, must be determined for the placed-in-service year and for all subsequent taxable years by taking into account the additional first year depreciation deduction. Thus, the election specified in paragraph (e)(1) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer=s method of accounting).

(f) Special rules--(1) Property placed in service and disposed of in the same taxable year. Rules similar to those provided in §1.168(k)-1T(f)(1) apply for purposes of this paragraph (f)(1).

(2) Redetermination of basis. If the unadjusted depreciable basis (as defined in §1.168(k)-1T(a)(2)(iii)) of qualified New York Liberty Zone property is redetermined (for example, due to contingent purchase price or discharge of indebtedness) on or before December 31, 2006 (or on or before December 31, 2009, for nonresidential real property and residential rental property described in paragraph (c)(2)(i)(B) of this section), the additional first year depreciation deduction allowable for the qualified New York Liberty Zone property is redetermined in accordance with the rules provided in §1.168(k)-1T(f)(2).

(3) Section 1245 and 1250 depreciation recapture. The rules provided in §1.168(k)-1T(f)(3) apply for purposes of this paragraph (f)(3).

(4) Coordination with section 169. Rules similar to those provided in §1.168(k)-1T(f)(4) apply for purposes of this paragraph (f)(4).

(5) Like-kind exchanges and involuntary conversions. This paragraph (f)(5)

applies to acquired MACRS property (as defined in §1.168(k)-1T(f)(5)(ii)(A)) or acquired computer software (as defined in §1.168(k)-1T(f)(5)(ii)(C)) that is eligible for the additional first year depreciation deduction under section 1400L(b) at the time of replacement provided the time of replacement is after September 10, 2001, and on or before December 31, 2006, or in the case of acquired MACRS property or acquired computer software that is qualified New York Liberty Zone property described in paragraph (c)(2)(i)(B) of this section, the time of replacement is after September 10, 2001, and on or before December 31, 2009. The rules and definitions similar to those provided in §1.168(k)-1T(f)(5) apply for purposes of this paragraph (f)(5).

(6) Change in use. Rules similar to those provided in §1.168(k)-1T(f)(6) apply for purposes of this paragraph (f)(6).

(7) Earnings and profits. The rule provided in §1.168(k)-1T(f)(7) applies for purposes of this paragraph (f)(7).

(8) Section 754 election. Rules similar to those provided in § 1.168(k)-1T(f)(9) apply for purposes of this paragraph (f)(8).

(g) Effective date--(1) In general. Except as provided in paragraphs (g)(2) and (3) of this section, this section applies to qualified New York Liberty Zone property acquired by a taxpayer after September 10, 2001. This section expires on September 7, 2006.

(2) Technical termination of a partnership or section 168(i)(7) transactions. If qualified New York Liberty Zone property is transferred in a technical termination of a partnership under section 708(b)(1)(B) or in a transaction described in section 168(i)(7)

for a taxable year ending on or before September 8, 2003, and the additional first year depreciation deduction allowable for the property was not determined in accordance with paragraph (f)(1) of this section, the Internal Revenue Service will allow any reasonable method of determining the additional first year depreciation deduction allowable for the property in the year of the transaction that is consistently applied to the property by all parties to the transaction.

(3) Like-kind exchanges and involuntary conversions. If a taxpayer did not claim on a federal tax return for a taxable year ending on or before September 8, 2003, the additional first year depreciation deduction for the remaining carryover basis of qualified New York Liberty Zone property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not to deduct the additional first year depreciation deduction for the class of property applicable to the remaining carryover basis, the Internal Revenue Service will treat the taxpayer's method of not claiming the additional first year depreciation deduction for the remaining carryover basis as a permissible method of accounting and will treat the amount of the additional first year depreciation deduction allowable for the remaining carryover basis as being equal to zero, provided the taxpayer does not claim the additional first year depreciation deduction for the remaining carryover basis in accordance with paragraph (g)(4)(ii) of this section.

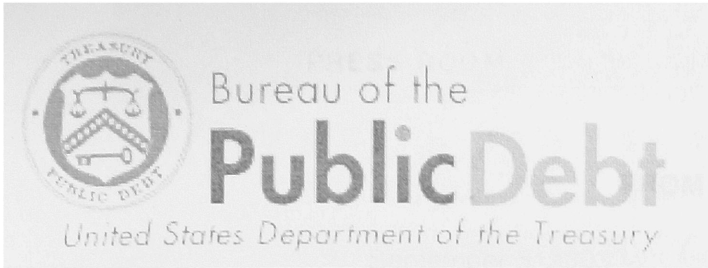
(4) Change in method of accounting --(i) Special rules for 2000 or 2001 returns. If a taxpayer did not claim on the federal tax return for the taxable year that included September 11, 2001, any additional first year depreciation deduction for a class of

property that is qualified New York Liberty Zone property and did not make an election not to deduct the additional first year depreciation deduction for that class of property, the taxpayer should refer to the guidance provided by the Internal Revenue Service for the time and manner of claiming the additional first year depreciation deduction for the class of property (for further guidance, see section 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

(ii) Like-kind exchanges and involuntary conversions. If a taxpayer did not claim on a federal tax return for any taxable year ending on or before September 8, 2003, the additional first year depreciation deduction allowable for the remaining carryover basis of qualified New York Liberty Zone property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not to deduct the additional first year depreciation deduction for the class of property applicable to the remaining carryover basis, the taxpayer may claim the additional first year depreciation deduction allowable for the remaining carryover basis in accordance with paragraph (f)(5) of this section either--

(A) By filing an amended return (or a qualified amended return, if applicable (for further guidance, see Rev. Proc. 94-69 (1994-2 C.B. 804) and §601.601(d)(2)(ii)(b) of this chapter)) on or before December 31, 2003, for the year of replacement and any affected subsequent taxable year; or,

(B) By following the applicable administrative procedures issued under §1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of



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

FOR IMMEDIATE RELEASE

September 5. 2003

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

	In Thousands
Principal Outstanding (Eligible Securities)	$2,396,789,307
Held in Unstripped Form	$2,223,515,972
Held in Stripped Form	$173,273,335
Reconstituted in August	$21,116,884

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.

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U S Department of the Treasury, Bureau of the Public Debt

Last Updated September 27, 2004

JS 704

FROM THE OFFICE OF PUBLIC AFFAIRS

September 5, 2003
JS-705

Statement by Treasury Secretary John Snow

As a result of the President's leadership, the recession has ended, our economy is beginning to recover, and we are seeing positive signs. But, today's unemployment numbers mean we need to do more to strengthen the environment for job creation. This Administration won't be satisfied until every American who wants to work can find a job. That is why we are working so closely with Congress to implement the President's specific steps to build employer confidence and create momentum to hire new workers.

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.
September 4, 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 $30,000 million to refund an estimated $34,647 million of publicly held 13-week and 26-week Treasury bills maturing September 11, 2003, and to pay down approximately $4,647 million. Also maturing is an estimated $15,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced September 8, 2003.

The Federal Reserve System holds $15,085 million of the Treasury bills maturing on September 11, 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 September 9, 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 $1,038 million into the 13-week bill and $802 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-706

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS TO BE ISSUED SEPTEMBER 11, 2003

September 4, 2003

Offering Amount	$15,000 million	$15,000 million
Maximum Award (35% of Offering Amount)	$ 5,250 million	$ 5,250 million
Maximum Recognized Bid at a Single Rate	$ 5,250 million	$ 5,250 million
NLP Reporting Threshold	$ 5,250 million	$ 5,250 million
NLP Exclusion Amount	$ 6,200 million	None

Description of Offering:

Term and type of security	91-day bill	182-day bill
CUSIP number	912795 PA 3	912795 PP 0
Auction date	September 8, 2003	September 8, 2003
Issue date	September 11, 2003	September 11, 2003
Maturity date	December 11, 2003	March 11, 2004
Original issue date	June 12, 2003	September 11, 2003
Currently outstanding	$24,230 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

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September 5, 2003
JS-706

Treasury And IRS Issue Proposed Regulations On The Tax Treatment Of Services Under The Transfer Pricing Rules

Today, the Treasury Department and the IRS issued proposed regulations on the tax treatment of services transactions, including services transactions related to intangible property, under the related party transfer pricing rules. The transfer pricing rules generally provide that the results of transactions between related parties must be consistent with the results that would have occurred had the transaction been between unrelated persons dealing at arm's length.

"The proposed transfer pricing regulations provide significant and much-needed guidance relating to the treatment of related-party cross-border services transactions," stated Treasury Assistant Secretary for Tax Policy Pamela Olson. "The proposed regulations preserve aspects of the current rules that provide reduced administrative and compliance burdens for low-margin services. At the same time, the proposed regulations will bring the current rules more into line with the arm's length standard and eliminate aspects of the current rules that have proved problematic. Modernizing the regulations also addresses a number of the concerns regarding the transfer of valuable intangibles outside the United States for less than arm's length consideration that have arisen in the context of the discussion of corporate inversions. The proposed regulations ensure that taxpayers cannot characterize a transfer of intangible property as a provision of services in order to reach inappropriate results."

The current regulations regarding related party services transactions were issued in 1968, and are the only significant part of the 1968 related party transfer pricing regulations that was not addressed by updated regulations issued in 1994 and 1995. The related party services regulations are being updated to reflect legal developments and developments in the economy and in business practices since the regulations were issued in 1968, as well as to address aspects of the regulations that have been particularly difficult to administer.

The proposed regulations provide guidance on the transfer pricing methods to be used to determine the arm's length price in a services transaction. The transfer pricing methods provided generally are consistent with current regulations applicable to transfers of tangible and intangible property and are consistent with international standards in this area. The proposed regulations provide a new transfer pricing method for low-margin services, such as routine back-office services, that would require a less robust analysis than would be required under the general transfer pricing rules. The proposed regulations provide guidance intended to coordinate and harmonize the rules applicable to services related to intangibles with the transfer pricing rules applicable to transfers of intangible property.

-30-

Related Documents:

- The Text Of The Proposed Regulations

q[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 31

[REG-146893-02]
[REG-115037-00]

RIN 1545-BB31, 1545-AY38

Treatment of Services Under Section 482
Allocation of Income and Deductions from Intangibles

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of controlled services transactions under section 482 and the allocation of income from intangibles, in particular with respect to contributions by a controlled party to the value of an intangible that is owned by another controlled party. These proposed regulations potentially affect controlled taxpayers within the meaning of section 482. The proposed regulations provide updated guidance that is necessary to reflect economic and legal developments since the issuance of the current guidance. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received December 9, 2003. Outlines of topics to be discussed at the public hearing scheduled for January 14, 2004, at 10 a.m. must be received by December 23, 2003.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-146893-02 and REG-115037-00), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station,

128 pp

federal financing bank NEW
WASHINGTON, D.C. 20220

FEDERAL FINANCING BANK

2003 PRESS RELEASE

September 2003

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $35.5 billion on September 30, 2003, posting a decrease of $875.2 million from the level on August 31, 2003. This net change was the result of decreases in holdings of agency assets of $750.0 million and in holdings of government-guaranteed loans of $125.2 million. The FFB made 36 disbursements and received 16 prepayments during the month of September. The FFB also priced 14 refinancings and extended the maturities of 168 loans guaranteed by the Rural Utilities Service ("RUS") during the month.

During the fiscal year 2003, the FFB holdings of obligations issued, sold or guaranteed by other Federal agencies posted a net decrease of $4,059.7 million from the level on September 30, 2002. This net change was the result of decreases in holdings of agency debt of $3,840.6 million and in holdings of agency assets of $1,220.0 million, and an increase in holdings of government-guaranteed loans of $1,000.8 million.

Below are tables presenting FFB September loan activity and FFB holdings as of September 30, 2003.

PRINT

FEDERAL FINANCING BANK
September 2003 ACTIVITY

Borrower	*Date*	*Amount of Advance*	*Final Maturity*	*Interest Rate*	*Semi-Annually or Quarterly*
AGENCY DEBT					
U.S. POSTAL SERVICE					

JS-707

U.S. Postal Service	9/04	$2,523,437,000.00	9/18/2003	1.102%	Semi-Annually
U.S. Postal Service	9/18	$2,523,437,000.00	9/24/2003	1.030%	Semi-Annually
U.S. Postal Service	9/24	$2,523,437,000.00	10/1/2003	1.000%	Semi-Annually
GOVERNMENT-GUARANTEED LOANS					
GENERAL SERVICES ADMINISTRATION					
San Francisco Bldg Lease	9/16	$2,075,082.56	8/1/2005	1.698%	Semi-Annually
San Francisco OB	9/16	$97,868.87	8/1/2005	1.698%	Semi-Annually
DEPARTMENT OF EDUCATION					
Tuskegee Univ.	9/09	$396,006.81	1/2/2032	5.094%	Semi-Annually
RURAL UTILITIES SERVICE					
A & N Electric #868	9/02	$1,113,000.00	12/31/2036	5.141%	Quarterly
Ravalli #641	9/02	$1,000,000.00	12/31/2029	5.020%	Quarterly
E. Iowa Coop. #807	9/03	$3,600,000.00	12/31/2008	3.697%	Quarterly
Lake Region Elec. #737	9/03	$200,000.00	12/31/2030	5.184%	Quarterly
Mille Lacs Electric #769	9/03	$462,000.00	12/31/2035	5.255°s	Quarterly
Roanoke Electric Mem. #820	9/03	$700,000.00	12/31/2036	5.266%	Quarterly
Tri-County Elec. Coop. #646	9/08	$2,800,000.00	1/2/2035	5.076%	Quarterly
Chariton Valley #524	9/11	$400,000.00	12/31/2029	4.899%	Quarterly
Vernon Electric Coop. #2008	9/11	$668,000.00	12/31/2036	5.054%	Quarterly
Farmer's Rural Elec. #2046	9/12	$5,000,000.00	12/31/2003	0.969%	Quarterly
Midwest Electric #610	9/12	$1,666,000.00	1/3/2034	5.055%	Quarterly
Mountrail-Williams #665	9/12	$1,162,000.00	1/2/2035	5.075%	Quarterly
Morgan County Elec. #710	9/12	$185,000.00	12/31/2009	2.845%	Quarterly
Morgan County Elec. #759	9/12	$1,000,000.00	12/31/2035	5.092%	Quarterly
Southside Electric #786	9/12	$475,000.00	12/31/2035	5.092%	Quarterly
Adams Rural Electric #706	9/15	$500,000.00	12/31/2003	0.973%	Quarterly
Polar Telecommunications #2056	9/15	$1,346,000.00	12/31/2003	0.972%	Quarterly
Upper Cumberland Elec. #2049	9/16	$8,500,000.00	12/31/2037	5.097%	Quarterly
York Electric Coop. #848	9/16	$5,000,000.00	12/31/2031	4.973%	Quarterly
Arkansas Valley Elec Coop #895	9/17	$6,000,000.00	12/31/2036	5.090%	Quarterly
Douglas Electric #725	9/17	$90,000.00	12/31/2035	5.072%	Quarterly
Carroll Elec. #618	9/22	$300,000.00	1/3/2034	4.901%	Quarterly
Flint Elec. #2016	9/22	$6,000,000.00	1/3/2034	4.903%	Quarterly
Jackson Energy #794	9/22	$7,348,000.00	12/31/2003	0.960%	Quarterly
Washington Electric #655	9/22	$350,000.00	1/2/2035	4.920%	Quarterly
Ironton Telephone Co. #2051	9/23	$2,956,000.00	12/31/2003	0.962%	Quarterly
San Carlos Apache Tele. #729	9/25	$195,000.00	1/2/2024	4.676%	Quarterly
Grundy Elec.Coop. #744	9/29	$500,000.00	12/31/2003	0.942%	Quarterly
Medina Electric #2050	9/29	$2,000,000.00	9/30/2004	1.209%	Quarterly
Pine Belt Cellular, Inc. #2061	9/29	$1,731,632.00	12/31/2019	4.109%	Quarterly

*Amicalola Electric #664	9/30	$6,772,390.66	12/31/2003	0.968%	Quarterly
*Atlantic Telephone Mem. #805	9/30	$5,852,576.00	12/31/2003	0.968%	Quarterly
*Bailey County Elec. #856	9/30	$1,896,000.00	12/31/2003	0.966%	Quarterly
*Bailey County Elec. #856	9/30	$615,000.00	12/31/2003	0.966%	Quarterly
*Basin Electric #425	9/30	$12,744,828.72	12/31/2003	1.093%	Quarterly
*Big Sand Elec. #540	9/30	$758,747.68	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$569,060.75	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$951,346.02	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$2,212,580.15	12/31/2003	0.968%	Quarterly
*Blue Grass Energy #674	9/30	$1,949,185.09	12/31/2003	0.968%	Quarterly
*Blue Grass Energy #674	9/30	$4,966,931.45	12/31/2003	0.968%	Quarterly
*Brazos Electric #917	9/30	$2,389,382.24	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,828,193.74	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,490,140.49	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,127,240.08	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,491,907.36	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$191,489.09	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,713,427.62	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,602,256.14	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$400,999.02	9/30/2010	3.210%	Quarterly
*Brazos Electric #917	9/30	$816,665.77	9/30/2010	3.210%	Quarterly
*Brazos Electric #917	9/30	$13,316.95	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$352,120.39	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$330,301.23	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$2,765,658.07	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$732,649.26	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$804,150.15	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$1,228,388.64	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$309,722.67	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$714,394.25	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$932,777.56	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$621,171.16	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$357,140.02	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$667,702.24	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$813,773.38	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$262,416.53	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$190,451.59	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$1,690,131.70	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,965,785.09	9/30/2010	3.251%	Quarterly
*Brazos Electric #844	9/30	$4,614,000.00	10/2/2023	4.820%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	9/30/2013	3.988%	Quarterly

*Brazos Electric #844	9/30	$5,000,000.00	9/30/2013	3.988%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	10/2/2023	4.820%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	10/2/2023	4.820%	Quarterly
*Brown County Elec. #687	9/30	$242,211.92	12/31/2003	0.968%	Quarterly
*Brown County Elec. #687	9/30	$581,308.63	12/31/2003	0.968%	Quarterly
*Brown County Elec. #687	9/30	$290,701.17	12/31/2003	0.968%	Quarterly
*Citizens Elec. #742	9/30	$2,659,200.62	12/31/2035	4.861%	Quarterly
*Citizens Elec. #878	9/30	$3,000,000.00	12/31/2031	4.774%	Quarterly
*Clark Energy Coop. #611	9/30	$2,854,038.03	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$1,896,580.17	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$4,232,592.25	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$3,539,698.98	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$2,563,960.74	12/31/2003	0.968%	Quarterly
*Cumberland Valley #668	9/30	$4,069,160.36	12/31/2003	0.968%	Quarterly
*Cooper Valley Tel. #648	9/30	$965,505.55	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$1,792,480.84	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$412,919.09	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$199,019.57	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$235,289.48	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$171,119.62	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$253,889.44	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$209,065.60	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$1,420,725.36	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$265,052.89	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$523,017.97	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$380,957.25	12/31/2003	0.968%	Quarterly
*East River Power #453	9/30	$370,545.38	12/31/2003	1.093%	Quarterly
*East River Power #453	9/30	$182,741.70	12/31/2003	1.093%	Quarterly
*East River Power #601	9/30	$3,223,773.96	12/31/2003	0.968%	Quarterly
*East River Power #601	9/30	$4,273,864.72	9/30/2008	2.861%	Quarterly
*East River Power #793	9/30	$624,419.98	12/31/2003	0.968%	Quarterly
*Fairfield Elec. #684	9/30	$3,132,999.79	12/31/2003	0.968%	Quarterly
*Farmer's Telephone #459	9/30	$21,048.02	12/31/2003	1.093%	Quarterly
*Farmer's Telephone #459	9/30	$200,760.12	12/31/2003	1.093%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,473,499.62	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,331,884.39	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,427,019.01	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,092,961.21	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,331,884.39	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,885,965.43	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,860,016.50	12/31/2003	0.968%	Quarterly

*Freeborn-Mower Coop. #736	9/30	$730,866.54	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$487,258.68	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$196,076.58	9/30/2010	3.467%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$197,332.55	9/30/2010	3.467%	Quarterly
*Farmers Telephone #476	9/30	$9,543,716.93	12/31/2003	1.093%	Quarterly
*Farmers Telephone #476	9/30	$7,109,387.88	12/31/2003	1.093%	Quarterly
*FTC Communications #709	9/30	$2,523,335.55	12/31/2003	0.968%	Quarterly
*FTC Communications #709	9/30	$3,227,113.39	12/31/2003	0.968%	Quarterly
*Grady Electric #690	9/30	$3,086,676.08	12/31/2003	0.968%	Quarterly
*Grady Electric #746	9/30	$3,188,109.81	12/31/2003	0.968%	Quarterly
*Grayson Aural Elec. #619	9/30	$1,141,615.21	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$570,807.62	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$951,346.02	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$1,232,498.03	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$973,546.39	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$2,465,527.86	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$1,716,536.69	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$495,515.48	12/31/2003	0.968%	Quarterly
*Grundy Elec.Coop. #744	9/30	$1,226,196.09	12/31/2003	0.968%	Quarterly
*Grundy Elec. Coop. #744	9/30	$981,088.94	12/31/2003	0.968%	Quarterly
*Habersham Electric Mem. #2001	9/30	$6,900,000.00	12/31/2036	4.879%	Quarterly
*Habersham Electric Mem. #2001	9/30	$4,400,000.00	12/31/2036	4.879%	Quarterly
*Harrison County #532	9/30	$947,477.17	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$852,729.47	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$953,869.49	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,555,437.31	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,674,618.05	12/31/2003	0.968%	Quarterly
*Hudson Valley Datanet #833	9/30	$5,000,000.00	12/31/2003	0.966%	Quarterly
*Hudson Valley Datanet #833	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #592	9/30	$1,421,215.75	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$1,894,954.36	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$2,470,072.99	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$210,247.46	12/31/2003	0.968%	Quarterly
*Inter-County Energy #850	9/30	$4,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #850	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Jackson Energy #794	9/30	$3,948,330.53	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,961,247.90	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$4,639,288.38	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,165.27	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,467,706.59	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,225.15	12/31/2003	0.968%	Quarterly

*Johnson County Elec. #482	9/30	$1,520,568.10	12/31/2003	1.093%	Quarterly
+Kansas Elec. Power #904	9/30	$34,391,134.28	12/31/2015	3.616%	Quarterly
+Kansas Elec. Power #904	9/30	$1,539,095.69	1/3/2017	3.737%	Quarterly
+Kansas Elec. Power #904	9/30	$785,236.16	1/3/2017	3.737%	Quarterly
+Kansas Elec. Power #904	9/30	$3,709,458.59	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$784,568.52	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,208,089.24	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$426,766.63	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,338,715.69	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$764,249.90	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$4,541,016.73	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,410,300.01	12/31/2018	3.958%	Quarterly
+Kansas E1ec. Power #904	9/30	$902,460.56	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$753,964.63	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$689,151.64	12/31/2018	3.958%	Quarterly
*Licking Valley Elec. #522	9/30	$2,604,614.75	12/31/2003	0.968%	Quarterly
*Licking Valley Elec. #854	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Magnolia Electric #560	9/30	$4,744,194.89	12/31/2003	1.093%	Quarterly
*North Carolina RSA 3 Tel #2009	9/30	$9,600,000.00	12/31/2003	0.966%	Quarterly
*New Horizon Elec. #791	9/30	$2,051,000.00	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #528	9/30	$1,793,574.28	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #577	9/30	$2,447,333.56	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #577	9/30	$2,447,333.56	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #840	9/30	$4,000,000.00	12/31/2003	0.966%	Quarterly
*North Central Elec. #638	9/30	$1,462,617.47	1/2/2035	4.843%	Quarterly
*Northstar Technology #811	9/30	$1,807,661.89	12/31/2003	0.968%	Quarterly
*Northstar Technology #811	9/30	$985,912.07	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,897,600.04	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,893,767.79	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$955,440.21	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,926,753.21	12/31/2003	0.968%	Quarterly
*Pennyrile Elec. #513	9/30	$5,802,451.99	12/31/2003	1.093%	Quarterly
*Pennyrile Elec. #513	9/30	$5,492,715.24	12/31/2003	1.093%	Quarterly
*PRTCommunications #798	9/30	$4,802,000.00	12/31/2003	0.968%	Quarterly
*PRTCommunications #798	9/30	$1,800,000.00	12/31/2003	0.968%	Quarterly
*Runestone Electric Ass. #886	9/30	$1,500,000.00	12/31/2003	0.966%	Quarterly
*San Miguel Electric #919	9/30	$7,302,416.60	12/31/2003	0.968%	Quarterly
*San Miguel Electric #919	9/30	$7,667,622.89	12/31/2003	0.968%	Quarterly
*Socorro Elec. #869	9/30	$1,652,000.00	12/31/2003	0.966%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly

*Surry-Yadkin Elec. #534	9/30	$466,822.30	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$948,952.24	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$955,129.92	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$2,206,437.04	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #852	9/30	$1,000,000.00	12/31/2003	0.966%	Quarterly
*Thumb Electric #767	9/30	$468,522.46	1/3/2034	4.861%	Quarterly
*United Elec. Coop. #870	9/30	$12,000,000.00	12/31/2003	0.966%	Quarterly
*Upsala Coop. Tele. #429	9/30	$285,962.22	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$6,567.80	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$19,063.95	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$83,090.24	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$78,966.04	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$90,087.12	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$57,209.60	1/2/2018	4.023%	Quarterly
*Webster Electric #705	9/30	$2,154,148.24	12/31/2003	0.968%	Quarterly
*West Plains Elec. #501	9/30	$2,231,750.74	12/31/2003	1.093%	Quarterly

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FEDERAL FINANCING BANK HOLDINGS
September 2003
(in millions of dollars)

Program	***FEDERAL FINANCING September 30, 2003***	***BANK HOLDINGS August 31, 2003***	***Monthly Net Change 9/1/03- 9/30/03***	***Fiscal Year Net Change 10/1/02- 9/30/03***
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	$805.0	$855.0	($50.0)	($145.0)
FmHA-RHIF	$1,830.0	$2,530.0	($700.0)	($1,075.0)
Rural Utilities Service-CBO	$4,270.2	$4,270.2	$0.0	$0.0
Subtotal*	$6,905.2	$7,655.2	($750.0)	($1,220.0)
Govt-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,688.4	$1,706.1	($17.6)	($234.1)
DoEd-HBCU+	$79.3	$79.l	$0.2	$10.7
DHUD-Comm. Dev. Block Grant	$2.l	$2.8	$0.6	($2.9)

DHUD-Public Housing Notes	$1,133.2	$1,133.2	$0.0	($74.1)
General Services Administration+	$2,147.1	$2,150.1	($3.0)	($58.5)
DOI-Virgin Islands	$9.6	$9.6	$0.0	($1.8)
DON-Ship Lease Financing	$607.5	$607.5	$0.0	($173.3)
Rural Utilities Service	$15,618.2	$15,720.7	($102.5)	$1,560.0
SBA-State/Local Devel. Cos.	$77.3	$79.0	($1.7)	($25.1)
DOT-Section 511	$3.1	$3.1	$0.0	($0.2)
Subtotal*	$21,366.0	$21,491.2	($125.2)	$1,000.8
Grand total*	**$35,544.6**	**$36,419.0**	**($875.2)**	**($4,059.7)**

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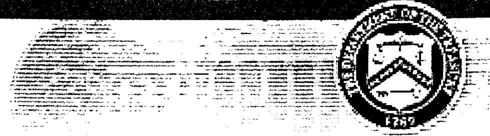
Return to PRESS RELEASES

Last Updated on 1/22/04

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

September 8, 2003
JS-708

Treasury Announces Appointment of Deputy Assistant Secretary of Public Affairs

The U.S. Treasury Department is pleased to announce today the appointment of Mr. Salvatore "Tony" Fratto to the position of Deputy Assistant Secretary of Public Affairs. In his new position, Mr. Fratto will be responsible for media relations for the Department of the Treasury, including planning strategies on how to present issues to the media; representing senior Treasury officials to the media; providing tactical communications counsel; acting as a Treasury spokesman; and representing the Bush Administration's views on issues to the press, and through them, to the general public.

Since March 2001, Mr. Fratto has served in the Treasury Office of Public Affairs, first as a public affairs specialist and more recently as the Director of the office. In these positions, he has held primary responsibility for the Department's communications regarding international finance and development issues, as well as overseen the day to day activities and budget of the office.

Prior to his experience at the Treasury Department, Mr. Fratto has served in a variety of communication and government positions, such as communications specialist for the Bush-Cheney 2000 campaign, Vice President of Government Affairs for the Pittsburgh Regional Alliance, Director of Community and Economic Affairs for Pennsylvania Governor Tom Ridge, and Communications Director for Senator Rick Santorum (R-PA).

Mr. Fratto earned his bachelors degree in economics from the University of Pittsburgh, and attended the University of Pittsburgh Graduate School of Public and International Affairs.

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
September 08, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	91-Day Bill
Issue Date:	September 11, 2003
Maturity Date:	December 11, 2003
CUSIP Number:	912795PA3

High Rate: 0.935% Investment Rate 1/: 0.951% Price: 99.764

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 21.02%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 31,440,005	$ 13,455,405
Noncompetitive	1,419,689	1,419,689
FIMA (noncompetitive)	125,000	125,000
SUBTOTAL	32,984,694	15,000,094 2/
Federal Reserve	5,565,270	5,565,270
TOTAL	$ 38,549,964	$ 20,565,364

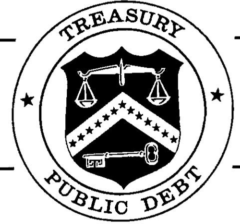
Median rate 0.925%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.900%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 32,984,694 / 15,000,094 = 2.20

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,126,837,000

JS 709

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
September 08, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term: 182-Day Bill
Issue Date: September 11, 2003
Maturity Date: March 11, 2004
CUSIP Number: 912795PP0

High Rate: 1.010% Investment Rate 1/: 1.033% Price: 99.489

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 60.78%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 35,958,655	$ 13,753,409
Noncompetitive	1,071,634	1,071,634
FIMA (noncompetitive)	175,000	175,000
SUBTOTAL	37,205,289	15,000,043 2/
Federal Reserve	5,460,737	5,460,737
TOTAL	$ 42,666,026	$ 20,460,780

Median rate 1.000%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.980%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 37,205,289 / 15,000,043 = 2.48

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $861,523,000

JS-710

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.
September 8, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS 5-YEAR NOTES AND 9-YEAR 11-MONTH 4 1/4% NOTES

The Treasury will auction $16,000 million of 5-year notes and $13,000 million of 9-year 11-month 4 1/4% 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 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.

The auctions being announced today 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 notes are given in the attached offering highlights.

oOo

Attachment

JS 711

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF
5-YEAR NOTES AND 9-YEAR 11-MONTH 4 1/4% NOTES TO BE ISSUED SEPTEMBER 15, 2003

September 8, 2003

Offering Amount	$16,000 million	$13,000 million
Maximum Award (35% of Offering Amount)	$ 5,600 million	$ 4,550 million
Maximum Recognized Bid at a Single Yield	$ 5,600 million	$ 4,550 million
NLP Reporting Threshold	$ 5,600 million	$ 4,550 million
NLP Exclusion Amount	None	$ 6,300 million
Description of Offering		
Term and type of security	5-year notes	9-year 11-month 4 1/4% notes (reopening)
Series	H-2008	D-2013
CUSIP number	912828 BK 5	912828 BH 2
Auction date	September 10, 2003	September 11, 2003
Issue date	September 15, 2003	September 15, 2003
Dated date	September 15, 2003	August 15, 2003
Maturity date	September 15, 2008	August 15, 2013
Interest rate	Determined based on the highest accepted competitive bid	4 1/4%
Amount currently outstanding	Not applicable	$20,521 million
Yield	Determined at auction	Determined at auction
Interest payment dates	March 15 and September 15	February 15 and August 15
Minimum bid amount and multiples	$1,000	$1,000
Accrued interest payable by investor	None	$3.58016 per $1,000 (from August 15 to Sept. 15, 2003)
Premium or discount	Determined at auction	Determined at auction
STRIPS Information:		
Minimum amount required	$1,000	$1,000
Corpus CUSIP number	912820 JG 3	912820 JE 8
Due date(s) and CUSIP number(s) for additional TINT(s)	See chart below	Not applicable

5-Year Note Due Dates and CUSIP Numbers for TINTS

	2004	2005	2006	2007	2008
March 15	912833 ZP 8	912833 ZR 4	912833 ZT 0	912833 ZV 5	912833 ZX 1
September 15	912833 ZQ 6	912833 ZS 2	912833 ZU 7	912833 ZW 3	912833 ZY 9

The following rules apply to all securities mentioned above:

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 (NLP) 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.
September 8, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $11,000 million to refund an estimated $15,000 million of publicly held 4-week Treasury bills maturing September 11, 2003, and to pay down approximately $4,000 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 $15,085 million of the Treasury bills maturing on September 11, 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 712

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED SEPTEMBER 11, 2003

September 8, 2003

Offering Amount.........................$11,000 million
Maximum Award (35% of Offering Amount)...$ 3,850 million
Maximum Recognized Bid at a Single Rate..$ 3,850 million
NLP Reporting Threshold.................$ 3,850 million
NLP Exclusion Amount....................$11,500 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NR 8
Auction date.......................September 9, 2003
Issue date.........................September 11, 2003
Maturity date......................October 9, 2003
Original issue date................April 10, 2003
Currently outstanding..............$44,024 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.
September 8, 2003

CONTACT: Office of Financing
202/691-3550

TREASURY OFFERS CASH MANAGEMENT BILLS

The Treasury will auction approximately $10,000 million of 4-day Treasury cash management bills to be issued September 11, 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.

Note: The closing times for receipt of noncompetitive and competitive tenders will be at 11:00 a.m. and 11:30 a.m. eastern daylight saving time, respectively.

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 713

HIGHLIGHTS OF TREASURY OFFERING
OF 4-DAY CASH MANAGEMENT BILLS

September 8, 2003

Offering Amount .... $10,000 million
Maximum Award (35% of Offering Amount) .. $ 3,500 million
Maximum Recognized Bid at a Single Rate . $ 3,500 million
NLP Reporting Threshold .... $ 3,500 million
NLP Exclusion Amount .... $ 8,100 million

Description of Offering:

Term and type of security .... 4-day Cash Management Bill
CUSIP number .... 912795 QG 9
Auction date .... September 10, 2003
Issue date .... September 11, 2003
Maturity date .... September 15, 2003
Original issue date .... September 3, 2003
Currently outstanding .... $23,000 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 11:00 a.m. eastern daylight saving time on auction day

Competitive tenders:
Prior to 11:30 a.m. eastern daylight saving time on auction day

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 9, 2003
JS-714

Testimony of
Wayne A. Abernathy
Assistant Secretary of the Treasury for Financial Institutions
Before the Subcommittee on Financial Institutions
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC

Thank you, Chairman Bennett and Ranking Member Johnson and members of the Subcommittee for this opportunity to testify today on the Federal Home Loan Bank (FHLBank) System. The Department of the Treasury is keenly interested in the operations of the Federal Home Loan Bank System because of the important responsibility that the Congress has placed with the Federal Home Loan Banks to enhance the liquidity of financial institutions, particularly as the Federal Home Loan Bank members meet such important community needs as promoting home ownership.

The housing finance market in the United States is the broadest, deepest, and most successful housing finance market in the world. That market is supported by a complex financial services infrastructure, which includes depository institutions, mortgage brokers, mortgage bankers, mortgage insurers, and a variety of other capital market intermediaries. Prominent among capital market intermediaries that make up that infrastructure are the housing government sponsored enterprises (GSEs) – Fannie Mae, Freddie Mac, and the FHLBank System.

The FHLBank System has had a long history of supporting housing finance in America. Congress created the FHLBank System in 1932 in response to a Depression-era liquidity crisis in housing finance. The FHLBank Act directs the FHLBanks to make loans called advances to eligible members. Advances traditionally served the role of providing thrifts access to reliable long-term funding for mortgage lending and as a source of liquidity to help thrifts finance deposit outflows without calling or selling their mortgages. Over time, Congress has expanded the System's membership base beyond thrifts, but the primary function of advances has remained relatively constant. Today, financial markets and our nation's housing finance system bear little resemblance to the one that existed when the FHLBank System was created.

It is in that light that I would like to focus on three topics this morning: the need for the FHLBanks to voluntarily register with the Securities and Exchange Commission (SEC) under the terms of the Securities Exchange Act of 1934; the FHLBank Act and the activities of the FHLBank System; and Treasury's current detailed review of the FHLBank System.

Voluntary Registration with the SEC under the 1934 Act

The observance of good, fundamental practices of corporate governance is a high priority of this Administration. Foremost among such practices is regular, comparable, quality disclosure of corporate financial conditions. A key part of that commitment is improving the quality of corporate disclosure requirements by the GSEs, which is why for more than a year the Administration has been urging all GSEs to comply with the same corporate disclosure requirements of the Securities Exchange Act of 1934, as interpreted and applied by the SEC. Investors in GSE securities should have access to the same corporate disclosures as they have for other companies who publicly offer their securities for investment.

We are pleased that Fannie Mae has complied with this request to voluntarily

register and made its first disclosures under the 1934 Act in the first quarter of 2003. Freddie Mac has also agreed to register with the SEC, though we are disappointed to learn that Freddie Mac may not be registering until sometime in 2004. The sooner that they register with the SEC the better for them and their investors, though we fully concur with their intention that such registration and the financial disclosures that this step entails fully meet the high standards that are required.

The Administration has continued to urge the FHLBanks to move forward with voluntary registration with the SEC under the 1934 Act. Some have argued that the structure of the FHLBank System and the unique characteristics of the FHLBanks in comparison to Fannie Mae and Freddie Mac lessen the need for registration under the 1934 Act. Certainly there are differences: when the FHLBank System was created in 1932, it was created with geographically-limited regional banks. Each regional Home Loan Bank is cooperatively owned by its members, and its capital stock is not publicly traded. The twelve FHLBanks raise funds in the capital markets by issuing consolidated obligations for which they are jointly and severally liable. All of these facts are important and must be—and I believe can be—taken into account.

However, the differences between the FHLBanks and the other GSEs do not change the fundamental fact that the FHLBanks are significant participants in our capital markets by any measure, and that investors should have the same information regarding the condition of the Home Loan Banks as they have for other significant capital market participants. The facts make this case dramatically:

At the end of June, the FHLBanks had outstanding consolidated obligations of $712 billion, of which bonds with original maturity of one year or longer constituted $556 billion of the total.

The individual FHLBanks are each large financial institutions. As of year-end 2002, the largest Home Loan Bank (the FHLBank of San Francisco) had $135 billion in total assets, the smallest (the FHLBank of Topeka) had $33 billion in total assets, while the average among the 12 banks was $58 billion in total assets. Even the smallest Federal Home Loan Bank would rank among the top 40 commercial banks in the United States.

Federal Home Loan Bank registration under the Securities Exchange Act of 1934 is an important step in increasing the transparency of the FHLBanks' financial information to investors. The recent problems of Freddie Mac and a credit rating agency's revision of its outlook for one of the Federal Home Loan Banks from stable to negative illustrate the need for investors to have a more accurate picture of the GSEs' financial operations. Following Federal Home Loan Bank registration under the 1934 Act, investors would have access to the FHLBanks' financial information through the same forms and methods as those that apply to other companies that sell publicly traded securities. Investors would benefit from the added oversight of the SEC, both in terms of reviewing the Federal Home Loan Banks' financial disclosures and through the uniform enforcement of current standards. And investors would have the basis for making comparable evaluations of the financial conditions of the variety of institutions competing for their investment dollars. Our system of securities regulation should offer investors nothing short of that standard.

The continued operation of the FHLBanks outside of the SEC-administered corporate disclosure regime is inconsistent with our objective of a sound and resilient financial system. We understand that the FHLBanks have some remaining concerns with how certain aspects of their business operation would be treated if they registered under the 1934 Act. I would remind them and all concerned that the Federal Home Loan Banks are not the only corporate institutions in America that have unique characteristics. It was specifically in order to deal with the variety of corporations in the nation—while still preserving a high standard of comparable disclosures—that the SEC was given its exemptive authority under the securities statutes. Given the flexibilities that the SEC has to address the individual circumstances of the various registrants under the 1934 Act, we are confident that the Federal Home Loan Banks' concerns can be worked out with the SEC.

We appreciate the discussions that several of the banks have had with the SEC earlier in the year, and we look forward to those discussions being renewed in the immediate future, within a context of acceptance of the public interest that would be

served by the Federal Home Loan Banks registering under the terms of the Securities Exchange Act of 1934. We understand that the Board of Directors of the Federal Home Loan Bank of
Cincinnati recently announced the Bank will be taking the next step in the process of voluntary registration with the SEC. In a recent letter to Secretary Snow, Housing and Urban Development Secretary Martinez, and Federal Housing Finance Board Chairman Korsmo, the Board of Directors of the Federal Home Loan Bank of San Francisco expressed their goal "to enable the Federal Home Loan Banks to become role models for corporate transparency."
That is our goal as well, to which Federal Home Loan Bank registration under the Securities Exchange Act of 1934 is essential.

Multi-District Membership, In Context

In chartering each of the housing GSEs, Congress described the markets to be served by these GSEs, the financial activities these GSEs should undertake, and created a regulatory structure to oversee the GSEs and their activities. While there have been and continue to be debates over a number of Home Loan Bank activities and how these activities fit within the statutory confines of the Federal Home Loan Bank Act, one current issue – the question of multi-district membership – raises particular concern. The Federal Housing Finance Board (Finance Board) has received a number of petitions requesting that Federal Home Loan Bank members be permitted to join more than one Federal Home Loan Bank. The Finance Board has analyzed this issue, obtained outside legal counsel on its authority to authorize multi-district membership, and solicited views from interested parties.

All of that is well and good and appropriate. A lively discussion of policies and programs is healthy. But the appropriate forum for the resolution of these issues must be kept in mind. As the Treasury Department has written in a comment letter to the Finance Board, regardless of whether allowing multidistrict membership is wise, a plain reading of the statute finds little room to conclude that the Finance Board has the legal authority to approve it. It provides:

An institution eligible to become a member under this section may become a member only of, or secure advances from, the Federal Home Loan Bank of the district in which is located the institution's principal place of business, or of the bank of a district adjoining such district, if demanded by convenience and then only with the approval of the Board.

This view is reinforced by the comments of Assistant Legislative Counsel Mr. John O'Brien (a principal drafter of the Federal Home Loan Bank Act) in response to questions regarding the Federal Home Loan Act at a Senate hearing in 1932.

[I]t was not the desire, say, for members in South Carolina to borrow of a New York bank, because it would mean too great a concentration at the New York bank. If the New York bank happened to do better than a South Carolina bank, all members would go there. There is the opportunity in the bill for a member whose principal place of business is in one district to belong to a bank in the adjoining district, but outside of that there is no provision. It is impossible under the terms of the bill for a company doing business in New York to belong to a South Carolina bank.

12 U.S.C. § 1424(b).

Id. (citing Hearings on S. 2959 concerning creation of the FHLBank System), 72nd Cong., 1st Sess (1932), at 199.

To say this is not to render a policy point of view. There are compelling arguments on both sides of the question with regard to the advisability of multi-district membership. Clearly our financial system has changed dramatically since the System was established in 1932 and the predecessor to the current regulator created the 12 banks, and determined their locations and boundaries. In the intervening years, however, Congress has revised the governing statutes on several occasions. It is to the Congress that these arguments should be offered and where any change in the statute will have to be made.

To some, multi-district membership represents a natural progression in the modernization of the FHLBank System. We would only add our view that if multi-district membership is considered, it should be done within the general context of

evaluating the Federal Home Loan Bank System's charter.

Treasury's Review of the FHLBank System

Perhaps the time for such a review is near. Earlier this year I requested the Office of Financial Institutions Policy at the Treasury Department to conduct an in-house review of the Federal Home Loan Bank System, with particular – but not exclusive – consideration of the effect of the changes enacted as part of the Gramm-Leach-Bliley Act of 1999 (GLBA). As I announced at that time, the review would consider—

• how these changes have affected the ability of the Federal Home Loan Banks to meet their statutory mission;
• implications for the financial strength of the Banks individually and the system in general;
• how the business operations of the Banks contribute to accomplishing their statutory mission;
• issues regarding governance structure and management, including executive compensation;
• effect of new capital structures on operations; and
• other issues regarding the strength of the system and the structure of federal oversight.

We are now about four months into that process, nearing completion of the first phase. In the first phase, the staff conducted a general review of the literature, discussions, debates, and developments to put a sharper focus to the questions to be examined. Now they are preparing to go into greater detail. The initial step in the second phase will be to discuss specific topics with the Finance Board.

Some of the issues we will be looking at in greater detail include:

Capital Structure – GLBA significantly changed the capital structure of the Federal Home Loan Banks and provided greater flexibility in the development of capital plans. What are the similarities and differences among the various capital plans? How have the risk-based capital requirements been implemented? How will new capital plans impact the banks' investment portfolios?

Membership – GLBA eliminated mandatory membership requirements for Federal savings associations and permitted broader access to FHLBank membership for community financial institutions (insured depository institutions with less than $500 million in total assets). What has been the impact of these changes in membership participation? Have those changes affected governance of the Home Loan Banks?

Advances and Collateral – GLBA provided community financial institutions with a broader range of eligible collateral for FHLBank advances. The Finance Board reports that as of June 30, 2003, expanded collateral from community financial institutions represents approximately $10.6 billion of the $486 billion in outstanding advances. How has this provision been implemented by the FHLBanks and what factors impact community financial institutions use of the broader range of eligible collateral?

In addition to evaluating these specific legislative changes, over the last decade the activities of the Federal Home Loan Banks have evolved in many ways. Some specific activities that we will be focusing on include:

Balance Sheet Developments – How have key activities (advances, investments, and mortgage purchases) of the System and the individual Home Loan Banks evolved over the last decade, and what does this imply for the future of the System?

Advance Usage – What are the characteristics of FHLBank advance users? What types of advances are most commonly used by System members? What impact is it having on the activities of the members and their ability to serve their customers?

Again I would like to emphasize that Treasury's review of the Federal Home Loan Bank System is part of what we normally do at Treasury, and what I envision for our current review is a more specific look at how the changes made to the FHLBank

System as part of GLBA have been implemented. Treasury is not primarily a regulatory agency. We see as part of our important function, however, providing executive branch oversight of the activities of the independent financial regulators, and this study is part of meeting that responsibility.

And before I leave this subject, with regard to regulatory oversight of the FHLBank System, I would like to commend Finance Board Chairman Korsmo for the increased emphasis he has placed on safety and soundness oversight, in particular the emphasis he has placed on the supervision and examination function. In recent years, many observers have pointed to weaknesses in the Finance Board's supervision of the Federal Home Loan Banks. Chairman Korsmo has given major focus to strengthening the examination process, doubling examination staff on the way to tripling it. I have no doubt that even further increases will be made as necessary.

As another related aside, I would like to raise a point about a legislative proposal regarding the membership of privately-insured credit unions in Federal Home Loan Banks. As part of that proposal, private insurers of credit union deposits would be required to submit annual audit reports to the National Credit Union Administration (NCUA).
In addition, upon the NCUA's request, the appropriate state supervisory agency would be required to provide the NCUA with examination reports of private deposit insurers. We are concerned that the provisions related to the NCUA could give the false impression that the NCUA has oversight authority over the private deposit insurers of credit unions and that the Federal Government somehow stands behind the private insurers. Not only would that be a terribly false impression potentially harmful to depositors, but it would also remove some of the market discipline that is so essential to the successful functioning of any private insurance program.

Conclusion

The Federal Home Loan Bank System presents policymakers with issues that deserve continued attention. The System has historically played an important role in our nation's housing finance markets. We must continue to evaluate the System to ensure that it is achieving the objectives set forth by Congress, meeting the needs of our communities that might not otherwise be met.

Thank you again for providing me with the opportunity to discuss these important issues with the Subcommittee today.

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
September 09, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term: 28-Day Bill
Issue Date: September 11, 2003
Maturity Date: October 09, 2003
CUSIP Number: 912795NR8

High Rate: 0.915% Investment Rate 1/: 0.929% Price: 99.929

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 7.55%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 38,757,850	$ 10,960,475
Noncompetitive	39,795	39,795
FIMA (noncompetitive)	0	0
SUBTOTAL	38,797,645	11,000,270
Federal Reserve	4,059,329	4,059,329
TOTAL	$ 42,856,974	$ 15,059,599

Median rate 0.900%: 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 = 38,797,645 / 11,000,270 = 3.53

1/ Equivalent coupon-issue yield.

http://www.publicdebt.treas.gov

JS-715

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 10, 2003
JS-716

Testimony of
John W. Snow
Secretary of the Treasury
Before the Committee on Financial Services
United States House of Representatives
Washington, D.C.
September 10, 2003

Thank you Chairman Oxley, Ranking Member Frank, and members of the Committee for inviting Secretary Martinez and me to appear before you today. This Committee has a strong record of interest in the effective supervision and regulation of government sponsored enterprises.

There is a general recognition that the supervisory system for housing-related government sponsored enterprises (GSEs) neither has the tools, nor the stature, to deal effectively with the current size, complexity, and importance of these enterprises. As we attempt to remedy this situation, we must be mindful that we have two core objectives that should guide us: a sound and resilient financial system, and increased homeownership opportunities for less advantaged Americans.

To serve both of these objectives we need to devote careful attention to the resilience of our system of housing finance. That system is the envy of the world, but we cannot be complacent. I am here to outline the Administration's recommendations for important improvements that we can make to the oversight of our housing finance system. Secretary Martinez will discuss in particular the measures that the Administration would like to see implemented to reinforce the focus on the objective of increasing homeownership opportunities.

Recommendation

The Administration recommends that Congress enact legislation to create a new Federal agency to regulate and supervise the financial activities of our housing-related government sponsored enterprises.

Housing finance is so important to our national economy that we need a strong, world-class regulatory agency to oversee the prudential operations of the GSEs and the safety and soundness of their financial activities consistent with maintaining healthy national markets for housing finance.
Such legislation should fulfill this underlying purpose and not be merely an exercise in moving existing agencies from one part of the government to another.

We should keep our eye on the crucial task of getting the regulatory organization right. In addition to the housing goals which Secretary Martinez will discuss, the legislative objective should be to create a strong, credible, and well-resourced supervisor with all of the powers needed to do its job.

It is of central importance in this endeavor that Congress provide the new agency with a clear mandate. This mandate should be to oversee the prudential operations of the enterprises and the safety and soundness of their financial activities in order to foster liquid, efficient, competitive, and resilient national housing financial markets, including secondary mortgage markets.

Powers of the New Agency

This new agency's powers should be comparable in scope and force to those of other world-class financial supervisors, fully sufficient to carry out the agency's mandate. This means that the agency should have general regulatory, supervisory, and enforcement powers with respect to the enterprises, including responsibility for ongoing prudential review of GSE activities in keeping with the terms of their charter, with the evaluation of new activities being made in consultation with the Secretary of Housing and Urban Development. With respect to conservatorship/receivership powers, the new agency should have all of the authority necessary to direct the liquidation of assets and otherwise to direct an orderly wind down. However, rescinding a GSE charter would require an act of Congress.

Taking into account the particular nature and unique mission of the enterprises as chartered by the Congress, the powers of the new agency should meet the following standards, which are widely recognized as essential for effective financial supervision. The agency must have an integrated package of clear authorities, including the following:

• The agency should possess operational independence and adequate resources, including provision for ongoing supervision, and powers to address compliance with laws as well as safety and soundness concerns.

• The agency should have authority for and supervisory practices that consist of some form of both on-site and off-site supervision.

• The agency should have the authority to review and reject any proposals to transfer significant ownership or controlling interests to other parties.

• The agency should have the authority to establish and enforce the criteria for acquisitions, new lines of business, or investments by the GSE and for ensuring that corporate affiliations or structures do not expose the GSE to undue risks or hinder effective supervision.

• An essential element of supervision is the ability of the agency to supervise the consolidated GSE organization. The agency should decide which prudential requirements will be applied on an enterprise-only (solo) basis, which ones will be applied on a consolidated basis, and which ones will be applied on both bases.

• The agency should have the authority to ensure that the GSE has in place systems that accurately measure, monitor, and adequately control market risks; the agency should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

• The agency should have at its disposal adequate supervisory measures to bring about timely corrective action when a GSE fails to meet prudential requirements, including when there are regulatory violations.

• The agency should have independent litigation authority and related powers.

• The agency should set prudent and appropriate minimum capital adequacy requirements for the GSE. Such requirements should reflect the risks that the GSE undertakes, and should define the components of capital, bearing in mind the ability of the GSE to absorb losses.

Capital

The regulator should also have authority with regard to capital for the GSEs. A key issue is the setting of appropriate levels for risk-based capital. The current statute establishes the standard for the basic, minimum capital, the resources that are reserved for the general, indefinable, perhaps unforeseen risks that are present with any financial enterprise.

The statute also treats, in some detail, the question of risk-based capital. We do not propose any changes at this time to the risk based capital regulation that is now in place. That rule took ten years to develop and is in only its first year of operation. Capital is the fundamental element of the financial condition of an enterprise, and the capital standards should not become the subject of frequent

change. There is a need for stability in capital standards. There is some degree of flexibility in the current risk-based capital rule to deal with changes in the risk profile of the enterprises, at least with regard to the near term.

Having said this, I am in no way proposing a moratorium on making any adjustments to risk-based capital. The existing statutes place a clear responsibility on GSE supervisors to ensure that each GSE retains adequate capital to support its risks and they give supervisors the power and duty to require capital changes as risks change. We expect the supervisors to make full and proper use of that authority as need arises.

But ultimately, the new agency should have more flexible authority to adjust risk-based capital standards for GSEs than what is currently provided in the law. Broad authority over capital standards and the ability to change them as appropriate are of vital importance to a credible, world class financial regulator. Capital standards need to be flexible enough to employ the best regulatory thinking, conscious of the enterprises' own measures of risk, adequate to ensure that the enterprises operate in a safe and sound manner, with capital and reserves sufficient to support the risks that arise in their business. We believe that legislation should provide the new agency with this more flexible authority.

Duties

The new agency must have the duty to exercise its authorities for a number of essential tasks, such as the following:

• An essential part of the agency's responsibility must be the evaluation of a GSE's policies, practices, and procedures related to the extension of credit and the making of investments and the ongoing management of the credit and investment portfolios, including GSEs' fulfillment of their missions.
• The agency should satisfy itself that the GSE establishes and adheres to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and loan loss reserves.
• The agency should satisfy itself that the GSE has management information systems that enable the management to identify concentrations within the portfolio, and the agency should set prudential limits to restrict GSE exposure to single counterparties or groups of related counterparties.
• The agency should satisfy itself that the GSE has in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks. The agency should determine that the GSE has adequate and well-tested business resumption plans for all major systems, with remote site facilities, to protect against disruptive events.

• The agency should determine that the GSE has in place internal controls that are adequate for the nature and scale of its business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the enterprise, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets, and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
• The agency should determine that the GSE has adequate policies, practices, and procedures in place, including strict rules for identifying customers/counterparties, that promote high ethical and professional standards in the financial sector and prevent the enterprise being used, intentionally or unintentionally, by criminal elements.
• The agency should have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from GSEs on a solo and consolidated basis.
• The agency should have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
• The agency should satisfy itself that each GSE maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the agency to obtain a true and fair view of the financial condition of the enterprise and the profitability of its business, and that the enterprise publishes on a regular basis financial statements that fairly reflect its condition.
• The agency should set risk-based capital standards and review and change them as prudent.
• The agency should exercise authority over new lines of business, new types of investments, and acquisitions.

Application to All GSEs

In my remarks, I have not limited myself to one group of housing GSEs. The importance of our housing finance markets requires that all of the housing GSEs be included in a program of world-class supervision. We see the need for this for the Federal Home Loan Banks just as we see it for Fannie Mae and Freddie Mac.

We recognize the development of a consensus for action on how to provide that supervisory system for Fannie Mae and for Freddie Mac and are ready to work with Congress on a new agency for their supervision. A similar consensus may not exist with regard to the Federal Home Loan Banks, but we look forward to working with Congress, the Home Loan Banks, and other interested parties to achieve a resolution of these matters.

Location of the New Agency

Today we recommend that Congress create a new regulatory agency that is strong, credible, possessing all of the standards and duties for effective financial supervision as I have outlined above. The Administration is prepared to consider placing the agency within a cabinet department, if Congress considers the additional benefits of stature and policy support that can come from such an arrangement to be valuable.

Any such arrangement would need to protect the independence of the agency over specific matters of supervision, enforcement, and access to the federal courts. The agency should be structured like other financial institution regulators currently embedded in cabinet departments. But to provide real value, placing the new agency within a cabinet department should draw upon the resources of that department for depth of policy guidance. At a minimum, the new agency should be required to clear new regulations and congressional testimony through the department.

In addition, while the agency should be adequately funded by assessments on its regulated entities, without going through the appropriations process, the agency budget and fee assessments should be subject to review by the Administration to avoid any long-term temptation to gold-plate agency operations and to ensure an appropriate allocation of resources among the agency's responsibilities.

In the context of this combination of operational independence and policy oversight, the Administration would be willing to support proposals to establish the new agency as a bureau of the Treasury.

Corporate Governance

In addition, good corporate governance, as we all have come to recognize, requires that there be great clarity that the people running large companies are there to serve the interests of the shareholders and that their incentives and loyalties be clearly aligned in this way. One man cannot serve two masters. Fannie Mae and Freddie Mac are large, experienced, publicly-traded enterprises that have grown significantly and taken important places in our capital markets. Reflecting on that fact, the Congress should consider whether the statutory requirement for presidential appointment of members to publicly-traded GSE boards of directors has become obsolete, and we would support their elimination.

Before I conclude, I wish to make one more essential point. We are pleased with the action of Fannie Mae to register under the Securities Exchange Act of 1934. Such registration operates as an important window into the operations of that GSE to see how it is promoting its mission in keeping with the highest standards of corporate disclosure. This is consistent with our view that GSEs should serve as models of good corporate governance and disclosure, not as exceptions from these standards.

We all regret that Freddie Mac has not yet been able to fulfill its pledge to come into compliance with registration under the 1934 Act, but we look forward to their doing so in the near future. Secretary Martinez and I recently joined with Federal Housing Finance Board Chairman John Korsmo in calling upon the Federal Home Loan Banks also to come into compliance with the 1934 Act, as administered by the Securities and Exchange Commission. Their doing so will be a crucial immediate

step in regularizing their important participation in our nation's capital markets.

Conclusion

Treasury will continue, in a study, to review GSEs and the secondary mortgage markets, and the operation of the regulatory system that supervises the GSEs to ensure that they are subject to proper standards of capital, corporate governance, and other levels of conduct, and in general serve the objectives I described in the beginning of my remarks. We will keep you posted on the results of our studies.

In conclusion, let us consider once again our purpose here this morning. It is to discuss how best to promote the strength and resilience of our housing finance markets, in order to increase our progress in advancing home ownership throughout the nation. The housing-related government sponsored enterprises were created by Congress to assist in that mission. Our aim must be to give them the caliber of supervisor that the importance of their mission requires.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 10, 2003
JS-717

Statement to the Board of Executive Directors of the Inter-American Development Bank by Jose A. Fourquet, United States Executive Director, on the Proposal for a loan for Camisea Project in Peru

The US is abstaining on IDB financing of the Camisea gas project. We wanted to be able to vote in favor of this project, and went to unprecedented lengths to work with the IDB, the project sponsors, and the Government of Peru to strengthen its environmental and social protections. We greatly appreciate the efforts and patience of IDB Management and staff, the project sponsors, and the Government of Peru to work with us to address these risks. We are encouraged by recent actions by the Government of Peru, project sponsors, and the IDB to improve the project. We applaud the government's commitment to improve the marine reserve area.

The United States strongly supports President Toledo and his goals for increasing Peru's economic growth and improving the standard of living for Peru's people. The Camisea project offers profound economic benefits for Peru, forecast to boost Peru's economic growth by nearly 1% per year over its thirty-year expected operation. Regardless of our vote, our expectation is that the Camisea project, now 70% constructed, will be completed soon, bringing these benefits to the people of Peru. We look forward to continuing to work with Peru in the sound development of its hydrocarbon industry.

Our decision is based in part on indications that private financing may be available on favorable terms. In addition, unfortunately, the IDB's involvement was constrained because it was unable to formally apply its environmental policies to the upstream component of the project, and was able to begin serious engagement with the downstream sponsors only after the project's design was completed. We are also concerned that tight completion deadlines became a serious obstacle to mitigating environmental risks and encouraged the sponsors to expedite construction sometimes in advance of receiving government approvals. Finally, we have not been able to allay doubts about the adequacy of the environmental assessment conducted for the project.

We will continue to work diligently with the international community to improve environmental processes and standards that apply to projects supported by official financing. Looking ahead, this project highlights the pressing need for the IDB to establish a policy to improve consultation with and address the needs of indigenous peoples. We want to work with the IDB on the application of its environmental oversight to facilities that are closely related to projects being funded.

In closing, I want to reiterate my government's profound gratitude for the hard work done by IDB management and staff, the Government of Peru, and project sponsors to improve the Camisea project. We applaud commitments made and are prepared to help bilaterally with Peru's efforts to improve the quality of the natural environment in Paracas Bay. In fact, the United States is committed to provide roughly $2 million over the coming two years to help with these efforts. We will continue to support wherever possible, well-designed initiatives to increase Peru's economic growth, including in the IDB.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 10, 2003
JS-718

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 $80,596 million as of the end of that week, compared to $80,467 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 29, 2003			September 5, 2003		
TOTAL		80,467			80,596	
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	7,287	13,477	20,764	7,344	13,437	20,781
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,924	2,707	14,631	12,023	2,699	14,722
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]			22,506			22,520
3. Special Drawing Rights (SDRs) [2]			11,523			11,530
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 29, 2003			September 5, 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:

JS 718

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

	August 29, 2003			September 5, 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

September 10, 2003
JS-718a

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 $80,596 million as of the end of that week, compared to $80,467 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 29, 2003			September 5, 2003		
TOTAL		80,467			80,596	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	7,287	13,477	20,764	7,344	13,437	20,781
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,924	2,707	14,631	12,023	2,699	14,722
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]			22,506			22,520
3. Special Drawing Rights (SDRs) [2]			11,523			11,530
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 29, 2003			September 5, 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:						

JS-718a

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

	August 29, 2003			September 5, 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:

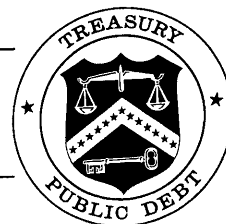
1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign 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
September 10, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Interest Rate:	3 1/8%	Issue Date:	September 15, 2003
Series:	H-2008	Dated Date:	September 15, 2003
CUSIP No:	912828BK5	Maturity Date:	September 15, 2008

High Yield: 3.230% Price: 99.519

All noncompetitive and successful competitive bidders were awarded securities at the high yield. Tenders at the high yield were allotted 97.60%. All tenders at lower yields were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 39,344,023	$ 15,866,800
Noncompetitive	133,471	133,471
FIMA (noncompetitive)	0	0
SUBTOTAL	39,477,494	16,000,271 1/
Federal Reserve	0	0
TOTAL	$ 39,477,494	$ 16,000,271

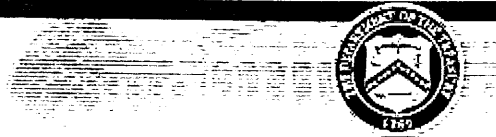
Median yield 3.210%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low yield 3.150%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 39,477,494 / 16,000,271 = 2.47

1/ Awards to TREASURY DIRECT = $71,228,000

http://www.publicdebt.treas.gov

JS-719



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 10, 2003
JS-720

U.S. Treasury Secretary John W. Snow to Visit Middle East Region September 14-24, 2003

On September 14, Treasury Secretary John W. Snow will depart the United States for a ten-day tour through the Middle East and South/Central Asia. The trip will include visits to Israel, Saudi Arabia, Afghanistan, Pakistan, and the United Arab Emirates, and meetings with top political, financial and business leaders in each country.

In Israel and the West Bank, Secretary Snow will support President Bush's vision for peace by emphasizing steps that Israelis and Palestinians can take to strengthen and improve the lives of their peoples. He will meet with key Israeli and Palestinian leaders to discuss the economic situation, encourage cooperation for mutual prosperity and urge action in the fight against terrorism.

In Saudi Arabia, the Secretary will advance U.S.-Saudi cooperation in the financial war on terror and Saudi support for the reconstruction of Afghanistan and Iraq, as well as aid to the Palestinian people. As part of war on terrorism, Saudi Arabia has taken significant steps to prevent the abuse of charities to finance terror.

In Afghanistan, Secretary Snow will highlight President Bush's commitment to reconstruction, and he will review U.S. efforts to build the Afghani private sector, including its financial systems, trade relations, and business environment.

In Pakistan, Secretary Snow will discuss the need for continued economic reforms and pro-growth policies that will strengthen this key ally in the war on terror. He will also emphasize Pakistan's support for reconstruction in Afghanistan and Iraq, and progress in combating terrorist financing. While there, the Secretary will tour a newly registered hawala. Pakistan has been an important partner in the war on terrorist financing and in the effort to regulate hawalas and prevent their abuse by terrorists.

In the final leg of the trip, Secretary Snow will attend the annual meetings of the World Bank and the International Monetary Fund in Dubai.

During three days in Dubai, both in group discussions and in bilateral meetings, Snow will continue to press the themes he has pressed during his previous trips to Europe and Asia to encourage domestic led growth and job creation.

He will stress our view that the best international economic system – for the United States, for Asia, for Europe and for the world – is one based on the principles of free trade, the free flow of capital, and market-based exchange rates.

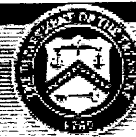
He will stress the need for each individual nation to take steps to increase economic growth in our domestic economies. Raising productivity through structural reform and private investment is the most direct route to raising living standards for our people. He will repeat what he has said time and again that the number one issue facing the global economy is the need for more engines of growth.

During his talks, he will report that as a result of President Bush's leadership, the U.S. economy is returning to higher levels of growth, but that the global economy requires Europe and Asia to attain higher levels of growth as well.

The Secretary's discussions on terrorist financing will follow significant recent

progress in this area. Following the designation of several Hamas related charities and political leaders by the U.S. Treasury last month, the European Union has reached consensus on the designation of the political arm of Hamas as a terrorist organization and the Palestinian Authority and the United Kingdom have taken action to freeze accounts of charities funding Hamas.

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

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September 11, 2003
JS-721

Progress in the War on Terrorist Financing

The opening salvo in the war on terrorism was launched with a stroke of a pen on September 23, 2001 when President Bush signed Executive Order 13224, freezing the assets of terrorists and their supporters and authorizing the Secretaries of Treasury and State to identify, designate and freeze the U.S.-based assets of those who financially facilitate terrorism. President Bush's action began an unprecedented international campaign to deter and dismantle the sources of terrorist financing.

Related Documents:

- Progress in the War on Terrorist Financing

Progress in the War on Terrorist Financing

September 11, 2003

OVERVIEW

The opening salvo in the war on terrorism was launched with a stroke of a pen on September 23, 2001 when President Bush signed Executive Order 13224, freezing the assets of terrorists and their supporters and authorizing the Secretaries of Treasury and State to identify, designate and freeze the U.S.-based assets of those who financially facilitate terrorism. President Bush's action began an unprecedented international campaign to deter and dismantle the sources of terrorist financing.

In the nearly two years since the September 11 attacks, those efforts have left few places for terrorists and their supporters to hide their money. The U.S. and our international partners have seized or frozen nearly $200 million in terrorist-related assets and have designated 315 individuals and organizations as terrorists or as part of terrorist support networks. Pipelines of terrorist financing that once funneled millions of dollars to terrorists have been dismantled. Several key fundraisers and facilitators have been identified and arrested around the world, further limiting sources of money for terrorists.

The fight to stop the financing of terror is virtually without borders. Nearly every country in the world has expressed support in the war on terrorist financing -- 173 nations have implemented orders to freeze terrorist assets, more than 100 countries have introduced new legislation to fight terrorist financing, and 84 countries have established Financial Intelligence Units to share information.

The 9/11 hijackers took advantage of a financial system that afforded them the ability to transmit and receive money with relative anonymity and to find the financial resources to carry out their plots. But, the past two years have yielded tremendous progress in securing the financial system against terrorist financing and in shining the light of international scrutiny on sectors of the financial system previously untouched by regulation or oversight. Designations and freezing of assets, structural changes to financial systems around the world, and the cooperation of international partners have helped to dry up sources of financial support for terrorism and have restricted the ability of terrorists to operate. Our efforts and the world's focus have made it more difficult for terrorists to succeed in their attacks. The war on terrorist financing, like the war on terror as a whole, is a long fight. While there is still much work to be done, the progress made since the first 9/11 will hopefully help to prevent the next.

Designation and Freezing of Assets

Executive Order 13224 gave the Secretaries of State and Treasury the authority to designate individuals and organizations as terrorists and terrorist supporters - freezing their U.S. assets, prohibiting financial transactions with U.S. persons, and publicly shaming those designated by notifying the world of their involvement in terrorism. International cooperation has broadened the net of designations to encompass not just the U.S., but jurisdictions globally. Through bilateral cooperation and multilateral action by the United Nations, 173 countries have implemented blocking orders to freeze the assets of terrorists.

In a world interconnected by a vast financial web, the ability to ostracize terrorists and their supporters and banish them from the international financial system deters those who would fund acts of terror and cripples the ability of terrorists to operate on a global scale. By freezing assets and dismantling key nodes of terrorist financing, designation provides an extraordinary tool to starve terrorists of the financing to carry out their plans, helping to prevent terrorist attacks before they happen.

Since September 11, 2001:

- **1439** accounts, containing more than **$136.7 million** in assets, frozen worldwide - including **$36.6 million** in the U.S.
- More than **$60 million** in additional terrorist related assets seized by authorities globally.
- **315** individuals and organizations listed as Specially Designated Global Terrorists (SDGTs) under Executive Order 13224.
- **Countless millions in additional funds** prevented from flowing to terrorists by disruption of terrorist financing networks, deterrence of donors, and international efforts to secure the world financial system from the financing of terror.
- Several major sources of terrorist financing dismantled:
  - In August, 2003, Sec. Snow announced the U.S. designation of several charities funding Hamas and several members of Hamas' senior leadership. In the weeks since, the EU has now reached consensus to designate the political wing of Hamas. Several other jurisdictions, including the Palestinian Authority and the U.K., have also taken action to freeze assets of Hamas related charities.
  - In support of previous action by European partners, the U.S. designated the **Al-Aqsa International Foundation**, a major source of funding to Hamas in April of 2003, helping to shut-down the German based charity.
  - The Somali based **al-Barakaat** network once provided funding and transferred money too and from al-Qaida. The U.S. and our international partners took action to designate al-Barakaat and close down their operations in November of 2001.
  - Three major U.S. based charities providing funding to terrorists, the **Global Relief Foundation, Benevolence International Foundation** and **Holy Land Foundation for Relief and Development** were designated and shuttered in December of 2001.

International Cooperation

The same international financial system that allows commerce to flow freely between nations also provides terrorists a way to move money around the globe in seconds. Terrorism is a global problem, and therefore our effort to disrupt its financing must extend beyond borders -- to block the money wherever it is hidden and to track it down wherever it flees.

Since September 11, 2001:

- **209 countries** have offered their support in the financial war on terror.
- **173** countries have issued blocking orders freezing terrorist assets.
- **100** countries have passed new laws, strengthening their safeguards against terrorist financing.
- **80** countries have established Financial Intelligence Units to share information on terrorist financing.
- **The UN Security Council** has approved Resolutions 1372 and 1390 that compel action by member states to combat terrorist financing.
- **The Financial Action Task Force (FATF)** has issued 8 Special Recommendations on Terrorist Financing and revisions to the 40 Recommendations on Money Laundering, incorporating international standards to prevent terrorist financing.

Major bombings in Indonesia, Saudi Arabia, and Iraq underscore the global nature of the terrorist threat. To respond to such a threat requires the cooperation of all nations and the focus of the international community. An unprecedented 209 of the 219 countries in the world have expressed support for the global effort to fight terrorist financing. This level of support is perhaps one of the most significant success stories in the terrorist financing effort.

The United Nations has adopted Security Council resolutions requiring all members to freeze assets of any al-Qaida and Taliban related financial target listed by the UN and to take actions to prevent the financing of terror. The Financial Action Task Force (FATF), an international body devoted to the development and promotion of policies aimed at combating money laundering and terrorist financing, has issued important standards that outline steps that countries should take to bolster defenses against terrorist financing and money laundering.

Countries around the world are implementing new laws to secure their financial systems against terrorist financing and are working together to identify and disrupt the financing of terror. More than 80 countries have established Financial Intelligence Units to share information and 173 countries have implemented blocking orders to freeze terrorist assets.

Securing the Financial System and Preventing the Abuse of Charities

Cutting off terrorists from the international financial system is fundamental to our efforts to disrupt their activities. Enhanced safeguards are making it more difficult for terrorists to move money through formal financial systems and are exposing them to greater risk of detection when they do. As a result, terrorists are crippled in their ability to move money and to operate on a global scale. In addition, the worldwide attention on the abuse of charities by terrorist groups has resulted in unprecedented actions to secure charitable giving.

Protection of the U.S. financial system begins with a robust regulatory regime that enhances the ability of financial institutions to deny access to terrorists and money launderers. Over the past two years, we have expanded dramatically the protections afforded our domestic financial system through the implementation of important anti-money laundering and anti-terrorist financing provisions of the U.S.A PATRIOT Act.

For example, we have issued regulations to facilitate the sharing of critical information related to the financing of terrorism -- between law enforcement and financial institutions and among financial institutions themselves. Regulations have enhanced the financial audit trail by ensuring that basic customer information is collected, customer identity is verified, and increased due diligence is performed for high risk accounts. Finally, we have extended, and are continuing to extend, the reach of our anti-money laundering and anti-terrorist financing regulatory regime to additional categories of financial institutions to reflect the reality that terrorist financiers may resort to non-traditional means of moving their assets.

Our efforts to protect the financial system, however, cannot stop at our shores. To fight terrorist financing, all countries must take steps to safeguard their financial sectors from abuse by terrorists. The world has recognized this reality.

Immediately following the September 11th attacks, the Financial Action Task Force (FATF) held an Extraordinary Session in Washington D.C. to issue the "Eight Special Recommendations on Terrorist Financing." These Eight Recommendations – which address such issues as wire transfers, charities, alternate remittance systems, and asset freezing – have been recognized as the international standard for terrorist financing.

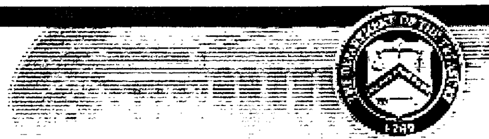
The FATF followed this up in June of this year with a major revision of the "Forty Recommendations on Money Laundering" that require additional steps to secure financial systems against terrorist financing. The revised Forty Recommendations expand the definition of money laundering, enlarge the scope of institutions to which anti-money laundering controls must be applied, articulate specific customer identification measures that financial institutions should take, provide for enhanced scrutiny of certain high risk categories of customers, prohibit shell banks, and tighten controls on correspondent banking.

Countries throughout the world are working to put these important measures into place and the FATF has joined forces with the IMF and World Bank on a global program to assess compliance with these standards by countries throughout the world.

The United States government is also working closely with domestic and international partners to deal with the threat of terrorist financing through charities. In November 2002, the Treasury Department released voluntary best practices for charities, which provide guidelines that empower charities to reduce the risk of abuse of their organizations to fund terror. The Treasury Department is actively reaching out to the charitable community in an effort to work together to prevent terrorist financing through charitable institutions. These guidelines, combined with our outreach efforts, have launched a reassessment of how charities conduct business and the steps they should take to safeguard the giving for their donors.

The international community, through the FATF, has also set forth international best practices that set the standard for how governments should approach the problem of terrorist financing through charities. Countries around the world have taken important steps to increase the oversight and regulation of charities and to take actions against those involved in the funding of terror. Over the past two years, the U.S. and our international partners have taken action against 23 such charities.

PRESS ROOM



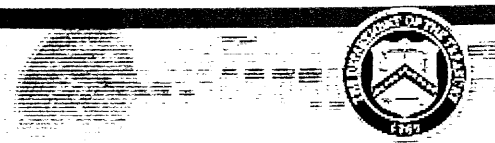
FROM THE OFFICE OF PUBLIC AFFAIRS

September 11, 2003
JS-722

Statement of Secretary John W. Snow on House Passage of Fair Credit Reporting Act Legislation

On June 30, I outlined an Administration proposal with far-reaching consequences for all Americans. It would broaden the availability of credit, give consumers greater access to their credit records, and equip consumers and law enforcers with important new tools in the fight against identity theft.

Last night, by an overwhelming bipartisan vote, the House of Representatives approved legislation to implement our proposal. I congratulate the House on this prompt action. Americans need these tools, and the House has acted without delay.



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 11, 2003
JS-723

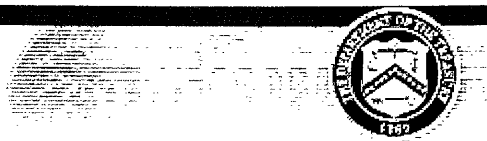
MEDIA ADVISORY
Secretary Snow to Hold Pre-Trip Press Conference

Treasury Secretary John Snow will hold a press conference today in advance of his trip to Israel, Saudi Arabia, Afghanistan, Pakistan and UAE. The press conference will be held at 2:30 PM at the Treasury Building. Secretary Snow will make an opening statement and then be available for questions.

Please click on the attached link to read the announcement outlining the Secretary's trip treas.gov/press/releases/js720.htm

Members of the media who do not hold either Treasury or White House credentials should contact Frances Anderson at 202-622-2960 for clearance into the Treasury Building as soon as possible. Late requests will not be accepted.

Secretary John Snow
Pre-trip Press Conference
2:30 PM
U.S. Department of the Treasury
Media Room 4121
1500 Pennsylvania Avenue
Washington, DC



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

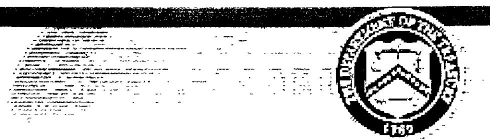
September 11, 2003
JS-724

Statement by Treasury Secretary John Snow regarding the Agreement by Argentina and IMF management

We welcome the agreement between IMF management and the Government of Argentina on a medium-term program. The United States expects to support the program when it is submitted to the IMF Executive Board for approval next week.

With strong implementation by Argentina of the program's macroeconomic framework and reform measures, and with a good faith effort to reach prompt agreement on a comprehensive debt restructuring, the program can help Argentina lay the basis for sustained growth and rising living standards.

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

September 11, 2003
JS-725

Snow opening statement at today's press conference

Today marks two years since our nation suffered the brutal terrorist attacks of September 11. Like every American, I will never forget the magnitude of this deliberate attack on our country. On that day, and in its aftermath, we saw the greatness of Americans in the heroism of those who laid down their lives to save others, the compassion of those who helped those they had never met, and in the generosity of millions of Americans who acted with service and kindness.

September 11th will forever be a day of prayer and remembrance. Across the country, Americans will honor the 11th with memorial services, moments of silence, the ringing of bells, and candlelight vigils. To remember the events of that terrible morning and how Americans responded in New York City, at the Pentagon, and in the skies over Pennsylvania—President Bush proclaimed today "Patriot Day."

We will always remember the more than 3,000 innocent people who lost their lives that day, including two members of the Treasury family who showed courage and fortitude on that day—Secret Service Master Special Officer Craig Miller and IRS Technical Advisor Dave Bernard. To remember Miller and Bernard, as well as the other victims of the attack, the Treasury Department observed a moment of silence today at 8:46 am eastern time.

I am proud of the Treasury employees who have taken on new responsibilities since the attacks to lead the effort to disrupt and dismantle terrorist financing. I issued a report yesterday detailing the Department's efforts undertaken in the war on terror since September 11. We have enjoyed success in the war on terrorism, but much more remains to be done. This leads me to the trip I am about to embark on.

On Sunday, I depart for a ten-day tour through Israel, Saudi Arabia, Afghanistan, Pakistan, and the United Arab Emirates.
Here is a brief overview of the objectives of this trip.
In Israel and the West Bank, I will support President Bush's vision for peace by emphasizing steps that Israelis and Palestinians can take to strengthen and improve the lives of their peoples. I will meet with key Israeli and Palestinian leaders to discuss the economic situation, encourage cooperation for mutual prosperity and urge action in the fight against terrorism.
The U.S. remains fully committed to working with Israeli and Palestinian, and Arab partners toward a vision outlined by President Bush of two states living side by side in peace and security. We still believe strongly that two states living side by side in peace is a hopeful vision for the future of the Middle East.

One of the essential tenets of the President's vision is that people need to be responsible for creating the conditions necessary for peace to prevail. Probably the most -- "the" most important condition for peace to prevail is for all parties to fight off terror, to dismantle organizations whose intent is to destroy the vision of peace.

In Saudi Arabia, I will advance U.S.-Saudi cooperation in the financial war on terror and Saudi support for the reconstruction of Afghanistan and Iraq, as well as aid to the Palestinian people. As part of war on terrorism, Saudi Arabia has taken significant steps to prevent the abuse of charities to finance terror.
In Afghanistan, I will highlight President Bush's commitment to reconstruction, and will review U.S. efforts to build the Afghani private sector, including its financial systems, trade relations, and business environment.

In Pakistan, I will discuss the need for continued economic reforms and pro-growth

policies that will strengthen this key ally in the war on terror. I will emphasize Pakistan's support for reconstruction in Afghanistan and Iraq, and progress in combating terrorist financing. While there, I will also tour a newly registered hawala. Pakistan has been an important partner in the war on terrorist financing and in the effort to regulate hawalas and prevent their abuse by terrorists.

In the final leg of the trip, I will attend the annual meetings of the World Bank and the International Monetary Fund in Dubai.

During three days in Dubai, both in group discussions and in bilateral meetings, I will continue to press the themes I have pressed during his previous trips to Europe and Asia to encourage domestic led growth and job creation.

I will stress our view that the best international economic system – for the United States, for Asia, for Europe and for the world – is one based on the principles of free trade, the free flow of capital, and market-based exchange rates.

I will stress the need for each individual nation to take steps to increase economic growth in our domestic economies. Raising productivity through structural reform and private investment is the most direct route to raising living standards for our people. I will repeat what I have said has said time and again that the number one issue facing the global economy is the need for more engines of growth.

During my talks, I will report that as a result of President Bush's leadership, the U.S. economy is returning to higher levels of growth, but that the global economy requires Europe and Asia to attain higher levels of growth as well.
In Dubai, our discussions on terrorist financing will follow significant recent progress in this area. Following the designation of several Hamas related charities and political leaders by the U.S. Treasury last month, the European Union has reached consensus on the designation of the political arm of Hamas as a terrorist organization and the Palestinian Authority and the United Kingdom have taken action to freeze accounts of charities funding Hamas.

PRLSS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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September 11, 2003
JS-726

Treasury and IRS Issue Final Regulations for Split-Dollar Life Insurance Arrangements

Today, the Treasury Department and the IRS issued final regulations on the tax treatment of split-dollar life insurance arrangements. The regulations provide comprehensive tax rules for split-dollar life insurance arrangements that are entered into or materially modified after September 17, 2003.

"The regulations provide tax rules that reflect the underlying economics of split-dollar life insurance arrangements," stated Treasury Assistant Secretary for Tax Pam Olson. "Under these rules, companies cannot use split-dollar life insurance arrangements to provide tax-free compensation to their executives. By insuring that split-dollar arrangements are appropriately taxed, the regulations curb a backdoor form of executive compensation and promote greater transparency."

A split-dollar life insurance arrangement involves two parties agreeing to split the premiums and/or benefits of a life insurance policy. These arrangements are often used for executive compensation or for gifts among family members.

The final regulations provide that the tax treatment of split-dollar life insurance arrangements will be determined under one of two sets of rules, depending on who owns the policy. If the executive owns the policy, the employer's premium payments are treated as loans to the executive. Consequently, unless the executive is required to pay the employer market-rate interest on the loan, the executive will be taxed on the difference between market-rate interest and the actual interest.

If the employer is the owner, the employer's premium payments are treated as providing taxable economic benefits to the executive. The economic benefits include the executive's interest in the policy cash value and current life insurance protection.

In its report on the Enron Corporation, the Joint Committee on Taxation recommended the finalization of these regulations.

The regulations provide similar loan and economic benefit rules for split-dollar life insurance arrangements between family members or other parties, such as corporations and their shareholders.

Notice 2002-8, which was issued on January 3, 2002, included certain transition rules for split-dollar arrangements entered into prior to January 28, 2002. Those transition rules expire on December 31, 2003.

Treasury and IRS also released today a revenue ruling stating that certain prior administrative guidance on split-dollar life insurance arrangements is now obsolete.

-30-

Related Documents:

- Final Regulations
- Split-Dollar Life Insurance Arrangements

Part I

Section 61.—Gross Income

26 CFR 1.61-22: Taxation of split-dollar life insurance arrangements.
(Also: §§ 83; 301; 316; 2503; 2511; 2512; 7805; 7872; 1.83-3; 1.83-6; 1.301-1; 1.316-1; 25.2503-1; 25.2511-1; 25.2512-6; 301.7805-1; 1.7872-15.)

Rev. Rul. 2003-105

Treasury Decision 9092 provides comprehensive final regulations (under §§ 1.61-22, 1.83-3(e), 1.83-6(a)(5), 1.301-1(q), and 1.7872-15 of the Income Tax Regulations) regarding the federal income, gift, and employment taxation of split-dollar life insurance arrangements (as defined in § 1.61-22(b)(1) or (2)). These regulations apply to any split-dollar life insurance arrangement that is entered into after September 17, 2003 and to any split-dollar life insurance arrangement entered into on or before September 17, 2003 that is materially modified after September 17, 2003. See § 1.61-22(j).

The revenue rulings listed below are obsolete to the extent described below.

Rev. Rul. 79-50, 1979-1 C.B. 139

Rev. Rul. 78-420, 1978-2 C.B. 67

Rev. Rul. 66-110, 1966-1 C.B. 12 (except as provided in Section III, Paragraph 3 of Notice 2002-8, 2002-1 C.B. 398, and Notice 2002-59, 2002-36 I.R.B. 481)

Rev. Rul. 64-328, 1964-2 C.B. 11.

In the case of any split-dollar life insurance arrangement entered into on or before September 17, 2003, taxpayers may continue to rely on these revenue rulings to the extent described in Notice 2002-8, but only if the arrangement is not materially modified after September 17, 2003.

DRAFTING INFORMATION

The principal author of this revenue ruling is Elizabeth K. Kaye of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Elizabeth K. Kaye on (202) 622-4920 (not a toll-free call).

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 31, and 602

[TD 9092]

RIN 1545-BA44

Split-Dollar Life Insurance Arrangements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

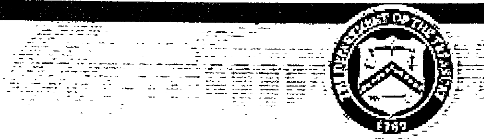
SUMMARY: This document contains final regulations relating to the income, employment, and gift taxation of split-dollar life insurance arrangements. The final regulations provide needed guidance to persons who enter into split-dollar life insurance arrangements.

DATES: Effective Date: These regulations are effective September 17, 2003.

Applicability Dates: For dates of applicability of the final regulations, see §§1.61-22(j), 1.83-3(e), 1.83-6(a)(5)(ii), 1.301-1(q)(4), and 1.7872-15(n).

FOR FURTHER INFORMATION CONTACT: Concerning the section 61 regulations, please contact Elizabeth Kaye at (202) 622-4920; concerning the section 83 regulations, please contact Erinn Madden at (202) 622-6030; concerning the section 301 regulations, please contact Krishna Vallabhaneni at (202) 622-7550; concerning the section 7872 regulations, please contact Rebecca Asta at (202) 622-3930; and concerning the application of these regulations to the Federal gift tax, please contact Lane Damazo at (202) 622-3090.

101 pp.



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 12, 2003
JS-727

MEDIA ADVISORY: TREASURY, IRS AND STATES TO ANNOUNCE NEW PARTNERSHIP TO FIGHT ABUSIVE TAX AVOIDANCE ON TUESDAY; NEW YORK, CALIFORNIA, OTHER STATE OFFICIALS ATTEND

The Treasury Department, the Internal Revenue Service and tax officials from nine states will announce the details of a new agreement between state and federal tax officials to fight abusive tax avoidance schemes. The event will be at 11 a.m. Tuesday, September 16 at the Department of Treasury Media Room (Room 4121) at the Main Treasury Building at 1500 Pennsylvania Avenue NW, Washington, DC.

Abusive transactions to avoid taxes, according to private estimates, deprive state and federal governments of billions of dollars annually.

Appearing at the announcement will be IRS Commissioner Mark W. Everson, Treasury Assistant Secretary for Tax Policy Pamela F. Olson, IRS Small Business/Self-Employed Division Commissioner Dale F. Hart, a representative of the Federation of Tax Administrators as well as officials from California, Louisiana, Maryland, Massachusetts, New Jersey, New York, Ohio, Virginia and the District of Columbia.

The event will be featured in a live Webcast available through www.ustreas.gov

The news conference will be held at the Treasury Department's press room (Room 4121). The room will be available for camera set up beginning at 10:00 a.m. Please note: seating at the event is limited.

News media wishing to attend the event should contact IRS Media Relations or Treasury Public Affairs as early as possible.

Media without Treasury or White House press credentials 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.

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.
September 11, 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 $28,000 million to refund an estimated $34,270 million of publicly held 13-week and 26-week Treasury bills maturing September 18, 2003, and to pay down approximately $6,270 million. Also maturing is an estimated $18,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced September 15, 2003.

The Federal Reserve System holds $15,471 million of the Treasury bills maturing on September 18, 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 September 16, 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 $1,071 million into the 13-week bill and $620 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 728

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS
TO BE ISSUED SEPTEMBER 18, 2003

September 11, 2003

Offering Amount	$14,000 million	$14,000 million
Maximum Award (35% of Offering Amount)	$ 4,900 million	$ 4,900 million
Maximum Recognized Bid at a Single Rate	$ 4,900 million	$ 4,900 million
NLP Reporting Threshold	$ 4,900 million	$ 4,900 million
NLP Exclusion Amount	$ 6,300 million	None

Description of Offering:

Term and type of security	91-day bill	182-day bill
CUSIP number	912795 PB 1	912795 PQ 8
Auction date	September 15, 2003	September 15, 2003
Issue date	September 18, 2003	September 18, 2003
Maturity date	December 18, 2003	March 18, 2004
Original issue date	June 19, 2003	September 18, 2003
Currently outstanding	$24,362 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.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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EMBARGOED UNTIL 11:00 A.M.
September 15, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $9,000 million to refund an estimated $18,000 million of publicly held 4-week Treasury bills maturing September 18, 2003, and to pay down approximately $9,000 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 $15,471 million of the Treasury bills maturing on September 18, 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 729

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED SEPTEMBER 18, 2003

September 15, 2003

Offering Amount.......................... $ 9,000 million
Maximum Award (35% of Offering Amount)... $ 3,150 million
Maximum Recognized Bid at a Single Rate.. $ 3,150 million
NLP Reporting Threshold................. $ 3,150 million
NLP Exclusion Amount.................... $10,800 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NS 6
Auction date.......................September 16, 2003
Issue date.........................September 18, 2003
Maturity date......................October 16, 2003
Original issue date................April 17, 2003
Currently outstanding..............$41,561 million
Minimum bid amount and multiples....$1,000

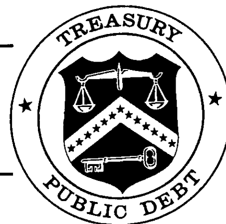
Submission of Bids:
Noncompetitive bids: Accepted in full up to $1 million at the highest discount rate of accepted competitive bids.
Foreign and International Monetary Authority (FIMA) bids: Noncompetitive bids submitted through the Federal Reserve Banks as agents for FIMA accounts. Accepted in order 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
September 15, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term: 91-Day Bill
Issue Date: September 18, 2003
Maturity Date: December 18, 2003
CUSIP Number: 912795PB1

High Rate: 0.930% Investment Rate 1/: 0.947% Price: 99.765

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 57.15%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 31,626,906	$ 12,424,779
Noncompetitive	1,450,509	1,450,509
FIMA (noncompetitive)	125,000	125,000
SUBTOTAL	33,202,415	14,000,288 2/
Federal Reserve	5,726,793	5,726,793
TOTAL	$ 38,929,208	$ 19,727,081

Median rate 0.920%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.900%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 33,202,415 / 14,000,288 = 2.37

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,170,424,000

JS-730

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
September 15, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term: 182-Day Bill
Issue Date: September 18, 2003
Maturity Date: March 18, 2004
CUSIP Number: 912795PQ8

High Rate: 0.995% Investment Rate 1/: 1.017% Price: 99.497

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 53.35%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

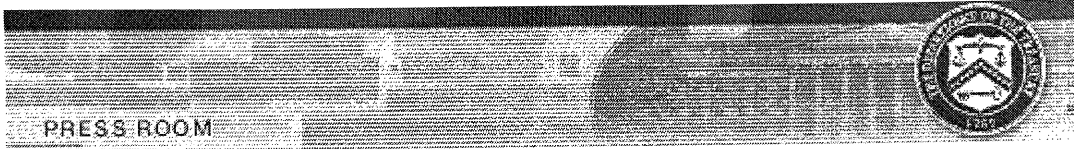
Tender Type	Tendered	Accepted
Competitive	$ 25,995,580	$ 12,939,518
Noncompetitive	910,809	910,809
FIMA (noncompetitive)	150,000	150,000
SUBTOTAL	27,056,389	14,000,327 2/
Federal Reserve	5,350,859	5,350,859
TOTAL	$ 32,407,248	$ 19,351,186

Median rate 0.985%: 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 = 27,056,389 / 14,000,327 = 1.93

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $681,854,000

JS 731



FROM THE OFFICE OF PUBLIC AFFAIRS

September 15, 2003
JS-732

Testimony of the Honorable Peter R. Fisher
Under Secretary for Domestic Finance
U.S. Department of the Treasury
Before the Subcommittee on Financial Management, the Budget, and International Security
Committee on Governmental Affairs
United States Senate

THE ADMINISTRATION'S PROPOSAL FOR ACCURATELY MEASURING PENSION LIABILITIES

Chairman Fitzgerald, Ranking Member Akaka, and Subcommittee members I am pleased to appear before you with Pension Benefit Guaranty Corporation (PBGC) Executive Director Steven Kandarian to discuss defined benefit pension plans. Executive Director Kandarian will discuss the current financial situation of the PBGC while I will discuss the Administration's proposals for strengthening the long-term health of the defined benefit pension system. A strong pension system requires that we not only make pension benefits more secure for America's working men and women but that we also make certain the system that insures these benefits remains financially sound.

To begin, we must be clear on our objective: we all want to improve the retirement security for the nation's workers and retirees by strengthening the financial health of the voluntary defined benefit system that they rely upon. PBGC's current estimate suggests that pension plans in aggregate are underfunded by more than $350 billion. To achieve our objective, pension funding must improve. That will not happen until the existing pension funding rules are fixed. The Administration has been working with Congress to analyze the existing funding rules and develop additional proposals to improve and strengthen them.

Making Americans' pensions more secure is a big job that will require comprehensive reform of the pension system. The Administration proposal that we released on July 8 is the necessary first step in the reform process but it is only the first step. Before I outline that proposal in detail, I would like to summarize briefly the case for comprehensive reform and list some of the topics that we believe reform should address.

Reform Issues

Americans have a broadly shared interest in adequate funding of employer-provided defined benefit pensions. Without adequate funding, the retirement income of America's workers will be insecure. This by itself is a powerful reason to pursue improvements in our pension system.

At the same time, we must remember that the defined benefit pension system is a voluntary system. Firms offer defined benefit pensions to their workers as an employee benefit, as a form of compensation. Our pension rules should thus be structured in ways that encourage, rather than discourage, employer participation.

Key aspects of the current system frustrate participating employers while also failing to produce adequate funding. We thus have multiple incentives to improve our pension system, and to thus better ensure both the availability and the viability of worker pensions. We owe it to the nation's workers, retirees, and companies to roll up our sleeves and to create a system that more clearly and effectively funds pension benefits. Major areas that require our prompt attention include:

1. Funding Rules

Our complicated system of funding rules has been constructed, in part, to dampen the volatility of firms' funding contributions. Yet current rules fail to do so. After years of making few or no contributions at all, many firms are facing precipitous increases in their annual funding requirements. This outcome is frustrating to business and it has failed to provide adequate funding for workers and retirees.

Improvements to funding rules should mitigate volatility, foster more consistent contributions, and increase flexibility for firms to fund up their plans in good times. Specific issues in the funding rules that need to be examined include:

a. Volatility Caused by the Minimum Funding Backstop. The current minimum funding backstop, known as the deficit reduction contribution, causes minimum contributions of underfunded plans to be excessively volatile from year to year.
b. Funding Target. The existing funding target is based on current liability, a measure with no clear or consistent meaning. We will seek to develop a better target.
c. Contribution Deductibility. Together, minimum funding rules and limits on maximum deductible contributions require sponsors to manage their funds within a narrow range. Raising the limits on deductible contributions would allow sponsors to build larger surpluses to provide a better cushion for bad times.
d. Asset Measurement. Under existing rules, assets can be measured as multi-year averages rather than current values. Pension funding levels can only be set appropriately if both asset and liability measures are current and accurate. Failure to accurately measure assets and liabilities contributes to funding volatility.
e. Credit Balances. If a sponsor makes a contribution in any given year that exceeds the minimum required contribution, the excess plus interest can be credited against future required contributions. These credit balances mere accounting entries -- do not fall in value even if the assets that back them lose value. Credit balances allow seriously underfunded plans to avoid making contributions, often for years, and contribute to funding volatility.
f. Benefit Amortization. The amortization period for new benefits can be up to 30 years long. This may be excessive. We will also look at other statutorily defined amortization periods.

2. Actuarial Assumptions

We also intend to examine how the application of actuarial assumptions in the current funding rules may contribute to funding volatility and to inaccurate measurement of pension liabilities. For example, companies do not want to be surprised to find they have inadequately funded their plans because the mortality tables used in the funding rules are outdated or because those rules fail to account for lump sum payments. We will examine:

a. Mortality Tables. In order to ensure that liabilities are measured accurately mortality estimates need to be made from the most up to date and accurate tables available. On September 3, 2003 the Treasury and the Internal Revenue Service released to the press Notice 2003-62, a request for comments on the mortality tables used in determining current liabilities. The notice, which will be published in the Federal Register on September 22, invites comments on methods of projecting mortality and on factors, in addition to age and year of birth, that might be appropriately reflected in any new tables that may be adopted.
b. Retirement Assumptions. Retirement assumptions made by plan actuaries need to reflect the actual retirement behavior of those covered by the plan.
c. Lump Sums. Liability computations for minimum funding purposes need to include reasonable estimates of expected future lump sum withdrawals that are determined by methodologies that are broadly consistent with other estimates of

plan obligations.

3. Other Issues

Three other issues also deserve review:

a. Extent of Benefit Coverage. It may be advisable to limit or eliminate guarantees of certain benefits that typically are not funded, such as shutdown benefits.
b. Multi-employer Plan Problems. Multi-employer plans operate under a different set of rules than single-employer plans. Despite these regulatory differences, the same principles of accuracy and transparency should apply to multi-employer plans, and we will be reviewing the best ways to accomplish this.
c. PBGC Premiums. PBGC's premium structure should be re-examined to see whether it can better reflect the risk posed by various plans to the pension system as a whole.

Although comprehensive reform needs prompt attention, the necessary first step is to develop a more precise measurement of pension liabilities. Fixing the pension funding rules won't help unless we give our immediate attention to ensuring that we are accurately measuring the pension liabilities on which those rules rely. Our most immediate task then is replacing the 30-year Treasury rate used in measuring pension liabilities for minimum funding purposes

I think that we all agree that any permanent change in pension discounting rules should not contribute to future pension plan underfunding. In making the recommendations that I am about to describe, the Administration is seeking to measure accurately pension liabilities, in order to provide the necessary foundation for reform of the funding rules, which then will help ensure that pension promises made are pension promises kept.

We face two near-term concerns that must be addressed in getting to a permanent replacement of the current discount rate.

First, firms that sponsor defined benefit plans already are budgeting their pension contributions for the next several years. Near-term changes to the current rules that would increase pension contributions above current expectations could disrupt these firms' existing short-term plans.

Second, many underfunded plans are already facing sharp increases in their required pension funding contributions. Thus, while we must ultimately ensure that liabilities are measured accurately and that firms appropriately fund the pension promises they have made, an abrupt change from the current system could do more short-term harm than good by triggering plan freezes or terminations.

There are two other reform tasks that the Administration recommends for immediate attention. First, the transparency of information pertaining to pension plan funding needs to be increased. Under current law most workers and retirees are not provided with timely information about the funding of their pension plans. We propose to remedy this by requiring that each year sponsors disclose to participants the value of their pension plan's assets and the level of liabilities measured on both an ongoing yield curve basis and a termination basis.

The Administration also proposes that certain financial data already collected by the PBGC from companies sponsoring pension plans with more than $50 million of underfunding should be made public. Publicly available information would include the assets, liabilities and funding ratios of the underfunded plan, but not confidential employer financial information. This data is more timely and accurate than what is publicly available under current law.

Second, the Administration proposes to restrict benefit increases for certain underfunded plans whose sponsors are financially troubled. When firms with below investment grade credit ratings increase pension benefit promises, the costs of these added benefits stand a good chance of being passed on to the pension

insurance system, frustrating the benefit expectations of workers and retirees and penalizing employers who have adequately funded their plans. Under the Administration's proposal, if a plan sponsored by a firm with a below investment grade credit rating has a funding ratio below 50 percent of termination liability, benefit improvements would be prohibited, the plan would be frozen (no accruals resulting from additional service, age or salary growth), and lump sum payments would be prohibited unless the employer contributes cash or provides security to fully fund these added benefits. When a plan sponsor files for bankruptcy the PBGC's guarantee limits would also be frozen.

The Importance of the Discount Rate in Pension Funding

To determine minimum required funding contributions, a plan sponsor must compute the present value of the plan participants' accrued future benefit payments, which is known as the plan's current liability. The present value of a benefit payment due during a particular future year is calculated by applying a discount factor to the dollar amount of that payment. This discount factor converts the dollar value of the future payment to today's dollars. Current liability is simply the sum of all these discounted future payments.

Pension liabilities must be accurately measured to ensure that pension plans are adequately funded to protect workers' and retirees' benefits and to ensure that minimum funding rules do not impose unnecessary financial burdens on plan sponsors. Liability estimates that are too low will lead to plan underfunding, potentially undermining benefit security. Pension plan liability estimates that are too high lead to higher than necessary minimum contributions, reducing the likelihood that sponsors will continue to operate defined benefit plans.

Computing pension liabilities is basically a two step process. In the first step, the plan actuary estimates the payments that will be made to retirees each year in the future. The pension plan's actuary makes these estimates based on the plan's terms, and estimates of how long current employees will work before retirement and receive benefits in retirement. Estimating the future stream of payments involves considerable judgment on the part of the actuary.

Step two, converting the value of future payments to today's dollars, is, by comparison, simple and rather mechanical. To convert payments in a future year to present dollars, the estimated payments are simply adjusted by the appropriate discount rate. Although some discounting schemes use the same discount rate to compute the present value of payments for all future years, it is no more difficult to compute the present value using different discount rates for each future year.

Choosing the right rate is the key to accurate pension discounting. The wrong rate leads to inaccurate estimates of liabilities that can be either too high or too low.

Therefore, the primary goal of the Administration's proposal to replace the 30-year Treasury rate can be summed up in one word: accuracy. Without first accurately measuring a plan's pension liabilities, the minimum funding rules cannot ensure that the firm is setting aside sufficient funds to make good on its pension promises to its workers. Accurate liability measures also provide a firm's investors with valuable information about the pension contributions that will be made from the firm's earnings. Accurate liability measures allow workers and retirees to monitor the health of their pension plans. Finally, accurate liability measures allow the PBGC as pension insurer to better monitor the health of the overall pension system.

Pension Discounting under Current Law

Since 1987, federal law has required that pension liabilities that determine minimum pension contributions be computed using the interest rate on the 30-year Treasury bond. Liabilities computed using this discount rate have become less accurate over time, as financial conditions have changed. In the late 1980s, inflation was at higher levels than today. As the inflation rate has declined, the term structure of interest rates has changed. Congress recognized this and in 2002 passed legislation that temporarily changed the discount rate to provide funding relief to

plan sponsors. This temporary fix expires at the end of this year.

Dissatisfaction with the continued use of the 30-year rate, even on an interim basis, has been expressed by many members of Congress and pension sponsors. This dissatisfaction and the recognition that the 30-year rate is no longer an accurate discount rate make it imperative that a replacement be promptly enacted.

The Administration's Proposal for Accurately Measuring Pension Liabilities

The Administration believes that corporate bond rates, not Treasury rates, should be the basis for the pension discount methodology. Three key issues need to be addressed in selecting a permanent replacement for the 30-year Treasury rate: the time structure of a pension plan's future benefit payments; the appropriateness of smoothing the discount rate; and the appropriate relationship between the discount rate and the computation of lump sum payments.

The proposal I will now set forth deals with each of these issues.

1. Pension discount rates should be based on market determined interest rates for similar obligations.

The terms of pension contracts are not market determined because pensions are not bought and sold in an open market and pension sponsors do not compete with one another for participants. However, group annuity contracts, which are very similar to employer sponsored pensions, are sold in a competitive market by insurance companies. Group annuity contracts obligate the seller to provide a stream of annual cash payments, in exchange for a competitively priced premium, to individuals covered by the policy. We take the view, as Congress has in the past, that pension discount rates should reflect the risk embodied in assets held by insurance companies to make group annuity payments. These assets consist largely of bonds issued by firms with high credit ratings. Furthermore, the insurance companies issuing the group annuity contracts also have high credit ratings.

Therefore, the Administration proposes that the new pension discount rate be based upon an index of interest rates on high-grade corporate bonds.

2. Pension discount rates should be designed to ensure that liabilities reflect the timing of future benefit payments.

Each pension plan has a unique schedule of future benefit payments - or cash flow profile - that depends on the characteristics of the work force covered by the plan. These characteristics include the percent of participants that are retired, the age of current workers covered by the plan, the percent receiving lump sums and whether the covered work force has been growing or shrinking over time. Plans with more retirees and older workers, more lump sum payments, and shrinking workforces will make a higher percentage of their pension payments in the near future, while plans with younger workers, fewer retirees, fewer lump sums, and growing workforces will make a higher percentage of payments in later years.

One approach to liability computation applies the same discount rate to all future payments regardless of when they occur. This approach produces inaccurate liability estimates because it ignores a basic reality of financial markets: that the rate of interest earned on an investment or paid on a loan varies with the length of time of the investment or the loan. If a consumer goes to a bank to buy a Certificate of Deposit, he will expect to receive a higher rate on a five-year CD than on a one-year CD. Likewise, that same consumer who borrows money to buy a house expects to pay a higher interest rate for a 30-year than a 15-year mortgage.

Pension discount rates must recognize this simple financial reality. Pension payments due next year should be discounted at a different, and typically lower, rate than payments due 20 years from now. Why is this important? Pension plans covering mostly retired workers that use a 20-year interest rate to discount all their

benefit payments will understate their true liabilities. This will lead to plan underfunding that could undermine retiree pension security, especially for workers who are nearing retirement age. Proper matching of interest rates to payment schedules cannot be accomplished using any single discount rate.

Computing liabilities by matching interest rates on zero-coupon bonds that mature on the same date that benefit payments are due is not complicated. Once expected pension cash flows are calculated by the actuary it is no more difficult to discount benefit payments on a spreadsheet with an array of different interest rates than it is if only one discount rate is used.

It is also important to understand that the discount rate used does not change the actual obligation - the liability is what it is. Choosing the proper discount rate gives us an accurate measure in today's dollars of future benefit payments; it does not change those payments. But if we don't measure that value properly today, plans may not have sufficient funds set aside in the future to make good on those pension promises.

The Administration proposes that benefit payments made in future years be discounted to today's dollars using discount rates taken from a corporate bond yield curve (a table or graph that illustrates the interest rates on bonds that mature at different dates in the future). Liabilities would be computed by using interest rates on bonds that mature on a specific date in the future to discount benefit payments due to be made that same year.

Furthermore, implementation of the yield curve would be phased in over five years. The phase-in would start with the use of a single long-term corporate bond rate as recommended in HR 1776 (proposed by Congressmen Portman and Cardin) for the first two years. In the third year a phase-in to the appropriate yield curve discount rate would begin. The yield curve would be fully applicable by the fifth year. 1

This phase-in period would provide some short term funding relief for sponsors, but achieve the desired level of accuracy at the end of five years.

3. Pension discount rates should be based on current financial conditions.

Pension liability computations should reflect the current market value of future benefit payments - this is a key component of accuracy. Plan sponsors and investors are interested in the current value of liabilities in order to determine the demands pension liabilities will place on the company's future earnings. Workers and retirees are interested in the current value of liabilities so that they can determine whether their plans are adequately funded.

Some argue that discount rates should be averaged (smoothed) over long periods of time. Under current law they are smoothed over four years. Such smoothing is intended to reduce the volatility of liability measures and helps make contribution requirements more predictable. Unfortunately current smoothing rules reduce the accuracy of liability measures while failing to achieve stability in annual contributions. Smoothing can mask changes in pension plan solvency of which workers and retirees should be aware. As I mentioned earlier, we would like to work with Congress to identify permanent reforms of the funding rules that would reduce volatility in annual contributions, without the corollary effect of reducing measurement accuracy.

The Administration proposes to decrease smoothing gradually during the 5 year phase-in. In years one and two, four year smoothing is maintained. Smoothing is reduced in years three and four and finally, in year five, set at a 90-day moving average to eliminate the impact of day-to-day market volatility. This will provide an appropriately current measure of interest rates.

4. Pension discount rates should apply to annuities and lump sum payments in a consistent and neutral manner.

Retirees and departing workers in some plans can opt to receive a single payment for their pension benefits rather than regular payments over their lifetimes. The value of these so-called lump sum payments is the present value of the worker's expected retirement annuity. Using different discount rates for annuities and lump sums creates an economic incentive for choosing one form of payment over the other.

The Administration proposes that the yield curve used to measure pension liabilities also be used to compute lump sum payments so as to reflect accurately the life expectancy of retirees in the amounts that they will receive. In order to minimize the disruption of plans of workers who will receive benefits in the immediate future, lump sums would be computed using the 30-year Treasury rate as under current law in years one and two. In the third year a phase-in to the appropriate yield curve discount rate would begin. By the fifth year lump sums will be computed using the yield curve.

Workers receiving lump sums, especially those in their 50's, 60's and older, would be better off under the Administration proposal than under an alternative that would compute lump sums using a single long term corporate interest rate. Workers electing lump sums at relatively younger ages would have a higher proportion of their future payments discounted at long-term interest rates than workers retiring at relatively older ages. This is appropriate given the different time frames over which they had been expecting to receive their benefits. While moving from the 30-year Treasury rate to any corporate bond based rate will result in lower lump sum payments for younger workers who leave their jobs, under the yield curve approach older workers closer to retirement age will be little affected by the change.

However, some workers who will soon be leaving their jobs have been anticipating taking their pension benefits in the form of a lump sum with the expectation that those benefits would be computed using the 30-year Treasury rate. Computing lump sums using the yield curve rather than the 30-year Treasury rate may result in lower lump sum payments for those who leave at a young age. The Administration proposal is for the benefits of younger and older workers alike to be consistently and accurately valued, whether a lump sum or a traditional annuity benefit.

Concluding Observations

In closing I would like to make a few general observations about the Administration's proposed permanent discount rate for pension liabilities.

Because discounting pension payments using a yield curve is already considered a best practice in financial accounting, large sponsors are almost certainly making these computations now or know how to make them.2 Sponsors certainly know what their expected future pension cash flows are.

The mechanics of discounting future pension cash flows are in fact quite simple. This is true whether one uses a single rate to discount all payments or uses different rates to discount payments made in each year. Such calculations, which can be done with a simple spreadsheet, should not pose serious problems even for small plans let alone plans sponsored by large, financially sophisticated firms.

Yield curves used to discount pension benefit payments have been available for a number of years. One example of such a pension yield curve is the one developed by Salomon Brothers in 1994 for the Securities and Exchange Commission. Monthly Salomon Brothers yield curves dating back to January 2002 can be found on the Society of Actuaries web site at http://www.soa.org/sections/pendis.html. We envision that the Treasury Department would adopt a similar methodology. Using this widely accepted approach, we would develop and publish a yield curve reflecting interest rates for high-quality zero-coupon call adjusted corporate bonds of varying maturities.

The adjustments that we would anticipate making - through a rulemaking process subject to public comment - would only be to reflect accurately the time structure of the yield curve. The procedure we envision would involve two types of

adjustments: (1) standardizing the corporate rates as zero coupon, call adjusted rates; and (2) extrapolating the shape of the corporate yield curve using the shape of the Treasury yield curve because of the thinness of the market for corporate bonds of some durations, especially long-term bonds. The yield curve rates would not be adjusted to reflect expenses, mortality or any other actuarial or administrative concerns. The high-grade corporate rates used to construct the curve will only be adjusted so that they accurately reflect the time structure of benefit payments.

As I mentioned, the Treasury would undertake this process using a formal notice and comment rulemaking process to ensure market transparency and to incorporate input from all interested parties in final development of the yield curve. Although the groundwork is well established, we certainly plan to work with all stakeholders to finalize the methodological details of the ultimate yield curve.

While we believe that important near-term considerations warrant beginning the transition by allowing plans to use a long-term corporate bond index for the first two years, staying there would result in greater underfunding over time than we face today. Such an outcome would be counterproductive and harmful, and would certainly move the defined benefit system in the wrong direction. Most importantly, it would put workers' pensions at greater risk.

Some have alleged that there would be adverse macroeconomic consequences to using a yield curve. Such critics allege that the economy would suffer because the resulting increased pension contributions would deplete funds from the economy. That argument is, we submit, incorrect. A firm's pension contributions are invested by the plan for the future benefit of the plan's participants. Those contributions go right back into the economy as savings. They are not withdrawn from the economy. Pension funds are a significant source of capital investment in our economy-investment that creates jobs and growth. And again, an accurate measurement of liabilities is necessary to ensure appropriate funding of pension promises to America's workers.

The macroeconomic effect we should be worried about is that which would result if plan sponsors failed to fund the pension promises that America's workers are depending upon for their retirement security. This is why the Administration is urging that pension liabilities be accurately measured and why we intend to provide Congress with further recommendations to fix the pension funding rules. Only if our pension liabilities are accurately measured will we be able to have an informed dialogue about such comprehensive reforms.

Some have alleged that this proposal would place sponsors of plans with older workforces at a disadvantage by requiring them to put more money into their plans than they would under alternative proposals. The fact of the matter is that more money is needed in those plans to ensure that older workers receive the benefits they have earned through decades of hard work. These obligations of employers to our older workers exist whether our measurement system accurately recognizes them or not. We think that older workers have the same right to well funded pensions that younger workers have and that they should not be systematically disadvantaged by the funding rules.

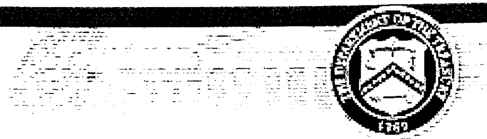
Finally, we should also not overlook other positive consequences of more accurate pension liability measures. We live in an era when Americans are rightly demanding increased accuracy and transparency in corporate accounting. Surely this is the standard we should pursue for the pension systems on which Americans' workers depend. Uncertainty about the size of pension liabilities has negative effects on sponsor stock prices. Increased accuracy of pension liability measurement will greatly reduce that uncertainty when such measures become available to the public under the enhanced disclosure measures that we are proposing. We see all of these recommendations as working together to clarify our pension funding challenges, better informing the public, employers and policy makers about what must be done to ensure adequate worker retirement security.

As I stated at the outset, the Administration's permanent discount rate replacement proposal is designed to strengthen American's retirement security by producing

accurate measures of pension liabilities. And accurate measurement is the essential first step in ensuring that pension promises made are pension promises kept.

1- In years 1 and 2 pension liabilities for minimum funding purposes would be computed using a discount rate that falls within a corridor of between 90 and 105 percent of a 4 year weighted average of the interest rate on a long-term highly-rated corporate bond. In years 3 and 4, pension liabilities would be an average of that calculated using a long-term corporate rate and that using a yield curve. In year 3, the corporate rate would receive a 2/3 weight and the yield curve a 1/3 weight. In year 4 the weights would be switched and in year five liabilities would be computed using the yield curve.

2 - See Financial Accounting Standard 87.



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 10, 2003
JS-733

Remarks of Greg Zerzan
Deputy Assistant Secretary for Financial Institutions
Before the National Association of State Credit Union Supervisors
Vail, Colorado

Thank you very much for having me here today to address some of America's leaders in the credit union industry. Representing both the CEOs of state credit unions as well as the supervisors which regulate them, NASCUS provides a unique forum for participants in this industry to meet together and discuss important ideas that affect not only state-chartered credit unions, but our nation's economic health as a whole.

As you well know, state and federally chartered credit unions play an important role in providing financial services to Americans who participate in all aspects of our national life. From teachers, to unions, to our policemen and firemen, to small businessmen and women across our country, credit unions allow individuals who share a common bond to come together and create their own associations to meet their financial services needs. Some of America's credit unions rank among the largest financial services providers in their communities; others play a role not unlike that of the old Bailey Building and Loan Association in the movie "It's a Wonderful Life." In either case, credit unions play a vital role in ensuring competitiveness in America's financial services industry by providing valuable options for Americans to choose where to place their deposits, and increasing opportunities to obtain credit.

State-chartered credit unions play a uniquely important role in this process. The dual banking system, which allows institutions to choose whether to be chartered at the state or federal level, increases both our opportunities to access financial services and the likelihood that individuals will find creative new ways to provide those opportunities. The state-chartering system allows us to be more innovative with the range of financial services offered to consumers, and allows us to tailor our particular regulatory structures in a way that most meets the needs of our local communities. The best example of this is the frequency with which credit unions are able to switch their charters between the state and federal levels.

I want to thank you for the leadership which you have shown in providing Americans with financial opportunities. I once had a visit with the President of one of our credit unions, who told me that her business wasn't simply a way to make a living, but rather it was a vocation. This person's credit union happened to be located in one of America's poorest neighborhoods; most of her members, she told me, had not only never had a loan before; not only never owned their own homes; many had never even been in a bank. By providing these men and women with access to financial services, she was taking a step towards improving their lives and thus improving their community.

And I know that her story was not atypical. I'm sure many of you recognize in her story your own experiences in fulfilling a mission to improve the lives of everyday Americans by providing them with the means to take their financial well-being into their own hands. This critical role, which credit unions play such an important part in filling, is invaluable to improving our country.

Of course, in Washington we are also very concerned with improving the quality of life for all Americans. President Bush has taken the lead in the fight to provide Americans with control of their own economic well-being, and that leadership is invaluable at this time in our nation's history.

Tomorrow marks the second anniversary of the cowardly attacks of September 11. But even before the terrorists struck, our economy was in recession due to the burst of the market bubble and a general weakening in demand. The attacks of 9-11, occurring in the very heart of America's financial sector, threatened to completely derail the economy and throw chaos into our economic life.

President Bush responded to this threat with vigor. He proposed tax cuts which some in Washington couldn't wait to attack, saying "now is not the right time." But the President's response was straight-forward: if our economy is slow, the answer is to allow people to keep more of their own money. The President knew that we weren't going to climb out of a recession by having the government spend the people's money; we would get out of recession by stimulating growth through allowing the taxpayers to keep more of what they earn.

I don't think I need to tell you who was right in the tax cut debate; the results speak for themselves. Under the President's leadership our economy has begun to grow; we have seen promising results over the last few quarters in the GDP, business spending, and continued strength in housing starts and consumer spending. Real wages have also increased. Under the President's leadership we have emerged from recession. Although we are not out of the woods yet, and fragility still exists in some sectors of the recovery, we are well on our way to meeting the President's goal that every American who wants a job should be able to get one.

Towards this end, the President recently announced his economic plan, entitled "A Full Agenda for the Creation of Jobs in America." The President's plan demonstrates a rock solid commitment to expanding growth and opportunities in the labor market.

The President's plan has six points to build employer confidence and create momentum to hire new workers by:

* Making Health Care Costs More Affordable and Predictable. Health insurance costs for employers have been rising by 10 percent per year since 2000, causing businesses to hire fewer workers and too many families to go without insurance. President Bush proposes to allow small businesses to pool together to purchase health coverage for workers at lower rates; expand medical savings accounts to give workers more control over their health care insurance and costs; and reduce frivolous and excessive lawsuits against doctors and hospitals that drive up insurance costs for workers and businesses.

* Reducing the Lawsuit Burden on Our Economy. President Bush has proposed, and the House has approved, measures that would allow more class action and mass tort lawsuits to be moved into Federal court - so that trial lawyers have a harder time shopping for a favorable court. The President's reforms would also ensure that, in a class action lawsuit, most of the benefits of a settlement will actually go to the people who were injured. These reforms will help businesses focus on creating jobs, rather than fighting junk lawsuits.

* Ensuring an Affordable, Reliable Energy Supply. Businesses depend on affordable and reliable energy. Energy shortages, price spikes, and blackouts disrupt the economy and discourage businesses from planning with confidence and adding new workers. President Bush has proposed a comprehensive national energy plan to upgrade the Nation's electrical grid, promote energy efficiency, increase domestic energy production, and provide enhanced conservation efforts, all while protecting the environment.

* Streamlining Regulations and Reporting Requirements. Government has a responsibility to ensure that its regulatory actions are reasonable and affordable. Too often, government regulations and compliance burdens discourage, rather than promote, job creation. The President will continue to work to simplify and streamline regulations, along with ensuring that well-intentioned compliance requirements do not have the unintended effect of killing jobs. The Administration also recently streamlined tax reporting requirements for small businesses, helping 2.6 million small businesses save 61 million hours of unproductive work.

* Opening New Markets for American Products. American workers can compete with anyone in the world when given a chance. Unfortunately, foreign taxes and tariffs drive up the costs of American products in too many countries, making our

products more expensive and less competitive than those produced elsewhere. For example, in Chile, some kinds of American-made heavy machinery (such as motor graders) produced by American workers cost $11,200 more than those produced in the European Union or Canada solely because of tariffs.
President Bush recently signed into law new free trade agreements with Chile and Singapore that will enable U.S. manufacturers to compete on a level playing field and he will continue to work to open new markets to American products.

* Enabling Families and Businesses to Plan for the Future with Confidence.
To make important spending, saving, and investment decisions, America's families and businesses need to be able to plan for the future. Right now, some key elements of the tax relief passed by Congress and signed into law by President Bush - such as the increase in the child tax credit, the elimination of the death tax, and the new incentives for small business investment - will expire in a few years. For example, a married couple with two children and an annual income of $40,000 would face a $922 tax increase (112% increase) in 2005 if these and similar provisions in the Jobs and Growth Act are not made permanent.

As the President has said, these specific steps will help us build on our economic recovery and move on to the next stage of economic progress - the sustained expansion of employment.

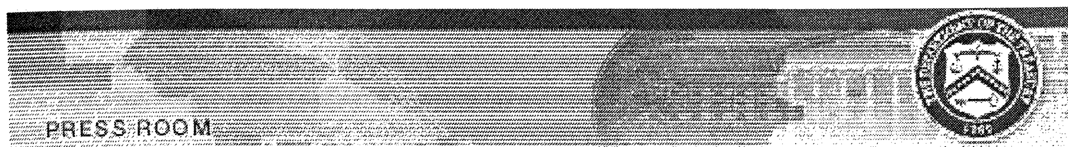
Ironically, one of the sources of fragility in our economy is the perverse consequence of our own industriousness. American productivity has increased at a rate never before seen in human history. As an example, the President recently noted that in 1970 it took 40 hours of labor to produce a car; it now takes 18. The sweeping technological innovation of the last thirty years, particularly in the area of computing and data processing, has meant that our workers can out-produce and out-compete workers everywhere else. Greater productivity means less expensive products and lower business costs; it also means that some workers will be temporarily displaced while they learn new skills in order to take on new jobs created by the technological revolution. We are moving towards a society where human capital, in the form of human knowledge, is truly the greatest source of wealth. One need not think back very far in human history to remember when human labor was viewed as not only cheap, but humans themselves were thought of as expendable. One of the greatest fruits of the American creed, which values the individual and his or her rights above all else, is that it has resulted in an economic system where the man or woman at his or her desk is indeed the most valuable resource in the entire organization. It is difficult to fully express what a radical change this is from all that has come before us, and difficult to fully predict what new opportunities it will present our posterity.

Of course, we cannot discuss the economy without taking into account the uncertainty that remains stemming from the continued threat of terror attacks. 9-11 reminded us again that we live in a world where many people despise us and our way of life; despise freedom and are envious of the blessings which liberty provides. This Administration has made combating terror its top priority. Even as we meet here today, there are thousands of American fighting men and women placing themselves in harm's way so that the American way of life will survive. These heroes' sacrifice makes what we do possible, and it is impossible to overstate their courage or the debt of gratitude we owe them.

Likewise, the President has mobilized the Federal government to prevent terror here at home. The creation of the Department of Homeland Security was a critical step in reorganizing the government to focus our resources on stopping terror. Likewise, the Terrorism Risk Insurance Program, which is run out of the Treasury Department, exists to provide a temporary federal backstop in the terrorism insurance market. Thanks to this program, businesses across America are ensured that they have access to insurance for this new type of threat to their operations.

This Administration remains committed to providing both economic and personal security to all Americans. The challenges we have faced since President Bush took office have been the most daunting to face our country in generations, but the President remains committed to ensuring that our economy is strong and our homes and families are secure. You in this room play an important role in meeting this challenge. Your leadership in your communities, in providing access to credit and financial services to your members, in providing prudent supervision of your institutions, is what allows us to own our own homes, run our own businesses and

provide a better future for our children. Thank you for your dedication, and thank you for allowing me to visit with you today.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 16, 2003
JS-734

Financial Reconstruction in Iraq:
Strategy and Tactics
John B. Taylor
Under Secretary of the Treasury for International Affairs
Senate Banking, Housing, and Urban Affairs Committee
Subcommittee on International Trade and Finance

Senate Banking, Housing, and Urban Affairs Committee
Subcommittee on International Trade and Finance

Chairman Hagel, Ranking Member Bayh, other members of the Subcommittee, thank you for inviting me to testify on the financial reconstruction of Iraq. Given the importance of trade and finance for Iraq's reconstruction, this Subcommittee is an ideal forum for this discussion. And the presence of my colleagues, Under Secretary Larson and Chairman Merrill, further underscores the importance of active government-wide participation in the reconstruction effort.

When I last testified on this subject, on June 4 before the Senate Committee on Foreign Relations, I stressed that "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...by 2001 it had declined to $40 billion." I also stressed the strategy of financial reconstruction—the contingency plans developed in advance of the military conflict—and the tactics followed on the ground since the conflict began. I would like to stress these same issues in my testimony today, with emphasis on the additional information we have obtained on the state of the Iraqi economy and on what has happened on the ground during the summer months.

Much has been accomplished in the financial area since the fall of Saddam Hussein's repressive regime, and many potential financial catastrophes have been avoided. In my view, months of advance planning by the United States government before Saddam's fall as well as the dedicated work of the Coalition Provisional Authority and the Iraqi people since Saddam's fall are responsible for these accomplishments.

Starting late last year, we began developing a strategy for financial reconstruction based on the information we had at the time. The strategy addressed such issues as (1) payments to Iraqi workers and pensioners, (2) the currency, (3) the banking system, (4) Iraq's international debt, (5) an assessment of reconstruction costs, and (6) the international fundraising efforts. I want to review how that strategy is playing out today. But before doing so I must emphasize that an important part of our advance planning has been the selection of people to participate in the financial reconstruction effort. We began selecting financial experts in January; the first wave of people was deployed to Kuwait in March and to Baghdad in April. Early on we decided that a financial coordinator was essential and we are very grateful to Peter McPherson who took leave from the Presidency of Michigan State University and has served most ably in this position, advising Ambassador Bremer and the rest of the Coalition Provisional Authority.

A Strategy for Paying Workers and Pensioners

It was clear that we had to have a strategy for paying Iraqi workers and pensioners after the fall of Saddam Hussein, and thus we crafted a strategy well in advance of his fall. Keeping workers on the payroll with stable purchasing power would be essential to prevent severe hardship and economic collapse. But how many workers were there and how much should they be paid? What currency should be used to make the payments? Where would the funds come from? Would the payments system be in good enough condition after the conflict to actually make payments? How could we prevent hyperinflation and a sharp depreciation of the currency, which would further impoverish people? After all, one of the reasons for the terrible economic performance under Saddam was that he resorted to the printing press to finance his spending, causing high inflation and a drop in the dinar to about 1/5000th of its former value.

Starting late last year we developed such a payments strategy, which was approved interagency after much valuable discussion and debate about alternative strategies. The strategy called for paying workers and pensioners in U.S. dollars on an interim basis. This was not dollarizing the economy, because the strategy called for the continued use of local currencies—such as the Saddam dinar in the center and south and the Swiss dinar in the north—and their eventual replacement by a new national currency, as described below. Using U.S. dollars on an interim basis would create stability and would help prevent a collapse of the dinar.

Finding a way to secure the funds to make these payments in advance of the conflict proved to be a challenge. After much discussion and debate, we decided that the best approach was to use Iraqi regime assets that were frozen at U.S. commercial banks back in 1990 at the time of the first Gulf War. In order to use the assets for this purpose, they had to be "vested" for the use of the Iraqi people. Our estimates were that there was about $1.7 billion that could be vested in the United States and that this amount would probably be sufficient to last until a new currency could be issued in Iraq. A vesting strategy was worked out and approved by interagency legal experts. Under this plan the President would call for the vesting of the assets in the Federal Reserve Bank of New York near the time that the military conflict began.

To make such a strategy operational, many tactical issues and contingencies had to be considered. For example, the plan called for the military on the ground to issue public statements—worked out with the Departments of Defense and Treasury—that the dinar would continue to be accepted as a means of payment after the fall of the Saddam regime. The plan also called for the first wave of financial advisers into Baghdad to assess the payments system's capability for making dollar payments.

Another essential operational issue concerned the actual shipping of the currency to Iraq, and a plan for making the payments to workers and pensioners on the ground had to be developed. We estimated that enough currency in the right denominations was in storage in the New York Fed's warehouse in East Rutherford, New Jersey, and we determined that it was feasible to ship the currency by tractor trailer to Andrews Air Force Base, load it on military aircraft, and fly it to Camp Arifjan in Kuwait for the last leg into Iraq. Many tons of currency were involved because of the need for small denominations: one-dollar or five-dollar bills. On the ground, the military would assist in the actual shipment of the currency around the country. Financial experts would develop lists of eligible workers and pensioners who would be paid. The currency would be distributed to Iraqis who would then actually make the payments. In some cases, the currency would be paid at the state owned enterprises or government ministries. In other cases, pensioners would come to local banks to receive payments.

I am pleased to say that this strategy along with all its tactical details has been carried out with great success. On March 20, at the start of the conflict, President Bush issued an order calling for the vesting of the frozen assets. As a result, approximately $1.7 billion was vested in the New York Fed. With these funds at the New York Fed, the first shipment of currency from the Fed's East Rutherford, New Jersey warehouse to Camp Arifjan was made on April 13. Even as major combat operations were winding down, a mechanism for shipment of cash and distribution of emergency payments was established and began to function. Thanks to this system, we were able to make monthly emergency payments to dock workers, rail

workers, power plant workers, and others essential to restoring basic services. We soon transitioned to regular civil service salary and pension payments to over 2 million Iraqis.

Despite tremendous logistical challenges, the system of payments has worked well. Our financial experts in Baghdad consider this to be a major force for stability in the country, as well as a significant spur to economic growth. As of this date all but $64 million of the vested assets has been shipped to Iraq where they have been used principally to support salary and pension payments to the Iraqi people. The Department of Defense's logistical support has been crucial in this enormous undertaking.

Throughout this period there has been no collapse of the currency, no hyperinflation, and no serious glitch in the payments process itself. In sum, this major and essential success in the reconstruction was due in large part to pre-conflict planning and to adjustments that were made as we implemented the plan and learned from
experience.

A New Unified Currency for Iraq

As I indicated, the payments strategy called for the use of U.S. dollars on an interim basis only. Our goal was for the Iraqi people to choose a new national currency to replace the Saddam dinar and the Swiss dinar, and to provide the necessary financial and logistical assistance to do so. A stable unified currency is an essential part of a market economy and therefore one of the key parts of financial reconstruction.

I am happy to say that this part of the financial reconstruction strategy is on track as well. Last July 7, after consulting with representatives from the Central Bank, the finance ministry, and other interested Iraqis in the north and the south, the Coalition Provisional Authority announced that a new currency would be issued starting in October. The new currency would replace the old currencies at fixed rates that were also announced. Hence, the Coalition Provisional Authority and Iraqi officials in the Central Bank and the finance ministry are about to begin one of the most important parts of the financial reconstruction to date: issuing a new currency to replace the Iraqi currencies that are now circulating. The new currency is a key component in the effort to establish a stable financial system.

The new currency bears the designs of the old Iraqi, or Swiss, dinar and is being produced at printing facilities around the world on schedule. There will be six denominations to replace the current two denominations. About 2200 tons of currency will be shipped from printing facilities in England, Spain, and other countries. A sufficient supply of new notes will be available when they are introduced.

The exchange period will begin on October 15 and last until January 15. A public education campaign is underway in Iraq to ensure that the Iraqi people are well informed about the new currency and are prepared for the currency exchange. The new currency will improve the ease of transactions, since it will be issued in more denominations than are currently available, and will have built-in security features that will enhance public confidence by making the notes more difficult to counterfeit.

Restoring and Revitalizing the Banking Sector

We knew well before hostilities began that strengthening and modernizing Iraq's financial sector would be central to achieving overall economic reconstruction, and that a thorough on-the-ground assessment of Iraq's financial sector would be needed as soon as conditions allowed. Thanks to extensive pre-war planning, Treasury was able to position advisors in Iraq's finance ministry, Central Bank and two main commercial banks even as hostilities were winding down.

The challenges they faced to perform seemingly simple tasks, such as schedule a meeting with Iraqi bankers, were enormous due to security concerns, the lack of working phones or faxes, and language barriers. Despite these difficulties, I am pleased to report some major successes.

One of the most important is the reopening of most of the branches of Iraq's two large state-owned banks – Rafidain and Rasheed – which enabled cash-strapped Iraqi families to gain access to their savings. Opening these branches was no small feat. Many of the banks' branches were damaged and we were fearful of a bank run once the banks reopened. Due to careful planning, individual Iraqis now have access to their deposits and there were no bank runs.

The initial assessments conducted by our advisors have provided much insight into the operations of Rafidain and Rasheed banks. As our pre-planning analyses indicated, these banks did not function independently of the former regime. We now know that these banks were not permitted to make loans based on commercial viability and a borrower's ability to repay, but instead on the ability of the borrower to fulfill a Ba'athist party political objective. The Coalition Provisional Authority, with the support of Treasury, is hard at work reviewing ideas for restructuring the two major state-owned banks.

Analyses of Iraq's private banks are almost complete. While these banks are small in relation to the two large state-owned banks, they will play a role in Iraq's future. We know that remittances through these banks are starting to occur. Remittances by Iraqis overseas will soon form a large pool of resources in Iraq that will finance investment and consumption. According to some estimates, about 4 million Iraqis live abroad, and in recent years they have transferred over $1 billion per year to relatives in Iraq.

In addition to strengthening specific banks, the financial system more broadly – including the relevant laws and regulations – will require significant work to ensure that an efficient and effective system for financial intermediation is achieved. In consultation with the International Monetary Fund, we are working with the Iraqi Governing Council, other Iraqi officials, and the Iraq Bankers' Association on a revision of Iraq's Central Bank law and commercial banking law. Creating a sound supervisory and regulatory regime is also critical to establishing a strong financial system. We have reached out to countries in the region, including Jordan, Bahrain, and the UAE, who have offered to provide technical training to Central Bank and commercial bank employees.

As work proceeds on these broad objectives, some initial bank lending has started, with the focus on loans directed towards Iraqi small- and medium-sized enterprises. Additionally, the Treasury has approached the International Finance Corporation, the private sector arm of the World Bank, about setting up a facility in Iraq to provide loans to micro-, small- and medium-sized businesses. This would be a multilateral facility modeled after other highly successful programs in Russia, Central Asia and Southeast Europe.

One major initiative that is now getting off the ground is the creation of the Trade Bank of Iraq. This Iraqi-staffed institution will facilitate imports to and exports from Iraq by putting in place the people and systems needed for the country to trade more efficiently and on a larger scale with the rest of the world. Currently, trade is taking place at the retail level. In Baghdad's markets one can find consumer goods – from refrigerators to satellite disks – imported from neighboring countries. But in order for Iraq's reconstruction to move forward as quickly as possible, and for private sector activity to take off, there needs to be an efficient system for importing a broad range of capital goods and services.
Our goal is for Iraqi banks to provide trade finance services. But as the process of strengthening Iraqi banks goes forward, there is an immediate need to do this. The Trade Bank of Iraq is intended to fill that gap.

Following a competitive bidding process, the CPA is negotiating a contract with a consortium of international banks which will facilitate the operations of the Trade Bank. Additionally, the Trade Bank will be the entity by which Export Credit Agencies around the world support trade with Iraq. There is precedent in creating

institutions such as the Trade Bank in post-war Japan and Germany. Those institutions evolved and took on functions akin to export-import banks, although how the Trade Bank evolves will be up to the Iraqi people.

Iraq's International Debt

Early on we recognized that dealing with Iraq's substantial foreign debt problem would be crucial to the country's medium-term economic health. We therefore developed a strategy to resolve this problem.

First, using the financial information we had, we ensured that Iraq would not have to service its debt following the end of the war and during the critical reconstruction phase. Demands for repayment would have greatly reduced the resources available to a new Iraqi government. Therefore, we secured recognition from the G7 that Iraq would not service its external debt at least through the end of 2004. Subsequently, the Paris Club group of official creditors stated their expectation that Iraq would not make payments over this time period.

Next we sought to obtain the best possible data on Iraq's foreign debt and its economic condition. Without any reliable data, it would be difficult to reach an international consensus on a debt strategy. We began collecting data by sending several technical assistance advisors to Iraq to review the government's debt records once the war ended. At the same time, we worked intensively through the Paris Club and the International Monetary Fund to obtain data from creditors.

We have made significant progress. The latest available information indicates that Iraq's external debt amounts to at least $70 billion and is probably closer to $100 to $120 billion. Paris Club members report that they are owed roughly $40 billion -- $21 billion in principal and roughly an equivalent amount in late interest. The IMF has polled non-Paris Club governments and, as of September 10, reports creditor claims of $28 billion in principal and interest. Since 20 governments have yet to respond to the IMF poll, this figure is likely to increase.

With better data in hand, we can now proceed with our strategy and work out a long-term solution to Iraq's debt problem. We will continue to work with other creditors toward the objective of achieving a substantial restructuring of Iraq's debt that will permit the Iraqi government to channel resources into reconstruction activities.

Assessment of Reconstruction Costs and International Fundraising Efforts

We also knew at the outset that one of the major priorities following the conflict would be to produce a comprehensive assessment of reconstruction costs in Iraq. We recognized that we could not focus solely on the costs of repairing the damage inflicted during the short conflict. Saddam Hussein's total disregard for the welfare of his population likely meant that the needs of the Iraqi people – and the cost of reversing decades of economic decline – would be substantial.

Because of the extent of Iraq's isolation from the international community, we had little reliable information regarding the extent to which critical investments had been neglected. We were concerned that the absence of economic data and other information would make the job of producing a timely needs assessment especially challenging. We engaged early with our fellow shareholders and with senior officials from the World Bank and the International Monetary Fund to create a process for making a needs assessment as soon as the environment was permissible. As a result of these discussions, these institutions acted quickly to develop the scope of the assessment, divide up responsibility for different sectors, and recruit the necessary staff.

We expect that the cost for reconstruction will be in the range of $50 to $75 billion. This estimate covers critical infrastructure needs in electricity, public works, transport, telecommunications, health, education and agricultural sectors, among others. But it excludes the annual expenses that have been identified by the

Coalition Provisional Authority to cover the government operating budget.

Clearly, this is a cost that will need to be shared widely, and underscores the importance of a major donor effort for Iraq. In June, we established a "Core Group" of donors, consisting of Japan, the EC and the United Arab Emirates, to consult regularly with the UN, World Bank, IMF and CPA, on the planning and preparation for the donor conference. The members of this group are engaging intensively with other potential donors to urge them to pledge generously at the donor meeting in Madrid on October 24. We believe our own substantial contribution of $20 billion – as reflected in the President's forthcoming supplemental request – will be critical to leveraging support from other governments.

In addition, we are encouraging the international financial institutions to commit their own resources to the people of Iraq. As you are aware, the IMF and World Bank recalled their staff following the bombing of UN headquarters where they were also housed. However, these institutions remain actively engaged on Iraq, and are continuing to work with CPA and Iraqi officials, providing technical assistance and finalizing the needs assessment. The World Bank – in conjunction with the UN – is also completing the design of a multi-donor trust fund that would pool bilateral donations and make them available for priority needs identified by these agencies in their needs assessments. In addition to these vital contributions, we have made good progress in our discussions with the IMF and the World Bank on identifying the type and amounts of resources that could be made available to the Iraqi people once the conditions for lending are in place.

In a related exercise, we are reaching out to Export Credit Agencies (ECAs) around the world, encouraging them to follow the U.S. Ex-Im Bank's efforts to support investments in Iraq by insuring repayments. Many other governments have responded positively to this effort, including Japan and the United Kingdom. Through credit facilities such as the one proposed by Ex-Im Bank, credit agencies will be able to provide short-term export credits worth several billion dollars. Initiatives like this will be very important for supporting trade, facilitating commercial activity and spurring growth in Iraq.

Countries other than the U.S. have been identifying and freezing assets of the Hussein regime in accordance with UN Security Council Resolution 1483. Over $1 billion of such assets has been identified and frozen. We are working hard to encourage countries that have frozen assets to transfer those funds to the Development Fund for Iraq (DFI), where they will assist in the reconstruction of the country. We have already had some success in these efforts, including a transfer of approximately $98 million to the DFI announced by Japan on August 29.

Conclusion

Achieving a stable and productive economy is central to our goal of a unified and prosperous Iraq. We have made considerable progress on financial reconstruction over the last several months, thanks to extensive advance planning and the work of many dedicated professionals from the U.S., Coalition partners, and Iraq. Our activities will only intensify in the coming months. While the challenges are formidable, we are well on the way to establishing a vibrant economy that creates opportunities for all Iraqis to achieve a better future for themselves and their children.

FROM THE OFFICE OF PUBLIC AFFAIRS

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September 16, 2003
JS-735

**Statement by
Treasury Assistant Secretary for Tax Policy Pam Olson
on Announcement of New Partnership
to Combat Abusive Tax Avoidance Transactions**

Good Morning. Thank you for joining us. I would like to thank the Federation of Tax Administrators and the States for being here today. Many of you traveled great distances to do so.

We are here today to announce an important new partnership between the Treasury Department, the Internal Revenue Service and the States in the fight against abusive tax scams and abusive tax avoidance transactions. This partnership will aid the federal government and the states in their efforts to ensure that all taxpayers pay their fair share, protecting the integrity of our tax systems.

In the past few years, the Treasury Department has worked closely with the IRS to ensure that the IRS has the necessary information and tools to fully and fairly enforce the tax laws and to combat abusive tax scams and transactions. By joining forces with the states, we take another important step in those efforts.

Through this partnership, the IRS and participating states will exchange information regarding abusive tax avoidance transactions, expanding the web of information that has given the IRS traction in its effort to stem the spread of abusive tax avoidance transactions. Working together, the IRS and state tax authorities will significantly reduce the opportunities for taxpayers and promoters to avoid detection.

This partnership will also allow the states and the federal government to make better use of our collective resources. We can be more efficient with the resources we have, reducing duplicative efforts and identifying more promoters and more taxpayers who have participated in abusive tax avoidance transactions.

Sharing resources will also enhance our education and outreach efforts. One of the best ways to combat abusive tax scams and transactions is to prevent taxpayers from engaging in them in the first place. By better educating taxpayers about the risks of abusive scams and transactions, we can prevent taxpayers from participating in them and deter promoters from selling them. The federal/state partnership means our education and outreach efforts will reach an even larger audience of taxpayers and potential promoters.

We believe the fruits of these efforts will restore faith in the tax system. When some taxpayers game the tax system, the honest taxpayers who foot the bill lose confidence in the tax system and in the government. The partnership we are announcing today is aimed at restoring that faith by ensuring that everyone pays the taxes they owe.

I would like to thank everyone who worked so hard to make this partnership a reality. We look forward to working with you in the future.

Now, I would like to introduce IRS Commissioner Everson.

Related Documents:

- IR2003-111 IRS and States Announce Partnership to Target Abusive Tax Avoidance Transactions
- Comments of IRS Commissioner Mark W. Everson
- Comments of Dale F. Hart Commissioner of Small Business/Self-Employed Division
- Statemetn of State Tax Officials
- Text of Abusive Tax Avoidance Transation (ATAT) Memorandum of Agreement

PREPARED REMARKS
COMMISSIONER OF INTERNAL REVENUE
MARK W. EVERSON
ATAT MOU SIGNING CEREMONY PRESS CONFERENCE
TREASURY DEPARTMENT
SEPTEMBER 16, 2003

Abusive tax avoidance transactions are a cancer. They mock honest taxpayers who pay what they owe and stick law-abiding citizens with a bigger tax bill. Abusive schemes erode confidence in the fairness of our tax system.

And these abusive schemes are not just the IRS' problem. They are not just the States' problem. They are a shared problem demanding the unified approach we're announcing today.

The inauguration of this partnership agreement sends a strong message to those promoting and using abusive tax avoidance transactions. We're closing in on you from all sides. The States and the Federal Government are now fighting as allies.

This agreement marks a milestone in state and federal cooperation. From today forward, we will work together combating abusive tax schemes. We will share information and coordinate case management. This agreement effectively extends the resources of the IRS.

From the IRS perspective, this is another important component in our renewed focus on strengthening the integrity of our tax system through enhanced

enforcement activities. Service plus enforcement equals compliance. The IRS must help people understand their tax obligations. But when people don't meet their tax obligations, we must ensure fairness. People should pay what they owe. We will enforce the law with particular vigor in the corporate arena and for high-income individuals who enter into abusive shelters to game the system.

I want to make one additional point. I believe that the privacy of taxpayer information is a cornerstone of taxpayer rights. The information shared under this agreement will be strictly limited to that pertaining to abusive transactions.

To wrap up, I would like to thank Dale Hart for leading this effort on behalf of the IRS. And I would like to thank Stephen Cordi, who is here on behalf of the Federation of Tax Administrators, which played an important role in reaching this agreement.

Steve is also here in his role with the Maryland Comptroller of the Treasury. I'd also like to acknowledge seven other tax administrators for their efforts on this agreement:

1) **Marcy Jo Mandel from California.**
2) **Kimberly Lewis Robinson from Louisiana.**
3) **Alan LeBovidge from Massachusetts.**
4) **Dominic Louis Vitale from New Jersey**
5) **Kenneth Thorsen from Virginia**

6) **Phil Brand from Washington, D.C.**

7) **And Arthur Roth, who has just retired as Commissioner of New York Department of Taxation and Finance.**

Thank you for your efforts. Now, I'll turn this over to Dale Hart for more details on the agreement.

Prepared Remarks
Dale F. Hart
Commissioner, Small Business/Self-Employed Division
Internal Revenue Service
IRS/State ATAT MOU Event
Treasury Department
September 16, 2003

The agreement we are announcing today is a testament to the positive impact that partnering between the IRS and the State tax organizations can have on good tax administration. This agreement to jointly address abusive schemes and transactions is the culmination of a ten-month partnership by a joint IRS and State team. In particular, I'd like to take this opportunity to express my sincere thanks to officials from the New York Tax Commission who co-chaired the team, as well as State tax administrators from Arizona, California and North Carolina, for their contributions to the team. Their assistance and expertise, as well as the support of our respected colleagues at the Federation of Tax Administrators, has fortified my belief in the value of FedState partnerships when dealing with the most complex tax administration issues.

This new agreement increases cooperation between the IRS, the majority of States and the District of Columbia, plus it enables us to leverage our resources and expertise across the board.

I would now like to highlight a few of the major provisions of this cooperative effort.

A major change resulting from this agreement will be the up-front exchange of information around identified schemes and abusive transactions. This will allow us to leverage and focus our limited resources and reduce duplication of efforts. This is a different approach from many of our past partnerships, where we have not always taken such a collaborative approach in dealing with compliance challenges common to both IRS and the States.

Another component of the new agreement, which will further increase efficiency in the use of federal and State resources, involves a plan to establish a method for the sharing of leads for possible examination by the States. This approach will leverage our ability to identify those involved in these schemes, and take appropriate actions to bring these individuals into compliance with both the State and federal taxes they have chosen to avoid paying.

A final key element I would like to mention involves partnerships on outreach and education efforts. Informing the public about the dangers and the consequences of participating in these schemes is a vital aspect of our strategy. We recognize that in teaming together with the States in our counter-marketing efforts, we can reach the maximum audience and perhaps prevent others from being lured into these schemes and scams.

In closing, I want to emphasize that the States and the IRS are committed to the same thing: effective, fair tax administration. This initiative fosters that goal by proactively partnering to deal with those who choose to not participate in paying their fair share. For those honest people who file and pay their taxes, the establishment of this united compliance front by the IRS and the States against the growing problem of abusive schemes is good news. It's a smart, common sense approach and the latest in the government's ongoing efforts to ensure the fairness of the American tax system.

Now, I'd like to invite Steve Cordi, President of the Federation of Tax Administrators, and Deputy Comptroller for the state of Maryland to share his comments.

Alabama

Mike Mason
Director of Tax Policy
Alabama Department of Revenue

With Alabama's current fiscal condition, we welcome the opportunity to work with the IRS in this initiative. The combined resources of federal and state can strengthen the aggressive identification and elimination of tax avoidance schemes.

Arizona

J. Elliott Hibbs
Director
Arizona Department of Revenue

Arizona is excited about signing the Abusive Tax Avoidance Transactions (ATAT) Memorandum of Understanding (MOU) for several reasons. Abusive tax schemes cost the state of Arizona several million dollars each year. The MOU will allow the Department of Revenue (DOR) to take a more aggressive approach against taxpayers that are purchasing abusive tax avoidance products to evade paying their fair share of Arizona income tax. Partnering with IRS will provide auditor training opportunities, audit leads and joint taxpayer education.

Abusive tax avoidance schemes create inequities in the Arizona tax system, undermine the Arizona tax system and weaken Arizona tax revenues. DOR is determined and eager to pursue those taxpayers that are *not* paying their fair share of Arizona income tax; joining forces with the IRS is just the beginning.

California

Steve Westly
California State Controller and Chair of the
Franchise Tax Board

This agreement is a "win-win" for State and Federal government and a "lose-lose" for tax cheats. It will help us find and prosecute more tax evaders without adding to our costs.

District of Columbia

Phil Brand
Deputy Chief Financial Officer
Office of Tax and Revenue
Washington, District of Columbia

The District of Columbia Office of Tax and Revenue (OTR) is pleased to be part of the effort combating the abuse of tax shelters. OTR intends to work vigorously with IRS and our counterparts in the states to collectively deal with those who attempt to avoid or evade taxes.

Iowa

Michael Ralston
Director
Iowa Department of Revenue

Michael Ralston, director of the Iowa Department of Revenue, said, "Participating in the Abusive Tax Avoidance Transaction effort with the Internal Revenue Service will improve tax administration at both the federal and state levels. Resources will be better utilized to result in additional compliance and more revenue for the State of Iowa. The Iowa Department of Revenue is committed to allocating resources for this project."

"Working with the IRS is something we do every day," continued Ralston. "This partnership benefits taxpayers through more effective use of resources, and we look forward to this new partnering initiative."

Illinois

Brian Hamer
Director
Illinois Department of Revenue

"Illinois is pleased to be part of this joint effort to crack down on tax evasion," said Illinois Revenue Director Brian Hamer, noting that Illinois has already seen benefits from the federal crackdown on abusive shelters. In recent months two individual taxpayers had come forward, filed amended returns, and paid Illinois $2.3 million, after they became aware of IRS efforts involving tax shelters. "I'm confident that this concerted joint effort will identify further abuse, assure that taxpayers fully pay the tax they owe, and ease the tax burden on other taxpayers," Hamer said.

Louisiana

Cynthia Bridges
Secretary
Louisiana Department of Revenue

It has been estimated that Louisiana lost between $44 million and $94 million in 2001 as a result of corporate tax sheltering. This ATAT Memorandum of Understanding is another example of Louisiana's cooperative partnership with the IRS to eliminate abusive tax avoidance schemes.

Maryland

Steve Cordi
Deputy Comptroller and President of the
Federation of Tax Administrators

This partnership takes FedState cooperation to a new level beyond simply sharing data and joint customer service projects to real compliance. Taxpayers not complying with federal laws are most certainly not complying with state laws. We hope to recover unpaid state taxes but more importantly, if we don't partner with the IRS to confront abusive tax schemes, we lose the trust of our compliant taxpayers, and that's a big deal.

Massachusetts

Alan LeBovidge
Commissioner of Revenue

"This sort of cooperation is really the wave of the future," said Alan LeBovidge, commissioner of revenue for Massachusetts. "As businesses get more and more complex, the only way to move forward is to foster cooperation among government agencies."

Massachusetts, which closed a number of tax loopholes earlier this year, has a goal of making everyone pay their fair share of taxes. The memorandum of understanding with the IRS will help the Commonwealth evaluate some of the more sophisticated tax avoidance schemes employed by businesses, LeBovidge said.

Minnesota

Dan Salomone
Commissioner
Minnesota Department of Revenue

The State of Minnesota is pleased to be part of this collaborative effort to identify and combat abusive tax avoidance transactions. Minnesota has garnered a national reputation for the management of its tax system, in part because of the close working relationship between the Minnesota Department of Revenue and the Internal Revenue Service.

I am confident that the new initiatives that will spring from the memorandum of understanding will increase the fairness of our tax system, help us maintain quality public services, and reduce future tax burdens on compliant taxpayers.

Missouri

Todd Iveson
Deputy Director of Taxation and Collection
Missouri Department of Revenue

Missouri is in a tough budget time when every dollar counts. The agreement between our state and the IRS will help identify individuals who are not filing and not paying their fair share of taxes. The program will allow federal and state auditors to team up from the start, using joint strategies, procedures, and audit techniques to find abusive taxpayers. We are very excited about this new program and look forward to working more closely with the IRS.

Missouri's tax amnesty program runs until October 31, 2003. During amnesty, individuals can pay eligible unpaid state taxes that were due on or before December 31, 2002, without paying interest or penalties. Delinquent taxpayers should consider coming forward now to file and/or pay any unpaid taxes, before the IRS and Missouri team up and find them. Individuals identified after the amnesty program will be required to pay the full tax, interest, and penalties and will be subject to all criminal and civil actions provided by law.

Montana

Linda Francis
Director
Montana Department of Revenue

The cooperative federal-state agreement between the Internal Revenue Service and the State of Montana to share information on Abusive Tax Avoidance Transactions (ATAT) is a great opportunity. Working together to identify and bring ATAT participants into compliance, the Internal Revenue Service and the State of Montana will reduce duplicative efforts and maximize audit resources.

Governor Judy Martz is very supportive, and believes that entering into this agreement will benefit Montana citizens by improving government's pursuit of tax scheme participants. The cooperative effort will enhance Montana's effectiveness in administering the state's tax code and in educating ATAT participants on tax requirements. Ultimately, this will ensure that all Montana taxpayers are treated consistently, with everyone paying his or her fair share.

New Jersey

Robert K. Thompson
Director
New Jersey Division of Taxation

This is just one more example of the IRS and the New Jersey Division of Taxation working together to insure that all taxpayers pay their fair share and that the costs of good tax enforcement is born by those who are truly non-compliant. It further highlights the fact that taxpayers that use high priced tax preparers are held to the same standard as all others.

New York

Arthur J. Roth
Commissioner of Taxation and Finance

New York State Commissioner of Taxation and Finance Arthur J. Roth said, "I was pleased and honored that New York was the first state to sign onto this MOU. Because of this important agreement, we will no longer have to discuss the 'growing' area of tax schemes and scams. I now look forward to referring to the 'shrinking' or 'once thriving, but now dying' area of tax schemes and scams."

North Carolina

Norris Tolson
Secretary
North Carolina Department of Revenue Secretary

The North Carolina Department of Revenue is pleased to be a partner with the Internal Revenue Service in our continued effort to address tax compliance issues in this state. Our partnership with the IRS is a vital link in our agency's overall compliance program.

We have worked closely with IRS tax officials during this year to develop procedures for addressing tax avoidance schemes. Our newly signed Memorandum of Understanding with the IRS targets abusive tax avoidance transactions used by citizens of our state. These abusive transactions cost the state of North Carolina millions of dollars in lost tax revenue each year.

As the North Carolina Department of Revenue launches its Project Compliance initiative, our agency is committed to returning more than $40 million in lost revenue to the state's general fund during this fiscal year. Our initiative is aimed at addressing abusive tax avoidance transactions and is a key element of our compliance enforcement strategy during this year.

Our efforts focus on fairness for all citizens and proper compliance with our state's tax laws.

Oklahoma

Steve Kemp
Commissioner
Oklahoma Tax Commission

We are very pleased to join forces with the Internal Revenue Service in combating abusive tax avoidance transactions through information sharing to identify, to examine, and to bring into compliance with Oklahoma tax laws those who participate. We feel that it is important to identify and pursue these abusive tax schemes and bring the people that participate in them into compliance. To allow them to continue places an unfair burden on the honest taxpayer."

Oregon

Elizabeth Harchenko
Director
Oregon Department of Revenue

This agreement reflects the growing commitment between the states and the IRS to work together to achieve tax compliance. Citizens expect us to coordinate our efforts and to cooperate in addressing abusive tax shelters. We must share information and develop strategies together in order to assure the public that all taxpayers report and pay the taxes they owe under the law.

Pennsylvania

Gregory C. Fajt
Secretary of Revenue
Commonwealth of Pennsylvania

This Memorandum of Understanding among the Pennsylvania Department of Revenue, other U.S. states and the Internal Revenue Service gives us all new weapons to use against those who seek to avoid paying taxes in violation of the law. The information we will share under the agreement announced today will help my Department ensure that Pennsylvania's tax laws are enforced fully and fairly, and that those who do pay their taxes do not shoulder a greater burden because of those who do not.

South Carolina

Burnett R. Maybank III
Director
South Carolina Department of Revenue

The South Carolina Department of Revenue has always had a cordial and mutually-benefiting relationship with the Internal Revenue Service. For that reason we are extremely pleased to enter into this latest agreement with the IRS, and 39 other states, because it not only enhances our ability to exchange important tax information regarding corporate tax shelters and other abusive tax avoidance transactions, but allows us to share resources of all types in our efforts to alleviate this abuse of the tax system.

A recent Multi-State Tax Commission study estimated South Carolina loses more than $80 million each year in revenue from illegal business and corporate tax shelters. That is especially critical when the state desperately needs every legitimate revenue dollar. Such abuse also places businesses that pay their taxes at an unfair competitive disadvantage to those who are not paying.

We have a common goal with the IRS, and that is to insure our honest and diligent taxpayers are not burdened by those who would use any measure to avoid paying their fair share. This agreement is yet another tool at our disposal to help us reach that goal.

South Dakota

Gary R. Viken
Secretary
South Dakota Department of Revenue and Regulation

The SD Department of Revenue and Regulation recognizes that improving taxpayer compliance is key to improving tax revenues for the State of South Dakota. Through our participation in this information exchange between the Internal Revenue Service and state tax entities, we will be able to further maximize our efforts in combating tax avoidance. This expansion of our resources will enable us to better identify those individuals who are not meeting their tax obligations and to ensure that the State of South Dakota receives the tax revenues that they are owed.

Vermont

Tom Pelham
Commissioner
Vermont Department of Taxes

The Vermont Tax Department looks forward to partnering with the Internal Revenue Service in this cooperative effort to stamp out abusive tax avoidance transactions.

The bottom line is all taxpayers must pay their fair share of federal and state taxes to fund the benefits received by living in our great nation and our great state.

Virginia

Kenneth W. Thorson
Tax Commissioner
Virginia Department of Taxation

The IRS' new Abusive Tax Avoidance Transactions (ATAT) program highlights the partnership between the IRS and State tax officials to address the growing area of tax schemes and scams. Virginia strongly supports the Internal Revenue Service's program to combat abusive tax avoidance transactions.

Over the past several years, Virginia strengthened its efforts to protect the integrity of our system of voluntary tax compliance. Cooperation with the IRS in the program announced today complements our state-based efforts.

We owe it to honest taxpayers that routinely pay their fair share of taxes to pursue aggressively those persons who improperly seek to avoid this most central civic responsibility. We look forward to becoming an ally of the IRS in this important initiative.

Wisconsin

Michael L. Morgan
Wisconsin Revenue Secretary
Wisconsin Department of Revenue

Michael L. Morgan, Wisconsin Revenue Secretary, praised the ATAT partnership saying the effort will address tax equity while helping his state reduce its delinquent tax balance.

"Wisconsin expects to see tangible benefits from this innovative partnership," said Morgan. "Together with the federal government we can improve on the collection of revenues that are critical to our state and we can do so with an even greater measure of fairness."

Memorandum of Understanding
Between
Internal Revenue Service
Small Business/Self-Employed Division (SB/SE)
And
[State tax agency]

Concerning Abusive Tax Avoidance Transactions

1. INTRODUCTION:

This Memorandum of Understanding (MOU) between the Internal Revenue Service (IRS) Small Business/Self-Employed Division (SB/SE) and the [state tax agency name (state tax agency abbreviation)] sets forth the agreement of the parties with respect to an initiative to facilitate information sharing for tax administration purposes in conjunction with Abusive Tax Avoidance Transactions (ATAT).

2. AUTHORITY:

A. Under the terms of this MOU, federal tax returns and return information related to ATAT will be disclosed by the IRS to [state tax agency] pursuant to Internal Revenue Code (IRC) section 6103(d). This MOU is intended to facilitate information sharing between the IRS and [state tax agency] pursuant to the existing Agreement on Coordination of Tax Administration between the IRS and [state tax agency] (herewith "Basic Agreement") executed by IRS on [date], and the Amended Implementing Agreement on Coordination of Tax Administration between the IRS and [state tax agency] (herewith "Amended Implementing Agreement") executed by the IRS on [date]. The Basic Agreement, the Amended Implementing Agreement, and this MOU constitute the written request required under IRC 6103(d) for the disclosure of federal returns and return information related to ATAT from the IRS to the [state tax agency]. The [state tax agency] will use the information to be disclosed to identify, examine, and bring participants in ATAT into compliance with [state] tax laws. The (state tax agency) agrees that it will only use the information for purposes of state tax administration pursuant to IRC 6103(d) and the Basic Agreement, the Amended Implementing Agreement, and this MOU. In any situation where a conflict arises between the provisions of this MOU and the Basic and Implementing Agreements, the Agreements shall govern.

B. State returns and return information will be disclosed to IRS pursuant to [state statute]. The information will be used by the IRS to identify, examine, and bring ATAT participants into compliance with federal tax laws and regulations.

3. PURPOSE:

A. This sharing of ATAT-related information will present a united compliance front to taxpayers and their representatives, increase audit coverage, and leverage federal and state resources in the ATAT area.

B. This MOU also serves to facilitate communication between IRS and [state tax agency] and the disclosure of returns and return information between IRS and [state tax agency] employees who deal with ATAT leads, cases, and audits.

4. PARTIES TO AGREEMENT:

A. Parties that will share tax returns and return information include IRS and [state tax agency]. IRS and [state tax agency] employees authorized to request and receive tax information will be designated in writing pursuant to Article [number] of the Amended Implementing Agreement.

B. The SB/SE Compliance Area Director (working with the Headquarters, ATAT Program Office) and the [head of state tax agency], will designate, in writing, the names of IRS and state employees who will be authorized to request and receive ATAT-related tax information pursuant to this MOU. The names, telephone numbers, and addresses of these IRS and [state agency] employees will be attached to this MOU as an addendum within 30 calendar days of execution of this agreement. A copy of this list will be provided to the IRS Disclosure Officer. This list will be updated annually, or as needed, by the SB/SE Compliance Area Director, and headquarters, ATAT Program Office, and by the [head of state tax agency]. A copy of the amended list will be provided to the IRS Disclosure Officer. Amendments to the list of IRS employees authorized to request and receive tax information may be made at any time by written notification from the IRS SB/SE Compliance Area Director (working with headquarters, ATAT Program Office) to the [head of the state agency]. Amendments to the list of [state agency] employees may be made at any time by written notification from the [head of the state agency] to the IRS SB/SE Compliance Area Director.

C. IRS and [state agency] employees who are named on the list described above will be authorized to request and receive tax information pursuant to the Basic Agreement, the Amended Implementing Agreement, and this MOU for the duration of their designation on the list, their participation in this cooperative effort related to ATAT, and based on their "need to know" the information as best serves effective tax administration.

5. CONTACTS:

Contacts for the purpose of this MOU will be the IRS SB/SE designee, the IRS Governmental Liaison for [state], the IRS Disclosure Officer, and the [state tax agency] Disclosure Officer designee (see attached contact list).

6. JOINT OUTREACH:

The IRS and [state tax agency] will coordinate outreach activities relating to ATAT issues as appropriate. This may include, but is not limited to, joint press releases, joint dissemination of counter-marketing messages, joint publicity of ATAT initiatives, and other outreach materials.

7. DUTIES AND RESPONSIBILITIES OF THE IRS:

A. To avoid duplication of efforts, the IRS SB/SE Headquarters, ATAT Program Office will provide to [state tax agency] a list of participants in a particular ATAT scheme that may be investigated by the State. The list will be provided after the participants in a particular scheme are identified and the IRS determines a compliance strategy for the promotion. This list will be updated semi-annually on or about July 31 and January 31 and provided to [state tax agency].

B. The IRS will provide to [state tax agency] all audit results from ATAT participant cases conducted by the IRS.

C. The IRS will exchange information on types of ATAT schemes identified at the federal level with [state tax agency].

D. The IRS will provide audit technique guides, when available, for ATAT schemes to [state tax agency].

E. IRS employees who request state returns or return information should complete Form 8796, "Request for Return/Information."

F. Form 8796, "Request for Return/Information" to request state information or Form 10475, "State Tax Information Request" will be signed and approved by the SB/SE Compliance Territory Manager.

G. All requests from authorized IRS employees for state information should be forwarded to the [state title & address] for response.

H. The IRS will partner with [state tax agency] on training and other educational activities. The IRS will provide [state tax agency] with opportunities to attend ATAT training classes or use IRS instructors.

I. The IRS may initiate communications on an as needed basis to facilitate the purposes of this MOU.

8. DUTIES AND RESPONSIBILITIES OF [STATE TAX AGENCY]:

A. After receipt of a participant list from the IRS, [state tax agency] will provide IRS a list of those participants, [state tax agency] intends to examine.

B. States will assist IRS in utilizing State databases to further refine participant lists.

C. Upon completion of state examinations and state assessments of ATAT cases, the [state tax agency] will forward the results to the IRS SB/SE Chief, Planning and Special Programs.

D. [State tax agency] will provide information on types of ATAT schemes identified at the state level to the IRS.

E. [State tax agency] will exchange state audit strategies and procedures regarding ATAT with the IRS.

F. [State tax agency] employees who request federal returns or return information should normally complete Form 8796, "Request for Return/Information."

G. Requests from [state tax agency] employees for federal ATAT information should be forwarded to the IRS Disclosure Officer.

H. [State tax agency] will partner with IRS on training and other educational activities. [State tax agency] will provide IRS with opportunities to attend ATAT training classes or use [state tax agency] instructors.

I. Where appropriate, [state tax agency] will have members on the IRS cross-functional ATAT council.

J. [State tax agency] may initiate communications on an as needed basis to facilitate the purposes of this MOU.

9. DISCLOSURE, SAFEGUARDS, AND RECORD KEEPING REQUIREMENTS:

A. The IRS Disclosure Officer will ensure that all requirements for recordkeeping and accounting for disclosures are met in accordance with IRC section 6103 and its implementing regulations.

B. In order to comply with the federal safeguards required by IRC section 6103(p)(4), [state tax agency] employees will maintain federal tax returns and return information separately, in addition to abiding by the procedures implementing IRC section 6103(p)(4).

C. IRS employees will maintain state information separately. All records and documents collected, maintained, or generated by the IRS and/or disclosed to [state tax agency] under this MOU, and any information collected as a result of joint correspondence, joint interviews, or IRS administrative summonses, will be subject to the confidentiality requirements of IRC section 6103(a).

D. All information obtained under this Agreement must be safeguarded in accordance with the [date] Agreement on Coordination of Tax Administration (herewith "Basic Agreement"), any revisions, and the Amended Implementing Agreement as well as the safeguards described in IRS Publication 1075, *Tax Information Security Guidelines for Federal, State, and Local Agencies.*

E. Nothing in this Agreement will cause IRS or [state tax agency] to disclose information that is normally protected by governmental, attorney/client, or attorney work product privileges consistent with applicable laws, or any other information that is prohibited from disclosure. See IRM Section 11.3.32.17, Restrictions on disclosure of returns and return information.

F. Neither the IRS nor [state tax agency] will disclose return information that would identify a confidential informant or seriously impair any civil or criminal tax investigation. Voluntary disclosures to the IRS under the guidance of Internal Revenue Code (IRC) 6011 will not be included in the participants lists provided to the states. States will receive final assessments related to IRC 6011 voluntary disclosures through established channels.

10. LIABILITY:

A. Each party to this Agreement shall be liable for the acts and omissions of its own employees.

B. The IRS shall not be liable for any injury to another party's personnel or damage to another party's property unless such injury or damage is

compensable under the Federal Tort Claims Act, 28 U.S.C. § 1346(b), or pursuant to other federal statutory authority.

C. [State tax agency] shall not be liable for any injury to another party's personnel or damage to another party's property unless such injury or damage is compensable under the law of the state of [state].

11. THIRD PARTY RIGHTS:

This MOU does not confer any rights or benefits on any third party.

12. AMENDMENT OR TERMINATION OF MOU:

This MOU will become effective on the date of the last signature written below and will remain in force until terminated by either IRS or [state tax agency]. If the IRS or [state tax agency] wishes to terminate this MOU, a written notice must be mailed to, or otherwise delivered to, the other party. The MOU will terminate 30 calendar days after the receipt of such notice. This MOU may only be amended upon the mutual consent of the IRS and [state tax agency]. A written notice of the terms of the amendment must be mailed to, or otherwise delivered to, the other party.

13. LIMITATIONS:

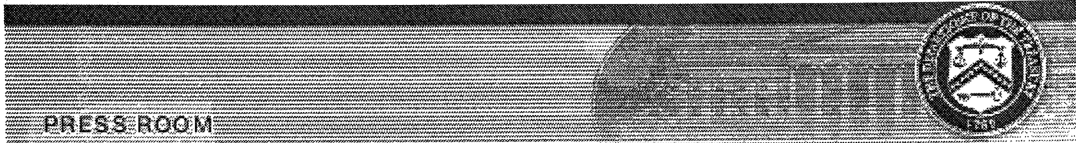
The terms of this MOU are not intended to alter, amend, or rescind any provisions of Federal law. Any provision of this MOU, which conflicts with Federal law will be null and void. Nor are the terms of this MOU intended to alter, amend, or rescind any provisions of the Basic Agreement or the Amended Implementing Agreement now in effect. In the case of conflict, the provisions of the Basic Agreement and/or the Amended Implementing Agreement will govern.

APPROVALS:

____
[Name], Commissioner
[Name of State Tax Agency]
Signed at _______________, this _______ day of ___________, 2003.

____
[Name], Area Manager
Governmental Liaison and Disclosure
Internal Revenue Service
Signed at _______________, this _______ day of ___________, 2003.

____
[Name & title]
SB/SE Director of Compliance
Internal Revenue Service
Signed at _____________ this _______ day of ___________, 2003.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 17, 2003
JS-736

U.S. Treasury Secretary John W. Snow Statement following Visit to Saudi Arabia September 17, 2003

I am pleased to report a fruitful day of discussion in Saudi Arabia, on subjects ranging from pro-growth economic reforms, to reconstruction efforts in Afghanistan and Iraq, to the ongoing war on terrorist financing.

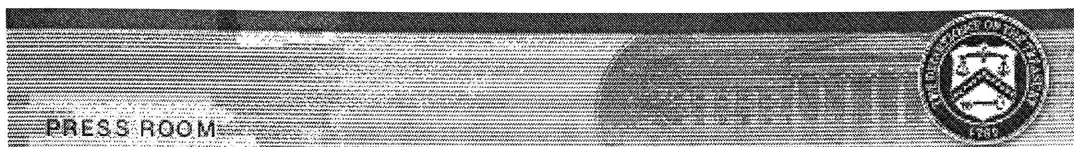
Earlier today, I met with Finance Minister Al-Assaf, SAMA Governor Al-Sayari, and Commerce Minister Yamani, as well as with Foreign Minister Faisal, and we engaged in a constructive dialogue regarding economic reforms that will strengthen and diversify the Saudi Arabian economy. In particular, I believe Saudi Arabia's plan for accession to the World Trade Organization sets achievable targets for attaining an important milestone. We also discussed reforms underway to open a variety of industry sectors to foreign investment, which will attract international capital and best practices to Saudi Arabia, spurring growth and stability. There is general agreement that the Saudi economy needs to produce more jobs and investment outside the energy sector, to withstand the uncertainties of global oil markets and accommodate high population growth.

I am also pleased to say that the Saudi people are continuing their generous aid to relieve suffering in Afghanistan, which is the next stop on my tour through the Middle East. The Saudi Kingdom has been a leader, along with the United States and Japan, in rebuilding the Kabul-Kandahar-Herat road, and they have pledged to join the United States in further bolstering reconstruction.

We also discussed Saudi Arabia's contribution to Iraq's reconstruction, and we are hopeful that the Saudis will choose to take a leadership role in helping its neighboring nation get onto its feet.

Finally, in our meetings today we discussed our outstanding progress working together on the fight against terrorist financing. Saudi Arabia has been a strong ally to the United States in this essential matter. Their close oversight of charities to guard against money laundering and terrorist financing sets an example to all countries engaged in the war against terror.

Thank you.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 17, 2003
JS-737

Snow and Evans Praise House for Approving Legislation to Make Internet Tax Moratorium Permanent

Treasury Secretary John Snow and Commerce Secretary Don Evans today praised the passage of legislation by the U.S. House of Representatives that would permanently extend the moratorium on taxes on Internet access and multiple or discriminatory taxes on electronic commerce.

"A permanent moratorium means a permanent victory for American consumers and businesses. Keeping the Internet free of multiple or discriminatory taxes will help create an environment for innovation and will help ensure that electronic commerce remains a vital, and growing, part of our economy."

"The House Leadership deserves much credit for getting this legislation passed. The Departments of Commerce and Treasury will continue to pursue this issue to make sure a permanent moratorium is available for President Bush to sign by the November 1 deadline.

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
September 16, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term: 28-Day Bill
Issue Date: September 18, 2003
Maturity Date: October 16, 2003
CUSIP Number: 912795NS6

High Rate: 0.870% Investment Rate 1/: 0.889% Price: 99.932

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 93.21%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 27,966,482	$ 8,956,672
Noncompetitive	43,406	43,406
FIMA (noncompetitive)	0	0
SUBTOTAL	28,009,888	9,000,078
Federal Reserve	4,393,661	4,393,661
TOTAL	$ 32,403,549	$ 13,393,739

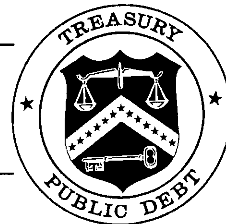
Median rate 0.865%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.090%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 28,009,888 / 9,000,078 = 3.11

1/ Equivalent coupon-issue yield.

JS-738

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
September 11, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 9-YR 11-MONTH NOTES

This issue is a reopening of a note originally issued August 15, 2003.

Interest Rate:	4 1/4%	Issue Date:	September 15, 2003
Series:	D-2013	Dated Date:	August 15, 2003
CUSIP No:	912828BH2	Maturity Date:	August 15, 2013

High Yield: 4.340% Price: 99.275

All noncompetitive and successful competitive bidders were awarded securities at the high yield. Tenders at the high yield were allotted 63.42%. All tenders at lower yields were accepted in full.

Accrued interest of $ 3.58016 per $1,000 must be paid for the period from August 15, 2003 to September 15, 2003.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 28,937,010	$ 12,934,875
Noncompetitive	65,252	65,252
FIMA (noncompetitive)	0	0
SUBTOTAL	29,002,262	13,000,127 1/
Federal Reserve	0	0
TOTAL	$ 29,002,262	$ 13,000,127

Median yield 4.313%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low yield 4.240%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 29,002,262 / 13,000,127 = 2.23

1/ Awards to TREASURY DIRECT = $37,342,000

JS-739

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

September 3, 2003
JS-740

Remarks by Michael A. Dawson Deputy Assistant Secretary for Critical Infrastructure Protection and Compliance Policy to The Continuity Planning Exchange

I would like to begin by thanking you and the Continuity Planning Exchange for this opportunity to speak to you about critical financial infrastructure protection. I would also like to thank John Dinuzzo, even though he could not be with us today, for introducing me to the Continuity Planning Exchange. Your organization has accomplished much. It demonstrates that here, in the center of the most ruthlessly competitive community on earth, we are, at bottom a community committed to working together to address common problems like business continuity.

Today, I will provide a quick introduction to the work that Treasury is doing, together with our fellow financial regulators and the private sector, to enhance the resiliency of our critical financial infrastructure.

I will outline the principles that guide our work. I will then outline the partnerships that we have established with our fellow financial regulators and the private sector to advance our work. I will next describe some of

Guiding Principles
Every thing that we do at Treasury to protect the critical financial infrastructure is guided by a few important principles. I will talk about three, although there are others.

People. First, as the President has said, the highest responsibility of government is the protection of its citizens. We are devoted to protecting the critical financial infrastructure, because it is essential to meeting that responsibility.

For one thing, the most important component of our financial infrastructure is the people who make it work. We must protect the safety of the tellers, loan officers, traders, and technicians that make up our financial infrastructure. Americans trust these employees with their money. Financial services employees, in turn, trust us with their lives. We have a profound obligation to keep these employees safe.

For another thing, Americans depend on the critical financial infrastructure to make the economy work and grow. As Treasury Secretary Snow has said, the financial system is the engine of our free enterprise economy. We have to protect this engine so that it can continue to support growth in the American economy, so that it can continue to create jobs for American workers.

Confidence. Second, we work to ensure that Americans – and the world – maintain their well-placed confidence in the U.S. financial system. It is hard to overstate our dependence on the financial infrastructure. We depend on it to receive our paychecks; to withdraw cash from an ATM; to pay for our groceries with cash, check, debit cards, or credit cards; to finance the purchase of a house or a car; to save for our children's education; to plan for a secure retirement.

Americans have confidence in our financial infrastructure. And they should. Our financial infrastructure is the most resilient in the world. Our job is to keep it that way, to ensure the resiliency of the infrastructure in the face of evolving threats.

Continuity. Third, we are committed to ensuring that our financial institutions continue to function even during – especially during – times of stress. Of course, the physical safety of your employees and customers comes first. But absent a

specific and credible threat to physical safety, it is important for financial institutions and markets to continue to operate as close to business-as-usual as possible. There are several important reasons for this. One is that it is precisely during times of stress that Americans need the financial system most. During times of stress, investors need to price the impact of that disruption on assets. The longer they are prevented from pricing the impact, the more anxiety builds and the worse the consequences will be, we believe, when markets eventually re-open.

Competence. A fourth guiding principle is that we want to promote decentralized decision-making and problem-solving, both as we prepare for disruptions and as we weather them. We favor a cooperative, public-private partnership as we work together to protect our financial infrastructure. In the event of a disruption to the payment system, for example, we want the subject matter experts in payments systems to fix it. We don't want them to wait for guidance from Treasury on how to fix it. Just fix it. You are in the best position to determine what steps you should take to protect your employees and your customers. We will help where we can, but we intend to stand out of the way and let the financial institutions and the regulators that are closest to the problems find the solutions.

These principles have important implications for national-regional cooperation. State and local governments are, of course, right here, right now. Financial institutions are closer to their employees and customers than we are in Washington.

Partnerships

The President has established two principle partnerships for enhancing the resiliency of the critical financial infrastructure.

Shortly after September 11, 2001, the President established the Financial and Banking Information Infrastructure Committee, the FBIIC. This Committee is now sponsored by the President's Working Group on Financial Markets – an interagency task force lead by Secretary Snow, Chairman Greenspan, Chairman Donaldson, and Chairman Newsome –Treasury chairs the FBIIC. Its members include the Federal Reserve Board, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, and the Office of Federal Housing Enterprise Oversight. It includes state authorities as well – the Conference of State Banking Supervisors, and the National Association of Insurance Commissioners.

One of the things that we use the FBIIC for is as a mechanism to evaluate and share available threat information. For example, Treasury has installed secure telecommunications equipment and arranged for appropriate security clearances for personnel in the members of FBIIC, so that we can effectively share sensitive and even classified information. Where appropriate, we can share information with an individual institution, in the case of a specific and credible threat against a specific institution, or with the financial sector more generally.

Another important partnership is the Financial Services Sector Coordinating Council. The Council is led by Rhonda MacLean, a senior executive with Bank of America. Treasury appointed Ms. MacLean last June. She has done an outstanding job. Over two dozen financial services trade associations have joined the council. Among many other things, the Council has worked to collect and disseminate considerations for private institutions to bear in mind in the event that the threat advisory level is at some point in the future raised to red. The Council is also working to construct a repository of table-top exercises, war-games, and tests. This repository will provide a central source for the industry to learn what is happening in the critical financial protection area. In the future, the repository will be a useful tool as we move to more coordinated, inter-institutional testing and planning. Our hope is that we can improve from the situation we have today, in which many well-intentioned exercises are taking place, but without much coordination between exercises. We need to improve coordination so that the exercises build on each other and, over time, systematically improve the resiliency of the industry as a whole. The government and the private sector did a good job of coordinating the planning, preparation, and testing for Y2K. We hope we can replicate that experience in this context.

A third important partnership is the Financial Services Information Sharing and

Analysis Center, the FS/ISAC. Under the leadership of Suzanne Gorman, a senior executive at the Securities Industry Automation Corporation, the FS/ISAC has emerged as a leader in information sharing. For example, many of you will remember that in January of this year a worm called Slammer rocketed around the internet. The FS/ISAC was instrumental in alerting the financial services sector to this threat. We believe that the FS/ISAC was largely responsible for the fact that the financial sector experienced relatively low disruption from the worm.

Each sector has an ISAC, and I am proud of the fact that the Financial Services ISAC was both the first and the best. I am even more proud of the vision that Ms. Gorman has shown to enhance the value proposition of the FS/ISAC by expanding its membership base; improving cross-sectoral information sharing; and working to encourage members to contribute more information, not just receive it. Treasury was pleased to devote resource to the FS/ISAC as it planned these improvements. We look forward to supporting the FS/ISAC with a significant financial investment as it implements its next phase. Already, I am told by Homeland Security officials that they regard the FS/ISAC's vision as a model that other ISACs can look to and learn from.

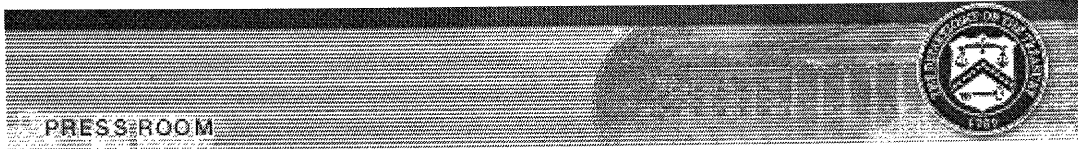
Programs and Products

We have several programs and products that we have developed with our fellow financial regulators and the private sector to enhance the resiliency of the critical financial infrastructure. I will provide just two examples.

Priority Telecommunications Programs. Together with our fellow financial regulators, we sponsor critical financial institutions for participation in three priority telecommunications programs run by the National Communications Services. These three programs enable key personnel and telecommunications lines to receive access to priority telecommunications services. If you are interested in learning more about these services, please contact Brian Peretti (brian.peretti@do.treas.gov), who manages this program in my office.

Protective Response Plans. We work with certain key financial institutions and their regulators to develop integrated protective plans. These plans incorporate the response of local, state, and federal protectors from the local Chief of Police to the County Sheriff, to the State Police authority, to the FBI, to the United States Secret Service, and others. We have conducted one planning exercise and are preparing to conduct two more over the next six months. Thus far, we have found that the exercise vastly improves coordination among local, state, and federal authorities and we look forward to replicating it with more institutions in varying locales. We limit participation in this program to major institutions and require the institution to jointly fund the planning exercise. If you are interested in learning more about this program, please contact Scott Parsons (scott.parsons@do.treas.gov), who manages this program in my office.

That, in a nutshell, is a quick overview of our efforts to enhance the resiliency of the critical financial infrastructure. We undertake these efforts in close partnership with our fellow financial regulators and with the private sector. We look forward to continuing these partnerships as we work together in the future to ensure that the U.S. financial infrastructure remains the most resilient in the world.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 18, 2003
JS-741

United States Treasury Secretary John W. Snow
Statement upon leaving Kabul, Afghanistan
September 18, 2003

My visit to Kabul has offered an enlightening and encouraging perspective on the reconstruction of Afghanistan. Clearly, this is a crucial time in Afghanistan's post-war economic development. The United States and the international community are committed to seeing this long-troubled nation through to peace and stability, and we redoubling our support for the goals and priorities of President Karzai's government.

We cannot allow the people of Afghanistan suffer a return to the humanitarian disaster of the past 20 years, in which a lawless land with the promise of much more unfortunately became a haven for terrorists and drug traffickers. We must reverse this sad history. The reconstruction of a new, democratic Afghanistan must succeed – for the sake of the Afghan people, for the region and for the world community. Much hangs in the balance and failure cannot be an option.

During my visit, I held meetings with President Karzai, Finance Minister Ghani, Central Bank Governor Ahady and other cabinet ministers, and saw several examples of their leadership and vision for Afghanistan's future. Among their notable achievements are the new banking laws, the new currency, improvements in centralizing customs revenue and increasing the transparency and accountability of the budget process.

Most important for long-term growth and employment opportunities in the country are the Karzai administration's policies encouraging private sector investment and productivity. Also, stronger trade and transportation relationships between Afghanistan and its neighbors, especially Pakistan, will be essential for integrating Afghanistan's economy with the global economy, and creating opportunity for the Afghan people.

I want to thank the Karzai government and the people of Afghanistan for their hospitality today. The American people will stand by you. I look forward to returning soon to scenes of even greater progress.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 18, 2003
JS-742

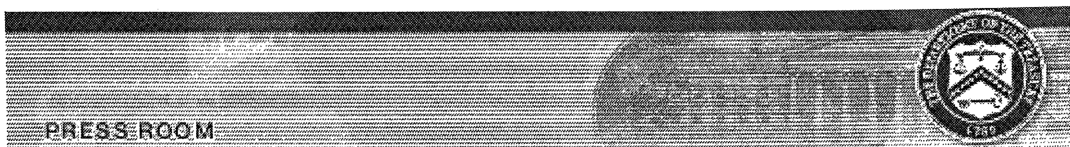
Treasury Announces Scheduled Events Will Proceed

Despite the closing of federal agencies today in preparation for Hurricane Isabel, the following events will proceed as scheduled:

The 13 week/26 week bill announcement will occur at 11:00 am EDT. (www.publicdebt.treas.gov)

The results of the TIO auction will be posted to the Financial Management Service's website at 12:00 pm EDT (www.fms.treas.gov).

The Daily Treasury Statement will be released at 4:00 pm EDT (www.fms.treas.gov).



FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the Microsoft Word content on this page, download the free Microsoft Word Viewer.

September 18, 2003
JS-743

Treasury Announces Results of PATRIOT ACT Section 326 Notice of Inquiry

The U.S. Treasury Department today announced the results of the notice of inquiry published in the Federal Register July 1, 2003 requesting additional information pertinent to the final rules published on May 9, 2003 implementing customer identification requirements for financial institutions under Section 326 of the USA PATRIOT Act. After reviewing over 34,000 comments, Treasury found that no new information had been presented that had not been considered prior to issuing the final rules. Accordingly, Treasury is recommending no changes to the rules.

The July notice of inquiry sought comment on two specific issues: (1) whether financial institutions should be required to retain photocopies of identification documents used to verify customers' identities; and (2) whether financial institutions should be prohibited from accepting foreign government issued identification documents other than passports as an acceptable form of identification.

On the first issue, Treasury reaffirmed its original judgment that the maintenance of photocopies in all cases did not provide a security benefit that justified the additional record keeping burden. Further, many identification documents contain security features that render copies illegible. However, Treasury does note that in some cases financial institutions, at their discretion, may find it prudent to maintain photocopies of identification documents.

On the second issue, Treasury concluded that the risk-based approach taken by the final rules, combined with the ability to notify financial institutions if concerns arise with specific identification documents, provide an ample mechanism to address any security concerns.

Treasury expects all financial institutions covered by the customer identification regulations to have their customer identification program drafted and approved by October 1, 2003.

This additional comment period, which concluded July 31, represented Treasury's commitment to considering all relevant information in implementing these regulations in a way that is fair to those regulated and effective in properly identifying new customers.

A fact sheet providing further information on the notice of inquiry and the original rule, as well as a copy of the notice that will appear in the Federal Register announcing the results of the notice of inquiry are attached.

Related Documents:

- Final Regulations Implementing Customer Identity Verification Requirements under Section 326 of the USA PATRIOT Act

DEPARTMENT OF THE TREASURY

Office of Public Affairs

September 18, 2003

FACT SHEET:

Results of the Notice of Inquiry on Final Regulations Implementing Customer Identity Verification Requirements under Section 326 of the USA PATRIOT Act

Overview:

Following the review of over 34,000 comments received as a result of the July notice of inquiry on certain provisions of the final rules implementing Section 326 of the USA PATRIOT Act, Treasury found that there was no new information presented that was not considered prior to issuing the final rules. Accordingly, Treasury *will not* seek changes to the final rules to prohibit the acceptance of foreign issued identification documents, such as consular IDs, or to require that financial institutions maintain photocopies of identification documents.

Background:

The U.S. Treasury, the Financial Crimes Enforcement Network and the federal financial regulators announced final rules implementing customer identification and verification requirements under Section 326 of the USA PATRIOT Act May 9, 2003.

Treasury published a notice of inquiry in the Federal Register July 1, 2003 initiating a 30-day comment period that concluded July 31, 2003. The notice of inquiry sought comment on two specific issues: (1) whether financial institutions should be required to retain photocopies of identification documents used to verify customers' identities; and (2) whether financial institutions should be prohibited from accepting foreign government issued identification documents other than passports as an acceptable form of identification.

Treasury expects all financial institutions covered by the customer identification regulations to have their customer identification program drafted and approved by October 1, 2003 as scheduled.

****MORE****

Foreign issued identification documents:

Treasury concluded that the risk-based approach taken by the final rules, combined with the ability to notify financial institutions if concerns arise with specific identification documents, provide an ample mechanism to address any security concerns. There was no need to expressly prohibit specific IDs in the regulations themselves.

- An effective program for identifying new customers must allow financial institutions the flexibility to use methods of identifying and verifying the identity of their customers appropriate to their individual circumstances. For example, some financial institutions open accounts via the Internet, never meeting customers face-to-face.

- Rather than dictating which forms of identification documents financial institutions may accept, the final rule employs a risk-based approach that allows financial institutions flexibility, within certain parameters, to determine which forms of identification they will accept and under what circumstances.

- However, with this flexibility comes responsibility. When an institution decides to accept a particular form of identification, they must assess risks associated with that document and take whatever reasonable steps may be required to minimize that risk.

- Federal regulators will hold financial institutions accountable for the effectiveness of their customer identification programs.

- Additionally, federal regulators have the ability to notify financial institutions of problems with specific identification documents allowing financial institutions to take appropriate steps to address those problems.

Photocopy requirement:

Treasury reaffirmed its original judgment that the maintenance of photocopies in all cases did not provide a security benefit that justified the additional record keeping burden.

- The final rules implementing Section 326 of the PATRIOT Act require that financial institutions maintain records of the steps taken to verify identity, including all relevant information in an identification document, such as address, document number, etc.

- The record keeping may include photocopies of identification documents but does not require it. In some cases financial institutions, at their discretion, may find it prudent to maintain photocopies of identification documents.

- Additionally, some IDs have security features that render photocopies illegible, making copies useless.

Breakdown of Comments:

Total Comments:	**34602**

Photocopy Issue:	
Total Comments Received:	10704
Total Comments Requesting No Change to the Final Regulation:	9623
Total Percent in Favor of No Change:	**89.90%**

Identification Card Issue:	
Total Comments Received:	23898
Total Comments Requesting No Change to the Final Regulation:	19770
Total Percent in Favor of No Change:	**82.73%**

DEPARTMENT OF THE TREASURY

Office of Public Affairs

April 30, 2003

FACT SHEET:

Final Regulations Implementing Customer Identity Verification Requirements under Section 326 of the USA PATRIOT Act

Overview:

On May 9, 2003, the U.S. Treasury, the Financial Crimes Enforcement Network and the federal financial regulators announced final regulations implementing customer identification and verification requirements under Section 326 of the USA PATRIOT Act. These new regulations will provide another tool to protect the U.S. financial system from money laundering, terrorist financing, identity theft and other forms of fraud.

Background:

On October 26, 2001, President Bush signed into law the USA PATRIOT Act, important legislation providing a wide range of new tools to combat money laundering and the financing of terrorists. In July of 2002, Treasury announced a proposed rule implementing Section 326 of the PATRIOT Act. The final rule incorporates important changes that increase the effectiveness of the rule while eliminating unnecessary burden on regulated institutions.

What it requires:

The rule requires that financial institutions develop a Customer Identification Program (CIP) that implements reasonable procedures to:

1) Collect identifying information about customers opening an account
2) Verify that the customers are who they say they are
3) Maintain records of the information used to verify their identity
4) Determine whether the customer appears on any list of suspected terrorists or terrorist organizations

Collecting information:

As part of a Customer Identification Program (CIP), financial institutions will be required to develop procedures to collect relevant identifying information including a customer's name, address, date of birth, and a taxpayer identification number – for individuals, this will likely be a Social Security number. Foreign nationals without a U.S. taxpayer identification number could provide a similar government-issued identification number, such as a passport number.

Verifying identity:

A CIP is also required to include procedures to verify the identity of customers opening accounts. Most financial institutions will use traditional documentation such as a driver's license or passport. However, the final rule recognizes that in some instances institutions cannot readily verify identity through more traditional means, and allows them the flexibility to utilize alternate methods to effectively verify the identity of customers.

Maintaining records:
As part of a CIP, financial institutions must maintain records including customer information and methods taken to verify the customer's identity.

Checking terrorist lists:
Institutions must also implement procedures to check customers against lists of suspected terrorists and terrorist organizations when such lists are identified by Treasury in consultation with the federal functional regulators.

Reliance on other financial institutions:
The final rule also contains a provision that permits a financial institution to rely on another regulated U.S. financial institution to perform any part of the financial institution's CIP. For example, in the securities industry it is common to have an introducing broker – who has opened an account for a customer – conduct securities trades on behalf of the customer through a clearing broker. Under this regulation, the introducing broker is required to identify and verify the identity of their customers and the clearing broker can rely on that information without having to conduct a second redundant verification, provided certain criteria are met.

The following financial institutions are covered under the rule:

- Banks and trust companies
- Savings associations
- Credit unions
- Securities brokers and dealers
- Mutual funds
- Futures commission merchants and futures introducing brokers

The regulations were developed jointly by:

- The Department of the Treasury
- Treasury's Financial Crimes Enforcement Network
- The Board of Governors of the Federal Reserve System
- The Commodity Futures Trading Commission
- The Federal Deposit Insurance Corporation
- The National Credit Union Administration
- The Office of the Comptroller of the Currency
- The Office of Thrift Supervision
- The Securities and Exchange Commission

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.
September 18, 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 $30,000 million to refund an estimated $33,831 million of publicly held 13-week and 26-week Treasury bills maturing September 25, 2003, and to pay down approximately $3,831 million. Also maturing is an estimated $26,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced September 22, 2003.

The Federal Reserve System holds $15,355 million of the Treasury bills maturing on September 25, 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 September 23, 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 $993 million into the 13-week bill and $797 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-744

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS
TO BE ISSUED SEPTEMBER 25, 2003

September 18, 2003

Offering Amount	$15,000 million	$15,000 million
Maximum Award (35% of Offering Amount)	$ 5,250 million	$ 5,250 million
Maximum Recognized Bid at a Single Rate	$ 5,250 million	$ 5,250 million
NLP Reporting Threshold	$ 5,250 million	$ 5,250 million
NLP Exclusion Amount	$ 6,300 million	None

Description of Offering:

Term and type of security	92-day bill	182-day bill
CUSIP number	912795 PC 9	912795 PR 6
Auction date	September 22, 2003	September 22, 2003
Issue date	September 25, 2003	September 25, 2003
Maturity date	December 26, 2003	March 25, 2004
Original issue date	June 26, 2003	September 25, 2003
Currently outstanding	$24,421 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.

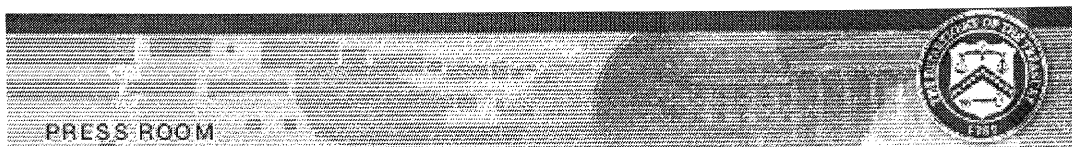
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

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

September 22, 2003
JS-745

Statement by U.S. Treasury Secretary John Snow to the World Bank Development Committee, Dubai, UAE, September 20, 2003

We have come together in Dubai to address a vital cause, supporting developing countries' efforts to increase economic growth, raise living standards, and reduce poverty. The United States is committed to meeting this challenge. Our shared objective further reinforces the urgency of increasing global economic growth.

Increasing Grants

The World Bank has made some important changes that will help to advance developing countries' growth more rapidly and effectively. One such reform is the increasing use of grants. For the poorest countries, grants are particularly important in such areas as education and health – investments that increase productivity but do not directly generate the income needed for debt servicing. We must increase grants in IDA 14 and beyond so that strong performers with heavy debt burdens can still access the external resources they need to support real growth-promoting development.

Mainstreaming Results Measurement

I commend the World Bank for the ambitious transformation it has launched to orient itself toward producing results. No development endeavor should be considered a success unless it achieves measurable impact on the lives of the poor. The Bank's work to integrate a results measurement system and evaluation into its operations and strategies must be practical, achievable and transparent. The focus on results should also apply to Bank lending for budget support for recipient countries. Budget support must be designed around a strong results framework, with clear, measurable baselines, indicators and objectives. It should be going to solid performers with the most credible public expenditure management.

Measuring results, rewarding performance, and increasing transparency are all steps intended to bolster program effectiveness and enhance accountability. To advance this agenda, we call on the Bank to:

Fully disclose the performance rating system it uses to allocate resources to poor countries, including disclosure of individual country performance scores that are used to apportion IDA resources, and the scores of their components;
Tie staff performance incentives to the quality of development outcomes rather than the quantity of development flows, and;
Conduct an external performance audit of the IDA-13 results commitment, to which the United States has tied its $200 million incentive contribution.

Supporting Private Sector-Led Growth

The World Bank is engaging more seriously in supporting private sector-led growth, which is essential for poverty reduction. I particularly want to commend the IFC and IDA initiatives to expand small business access to credit in Africa. I welcome the focus of next year's World Development Report on the links between investment climate improvements, growth and poverty reduction. Investment climate diagnostics must be central to all country programs. Where private finance is

unavailable, the Bank must also catalyze infrastructure investments necessary to strengthen markets, productivity and services delivery.

Remittances

Remittances from the developed countries to people in poor countries play a crucial role in economic development, with recorded flows reaching over $70 billion per year and far exceeding official development assistance. These flows reduce poverty and help achieve other development goals in education and health. Actual flows are believed to be significantly higher given that remittances often flow through informal channels. The use of informal channels indicates that there is room for improvement in our formal financial systems and that we can reduce the cost of remittances thereby increasing the flows significantly. It is critical that the IFIs dedicate resources to the systematic analysis of remittance issues. In this vein, we welcome the World Bank's recent draft report for APEC that creates a framework for estimating the magnitude of remittance flows and examines the incentives for using informal systems.

Reducing Barriers to Trade

Increased trade offers significant potential for developing countries to increase growth and reduce poverty. The World Bank has made commendable efforts to incorporate trade issues into country programs, reducing administrative obstacles to trade and supporting regional integration projects. More operations are needed to improve the legal, administrative, financial and customs/transportation frameworks that can make or break a country's ability to compete. The most important means of increasing trade, however, is to bring down trade barriers in both developed and developing countries. World Bank studies show that the gains from such reforms for emerging markets alone could be $500-$800 billion annually.

The United States commends the willingness of the World Bank to support developing countries with adjustment needs related to trade liberalization. We must not let the outcome at Cancun become a lost opportunity for global trade liberalization. As governments reflect on next steps, it will be critical for all countries to consider their contributions to reducing barriers to poverty-reducing trade and investment.

Voice of Developing and Emerging Market Countries

The United States has long supported strengthening the voice of developing and emerging market countries in the international financial system. The U.S. was one of the earliest and strongest advocates of the creation of the G-20 and the country-driven PRSP process, and the U.S. has advocated including borrowing country representatives in IDA-13 and African Fund replenishment negotiations. We supported measures taken last spring to enhance the influence of the borrowing countries with regard to the Bank, including adding resources to the largest constituencies.

Supporting Iraq and Afghanistan

It is propitious that we are meeting in Dubai. Our coming together here underscores the vital work that the World Bank and other institutions are doing in this region. As we all know, the task of supporting reconstruction and recovery in Iraq is enormous. The World Bank is already making a tremendous contribution on a needs assessment, and we look forward to its continuing active engagement. In particular, the World Bank should work with the Iraqi Governing Council and relevant Iraqi ministries to provide substantial financial support to Iraq as soon as possible.

I believe that we have already achieved important successes in Iraq, especially in the economic and financial areas. While these achievements are helping to underpin economic stability in Iraq, substantial work is needed to lay the foundation for private sector-led growth and to bring lasting and meaningful improvements to the Iraqi people. Helping Iraqis achieve these objectives will require a sustained commitment by the international community, and I look forward to next month's

meeting in Madrid as an opportunity for donors to pledge their support.

In Afghanistan, reconstruction is moving forward with the help of the international community. Substantial progress has been made on crucial infrastructure projects, and I commend the contributions that the World Bank and Asian Development Bank are making in this area. The Afghan government deserves credit for its efforts to provide the basis for a working economy.

Afghanistan is at a critical juncture. To ensure success, the United States will increase its assistance to Afghanistan this year and accelerate projects to provide concrete, visible results to the Afghan people. To be successful, however, this must be a united effort with the full support of the Afghan government and the international community. I urge donors to increase and expedite their assistance.

Combating Terrorist Financing/Anti-Money Laundering

We are making progress in protecting people from terrorism by combating terrorist financing and money laundering, but much remains to be done. The World Bank has contributed to this effort and I look forward to further work. A high priority is the joint World Bank, IMF and Financial Action Task Force (FATF) pilot project for assessing country compliance with standards for combating terrorism financing and money laundering. This should become a permanent part of the IFIs' oversight and surveillance of financial systems. It will be critical to the war on terrorism and will help to anchor the foundations of sustainable growth and development.

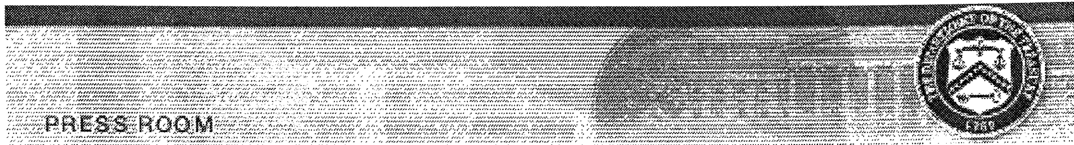
World Bank Budget

To ensure the ability of the World Bank to deliver its assistance more effectively and achieve its objectives, its administrative budget must be more transparent and focused on the strategic priorities of the Bank. The US will work with other shareholders in the World Bank and the other international financial institutions to propose changes in the way their budgets are structured, with a view to implementing these changes over the next year.

Conclusion

I want to share a longer-term vision reflecting on the ambitious goals that we have set for reducing poverty. As these goals are met, we can add another target that we should all want to achieve, and that is for the development institutions – bilateral and multilateral – to work themselves out of business. While it may seem like a strange measure of success, such an achievement would mean that people's lives have improved and countries are relying on investment, private capital, and entrepreneurship instead of pledges, concessions, and debt relief. It would mean that the people of developing countries will have governments that deliver basic services and provide for the rule of law; it will mean that they will have a chance to better their lives and see their children educated; and it will mean that they will know freedom and human dignity.

Thank you.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 20, 2003
JS-746

Statement by U.S. Treasury Secretary John Snow following the G7 Finance Ministers Meeting, Dubai, UAE, September 20, 2003

Good afternoon. I welcomed the chance to meet today for the fourth time with my fellow G-7 Finance Ministers and Central Bank Governors.

Strengthening global growth must be the top priority for the G-7. I repeated that strong message today. Growth in the major economies, in Europe, and in Asia, is simply not what it could be. We need to do more to ensure a robust global recovery and to promote higher growth rates in our economies and I was pleased the communiqué came out so strongly in support of this idea.

The United States has taken legislative action, proposed by President Bush, to strengthen the U.S. recovery. That legislation is clearly beginning to take affect. After a series of shocks that included terrorist attacks, corporate scandals, and a recession, the U.S. economy is finally accelerating.

I made clear today that the United States can not be the sole engine of world growth, others need to take bold actions themselves – including fundamental structural reforms where necessary – to spur domestic led growth, create jobs and contribute to global prosperity. This is the very same growth message I have taken to Europe, Asia and across the world on my global growth campaign and I was pleased to see the G7 for the first time come together on this point.

But I also made clear the U.S. leads by example, and with actions, not just words. Thus, we are continuing to act to strengthen our economy and create jobs.

Earlier this month, President Bush unveiled a six-point plan for ensuring the economic success we all want to see, which I reviewed with my colleagues in some detail. Under the President's plan, we will take the following steps to create the conditions in which employers will hire more workers and our economy will continue to grow.

First, we are working to make health care more affordable and its costs more predictable, so employers can add new workers without also adding a large and uncertain burden from health care costs.

Second, we are working to prevent frivolous lawsuits from diverting money from job creation into legal battles.

Third, we are working to build a more affordable, reliable energy system that can support the expansion of our economy.

Fourth, we are streamlining regulations and needless paperwork requirements that reduce business productivity and deter growth.

Fifth, we are opening new markets to high value American products and bringing down prices for American consumers through trade agreements.

And lastly, number six, we are working to make tax relief permanent, so businesses and families alike can plan for the future with confidence.

We have an ambitious agenda for maximizing economic growth and job creation in our country. These actions, together with President Bush's previous stimulative measures, will take the U.S. economy through the recovery stage, and move to a

new level of expansion, prosperity and success. I urged my G7 colleagues to embark on their own appropriate and equally ambitious agendas and they were quite receptive.

Throughout my meetings we had extensive discussions on the issue of currencies. I expressed my long-held view that the world trading system works best under a regime with market based exchange rates. I was pleased the communiqué reflected this view.

The need for action, however, extends beyond the G-7. All countries need to strengthen their policies and implement reforms aimed at achieving growth. We all benefit when the international financial system relies on the principles of free trade, free capital flows, and market based exchange rates among the major economies.

Trade, and its importance to global prosperity, was discussed. I was very disappointed with the collapse of the WTO talks in Cancun, Mexico earlier this month. To reaffirm our views on global trade, I made this point crystal clear today: the United States supports free trade because a world that trades freely will grow in prosperity. For developing nations, free trade tied to economic reform has helped to lift hundreds of millions of people out of poverty. The growth of economic freedom and ownership in developing countries creates the habits of liberty and creates the pressure for democracy and political reform. Also, of course, we support free trade in America because it creates jobs. It's vital to the success of our economy. I made clear to my colleagues and reiterate here that the United States stands ready to work with others who seek trade liberalization.

Economic and financial crises can disrupt our drive for sustained growth. I am pleased that spreads in emerging markets are down, and that there have been fewer crises, and that capital flows are up. I am also pleased that we have made progress on policy changes that improve predictability in emerging markets. The establishment of collective action clauses as a market standard is a critical step forward.

Yet we all agreed today that there is more to be done to make the IMF as effective as it needs to be. In particular, I underscored the need for IMF to address currency mismatches in assessing its members' economies. The IMF also needs to focus its lending on countries truly committed to reform. The United States and others in the G-7 strongly support recent steps to enhance IMF transparency. Today, we underscored in particular the importance of disclosing all IMF documents – especially the exceptional access reports that justify large scale lending.

Promoting growth and job creation is the single best way that we can help developing countries. In the spirit of Monterrey, the G-7 continues to work to improve development assistance through a results-based approach that focuses on countries implementing credible reforms. We highlighted today the need for these countries to address structural weaknesses and governance issues. I also emphasized the need for the World Bank to reflect the priorities of development and growth in their administrative budgets.

Turning to Iraq and Afghanistan, my colleagues and I discussed the enormous but critical task of supporting reconstruction and recovery. Over the last week, as I traveled through Israel, Jordan, Saudi Arabia, Afghanistan and Pakistan, I have had extensive discussions on this topic with the leaders of this region.

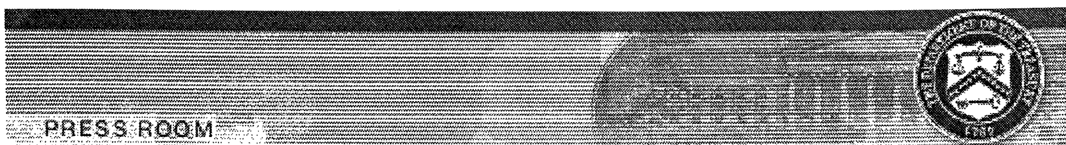
While there has been important progress, much work remains to lay the foundation for private sector- led growth and to bring meaningful improvements to the Iraqi and Afghan people. President Bush has indicated our commitment to providing very substantial sums in support of this effort. I urged others to rise to the challenge of helping both countries with the task of reconstruction. And, to help provide a sound footing for the future, we in the G-7 have pledged to seek a solution to Iraq's debt problem by the end of 2004. Tomorrow morning, I will meet with the new Iraqi Finance Minster Al-Kilani for the first time. During that meeting, I will underscore our dedication and commitment to rebuilding Iraq for the people of Iraq.

In addition to our normal meeting, I am pleased the G-7 had the opportunity to meet together this morning with Palestinian Finance Minister Fayyad. I met with Minister Fayyad last week to underscore with him President Bush's vision of peace and prosperity for the Middle East, and for both the Israeli and Palestinian people.

We fully support the Palestinian Authority in its efforts to bring peace and economic stability and prosperity to the Palestinian people. Toward this end, the United States will continue to provide budgetary support and other aid to the Authority to help insure that it can effectively conduct normal government functions. During our meeting today, I called on others in the G-7 to provide similar support.

Finally, I am eager to sit down this evening with Finance Ministers from countries engaged in the fight against terrorist financing. In the past two years, we have made important progress in protecting the world's financial systems from abuse by terrorists – thanks to the hard work of many countries, the FATF, and the IMF and World Bank. I look forward to the Fund and Bank making terrorist financing/money laundering assessments a permanent part of their surveillance and oversight function. I will also press during our dinner discussion for broad support for measures to ensure that the informal sectors are not alternative havens for the flows of terrorist funds. I will encourage steps to make sure charitable donations go for worthy causes and not to support terror. These steps are important counterparts to our continuing effort to deny terrorists access to the formal networks of international finance.

Thank you.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 22, 2003
JS-747

United States - Turkey Financial Agreement
Joint Statement Following Signing of the Agreement
September 22, 2003
Dubai, UAE

Turkey and the United States signed a Financial Agreement today by which the United States is making available as much as $8.5 billion in loans to Turkey.

The purpose of the Financial Agreement is to support Turkey's ongoing economic reform process.

The loan disbursements will be used to service Turkey's external and domestic debts.

The loan will have a 10-year maturity with a 4-year grace period for repayment of principal.

The loan will be disbursed over a period of about 18 months in 4 equal disbursements.

Under the Financial Agreement, each disbursement is conditioned on Turkey meeting the conditions set forth in U.S. law. The two conditions are: (1) Turkey is implementing strong economic policies; and (2) Turkey is cooperating with the United States in Iraq.

The contribution of Turkish troops for peacekeeping and stability operations in Iraq is not a necessary condition for determining Turkish cooperation in Iraq.

The Turkish Treasury will decide on the timing of the request for each disbursement, taking into account cash flow, and internal and external debt service.

The United States will reply within 8 business days of a request for a disbursement as to whether it considers that Turkey meets the conditions.

The last two disbursements can be converted into a grant, if Turkey wishes.

Turkey may pre-pay the loan.

The Financial Agreement will become effective once remaining legal and technical procedures are completed.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 22, 2003
JS-748

United States - Turkey Financial Agreement
Statement by United States Treasury Secretary John Snow
Monday, September 22, 2003

On April 16, President Bush signed the war supplemental appropriations act that provides economic assistance for Turkey. I am very pleased to announce that Turkey and the U.S. signed a Financial Agreement today that will provide as much as $8.5 billion in loans.

The purpose of the assistance is to support Turkey's ongoing economic reform process and to mitigate the economic impact on Turkey related to Operation Iraqi Freedom. Turkey is a valuable regional ally of the U.S. and is a partner in the global war on terrorism. Turkey also serves as a valuable example of a strong and economically stable democracy in the Islamic world.

It is in the U.S. interests that Turkey maintain its economic stability and continue its ambitious economic and political reform process. This U.S. assistance aims to reinforce the Turkish government's own economic policies.

Turkey's economy has made great strides in recovering from the crisis of 2001. Growth has been strong over the past year and a half, and inflation has declined to historic lows. Resolute implementation of good economic policies does make a difference. Strong economic growth improves the lives of ordinary Turks and reduces poverty, a message I have been delivering around the world on my global growth campaign.

The contribution of Turkish troops for peacekeeping and stability operations in Iraq is not a necessary condition for determining Turkish cooperation in Iraq. This assistance package offered by the U.S. to Turkey and the deployment of Turkish troops in Iraq are two separate issues.

Although the U.S. Treasury will administer the loan program, numerous U.S. government agencies have contributed to the process of finalizing the agreement, including State, Defense, and OMB. State and Defense have roles in determining whether Turkey is meeting conditions, and all involved agencies will continue to provide valuable input during the life of the loan.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 22, 2003
JS-749

George Wolfe, Treasury Deputy General Counsel Named New Director of Economic Development for the Coalition Provisional Authority in Iraq

The Coalition Provisional Authority (CPA) today announced the appointment of Mr. George Wolfe as the Director of Economic Development for the CPA. Mr. Wolfe will assume this position on the departure of Mr. Peter McPherson, the current Director, on 24 September when he returns to his position as President of Michigan State University.

Mr. Wolfe has served as the Deputy Director of Economic Development since May.

CPA Administrator, Ambassador Paul Bremer said:

"I am extremely pleased that George has agreed to serve as the Director o Economic Development. Since May, he has performed with great skill, energy and effectiveness. George brings a wealth of talents to his new position, and I have great confidence in him."

Mr. Wolfe has served as Deputy General Counsel for the U.S. Treasury Department since July 2001. Before that, he practiced law in the private sector in Washington DC and in South Carolina. He also served as a private sector adviser to the US Trade Representative under President George H.W. Bush.

Mr. Wolfe will serve as Director of Economic Development until November 1, when he will return to the United States to become Acting General Counsel of the U.S. Treasury Department. He will be succeeded at that time by Marek Belka, whose appointment as CPA's Director of Economic Development staring on November 1 was recently announced. Belka is the former Deputy Prime Minister of Poland, and has been serving as head of the CPA Centre for International Cooperation.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 20, 2003
JS-750

Statement of G7 Finance Ministers and Central Bank Governors

Recent data indicate that a global recovery is underway. Equity markets have rebounded, confidence has increased, financial conditions have improved, oil prices are expected to remain stable and inflation is under control.

Macroeconomic policies should continue to support the recovery while ensuring medium-term fiscal sustainability. However, for growth to strengthen, be sustained and be less unbalanced, structural reforms must be accelerated. We support the progress made to reform tax and regulatory regimes, labour markets and pension systems. Further efforts are needed. Our top priority is to raise productivity and employment. We will do our part in further reforms as set out in the attached Agenda for Growth.

We reiterate the importance of a rules based and multilateral approach to trade. We are disappointed at the breakdown of trade negotiations in Cancun. We urge a speedy resumption of the Doha Round which is vital for global growth and the alleviation of world poverty. We believe that the immediate blockages can be removed and, with an effort on all sides, agreement reached on the remaining issues. We welcome the International Financial Institutions' proposed assistance for countries to deal with the transition to a more open trading system.

We reaffirm that exchange rates should reflect economic fundamentals. We continue to monitor exchange markets closely and cooperate as appropriate. In this context, we emphasize that more flexibility in exchange rates is desirable for major countries or economic areas to promote smooth and widespread adjustments in the international financial system, based on market mechanisms.

Effective and persuasive surveillance is crucial. Even in current favourable conditions, the IMF should identify vulnerabilities, in particular currency mismatches, and provide candid advice on policy reforms. We welcome the agreement to publish exceptional access reports. We welcome the increasingly widespread use of collection action clauses (CACs) in foreign sovereign bond issues. We look forward to further work on the Code of Conduct, which will be discussed by the G-20 meeting in October.
JS-750
We encourage emerging market countries to pursue sound policies and to enhance their climate. This will help attract flows, reduce external vulnerabilities, and support sustained growth. We welcome the progress Brazil and Turkey have made in implementing structural reforms and support further efforts. We welcome today's agreement between Argentina and the IMF. The implementation of the program will be the key to restore strong and long-lasting economic growth and investment climate. We look forward to a speedy agreement with private creditors ensuring fair treatment.

We remain committed to transparency and effective exchange of information between countries as vital weapons is the fight against money laundering and tax evasion. We strongly urge those OECD countries that have not taken necessary steps – in particular in allowing access to bank information – to do so as soon as possible.

We welcome the work of the Financial Stability Forum, in particular in areas of

audit, financial analysts, credit risk, reinsurance and rating agencies, and encourage it to continue strengthening cooperation in these areas.

We reaffirm our commitment to fight global poverty and to help developing countries achieve the international development goals of the Millennium Declaration. In this respect, we discussed financing issues and results based measurement. We asked the IMF and the World Bank to do further work on aid effectiveness, absorption capacity, financing facilities and results-based measurement mechanisms, and report at the Annual Meetings in September 2004. We welcome the views of developing and emerging market countries on these issues.

We reaffirm our strong commitment to complete the Heavily Indebted Poor Countries Initiative. We urge all bilateral creditors to join with us in canceling out the 100% of their eligible claims. We ask the IFIs to review the methodology for calculating the amount of "topping up" debt relief. We look forward to the outcome of the IFIs work on low income countries vulnerabilities to exogenous shocks.

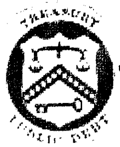
Since September 11, 2001, we have made significant progress in the fight against terrorist financing, although much remains to be done. We look forward to the Fund and Bank making terrorist financing/money laundering assessments a permanent part of their work. We have intensified the dialogue with several non-G7 countries to prevent abuse of non-profit organizations and alternative remittance systems. We seek to eliminate terrorist financing through implementation of measures in accordance with the FATF Eight Special Recommendations.

We welcome both the Afghan donors meetings this month and the upcoming Iraq Donors' Conference. We reaffirm our support for a multilateral effort to help rebuild and develop Iraq, based on a needs assessment led by the World Bank at the Donors' Conference in Madrid, next month. We support the IMF and the World Bank rapidly providing, subject to their policies, financial and other assistance to Iraq and call upon regional financial institutions to do likewise.

We call upon the Paris Club to make its best effort to complete the restructuring of Iraq's debt before the end of 2004. We urge all non-Paris creditors to cooperate.

Related Documents:

- G7 Agenda for Growth
- G7 Statement Regarding the Economy of the Palestinian Authority



Bureau of the
Public Debt
United States Department of the Treasury

ıreau Of The Public Debt Aids Savings Bonds Owners Ravaged By Severe 'eather In North Carolina and Virginia

ıR IMMEDIATE RELEASE

ɔtember 22, 2003

: Bureau of Public Debt took action to assist victims of severe weather in North Carolina and Virginia by expediting the replacement or 'ment of United States Savings Bonds for owners in those areas. The emergency procedures are effective immediately for paying :nts and owners in North Carolina and Virginia affected by the storms. These procedures will remain in effect through the end of ober 2003.

ılic Debt's action waives the normal minimum holding period for Series EE and Series I savings bonds presented to authorized paying :nts for redemption by residents of the affected area. Most financial institutions serve as paying agents for savings bonds.

: counties in North Carolina are: Beaufort, Bertie, Brunswick, Camden, Carteret, Chowan, Craven, Currituck, Dare, Edgecombe, Gates, ifax, Hertford, Hyde, Jones, Martin, New Hanover, Northampton, Onslow, Pamlico, Pasquotank, Pender, Perquimans, Pitt, Tyrell and shington. In Virginia, for independent cities of: Norfolk, Chesapeake, Virginia Beach, Portsmouth, Suffolk, Franklin, Hampton, uoson, Newport News, Alexandria, Williamsburg, Hopewell, and Emporia and the counties of: Greensville, Southampton, thhampton, Accomack, Isle of Wight, Sussex, Surry, Prince George, Charles City, James City, York, Gloucester, Mathews, Middlesex, caster, Northumberland, Westmoreland and Richmond. Should additional counties be declared disaster areas the emergency cedures for savings bonds owners will also go into effect.

replacement of bonds lost or destroyed will also be expedited by Public Debt. Bond owners should complete form PDF-1048, available nost financial institutions or by writing the Richmond Federal Reserve Bank's Savings Bond Customer Service Department, 701 East d Street, Richmond, Virginia 23219; phone (804) 697-8000. This form can also be downloaded from Public Debt's website at: w.treasurydirect.gov. Bond owners should include as much information as possible about the lost bonds on the form. This information uld include how the bonds were inscribed, social security number, approximate dates of issue, bond denominations and serial ıbers if available. The completed form must be certified by a notary public or an officer of a financial institution. Completed forms uld be forwarded to Public Debt's Office of Investor Services, 200 Third St., Parkersburg, West Virginia 26106-1328. Bond owners uld write the word "DISASTER" on the front of their envelopes, to help expedite the processing of claims.

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U.S. Department of the Treasury, Bureau of the Public Debt

Last Updated September 27, 2004

05-751

federal financing bank NEW
WASHINGTON, D.C. 20220

FEDERAL FINANCING BANK

2003 PRESS RELEASE

September 2003

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $35.5 billion on September 30, 2003, posting a decrease of $875.2 million from the level on August 31, 2003. This net change was the result of decreases in holdings of agency assets of $750.0 million and in holdings of government-guaranteed loans of $125.2 million. The FFB made 36 disbursements and received 16 prepayments during the month of September. The FFB also priced 14 refinancings and extended the maturities of 168 loans guaranteed by the Rural Utilities Service ("RUS") during the month.

During the fiscal year 2003, the FFB holdings of obligations issued, sold or guaranteed by other Federal agencies posted a net decrease of $4,059.7 million from the level on September 30, 2002. This net change was the result of decreases in holdings of agency debt of $3,840.6 million and in holdings of agency assets of $1,220.0 million, and an increase in holdings of government-guaranteed loans of $1,000.8 million.

Below are tables presenting FFB September loan activity and FFB holdings as of September 30, 2003.

PRINT

FEDERAL FINANCING BANK
September 2003 ACTIVITY

Borrower	*Date*	*Amount of Advance*	*Final Maturity*	*Interest Rate*	*Semi-Annually or Quarterly*
AGENCY DEBT					
U.S. POSTAL SERVICE					

JS 751

U.S. Postal Service	9/04	$2,523,437,000.00	9/18/2003	1.102%	Semi-Annually
U.S. Postal Service	9/18	$2,523,437,000.00	9/24/2003	1.030%	Semi-Annually
U.S. Postal Service	9/24	$2,523,437,000.00	10/1/2003	1.000%	Semi-Annually
GOVERNMENT-GUARANTEED LOANS					
GENERAL SERVICES ADMINISTRATION					
San Francisco Bldg Lease	9/16	$2,075,082.56	8/1/2005	1.698%	Semi-Annually
San Francisco OB	9/16	$97,868.87	8/1/2005	1.698%	Semi-Annually
DEPARTMENT OF EDUCATION					
Tuskegee Univ.	9/09	$396,006.81	1/2/2032	5.094%	Semi-Annually
RURAL UTILITIES SERVICE					
A & N Electric #868	9/02	$1,113,000.00	12/31/2036	5.141%	Quarterly
Ravalli #641	9/02	$1,000,000.00	12/31/2029	5.020%	Quarterly
E. Iowa Coop. #807	9/03	$3,600,000.00	12/31/2008	3.697%	Quarterly
Lake Region Elec. #737	9/03	$200,000.00	12/31/2030	5.184%	Quarterly
Mille Lacs Electric #769	9/03	$462,000.00	12/31/2035	5.255°s	Quarterly
Roanoke Electric Mem. #820	9/03	$700,000.00	12/31/2036	5.266%	Quarterly
Tri-County Elec. Coop. #646	9/08	$2,800,000.00	1/2/2035	5.076%	Quarterly
Chariton Valley #524	9/11	$400,000.00	12/31/2029	4.899%	Quarterly
Vernon Electric Coop. #2008	9/11	$668,000.00	12/31/2036	5.054%	Quarterly
Farmer's Rural Elec. #2046	9/12	$5,000,000.00	12/31/2003	0.969%	Quarterly
Midwest Electric #610	9/12	$1,666,000.00	1/3/2034	5.055%	Quarterly
Mountrail-Williams #665	9/12	$1,162,000.00	1/2/2035	5.075%	Quarterly
Morgan County Elec. #710	9/12	$185,000.00	12/31/2009	2.845%	Quarterly
Morgan County Elec. #759	9/12	$1,000,000.00	12/31/2035	5.092%	Quarterly
Southside Electric #786	9/12	$475,000.00	12/31/2035	5.092%	Quarterly
Adams Rural Electric #706	9/15	$500,000.00	12/31/2003	0.973%	Quarterly
Polar Telecommunications #2056	9/15	$1,346,000.00	12/31/2003	0.972%	Quarterly
Upper Cumberland Elec. #2049	9/16	$8,500,000.00	12/31/2037	5.097%	Quarterly
York Electric Coop. #848	9/16	$5,000,000.00	12/31/2031	4.973%	Quarterly
Arkansas Valley Elec Coop #895	9/17	$6,000,000.00	12/31/2036	5.090%	Quarterly
Douglas Electric #725	9/17	$90,000.00	12/31/2035	5.072%	Quarterly
Carroll Elec. #618	9/22	$300,000.00	1/3/2034	4.901%	Quarterly
Flint Elec. #2016	9/22	$6,000,000.00	1/3/2034	4.903%	Quarterly
Jackson Energy #794	9/22	$7,348,000.00	12/31/2003	0.960%	Quarterly
Washington Electric #655	9/22	$350,000.00	1/2/2035	4.920%	Quarterly
Ironton Telephone Co. #2051	9/23	$2,956,000.00	12/31/2003	0.962%	Quarterly
San Carlos Apache Tele. #729	9/25	$195,000.00	1/2/2024	4.676%	Quarterly
Grundy Elec.Coop. #744	9/29	$500,000.00	12/31/2003	0.942%	Quarterly
Medina Electric #2050	9/29	$2,000,000.00	9/30/2004	1.209%	Quarterly
Pine Belt Cellular, Inc. #2061	9/29	$1,731,632.00	12/31/2019	4.109%	Quarterly

*Amicalola Electric #664	9/30	$6,772,390.66	12/31/2003	0.968%	Quarterly
*Atlantic Telephone Mem. #805	9/30	$5,852,576.00	12/31/2003	0.968%	Quarterly
*Bailey County Elec. #856	9/30	$1,896,000.00	12/31/2003	0.966%	Quarterly
*Bailey County Elec. #856	9/30	$615,000.00	12/31/2003	0.966%	Quarterly
*Basin Electric #425	9/30	$12,744,828.72	12/31/2003	1.093%	Quarterly
*Big Sand Elec. #540	9/30	$758,747.68	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$569,060.75	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$951,346.02	12/31/2003	0.968%	Quarterly
*Big Sand Elec. #540	9/30	$2,212,580.15	12/31/2003	0.968%	Quarterly
*Blue Grass Energy #674	9/30	$1,949,185.09	12/31/2003	0.968%	Quarterly
*Blue Grass Energy #674	9/30	$4,966,931.45	12/31/2003	0.968%	Quarterly
*Brazos Electric #917	9/30	$2,389,382.24	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,828,193.74	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,490,140.49	9/30/2008	2.755%	Quarterly
*Brazos Electric #917	9/30	$1,127,240.08	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,491,907.36	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$191,489.09	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,713,427.62	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,602,256.14	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$400,999.02	9/30/2010	3.210%	Quarterly
*Brazos Electric #917	9/30	$816,665.77	9/30/2010	3.210%	Quarterly
*Brazos Electric #917	9/30	$13,316.95	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$352,120.39	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$330,301.23	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$2,765,658.07	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$732,649.26	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$804,150.15	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$1,228,388.64	9/30/2010	3.251%	Quarterly
*Brazos Electric #917	9/30	$309,722.67	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$714,394.25	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$932,777.56	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$621,171.16	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$357,140.02	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$667,702.24	9/30/2010	3.283%	Quarterly
*Brazos Electric #917	9/30	$813,773.38	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$262,416.53	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$190,451.59	9/30/2013	3.701%	Quarterly
*Brazos Electric #917	9/30	$1,690,131.70	9/30/2008	2.782%	Quarterly
*Brazos Electric #917	9/30	$1,965,785.09	9/30/2010	3.251%	Quarterly
*Brazos Electric #844	9/30	$4,614,000.00	10/2/2023	4.820%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	9/30/2013	3.988%	Quarterly

*Brazos Electric #844	9/30	$5,000,000.00	9/30/2013	3.988%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	10/2/2023	4.820%	Quarterly
*Brazos Electric #844	9/30	$5,000,000.00	10/2/2023	4.820%	Quarterly
*Brown County Elec. #687	9/30	$242,211.92	12/31/2003	0.968%	Quarterly
*Brown County Elec. #687	9/30	$581,308.63	12/31/2003	0.968%	Quarterly
*Brown County Elec. #687	9/30	$290,701.17	12/31/2003	0.968%	Quarterly
*Citizens Elec. #742	9/30	$2,659,200.62	12/31/2035	4.861%	Quarterly
*Citizens Elec. #878	9/30	$3,000,000.00	12/31/2031	4.774%	Quarterly
*Clark Energy Coop. #611	9/30	$2,854,038.03	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$1,896,580.17	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$4,232,592.25	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$3,539,698.98	12/31/2003	0.968%	Quarterly
*Clark Energy Coop. #611	9/30	$2,563,960.74	12/31/2003	0.968%	Quarterly
*Cumberland Valley #668	9/30	$4,069,160.36	12/31/2003	0.968%	Quarterly
*Cooper Valley Tel. #648	9/30	$965,505.55	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$1,792,480.84	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$412,919.09	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$199,019.57	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$235,289.48	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$171,119.62	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$253,889.44	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$209,065.60	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$1,420,725.36	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$265,052.89	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$523,017.97	12/31/2003	0.968%	Quarterly
*Darien Telephone Co. #719	9/30	$380,957.25	12/31/2003	0.968%	Quarterly
*East River Power #453	9/30	$370,545.38	12/31/2003	1.093%	Quarterly
*East River Power #453	9/30	$182,741.70	12/31/2003	1.093%	Quarterly
*East River Power #601	9/30	$3,223,773.96	12/31/2003	0.968%	Quarterly
*East River Power #601	9/30	$4,273,864.72	9/30/2008	2.861%	Quarterly
*East River Power #793	9/30	$624,419.98	12/31/2003	0.968%	Quarterly
*Fairfield Elec. #684	9/30	$3,132,999.79	12/31/2003	0.968%	Quarterly
*Farmer's Telephone #459	9/30	$21,048.02	12/31/2003	1.093%	Quarterly
*Farmer's Telephone #459	9/30	$200,760.12	12/31/2003	1.093%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,473,499.62	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,331,884.39	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,427,019.01	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,092,961.21	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$1,331,884.39	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,885,965.43	12/31/2003	0.968%	Quarterly
*Fleming-Mason Energy #644	9/30	$2,860,016.50	12/31/2003	0.968%	Quarterly

*Freeborn-Mower Coop. #736	9/30	$730,866.54	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$487,258.68	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$196,076.58	9/30/2010	3.467%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$197,332.55	9/30/2010	3.467%	Quarterly
*Farmers Telephone #476	9/30	$9,543,716.93	12/31/2003	1.093%	Quarterly
*Farmers Telephone #476	9/30	$7,109,387.88	12/31/2003	1.093%	Quarterly
*FTC Communications #709	9/30	$2,523,335.55	12/31/2003	0.968%	Quarterly
*FTC Communications #709	9/30	$3,227,113.39	12/31/2003	0.968%	Quarterly
*Grady Electric #690	9/30	$3,086,676.08	12/31/2003	0.968%	Quarterly
*Grady Electric #746	9/30	$3,188,109.81	12/31/2003	0.968%	Quarterly
*Grayson Aural Elec. #619	9/30	$1,141,615.21	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$570,807.62	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$951,346.02	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$1,232,498.03	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$973,546.39	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$2,465,527.86	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$1,716,536.69	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$495,515.48	12/31/2003	0.968%	Quarterly
*Grundy Elec.Coop. #744	9/30	$1,226,196.09	12/31/2003	0.968%	Quarterly
*Grundy Elec. Coop. #744	9/30	$981,088.94	12/31/2003	0.968%	Quarterly
*Habersham Electric Mem. #2001	9/30	$6,900,000.00	12/31/2036	4.879%	Quarterly
*Habersham Electric Mem. #2001	9/30	$4,400,000.00	12/31/2036	4.879%	Quarterly
*Harrison County #532	9/30	$947,477.17	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$852,729.47	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$953,869.49	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,555,437.31	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,674,618.05	12/31/2003	0.968%	Quarterly
*Hudson Valley Datanet #833	9/30	$5,000,000.00	12/31/2003	0.966%	Quarterly
*Hudson Valley Datanet #833	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #592	9/30	$1,421,215.75	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$1,894,954.36	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$2,470,072.99	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$210,247.46	12/31/2003	0.968%	Quarterly
*Inter-County Energy #850	9/30	$4,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #850	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Jackson Energy #794	9/30	$3,948,330.53	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,961,247.90	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$4,639,288.38	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,165.27	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,467,706.59	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,225.15	12/31/2003	0.968%	Quarterly

*Freeborn-Mower Coop. #736	9/30	$730,866.54	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$487,258.68	12/31/2003	0.968%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$196,076.58	9/30/2010	3.467%	Quarterly
*Freeborn-Mower Coop. #736	9/30	$197,332.55	9/30/2010	3.467%	Quarterly
*Farmers Telephone #476	9/30	$9,543,716.93	12/31/2003	1.093%	Quarterly
*Farmers Telephone #476	9/30	$7,109,387.88	12/31/2003	1.093%	Quarterly
*FTC Communications #709	9/30	$2,523,335.55	12/31/2003	0.968%	Quarterly
*FTC Communications #709	9/30	$3,227,113.39	12/31/2003	0.968%	Quarterly
*Grady Electric #690	9/30	$3,086,676.08	12/31/2003	0.968%	Quarterly
*Grady Electric #746	9/30	$3,188,109.81	12/31/2003	0.968%	Quarterly
*Grayson Aural Elec. #619	9/30	$1,141,615.21	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$570,807.62	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$951,346.02	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$1,232,498.03	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$973,546.39	12/31/2003	0.968%	Quarterly
*Grayson Rural Elec. #619	9/30	$2,465,527.86	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$1,716,536.69	12/31/2003	0.968%	Quarterly
*Greenbelt Elec. #743	9/30	$495,515.48	12/31/2003	0.968%	Quarterly
*Grundy Elec.Coop. #744	9/30	$1,226,196.09	12/31/2003	0.968%	Quarterly
*Grundy Elec. Coop. #744	9/30	$981,088.94	12/31/2003	0.968%	Quarterly
*Habersham Electric Mem. #2001	9/30	$6,900,000.00	12/31/2036	4.879%	Quarterly
*Habersham Electric Mem. #2001	9/30	$4,400,000.00	12/31/2036	4.879%	Quarterly
*Harrison County #532	9/30	$947,477.17	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$852,729.47	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$953,869.49	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,555,437.31	12/31/2003	0.968%	Quarterly
*Harrison County #532	9/30	$1,674,618.05	12/31/2003	0.968%	Quarterly
*Hudson Valley Datanet #833	9/30	$5,000,000.00	12/31/2003	0.966%	Quarterly
*Hudson Valley Datanet #833	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #592	9/30	$1,421,215.75	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$1,894,954.36	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$2,470,072.99	12/31/2003	0.968%	Quarterly
*Inter-County Energy #592	9/30	$210,247.46	12/31/2003	0.968%	Quarterly
*Inter-County Energy #850	9/30	$4,000,000.00	12/31/2003	0.966%	Quarterly
*Inter-County Energy #850	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Jackson Energy #794	9/30	$3,948,330.53	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,961,247.90	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$4,639,288.38	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,165.27	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$2,467,706.59	12/31/2003	0.968%	Quarterly
*Jackson Energy #794	9/30	$1,974,225.15	12/31/2003	0.968%	Quarterly

*Johnson County Elec. #482	9/30	$1,520,568.10	12/31/2003	1.093%	Quarterly
+Kansas Elec. Power #904	9/30	$34,391,134.28	12/31/2015	3.616%	Quarterly
+Kansas Elec. Power #904	9/30	$1,539,095.69	1/3/2017	3.737%	Quarterly
+Kansas Elec. Power #904	9/30	$785,236.16	1/3/2017	3.737%	Quarterly
+Kansas Elec. Power #904	9/30	$3,709,458.59	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$784,568.52	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,208,089.24	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$426,766.63	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,338,715.69	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$764,249.90	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$4,541,016.73	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$1,410,300.01	12/31/2018	3.958%	Quarterly
+Kansas E1ec. Power #904	9/30	$902,460.56	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$753,964.63	12/31/2018	3.958%	Quarterly
+Kansas Elec. Power #904	9/30	$689,151.64	12/31/2018	3.958%	Quarterly
*Licking Valley Elec. #522	9/30	$2,604,614.75	12/31/2003	0.968%	Quarterly
*Licking Valley Elec. #854	9/30	$2,000,000.00	12/31/2003	0.966%	Quarterly
*Magnolia Electric #560	9/30	$4,744,194.89	12/31/2003	1.093%	Quarterly
*North Carolina RSA 3 Tel #2009	9/30	$9,600,000.00	12/31/2003	0.966%	Quarterly
*New Horizon Elec. #791	9/30	$2,051,000.00	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #528	9/30	$1,793,574.28	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #577	9/30	$2,447,333.56	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #577	9/30	$2,447,333.56	12/31/2003	0.968%	Quarterly
*Noun Rural Elec. #840	9/30	$4,000,000.00	12/31/2003	0.966%	Quarterly
*North Central Elec. #638	9/30	$1,462,617.47	1/2/2035	4.843%	Quarterly
*Northstar Technology #811	9/30	$1,807,661.89	12/31/2003	0.968%	Quarterly
*Northstar Technology #811	9/30	$985,912.07	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,897,600.04	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,893,767.79	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$955,440.21	12/31/2003	0.968%	Quarterly
*Owen Electric #525	9/30	$1,926,753.21	12/31/2003	0.968%	Quarterly
*Pennyrile Elec. #513	9/30	$5,802,451.99	12/31/2003	1.093%	Quarterly
*Pennyrile Elec. #513	9/30	$5,492,715.24	12/31/2003	1.093%	Quarterly
*PRTCommunications #798	9/30	$4,802,000.00	12/31/2003	0.968%	Quarterly
*PRTCommunications #798	9/30	$1,800,000.00	12/31/2003	0.968%	Quarterly
*Runestone Electric Ass. #886	9/30	$1,500,000.00	12/31/2003	0.966%	Quarterly
*San Miguel Electric #919	9/30	$7,302,416.60	12/31/2003	0.968%	Quarterly
*San Miguel Electric #919	9/30	$7,667,622.89	12/31/2003	0.968%	Quarterly
*Socorro Elec. #869	9/30	$1,652,000.00	12/31/2003	0.966%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly

*Surry-Yadkin Elec. #534	9/30	$466,822.30	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$933,644.60	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$948,952.24	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$955,129.92	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #534	9/30	$2,206,437.04	12/31/2003	0.968%	Quarterly
*Surry-Yadkin Elec. #852	9/30	$1,000,000.00	12/31/2003	0.966%	Quarterly
*Thumb Electric #767	9/30	$468,522.46	1/3/2034	4.861%	Quarterly
*United Elec. Coop. #870	9/30	$12,000,000.00	12/31/2003	0.966%	Quarterly
*Upsala Coop. Tele. #429	9/30	$285,962.22	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$6,567.80	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$19,063.95	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$83,090.24	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$78,966.04	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$90,087.12	1/2/2018	4.023%	Quarterly
*Upsala Coop. Tele. #429	9/30	$57,209.60	1/2/2018	4.023%	Quarterly
*Webster Electric #705	9/30	$2,154,148.24	12/31/2003	0.968%	Quarterly
*West Plains Elec. #501	9/30	$2,231,750.74	12/31/2003	1.093%	Quarterly

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FEDERAL FINANCING BANK HOLDINGS
September 2003

(in millions of dollars)

Program	***FEDERAL FINANCING September 30, 2003***	***BANK HOLDINGS August 31, 2003***	***Monthly Net Change 9/l/03- 9/30/03***	***Fiscal Year Net Change 10/1/02- 9/30/03***
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	$805.0	$855.0	($50.0)	($145.0)
FmHA-RHIF	$1,830.0	$2,530.0	($700.0)	($1,075.0)
Rural Utilities Service-CBO	$4,270.2	$4,270.2	$0.0	$0.0
Subtotal*	$6,905.2	$7,655.2	($750.0)	($1,220.0)
Govt-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,688.4	$1,706.1	($17.6)	($234.1)
DoEd-HBCU+	$79.3	$79.l	$0.2	$10.7
DHUD-Comm. Dev. Block Grant	$2.l	$2.8	$0.6	($2.9)

DHUD-Public Housing Notes	$1,133.2	$1,133.2	$0.0	($74.1)
General Services Administration+	$2,147.1	$2,150.l	($3.0)	($58.5)
DOI-Virgin Islands	$9.6	$9.6	$0.0	($1.8)
DON-Ship Lease Financing	$607.5	$607.5	$0.0	($173.3)
Rural Utilities Service	$15,618.2	$15,720.7	($102.5)	$1,560.0
SBA-State/Local Devel. Cos.	$77.3	$79.0	($1.7)	($25.1)
DOT-Section 511	$3.1	$3.1	$0.0	($0.2)
Subtotal*	$21,366.0	$21,491.2	($125.2)	$1,000.8
Grand total*	**$35,544.6**	**$36,419.0**	**($875.2)**	**($4,059.7)**

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Last Updated on 1/22/04

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
September 22, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	92-Day Bill
Issue Date:	September 25, 2003
Maturity Date:	December 26, 2003
CUSIP Number:	912795PC9

High Rate: 0.935% Investment Rate 1/: 0.953% Price: 99.761

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 73.75%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 33,157,101	$ 13,376,476
Noncompetitive	1,380,192	1,380,192
FIMA (noncompetitive)	243,600	243,600
SUBTOTAL	34,780,893	15,000,268 2/
Federal Reserve	5,961,901	5,961,901
TOTAL	$ 40,742,794	$ 20,962,169

Median rate 0.925%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.910%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 34,780,893 / 15,000,268 = 2.32

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,086,825,000

JS-752

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.
September 22, 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 $26,000 million of publicly held 4-week Treasury bills maturing September 25, 2003, and to pay down approximately $14,000 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 $15,355 million of the Treasury bills maturing on September 25, 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 753

HIGHLIGHTS OF TREASURY OFFERING OF 4-WEEK BILLS TO BE ISSUED SEPTEMBER 25, 2003

September 22, 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....................$10,700 million

Description of Offering:
Term and type of security..........28-day bill
CUSIP number.......................912795 NT 4
Auction date.......................September 23, 2003
Issue date.........................September 25, 2003
Maturity date......................October 23, 2003
Original issue date................April 24, 2003
Currently outstanding..............$41,879 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.
September 22, 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 $16,140 million of publicly held notes maturing September 30, 2003, and to raise new cash of approximately $8,860 million.

In addition to the public holdings, Federal Reserve Banks hold $6,535 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 $522 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-754

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF
2-YEAR NOTES TO BE ISSUED SEPTEMBER 30, 2003

September 22, 2003

Offering Amount .... $25,000 million
Maximum Award (35% of Offering Amount) .... $ 8,750 million
Maximum Recognized Bid at a Single Yield ...... $ 8,750 million
NLP Reporting Threshold .... $ 8,750 million

Description of Offering:
Term and type of security .... 2-year notes
Series Q-2005
CUSIP number .... 912828 BL 3
Auction date .... September 24, 2003
Issue date .... September 30, 2003
Dated date .... September 30, 2003
Maturity date .... September 30, 2005
Interest rate .... Determined based on the highest accepted competitive bid
Yield .... Determined at auction
Interest payment dates .... March 31 and September 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 JH 1
Due date(s) and CUSIP number(s)
for additional TINT(s) .... September 30, 2005 - - 912833 ZZ 6

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
September 22, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term: 182-Day Bill
Issue Date: September 25, 2003
Maturity Date: March 25, 2004
CUSIP Number: 912795PR6

High Rate: 1.010% Investment Rate 1/: 1.033% Price: 99.489

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 58.93%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

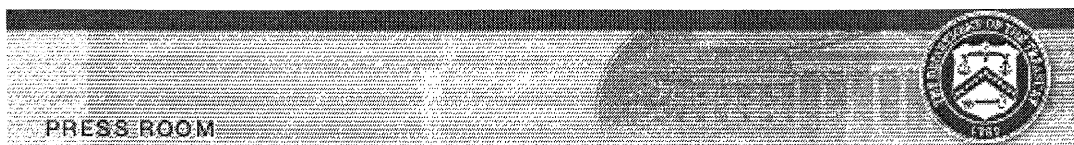
Tender Type	Tendered	Accepted
Competitive	$ 31,727,077	$ 13,742,507
Noncompetitive	1,082,915	1,082,915
FIMA (noncompetitive)	175,000	175,000
SUBTOTAL	32,984,992	15,000,422 2/
Federal Reserve	5,689,996	5,689,996
TOTAL	$ 38,674,988	$ 20,690,418

Median rate 1.000%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.945%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 32,984,992 / 15,000,422 = 2.20

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $858,116,000

JS 755



FROM THE OFFICE OF PUBLIC AFFAIRS

September 21, 2003
JS-755

United States Treasury Secretary John W. Snow
Statement to the International Monetary and Financial Committee (IMFC)
Dubai, UAER
September 21, 2003

The balance of risks to the global economy has improved since we met in Washington this spring. While uncertainties have eased and recovery is strengthening in some regions, we cannot relax. We must continue to strive for higher economic growth.

This is the message I delivered to my colleagues in Japan earlier this month, and in Europe over the summer. We must all work together to ensure a strong, broad-based, and sustained upturn in the global economy.

On the demand side, appropriate monetary and fiscal policies are already in place in many of the key economies. But the success of the agenda for growth will depend on improving economic structures that raise productivity and provide a lasting basis for a durable recovery in private sector activity. Important steps have been taken – for instance to reduce marginal tax rates, reform labor markets, strengthen financial systems and stimulate investment. We now need to build on this progress. The rewards of taking decisive action now will be sizable in the long run.

The U.S. recovery is gaining momentum, and I expect growth to accelerate in the latter half of this year. In fact, a recent Wall Street Journal survey of economists predicts growth of 4.7% in the second half of this year.

Yet the global economy cannot continue to rely on the United States alone to power the global growth engine. Industrial countries must take additional action to address remaining structural impediments to long-term growth. Emerging markets, which are benefiting from benign external financing conditions, should seize the opportunity to consolidate reform. Finally, we all need to act to avail ourselves of the benefits of open trade – with the international financial institutions helping as needed to build trade capacity and facilitate adjustment.

A Global Growth Agenda

Through sound advice and strong support for reforms, the IMF can help foster financial stability and promote economic growth. The IMF needs to focus on its core strengths, coordinating with the World Bank, other international institutions, and bilateral donors in order to achieve results.

Promoting Crisis Prevention and Resolution

The number and severity of crises in recent years has diminished, and flows into emerging markets' debt have risen. Yet foreign direct investment is likely to fall to a seven-year low this year. Neither we, nor the IMF, can afford to be complacent. The IMF has taken some key steps in the last year, but more needs to be done.

The IMF must do a better job of analyzing vulnerabilities and predicting crises. Good work has been done to improve analysis of debt sustainability. Now the IMF should follow up on currency mismatches and balance sheet impacts. And the Fund needs to focus on providing a candid and fresh approach in all its surveillance activities.

Wider dissemination of IMF analysis is essential to achieving the goals of stability and growth. It will be critical that members and IMF management work together to strengthen IMF transparency, especially the publication of all exceptional access documentation and a separate justification of occasions of exceptional access. More information will help the market and public at large understand and respond to reforms, and greater transparency will make the IMF itself more accountable, and over time further enhance the quality of the analysis. I urge all countries to publish their surveillance documents.

Official resources are limited, and there will not be a quota increase in the foreseeable future. Neither large scale nor repeated access to IMF lending will itself solve any country's economic challenges. The IMF made an important decision earlier this year by developing procedures to govern exceptional access to Fund resources. These rules make the role of the official sector in crisis resolution more predictable. We should now seek to raise the bar for lending standards, with the goal of reducing the number of IMF programs.

I want to reflect briefly on a key development this year that has made the debt restructuring process more orderly and predictable. Collective action clauses are now standard in internationally-issued sovereign debt. We commend the countries that have issued external bonds with these clauses. We hope that future issuers will follow this important trend in strengthening market practices.

Promoting Growth in Low Income Countries

The IMF's principal role in low income countries should be macroeconomic surveillance, monitoring and technical assistance. Many low income countries have attained macroeconomic stability.

The IMF will be considering its role in low income countries over the next few months. It is important for the Fund to support countries that have good policies in place. I want to challenge the IMF to more clearly define the scope and terms for its support to low income countries and to consider transforming PRGFs from loans to grants.

Finally, I want to underscore that the United States supports a strong role for developing countries and emerging market countries in the international financial system.

We also believe, however, that quotas should reflect economic weight and the ability to contribute to the financing of the IMF. As the world has changed, some countries are now under-represented, and some carry too much weight. There is merit in discussing potential changes, but we recognize that quota redistribution is only likely in the context of a general quota increase, and the Fund's current ample liquidity does not require such an increase. To help developing countries enhance their participation in decision making, we have strongly supported measures to improve the capacity and influence of governments and their Executive Board representatives.

Assisting Iraq

The IMF must play an integral role in facilitating the reconstruction and recovery of Iraq. I look forward to next month's meeting in Madrid as an opportunity for the international community to demonstrate its sustained commitment. The IMF should be prepared, expeditiously, to provide its expertise and financial support.

Combating Terrorist Finance and Money Laundering

Protecting the world's financial systems from abuse by terrorists and money launderers protects our citizens. We have made good progress over the past 24 months, and this reflects to a significant degree the hard work of many of those attending this session. I especially want to commend the IMF, along with the World Bank and FATF, for their important and ongoing contributions in the fight against terrorist financing and money laundering, and I look forward to the AML/CFT assessments becoming a permanent part of the IFI's oversight and surveillance of financing systems.

Our successes, however, cannot blind us to the long road that remains ahead. We

cannot yet say that we are fully denying terrorists access to the formal networks of international finance (or capital flows) – and we cannot be satisfied even when we do. Remittances are an important source of income for many poor people. However, at times, the channels through which remittances flow lack the transparency of the traditional financial sector, rendering those channels vulnerable to abuse by terrorists and money launderers. We must work to reduce the risk of abuse of informal remittance channels by encouraging a further deepening of the formal financial system – a win/win measure that will benefit developing countries and emerging markets. Above all, we must cut off terrorist financing at its source. Our next steps should include making national asset freezing regimes more effective, extending safeguards to informal financial sectors, addressing the inadequacies in our formal sectors that drive legitimate customers elsewhere, and ensuring that charitable donations go for worthy causes, not to support terror.

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
September 23, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term:	28-Day Bill
Issue Date:	September 25, 2003
Maturity Date:	October 23, 2003
CUSIP Number:	912795NT4

High Rate: 0.860% Investment Rate 1/: 0.876% Price: 99.933

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 47.93%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 34,659,500	$ 11,965,475
Noncompetitive	35,085	35,085
FIMA (noncompetitive)	0	0
SUBTOTAL	34,694,585	12,000,560
Federal Reserve	3,702,771	3,702,771
TOTAL	$ 38,397,356	$ 15,703,331

Median rate 0.855%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.845%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 34,694,585 / 12,000,560 = 2.89

1/ Equivalent coupon-issue yield.

http://www.publicdebt.treas.gov

JS 756

FROM THE OFFICE OF PUBLIC AFFAIRS

September 23, 2003
JS-756

U.S Treasury Secretary John W. Snow
Plenary Statement
2003 Annual Meeting
Dubai, UAE

Chairmen, Governors, Ladies and Gentlemen, Mr. Wolfensohn, Mr. Koehler. To Sheikh Maktoum bin Rashid al Maktoum, Emir of Dubai, and the people of the Emirate of Dubai, I want to express my heartfelt appreciation for your wonderful hospitality.

All our nations, today, have achieved a level of interdependence. Economic performance and financial flows in each of our economies affects all of our economies. This connection reinforces our mutual imperative for economic growth.

In the United States, President Bush has taken significant steps to accelerate economic growth. The President's Jobs and Growth plan, in particular, has made a real difference. A recent Wall Street Journal survey of economists now predicts growth of 4.7% in the second half of this year. This month, President Bush unveiled a six point plan for the economy to further strengthen the recovery.

Other countries have also moved to stimulate growth. We need to work together to build on this progress. And we believe strongly that progress is best achieved in a system incorporating the principles of free trade, free capital flows, and market-based exchange rates among the major economies.

Together, developing and industrialized countries alike should take advantage of the opportunities offered by free trade. The United States commends the willingness of the IMF and the World Bank to support developing countries with adjustment needs related to trade liberalization.

This was an important message to WTO members at Cancun, despite the impasse.

The fact is, emerging markets are enjoying improved circumstances today. Borrowing costs have fallen; crises are less numerous and less severe; and more capital is flowing to these economies.

Not coincidentally, we have been making great progress in strengthening the international financial system. Collective action clauses in sovereign debt are now the market standard. The official community has set clear limits on its resources, limiting contagion. Crisis prevention has improved as well.

We can and should go further. We need an IMF that is at the cutting edge in its analysis, resolute in its advice, and forceful in its support for strong economic policies.

The IMF should ensure that its analysis of member economies is thorough and rigorous. This means addressing the issue of currency mismatches. The IMF also needs to focus its lending where it can achieve results – results that will reduce reliance on IMF resources. Moreover, greater transparency in IMF procedures and

public disclosure of IMF documents will help the markets and the public at large to understand and support reforms.

Official assistance to developing countries should have the objective of raising productivity growth. Fast growing economies create jobs and opportunities for their entire populations, far more than any external aid program can create.

President Bush's Millennium Challenge Account ties assistance directly to the performance of recipient countries, to make a real difference for their populations. The World Bank, too, is increasing its use of grants, focusing on results, and helping countries foster a vibrant private sector. I want to specifically recognize the IFC and IDA initiatives to expand small business access to credit in Africa. I commend the Bank for a good start. Nonetheless, there is more to be done.

I call on the Bank to integrate the principles of rewarding performance and delivering results throughout its operations. We should fully disclose the performance rating system used to allocate resources to the poorest countries.We should conduct an external performance audit of the IDA-13 results commitment, to which the U.S. has tied its incentive contribution. We should further increase grant financing in the next replenishment of IDA, and IMF should consider transforming its financial assistance to low income countries from loans to grants.

I'd like to conclude by acknowledging our progress fighting terrorist financing, and rebuilding the infrastructure and economies of Afghanistan and Iraq.

We have made important progress protecting our citizens from terrorism by restricting terrorist financing and money laundering. I praise the World Bank, IMF and FATF for their ongoing contributions and look forward to a continuation of their work. In addition to denying terrorists access to the formal financial networks, we must also ensure that the informal sectors are not havens for terrorist funds.

With regard to Iraq, the task of reconstruction and recovery is enormous. Substantial work remains before private sector-led growth can bring greater opportunity to the Iraqi people. I am looking forward to next month's meeting in Madrid where I hope to see the international community demonstrate its sustained commitment to Iraq.

Finally, I have just come from a trip to Kabul. Reconstruction is moving apace. To ensure success, however, the Afghan government needs the full support of the international community. The United States is doubling its commitment to Afghanistan over the next year.

Thank you for your attention, and thanks again to our gracious host, the Emirate of Dubai.

FROM THE OFFICE OF PUBLIC AFFAIRS

September 24, 2003
JS-757

Treasury Designates Six Al-Qaida Terrorists

– The U.S. Treasury today announced that it has designated six individuals as Specially Designated Global Terrorists (SDGTs) under Executive Order 13224, freezing any assets in the U.S. and prohibiting transactions with U.S. nationals. Today's action comes in coordination with the listing of these individuals by the United Nations. The UN action requires all UN Member States to freeze without delay any assets belonging to these individuals.

The list, submitted to the UN by Germany, includes Abu Musa'ab Al-Zarqawi (also known as Ahmed Fadil Al-Khalayleh, among other aliases), who provided financial and other support to the terrorists who assassinated U.S. diplomat Laurence Foley in Amman, Jordan last October. Zarqawi has also been involved in smuggling terrorists into Israel, has arranged training for Jordanian terrorists in al-Qaida camps. In his speech to the United Nations Security Council last February, Secretary of State Powell revealed that under the regime of Saddam Hussein, Zarqawi and his network found refuge in Iraq and Zarqawi himself was treated in a Baghdad hospital. Zarqawi's network also established a poisons and explosives training camp in Northwest Iraq.

Also designated are members of Zarqawi's German-based terrorist cell Al Tawhid, an organization with close links to al-Qaida. The German government has established that Zarqawi serves as the operational leader of the cell.

This action underscores the international commitment to fight terrorist financing. Since September 11, 2001, 173 countries have issued blocking orders to freeze assets, and $136.8 million has been frozen worldwide. With today's designation, the U.S. has now listed a total of 320 individuals and organizations as terrorists and terrorist supporters since September 11, 2001.

The following individuals were designated today:

- Abu Musa'ab AL-ZARQAWI
- Mohamed ABU DHESS
- Shadi ABDALLA
- Aschraf AL-DAGMA
- Ismail SHALABI
- Djamel MOUSTFA

A fact sheet on today's designation and excerpts from Secretary Powell's speech to the UN Security Council discussing Zarqawi are attached.

FACT SHEET
September 23, 2003

ABU MUSA'AB AL-ZARQAWI
AKAs: KHALAILAH, Ahmed Fadee li AL-KHALAYLAH, Ahmad Fadi1 Nazza1i ABU AL-MU'TAZ

Abu Musa'ab a1-ZARQAWI, a Jordanian citizen, has ties to a1-Qaida, Asbat a1-Ansar and Hizba11ah. In addition to providing the financial and material support for the assassination of a U.S. diplomat, he has participated in acts of terrorism, trained terrorist, led terrorist cells, facilitated transport of terrorists and is being cited in the international press as a suspect in the recent devastating bombing of the Jordanian embassy in Baghdad.

ZARQAWI has arranged training for terrorists at a1-Qaida camps. While he was in Pakistan, ZARQAWI made contact with a1-Qaida to train Jordanians. His operatives (called "Jund a1-Sham") began to arrive in Afghanistan in large numbers in 1999. Some of these operatives trained at a1-Qaida's a1-Faruq Camp, where they received full support from a1-Qaida. ZARQAWI eventually established his own cell and camp in Herat, Afghanistan.

Plans were made to send ZARQAWI's operatives to meet with Asbat a1-Ansar (designated under E.O. 13224 as a Specially Designated Global Terrorist on September 24, 2001 and as a Foreign Terrorist Organization on March 27, 2002), Hizballah and any other group that would enable them to smuggle mujaheddin into Palestine. This plan was launched by ZARQAWI with other terrorist leaders in order to smuggle operatives into Israel to conduct operations. In addition to being tasked with finding a mechanism that would enable more suicide martyrs to enter Israel, these operatives were also sent to provide training on explosives, poisons, and remote controlled devices.

In October 2000, ZARQAWI was indicted in absentia in Jordan for his role in the al-Qaida Millennium bombing plot targeting the Radisson SAS hotel in Amman as well as other American, Israeli, and Christian religious sites in Jordan.

In mid 2001, ZARQAWI returned to Qandahar from Herat. At this time, he had received more than U.S. $35,000 for work in Palestine. ZARQAWI planned to use the money to bring more Jordanian and Palestinian mujaheddin to the camp in Herat, to purchase passports, and to facilitate travel to Lebanon. He received assurances that further financing would be provided for attacks against Israel. In early 2002, ZARQAWI was reported to have found a way into Palestine.

On October 28, 2002, U.S. diplomat Laurence Foley, an officer with the U.S. Agency for International Development, was assassinated in Amman, Jordan. ZARQAWI provided financial and material support for this assassination. Key individuals involved in both the planning and execution of the operation had strong ties to Afghan Jihad, the International Mujaheddin Movement, and al-Qaida. One of these individuals, Salim Sa'd Salim Bin-Suwayd, a member of al-Qaida, received more than U.S. $50,000 for his cooperation in planning assassinations in Jordan against U.S., Israeli, and Jordanian government officials. ZARQAWI instructed Suwayd to hide after he had completed his first operation and to plan to pursue additional operations against Israeli and Jordanian targets in Amman in the future. Jordanian authorities arrested Suwayd for the murder. The trial of Suwayd, a Libyan national, is currently underway in Jordan.

In late 2002, ZARQAWI traveled to Iraq where he initiated plans to smuggle additional small arms, explosives, and rockets (NFI) into Jordan for use by his terrorist cell.

DOB: 20 October 1966
POB: Zarqa, Jordan
Passport Number: Z264958; Issued 4 April 1999, valid through 4 April 2004 (also using fraudulent Lebanese and Saudi passports (NFI))
Citizenship: Jordan
National No. 9661031030

Additional information on ZARQAWI can be found in excerpts from Secretary of State Colin L. Powell's Remarks to the United Nations Security Council on 5 February 2003 at www.state.gov//document/organization/20124.pdf.

ZARQAWI 'S GERMAN CELL

The German government has established that ZARQAWI is the operational leader of Al Tawhid, an organization with close personal and organizational links to the al-Qaida network. Al Tawhid, which has the figurative meaning of "unity of all the faithful" -is the name of a Palestinian Sunni movement with roots in Jordan. It is waging a campaign against the Jordanian monarchy, which it rejects as "un-Islamic." Based on a militant interpretation of Islam, the Al Tawhid movement promotes and supports the "jihad" of all fellow-believers worldwide; in particular, the "fight against non-believers and crusaders" led by Usama bin Laden and al-Qaida.

The German government notes that an independent Al Tawhid cell was formed in Germany by September 2001. Formed around Mohamed ABU DHESS, the cell worked in both an isolated and clandestine manner. In addition to ZARQAWI, members of the cell included Mohamed ABU DHESS, Shadi ABDALLA, Aschraf Al-DAGMA, and Ismail SHALABI, who were living in Beckum, German. In early September 2001, ZARQAWI met his confidant, Mohamed ABU DHESS, in Iran and instructed him to commit terrorist attacks against Jewish or Israeli facilities in Germany with "his people."

According to the German government, the group was involved in gathering donations, smuggling "fighters" and forging passports, but then increasingly concentrated on planning the attacks in Germany. ZARQAWI urged them to carry out his instructions swiftly. The members of the cell planned to use a pistol fitted with a silencer to carry out an attack on a busy square in a German town or city and to explode hand grenades in another German town in the immediate vicinity of an Israeli or Jewish property with the aim of killing as many people as possible. The attacks were supposed to be carried out by Shadi ABDALLA, Aschraf AL-DAGMA and Ismail SHALABI.

The German government has also stated that Shadi ABDALLA, a trusted ally of ZARQAWI with close contacts to Mohamed ABU DHESS, was instructed to identify potential targets in German cities and, above all, to obtain the necessary weapons. In March 2002 he ordered a pistol fitted with a silencer and a crate of hand grenades from Djamel MOUSTFA, a supporter of the cell based in Dusseldorf. However, before the weapons could be delivered, Shadi ABDALLA, Mohamed ABU DHESS, Aschraf AL-DAGMA, Ismail SHALABI and Djamel MOUSTFA were arrested along with other suspects on April 23, 2002. All five of them are currently in detention awaiting trial.

Shadi ABDALLA was indicted by the German Public Prosecutor General of the Federal Court of Justice on May 15, 2003 before the State Security Division of the Dusseldorf Higher Regional Court for being a member of a terrorist organization and for the organized forging of passports. The investigations against Mohamed ABU DHESS, Aschraf AL-DAGMA, Ismail SHALABI, and Djamel MOUSTFA are still ongoing.

In addition to ZARQAWI, the German government submitted several Al Tawhid members to the United Nations to be added to the UN Security Council Resolution 1267-list of terrorists and terrorist supporters. The U.S. supports the UN action to designate the following individuals:

- Mohamed ABU DHESS
- Shadi ABDALLA
- Aschraf AL-DAGMA
- Ismail SHALABI
- Djamel MOUSTFA

EXCERPTS FROM REMARKS TO THE UN SECURITY COUNCIL BY SECRETARY OF STATE COLIN POWELL

New York City
February 5, 2003

"Iraq today harbors a deadly terrorist network headed by Abu Musab al-Zarqawi an associate and collaborator of Usama bin Laden and his al-Qaida lieutenants.

Zarqawi, Palestinian born in Jordan, fought in the Afghan war more than a decade ago. Returning to Afghanistan in 2000, he oversaw a terrorist training camp. One of his specialties, and one of the specialties of this camp, is poisons.

When our coalition ousted the Taliban, the Zarqawi network helped establish another poison and explosive training center camp, and this camp is located in northeastern Iraq. You see a picture of this camp.

The network is teaching its operatives how to produce ricin and other poisons. Let me remind you how ricin works. Less than a pinch -- imagine a pinch of salt -- less than a pinch of ricin, eating just this amount in your food, would cause shock, followed by circulatory failure. Death comes within 72 hours and there is no antidote. There is no cure. It is fatal.

Those helping to run this camp are Zarqawi lieutenants operating in northern Kurdish areas outside Saddam Hussein's controlled Iraq. But Baghdad has an agent in the most senior levels of the radical organization Ansar al-Islam that controls this corner of Iraq. In 2000, this agent offered al-Qaida safe haven in the region.

After we swept al-Qaida from Afghanistan, some of those members accepted this safe haven. They remain there today.

Zarqawi's activities are not confined to this small corner of northeast Iraq. He traveled to Baghdad in May of 2002 for medical treatment, staying in the capital of Iraq for two months while he recuperated to fight another day.

During his stay, nearly two dozen extremists converged on Baghdad and established a base of operations there. These al-Qaida affiliates based in Baghdad now coordinate the movement of people, money and supplies into and throughout Iraq for his network, and they have now been operating freely in the capital for more than eight months.

Iraqi officials deny accusations of ties with al-Qaida. These denials are simply not credible. Last year, an al-Qaida associate bragged that the situation in Iraq was "good," that Baghdad could be transited quickly.

We know these affiliates are connected to Zarqawi because they remain, even today, in regular contact with his direct subordinates, include the poison cell plotters. And they are involved in moving more than money and materiel. Last year, two suspected al-Qaida operatives were arrested crossing from Iraq into Saudi Arabia. They were linked to associates of the Baghdad cell and one of them received training in Afghanistan on how to use cyanide.

From his terrorist network in Iraq, Zarqawi can direct his network in the

Middle East and beyond. We in the United States, all of us, the State Department and the Agency for International Development, we all lost a dear friend with the cold-blooded murder of Mr. Laurence Foley in Amman, Jordan, last October. A despicable act was committed that day, the assassination of an individual whose sole mission was to assist the people of Jordan. The captured assassin says his cell received money and weapons from Zarqawi for that murder. After the attack, an associate of the assassin left Jordan to go to Iraq to obtain weapons and explosives for further operations. Iraqi officials protest that they are not aware of the whereabouts of Zarqawi or of any of his associates. Again, these protests are not credible. We know of Zarqawi's activities in Baghdad. I described them earlier.

Now let me add one other fact. We asked a friendly security service to approach Baghdad about extraditing Zarqawi and providing information about him and his close associates. This service contacted Iraqi officials twice and we passed details that should have made it easy to find Zarqawi. The network remains in Baghdad. Zarqawi still remains at large, to come and go.

As my colleagues around this table and as the citizens they represent in Europe know, Zarqawi's terrorism is not confined to the Middle East. Zarqawi and his network have plotted terrorist actions against countries including France, Britain, Spain, Italy, Germany and Russia. According to detainees Abu Atiya, who graduated from Zarqawi's terrorist camp in Afghanistan, tasked at least nine North African extremists in 2001 to travel to Europe to conduct poison and explosive attacks.

Since last year, members of this network have been apprehended in France, Britain, Spain and Italy. By our last count, 116 operatives connected to this global web have been arrested. The chart you are seeing shows the network in Europe.

We know about this European network and we know about its links to Zarqawi because the detainees who provided the information about the targets also provided the names of members of the network. Three of those he identified by name were arrested in France last December. In the apartments of the terrorists, authorities found circuits for explosive devices and a list of ingredients to make toxins.

The detainee who helped piece this together says the plot also targeted Britain. Later evidence again proved him right. When the British unearthed the cell there just last month, one British police officer was murdered during the destruction of the cell.

We also know that Zarqawi's colleagues have been active in the Pankisi Gorge, Georgia, and in Chechnya, Russia. The plotting to which they are linked is not mere chatter. Members of Zarqawi's network say their goal was to kill Russians with toxins.

We are not surprised that Iraq is harboring Zarqawi and his subordinates. This understanding builds on decades-long experience with respect to ties between Iraq and al-Qaida. Going back to the early and mid-1990s when bin Laden was based in Sudan, an al-Qaida source tells us that Saddam and bin Laden reached an understanding that al-Qaida would no longer support activities against Baghdad. Early al-Qaida ties were forged by secret high-level intelligence service contacts with al-Qaida, secret Iraqi intelligence high-level contacts with al-Qaida.

We know members of both organizations met repeatedly and have met at least eight times at very senior levels since the early 1990s. In 1996, a foreign security service tells us that bin Laden met with a senior Iraqi intelligence official in Khartoum and later met the director of the Iraqi intelligence service.

Saddam became more interested as he saw al-Qaida's appalling attacks. A detained al-Qaida member tells us that Saddam was more willing to assist al-Qaida after the 1998 bombings of our embassies in Kenya and Tanzania. Saddam was also impressed by al-Qaida's attacks on the *USS Cole* in Yemen in October 2000.

Iraqis continue to visit bin Laden in his new home in Afghanistan. A senior defector, one of Saddam's former intelligence chiefs in Europe, says Saddam sent his agents to Afghanistan sometime in the mid-1990s to provide training to al-Qaida members on document forgery.

From the late 1990s until 2001, the Iraqi Embassy in Pakistan played the role of liaison to the al-Qaida organization.

Some believe, some claim, these contacts do not amount to much. They say Saddam Hussein's secular tyranny and al-Qaida's religious tyranny do not mix. I am not comforted by this thought. Ambition and hatred are enough to bring Iraq and al-Qaida together, enough so al-Qaida could learn how to build more sophisticated bombs and learn how to forge documents, and enough so that al-Qaida could turn to Iraq for help in acquiring expertise on weapons of mass destruction.

And the record of Saddam Hussein's cooperation with other Islamist terrorist organizations is clear. Hamas, for example, opened an office in Baghdad in 1999 and Iraq has hosted conferences attended by Palestine Islamic Jihad. These groups are at the forefront of sponsoring suicide attacks against Israel.

Al-Qaida continues to have a deep interest in acquiring weapons of mass destruction. As with the story of Zarqawi and his network, I can trace the story of a senior terrorist operative telling how Iraq provided training in these weapons to al-Qaida. Fortunately, this operative is now detained and he has told his story. I will relate it to you now as he, himself, described it.

This senior al-Qaida terrorist was responsible for one of al-Qaida's training camps in Afghanistan. His information comes firsthand from his personal involvement at senior levels of al-Qaida. He says bin Laden and his top deputy in Afghanistan, deceased al-Qaida leader Muhammad Atif, did not believe that al-Qaida labs in Afghanistan were capable enough to manufacture these chemical or biological agents. They needed to go somewhere else. They had to look outside of Afghanistan for help.

Where did they go? Where did they look? They went to Iraq. The support that this detainee describes included Iraq offering chemical or biological weapons training for two al-Qaida associates beginning in December 2000. He says that a militant known as Abdallah al-Iraqi had been sent to Iraq several times between 1997 and 2000 for help in acquiring poisons and gasses. Abdallah al-Iraqi characterized the relationship he forged with Iraqi officials as successful.

As I said at the outset, none of this should come as a surprise to any of us. Terrorism has been a tool used by Saddam for decades. Saddam was a

supporter of terrorism long before these terrorist networks had a name, and this support continues. The nexus of poisons and terror is new. The nexus of Iraq and terror is old. The combination is lethal.

With this track record, Iraqi denials of supporting terrorism take their place alongside the other Iraqi denials of weapons of mass destruction. It is all a web of lies."

FROM THE OFFICE OF PUBLIC AFFAIRS

September 24, 2003
JS-758

Written Testimony of
David D. Aufhauser, General Counsel
Before the House Financial Services Committee
Subcommittee on Oversight and Investigations
September 24, 2003 – 10:00 AM
The United States House of Representatives

Chairman Kelly, Congressman Gutierrez and distinguished members of this Committee, thank you for inviting me to testify today about the United States Government's efforts to address the financing of terror. Let me tell you why we believe it is so important.

For more than a decade – after its misadventure into Kuwait in August of 1990 – Iraq has been an international pariah. More particularly, it has been the subject of the most comprehensive and far-reaching economic sanctions program ever imposed by the United Nations. The Oil for Food Program, later added to the sanctions program, permitted barter trading of Iraqi oil in exchange for humanitarian goods and services, all subject to UN monitoring and control.

The good news is that tens of billions of dollars flowed through the program between 1996 and today, providing food, medicine, shelter and necessities of life for the Iraqi people. It was one of the rare programs that well served both a moral imperative and the most fundamental physical needs of people for whom freedom is a stranger.

The bad news is that the program was viewed by the Iraqi regime as an invitation for graft, corruption and sanctions busting. And they made it their holiday. Within the OFF program, they skimmed, they demanded kickbacks, they bought brokers, they created false front companies and they banked the money abroad in cash, or in accounts for product credit. They also began to deal in oil – in an open and notorious fashion – outside of the UN sanctioned program. The smuggled oil produced rivers of money and credit – a conservative GAO estimate is $6.0 billion in a four year period alone – that were banked abroad.

That money – and those credits – purchased the goods and services that kept Iraq a threat against all reason and international law. That is the cost of turning a blind eye to laundered funds. We all witnessed a second cost when the World Trade Center vanished before our eyes two years ago this month.

I was in Cambridge, England on September 11th attending an international conference on money laundering. The conference was populated by Attorneys General, Chief Justices, Ministers of Police, and even General Counsels. It had the trappings of a sober and serious affair, but in truth, there was a lot of self-congratulation. The law enforcement community had been on the trail of money laundering for more than a decade, and it had much to crow about. Elaborate computer screens, predictive models, profiles of conduct, capture and indictment of persons moving or hiding dirty money, evidenced that we were gaining a lead on a tough issue.

The assaults on New York and Washington silenced the gathering. It was not just the awfulness of the video replaying its unspeakable carnage. It was the realization that we – the professionals charged with the responsibility of policing the

international financial system – had been looking at the world through the wrong end of the telescope. Money had been spirited around the globe, by means and measures and in denominations that mocked detection. The more serious threat to our well being was now clean money intended to kill, not dirty money looking for a place of hiding.

Shortly after the September 11th attacks, President Bush gave those of us who deal with these issues clear orders. He told us to starve the terrorists of funding. Since that mandate over two years ago, the United States has waged a "war" against global terrorism. But this "war" is profoundly uncommon. There is no known sovereign; no uniformed army; no hill to take; no target that is seemingly out of bounds. Indeed, terrorists obscenely place a premium upon the death of innocents. It is shadow warfare, and the primary source of the stealth and mobility necessary to wage the war is money. Much of the intelligence of war is, in fact, suspect – the product of treachery, deceit, custodial interrogation, bribery and encrypted talk. But financial audit trails do not lie. They are literally the diaries of terror and they reveal the secrets necessary to stem tithes intended to underwrite acts of terror.

Money leaves a signature, an audit trail, which once discovered might well prove invaluable in the identification and capture of terrorists. Stopping the flow of money to terrorists may also be one of the very best ways we have to stopping terror altogether. That is a dramatic statement, but it is not possible to overstate the importance of the campaign against terrorist financing. We believe that if you stop the money, you go a long way to stop the killing.

That being said, it is unwise to understate the difficulty of this endeavor. Our economies are deliberately open and porous. The ways to game restrictions on the flow of capital are nearly infinite. Moreover, the challenge is worldwide in scope.

The overwhelming bulk of the assets we seek to freeze; the cash flow that we hope to strangle; and the records we aspire to exploit are beyond the oceans that surround us here in North America. To act alone in this endeavor would justly invite critique, and be ultimately ineffective.

In the United States, our program to wage this war includes the following:
i. An Executive Order (Executive Order 13224) using the powers in the International Emergency Economic Powers Act that raises the standards of conduct and due diligence of financial intermediaries, and explicitly targets underwriters of terror for the freezing of their assets;
ii. UN Security Council resolutions that internationalize certain asset freezes and mandate the criminalization of terrorist financing;
iii. More scrutiny at the gateway to U.S. financial markets as provided by the USA PATRIOT Act;
iv. Law enforcement criminal investigations and other actions aimed at terrorists and their financiers;
v. Extensive diplomatic efforts, including the engagement of central bankers and finance ministries, to champion the need and wisdom for international vigilance against terrorist financing;
vi. Outreach to the private sector for assistance in the identification, location and apprehension of terrorists and their bankers; and,
vii. Bilateral and multilateral efforts to build laws and systems that will help prevent terrorists from gaming the system in developing countries around the globe, and then developing programs to train those countries in how to administer those laws.

Perhaps the most visible tactic of our comprehensive strategy has been the public designation of terrorists and their support network coupled with the freezing of their assets. Public designation of terrorists, terrorist supporters and facilitators, and blocking their abilities to receive and move funds through the world's financial system has been and is a crucial component in the fight against terrorism. The Executive Order imposing economic sanctions under the International Emergency Economic Powers Act permits the public designation of not only terrorists and terrorist organizations, but also supporters, facilitators and underwriters of terror as well. Once designated, this order freezes the assets within U.S. jurisdiction of the designee. Action under this order is not "criminal" and does not require proof

beyond a reasonable doubt. Currently, 321 individuals and entities are publicly designated as terrorists or terrorist supporters by the United States, and since September 11th, over $136.8 million dollars have been frozen around the world.

However, only a small measure of success in the campaign is counted in the dollars of frozen accounts. The larger balance is found in the wariness, caution, and apprehension of donors; in the renunciation of any immunity for fiduciaries and financial intermediaries who seek refuge in notions of benign neglect and discretion, rather than vigilance; in pipelines that have gone dry; in the flight to old ways of value transfer such as the use of cash couriers and the ability to focus our resources on those avenues of last resort; and, in the gnawing awareness on the part of those who bank terror that the symmetry of borderless war means that there is no place to hide the capital that underwrites terror.

Notwithstanding the power of this tool, it is important to remember that it is only powerful to the extent we can pull the rest of the world with us in identifying and freezing the assets of identified terrorists and their supporters. Most of the capital we are attempting to freeze is beyond the reach of the United States. Acting unilaterally is often an empty gesture; an action without an effect. Therefore, we need our allies to join with us in a coordinated manner. This is no easy task. This is the task that occupies much of our time on the financial front of the war against terrorism. The most critical aspect of this task is the ability to provide sufficient actionable information – information that is often thin and encumbered by sensitivity. The predicate for everything we do is actionable intelligence. Without actionable intelligence, it is impossible to fight this war.

Organization of the Effort

Shortly after the attacks of September 11th, the National Security Council established a Policy Coordinating Committee on Terrorist Financing. The purpose of the committee is to (i) recommend strategic policy direction to the National Security Council on issues relating to terrorist financing; (ii) vet and approve proposed public action against targeted terrorists and terrorist financiers; and, (iii) coordinate the United States efforts on issues relating to terrorist financing. I have chaired the committee since October 2001. We have purposefully kept the process flexible, informal, collaborative and iterative. It is a process that has worked well to vet and coordinate proposed action on the financial front of the war.

HAMAS

The focus of this hearing is the terrorist organization HAMAS, and whether our actions to interdict the funds flowing to HAMAS have had any real world effect. The answer is yes, but it is a qualified yes. As stated earlier, many of our actions – particularly actions involving public designation and freezing of assets – have dramatic impact only when we can convince the rest of the world to act with us. It has been an uphill road with HAMAS.

HAMAS was formed in 1987 with a goal of establishing an Islamic Palestinian state in place of Israel. HAMAS' strength is in Gaza and the West Bank. HAMAS relies on broad popular appeal and it is an integral part of the Palestinian political and social landscape.

HAMAS has established networks of mosques, schools, and relief organizations that are highly visible and widely seen by many Palestinians as more effective than services provided by the Palestinian Authority. HAMAS is loosely structured, with some elements working clandestinely and others working openly through mosques and social service institutions to recruit members, raise money, organize activities, and distribute propaganda. It is this dichotomy that has created one of the principal challenges with this organization.

Unlike action against al-Qa'ida, action against HAMAS does not enjoy the same support around the globe. For example, an al-Qa'ida related UN economic sanctions program, which mandates action by all members, has been an extremely valuable tool in getting the world to act in concert against al-Qa'ida. No economic sanctions program exists at the UN for HAMAS. Countries in Europe and the

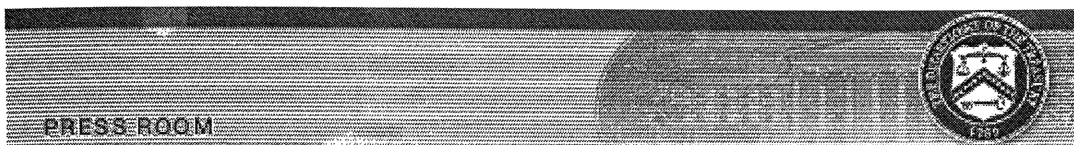
Persian Gulf – two principal areas that supply funds to HAMAS – have been slow to support action against the entire organization, if at all. In fact, some sources estimate that as much as half of HAMAS' income is derived from money raised in the Persian Gulf, including the Kingdom of Saudi Arabia – notwithstanding a May 2002 decree by Crown Prince Abdullah that ceased official Saudi support for the group.

The United States designated the entire HAMAS organization as a foreign terrorist organization in 1995 and we have acted or are acting against HAMAS fundraisers identified and located here in the United States. A principal example of our action is our designation of the Holy Land Foundation for Relief and Development, a Texas based NGO, in December 2001. This designation was challenged in Federal court and has been upheld. The Holy Land Foundation no longer operates. Additionally, our colleagues from the FBI have a number of on-going investigations of other individuals and organizations linked to HAMAS. We are working side-by-side with the FBI to ensure that those individuals and organizations will be addressed and the funding that is occurring will be stopped.

We have also taken action against HAMAS outside of the United States. On August 22nd, we announced the freezing of four European-based HAMAS fundraisers and one HAMAS fundraiser based in Lebanon: the Comite de Bienfaisance et de Secours aux Palestinians (CBSP), the Association de Secours Palestinian (ASP), Interpal, the Palestinian Association in Austria (PVOE) and the Sanabil Association for Relief and Development. We announced the public designation of six top HAMAS leaders, and earlier this year we designated the Al-Aqsa Foundation – another European-based HAMAS fundraiser. Of the 321 persons and entities designated to date, 16 are HAMAS related entities. These designations have resulted in the freezing of $24.7 million dollars around the world.

The rest of the world, particularly Europe (until recently) and countries in the Persian Gulf, view the political/charitable wing of HAMAS differently from its so-called military wing. In our view this is pure sophistry. We have advocated forcefully throughout the world that this distorted view of HAMAS should end. On this front, we have some good news.
After nearly constant diplomatic pressure from the United States, on September 12th the European Union, having previously only designated the military wing of HAMAS, designated the entire organization. The European Union's recent action is welcome, if late in coming. A large portion of HAMAS' fundraising has come from Europe and we think the EU's designation of the entire organization will help change that dynamic. Despite the EU's welcome action, the political questions surrounding the Palestinian people coupled with the political and charitable work HAMAS undertakes make it hard to convince other countries around the world – especially in the Persian Gulf – to cease supporting HAMAS.

We think it is critical that governments move now to stop the flow of funds to HAMAS, a terrorist organization that has the conceit and audacity to proclaim with pride that it is sends suicide bombers onto buses and into public plazas to kill innocents with the aim of destroying any chance for progress toward peace between the Israelis and Palestinians. Funds flowing to HAMAS fuel this terror. Again, we think if you stop the money, you go a long way toward stopping the terror. No matter how terrible the plight of the Palestinian people, there can be no justification for the killing of innocents. In our view, toleration of such terror by anyone is nothing short of complicity.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 24, 2003
JS-759

Statement of
Assistant Secretary for Financial Institutions Wayne A. Abernathy
Regarding Senate Banking Committee Approval of FCRA Legislation

"I wish to congratulate Chairman Shelby, Ranking Member Sarbanes, and the members of the Senate Banking Committee for their expeditious work, approving the National Consumer Credit Reporting System Improvement Act of 2003. This unified action of the Committee on this important legislation is a key milestone toward achieving our shared objective, announced by Secretary Snow on June 30, to ensure that our national credit system continues to deliver expanded access to credit for all Americans while protecting the accuracy and security of their personal financial information. Of particular significance is the prominent attention in the legislation to fighting the scourge of identity theft.

"As the Federal Trade Commission recently reported, approximately 10 million Americans have become victims of identity theft in the past year, at a direct cost to these victims of $5 billion, with a cost of $50 billion to businesses—a further cost born by all their customers and the people who invest in these businesses.

"The Committee action was timely, greatly increasing the likelihood that our nation's financial information system will be preserved and strengthened this year as a tool against identity theft and as a means of broadening access to financial services for people throughout the nation. We look forward to continuing to work with the Senate in the legislative refinement process as the bill moves on to consideration on the Senate floor."

FROM THE OFFICE OF PUBLIC AFFAIRS

September 25, 2003
JS-760

Written Testimony of
David D. Aufhauser, General Counsel
before the
the Committee on Banking, Housing and Urban Affairs
United States Senate
September 25, 2003

Chairman Shelby, Senator Sarbanes, and distinguished members of this Committee, thank you for inviting me to testify today about the United States Government's efforts generally, and the efforts of the Department of the Treasury in particular, to address the financing of terror.

Shortly after the September 11th attacks, President Bush gave those of us who work on these issues very clear orders. He told us to starve the terrorists of funding. Since that mandate over two years ago, the United States has waged a "war" against global terrorism. We at Treasury are principally involved in the financial front of that "war." But this "war" is profoundly uncommon. There is no known sovereign; no uniformed army; no hill to take; no target that is seemingly out of bounds. Indeed, terrorists obscenely place a premium upon the death of innocents. It is shadow warfare, and a key source of the stealth and mobility necessary to wage the war is money.

Money is the fuel for the enterprise of terror. It may also be its Achilles' heel. It can leave a signature, an audit trail, which, once discovered, might well prove the best single means of identification and capture of terrorists and pinpointing their donors. Financial records are literally the diaries of terror. Stopping the flow of money to terrorists may be one of the very best ways we have of stopping terror altogether. That is a dramatic statement, but it is not possible to overstate the importance of the campaign against terrorist financing. If you follow and stop the money, you have gone a long way to diminish the killing and destruction.

That being said, it is unwise to understate the difficulty of this endeavor. Our economy is deliberately open and porous. The ways to game restrictions on the flow of capital within the banking system are nearly infinite, and the endeavor becomes more difficult when money is moved outside the banking system. Moreover, the challenge is worldwide in scope. The overwhelming bulk of the assets we seek to freeze; the cash flow that we hope to strangle; and the records that we aspire to exploit are beyond the oceans that surround us. To act alone would justly invite critique.

In the United States, the program to wage the financial front of the war includes:
(i) an Executive Order using the powers granted by the Congress through the International Emergency Economic Powers Act that raises the standards of conduct and due diligence of financial intermediaries, and explicitly targets underwriters of terror for the freezing of their assets;
(ii) UN Security Council resolutions and conventions that internationalize asset freezes and mandate the criminalization of terrorist financing;
(iii) more scrutiny at the gateway to U.S. financial markets that has been provided under the USA PATRIOT Act;
(iv) law enforcement criminal investigations and foreign intelligence operations aimed at terrorist supporters and terrorist financiers;
(v) extensive diplomatic efforts, including the engagement of central bankers and

finance ministries, to champion the need and wisdom for international vigilance against terrorist financing and the taking of appropriate action to address it;
(vi) outreach to the private sector for assistance in the identification, location and apprehension of terrorists and their bankers; and,
(vii) bilateral and multilateral efforts to build laws and systems that will help prevent terrorists from corrupting the financial system in developing countries around the globe, followed by training missions dispatched to those countries to help their officials administer those laws.
Perhaps the most visible weapon on the financial front of the war has been the public designation of terrorists and their support network coupled with the freezing of their assets. Publicly designating terrorists, terrorist supporters and facilitators, and blocking their abilities to receive and move funds through the world's financial system have been, and continue to be, a crucial component in the fight against terrorism. The Executive Order imposing economic sanctions under the International Emergency Economic Powers Act permits the public designation of not only terrorists and terrorist organizations, but also supporters, facilitators and underwriters of terror as well. Once designated, this order freezes the assets of the designee held by U.S. persons. Action under this order is not "criminal" and does not require proof beyond a reasonable doubt. Currently, we have publicly designated 320 individuals and entities as terrorists or terrorist supporters and over $136.8 million dollars have been frozen around the world.

This is not, however, a "box score" game. Only a small measure of success in the campaign is counted in the dollars of frozen accounts. The larger balance is found in the wariness, caution, and apprehension of donors; in the renunciation of any immunity for fiduciaries and financial intermediaries who seek refuge in notions of benign neglect and discretion, rather than vigilance; in financial pipelines that have gone dry; in the flight to old ways of value transfer, such as the use of cash couriers, in the ability to focus our resources on those avenues of last resort; and in the gnawing awareness on the part of those who bank terror that the symmetry of borderless war means that there is no place to hide the capital that underwrites terror.

Notwithstanding the power of this tool, it is important to remember that it is only potent when we can pull the rest of the world with us, through coordinated multilateral action, in identifying and freezing the assets of identified terrorists and their supporters. The simple fact is that most of the funds we are attempting to freeze are beyond the reach of the United States. Acting unilaterally is often an empty gesture; an action without effect. Therefore, we need our allies to join with us and act in concert and in a coordinated way. This is no easy task. And this is a task that occupies much of our time on the financial front of the war against terrorism. The most critical aspect of this task is the ability to develop and provide our allies in the war with sufficient actionable information – information that is often thin and also derived from extremely sensitive sources. The predicate for everything we do is actionable information about a target.

Organization of the Effort
Shortly after the attacks of September 11, in furtherance of developing and implementing a coordinated attack on terrorist financing, the National Security Council established a Policy Coordinating Committee on Terrorist Financing. The purpose of the Committee is to (i) recommend strategic policy direction to the National Security Council on issues relating to terrorist financing; (ii) vet and approve proposed public action against targeted terrorists and terrorist financiers; and (iii) coordinate the United States' efforts on issues relating to terrorist financing. I have chaired that Committee since October 2001.

The Committee has sufficient structure to ensure we are working toward achieving the goals of the committee; however, we have purposefully kept the process flexible, informal, collaborative and iterative. It is a process that has worked well to vet and coordinate proposed action by the United States on the financial front of the war on terrorism.

Challenges Ahead
1. The Kingdom of Saudi Arabia. I have testified before that Saudi Arabia has been an "epicenter" of terrorist financing. Financing emanating from Saudi Arabia

and a balance of Gulf States has been a central focus of our efforts at collection and prevention. The Saudi Government has taken action and implemented systemic changes – both before and after the May 12th bombings in Riyadh – that are promising and constructive. More initiative, follow-through on systemic change, and personal accountability are required.

The May 12th bombings in Riyadh appear to have given life to such a sea change. A sense of urgency now informs Saudi efforts. The promising change on the financial front of the war is the agreement to create a Joint Task Force with the United States to investigate terrorist financing and follow financial leads. The dialogue and dynamic in this task force will be "cop to cop" – taking place on the ground rather than between diplomats at 30,000 feet. The task force will share financial leads on a real time basis and begin meaningful – and hopefully productive – investigations to track down the "banking of terror." This will be an important proving ground to determine Saudi commitment on the financial front of the war. We must watch diligently as the task force is established and moves forward.

2. HAMAS, etc. We must continue to focus our resources on HAMAS and similar terrorist organizations. We must work as hard as we can to convince the rest of the world that it cannot stand by and do nothing against groups that are sending suicide bombers onto buses or into plazas to kill innocent children. Unlike al-Qa'ida, we do not enjoy a UN Sanctions program mandating the freezing of these organizations' and their operatives' and supporters' assets. What is required is unrelenting, consistent, well-informed diplomatic outreach using well developed facts – actionable intelligence – to bring a principled discipline to countries that now stand on the sideline refusing to act because the purpose of acts of terror are believed to be politically laudable, not withstanding the moral obscenity of the means of reaching any such goal.

3. Global Systemic Change. We must continue to work bilaterally and multilaterally to build financial safeguards throughout the globe to do all we can to ensure terrorists cannot game the financial system. Charities and informal money transfer operations, or hawalas, are of particular concern. We have done much in this area, but we need to continue to do more.

4. Address Root Causes. In the long run, the war on terror will be like Sisyphus toiling to push the stone up the hill if the community of nations does not do something to address the despair and economic misery that permits false prophets to preach hate and killing and terror as remedy.

Those are some of the more significant challenges we see as we move forward on the financial front of the war. We have come a long way, but we have a long way to go. The President has said on many occasions that this will be a long battle. I can validate that statement. But you should know I see tremendous commitment to this battle every day.

Because of this Committee's jurisdiction, we think it is important to spend some time discussing what we have done with the tools the Congress provided to us nearly two years ago in the USA PATRIOT Act.

The Role of the Anti-Money Laundering Regulatory Regime in the Financial War on Terrorism

After the attacks of September 11th, it seemed as if we were looking at the world through the wrong end of a telescope. Worldwide efforts to combat money laundering were focused, rightly so, on identifying large scale criminal enterprises that were injecting millions of dollars into the financial system. In the world of the financing of terrorism, however, we were reminded that the deadliest of operations can be financed with relatively paltry sums of money that would give even the best of financial institutions not the slightest hint of their illicit purpose. An integral part of the financial war on terrorism over the past two years has focused on enhancing the ability of financial institutions to better identify and guard against the financing of terrorism. The first step, however, is recognizing our limitations. We are still discovering the many different ways in which our enemies use the recorded

financial system to fund their operations. While we have developed considerable information on their methods, we still have much to learn.

This we do know – even the most unsophisticated of terrorism financing operations will likely intersect the regulated financial system at some point. Title III of the USA PATRIOT Act mandates many substantial changes to the United States anti-money laundering regulatory regime. We wish to thank this Committee for its work in developing and securing passage of these provisions. Title III, in our view, reflects the realities of today's global financial marketplace and the new threats to our financial system. As you know, for the past two years we have been engaged in the most extensive revision of the anti-money laundering regulatory regime in recent memory.

Once complete, if properly enforced, these changes will go far to prevent not only the laundering of illicit proceeds, but also aid the financial system in preventing the use of clean money to finance terror. The Act's principal focus on financial intermediaries, the international gateways to the US financial system, the expansion of due diligence and monitoring requirements, enhanced reporting obligations, and renewed commitment to information sharing comprise the elements of a comprehensive anti-terrorist financing regime. While the end goal of devising systems capable of proactively identifying potential terrorist financing activities remains elusive, we are creating the necessary infrastructure within financial institutions that will one day support such systems. For example, several sections of the Act focus on the correspondent account, the international gateway to the US financial system. These provisions require financial institutions to conduct greater due diligence both before opening such accounts and while they are open. The scrutiny given to these accounts not only augments the audit trail, but also serves to deny certain foreign financial institutions access to the US financial system in the first place. Uniform customer identification regulations recently issued will require all financial institutions to take important steps to verify the identity of their customers. Additionally, we have created a system pursuant to section 314(a) of the Act to enable law enforcement to locate quickly the accounts and transactions of those suspected of money laundering or the financing of terrorism. While we are still working closely with law enforcement and the financial community on the operation of the system, since its creation, the system has been used to send the names of 256 persons suspected of terrorism financing to financial institutions. This has resulted in 1,739 matches that were passed on to law enforcement.

A particularly important provision is Section 311 of the Act, which provides the Secretary with the necessary ability to protect the US financial system against specific terrorist financing threats posed by foreign financial institutions, accounts, transactions, or even entire jurisdictions. The Secretary can require US financial institutions to take appropriate countermeasures against such threats, countermeasures which include requiring the termination of any correspondent accounts involving the threat. We have utilized this authority in the money laundering context, and we are presently considering its use in connection with the financing of terrorism.

I thought it would be helpful to bring you up-to-date on where we are in the process of implementing Title III of the Act. Since its passage, Treasury, the Financial Crimes Enforcement Network (FinCEN), the financial regulators, and the Department of Justice have worked together to draft and issue extensive regulations that implement the Act's provisions. Among other things, we have published regulations that --
(i) Permit and facilitate the sharing of critical information between law enforcement and the financial community, as well as among financial institutions themselves;
(ii) Close off our financial borders to foreign shell banks, require additional due diligence for correspondent accounts maintained for foreign financial institutions, and require foreign banks with correspondent accounts in the United States to supply the name of a US agent for service of process as well as the identities of their owners;
(iii) Require US financial institutions to establish customer identification and verification procedures for all new accountholders;
(iv) Expand the universe of financial institutions reporting potentially suspicious activities to FinCEN; and
(v) Expand our basic anti-money laundering regime to include a wide range of

financial service providers, such as the securities and futures industry and money services businesses.

Our work is not yet finished. We are working to complete several regulatory packages. First on the list is the issuance of a final regulation that will delineate the scope of the obligation of US financial institutions to conduct due diligence and enhanced due diligence on correspondent accounts maintained for foreign financial institutions and private banking accounts for high net worth foreign individuals. Although the banking, securities, and futures industries have been operating under an interim rule since last year, important questions regarding the application of this statutory provision remain.

We will also complete final regulations requiring other categories of financial institutions, such as those in the insurance and hedge fund industries, to establish anti-money laundering programs. This is an integral component of our anti-money laundering and anti-terrorist financing efforts – to ensure that all available avenues for financial crime are blocked by this basic protection. Similarly, now that we have issued final regulations requiring the banking, securities, futures, and mutual fund industries to establish customer identification programs, we will be drafting regulations applicable to financial institutions in other industries that offer their customers accounts. Finally, we are continuing to explore the appropriate expansion of the suspicious activity reporting regulations to additional categories of financial institutions. We have already proposed to require mutual funds, futures commission merchants, and insurance companies to file such reports.

Let me provide you with some sense of how we are using the USA PATRIOT Act and the implementing regulations to combat terrorist financing. While it is still relatively premature to evaluate their impact, we do have some indication of their effectiveness. For example, as I noted above, the section 314(a) system has been used in many cases and has resulted in a substantial number of leads. The additional reporting and recordkeeping authorities have enhanced the database FinCEN uses for its research and analysis in supporting terrorism investigations – since September 11th, FinCEN has supported 2,692 terrorism investigations. The Terror Hotline established by FinCEN has resulted in 789 tips passed on to law enforcement. Since the World Trade Center Attacks, FinCEN has made 519 proactive case referrals to law enforcement based upon an analysis of information in the Bank Secrecy Act database. With the expansion of the suspicious activity reporting regime, financial institutions have filed 2,655 suspicious activity reports ("SARs") reporting possible terrorist financing. In addition to passing these reports on to law enforcement, FinCEN has and will continue to analyze the SARs to report on systemic patterns in the financing of terrorism.

Finally, I cannot neglect mentioning our partnership with the financial community. Since passage of the Act, the willingness of the financial community to work with us in this fight has been remarkable. Cooperation comes in the form of formal and informal feedback on new regulations, one-on-one assistance with specific investigations, and the proactive identification of potential instances of the movement of funds to finance terrorism. While we expect the financial community to join us in this fight -- and they have done so -- we also recognize and appreciate these efforts, from the largest of financial institutions to the smallest of the community banks.

While it is appropriate on this occasion to reflect on what we have accomplished, it is essential that we map out a strategy for proceeding. The plan is straightforward – do a better job of leveraging the regulatory regime to maximize the protections against the financing of terrorism. We will do so in the following manner:

• Better utilization of technology

Technology holds one of the keys to our success in the financial war on terrorism. This involves the ability to marshal and synthesize all available information to proactively identify possible instances of the movement of illicit funds. Now more than ever we require our financial institutions to produce data and information. Several initiatives are already under way within Treasury and FinCEN. For example, FinCEN will be receiving assistance from the Business Executives for National Security and the Wharton School of the University of Pennsylvania in

developing technology that will allow financial institutions to report suspicious transactions more easily and quickly. As part of an overall plan to enhance our technological platform, FinCEN is also developing a new system to manage the Bank Secrecy Act ("BSA") database. "BSA Direct" will involve a significant upgrade to the platform on which the BSA database is maintained, and will provide users with web-based, secure access that allows for faster and easier searching. Finally, we will continue to work to assist financial institutions in developing proactive software to better identify potential terrorist financing activities.

• Increased Information Sharing
A central theme of the USA PATRIOT Act is enhanced information sharing. While we have taken substantial steps toward this goal, our challenge remains to find better ways of providing information and feedback. This is not simple. Often the information we develop is highly protected intelligence information that cannot be disclosed, and we are always wary of providing our enemies with a roadmap or a "how-to" guide to manipulating our defenses. That said, we understand the importance of, and are searching for, better ways to share information with the private sector.

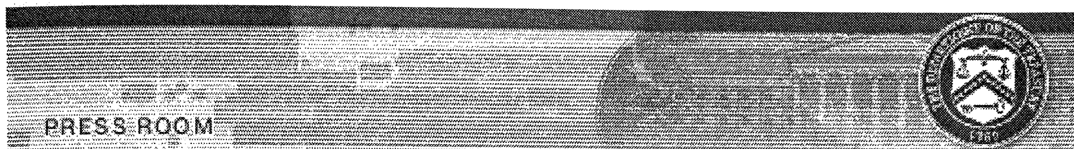
• Developing Similar International Standards
For our regulatory efforts to be effective, standards should be internationalized as much as possible. Thus, we will continue to devote ourselves to encouraging the development of international money laundering and terrorism financing standards that reflect the principles of our domestic regime. We have already done this in several areas. In conjunction with the Financial Action Task Force, in addition to securing the promulgation of the Eight Special Recommendations on Terrorist Financing, the FATF recently completed the revision of the 40 Recommendations on Money Laundering. The changes reflect many of the concepts of the USA PATRIOT Act. For example, key changes to the 40 Recommendations include: (1) enhanced due diligence with respect to correspondent banking accounts; (2) increased scrutiny for politically exposed persons; and (3) prohibition on the use of shell banks.

• Ensuring Compliance with International Standards
Assessing jurisdictions against these standards and cultivating their compliance with them are important components of our work. Without vigorous and consistent implementation of these standards throughout the globe, terrorists and criminals will enter the international financial system at the point of least resistance, and preventive national efforts will be rendered considerably less effective. Ensuring global compliance with international standards is accomplished through a three-prong strategy that includes: (i) objectively assessing every country's standards against the international standards; (ii) providing capacity-building assistance for key countries in need; and (iii) ensuring appropriate consequences for countries and institutions that fail to take reasonable steps to implement standards to prevent terrorist financing and money laundering.

Treasury is participating in a variety of global assessments sponsored by the IMF and the World Bank, the FATF, and FATF-Style Regional Bodies. We are also seeking to build the capacity of jurisdictions to combat money laundering and the financing of terrorism through a robust regulatory regime. This is done through bilateral and multilateral outreach and training. Finally, recalcitrant jurisdictions face potential sanctions pursuant to section 311 of the USA PATRIOT Act.

• Evaluating the US Regulatory Regime
As we complete regulations implementing the USA PATRIOT Act, our next and perhaps most important task is to take a critical look at what we have done and ask the difficult questions of whether they are effective and what additional regulations may be necessary. We will work through both formal and informal means to conduct this evaluation, and look forward to working with this Committee during the process.

We are, in our judgment, on the right path. We have much work left to do. We appreciate the support we have received from the Congress – particularly this Committee – on these important issues. I believe what I have said time and again, stopping the flow of money is one of the very best ways to stop the terror.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 25, 2003
JS-761

Senate Banking Committee
Hearing on Terrorist Financing
Opening Statement
David D. Aufhauser
General Counsel
Department of the Treasury
September 25, 2003

Mr. Chairman, it is a distinct honor to appear before the Committee today. You and I have previously discussed enforcement and terrorist financing matters in closed hearings before the Senate Intelligence Committee. I am grateful for the chance to speak about these issues in the daylight so we may all profit from an informed debate on something that is central to the lives of our families and to our country.

Senator Sarbanes, I am equally grateful for the attention that you have turned to this matter. I live in the District of Columbia, so for twenty years you have been the closest thing that I have ever had to a Senator. But what recommends you most, respectfully, is a staff that includes my friend and, literally teacher when I first set foot at Treasury, Steve Kroll. Working closely with Steve Harris, Cathy Casey and, in particular, John Smith, we are all a safer and a freer people because the work of the Chairman, yourself and this Committee.

Terror traffics in three forms of currency – hate, counterfeit religion and money. The first two are born out of a deficit of hope in the Middle East, the most naked symbol of which is the failure to resolve the question of Palestine.

But the malevolence preys on a dynamic that extends far beyond those borders, to corners of the world where you find the Islamic Diaspora – hungry, torn by civil war, living in near permanent refugee camps, looking for remedy where reason seems to beggar the notion. There, hopelessness is forged into hate by merchants of the false cure called terror.

These are problems writ large that must be addressed if we hope to bring our children up in a world no longer haunted by killers whose political agenda calls for the death of innocents. But it will take years to win hearts and minds and the challenge may be beyond my personal ken.

I've had a more immediate calling – to deal with the third leg of terror, its funding.

The task came to me with some irony. I joined the Treasury Department in March of 2001, challenged by Paul O'Neill to help him put good money –development aid – to good account. We wanted real world consequence, and our model was water wells in a thousand villages rather than the narcotic of grand master plans.

After September 11th, I was asked to deal with the distorted mirror image of that ambition, no longer responsible for money intended to enrich people, but to destroy them.

It is something that we have never done before in this country– at least in any systemic way – and a legitimate subject for examination and, perhaps, reproach.

I say that because almost nothing is more important on the battlefield of the war on terror than diminishing the flow of money. And there is additional irony that it took the destruction of a temple of commerce to teach us that lesson.

Why is it important? First, it is doable and within our reach.
Al-Qaida's cash flow has been balkanized and cut by two-thirds since we started this campaign.

Second, it provides near infinite leverage to prevent calamity. You cannot limit the imagination or designs of a terrorist cell that is rich with money in its pockets. But all their invention is forfeit if the funds never materialize.

Third, in this uncommon shadow war of terror, virtually every source of information is suspect, the product of treachery, deceit, bribes or interrogation. But financial records don't lie and bring integrity to the process of threat assessment and the prevention of mayhem.

Fourth, a man who straps a bomb to his chest is an implacable foe – beyond redemption and certainly beyond deterrence because of any threat of economic or physical sanction. But his would be banker is a coward and can be made to be wary, apprehensive and a bankrupt source of future funding.

Fifth, developing intelligence on future acts of terror is a compound of genius, sweat-equity and serendipity. I don't like the serendipity part. The prospect of collecting and successfully analyzing intelligence on a hundred events at the end of the pipeline of the terrorist enterprise would be nothing short of miraculous.

Stopping the capital formation of that enterprise before all such invention, while a daunting challenge, is our more promising strategic choice and goal.

There will be no surrender on the battleship Missouri in this war. There is no flag to capture. There is no uniform army to corral. There is no clod of earth that our enemies will wish to preserve in the event of defeat.

Rather, we will count our victories one at a time, measured in single captures or killings. We will defeat them, however, in a systematic way only by denying them the lifeline of their mobility and stealth – and that is their financing.

It cannot be done alone. Virtually all of our concerns – save for John Pistole's good industry on domestic threat – are abroad. We therefore mark our successes by building a new vocabulary, new laws, new capacities and political will globally to stem the flow of terrorist financing -- whether it is Syrian and Iranian support for Hezbollah, European support for Hamas, or Gulf state support for al-Qaida.

There has been a sea change because of our efforts. Let me close with one example.

Over the past 1700 years, any member of the Islamic faith could walk into one of the tens of thousands of mosques that populate Saudi Arabia and reaffirm a covenant with God – at least in some small part – by depositing coin or currency into a collection box (known as sakadah).

It is an intensely private act – what you might call a good secret. Nothing vain-glorious, just a simple act of faith and charity.

In a world of peace, it would not be the business of government. Indeed, to regulate it could be called sacrilege.

We do not, however, live in a world of peace. And some of these collection boxes have been found in the hands of al-Qaida. And, today, in Saudi Arabia – the keeper of Mecca – cash collection in sakadah is banned.

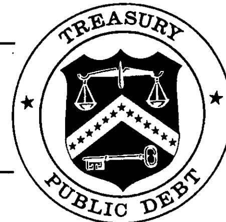
That kind of change in even the most fundamental acts of a society, let alone a faith – has taken enormous resources and the kind of industry that would make this Committee proud of a government and interagency process that works as one.

For a while there, we were spinning gold out of straw. And surely, we can make improvements. But with colleagues like Tony and John, the campaign against terrorist financing will bring more peace to our citizens than an army of soldiers.

And maybe if I get the privilege to return to public service, I can work on those village wells that Paul and I spoke about three years ago when the world was a different place.

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
September 24, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Interest Rate:	1 5/8%	Issue Date:	September 30, 2003
Series:	Q-2005	Dated Date:	September 30, 2003
CUSIP No:	912828BL3	Maturity Date:	September 30, 2005

High Yield: 1.695% Price: 99.863

All noncompetitive and successful competitive bidders were awarded securities at the high yield. Tenders at the high yield were allotted 78.20%. All tenders at lower yields were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 54,190,070	$ 24,237,000
Noncompetitive	763,107	763,107
FIMA (noncompetitive)	0	0
SUBTOTAL	54,953,177	25,000,107 1/
Federal Reserve	6,535,067	6,535,067
TOTAL	$ 61,488,244	$ 31,535,174

Median yield 1.670%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low yield 1.500%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 54,953,177 / 25,000,107 = 2.20

1/ Awards to TREASURY DIRECT = $624,571,000

http://www.publicdebt.treas.gov

JS 762

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.
September 25, 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 $32,000 million to refund an estimated $33,381 million of publicly held 13-week and 26-week Treasury bills maturing October 2, 2003, and to pay down approximately $1,381 million. Also maturing is an estimated $17,000 million of publicly held 4-week Treasury bills, the disposition of which will be announced September 29, 2003.

The Federal Reserve System holds $15,303 million of the Treasury bills maturing on October 2, 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 September 30, 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 $962 million into the 13-week bill and $611 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 763

HIGHLIGHTS OF TREASURY OFFERINGS OF BILLS
TO BE ISSUED OCTOBER 2, 2003

September 25, 2003

Offering Amount	$16,000 million	$16,000 million
Maximum Award (35% of Offering Amount)	$ 5,600 million	$ 5,600 million
Maximum Recognized Bid at a Single Rate	$ 5,600 million	$ 5,600 million
NLP Reporting Threshold	$ 5,600 million	$ 5,600 million
NLP Exclusion Amount	$ 6,300 million	None

Description of Offering:

Term and type of security	92-day bill	182-day bill
CUSIP number	912795 PD 7	912795 PS 4
Auction date	September 29, 2003	September 29, 2003
Issue date	October 2, 2003	October 2, 2003
Maturity date	January 2, 2004	April 1, 2004
Original issue date	July 3, 2003	October 2, 2003
Currently outstanding	$24,288 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:

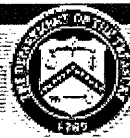
(1) Must be expressed as a discount rate with three decimals in increments of .005%, e.g., 7.100%, 7.105%.
(2) Net long position (NLP) for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position equals or exceeds the NLP reporting threshold 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.

ESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

September 25, 2003
JS-764

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 $81,233 million as of the end of that week, compared to $80,596 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	September 5, 2003			September 12, 2003		
TOTAL		80,596			81,233	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	7,344	13,437	20,781	7,516	13,400	20,916
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,023	2,699	14,722	12,281	2,691	14,972
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]			22,520			22,686
3. Special Drawing Rights (SDRs) [2]			11,530			11,615
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	September 5, 2003			September 12, 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

	September 5, 2003			September 12, 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

October 7, 2003
JS-765

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 $83,074 million as of the end of that week, compared to $82,068 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	September 19, 2003			September 26, 2003		
TOTAL		**82,068**			**83,074**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	7,549	13,798	21,347	7,656	14,069	21,724
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,329	2,771	15,100	12,481	2,826	15,307
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]			22,869			23,148
3. Special Drawing Rights (SDRs) [2]			11,709			11,851
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	September 19, 2003			September 26, 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

	September 19, 2003			September 26, 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						

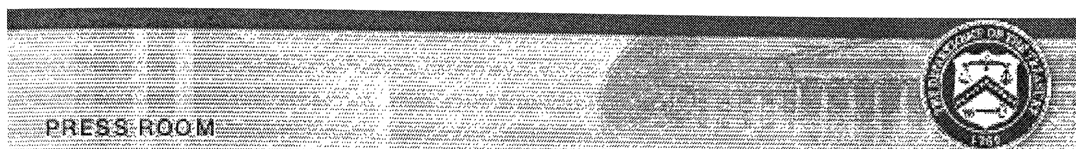
Notes:

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

September 20, 2003
JS-766

Statement of G7 Finance Ministers and Central Bank Governors

Recent data indicate that a global recovery is underway. Equity markets have rebounded, confidence has increased, financial conditions have improved, oil prices are expected to remain stable and inflation is under control.

Macroeconomic policies should continue to support the recovery while ensuring medium-term fiscal sustainability. However, for growth to strengthen, be sustained and be less unbalanced, structural reforms must be accelerated. We support the progress made to reform tax and regulatory regimes, labour markets and pension systems. Further efforts are needed. Our top priority is to raise productivity and employment. We will do our part in further reforms as set out in the attached Agenda for Growth.

We reiterate the importance of a rules based and multilateral approach to trade. We are disappointed at the breakdown of trade negotiations in Cancun. We urge a speedy resumption of the Doha Round which is vital for global growth and the alleviation of world poverty. We believe that the immediate blockages can be removed and, with an effort on all sides, agreement reached on the remaining issues. We welcome the International Financial Institutions' proposed assistance for countries to deal with the transition to a more open trading system.

We reaffirm that exchange rates should reflect economic fundamentals. We continue to monitor exchange markets closely and cooperate as appropriate. In this context, we emphasize that more flexibility in exchange rates is desirable for major countries or economic areas to promote smooth and widespread adjustments in the international financial system, based on market mechanisms.

Effective and persuasive surveillance is crucial. Even in current favourable conditions, the IMF should identify vulnerabilities, in particular currency mismatches, and provide candid advice on policy reforms. We welcome the agreement to publish exceptional access reports. We welcome the increasingly widespread use of collection action clauses (CACs) in foreign sovereign bond issues. We look forward to further work on the Code of Conduct, which will be discussed by the G-20 meeting in October.

We encourage emerging market countries to pursue sound policies and to enhance their climate. This will help attract flows, reduce external vulnerabilities, and support sustained growth. We welcome the progress Brazil and Turkey have made in implementing structural reforms and support further efforts. We welcome today's agreement between Argentina and the IMF. The implementation of the program will be the key to restore strong and long-lasting economic growth and investment climate. We look forward to a speedy agreement with private creditors ensuring fair treatment.

We remain committed to transparency and effective exchange of information between countries as vital weapons is the fight against money laundering and tax evasion. We strongly urge those OECD countries that have not taken necessary steps – in particular in allowing access to bank information – to do so as soon as possible.

We welcome the work of the Financial Stability Forum, in particular in areas of audit, financial analysts, credit risk, reinsurance and rating agencies, and encourage it to continue strengthening cooperation in these areas.

We reaffirm our commitment to fight global poverty and to help developing countries achieve the international development goals of the Millennium Declaration. In this respect, we discussed financing issues and results based measurement. We asked the IMF and the World Bank to do further work on aid effectiveness, absorption capacity, financing facilities and results-based measurement mechanisms, and report at the Annual Meetings in September 2004. We welcome the views of developing and emerging market countries on these issues.

We reaffirm our strong commitment to complete the Heavily Indebted Poor Countries Initiative. We urge all bilateral creditors to join with us in canceling out the 100% of their eligible claims. We ask the IFIs to review the methodology for calculating the amount of "topping up" debt relief. We look forward to the outcome of the IFIs work on low income countries vulnerabilities to exogenous shocks.

Since September 11, 2001, we have made significant progress in the fight against terrorist financing, although much remains to be done. We look forward to the Fund and Bank making terrorist financing/money laundering assessments a permanent part of their work. We have intensified the dialogue with several non-G7 countries to prevent abuse of non-profit organizations and alternative remittance systems. We seek to eliminate terrorist financing through implementation of measures in accordance with the FATF Eight Special Recommendations.

We welcome both the Afghan donors meetings this month and the upcoming Iraq Donors' Conference. We reaffirm our support for a multilateral effort to help rebuild and develop Iraq, based on a needs assessment led by the World Bank at the Donors' Conference in Madrid, next month. We support the IMF and the World Bank rapidly providing, subject to their policies, financial and other assistance to Iraq and call upon regional financial institutions to do likewise.
We call upon the Paris Club to make its best effort to complete the restructuring of Iraq's debt before the end of 2004. We urge all non-Paris creditors to cooperate.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

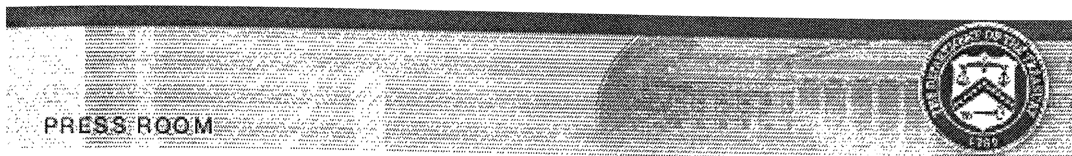
October 8, 2003
JS-768

Gross External Debt Reporting System Becomes Operational

The Treasury Department today began publication of a data series on U.S. gross external debt. The overall magnitude of U.S. indebtedness to foreigners and some of the major components are already well known. This presentation provides more detail.

U.S. data are now available for the quarter ending June 30, 2003, and will henceforth be available quarterly, with a lag of one quarter, on Treasury's website located at http://www.treas.gov/tic/external-debt.html.

This data series conforms to guidelines of the IMF's Special Data Dissemination System (SDDS).



FROM THE OFFICE OF PUBLIC AFFAIRS

September 29, 2003
JS-769

Remarks of
Assistant Secretary for Financial Markets Brian C. Roseboro
to
CFO Magazine Forum on Total Working Capital Management
New York, NY

Good afternoon. I would like to thank CFO magazine for offering this opportunity to speak with you on the topic of government borrowing. I will use my time to make three related points; first, yes deficits matter but focusing merely on current and forecast deficits is focusing on the symptom and not the disease. Second, Treasury's debt management policy is well positioned to manage the challenges of aiding economic recovery and fighting the war on terrorism and lastly, the enactment of the Administration's policies over the past two years have indeed facilitated the emerging economic recovery.

Financing outlook:

The recession, corporate scandals and continuing war on terrorism all played a part in slowing the growth of our economy and increasing the deficit. In the spring of 2001, the forecast for FY2003 was for a surplus of $334 billion. The Office of Management and Budget's (OMB) most recent forecast for FY2003 was for a deficit of $455 billion – a $789 billion adverse swing in 2 years. OMB has forecast deficits, although declining after FY2004, for the next five years. Secretary Snow has said deficits matter but there are times when they are unavoidable, especially when we face critical needs. Further, let's put the current deficit outlook into perspective. When viewed beyond a simplistic and often misleading "nominal" measure, it remains at a manageable level relative to the size of the US economy at 4.2% of GDP.

Managing these unwelcome deficits is an Administration priority. But effectively managing deficits can only be done by not confusing the cause with the cure. Let's do some simple math. In the 2 year FY2003 forecast swing of -$789 billion, approximately 22% is a "static" accounting result of the President's tax cuts, 24% for Homeland Security cost. But 53% or approximately -$418 billion of that was due to lower economic growth than originally forecast. Clearly, even without the President's tax cut package passed in 2001, the economic growth and jobs package, spending on homeland security and the war on terrorism, we would have deficits now because of the downturn in the economy.

The obsession some have today with focusing on projected deficits, especially long-term, brings up another important issue. The most frequent conceptual error I see committed by Capital Hill watchers and Wall Street analysts, with respect to the government's financing needs, is to over-rely on official budget "point" forecasts, and to under-invest in understanding the likely scope of deviation in these projections. As Yogi Berra said – "It's tough to make predictions, especially about the future".

Over the past 10 years, the average error in Administration budget forecasts, realized four months into the fiscal year, is approximately +/- $70 billion and the Congressional Budget Office (CBO) and Wall Street get it just as wrong. OMB, the Council of Economic Advisors (CEA), and other Administration officials strive to improve our economic forecasting and thus our borrowing projections. However, the

underlying problem is that our financing needs, driven by a $2 trillion budget, are constantly shifting in response to numerous dynamic, ever-evolving variables such as seasonal changes in cash flows, structural changes in tax and expenditure policies and the level of US economic activity.

But striving towards better forecasting is only part of the answer. In preparing for battle, General Eisenhower observed, **"I have always found that plans are useless, but planning is indispensable."** So to manage the government's borrowing requirements, Treasury debt managers must constantly ask those fundamental risk management questions, "What is? What was? What if? And How?" What is our up-to-date borrowing estimate? What was the market response to changes in previous borrowing quarters? What if we vary the assumptions driving future borrowing needs? How can we better prepare the market for changes in our borrowing pattern when – not if – the future does not fit our forecast. We have to look at a range of futures and test how our decisions would turn out in each.

Deficits are manageable:

Treasury's single objective in managing its marketable debt is just like that of a private sector chief financial officer; our objective is **to achieve the lowest cost, over time, for the federal government's financing needs**. But we have constraints unlike those of a private sector CFO, most notably that a Treasury debt manager does not, and must not attempt to "time the market". Providing investors and financial intermediaries with confidence that the value of their holdings will not change due to unforeseen changes in the amounts we have issued, lowers our cost of borrowing. Ten-year yields are still low by historical standards for example, but we aren't holding impromptu auctions. We don't even take the yield curve into account when we allocate how much to raise by different maturities. Nor do we cancel auctions due to spikes in our cash balances. Instead, to achieve our objective of lowest cost over time, the Treasury commits to regular and **predictable** issuance across a range of securities. This regularity and predictability gives investors certainty that they can get our securities if they need them. We're always there.

Market participants knowing of our stable issuance patterns have thus grown habituated to using Treasuries for pricing, hedging, and cash management. There is ongoing and increasing demand for our issuance. In 2001, the volume of transactions in the Treasury market averaged almost $300 billion a day. That was over three times the average daily volume for each of corporate debt, agency debt, mortgage-related securities, and even the New York Stock Exchange. In 2002, we averaged close to $350 billion and in 2003 we are averaging over $400 billion a day. Over time, we believe this regularity and predictability cuts our financing costs more than market-timing moves ever could.

However "regular and predictable" does not mean static, inflexible or never changing. It means factoring "variance" into our debt management policies. It means reducing the uncertainty where we can and planning for where we cannot. It means preparing the market, as much as possible, when we do have to make policy changes.

Our planning is further aided by offering as broad a product range as we can, consistent with minimizing cost to the taxpayer over time. Our current calendar has roughly 195 auctions per year: 3 bill auctions per week (4-week, 13-week, and 26-week bills), monthly 2-year & 5-year note auctions, quarterly 3-year notes, quarterly 10-year notes with re-openings one month later, and quarterly auctions for inflation-indexed securities.

Occasional policy changes occur when our borrowing needs exceed the flexibility built into our auction schedule. Over the last three decades, Treasury has introduced, withdrawn and re-introduced numerous securities. These include the 52-week bill, 3-year note, 4-year note, 5-year inflation indexed note, 7-year note, 20-year bond, 30-year bond, 30-year callable bond, 30-year inflation indexed bond, foreign targeted and foreign currency denominated securities.

We signal our deliberations well ahead of time through our refunding statements,

the questions we ask of primary dealers and the publicly reported discussions we have with our private sector advisory committee made up of fixed income "buy" and "sell" side participants. We have worked hard to improve communications with investors, both so that you know what to expect from Treasury debt management and so that you have more opportunities to tell us what we should expect from you. When we make a decision, we announce it at a quarterly refunding as early as we can. We want you to have substantial lead-time for any specific changes to our offerings as well as an awareness of the problems or choices we face.

But is current and prospective issuance "crowding out" the other fixed income issuers? Answering this first requires a measure of the market. Today's total value of major US dollar credit markets is about $21 trillion. Of that, Treasury marketable debt is $3.5 trillion. The mortgage backed securities market is nearly $5 trillion. The asset-backed securities market is $1.6 trillion. The corporate bond market is $4.1 trillion. The agency debt market is $2.4 trillion and other offerings (such as municipal securities and money market instruments) account for $4.3 billion. Over the last 10 years, Treasury marketable debt has net increased by approximately $389 billion while the other markets have grown by a combined $10.8 trillion.

Yet another perspective on Treasury's size in the market is to see that Treasury notes and bonds account for only 10% of the afore mentioned long-term credit market debt compared to 18% ten years ago. Further, this 10% level is a 22-year low as a percentage of long-term debt securities. Indeed, even looking at short-term issuance – i.e., short-term commercial paper plus Treasury bills - "T-bill" issuance is at 41% of open market paper compared to 54% 10-years ago. Evidence of any "crowding out" effect is lacking.

US economic outlook:

It's most likely that only returning to balanced budgets will eliminate questions and concerns over the myth of "crowding out". The prescription for returning to balanced budgets is straightforward: hold the line on spending and grow the economy. The CEA has estimated that for every increase of 1% in the economic growth rate, the budget outlook improves by $1 trillion over 10 years. It is economic growth that corrected the economic problems and closed budget gaps over the last 30 years. The President put forth and signed legislation that is encouraging consumer spending and promoting investment by individuals and businesses that will lead to economic growth and job creation. Positive economic developments are occurring. Housing starts recently reached a 17-year high. Retail sales have been robust over the summer and disposable personal income, helped by recent tax cuts, has been strong as well. Business investment in equipment and software in the second quarter posted the largest increase in three years. While employment numbers remain weak and a concern, improved economic growth will restore job gains. The private sector consensus forecast is that real growth will exceed 4 percent in the second half of this year and average just under 4 percent next year. In addition, the President has recently announced a six-point plan to build employer confidence and create momentum to hire new workers.

Confidence that the Administration's plans have played a significant part in the recovery can be found in testing the "null hypothesis" – " What would be US economic performance without the fiscal stimulus measures implemented through the President's leadership?", i.e., eliminate the tax and spending provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001- June 2001-, the Job Creation and Worker Assistance Act of 2002 –March 2002 - and the Jobs and Growth Tax Relief Reconciliation Act of 2003 – May 2003. Treasury's Office of Economic Policy estimates that through first half of this year:

- The unemployment rate would have been nearly 1 percentage point higher
- The economy would have created as many as 1.5 million fewer jobs.
- Real GDP would have been as much as 2 percent lower.

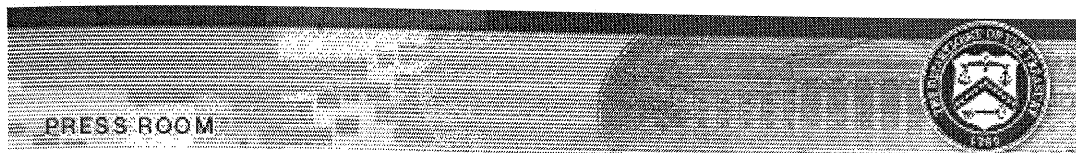
The President's actions, along with the impact of accommodative monetary policy, low inflation, low interest rates and necessary adjustments by US businesses helped make the recession one of the shallowest in our nation's history.

Conclusion:

Yes, deficits matter but the need to implement policies that encourage and support economic growth is what's important. Treasury's debt issuance calendar is well positioned to manage the ongoing obligations from past decades of Congressional decisions on taxes and spending, any new additional requirements to support the economic recovery and war needs, and any further negative or positive variance in budget forecast. In doing so, Treasury issuance will continue to support the broader functioning and growth of the fixed income market.

America's economy is showing signs of promise. But there are still Americans out of work today; there are still American businesses struggling. Partial success will not be sufficient. As the President has stated, we can and must do better for all Americans. The Administration's economic policies are helping to move the economy in the right direction and improved growth and opportunity can be expected.

Thank you.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 29, 2003
JS-770

**Treasury Department Names Dan Iannicola, Jr.
as Deputy Assistant Secretary for Financial Education**

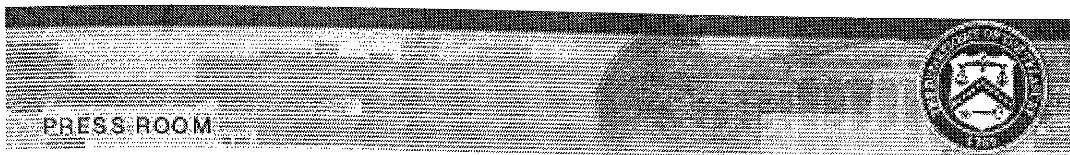
The Treasury Department today announced that Dan Iannicola, Jr. has been appointed as Deputy Assistant Secretary for Financial Education. Bringing experience in both the education and financial fields, he begins his new post September 29, 2003.

In this position, Mr. Iannicola is responsible for overseeing the Treasury's Office of Financial Education (OFE), which was established in 2002 to promote access to financial education programs so that Americans obtain the practical knowledge and skills that will enable them to make informed financial choices throughout their lives. Mr. Iannicola will advise the Assistant Secretary of Financial Institutions on matters pertaining to financial education, including the development, implementation and analysis of policy.

Mr. Iannicola was most recently Special Counsel to the Assistant Secretary and Director of Communications in the Department of Education's Office of Postsecondary Education, where he has worked since 2002. During that time, he drafted policy documents, provided legal analysis of statutes and regulations, and represented the Department at public events.

Previously, Mr. Iannicola served as Counsel for The May Department Stores Company and Vice President/Regulatory Liaison for the May National Banks in St. Louis, MO (1996-2002), while also serving as Adjunct Professor of Business Law at St. Louis Community College (2000-2002). He was president of the Affton Board of Education in St. Louis, MO during 1999-2001, following membership on the Board since 1997. Mr. Iannicola also was an attorney with John Deere Credit in Moline, IL (1994-1996).

Mr. Iannicola earned his Bachelor of Science degree in Economics from The Wharton School at the University of Pennsylvania, and his Juris Doctor from the Univeristy of Illinois College of Law. He resides in Arlington, Virginia.



FROM THE OFFICE OF PUBLIC AFFAIRS

September 30, 2003
JS-771

TREASURY AND IRS ISSUE GUIDANCE ON THE DEDUCTIBILITY OF CONVENTION EXPENSES

The Treasury Department and the Internal Revenue Service issued today Revenue Ruling 2003-109, which provides an updated list of geographical areas that are included in the "North American area" for purposes of deducting convention expenses.

Section 274(h) of the Internal Revenue Code provides that expenses incurred by U.S. taxpayers for conventions, seminars, or similar meetings in the North American area that are otherwise deductible as ordinary and necessary business expenses will be allowed without regard to the additional statutory limitations applicable to foreign convention deductions. For this purpose, the North American area includes the United States and its possessions, Canada, Mexico, jurisdictions that have entered into Compacts of Free Association with the United States providing for such treatment, and jurisdictions that are beneficiary countries as defined in the Caribbean Basin Economic Recovery Act of 1983 and that have in effect a tax information exchange agreement with the United States consistent with the standards described in section 274(h)(6)(C). Revenue Ruling 2003-109 reflects tax information exchange agreements in effect with such beneficiary countries, including the tax information exchange agreement with Antigua and Barbuda that recently came into effect.

The revenue ruling provides that it will be updated as future developments result in the inclusion of other areas in, or the exclusion of areas from, the North American area.

Related Documents:

- The text of Revenue Ruling 2003-109

Part I

Section 274.---Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-1: Disallowance of Certain Entertainment, Etc., Expenses

Rev. Rul. 2003-109

ISSUE

Section 274(h) of the Internal Revenue Code limits deductions for expenses incurred in connection with a convention, seminar, or similar meeting held outside the "North American area." This revenue ruling contains an updated list of all geographical areas currently included in the North American area for purposes of this section.

LAW AND ANALYSIS

Section 274(h) disallows deductions under section 162 for expenses allocable to attendance of an individual at a convention, seminar, or similar meeting (a "convention") held outside the "North American area." However, the disallowance does not apply if the taxpayer can demonstrate that the convention's location satisfies specified standards of reasonableness.

Geographical areas are included in the "North American area" for purposes of section 274(h) under one of four provisions.

Section 274(h)(3)(A)

Section 274(h)(3)(A) defines the term "North American area" as the United States, its possessions, the Trust Territory of the Pacific Islands, Canada, and Mexico. The United States consists of the fifty states of the United States and the District of Columbia. The possessions of the United States, for this purpose, are American Samoa, Baker Island, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, Howland Island, Jarvis Island, Johnston Island, Kingman Reef, the Midway Islands, Palmyra, the United States Virgin Islands, Wake Island, and other United States islands, cays, and reefs not part of the fifty states or the District of Columbia. The jurisdictions that formerly constituted the Trust Territory of the Pacific Islands – the Republic of the Marshall Islands, the Federated States of Micronesia, and the Republic of Palau – are now covered by the compacts with the United States described below.

The Compact of Free Association Act of 1985

The Compact of Free Association Act of 1985, Pub. L. No. 99-239, 99 Stat. 1770 (1986) went into effect on October 21, 1986, with respect to the Republic of the Marshall Islands, and on November 3, 1986, with respect to the Federated States of Micronesia. Section 405 of Title IV of the Compact provides that, for purposes of section 274(h)(3)(A) of the Code, the Republic of the Marshall Islands and the Federated States of Micronesia are included in the North American area.

The Compact of Free Association Between the United States and the Republic of Palau

The Compact of Free Association between the United States and the Republic of Palau, Pub. L. 99-658, 100 Stat. 3672 (1986) went into effect on October 1, 1994. Section 255(d) of Title II of the Compact with Palau provides that, for purposes of section 274(h)(3)(A) of the Code, Palau is included in the North American area.

Section 274(h)(6)

Section 274(h)(6) provides that the term "North American area" also includes any "beneficiary country" if, as of the time a convention begins, (1) there is in effect an agreement described in section 274(h)(6)(C) providing for the exchange of tax information between the United States and the beneficiary country, and (2) there is not in effect a finding by the Secretary of the Treasury that the tax laws of the beneficiary country discriminate against conventions held in the United States.

Section 274(h)(6)(B) defines the term, "beneficiary country" as meaning a beneficiary country as defined in section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, 97 Stat. 384 (1983), and Bermuda. An agreement described in section 274(h)(6)(C) providing for the exchange of information between the United States and a beneficiary country generally must provide:

> for the exchange of such information (not limited to information concerning nationals or residents of the United States or the beneficiary country) as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares. Section 274(h)(6)(C)(i).

Rev. Rul. 94-56, 1994-2 C.B. 37, modifying Rev. Rul. 87-95, 1987-2 C.B. 79, identifies each of the following jurisdictions as a beneficiary country for which there is in effect an agreement with the United States described in section 274(h)(6)(C) and for which there is not in effect a finding by the Secretary of the Treasury that the tax laws of the beneficiary country discriminate against conventions held in the United States: Barbados, Bermuda, Costa Rica, Dominica, Dominican Republic, Grenada, Guyana, Honduras, Jamaica, Saint Lucia, and Trinidad and Tobago. Each of these jurisdictions continues to be considered as part of the North American area under section 274(h)(6) for purposes of claiming deductions for expenses incurred in connection with a convention beginning on or after the date on which the tax information exchange agreement between the jurisdiction and the United States came into effect.

Since the publication of Rev. Rul. 94-56, the "Agreement Between the Government of the United States of America and the Government of Antigua and Barbuda for the Exchange of Information with Respect to Taxes" has come into effect. This agreement entered into force on February 10, 2003 and came into effect as of that date. See Treas. News Release JS-165 (April 8, 2003). Antigua and Barbuda is included within the North American area under section 274(h)(6) as of February 10, 2003.

HOLDING

For purposes of claiming deductions for expenses incurred in connection with a convention, seminar, or similar meeting, the following areas are included in the "North American area" as of the effective date of section 274(h) except as otherwise indicated:

1. The fifty states of the United States and the District of Columbia;
2. The possessions of the United States, which for this purpose are American Samoa, Baker Island, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, Howland Island, Jarvis Island, Johnston Island, Kingman Reef, the Midway Islands, Palmyra, the United States Virgin Islands, Wake Island, and other United States islands, cays, and reefs not part of the fifty states or the District of Columbia;
3. Canada;
4. Mexico;
5. The Republic of the Marshall Islands;
6. The Federated States of Micronesia;
7. The Republic of Palau;

		For expenses incurred in attending a convention that began after:
8.	Antigua and Barbuda	February 9, 2003
9.	Barbados	November 2, 1984
10.	Bermuda	December 1, 1988
11.	Costa Rica	February 11, 1991
12.	Dominica	May 7, 1988
13.	Dominican Republic	October 11, 1989
14.	Grenada	July 12, 1987
15.	Guyana	August 26, 1992
16.	Honduras	October 10, 1991
17.	Jamaica	December 17, 1986
18.	Saint Lucia	April 21, 1991
19.	Trinidad and Tobago	February 8, 1990

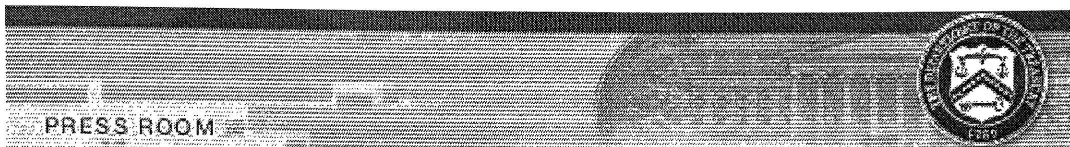
This revenue ruling will be updated as future developments result in the inclusion of other areas in, or the exclusion of areas from, the North American area.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 94-56 and Rev. Rul. 87-95 are superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mae J. Lew of the Office of Associate Chief Counsel (International), Branch 1. For further information regarding this revenue ruling, contact Mae J. Lew on (202) 435-5262 (not a toll-free call).



FROM THE OFFICE OF PUBLIC AFFAIRS

September 30, 2003
JS-772

TREASURY AND IRS ISSUE TREATY LIST FOR NEW REDUCED TAX RATE ON DIVIDENDS

Today, the Treasury Department and the IRS issued a Notice covering the taxation of dividends paid by foreign corporations under the provisions of The Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act"). By reducing the rates of tax for individuals on certain dividends, the 2003 Act reduces the double tax on dividends. The Notice provides guidance on the application of the reduced rates of tax to dividends paid by a foreign corporation.

Dividends paid by a foreign corporation are subject to the reduced tax rates if the corporation is a qualified foreign corporation. With certain exceptions, a "qualified foreign corporation" for this purpose includes a foreign corporation that is eligible for benefits of a U.S. income tax treaty if the treaty meets three requirements. To qualify, the treaty must be comprehensive, the Secretary must determine it is satisfactory, and it must provide for the exchange of tax information. The Notice issued today contains the current list of the U.S. tax treaties that meet these three requirements.

Corporations incorporated in one of the countries included in this treaty list must also be eligible for benefits of the U.S. income tax treaty in order to qualify for the reduced tax rates for dividends. Treasury and the IRS are working on further guidance regarding the eligibility requirements for foreign corporations.

Dividends paid by a foreign corporation also may qualify for the reduced rates of tax under an alternative test based on whether the stock of the corporation is readily tradable on an established U.S. securities market. Treasury and the IRS will issue guidance relating to this alternative test shortly.

Related Documents:

- The text of Notice 2003-69

Part III - Administrative, Procedural, and Miscellaneous

United States income tax treaties that meet the requirements of section 1(h)(11)(C)(i)(II).

Notice 2003-69

Summary

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27, 117 Stat. 752) (the "2003 Act"), was enacted on May 28, 2003. Subject to certain limitations, the 2003 Act generally provides that a dividend paid to an individual shareholder from either a domestic corporation or a "qualified foreign corporation" is subject to tax at the reduced rates applicable to certain capital gains. A qualified foreign corporation includes certain foreign corporations that are eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program. This Notice contains the current list of the U.S. tax treaties that meet these requirements. Treasury and the IRS are working on additional guidance concerning other aspects of this provision.

Analysis

Section 1(h)(1) of the Code generally provides that a taxpayer's "net capital gain" for any taxable year will be subject to a maximum tax rate of 15 percent (or 5 percent in the case of certain taxpayers). The 2003 Act added section 1(h)(11), which provides that net capital gain for purposes of section (1)(h) means net capital gain (determined without regard to section 1(h)(11)) increased by "qualified dividend income." Qualified dividend income means dividends received during the taxable year from domestic corporations and "qualified foreign corporations." Section 1(h)(11)(B)(i). Subject to certain exceptions, a qualified foreign corporation is any foreign corporation that is either (i) incorporated in a possession of the United States, or (ii) eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program (the "treaty test"). Section 1(h)(11)(C)(i).[1] A qualified foreign corporation does not include any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, is a foreign personal holding company (as defined in section 552), a foreign investment company (as defined in section 1246(b)), or a passive foreign investment company (as defined in section 1297).[2] Section 1(h)(11)(C)(iii).

The appendix to this Notice sets forth the current list of U.S. income tax treaties that meet the requirements of section 1(h)(11)(C)(i)(II). Four U.S. income tax treaties do not meet the requirements of section 1(h)(11)(C)(i)(II). The tax treaties with Bermuda and The Netherlands Antilles are not comprehensive income tax treaties within the meaning of section 1(h)(11). The U.S.-U.S.S.R. income tax treaty, which was signed on June 20, 1973 and currently applies to certain former Soviet Republics, does not include an information exchange program. The current income tax treaty with Barbados was determined not to be satisfactory for purposes of section 1(h)(11) because of concern that the treaty may operate to provide benefits which are intended to mitigate or eliminate double taxation in cases where there is no risk of double taxation.[3]

Treasury and the IRS intend to update this list, as appropriate. Situations that may result in changes to the list include the entry into force of new income tax treaties and the amendment or renegotiation of existing tax treaties. Further,

Treasury and the IRS continue to study the operation of each of our income tax treaties, including the implications of any changes in the domestic laws of the treaty partner, to ensure that the treaty accomplishes its intended objectives and continues to be satisfactory for purposes of this provision. It is anticipated that any changes to the list of income tax treaties that meet the requirements of section (1)(h)(11)(C)(i)(II) will apply only to dividends paid after the date of publication of the revised list.

Finally, in order to be treated as a qualified foreign corporation under the treaty test, a foreign corporation must be eligible for benefits of one of the U.S. income tax treaties listed in the Appendix. Accordingly, the foreign corporation must be a resident within the meaning of such term under the relevant treaty and must satisfy any other requirements of that treaty, including the requirements under any applicable limitation on benefits provision. Treasury and the IRS are working on guidance concerning whether foreign corporations are qualified foreign corporations under the treaty test.

The Notice is effective for taxable years beginning after December 31, 2002.

APPENDIX

U.S. INCOME TAX TREATIES SATISFYING THE REQUIREMENTS OF SECTION 1(h)(11)(C)(i)(II)

Australia
Austria
Belgium
Canada
China
Cyprus
Czech Republic
Denmark
Egypt
Estonia
Finland
France
Germany
Greece
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Kazakhstan
Korea
Latvia
Lithuania
Luxembourg
Mexico
Morocco
Netherlands
New Zealand
Norway
Pakistan
Philippines
Poland
Portugal
Romania
Russian Federation
Slovak Republic
Slovenia
South Africa
Spain
Sweden
Switzerland
Thailand
Trinidad and Tobago
Tunisia
Turkey
Ukraine
United Kingdom
Venezuela

[1]
A foreign corporation that does not satisfy either of these two tests is treated as a qualified foreign corporation with respect to any dividend paid by such corporation if the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States. Section 1(h)(11)(C)(ii). Treasury and the IRS are working on guidance concerning the definition of "readily tradable on an established securities market in the United States."

[2]
A dividend from a qualified foreign corporation also is subject to the other limitations in section 1(h)(11). For example, a shareholder receiving a dividend from a qualified foreign corporation must satisfy the holding period requirements of section 1(h)(11)(B)(iii).

[3]
The conference report provides that, for the period prior to this determination, foreign corporations will not be considered qualified foreign corporations by reason of eligibility for benefits of the U.S.-Barbados income tax treaty. H.R. Rep. 108-126, 108th Cong., 1st Sess. at 42 (2003).

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
September 30, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 4-WEEK BILLS

Term:	28-Day Bill
Issue Date:	October 02, 2003
Maturity Date:	October 30, 2003
CUSIP Number:	912795NU1

High Rate: 0.845% Investment Rate 1/: 0.863% Price: 99.934

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 64.83%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 29,001,882	$ 12,960,047
Noncompetitive	39,985	39,985
FIMA (noncompetitive)	0	0
SUBTOTAL	29,041,867	13,000,032
Federal Reserve	3,472,174	3,472,174
TOTAL	$ 32,514,041	$ 16,472,206

Median rate 0.840%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.820%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 29,041,867 / 13,000,032 = 2.23

1/ Equivalent coupon-issue yield.

JS 773

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.
September 29, 2003

Contact: Office of Financing
202/691-3550

TREASURY OFFERS 4-WEEK BILLS

The Treasury will auction 4-week Treasury bills totaling $13,000 million to refund an estimated $17,000 million of publicly held 4-week Treasury bills maturing October 2, 2003, and to pay down approximately $4,000 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 $15,303 million of the Treasury bills maturing on October 2, 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 774

HIGHLIGHTS OF TREASURY OFFERING
OF 4-WEEK BILLS TO BE ISSUED OCTOBER 2, 2003

September 29, 2003

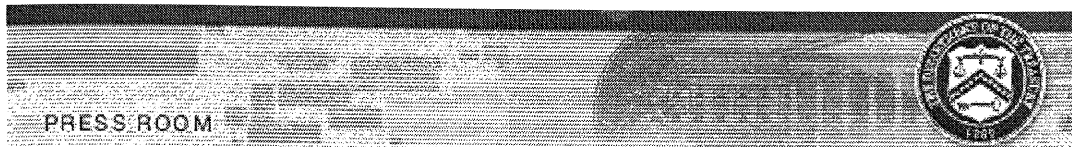
Offering Amount.........................$13,000 million
Maximum Award (35% of Offering Amount)...$ 4,550 million
Maximum Recognized Bid at a Single Rate..$ 4,550 million
NLP Reporting Threshold.................$ 4,550 million
NLP Exclusion Amount....................$11,100 million

Description of Offering:
Term and type of security...........28-day bill
CUSIP number........................912795 NU 1
Auction date........................September 30, 2003
Issue date..........................October 2, 2003
Maturity date.......................October 30, 2003
Original issue date.................May 1, 2003
Currently outstanding...............$43,124 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

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

September 30, 2003
JS-775

Report to Congress on the Financing of Benefits Attributable to the Military Service of Current and Former Employees of the Postal Service

The Postal Civil Service Retirement System Funding Reform Act of 2003, P.L. 108-18 requires that:

"The United States Postal Service, the Department of the Treasury, and the Office of Personnel Management shall, by September 30, 2003, each prepare and submit to the President, the Congress, and the General Accounting Office proposals detailing whether and to what extent the Department of the Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service that, prior to the date of the enactment of this Act, were provided for under section 8348(g)(2) of title 5, United States Code."

Executive Summary

It is the Administration's position that the U.S. Postal Service (USPS) should be responsible for a share of the costs paid to retired employees of the Postal Service that arise from increasing Civil Service pension benefits because of military service. One of the primary goals for the reorganization of the Post Office into the USPS was to ensure that all the costs associated with the new organization be paid through stamp revenue and not through taxpayer dollars. Therefore, all pension costs for employees that are attributable to service after the reorganization should be borne by the Postal Service.

The question then is how to determine what portion of the cost of military credit is attributable to service since the Postal Service became independent in 1971. We maintain that the attribution method adopted in the new legislation (P.L. 108-18) is an easy-to-administer method that is fair to both the Postal Service and the Federal

taxpayer.

The Postal Service should be Responsible for the Cost of Military Service Credits Attributable to Service Since the Postal Service Became Independent in 1971

The Postal Service Should Pay the Full Cost of Benefits Received by its Employees

We maintain that it has been a basic principle of the legislation that created the Postal Service that revenue and expenses for Postal Service should be kept separate from the rest of the Federal Government, and that the Postal Service should pay for all of its expenses through Postal rates. The benefits attributable to military service are a retirement benefit that Postal employees receive just like other benefits, such as the Cost of Living Allowances (COLAs) increases for annuitants, and Postal Service customers should pay for the full cost of all benefits received by its employees.

Some have argued that it is not fair to ask the Postal Service to finance the cost of military service for Civil Service Retirement System (CSRS) employees, as it would be the only agency required to operate under this financing mechanism. However, for other agencies the special treatment of military service under the CSRS merely shifts the timing of when the contributions are made and whether they are charged to the Treasury or charged to agency budgets. In either case, the costs would still ultimately be borne by the taxpayer. By contrast, Postal Service costs are paid through postage revenues rather than funded by the Treasury.

The special treatment of military service that applied to Postal Service employees under the old law can be viewed as more of an historic accident than a deliberate policy choice.

As described in Appendix A, the prior funding mechanism for the Postal Service under CSRS (including the special treatment of military service) was developed in a piecemeal fashion that never fully addressed all of the factors that affect the costs of the system.

By contrast to CSRS, each time a comprehensive system for funding Federal annuities was developed there was no special treatment of military service. For example, in the Federal Employees' Retirement System (FERS) that was enacted in 1984, the cost of benefits attributable to military service is borne by the agencies (including the Postal Service) through the normal cost. The Administration has also proposed the same method for funding the cost of CSRS benefits attributable to military service for non-Postal agencies under the Managerial Flexibility Act.

In view of the long history of Congressional action, it is reasonable to assume that Congress may have taken further action to address the issues of excess interest earnings and the costs of military service, if OPM had not identified the problems with the static funding methodology.

The payment of military service costs for Postal Service employees is consistent with the funding of FERS, the funding system on which the new law was patterned.

The adoption of a new financing system for the Postal Service under P.L. 108-18 provided an opportunity to design a *complete* funding system for the Postal Service retroactive to when the Postal Service became independent in 1971. Although the old law static funding of CSRS did not require the Postal Service to fund the cost of military service, it also did not contemplate that the actuarial gains or losses of the retirement system would be attributed to the Postal Service. Experience shows that the retirement system benefited from extremely high interest rates during the 1980's. The gains from interest earnings in excess of the static interest rate far exceed the additional costs of military service. The Postal Service should not benefit from the positive dynamic experience of the pension fund without assuming the other responsibilities that come with dynamic funding.

The Attribution Method Adopted in P.L. 108-18 is a Fair Approach for Determining the Benefits Attributable to Pre-1971 Military Service.

Although it is clear that the Postal Service should be responsible for all employee benefit costs that arise due to employment under its tenure, there remains the question of what its responsibility should be for military service costs for employees who worked for both organizations.

The Postal Service should be responsible for a share of the costs associated with military service based on the portion of the career that is served with the Postal Service. This is the method that was adopted in the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18). It is consistent with the funding provisions of FERS and with the policy that the Postal Service should pay for all of its expenses through Postal rates.

The following describes several ways to allocate military costs for Postal Service employees. An illustrative example of each method is shown in Appendix B.

"USPS Pays All" for Post-1971 Retirement

The most straightforward method of allocating costs would be to assume that the Treasury should be responsible for the cost of military service for employees who retired from the old Post Office Department before July 1, 1971, and that the Postal Service should be responsible for the cost for employees who retired after June 30, 1971.

Because military service only becomes creditable at the time when an employee actually retires, it would not be unreasonable to charge Postal Service for the entire amount of military service for all employees who retired from the Postal Service

after June 30, 1971. It was only because these employees retired from the Postal Service that they received credit for their military service.

Civil Service rules required that to receive a regular retirement benefit the employees must have at least five years of civilian service and then attain additional age and service requirements.

"P.L. 108-18 -- USPS Pays Pro-rata Share" Based on the Portion of Total Career Served under the Post Office Department

Under the Administration's approach (as adopted in P.L. 108-18) the cost of military service for employees who were hired before July 1, 1971, but who retired on or after this date, is pro-rated based on the ratio of pre-1971 civilian service to total civilian service. We believe this pro-rata method provides a fair way of allocating the cost of military service for these employees and is the most consistent with FERS funding.

"Treasury Pays for Pre-1971 Hires"

Under this allocation the Postal Service would only be responsible for the cost of military service for employees hired after June 30, 1971. For example, an employee hired in 1970 who spends almost all of his/her career at the Postal Service would, of course, receive credit for their military service. However, under this approach, the Postal Service would not be charged with any of the cost of these benefits, even though they are being paid as a result of the employee having worked for almost an entire career at the Postal Service.

"USPS Pays for Post-September 30, 2002 Military Service Benefits"

An allocation suggested in discussions with Congressional staff was to charge the Postal Service only for the cost of military service benefits that are payable after September 30, 2002. This method was based on the notion that "the Treasury already paid for the military service" before this date. However if the objective after Postal Service reorganization was to raise revenue to pay the employment costs of Postal workers from the sale of stamps instead of the payment of taxes, this proposed method continues to require Government revenues to fund benefits paid to Postal employees.

It is our position that the Postal Service should not benefit from the positive dynamic experience of the pension fund without assuming the other responsibilities that come with dynamic funding.[1] As was mentioned previously, we believe that Postal Service should be responsible for all of its retirement costs, and it is irrelevant what may or may not have been paid for by Treasury under the old law. This method does not provide a reasonable way of allocating the cost based on pre-1971 and post-1971 service.

"Treasury Pays All"

Treasury would be responsible to pay all of the costs of military service and the Postal Service would pay none of the costs of military service.

It is our position that this policy violates the principle that the Postal Service should pay for its own expenses through Postal rates. Individuals retiring from the Postal Service receive CSRS credit for their military service only because of their employment with the Postal Service.

The following table summarizes the costs of these different ways of treating military service, with more complete information shown in Appendix C:

	USPS Responsible for:	Total Additional Cost To Treasury (in billions of dollars)
USPS Pays All	All military for post-71 retirees	(20.7)
P.L 108-18 - - USPS Pays a Pro-Rata Share	All military for post-71 hires, pro-rata share for pre-71 hires	0
Treasury Pays for Pre-1971 Hires	All military for post-71 hires, no military for pre-71 hires	7.1
USPS Pays post-9/30/02 Military Service Benefits	Only for military service benefits paid in the future	16.6
Treasury Pays All	No military service, past or future	27.2

Budgetary Implications of the Allocations Presented Above

Under P.L. 108-18, the military service for pre-1971 hires is allocated between Treasury and the Postal Service based on the ratio of pre-1971 civilian service to total civilian service. Appendix C shows that, as of September 30, 2002, USPS is still required to fund a supplemental liability of $4.8 billion under this approach. This supplemental liability would be amortized by the Postal Service through 40-year amortization payments. Current law (P.L. 108-18) has already incorporated these supplemental liability payments into the scoring of the legislation.

If the Postal Service paid for all of the cost of military service for its post-1971 retirees, the supplemental liability to be amortized by the Postal Service would be $25.5 billion, an increase of $20.7 billion over the current law.

Under the allocation where the Postal Service is responsible only for the cost of military service benefits that are paid after September 30, 2002 ("USPS Pays for Post-9/30/02 Military Service"), USPS would carry a supplemental liability of negative $11.8 billion, or, in other words, there would be an over-funding of $11.8 billion. This assumes that the Postal Service would continue to pay the full normal cost of 24.4 percent of payroll. However the over-funding position would likely necessitate the elimination of all future Postal agency contributions (only the employee contributions would remain). The $16.6 billion difference between the $4.8 billion supplemental liability under P.L. 108-18 and the negative $11.8 billion under the "USPS Pays for Post-9/30/02 Military Service"

Method represents the additional cost to the Treasury.

Appendix A

Background

The benefit payments under Civil Service Retirement System (CSRS) include credit for military service. Generally, employees must pay a deposit of the 7 percent employee contributions on their military pay to receive this credit. The policy issue addressed here is to what degree the cost of the benefits attributable to military service in excess of the employee deposits should be paid for by the Postal Service. The U.S. Department of the Treasury must pay any portion of this cost not paid by the Postal Service.

Static Funding of CSRS – 1969 Law

P.L. 91-93, which was passed in 1969, set up the basic funding methodology for CSRS Government-wide. This methodology did not provide full funding of CSRS under private sector standards that were later incorporated into the Employee Retirement Income Security Act (ERISA) and into the dynamic funding methodology for the Federal Employees' Retirement System (FERS). Under the static funding of CSRS, the increases in retirement costs due to general salary increases and Cost of Living Allowances COLAs for annuitants are not anticipated or financed in advance. Each general salary increase is financed by means of a new series of 30-year amortization payments that is set up after that salary increase has occurred. Under the original law, there was no separate financing of the cost of COLAs for annuitants, although this was later added for the Postal Service only.

Employees and agencies each contribute 7 percent of pay, which approximates the ongoing or normal cost, and which does not pay for the cost of salary increases or COLAs for annuitants.

The Treasury is required to pay for the cost of military service through military service payments that are made each year, which are equal to the total amount of benefits attributable to military service that were paid out during that fiscal year. Finally, the Treasury also pays interest on the static unfunded liability, which covers any costs that are not otherwise being financed, such as the cost of COLAs for annuitants. [2] Any gains from excess interest earnings, beyond what were assumed under the static interest rate assumption, would reduce the unfunded liability, and thus lower the Treasury payments of interest on the unfunded liability. Thus, all of the gains due to excess interest earnings flow through to the Treasury.

Postal Service Financing of CSRS

Shortly after the Postal Service became independent in 1971, Congress passed P.L. 93-349 which required the Postal Service to finance the cost of all Postal salary increases by means of separate thirty-year amortization payments. These payments covered the entire cost of all Postal salary increases, and did not distinguish between the portions of the salary increases attributable to the pre- or the post-1971 service of Postal employees.

Under the Omnibus Budget Reconciliation Acts of 1987, 1989, 1990, and 1993, Congress gradually instituted a series of measures that eventually required the Postal Service to finance the entire cost of COLAs for Postal annuitants attributable to service since 1971 by means of fifteen-year amortization payments.[3]

In summary, the Postal Service financing of CSRS gradually evolved over time through a series of steps that resulted in the Postal Service paying for the full cost of all salary increases and the cost of COLAs attributable to post-1971 service. There was no comprehensive plan for Postal financing of CSRS such as was

adopted under FERS. Any gains from excess interest earnings, and the costs of military service, stayed with the Treasury.

FERS Financing Provisions

FERS was a result of Congress taking a comprehensive approach to designing a new retirement system for Federal employees who were also covered under Social Security. Under the dynamic funding methodology that was adopted for FERS in 1986, there was separate accounting for the assets and liabilities for Postal and non-Postal employees. Postal Service was required to pay for all of the retirement costs for Postal employees, including the cost of military service.

Appendix B

Examples of Methods for Allocating the Cost of Military Service For an Employee Hired Before 1971 Who Retired After 1971

Employee Retired in 1991 (on 7/1/1991) with 30 years total service (including 3 yrs. military and 1 yr. sick leave)

1991 Final Average Salary: $50,000

1971 Salary: $20,000 (= High-3 Average Salary in 1991 assuming no post-1971 pay increases)

CSRS Benefit Formula: 1.5% of High-3 Average Salary for first 5 years of service, 1.75% for next

5 years of service, 2.0% for remaining years of service.

Total Service = 30 yrs.

Total Benefit = $ 50,000 * [(5 yrs.) * 0.015 + (5 yrs.) * 0.0175 + (20 yrs.) * 0.02]

= $ 50,000 * 0.5625

= $ 28,125

Civilian Service = 30 – 3 = 27 yrs

Civilian Service Benefit = $ 50,000 * [(5 yrs.) * 0.015 + (5 yrs.) * 0.0175 + (17 yrs.) * 0.02]

= $ 50,000 * 0.5025

= $ 25,125

Military Service Benefit = Total Benefit – Civilian Service Benefit

= $ 28,125 - $25,125

= $ 3,000

Military Service = 3 yrs.

Sick Leave = 1 yr.

Actual Civilian Service = 27 yrs. – 1 yr. = 26 yrs.

Civilian Year of Hire = 1991 – (30 – 3 – 1) = 1965

Pre-1971 Actual Civilian Service = 1971 – 1965 = 6 yrs.

Ratio of Pre-1971 Actual Civilian Service to Actual Civilian Service = (6 / 26)

<u>Method 1 - "USPS Pays All" for Post-1971 Retirement</u>

Federal Civilian Service = 6 yrs. + [1 yr. * (6 / 26)] = 6.231 yrs.

Federal Share = Federal Civilian Service Benefit

= $ 20,000 * [(5 yrs.) * 0.015 + (1.231 yrs.) * 0.0175]

= $ 20,000 * 0.09654

= $ 1,931

<u>Method 2 - "P.L. 108-18 -- USPS Pays Pro-rata Share" Based on the Portion of Total Career Served under the Post Office Department</u>

Federal Service = 6 yrs. + [(3 yrs. + 1 yr.) * (6 / 26)] = 6.923 yrs.

Federal Share = $ 20,000 * [(5 yrs.) * 0.015 + (1.923 yrs.) * 0.0175]

= $ 20,000 * [0.10865]

= $ 2,173

Method 3 - "Treasury Pays for Pre-1971 Hires"

Federal Service = Federal Civilian Service + Military Service = 6 + [1 * (6/26)] + 3 = 9.231 years

Federal Share = $ 20,000 * [(5 yrs.) * .015 + (4.231 yrs.) * .0175]

= $ 20,000 * .14904

= $ 2,981

Method 4 - "USPS Pays for Post-September 30, 2002 Military Service Benefits"

Federal Civilian Service = 6 + [1 * (6 / 26)] = 6.231 yrs.

Federal Civilian Service Benefit = $ 20,000 * [(5 yrs.) * 0.015 + (1.231 yrs.) * 0.0175]

= $ 20,000 * 0.09654

= $ 1,931

Federal Share before 10/1/2002 = Federal Civilian Service Benefit + Military Service Benefit

= $1,931 + $3,000 = $4,931 initial benefit, adjusted by COLA's

Federal Share after 9/30/2002 = Federal Civilian Service Benefit

= $ 1,931 initial benefit, adjusted by COLA's

Method 5 - "Treasury Pays All"

Federal Civilian Service = 6 + [1 * (6 / 26)] = 6.231 yrs.

Federal Civilian Service Benefit = $ 20,000 * [(5 yrs.) * 0.015 + (1.231 yrs.) * 0.0175]

= $ 20,000 * 0.09654

= $ 1,931

Federal Share = Federal Civilian Service Benefit + Military Service Benefit

= $ 1,931 + $ 3,000

= $ 4,931

Appendix C

Comparison of Allocation Methods for Postal CSRS Benefits Attributable to Military Service

(in billions of dollars)

	USPS Responsible for:	PV Future Benefits	- Postal Fund	= Current Liability	- PV Future Contributions	= Projected Supplemental Liability	Total Additional Cost To Treasury
USPS Pays All	All military for post-71 retirees	192.1	149.4	42.7	17.2	25.5	(20.7)
P.L 108-18 -- USPS Pays a Pro-Rata Share	All military for post-71 hires, pro-rata share for pre-71 hires	190.4	168.4	22.0	17.2	4.8	0
Treasury Pays for Pre-1971 Hires	All military for post-71 hires, no military for pre-71 hires	189.1	174.2	14.9	17.2	(2.3)	7.1
USPS Pays post-9/30/02 Military Ser-vice Benefits	Only for military service benefits paid in the future	190.4	185.0	5.4	17.2	(11.8)	16.6
Treasury Pays All	No military service, past or future	179.1	185.0	(5.9)	16.5	(22.4)	27.2

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[1] The gains from interest earnings in excess of the static interest rate far exceed the additional costs of military service. Assuming that the Treasury were to fund all military costs, the present value of all interest gains to the Postal Service from July 1, 1971 through September 30, 2002 would be approximately $106.6 billion. The cost to the Treasury of military service would be $16.6 billion, resulting in a net gain of $90 billion.

[2] More precisely, the Treasury was required to contribute 10 percent of the interest on the static unfunded liability and 10 percent of the military service benefits in FY1971, and to contribute 20 percent in FY1972, and so on through 100 percent in FY1980 and future years.

[3] These statutes were P.L. 100-203, P.L. 101-239, P.L.101-508, and P.L.103-66.

Related Documents:

- Letter to Speaker Hastert

CORRECTED COPY

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON, DC 20415-0001

OFFICE OF THE DIRECTOR

SEP 3 0 2003

The Honorable J. Dennis Hastert
Speaker of the House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

On April 23,2003, the President approved Public Law 108-18, the "Postal Civil Service Retirement System Funding Reform Act of 2003." Section 2(e) of the Act requires that the Office of Personnel Management, the Department of the Treasury, and the United States Postal Service each prepare and submit, by September 30,2003, to the President, the Congress, and the General Accounting Office proposals detailing whether and to what extent the Department of the Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service that, prior to the date of enactment of this statute, were the responsibility of the Department of the Treasury under section **8348** of title 5, United States Code.

The Office of Personnel Management and the Department **of** the Treasury have prepared a joint report in accordance with these provisions which we are pleased to transmit to you.

The Office **of** Management and Budget advises that there is no objection to the submission **of** this report from the standpoint of the Administration's program.

Similar letters will be sent to the President of the United States, the President of the Senate, and the Comptroller General of the United States.

Sincerely,

Kay Coles James
Director of the Office of Personnel Management

John W. Snow
Secretary of the Treasury

Enclosure

CON 131-64-4
September 1993

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
September 29, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Term:	182-Day Bill
Issue Date:	October 02, 2003
Maturity Date:	April 01, 2004
CUSIP Number:	912795PS4

High Rate: 1.005% Investment Rate 1/: 1.027% Price: 99.492

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 33.92%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 28,280,300	$ 14,852,020
Noncompetitive	913,008	913,008
FIMA (noncompetitive)	235,000	235,000
SUBTOTAL	29,428,308	16,000,028 2/
Federal Reserve	5,815,853	5,815,853
TOTAL	$ 35,244,161	$ 21,815,881

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 = 29,428,308 / 16,000,028 = 1.84

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $685,551,000

JS 775

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
September 29, 2003

CONTACT: Office of Financing
202-691-3550

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Term:	92-Day Bill
Issue Date:	October 02, 2003
Maturity Date:	January 02, 2004
CUSIP Number:	912795PD7

High Rate: 0.935% Investment Rate 1/: 0.953% Price: 99.761

All noncompetitive and successful competitive bidders were awarded securities at the high rate. Tenders at the high discount rate were allotted 54.97%. All tenders at lower rates were accepted in full.

AMOUNTS TENDERED AND ACCEPTED (in thousands)

Tender Type	Tendered	Accepted
Competitive	$ 32,754,604	$ 14,390,799
Noncompetitive	1,384,543	1,384,543
FIMA (noncompetitive)	225,000	225,000
SUBTOTAL	34,364,147	16,000,342 2/
Federal Reserve	6,015,065	6,015,065
TOTAL	$ 40,379,212	$ 22,015,407

Median rate 0.920%: 50% of the amount of accepted competitive tenders was tendered at or below that rate. Low rate 0.905%: 5% of the amount of accepted competitive tenders was tendered at or below that rate.

Bid-to-Cover Ratio = 34,364,147 / 16,000,342 = 2.15

1/ Equivalent coupon-issue yield.
2/ Awards to TREASURY DIRECT = $1,052,030,000

JS 776

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06/29/05 MAB

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