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FROM THE OFFICE OF PUBLIC AFFAIRS

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November 16, 2004
js-2101

Treasury International Capital (TIC) Data For September

We recommend printing this release using the PDF file below.

Treasury International Capital (TIC) data for September are released today and posted on the U.S. Treasury web site (www.treas.gov/ti
will report on data for October, is scheduled for December 15, 2004.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,397.7 billion in September, exceeding gross sales of domestic securities
during the same month.

Foreign purchases of domestic securities reached $61.0 billion on a net basis in September, relative to $60.2 billion during the previous
reached $47.7 billion in September. Net private purchases of Treasury Bonds and Notes increased to $9.2 billion from minus $4.4 billio
private purchases of Government Agency Bonds were minus $1.1 billion, down from $18.6 billion the previous month. Net private purch
$43.5 billion from $25.4 billion the previous month. Net private purchases of Equities declined to minus $3.9 billion from minus $2.1 billi

Official net purchases of U.S. securities were $13.3 billion in September, relative to $22.8 billion in August. Official net purchases of Tre
billion accounted for the bulk of official inflows in September, down from $19.1 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $253.8 billion in September, relative to gross sales of foreign secu
billion during the same month.

Gross sales of foreign securities to U.S. residents fell short of purchases by $2.4 billion, highlighting net U.S. sales of $2.1 billion in For
$0.3 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $63.4 billion in September compared
foreign purchases of long-term securities were $833.5 billion in the 12-months through September 2004 as compared to $664.3 billion c
September 2003.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical series, can be founc
http://www.treas.gov/tic/..

Foreigners' Transactions in Long-Term Securities with U.S. Residents

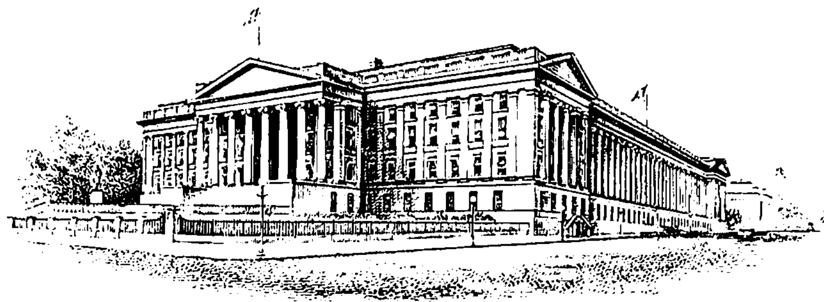
(Billions of dollars, not seasonally adjusted)

			12 Months Through			
	2002	2003	Sep-03	Sep-04	Jun-04	Jul-04

1	Gross Purchases of Domestic Securities	13,022.9	14,922.1	14,565.5	16,327.2	1,338.6	1,309.1
2	Gross Sales of Domestic Securities	12,475.4	14,175.0	13,869.7	15,427.8	1,253.3	1,230.0
3	Domestic Securities Purchased, net (line 1 less line 2) /1	547.6	747.1	695.8	899.4	85.3	79.2
4	Private, net /2	508.3	607.7	591.6	647.1	66.9	72.8
5	Treasury Bonds & Notes, net	112.8	168.8	161.6	167.3	23.0	18.3
6	Gov't Agency Bonds, net	166.6	136.1	159.2	172.2	15.2	17.7
7	Corporate Bonds, net	176.7	264.7	240.7	288.2	26.5	27.1
8	Equities, net	52.2	38.1	30.0	19.4	2.2	9.7
9	Official, net	39.3	139.4	104.3	252.2	18.3	6.4
10	Treasury Bonds & Notes, net	7.1	109.3	78.3	213.9	17.5	4.1
11	Gov't Agency Bonds, net	28.6	24.9	21.4	30.0	0.6	1.4
12	Corporate Bonds, net	5.6	5.5	4.4	8.9	0.7	0.8
13	Equities, net	-2.0	-0.4	0.1	-0.6	-0.5	0.1
14	Gross Purchases of Foreign Securities	2,640.0	3,037.8	2,874.5	3,529.7	291.6	287.0
15	Gross Sales of Foreign Securities	2,613.0	3,086.4	2,906.1	3,595.6	303.9	303.1
16	Foreign Securities Purchased, net (line 14 less line 15) /3	27.0	-48.7	-31.6	-65.9	-12.2	-16.2
17	Foreign Bonds Purchased, net	28.5	22.3	35.8	-4.0	-7.0	-7.3
18	Foreign Equities Purchased, net	-1.5	-71.0	-67.4	-61.9	-5.2	-8.9
19	Net Long-Term Flows (line 3 plus line 16)	574.6	698.4	664.3	833.5	73.0	63.0

REPORTS

- Treasury International Capital Data For September (PDF)



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

November 16, 2004 **Contact:** **Brookly McLaughlin**
EMBARGOED UNTIL 9:00 AM **202-622-1996**

TREASURY INTERNATIONAL CAPITAL DATA FOR SEPTEMBER

Treasury International Capital (TIC) data for September are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release date, which will report on data for October, is scheduled for December 15, 2004.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,397.7 billion in September, exceeding gross sales of domestic securities by foreigners of $1,336.7 billion during the same month.

Foreign purchases of domestic securities reached $61.0 billion on a net basis in September, relative to $60.2 billion during the previous month. Private net flows reached $47.7 billion in September. Net private purchases of Treasury Bonds and Notes increased to $9.2 billion from minus $4.4 billion the preceding month. Net private purchases of Government Agency Bonds were minus $1.1 billion, down from $18.6 billion the previous month. Net private purchases of Corporate Bonds rose to $43.5 billion from $25.4 billion the previous month. Net private purchases of Equities declined to minus $3.9 billion from minus $2.1 billion.

Official net purchases of U.S. securities were $13.3 billion in September, relative to $22.8 billion in August. Official net purchases of Treasury Bonds and Notes of $10.1 billion accounted for the bulk of official inflows in September, down from $19.1 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $253.8 billion in September, relative to gross sales of foreign securities to U.S. residents of $251.4 billion during the same month.

Gross sales of foreign securities to U.S. residents fell short of purchases by $2.4 billion, highlighting net U.S. sales of $2.1 billion in Foreign Equities and net sales of $0.3 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $63.4 billion in September compared with $59.9 billion in August. Net foreign purchases of long-term securities were $833.5 billion in the 12-months through September 2004 as compared to $664.3 billion during the twelve months through September 2003.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical series, can be found on the TIC web site, http://www.treas.gov/tic/.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2002	2003	Sep-03	Sep-04	Jun-04	Jul-04	Aug-04	Sep-04
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3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**547.6**	**747.1**	**695.8**	**899.4**	**85.3**	**79.2**	**60.2**	**61.0**
4	**Private, net /2**	**508.3**	**607.7**	**591.6**	**647.1**	**66.9**	**72.8**	**37.4**	**47.7**
5	Treasury Bonds & Notes, net	112.8	168.8	161.6	167.3	23.0	18.3	-4.4	9.2
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7	Corporate Bonds, net	176.7	264.7	240.7	288.2	26.5	27.1	25.4	43.5
8	Equities, net	52.2	38.1	30.0	19.4	2.2	9.7	-2.1	-3.9
9	**Official, net**	**39.3**	**139.4**	**104.3**	**252.2**	**18.3**	**6.4**	**22.8**	**13.3**
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13	Equities, net	-2.0	-0.4	0.1	-0.6	-0.5	0.1	0.1	0.0
14	Gross Purchases of Foreign Securities	2,640.0	3,037.8	2,874.5	3,529.7	291.6	287.0	255.7	253.8
15	Gross Sales of Foreign Securities	2,613.0	3,086.4	2,906.1	3,595.6	303.9	303.1	256.0	251.4
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**27.0**	**-48.7**	**-31.6**	**-65.9**	**-12.2**	**-16.2**	**-0.4**	**2.4**
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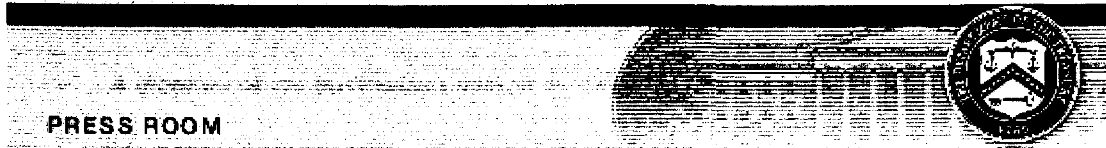
18	Foreign Equities Purchased, net	-1.5	-71.0	-67.4	-61.9	-5.2	-8.9	1.3	2.1
19	**Net Long-Term Flows** (line 3 plus line 16)	**574.6**	**698.4**	**664.3**	**833.5**	**73.0**	**63.0**	**59.9**	**63.4**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. acquisitions of foreign securities (-)

Source: U.S. Department of the Treasury



FROM THE OFFICE OF PUBLIC AFFAIRS

November 16, 2004
JS-2102

OFAC Licensing Policy for Three Specially-Designated Businesses in Colombia

The U. S. Department of the Treasury's Office of Foreign Assets Control (OFAC) has adopted a policy to issue specific licenses, on a case by case basis, authorizing U.S. suppliers to engage in certain transactions with the following Colombian Government-controlled entities, which have been designated by OFAC as Specially Designated Narcotics Traffickers (SDNTs) pursuant to 31 CFR Part 536:

- Cooperativa Multiactiva de Empleados de Distribuidores de Drogas Copservir Ltda. (COPSERVIR), NIT # 830011670-3, which manages the Drogas La Rebaja establishments in Colombia;
- Cooperativa Multiactiva de Comercializacion y Servicios Farmacoop (FARMACOOP) NIT # 830010878-3;
- Cooperativa de Cosmeticos y Populares Cosmepop (COSMEPOP) NIT # 800251322-5.

The Government of Colombia took control of these companies in September 2004. By establishing a licensing policy, OFAC is ensuring that these entities continue to operate – and do so in a legitimate manner – under the control of the Colombian government, thereby preserving the jobs of several thousand Colombians who were unknowingly manipulated by Cali drug cartel leaders Miguel and Gilberto Rodriguez-Orejuela. OFAC continues to work closely with Colombian officials to monitor the situation.

U.S. suppliers seeking a license to sell products to COPSERVIR, FARMACOOP or COSMEPOP should submit a written license application in accordance with 31 CFR § 501.801(b) to the Office of Foreign Assets Control, Licensing Division, U.S. Department of the Treasury, 1500 Pennsylvania Avenue, NW – Annex, Washington, DC 20220.

In addition to the information required by 31 CFR § 501.801(b)(3), the application must include a detailed description of the proposed transactions, the source and method of payment and a copy of a signed purchase request from any of the aforementioned cooperatives. Questions regarding this policy should be directed to OFAC's Licensing Division at (202) 622-2480.

FROM THE OFFICE OF PUBLIC AFFAIRS

November 16, 2004
JS-2103

Joint Statement of the 2005 US-UK Transatlantic Enterprise Partnership

Both the US administration and the UK Government are committed to the economic reform agenda and to sharing ideas across the Atlantic on how to strengthen enterprise, productivity and jobs - which are essential for faster growth in the US, UK and across Europe, and for balanced global growth.

Following the success of the US-UK initiative in 2004, the 2005 US-UK Transatlantic Enterprise Partnership will build on the earlier initiatives, and will take the policy dialogue further.

US - UK Enterprise Initiatives

UK-US Enterprise Summit

Following the success of last year's summit and academic seminar held in the US, we agree to co-chair a second joint government-business enterprise summit in the UK next year to discuss the contribution of enterprise to productivity, jobs and growth and the best methods for encouraging entrepreneurship. The summit will draw on experience from entrepreneurs and policy makers, and share lessons from areas of national strength in both countries. In conjunction with the summit, we will convene a group of academic experts to consider the role of government and education in fostering entrepreneurship, productivity and jobs, to assess progress over the last year and to propose areas for future policy action.

Enterprise in education

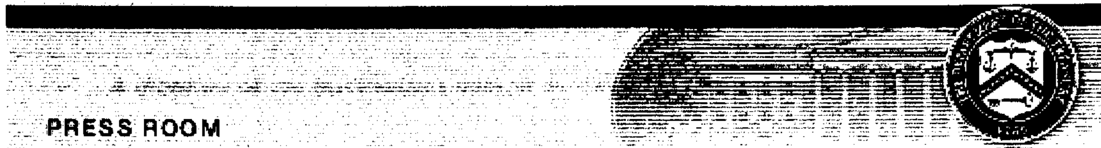
The UK has established the National Council for Graduate Entrepreneurship in order to encourage students and graduates to consider entrepreneurship as a viable career option. Lessons have already been learnt from US models of stimulating interest in enterprise in universities, and the UK is keen to maintain this momentum. We propose to hold a conference for UK and US leaders of universities, working with the National Council for Graduate Entrepreneurship and the Kauffman Foundation.

In June this year, experts, teachers, and enterprise education providers from the US and the UK exchanged ideas and best practice on all aspects of enterprise education in schools. We believe that this co-operation should continue and therefore we propose to continue this dialogue in 2005.

EU-US Economic Cooperation

We reaffirm the importance of enhancing economic cooperation between the EU and the US for growth and prosperity on both sides of the Atlantic. We welcome the June EU-US summit declaration calling for a new forward-looking strategy for eliminating barriers to further economic integration, and the steps taken by the US administration and the Commission to consult stakeholders.

We look to the 2005 Summit to endorse an ambitious strategy injecting new impetus into the transatlantic economic agenda and including the active engagement of key policy makers and regulators on both sides of the Atlantic. We are also pleased that the OECD is taking forward a study of the potential economic benefits of closer economic cooperation and look forward to the publication of results in March.



FROM THE OFFICE OF PUBLIC AFFAIRS

November 16, 2004
JS-2104

Media Advisory
Treasury Official to Discuss Identity Theft

Treasury Assistant Secretary for Financial Institutions Wayne A. Abernathy will speak Thursday at an identity theft briefing sponsored by American Express.

"Holidays are a great time for family, friends, and celebration, but they're also the time when identity thieves go into overdrive," said Abernathy. "Fortunately, there are some simple things that Americans can do that will seriously reduce their chances of becoming financial victims. These simple things are all about being careful as you shop: know who you are doing business with; empty your purse or wallet of extra cards, checks, and identifying documents you won't need; don't let your credit card out of your sight; don't leave receipts behind or lying around and don't put them into the trash without cutting them up or shredding them; check your financial statements when they arrive and ask for them if they don't show up at their usual time."

Additionally, Abernathy reminded consumers that beginning on December 1, legislation signed by President Bush last year gives those living in the western U.S. (and then progressing across the nation through 2005) the right to a free copy of their credit report each year.

Abernathy will be joined by representatives from the FBI, the Federal Trade Commission, the Better Business Bureau, and consumer advocacy groups to discuss the growing problem of identity theft.

This event is open to the media:

WHO: Treasury Assistant Secretary for Financial Institutions Wayne A. Abernathy

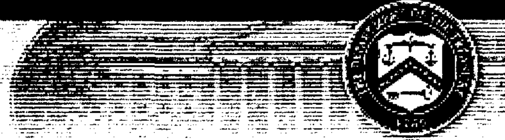
WHAT: Remarks at American Express Identity Theft Briefing

WHEN: Thursday, November 18, 2004, Noon (EST)

WHERE:Café Gray 10 Columbus Circle
New York, NY

*** Media wishing to attend should contact Smita Reddy at (212) 481-7000, ext. 611 or** smitar@mbooth.com.

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

November 17, 2004
js-2105

The Honorable John W. Snow
Prepared Remarks at Chatham House
The Royal Institute of International Affairs
London, England

Good morning. It is a great pleasure to be here in London, and to be here with all of you. The relationship between our countries is a special one; it is a friendship that is cherished by leaders and citizens alike. My own friendship with Chancellor Gordon Brown has been one of the highlights so far of my tenure as Treasury Secretary, and I believe that our alliance exemplifies international ties that are both genial and productive.

This is a significant time for me to be visiting Europe. As you know, two weeks ago the people of the United States voted to return President Bush to office for another four-year term. His agenda for this second term is already underway, and it is an agenda that holds great promise for the people of our country and for others as well. We want to continue our relationship with Europe and believe there are terrific economic examples to be followed and expanded upon this side of the Atlantic.

For example, I was in Dublin on Sunday and Monday of this week, and had a chance to talk with financial, business and academic leaders there about the creation of "Celtic Tiger" economy and the outstanding economic success they have had in recent years. We talked about the specific economic reforms that have been so successful in Ireland and how the political consensus that made them possible came about. I was particularly delighted to visit with so many of the architects of the new Ireland and get their first-hand sense of how the reforms were put in place. As one of them said to me, "Developing policy was relatively straightforward – something any first year grad student in economics could have done. The hard part was getting the broad based consensus from labor, management, the public, and politicians to move forward. That took courage, decisiveness, and planning." That strikes me as the real story of economic reform – whether it is Ireland, the United States, Asia or Europe – it takes courage, it takes planning, and it takes action.

In Ireland, thoughtful political leadership carried the day. Good fiscal policies including income tax rate cuts, government spending restraint and education reforms led to terrific economic growth in that country. They've had nearly eight percent growth a year for the past eleven years. They've cut tax rates and reduced expenditures and deficits.

Some say Ireland benefited from good fortune. I say they benefited from good policy. I applaud them and believe they ought to be emulated.

Ireland is proof-positive that pro-growth, free-market policies work. The U.S. has traditionally embraced these policies, and I was thrilled to see them implemented so successfully in Ireland.

Ireland's experience reminded me that economic growth and opportunity is much more than a by-product of freedom; economic opportunity is freedom's greatest catalyst as well as its most essential safeguard. Business growth, free trade and financial reforms lead to a better life for citizens of any country. And with that better life comes an increased esteem for fairness, liberty and equality, which is good for the human condition.

I look forward to discussing pro-growth policies like those that worked so well in

Ireland with members of the G20 this weekend, and with finance ministers of four countries that are new members of the European Union: Poland, Hungary, Slovakia and the Czech Republic. I will be meeting with those ministers in Warsaw tomorrow. Of course, the purpose of these discussions is to build a broad-based consensus to develop and implement pro-growth policies.

I know that the G20 ministers and central bank governors and I will also discuss principles for world trade and the global economy. There is broad agreement today that the world economy is best served by open, competitive currency markets, free capital flows and free trade – policies that promote growth and avoid imbalances. The world today embraces these policies more widely than ever before, and global growth is at historic levels because of it.

The results are evident: we are seeing the highest global growth rates in 30 years, with no major recessions or financial crises. What a contrast to the picture of just a few years ago.

That said, economic expansion is not as balanced as it could be. Where countries are growing too slowly, they need to adopt pro-growth policies, as Ireland has done, and their success has demonstrated. In today's interconnected global economy where products and services, information and capital flow freely, stronger growth rates in those places are critical if we are to achieve economic prosperity for all.

I am proud to point out that much of the success of the U.S. economy comes from embracing the principles of growth, free markets and free trade. And we stand as a beacon of those ideas. But we have our challenges as well, of course. I'd like to address a few of those challenges here today, and describe to you the Bush Administration's strategy for tackling them.

Let me start with the U.S. fiscal deficit, which from my perspective, is our most pressing issue. It is too large and needs to be brought down. As a life-long deficit hawk, I want to make it clear that the budget deficit is unwelcome. I also want to make it clear that it is being addressed. The President's budget plan will cut the U.S. fiscal deficit in half over the four years, bringing the deficit to less than 2% of GDP – well below our historical average.

While unwelcome, the deficit is understandable given the extraordinary circumstances of recent history: the bursting of the tech bubble, the unthinkable acts of terror on 9/11, followed by the need to fight and protect ourselves from an enemy unlike any we've ever known.

When the President took office, government receipts were suffering because of a weakening economy and the steep stock market declines. Just as invigorating fiscal policies were being put into place we were then hit with the terrorist assaults and faced with a need to make unprecedented and necessary expenditures that increased spending on the other side of the balance sheet. Government revenues were declining while expenditures were rising – a clear recipe for fiscal imbalance.

At this time, the U.S. suffered a perfect storm of economic blows. The bursting of the stock market bubble -- combined with the shock of 9/11 -- resulted in a market loss of $7 trillion in 2001.

Since then, the United States has made important strides, putting our economy on the right track. We are now experiencing strong economic growth and we have excellent traction on the road to budget deficit reduction.

The President's tax cuts, combined with sound monetary policy set by our independent Federal Reserve Board, tapped into the most powerful elements of the American economy: our small-business owners and entrepreneurs, our outstanding workforce and the simple fact that we operate as a free market. The policies stimulated the most open, dynamic, adaptive and resilient economy in the world.

Make no mistake: our economic strength and ongoing growth is the primary key to reducing our country's budget deficit and keep it low on a sustained basis.

It's a simple truth that is too often overlooked: there are only two sensible ways to reduce a budget deficit: grow the economy and control spending.

First: growing the economy. An increase in economic growth and activity leads to an increase in tax revenue. Receipts at the U.S. Treasury are increasing smartly with our economic growth. U.S. gross domestic product continues to grow above the average of the 1970s, 80s and 90s, while the unemployment rate remains below the average for those decades.

In October, for the fourteenth consecutive month, jobs were added in America. With the addition of 337,000 jobs in October and upward revisions to August and September jobs numbers, roughly 2.4 million jobs have been created since August of 2003, with 2 million so far in 2004.

Again, this type of economic growth reduces deficits. The numbers illustrate that fact: The 2004 deficit is $108 billion lower – that's 20.8 percent lower – than was projected less than a year ago. And projections for the 2005 deficit bring it below 3% of GDP -- a figure that has special significance for our EU friends.

Good strong growth is the key to deficit reduction. This is a point that is too often missed in economic discussions and commentary. We have the growth and it is melting the deficit.

The other essential part of deficit reduction, as I mentioned, is spending restraint, and it is something that must be adhered to. It is beyond a promise or an idea; fiscal discipline is necessary, period. That's why President Bush has submitted such a strict budget to the Congress.

The President's budget calls for an increase of less than one percent on non-defense, non-homeland security, discretionary spending. With government receipts outpacing spending increases, the budget deficit *will be* cut in half over the next four years, bringing it well below historic norms. You will see quite soon, as we get into the budget process back home, a renewed and intensified effort on this front.

We're extremely serious about this. Deficits matter and we are committed to the President's plan to bring our budget deficit down.

Like so many other countries, the United States is also faced with a serious demographic problem in the near future. Our "baby boom" generation will begin to retire, putting our Social Security System under financial stress that demands reform as soon as possible.

And that is the President's intention. He has shown real leadership on this issue – dating back to his election campaign four years ago. In his November 3rd acceptance speech earlier this month, strengthening Social Security for the next generation was one of the very first policy issues he pointed to. Along with broad-based tax reform, it is one of the top two domestic policy issues for his second term.

The *need* to strengthen Social Security is not news. Academics and policy analysts have been writing about it and designing "fixes" for some time. And although proposals have differed in details, they are consistent in showing that if we give workers the opportunity to invest a portion of their wages in personal accounts, Social Security will be able to offer the opportunity for higher returns than would otherwise be the case.

That's why the President is committed to offering younger workers a chance to invest in retirement accounts that they will control and they will own. His plan speaks to the thing that has always brought economic success to the people everywhere: increased freedom and independence.

The President's plan to strengthen retirement security includes a number of core principles including expanding ownership of retirement assets, ensuring freedom of choice, creating a society of stakeholders, minimizing risk through diversification, strengthening women's retirement security, and spurring national savings and economic growth.

We believe this is a fiscally responsible path for the near future as well as for the long term. Giving Americans more control, more ownership over their own retirement will make this fix a long-lasting one. Government does its citizens the greatest service when it empowers the people to determine their own future. The

President believes that people make better choices than the government when it comes to retirement savings, education and health care.

Another economic benefit of what the President calls an "ownership society" is increased household savings. For example, we now have Health Savings Accounts (HSAs) which encourage individual savings while putting patients back in charge of their own health care. The President has also proposed to expand savings opportunities through the creation of Retirement Savings Accounts (RSAs) and Lifetime Savings Accounts (LSAs). RSAs would provide an easy, tax-preferred way to prepare for retirement. LSAs would create an opportunity to save -- tax free -- to pay for job training, college tuition, a down-payment on a first home, a car to drive to work, or for retirement.

Encouraging investment and savings through these means will also help America with another deficit situation -- our current account deficit.

I stated earlier that there are two essential parts to reducing budget deficits: growth and spending restraint.

Similarly, we see three key parts to addressing the issue of the current account deficit: increasing savings in the United States; increasing growth levels among our trading partners; and ensuring currency flexibility in large economies that do not have such flexibility. Each has an important role to play.

The current account deficit is a shared responsibility. I've already discussed our efforts at home to reduce our budget deficit and increase savings – the first part of the three-part equation. Part two is where our trading partners play a key role. Specifically, they need to grow more rapidly.

Let me take a minute to discuss this very important point.

Essentially, the current account deficit is a gap between U.S. investment and U.S. savings. Today we are in a situation where sound, growth-enhancing policies in the U.S. have made it an extremely attractive place to invest. Because we are growing at such a rapid pace, we are generating more investment opportunities than our trading partners. At the same time, we recognize that investment opportunities in the U.S. are growing at a rate in excess of our savings, while for Europe the opposite is true. Those partners need to grow to address this gap, just as United States needs to save more.

If other countries strengthened their investment environment, their level of investment, and their economic growth performance, that would go a long way toward reducing the current account deficit.

The global growth deficit is something Chancellor Brown and I, along with all of the G7 ministers, have been concerned with and have dedicated our countries to addressing through our Agenda for Growth. We are each dedicated to pursuing growth in each individual country, both for the good of our own countries and for the good of our group of countries.

The G7 is also in agreement on something that is the third element of current account deficit reduction: more flexible exchange rates in countries that do not have such flexibility.

The desired policy of exchange values that are set in open, competitive markets are reflected in the G7 communiqué. We've also taken this message to China, and they have agreed. As Governor Zhou of the Central Bank of China said recently, "building a more market-driven trading system for the renminbi is now a task of top priority."

The Bush Administration has had an unprecedented level of engagement with the Chinese government on its exchange rate policy including a technical cooperation program. We have broadened our diplomatic strategy to include China's major trading partners through the G7. In early October, G7 Finance Ministers and Central Bank Governors met for the first time as a group with their Chinese counterparts and discussed these issues.

Additionally, the People's Bank of China's recent moves to increase its one-year lending and deposit rates are the latest examples of China's more systematic management of monetary policy. I believe that these actions represent significant steps consistent with China's move to a flexible and market-based exchange rate – which is, again, the third key for current account adjustment.

I'm proud of the strides that the U.S. economy has made after significant hardship. We quickly returned to our status as the best place in the world – on a risk-adjusted basis – for anyone to invest their money. We offer high rates of return and we are committed to keeping it that way, to remaining a great place for people to invest their money.

I know that I've outlined an ambitious agenda today - for both U.S. growth and global growth. I've emphasized the President's absolute dedication to reducing our budget deficit and fixing Social Security. He's also committed to putting in place a tax system that ensures high-level, long-term growth without inflation.

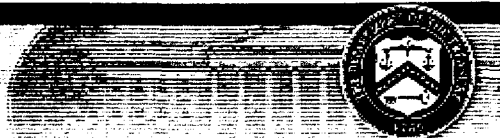
These goals are important for the economic prosperity of the United States. Furthermore, we have a responsibility not just to our own citizens, but also to the citizens of the world to remain the economic leader. And we are up to the task. Let me be clear: our policy is for a strong dollar. Our dollar policy remains unchanged because a strong dollar is in both the national and international interest.

And I'm optimistic about our ability to overcome the challenges we face today. We are economically strong, have proved our resiliency in recent years, and are strong enough to continue to be the preeminent global economy.

In the spirit of continued economic progress, I've come to Europe this week to embrace our international economic partners. Because today's economy *is* global; and the U.S. cannot grow alone. We need our partners, we need you, and I am very much looking forward to our continued collaboration to bring economic opportunity and prosperity to this world.

Thank you so much for having me here today.

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

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November 17, 2004
JS-2106

Treasury Further Assails the Financial Infrastructure of the Cali Drug Cartel by Designating 23 Linked

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today added seven businesses and 16 individuals to its list of Specially Designated Narcotics Traffickers (SDNTs). These companies and individuals were acting as fronts for Colombian drug lords Miguel and Gilberto Rodriguez Orejuela and formed a vital part of the organization's financial network in Colombia and abroad.

"We have seen that the notorious Rodriguez Orejuela organization manipulates people and businesses – both inside Colombia and out – to traffic narcotics and bankroll their network," said OFAC Director Robert Werner. "We continue to attack the financial web of the Cali Cartel, and today's action ensures that these sham companies and operatives are denied access to the U.S. economy and financial system."

Today's announcement is a follow-up to OFAC sanctions actions in 2003-2004 against the world-wide financial network of the Rodriguez Orejuela organization. The OFAC action blocks the assets of SDNTs found in U.S. jurisdiction and prohibits Americans from doing business with them, thereby further exposing, isolating, and incapacitating Colombian drug cartels and their agents.

U.S. fugitive William Rodriguez Abadia, son of Miguel Rodriguez Orejeula and heir to the organizational throne, is among the shareholders of *Alero S.A.*, a garment manufacturer located in Cali, Colombia and named in today's action. Also included among the seven businesses designated today are the Colombian financial front companies, *A G Representaciones Ltda.*, *Inversiones Capital Ltda.*, *Representaciones Zatza Ltda.*, and *Valores Corporativos S.A.* These businesses are all affiliated with the money remittance company *Internacional de Divisas S.A.* and the stock brokerage firm *Obursatiles S.A.*, both of which were named to the SDNT list in 2003 because of their links to the Rodriguez Orejuela organization. In addition, *Farfalla Investment S.A.* of Panama and *Galaviz Corporation, Ltd.* of the Bahamas were also designated.

The legal representative of *Alero* is Maria Iragorri Torres, who was named as an SDNT in March 2003 due to her involvement in *Internacional de Divisas* and *Obursatiles*. Iragorri Torres, who is also involved in *Valores Corporativos*, was arrested by Colombian authorities due to allegations of money laundering in January 2004.

Previously designated SDNT entities from the Cali and North Valle cartels include the Colombian airline *Intercontinental de Aviacion S.A.*, the paso fino horse farm *Criadero La Luisa E.U.*, the industrial brick company *Ladrillera La Candelaria Ltda.*, the mining company *Industrial Minera y Pecuaria S.A.*, the industrial paper manufacturer *Unipapel S.A.*, the agro-industrial business *Viscaya Ltda.*, and the *America de Cali* professional soccer team, as well as other agricultural, aviation, consulting, construction, distribution, financial, hotel, investment, manufacturing, mining, offshore, pharmaceutical, real estate and service firms.

This action is part of the ongoing interagency effort of the Treasury, Justice, State, and Homeland Security Departments to carry out Executive Order 12978, signed on October 21, 1995, which applies economic sanctions against Colombia's narcotics traffickers. The assets of a total of 1,147 Colombian businesses and individuals are now blocked under the 1995 Executive Order. The SDNT list includes 16 kingpins

from the Cali, North Valle, and North Coast drug cartels in Colombia.

A diagram of the businesses named by OFAC today is attached.

For a complete list of the entities designated today, please visit:
http://www.treas.gov/offices/enforcement/ofac/actions/

For further information on actions taken against the Cali Cartel, please visit:

http://www.treasury.gov/press/releases/js1915.htm (September 14, 2004)

http://www.treas.gov/press/releases/js15.htm (February 6, 2003)

http://www.treas.gov/press/releases/js122.htm (March 21, 2003)

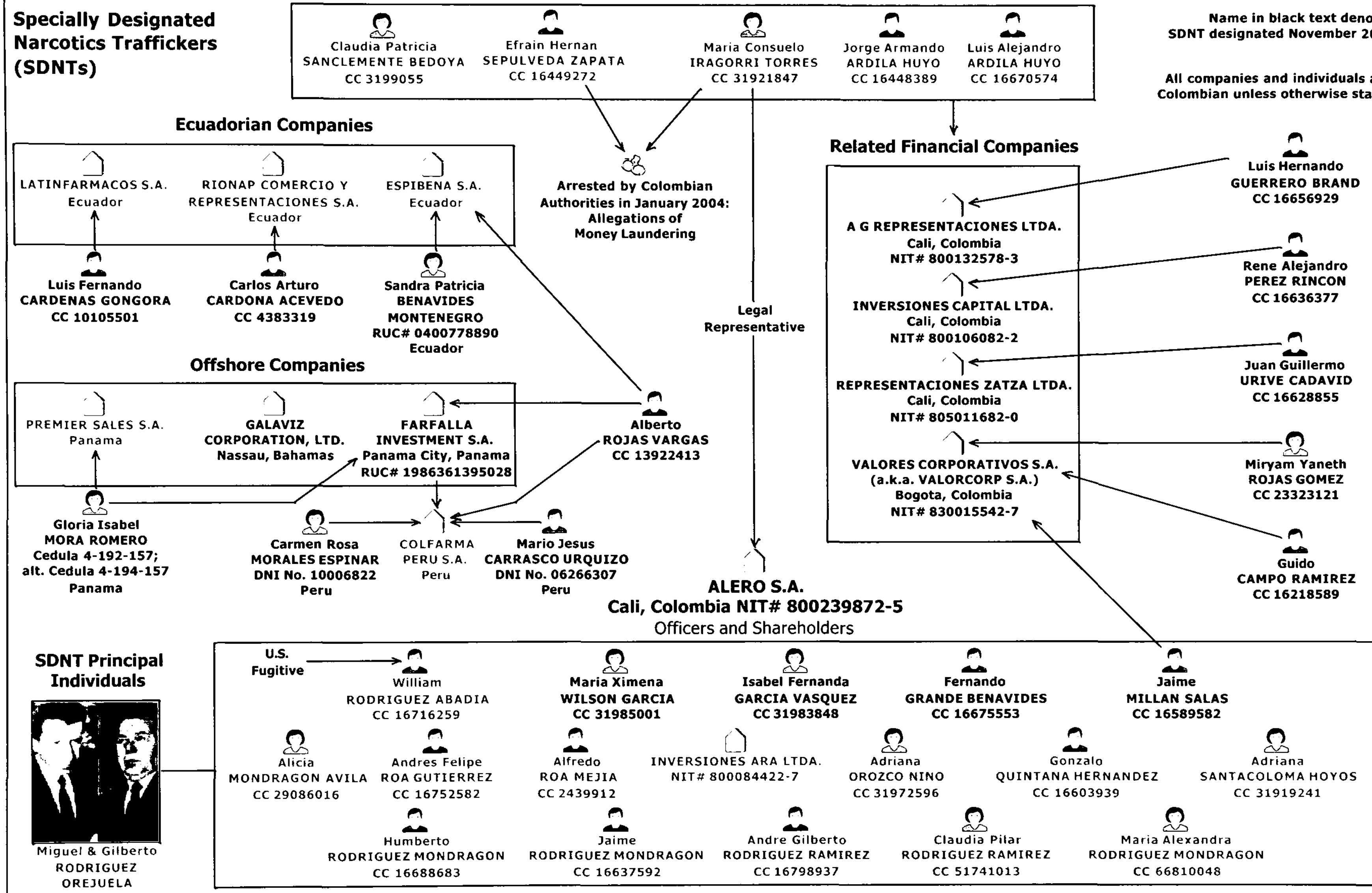
http://www.treas.gov/press/releases/js915.htm (October 17, 2003)

Cali Cartel Financial Network November 2004

Department of the Treasury
Office of Foreign Assets Control

OBURSATILES S.A. NIT# 800012425-0
INTERNACIONAL DE DIVISAS S.A. NIT # 805013989-5
and INTERNACIONAL DE DIVISAS S.A., LLC (USA)
Officers and Shareholders

Name in red text denotes SDNT previously designated



federal financing bank NEWS
WASHINGTON, D.C. 20220

Press 202-622-29
FFB 202-622-245

FEDERAL FINANCING BANK 10/04

Brian D. Jackson, Chief Financial Officer, Federal Financing Bank (FFB) announced the following activity for the month of September 2004.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $29.3 billion on September 30, 2004, posting an increase of $111.5 million from the level on August 31, 2004. This net change was the result of an increase in holdings of agency debt (U.S. Postal Service) of $1,348.0 million and decreases of agency assets of $1,200.0 million and in net holdings of government-guaranteed loans of $36.5 million. The FFB made 51 disbursements and received 12 prepayments during the month of September. The FFB also extended the maturities of 202 loans guaranteed by the Rural Utilities Service ("RUS") during the month.

During the fiscal year 2004, the FFB holdings of obligations issued, sold or guaranteed by other Federal agencies posted a net decrease of $6,288.2 million from the level on September 30, 2003. This net change was the result of decreases in holdings of agency debt (U.S. Postal Service) of $5,473.4 million and in holdings of agency assets of $1,755.0 million, and an increase in net holdings of government-guaranteed loans of $940.2 million, representing primarily an increase in RUS loans.

Attached to this release are tables presenting FFB September loan activity and FFB holdings as of September 30, 2004.

JS-2107

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
GENCY DEBT				
U.S. POSTAL SERVICE				
U.S. Postal Service	9/15	$423,300,000.00	9/16/04	1.688% S/A
U.S. Postal Service	9/16	$245,800,000.00	9/17/04	1.668% S/A
U.S. Postal Service	9/17	$59,700,000.00	9/20/04	1.698% S/A
U.S. Postal Service	9/24	$378,400,000.00	9/27/04	1.647% S/A
U.S. Postal Service	9/27	$500,000,000.00	9/28/04	1.648% S/A
U.S. Postal Service	9/27	$156,100,000.00	9/28/04	1.698% S/A
U.S. Postal Service	9/28	$557,400,000.00	9/29/04	1.749% S/A
U.S. Postal Service	9/29	$395,000,000.00	9/30/04	1.637% S/A
U.S. Postal Service	9/30	$1,600,000,000.00	10/01/04	1.749% S/A
U.S. Postal Service	9/30	$200,000,000.00	10/01/04	1.587% S/A
OVERNMENT-GUARANTEED LOANS				
GENERAL SERVICES ADMINISTRATION				
San Francisco OB	9/23	$159,087.93	8/01/05	2.194% S/A
San Francisco OB	9/23	$79,663.94	8/01/05	2.194% S/A
San Francisco Bldg Lease	9/24	$3,728,691.51	8/01/05	2.226% S/A
San Francisco Bldg Lease	9/27	$34,480.00	8/01/05	2.262% S/A
RURAL UTILITIES SERVICE				
St. Croix Electric Coop. #801	9/01	$700,000.00	12/31/35	4.778% Qtr.
Farmers' Elec. #2122	9/02	$14,000.00	9/30/11	3.715% Qtr.
Owen Electric #2097	9/02	$4,000,000.00	1/03/06	2.129% Qtr.
Vernon Electric Coop. #2008	9/02	$1,099,000.00	12/31/36	4.794% Qtr.
Mid-Yellowstone Elec. #745	9/03	$300,000.00	12/31/35	4.841% Qtr.
Tri-State #757	9/03	$16,918,000.00	12/31/25	4.542% Qtr.
Tri-State #2052	9/03	$4,646,000.00	1/03/34	4.805% Qtr.
Farmers Telephone #476	9/07	$4,514,610.00	1/03/05	1.863% Qtr.
Sawnee Electric #766	9/10	$28,949,000.00	12/31/35	4.844% Qtr.
D.S. & O Rural Elec. #2149	9/13	$800,000.00	1/03/39	4.869% Qtr.
La Plata Electric #2140	9/13	$24,207,000.00	10/01/07	2.841% Qtr.
South Miss. Elec. #2109	9/13	$3,077,000.00	1/03/34	4.790% Qtr.
Washington Electric #655	9/14	$550,000.00	1/02/35	4.775% Qtr.
Dunn Electric Coop. #861	9/15	$665,000.00	12/31/36	4.798% Qtr.
Fleming-Mason Energy #644	9/15	$2,437,000.00	1/03/05	1.701% Qtr.
Hancock-Wood Elec. #842	9/15	$1,800,000.00	12/31/36	4.798% Qtr.
Tennessee Valley Elec. #2079	9/15	$2,000,000.00	12/31/37	4.813% Qtr.
Tipmont Rural Electric #2150	9/15	$3,000,000.00	1/03/39	4.829% Qtr.
Burt County Public #669	9/16	$200,000.00	1/02/35	4.794% Qtr.
Deep East Texas Electric #872	9/17	$60,000.00	12/31/36	4.735% Qtr.
Cental Virginia Elec. #2126	9/20	$1,000,000.00	1/03/39	4.810% Qtr.
Pemiscot-Dunklin Elec. #853	9/20	$500,000.00	12/31/36	4.780% Qtr.
Endless Mtns. Wireless #2103	9/21	$4,820,000.00	9/30/09	3.277% Qtr.

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
Hamilton County Elec. #2129	9/22	$1,300,000.00	12/31/37	4.723% Qtr.
Amicalola Electric #664	9/23	$3,000,000.00	1/02/35	4.607% Qtr.
Eastern Maine Coop. #795	9/23	$906,000.00	12/31/35	4.626% Qtr.
Rock County Electric #2029	9/23	$529,000.00	12/31/37	4.660% Qtr.
Consolidated Elec. #2070	9/24	$305,000.00	12/31/37	4.670% Qtr.
Dakota Central Telecomm. #2164	9/27	$11,767,391.38	1/03/17	3.776% Qtr.
Sand Mountain Electric #2130	9/27	$6,254,000.00	1/03/33	4.595% Qtr.
Duo County Telephone #2161	9/28	$13,247,286.71	12/31/14	3.566% Qtr.
Midstate Communications #780	9/29	$362,169.00	1/03/12	3.541% Qtr.
Red River Rural Tel. #2113	9/29	$608,000.00	1/03/05	1.726% Qtr.
W. Farmers Elec. Coop. #701	9/29	$347,000.00	12/31/25	4.352% Qtr.
W. Farmers Elec. Coop. #2116	9/29	$4,212,000.00	12/31/20	4.058% Qtr.
Adams Rural Electric #706	9/30	$486,421.70	1/03/05	1.734% Qtr.
Adams Rural Electric #706	9/30	$486,630.20	1/03/05	1.734% Qtr.
Adams Rural Electric #706	9/30	$630,937.20	1/03/05	1.734% Qtr.
Amicalola Electric #664	9/30	$4,743,764.77	1/03/05	1.734% Qtr.
Amicalola Electric #664	9/30	$6,588,633.91	1/03/05	1.734% Qtr.
Atlantic Telephone Mem. #805	9/30	$5,541,758.99	1/03/05	1.734% Qtr.
Bailey County Elec. #856	9/30	$1,860,022.89	1/03/05	1.734% Qtr.
Bailey County Elec. #856	9/30	$603,330.22	1/03/05	1.734% Qtr.
Basin Electric #425	9/30	$12,075,042.94	12/31/20	4.260% Qtr.
Basin Electric #425	9/30	$14,171,792.42	12/31/20	4.260% Qtr.
Basin Electric #425	9/30	$9,619,000.00	12/31/20	4.260% Qtr.
Basin Electric #2005	9/30	$3,000,000.00	12/31/20	4.134% Qtr.
Big Sand Elec. #540	9/30	$737,360.80	1/03/05	1.734% Qtr.
Big Sand Elec. #540	9/30	$553,020.60	1/03/05	1.734% Qtr.
Big Sand Elec. #540	9/30	$924,530.35	1/03/05	1.734% Qtr.
Big Sand Elec. #540	9/30	$2,150,214.00	1/03/05	1.734% Qtr.
Big Sand Elec. #540	9/30	$2,686,103.23	1/03/05	1.734% Qtr.
Blue Grass Energy #674	9/30	$4,746,646.21	1/03/05	1.734% Qtr.
Blue Grass Energy #674	9/30	$1,896,297.43	1/03/05	1.734% Qtr.
Blue Grass Energy #674	9/30	$4,832,162.61	1/03/05	1.734% Qtr.
Blue Grass Energy #674	9/30	$4,932,160.67	1/03/05	1.734% Qtr.
Blue Grass Energy #674	9/30	$2,868,097.34	1/03/05	1.734% Qtr.
Brazos Electric #561	9/30	$9,613,127.76	1/03/05	1.734% Qtr.
Brown County Elec. #687	9/30	$235,639.92	1/03/05	1.734% Qtr.
Brown County Elec. #687	9/30	$565,535.85	1/03/05	1.734% Qtr.
Brown County Elec. #687	9/30	$282,813.50	1/03/05	1.734% Qtr.
Brown County Elec. #687	9/30	$443,918.62	1/03/05	1.734% Qtr.
Central Iowa Power Coop. #2093	9/30	$3,900,000.00	1/03/34	4.558% Qtr.
Central Texas Elec. #520	9/30	$954,564.77	1/03/33	4.786% Qtr.
Central Texas Elec. #520	9/30	$478,110.65	1/03/33	4.786% Qtr.
Citizens Tel (VA) #680	9/30	$1,463,382.22	1/03/05	1.734% Qtr.
Clark Energy Coop. #611	9/30	$2,773,591.04	1/03/05	1.734% Qtr.
Clark Energy Coop. #611	9/30	$1,843,121.11	1/03/05	1.734% Qtr.
Clark Energy Coop. #611	9/30	$4,113,287.85	1/03/05	1.734% Qtr.
Clark Energy Coop. #611	9/30	$3,439,925.24	1/03/05	1.734% Qtr.
Clark Energy Coop. #611	9/30	$2,491,690.20	1/03/05	1.734% Qtr.
Clark Energy Coop. #2087	9/30	$2,500,000.00	1/03/05	1.734% Qtr.
Cumberland Valley #668	9/30	$3,958,750.95	1/03/05	1.734% Qtr.

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
umberland Valley #668	9/30	$4,754,454.26	1/03/05	1.734% Qtr.
'ooper Valley Tel. #648	9/30	$920,069.99	1/03/05	1.734% Qtr.
'ooper Valley Tel. #648	9/30	$209,361.16	1/03/05	1.734% Qtr.
›arien Telephone Co. #719	9/30	$1,654,733.69	1/03/05	1.734% Qtr.
›arien Telephone Co. #719	9/30	$381,187.40	1/03/05	1.734% Qtr.
›arien Telephone Co. #719	9/30	$183,725.47	1/03/05	1.734% Qtr.
›arien Telephone Co. #719	9/30	$217,208.14	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$157,969.54	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$234,378.75	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$192,999.50	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$1,311,546.57	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$244,684.31	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$482,825.49	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$351,681.74	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$435,836.11	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$611,915.72	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$685,739.72	1/03/05	1.734% Qtr.
)arien Telephone Co. #719	9/30	$734,760.08	1/03/05	1.734% Qtr.
East River Power #453	9/30	$356,621.80	1/03/05	1.859% Qtr.
East River Power #453	9/30	$175,875.01	1/03/05	1.859% Qtr.
East River Power #601	9/30	$3,041,035.67	1/03/05	1.734% Qtr.
East River Power #793	9/30	$607,477.46	1/03/05	1.734% Qtr.
East River Power #793	9/30	$4,556,319.88	1/03/05	1.734% Qtr.
East River Power #793	9/30	$2,754,111.34	1/03/05	1.734% Qtr.
Fairfield Elec. #684	9/30	$3,047,991.42	1/03/05	1.734% Qtr.
Fairfield Elec. #684	9/30	$89,386.76	1/03/05	1.734% Qtr.
Farmer's Rural Elec. #2046	9/30	$5,000,000.00	1/03/05	1.734% Qtr.
Farmer's Rural Elec. #2046	9/30	$1,000,000.00	1/03/05	1.734% Qtr.
Farmer's Rural Elec. #2046	9/30	$1,000,000.00	1/03/05	1.734% Qtr.
Farmer's Telephone #459	9/30	$19,684.22	1/03/05	1.859% Qtr.
Farmer's Telephone #459	9/30	$186,671.68	1/03/05	1.859% Qtr.
Fleming-Mason Energy #644	9/30	$2,403,778.90	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$1,294,342.45	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$1,386,795.53	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$2,033,966.76	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$1,294,342.45	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$2,804,618.50	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$2,779,401.01	1/03/05	1.734% Qtr.
Fleming-Mason Energy #644	9/30	$2,936,741.16	1/03/05	1.734% Qtr.
Freeborn-Mower Coop. #736	9/30	$711,035.78	1/03/05	1.734% Qtr.
Freeborn-Mower Coop. #736	9/30	$474,037.79	1/03/05	1.734% Qtr.
Farmers Telephone #476	9/30	$8,746,015.92	1/03/05	1.859% Qtr.
Farmers Telephone #476	9/30	$6,515,157.57	1/03/05	1.859% Qtr.
Farmers Telephone #476	9/30	$5,059,373.09	1/03/05	1.859% Qtr.
FTC Communications #709	9/30	$2,380,301.31	1/03/05	1.734% Qtr.
FTC Communications #709	9/30	$3,044,185.81	1/03/05	1.734% Qtr.
FTC Communications #709	9/30	$1,072,771.04	1/03/05	1.734% Qtr.
FTC Communications #709	9/30	$1,278,202.25	1/03/05	1.734% Qtr.
FTC Communications #2101	9/30	$425,179.00	1/03/05	1.734% Qtr.
Grady Electric #690	9/30	$2,992,468.70	1/03/05	1.734% Qtr.

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
Grady Electric #746	9/30	$3,104,755.66	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$1,109,436.42	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$554,718.22	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$924,530.35	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$1,197,757.52	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$946,104.97	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$2,396,031.84	1/03/05	1.734% Qtr.
Grayson Rural Elec. #619	9/30	$978,913.73	1/03/05	1.734% Qtr.
Greenbelt Elec. #743	9/30	$1,671,657.29	1/03/05	1.734% Qtr.
Greenbelt Elec. #743	9/30	$482,560.06	1/03/05	1.734% Qtr.
Greenbelt Elec. #743	9/30	$707,217.48	1/03/05	1.734% Qtr.
Grundy Elec.Coop. #744	9/30	$1,194,136.79	1/03/05	1.734% Qtr.
Grundy Elec.Coop. #744	9/30	$955,438.06	1/03/05	1.734% Qtr.
Grundy Elec.Coop. #744	9/30	$486,925.43	1/03/05	1.734% Qtr.
Grundy Elec.Coop. #744	9/30	$493,469.44	1/03/05	1.734% Qtr.
Grundy County Elec. #689	9/30	$195,930.07	1/03/05	1.734% Qtr.
Harrison County #532	9/30	$920,770.57	1/03/05	1.734% Qtr.
Harrison County #532	9/30	$828,693.52	1/03/05	1.734% Qtr.
Harrison County #532	9/30	$926,982.71	1/03/05	1.734% Qtr.
Harrison County #532	9/30	$1,511,594.09	1/03/05	1.734% Qtr.
Harrison County #532	9/30	$1,627,415.46	1/03/05	1.734% Qtr.
Hart Elec. #885	9/30	$3,844,601.23	1/03/05	1.734% Qtr.
Hudson Valley Datanet #833	9/30	$4,833,574.15	1/03/05	1.734% Qtr.
Hudson Valley Datanet #833	9/30	$3,522,600.00	1/03/05	1.734% Qtr.
Hudson Valley Datanet #833	9/30	$1,933,429.66	1/03/05	1.734% Qtr.
Inter-County Energy #592	9/30	$1,381,155.84	1/03/05	1.734% Qtr.
Inter-County Energy #592	9/30	$1,841,541.14	1/03/05	1.734% Qtr.
Inter-County Energy #592	9/30	$2,400,448.86	1/03/05	1.734% Qtr.
Inter-County Energy #592	9/30	$204,321.20	1/03/05	1.734% Qtr.
Inter-County Energy #850	9/30	$3,924,098.92	1/03/05	1.734% Qtr.
Inter-County Energy #850	9/30	$1,962,049.45	1/03/05	1.734% Qtr.
Inter-County Energy #850	9/30	$1,962,172.71	1/03/05	1.734% Qtr.
Inter-County Energy #850	9/30	$3,481,209.11	1/03/05	1.734% Qtr.
Ironton Telephone Co. #888	9/30	$3,148,475.71	1/03/05	1.734% Qtr.
Ironton Telephone Co. #2051	9/30	$2,956,000.00	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$3,845,100.18	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$2,883,825.13	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$4,517,992.71	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$1,922,550.09	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$2,403,187.60	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$1,922,608.40	1/03/05	1.734% Qtr.
Jackson Energy #794	9/30	$7,157,321.02	1/03/05	1.734% Qtr.
Jackson Energy #2133	9/30	$3,000,000.00	1/03/05	1.734% Qtr.
Johnson County Elec. #482	9/30	$1,474,984.67	1/03/05	1.859% Qtr.
Kenergy Corp. #2068	9/30	$6,000,000.00	1/03/05	1.734% Qtr.
Kenergy Corp. #2068	9/30	$5,000,000.00	1/03/05	1.734% Qtr.
Licking Valley Elec. #522	9/30	$2,531,198.29	1/03/05	1.734% Qtr.
Licking Valley Elec. #854	9/30	$1,974,859.07	1/03/05	1.734% Qtr.
Lynches River Elec. #634	9/30	$428,358.81	10/01/07	2.874% Qtr.
Lynches River Elec. #634	9/30	$574,188.82	10/01/07	2.874% Qtr.

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
agnolia Electric #560	9/30	$4,613,029.78	1/03/05	1.859% Qtr.
edina Electric #2050	9/30	$2,000,000.00	1/02/07	2.690% Qtr.
orth Carolina RSA 3 Tel #2009	9/30	$9,600,000.00	1/03/05	1.734% Qtr.
orth Carolina RSA 3 Tel #2009	9/30	$4,744,104.00	1/03/05	1.734% Qtr.
orth Carolina RSA 3 Tel #2009	9/30	$5,559,827.00	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$1,988,402.16	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$1,344,661.64	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$1,648,389.94	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$1,010,934.27	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$984,704.26	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$1,477,077.94	1/03/05	1.734% Qtr.
ew Horizon Elec. #791	9/30	$992,904.71	1/03/05	1.734% Qtr.
olin Rural Elec. #528	9/30	$1,743,018.66	1/03/05	1.734% Qtr.
olin Rural Elec. #577	9/30	$2,378,350.39	1/03/05	1.734% Qtr.
olin Rural Elec. #577	9/30	$2,378,350.39	1/03/05	1.734% Qtr.
olin Rural Elec. #840	9/30	$3,924,098.92	1/03/05	1.734% Qtr.
olin Rural Elec. #840	9/30	$2,892,060.90	1/03/05	1.734% Qtr.
orthstar Technology #811	9/30	$1,705,195.32	1/03/05	1.734% Qtr.
orthstar Technology #811	9/30	$930,026.05	1/03/05	1.734% Qtr.
) & A Electric Coop. #379	9/30	$764,779.74	10/02/06	2.722% Qtr.
range County Elec. #771	9/30	$721,515.19	10/01/07	2.875% Qtr.
wen Electric #525	9/30	$1,844,112.25	1/03/05	1.734% Qtr.
wen Electric #525	9/30	$1,840,388.02	1/03/05	1.734% Qtr.
wen Electric #525	9/30	$928,509.14	1/03/05	1.734% Qtr.
wen Electric #525	9/30	$1,872,443.68	1/03/05	1.734% Qtr.
wen Electric #525	9/30	$1,907,831.90	1/03/05	1.734% Qtr.
wen Electric #525	9/30	$3,152,232.09	1/03/05	1.734% Qtr.
ee Dee Elec. #547	9/30	$2,305,519.06	9/30/09	3.324% Qtr.
ennyrile Elec. #513	9/30	$5,635,501.16	1/03/05	1.859% Qtr.
ennyrile Elec. #513	9/30	$5,334,676.28	1/03/05	1.859% Qtr.
eoples Cooperative Svcs #2024	9/30	$1,887,797.41	12/31/36	4.739% Qtr.
RTCommunications #798	9/30	$4,488,197.46	1/03/05	1.734% Qtr.
RTCommunications #798	9/30	$1,682,373.06	1/03/05	1.734% Qtr.
RTCommunications #798	9/30	$747,477.84	1/03/05	1.734% Qtr.
RTCommunications #798	9/30	$988,888.89	1/03/05	1.734% Qtr.
ed River Valley Elec. #2095	9/30	$3,000,000.00	1/03/05	1.734% Qtr.
unestone Electric Ass. #886	9/30	$1,481,144.30	1/03/05	1.734% Qtr.
unestone Electric Ass. #886	9/30	$345,613.24	1/03/05	1.734% Qtr.
an Miguel Electric #919	9/30	$6,786,405.07	1/03/05	1.734% Qtr.
an Miguel Electric #919	9/30	$7,125,804.73	1/03/05	1.734% Qtr.
an Miguel Power #492	9/30	$2,896,604.08	10/02/06	2.724% Qtr.
awnee Electric #766	9/30	$17,539,391.53	9/30/11	3.696% Qtr.
outheastern Indiana #2062	9/30	$2,650,000.00	1/03/05	1.734% Qtr.
outheastern Indiana #2062	9/30	$2,650,000.00	1/03/05	1.734% Qtr.
outheastern Indiana #2062	9/30	$3,700,000.00	1/03/05	1.734% Qtr.
helby Energy Coop. #758	9/30	$1,688,571.54	9/30/05	2.195% Qtr.
urry-Yadkin Elec. #534	9/30	$902,635.65	1/03/05	1.734% Qtr.
urry-Yadkin Elec. #534	9/30	$902,635.65	1/03/05	1.734% Qtr.
urry-Yadkin Elec. #534	9/30	$451,317.82	1/03/05	1.734% Qtr.
urry-Yadkin Elec. #534	9/30	$902,635.65	1/03/05	1.734% Qtr.

FEDERAL FINANCING BANK
SEPTEMBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
Surry-Yadkin Elec. #534	9/30	$902,635.65	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #534	9/30	$917,434.88	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #534	9/30	$923,407.38	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #534	9/30	$2,133,155.10	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #852	9/30	$987,429.53	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #852	9/30	$1,974,859.07	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #852	9/30	$493,714.77	1/03/05	1.734% Qtr.
Surry-Yadkin Elec. #852	9/30	$2,000,000.00	1/03/05	1.730% Qtr.
Tri-County Electric Ass. #830	9/30	$493,969.35	1/03/05	1.734% Qtr.
Tri-County Electric Ass. #830	9/30	$505,263.46	1/03/05	1.734% Qtr.
United Elec. Coop. #870	9/30	$11,849,154.38	1/03/05	1.734% Qtr.
United Elec. Coop. #870	9/30	$2,962,288.60	1/03/05	1.734% Qtr.
Upsala Coop. Tele. #429	9/30	$89,860.52	1/02/18	4.035% Qtr.
Virgin Islands Telephone #2089	9/30	$64,655,000.00	1/03/05	1.734% Qtr.
Webster Electric #705	9/30	$2,085,215.48	1/03/05	1.734% Qtr.
West Plains Elec. #501	9/30	$2,167,537.77	1/03/05	1.859% Qtr.

S/A is a Semiannual rate.
Qtr. is a Quarterly rate.
maturity extension or interest rate reset

FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	September 30, 2004	August 31, 2004	Monthly Net Change 9/1/04- 9/30/04	Fiscal Year Net Change 10/1/03- 9/30/04
Agency Debt:				
U.S. Postal Service	$1,800.0	$452.0	$1,348.0	-$5,473.4
Subtotal*	$1,800.0	$452.0	$1,348.0	-$5,473.4
Agency Assets:				
FmHA-RDIF	$200.0	$250.0	-$50.0	-$605.0
FmHA-RHIF	$680.0	$1,830.0	-$1,150.0	-$1,150.0
Rural Utilities Service-CBO	$4,270.2	$4,270.2	$0.0	$0.0
Subtotal*	$5,150.2	$6,350.2	-$1,200.0	-$1,755.0
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,464.9	$1,475.8	-$10.9	-$223.5
DoEd-HBCU+	$118.0	$118.2	-$0.2	$38.7
DHUD-Community Dev. Block Grant	$0.4	$0.6	-$0.2	-$1.7
DHUD-Public Housing Notes	$1,054.8	$1,054.8	$0.0	-$78.5
General Services Administration+	$2,141.4	$2,140.9	$0.5	-$5.8
DOI-Virgin Islands	$7.6	$7.6	$0.0	-$2.0
DON-Ship Lease Financing	$498.6	$498.6	$0.0	-$108.9
Rural Utilities Service	$16,961.0	$16,985.0	-$24.0	$1,342.8
SBA-State/Local Development Cos.	$56.6	$58.3	-$1.7	-$20.7
DOT-Section 511	$2.9	$2.9	$0.0	-$0.2
Subtotal*	$22,306.2	$22,342.7	-$36.5	$940.2
Grand total*	$29,256.4	$29,144.9	$111.5	-$6,288.2

* figures may not total due to rounding
+ does not include capitalized interest

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 202-622-2960
FFB 202-622-2450

FEDERAL FINANCING BANK 11/04

Brian D. Jackson, Chief Financial Officer, Federal Financing Bank (FFB) announced the following activity for the month of October 2004.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $27.8 billion on October 31, 2004, posting a decrease of $1,502.2 million from the level on September 30, 2004. This net change was the result of a decrease in holdings of agency debt (U.S. Postal Service) of $1,600.0 million and an increase in net holdings of government-guaranteed loans of $97.8 million. The FFB made 44 disbursements and received 6 prepayments during the month of October.

Attached to this release are tables presenting FFB October loan activity and FFB holdings as of October 31, 2004.

JS-2108

FEDERAL FINANCING BANK
OCTOBER 2004 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
;ENCY DEBT				
J.S. POSTAL SERVICE				
J.S. Postal Service	10/01	$237,800,000.00	10/04/04	1.637% S/A
J.S. Postal Service	10/04	$20,900,000.00	10/05/04	1.647% S/A
J.S. Postal Service	10/08	$231,600,000.00	10/12/04	1.678% S/A
J.S. Postal Service	10/12	$482,900,000.00	10/13/04	1.698% S/A
J.S. Postal Service	10/13	$182,000,000.00	10/14/04	1.709% S/A
J.S. Postal Service	10/14	$26,300,000.00	10/15/04	1.719% S/A
J.S. Postal Service	10/22	$38,700,000.00	10/25/04	1.759% S/A
J.S. Postal Service	10/25	$300,000,000.00	10/26/04	1.749% S/A
J.S. Postal Service	10/25	$62,200,000.00	10/26/04	1.830% S/A
J.S. Postal Service	10/26	$96,800,000.00	10/27/04	1.942% S/A
J.S. Postal Service	10/29	$200,000,000.00	11/01/04	1.851% S/A
)VERNMENT-GUARANTEED LOANS				
;ENERAL SERVICES ADMINISTRATION				
'oley Services Contract	10/04	$48,003.40	7/31/25	4.670% S/A
'oley Services Contract	10/12	$7,434.43	7/31/25	4.619% S/A
'oley Services Contract	10/12	$7,261.93	7/31/25	4.619% S/A
;an Francisco Bldg Lease	10/25	$4,741,951.39	8/01/05	2.284% S/A
)EPARTMENT OF EDUCATION				
;haw University	10/01	$9,553,445.90	4/01/05	1.998% S/A
¿URAL UTILITIES SERVICE				
:otton Electric Coop #2038	10/01	$1,953,000.00	12/31/37	4.777% Qtr.
;rayson Rural Elec. #619	10/01	$1,675,000.00	3/31/05	1.992% Qtr.
'aquoketa Valley #2012	10/01	$316,000.00	12/31/36	4.764% Qtr.
'issoula Elec. #688	10/01	$699,000.00	12/31/29	4.614% Qtr.
)range County Elec. #771	10/01	$640,000.00	3/31/11	3.624% Qtr.
¿oanoke Electric Mem. #820	10/01	$1,000,000.00	12/31/36	4.764% Qtr.
;pringer Electric Coop. #2141	10/01	$450,000.00	12/31/37	4.779% Qtr.
Jemez Mountains Elec. #2107	10/04	$6,600,000.00	12/31/37	4.800% Qtr.
Jorth Central Elec Coop #2015	10/04	$1,264,000.00	12/31/36	4.834% Qtr.
:raig-Botetourt #2077	10/05	$690,000.00	12/31/37	4.830% Qtr.
)tsego Electric #653	10/05	$370,000.00	1/03/34	4.759% Qtr.
'edina Electric #2050	10/06	$2,000,000.00	12/31/37	4.829% Qtr.
Jorth Georgia Elec. #2135	10/06	$1,111,000.00	12/31/37	4.831% Qtr.
\ & N Electric #868	10/14	$3,859,000.00	3/31/11	3.593% Qtr.
(amo Electric #2162	10/15	$19,885,000.00	1/03/39	4.725% Qtr.
(otzebue Electric #2155	10/18	$1,098,000.00	12/31/30	4.594% Qtr.
'armers' Elec. #2122	10/19	$15,000.00	12/31/14	4.015% Qtr.
(auai Island Util. Coop #2166	10/19	$8,240,000.00	3/31/09	3.137% Qtr.

FEDERAL FINANCING BANK
OCTOBER 2004 ACTIVITY

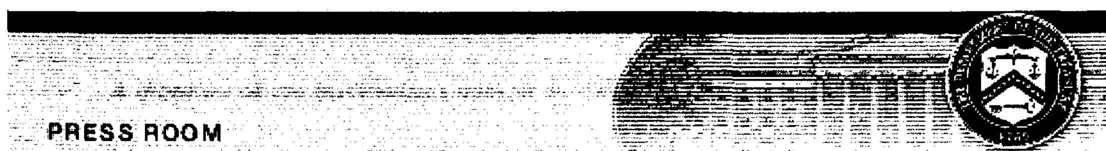
Borrower	Date	Amount of Advance	Final Maturity	Interest Rate	
auai Island Util. Coop #2166	10/19	$8,240,000.00	3/31/14	3.876%	Qtr.
auai Island Util. Coop #2166	10/19	$16,480,000.00	1/02/24	4.305%	Qtr.
.S. & O Rural Elec. #2149	10/20	$800,000.00	1/03/39	4.732%	Qtr.
abersham Electric Mem. #2084	10/25	$4,100,000.00	12/31/37	4.655%	Qtr.
ew Horizon Elec. #791	10/25	$2,700,000.00	3/31/05	2.034%	Qtr.
wan's Island Electric #2037	10/25	$45,000.00	12/31/36	4.639%	Qtr.
outh Miss. Elec. #2109	10/27	$2,711,000.00	1/03/34	4.586%	Qtr.
ountain Parks Elec. #889	10/28	$2,000,000.00	12/31/36	4.736%	Qtr.
ioux Valley Tel. Co. #2167	10/28	$2,878,731.22	12/31/14	3.653%	Qtr.
nion Electric #783	10/28	$4,820,000.00	12/31/24	4.388%	Qtr.
lumas-Sierra Elec. #2138	10/29	$1,617,000.00	12/31/37	4.602%	Qtr.

S/A is a Semiannual rate.
Qtr. is a Quarterly rate.
.naturity extension or interest rate reset

FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	October 31, 2004	September 30, 2004	Monthly Net Change 10/1/04-10/31/04	Fiscal Year Net Change 10/1/04-10/31/04
Agency Debt:				
U.S. Postal Service	$200.0	$1,800.0	-$1,600.0	-$1,600.0
Subtotal*	$200.0	$1,800.0	-$1,600.0	-$1,600.0
Agency Assets:				
FmHA-RDIF	$200.0	$200.0	$0.0	$0.0
FmHA-RHIF	$680.0	$680.0	$0.0	$0.0
Rural Utilities Service-CBO	$4,270.2	$4,270.2	$0.0	$0.0
Subtotal*	$5,150.2	$5,150.2	$0.0	$0.0
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,462.3	$1,464.9	-$2.7	-$2.7
DoEd-HBCU+	$117.8	$118.0	-$0.1	-$0.1
DHUD-Community Dev. Block Grant	$0.2	$0.4	-$0.2	-$0.2
DHUD-Public Housing Notes	$1,054.8	$1,054.8	$0.0	$0.0
General Services Administration+	$2,145.5	$2,141.4	$4.1	$4.1
DOI-Virgin Islands	$7.6	$7.6	$0.0	$0.0
DON-Ship Lease Financing	$498.6	$498.6	$0.0	$0.0
Rural Utilities Service	$17,059.3	$16,961.0	$98.3	$98.3
SBA-State/Local Development Cos.	$55.0	$56.6	-$1.6	-$1.6
DOT-Section 511	$2.9	$2.9	$0.0	$0.0
Subtotal*	$22,404.0	$22,306.2	$97.8	$97.8
Grand total*	$27,754.2	$29,256.4	-$1,502.2	-$1,502.2

* figures may not total due to rounding
\+ does not include capitalized interest



FROM THE OFFICE OF PUBLIC AFFAIRS

November 18, 2004
JS-2109

Treasury Delays Announcement of Weekly Bills and 2-Year Note

The Treasury Department is postponing announcement of its weekly 13- and 26-week bill auctions and its 2-year note auction, scheduled to be announced November 18, 2004, until further notice. This postponement is due to the statutory debt limit.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

November 18, 2004
JS-2110

Samuel W. Bodman, Deputy Secretary of the Treasury
Remarks before the Tax Foundation Annual Conference
November 18, 2004

Thank you very much, Scott. I'd like to thank you and the Directors of the Tax Foundation for inviting me to be here today.

For nearly 70 years, the Tax Foundation has committed itself to independent research on tax policy and has developed a reputation for principled, high quality analysis. You deserve the thanks of every taxpayer, and Secretary Snow and I look forward to your continued good work.

As you are no doubt keenly aware, President Bush has made it clear that fundamental tax reform will be a key priority of his second term. During his nomination acceptance speech in New York and on several occasions since, the President has outlined his goals for tax reform, including simplifying the tax code, increasing long-run economic growth and job creation, and ensuring that taxes are applied fairly. He has also indicated that reform should be revenue neutral and, among other things, should recognize the importance of homeownership and charitable giving in our society.

The President will soon appoint a bipartisan panel to advise the Secretary of the Treasury on options to fundamentally reform the tax code to achieve these goals. While it is premature to speculate on who may serve on the panel or what their product might be, we at the Department are looking forward to the panel's deliberations and to receiving their guidance.

I will discuss the President's rationale for tax reform in more detail, but first let me say that we have a solid foundation on which to build this effort. Since coming into office in 2001, the President has proposed and signed into law a number of tax revisions that strengthened our economy in the short-term and will encourage more robust growth in the future.

The tax cut packages in 2001 and 2003 reduced marginal individual income tax rates by between 3 and 5 percentage points. Lower income tax rates advance one of the President's key reform principles – increasing long-term economic growth – by increasing the after-tax rewards from work, saving, investment, and entrepreneurial activity. Lower rates also reduce the incentives to engage in sheltering or tax avoidance activities and increase compliance.

In addition, the 2003 tax cut also took a significant step toward eliminating the double tax on corporate income. This important tax change reduces a number of economic distortions that interfere with the productive use of our nation's resources.

As you will recall, the President proposed complete elimination of the double tax on corporate profits. While the legislation enacted in 2003 falls short of complete elimination, the maximum tax rate on dividends and capital gains was cut to 15 percent, which significantly reduces the double tax.

This tax cut reduced the tax bias against investment in the corporate sector of the economy, improved the neutrality of the system in its treatment of different forms of business organization and stimulated savings, investment and capital formation, which in turn will raise output and living standards in the long-term.

Importantly, the tax packages in 2002 and 2003 implemented partial expensing for business plant and equipment. They also increased the amount of investment small businesses are allowed to expense – from the previous limit of $25,000 to $100,000. These temporary provisions addressed a weak spot in the economic recovery – low corporate investment – at a key point in time, and helped keep the economy on the road to recovery.

Other important changes, enacted in 2001, included significantly expanding retirement saving incentives by raising contribution limits and indexing those limits for inflation. In addition, the 2001 tax cut also implemented a phase-out of the estate tax. The estate tax adds to the tax burden on investment returns accumulated over a lifetime, which reduces the incentive to save and invest, especially in closely held businesses.

The tax cuts adopted during this Administration have also made important improvements in fairness and simplification . . . by reducing the so-called "marriage penalty," for example. Married couples have benefited from expansions of the standard deduction, the 15-percent tax rate bracket, and the Earned Income Tax Credit. Lowering tax rates also helped reduce marriage penalties. In 2004, the combined effects of the tax cuts have reduced marriage penalties by over $15 billion. Marriage penalties have been eliminated for about 7 million couples.

Another significant step in tax simplification occurred this year when Congress passed an Administration proposal that affects over 50 million taxpayers with children. Taxpayers with children are eligible for five different tax benefits. And, though it may be hard to believe, each previously had a different definition of an eligible child. Taxpayers had to carefully check complicated rules for each of the separate benefits to determine if their child qualified. Not surprisingly, this resulted in taxpayer confusion and errors. In 2002, the Administration proposed replacing the diverse definitions of a child with a standard definition. This year, the proposal was enacted.

A few words about the American Jobs Creation Act, signed by the President last month, which included important reforms regarding the tax treatment of foreign earned income and tax administration relating to tax shelters. The Act made dramatic and much-needed changes that will help ensure that the foreign tax credit will operate as intended, so fewer U.S. businesses will be subject to double taxation on their income earned in foreign markets. Other changes better focus the U.S. rules regarding taxation of passive income earned abroad so those rules do not impose an inappropriate burden on U.S. businesses - a burden, I should add, that is not borne by their competitors from our trading partners. These international tax reforms will help U.S. businesses and American workers to compete on fair terms in the global marketplace.

The Act also included several provisions that will strengthen the IRS' enforcement capability with respect to potentially abusive transactions. It provides consistent, simplified rules for disclosure, registration and list-maintenance. For example, it requires that the same information about a questionable transaction be provided to the IRS both by the taxpayers participating in these transactions and by the promoters and their advisors, who also are required to maintain lists of investors. The law also imposes meaningful penalties on taxpayers and material advisors who fail to disclose transactions.

One of the primary goals of these rules is to provide certainty. Clearer disclosure rules, without exceptions and perceived loopholes, will be easier for taxpayers and their advisors to apply, harder for taxpayers and their advisors to manipulate, and easier for the IRS to administer and enforce.

While these tax law changes have made important improvements to our system, there is much more to be done. One top priority is making the President's tax cuts permanent. Under current law, the general tax rate cuts and the elimination of the estate tax expire at the end of 2010. The lower tax rates on dividends and capital gains expire at the end of 2008. The $100,000 expensing limit for small businesses expires at the end of 2007. In order to provide a stable tax environment for American families and American businesses to plan for the future, these tax changes must be made permanent.

In addition, as I mentioned at the outset, the President has made clear the crucial need for fundamental reform of the tax system. Our system is widely perceived as

complex, unfair, and easily manipulated. The resulting loss of faith in the code threatens voluntary compliance – a foundation of our system.

Complexity in the tax code results from the myriad incentives in the form of targeted deductions and credits, the tax treatment of capital income, the tax treatment of business income, and the Alternative Minimum Tax (AMT). The complexity is growing rapidly, not only because of new and frequent changes to complex provisions, but also because of the expanding reach of the individual AMT. By 2010, 34 million taxpayers will be affected by the AMT compared to 3.5 million today.

Both individual and business taxpayers spend enormous amounts of time and money filling out their tax returns. It is estimated that taxpayers spend 6 billion hours each year to decipher the tax rules, maintain records, and fill out returns. One reasonable estimate places the costs of compliance at $120 billion annually. This is nearly 13 percent of the amount of revenue collected by the tax, which is much too high. And this figure doesn't include any adjustment to reflect the frustration and annoyance experienced by taxpayers! Many turn to professionals for help – about 75 million individual taxpayers, including many with relatively simple tax returns, use paid preparers to fill out their returns.

The current tax system also imposes large costs on our economy by causing households and businesses to rearrange their affairs in ways that make poor use of economic resources, and ultimately lead to lower living standards. Taxpayers and businesses spend countless hours trying to figure out ways to minimize their taxes, with some going so far as to purchase tax shelters.

The tax system also influences important economic decisions. When people make decisions about whether and how much to work, save, or invest because of the tax system rather than economic fundamentals, resources are allocated inefficiently. By minimizing these economic inefficiencies, fundamental tax reform potentially could raise Gross Domestic Product and increase the capital stock substantially.

Understanding the short-comings of our current tax code helps set the stage for fundamental reform. As I mentioned earlier, the President has set out several objectives in this area. The first is that the tax system should be simpler. This means that it should be easier for taxpayers to understand. It means that complying with the tax system should be less onerous. Tax forms and instructions should be shorter and less complicated. It also means that the cost of administering the tax system should be reduced.

Another principle specified by the President is that tax reform should foster economic growth and job creation. Economic decisions need to be based on economics rather than the tax code. This also means that the tax system should be structured to maintain and enhance the international competitiveness of U.S. businesses in a rapidly-changing, highly competitive global economy.

The President also has stated that the tax system should be fair. Progressivity is one attribute that is fundamental to fairness in taxation. As you know, our current tax system is highly progressive. The top 50 percent of taxpayers (ranked by income) pay 96 percent of all individual income taxes. I should note that the President's tax cuts have actually increased the share of income taxes paid by higher income Americans. The top 1 percent of Americans would have paid 30.5 percent of all individual income taxes without the tax cuts, but now pay over 32 percent. The bottom 50 percent of taxpayers now pays a smaller share – 3.6 percent of all individual income taxes with the tax cuts, instead of 4.1 percent without the tax cuts.

Fairness also means that the tax system should be transparent. Too many people perceive the tax system as unfair – believing that their neighbors are able to reduce their taxes through a maze of loopholes and clever tax planning. The smooth and efficient functioning of our tax system depends on a high level of voluntary compliance. But, voluntary compliance erodes if taxpayers come to believe that others are getting away with something that they are not.

The President also has said that any reform needs to get the incentives right, recognizing, for example, the importance of homeownership and charitable giving in our American society, which receive favorable treatment in our current tax system.

We believe that by reforming our tax code along these lines, we will create a better, fairer, simpler system that will diminish the appetite for future frequent change. As we all know, frequent changes to multiple provisions make the code even more difficult to administer and even more confusing for taxpayers to deal with. I suppose one might imagine (or dream of!) a tax system that is so obviously perfect and enjoys such widespread support that Congress could not possibly consider changing a single provision! We are not so confident as to believe that we will achieve such a state of flawlessness, but, we are certainly looking at ways to improve the stability of the system.

One of the key challenges in approaching tax reform is confronting the misperceptions that surround our system. A big part of the tax reform discussion in our country for the past several years has been around whether we should have an income tax or a consumption tax. Many people approach that issue believing that we now have an income tax. That may be partly because we call our tax an income tax. But, in reality, we have a hybrid tax system with some elements of an income tax, some elements of a consumption tax, and some elements that are neither.

The fundamental difference between an income tax and a consumption tax is that an income tax taxes the return to saving whereas a consumption tax does not. Our current so-called income tax includes several vehicles that effectively allow savings to escape taxation, primarily pensions, 401(k) accounts, and individual retirement accounts, or IRAs. Thirty five percent of household financial assets are held in these tax-favored vehicles, receiving tax treatment consistent with a consumption tax, not an income tax.

A related point: Some people also believe that our major trading partners depend substantially on consumption taxes – their value added taxes – and we do not. While we do not have a value added tax or significant consumption taxes at the federal level, our states rely heavily on sales taxes. In total, over 12 percent of tax revenue in the U.S. is derived from consumption taxes. This is lower than our trading partners – most of which rely on consumption taxes for between 20 to 30 percent of total revenue – but still significant.

One thing we do know is that achieving fundamental reform of the tax system will not be quick or easy. Nonetheless, this is extremely important work . . . and President Bush is committed to taking it on. The improvements that can be achieved through tax reform – simplification, reduced compliance burdens and costs, increased economic growth and output, and increased confidence in the system – make it well worth the effort and difficulty.

To be sure, there will be many obstacles to overcome. Almost every element of the current tax system is supported by some influential interest group that will argue calamity from its elimination or revision. There is an old saying that "an old tax system is a good tax system." The people who know the current tax system and have figured out how to cope with it, fear the changes that might come in a new system. But another statement from a wise tax legislator says: "we ought to have a tax system that looks like someone might have adopted it on purpose." Our tax system currently does not come close to passing that test. We can and should do better.

As we go through this process, I am hopeful that groups like the Tax Foundation will contribute to and support our efforts. By working together, I believe that we can improve our tax system in ways that will make our lives easier, make our businesses more productive, and allow our economy to flourish.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

November 18, 2004
js-2111

Treasury Applauds Senate Approval of Protocol Amending U.S.-Netherlands Tax Treaty

The Treasury Department welcomes the Senate's action yesterday to approve the protocol amending the U.S. income tax treaty with the Netherlands.

"The protocol approved by the Senate last night will improve the long-standing tax treaty relationship between the United States and the Netherlands," said Secretary John W. Snow. "These enhancements to the tax treaty will foster still closer economic ties between our two countries, bringing benefits to both countries by further reducing tax barriers to real cross-border trade and investment in both directions."

The protocol amends the existing U.S.-Netherlands tax treaty, which entered into force in 1993, to take into account developments over the last decade, including changes in each country's tax laws and tax treaty policies. Key provisions in the protocol include the modernization of the anti-treaty shopping rules to prevent inappropriate exploitation of the treaty and the elimination of source-country withholding taxes on certain cross-border intercompany dividends.

The protocol amending the U.S.-Netherlands tax treaty will enter into force when the two countries have notified each other that their respective requirements for ratification have been completed.

The approval of the protocol by the Senate follows a hearing held by the Senate Committee on Foreign Relations on September 24 on both this protocol and a protocol amending the U.S.-Barbados tax treaty. The Senate approved the protocol amending the U.S.-Barbados tax treaty on October 11.

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FROM THE OFFICE OF PUBLIC AFFAIRS

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November 19, 2004
JS-2112

Treasury and IRS Issue Indexed Amounts for Health Savings Accounts

The Treasury Department and IRS today issued new guidance on the maximum contribution levels for Health Savings Accounts (HSAs) and out-of-pocket spending limits for High Deductible Health Plans (HDHPs) that must be used in conjunction with HSAs. These amounts have been indexed for cost-of-living adjustments for 2005 and are included in Revenue Procedure 2004-71, which announces changes in several indexed amounts for purposes of the federal income tax. The minimum deductible required for HDHPs did not change.

"Today's guidance will help consumers and employers who wish to participate in HSAs in 2005 to plan accordingly," said Treasury's Acting Assistant Secretary for Tax Policy Greg Jenner. "Knowing the dollar limits for these accounts, and for the high deductible insurance that goes with them, is critical for those who want to get the maximum benefit out of this revolutionary health care coverage option – one that puts health care spending decisions back in the hands of individuals."

The new levels are as follows:

New Annual Contribution Levels for HSAs:

- For 2005, the maximum annual HSA contribution for an eligible individual with self-only coverage is $2650. (Note: for any individual, the maximum contribution is the lesser of the indexed amount or the deductible of the HDHP.)
- For family coverage the maximum annual HSA contribution is $5250.
- Catch up contributions for individuals who are 55 or older is increased by statute from $500 to $600 for 2005.
- Both the HSA contribution and catch up contribution apply pro rata based on the number of the months of the year a taxpayer is an eligible individual, and, with respect to the catch up contribution, the number of months of the year that the taxpayer is age 55 and over.

New Amounts for Out-of-Pocket Spending on HSA-Compatible HDHPs:

- The maximum annual out-of-pocket amount for HDHP self-coverage increases to $5,100 and the maximum annual out-of-pocket amount for HDHP family coverage is twice that, $10,200.

Minimum Deductible Amounts for HSA-Compatible HDHPs:

- For 2005, the minimum deductible for HDHP is unchanged, remaining at $1,000 for self-only coverage and $2,000 for family coverage.

REPORTS

- The guidance containing the indexed amounts

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.602. Tax forms and instructions.

(Also, Part I, §§ 1, 23, 24, 25A, 32, 42, 59, 62, 63, 68, 132, 135, 137, 146, 1.148-5, 151, 170, 179, 213, 220, 221, 223, 512, 513, 685, 877, 2032A, 2503, 2523, 4261, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B)

Rev. Proc. 2004-71

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SECTION 4. EFFECTIVE DATE

SECTION 5. DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 2005.

SECTION 2. CHANGES

.01 The amounts in § 1.148-5(e)(2)(iii)(B)(1) of the Income Tax Regulations used to determine whether a broker's commission or similar fee with respect to the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable under § 1.148-5(e)(2)(i) are adjusted for inflation.

(Section 3.16).

.02 The amounts in § 223(b)(2) of the Internal Revenue Code used to determine the monthly limitation on deductions for health savings accounts under § 223(a) are adjusted for inflation. The amounts in § 223(c)(2)(A) used to determine whether a health plan meets the definition of a high deductible health plan are adjusted for inflation. (Section 3.22).

.03 The new "net worth" amount in § 877(a)(2)(B) used to determine whether an individual who ceased to be a U.S. citizen or long-term resident is subject to the special rules of § 877 is not adjusted for inflation. (Section 3.26).

SECTION 3. 2005 ADJUSTED ITEMS

.01 Tax Rate Tables. For taxable years beginning in 2005, the tax rate tables under § 1 are as follows:

TABLE 1 - Section 1(a). - Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	The Tax Is:
Not over $14,600	10% of the taxable income
Over $14,600 but not over $59,400	$1,460 plus 15% of the excess over $14,600
Over $59,400 but not over $119,950	$8,180 plus 25% of the excess over $59,400
Over $119,950 but not over $182,800	$23,317.50 plus 28% of the excess over $119,950
Over $182,800 but not over $326,450	$40,915.50 plus 33% of the excess over $182,800
Over $326,450	$88,320 plus 35% of

the excess over $326,450

TABLE 2 - Section 1(b). – Heads of Households

If Taxable Income Is:	The Tax Is:
Not over $10,450	10% of the taxable income
Over $10,450 but not over $39,800	$1,045 plus 15% of the excess over $10,450
Over $39,800 but not over $102,800	$5,447.50 plus 25% of the excess over $39,800
Over $102,800 but not over $166,450	$21,197.50 plus 28% of the excess over $102,800
Over $166,450 but not over $326,450	$39,019.50 plus 33% of the excess over $166,450
Over $326,450	$91,819.50 plus 35% of the excess over $326,450

TABLE 3 - Section 1(c). – Unmarried Individuals (other than Surviving Spouse and Heads of Households).

If Taxable Income Is:	The Tax Is:
Not over $7,300	10% of the taxable income
Over $7,300 but not over $29,700	$730 plus 15% of the excess over $7,300
Over $29,700 but not over $71,950	$4,090 plus 25% of the excess over $29,700
Over $71,950 but not over $150,150	$14,652.50 plus 28% of the excess over $71,950
Over $150,150 but not over $326,450	$36,548.50 plus 33% of the excess over $150,150
Over $326,450	$94,727.50 plus 35% of the excess over $326,450

TABLE 4 - Section 1(d). – Married Individuals Filing Separate Returns

If Taxable Income Is:	The Tax Is:
Not over $7,300	10% of the taxable income
Over $7,300 but not over $29,700	$730 plus 15% of the excess over $7,300
Over $29,700 but not over $59,975	$4,090 plus 25% of the excess over $29,700
Over $59,975 but not over $91,400	$11,658.75 plus 28% of the excess over $59,975
Over $91,400 but not over $163,225	$20,457.75 plus 33% of the excess over $91,400
Over $163,225	$44,160 plus 35% of the excess over $163,225

TABLE 5 - Section 1(e). – Estates and Trusts

If Taxable Income Is:	The Tax Is:
Not over $2,000	15% of the taxable income
Over $2,000 but not over $4,700	$300 plus 25% of the excess over $2,000
Over $4,700 but not over $7,150	$975 plus 28% of the excess over $4,700
Over $7,150 but not over $9,750	$1,661 plus 33% of the excess over $7,150
Over $9,750	$2,519 plus 35% of the excess over $9,750

.02 Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax"). For taxable years beginning in 2005, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to

the "kiddie tax," is $800. (This amount is the same as the $800 standard deduction amount provided in section 3.10(2) of this revenue procedure.) The same $800 amount is used for purposes of § 1(g)(7) (that is, in determining whether a parent may elect to include a child's gross income in the parent's gross income and for calculating the "kiddie tax"). For example, one of the requirements for the parental election is that a child's gross income is more than the amount referenced in § 1(g)(4)(A)(ii)(I) but less than 10 times such amount; thus, a child's gross income for 2005 must be more than $800 but less than $8,000 to satisfy that requirement.

.03 Adoption Credit. For taxable years beginning in 2005, under § 23(a)(3) the maximum credit allowed for an adoption of a child with special needs is $10,630. For taxable years beginning in 2005, under § 23(b)(1) the maximum credit allowed with regard to other adoptions is the amount of qualified adoption expenses up to $10,630. The available adoption credit begins to phase out under § 23(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $159,450 and is completely phased out for taxpayers with modified adjusted gross income of $199,450. (See section 3.14 of this revenue procedure for the adjusted items relating to adoption assistance programs.)

.04 Child Tax Credit. For taxable years beginning in 2005, the value used in § 24(d)(1)(B)(i) in determining the amount of credit under § 24 that may be refundable is $11,000.

.05 Hope and Lifetime Learning Credits.

(1) For taxable years beginning in 2005, 100 percent of qualified tuition and related expenses not in excess of $1,000 and 50 percent of such expenses in excess of $1,000

are taken into account in determining the amount of the Hope Scholarship Credit under § 25A(b)(1).

(2) For taxable years beginning in 2005, a taxpayer's modified adjusted gross income in excess of $43,000 ($87,000 for a joint return) is taken into account in determining the reduction under § 25A(d)(2)(A)(ii) in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise allowable under § 25A(a).

.06 Earned Income Credit.

(1) In general. For taxable years beginning in 2005, the following amounts are used to determine the earned income credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income credit is allowed. The "threshold phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of adjusted gross income (or if greater, earned income) at or above which no credit is allowed.

	Number of Qualifying Children		
Item	One	Two or More	None
Earned Income Amount	$ 7,830	$11,000	$ 5,220
Maximum Amount of Credit	$ 2,662	$ 4,400	$ 399
Threshold Phaseout Amount (Single, Surviving Spouse, or Head of Household)	$14,370	$14,370	$ 6,530
Completed Phaseout Amount (Single, Surviving Spouse, or	$31,030	$35,263	$11,750

Head of Household)			
Threshold Phaseout Amount (Married Filing Jointly)	$16,370	$16,370	$ 8,530
Completed Phaseout Amount (Married Filing Jointly)	$33,030	$37,263	$13,750

The instructions for the Form 1040 series provide tables showing the amount of the earned income credit for each type of taxpayer.

(2) Excessive investment income. For taxable years beginning in 2005, the earned income tax credit is denied under § 32(i) if the aggregate amount of certain investment income exceeds $2,700.

.07 Low-Income Housing Credit. For calendar years beginning in 2005, the amounts used under § 42(h)(3)(C)(ii) to calculate the State housing credit ceiling for the low-income housing credit is the greater of (i) $1.85 multiplied by the State population, or (ii) $2,125,000.

.08 Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax." For taxable years beginning in 2005, for a child to whom the § 1(g) "kiddie tax" applies, the exemption amount under §§ 55 and 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (i) such child's earned income for the taxable year, plus (ii) $5,850.

.09 Transportation Mainline Pipeline Construction Industry Optional Expense Substantiation Rules for Payments to Employees under Accountable Plans. For calendar years beginning in 2005, an eligible employer may pay certain welders and heavy equipment mechanics an amount of up to $13 per hour for rig-related expenses

that is deemed substantiated under an accountable plan when paid in accordance with Rev. Proc. 2002-41. If the employer provides fuel or otherwise reimburses fuel expenses, up to $8 per hour is deemed substantiated when paid under Rev. Proc. 2002-41.

.10 Standard Deduction.

(1) In general. For taxable years beginning in 2005, the standard deduction amounts under § 63(c)(2) are as follows:

Filing Status	Standard Deduction
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$10,000
Heads of Households (§ 1(b))	$7,300
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$5,000
Married Individuals Filing Separate Returns (§ 1(d))	$5,000

(2) Dependent. For taxable years beginning in 2005, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of (i) $800, or (ii) the sum of $250 and the individual's earned income.

(3) Aged and blind. For taxable years beginning in 2005, the additional standard deduction amounts under § 63(f) for the aged and for the blind are $1,000 for each. These amounts are increased to $1,250 if the individual is also unmarried and not a surviving spouse.

.11 Overall Limitation on Itemized Deductions. For taxable years beginning in 2005,

the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is $145,950 (or $72,975 for a separate return filed by a married individual).

.12 Qualified Transportation Fringe. For taxable years beginning in 2005, the monthly limitation under § 132(f)(2)(A) (regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass) is $105. The monthly limitation under § 132(f)(2)(B) (regarding the fringe benefit exclusion amount for qualified parking) is $200.

.13 Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses. For taxable years beginning in 2005, the exclusion under § 135 (regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses) begins to phase out for modified adjusted gross income above $91,850 for joint returns and $61,200 for other returns. This exclusion completely phases out for modified adjusted gross income of $121,850 or more for joint returns and $76,200 or more for other returns.

.14 Adoption Assistance Programs. For taxable years beginning in 2005, under § 137(a)(2) the maximum amount that can be excluded from an employee's gross income in connection with the adoption by the employee of a child with special needs is $10,630. For taxable years beginning in 2005, under § 137(b)(1) the maximum amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by the employer for qualified adoption expenses furnished pursuant to an adoption assistance program in connection with other adoptions by the employee

is $10,630. The amount excludable from an employee's gross income begins to phase out under § 137(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $159,450 and is completely phased out for taxpayers with modified adjusted gross income of $199,450. (See section 3.03 of this revenue procedure for the adjusted items relating to the adoption credit.)

.15 Private Activity Bonds Volume Cap. For calendar years beginning in 2005, the amounts used under § 146(d)(1) to calculate the State ceiling for the volume cap for private activity bonds is the greater of (i) $80 multiplied by the State population, or (ii) $239,180,000.

.16 Safe Harbor Rules for Broker Commissions on Guaranteed Investment Contracts or Investments Purchased for a Yield Restricted Defeasance Escrow. For calendar year 2005, under § 1.148-5(e)(2)(iii)(B)(1), a broker's commission or similar fee with respect to the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable to the extent that (i) the amount of the fee that the issuer treats as a qualified administrative cost does not exceed the lesser of (A) $31,000, or (B) 0.2 percent of the computational base (as defined in § 1.148-5(e)(2)(iii)(B)(2)) or, if more, $3,000; and (ii) the issuer does not treat more than $87,000 in brokers' commissions or similar fees as qualified administrative costs with respect to all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

.17 Personal Exemption.

(1) Exemption amount. For taxable years beginning in 2005, the personal

exemption amount under § 151(d) is $3,200.

(2) Phase out. For taxable years beginning in 2005, the personal exemption amount begins to phase out at, and is completely phased out after, the following adjusted gross income amounts:

Filing Status	AGI – Beginning of Phaseout	AGI – Exemption Fully Phased Out
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$218,950	$341,450
Heads of Households (§ 1(b))	$182,450	$304,950
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$145,950	$268,450
Married Individuals Filing Separate Returns (§ 1(d))	$109,475	$170,725

.18 Election to Expense Certain Depreciable Assets. For taxable years beginning in 2005, under § 179(b)(1) the aggregate cost of any § 179 property a taxpayer may elect to treat as an expense shall not exceed $105,000. Under § 179(b)(2) the $105,000 limitation shall be reduced (but not below zero) by the amount by which the cost of § 179 property placed in service during the 2005 taxable year exceeds $420,000.

.19 Eligible Long-Term Care Premiums. For taxable years beginning in 2005, the limitations under § 213(d)(10) (regarding eligible long-term care premiums includible in the term "medical care") are as follows:

Attained Age Before the Close of the Taxable Year	Limitation on Premiums
40 or less	$ 270
More than 40 but not more than 50	$ 510

More than 50 but not more than 60	$1,020
More than 60 but not more than 70	$2,720
More than 70	$3,400

.20 Medical Savings Accounts.

(1) Self-only coverage. For taxable years beginning in 2005, the term "high deductible health plan" as defined in § 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than $1,750 and not more than $2,650, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $3,500.

(2) Family coverage. For taxable years beginning in 2005, the term "high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $3,500 and not more than $5,250, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $6,450.

.21 Interest on Education Loans. For taxable years beginning in 2005, the $2,500 maximum deduction for interest paid on qualified education loans under § 221 is reduced under § 221(b)(2)(B) when modified adjusted gross income exceeds $50,000 ($105,000 for joint returns), and is completely eliminated when modified adjusted gross income is $65,000 ($135,000 for joint returns).

.22 Health Savings Accounts.

(1) Monthly contribution limitation. For calendar year 2005, the monthly limitation on deductions under § 223(b)(2)(A) for an individual with self-only coverage under a high

deductible plan as of the first day of such month is 1/12 of the lesser of (i) the annual deductible, or (ii) $2,650. For calendar year 2005, the monthly limitation on deductions under § 223(b)(2)(B) for an individual with family coverage under a high deductible plan as of the first day of such month is 1/12 of the lesser of (i) the annual deductible, or (ii) $5,250.

(2) High deductible health plan. For calendar year 2005, a high deductible health plan is defined under § 223(c)(2)(A) as a health plan with an annual deductible that is not less than $1,000 for self-only coverage or $2,000 for family coverage, and the annual out-of pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $5,100 for self-only coverage or $10,200 for family coverage.

.23 Treatment of Dues Paid to Agricultural or Horticultural Organizations. For taxable years beginning in 2005, the limitation under § 512(d)(1) (regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization) is $127.

.24 Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns.

(1) Low cost article. For taxable years beginning in 2005, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a "low cost article" of $8.30 or less.

(2) Other insubstantial benefits. For taxable years beginning in 2005, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90-12, 1990-1 C.B. 471 (as amplified and modified), for disregarding the value of insubstantial benefits received by a donor in

return for a fully deductible charitable contribution under § 170, are $8.30, $41.50, and $83, respectively.

.25 Funeral Trusts. For a contract entered into during calendar year 2005 for a "qualified funeral trust," as defined in § 685, the trust may not accept aggregate contributions by or for the benefit of an individual in excess of $8,200.

.26 Expatriation to Avoid Tax. For calendar year 2005, an individual with "average annual net income tax" of more than $127,000 for the 5 taxable years ending before the date of the loss of United States citizenship under § 877(a)(2)(A) is subject to tax under § 877(b).

.27 Valuation of Qualified Real Property in Decedent's Gross Estate. For an estate of a decedent dying in calendar year 2005, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A that is taken into account for purposes of the estate tax may not exceed $870,000.

.28 Annual Exclusion for Gifts.

(1) For calendar year 2005, the first $11,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2005, the first $117,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.29 Passenger Air Transportation Excise Tax. For calendar year 2005, the tax under § 4261(b) on the amount paid for each domestic segment of taxable transportation by air is $3.20. For calendar year 2005, the tax under § 4261(c) on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States, generally is $14.10. However, for a domestic segment beginning or ending in Alaska or Hawaii as described in § 4261(c)(3), the tax only applies to departures and is at the rate of $7.

.30 Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures. For taxable years beginning in 2005, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98-19, 1998-1 C.B. 547), regarding certain exempt organizations with nondeductible lobbying expenditures, is $88 or less.

.31 Notice of Large Gifts Received from Foreign Persons. For taxable years beginning in 2005, recipients of gifts from certain foreign persons may be required to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds $12,375.

.32 Persons Against Which a Federal Tax Lien Is Not Valid. For calendar year 2005, a federal tax lien is not valid against (i) certain purchasers under § 6323(b)(4) who purchased personal property in a casual sale for less than $1,200, or (ii) a mechanic's lienor under § 6323(b)(7) that repaired or improved certain residential property if the contract price with the owner is not more than $6,020.

.33 Property Exempt from Levy. For calendar year 2005, the value of property

exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) may not exceed $7,200. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) may not exceed $3,600.

.34 Interest on a Certain Portion of the Estate Tax Payable in Installments. For an estate of a decedent dying in calendar year 2005, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is $1,170,000.

.35 Attorney Fee Awards. For fees incurred in calendar year 2005, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is $150 per hour.

.36 Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts. For calendar year 2005, the stated dollar amount of the per diem limitation under § 7702B(d)(4) (regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual) is $240.

SECTION 4. EFFECTIVE DATE

.01 General Rule. Except as provided in section 4.02, this revenue procedure applies to taxable years beginning in 2005.

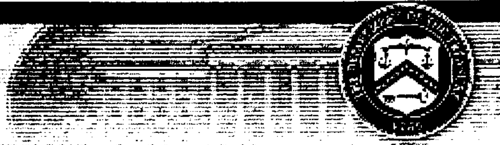
.02 Calendar Year Rule. This revenue procedure applies to transactions or events occurring in calendar year 2005 for purposes of sections 3.07 (low-income housing

credit), 3.09 (pipeline construction industry optional expense substantiation rules), 3.15 (private activity bond volume cap), 3.16 (safe harbor rules for broker commissions on guaranteed investment contracts or investments purchased for a yield restricted defeasance escrow), 3.22 (health savings accounts), 3.23 (funeral trusts), 3.24 (expatriation to avoid tax), 3.25 (valuation of qualified real property in decedent's gross estate), 3.26 (annual exclusion for gifts), 3.27 (passenger air transportation excise tax), 3.30 (persons against which a federal tax lien is not valid), 3.31 (property exempt from levy), 3.32 (interest on a certain portion of the estate tax payable in installments), 3.33 (attorney fee awards), and 3.34 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Marnette M. Myers of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Myers on (202) 622-4920 (not a toll-free call).

PRESS ROOM



FROM THE OFFICE OF PUBLIC AFFAIRS

November 21, 2004
js-2113

The Honorable John W. Snow
Conclusion of Meeting of G-20 Finance Ministers
and Central Bank Governors
Berlin, Germany
Sunday, November 21, 2004

I am very pleased to be here in Berlin and to have participated in such a productive discussion with my fellow Finance Ministers, as well as Central Bank Governors from the industrial and emerging market economies of the Group of 20. I want to thank Minister Eichel and Governor

Weber for hosting us and for leading the G-20 over the course of this year. I also want to thank Minister Eichel for our work together to reduce substantially Iraq's debt. This will ensure that the Iraqi people will have the opportunity to rebuild their economy.

This meeting caps a full week that I have spent in Europe, discussing the importance of economic growth with leaders of government, finance and academia. Growth was also a major theme of our meeting here. The world economy is growing faster than it has in nearly thirty years. With interest rates and inflation still low, conditions are ripe for strong growth to continue. In emerging market and developing countries, economic growth is expected to top six percent this year.

The United States is leading the global growth surge. Thanks to President Bush's pro-growth policies and sound monetary policy by the Fed, the economy is on a solid expansion path. GDP growth is strong. In 2004 alone our economy has created 2 million new jobs.

Sustaining this strong global growth requires all of us to act. Addressing global imbalances in particular is a shared challenge. The United States needs to do its part by raising national saving and reducing its budget deficit. President Bush is committed to cutting the budget deficit in half over the next four years. We will do this with spending restraint and continued growth - encouraged by pro-growth policies - in our economy.

Growth among our trading partners - including those here in Europe - also needs to increase and that requires addressing structural barriers that stand in the way of better performance. In Asia, more flexible exchange rates are needed in countries that do not have such flexibility.

We released today a G-20 Accord for Sustainable Growth, which describes our shared understanding of the economic policies needed for economic growth. This Accord reflects broad agreement that the world economy is best served by open, competitive markets, free capital flows and free trade. As part of the G-20 Accord we issued a Reform Agenda for Sustained Growth to set out specific policies being implemented in each of our countries. The G-20 Accord and Reform Agenda for Sustained Growth build on the path breaking G-7 Agenda for Growth initiative. I am gratified to see broad endorsement of a stronger focus on the policies that lead to economic growth.

The G-20 also reviewed the role of strong domestic financial sectors in supporting economic growth and reducing vulnerabilities. The review highlighted the importance of promoting financial intermediation and competition, implementing international standards and codes, and effective financial sector supervision and regulation. I also want to underscore the vital role remittances play as well in both

sending and receiving countries.

Looking beyond our own domestic policies, we all recognize the importance of robust and effective international institutions to advance growth. In recognition of the 60th anniversary of the Bretton Woods institutions, we discussed today the recent progress made in modernizing these institutions and the need for further reforms. I was pleased to share with the G-20 some of the conclusions of the G-7 Strategic Review that was conducted under the U.S. chairmanship this year. I believe that it is particularly worthwhile for members of the G-20, with their diverse perspectives, to reflect together on how these institutions are working and how they can do better.

For the international financial system to operate effectively, it is important to have clarity and predictability. I welcome the results achieved by emerging market issuers and creditors in their "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets." We hope that issuers and creditors will find the principles useful, and we encourage continued dialogue.

Finally, I want to note that the G-20 has played an important role in the financial fight against terror. We look forward to this work continuing. We all welcomed the new FATF standard calling on countries to take measures to prevent terrorists from transferring cash across borders. We are also delighted by the stepped up role that the IMF and World Bank have begun playing this year in assessments of the FATF standards.

Thank you.

-30-

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

ovember 22, 2004
004-11-22-15-57-21-8415

U.S. International Reserve Position

he Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets ›taled $85,720 million as of the end of that week, compared to $85,088 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	November 12, 2004			November 19, 2004		
TOTAL		85,088			85,720	
. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
ı. Securities	11,797	14,906	26,703	11,874	15,301	27,175
)f which, issuer headquartered in the U.S.			0			0
›. Total deposits with:						
›.i. Other central banks and BIS	11,598	2,996	14,564	11,679	3,075	14,754
›.ii. Banks headquartered in the U.S.			0			0
.ii. Of which, banks located abroad			0			0
›.iii. Banks headquartered outside the U.S.			0			0
.iii. Of which, banks located in the U.S.			0			0
. IMF Reserve Position [2]			19,636			19,636
. Special Drawing Rights (SDRs) [2]			13,112			13,112
. Gold Stock [3]			11,043			11,043
. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	November 12, 2004			November 19, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
. Foreign currency loans and securities			0			0
. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
.a. Short positions			0			0
b. Long positions			0			0
Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

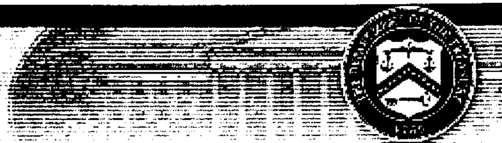
	November 12, 2004			November 19, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
. Contingent liabilities in foreign currency			0			0
.a. Collateral guarantees on debt due within 1 year						
.b. Other contingent liabilities						
. Foreign currency securities with embedded options			0			0
. Undrawn, unconditional credit lines			0			0
:.a. *With other central banks*						
:.b. *With banks and other financial institutions*						
ieadquartered in the U.S.						
:.c. *With banks and other financial institutions*						
ieadquartered outside the U.S.						
. Aggregate short and long positions of options in)reign						
:urrencies vis-à-vis the U.S. dollar			0			0
.a. *Short positions*						
.a.1. Bought puts						
.a.2. Written calls						
.b. *Long positions*						
.b.1. Bought calls						
.b.2. Written puts						

Notes:

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

The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are lued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any cessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

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



PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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November 23, 2004
js-2114

Treasury and IRS Clarify Employment Tax Treatment of Payments Made on the Signing or Cancellation of an Employment Contract

The Treasury Department and the IRS today published two revenue rulings clarifying that payments by employers to employees made in connection with employment contracts are to be treated as wages for purposes of FICA, FUTA and Federal income tax withholding.

The first ruling, Revenue Ruling 2004-109, clarifies that employment taxes must be paid – and income taxes withheld – on bonuses paid for signing of an employment contract. The ruling addresses situations such as signing bonuses paid in connection with the first contract between a baseball club and a baseball player and payments made upon ratification of a collective bargaining agreement.

The second ruling, Revenue Ruling 2004-110, concerns payments made in connection with the cancellation of an employment contract. The ruling clarifies that, if an employment contract is cancelled before its agreed-upon end and a payment is made in lieu of the remaining period of employment, the payment is treated as wages for purposes of employment taxes and income tax withholding.

Because these rulings revoke or modify prior rulings, the new rulings will not apply to certain payments made before January 12, 2005, such as signing bonuses, sign-on fees or other amounts paid in connection with an employee's initial employment or payments made or agreed to on the cancellation of an employment contract. This relief applies only where the facts and circumstances relating to the payments are substantially the same as the revoked or modified rulings.

Revenue Rulings 2004-109 and 2004-110 are attached.

REPORTS

- Revenue Rulings 2004-109
- Revenue Rulings 2004-110

Part I

Section 3121.-- Definitions

26 CFR 31.3121(a)-1: Wages.
(Also: 3306, 3401, 31.3306(b)-1, 31.3401(a)-1)

Rev. Rul. 2004-109

ISSUE

Whether certain amounts an employer pays as bonuses for signing or ratifying a contract are wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source (Federal income tax withholding)?

FACTS

Situation 1. Baseball Club negotiates an employment contract with an individual player. It is the first contract between the Club and the player. The contract provides that the player receives a signing bonus if he reports for spring training at the time and place directed by the Club. The contract provides that the signing bonus is not contingent on the player's future performance of services.

Situation 2. An employer negotiates a collective bargaining agreement (CBA) with a union representing a group of its employees. The CBA will take effect on the "ratification date," which is the date it is ratified by a majority of the union members covered by the agreement. The CBA provides that each employee covered by the terms of the agreement who is employed by the employer as of the ratification date receives a bonus. Each such employee is paid the same amount regardless of compensation, seniority, position and whether or not the employee voted for ratification. In addition, each eligible employee receives the payment even if the employee had not performed services for the employer before the ratification date. Finally, the CBA provides that the payment is not contingent on the employee's future performance of services.

LAW

Sections 3101 and 3111 of the Internal Revenue Code (Code) impose FICA taxes on "wages," as that term is defined in section 3121(a), with respect to "employment," as that term is defined in section 3121(b). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed on both the employer and employee. Sections 3101(a) and 3101(b) impose the employee portions of the social security tax and the Medicare tax, respectively. Sections 3111(a) and 3111(b) impose the employer portions of the social security tax and the Medicare tax, respectively.

The term "wages" is defined in section 3121(a) for FICA purposes as all remuneration for employment, with certain specific exceptions. Section 3121(b) defines the term "employment" as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Section 31.3121(a)-1(b) of the Employment Tax Regulations provides that the term "wages" means all remuneration for employment unless specifically excepted under section 3121(a). Section 31.3121(a)-1(c) provides that the name by which the remuneration for employment is designated is immaterial. Salaries, fees, and bonuses are wages, if paid as compensation for employment. Section 31.3121(a)-1(d) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Section 31.3121(b)-3(b) defines employment as services performed by an employee for an employer, unless specifically excepted under section 3121(b).

The FUTA taxation provisions are similar to the FICA provisions, except that only the employer pays the tax imposed under FUTA. See sections 3301 and 3306(b) and the regulations thereunder. Although there are differences in the statutory exceptions to what constitutes wages and employment, the general definitions of the terms "wages" and "employment" for FUTA purposes are similar to the definitions for FICA purposes. See sections 3306(b) and 3306(c).

Section 3402(a), relating to Federal income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages

a tax determined in accordance with prescribed tables or computational procedures. The term "wages" is defined in section 3401(a) for Federal income tax withholding purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions. Section 31.3401(a)-1(a)(2) provides that the name by which remuneration for services is designated is immaterial. Thus, salaries, fees and bonuses are wages if paid as compensation for services performed by the employee for his employer. Section 31.3401(a)-1(a)(3) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Unlike the FICA and the FUTA, the Federal income tax withholding provisions do not include a definition of employment.

Revenue Ruling 58-145, 1958-1 C.B. 360, in answering four specific questions, holds that a bonus paid by a baseball club to an individual solely for signing the individual's first contract and not in any way contingent on the performance of subsequent services is not remuneration for services and, therefore, is not wages for purposes of Federal income tax withholding under section 3402. The ruling further holds that a bonus paid to a baseball player that is contingent upon the performance of subsequent services is wages subject to Federal income tax withholding.

Revenue Ruling 69-424, 1969-2 C.B. 15, holds that amounts paid by a baseball club for educational expenses of a minor league baseball player attending college were not scholarships excluded from income under section 117 because the payments were "compensation for past, present or future employment services" within the meaning of section 1.117-4 of the Income Tax Regulations. The contract provided that the club was

not required to make the payments if the player failed to attend the college for two consecutive years without proper reason, did not report for spring training as directed by the club, or was placed on the voluntarily retired, disqualified or ineligible list. The ruling holds that the payments are wages for Federal income tax withholding and FICA purposes.

Revenue Ruling 71-532, 1971-2 C.B. 356, holds that Rev. Rul. 69-424 is to be applied without retroactive effect with respect to wages paid prior to January 1, 1970. The ruling makes clear that the amount paid for certain educational expenses under the employment contract described in Rev. Rul. 69-424 is distinguishable from the bonus paid solely as consideration for signing a contract described in Rev. Rul. 58-145, but nonetheless limits the retroactive effect of Rev. Rul. 69-424.

Rev. Rul. 74-108, 1974-1 C.B. 248, analyzes whether a sign-on fee paid by a domestic corporation that operates a professional soccer club to a non-resident alien player as an inducement not to negotiate with any other team is treated as income from sources within or without the United States. Rev. Rul. 74-108 cites Rev. Rul. 58-145 as authority for the conclusion that the sign-on fee is not compensation for labor or personal services and that, therefore, source is not determined under the rules in section 861(a)(3) or 862(a)(3). Instead, Rev. Rul. 74-108 characterized the sign-on fee as a payment for a covenant not to compete both within and without the United States, with the result that the sign-on fee was attributable to sources both within and without the United States.

ANALYSIS

The Code and regulations provide that amounts an employer pays an employee as remuneration for employment are wages, unless a specific exception applies. Sections 3121(a), 3306(b), and 3401(a) and sections 31.3121(a)-1(b), 31.3306(b)-1(b), and 31.3401(a)-1(a)(1) of the regulations. The regulations also provide that the name by which the remuneration is designated is immaterial. Salaries, fees, and bonuses, for example, are all wages, if paid as compensation for employment. Sections 31.3121(a)-1(c), 31.3306(b)-1(c), and 31.3401(a)-1(a)(2).

The Code and the regulations also provide that any service of whatever nature performed by an employee for the person employing him is employment, unless a specific exemption applies. Sections 3121(b) and 3306(c) and sections 31.3121(b)-3(b) and 31.3306(c)-2(b).

Employment encompasses the establishment, maintenance, furtherance, alteration, or cancellation of the employer-employee relationship or any of the terms and conditions thereof. If the employee provides clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions, the payment is not wages for purposes of FICA, FUTA, or Federal income tax withholding.

Under the facts presented in Situation 1, the individual receives the signing bonus in connection with establishing the employer-employee relationship. The individual does not provide clear, separate, and adequate consideration for the payment that is not dependent upon the employer-employee relationship and its component terms and conditions. Thus, the signing bonus is part of the compensation the Baseball Club pays

as remuneration for employment, making it wages regardless of the fact that the contract provides that the bonus is not contingent on the performance of future services.

Under the facts presented in Situation 2, the employees receive the ratification bonus payments as part of a bargain that establishes the terms and conditions of the employment relationship with all of the employees covered by the CBA. The employees do not provide clear, separate, and adequate consideration for the employer's payments that is not dependent upon the employer-employee relationship and its component terms and conditions. The payments are part of the compensation the employer pays as remuneration for employment. Thus, the ratification bonuses are wages regardless of the fact that they are uniform in amount, do not vary based on seniority or position or any other factor, and are not explicitly contingent on the performance of services.

Revenue Ruling 58-145 considered whether Federal income tax withholding applied to a bonus paid to a baseball player at the time a first contract was signed with a baseball club. It erred in its analysis by failing to apply the Code and regulations appropriately to the question of whether the bonus was wages in each of the four questions presented. Specifically, it failed to apply the correct definition of wages and to consider whether the bonus was paid in connection with establishing the employer-employee relationship. Accordingly, Rev. Rul. 58-145 is revoked. In addition, Rev. Rul. Rev. Rul. 74-108 is revoked as its conclusion relies upon Rev. Rul. 58-145.

HOLDING

Amounts an employer pays as bonuses for signing or ratifying a contract in connection with the establishment of the employer-employee relationship are wages for purposes of FICA, FUTA, and Federal income tax withholding. Accordingly, the payments in Situations 1 and 2 are wages for purposes of FICA, FUTA, and Federal income tax withholding.

EFFECT ON OTHER RULINGS

Rev. Rul. 58-145 and Rev. Rul. 74-108 are revoked. Rev. Rul. 69-424 and Rev. Rul. 71-532 are obsoleted in view of the amendment of section 117 by section 123(a) of the Tax Reform Act of 1986, 1986-3 (Vol.1) C.B. 1, 29. See section 117(c) and Notice 87-31, 1987-1 C.B. 475.

APPLICATION

Under the authority of section 7805(b), the Service will not apply the position adopted in this ruling to any signing bonus, sign-on fee, or similar amount paid to an employee in connection with the employee's initial employment with the employer pursuant to a sign-on agreement or other contract entered into before January 12, 2005, provided the amount is paid under facts and circumstances that are substantially the same as in Rev. Rul. 58-145 or Rev. Rul. 74-108.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Marie Cashman and Stephen Suetterlein of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt &

Government Entities). For further information regarding this revenue ruling, contact Mr. Suetterlein on (202) 622-6040 (not a toll-free call).

Part I

Section 3121.--Definitions

26 CFR 31.3121(a)-1: Wages.
(Also: 1221, 1222, 3306, 3401, 1.1221-1, 1.1222-1, 31.3306(b)-1, 31.3401(a)-1)

Rev. Rul. 2004-110

ISSUE

Whether an amount paid to an employee as consideration for the cancellation of an employment contract and relinquishment of contract rights is ordinary income, and wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source (Federal income tax withholding)?

FACTS

An employee performs services under a written employment contract providing for a specified number of years of employment. The contract does not provide for any payments to be made by either party in the event the contract is cancelled by mutual agreement. Before the end of the contract period, the employee and the employer agree to cancel the contract and negotiate a

payment from the employer to the employee in consideration for the employee's relinquishment of his contract rights to the remaining period of employment.

LAW

Ordinary Income

Section 1(h) of the Internal Revenue Code (Code) provides for maximum capital gains tax rates on net capital gain.

Section 1222(11) defines "net capital gain" as the excess of net long-term capital gain over net short-term capital loss. Under section 1222(3), the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than one year.

Section 1221 provides that the term "capital asset" means property held by the taxpayer, with certain exclusions listed in section 1221(a)(1)-(8).

Section 1231 provides generally for capital gain or loss if there is net gain from the sale or exchange of property used in a trade or business and from certain involuntary conversions of business or investment property.

The United States Supreme Court has held that not everything that can be called "property" in the ordinary sense and that is outside the statutory exclusions in section 1221 or section 1231 qualifies as a "capital asset" under section 1221 or for purposes of section 1231, and that the term does not include certain claims or rights, the consideration for which essentially substitutes for ordinary income. See Commissioner v. Gillette Motor Transport, Inc., 364 U.S. 130, 134-136 (1960), Ct. D. 1853, 1960-2 C.B. 466, 468; Commissioner v. P.G. Lake, Inc., 356 U.S. 260, 265-67 (1958), Ct. D. 1823, 1958-1 C.B. 516, 518-19. Under this line

of Supreme Court decisions, it is settled that consideration received for the transfer or termination of a right to receive income for the past or future performance of services is taxable as ordinary income. See, e.g., Rothstein v. Commissioner, 90 T.C. 488, 493-94 (1988).

Wages

Sections 3101 and 3111 impose FICA taxes on "wages," as that term is defined in section 3121(a), with respect to "employment," as that term is defined in section 3121(b). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed on both the employer and employee. Sections 3101(a) and 3101(b) impose the employee portions of the social security tax and the Medicare tax, respectively. Sections 3111(a) and 3111(b) impose the employer portions of the social security tax and the Medicare tax, respectively.

The term "wages" is defined in section 3121(a) for FICA purposes as all remuneration for employment, with certain specific exceptions. Section 3121(b) defines "employment" as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Section 31.3121(a)-1(b) of the Employment Tax Regulations provides that the term "wages" means all remuneration for employment unless specifically excepted under section 3121(a). Section 31.3121(a)-1(c) provides that the name by which the remuneration for employment is designated is immaterial. Section 31.3121(a)-1(d) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Section

31.3121(b)-3(b) defines employment as services performed by an employee for an employer, unless specifically excepted under section 3121(b).

Section 31.3121(a)-1(i) provides that remuneration, unless specifically excepted, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

The FUTA taxation provisions are similar to the FICA provisions, except that only the employer pays the tax imposed under FUTA. See sections 3301 and 3306(b) and the regulations thereunder. Although there are differences in the statutory exceptions to what constitutes wages and employment, the general definitions of the terms "wages" and "employment" for FUTA purposes are similar to the definitions for FICA purposes. See sections 3306(b) and 3306(c).

Section 3402(a), relating to Federal income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages a tax determined in accordance with prescribed tables or computational procedures. The term "wages" is defined in section 3401(a) for Federal income tax withholding purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions. Section 31.3401(a)-1(a)(2) provides that the name by which remuneration for services is designated is immaterial. Section 31.3401(a)-1(a)(3) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Unlike the FICA and the FUTA,

the Federal income tax withholding provisions do not include a definition of employment.

Section 31.3401(a)-1(a)(5) provides that remuneration, unless specifically excepted, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

Revenue Ruling 55-520, 1955-2 C.B. 393, concludes that an amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of a two-year employment contract is not wages for FICA and Federal income tax withholding purposes. The ruling further concludes that the payment is includible in the employee's gross income for Federal income tax purposes.

Revenue Ruling 58-301, 1958-1 C.B. 23, concludes that a lump sum payment received by an employee as consideration for his agreement to cancel the remaining period of a five-year employment contract during the second year of the term and to relinquish his contract rights is ordinary income, not capital gain, and is includible in his gross income in the year of receipt. The ruling further concludes that the payment is not subject to FICA and Federal income tax withholding.

Revenue Ruling 74-252, 1974-1 C.B. 287, concludes that payments made by an employer to an employee, following involuntary termination, under the provisions of a three-year contract are wages for FICA, FUTA, and Federal income tax withholding purposes. Under the terms of the contract, the employer

could terminate the relationship at any time, provided the employee was paid an amount equal to an additional six months salary. The ruling distinguishes Rev. Rul. 58-301 on the basis that these payments are in the nature of dismissal payments provided for under the terms of the contract, rather than as consideration for the relinquishment of interests the employee had in the employment contract.

Revenue Ruling 75-44, 1975-1 C.B. 15, involves an employer's payment to a railroad employee as consideration for the employee's agreement to perform a different type of work and refrain from asserting his employment rights acquired pursuant to his past service under a general contract of employment. The ruling concludes that the payment received by the employee is ordinary income in the taxable year of receipt and is "compensation" for purposes of the Railroad Retirement Tax Act (RRTA) and "wages" for purposes of Federal income tax withholding. This ruling distinguishes Rev. Rul. 58-301 on the basis that in Rev. Rul. 58-301 the lump sum payment was primarily in consideration of the cancellation of the employee's original contract rights rather than primarily in consideration of the past performance of services through which the relinquished employment rights were acquired.

ANALYSIS

The Code and regulations provide that amounts an employer pays an employee as remuneration for employment are wages, unless a specific exception applies. Sections 3121(a), 3306(b), and 3401(a) and sections 31.3121(a)-1(b), 31.3306(b)-1(b), and 31.3401(a)-1(a)(1) of the regulations. The

regulations also provide that the name by which the remuneration is designated is immaterial. Sections 31.3121(a)-1(c), 31.3306(b)-1(c), and 31.3401(a)-1(a)(2). Furthermore, the remuneration is wages even though at the time paid the relationship of employer and employee no longer exists. Sections 31.3121(a)-1(i), 31.3306(b)-1(i), and 31.3401(a)-1(a)(5).

The Code and the regulations also provide that any service of whatever nature performed by an employee for the person employing him is employment, unless a specific exemption applies. Sections 3121(b) and 3306(c) and sections 31.3121(b)-3(b) and 31.3306(c)-2(b).

Employment encompasses the establishment, maintenance, furtherance, alteration, or cancellation of the employer-employee relationship or any of the terms and conditions thereof. If the employee provides clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions, the payment is not wages for purposes of FICA, FUTA, or Federal income tax withholding.

Under the facts presented in this ruling, the employee receives the payment as consideration for canceling the remaining period of his employment contract and relinquishing his contract rights. As such, the payment is part of the compensation the employer pays as remuneration for employment. The employee does not provide clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions. Thus, the payment

provided by the employer to the employee is wages for purposes of FICA, FUTA, and Federal income tax withholding. This conclusion applies regardless of the name by which the remuneration is designated or whether the employment relationship still exists at the time the payment is made.

With respect to the application of FICA and Federal income tax withholding, Rev. Rul. 55-520 and Rev. Rul. 58-301 erred in their analysis by failing to apply the Code and regulations appropriately to the question of whether the payments made in cancellation of the employment contract were wages.

To qualify as capital gain, eligible for the reduced rates in section 1(h), a payment must be received in connection with a "sale or exchange" of "property," as those terms are used in sections 1221, 1222, and 1231. Under Gillette Motor, P.G. Lake, and the settled line of authority applying the Supreme Court's reasoning to compensation-related rights, consideration received for the transfer or termination of a right to receive income for the past or future performance of services is a substitute for ordinary income, taxable as such. The payment received by the employee in the present situation is a payment of this type, and for capital gains purposes is not a payment for property. It is therefore taxable to the employee as ordinary income.

With respect to the ordinary or capital character of a payment, the payments in Rev. Rul. 55-520, Rev. Rul. 58-301, Rev. Rul. 74-252, and Rev. Rul. 75-44 are ordinary income; in particular, the specific holdings to this effect in Rev. Rul. 58-301 and Rev. Rul. 75-44 remain correct.

Accordingly, Rev. Rul. 55-520 and Rev. Rul. 58-301 are modified and superseded. In addition, Rev. Rul. 74-252 and Rev. Rul. 75-44 are modified to the extent their holdings regarding FICA, FUTA, RRTA, and Federal income tax withholding rely on distinguishing Rev. Rul. 58-301.

HOLDING

An amount paid to an employee as consideration for cancellation of an employment contract and relinquishment of contract rights is ordinary income, and wages for purposes of FICA, FUTA, and Federal income tax withholding.

EFFECT ON OTHER REVENUE RULINGS

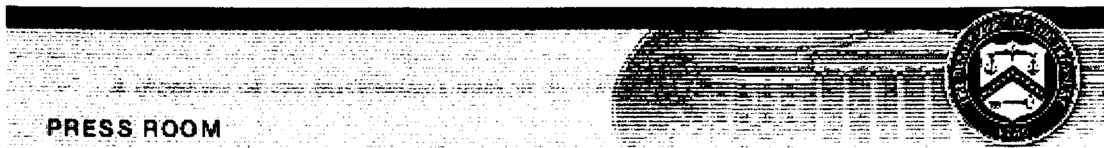
Rev. Rul. 55-520 and Rev. Rul. 58-301 are modified and superseded. Rev. Rul. 74-252 and Rev. Rul. 75-44 are modified.

APPLICATION

Under the authority of section 7805(b), the Service will not apply the position adopted in this ruling to any payment that an employer made to an employee or former employee before January 12, 2005, provided that the payment is made under facts and circumstances that are substantially the same as in Rev. Rul. 55-520 or Rev. Rul. 58-301.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Michael Swim and Elliot Rogers of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Mr. Rogers on (202) 622-6040 (not a toll-free call).



FROM THE OFFICE OF PUBLIC AFFAIRS

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November 24, 2004
js-2115

Treasury Names Leaders of Mexican Narcotics Cartel

The Treasury Department's Office of Foreign Assets Control (OFAC) today took another step to stifle the financial networks of drug traffickers by adding the names of six individuals to its list of persons designated pursuant to the Foreign Narcotics Kingpin Designation Act (Kingpin Act).

This action targets individuals who represent the top hierarchy of the Arellano Felix Organization (AFO), which was named as a drug kingpin by President Bush on June 1, 2004 pursuant to the Kingpin Act.

"The AFO is considered one of the strongest and most violent drug trafficking organizations operating in the Americas. Today's action underlines the sustained effort by the U.S. Government to tackle the illicit proceeds harvested by drug traffickers," said OFAC Director Robert Werner.

The Southern District of California unsealed an indictment in July 2003 that included these six individuals on charges of conducting the affairs of an illegal enterprise through a pattern of racketeering activity (RICO), conspiracy to import and distribute cocaine and marijuana, as well as money laundering.

The six AFO leaders designated by OFAC are Jesus Abraham Labra Aviles, Gilberto Higuera Guerrero, Efrain Perez Pasuengo, Jorge Aureliano Felix, Rigoberto Yanez Guerrero and Armando Martinez Duarte. All six individuals are from Mexico. Today's action prohibits all financial and commercial transactions between the designated persons and entities and any U.S. person and freezes any assets found in the United States.

OFAC has also added five addresses in the Mexican state of Baja California that are controlled by Juan Jose Esparragoza Moreno, named a drug kingpin by the President on May 29, 2003. Four of the addresses are located in the city of Tijuana, Mexico and the other is a rural beachfront property along the coast of Baja California. Juan Jose Esparragoza Moreno was also one of several leaders of Mexico's first organized drug trafficking group, the Guadalajara Cartel, in the late 1970s and mid-1980s and was a principal member of the Carrillo Fuentes Organization (CFO) or Juarez Cartel in the 1990s. The CFO was named a drug kingpin by the President on June 1, 2004 pursuant to the Kingpin Act.

Today's action against AFO leaders and CFO-associated drug kingpin Juan Jose Esparragoza Moreno is part of the U.S. government's continued efforts to fight both notorious Mexican drug trafficking organizations.

The six new names bring the total number of Tier I and Tier II designees under the Kingpin Act to 121: 48 drug kingpins worldwide, 15 companies in Mexico, Peru and the Caribbean and 58 other individuals in Mexico, Colombia and the Caribbean.

This action is part of the ongoing interagency effort of the Treasury, Justice, State, Defense and Homeland Security Departments, the Central Intelligence Agency, the Federal Bureau of Investigation and the Drug Enforcement Administration to carry out the Kingpin Act, which was signed into law on December 3, 1999, and which applies economic sanctions against narcotics traffickers on a worldwide basis. The Kingpin Act was modeled after Executive Order 12978 which applies economic sanctions against narcotics traffickers centered in Colombia, and which is also

administered by OFAC.

For a complete list of the entities designated today, please visit:
www.treas.gov/offices/enforcement/ofac/actions/20041124.shtml

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REPORTS

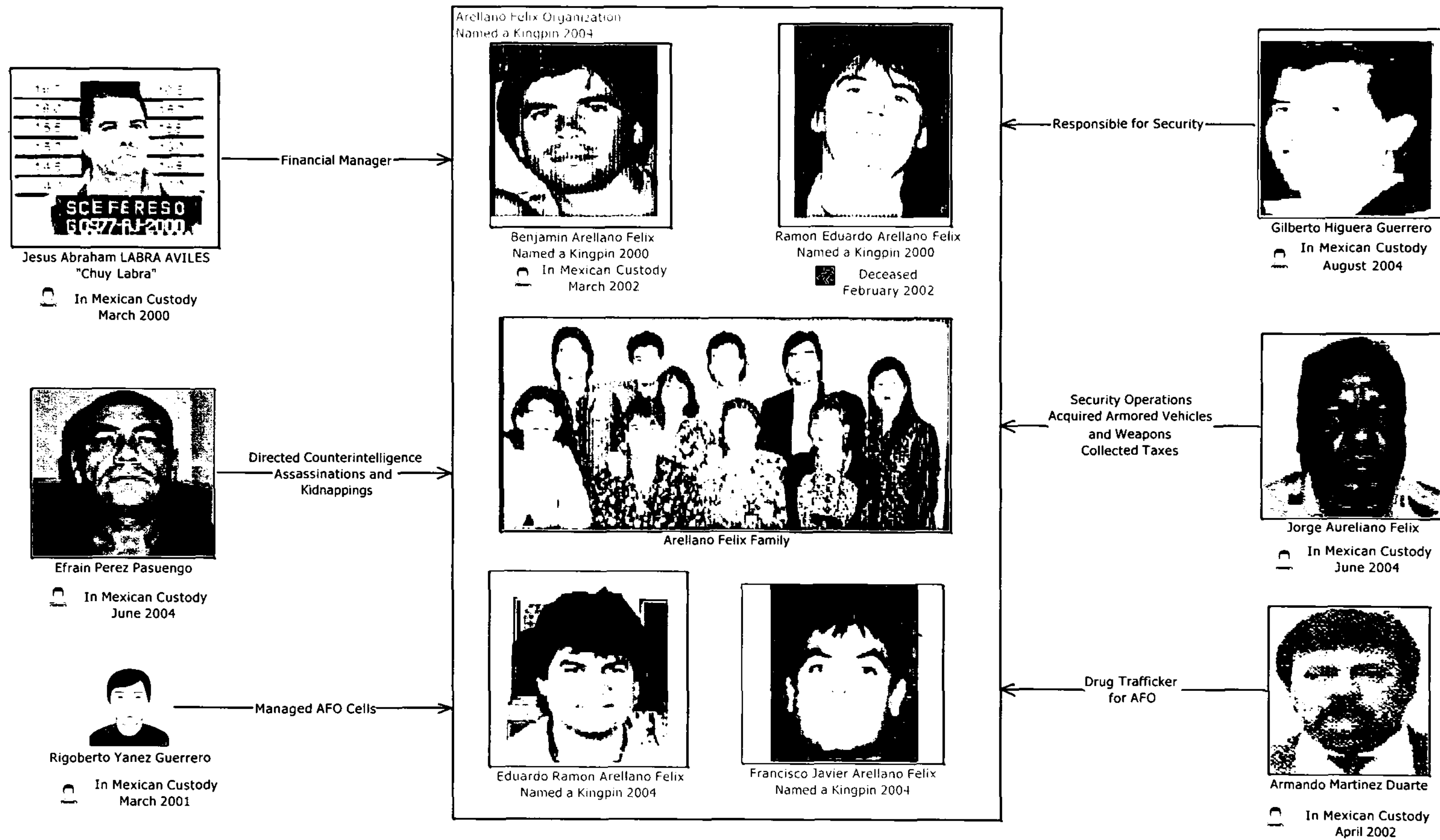
- Diagram of the Arellano Felix Organization (AFO)

Foreign Narcotics Kingpin
Designation Act
Tier II Individuals

ARELLANO FELIX ORGANIZATION

Major Lieutenants

Department of the Treasury
Office of Foreign Assets Control
Name in red text denotes
SDNTK previously designated



All 6 individuals have been indicted
by the Southern District of California
Indictment # 97-CR-2520K

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

November 22, 2004
js-2116

Economic Freedom and Georgia's Rose Revolution

John B. Taylor Under Secretary for International Affairs
United States Treasury
Remarks at the Caucasus Business School
Tbilisi, Georgia

It's a pleasure to be back in Georgia. I thank you for this opportunity to speak at the Caucasus Business School and to discuss economic issues with the future business leaders of Georgia.

When I last visited Georgia in July 2002, there was real concern about the future of the country and the economy. Now, at the one year anniversary of the Rose Revolution, Georgia is a very different country. The Rose Revolution itself stands as a tribute to the commitment of the Georgian people to peaceful democratic change. Your actions during that period were an inspiration.

My focus on this visit is on the economic change that has emerged in the year since the Rose Revolution. I have had the opportunity to meet the economic team of the Saakashvili government, and I am continuing this engagement during my visit to Tbilisi. We are very impressed both by the economic leaders and by the agenda they are pursuing. I believe that the economic reform agenda of the Saakashvili government represents a fundamentally new direction for the country. The reform agenda will increase and sustain economic growth and thereby raise living standards and reduce poverty significantly. I believe the Rose Revolution was not only a political revolution, it was also an economic revolution.

Today I would like to explain why we are so positive about this economic reform agenda and describe a novel way that we in the United States can support it.

The Economic Reform Agenda

I think it is useful to think about the economic agenda in four inter-related parts: improving government finances; cutting tax rates; reducing the size of government; and fighting corruption.

Improving Government Finances

One of the Saakashvili government's first and most impressive actions has been to improve government finances and arrest the deterioration of basic government services. The government of Georgia hadn't been paying its bills or keeping its commitments to government workers and pensioners. Public infrastructure had been deteriorating. According to a 2002 business climate survey, Georgian businesses lost an average of 110 business days a year because of infrastructure failures, largely in the energy sector.

Much of the problem involved an unwillingness to crack down on tax evasion. Unfair application of the tax laws meant well-connected individuals and businesses avoided taxes, often by bribing tax inspectors. Tax collections were very low.

By taking action on tax evasion, the government has significantly improved tax collection. In fact, tax revenues have already increased by 4 percent of GDP. As a result, this year the government has kept its budget commitments for the first time since 1997. It has cut the stock of budget arrears in half and is on track to eliminate them completely by the end of 2005. Moreover, it has begun to rebuild the country's infrastructure and renewed investments in health and education.

We saw that similar improvements in public finances in Russia in 1999-2000 led to an immediate boost in confidence which supported increased investment and growth. As wage and pension arrears were cleared, people had the income to increase consumption. Such economic benefits from higher confidence can be expected in Georgia.

Cutting Tax Rates

A second part of the reform agenda is tax reform. According to a 2003 business survey, Georgia businesses cited high tax rates and the unpredictability of the tax system as the primary obstacle to doing business. To reduce these obstacles the government is now pushing forward an impressive tax reform package. The reform would eliminate over 2/3 of existing taxes and significantly lower remaining tax rates. It would include a 12 percent flat income tax. Through greater simplification and uniformity, these changes will lower administration burdens and reduce opportunities for corruption. This gives domestic businesses greater incentives to operate openly in the formal sector and make investments. It will also lower barriers to greater foreign direct investment.

The link between lower taxes and higher economic growth is well established. In Russia and Ukraine, the reduction of personal income and corporate tax rates boosted formal business activity, increased compliance, and spurred investment. Another example, frequently cited in Europe, is Ireland where the government sharply lowered corporate and personal income tax rates. Labor force participation increased by an amazing 40 per cent in the 1990s as workers were able to take home a greater share of their pay. Foreign direct investment soared. In the central European economies, corporate tax reductions have also supported sizeable foreign investment flows.

Reducing the Size of Government

A third area of reform is the reduction of the size and scope of government. This makes a great deal of sense because by almost any comparison, the government sector is too big and the private sector too small in Georgia. The private sector accounts for only 40 percent of total employment in Georgia compared to 75 percent in Armenia and 80 percent in Estonia.

To begin to rectify the situation, the government has already reduced government employment by an estimated 50,000. The Economy Minister plans to eliminate his own ministry by 2007. Such actions will also allow pay increases for remaining civil servants, reducing the incentive for corruption.

At the same time, Georgia still has too many state-owned enterprises tying up valuable human capital. The Economy Ministry plans to privatize 1,800 state enterprises employing 180,000 people by 2007. Such privatizations further support a market-based allocation of capital and job creation in the economy.

International comparisons show that reducing the size of government has dramatic positive effects. Considering Ireland again, a reduction in the size of government was a fundamental part of the Irish success story. The government reduced expenditures implementing a hiring freeze, accelerating retirements, cutting subsidies to state enterprises, and imposing a 10 percent across the board cut in all department budgets. As a result government expenditure as a share of GDP fell by 20 percent by the end of the 1980s.

In transition economies like Georgia, the response to privatization in terms of higher

growth can be quick. In Hungary, for example, the privatizations of the early 1990s helped increase growth sharply by the mid 1990s. In Armenia, a renewal of the privatization process in 2001-2002 was followed by annual economic growth rate above 13 percent in 2003-2004.

Fighting Corruption

Now let me consider the fourth area: fighting corruption. Georgia ranked 133 out of 145 in Transparency International's Corruption Perceptions Index. That President Saakashvili was elected on a strong anti-corruption platform has given his government the opportunity to address this serious problem.

In fact, fighting corruption is fundamental to the whole economic reform agenda. Public finances can't be improved without fighting corruption among tax inspectors. A simpler, low rate tax code uniformly applied provides fewer incentives to evade. Fewer bureaucrats mean fewer bribes. Private ownership of business means success is determined by the company's bottom line and not its political connections. Finally, battling corruption requires accountability of the government to the people. The new government demonstrated its commitment to this principle by working hard to ensure free and fair elections following the Rose Revolution and not simply accepting the immediate outcome of the Rose Revolution as the final say of the people.

United States Support through the Millennium Challenge Account

These recent developments in Georgia show that good economic policy reforms don't just "happen". You need to understand the problem you are trying to solve, come up with a proposed solution, and then get the solution implemented. You need political will perhaps most of all. I think this is what the government has been doing since the Rose Revolution and it is clearly leading to good results.

The challenge for the international community, which has provided over $3.4 billion in assistance to Georgia since its independence, is how to support successful cases like Georgia after the Rose Revolution. To this end, I believe the Millennium Challenge Account (MCA) represents a revolution of sorts in the way we think about development assistance.

The MCA was designed to address impediments to economic growth in poor countries by rewarding governments implementing policies to remove those impediments. These impediments can be grouped into three areas:

1. Poor governance, including the lack of rule of law or enforceable contracts and the prevalence of corruption, raises the cost of doing business and creates disincentives for the private sector to create high-productivity jobs.
2. Inadequate investment in the development of human capital. Workers without adequate education do not build the skills to take on high-productivity jobs or adopt new technologies to increase the productivity of the jobs they do have. Better health care reduces absenteeism from work, which improves productivity.
3. Restrictions on markets prevent labor and capital from flowing to their most productive use and they restrict consumers' access to low cost goods and services. Lack of openness to international trade, monopolistic state marketing boards, and excessive regulations and red tape are all examples of restrictions that create disincentives for the private sector to invest and innovate so as to boost productivity.

Hence, the main principle underlying the MCA: focus economic development assistance on nations that (1) govern justly, (2) invest in people, and (3) encourage economic freedom. Policies promoting these goals underpin successful growth, catalyze private investment, and increase the effectiveness of aid. We have developed 16 indicators that are used to assess countries' performance against these three goals and then the Board of the Millennium Challenge Corporation (MCC) selects countries for MCA-eligibility after analyzing their performance.

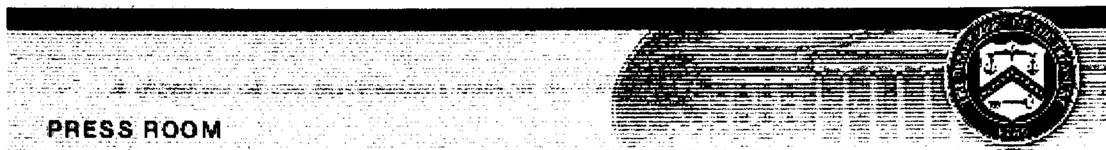
In Georgia's case, the country was selected as eligible to receive MCA assistance in 2004 having surpassed the median in at least half of the indicators in the "investing in people" and "economic freedom" categories. In the case of the "ruling justly" category, the MCC Board felt the "Corruption" indicator, which showed Georgia performing poorly, did not capture the substantial progress made by the newly elected government. The Board cited as evidence: the creation of an anti-corruption bureau; a new bureau to investigate and prosecute corruption cases; a single treasury account for all government revenue to ensure transparency and accountability; and the revamping of procurement legislation to ensure an open and competitive process. I believe the steady progress made by the government since then shows that the MCC board decision was the correct one.

The MCA indicators are a useful guide for areas of improvement. For Georgia, the indicators show relatively poor performance on the health and primary education expenditure indicators in the "investing in people" category. On health expenditures, Georgia was in the 8th percentile relative to the 74 other countries used to assess performance. On primary education expenditures, Georgia was in the 7th percentile. Partially in response to the poor outcomes identified by the MCA indicators, the government has made increasing social expenditures a priority. In the case of health, expenditures are expected to increase by almost three times to 1.3 percent of GDP – the exact kind of response that MCA was designed to elicit.

Conclusion

From my discussions with President Saakashvili's economic team, it is clear that the government of Georgia has a vision of economic freedom that matches their commitment to democracy. They are endeavoring to implement that vision through a bold economic reform agenda of improved government finances, low marginal tax rates, a dramatic reduction in the size of government, and vigorous anti-corruption efforts.

Economic reforms like these are never easy to implement, and the benefits are not always are immediate. But as I have indicated in these remarks such a reform agenda is the proven way to raise incomes and reduce poverty. It is a reform agenda that warrants our support, and one which we hope to see replicated in many other parts of the world.



FROM THE OFFICE OF PUBLIC AFFAIRS

November 8, 2004
JS-2117

Remarks of Mark J. Warshawsky
Assistant Secretary for Economic Policy
Keynote Speech for the 14th Annual Investment ActuarySymposium
Boston, Massachusetts

It is a great pleasure to be here this morning and to address a group that shares an interest in some of the primary issues that occupy my time in Washington. As Assistant Secretary for Economic Policy, one of my key responsibilities is to advise the Secretary of the Treasury on appropriate policies for matters of both macroeconomic and microeconomic significance. Today, I'd like provide you with a macroeconomic overview with a special focus on interest rates and also tell you a little about what we have been doing in several areas foremost on our agenda: Social Security, the defined benefit pension system, and our study of the federal terror risk insurance program. Finally, I will conclude with a brief discussion of an insurance product innovation of my own – the life care annuity.

MACROECONOMIC OVERVIEW

Overall, the performance of the economy has been impressive, particularly given the unusual succession of negative events it has had to withstand over the past several years. The bursting of the NASDAQ bubble in early 2000 was the beginning of significant weakness that took hold that year. Real GDP declined in the third quarter of 2000 and industrial production began to fall. By March 2001, we had officially entered recession and its effects were compounded by the terrorist attacks of September 11. The economy appeared to be on a recovery path in early 2002, when growing evidence of widespread corporate malfeasance dating back to the late 1990s once again undermined business activity. Slow growth abroad provided an additional headwind and the war with Iraq further raised uncertainty in the early part of 2003.

Fortunately, the combination of rapid monetary policy accommodation and perhaps the most well-timed fiscal policy response in our history resulted in the smallest GDP loss of any recession in the post-World War II era. Additional fiscal policy measures – especially the passage of the President's Jobs and Growth Plan in spring of last year – boosted household incomes to support consumption, offered tax relief on dividends and capital gains for stockholders, and provided large and small businesses with incentives to undertake investments in equipment.

The response to the Jobs and Growth Plan – also known as JGTRRA in Washington parlance, standing for the "Jobs and Growth Tax Relief Reconciliation Act" – was immediate. Real GDP surged at a 7.4 percent annual rate in the third quarter of 2003, when the full effect of JGTRRA kicked in. Real growth remained strong in the ensuing quarters and over the past year and a half has risen at a 4.5 percent annual rate – a healthy performance by any standard. JGTRRA also marked the beginning of solid job creation. Payroll employment began to rise in September 2003 and by this October we had recorded 14 straight monthly increases and a total of 2.4 million new jobs. The unemployment rate stands at 5.5 percent – below the average for any of the previous three decades.

The composition of economic growth has transitioned much as we had hoped. The consumer supported the economy throughout the recession, responding strongly to generous financing incentives offered by the auto industry. More recently, business investment has been the key driver. Real investment in equipment and software has grown at a 13.5 percent annual rate over the last six quarters, supported by rising profits, low interest rates, and declining risk spreads. Investment in structures is also making a comeback, rising in four of the last six quarters.

Along with investment in capital goods, residential investment also continues to be remarkably strong. Demand has held up very well, as 30-year mortgage interest rates have remained below 6 percent, generating record-high home sales so far in 2004.

While low longer-term rates evolved naturally as the economy weakened in 2000 and then were assisted by the Federal Reserve's monetary policy accommodation at the beginning of 2001, continuing low rates are in large measure the response to another hallmark of the current economy: the relative absence of inflation. In the third quarter, prices for personal consumption expenditures excluding food and energy were up at only a 0.7 percent annual rate – the smallest increase in more than 40 years. Low inflation is consistent with the phenomenal growth of productivity that we have witnessed throughout the current business cycle. Since the end of 2000 – a period that includes both recession and recovery – nonfarm productivity has risen at a 3.9 percent annual rate, much faster than the already-strong 2.6 percent pace averaged from 1995 through 2000.

The economy nonetheless faces some headwinds, particularly from oil prices and the trade deficit. Although the oil intensity of U.S. GDP has fallen by nearly half since the first oil shock in the early 1970s, the price of oil remains a key variable in the macro outlook. The Administration authorized the release of oil from the Strategic Petroleum Reserve in response to the temporary reduction in oil production from the Gulf of Mexico resulting from the recent run of hurricanes. This has helped contain prices and illustrated the long-held Administration stance that the SPR should be used only in the case of a true supply disruption. At the same time, the still-high price of oil also illustrates the importance for our economic security of following through on the Administration's proposals to enhance domestic energy supplies and to adopt technologies to use energy more efficiently.

The U.S. deficit on trade has also exerted a restraint on growth. Over the past six quarters, the net export deficit has reduced real GDP growth by an average annual rate of 0.5 percentage point, as imports have been rising faster than exports. The relatively stronger performance of the U.S. economy than of its major trading partners continues to be a factor in the widening trade gap.

Despite these difficulties, it is clear that the economy is now enjoying above-trend, noninflationary growth because of the policies of the past three and a half years. These policies have helped assure strong growth in the future by improving the after-tax rewards to work, increasing the returns to innovation and risk taking, and reducing the cost of equity capital through lower taxes on dividends and capital gains. A tax system that supports greater risk-taking, saving and investment, and innovation means greater productivity and capital accumulation and ultimately a higher standard of living.

Pro-growth policies have yielded a fiscal dividend. Federal revenues have rebounded and growth of outlays has slowed. As a result, the federal deficit for FY 2004 came in at $413 billion, equivalent to about 3.6 percent of GDP, and much below the $521 billion expected in the budget forecast made earlier this year. Overall, the current deficit – though unwelcome – appears manageable compared to deficits in the 4.5 to 6 percent of GDP range at various times in the 1980s and 1990s. With continued economic growth and job creation, along with spending restraint, the President has a plan to cut the deficit in half over the next five years to less than 2 percent of GDP.

The current federal deficit is being interpreted by financial markets, correctly in my view, as a necessary response to a serious but temporary economic situation. Thus, prophecies that the swing from surplus to deficit would result in sharply rising interest rates have failed to materialize. For those who subscribe to the "twin-deficit" theory – that the federal deficit is responsible for the current account deficit which will ultimately lead to high interest rates – there is also an absence of substantiating evidence. While foreign capital flows are volatile from month to month, the reality is that they have been more than sufficient to finance the current trade deficit without higher interest rates.

Financial markets are reflecting the fundamentals of the U.S. economy: strong real GDP growth, high productivity, low inflation, and a friendly tax environment. As the economy has strengthened, the Federal Reserve has begun the process of removing monetary policy accommodation. Starting at mid-year, short term interest rates have risen about 75 basis points, coming off near 50-year lows. But longer-

term yields have actually fallen about 50 basis points since short rates started rising. The spread between rates on 10 year notes and 90 day bills was about 330 basis points in late June; now it is roughly 200 basis points. Across business cycles, that spread has averaged about 140 basis points since 1959.

Low interest rates have overall been very positive for the economy but they also represent a challenge for defined-benefit pension funding, because they suggest lower rates of returns on bonds and less discounting of future cash flows. This increases plan under-funding and results in a requirement for increased employer pension contributions; such pro-cyclical funding may have in part been responsible for recent business caution in investment and hiring actions. It is therefore extremely important that the issue of pension funding be addressed in a comprehensive fashion. A bit later in my remarks, I will discuss the Bush Administration's approach to these issues.

SOCIAL SECURITY REFORM

President Bush has said that "Social Security is one of the greatest achievements of the American government, and one of the deepest commitments to the American people." The President supports Social Security reform that increases the power of the individual, does not increase the tax burden, and provides economic opportunity for more Americans. Today I want to discuss why reform is needed, why delay is costly, and the important role for personal retirement accounts in that reform.

At the end of 2003, the Social Security program paid about $470 billion in benefits to about 47 million beneficiaries, making it the largest federal transfer program in the United States.

The Social Security system began in the aftermath of the Great Depression with the passage of the 1935 Social Security Act that established the "Old-Age" portion of the program. Initially, the program was intended to provide cash benefits to persons age 65 and over who had made payroll contributions to the system with benefits based on the value of those contributions. Contributions would begin in 1937 and benefit payments would start about five years later. An accumulating trust fund would help pay benefits as the number of beneficiaries increased. Even before the first benefit was paid, however, benefit provisions were expanded in 1939 to include spouses and survivors insurance, the benefit formula was made more generous, and scheduled tax increases were delayed. Disability benefits were added in 1956. Before 1972, benefit increases were made on an ad hoc basis and four double-digit increases occurred between 1968 and 1972 (20 percent in 1972). Though an accumulating Trust Fund was envisioned, the system has operated primarily on a pay-as-you-go basis with a modest Trust Fund having developed in recent years. Therefore, tax increases have been steadily implemented to ensure the continuation of annual benefit payments. But, as I discuss below, the increases fell well short of what would be needed to pay lifetime benefits to a growing and longer-living beneficiary population.

In 1950, there were 16 workers to support every one beneficiary of Social Security. Today, there are only 3.3 workers supporting every Social Security beneficiary. By the time our youngest workers and others now entering the workforce turn 65, there will only be two workers supporting each beneficiary.

Moreover, in 1950, men and women age 65 could expect to live, on average, 12.8 and 15.1 more years, respectively. In the year 2000, life expectancy at age 65 had increased to 15.7 for men and to 19 for women. By 2030, these conditional life expectancies are projected to increase to 17.7 for men and 20.6 for women. Longer lives are clearly a good thing but they do mean a longer period over which Social Security (and Medicare) benefits must be paid.

As a result of these demographic changes and the generosity of benefit payments to prior generations, the current system will not be able to afford to pay the benefits scheduled for our children and grandchildren without enormous payroll tax increases. The Social Security payroll tax, which was 3 percent in 1950, is now 12.4 percent. The Social Security actuaries calculate that, if the system were to continue to operate on a pay-as-you-go basis and pay currently-scheduled benefits, the payroll tax would have to rise gradually, but steadily, to more than 19 percent before the end of the next 75 years.

But financial pressure on the federal budget (hence on taxpayers) begins much earlier. Tax revenue (payroll taxes plus benefit taxes) is expected to fall short of benefit payments less than 15 years from now (in 2018). Under the current Social Security financing structure, this growing annual revenue gap will be made up from federal general revenues for another 24 years (until 2042). After 2042 the authorization to fill the gap from general revenues ends (the Trust Fund is exhausted) and, in the absence of legislation, full benefit payments cannot be made after that time.

The important point is that the Social Security system is significantly under funded – future scheduled revenue will be inadequate to fully pay scheduled benefits. The 2004 Report of the Social Security Trustees estimates that, over the next 75 years, the present value of Social Security's deficit (i.e., the unfunded obligation) is about $3.7 trillion. For perspective, this deficit could be eliminated if payroll taxes were raised immediately by 1.9 percentage points (to 14.3 percent) (and a large Trust Fund would be accumulated) or if all current and future benefits were reduced by 13 percent.

Yet, 75 years, though a seemingly long time, does not capture fully the financial status of the Social Security program. In fact, no fixed finite period will completely embody the financial status of the program because people pay into the system when they are young and receive benefits when they are older and an arbitrary cutoff will miss some taxes and, especially, benefits to be paid. So estimates even over the long period of 75 years include a lot of payroll revenue from future workers who will not begin to receive benefits until after the 75-year horizon. The omission of future benefits is especially critical in an underfunded program facing the retirement of the baby boom generation. In order to get a complete picture of Social Security's permanent financial problem, the time horizon for calculating income and outgo must be extended to the indefinite future. I will note for this audience that Robert Myers, a former chief actuary of Social Security, in his classic book on the program stated that the infinite horizon was the appropriate period of analysis for the program. I am proud that we have been able to add such a measure to the Trustees Report during my tenure at Treasury. Such a calculation is provided in the 2004 Trustees Report which estimates that, for the entire past and future of the program, the present value of scheduled benefits exceeds the present value of scheduled tax income by $10.4 trillion. This is the financing gap that program reforms must ultimately close. To put this in perspective, eliminating the permanent deficit would require an immediate and permanent increase in the payroll tax rate of 3.5 percentage points (to 15.9 percent) (and the accumulation of a massive Trust Fund). Alternatively, all current and future benefits would have to be reduced immediately by 22 percent.

These results make clear that the Social Security system is not financially viable over the long term – it must be fixed – so doing nothing is not an option. How to close the permanent financing gap raises difficult questions over how the burden should be shared across generations. In this context, it is important to recognize that the large unfunded obligations in the system ($10.4 trillion) are in large part the consequence of the past system generosity. From the beginning, the Social Security program made benefit promises to generations that far exceeded the taxes they would pay over their lifetimes. Of course, past generations are past – they cannot contribute to reducing the unfunded obligations. As a consequence, closing the financing gap falls to future generations and this leads to the obvious but very important point that the longer reform is delayed the greater the number of future generations that also become past generations that cannot contribute – that is, delay means a greater burden on current and future generations.

Fortunately, this situation is fixable. The President has issued guiding principles for reforming Social Security. One very important principle is that seniors at or near retirement should be protected from benefit cuts, and that payroll taxes should not be increased.

Another principle is that personal retirement accounts (PRAs) should be made available for younger workers to build a nest egg for retirement that they own and control, and which they can pass on to their children and grandchildren.

Additionally, we must pursue the goal of a permanently sustainable system, eschewing reforms that treat only symptoms and halfway measures. As I noted above, halfway reform simply means a greater burden on future generations.

I would like to focus on the advantages of PRAs. PRAs provide individual control, ownership, and are important vehicles for pre-funding more of our Social Security benefits without encouraging more government spending. PRAs also offer individuals the opportunity to receive the benefits of investing in private-sector markets. Individual control and ownership means that people would be free to pass the value of accounts to their heirs.

Perhaps most importantly, the retirement security of our current young and future workers depends on PRAs. They will allow individuals to save now to help fund their retirement incomes. In principle, that could be done with reforms that save tax revenues in the Social Security Trust Fund. But such "saving" would almost certainly be undone by political pressures to increase government spending and hence produce larger deficits outside of Social Security. The only way to truly save for our retirement and give our children and grandchildren a fair deal is with personal accounts.

The appeal that PRAs have for individuals also serves as an impetus for Social Security reform. Because most people like the idea of ownership and control over their savings accounts, as voters they are more likely to support a reform of this type.

Setting up a new system of personal retirement accounts will require careful planning and the policy options that are chosen could have a significant affect on administrative costs. However, the challenges of reform are outweighed by the need for reform, and the potential benefits are great.

DEFINED BENEFIT PENSION REFORM

I will next discuss private sector defined benefit pension issues, why reform is needed, and provide an overview of what we have identified as important principles for this reform.

Before I discuss these proposals, let me briefly give you some background on the state of the regulatory structure of the defined benefit system.

Defined benefit plan sponsors today are subject to the "ERISA" funding requirements. Under current ERISA funding rules, adequate funding is defined in terms of the actuarial liability based on a specific actuarial funding method. An exception to this general rule occurs if the market value of pension fund assets is less than 90 percent of the current liability. Plans whose funding falls below this threshold are subject to the Deficit Reduction Contribution (DRC) rules which increase required annual contributions.

In addition to providing funding rules, ERISA created the Pension Benefit Guaranty Corporation (PBGC). The PBGC collects insurance premiums from employers that sponsor defined benefit pension plans and it pays monthly retirement benefits to participants of failed plans. Currently, PBGC insures the pensions of 44 million workers and retirees and pays benefits to over 930,000 people from failed plans.

PBGC's financial health suggests that we need to be concerned about the current set of funding rules for plan sponsors, the PBGC premium structure, and the long-term solvency of both PBGC and the defined benefit system.

The PBGC's single employer plan program ended 2003 with a record deficit of $11.2 billion. This deficit is the result of two consecutive years of staggering net losses. While I can't yet discuss 2004 results, it is fair to say that it is likely that the deficit will be higher.

The PBGC deficit will be increasing significantly for this fiscal year as a result of problems with airline company pensions. While the PBGC does have sufficient resources to pay benefits for a number of years, this Administration recognizes we must act now to ensure the longer-term solvency of the pension insurance program.

As I mentioned above, the ERISA funding requirements include a deficit reduction contribution or DRC. The role of the DRC is to act as a minimum threshold for plan funding. Plan funding experience prior to the introduction of the DRC showed that basic system was not effectively leading to funded pension plans. The DRC is a

backstop system. Plans that are persistently under funded based on the current liability measure employed by the DRC must make mandatory catch-up contributions. In particular, firms that fall into this category must make up the amount of the obligation that is unfunded over three to seven years.

Thus, the current ERISA system is a balance between a system that has proven to ineffective in inducing firms to fund their pensions because it is effectively riddled with loopholes and a minimum funding backstop which causes contributions of under funded plans to be excessively volatile from year to year. This is certainly not a healthy situation.

Add to this mix a pension benefit insurance system that does not adequately reflect risk in setting premiums and you have a recipe for a significant long-term problem. A properly designed insurance system has various mechanisms for encouraging responsible behavior – dealing with moral hazard - that will lessen the likelihood of incurring a loss and discouraging risky behavior that heightens the prospects of claims. However, the current pension insurance system can be gamed. A weak company will have incentives to make generous pension promises rather than increase wages. Employees may go along because of the federal guarantee. If the company recovers, it may be able to afford the increased benefits. If not, the costs of the increased benefits are shifted to the insurance fund. Similarly, a company may increase asset risk when it is under funded to try to make up the gap, with all the upside gain benefiting shareholders and the downside risk being shifted to other premium payers.

Finally, it is important to note that pension practitioners and CFOs have been preaching for years that limits on maximum deductible contributions are requiring sponsors to manage their funds within a narrow range and that raising the limits on deductible contributions would allow sponsors to build larger surpluses to provide a better cushion for bad times.

Both the current funding rules and pension insurance program lack basic checks and balances. There is too little opportunity for plan sponsors to act responsibly and too little consequence when plan sponsors act irresponsibly.

The goals of pension reform are twofold -- corporate responsibility and retirement security. Simply put, companies should be held accountable to make good on the pension promises they have made to their workers and retirees. The consequences of not honoring these commitments are unacceptable--the retirement security of millions of current and future retirees is put at risk.

Before discussing comprehensive reform, I would like to briefly discuss one important aspect of the proposals that the Administration had already put forward in July of 2003.

As part of the Administration's proposal to improve the accuracy and transparency of pension information we would have required that pension liabilities be measured more accurately. Accurate measurement helps ensure that pension plans are adequately funded to protect workers' and retirees' benefits and also that minimum funding rules do not impose unnecessary financial burdens on plan sponsors. Liability estimates that are too low will lead to plan under funding, 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. We therefore proposed that a corporate bond yield curve be used to measure pension liabilities. This proposal has garnered quite a bit of attention in the pension and actuarial communities. Unfortunately this proposal was not enacted, but I still believe it is an important component of pension reform. In my office at Treasury, we have spent time over the past year developing yield curves based on high quality corporate bonds.

At this point, I'd like to discuss fundamental pension reform. Clearly, I think the current pension funding and insurance systems need to be overhauled. We are developing a plan for a pension system that will be less complex, more flexible, logically consistent, and will achieve the goal of improving the security of defined benefit plans. The Administration strongly believes that a reform plan must have several characteristics:

- The proposal will center on the use of real incentives to motivate desired

behavior and frees responsible plans from burdensome regulation.

- The proposal will include improvements in pension asset and liability measurement, economically meaningful funding targets, and enhanced disclosure.
- The proposal will provide greater opportunity and incentive for employers to fund up in good times to ensure against economic shocks, and reduce the volatility of minimum required sponsor contributions.
- The proposal will improve the PBGC's ability to deal with firms that fail to make contributions while in bankruptcy; and
- The proposal must include a premium structure for the PBGC that meets its long-term revenue needs and reflects the risks that it covers.

When under funded pension plans terminate, three groups can lose: workers face the prospect of benefit reductions; other companies, including those that are healthy and have well funded plans, may face higher PBGC premiums; and, ultimately, taxpayers may be called upon by Congress to bail out the pension insurance fund, just as was the case more than a decade ago with the savings and loan bailout. This is the unfortunate result of a system that allows – and, one might even argue, sometimes encourages – companies to avoid paying for the promises they have made. This Administration wants to move towards a system that emphasizes employers' responsibility for their pension promises and the empowerment of employees through better information.

TRIA SURVEY

The Terrorism Risk Insurance Program (TRIP) was established by Congress through the Terrorism Risk Insurance Act of 2002 (TRIA). The TRIP is a temporary federal system of shared public and private compensation for insured losses resulting from foreign acts of terrorism. The objectives of the TRIP are:

- to ensure continued widespread availability of property and casualty insurance for terrorism risk; and
- to provide a transition period for private markets to stabilize, resume pricing, and build capacity while preserving state insurance regulation and consumer protection.

I am involved in this issue because my office is conducting a series of nationally representative surveys on TRIA. These surveys will provide data that we will use in preparing a congressionally mandated report on the program that is due next June. As I am sure many of you are aware, TRIA is scheduled to sunset at the end of 2005. While there has been a great deal of discussion about whether TRIA should or should not be extended, the Treasury Department believes it is premature to engage in such discussions until we evaluate the data and issue our report in June of 2005.

Today, after providing a bit of background on the program, I am going to discuss our surveys and why we believe they will be a unique source of information about TRIA.

Insurer participation in the TRIP for covered lines of business is mandatory. Insurers must make TRIA-eligible terrorism coverage available in commercial property, workers compensation, and other liability lines under terms and conditions comparable to coverage for non-terrorism events. It is important to note that does not mean insurers are required to provide such coverage, just to make an offer. There are no federal restrictions on rates or policyholder purchase decisions. However states do not permit the exclusion of terrorism insurance from workers compensation coverage.

In the event of a TRIA certified terrorist event, an insurer's exposure consists of a deductible that is a percentage of the prior year direct earned premiums across all applicable lines (not just terrorism) and a co-payment equal to 10 percent of insured losses above the deductible. Under certain conditions, insurers are also subject to post-event "mandatory recoupment" fees. In 2003 insurer deductibles for TRIA-eligible coverage were 7 percent of total 2002 directly earned premiums. They are now 10 percent of total 2003 directly earned premiums, and in 2005 they will be 15 percent of 2004 directly earned premiums. Total annual liability for the federal government and for insurers jointly is capped at $100 billion.

The Congressionally mandated study has three basic objectives:

- to assess the effectiveness of the Terrorism Risk Insurance Program;
- to evaluate the availability and affordability of terrorism risk insurance for various policyholders, including railroads, trucking and public transit; and
- to assess the capacity of the property and casualty insurance industry to offer terrorism risk insurance after the program sunsets, by law, on December 31, 2005.

To assess the program's effectiveness in addressing insurance market disruptions and ensuring widespread availability and affordability of terrorism coverage, Treasury must consider changes in TRIA-eligible insurance coverage purchased and premiums for terrorism risk covered by TRIA during the existence of the program, and immediately prior to its establishment. We are conducting panel surveys; that is, we are collecting data repeatedly from the same set of survey respondents, in order to measure year-over-year changes. There are three surveys. The largest is the survey of policyholders. We are also surveying insurers in TRIA-eligible lines. And to learn about the availability of reinsurance for terrorism coverage, for which the temporary federal program substitutes, we are surveying reinsurers. Our general strategy is to observe how policyholders, insurers, and reinsurers' terrorism insurance experience and behavior have evolved over the life of TRIA.

Each survey is collecting information on coverage purchased within broad TRIA-eligible lines as well as other factors that influence the decision to provide or purchase terrorism insurance coverage and the price at which it is purchased or provided. The factors include policyholder and insurer characteristics, overall risk management strategies, and other factors influencing the demand for, and supply of, insurance for non-TRIA terror risks. We believe this detailed micro data will provide us with the information we need to better understand issues related to who takes terrorism coverage, who offers coverage, and at what prices.

Access to a robust reinsurance market is considered an important determinant of the capacity of the property and casualty insurance industry to offer terrorism risk insurance after the program sunsets. We are therefore soliciting data about the reinsurance through both our survey of insurers and our direct survey of reinsurers. Our insurer survey also collects data on the availability of reinsurance for deductibles and co-payments for TRIA-eligible coverage, and for non-certified coverage. Survey data will also be collected from reinsurers to assess their capacity to offer coverage for this risk to primary insurers.

Data collection for the first wave of the policyholder and insurer surveys began last November and ran through mid-April of this year. Slightly more than 33,300 policyholders and insurers were contacted. Response rates have been especially good in the insurer survey. The second wave of data collection for these groups is now underway, and the reinsurers' questionnaire should be in the field in the next week or two.

As I mentioned, I believe the Treasury data will be a unique resource in helping us understand the dynamics of the terrorist risk insurance market. These critical data are not available from any other source. I believe that because we acted in a timely manner to respond to this important charge from Congress and have designed and fielded these detailed multi-year longitudinal surveys, we will have the data we need. Our survey is unique. We are touching on all parts of the market. We believe we have enough detailed information to really learn something new about the determinates of participation in this market. Finally, because we have designed our survey as longitudinal study, we believe we will be able to better assess the dynamics of the markets.

Undertaking any nationally representative survey is a complex and arduous undertaking. In this case, the complexity and difficulty are increased because we are operating under a tight deadline and attempting to get detailed information from three unique groups. Nevertheless we are pleased with our progress to date, and believe, ultimately, we will have a better understanding of the terrorism risk insurance market because of these efforts.

Thanks!

LIFE CARE ANNUITY

Finally, I'd like to conclude with a brief discussion of an insurance product innovation I have been working on for many years – the life care annuity. Use of long-term care by the elderly is projected to double between 2000 and 2050. Financing of long-term care is likely to be a challenge. The life care annuity combines an immediate life annuity with the disability form of long-term care insurance. In return for a single premium, an insurance company would make steady periodic payments to a retired household (individual or couple), and would increase them substantially when a member of the household becomes disabled to the extent that he would require long-term care services.

Such a product could offer economic security for retirees by providing a steady stream of income combined with protection in the event of catastrophic costs associated with disability. The important innovation is that by linking the annuity with the long-term care insurance, we pool populations with two different risks: individuals who are likely to be long-lived and individuals who are in relatively poor health. This pooling allows the integrated product to be sold more cheaply than a comparable life annuity and long-term care insurance policy purchased separately. Another benefit is that the pooling of risks also allows individuals who would not ordinarily pass underwriting for long-term care insurance to be eligible for the product, thus expanding the market.

While the long-term care insurance market is young, I believe the life care annuity could become an important element in financing the long-term care needs of certain elderly populations. Importantly, such an approach would reduce dependence on public programs like Medicaid, and would work well as a distribution mechanism from qualified retirement plans and Social Security PRAs.

There are still several open questions before such a product may be viable. Obviously, in my role as Assistant Secretary, I am not advocating that insurers enter any particular line of business; I leave the private sector to the private sector. I do, however, think this idea is a potentially important innovation that has real societal benefits.

CONCLUSION

In summary, the U.S. economy has responded well to the fiscal and monetary policies of the past several years and is currently on a solid growth path. Our task now is to secure the health of the economy in the future by facing our longer-term challenges. I expect the coming months and years to be a busy and productive time at the Treasury Department. As I have discussed today, fixing Social Security is a critical and urgent issue and I believe personal accounts are an important part of the solution. The defined benefit pension system provides retirement income for 44 million Americans; therefore adopting reforms that improve plan funding and ensure the long-term solvency of the system and the PBGC are critical. We look forward to sharing our findings about TRIA at the appropriate time. And if insurers are interested in pursuing the life care annuity idea, my interest in championing it will continue.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

November 30, 2004
JS-2118

Statement by Treasury Secretary John W. Snow on GDP Report

We learned today that America's Gross Domestic Product (GDP) grew even faster in the third quarter than we previously thought, with GDP rising at a solid rate of 3.9 percent. Today's report illustrates the strength of the U.S economy, and shows how its underlying fundamentals are ensuring sustainable, non-inflationary growth.

Consumer spending was particularly strong in the third quarter, the strongest since the fourth quarter of 2001, and this is a major key to our economy's strength.

Thanks to the President's economic policies that put more money into taxpayers' pockets and that enhance the incentive to work and invest, our economy is on a steady path of growth; today's GDP number is good news for all Americans.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 1, 2004
JS-2119

Treasury Deputy Assistant Secretary Iannicola to Keynote at Annual Meeting of Georgia Consortium for Personal Financial Literacy in Atlanta

Treasury's Deputy Assistant Secretary for Financial Education, Dan Iannicola, Jr., will deliver the keynote address at the annual meeting of the Georgia Consortium for Personal Financial Literacy, the Georgia Jump$tart affiliate. Iannicola will highlight the potential of financial literacy to change lives and will explain how grass roots organizations can help improve and expand financial education in Georgia.

The Georgia Consortium for Personal Financial Literacy works with businesses and state and local governments to implement policies and practices that encourage wise personal finance decision-making. The Jump$tart Coalition for Personal Financial Literacy is a non-profit organization that seeks to improve the personal financial literacy of young people.

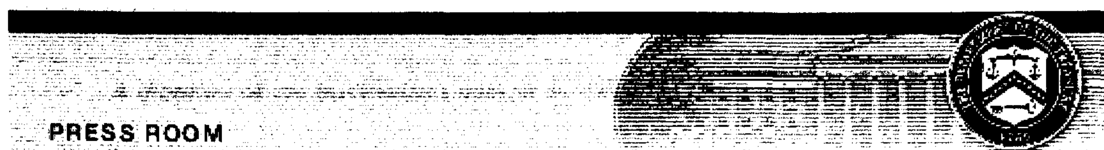
WHO Treasury Deputy Assistant Secretary for Financial Education, Dan Iannicola, Jr.

WHAT Remarks on the importance of financial literacy and how to improve and expand financial education in Georgia

WHEN Thursday, December 2, 2004
12 p.m. EST

WHERE Federal Reserve Bank of Atlanta
1000 Peachtree Street, NE
Atlanta, Georgia

***Due to security considerations, media planning to attend should call Jean Tate of the Atlanta Fed at (404) 521-8035.**



FROM THE OFFICE OF PUBLIC AFFAIRS

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December 1, 2004
JS-2120

Treasury and IRS Issue Guidance on Trade Show Activities

The Treasury Department and the IRS issued guidance today on the tax treatment of Internet activities conducted by a trade association in conjunction with a trade show.

The revenue ruling extends the current-law exception from the definition of unrelated trade or business for "qualified convention and trade show activity" to Internet activities that are ancillary to a convention, annual meeting or trade show. A "convention, annual meeting, or trade show" is a specific event at which individuals representing a particular industry and members of the public gather in person at one location during a certain period of time.

The ruling concludes that making the same information that is available at a trade show available on the Internet, during approximately the same time period as the trade show itself, is a "qualified convention and trade show activity." Making the same information available on the Internet enhances and augments the trade show by allowing interested persons to preview the show before attending and follow up on information gathered at the show. The ruling also concludes that Internet activities that are not ancillary to a convention, annual meeting, or trade show do not qualify for the statutory exception for conventions, annual meetings, and trade shows.

"The Internet is a valuable tool that organizations can use to supplement their trade shows by making available in a different medium the same information that is available at the event," said Treasury Acting Assistant Secretary Greg Jenner. "The UBIT exception for qualified trade shows is narrow, but this guidance makes clear that ancillary Internet activities fall within the exception."

REPORTS

- Rev. Rul. 2004-112

Part I

Section 513.--Unrelated Trade or Business

26 CFR 1.513-3: Qualified convention and trade show activity.

Rev. Rul. 2004-112

ISSUE

Under the circumstances described below, do Internet activities conducted by trade associations described in § 501(c)(6) of the Internal Revenue Code fall within the specific exception for qualified convention and trade show activity under § 513(d)(3)(B)?

FACTS

Situation 1. A is a trade association that is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(6). A improves business conditions in a certain industry and serves members that are part of this industry. A's purposes include supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

A conducts, as one of its substantial exempt purposes, semi-annual trade shows to promote and stimulate interest in and demand for the products of A's industry. Each trade show typically occurs at an exhibition facility, during a period of ten consecutive days. A undertakes the planning and direction of the show, secures the facility, and charges exhibitors a fee for use of space at the show. At each trade show, A sponsors conferences and seminars, and A's members and suppliers to A's industry display their products and services. The conferences, seminars, and exhibits offer a wide variety of information on products and developments in the industry. Sales and order taking are permitted. A's members, nonmembers, and potential customers attend the shows. Revenues from the shows are used by A to defray the shows' operating costs, and any excess of revenues over expenditures is used in furtherance of A's exempt purposes.

To serve its members throughout the year, A maintains a website with a variety of information, including dates, locations, and advance ticket information about A's trade

shows. In addition, in conjunction with each semi-annual trade show, A adds a section to its website that augments and enhances the trade show by allowing members and the interested public to access in an alternative medium the same information that is available at the show. The section contains information and visual displays, such as product directories and specific product listings, and links to the websites of exhibitors represented at the trade show, including members of A and those who are suppliers of goods and services to A's members. The section also contains order forms, and a function that allows on-line purchases from members and suppliers represented at the trade show. The supplementary section of the website typically is available on-line during the ten-day period in which the semi-annual trade show occurs, and during a three-day period prior to the beginning of the show and a three-day period subsequent to the end of the show. At the end of the final three-day period, the supplementary section is removed from the website. A charges a fee to exhibitors who wish to have information listed on the supplementary section of the website. A controls all the website's content.

Situation 2. B is a trade association that is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(6), and whose purposes are the same as those of A. B establishes an Internet website that it makes available to the general public 24 hours a day, 7 days a week for a two-week period. At the end of the two-week period, the website is taken down. The two-week period does not overlap or coincide with any international, national, State, regional, or local convention, annual meeting, or show conducted by B.

Like the website operated by A, B's website permits members and the interested public to access information and visual displays, such as product directories and specific product listings. The website contains links to the websites of members of B and those who are suppliers of goods and services to B's members. The website also contains order forms, and a function that allows on-line purchases from members and suppliers appearing on the website. B charges a fee to those who wish to have information listed on the website. B controls all the website's content.

LAW

Section 501(c)(6), in part, provides for the exemption from federal income tax of business leagues, chambers of commerce or boards of trade not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations, in part, provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. The regulation provides that organizations otherwise exempt from tax under § 501(c) are taxable on their unrelated business taxable income.

Section 511(a) provides for the imposition of tax on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c)(6).

Section 512(a)(1) defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions, but with the modifications provided in § 512(b).

Section 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 513(c) defines the term "trade or business" broadly to include any activity that is carried on for the production of income from the sale of goods or the performance of services. For purposes of § 513(c), an activity, such as advertising, does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors that may, or may not, be related to the exempt purposes of the organization.

Section 513(d)(1) provides, in part, that the term "unrelated trade or business" does not include qualified convention and trade show activities of an organization described in § 513(d)(3)(C). Organizations described in § 513(d)(3)(C) include any organization described in § 501(c)(6) that regularly conducts as one of its substantial exempt purposes a show that stimulates interest in, and demand for, the products of a particular industry or segment of such industry or that educates persons in attendance regarding new developments or products and services related to the exempt activities of the organization.

Section 513(d)(3)(A) defines the term "convention and trade show activity" as any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows. A convention and trade show activity includes, but is not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of (1) displaying industry products, (2) stimulating interest in, and demand for, industry products or services, or (3) educating persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Section 513(d)(3)(B) defines the term "qualified convention and trade show activity" as a convention and trade show activity carried out by a qualifying organization in conjunction with an international, national, State, regional, or local convention, annual meeting, or show conducted by a qualifying organization, if one of the purposes of such organization in sponsoring the activity is (1) the promotion and stimulation of interest in, and demand for, the products and services of that industry in general, or (2) to educate persons in attendance regarding new developments or products and services related to

the exempt activities of the organization, and the show is designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed.

Section 1.513-3(b) provides that a convention or trade show activity will not be considered unrelated trade or business if it is conducted by a qualifying organization described in § 513(d)(3)(C), in conjunction with a qualified convention or trade show sponsored by the qualifying organization. Section 1.513-3(c)(1) provides that a qualifying organization includes an organization described in § 501(c)(6) that regularly conducts as one of its substantial exempt purposes a qualified convention or trade show.

Section 1.513-3(c)(2) provides that a qualified convention or trade show is a show that is (i) conducted by a qualifying organization described in § 513(d)(3)(C), (ii) has as at least one of its purposes the education of the qualifying organization's members or the promotion of interest in and demand for the products or services of the industry (or segment thereof) of the members of the qualifying organization, and (iii) is designed to achieve that purpose through the character of a significant portion of the exhibits or the character of conferences and seminars held at a convention or meeting.

Section 1.513-3(d)(1) provides that the rental of display space to exhibitors (including exhibitors who are suppliers) at a qualified trade show or at a qualified convention and trade show will not be considered unrelated trade or business even though the exhibitors who rent the space are permitted to sell or solicit orders.

ANALYSIS

Activities that promote demand for industry products and services, like other advertising activities, generally would constitute a "trade or business" under § 513(c) if carried on for the production of income. Section 513(d) is a narrow exception to what constitutes an "unrelated trade or business" under § 513(a). Section 513(d) was added to the Code by the Tax Reform Act of 1976 (P.L. 94-455 § 1305), in response to a series of revenue rulings (Rev. Ruls. 75-516 through 75-520, 1975-2 C.B. 220-226) holding that income received by a § 501(c)(6) organization at its convention or trade show from renting display space may constitute unrelated business taxable income, if selling by exhibitors is permitted or tolerated at the show. S. Rep. 94-938, at 601-603, 1976-3 C.B. 639-641. The activities described in § 513(d)(3) are specifically excepted from the definition of an unrelated trade or business because they are conducted by a qualifying organization in furtherance of its exempt purposes and in connection with a convention, annual meeting, or trade show. The term "convention, annual meeting, or trade show" as used in § 513(d)(3) refers to a specific event at which individuals representing a particular industry and members of the general public gather in person at one location during a certain period of time. Not only must the activities be conducted at a "convention, annual meeting, or trade show," but the character of the exhibits and the extent of the industry products displayed at the show must be designed to stimulate interest in, and demand for, the products and services of the industry in general or to

educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization. It is the nature of the activities and their connection to a specific convention, annual meeting, or trade show that distinguishes "qualified convention and trade show activity" within the meaning of § 513(d)(3) and the regulations from other types of advertising and promotional activities conducted by organizations described in § 501(c)(6).

In ***Situation 1***, A is a "qualifying organization" within the meaning of § 513(d)(3)(C), because it is an organization described in § 501(c)(6) and regularly conducts as one of its substantial exempt purposes a trade show to promote public interest in A's industry. A's semi-annual trade shows include conferences, seminars and a wide variety of exhibits sponsored by members and suppliers with information useful to those in A's industry and take place during a limited time, at one physical location, where A's members, suppliers and potential customers meet together in person, and interact face to face. Thus, each of A's semi-annual trade shows is a "show" within the meaning of § 513(d)(3).

The activities conducted on the premises of each of A's semi-annual trade shows and on the special supplementary section of A's Internet website during the 16-day period that coincides with each semi-annual trade show are of a kind traditionally conducted at trade shows, as required by § 513(d)(3)(A), because the activities are designed to attract to the show persons in A's industry and members of the public to view industry products, to stimulate interest in, and demand for such products, and to educate persons in the industry about new products and services. Therefore, these activities are "convention and trade show activity."

Although not conducted on the premises of A's semi-annual trade shows, the activities conducted by A on the supplementary section of its Internet website during the 16-day period that coincides with each semi-annual trade show are carried out in conjunction with A's semi-annual trade shows, as required by § 513(d)(3)(B). The supplementary section is no more than ancillary to the trade show. The content of the supplementary section serves to augment and enhance each semi-annual trade show by making available in an alternative medium the same information available at the show. The supplementary section of A's Internet website is available to A's members and the interested public during essentially the same limited time period that each semi-annual trade show is in operation. Although the supplementary section is available for a slightly longer period than the trade show itself, the additional time is reasonably brief and serves to allow for previewing the show before attending, or following up on information gathered at the show. Thus, the supplementary section is merely an extension of each semi-annual trade show.

Accordingly, both the activities conducted on the premises at A's semi-annual trade show and the activities conducted on the supplementary section of A's Internet website during the 16-day period that coincides with A's semi-annual trade show meet the requirements to be a "qualified convention and trade show activity" under §

513(d)(3)(B). These activities, therefore, are not unrelated trade or business under § 513(a) because they meet the requirements for the limited exception under § 513(d)(3).

In ***Situation 2***, B's operation of a website for a two-week period under the circumstances described is not "qualified convention and trade show activity" as defined in § 513(d)(3)(B), because, unlike the activities conducted on the supplementary section of A's Internet website, B's Internet activities are not carried out in conjunction with any international, national, regional, State, or local convention, annual meeting, or show conducted by B. B's website is not itself a "convention, annual meeting, or trade show" within the meaning of § 513(d)(3) because the website is not a specific event at which B's members, suppliers and potential customers gather in person at one physical location during a certain period of time and interact face to face. Moreover, B's Internet activities do not coincide with, nor do they augment and enhance, any such specific event conducted by B for one of the purposes described in § 513(d)(3)(B). Therefore, because B's website is not qualified convention and trade show activity, the operation of the website, even for a relatively short period of time, is not excepted from the definition of an unrelated trade or business under § 513(d)(1).

As B does not meet the specific exception under § 513(d)(3), whether its Internet activities constitute an unrelated trade or business must be determined under the requirements of § 513.

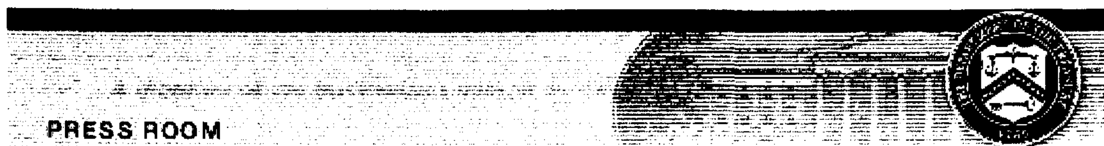
HOLDINGS

In ***Situation 1***, under the circumstances described, the Internet activities conducted by a trade association described in § 501(c)(6) on the special supplementary section of its Internet website do not constitute unrelated trade or business under § 513(a) because such activities meet the specific exception for qualified convention and trade show activity under § 513(d)(3)(B).

In ***Situation 2***, under the circumstances described, the activities conducted by a trade association described in § 501(c)(6) on its Internet website do not meet the specific exception for qualified convention and trade show activity under § 513(d)(3)(B).

DRAFTING INFORMATION

The principal author of this revenue ruling is Charles Barrett of the Tax Exempt and Government Entities Division, Exempt Organizations. For further information regarding this revenue ruling, contact Mr. Barrett at (202) 283-8944 (not a toll-free number).



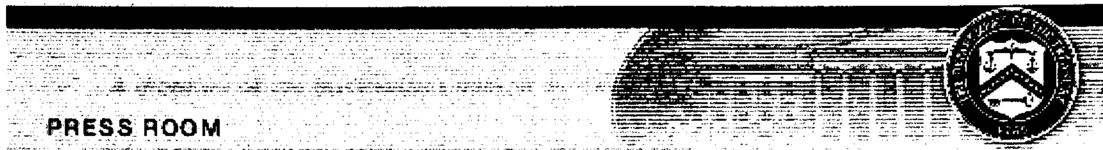
FROM THE OFFICE OF PUBLIC AFFAIRS

December 1, 2004
JS-2121

Secretary John W. Snow Applauds New Tool to Fight Identity Theft

A provision of the Fair and Accurate Credit Transactions Act - which President Bush signed into law last year - takes effect today, giving residents of the western part of the United States the right to a free copy of their credit report each year. The provision will be phased in for consumers in states east of the Rocky Mountains over the course of the next nine months.

"This is an important step in the President's efforts to empower consumers with the resources needed to fight identity theft," said Secretary Snow. "By closely monitoring their credit information, consumers can better protect the financial security and futures of their families. Improved access to credit reports provides a critical tool for consumers in the fight against financial fraud."



FROM THE OFFICE OF PUBLIC AFFAIRS

December 2, 2004
JS-2122

Statement by U.S. Treasury Assistant Secretary Randal Quarles
Jakarta, Indonesia
December 2, 2004

Over the past two days, I have met with economic and financial officials in the new Indonesian government as well as members of the business and international communities. The meetings were very useful and I was impressed with the energy and focus of President Yudhoyono's team. I also participated in the Manila Framework Group meeting in Yogyakarta and thank our gracious Indonesian hosts for chairing a very successful meeting.

With a strong mandate of over 60% of the popular vote, President Yudhoyono has an opportunity to press through his reform agenda. His team has already made it very clear: corruption will not be tolerated and the government must move forward with reforms to improve the investment climate. We are confident that this government can follow through with these pledges.

Macroeconomic stability has improved over the past few years, although some risks remain. Continued constraint of fiscal spending will both be crucial in maintaining macroeconomic stability, reducing the debt burden and increasing the confidence of the market. On monetary policy, Bank Indonesia is continuing to establish a inflation-targeting regime and full transparency will be key to its success.

The principal challenge facing Indonesia is to bring investment and growth back to pre-crisis levels. For this, increasing the confidence of investors, both domestic and foreign, is crucial. It is a concern that investors are deterred by high-profile and unfavorable court decisions, corruption, conflicting regulations, and tax administration issues, to name a few.

The government's efforts to review conflicting regulations between the center and local governments and reduce bureaucratic obstacles are welcome first steps in addressing this important issue. We look forward to the government continuing to dedicate its full energy to all aspects of improving the investment climate so that it will succeed.

There have clearly been improvements in governance in the banking and corporate sectors since the 1997 crisis. We were pleased to here that the government and Bank Indonesia will continue improving bank supervision, strengthening anti-money laundering and counter-terrorist finance laws. It will be important as well for there to be continued progress in privatizing the state banks.

This is a moment of opportunity for Indonesia - I believe that the new government will take advantage of it and we will work closely with them as they carry out these crucial tasks.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 2, 2004
JS-2123

Treasury and IRS Issue Final Instructions for New Corporate Tax Return Form

The Treasury Department and Internal Revenue Service today released the final instructions for the Schedule M-3, Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More. Schedule M-3 is to be used by certain corporate taxpayers filing Form 1120, U.S. Corporation Income Tax Return. The original draft version of the Schedule M-3 instructions was released for public comment on March 10, 2004. The final draft version of the Schedule M-3 was issued on October 25, 2004.

Schedule M-3 is effective for any taxable year ending on or after December 31, 2004. In general, Schedule M-3 must be filed by a corporation required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Form 1120 at the end of the corporation's taxable year total assets that equal or exceed $10 million. However, a corporation is only required to complete certain sections of Schedule M-3 in the first taxable year the corporation is required to file the schedule.

The final instructions to Schedule M-3 provide additional guidance to those corporations required to file the schedule, including detailed instructions for almost every line and many illustrative examples. The Treasury and IRS believe that the additional guidance and examples will significantly assist in completion of the schedule.

The final Schedule M-3 instructions and final draft Schedule M-3 are attached and may be accessed on www.irs.gov. The final Schedule M-3 also will be available on www.irs.gov when it is released.

REPORTS

- Instructions for Schedule M-3 (Form 1120)
- Reconciliation for Corporations

2004

Department of the Treasury
Internal Revenue Service

Instructions for Schedule M-3 (Form 1120)

Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Schedule

Schedule M-3 Part I asks certain questions about the corporation's financial statements and reconciles financial statement net income (loss) for the consolidated financial statement group to income (loss) per the income statement for the U.S. consolidated tax group.

Schedule M-3 Parts II and III reconcile financial statement net income (loss) for the U.S. consolidated tax group (per Schedule M-3, Part I, line 11) to taxable income on Form 1120, page 1, line 28.

Who Must File

Schedule M-3 is effective for any tax year ending on or after December 31, 2004. For purposes of determining whether a corporation with a 52-53-week tax year must file Schedule M-3, such corporation's tax year is deemed to end or close on the last day of the calendar month nearest to the last day of the 52-53 week tax year. (For further guidance on 52-53 week tax years, see Regulations section 1.441-2(c)(1).) Any domestic corporation (including a U.S. consolidated tax group consisting of a U.S. parent corporation and additional includible corporations listed on Form 851, Affiliations Schedule) required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Schedule L of Form 1120 total consolidated assets at the end of the corporation's tax year that equal or exceed $10 million must complete and file Schedule M-3 in lieu of Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return. A U.S. corporation filing Form 1120 that is not required to file Schedule M-3 may voluntarily file Schedule M-3 in place of Schedule M-1. A corporation filing Schedule M-3 must check the box on Form 1120, page 1, item A, indicating that Schedule M-3 is attached (whether required or voluntary). A corporation filing Schedule M-3 must not file Schedule M-1.

If the parent corporation of a U.S. consolidated tax group files Form 1120 and files Schedule M-3, all members of the group must file Schedule M-3. However, if the parent corporation of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, or Form 1120-L, U.S. Life Insurance Company Income Tax Return, that member may either (a) fully complete Schedule M-3 as if the member filed Form 1120; or (b) complete Schedule M-3 by including the sum of all differences between the member's income statement net income (or loss) and taxable income (differences) (regardless of whether the difference would otherwise be reported elsewhere on Part II or on Part III) on Part II, line 26, Other income (loss) items with differences, and separately state and adequately disclose each difference in a supporting schedule. Any member of the U.S. consolidated tax group that files Form 1120-PC or Form 1120-L and is required to file Schedule M-3 (in accordance with the preceding sentence) may classify all differences as permanent in column (c) or identify each difference as temporary or permanent, as appropriate.

If the parent company of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC or Form 1120-L and the consolidated Schedule L reported in the return includes the assets of all of the insurance companies (as well as the non-insurance companies in the U.S. consolidated tax group), in order to determine if the group meets the $10 million threshold test for the requirement to file Schedule M-3, use the amount of total assets reported on Schedule L of the consolidated return. If the parent company of a U.S. consolidated tax group files Form 1120 and any member of the group files Form 1120-PC or Form 1120-L and the consolidated Schedule L reported in the return does not include the assets of one or more of the insurance companies in the U.S. consolidated tax group, in order to determine if the group meets the $10 million threshold test for the requirement to file Schedule M-3, use the sum of the amount of total assets reported on the consolidated Schedule L plus the amounts of all assets reported on Forms 1120-PC and 1120-L that are included in the consolidated return.

Schedule M-3 is not required for any taxpayers other than those identified in the preceding paragraphs including, for example, taxpayers required to file Form 1065, U.S. Return of Partnership Income, Form 1120S, U.S. Income Tax Return for an S Corporation, Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts, Form 1120-F, U.S. Income Tax Return of a Foreign Corporation, Form 1120-H, U.S. Income Tax Return for Homeowners Associations, and Form 1120-SF, U.S. Income Tax Return for Settlement Funds. In addition, Schedule M-3 is not required for any member of a U.S. consolidated tax group if the parent corporation of the group files Form 1120-PC or Form 1120-L.

Example 1. U.S. corporation A owns U.S. subsidiary B and foreign subsidiary F. For its 2004 tax year, A prepares consolidated financial statements with B and F that report total assets of $12 million. A files a consolidated U.S. federal income tax return with B and reports total consolidated assets on Schedule L of $8 million. A's U.S. consolidated tax group is not required to file Schedule M-3 for the 2004 tax year.

If a corporation was required to file Schedule M-3 for the preceding tax year but reports on Schedule L of Form 1120 total consolidated assets at the end of the current tax year of less than $10 million, the corporation is not required to file Schedule M-3 for the current tax year. The corporation may either (a) file Schedule M-3, or (b) file

Cat. No. 38103Y

Schedule M-1, for the current tax year. However, if the corporation chooses to file Schedule M-1 for the current tax year, and for a subsequent tax year the corporation is required to file Schedule M-3, the corporation must complete Schedule M-3 in its entirety (Part I and all columns in Parts II and III) for that subsequent tax year.

In the case of a U.S. consolidated tax group, total assets at the end of the tax year must be determined based on the total year-end assets of all includible corporations listed on Form 851, net of eliminations for intercompany transactions and balances between the includible corporations. In addition, for purposes of determining for Schedule M-3 whether the corporation (or U.S. consolidated tax group) has total assets at the end of the current tax year of $10 million or more, the corporation's total consolidated assets must be determined on an overall accrual method of accounting unless both of the following apply: (a) the tax returns of all includible corporations in the U.S. consolidated tax group are prepared using an overall cash method of accounting, and (b) no includible corporation in the U.S. consolidated tax group prepares or is included in financial statements prepared on an accrual basis.

Other Form 1120 Schedules Affected by Schedule M-3 Requirements

Report on Schedules L, M-2, and Form 1120, page 1, amounts for the U.S. consolidated tax group.

Schedule L

Total assets shown on Schedule L, line 15, column (d), must equal the total assets of the corporation (or, in the case of a U.S. consolidated tax group, the total assets of all members of the group listed on Form 851) as of the last day of the tax year, and must be the same total assets reported by the corporation (or by each member of the U.S. consolidated tax group) in the financial statements, if any, used for Schedule M-3. If the corporation prepares financial statements, Schedule L must equal the sum of the financial statement total assets for each corporation listed on Form 851 and included in the U.S. consolidated tax return (includible corporation) net of eliminations for intercompany transactions between includible corporations. If the corporation does not prepare financial statements, Schedule L must be based on the corporation's books and records. The Schedule L balance sheet may show tax-basis balance sheet amounts if the corporation is allowed to use books and records for Schedule M-3 and the corporation's books and records reflect only tax-basis amounts.

Schedule M-2

The amount shown on Schedule M-2, line 2, Net income (loss) per books, must equal the amount shown on Schedule M-3, Part I, line 11. Schedule M-2 must reflect activity only of corporations included in the U.S. consolidated tax return.

Consolidated Return (Form 1120, Page 1)

Report on Form 1120, page 1, each item of income, gain, loss, expense, or deduction net of elimination entries for intercompany transactions between includible corporations. The corporation must not report as dividends on Form 1120, Schedule C, any amounts received from an includible corporation. In general, dividends received from an includible corporation must be eliminated in consolidation rather than offset by the dividends-received deduction.

Entity Considerations for Schedule M-3

For purposes of Schedule M-3, references to the classification of an entity (for example, as a corporation, a partnership, or a trust) are references to the treatment of the entity for U.S. federal income tax purposes. An entity that generally is disregarded as separate from its owner for U.S. federal income tax purposes (disregarded entity) must not be separately reported on Schedule M-3. Instead, any item of income, gain, loss, deduction, or credit of a disregarded entity must be reported as an item of its owner.

Consolidated Schedule M-3 Versus Consolidating Schedules M-3

A U.S. consolidated tax group must file a consolidated Schedule M-3. Parts I, II, and III of the consolidated Schedule M-3 must reflect the activity of the entire U.S. consolidated tax group. The parent corporation also must complete Parts II and III of a separate Schedule M-3 to reflect the parent's own activity. In addition, Parts II and III of a separate Schedule M-3 must be completed by each includible corporation to reflect the activity of that includible corporation. Lastly, it generally will be necessary to complete Parts II and III of a separate Schedule M-3 for consolidation eliminations. For example, if a U.S. consolidated tax group consists of four includible corporations (the parent and three subsidiaries), the U.S. consolidated tax group must complete six Schedules M-3 as follows: (a) one consolidated Schedule M-3 with Parts I, II, and III completed to reflect the activity of the entire U.S. consolidated tax group; (b) Parts II and III of a separate Schedule M-3 for each of the four includible corporations to reflect the activity of each includible corporation; and (c) Parts II and III of a separate Schedule M-3 to eliminate intercompany transactions between includible corporations and to include limitations on deductions (e.g., charitable contribution limitations and capital loss limitations) and carryover amounts (e.g., charitable contribution carryovers and capital loss carryovers).

If an item attributable to an includible corporation is not shared by or allocated to the appropriate member of the group but is retained in the parent corporation's financial statements (or books and records, if applicable), then the item must be reported by the parent corporation on its separate Schedule M-3. For example, if the parent of a U.S. consolidated tax group prepares financial statements that include all members of the U.S. consolidated tax group and the parent does not allocate the group's income tax expense as reflected in the financial statements among the members of the group but retains it in the parent corporation, the parent corporation must report on its separate Schedule M-3 the U.S. consolidated tax group's income tax expense as reflected in the financial statements.

Any adjustments made at the consolidated group level that are not attributable to any specific member of the U.S. consolidated tax group (e.g., disallowance of net capital losses, contribution deduction carryovers, and limitation of contribution deductions) must not be reported on the separate consolidating parent or subsidiary Schedules M-3 but rather on the consolidated Schedule M-3 and on the consolidating Schedule M-3 for consolidation eliminations (see the second preceding paragraph).

If an includible corporation has no activity for the tax year (e.g., because the corporation is a dormant or inactive corporation), no amount for the corporation was included in Part I, line 11, and the corporation has no amounts to report on Part II and Part III of Schedule M-3 for the tax year, the parent corporation of the U.S. consolidated tax group may attach to

the consolidated Schedule M-3 a statement that provides the name and EIN of the includible corporation in lieu of filing a blank Part II and Part III of Schedule M-3 for such entity.

Completion of Schedule M-3

A corporation (or any member of a U.S. consolidated tax group) required to file Schedule M-3 must complete the form in its entirety. At the time the Form 1120 is filed, all applicable questions must be answered on Part I (except that in the case of a U.S. consolidated tax group, Part I need only be completed once, on the consolidated Schedule M-3, by the parent corporation), all columns must be completed on Parts II and III, and all numerical data required by Schedule M-3 must be provided at the time the Form 1120 is filed. Any schedule required to support a line item on Schedule M-3 must be attached at the time Schedule M-3 is filed and must provide the information required for that line item.

Specific Instructions for Part I

Part I. Financial Information and Net Income (Loss) Reconciliation

When To Complete Part I

Part I must be completed for any tax year for which the corporation files Schedule M-3.

Line 1. Questions Regarding the Type of Income Statement Prepared

For Schedule M-3, Part I, lines 1 through 11, use only the financial statements of the U.S. corporation filing the U.S. federal income tax return (the consolidated financial statements for the U.S. parent corporation of a U.S. consolidated tax group). If the U.S. corporation filing a U.S. federal income tax return (or the U.S. parent corporation of a U.S. consolidated tax group) is controlled by another corporation (U.S. or foreign), the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must not use the financial statements of the controlling corporation for its Schedule M-3, Part I.

If no financial statements are prepared for the U.S. corporation (or, in the case of a U.S. consolidated tax group, for the U.S. parent corporation's consolidated group) filing Form 1120, the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must enter "No" on questions 1a, 1b, and 1c, skip Part I, lines 2 through 10, and enter the net income (loss) per the books and records of the U.S. corporation (or U.S. consolidated tax group) on Part I, line 11, Net income (loss) per income statement of includible corporations.

If a non-publicly traded U.S. parent corporation of a U.S. consolidated tax group prepares financial statements and that group includes a publicly traded subsidiary that files financial statements with the Securities and Exchange Commission (SEC), the consolidated financial statements of the parent corporation are the appropriate financial statements for purposes of completing Part I. Do not use any separate company financial statements that might be prepared for publicly traded subsidiaries.

If a corporation (a) is included in the consolidated financial statements of a group (consolidated financial statement group) with a U.S. parent corporation filing a Form 1120 and Schedule M-3, (b) is not included in the Form 1120 of the parent corporation of the consolidated financial statement group, (c) does not have a separate financial statement (certified or otherwise) of its own, and (d) files its own Form 1120 (separate or consolidated), the corporation must answer questions 1a, 1b, and 1c of Part I as appropriate for its own Form 1120 and must report on Part I, line 4 or 11, as appropriate, the amount for the corporation's net income (loss) that is equal to the amount included in the income statement of the consolidated financial statement group and removed in Schedule M-3, Part I of that group's U.S. federal income tax return. However, if in the circumstances described immediately above, the corporation does have separate financial statements (certified or otherwise) of its own, independent of the amount of the corporation's net income included in its parent company's consolidated financial statements, the corporation must answer questions 1a, 1b, and 1c of Part I, as appropriate, for its own Form 1120, based on its own separate income statement, and must report on Part I, line 4, the net income amounts shown on its separate income statement.

Line 2. Questions Regarding Income Statement Period and Restatements

Enter the beginning and ending dates on line 2a for the corporation's income statement period ending with or within this tax year. Answer "Yes" on lines 2b and/or 2c if the corporation's income statement has been restated for any reason, and attach an explanation for each restatement, the original amount of each income statement item restated, and the restated amount of each income statement item restated.

Line 3. Questions Regarding Publicly Traded Voting Common Stock

The primary U.S. publicly traded voting common stock class is the most widely held or most heavily traded within the U.S. as determined by the corporation. If the corporation has more than one class of publicly traded voting common stock, attach a list of the classes of publicly traded voting common stock, the trading symbol of each class, the nine-digit CUSIP number of each class, and the name and EIN of the corporation issuing the stock.

Line 4. Worldwide Consolidated Net Income (Loss) per Income Statement

In completing Schedule M-3, the corporation must use financial statement amounts from the financial statement type checked "Yes" on Part I, line 1. If Part I, line 1a, is checked "Yes," report on Part I, line 4, the net income amount reported in the income statement presented to the SEC on the corporation's Form 10-K (the Form 10-K for the security identified on Part I, line 3b, if applicable).

If a corporation prepares financial statements, the amount on line 4 must equal the financial statement net income (loss) for the income statement period ending with or within the tax year as indicated on line 2a.

If the corporation prepares financial statements and the income statement period differs from the corporation's tax year, the income statement period indicated on line 2a applies for purposes of Part I, lines 4 through 8.

If the corporation does not prepare financial statements, skip lines 2a through 10 and enter the net income (loss) per the books and records of the U.S. corporation or the U.S. consolidated tax group on Part I, line 11, Net income (loss) per income statement of includible corporations.

If line 4 includes net income (loss) for a corporation that files Form 1120-PC or Form 1120-L, see the

instructions for Part I, line 10, for adjustments that may be necessary to reconcile financial statement income to statutory income.

Line 5. Net Income (Loss) of Nonincludible Foreign Entities

Remove the financial statement net income (line 5a) or loss (line 5b) of each foreign entity that is included in the consolidated financial statement group and is not an includible corporation in the U.S. consolidated tax group (nonincludible foreign entity). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends for any nonincludible foreign entity. Do not remove in Part I the financial statement net income (loss) of any nonincludible foreign entity accounted for in the financial statements on the equity method.

Attach a supporting schedule that provides the name, EIN (if applicable), and financial statement net income (loss) included on line 4 that is removed on this line 5 for each nonincludible foreign entity.

Line 6. Net Income (Loss) of Nonincludible U.S. Entities

Remove the financial statement net income (line 6a) or loss (line 6b) of each U.S. entity that is included in the consolidated financial statement group and is not an includible corporation in the U.S. consolidated tax group (nonincludible U.S. entity). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends for any nonincludible U.S. entity. Do not remove in Part I the financial statement net income (loss) of any nonincludible U.S. entity accounted for in the financial statements on the equity method.

Attach a supporting schedule that provides the name, EIN (if applicable), and financial statement net income (loss) included on line 4 that is removed on this line 6 for each nonincludible U.S. entity.

Line 7. Net Income (Loss) of Other Includible Corporations

Include the financial statement net income (line 7a) or loss (line 7b) of each corporation includible in the U.S. consolidated tax group that is not included in the consolidated financial statement group (other includible corporation). In addition, on Part I, line 8, adjust for consolidation eliminations and correct for minority interest and intercompany dividends for any other includible corporation.

Attach a supporting schedule that provides the name, EIN (if applicable), and financial statement net income (loss) included on this line 7 for each other includible corporation.

Line 8. Adjustment to Eliminations of Transactions Between Includible Corporations and Nonincludible Entities

Include on line 8 any adjustments for minority interest, intercompany dividends, and eliminations of intercompany transactions associated with amounts included on Part I, line 4, amounts removed on Part I, line 5 or 6, or amounts included on Part I, line 7, so that the adjusted consolidation entries and intercompany eliminations are only those applicable to the income (loss) of includible corporations for the financial statement period. Adjustments on Part I, line 8, for consolidation entries are necessary to ensure that transactions between includible corporations and either nonincludible foreign entities or nonincludible U.S. entities are not eliminated. Additionally, adjustments on Part I, line 8, for consolidation entries are necessary to ensure that transactions between includible corporations that are in the consolidated financial statement group and other includible corporations that are not in the consolidated financial statement group are eliminated.

Line 9. Adjustment to Reconcile Income Statement Period to Tax Year

Include on line 9 any adjustments necessary to the income (loss) of includible corporations to reconcile differences between the corporation's income statement period reported on line 2a and the corporation's tax year.

Line 10. Other Adjustments Required To Reconcile to Amount on Line 11

Include on line 10 any other adjustments to reconcile net income (loss) on Part I, line 4, with net income (loss) of includible corporations reported on Part I, line 11. If the net income (loss) of an includible corporation that files Form 1120-PC or Form 1120-L is included on Part I, lines 4, 7, 8, or 9, and is computed on a basis other than statutory accounting, include on line 10 the adjustments necessary such that Part I, line 11, includes net income (loss) for such corporation on a statutory accounting basis.

Attach a supporting schedule that provides the name and EIN (if applicable) of each corporation to which the adjustment relates, the net adjustment included on line 10 for each corporation, and an explanation of each net adjustment.

Line 11. Net Income (Loss) per Income Statement of Includible Corporations

Report on line 11 the consolidated income statement net income (loss) of all corporations included in the U.S. consolidated tax return for the tax year and listed on the Form 851. If the corporation does not prepare financial statements, enter on line 11 the net income (loss) per the books and records of the U.S. consolidated tax group.

Example 2. U.S. corporation P is publicly traded and files Form 10-K with the SEC. P owns 80% or more of the stock of U.S. corporations DS1-DS75, between 51% and 79% of the stock of U.S. corporations DS76-DS100, and 100% of the stock of foreign subsidiaries FS1-FS50. P eliminates all dividend income from DS1-DS100 and FS1-FS50 in financial statement consolidation entries. Furthermore, P eliminates the minority interest ownership of DS1-DS100 in financial statement consolidation entries. P's SEC Form 10-K includes P, DS1-DS100 and FS1-FS50 on a fully consolidated basis. P files a U.S. consolidated tax return with DS1-DS75.

P must check "Yes" on Part I, line 1a. On Part I, line 4, P must report the consolidated net income from the SEC Form 10-K for the consolidated financial statement group of P, DS1-DS100, and FS1-FS50. P must remove the net income (loss) of FS1-FS50 on Part I, lines 5a or 5b, as applicable. P must remove the net income (loss) before minority interests of DS76-DS100 on Part I, lines 6a or 6b, as applicable. P must reverse on Part I, line 8, the elimination of any transactions between the includible corporations (P and DS1-DS75) and the nonincludible entities (DS76-DS100 and FS1-FS50), including dividends received from DS76-DS100 and FS1-FS50 and the minority interest's share of the net income (loss) of DS1-DS100.

P reports on Part I, line 11, the consolidated financial statement net income (loss) attributable to the includible corporations. Intercompany transactions between the includible corporations that had been eliminated in the net income amount on line 4 remain eliminated in the net income amount on line 11. Transactions between the includible corporations and the nonincludible entities that are eliminated in the net income amount on

line 4 are included in the net income amount on line 11.

Example 3. Foreign corporation F owns 100% of the stock of U.S. corporation P. P owns 100% of the stock of DS1, 60% of the stock of DS2, and 100% of the stock of FS1. F prepares certified audited financial statements. P does not prepare any financial statements. P files a U.S. consolidated tax return with DS1.

P must check "No" on Part I, lines 1a, 1b, and 1c, skip lines 2a through 10 of Part I, and enter net income (loss) per the books and records of the includible corporations (P and DS1) on Part I, line 11, net of eliminations for transactions between P and DS1.

Example 4. U.S. corporation C owns 60% of the capital and profits interests in U.S. LLC N. N has net income of $100 (before minority interests) and makes no distributions during the year. C treats N as a corporation for financial statement purposes and as a partnership for U.S. federal income tax purposes. In its financial statements, C consolidates N and includes $60 of net income ($100 less the minority interest of $40) on Part I, line 4.

C must remove the $100 net income of N on Part I, line 6a. C must reverse on Part I, line 8, the elimination of the $40 minority interest net income of N. The result is that C includes no income for N on Part I, line 11. C's taxable income from N must be reported by C on Part II, line 9, Income (loss) from U.S. partnerships.

Example 5. U.S. corporation P owns 80% of the stock of corporation DS1. DS1 is included in P's U.S. consolidated federal income tax return, even though DS1 is not included in P's consolidated financial statements. DS1 has current year net income of $100 after it pays interest of $40 to P. P has net income of $1,040 after recognition of the interest income from DS1. In its financial statements, P reports the $40 interest as part of its net income of $1,040 on Part I, line 4. P is required to include the $100 net income of DS1 on Part I, line 7, and the operations of DS1 must be included in P's return on a fully consolidated basis. P must remove on Part I, line 8, the $40 of interest income received from DS1 included by P on line 4 and the $40 of interest expense of DS1 included in line 7 for a net change of zero on line 8. On line 8, P must also remove the $20 minority interest in the net income of DS1 (DS1 net income of $100 × 20% minority interest). On Part 1, line 11, P reports $1,120, $1,040 from line 4, $100 from line 7, and ($20) from line 8. The result is that P includes on Part I, line 11, the entire net income of DS1 of $140 before minority interest and interest expense to P, less the minority interest of $20 in the net income of DS1, and the entire net income of P of $1,000 measured before recognition of the intercompany interest from DS1 and the consolidation of DS1 operations.

Specific Instructions for Parts II and III

For U.S. consolidated tax returns, file supporting schedules for each includible corporation. See *Consolidated returns* on page 4 of the Form 1120 instructions.

General Format of Parts II and III

For each line item in Parts II and III, report in column (a) the amount of net income (loss) included in Part I, line 11, and report in column (d) the amount included in taxable income.

When To Complete Columns (a) and (d)

A corporation is not required to complete columns (a) and (d) of Parts II and III for the first tax year the corporation is required to file Schedule M-3. The corporation must complete columns (a) and (d) of Parts II and III for all tax years subsequent to the first tax year the corporation is required to file Schedule M-3.

If, for any tax year (or tax years) prior to the first tax year a corporation is required to file Schedule M-3, a corporation voluntarily files Schedule M-3 in lieu of Schedule M-1, then in those voluntary filing years the corporation is not required to complete columns (a) and (d) of Parts II and III. In addition, in the first tax year the corporation is required to file Schedule M-3 the corporation is not required to complete columns (a) and (d) of Parts II and III.

If a corporation chooses not to complete columns (a) and (d) of Parts II and III in the first tax year the corporation is required to file Schedule M-3 (or in any year in which the corporation voluntarily files Schedule M-3), then Part II, line 30, is reconciled by the corporation (or, in the case of a U.S. consolidated tax group, by the group's parent corporation on Part II, line 30, of the group's consolidated Schedule M-3) in the following manner:

1. Report the amount from Part I, line 11, on Part II, line 30, column (a);
2. Leave blank Part II, lines 1 through 29, columns (a) and (d);
3. Leave blank Part III, columns (a) and (d); and
4. Report on Part II, line 30, column (d), the sum of Part II, line 30, columns (a), (b), and (c).

Note. Part II, line 30, column (d), must equal the amount on Form 1120, page 1, line 28.

When To Complete Columns (b) and (c)

Columns (b) and (c) of Parts II and III must be completed for any tax year for which the corporation files Schedule M-3.

For any item of income, gain, loss, expense, or deduction for which there is a difference between columns (a) and (d), the portion of the difference that is temporary must be entered in column (b) and the portion of the difference that is permanent must be entered in column (c).

If financial statements are prepared by the corporation in accordance with generally accepted accounting principles (GAAP), differences that are treated as temporary for GAAP must be reported in column (b) and differences that are permanent (that is, not temporary for GAAP) must be reported in column (c). Generally, pursuant to GAAP, a temporary difference affects (creates, increases, or decreases) a deferred tax asset or liability.

If the corporation does not prepare financial statements, or the financial statements are not prepared in accordance with GAAP, report in column (b) any difference that the corporation believes will reverse in a future tax year (that is, have an opposite effect on taxable income in a future tax year (or years) due to the difference in timing of recognition for financial accounting and U.S. federal income tax purposes) or is the reversal of such a difference that arose in a prior tax year. Report in column (c) any difference that the corporation believes will not reverse in a future tax year (and is not the reversal of such a difference that arose in a prior tax year).

If the corporation is unable to determine whether a difference between column (a) and column (d) for an item will reverse in a future tax year or is the reversal of a difference that arose in a prior tax year, report the difference for that item in column (c).

Example 6. For the 2004, 2005, and 2006 tax years, corporation A has total consolidated assets on the last day of the tax year as reported on Schedule L, line 15, column (d), of $8 million, $11 million, and $12 million, respectively. A is required to file Schedule M-3 for its 2005 and 2006 tax years.

For its 2004 tax year, A voluntarily files Schedule M-3 in lieu of Schedule

M-1 and does not complete columns (a) and (d) of Parts II and III.

For A's 2005 tax year, the first tax year that A is required to file Schedule M-3, A is only required to complete Part I and columns (b) and (c) of Parts II and III.

For A's 2006 tax year, A is required to complete Schedule M-3 in its entirety.

Example 7. Corporation B is a U.S. publicly traded corporation that files a U.S. consolidated tax return and prepares consolidated GAAP financial statements. In prior years, B acquired intellectual property (IP) and goodwill through several corporate acquisitions. The IP is amortizable for both U.S. federal income tax and financial statement purposes. In the current year, B's annual amortization expense for IP is $9,000 for U.S. federal income tax purposes and $6,000 for financial statement purposes. In its financial statements, B treats the difference in IP amortization as a temporary difference. The goodwill is not amortizable for U.S. federal income tax purposes and is subject to impairment for financial statement purposes. In the current year, B records an impairment charge on the goodwill of $5,000. In its financial statements, B treats the goodwill impairment as a permanent difference. B must report the amortization attributable to the IP on Part III, line 28, Other amortization or impairment write-offs, and report $6,000 in column (a), a temporary difference of $3,000 in column (b), and $9,000 in column (d). B must report the goodwill impairment on Part III, line 26, Amortization/impairment of goodwill, and report $5,000 in column (a), a permanent difference of ($5,000) in column (c), and $0 in column (d).

Reporting Requirements for Parts II and III

General Reporting Requirements

If an amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b) (other than a transaction described in Regulations section 1.6011-(4)(b)(6) relating to significant book-tax differences), the amount must be reported in columns (a), (b), (c), and (d), as applicable, of Part II, line 12, Items relating to reportable transactions, regardless of whether the amount would otherwise be reported on Part II or Part III of Schedule M-3. Thus, if a taxpayer files Form 8886, Reportable Transaction Disclosure Statement, the amounts attributable to that reportable transaction must be reported on Part II, line 12.

A corporation is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is in any manner included in the corporation's current year financial statement net income (loss) or in an income or expense account maintained in the corporation's books and records, even if there is no difference between that amount and the amount included in taxable income unless (a) otherwise provided in these instructions or (b) the amount is attributable to a reportable transaction described in Regulations section 1.6011-4(b) other than a transaction described in Regulations section 1.6011-(4)(b)(6) (relating to significant book-tax differences) and is therefore reported on Part II, line 12. For example, with the exception of interest income reflected on a Schedule K-1 received by a corporation as a result of the corporation's investment in a partnership or other pass-through entity, all interest income, whether from unconsolidated affiliated companies, third parties, banks, or other entities, whether imputed interest or not, whether from foreign or domestic sources, whether taxable or exempt from tax and regardless of how or where the income is classified in the corporation's financial statements, must be included on Part II, line 13, column (a). Likewise, all fines and penalties paid to a government or other authority for the violation of any law for which fines or penalties are assessed must be included on Part III, line 12, column (a), regardless of the government authority that imposed the fines or penalties, regardless of whether the fines or penalties are civil or criminal, regardless of the classification, nomenclature, or terminology attached to the fines or penalties by the imposing authority in its actions or documents, and regardless of how or where the fines or penalties are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records.

If a corporation would be required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 in accordance with the preceding paragraph, except that the corporation has capitalized the item of income or expense and reports the amount in its financial statement balance sheet or in asset and liability accounts maintained in the corporation's books and records, the corporation must report the proper tax treatment of the item in columns (b), (c), and (d), as applicable.

Furthermore, in applying the two preceding paragraphs, a corporation is required to report in column (a) of Parts II and III the amount of any item specifically listed on Schedule M-3 that is included in the corporation's financial statements or exists in the corporation's books and records, regardless of the nomenclature associated with that item in the financial statements or books and records. Accurate completion of Schedule M-3 requires reporting amounts according to the substantive nature of the specific line items included in Schedule M-3 and consistent reporting of all transactions of like substantive nature that occurred during the tax year. For example, all expense amounts that are included in the financial statements or exist in the books and records that represent some form of "Bad debt expense," must be reported on Part III, line 32, in column (a), regardless of whether the amounts are recorded or stated under different nomenclature in the financial statements or the books and records such as: "Provision for doubtful accounts"; "Expense for uncollectible notes receivable"; or "Impairment of trade accounts receivable." Likewise, as stated in the preceding paragraph, all fines and penalties must be included on Part III, line 12, column (a), regardless of the terminology or nomenclature attached to them by the corporation in its books and records or financial statements.

With limited exceptions, Part II includes lines for specific items of income, gain, or loss (income items). (See Part II, lines 1 through 25.) If an income item is described in Part II, lines 1 through 25, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the income item, or only a portion of the income item has a difference and a portion of the item does not have a difference, and the item is not described in Part II, lines 1 through 25, report and describe the entire amount of the item on Part II, line 26, Other income (loss) items with differences.

With limited exceptions, Part III includes lines for specific items of expense or deduction (expense items). (See Part III, lines 1 through 34.) If an expense item is described on Part III, lines 1 through 34, report the amount of the item on the applicable line, regardless of whether there is a difference for the item. If there is a difference for the expense item, or only a portion of the expense item has a difference and a portion of the item does not have a difference and the item is not described in Part III, lines 1 through 34, report and describe the

entire amount of the item on Part III, line 35, Other expense/deduction items with differences.

If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, loss, expense, or deduction and the item is not described or included in Part II, lines 1 through 26, or Part III, lines 1 through 35, report the entire amount of the item in column (a) and (d) of Part II, line 29, Other income (loss) and expense/deduction items with no differences.

Separately stated and adequately disclosed. Each difference reported in Parts II and III must be separately stated and adequately disclosed. In general, a difference is adequately disclosed if the difference is labeled in a manner that clearly identifies the item or transaction from which the difference arises. For further guidance about adequate disclosure, see Regulations section 1.6662-4(f). If a specific item of income, gain, loss, expense, or deduction is described on Part II, lines 9 through 25, or Part III, lines 1 through 34, and the line does not indicate to "attach schedule" or "attach details," and the specific instructions for the line do not call for an attachment of a schedule or statement, then the item is considered separately stated and adequately disclosed if the item is reported on the applicable line and the amount(s) of the item(s) are reported in the applicable columns of the applicable line. See the instructions beginning on page 8 for specific additional information required to be provided for amounts reported on Part II, lines 1 through 8.

Except as otherwise provided, differences for the same item must be combined or netted together and reported as one amount on the applicable line of Schedule M-3. However, differences for separate items must not be combined or netted together and each item (and corresponding amount attributable to that item) must be separately stated and adequately disclosed on the applicable line of Schedule M-3. In addition, every item of difference must be separately stated and adequately disclosed. Differences for dissimilar items cannot be combined even if the amounts are below a certain dollar amount.

Example 8. Corporation C is a calendar year taxpayer that placed in service ten depreciable fixed assets in 2000. C was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. C's total depreciation expense for its 2005 tax year for five of the assets is $50,000 for income statement purposes and $70,000 for U.S. federal income tax purposes. C's total annual depreciation expense for its 2005 tax year for the other five assets is $40,000 for income statement purposes and $30,000 for U.S. federal income tax purposes. In its financial statements, C treats the differences between financial statement and U.S. federal income tax depreciation expense as giving rise to temporary differences that will reverse in future years. C must combine all of its depreciation adjustments. Accordingly, C must report on Part III, line 31, Depreciation, for its 2005 tax year income statement depreciation expense of $90,000 in column (a), a temporary difference of $10,000 in column (b), and U.S. federal income tax depreciation expense of $100,000 in column (d).

Example 9. Corporation D is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. On December 31, 2005, D establishes three reserve accounts in the amount of $100,000 for each account. One reserve account is an allowance for accounts receivable that are estimated to be uncollectible. The second reserve is an estimate of a settlement D may have to pay as a result of pending litigation. The third reserve is an estimate of future warranty expenses. In its financial statements, D treats the three reserve accounts as giving rise to temporary differences that will reverse in future years. The three reserves are expenses in D's 2005 financial statements but are not deductions for U.S. federal income tax purposes in 2005. D must not combine the Schedule M-3 differences for the three reserve accounts. D must report the amounts attributable to the allowance for uncollectible accounts receivable on Part III, line 32, Bad debt expense, and must separately state and adequately disclose the amounts attributable to each of the two reserves for pending litigation and the warranty costs on a required, attached schedule that supports the amounts at Part III, line 35, Other expense/deduction items with differences.

Example 10. Corporation E is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. On January 2, 2005, E establishes an allowance for uncollectible accounts receivable (bad debt reserve) of $100,000. During 2005, E increased the reserve by $250,000 for additional accounts receivable that may become uncollectible. Additionally, during 2005 E decreases the reserve by $75,000 for accounts receivable that were discharged in bankruptcy during 2005. The balance in the reserve account on December 31, 2005, is $275,000. The $100,000 amount to establish the reserve account and the $250,000 to increase the reserve account are expenses on E's 2005 financial statements but are not deductible for U.S. federal income tax purposes in 2005. However, the $75,000 decrease to the reserve is deductible for U.S. federal income tax purposes in 2005. In its financial statements, E treats the reserve account as giving rise to a temporary difference that will reverse in future tax years. E must report on Part III, line 32, Bad debt expense, for its 2005 tax year income statement bad debt expense of $350,000 in column (a), a temporary difference of ($275,000) in column (b), and U.S. federal income tax bad debt expense of $75,000 in column (d).

Example 11. Corporation F is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. During 2005, F incurs $200 of meals and entertainment expenses that F deducts in computing net income per the income statement. $50 of the $200 is subject to the $50% limitation under section 274(n). In its financial statements, F treats the limitation on deductions for meals and entertainment as a permanent difference. Because meals and entertainment expenses are specifically described in Part III, line 11, Meals and entertainment, F must report all of its meals and entertainment expenses on this line, regardless of whether there is a difference. Accordingly, F must report $200 in column (a), $25 in column (c), and $175 in column (d). F must not report the $150 of meals and entertainment expenses that are deducted in F's financial statement net income and are fully deductible for U.S. federal income tax purposes on Part II, line 29, Other income (loss) and expense/deduction items with no differences, and the $50 subject to the limitation under section 274(n) on Part III, line 11, Meals and entertainment.

Part II. Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return

Lines 1 Through 8. Additional Information for Each Corporation

For any item reported on Part II, lines 1, 3 through 6, or 8, attach a supporting schedule that provides the name of the entity for which the item is reported, the type of entity (corporation, partnership, etc.), the entity's EIN (if applicable), and the item amounts for columns (a) through (d). See the instructions for Part II, lines 2 and 7, for the specific information required for those particular lines.

Line 1. Income (Loss) From Equity Method Foreign Corporations

Report on line 1, column (a), the income statement income (loss) included in Part I, line 11, for any foreign corporation accounted for on the equity method and remove such amount in column (b) or (c), as applicable. Report the amount of dividends received and other taxable amounts received or includible from foreign corporations on Part II, lines 2 through 5, as applicable.

Line 2. Gross Foreign Dividends Not Previously Taxed

Report on line 2, column (d), the amount (before any withholding tax) of any foreign dividends included in current year taxable income on Form 1120, page 1, line 28. Report on line 2, column (a), the amount of dividends from any foreign corporation included in Part I, line 11. Do not report any amounts that are reported on Part II, lines 3 or 4, or dividends that were previously taxed (see the instructions for line 5 on this page).

For any dividends reported on Part II, line 2, that are received on a class of voting stock of which the corporation directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting schedule the name of the dividend payer, the class of voting stock on which the dividend was paid, the payer's EIN (if applicable), and the item amounts for columns (a) through (d).

Line 3. Subpart F, QEF, and Similar Income Inclusions

Report on line 3, column (d), the amount included in taxable income under section 951 (relating to Subpart F), gains or other income inclusions resulting from elections under sections 1291(d)(2) and 1298(b)(1), and any amount included in taxable income pursuant to section 1293 (relating to qualified electing funds). The amount of Subpart F income corresponds to the total of the amounts reported by the corporation on line 6, Schedule I, of all Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. The amount of qualified electing fund income corresponds to the total of the amounts reported by the corporation on line 3(a), Part II, of all Forms 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

Also include on line 3 PFIC mark-to-market gains and losses under section 1296. Do not report such gains and losses on Part II, line 16, Mark-to-market income (loss).

Line 4. Section 78 Gross-Up

Report on line 4, column (d), the amount of any section 78 gross-up. The section 78 gross-up amount must correspond to the total section 78 gross-up amounts reported by the corporation on all Forms 1118, Foreign Tax Credit–Corporations.

Line 5. Gross Foreign Distributions Previously Taxed

Report on line 5 any distributions received from foreign corporations that were included in Part I, line 11, and that were previously taxed. For example, include amounts that are excluded from income under sections 959 and 1293(c). Report the full amount of the distribution before any withholding tax.

Line 6. Income (Loss) From Equity Method U.S. Corporations

Report on line 6, column (a), the income statement income (loss) included in Part I, line 11, for any U.S. corporation accounted for on the equity method and remove such amount in column (b) or (c), as applicable. Report on Part II, line 7, dividends received from any U.S. corporation accounted for on the equity method.

Line 7. U.S. Dividends Not Eliminated in Tax Consolidation

Report on line 7, column (a), the amount of dividends received from any U.S. corporation included in Part I, line 11. Report on line 7, column (d), the amount of any U.S. dividends included in taxable income on Form 1120, page 1, line 28 (that is, taxable dividends received from any U.S. corporation that is not included in the U.S. consolidated tax group and required to be listed on Form 851).

For any dividends reported on Part II, line 7, that are received on classes of voting stock in which the corporation directly or indirectly owned 10% or more of the outstanding shares of that class at any time during the tax year, report on an attached supporting schedule for Part II, line 7, the name of the dividend payer, the class of voting stock on which the dividend was paid, the payer's EIN (if applicable), and the item amounts for columns (a) through (d).

Line 8. Minority Interest for Includible Corporations

Report on line 8, column (a), the minority interest in the income (loss) included in the income statement income (loss) on Part I, line 11, for any member of the U.S. consolidated tax group that is less than 100% owned.

Example 12. Corporation G is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. G owns 90% of the stock of U.S. corporation DS1. G files a U.S. consolidated tax return with DS1. G prepares certified GAAP financial statements for the consolidated financial statement group consisting of G and DS1. G has no net income of its own, and G does not report its equity interest in the income of DS1 on its separate financial statements. DS1 has financial statement net income (before minority interests) and taxable income of $1,000 ($2,500 of revenue less $1,500 cost of goods sold). On Part I, line 11, Net income (loss) per income statement of includible corporations, of the consolidated Schedule M-3, the U.S. consolidated tax group must report $900 of financial statement income ($1,000 net income less $100 minority interest). On Part II, line 8, Minority interest for includible corporations, of the consolidated Schedule M-3, the U.S. consolidated tax group reports ($100) in column (a), $100 in column (c), and $0 in column (d). On Part II, line 29, Other income (loss) and expense/deduction items with no

differences, of the consolidated Schedule M-3, the U.S. consolidated tax group reports $1,000 in both columns (a) and (d). As a result, financial statement net income on Part II, line 30, column (a), will total $900, net permanent differences on Part II, line 30, column (c), will total $100, and taxable income on line 30, column (d), will total $1,000. G must prepare three consolidating Schedules M-3, each with Parts II and III, one for G, one for DS1, and one for consolidation eliminations. On the consolidating Schedule M-3 for DS1, on Part II, line 29 and line 30, G reports for DS1 $1,000 in both columns (a) and (d). On the consolidating Schedule M-3 for G, on Part II, line 30, G reports for itself zero in both columns (a) and (d). On the consolidating Schedule M-3 for consolidation eliminations, on Part II, line 8 and line 30, G reports the minority interest elimination for the U.S. consolidated tax group of ($100) in column (a), $100 in column (c), and $0 in column (d).

Line 9. Income (Loss) From U.S. Partnerships and Line 10. Income (Loss) From Foreign Partnerships

For any interest owned by the corporation or a member of the U.S. consolidated tax group that is treated as an investment in a partnership for U.S. federal income tax purposes (other than an interest in a disregarded entity), report the following on Part II, line 9 or 10, as applicable:

1. In column (a) the sum of the corporation's distributive share of income or loss from a U.S. or foreign partnership that is included in Part I, line 11, Net income (loss) per income statement of includible corporations;
2. In column (b) or (c), as applicable, the sum of all differences, if any, attributable to the corporation's distributive share of income or loss from a U.S. or foreign partnership; and
3. In column (d) the sum of all amounts of income, gain, loss, or deduction attributable to the corporation's distributive share of income or loss from a U.S. or foreign partnership (i.e., the sum of all amounts reportable on the corporation's Schedule(s) K-1 received from the partnership (if applicable)), without regard to any limitations computed at the partner level (e.g., limitations on utilization of charitable contributions, capital losses, and interest expense).

For each partnership reported on line 9 or 10, attach a supporting schedule that provides the name, EIN (if applicable), end of year profit-sharing percentage (if applicable), end of year loss-sharing percentage (if applicable), and the amount reported in column (a), (b), (c), or (d) of lines 9 or 10, as applicable.

Example 13. U.S. corporation H is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. H has an investment in a U.S. partnership USP. H prepares financial statements in accordance with GAAP. In its financial statements, H treats the difference between financial statement net income and taxable income from its investment in USP as a permanent difference. For its 2005 tax year, H's financial statement net income includes $10,000 of income attributable to its share of USP's net income. H's Schedule K-1 from USP reports $5,000 of ordinary income, $7,000 of long-term capital gains, $4,000 of charitable contributions, and $200 of section 179 expense. H must report on Part II, line 9, $10,000 in column (a), a permanent difference of ($2,200) in column (c), and $7,800 in column (d).

Example 14. Same facts as Example 13 except that corporation H's charitable contribution deduction is wholly attributable to its partnership interest in USP and is limited to $90 pursuant to section 170(b)(2) due to other investment losses incurred by H. In its financial statements, H treated this limitation as a temporary difference. H must not report the charitable contribution limitation of $3,910 ($4,000 - $90) on Part II, line 9. H must report the limitation on Part III, line 21, Charitable contribution limitation, and report the disallowed charitable contributions of ($3,910) in columns (b) and (d).

Line 11. Income (Loss) From Other Pass-Through Entities

For any interest in a pass-through entity (other than an interest in a partnership reportable on Part II, line 9 or 10, as applicable) owned by a member of the U.S. consolidated tax group (other than an interest in a disregarded entity), report the following on line 11:

1. In column (a) the sum of the corporation's distributive share of income or loss from the pass-through entity that is included in Part I, line 11, Net income (loss) per income statement of includible corporations;
2. In column (b) or (c), as applicable, the sum of all differences, if any, attributable to the pass-through entity; and
3. In column (d) the sum of all taxable amounts of income, gain, loss, or deduction reportable on the corporation's Schedules K-1 received from the pass-through entity (if applicable).

For each pass-through entity reported on line 11, attach a supporting schedule that provides that entity's name, EIN (if applicable), the corporation's end of year profit-sharing percentage (if applicable), the corporation's end of year loss-sharing percentage (if applicable), and the amounts reported by the corporation in column (a), (b), (c), or (d) of line 11, as applicable.

Line 12. Items Relating to Reportable Transactions

Any amounts attributable to any reportable transactions (as described in Regulations section 1.6011-4) other than transactions described in Regulations section 1.6011-4(b)(6) relating to significant book-tax differences must be included on Part II, line 12, regardless of whether the difference, or differences, would otherwise be reported elsewhere in Part II or Part III. Thus, if a taxpayer files Form 8886 for any reportable transaction described in Regulations section 1.6011-4 and the transaction is not described in Regulations section 1.6011-4(b)(6) relating to significant book-tax differences, the amounts attributable to that reportable transaction must be reported on Part II, line 12. In addition, all income and expense amounts attributable to a reportable transaction must be reported on Part II, line 12, columns (a) and (d) even if there is no difference between the financial statement amounts and the taxable amounts.

Each difference attributable to a reportable transaction must be separately stated and adequately disclosed. A corporation will be considered to have separately stated and adequately disclosed a reportable transaction on line 12 if the corporation sequentially numbers each Form 8886 and lists by identifying number on the supporting schedule for Part II, line 12, each sequentially numbered reportable transaction and the amounts required for Part II, line 12, columns (a) through (d).

In lieu of the requirements of the preceding paragraph, a corporation will be considered to have separately stated and adequately disclosed a reportable transaction if the corporation attaches a supporting schedule that provides the following for each reportable transaction:

1. A description of the reportable transaction disclosed on Form 8886 for which amounts are reported on Part II, line 12;
2. The name and tax shelter registration number, if applicable, as reported on lines 1a and 1b, respectively, of Form 8886; and

3. The type of reportable transaction (i.e., listed transaction, confidential transaction, transaction with contractual protection, etc.) as reported on line 2 of Form 8886.

If a transaction is a listed transaction described in Regulations section 1.6011-4(b)(2), the description also must include the description provided on line 3 of Form 8886. In addition, if the reportable transaction involves an investment in the transaction through another entity such as a partnership, the description must include the name and EIN (if applicable) of that entity as reported on line 5 of Form 8886.

Example 15. Corporation J is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. J incurred seven different abandonment losses during its 2005 tax year. One loss of $12 million results from a reportable transaction described in Regulations section 1.6011-4(b)(5), another loss of $5 million results from a reportable transaction described in Regulations section 1.6011-4(b)(4), and the remaining five abandonment losses are not reportable transactions. J discloses the reportable transactions giving rise to the $12 million and $5 million losses on separate Forms 8886 and sequentially numbers them X1 and X2, respectively. J must separately state and adequately disclose the $12 million and $5 million losses on Part II, line 12. The $12 million loss and the $5 million loss will be adequately disclosed if J attaches a supporting schedule for line 12 that lists each of the sequentially numbered forms, Form 8886-X1 and Form 8886-X2, and with respect to each reportable transaction reports the appropriate amounts required for Part II, line 12, columns (a) through (d). Alternatively, J's disclosures will be adequate if the description provided for each loss on the supporting schedule includes the names and tax shelter registration numbers, if any, disclosed on the applicable Form 8886, identifies the type of reportable transaction for the loss, and reports the appropriate amounts required for Part II, line 12, columns (a) through (d). J must report the losses attributable to the other five abandonment losses on Part II, line 23e, Abandonment losses, regardless of whether a difference exists for any or all of those abandonment losses.

Example 16. Corporation K is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. K enters into a transaction with contractual protection that is a reportable transaction described in Regulations section 1.6011-4(b)(4). This reportable transaction is the only reportable transaction for K's 2005 tax year and results in a $7 million capital loss for both financial statement purposes and U.S. federal income tax purposes. Although the transaction does not result in a difference, K is required to report on Part II, line 12, the following amounts: ($7 million) in column (a), zero in columns (b) and (c), and ($7 million) in column (d). The transaction will be adequately disclosed if K attaches a supporting schedule for line 12 that (a) sequentially numbers the Form 8886 and refers to the sequentially-numbered Form 8886-X1 and (b) reports the applicable amounts required for line 12, columns (a) through (d). Alternatively, the transaction will be adequately disclosed if the supporting statement for line 12 includes a description of the transaction, the name and tax shelter registration number, if any, and the type of reportable transaction disclosed on Form 8886.

Line 13. Interest Income

With the exception of interest income derived from a pass-through entity and required to be reported on Part II, line 9, 10, or 11, as applicable, or interest from a reportable transaction (as described in Regulations section 1.6011-4) other than a transaction described in Regulations section 1.6011-4(b)(6) relating to significant book-tax differences required to be reported on Part II, line 12, Items relating to reportable transactions, report on Part II, line 13, column (a), the total amount of interest income included on Part I, line 11, and report on Part II, line 13, column (d), the total amount of interest income included on Form 1120, page 1, line 28. In columns (b) or (c), as applicable, adjust for any amounts treated for U.S. federal income tax purposes as imputed interest income or other interest income that are treated as some other form of income in the financial statements. For example, if rental income is reported in the financial income statement or books and records with respect to a transaction required to be treated for U.S. federal income tax purposes as a sale in exchange for periodic payments of purchase price, part of the "rent" each year is principal and part is interest income for U.S. federal income tax purposes. The interest income imputed on the transaction each year must be shown as a difference on Part II, line 13, columns (b) or (c), as applicable, with the taxable interest amount being included in column (d). A description of how to report the difference for the corresponding financial statement rental income is included on page 11 in the instructions for line 18, Sale versus lease (for sellers and/or lessors).

Line 14. Total Accrual to Cash Adjustment

This line is completed by a corporation that prepares financial statements (or books and records, if permitted) using an overall accrual method of accounting and uses an overall cash method of accounting for U.S. federal income tax purposes (or vice-versa). With the exception of amounts required to be reported on Part II, line 12, Items relating to reportable transactions, the corporation must report on Part II, line 14, a single amount net of all adjustments attributable solely to the use of the different overall methods of accounting (e.g., adjustments related to accounts receivable, accounts payable, compensation, accrued liabilities, etc.), regardless of whether a separate line on Schedule M-3 corresponds to an item within the accrual to cash reconciliation. Differences not attributable to the use of the different overall methods of accounting must be reported on the appropriate lines of Schedule M-3 (e.g., a depreciation difference must be reported on Part III, line 31, Depreciation).

Example 17. Corporation L is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. L prepares financial statements in accordance with GAAP using an overall accrual method of accounting. L uses an overall cash method of accounting for U.S. federal income tax purposes. L's financial statements for the year ending December 31, 2005, report accounts receivable of $35,000, an allowance for bad debts of $10,000, and accounts payable of $17,000 related to current year acquisition and reorganization legal and accounting fees. In addition, for L's year ending December 31, 2005, L reported financial statement depreciation expense of $15,000 and depreciation for U.S. federal income tax purposes of $25,000. For L's 2005 tax year using an overall cash method of accounting, L does not recognize the $35,000 of revenue attributable to the accounts receivable, cannot deduct the $10,000 allowance for bad debt, and cannot deduct the $17,000 of accounts payable. In its financial statements, L treats both the difference in overall accounting methods used for financial statement and U.S. federal income tax purposes and the difference in depreciation expense as temporary differences. L must combine all

adjustments attributable to the differences related to the overall accounting methods on Part II, line 14. As a result, L must report on Part II, line 14, $8,000 in column (a) ($35,000 - $10,000 - $17,000), ($8,000) in column (b), and zero in column (d). L must not report the accrual to cash adjustment attributable to the legal and accounting fees on Part III, line 24, Current year acquisition or reorganization legal and accounting fees. Because the difference in depreciation expense does not relate to the use of the cash or accrual method of accounting, L must report the depreciation difference on Part III, line 31, Depreciation, and report $15,000 in column (a), $10,000 in column (b), and $25,000 in column (d).

Line 15. Hedging Transactions

Report on line 15, column (a), the net gain or loss from hedging transactions included in net income per the income statement. Report in column (d) the amount of taxable income from hedging transactions. Use columns (b) and (c) to report all differences caused by treating hedging transactions differently for financial accounting purposes and for U.S. federal income tax purposes. For example, if a portion of a hedge is considered ineffective under GAAP but still is a valid hedge under section 1221(b)(2), the difference must be reported on line 15. The hedge of a capital asset, which is not a valid hedge for U.S. federal income tax purposes but may be considered a hedge for GAAP purposes, must also be reported here.

Report hedging gains and losses computed under the mark-to-market method of accounting on line 15 and not on Part II, line 16, Mark-to-market income (loss).

Report any gain or loss from inventory hedging transactions on line 15 and not on Part II, line 17, Inventory valuation adjustments.

Line 16. Mark-to-Market Income (Loss)

Report on line 16 any amount representing the mark-to-market income or loss for any securities held by a dealer in securities, a dealer in commodities having made a valid election under section 475(e), or a trader in securities or commodities having made a valid election under section 475(f). "Securities" for these purposes are securities described in section 475(c)(2) and section 475(e)(2). "Securities" do not include any items specifically excluded from sections 475(c)(2) and 475(e)(2), such as contracts to which section 1256(a) applies.

Report hedging gains and losses computed under the mark-to-market method of accounting on Part II, line 15, Hedging transactions, and not on line 16.

Line 17. Inventory Valuation Adjustments

Report on line 17 any amounts deducted as part of cost of goods sold during the tax year, including any amounts attributable to inventory valuation, for example, amounts attributable to cost-flow assumptions, additional costs required to be capitalized to ending inventory (including depreciation) such as section 263A costs, inventory shrinkage accruals, inventory obsolescence reserves, and lower of cost or market write-downs. Report section 481(a) adjustments related to cost of goods sold or inventory valuation on Part II, line 19, Section 481(a) adjustments, and not on this line 17.

Report any gain or loss from inventory hedging transactions on Part II, line 15, Hedging transactions, and not on this line 17.

Report mark-to-market income or (loss) associated with the inventories of dealers in securities under section 475 on Part II, line 16, Mark-to-market income (loss), and not on this line 17.

Line 18. Sale Versus Lease (for Sellers and/or Lessors)

(Also see the instructions at Part III, line 34, on page 15, for purchasers and/or lessees.)

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a sale or a lease may, under some circumstances, be characterized as the opposite for tax purposes. If the transaction is treated as a lease, the seller/lessor reports the periodic payments as gross rental income and also reports depreciation expense or deduction. If the transaction is treated as a sale, the seller/lessor reports gross profit (sale price less cost of goods sold) from the sale of assets and reports the periodic payments as payments of principal and interest income.

On Part II, line 18, column (a), report the gross profit or gross rental income for financial income purposes for all sale or lease transactions that must be given the opposite characterization for tax purposes. On Part II, line 18, column (d), report the gross profit or gross rental income for federal income tax purposes. Interest income amounts for such transactions must be reported on Part II, line 13, Interest income, in column (a) or (d), as applicable. Depreciation expense for such transactions must be reported on Part III, line 31, Depreciation, in column (a) or (d), as applicable. Use columns (b) and (c) of Part II, lines 13 and 18, and Part III, line 31, as applicable to report the differences between column (a) and (d).

Example 18. Corporation M sells and leases property to customers. M is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. For financial accounting purposes, M accounts for each transaction as a sale. For U.S. federal income tax purposes, each of M's transactions must be treated as a lease. In its financial statements, M treats the difference in the financial accounting and the U.S. federal income tax treatment of these transactions as temporary. During 2005, M reports in its financial statements $1,000 of sales and $700 of cost of goods sold with respect to 2005 lease transactions. M receives periodic payments of $500 in 2005 with respect to these 2005 transactions and similar transactions from prior years and treats $400 as principal and $100 as interest income. For financial income purposes, M reports gross profit of $300 ($1,000 - $700) and interest income of $100 from these transactions. For U.S. federal income tax purposes, M reports $500 of gross rental income (the periodic payments) and (based on other facts) $200 of depreciation deduction on the property. On its 2005 Schedule M-3, M must report on Part II, line 13, Interest income, $100 in column (a), ($100) in column (b), and zero in column (d). In addition, M must report on Part II, line 18, $300 of gross profit in column (a), $200 in column (b), and $500 of gross rental income in column (d). Lastly, M must report on Part III, line 31, Depreciation, $200 in column (b) and (d).

Line 19. Section 481(a) Adjustments

With the exception of a section 481(a) adjustment that is required to be reported on Part II, line 12, Items relating to reportable transactions, any difference between an income or expense item attributable to an authorized (or unauthorized) change in method of accounting made for U.S. federal income tax purposes that results in a section 481(a) adjustment must be reported on Part II, line 19, regardless of whether a separate line for that income or expense item exists in Part II or Part III.

Example 19. Corporation N is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. N was depreciating certain fixed assets over an erroneous recovery period and, effective for its 2005 tax year, N receives IRS consent to change its method of accounting for the depreciable fixed assets and begins using the proper recovery period. The change in method of accounting results in a positive section 481(a) adjustment of $100,000 that is required to be spread over four tax years, beginning with the 2005 tax year. In its financial statements, N treats the section 481(a) adjustment as a temporary difference. N must report on Part II, line 19, $25,000 in columns (b) and (d) for its 2005 tax year and each of the subsequent three tax years (unless N is otherwise required to recognize the remainder of the 481(a) adjustment earlier). N must not report the section 481(a) adjustment on Part III, line 31, Depreciation.

Line 20. Unearned/Deferred Revenue

With the exception of income recognized from long-term contacts that is reported on line 21, Income recognition from long-term contracts, report on line 20 any revenue amounts that are attributable to revenue that is, or was, unearned or deferred for financial statement purposes (or books and records, if applicable) or U.S. federal income tax purposes.

Line 21. Income Recognition From Long-Term Contracts

Report on line 21 the amount of net income or loss for financial statement purposes (or books and records, if applicable) or U.S. federal income tax purposes for any contract accounted for under a long-term contract method of accounting.

Line 22. Original Issue Discount and Other Imputed Interest

Report on line 22 any amounts of original issue discount (OID) and imputed interest. The term "original issue discount and other imputed interest" includes, but is not limited to:

1. The difference between issue price and the stated redemption price at maturity of a debt instrument, which may be wholly or partially realized on the disposition of a debt instrument under section 1273;
2. Amounts that are imputed interest on a deferred sales contract under section 483;
3. Amounts treated as interest or OID under the stripped bond rules under section 1286; and
4. Amounts treated as OID under the below-market interest rate rules under section 7872.

Line 23a. Income Statement Gain/Loss on Sale, Exchange, Abandonment, Worthlessness, or Other Disposition of Assets Other Than Inventory and Flow-Through Entities

Report on line 23a, column (a), all gains and losses on the disposition of assets except for (a) gains and losses on the disposition of inventory, and (b) gains and losses allocated to the corporation from a flow-through entity (e.g., on Schedule K-1) that are included in the net income (loss) per income statement of includible corporations reported on Part I, line 11. Reverse the amount reported in column (a) in column (b) or (c), as applicable. The corresponding gains and losses for U.S. federal income tax purposes are reported on Part II, lines 23b through 23g, as applicable.

Line 23b. Gross Capital Gains From Schedule D, Excluding Amounts From Flow-Through Entities

Report on line 23b, gross capital gains reported on Schedule D, excluding capital gains from flow-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable.

Line 23c. Gross Capital Losses From Schedule D, Excluding Amounts From Flow-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23c, gross capital losses reported on Schedule D, excluding capital losses from (a) flow-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f. Do not report on line 23c capital losses carried over from a prior tax year and utilized in the current tax year. See the instructions for Part II, line 25, regarding the reporting requirements for capital loss carryovers utilized in the current tax year.

Line 23d. Net Gain/Loss Reported on Form 4797, Line 17, Excluding Amounts From Flow-Through Entities, Abandonment Losses, and Worthless Stock Losses

Report on line 23d the net gain or loss reported on line 17 of Form 4797, Sales of Business Property, excluding amounts from (a) flow-through entities, which must be reported on Part II, lines 9, 10, or 11, as applicable; (b) abandonment losses, which must be reported on Part II, line 23e; and (c) worthless stock losses, which must be reported on Part II, line 23f.

Line 23e. Abandonment Losses

Report on line 23e any abandonment losses, regardless of whether the loss is characterized as an ordinary loss or a capital loss.

Line 23f. Worthless Stock Losses

Report on line 23f any worthless stock loss, regardless of whether the loss is characterized as an ordinary loss or a capital loss. Attach a schedule that separately states and adequately discloses each transaction that gives rise to a worthless stock loss and the amount of each loss.

Line 23g. Other Gain/Loss on Disposition of Assets Other Than Inventory

Report on line 23g any gains or losses from the sale or exchange of property other than inventory and that are not reported on lines 23b through 23f.

Line 24. Disallowed Capital Loss in Excess of Capital Gains

Report as a positive amount on line 24, columns (b) or (c), as applicable, and (d), the excess of the net capital losses over the net capital gains reported on Schedule D, Capital Gains and Losses, by the corporation. For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated net capital loss that is disallowed should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidation eliminations as described in *Consolidated Schedule M-3 Versus Consolidating Schedules M-3*, on page 2.

Line 25. Utilization of Capital Loss Carryforward

If the corporation utilizes a capital loss carryforward on Schedule D in the current tax year, report the carryforward utilized as a negative amount on Part II, line 25, columns (b) or (c), as applicable, and column (d). For a U.S. consolidated tax group, the Schedule M-3 adjustment for the amount of the consolidated capital loss carryforward should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate Schedule M-3 for consolidation eliminations as described in *Consolidated Schedule M-3 Versus Consolidating Schedules M-3*, on page 2.

Line 26. Other Income (Loss) Items With Differences

Separately state and adequately disclose on Part II, line 26, all items of income (loss) with differences that are not otherwise listed on Part II, lines 1 through 25. Attach a schedule that itemizes the type of income (loss) and the amount of each item.

If any "comprehensive income" as defined by Statement of Financial Accounting Standards (SFAS) No. 130 is reported on this line, describe the item(s) in detail. Examples of sufficiently detailed descriptions include "Foreign currency translation adjustments" and "gains and losses on available-for-sale securities."

Line 28. Total Expense/ Deduction Items

Report on Part II, line 28, columns (a) through (d), as applicable, the negative of the amounts reported on Part III, line 36, columns (a) through (d). For example, if Part III, line 36, column (a), reflects an amount of $1 million then report on Part II, line 28, column (a), ($1 million). Similarly, if Part III, line 36, column (b), reflects an amount of ($50,000), then report on Part II, line 28, column (b), $50,000.

Line 29. Other Income/Loss and Expense/Deduction Items With No Differences

If there is no difference between the financial accounting amount and the taxable amount of an entire item of income, gain, loss, expense, or deduction and the item is not described or included in Part II, lines 1 through 26, or Part III, lines 1 through 35, report the entire amount of the item in columns (a) and (d) of line 29. If a portion of an item of income, loss, expense, or deduction has a difference and a portion of the item does not have a difference, do not report any portion of the item on line 29. Instead, report the entire amount of the item (i.e., both the portion with a difference and the portion without a difference) on the applicable line of Part II, lines 1 through 26, or Part III, lines 1 through 35. See Example 11 on page 7.

Line 30. Reconciliation Totals

Combine all the amounts on lines 27 through 29 and enter the totals in columns (a), (b), (c), and (d).

Note. Line 30, column (a), must equal the amount on Part I, line 11, and line 30, column (d), must equal Form 1120, page 1, line 28.

If a corporation chooses not to complete columns (a) and (d) of Parts II and III in the first tax year the corporation is required to file Schedule M-3 (or for any year in which the corporation voluntarily files Schedule M-3), Part II, line 30, is reconciled by the corporation (or, in the case of a U.S. consolidated tax group, on the group's consolidated Schedule M-3) in the following manner:

1. Report the amount from Part I, line 11, on Part II, line 30, column (a);
2. Leave blank Part II, lines 1 through 29, columns (a) and (d);
3. Leave blank Part III, columns (a) and (d); and
4. Report on Part II, line 30, column (d), the sum of Part II, line 30, columns (a), (b), and (c).

Part III. Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return — Expense/ Deduction Items

Lines 1 Through 6. Income Tax Expense

If the corporation does not distinguish between current and deferred income tax expense in its financial statements (or its books and records, if applicable), report income tax expense as current income tax expense using lines 1, 3, and 5, as applicable.

A U.S. consolidated tax group must complete lines 1 through 6 in accordance with the allocation of tax expense among the members of the U.S. consolidated tax group in the financial statements (or its books and records, if applicable). If the current and deferred U.S., state, and foreign income tax expense for the U.S. consolidated tax group (income tax expense) is allocated among the members of the U.S. consolidated tax group in the group's financial statements (or its books and records, if applicable), then each member must report its allocated income tax expense on Part III, lines 1 through 6, of that member's separate Schedule M-3. However, if the income tax expense is not shared or allocated among members of the U.S. consolidated tax group but is retained in the parent corporation's financial statements (or books and records, if applicable), then amounts are reported only on Part III, lines 1 through 6, of the parent's separate Schedule M-3.

Line 7. Foreign Withholding Taxes

Report on line 7, column (a), the amount of foreign withholding taxes included in financial accounting net income on Part I, line 11. If the corporation is deducting foreign tax, use column (b) or (c), as applicable, to correct for any difference between foreign withholding tax included in financial accounting net income and the amount of foreign withholding taxes being deducted in the return. If the corporation is crediting foreign withholding taxes against the U.S. income tax liability, use column (b) or (c), as applicable, to negate the amount reported in column (a).

Line 8. Incentive Stock Options

Do not report any amount on line 8, column (a). Instead, include any amount expensed per the income statement for incentive stock options as part of the amount on Part III, line 9, column (a). Report on line 8, columns (b), (c), and (d), as applicable, any deductible amounts attributable to the disposition of shares delivered pursuant to the exercise of incentive stock options.

Line 9. Nonqualified Stock Options

Report on line 9, column (a), any amounts expensed per the income statement attributable to all stock options. Report on line 9, column (d), any deductible amounts attributable to the exercise of payments made pursuant to nonqualified stock options (i.e., stock options not qualified under section 422 or 423).

Line 10. Other Equity-Based Compensation

Report on line 10 any amounts for equity-based compensation or consideration that are reflected as expense in the financial statements

(column (a)) or deducted in the U.S. federal income tax return (column (d)) other than amounts reportable elsewhere on Schedule M-3, Parts II and III (e.g., on Part III, lines 8 and 9, for incentive stock options and nonqualified stock options, respectively). Examples of amounts reportable on line 10 include payments attributable to employee stock purchase plans (ESPPs), phantom stock options, phantom stock units, stock warrants, stock appreciation rights, and restricted stock, regardless of whether such payments are made to employees or nonemployees, or as payment for property or compensation for services.

Line 11. Meals and Entertainment

Report on line 11, column (a), any amounts paid or accrued by the corporation during the tax year for meals, beverages, and entertainment that are accounted for in financial accounting income, regardless of the classification, nomenclature, or terminology used for such amounts, and regardless of how or where such amounts are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. Report only amounts not otherwise reportable elsewhere on Schedule M-3, Parts II and III (e.g., Part II, line 17, Inventory valuation adjustments).

Line 12. Fines and Penalties

Report on line 12 any fines or similar penalties paid to a government or other authority for the violation of any law for which fines or penalties are assessed. All fines and penalties expensed in financial accounting income (paid or accrued) must be included on this line 12, column (a), regardless of the government or other authority that imposed the fines or penalties, regardless of whether the fines and penalties are civil or criminal, regardless of the classification, nomenclature, or terminology used for the fines or penalties by the imposing authority in its actions or documents, and regardless of how or where the fines or penalties are classified in the corporation's financial income statement or the income and expense accounts maintained in the corporation's books and records. See sections 162(f) and 162(g) for additional guidance.

Line 13. Punitive Damages

Include on line 13, column (a), any amount included in net income per the income statement attributable to punitive damages, regardless of whether the amount deducted was attributable to an estimate of future anticipated payments or actual payments. Report in column (b) or (c), as applicable, the deductible or nondeductible punitive damages. Report in column (d) the amount of punitive damages deductible for U.S. federal income tax purposes.

Line 14. Parachute Payments

Report on line 14, column (a), the total expense included in financial accounting net income on Part I, line 11, that is subject to section 280G. Report in column (b) or (c), as applicable, the amount of nondeductible parachute payments pursuant to section 280G, and report in column (d) the deductible amount of compensation after any excess parachute payment limitations under section 280G. If a payment is subject to limitation under both sections 162(m) and 280G, report the total payment on this line 14.

Line 15. Compensation With Section 162(m) Limitation

Report on line 15, column (a), the total amount of non-performance-based current compensation expense for the corporate officers to whom section 162(m) applies. Report the nondeductible amount of current compensation in excess of $1 million in column (b) or (c), as applicable, and the deductible compensation in column (d). If a payment is subject to limitation under both sections 162(m) and 280G, report the total payment on Part III, line 14, Parachute payments. See Regulations section 1.162-27(g) for the interaction between sections 162(m) and 280G.

Line 16. Pension and Profit-Sharing

Report on line 16 any amounts attributable to the corporation's pension plans, profit-sharing plans, and any other retirement plans.

Line 17. Other Post-Retirement Benefits

Report on line 17 any amounts attributable to other post-retirement benefits not otherwise includible on Part III, line 16, for example, retiree health and life insurance coverage, dental coverage, etc.

Line 18. Deferred Compensation

Report on line 18, column (a), any compensation expense included in the net income amount reported in the income statement that was not reported elsewhere on Schedule M-3, column (a). Report on line 18, column (d), any compensation deductible in the current tax year that is not otherwise reportable elsewhere on Schedule M-3, including any compensation deductions deferred in a prior tax year.

Line 20. Charitable Contribution of Intangible Property

Report on line 20 any charitable contribution of intangible property, for example, contributions of:

- Intellectual property, patents (including any amounts of additional contributions allowable by virtue of income earned by donees subsequent to the year of donation), copyrights, trademarks;
- Securities (including stocks and their derivatives, stock options, and bonds);
- Conservation easements (including scenic easements or air rights);
- Railroad rights of way;
- Mineral rights; and
- Other intangible property.

Line 21. Charitable Contribution Limitation

Report as a negative amount on line 21, columns (b), (c), and (d) as applicable, the excess of charitable contributions made during the tax year over the amount of the charitable contribution limitation amount. When a U.S. consolidated federal income tax return is being filed, the Schedule M-3 adjustment for the amount of contributions in excess of the limitation should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate consolidating Schedule M-3 for consolidation eliminations as described in *Consolidated Schedule M-3 Versus Consolidating Schedules M-3*, on page 2.

Line 22. Charitable Contribution Carryforward Used

If the corporation utilizes a contribution carryforward in the current tax year, report the carryforward utilized as a positive amount on Part III, line 22, columns (b), (c), and (d), as applicable. When a U.S. consolidated federal income tax return is being filed, the Schedule M-3 adjustment for the amount of charitable contribution carryforward used should not be made on the separate consolidating Schedules M-3 of the includible corporations, but on the separate consolidating Schedule M-3 for consolidation eliminations and adjustments as described in *Consolidated Schedule M-3 Versus Consolidating Schedules M-3*, on page 2.

Line 23. Current Year Acquisition or Reorganization Investment Banking Fees

Report on line 23 any investment banking fees paid or incurred in connection with a taxable or tax-free acquisition of property (e.g., stock or assets) or a tax-free reorganization. Report on this line any investment banking fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line 23 investment banking fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 24. Current Year Acquisition or Reorganization Legal and Accounting Fees

Report on line 24 any legal and accounting fees paid or incurred in connection with a taxable or tax-free acquisition of property (e.g., stock or assets) or tax-free reorganization. Report on this line any legal and accounting fees incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line 24 legal and accounting fees incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 25. Current Year Acquisition/Reorganization Other Costs

Report on line 25 any other fees paid or incurred in connection with a taxable or tax-free acquisition of property (e.g., stock or assets) or a tax-free reorganization not otherwise reportable on Schedule M-3 (e.g., Part III, line 23 or 24). Report on this line any fees paid or incurred at any stage of the acquisition or reorganization process including, for example, fees paid or incurred to evaluate whether to investigate an acquisition, fees to conduct an actual investigation, and fees to consummate the acquisition. Also include on this line 25 other acquisition/reorganization costs incurred in connection with the liquidation of a subsidiary, a spin-off of a subsidiary, or an initial public stock offering.

Line 26. Amortization/ Impairment of Goodwill

Report on line 26 amortization of goodwill or amounts attributable to the impairment of goodwill.

Line 27. Amortization of Acquisition, Reorganization, and Start-Up Costs

Report on line 27 amortization of acquisition, reorganization, and start-up costs. For purposes of column (b), (c), and (d), include amounts amortizable under section 167, 195, or 248.

Line 28. Other Amortization or Impairment Write-Offs

Report on line 28 any amortization or impairment write-offs not otherwise includible on Schedule M-3.

Line 29. Section 198 Environmental Remediation Costs

Report on line 29, column (a), any amounts attributable to environmental remediation costs included in the net income per the income statement. Report in columns (b), (c), and (d), as applicable, any deductible amounts attributable to environmental remediation costs described in section 198 that are paid or incurred during the current tax year.

Line 31. Depreciation

Report on line 31 any depreciation expense that is not required to be reported elsewhere on Schedule M-3 (e.g., on Part II, lines, 9, 10, 11, or 17).

Line 32. Bad Debt Expense

Report on line 32, column (a), any amounts attributable to an allowance for uncollectible accounts receivable or actual write-offs of accounts receivable included in net income per the income statement. Report in column (d) the amount of bad debt expense deductible for federal income tax purposes in accordance with section 166.

Line 33. Corporate Owned Life Insurance Premiums

Report on line 33 all amounts of insurance premiums attributable to any life insurance policy if the corporation is directly or indirectly a beneficiary under the policy or if the policy has a cash value. Report in column (d) the amount of the premiums that are deductible for federal income tax purposes.

Line 34. Purchase Versus Lease (for Purchasers and/or Lessees)

(Also see the instructions at Part II, line 18, on page 11, for sellers and/or lessors.)

Asset transfer transactions with periodic payments characterized for financial accounting purposes as either a purchase or a lease may, under some circumstances, be characterized as the opposite for tax purposes.

If a transaction is treated as a lease, the purchaser/lessee reports the periodic payments as gross rental expense. If the transaction is treated as a purchase, the purchaser/lessee reports the periodic payments as payments of principal and interest and also reports depreciation expense or deduction with respect to the purchased asset.

Report on Part III, line 34, column (a), gross rent expense for a transaction treated as a lease for income statement purposes but as a sale for tax return purposes. Report on Part III, line 34, column (d), gross rental deductions for a transaction treated as a lease for tax purposes but as a purchase for income statement purposes. Report interest expense or deduction amounts for such transactions on Part III, line 35, Other expense/deduction items with differences, in column (a) or (d), as applicable. Report depreciation expense or deductions for such transactions on Part III, line 31, Depreciation, in column (a) or (d), as applicable. Use columns (b) and (c) of Part III, lines 31, 34, and 35, as applicable, to report the differences between column (a) and (d) for such recharacterized transactions.

Example 20. U.S. corporation X acquired property with a sale price of $3,000 in a transaction that, for financial accounting purposes, X treats as a lease. X is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. For U.S. federal income tax purposes, because of its terms, the transaction is taxed as a purchase and X must treat the periodic payments it makes partially as payment of principal and partially as payment of interest. In its financial statements, X treats the difference between the financial accounting and U.S. federal tax treatment of this transaction as temporary. During 2005, X reports in its financial statements $1,000 of gross rental expense that, for federal income tax purposes, is recharacterized as a $700 payment of principal and a $300 payment of interest, accompanied by a

depreciation deduction of $1,200 (based on other facts). On its 2005 Schedule M-3, X must report the following on Part III, line 34: column (a) $1,000, its financial accounting gross rental expense; column (b), ($1,000); and column (d), zero. On Part III, line 35, X reports $300 in columns (b) and (d) for the interest deduction. On Part III, line 31, X reports $1,200 in columns (b) and (d) for the depreciation deduction.

Line 35. Other Expense/ Deduction Items With Differences

Report on Part III, line 35, all items of expense/deduction that are not otherwise listed on Part III, lines 1 through 34.

Comprehensive income. If any "comprehensive income" as defined by SFAS No. 130 is reported on this line, describe the item(s) in detail as, for example, "Foreign currency translation adjustments" and "Gains and losses on available-for-sale securities."

Reserves and contingent liabilities. Report on line 35 each reserve or contingent liability that is not reported elsewhere in Schedule M-3. Report on line 35, column (a), expenses included in net income reported on Part I, line 11, that are related to reserves and contingent liabilities. Report on line 35, column (d), amounts related to liabilities for reserves and contingent liabilities that are deductible in the current tax year for U.S. federal income tax purposes. Examples of items that must be reported on line 35 include warranty reserves, restructuring reserves, reserves for discontinued operations, reserves for legal proceedings, and reserves for acquisitions and dispositions. Only report on line 35 items that are not required to be reported elsewhere on Schedule M-3, Parts II and III. For example, the expense for a reserve for inventory obsolescence must be reported on Part II, line 17, Inventory valuation adjustments.

The schedule of details attached to the return for line 35 must separately state and adequately disclose the nature and amount of the expense related to each reserve and/or contingent liability. The appropriate level of disclosure depends upon each taxpayer's operational activity and the nature of its accounting records. For example, if a corporation's net income amount reported in the income statement includes anticipated expenses for a discontinued operation as a single amount, and its general ledger or other books, records, and workpapers provide details for the anticipated expenses under more explanatory and defined categories such as employee termination costs, lease cancellation costs, loss on sale of equipment, etc., a supporting schedule that lists those categories of expenses and their details will satisfy the requirement to separately state and adequately disclose. In order to separately state and adequately disclose the employee termination costs, it is not required that an anticipated termination cost amount be listed for each employee, or that each asset (or category of asset) be listed along with the anticipated loss on disposition.

Example 21. Corporation P is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. P has been sued by its customers in a class action product liability lawsuit. The trial date is in 2006. In its 2005 financial statements, P establishes a reserve of $1 million for its potential liability related to the class action lawsuit and reports corresponding expenses in the amounts of $400,000 for estimated product replacement and $600,000 for estimated personal damages. For U.S. federal income tax purposes, the $1 million is not deductible in 2005. In its financial statements, P treats the difference between the financial statement treatment and the U.S. federal income tax treatment of the reserve for the lawsuit as a temporary difference. P must report in its 2005 U.S. federal income tax return on Part III, line 35, $1 million in column (a), ($1 million) in column (b), and zero in column (d). If P attaches a supporting schedule to Part III, line 35, explaining that the $1 million of difference is attributable to estimated product replacement cost in the amount of $400,000 and estimated personal damages in the amount of $600,000, that level of detail will be sufficient to separately state and adequately disclose the $1 million adjustment.

Example 22. Same as Example 21 except that in 2006 P pays $1 million to settle the lawsuit with the settlement documents stipulating that the product replacement amount is $450,000 and the damage amount is $550,000. Both the $450,000 and $550,000 settlement amounts are deductible for U.S. federal income tax purposes in 2006. On its 2006 Schedule M-3, P must report on Part III, line 35, zero in column (a), $1 million in column (b), and $1 million in column (d). If P attaches a supporting schedule to Part III, line 35, explaining that the $1 million of difference is attributable to actual product replacement cost in the amount of $450,000 and actual personal damages in the amount of $550,000, that level of detail will be sufficient to separately state and adequately disclose the $1 million deduction.

Various prepaid expenses. Report on Part III, line 35, the amortization of various items of prepaid expense, such as prepaid subscriptions and license fees, prepaid insurance, etc.

Example 23. Corporation Q is a calendar year taxpayer that was required to file Schedule M-3 for its 2004 tax year and is required to file Schedule M-3 for its 2005 tax year. On July 1 of each year, Q has a fixed liability for its annual insurance premiums that provides a 12-month coverage period beginning July 1 through June 30. In addition, Q historically prepays 12 months of advertising expense on July 1. On July 1, 2005, Q prepays its insurance premium of $500,000 and advertising expenses of $800,000. For financial statement purposes, Q capitalizes and amortizes the prepaid insurance and advertising over 12 months. For U.S. federal income tax purposes, Q deducts the insurance premium when paid and amortizes the advertising over the 12-month period. In its financial statements, Q treats the differences attributable to the financial statement treatment and U.S. federal income tax treatment of the prepaid insurance and advertising as temporary differences. Q must separately state and adequately disclose on Part III, line 35, its prepaid insurance premium and report $250,000 in column (a) ($500,000/12 months X 6 months), $250,000 in column (b), and $500,000 in column (d). Q must also separately state and adequately disclose on Part II, line 29, Other income (loss) and expense/ deduction items with no differences, its prepaid advertising and report $400,000 in column (a) and (d).

Line 36. Total Expense/ Deduction Items

Report on Part II, line 28, columns (a) though (d), as applicable, the negative of the amounts reported on Part III, line 36, column (a) through (d), as applicable. For example, if Part III, line 36, column (a), reflects an amount of $1 million, then report on Part II, line 28, column (a), ($1 million). Similarly, if Part III, line 36, column (b), reflects an amount of ($50,000), then report on Part II, line 28, column (b), $50,000.

SCHEDULE M-3 (Form 1120) Department of the Treasury Internal Revenue Service	**Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More** ▶ Attach to Form 1120. ▶ See separate instructions.	OMB No. 1545-0123 **2004**

Name of corporation (common parent, if consolidated return)	**Employer identification number**

Part I **Financial Information and Net Income (Loss) Reconciliation**

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☐ **No.** Go to line 1b.

b Did the corporation prepare a certified audited income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☐ **No.** Go to line 1c.

c Did the corporation prepare an income statement for that period?
☐ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 10 and enter the corporation's net income (loss) per its books and records on line 11.

2a Enter the income statement period: Beginning ____/____/____ Ending ____/____/____

b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☐ **No.**

c Has the corporation's income statement been restated for any of the five income statement periods preceeding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☐ **No.**

3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☐ **No.** If "No," go to line 4.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . . ☐☐☐☐☐

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . . ☐☐☐☐☐☐☐☐☐

4	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1	**4**	
5a	Net income from nonincludible foreign entities (attach schedule)	**5a**	( )
b	Net loss from nonincludible foreign entities (attach schedule and enter as a positive amount) . .	**5b**	
6a	Net income from nonincludible U.S. entities (attach schedule)	**6a**	( )
b	Net loss from nonincludible U.S. entities (attach schedule and enter as a positive amount) . . .	**6b**	
7a	Net income of other includible corporations (attach schedule)	**7a**	
b	Net loss of other includible corporations (attach schedule)	**7b**	( )
8	Adjustment to eliminations of transactions between includible corporations and nonincludible entities (attach schedule)	**8**	
9	Adjustment to reconcile income statement period to tax year (attach schedule)	**9**	
10	Other adjustments to reconcile to amount on line 11 (attach schedule)	**10**	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10	**11**	

Name of corporation (common parent, if consolidated return) | Employer identification number

Name of subsidiary (if consolidated return) | Employer identification number

Part II Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return

	Income (Loss) Items	(a) Income (Loss) per Income Statement (optional)	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return (optional)
1	Income (loss) from equity method foreign corporations				
2	Gross foreign dividends not previously taxed				
3	Subpart F, QEF, and similar income inclusions				
4	Section 78 gross-up				
5	Gross foreign distributions previously taxed				
6	Income (loss) from equity method U.S. corporations				
7	U.S. dividends not eliminated in tax consolidation				
8	Minority interest for includible corporations				
9	Income (loss) from U.S. partnerships (attach schedule)				
10	Income (loss) from foreign partnerships (attach schedule)				
11	Income (loss) from other pass-through entities (attach schedule)				
12	Items relating to reportable transactions (attach details)				
13	Interest income				
14	Total accrual to cash adjustment				
15	Hedging transactions				
16	Mark-to-market income (loss)				
17	Inventory valuation adjustments				
18	Sale versus lease (for sellers and/or lessors)				
19	Section 481(a) adjustments				
20	Unearned/deferred revenue				
21	Income recognition from long-term contracts				
22	Original issue discount and other imputed interest				
23a	Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and flow-through entities				
23b	Gross capital gains from Schedule D, excluding amounts from flow-through entities				
23c	Gross capital losses from Schedule D, excluding amounts from flow-through entities, abandonment losses, and worthless stock losses				
23d	Net gain/loss reported on Form 4797, line 17, excluding amounts from flow-through entities, abandonment losses, and worthless stock losses				
23e	Abandonment losses				
23f	Worthless stock losses (attach details)				
23g	Other gain/loss on disposition of assets other than inventory				
24	Disallowed capital loss in excess of capital gains				
25	Utilization of capital loss carryforward				
26	Other income (loss) items with differences (attach schedule)				
27	**Total income (loss) items.** Combine lines 1 through 26				
28	**Total expense/deduction items** (from Part III, line 36)				
29	Other income (loss) and expense/deduction items with no differences				
30	**Reconciliation totals.** Combine lines 27 through 29				

Note. Line 30, column (a), must equal the amount on Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

Name of corporation (common parent, if consolidated return) | **Employer identification number**

Name of subsidiary (if consolidated return) | **Employer identification number**

Part III Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items

	Expense/Deduction Items	(a) Expense per Income Statement (optional)	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return (optional)
1	U.S. current income tax expense				
2	U.S. deferred income tax expense				
3	State and local current income tax expense				
4	State and local deferred income tax expense				
5	Foreign current income tax expense (other than foreign withholding taxes)				
6	Foreign deferred income tax expense				
7	Foreign withholding taxes				
8	Incentive stock options				
9	Nonqualified stock options				
10	Other equity-based compensation				
11	Meals and entertainment				
12	Fines and penalties				
13	Punitive damages				
14	Parachute payments				
15	Compensation with section 162(m) limitation				
16	Pension and profit-sharing				
17	Other post-retirement benefits				
18	Deferred compensation				
19	Charitable contribution of cash and tangible property				
20	Charitable contribution of intangible property				
21	Charitable contribution limitation				
22	Charitable contribution carryforward used				
23	Current year acquisition or reorganization investment banking fees				
24	Current year acquisition or reorganization legal and accounting fees				
25	Current year acquisition/reorganization other costs				
26	Amortization/impairment of goodwill				
27	Amortization of acquisition, reorganization, and start-up costs				
28	Other amortization or impairment write-offs				
29	Section 198 environmental remediation costs				
30	Depletion				
31	Depreciation				
32	Bad debt expense				
33	Corporate owned life insurance premiums				
34	Purchase versus lease (for purchasers and/or lessees)				
35	Other expense/deduction items with differences (attach schedule)				
36	**Total expense/deduction items.** Combine lines 1 through 35. Enter here and on Part II, line 28				

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 2, 2004
JS-2124

Treasury's Deputy Assistant Secretary Iannicola Speaks at Annual Meeting of Georgia Consortium for Per Financial Literacy

Treasury's Deputy Assistant Secretary for Financial Education, Dan Iannicola, Jr., today delivered the keynote address at the annual meeting of the Georgia Consortium for Personal Financial Literacy, the Georgia Jump$tart affiliate, at the Federal Reserve Bank of Atlanta. Iannicola addressed over 100 participants representing nonprofit, private and government organizations focused on improving financial education in Georgia. He presented the group with Treasury's Eight Elements for a Successful Financial Education Program, which can help grass roots organizations improve and expand financial education in the state.

Iannicola encouraged the members of the Georgia Consortium for Personal Financial Literacy to continue their efforts. "By partnering with one another you're improving financial education in Georgia and you're getting the right information, to the right people, at the right time," said Iannicola. "These organizations you represent are putting individuals and whole communities on the path to financial security."

The Georgia Consortium for Personal Financial Literacy works with businesses and state and local governments to implement policies and practices that encourage wise personal finance decision-making. Some of the founding member organizations include the Community Foundation for Greater Atlanta, Consumer Credit Counseling Service, Georgia Council on Economic Education, the Federal Reserve Bank of Atlanta, and Junior Achievement of Georgia. The Jump$tart Coalition for Personal Financial Literacy is a non-profit organization that seeks to improve the personal financial literacy of young adults.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

REPORTS

- Iannicola's presentation of Treasury's Eight Elements for a Successful Financial Education Program

Deputy Assistant Secretary Dan Iannicola's Presentation of Treasury's Eight Elements of a Successful Financial Education Program to the Georgia Consortium for Personal Financial Literacy

The Office of Financial Education works to ensure that Americans have access to financial education programs that can help them obtain practical knowledge and skills to make informed financial choices throughout their lives. To that end, the Treasury Department published a list of eight elements of a successful financial education program. The success factors relate to the program's content, delivery, impact, and sustainability, and I suspect that upon closer inspection, many of the programs offered by the organizations represented here today are already well on their way to meeting these success factors. These elements can serve as a guide, whether your organization's goal is to develop new programs or to enhance existing program strategies for achieving the greatest impact throughout the state.

Our first element states that a successful financial education program is one that focuses on one or more of the four basic tenets of financial empowerment: basic savings, credit management, home ownership and retirement planning. While there are other worthwhile financial education topics, these four areas are the basic building blocks to achieving financial security and are therefore the primary focus of Treasury's Office of Financial Education.

Our second element points out that a successful program is tailored to its target audience, taking into account its language, culture, age and experience. Cultural biases, language differences, and other related factors play an important role in the development of any educational program.

Our third element of a successful financial education program recognizes that programs having the most profound impact are delivered through a local distribution channel that makes effective use of community resources and contacts. Partnerships with local organizations that are already ingrained in the community are one of the most effective means of garnering support and acceptance within a community and will result in the more effective delivery of information.

Our fourth element is demonstrated when a financial education program follows up with participants to reinforce the message and ensure that participants are able to apply the skills taught. These actions serve to further break down those barriers and to pave the road to better access to financial services.

Our fifth element requires that a successful program establishes specific program goals and uses performance measures to track progress toward meeting those goals. To achieve goals, an organization must set goals. It is important that financial education providers set a standard of excellence and track progress toward achieving their missions.

Our sixth element states that successful programs can prove their worth, by demonstrating a positive impact on participants' attitudes, knowledge or behavior through testing, surveys or other objective evaluation. Did participants increase their savings? Did they open bank accounts? Did they save for a home and qualify for a mortgage? These are all measures of success and ways that a financial education program can demonstrate impact on its community.

Our seventh element inquires whether a financial education program can be easily replicated on a local, regional or national basis so as to have broad impact and sustainability.

And finally, under our eighth element we ask whether a financial education program is built to last as evidenced by factors such as continuing financial support, legislative backing or integration into an established course of instruction. This element simply recognizes that good programs must have the ability to survive if they are to have a strong impact.

Additionally, organizations with an interest in financial education can also receive input on program design and available resources, explore partnerships with other organizations and learn about best practices in financial education through the office's recently launched Technical Assistance Center. By helping organizations to launch new programs or improve existing ones, the center fills an important need in the financial education community. The center can be accessed online at http://www.treasury.gov/financialeducation or by telephone at (202) 622-9372.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 3, 2004
JS-2125

Statement of Secretary John W. Snow on November Employment Report

"November's job creation numbers are a confirmation that the American economy is on a steady growth path. The economy has created more than 2 million jobs so far this year, averaging nearly 200,000 new jobs a month. This is the fifteenth consecutive month of job creation, with the economy adding 112,000 new jobs in November. Falling to 5.4 percent last month, the unemployment rate remains below the average of each of the past three decades.

"This is a clear sign that the President's economic policies are working the way they were intended. By putting more money into taxpayers' pockets and enhancing the incentive to work and invest, his tax cuts continue to lead to economic growth and good job creation."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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Report to Congress on International Economic and Exchange Rate Policies

This report reviews developments in international economic policy, including exchange rate policy, focusing on the first half of 2004. The report is required under the Omnibus Trade and Competitiveness Act of 1988, which states, among other things, that: "The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

This report reviews the effects that significant international economic developments have had on the United States and foreign economies and evaluates the factors that underlie those developments. For the specific purpose of assessing whether an economy is manipulating the rate of exchange between its currency and the U.S. dollar according to the terms of the Act, Treasury has traditionally undertaken a careful review of the trading partner's exchange rates, external balances, foreign exchange reserve accumulation, macroeconomic trends, monetary and financial developments, the state of institutional development, and financial and exchange restrictions. Attention is given to both the changes and interactions of significant variables. Isolated developments in any one area do not typically provide sufficient grounds to conclude that exchange rates are being manipulated under the terms of the Act. A combination of factors, on the other hand, can and has in the past led Treasury to find that certain countries had satisfied the terms of the Act.

After reviewing developments in the United States, the report examines exchange rate policies in major economies across five regions of the world: (1) the Western Hemisphere, (2) Europe and Eurasia, (3) Sub-Saharan Africa, (4) North Africa, the Middle East and South Asia, and (5) East Asia. To summarize, the report finds that:

- Economies around the world continue to follow a variety of exchange rate policies, ranging from a flexible exchange rate with little or no intervention to currency unions and full dollarization. For example, Canada follows a flexible exchange rate regime with no intervention, twelve countries are members of the European Monetary Union, and El Salvador, Ecuador and Panama use the U.S. dollar as their "domestic" currency.

- A notable trend observed over the past several years is the move by many economies to adopt flexible exchange rates, combined with clear price stability goals and a transparent system for adjusting monetary policy instruments.

- The report finds that no major trading partner of the United States met the technical requirements for designation under the Omnibus Trade and Competitiveness Act of 1988 during the first half of 2004. The report notes that while a number of economies continue to use pegged exchange rates and/or intervene in foreign exchange markets, a peg or intervention does not in and of itself satisfy the statutory test. Treasury has consulted with the IMF management and staff, as required by the statute, and they concur with our conclusions. The Administration strongly believes that a system of flexible, market-based exchange rates is best for major trading partners of the United States.

- Treasury is continuing to engage actively with economies and to encourage,

in both bilateral and multilateral discussions, policies for large economies that promote a flexible market-based exchange rate combined with a clear price stability goal and a transparent system for adjusting policy instruments. In this light, the communiqués of the G-7 Finance Ministers and Central Bank Governors in February, April and October of this year stated: "...that more flexibility in exchange rates is desirable for major countries or economic areas that lack such flexibility to promote smooth and widespread adjustments in the international financial system, based on market mechanisms."

The United States International Accounts[1]

The current account deficit is conceptually equal to the gap between investment and saving as a matter of international accounting. When investment in the United States is higher than domestic saving, foreigners make up the difference, and the United States has a current account deficit. In contrast, if saving exceeds investment in a country, then that country has a current account surplus as its people invest abroad.

The growth of the U.S. current account deficit over more than a decade has been linked to high levels of domestic U.S. capital formation compared to domestic U.S. saving. Perceived high rates of return on U.S. assets, based on sustained strong productivity growth relative to the rest of the world, attract foreign investment.

In the first half of 2004, for example, the U.S. current account deficit was $594 billion (at a seasonally adjusted annual rate and on a national income and product accounting, or NIPA, basis) or 5.1 percent of GDP. This $594 billion deficit equaled the gap between $2,246 billion in investment and $1,652 billion in saving[2]. That is, U.S. domestic investment was $594 billion more than domestic saving with net foreign investment making up the difference.

Overall, rapid growth in real GDP over the latter part of 2003 extended into the first quarter of 2004 when real GDP rose at a strong 4.5 percent annual rate. That was followed by a softening in the second quarter, with real GDP rising at a 3.3 percent pace, leaving growth in the first half, however, at a solid 3.9 percent annual rate. The second-quarter slowdown was concentrated in personal consumption expenditures, inventory investment and net exports. In contrast, business fixed investment strengthened considerably in the second quarter, rising at a 12.5 percent pace following a 4.2 percent increase in the first quarter, supported by growing profits and a profit margin that has been holding near a six-year high.

The current account was $627 billion in deficit (at a seasonally adjusted annual rate and on a balance of payments basis[3]) in the first half of 2004. A major item financing the current account deficit has been net private foreign purchases of U.S. securities, which reached an annualized $503 billion in the first half of 2004. (Included in these were net private foreign purchases of U.S. Treasury securities amounting to $202 billion.) In addition, foreign official institutions increased their U.S. assets by $403 billion.

Viewed over a longer period, the U.S. current account balance declined, as a percent of GDP, from a 1 percent surplus in the first quarter of 1991 to a 4 percent deficit in the fourth quarter of 2000, to a 5 percent deficit in the first half of 2004.

Due to the current account deficit the net investment position of the United States (with direct investment valued at the current stock market value of owners' equity) fell to a negative $2.7 trillion as of December 31, 2003, the latest date for which data are available, from a negative $2.6 trillion at the end of 2002. A $398 billion valuation adjustment due to exchange rate changes offset much of 2003's financial outflow. Despite a large negative position, U.S. residents earned $39 billion more on their foreign investments in 2003 than foreigners earned on their U.S. investments. These positive net income receipts are the result of large net inflows of income from direct investment offsetting net outflows of income on portfolio investment.

The U.S. current account deficit is the counterpart of the aggregate surplus of other economies in the world. The policies of all countries affect the global pattern of current account balances. It is important that policies that the United States follows to reduce global imbalances keep the United States and the world economy strong. There are three types of economic policies that the Bush Administration is pursuing and will continue to pursue which relate directly to the current account. First are policies aimed at increasing saving of the public sector and the private sector as the U.S. economy continues to expand. A second group of economic policies are those that will raise global growth. A third area of policy relates to exchange rate flexibility for certain Asian economies that lack such flexibility.

The U.S. Dollar

The Federal Reserve Board's "broad" nominal dollar index increased 2.2 percent during the first half of 2004. The dollar rose 2.9 percent against the "major" foreign currencies (seven other industrialized economy currencies) while rising 1.4 percent against "other important trading partners" (largely currencies of emerging market economies). The broad index declined 11.0 percent from February 27, 2002, when it reached its recent peak, through June 30, 2004. Over this latter period the dollar depreciated 22.6 percent against the major currencies while appreciating 5.8 percent against the currencies of other important trading partners.

Over the year ending in June 2004, the consumer price index rose 3.3 percent, the largest 12-month increase since mid-2001. Energy prices were a primary factor, up 17.0 percent over the year ending in June. The core CPI (excluding food and energy) increased 1.9 percent over the twelve months through June 2004 compared to 1.1 percent in the twelve months through December 2003, the latter being the smallest increase in core consumer prices since 1966. The Fed increased the federal funds target rate by 25 basis points to 1.25 percent at the end of June from the 1 percent where it had been held for the preceding 12 months. There were additional 25-basis point increases in August, September and November.

As discussed below, the currencies of different economies showed varying degrees of flexibility relative to the dollar, as some monetary authorities sought to dampen or prevent movements of their exchange rates against the dollar while others did not intervene at all. The United States did not intervene in foreign exchange markets during the first half of 2004.

Western Hemisphere

Nominal exchange rates in the region on average depreciated against the U.S. dollar in the first half of the year. Interest rate spreads between the Latin American Emerging Market Bond Index (EMBI+) and U.S. Treasury securities increased from 518 basis points at the end of 2003 to 600 basis points by end June. The region's growth outlook remains positive for 2004, with the major economies posting solid growth rates in the first half of the year.

Argentina

Argentina has had a flexible exchange rate since the end of 2001 when it abandoned its convertibility law, which pegged the peso one-to-one with the U.S. dollar. Argentina's currency remained relatively steady in the first half of 2004, depreciating 1.0 percent from 2.93 pesos per dollar to 2.96 pesos per dollar. Argentina's trade surplus was $5.9 billion in the first half of 2004, compared with $8.3 billion for the same period the previous year, with exports rising 13 percent and imports rising 71 percent. The seasonally adjusted current account surplus narrowed to 2.1 percent in the first half of 2004 compared to 7.5 percent in the first half of 2003. Argentina's gross foreign exchange reserves grew by $3.3 billion during the first half of the year to $17.4 billion at the end of June 2004 as Argentina intervened during periods of peso strengthening in order to rebuild reserves. The economic recovery continued after the severe contraction in the first half of 2002, with real GDP growing 6.7 percent at a seasonally adjusted annualized rate in the first half of 2004 over the second half of 2003. Consumer prices accelerated somewhat, with the year-on-year increase reaching 4.8 percent in June 2004 compared with 3.8 percent in December 2003. Conditions in the banking system continued to improve. Interest rates on saving deposits of 30-44 day maturities fell from 3.6 percent at end-December 2003 to 2.4 percent as of end-June 2004.

Brazil

Brazil has a floating exchange rate regime and relies on inflation targeting to guide monetary policy. Following a 22 percent nominal appreciation in 2003, the *real* depreciated 6.3 percent in the first half of the year to BRL3.08/US$. Brazil's sovereign risk spread stood at 646 basis points over U.S. Treasuries at end-June 2004 versus 463 basis points at the end of 2003. Year-on-year inflation stood at 6.0 percent in June, slightly above the center of the central bank's 5.5 percent target for 2004 but within the target band. Brazil had seasonally adjusted current account surpluses of 1.2 percent and 2.2 percent of GDP in the first and second quarters of 2004, respectively. The United States had a bilateral trade deficit with Brazil of $2.4 billion in the first half of 2004 compared to a $3.3 billion deficit during the same period in 2003. Foreign direct investment inflows grew in the first half of the year to $4.0 billion compared with $3.5 billion during the same period in 2003. Net international reserves increased to $25 billion at the end of June 2004 compared to $20.5 billion at the end of December 2003, in part due to central bank purchases of foreign exchange. The economic recovery continued in the first half of the year with annualized GDP growth rates of 7.5 percent and 5.5 percent in the first and second quarters, respectively.

Canada

Canada has a floating exchange rate regime. It has not intervened in the foreign exchange market since 1998, except to make a small contribution to the brief G-7 intervention in support of the euro in September 2000. During the first half of 2004 the Canadian dollar depreciated 3.6 percent, from 0.77 US$/C$ to 0.75 US$/C$. The J.P. Morgan trade-weighted index for the real exchange rate for Canada depreciated 5.6 percent while the J.P. Morgan trade-weighted index for the nominal exchange rate for Canada depreciated 3.2 percent. Canada's current account surpluses during the first and second quarters of 2004 were 2.6 percent and 3.5 percent of GDP, respectively. The merchandise trade surplus with the U.S. was $32.5 billion during the first half of 2004. Canada's international reserves declined by 2.3 percent in the first half of 2004 to $35.4 billion. M3 grew 8.1 percent year-on-year in June 2004 compared to 6.8 percent year-on-year in December 2003. Year-on-year headline inflation in June 2004 was 2.5 percent. The economy expanded in the first half of 2004, with annualized real GDP growth of 2.7 percent and 3.9 percent in the first and second quarters, respectively.

Mexico

Mexico has a floating exchange rate regime. Its central bank targets an inflation rate of 3 percent with a +/-1percent band. The Bank of Mexico also follows a transparent rule for selling foreign reserves accumulated by state enterprises. During the first half of 2004 the Mexican peso depreciated 2.6 percent, from 11.2 pesos/dollar to 11.5 pesos/dollar. J.P. Morgan's Narrow Nominal Effective Exchange Rate Index of the peso depreciated 1.0 percent while the J.P Morgan real effective index of the peso appreciated by 1.8 percent. Mexico's current account deficits during the first and second quarters of 2004 were 1.2 percent and 0.9 percent of GDP, respectively. The merchandise trade surplus with the U.S. was $22.3 billion during the first half of 2004. Foreign direct investment during the period was $11.0 billion, versus $6.8 billion in the comparable period in 2003. International reserves grew $1.7 billion during the first half of the year, reaching $59.1 billion by the end of June. M3 grew 13.9 percent year-on-year in June 2004 compared with 13.6 percent year-on-year in December 2003. Year-on-year headline inflation was 4.4 percent in June. The economy grew robustly in the first six months of 2004, with real seasonally adjusted GDP increasing at annual rates of 5.5 percent and 4.5 percent during the first and second quarters, respectively.

Europe and Eurasia

The European Monetary Union

The euro depreciated 3.3 percent against the dollar in the first half of 2004. The real effective exchange rate depreciated 2.0 percent over the period. The ECB did not intervene in foreign exchange markets during the first half of 2004.

The countries in the Euro-zone taken together had a current account surplus during the first half of 2004 equal to $41.1 billion (sa) or 0.9 percent of GDP, up from $7.2

billion and $20.5 billion in the first and second halves of 2003, respectively. Goods exports increased 8.0 percent while goods imports increased 4.6 percent in the first half of 2004 over the same period in 2003. The trade surplus of the Euro-zone vis-à-vis the U.S. was $35.2 billion, which is about the same level as in the second half of 2003.

Euro-zone growth was an estimated 2.3 percent (annualized) in the first half of 2004. Germany and Italy have held back Euro-zone growth, but France had annualized growth of 3.3 percent in the second quarter, led by strong domestic demand. For the region, final consumption expenditure rose 0.8 percent in the first half of 2004 while investment declined 0.1 percent. The harmonized consumer price index rose at an annual rate of 2.8 percent in the first half of 2004 while the index excluding energy, food, alcohol and tobacco rose 2.0 percent.

Central Europe

The currencies of the major central European economies weakened slightly against the dollar during the first half of 2004. This largely resulted from the dollar's appreciation against the euro. Each of the currencies strengthened against the euro, their main reference currency, supported by expectations of higher domestic interest rates.

In Hungary, shorter term yields of 11.0 percent helped the forint appreciate 3.5 percent against the euro (and decrease 0.4 percent against the dollar), despite continued concern about large fiscal and current account deficits. The National Bank of Hungary's index of the real value of the forint rose 7.8 percent during the first half due to higher inflation.

Expectations of upcoming interest rate increases also led to appreciation of the Polish zloty and the Czech koruna. The koruna appreciated 2.0 percent against the euro (a decrease of 1.6 percent against the dollar), while the zloty rose 3.8 percent against the euro during the first half of 2004 (a decrease of 0.2 percent against the dollar). The koruna was little changed in real terms, but the National Bank of Poland's index of the real zloty appreciated 7.6 percent.

In Slovakia, the koruna appreciated 3.0 percent against the euro (and decreased 0.2 percent against the dollar) supported by strong export growth and expectations of large FDI inflows. High inflation contributed to a real koruna appreciation of 6.6 percent. Separately, the Bulgarian lev weakened against the dollar as its value was fixed to the euro as part of Bulgaria's successful currency board arrangement.

Russia

The large net inflows resulting from high oil prices and high foreign borrowing by Russian corporations in 2003 continued during the first half of 2004. Russia's current account surplus in the first half of 2004 was $22.6 billion, or 8.1 percent of GDP, compared to $17.4 billion, or 7.6 percent of GDP, in the second half of 2003. The ruble appreciated 0.6 percent against the U.S. dollar in the first half 2004 compared to 3.8 percent in the second half of 2003. According to the J.P. Morgan Broad Real Effective Exchange Rate Index, the ruble appreciated 6.0 percent in the first half of 2004 compared to 3.3 percent in the second half of 2003. The Russian monetary authorities continued to intervene to moderate the appreciation of the ruble against the dollar, and foreign exchange reserves increased $11.3 billion to a record high of $88.2 billion. M2 grew 40.4 percent in the year through June 2004 compared to 51.6 percent in the year through December 2003. Consumer prices rose 10.1 percent in the year through June 2004 compared to 12.0 percent in the year through December 2003.

Sub-Saharan Africa

Many African countries maintain pegged exchange rates. The currencies of the CFA zone depreciated against the dollar during the period, in line with the euro to which these currencies are pegged. Sub-Saharan African currencies with more flexible regimes saw their currencies generally appreciate against the U.S. dollar on a nominal basis in the first half of 2004. The South African rand, which is close to freely floating, continued to strengthen, appreciating by 9.2 percent on a nominal effective basis and 5.2 percent on a real effective basis. The rand has now appreciated by over 60 percent in real terms from lows reached in December 2001.

This strength reflects unwinding of the undershooting in 2001, rising commodity prices, strong economic fundamentals, and improved investor sentiment toward emerging markets in general. In Zimbabwe, the introduction of new foreign exchange regulations including a managed foreign exchange auction, together with a government clampdown on parallel market activities, led to an appreciation of the Zimbabwe dollar in the early part of the year. Later in the period, in an effort to encourage exporters and overseas workers to remit foreign exchange earnings through formal channels, the government allowed the auction rate to depreciate. Nevertheless, the depreciation of the Zimbabwe dollar has not kept pace with inflation, which stood at 363 percent in the year to end-July.

Real GDP growth in sub-Saharan Africa is expected to rise to around 4 ½ percent in 2004 from 3 1/2 percent in 2003. This pickup in growth reflects improving macroeconomic stability in many countries, easing external debt burdens, large increases in oil production, higher global commodity prices, and improved security situations in several countries. Sub-Saharan Africa's overall current account deficit is projected to be 1.4 percent of GDP in 2004, compared to a deficit of 2.4 percent in 2003, due largely to higher oil and other commodity prices. Africa's trade surplus with the United States increased to $22.6 billion during the first three quarters of 2004, compared to $16.5 billion during the same period of 2003, due in large part to higher oil prices.

North Africa, the Middle East and South Asia

Growth continues to be very strong across the Middle East and North Africa, supported by record high oil prices. GDP in the oil-exporting countries of the Gulf Cooperation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE), in particular, increased significantly. Current accounts across the Gulf remain largely in balance or surplus, and have increased significantly, along with holdings of official reserves, mainly due to higher oil prices. Oil-exporting GCC countries tie their currencies directly to the U.S. dollar.

Many other countries in the region, such as Jordan and the countries of North Africa, also maintain pegged exchange rate regimes. Egypt returned to a *de facto* peg after the Egyptian pound depreciated 23 percent in nominal terms in the six months following its official float in January 2003. In the first six months of 2004, the pound depreciated 0.7 percent in the official market, while at the same time very strong export receipts (primarily due to high oil export revenues, Suez Canal receipts, and a rebound in tourism) and a tightening of monetary policy helped the pound to appreciate nearly 10 percent on the black market, virtually eliminating the spread between the two rates. Net international reserves increased by $60 million to $14.8 billion during that period.

Turkey, however, maintains a floating exchange rate regime. The Turkish lira depreciated 5.5 percent in nominal terms against the U.S. dollar in the six months to June, but the lira's real trade-weighted value fell a more modest 2.2 percent. Real GNP in the first half of 2004 grew by 13.5 percent compared to the first half of 2003, a significant increase from the 5.9 percent growth rate recorded in 2003. Despite the strong growth, the inflation rate continued to decline, falling to 8.9 percent year-on-year in June 2004 from 18.4 percent in 2003. The current account deficit for the first half of 2004 widened to 4 percent of GNP from its 2.8 percent level in 2003 on the back of the strong domestic economy and consumer demand. In the first six months of 2004, imports and exports increased 47 percent and 32 percent, respectively, compared with the same period in 2003. Imports of capital and consumption goods grew by 84 percent and 109 percent, respectively, in the same period, but intermediate goods continue to account for 67 percent of imports. The growing current account deficit is still mostly financed through short-term capital inflows. As a result, gross foreign exchange reserves changed little to June 2004, continuing to hover around $33 billion compared to $33.6 billion at end-December 2003.

In Israel, which also maintains a floating exchange rate, the shekel depreciated during the first half of 2004, falling 2.7 percent against the dollar in nominal terms and 3.0 percent in real trade-weighted terms. This followed a 5.8 percent trade-weighted depreciation in the last half of the 2003. Foreign exchange reserves remained nearly unchanged at around $25.7 billion at end-June, as compared with the 4.9 percent growth in reserves in the second half of 2003. A weaker currency and rising demand in major export markets helped boost exports, and as a result GDP growth increased to 2.5 percent for the first half of 2004 compared to 1.2

percent for 2003 as a whole.

In South Asia, India targets a Real Effective Exchange Rate (REER) benchmark based on cross-border inflation differentials and currency movements. Although the Reserve Bank of India does not intervene to curtail short-term volatility relative to the U.S. dollar, the exchange rate has not been allowed to stray too far from its REER benchmark. The rupee depreciated by less than 1 percent in the first half of 2004. The U.S. bilateral merchandise trade deficit with India rose to $4.8 billion for the first half of 2004, compared to $4.1 billion for the first half of 2003. Foreign exchange reserves stood at $114.15 billion at the end of June, up from $96.5 billion at the end of 2003. Real GDP grew by 7.4 percent year-on-year in the second quarter of 2004.

East Asia

After picking up speed in the last half of 2003, East Asian GDP growth accelerated in the first quarter of 2004, fueled by buoyant export markets, the recovery of the global IT sector, and strong growth in domestic demand, most notably in China and Japan. Economic growth has been widespread across the economies of East Asia, increasing at the fastest rate since the 1997 financial crisis.

After a very strong first quarter, East Asian growth rates dropped off in the second quarter, particularly in Japan. Higher oil prices, and the expectation that they might persist for some time, were clearly part of the reason. But efforts to slow the growth of the Chinese economy also had an impact, since rapidly growing Chinese import demand had provided a major boost to growth throughout the region.

Rising interest rates in the United States; a sharp, although relatively brief, widening of emerging market spreads; and higher oil prices all appear to have reduced portfolio investment inflows to East Asia in the second quarter of 2004. As a result, monetary authorities that faced large foreign exchange inflows and upward pressures on their currencies in the second half of 2003 and first quarter of 2004 saw diminished inflows in the second quarter.

Trade flows among East Asian economies have increased sharply in recent years, reflecting increased integration of economies in the region. But increased intra-regional trade also reflects the increasing diffusion of component production among economies in the region, often for products that are exported outside East Asia. As a result, monetary authorities appear to be increasingly concerned about the effect of currency appreciation on their competitiveness relative to other economies in East Asia. While noting these concerns, the Administration has encouraged increased exchange rate flexibility for East Asian economies generally, both in bilateral discussions and in regional fora such as APEC. APEC Finance Ministers took a significant step in this direction in their statement of September 3, welcoming steps taken by member economies to facilitate the move to greater exchange rate flexibility.

Japan

Japan's economic recovery, which began in the second quarter of 2002, continued in the first half of 2004. Strong growth carried over into the first quarter but slowed markedly in the second quarter. Japan also made some progress in its long struggle to overcome deflation. In the first half of the year, consumer prices, excluding fresh food, declined at the rate of 0.1 percent year-over-year, compared to a deflation rate of about 0.6 percent a year ago. However, if the effect of higher oil prices and other special factors are excluded, underlying consumer price deflation appears to remain close to half a percent per year, and other measures of price change show greater and undiminished deflation.

As in past recoveries, exports have contributed to this recovery, with particularly strong growth of exports to China in this case. In the first half of 2004, exports grew by 6.5 percent and imports by 4.8 percent. Japan's global current account surplus grew to $88.9 billion (3.8 percent of GDP) in the first half of 2004, up from $75.8 billion (3.4 percent of GDP) in the second half of 2003. Japan's bilateral merchandise trade surplus with the United States totaled $36.2 billion in the first half, up from $33.8 billion in the second half of 2003.

However, private spending, notably private investment and consumer spending,

has played an important role in this recovery, and contributed most of first half 2004 growth.[4] In contrast to past recoveries, expansionary fiscal policy has not contributed to output growth this time, as the government continues with its medium-term fiscal consolidation program. The persistent Japanese global current account surplus reflects the high rate of Japanese domestic saving relative to domestic investment. Despite the recent recovery of investment, expectations of slower trend growth have meant lower investment, and the share of private investment in GDP has fallen from 26 percent in the 1960s, to 22 percent in the 1980s, to 19 percent in the last three years. Rates of return on domestic investment have been generally low, although the Prime Minister's program of structural reform and deregulation and the recent acceleration of corporate restructuring and mergers and acquisition activity hold out the prospect of higher returns. Japan's surplus of private saving over private investment has been only partially absorbed by government deficits, leading to a persistent current account surplus and capital outflows to the rest of the world.

The Japanese recovery and the prospects of higher stock market prices led to large net portfolio capital inflows in Japan, starting in May 2003. These inflows strengthened over the course of 2003 and into the first quarter of 2004. Expectations of yen appreciation also contributed to first quarter 2004 inflows. International Monetary Market (IMM) data on short and long futures positions show that market expectations of an appreciation of the yen were particularly strong at the beginning of 2004. This net portfolio capital inflow slowed and then reversed in the second quarter in response to changing expectations of U.S. growth relative to Japanese growth and higher U.S. interest rates. About one-third of the net capital inflows during the first quarter were subsequently reversed in the second quarter. Following the end of the Japanese fiscal year March 30, pension fund reinvestment overseas surged in April and May. Japanese investors also began diversifying into overseas equities and shifted funds into U.S. bonds.

During the December 31, 2003 to June 30, 2004 reporting period, the yen depreciated 2.1 percent against the dollar, and 2.7 percent on a real trade-weighted basis, as measured by the J.P. Morgan Broad Real Effective Exchange Rate index. The yen appreciated by 2.8 percent to ¥104.2 during the first quarter, a period in which its value fluctuated fairly widely.[5] The yen subsequently weakened by 4.8 percent during the second quarter. Over a more extended period, since late February 2002 through the end of June 2004, the dollar has depreciated by 18.7 percent against the yen, similar to its 22.6 percent depreciation against the major currency component of the index over the same period. Since June 30, the yen has traded more narrowly against the dollar, ending October at ¥106.04, or 3.2 percent stronger than at end-June.

Japanese authorities intervened in the foreign exchange market during the first quarter of 2004, with yen sales totaling approximately $138 billion. Japanese authorities publicly report their foreign exchange market intervention at the end of each month, and have not reported any intervention since March 16, 2004. Japanese authorities have stated that their "intervention is carried out when excess volatility or over-shooting is observed in the markets," and that they do not target particular values of the exchange rate.

The Treasury is actively engaged in discussions with Japanese authorities on these issues, both bilaterally and through the meetings of the G-7 finance ministers and central bank governors. At G-7 meetings in Dubai, Boca Raton and more recently Washington, the Treasury worked with the G-7 to promote a strong consensus in support of flexible exchange rates. Japan joined the United States and other G-7 nations in these declarations.

China

China's economic growth rate accelerated in 2003 and into the first half of 2004, with particularly rapid growth in investment. The officially reported growth figure for 2003 was 9.3 percent, but estimates based on expenditure suggest that growth in 2003 was over 11 percent. This led to bottlenecks in several sectors and rising prices. Macroeconomic policy during 2004 has primarily been directed at slowing credit and investment growth in order to dampen inflationary pressures and assure sustained growth.

China's fixed exchange rate regime has made carrying out macroeconomic policy more difficult during this period. China's accumulation of foreign exchange

reserves continues to create monetary pressures that have fueled domestic credit and investment growth and inflation. Chinese policymakers took administrative measures over the last year to curb lending, but, until October 2004, hesitated to raise domestic interest rates.

These macroeconomic policy measures have had some success in cooling off the economy. Recent data suggest that the growth of several economic indicators has moderated from the rapid pace of 2003. Industrial production, broad money growth, and total loan growth slowed during the third quarter of this year compared to the same period in 2003. Reported real GDP growth slowed to a year-over-year rate of 9.1 percent in the third quarter of this year, down from 9.7 percent in the first half. But the risk of an inflationary boom followed by the hard landing that has characterized past Chinese cycles remains. Fixed asset investment is still growing at a double digit pace. Moreover, headline consumer price inflation rose to 5.2 percent year-on-year in September 2004, compared to 1.2 percent year-on-year one year ago.

Reflecting strong import demand driven by investment growth, China's overall trade balance recorded a (seasonally unadjusted) deficit in the first half of 2004 of $7 billion (1.0 percent of GDP), compared to a $4 billion surplus in the same period in 2003. China's exports rose 36 percent in the first half of 2004 compared to the first half of 2003 on strong external demand. China's imports grew by 43 percent during the same period. China's import growth has been driven by its rapid economic growth and integration into the world trading system following accession to the World Trade Organization (WTO). Growth rates for both Chinese imports and exports have also been driven by increasing use of China as a locale for assembly and final processing for East Asian manufacturing components into products destined for other markets, often the United States. As a result of the latter factor, China's trade surplus with the United States has been much larger than its overall trade balance. China's bilateral surplus on trade in goods with the United States in the first half of 2004 reached

$68.5 billion compared to $53.9 billion in the comparable period of 2003.

China kept its fixed exchange rate of 8.28 renminbi to the U.S. dollar throughout the reporting period, a rate it has maintained since 1995, through periods of both upward and downward pressures on the balance of payments. Its real trade-weighted exchange rate, a more important determinate of competitiveness, has fluctuated considerably. With faster domestic inflation, the renminbi appreciated 3.0 percent in real trade-weighted terms, as measured by the J.P. Morgan Broad Real Effective Exchange Rate Index, in the first half of 2004.

China's official foreign exchange reserves grew by a net $67 billion to $471 billion during the first half of 2004.[6] This growth in Chinese reserves is the counterpart of China's current account balance and net financial and capital inflows to the nonofficial sector. Foreign direct investment inflows in the first nine months of 2004 were $48.7 billion, up 21 percent from the comparable period in 2003. As in 2003, net non-FDI financial inflows to the non-official sector continue to be large and positive in 2004, due mainly to a sharp increase in portfolio capital inflows reflecting investors' expectations of continued strong growth and possible change in the exchange rate regime.

The Administration has urged Chinese leaders to move as soon as possible to greater flexibility, and has initiated an unprecedented level of engagement with the Chinese government and other major trading partners of the United States to help bring this about. In September 2004, the Treasury held the 16th U.S.-China Joint Economic Committee (JEC) meeting in Washington to discuss progress on a broad range of economic and financial issues, including exchange rates and how greater flexibility would better enable China to conduct monetary policy. In the JEC Joint Statement, China strengthened its commitment to move to a market-based, flexible exchange rate. In early October, G-7 Finance Ministers and Central Bank Governors met for the first time as a group with their Chinese counterparts; China's exchange rate policy was an important component of the discussions.

The United States continues to work actively with China in identifying and overcoming impediments to greater exchange rate flexibility. Treasury held three sessions with Chinese officials in 2004 focused on the mechanics of a flexible currency regime, as part of its Technical Cooperation Program. In February, meetings dealt with assessing and supervising currency risk in banking systems

and developing financial instruments to manage that risk. The session in June discussed banking supervision, credit analysis, international accounting standards, and resolution of non-performing loans. In September, Chinese central bank officials met with Treasury and other U.S. government agencies to discuss foreign reserve management and supervision and regulation of a currency derivatives market.

China has publicly stated its commitment to move to a flexible exchange rate regime. In September 2004, Chinese Premier Wen said China "will further advance the reform and forge a mechanism which is more adapted to the changes in market supply and demand, with still better flexibility." In the communiqué of the 16th U.S.-China Joint Economic Committee (JEC) meeting, China "reaffirmed its commitment to further advance reform and to push ahead firmly and steadily to a market-based flexible exchange rate." Governor Zhou of China's central bank has referred to the movement to a flexible exchange rate as a top priority issue for China.

China is laying the groundwork for a shift to a market-based, flexible exchange rate. The People's Bank of China, the central bank, recently liberalized certain interest rates, which is consistent with a move towards a flexible exchange rate. China has taken steps to reduce barriers to capital flows, which will help to deepen markets involving foreign exchange transactions. In July, China announced it would allow its national social security fund to invest in overseas capital markets. China is working to strengthen its banks and bank supervision, and to prepare these institutions for exchange rate flexibility. In addition, China has taken steps to develop financial products and systems to support foreign exchange trading and hedging of exchange rate risk.

The U.S. Government will pursue persistently and firmly its approach to promote economic, financial and market reforms in China and assist China to move as soon as possible to a flexible exchange rate regime.

Korea

Like the other economies in East Asia, Korea benefited greatly from growing Chinese and U.S. import demand and the recovery of the global IT sector. But domestic private demand in Korea has been much weaker than in other economies in the region, as Korea has struggled with the after-effects of a credit card boom and bust that has depressed household spending. Although Korea's economy was strong in the second half of 2003, growth decelerated to a 4.9 percent annual rate in the first half of 2004, largely due to a decline in private consumption of 0.7 percent. While inflation increased to 3.6 percent year-on-year by June 2004, this was mainly due to higher oil prices. Citing a slowdown in the pace of economic recovery, particularly in domestic demand, the Korean central bank reduced its benchmark call rate a quarter-point in August and again in November, bucking the global trend towards interest rate stabilization or increase.

External demand continued to support Korean growth in the reporting period. Exports in the first half of 2004 were up 38.4 percent year-on-year, continuing the strong pace set in the second half of 2003. Export growth to China was particularly strong, rising 57 percent. The growth of imports did not nearly match that of exports, although imports did rise 27 percent over the year. The difference in import and export growth rates was reflected in Korean external balances. Korea's current account surplus was 4.4 percent of GDP for the first half of 2004, compared to 0.2 percent in the first half of 2003. The U.S. bilateral trade deficit with Korea for the first half of 2004 totaled $9.0 billion, up from $2.1 billion for the same period in 2003, as U.S. imports from Korea grew by 21 percent, and exports to Korea by 5 percent. Total capital and financial flows, exclusive of reserve accumulation, registered a net deficit (outflow) of $0.6 billion (nsa) for the first half of 2004, down from a surplus of $13.2 billion for 2003, as investors become more concerned about Korea's growth prospects.

Korea maintains a managed floating exchange rate regime. Consistent with maintaining a relatively accommodative monetary stance in light of weak domestic demand, the Korean authorities continued to intervene in the first half of 2004, although the pace of reserve accumulation slackened. Official foreign reserves increased by $11.7 billion over the first half of 2004 to $166.2 billion, roughly equivalent to the total external debt of Korea, and equal to 2.8 times short-term external debt. In April, the government partially removed restrictions that were imposed in January 2004 limiting positions that domestic financial institutions could

take in the foreign exchange non-deliverable forwards market. These measures had been imposed in an attempt to curb upward speculation on a won appreciation. Despite the Korean authorities' intervention, by end-June 2004 the won had risen 3.1 percent against the dollar since end-2003. Korea's real effective exchange rate appreciated 5.5 percent over the course of the first half of 2004.

Taiwan

Accommodative monetary policy, along with higher oil and commodity prices, succeeded in halting three years of deflation as the headline consumer price index rose 3.1 percent saar in the six months through June 2004. Taiwan's GDP growth slowed to 3.6 percent in the first half of 2004 relative to the second half of 2003, after having rebounded at an annualized, seasonally adjusted rate of 10.7 percent in the second half of 2003 due to a sharp recovery of domestic demand (in particular business investment) and strong export growth (particularly to China). The slowdown was the result of both a slowing of investment from the very high growth of the second half of 2003 and a modest slowdown in government consumption.

Taiwan's exports grew by 25.5 percent in the first half of 2004, compared to the first half of 2003, with growth of exports to China particularly strong. Imports expanded by 34.6 percent, resulting in a decline of the overall trade surplus from $12.0 billion to $9.9 billion. Taiwan's bilateral trade surplus with the United States decreased from $7.4 billion in the first half of 2003 to $5.8 billion in the first half of 2004.

The current account surplus in the first half of 2004 was 7.5 percent of GDP (or $11.4 billion), marking a decline from a surplus of nearly 10 percent of GDP in 2003. Taiwan's high domestic saving relative to domestic investment make it a substantial net exporter of capital, contributing to continued current account surpluses.

Taiwan experienced strong portfolio capital inflows in the last half of 2003 and the first quarter of 2004. These followed the decision by the Taiwan government in July 2003 to scrap a rule restricting foreign fund investments in Taiwanese shares to $3 billion per fund. However, portfolio capital inflows turned negative in the second quarter due to tensions with China and several weeks of uncertainty following the presidential election.

Taiwan maintains a managed floating exchange rate regime. Total foreign exchange reserves increased by $23 billion in the first half of 2004, compared to a $30 billion increase in the latter half of 2003. By end-June, total foreign exchange reserves had reached $230 billion, or 80 percent of GDP and four times short term external debt. Most (roughly four-fifths) of the first half growth in reserves occurred in the first quarter. Reserve growth due to intervention diminished along with capital inflows in the second quarter of 2004. Reserve growth has continued at this slower pace since mid-year, with reserves rising by 1.3 percent in the third quarter to $233 billion.

The NT dollar appreciated gradually against the U.S. dollar during the first quarter of 2004, reaching a peak of NT32.93/USD in mid-April, up 3.8 percent from its end-2003 value. It depreciated during the latter part of the reporting period, ending June only slightly above its December 31 level. While Taiwan's central bank maintains that "the NT dollar exchange rate is determined by market forces," the bank also notes that "when the foreign exchange market is disrupted by seasonal or irregular factors the Bank will step in."

Malaysia

Malaysia's economic recovery continued to accelerate in the first half of 2004, growing at an 6.8 percent saar pace from the second half of 2003 after growth of 5.3 percent in 2003 and 4.1 percent in 2002. Personal spending picked up, and private investment strengthened. Fiscal consolidation continued, as total public sector spending grew moderately and public investment contracted.

The current account surplus was 13.1 percent of GDP in the first half of 2004, compared with 14.4 percent in the first half of 2003. Malaysia's bilateral trade surplus with the United States totaled $7.5 billion in the first half of 2004, up 13.7 percent from its level a year earlier.

Malaysia has maintained a fixed peg to the dollar since September 1998, when it also expanded capital controls. Although unchanged against the dollar in nominal terms, the ringgit depreciated 0.7 percent over the first half of 2004 on a real trade-weighted basis, as measured by the JP Morgan index. At the end of June, total foreign exchange reserve holdings stood at $53.9 billion, about five times short-term external debt and up from $44.9 billion at end-December 2003.

Controls on capital flows have been relaxed since 1998, but offshore trading of the ringgit remains prohibited, and foreign portfolio investment by residents continues to be restricted. However, Malaysia implemented a number of capital account liberalization measures in the first half of 2004. On March 26, the central bank raised the ceilings on foreign currency holdings by residents, relaxed reporting requirements for exporters, allowed domestic institutional investors and mutual funds to invest up to 10 percent of their assets abroad, made it easier for non-residents to borrow in ringgit, and allowed forward foreign exchange contracts.

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[1] The IMF annually reviews U.S. economic performance and policies through the so-called IMF Article IV surveillance process. The last Article IV surveillance review took place in July 2004. The IMF staff paper and the results of the IMF Executive Board's discussion of the U.S. Article IV review can be found at http://www.imf.org/external/pubs/ft/scr/2004/cr04230.pdf. In addition, the IMF discusses U.S. economic policies and performance in the context of its twice yearly World Economic Outlook reports. These can be found at http://www.imf.org/external/pubs/ft/weo/weorepts.htm.

[2] Including a relatively small statistical discrepancy.

[3] Although the current account measures are conceptually the same, balance of payments statistics are compiled on a slightly different basis from national income statistics. Saving includes the statistical discrepancy between the income and product accounts.

[4] That is, 4.2 percentage points of the 5.3 percent annualized growth.

[5] The yen varied over a range of 8-10 percent between its highs and lows against the dollar during the first quarter.

[6] The Chinese government used $45 billion of its foreign exchange reserves to recapitalize two Chinese banks at the end of 2003. This figure is not included in the $471 billion foreign exchange reserves total.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 5, 2004
js-2128

Remarks by John B. Taylor
Under Secretary for International Affairs
United States Treasury
World Economic Forum's India Economic Summit
New Delhi, India

India and the World Economic Expansion

I am so pleased to have been invited to speak to this very distinguished audience. would like to thank the World Economic Forum for organizing this important event, and the Indian government for its hospitality. And I would like to express my thanks to Klaus Schwab for his kind introduction.

Before I begin, I would like to congratulate Finance Minister Chidambaram and the entire economic team for their extraordinary leadership, and for the bold steps they are taking on economic policy. They are setting a course for India towards a promising and prosperous future with strong economic growth and poverty reduction.

I would like to talk this afternoon about the state of the world economy, focusing in particular on the role of economic policy in emerging market countries like India and in developed countries like the United States. And I would like to use this opportunity to discuss how economic experiences of fast growing economies offer some lessons for economies around the world to meet their enormous economic potential.

The World Economic Expansion

Since this is a meeting of the World Economic Forum, it is appropriate to begin by reminding ourselves that the world economy is in a remarkably good state right now. And then we should ask ourselves why it is in such a good state.

First note that for the world as a whole, economic growth is as high as it has been in three decades. It is good news that there are no major recessions and no major financial crises, a huge improvement over the crisis-ridden years of the 1990s. And interest rate spreads between emerging market bonds and U.S. Treasuries, an important measure of global risk, are at historically low levels. High inflation, once a force of financial instability around the world, is gone in most countries; in the emerging markets it is one-tenth what is was in the mid 1990s. I think it is important that forces of contagion have diminished: when spreads increase in one country, as they have recently in Ukraine, there is little or no spillover to other countries.

In the United States, the economy has nearly completed its recovery from the 2000-2001 stock market crash, corporate scandals, and 9/11 terrorist attacks, and it is moving into an expansion phase. This year it is on track to complete the third year of recovery with a strong 4 percent growth pace. Among other developed economies, Japan, France, the United Kingdom, and Canada have also been growing well, though Germany continues to lag. It is of particular note here in Asia that Japan has been growing nicely for the last several years after its lost decade in the 1990s. Of course, the rest of Asia is also growing strongly with India at close to 7 percent and China even trying to slow down a bit and remove inflationary pressures. I could go on and on, reviewing the economic expansion in emerging markets from Russia, to Turkey, to South Africa, to Brazil and Chile.

Good Economic Policies

What accounts for this positive scenario? In my view, economic policies provide the major part of the explanation. In the United States, we have implemented well-timed monetary and fiscal policies, including marginal tax rate cuts, which mitigated the impacts of the 2000-2001 shocks and led to a sustainable recovery. Of course the U.S. growth induced by those policies has been a major source of world growth. In Japan, the focus on a monetary policy to end the deflation has been a factor in the end of the stagnation of the 1990s. Similarly, the emphasis on strong monetary and fiscal policy in Brazil and Turkey has brought these countries out of crisis. These policies reflect an emerging consensus on how to support economic growth and stability, including the importance of price stability, market flexibility, and policies to raise productivity.

I believe that this growing policy convergence can be attributed--at least in part--to several international economic policy initiatives underway. For example, the G-7 recently adopted the Agenda for Growth, which has emphasized increased flexibility to boost productivity growth and employment. And the G-20--which includes emerging market countries like India, China, and Indonesia--has adopted the Accord for Sustained Growth, which has brought attention to the importance of price stability, exchange rate flexibility, and structural reforms.

The U.S. is also pursuing several bilateral efforts intended to reinforce these multilateral initiatives, including the Economic Dialogue with India, the Partnership for Prosperity with Mexico, and the U.S.– Brazil Group for Growth. I welcome the attention that India's government is giving to the Economic Dialogue with the United States and would like to emphasize that we too view this as a very important forum.

With the widespread adoption of sound monetary and fiscal policies, the global economy may be poised to record the longest global expansion in history. I say this because we have seen the tendency for expansions to get longer in countries that adopt such policies. In the United States, for example, the move to end inflation and focus on price stability in the early 1980s led to a major increase in the length of our economic expansions in the 1980s, in the 1990s, and I believe now. The same is true of other countries.

Avoiding Policy Mistakes

But realizing this outcome will depend on continued vigilance of economic policy makers to avoid mistakes. Staying the monetary policy course and reacting in time to keep inflation low is essential, because so many expansions in the past were cut off by inflationary booms and the inevitable busts.

And we need to work together to combat the risks to this scenario. One issue that has received a great deal of attention recently are the global current account imbalances, as evidenced by the large current account deficit in the United States, which has risen from about 1 percent in 1990 to about 4 percent in 2000 and about 5 percent in the first half of this year. The current account deficit is equal to the gap between investment and saving in the United States. U.S. policies to reduce the budget deficit and promote private savings through personal saving accounts will raise saving and thereby reduce the current account deficit. These policies should be matched by policies to raise economic growth in other countries and increase exchange rate flexibility in countries that do not have such flexibility, which will also help render a smooth adjustment in global payments.

Another worry is the threat from high oil prices. It is good news that prices have eased off the recent peaks. But this should not mean that we are complacent about developing policies to increase energy supplies. And while the credibility of central banks in achieving low inflation has allowed monetary policy to continue to support recovery, they cannot be complacent if inflationary expectations rise with the higher oil prices.

Raising Economic Growth

My biggest concern is not with the length of the current global expansion, but with its strength. Growth in some countries is simply not robust enough to seriously reduce poverty. An important goal of the Bush Administration is to reduce poverty by raising economic growth around the world. For example, our new development agenda channels more funds to countries that follow pro-growth policies, and

embodies two major principles: one, that resource flows be tied to measurable results, and two, that the poorest countries receive increased levels of grants instead of loans. This approach is reflected in the Millennium Challenge Corporation, a new U.S. organization which will provide grant financing to strong performers based on clear strategies for measuring progress toward stated results.

India's Window of Opportunity

Economic growth this past year in India came in at 8 percent. India's leaders are now facing critical decisions that will determine whether that high growth rate can be sustained. The key here is productivity growth. Why productivity growth? Because countries with low productivity have low per capita incomes and high rates of poverty; to eradicate poverty, there is no alternative to increasing productivity. If there are no impediments to the flow and accumulation of capital and technology, then countries that are lagging in technology should have higher productivity growth, and "catch up" to more advanced economies. Therefore, with the right set of policies, countries should make productivity gains. This is not merely economic theory, but has been borne out by countries from all regions of the globe.

Productivity growth in India has been about 3-1/2 percent over the past decade. To get economic growth to 8 percent on a sustainable basis will require productivity growth of about 6 percent because employment growth can be expected to be about 2 percent.

Is this kind of productivity growth feasible? I believe it is if the right policies are followed. Capital investment will have to grow rapidly and that will require economic policies that encourage investment. The recent elimination of the long-term capital gains tax is exactly the kind of policy to encourage investment.

There is another crucial factor--education. In the R&D and IT sectors, investors came to India because they were attracted to India's well-educated labor pool. But with only 5 percent of Indians of college-age receiving a college education, this pool is a relatively small part of the total workforce. In order for India's citizens to move into high productivity sectors and away from low productivity sectors, India must invest in its people, especially by doing more to provide education. Of course India's leadership is fully aware of the need to significantly increase investment in human capital, and has laid out its commitment to improving education and health services in its Tenth Plan.

Clearly policy played an important role in productivity growth in the IT sector in India. The IT sector has benefited from deregulation, liberalization of FDI, and the privatization of government-owned services. In addition, IT-enabled services have not had to face the infrastructural constraints faced by other sectors. Operating through satellite links, Indian programmers are providing IT support to U.S. and European firms in areas ranging from software development and maintenance, back-office operations, data transcription and transmission, and telemarketing.

With respect to India, I am confident that deregulation and liberalization in other critical sectors will generate new success stories, and welcome this government's commitment to increase investment opportunities in telecom, insurance and civil aviation.

These objectives underscore the urgency of moving ahead with other reforms, such as tax reform, trade liberalization, and the elimination of subsidies, to ensure that the government is not forced to confront the unenviable policy choice of whether to invest in its people *or* pursue fiscal discipline. Fortunately, if the agenda outlined by Prime Minister Singh and his government is implemented as planned, both goals should be achievable.

I think it is interesting to note that in the United States, productivity acceleration also seems to be happening more in some sectors than others, and, also like India, gains have been especially relevant in areas such as the information technology sector. Economists who have looked closely at this phenomenon speculate that the U.S. predisposition to accepting intense competition and capacity to adjust rapidly have enabled the retail sector to benefit from IT innovations. This phenomenon may also encourage capital market development and more dynamic forms of higher education, both of which contribute to higher productivity, all of which point to the

importance of providing flexibility to reward and encourage more productive ways of doing things.

Conclusion

Yesterday, I had the opportunity to travel to farms and villages in the state of Uttar Pradesh. I visited World Bank-financed projects that are designed to improve productivity of agricultural production systems, promote private sector development, and improve rural infrastructure. I was especially impressed with a project involving sodic land reclamation, which has had tremendous results in raising productivity and reducing poverty. I visited schools and talked to students and teachers. I also spoke with farmers and with business people. I addressed a crowd of nearly 5,000 people from villages and farms in the area, and spoke about the friendship between the people of the United States and India.

This visit showed me the huge upside potential for policies that provide opportunity to people. It is clear to me that if given the opportunity to work productively, the Indian people can create economic growth rates on the order of 8 percent, which in turn will translate into rapid improvements in living standards, lifting millions of people out of poverty. I am confident that under its current leadership, India is on the right path. We in the United States look forward to strengthening our economic partnership with this great country.

Thank you.

***

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 6, 2004
JS-2129

Timothy S. Bitsberger Sworn in as Treasury Assistant Secretary for Financial Markets

Timothy S. Bitsberger was sworn in today by Secretary John W. Snow as Treasury's Assistant Secretary for Financial Markets. President Bush nominated him to the post on May 11, 2004; the U.S. Senate confirmed Bitsberger on November 21, 2004.

As Assistant Secretary, Bitsberger will lead the efforts of the Office of Financial Markets to formulate policy on federal debt management and financial markets oversight. He will advise the Under Secretary for Domestic Finance on policy and legislation on federal finance market issues and examine the impact of such policies on industries and the markets.

Prior to joining the Treasury Department Bitsberger worked on Wall Street for more than 15 years. He has extensive experience trading bonds and derivatives. In 1999 he was a Senior Vice President of Investments at Salomon Smith Barney. Before that, he worked as a consultant for J.F. Lehman & Company, a LBO firm. From 1989 to 1998 he was a Senior Trading Manager and Vice President for NationsBanc Capital Markets in New York. He was a trader for Drexel Burnham Lambert from 1985 to 1989.

Bitsberger earned an MBA from Harvard University in 1985 after graduating from Yale University in 1981 with a B.A. in Economics.

He was appointed in October of 2001 to serve as Deputy Assistant Secretary for Federal Finance. He has served as Acting Assistant Secretary for Financial Markets since July 16, 2004.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 7, 2004
js-2130

Treasury Releases Report on Critical Financial Infrastructure Protection

Treasury Releases Report on Critical Financial Infrastructure Protection Study to Serve as Model for Regional Coalitions to Strengthen Resiliency of Financial Sector

The Treasury Department today released a study commissioned by the Department in coordination with BITS, the technology branch of the Financial Services Roundtable. The study will provide a model for the nation's regional financial centers to protect and strengthen their critical financial services infrastructure at the local level.

The study is based on the experiences of ChicagoFIRST, a regional coalition of financial institutions and local governmental organizations that banded together to strengthen the Chicago financial services industry and coordinate with local, state, and federal government agencies in the event of a potential natural or manmade disorder.

"ChicagoFIRST is exemplary. It shows what a creative, dedicated group of individuals and organizations can do, working together, to protect and strengthen financial services readiness on a regional basis. These 'lessons learned' serve as a model for other regional coalitions," said Treasury Assistant Secretary for Financial Institutions Wayne A. Abernathy. "This past year, we visited over two dozen leading financial communities across the nation to encourage local organization. This 'cookbook' will help people in those communities succeed in coming together," Abernathy said.

ChicagoFIRST was established in the wake of September 11 to protect the lives of the people who work for its members, protect the financial assets that have been entrusted to its members and to coordinate employee evacuations and access to restricted areas with local authorities in the event of an emergency.

As the lead agency for the financial sector, the Treasury Department continues to seek innovative ways to protect critical financial infrastructure here in the United States. The Department backs the concept of regional coalitions to augment existing information sharing efforts and will continue to work with interested groups to facilitate their formation. The Department has supported ChicagoFIRST and hopes it can be a helpful example for communities around the nation.

The study outlines the lessons derived from the creation of ChicagoFIRST and the steps necessary to apply this model to other regions.

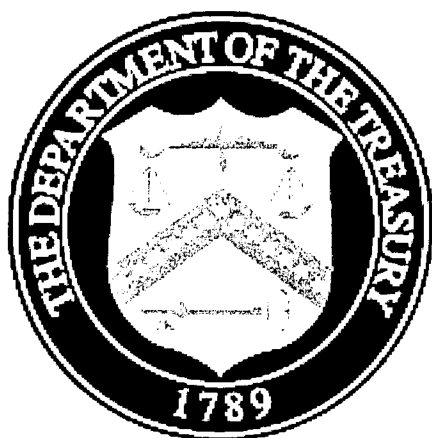
You can view the report, "Improving Business Continuity in the Financial Services Sector: A Model for Starting Regional Coalitions," at the link below. Media interested in contacting ChicagoFIRST should call (312) 322-6267.

REPORTS

- Improving Business Continuity in the Financial Services Sector: A Model for Starting Regional Coalitions

Improving Business Continuity in the Financial Services Sector:

A Model for Starting Regional Coalitions



US Department of the Treasury

December 2004

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ACKNOWLEDGEMENTS

This handbook is the result of a collaborative effort, funded by The United States Department of the Treasury (the Treasury) and co-authored by BITS, The Boston Consulting Group (BCG) and ChicagoFIRST. It is based on several sources, including a comprehensive review of the existing documentation in the archives of BITS and ChicagoFIRST, a survey of representatives of the founding member institutions, and in-depth interviews with leaders and key participants at more than 15 institutions.

The Treasury, BITS and BCG wish to acknowledge all the dedicated individuals whose hard work and commitment contributed to the success of ChicagoFIRST. The ChicagoFIRST experience serves as the foundation for this handbook.

The financial services industry is in debt to the founding Members and Strategic Partners of ChicagoFIRST, the City of Chicago's Office of Emergency Management and Communications (OEMC) and BITS for establishing a model for regional coalitions of financial services firms. There are many people to cite for their contributions to ChicagoFIRST. (For a full list of the organizations involved, please see Appendix 6.) However, two key individuals must be acknowledged at the outset: Louis F. Rosenthal, Executive Vice President, LaSalle Bank Corporation, and Ro Kumar, First Vice President of The Options Clearing Corporation. Their vision, commitment and leadership created and continue to sustain ChicagoFIRST.

> *ChicagoFIRST is exemplary. It shows what a creative, dedicated group of individuals and organizations can do, working together, to protect and strengthen the critical financial services infrastructure on a regional basis. These "lessons learned" serve as a model for other regional coalitions.*
>
> *Wayne A. Abernathy*
> *Assistant Secretary for Financial Institutions*
> *U.S. Department of the Treasury*

Prior to September 11, 2001, business continuity and disaster recovery plans were primarily developed by and geared to individual financial services firms—with firms establishing, testing and refining their own plans. The events of 9/11 showed us in horrifying detail how vulnerable these firms are—and how dependent they are on each other. The financial services industry, under the auspices of the Department of the Treasury, formed a national private sector coordinating body known as The Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security (FSSCC). The FSSCC was created to foster and facilitate financial services sector-wide voluntary activities and initiatives designed to improve critical infrastructure protection and homeland security. While the FSSCC serves at the national level, a few individuals saw the need to establish regional coalitions. A physical terrorist attack will likely have localized or regional implications. It makes sense for financial services firms located in close geographic proximity to collaborate and cooperate on issues related to business continuity. **It is important to note that regional coalitions are not substitutions for national initiatives. Instead they are intended to augment existing information sharing efforts.**

Throughout 2003, a dedicated group of individuals from financial services firms in the Chicago area—in collaboration with city, state and federal officials—worked together to form a regional coalition known as ChicagoFIRST.

This document first tells the story of the "start up" of ChicagoFIRST, focusing on a core set of questions:

- Why and how did ChicagoFIRST take shape?
- Who joined? When? Why?
- What was the group's agenda?
- How did they organize to achieve it?
- What results have been achieved?
- What were the most important resources and contributions that drove the start up's success?
- What were the reactions of participants to the experience?

The answers to these questions form a solid roadmap for financial services firms in other regions to follow if they wish to replicate ChicagoFIRST's success. Further, a set of "key success factors" emerges from this example. Some combination of these factors will need to be present for a regional coalition to succeed. To be successful, a regional coalition should:

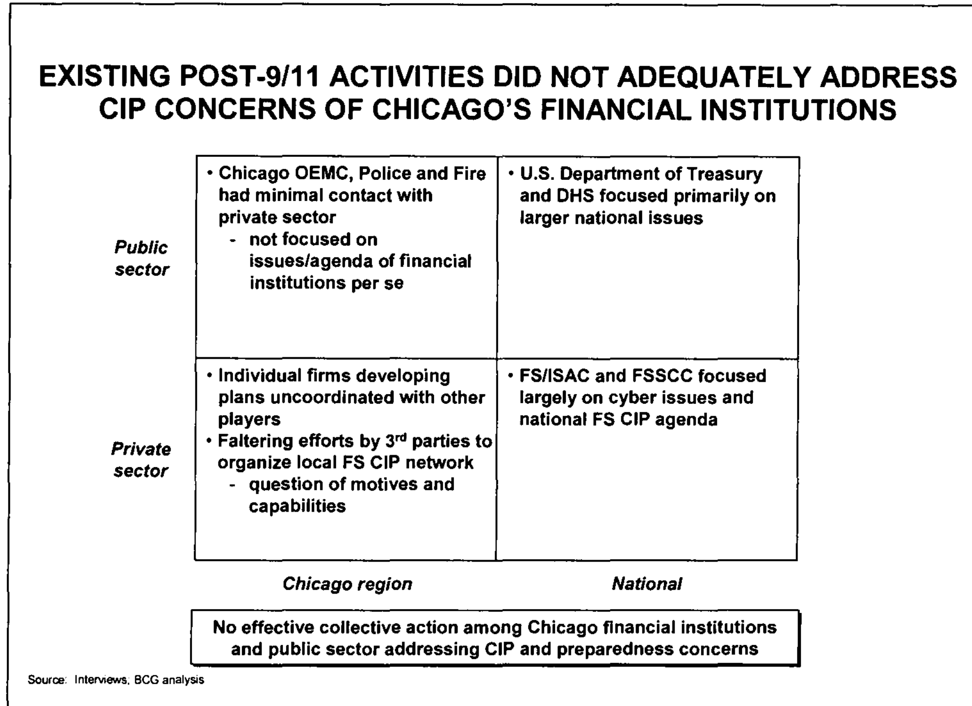
- Have senior, dedicated and determined leadership at the outset.
- Arrange for support and involvement of key federal agencies to help jumpstart progress.
- Obtain "buy-in" and support of local authorities.
- Ensure that the private sector understands the public sector and vice versa.
- Stay focused on a prioritized and practical agenda with concrete, identifiable goals.
- Rely on a trusted third party for interim project management support.
- Steadily increase participant involvement and commitment over time.
- Appreciate the benefits of establishing an informal network to support business continuity and disaster recovery across the financial services sector.

Using the ChicagoFIRST experience and the key success factors that were gleaned from it, this handbook concludes by outlining the steps necessary to adapt and apply the model to other regions.

The Treasury supports the concept of regional coalitions of financial services firms and will work with interested parties to facilitate their formation. For more information, please contact the Office of Critical Infrastructure Protection and Compliance Policy at (202) 622-2602 or ocip@do.treas.gov.

THE IMPETUS

In early 2003, key financial institutions in Chicago began discussions about the need for financial services institutions in the city to cooperate on issues related to business continuity. These discussions were prompted by a consensus that existing activities did not adequately address the critical infrastructure protection concerns of Chicago's financial institutions.



The close geographic proximity of the financial institutions in Chicago—the core founding members all had regional headquarters within a six-block radius—led to a common set of concerns including:

- How can we get people out of the area safely?
- How can we keep our business functioning during an emergency?
- How can we get timely and accurate information during a crisis?
- How can we get essential personnel back into affected areas for recovery?

In previous efforts to try to answer these questions on their own, leaders of the institutions that would become the founding members experienced a great deal of frustration. They often did not know whom in the city to call, and when they did they had difficulty in getting their questions answered—and in some instances even in getting their calls returned. Similarly, city officials were frustrated by having multiple points of contact for the financial services sector in Chicago.

[1] This Case Study covers the formative stages of ChicagoFIRST, spanning roughly calendar year 2003.

The urgency and the ongoing frustration that characterized individual outreach efforts led to some initial informal discussions among executives across institutions. These informal discussions rapidly evolved into a proactive, grass-roots movement spearheaded by two individuals: Louis Rosenthal, Executive Vice President of LaSalle Bank Corporation, and Ro Kumar, First Vice President of The Options Clearing Corporation. The table below illustrates the key qualities shared by Louis and Ro, as well as the effects of those qualities on the others contemplating ChicagoFIRST membership.

QUALITIES		EFFECTS
Senior within their own institutions	➔	Had credibility
Dedicated to the cause	➔	Inspired others
Had support of their institution	➔	Able to commit resources
Effective at outreach/networking	➔	Convinced others to join the cause

As representatives from various financial institutions in Chicago met informally, they discovered commonalities that all agreed could best be addressed collaboratively. By April 2003, discussions led to a formal meeting, during which the institutions represented agreed unanimously to pursue the effort.

THE MEMBERSHIP

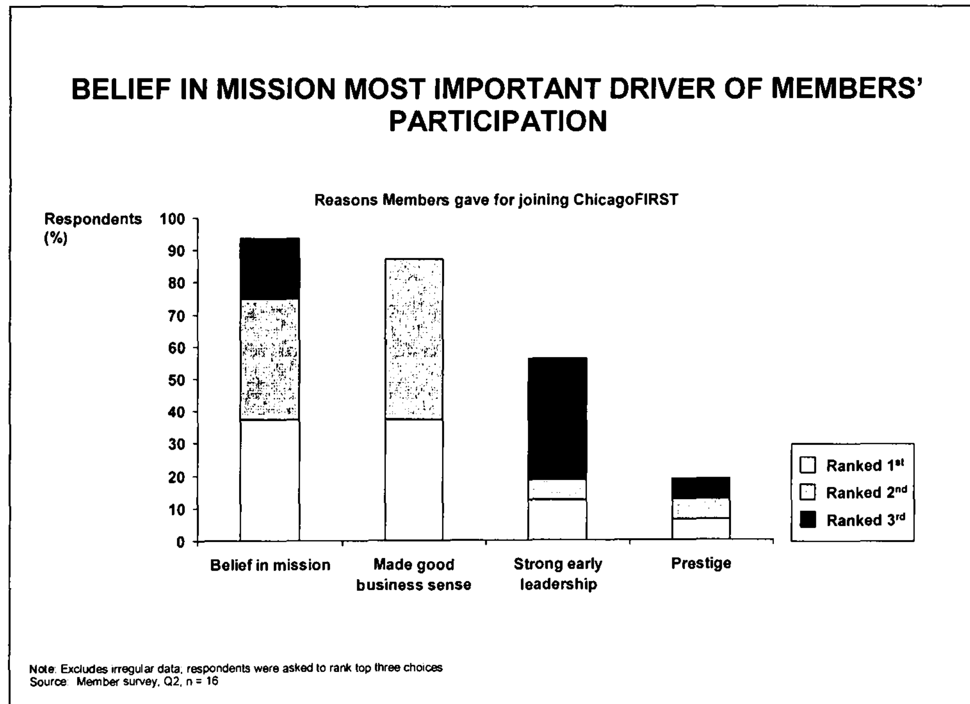
At the outset, 14 financial institutions comprised the founding membership of ChicagoFIRST. The members were cognizant of the responsibilities that come with joining the single point of contact for the financial services industry in the Chicago area. The membership had to be encompassing to adequately cover the perspectives of the industry. Additionally, members recognized that for the coalition to be successful, it was both necessary and advantageous to engage non-financial institutions from the public and not-for-profit sectors as "strategic partners." This dual structure allowed for a wide variety of institutions and organizations to participate in ChicagoFIRST.

FOUNDING MEMBERS		STRATEGIC PARTNERS
ABN Amro/LaSalle Bank Corporation		BITS
Archipelago		City of Chicago
Bank of America Corporation		Chicago Police Department
Chicago Board Options Exchange		Chicago Regional Office of the FDIC
Chicago Mercantile Exchange		Commodities Futures Trading Commission
Chicago Stock Exchange		U.S. Department of Homeland Security
Harris Bankcorp, Inc.		• FEMA – Region V
JP Morgan Chase		• U.S. Secret Service
Mesirow Financial		Federal Reserve Bank of Chicago
Mizuho Securities USA Inc.		FS/ISAC
Northern Trust Corporation		FSSCC
The Options Clearing Corporation		U.S. Department of the Treasury
UBS		• The Office of the Comptroller of the Currency
William Blair		Securities and Exchange Commission
		State of Illinois – Office of Banks and Real Estate
		U.S. Attorney's Office – Northern District of Illinois
		Futures Industry Association

The Members and Strategic Partners of ChicagoFIRST are differentiated as follows:

	MEMBERS	STRATEGIC PARTNERS
QUALIFICATIONS	Private sector financial institutions	Public sector agencies or not-for-profit sector organizations
PRIVILEGES	• Attend all meetings • Voting rights	• Attend general meetings • No voting rights
OBLIGATIONS	• Pay dues • Sign LLC agreement	• Do not pay dues • Do not sign LLC agreement

Why did member firms seek to participate in ChicagoFIRST? As illustrated below, Members reported that their belief in the mission of ChicagoFIRST was the primary driver for participating, followed closely by the fact that participation made good business sense.



The Strategic Partners also cited "belief in mission" as the primary driver for participation, followed by "strong early leadership."

Conversely, when Members were asked what gave them the most pause about participation, the concerns (ranked 1 and 2, respectively) were expense and the amount of time investment. A significant number of Members stated that they had no concerns or reservations about participation.

THE AGENDA

In May 2003, an organizational "straw model" was presented to interested financial institutions. The straw model outlined the following regional imperatives and operating assumptions:

- The operational interdependence of the industry participants requires a cooperative and non-competitive effort to protect industry stakeholders such as the public, local and state administrations and the people in the industry.
- Recoverability of the industry in the event of a regional disaster will be substantially increased by working directly with city and state authorities on emergency coordination and evacuation.
- An emphasis on rapid implementation of high-priority action items is required.

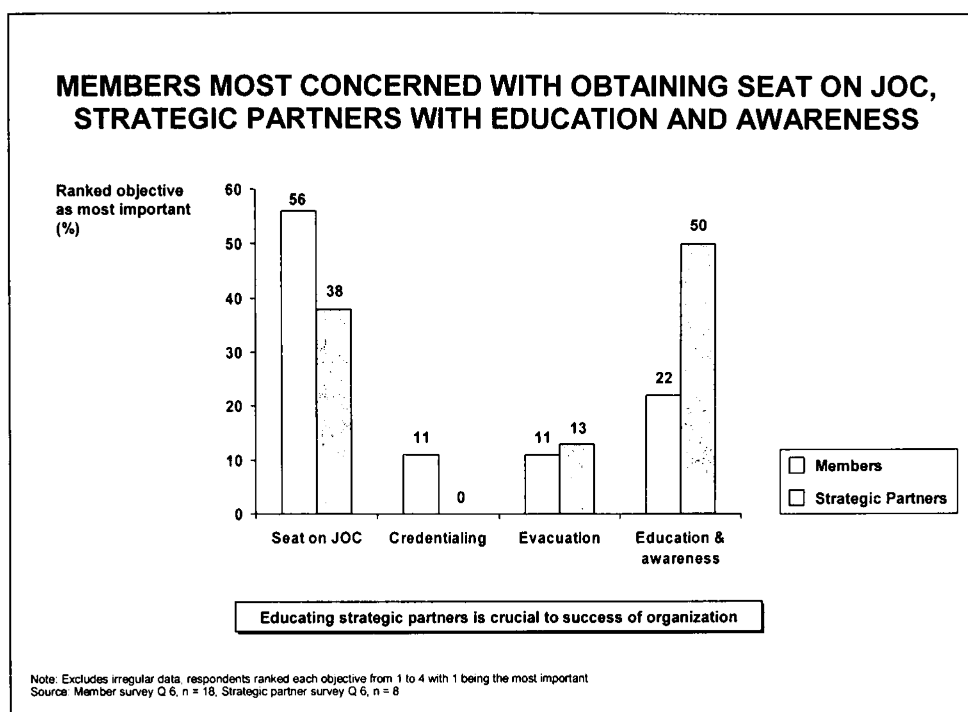
The mission of ChicagoFIRST, announced in May 2003, was (and remains):

- To increase the resilience of the Chicago financial services industry in the event of a regional disaster in collaboration with the city, state and federal agencies, including to:
  - protect the lives of the thousands of people that work in the industry;
  - protect the financial assets that have been entrusted for safe keeping and investment;
  - work directly with city and state authorities on emergency coordination and evacuation; and
  - implement the primary objectives in a rapid manner.

The primary objectives were:

- Obtaining a seat at Chicago's Joint Operations Center (JOC) in the event of a crisis that affects Chicago's financial community.
- Creating permits/passes for essential personnel to safely access business facilities in the event of a general evacuation of the city (credentialing).
- Developing and communicating standard evacuation procedures for industry personnel to exit city limits in the event of a disaster.
- Increasing city and state administrators' awareness of the criticality of the financial services sector.

Not surprisingly, when asked to rank the importance of the primary objectives to the institutions, Members and Strategic Partners had differing views. The Members cited obtaining a seat at Chicago's JOC as most important, consistent with their desire to be squarely in the communication loop regarding emergency situations that could threaten their employees, facilities and businesses. Strategic Partners cited increasing city and state administrators' awareness about the criticality of the financial services sector as most important (perhaps in recognition that, once established, this would help secure progress on many fronts).



To further increase the resiliency of the industry, the following secondary objectives were identified:

- Collaborate with the city and regional telecommunications vendors to insure diverse routing of networks within city limits.
- Work with key technology vendors to insure uninterrupted support services during a crisis.
- Provide a forum for public-private dialogue on issues related to business continuity and protecting the regional financial industry.

THE ORGANIZATION

Rosenthal and Kumar were elected as co-chairmen. Shortly after the May meeting, they determined that in order for ChicagoFIRST to gain traction on its primary objectives, the coalition would need short-term operational assistance.

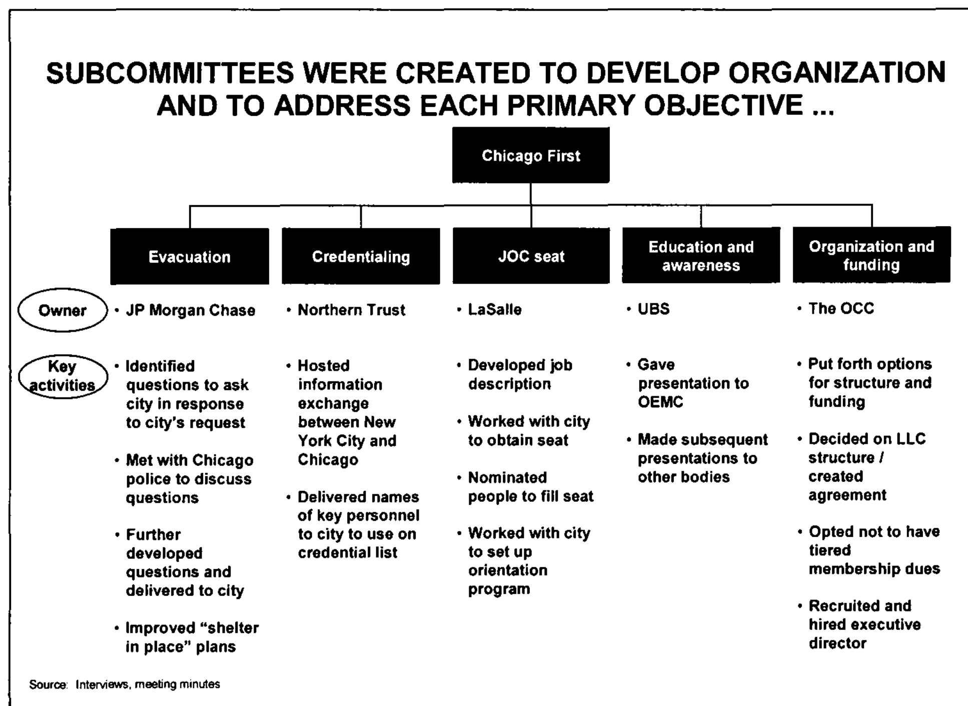
In July 2003, Rosenthal and Kumar asked BITS to provide ChicagoFIRST with interim support. BITS is a nonprofit industry consortium whose members are 100 of the largest financial institutions in the United States. Serving as the strategic "brain trust" for the industry, BITS focuses on issues related to e-commerce, payments and emerging technologies. The specifics of the arrangement between BITS and ChicagoFIRST were defined in a memorandum of understanding (MOU). Key points from the MOU include:

- BITS would provide facilitation and expertise in crisis management coordination by detailing Teresa C. Lindsey, BITS chief of staff, to the project.
- ChicagoFIRST would provide thought leadership, commitment and responsiveness.

- In exchange for the resources BITS would devote to ChicagoFIRST, BITS would be allowed to document the process and develop a "lessons learned" publication so that the ChicagoFIRST experience could be replicated in other regions.

BITS was not paid for the time devoted to the project with the exception of reimbursement of travel expenses. BITS' overall support, coupled with the fact that there was no payment for services rendered, enabled members to steadily increase their participation in and benefits from the organization without a major upfront investment.

The membership agreed to weekly conference calls. In addition to the conference calls, ChicagoFIRST held in-person meetings with Members and with Strategic Partners. Task forces were established around each of the primary objectives with member institutions taking ownership for specific objectives. The ownership and activities of the task forces are described below.



Education and Awareness

- <u>Objective</u>: Increasing city and state administrators' awareness about the criticality of the financial services sector.

An "Education and Awareness Briefing" was held August 22, 2003 and was well attended by representatives from the City of Chicago. The Department of the Treasury and the FSSCC partnered with ChicagoFIRST for the briefing. The agenda ranged from answering the question "Why should the City of Chicago care about the financial services industry in Chicago?" to the big picture of how the financial services industry is organized nationally. The briefing also provided an

opportunity for ChicagoFIRST to express to the City what was needed from them—as well as to solicit what ChicagoFIRST could provide the City.

In addition to this general briefing to the City of Chicago, ChicagoFIRST members presented at many outreach events, including FDIC-hosted/FBIIC and FSSCC sponsored events in Minneapolis, Cleveland, Charlotte and Philadelphia, and presentations delivered to the State of Illinois Terrorism Task Force, the Business Continuity Planning Exchange and the Lake County Emergency Management Officials.

Joint Operations Center

- Objective: Obtaining a seat at Chicago's Joint Operations Center (JOC) in the event of a crisis that affects Chicago's financial community.

By July 2003, the City's OEMC had agreed that ChicagoFIRST would have a seat at the JOC. However, many details needed to be worked out, including an agreement on when the ChicagoFIRST seat would be occupied and who would fill it. Through a series of conference calls, ChicagoFIRST established a job description for the "JOC Analyst" [2] and a rotation schedule so ChicagoFIRST members would know who would occupy the seat and when. Additionally, the OEMC gave ChicagoFIRST members a tour of the JOC so they would be familiar with the facilities and procedures.

Evacuation Procedures

- Objective: Developing and communicating standard evacuation procedures for industry personnel to exit city limits in the event of a disaster.

City officials requested that ChicagoFIRST articulate what members needed to know relative to evacuation procedures. A task force of Members and Strategic Partners developed a series of questions. ChicagoFIRST then requested an in-person meeting with appropriate city officials to discuss the questions. The questions[3] were delivered to the executive director of the OEMC in a letter dated September 5, 2003. The executive director responded in a letter dated October 17, 2003. Although not all of the questions posed were answered as thoroughly as anticipated, the letter demonstrated the City's desire to work with ChicagoFIRST.

[2] A Sample Analyst Job Description for an Emergency Operations Center is included as Appendix 1 of this document.
[3] Sample Questions Regarding Evacuation Procedures are included as Appendix 2 of this document.

Credentialing

- Objective: Creating permits/passes for essential personnel to safely access business facilities in the event of a general evacuation of the city (credentialing).

ChicagoFIRST took a proactive stance and hosted a "Credentialing Information Exchange" on November 4, 2003. ChicagoFIRST invited officials from Chicago's OEMC, as well as officials from New York's Office of Emergency Management (OEM). The officials from New York presented the turn-key credentialing system[4] being used in New York City. ChicagoFIRST Members worked with Chicago officials to outline and document the current "informal" process for credentialing. Additionally, a "preferred" process was outlined. This process extended beyond the informal process while falling short of the final model the City will eventually build.

Organization and Funding

- Objective: Determining how ChicagoFIRST would be organized and funded long term.

While the original intent was not to build an organization but to accomplish specific goals, it was agreed that the interests of the Chicago financial services industry would be best served by establishing an independent entity that would be closely aligned with established and reputable national industry associations. The Organization and Funding Task Force studied multiple organizational models ranging from an informal coalition to a division of an existing organization to a standalone organization to a variation of all of the above. The membership decided to form a limited liability company (LLC). This decision was based on the advice of legal counsel. **Readers considering creating organizations similar to ChicagoFIRST should consult legal counsel regarding whether an LLC structure is appropriate for their needs.** To keep operating expenses down, only one employee would be hired (an executive director[5]) and other resources—including space, equipment and administrative support—would be provided by member companies.

Each week, ChicagoFIRST made progress in its primary objective areas with varying degrees of success. Organization and Funding, Education and Awareness and the JOC Seat achieved the highest degrees of success as they were the least dependent on external forces. Evacuation Procedures and Credentialing are complex issues that are still being worked on by ChicagoFIRST. Below is a brief summary of the major accomplishments and the key enablers/obstacles for each of the different initiatives.

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[4] Highlights of BNET's Corporate Emergency Access System (CEAS) are included as Appendix 3 of this document.
[5] A sample Position Specification Statement for an Executive Director is included as Appendix 5 of this document.

VARYING LEVELS OF PROGRESS TO DATE

Subcommittee	Evacuation	Credentialing	JOC seat	Education and awareness	Organization and funding
Results to date	• Limited sharing of plans by City due to contingent nature of appropriate response in a given situation • "Shelter in place plans" by individual institutions have been developed / improved	• City has list of individuals from CF members • CF persuaded City not to use "from scratch" RFP for new system • City and state working together to develop system	• JOC seat obtained • Some open questions on situations in which CF can occupy seat	• Initial education of city officials achieved – recognize importance of sector • Taskforce largely completed work	• LLC created • Dues structure implemented for current year • Executive director hired
Key drivers / enablers		• Education / information flow has been key success • NYC and State of IL each have systems that could be used	• Willingness of City and private sector to cooperate	• Communication lines formed between city and CF • Willingness of members to devote time to education	• Need to have more permanent organization
Impediments / obstacles to overcome	• Optimal evacuation routes depend on nature of incidents	• City is using interim web-based solution, not fully operational	• City has more limited view of the situations in which CF rep should occupy seat		• Concern about committing to LLC structure • Worries that dues too high for smaller organizations

Source: Interviews; minutes

RESOURCES AND CONTRIBUTIONS

When asked to identify the critical success factors that allowed ChicagoFIRST to grow from an idea to an independent organization, both Members and Strategic Partners ranked "commitment, leadership and outreach of founding chairmen" as the most important factor. Thereafter, the Members and Strategic Partners differed on how they viewed the success factors.

CF PARTICIPANTS VIEW COMMITMENT OF FOUNDING CHAIRMEN AS MOST IMPORTANT SUCCESS FACTOR

Factor	Member relative importance ranking [1]	Strategic Partner relative importance ranking[1]
Commitment, leadership and outreach of founding chairmen	1	1
Interim leadership and project management provided by neutral 3rd party	2	9
Commitment of founding member institutions	3	3
Active involvement of reps from member institutions	4	5
Criticality of the mission and primary objectives	5	2
Endorsement of Chicago's OEMC	6	4
Objectives and mission being very clear and manageable	7	7
Endorsement of Department of Treasury	8	8
Level of trust engendered among the members	9	6
Other	10	11
Endorsement of other strategic partners	11	10

1) Respondents were asked to rank top 5 with 1 being most important. Points were assigned on a sliding scale to each ranking with 1 = 5 points, 5 = 1 point and anything greater than 5 = 0 points. The factors were then ranked based on the number of points given
Note: Excludes irregular data
Source: Member survey Q9, n = 19, Strategic partner survey Q9, n = 6

The input of "strategic partners" who were not direct members of ChicagoFIRST played an important role in helping the organization get started. Seven institutions were singled out by at least 50% of survey respondents as being either "very helpful" or "helpful," including BITS (95%), Treasury (95%), Chicago's OEMC (85%), the U.S. Federal Reserve Bank of Chicago (80%), Chicago's Police Department (75%), the State of Illinois (65%) and the U.S. Secret Service (50%).

THE EXPERIENCE

Members were asked to identify the factors they found most rewarding about the experience of forming and participating in ChicagoFIRST. Their top five responses, ranked in order:

1. The proactive nature of the experience (85%)
2. The chance to work with a coalition of other local financial institutions (80%)
3. The opportunity to ensure that certain initiatives would be accomplished (65%)
4. The experience of creating an organization from scratch that would likely serve as an example elsewhere (45%)
5. The potential to forestall regulation that might force a less desirable outcome (15%)

Members were also asked to identify what they found most frustrating about the experience. While not as salient as the benefits, the responses are nonetheless worth noting as items for other groups to manage during any start-up effort:

1. The amount of time commitment (30%)
2. The need to secure help or support from public agencies (30%)
3. The heavy reliance on volunteer staffing (30%)
4. The need and process to secure funding (25%)
5. The pace of collective decision making (20%)

CHICAGOFIRST TODAY

The start-up period of ChicagoFIRST ended in December 2003, at which time BITS concluded its engagement with ChicagoFIRST. An employee from one of the member institutions took on the role of facilitator until late January 2004, when Brian Tishuk, a senior staff member of the Treasury Department, was hired to serve as the executive director of the organization. Member financial institutions signed the LLC agreement and made their first capital contributions to the LLC in early 2004, supporting the full-time executive director position.

ChicagoFIRST has continued to push and enhance its agenda. Recent initiatives include: development of plans for "shelter-in-place" protocols for employees of member institutions; mutual exploration with the OEMC of technology platforms to support credentialing; and the sponsorship in July of 2004 of a highly successful "tabletop" exercise during which Members and Strategic Partners worked through a scenario to test the plans and communication channels established to date. ChicagoFIRST is a thriving, successful regional coalition of committed Members and Strategic Partners and serves as a model for other regional coalitions.

KEY SUCCESS FACTORS

As stated in the Executive Summary, by studying the ChicagoFIRST experience, a solid roadmap emerges for financial services firms to follow if they wish to replicate ChicagoFIRST's success in other regions. Further, a set of "key success factors" can be identified. Some combination of these factors must be present for a regional coalition to succeed. A regional coalition should:

- Have senior, dedicated and determined leadership at the outset.
- Arrange for support and involvement of key federal agencies to help jumpstart progress.
- Obtain "buy-in" of local authorities.
- Ensure that the private sector understands the public sector and vice versa.
- Stay focused on a prioritized and practical agenda with concrete, identifiable goals.
- Rely on a trusted third party for interim project management support.
- Steadily increase participant involvement and commitment over time.
- Appreciate the benefits of establishing an informal network to support business continuity and disaster recovery across the financial services sector.

The first three factors are presented in priority order and are considered "must haves." The remaining five factors will greatly enhance the chances of achieving success when forming a regional coalition.

LEADERSHIP

The importance of having senior, dedicated and determined leaders cannot be overstated. The individuals who lead the charge will instill in others the desire to follow. The leaders should be:

- **Senior within their company** – so they can gain the necessary support of management and their institution.
- **Dedicated to the cause** – so that their belief will be seen by others and serve as an inspiration. This dedication includes a willingness to work to get the job done as a large time commitment will be required, especially during the start-up phase.
- **Able to garner support of their institution** – so they can secure the time—and perhaps the funding—necessary to launch a regional coalition.
- **Effective at outreach and mobilizing the coalition** – so they can convince others of the cause and the value proposition.
- **More than one person from more than one institution** – to ensure that the project is seen as a collective effort. This diffuses concerns about the coalition being formed for one institution's benefit. Two leaders from two institutions allow these individuals to lend support to each other.

SUPPORT

The support and involvement of key federal agencies will help to jumpstart progress. These agencies:

- **Add credibility** – making members more willing to invest their resources. Additionally, they can help cut through local red tape and encourage local authorities to get involved.
- **Provide knowledge** – leveraging experts who may reside in the agencies, contacts outside of the agencies and existing knowledge bases.
- **Provide funding** – supporting initial meetings and future tabletop exercises.

BUY-IN OF LOCAL AUTHORITIES

By "buy-in," we mean that local authorities want a regional coalition formed and see the overall benefits of a successful coalition. There must be a two-way information flow between the private-sector coalition and the local authorities. The benefits to the coalition members and to the local authorities are almost mirror images. These benefits include:

- **Establishing single points of contact** – to facilitate communications during a crisis.
- **Increasing information** – to provide timely, accurate and credible information.
- **Providing additional contacts** – to increase the overall network of individuals who provide support to each other.
- **Increasing knowledge** – so the public-sector partners understand the private sectors' needs, and the private-sector members understand the public sectors' position on providing for those needs.

UNDERSTANDING

To facilitate the kind of two-way information flow referred to above, there needs to be mutual respect and understanding of the parameters under which both the private and public sectors operate. The following "best practices" should help decrease misunderstandings and frustrations.

The private-sector members should understand that the public sector:

- Wants to help.
- Can't focus on the needs of just one group.
- Wants to understand the private sector's needs.
- Has a different pace and culture.
- May not be unwilling to provide information, but may be understaffed or unable to respond due to other factors.

The public-sector partners should:

- Work to understand the private sector's needs.
- Proactively help the private sector understand any limitations and why they exist.
- Share information as appropriate and on a timely basis.
- Make personnel available for meetings and conference calls.

FOCUS

Regional coalitions should stay focused on a practical and prioritized agenda with concrete, identifiable goals. Starting with a small number of critical, shared goals will help the Members and Strategic Partners coalesce. Ideally, the agenda should:

- **Include three to four initial primary objectives** – This will allow participants to stay on track and focus on what they have in common. Also, limiting the number of objectives will allow for optimal use of the available resources.
- **Focus on deliverables rather than building an organization** – The participants should come together to achieve practical, actionable deliverables. By working together to achieve these deliverables, the participants build experience and trust. A sustainable, longer-term organization may or may not grow from the experience

INTERIM EXECUTIVE LEADERSHIP AND PROJECT MANAGEMENT SUPPORT

One of the challenges when launching a regional coalition is finding the resources necessary to devote to the task. Representatives from Member institutions will have full-time responsibilities at their individual institutions. Relying on a trusted third party for initial project management support is a practical and effective way to deal with this potential roadblock. It is preferable for the third party to be seen as a neutral entity that is not primarily driven by its own profit-seeking, trusted by member institutions, and highly capable of managing the wide array of challenges in the start-up phase. Financial services trade associations or regional business roundtables are examples of organizations that could potentially provide staff to serve in this capacity.

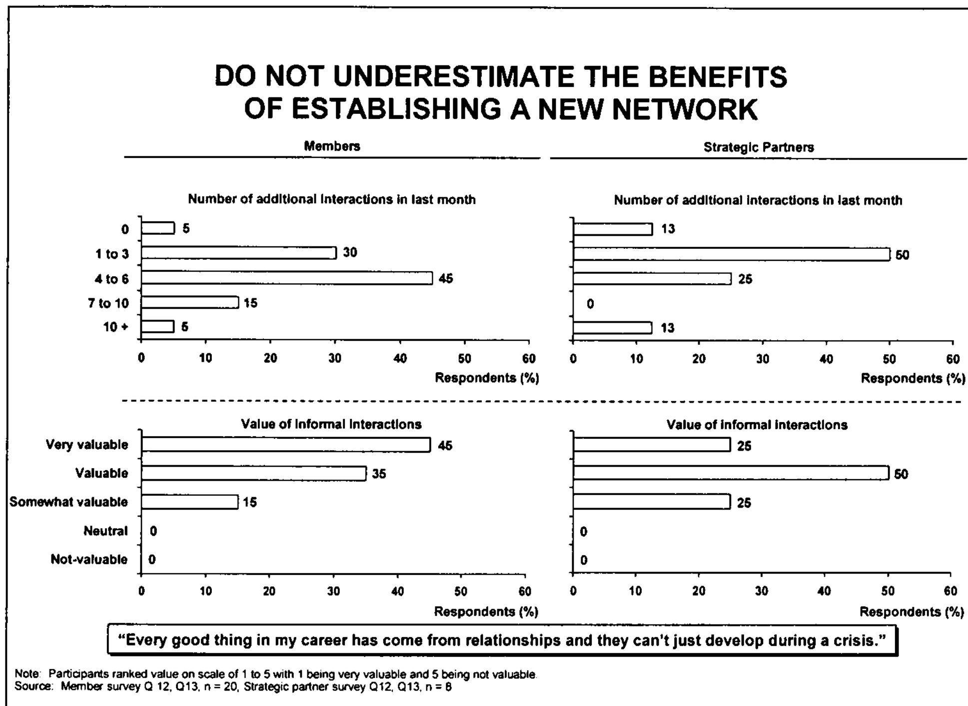
INVOLVEMENT AND COMMITMENT

It is vitally important that the Members and Strategic Partners be committed to the cause. The clearest way to demonstrate that commitment is through gradually increasing involvement over time, as the benefits of membership become increasingly clear. The sequence could begin with simply attending meetings; hosting them and paying for assorted incidentals; volunteering to lead and "own" an agenda initiative; and finally serving as an external representative of the organization to recruit members and resources. The financial and "in-kind" commitments (e.g., senior executive/staff time) Members need to make also increase over each of these phases.
If participants are required to give too much, too soon—without seeing a return on their investment—they may become wary and/or discouraged and disengage.

INFORMAL BENEFITS

One of the unexpected but clear benefits arising from participation in ChicagoFIRST was the opportunity to open up communication links and interact with colleagues at other Member financial institutions, the Strategic Partner public agencies and not-for-profit organizations on an ongoing and informal basis. This is what organizational theorists refer to as a "social network."

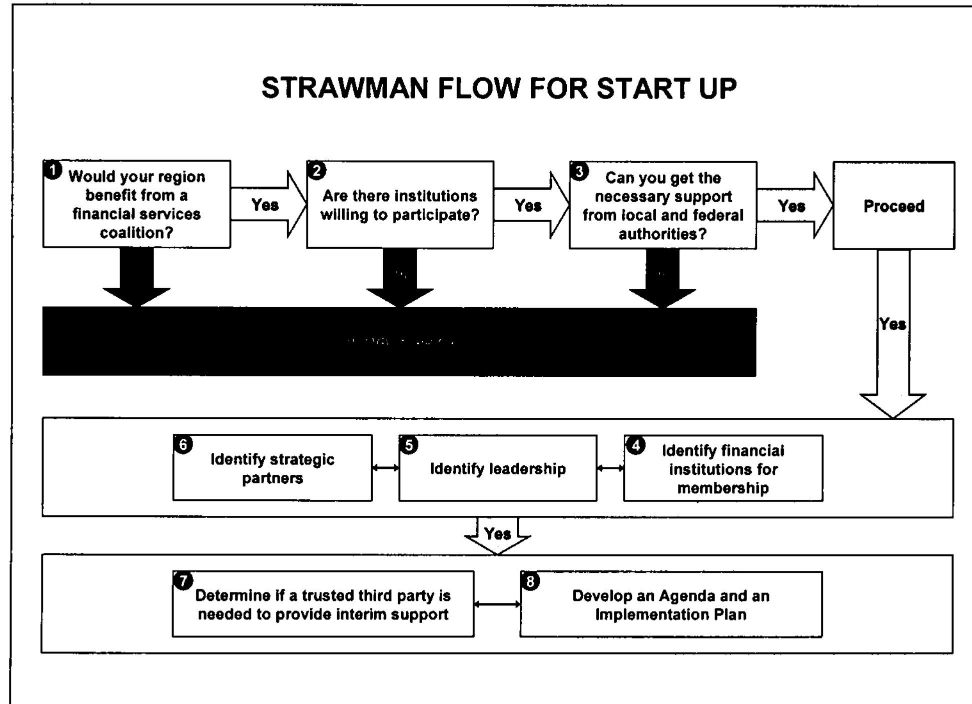
To gauge the extent and impact of the network that ChicagoFIRST is helping to establish, the Members and Strategic Partners were asked to estimate how many of these interactions they had experienced over the past month (not including regular ChicagoFIRST meetings or conference calls). The exhibit below conveys the results. Sixty-five percent of member representatives reported four or more additional interactions in the month, with 80% of the respondents finding those interactions "valuable" or "very valuable."



The increased lines of communication and trust illuminated in these survey results can only help to increase the preparedness and resilience of the financial sector in Chicago. While informal and thus hard to measure, the benefits of linking business leaders and continuity planning professionals together in a rich, interactive network should not be underestimated. Several of our interviewees indicated that this was the most important benefit of participating in the organization.

PRECONDITIONS FOR SUCCESS

Establishing a regional financial services coalition takes a substantive commitment of time, energy and resources. The reward, however, is commensurate with the effort. Those considering whether to undertake this responsibility should think through the following decision tree.



When it comes to getting started, with respect to question ❶, the answer is more likely to be yes if the following circumstances prevail:

- The financial services sector constitutes a significant portion of the regional economy and employment base.
- Financial institutions are relatively concentrated in the region so that:
  - The institutions face the same set of issues and challenges with respect to critical infrastructure protection, physical security/employee safety, and continuity of operations.
  - The institutions need to deal with the same state and local officials on these issues.

With respect to question ❷, the best way to find out is to network and take up these issues with peers and leaders at other financial institutions in your region. Chances are that if you are concerned about them so is a critical mass of your peer group. This was certainly the experience of the ChicagoFIRST founders.

If you can answer "yes" to the top three questions (labeled ➊, ➋ and ➌), you are ready to proceed with the next steps (➍, ➎, ➏, ➐ and ➑). If you answered "no" to any of the questions, you should reconsider whether you should proceed with trying to establish a regional coalition of financial services firms. The imperative may well be to focus on the "must haves" first.

Steps ➍, ➎ and ➏ are critical and should occur simultaneously. Identifying the leadership will be a natural byproduct of this phase. Early on, the coalition members must determine whether or not they will need to recruit a trusted third party to provide interim project management support (step ➐). Also, the development of the agenda and the implementation plan (step➑) is best achieved as a "team building" exercise and can occur at one of the initial meetings of the interested participants.

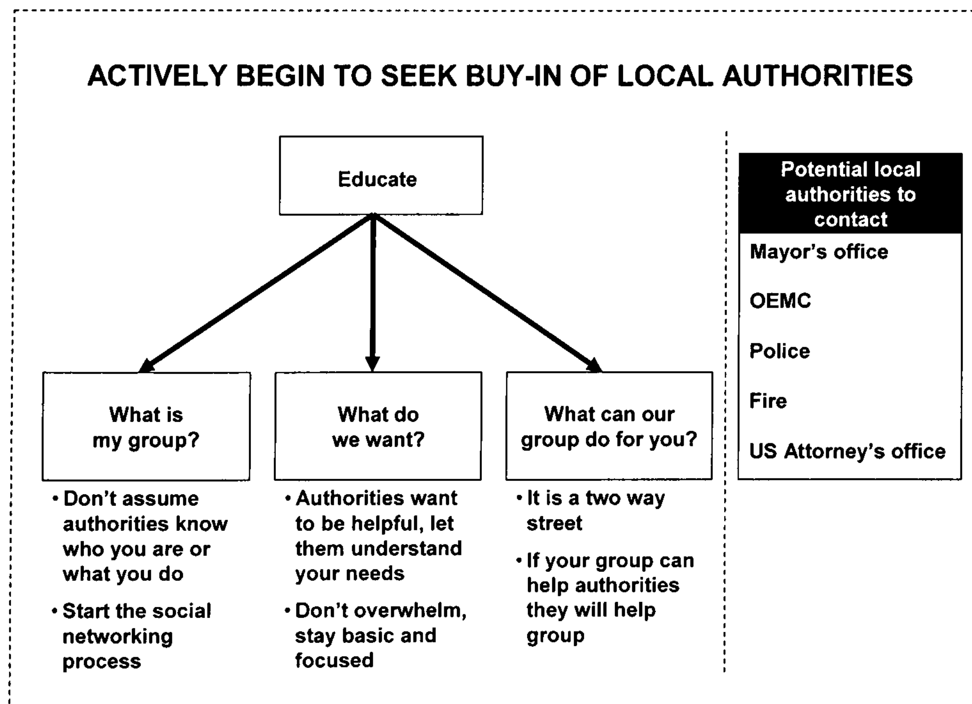
For the purposes of this Model, we will assume that the answers to questions ➊ and ➋ are yes. The following are considerations to keep in mind as you answer question ➌ and work through steps➍, ➎, ➏, ➐ and ➑.

QUESTION ➌

Can you get the necessary support from local and federal authorities?

Coalition members must proactively seek buy-in from local and federal authorities. These are two separate and distinct constituencies.

The table below identifies potential local authorities that you may wish to contact and illustrates the areas in which the coalition should seek to educate local authorities.



When seeking endorsement from a federal agency:
- Use your contacts.
- See what others have done.
- Be prepared to educate.
- Let them know how they can benefit.
- Have initiatives—not the organization—at the forefront.

Some agencies to consider:
- U.S. Department of the Treasury
- Federal Reserve Banks
- Federal Reserve Board
- Financial and Banking Information Infrastructure Committee (FBIIC)
- InfraGard
- Securities and Exchange Commission
- U.S. Department of Commerce
- U.S. Department of Homeland Security
- Your federal or state regulator

Keep in mind—whether you are dealing with local or federal authorities—that the public and private sectors often work at different paces. Respect the differences.

STEP ❹

Identify financial institutions for membership.

Personal contacts will help tremendously as coalition members seek eligible financial institutions. The coalition should determine the geographic area that it intends to serve and then determine eligible institutions within that area. They may be all or some combination of the following types of financial institutions:
- a registered broker-dealer under the Securities and Exchange Act of 1934;
- a registered futures commission merchant or otherwise exempt from registration under the Commodity Exchange Act;
- a registered national securities exchange or securities association;
- a registered contract market;
- a registered clearing agency;
- a registered derivatives clearing organization;
- a bank or trust company organized under the laws of the United States or a state thereof, and regulated and examined by federal or state authorities having regulatory authority over banks or trust companies;
- a bank or trust company that is organized under the laws of a country other than the United States and has a federal or state branch or agency located in the United States; or
- an insurance company that is regulated and examined by a state authority(ies) having regulatory authority over insurance companies.

It is best to start small and let the membership grow gradually over time. By keeping the initial membership small (10 to 20 institutions), it is likely that a coalition will develop comprised of members that:

- Are dedicated.
- Have commonalities.
- Are willing to devote resources and funds.

STEP ❺

Identify leadership.

As coalition members begin to meet, natural leaders will more than likely emerge. But who among these leaders can step up to the challenge of shepherding a new coalition through its formative stages? The types of qualities that should be present in the coalition leaders are:

- Individuals senior enough within their institution to ensure credibility.
- Individuals with the support of their institution.
- Individuals personally dedicated and willing to devote time and money to the cause.
- Individuals with contacts that will prove helpful to the coalition and advance the accomplishment of its initiatives.
- Individuals respected by peers and capable of effectively exercising leadership of nascent/informal groups.

The importance of this last point should not be underestimated. By definition, a voluntary coalition is not a formal, hierarchical organization with clearly established leadership selection mechanisms. The respect among peers and the willingness and capabilities to lead were what ultimately established the founding chairmen of ChicagoFIRST in their positions.

STEP ❻

Identify Strategic Partners.

Strategic Partners should be selected from the public and not-for-profit sectors. Organizations invited to participate as Strategic Partners should be ready, willing and able to provide needed expertise, resources, and/or prestige to the organization, helping to drive the development of the overall network and its agenda.

STEP ❼

Determine if a trusted third party will be needed to provide interim support.

The coalition members must determine if they have the bandwidth to drive the organization forward until they hire full-time staff to take on the responsibility (if they do indeed hire full-time staff). Having a trusted and neutral third party provide interim support has been identified as a key success factor for establishing regional coalitions. The following questions should be considered as organizations are considered as potential interim project managers:

- Is the party neutral?
- Is it sufficiently respected by the Members and Strategic Partners?
- Does it have helpful contacts?
- Can it effectively drive the process?
- Is it connected to our industry?
- Will it be available for an appropriate duration?
- Will it devote key personnel?

STEP ❽

Develop an agenda and an implementation plan.

The agenda must be focused, prioritized and contain actionable deliverables. The coalition members may start by creating a master list of possible items through a brainstorming session. The master list should then be filtered, identifying those items that are both important and achievable. Select a few (three to four) objectives where success can be achieved.

Once the primary objectives are determined, the coalition members can identify secondary objectives. However, these secondary objectives should not be pursued until the primary objectives are achieved.

It is important to formalize the meeting process and to begin to identify individuals who can lead and "own" coalition initiatives.

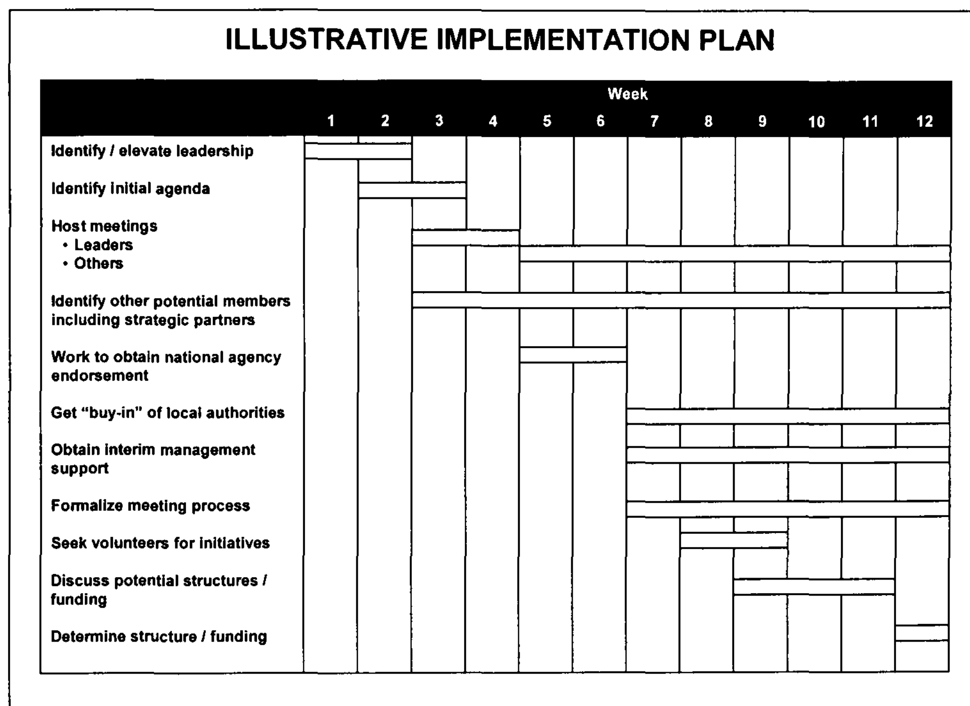
Considerations for effective meetings:

- Meetings must be held at regular intervals (e.g., once a week at a specific time). These meetings can be held via conference call.
- Meetings should be action-oriented.
- Active participation is crucial to success.
- Meetings should be held early or late in the day so that attendance is not preempted by other events.
- Each institution should have more than one representative available to participate in meetings.
- Detailed minutes of meetings will help track progress and establish actionable next steps.
- For in-person meetings, institutions can rotate hosting.

Initiative leaders will share many of the qualities found in the coalition leaders. These individuals must:

- Be actively involved.
- Have the support of their institution.
- Be given clear objectives and timeframes within which to accomplish those objectives.
- Be willing to report on their progress at meetings.

With the objectives identified, the coalition members can create an implementation plan. The plan below is based on the ChicagoFIRST experience and is intended to be illustrative. Each region will be unique, with differing needs, so the plan should be modified accordingly.



A detailed, illustrative implementation plan can be found in Appendix 5 of this document. The detailed plan covers the 12-week period outlined above.

Collaboration, trust and commitment to get past ordinary obstacles were keys to enabling ChicagoFIRST to accomplish extraordinary goals. Nothing less than the safety and soundness of an essential part of our Nation's critical financial services infrastructure was at stake. We could not take "no" for an answer. The Nation is better off as a result. We urge our counterparts throughout the country to create similar coalitions.

Ro Kumar
First Vice President
The Options Clearing Corporation

Louis Rosenthal
Executive Vice President
LaSalle Bank Corporation

A community has been defined as "a dynamic set of relationships in which a synergic, self-regulating whole is created out of the combination of individual parts into a cohesive, identifiable, unified form."[6] ChicagoFIRST is a community of dedicated, committed individuals with a shared sense of purpose. ChicagoFIRST possesses many of the characteristics attributed to healthy communities: participation, communication, commitment, trust, collaboration and efficacy.

By studying the experience and the key success factors of ChicagoFIRST, and by following the steps to adapt and apply the model, similarly healthy, robust communities can evolve elsewhere. These communities will strengthen the resiliency of the financial services industry as a whole.

[6] Cheryl Charles and Bob Samples, *Coming Home: Community, Creativity and Consciousness (Personhood Press, April 2004)*, pp. 36-43.

SAMPLE ANALYST JOB DESCRIPTION FOR AN EMERGENCY OPERATIONS CENTER[7]

The City of ______________ Emergency Operations Center, located at__________________, will generally be activated in cases where city- or region-wide coordination is imperative for effective response to an emergency event, security threat, or extended weather condition. These events include, but are not limited to extreme heat or cold, severe winter storm, extended or widespread utility emergency, major building fire or emergency, major hazardous materials event, security threat, terrorist attack, large-scale civil disorder or disobedience or a planned citywide special event.

During certain emergencies or disasters, ______________________ will have access to and will be requested to staff one position at the ________________ Emergency Operations Center (EOC). This includes emergencies in which financial institutions are threatened, are at risk, or are affected by an event. ___________________ representatives will be present to liaison between the _______________ and the financial sector. The representative's primary role is to provide information to and gather information from City officials regarding events affecting or potentially affecting the financial sector, disseminate the information efficiently and effectively to _______________ contacts, and act as an advocate for the financial sector.

________________ will also be requested to staff the Emergency Operations Center during a RED National Threat Alert or during an ORANGE National Threat Alert, and/or when there have been specific threats to the ________________ region or the financial sector leading to elevated threat levels for the state or local area. The analysts will generally work at the center in three 8½ hour shifts, providing 24-hour support during these event periods. The shifts will generally be as follows (although these times may be changed depending on City preferences or staffing issues):

- 1st shift 7:30 a.m.–4 p.m.
- 2nd shift 3:30 p.m.–12 a.m.
- 3rd shift 11:30 p.m.–8 a.m.

Responsibilities

- Track the status of problems, and response and recovery efforts by all levels of government. Assess the impact to the financial sector of problems reported by other entities.
- Gather information on financial sector operations and related entities by phone, fax, email, Internet, and the media.
- Proactively provide first responders with information regarding financial sector issues (key operational timelines, facility locations, staffing issues, relocation logistics and recovery priorities).
- Utilize voice, Internet, and other communication tools to disseminate information to contacts.
- Arrange and attend conference calls and provide briefings on information.
- Provide brief status updates regarding the health of the financial sector and key infrastructure providers (oral and written). Provide a shift turnover report to the next analyst on duty.

[7] The authors wish to acknowledge the contribution of the Securities Industry Association (SIA) for providing the original documentation upon which this analyst description is based.

- Provide information for status reports as requested.
- Participate in meetings and conference calls as needed during the event periods.

Qualifications
- Ability to work under pressure.
- Minimum of five years of financial sector experience.
- Familiarity with regional, national and worldwide financial sector organizations and functions.
- Strong oral and written communication skills.
- Superior problem assessment and evaluation skills.
- Strong computer skills.
- If on-call, staff must be within one-half hour travel time to the Emergency Operations Center, if activated.
- Must not have existing, higher-priority duties during an emergency.

SAMPLE QUESTIONS TO ASK LOCAL AUTHORITIES REGARDING EVACUATION PROCEDURES

1. Where does "developing evacuation procedures" fall within the City's priorities?
2. Do primary and secondary evacuation routes already exist?
3. If an evacuation were imminent, when and how could industry representatives expect notification? Whom should industry representatives expect to hear from? Will there be some lead time before the information is released to the general public or to the media?
4. If a single building needs to be evacuated, will a certain circumference around that building also be evacuated? If yes, can the City share what that circumference would likely be?
5. Would the City dedicate some mass transit (buses, for example) to help transport individuals that perform critical sector functions to their relocation centers in the suburbs?
6. Is there a contact at the Department of Transportation that could provide a briefing on likely evacuation scenarios, existing alternative plans for holidays/special events and lessons learned from other events?
7. Would the City participate in a "tabletop exercise" with private industry that would illustrate how the City would respond to a large-scale disaster?
8. Given that other areas in the U.S. publish evacuation routes for natural disasters, what can we do to give the City some comfort that sharing evacuation routes with key industry representatives—before a disaster—will help the private sector assist the City in achieving an orderly evacuation if the need should arise?
9. What can we do to help?

HIGHLIGHTS OF THE "CORPORATE EMERGENCY ACCESS SYSTEM" (CEAS)[8]

Emergency Credentialing is a big issue for all areas – large and small. One alternative to Credentialing – provided here for educational purposes – is the Corporate Emergency Access System (CEAS). CEAS is:

- An identification system that provides a form of recognizable ID for private sector "first responders".
- Allows priority emergency access to cardholder when safety permits, through a written agreement with local authorities.
- Designed to help businesses - both large and small.
- Constructed to help mitigate the potential damage and financial losses resulting from an unforeseen emergency or catastrophe.
- Fully funded and administered by the private sector.

CEAS purpose is to:

- Assist local businesses in re-entering areas where their offices are located and typically restricted from public access due to an emergency condition.
- Pre-identify and authorize building access to employees and contractors of companies that do business in an area, whose job functions are considered essential to their companies' on-going viability.

CEAS offers benefits to both the private and public sectors. Benefits to the private sector include the ability to:

- Rescue assets such as, cash, checks, securities, bank notes, receipts, credit cards and stock certificates.
- Retrieve vital records such as, contracts, invoices, client applications, customer records, phone lists, legal briefs, letters of credit, emails, insurance documents, tax records, floor plans, deeds and licenses.
- Power down networks, mainframes, and servers.
- Retrieve laptops and servers.
- Recover files, computer records, and microfiche and back up tapes.
- Restore critical operations and customer services.
- Begin clean-up and restoration.
- Avoid severe financial loss, the loss of customers.

Benefits to the public sector include:

- Helps local governments speed area recovery by having businesses ready to resume normal activities once restrictions are lifted.
- Limits the financial impact to the local economy by helping businesses control and limit loss.

[8] The authors wish to acknowledge Business Network of Emergency Resources (BNet) for providing this information, all rights reserved, BNet Inc. - 2004

- Limits the loss of local tax revenues by shortening business recovery times.
- Provides a great business retention and recruitment tool.

Basis tenets of the system:

- Individuals who are credentialed should be those who are necessary for the business to maintain guardianship and keep core business functions operable. This is not "business as usual." Only those individuals required to minimally sustain the company should be credentialed.
- Individual companies would be granted a pre-defined number of credentials based upon a percentage of employees per facility. For example, for a facility with a staff of 1000 or more, the company would be allowed to identify 10% of the employee base as key personnel. For a facility with less than 20 people, the percentage is 25%. Exceptions could be granted with the concurrence of the sponsoring City.
- Critical service providers can be included in a facility's total card allotment.
- The card is security embossed and includes a photo of the individual, primary location of business. Upon demand, individuals would be required to provide a second form of photo ID. There are no current plans to require additional authentication/validation other than physical possession of the card. Local public safety officials maintain complete control of access on site and may alter or terminate access at any time based on safety conditions
- The system is developed by BNet (Business Network of Emergency Resources) and grew out of the Joint Loss Reduction Partnership study performed for the New York State Emergency Management Office in conjunction with a consortium of top New York State businesses.
- The system is web-based. Administrative burden rests with the companies. They must apply for and maintain their credentials through the web-based program. Charges are per card, per year – with a 2 year expiration period. All costs associated with the development and maintenance of the program are built into the price of the credential.
- The system has reporting capabilities so that companies can track the status of cards issued. Local authorities also have access to information necessary for enforcement of the program.
- Key to implementation and overall success requires support from the chief elected official, police and other local first responders.

SAMPLE POSITION SPECIFICATION STATEMENT FOR AN EXECUTIVE DIRECTOR

POSITION SPECIFICATION

TITLE: Executive Director

ORGANIZATION: ______________________________

LOCATION: ______________________________

REPORTING RELATIONSHIP: The Executive Director will report to a Board of Directors (number to be determined) consisting of representatives from the founding members of ____________________________.

On a day-to-day basis, the Executive Director will report to the Chairman of the Board.

ORGANIZATION BACKGROUND: ____________________ major financial institutions formed ____________________, an industry coalition that will address homeland security issues requiring a common response by the financial community. Federal and local authorities have endorsed and expressed their support of ______________________.

____________________ mission is to enhance the resilience of the financial services industry in the event of a regional disaster. __________________ will partner with city, state and federal agencies to immediately work towards achieving the following first priority business objectives:

- To Be Inserted by Regional Coalition

RESPONSIBILITIES: The Executive Director will manage the activities of _______________ and serve as the primary liaison between _______________ and the City of _______________. The Executive Director will be responsible for proactively advancing the first priority business objectives (listed above) and for developing and advancing future business objectives, including but not limited to:

- Collaborating with the City and regional telecommunications vendors to insure diverse routing of networks within city limits.
- Working with technology vendors to insure uninterrupted support services during a crisis.

- Provide a forum for public-private dialog on issues related to business continuity and protecting the regional financial industry.
- Champion national efforts such as simulation exercise and readiness plans.
- Coordinate with credible industry groups such as FSSCC, BITS and the SIA.

The Executive Director will serve as the primary liaison between ___________________ and its Strategic Partners. This liaison role includes keeping the Strategic Partners informed and engaged in the activities of ______________________.

The Executive Director will be responsible for coordinating and facilitating meetings, whether by conference call or in person. The Executive Director will publish minutes for the meetings. The Executive Director will also be expected to serve as a spokesperson for _________________ and develop and deliver presentations at various industry events.

The Executive Director will be the primary and key responder and will fill the financial services seat at the Emergency Operations Center when activated. Though there will be others to staff the position on a rotation basis, the Executive Director will be expected to always fill the first shift during a crisis.

The Executive Director will develop and manage the annual budget and manage an administrative assistant.

QUALIFICATIONS: The Executive Director will be an adept, diplomatic negotiator, able to build consensus and support among those with diverse views and opinions. The Executive Director shall:

- Have a minimum of five years of experience in financial services.
- Be an exceptional communicator, proficient in oral and written communication skills.
- Have excellent organizational skills.
- Have excellent computer skills.
- Have a broad background in a variety of functions in a financial services entity.

COMPENSATION: A competitive compensation package will be offered to attract the most qualified candidates.

ILLUSTRATIVE DETAILED IMPLEMENTATION PLAN

The following tables are based on ChicagoFIRST and are intended to be illustrative. Each region will be unique, with differing needs. The Plan should be modified accordingly.

ILLUSTRATIVE IMPLEMENTATION PLAN

	Week 1	2	3	4	5	6	7	8	9	10	11	12
Identify / elevate leadership												
Identify initial agenda												
Host meetings • Leaders • Others												
Identify other potential members including strategic partners												
Work to obtain national agency endorsement												
Get "buy-in" of local authorities												
Obtain interim management support												
Formalize meeting process												
Seek volunteers for initiatives												
Discuss potential structures / funding												
Determine structure / funding												

IMPLEMENTATION SHOULD HAVE CLEAR OBJECTIVES BUT MUST REMAIN FLEXIBLE (I)

	Goals	Key activities
Week 1	• Identify/elevate leaders	• Natural leaders may exist • If not, select at least 2 leaders who are - senior within own organization - dedicated to cause - have support of their company - able to effectively outreach
Week 2	• Identify initial agenda • Identify/elevate leaders	• Continue to identify / elevate leaders • Begin to identify agenda for group - gather as many potential action items as possible - select no more than 4 to pursue from start - make items focused, prioritized and achievable

IMPLEMENTATION SHOULD HAVE CLEAR OBJECTIVES BUT MUST REMAIN FLEXIBLE (II)

	Goals	Key activities
Week 3	• Identify other potential members (including strategic partners) • Identify initial agenda	• Continue to identify and refine initial agenda • Identify and recruit other potential members including strategic partners - number of initial members should be small - members should be dedicated and willing to donate time and money to cause
Week 4	• Identify other potential members (including strategic partners)	• Continue to identify and recruit other potential members

IMPLEMENTATION SHOULD HAVE CLEAR OBJECTIVES BUT MUST REMAIN FLEXIBLE (III)

	Goals	Key activities
Weeks 5-6	• Work to obtain endorsement of national agency • Identify other potential members (including strategic partners)	• Continue to identify and recruit other potential members • Work with contacts to obtain endorsement of national agency(s) • Members other than leaders should begin to host meetings
Week 7	• Get "buy-in" of local authorities • Obtain interim management support • Formalize meeting process • Identify other potential members (including strategic partners)	• Continue to identify and recruit other potential members • Work with local authorities to gain their support - hold meetings to educate - use contacts • Obtain interim/project management support - helps to drive processes • Formalize meeting process - hold weekly conference calls

IMPLEMENTATION SHOULD HAVE CLEAR OBJECTIVES BUT MUST REMAIN FLEXIBLE (IV)

	Goals	Key activities
Week 8	• Seek volunteers for initiatives • Get "buy-in" of local authorities • Obtain interim management support • Formalize meeting process • Identify other potential members (including strategic partners)	• Continue to pursue activities from week 5 • Seek volunteers to lead subcommittees addressing initiatives - must have real accountability and responsibility
Weeks 9-11	• Discuss potential structures/funding • Seek volunteers for initiatives • Get "buy-in" of local authorities • Obtain interim management support • Formalize meeting process • Identify other potential members (including strategic partners)	• Continue to pursue activities from week 8 • Begin to discuss potential structures and funding for group - consider how formal structure must be - potential tiering of dues structure

IMPLEMENTATION SHOULD HAVE CLEAR OBJECTIVES BUT MUST REMAIN FLEXIBLE (V)

	Goals	Key activities
Week 12	• Determine structure/funding • Seek volunteers for initiatives • Get "buy-in" of local authorities • Obtain interim management support • Formalize meeting process • Identify other potential members (including strategic partners)	• Continue to pursue activities from weeks 9-11 • Reach decision point on structure/funding matters

FOUNDING MEMBERS AND STRATEGIC PARTNERS

The financial services industry is in debt to the Founding Members and Strategic Partners of ChicagoFIRST and the City of Chicago's Office of Emergency Management and Communications (OEMC) for serving as a role model for other regions. The coalition could not have been established without the commitment and dedication of the organizations listed below.

CHICAGOFIRST FOUNDING MEMBERS:

ABN Amro/LaSalle Bank Corporation

Archipelago

Bank of America Corporation

Chicago Board Options Exchange

Chicago Mercantile Exchange

Chicago Stock Exchange

Harris Bankcorp, Inc.

JP Morgan Chase

Mesirow Financial

Mizuho Securities USA Inc.

Northern Trust Corporation

The Options Clearing Corporation

UBS

William Blair

STRATEGIC PARTNERS

BITS

City of Chicago

Chicago Police Department

Chicago Regional Office of the FDIC

Commodities Futures Trading Commission

U.S. Department of Homeland Security
- FEMA – Region V
- U.S. Secret Service

Federal Reserve Bank of Chicago

FS/ISAC

FSSCC

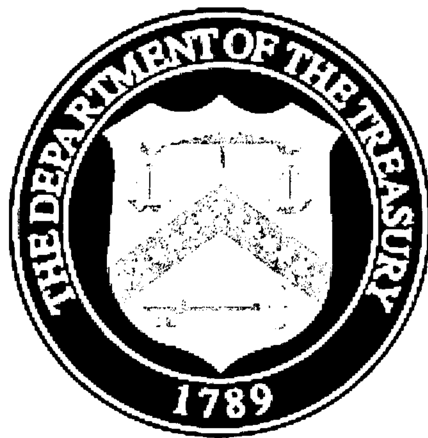
Futures Industry Association

U.S. Securities and Exchange Commission

State of Illinois – Office of Banks and Real Estate

U.S. Attorney's Office – Northern District of Illinois

U.S. Department of the Treasury
- The Office of the Comptroller of the Currency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1789

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 7, 2004
JS-2131

Timothy S. Bitsberger Appointed to Air Transportation Stabilization Board

Treasury Secretary John W. Snow appointed Assistant Secretary for Financial Markets Timothy S. Bitsberger this week to serve as Treasury's designee on the Air Transportation Stabilization Board. Bitsberger will replace Under Secretary for Domestic Finance Brian C. Roseboro who is resigning from the Treasury Department at the end of the year.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 7, 2004
JS-2132

Media Advisory: United States and France to Sign Protocols Amending the U.S.-France Tax Treaties

Treasury Deputy Secretary Samuel Bodman and Jean-David Levitte, French Ambassador to the United States, will hold a ceremony to sign protocols amending the U.S.-France Income Tax and Estate Tax Treaties at 3:00 p.m. EST on Wednesday, December 8, 2004 in the Treasury Department's Media Room (Room 4121), 1500 Pennsylvania Avenue, NW.

Media without Treasury or White House press credentials planning to attend should contact Treasury's Office of Public Affairs at (202) 622-2960 with the following information: name, social security number and date of birth. This information may also be faxed to (202) 622-1999.

ƷS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

Ɔecember 7, 2004
ᒾ004-12-7-17-43-24-21879

U.S. International Reserve Position

ˉhe Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets otaled $87,028 million as of the end of that week, compared to $86,748 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	November 26, 2004			December 3, 2004		
TOTAL		86,748			87,028	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	12,104	15,334	27,438	12,209	15,337	27,546
Of which, issuer headquartered in the U.S.			0			0
ɔ. Total deposits with:						
b.i. Other central banks and BIS	11,890	3,082	14,972	11,985	3,083	15,068
b.ii. Banks headquartered in the U.S.			0			0
ɔ.ii. Of which, banks located abroad			0			0
ɔ.iii. Banks headquartered outside the U.S.			0			0
ɔ.iii. Of which, banks located in the U.S.			0			0
ᒾ. IMF Reserve Position [2]			19,964			20,009
ӡ. Special Drawing Rights (SDRs) [2]			13,331			13,361
ŀ. Gold Stock [3]			11,043			11,043
ɔ̇. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	November 26, 2004			December 3, 2004		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
. Foreign currency loans and securities			0			0
. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
.a. Short positions			0			0
.b. Long positions			0			0
. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	November 26, 2004			December 3, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

l/ 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 leposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

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

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 8, 2004
JS-2133

Statement of U.S. Treasury Deputy Assistant Secretary David Loevinger Monrovia, Liberia, December 8, 2004

During December 7-8, I met with Liberia's economic leaders, including Chairman Bryant, Finance Minister Lusinee Kamara, Minister for Planning and Economic Affairs, Christian Herbert, and Acting Executive Governor of the Central Bank, Charles Greene. I want to thank Chairman Bryant and his team for their gracious hospitality. I also want to thank Ambassador Blaney, whose tireless efforts have ensured that we in Washington are not distracted by events elsewhere in the world.

The U.S. Treasury Department has devoted significant resources to helping Liberia recover and grow. In Africa, Liberia is the largest recipient of technical assistance from the Treasury Department because we believe that peace will be sustained only if there is economic growth and job creation. This will require disciplined, transparent and accountable monetary and fiscal policies. That is why we have provided advisors to the Ministry of Finance, the Bureau of the Budget, and the Central Bank. The Treasury Department is also working closely with the IMF, World Bank, and the African Development Bank to create conditions for these institutions to once again provide resources to create jobs and reduce poverty.

The Transitional Government of Liberia has made important progress in restoring growth (expected to be over 20% this year) and improving people's lives. As one example, increased competition in cellular telecommunications has cut costs to consumers significantly. Increased competition in other sectors could lead to similar results.

But I must tell my Liberian friends that, despite some very useful reforms taken by the NTGL and the progress made, there remain too many instances where actions of a few individuals cost the Liberian people dearly and undermine the ability of donors, the IMF and the Multilateral Development Banks to reengage with Liberia. Too many revenues still never make it into the government's budget, particularly from the port. And too much of the money collected continues to be spent outside of agreed budgetary procedures. Government officials must be held accountable for transparent management of public resources. This is important to donors, but even more important to the welfare of the Liberian people. It is their money.

My visit to the Finance Ministry highlighted both the progress that has been made and the work yet to do. A large taxpayers unit is making strides in ensuring that businesses pay their fair share. I observed deliberations of the Cash Management Committee, which was created to ensure that the government spends only the resources it has, does not again run up arrears, and allocates scarce resources to priority areas. However, there continues to be spending that does not conform with the committee's recommendations.

I came because of Liberia's importance to the United States and the unique and special relationship that we share. I came now because Liberia is at an important crossroads. Actions in the coming months – particularly in the collection and use of public funds -- will determine whether this country, so rich in human and natural resources, achieves its economic potential or slips back to being a failed state.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 8, 2004
JS-2134

Treasury Identifies Cuban Online Travel
Agency Targeting American Tourists
Bush Administration's Crackdown on Castro Castro e Continues

In another step against Fidel Castro's oppressive regime, the U.S. Department of the Treasury today identified the travel agency TOUR & MARKETING INTERNATIONAL LTD. as a National of Cuba.

"This travel provider is not only a generator of resources that the Cuban regime uses to oppress its people, but it also facilitates the evasion of U.S. sanction policy," said Juan Carlos Zarate, Treasury's Assistant Secretary for Terrorist Financing and Financial Crimes.

"Castro himself placed his military in charge of Cuba's travel industry earlier this year –reconfirming his urgent need for travel-related dollars to go directly to propping up his regime," Zarate continued.

TOUR & MARKETING INTERNATIONAL LTD. provides a means by which U.S. persons can travel to Cuba via third countries by purchasing Cuba travel and tour services through the company's 60 Cuba-oriented websites, the most notable being www.gocubaplus.com.

TOUR & MARKETING INTERNATIONAL LTD. caters to U.S. citizens by asserting that it is not only Cuba's number one agency for American travelers, but also that it is able to serve all travelers – regardless of whether they have a Treasury-issued license to travel to the sanctioned country. In addition, the travel agency emphasizes that it is mandatory for U.S. citizens to use the company's online payment system.

TOUR & MARKETING INTERNATIONAL LTD. has five offices in Cuba, one in Spain, one in England and one in the British Virgin Islands. The company's principal and manager are either domiciled in Cuba or nationals of Cuba. TOUR & MARKETING INTERNATIONAL LTD. is the official tour operator representing the Government of Cuba's Agencia Receptora Ecotur S.A., one of Cuba's largest local agencies.

Persons subject to U.S. jurisdiction may not engage in any transactions with TOUR & MARKETING INTERNATIONAL LTD. unless authorized by the Treasury's Office of Foreign Assets Control (OFAC). In addition, all property of TOUR & MARKETING INTERNATIONAL LTD. that is in the possession of persons subject to U.S. jurisdiction is blocked.

Today's action is part of the ongoing effort by the Bush Administration to choke off dollars streaming to the Castro regime and to make it more difficult for the Cuban government to harden its internal security and military infrastructure. These efforts are part of the Bush Administration's overall strategy to hasten the day when the people of Cuba can live free, democratic lives. Both in October 2003 and May 2004, President Bush announced stepped-up enforcement of U.S. laws prohibiting travel-related transactions with the island.

Treasury's identification of Cuban-controlled businesses furthers these efforts by cutting the designees out of the U.S. financial system, therefore keeping more hard currency from flowing into the coffers of Castro's regime. Today's action follows an

October announcement by the Treasury identifying the electronic money transfer business, SERCUBA, as a national of Cuba.

With today's announcement, the Treasury Department has now taken action against 14 Cuban-controlled entities since President Bush's October 2003 statement.

REPORTS

- Entity Tour & Marketing International ltd.
- Addresses

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 8, 2004
JS-2135

**Deputy Treasury Secretary Samuel Bodman
Remarks at the Signing Ceremony for
Protocols to the Income Tax and Estate Tax Treaties
Between the United States and France**

Thank you all for being here today. It's my pleasure to welcome you to the Treasury Department. I would like to extend a particular welcome to Ambassador Levitte and his colleagues from the French Embassy.

This Administration has made a strong commitment to our tax treaty program. We are working to expand our treaty network by establishing new tax treaty relationships with countries around the world.

Equally important to improving our tax treaty network is our work to keep existing agreements up-to-date. We need to work together to ensure that our treaties continue to serve the purposes of eliminating double taxation and preventing fiscal evasion. And the protocols we will sign here today provide a great example of that collaboration. Through these protocols, we will improve two existing agreements between the United States and France – our income tax treaty and our estate tax treaty.

The tax treaty relationship between our countries goes back 65 years, making it one of our oldest such relationships. This long-standing relationship is particularly notable because our legal and tax systems are in many ways quite different. These protocols evidence our mutual commitment to ensuring that the differences in our two countries' systems do not create tax barriers to the cross-border activity that benefits both our economies.

While these are highly technical agreements, they are important to the lives of the people who are affected by their provisions. These two protocols include key provisions that will benefit individuals in both our countries -- including provisions relating to the tax treatment of retirement benefits and the application of estate taxes. With the ageing of our populations, these types of provisions are becoming more and more important.

Another key provision in the income tax protocol addresses the treatment of cross-border investments made through partnerships and other similar forms of entity. Because our two countries have very different approaches to the taxation of partnerships, ensuring the right results was a particular challenge. But we worked together to address it. This protocol includes rules needed to provide flexibility in terms of form-of-entity and to reduce the risk of double taxation for U.S. investors in France.

Today we are improving an already strong treaty relationship between the United States and France. These two protocols will further our goals of facilitating cross-border trade and investment to the benefit of the citizens and businesses of both our countries. I very much appreciate the hard work of everyone involved – on both sides – in completing these agreements. I am pleased to sign these protocols today.

REPORTS

- U.S. France Income Tax Protocol
- U.S. France Estate Tax Protocol

- U.S. France Income Tax Protocol
- U.S. France Estate Tax Protocol

PROTOCOL
AMENDING THE CONVENTION BETWEEN
THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND
THE GOVERNMENT OF THE FRENCH REPUBLIC
FOR THE AVOIDANCE OF DOUBLE TAXATION
AND THE PREVENTION OF FISCAL EVASION
WITH RESPECT TO TAXES ON INCOME AND CAPITAL,
SIGNED AT PARIS ON AUGUST 31, 1994

The Government of the United States of America and the Government of the French Republic, desiring to amend the Convention Between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Paris on August 31, 1994, have agreed as follows:

ARTICLE I

1. Subparagraph (b) (iii) of paragraph 2 of Article 4 (Resident) of the Convention shall be deleted and replaced by the following:

> "(iii) in the case of the United States, a regulated investment company, a real estate investment trust, and a real estate mortgage investment conduit; in the case of France, a "société d'investissement à capital variable"; and any similar investment entities agreed upon by the competent authorities of both Contracting States;".

2. Subparagraph (b) (iv) of paragraph 2 of Article 4 (Resident) of the Convention shall be deleted and replaced, and new subparagraphs (b) (v) and (vi) of paragraph 2 of Article 4 are added as follows:

"iv) a partnership or similar pass-through entity, an estate, and a trust (other than one referred to in subparagraph (ii) or (iii) above), whether or not organized or managed in one of the Contracting States, but only to the extent that the income derived by such partnership, similar entity, estate, or trust is treated for taxation purposes in that Contracting State as the income of a resident, either in the hands of such partnership, entity, estate or trust, or in the hands of its partners, beneficiaries or grantors, it being understood that a "société de personnes", a "fonds commun de placement", a "groupement d'intérêt économique" (economic interest group), or a "groupement européen d'intérêt économique" (European economic interest group) that is constituted in France and has its place of effective management in France and that is not subject to company tax therein shall be treated as a partnership for purposes of United States tax benefits under this Convention, provided that a partnership or similar pass-through entity, an estate and a trust which is not organized or managed in one of the Contracting States shall be entitled to the benefits of this convention with respect to the income or gains derived by such entity arising in France if the following additional conditions are satisfied:

(aa) the absence of contrary provisions in a double taxation convention between a Contracting State and the third State;

(bb) the fact that the partnership or similar pass-through entity, estate or trust is not treated as a body corporate for tax purposes or otherwise liable to tax on French source income either in its own hands or in the hands of its

partners, beneficiaries or grantors under the tax law of the third State;

(cc) a partner's, beneficiary's, or grantor's share of the income or gain of the partnership or similar pass-through entity, estate or trust is taxed in the same manner, including the nature or source of that income or gain and the time when that income or gain is taxed, as would have been the case if the income or gain had been derived directly, except to the extent resulting from any difference in accounting methods, accounting periods, or other similar difference; and

(dd) it is possible to exchange information concerning the partnership or similar pass-through entity, estate or trust or partners, beneficiaries or grantors under the terms of a double taxation convention between the Contracting State in which the income or gain arises and the third State;

v) a partnership or similar pass-through entity, an estate, and a trust (other than one referred to in subparagraph (ii) or (iii) above), which is organized in the United States, shall be treated as a resident of the United States to the extent provided in subparagraph (iv) above, and as a resident of France to the extent that the income derived by such partnership, similar pass-through entity, estate or trust arises in France and corresponds to the share ofthe profits or losses of such entity which benefits a resident of France;

vi) it is understood that, for the purposes of the subparagraphs (iv) and (v) above, the income derived by a partnership or similar pass-through entity, an estate and a trust (other than one referred to in subparagraph (ii) or (iii) above), is

considered to be treated for taxation purposes in a Contracting State as the income of a resident to the extent of this income which benefits a partner, beneficiary, or grantor that is a pension trust, an other organization or a not-for-profit organization referred to in subparagraph (ii) above, notwithstanding that all or part of this income of such trust, other organization, or not-for-profit organization is exempt from income taxation in that State."

ARTICLE II

The last sentence in the final paragraph of paragraph 2 of Article 10 (Dividends) of the Convention shall be deleted and replaced by the following new sentence:

"In the case of dividends paid by a United States real estate investment trust, the provisions of subparagraph (b) shall apply only if:

(i) the beneficial owner of the dividends is an individual holding an interest of not more than 10 percent in such real estate investment trust;

(ii) the dividends are paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividends is a person holding an interest of not more than 5 percent of any class of the real estate investment trust's stock; or

(iii) the beneficial owner of the dividends is a person holding an interest of not more than 10 percent in the real estate investment trust and the value of no single interest in the real estate investment trust's real property exceeds 10 percent of the real estate investment trust's total interests in

real property."

ARTICLE III

Article 18 (Pensions) of the Convention shall be deleted and replaced by the following:

"ARTICLE 18 - Pensions

1. Payments under the social security legislation or similar legislation of a Contracting State to a resident of the other Contracting State, and pension distributions and other similar remuneration arising in one of the Contracting States in consideration of past employment paid to a resident of the other contracting State, whether paid periodically or in a lump sum, shall be taxable only in the first-mentioned State. For purposes of this paragraph, pension distributions and other similar remuneration shall be deemed to arise in a Contracting State only if paid by a pension or other retirement arrangement established in that State.

2. (a) Where an individual renders personal services and is a resident of a Contracting State but not a national of that State, and that individual is a participant in a pension or other retirement arrangement that is established, maintained, and recognized for tax purposes in the other Contracting State:

(i) contributions paid by, or on behalf of, such individual to such pension or retirement arrangement shall be deductible from the income taxable in the first-mentioned State as if the contributions had been paid to a pension or other retirement arrangement that is established, maintained, and recognized for tax purposes in that State, subject to the same monetary limits provided for by the law of that State; and

(ii) in the case of dependent personal services, any benefits accrued under such arrangement or payments made to such an arrangement by or on behalf of the individual's employer shall be excluded from the individual's income taxable in the first-mentioned State and shall be allowed as a deduction in computing the profits of the employer in that State as if the contributions had been paid to a pension or other retirement arrangement that is established, maintained, and recognized for tax purposes in that State, subject to the same monetary limits provided for by the law of that State.

(b) The provisions of this paragraph shall not apply unless:

(i) contributions by or on behalf of the individual to the pension or other retirement arrangement (or to another similar arrangement for which this arrangement was substituted) were made before he arrived in the first-mentioned State; and

(ii) the competent authority of the first-mentioned State agrees that the arrangement generally corresponds to a pension or other retirement arrangement established, maintained, and recognized for tax purposes in the first-mentioned State.

(c) For purposes of this paragraph:

(i) in the case of the United States, it is understood that a French pension or other retirement arrangement organized under the French social security legislation shall be considered to generally correspond to a pension or

other retirement arrangement established, maintained, and recognized for tax purposes in the United States; and

(ii) in the case of France, it is understood that the social security or similar legislation of the United States, qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, and section 408(p) accounts), section 403(a) qualified annuity plans, and section 403(b) plans shall be considered to generally correspond to a pension or other retirement arrangement established, maintained, and recognized for tax purposes in France; and

(iii) a pension or other retirement arrangement is recognized for tax purposes in a Contracting State if the contributions to the arrangement would qualify for tax relief in that State."

ARTICLE IV

1. Paragraphs 2 and 3 of Article 19 (Public Remuneration) of the Convention shall be deleted.

2. A new paragraph 2 of Article 19 (Public Remuneration) of the Convention shall be added as follows:

"2. The provisions of Articles 14 (Independent Personal Services), 15 (Dependent

Personal Services), 16 (Directors' Fees), and 17 (Artistes and Sportsmen) shall apply to remuneration paid in respect of services rendered in connection with a business carried on by a Contracting State, a political subdivision (in the case of the United States) or local authority thereof, or an agency or instrumentality of that State, subdivision, or authority."

ARTICLE V

1. Subparagraph (b) (iv) of paragraph 2 [*Paragraph 1 in French language*] of Article 24 (Relief From Double Taxation) of the Convention shall be deleted.

2. Subparagraphs (b) (v) and (b) (vi) of paragraph 2 [*Paragraph 1 in French language*] of Article 24 (Relief From Double Taxation) of the Convention shall be renumbered as subparagraphs (b) (iv) and (b) (v), respectively.

3. Subparagraph (c) of paragraph 1 [*Paragraph 2 in French language*] of Article 24 (Relief From Double Taxation) of the Convention shall be deleted and replaced by the following:

"(c) In the case of an individual who is both a resident and citizen of the United States and a national of France, the provisions of paragraph 2 of Article 29 (Miscellaneous Provisions) shall apply to remuneration described in paragraph 1 of Article 19 (Public Remuneration), but such remuneration shall be treated by the United States as income from sources within France."

ARTICLE VI

1. The last sentence of Paragraph 2 of Article 29 (Miscellaneous Provisions) of the

Convention shall be deleted and replaced by the following:

"For this purpose, the term "citizen" shall include a former citizen or long-term resident whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under the laws of the United States), but only for a period of ten years following such loss."

2. Paragraph 3 of Article 29 (Miscellaneous Provisions) of the Convention shall be deleted and replaced by the following:

" 3. The provisions of paragraph 2 shall not affect:

(a) the benefits conferred under paragraph 2 of Article 9 (Associated Enterprises), under paragraph 3 (a) of Article 13 (Capital Gains), under paragraph 1 of Article 18 (Pensions), and under Articles 24 (Relief From Double Taxation), 25 (Non-Discrimination), and 26 (Mutual Agreement Procedure); and

(b) the benefits conferred under paragraph 2 of Article 18 (Pensions), and under Articles 19 (Public Remuneration), 20 (Teachers and Researchers), 21 (Students and Trainees), and 31 (Diplomatic and Consular Officers), upon individuals who are neither citizens of, nor have immigrant status in, the United States."

ARTICLE VII

1. The Contracting States shall notify each other when their respective constitutional and statutory requirements for the entry into force of this Protocol have been satisfied. The Protocol shall enter into force on the date of receipt of the later of such notifications.

2. Except as provided in paragraph 3, the provisions of this Protocol shall have effect:

(a) in respect of taxes withheld at source, for any amount paid or credited on or after the first day of the second month next following the date on which the Protocol enters into force; and

(b) in respect of other taxes, for taxable periods beginning on or after the first day of January next following the date on which the Protocol enters into force.

3. The provisions of Article I, paragraph 2, of this Protocol, except to the extent such paragraph treats a "fonds commun de placement" as a partnership for purposes of United States tax benefits under this Convention, shall have effect:

(a) in respect of taxes withheld at source, for any amount paid or credited on or after February 1, 1996; and

(b) in respect of other taxes, for taxable periods beginning on or after January 1, 1996.

IN WITNESS WHEREOF, the undersigned, being duly authorized thereto, have signed this Protocol.

Done at Washington, this eighth day of December, 2004, in duplicate, in the English and French languages, each text being equally authentic.

FOR THE GOVERNMENT
OF THE UNITED STATES OF AMERICA

FOR THE GOVERNMENT
OF THE FRENCH REPUBLIC

PROTOCOL
AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES, INHERITANCES, AND GIFTS, SIGNED AT WASHINGTON ON NOVEMBER 24, 1978

The Government of the United States of America and the Government of the French Republic, desiring to amend the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts, signed at Washington on November 24, 1978, have agreed as follows:

ARTICLE I

A new paragraph (4) shall be added to Article 1 (Estates and Gifts Covered) of the Convention as follows:

" (4)(a) Notwithstanding any other provision of the Convention, the provisions of this Convention shall not preclude the United States from taxing in accordance with its law the estate of a decedent or the gift of a donor who, at his death or at the making of the gift, was

(i) a citizen of the United States,

(ii) domiciled (within the meaning of Article 4 (Fiscal Domicile)) in the United States, or

(iii) a former citizen or long-term resident whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under the laws of the United States), but only for a period of ten years following such loss;

(b) Subparagraph (a) of this paragraph (4) shall not, however, affect the obligation undertaken by the United States under:

(i) Article 10 (Charitable Exemptions and Deductions); paragraph (2) of Article 11 (Community Property and Marital Deduction); paragraphs (2) or (8) of Article 12 (Exemptions and Credits); Article 13 (Time Limitations on Claims for Credit or Refund) or Article 14 (Mutual Agreement Procedure);

(ii) paragraph (3) of Article 11 (Community Property and Marital Deduction) as applied to the estates of persons other than former citizens or long-term residents referred to in subparagraph (a) of this paragraph (4); or

(iii) the benefits conferred by the United States under Article 17 (Diplomatic and Consular Officials), as applied to transfers by individuals who are neither citizens of, nor have immigrant status in, the United States."

ARTICLE II

Paragraph (2) of Article 3 (General Definitions) of the Convention shall be deleted and replaced with the following:

"(2) As regards the application of the Convention at any time by a Contracting State any term not defined therein shall, unless the context otherwise requires, or the competent authorities agree to a common meaning pursuant to the provisions of Article 14 (Mutual Agreement Procedure), have the meaning which it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

ARTICLE III

Article 5 (Immovable (Real) Property) of the Convention shall be deleted and replaced with the following:

"ARTICLE 5 - REAL PROPERTY

(1) Real property may be taxed by a Contracting State if such property is situated in that State.

(2) The term "real property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated, being understood, however, that mortgages or other debt-claims secured by real property shall not be regarded as real property. The term shall in any case include property accessory to real property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of real property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as real property.

(3) The term "real property" shall also include shares, participations and other rights in a company or legal person the assets of which consist, directly or through one or more other companies or legal entities, at least 50 percent of real property situated in one of the Contracting States or of rights pertaining to such property. These shares, participations and other rights shall be deemed to be situated in the Contracting State in which the real property is situated.

(4) The provisions of paragraph (1) shall also apply to real property of an enterprise and to real property used for the performance of independent personal services."

ARTICLE IV

The last sentence of Article 6 (2) (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services) of the Convention shall be deleted and replaced with the following:

"If an individual is a member of a partnership or other similar pass-through entity which is engaged in industrial or commercial activity through a fixed place of business, he shall be deemed to have been so engaged to the extent of his interest therein."

ARTICLE V

Paragraph (2) (b) of Article 10 (Charitable Exemptions and Deductions) of the Convention shall be deleted and replaced with the following:

"(b) Is organized and operated exclusively for religious, charitable, scientific, literary, educational, or cultural purposes; and".

ARTICLE VI

1. Paragraph (2) of Article 11 (Community Property and Marital Deduction) of the Convention shall be deleted and replaced with the following:

"(2) Property (other than community property) which passes to a spouse who is not a citizen of the United States from a decedent or donor who was domiciled in France, and which may be taxed by the United States solely in accordance with Article 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services), or 7 (Tangible Movable Property), shall, for the purpose of determining United States tax, be included in the taxable base only to the extent its value (after taking into account any applicable deductions) exceeds 50 per cent of the value of all property included in the taxable base which may be taxed by the United States. The provisions of this paragraph shall not apply to a citizen of the United States domiciled in France or a former citizen or long-term resident of the United States referred to in subparagraph (4) (a) (iii) of Article 1 (Estates and Gifts Covered) of the Convention."

2. Paragraph (3) of Article 11 (Community Property and Marital Deduction) of the Convention shall be renumbered as paragraph (4).

3. A new paragraph (3) shall be added to Article 11 (Community Property and Marital Deduction) of the Convention as follows:

"(3) In determining the estate tax imposed by the United States on a decedent's estate with respect to property that (within the meaning of the law of the United States) passes to the decedent's surviving spouse and that would qualify for the estate tax marital deduction under the law of the United States if the surviving spouse were a citizen of the United States and all

applicable elections were properly made (the "qualifying property"), the decedent's estate shall be entitled to a marital deduction provided that:

(a) At the time of the decedent's death (i) the decedent was domiciled in either France or the United States or was a citizen of the United States; (ii) the decedent's surviving spouse was domiciled in either the United States or France; and (iii) if both the decedent and the decedent's surviving spouse were domiciled in the United States at the time of the decedent's death, one or both was a citizen of France; and

(b) The executor of the decedent's estate elects the benefits of this paragraph and irrevocably waives the benefits of any other estate tax marital deduction that would be allowed under the law of the United States on a United States federal estate tax return for the decedent's estate by the date on which a qualified domestic trust election could be made under the law of the United States.

The marital deduction allowed under this paragraph (3) shall be equal to the lesser of the value of the qualifying property or the applicable exclusion amount (within the meaning of the law of the United States of America as of the date of death of the decedent) determined without regard to any gift previously made by the decedent."

ARTICLE VII

Article 12 (Exemptions and Credits) of the Convention shall be deleted and replaced with the following:

"ARTICLE 12 - EXEMPTIONS AND CREDITS

(1) Except as otherwise provided in this Convention, each Contracting State shall impose its tax, and shall allow exemptions, deductions, credits, and other allowances, in accordance with its laws.

(2) Double taxation shall be avoided in the following manner:

(a) In determining the French tax, where the decedent or the donor was domiciled in France at the time of the transfer:

(i) France shall tax the entire property comprising the estate or the gift, including any property which may be taxed by the United States in accordance with the provisions of this Convention, and shall allow as a deduction from that tax an amount equal to the United States tax paid upon the transfer of any property, which, in relation to the same event, may be taxed in the United States.

(ii) The deduction referred to in subparagraph (i) shall not, however, exceed that part of the French tax, as computed before any deduction is made, which is attributable to the property in respect of which the deduction is to be allowed. For purposes of this subparagraph (ii), "that part of the French tax" means:

(A) Where the tax on the property concerned is computed by applying a proportional rate, the amount of the taxable net value of

such property multiplied by the rate which actually applies to that property; and

(B) Where the tax on the property concerned is computed by applying a progressive scale, the amount of the taxable net value of such property multiplied by the rate resulting from the ratio of the French tax actually payable on the total property taxable in accordance with French law to the net value of that total property.

(iii) For purposes of subparagraph (i), the United States tax

(A) shall include any United States tax referred to in Article 2 (Taxes Covered) but shall not include any tax that is permitted to be imposed by the United States under this Convention solely by reason of paragraph (4) of Article 1 (Estates and Gifts Covered), and

(B) shall be considered, in the case of property which may be taxed by the United States pursuant to Article 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services), or 7 (Tangible Movable Property), to be equal to that part of the French tax, as defined in subparagraph (ii), which is attributable to such property, but only if the decedent at his death or the donor at the time of the gift was a citizen of the United States and if it is

established that the United States tax obligations with respect to the death or gift have been complied with.

(b) In determining the United States tax:

(i) Where both Contracting States impose tax with respect to property which is taxable by France in accordance with Article 5 (Real Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services), or 7 (Tangible Movable Property), the United States shall allow a credit equal to the amount of the tax imposed by France with respect to such property.

(ii) If the decedent or donor was a citizen of the United States at the time of death or the making of a gift and would be considered under Article 4 (Fiscal Domicile) as having been domiciled in France at such time, the United States shall allow a credit equal to the amount of the tax imposed by France (after allowing for the deduction from tax, if any, allowed under paragraph (2) (a) of this Article).

If the decedent was a former citizen or long-term resident of the United States described in subparagraph (4) (a) (iii) of Article 1 (Estates and Gifts Covered), the United States shall allow a credit equal to the amount of the tax imposed by France in respect of all

property which is included in the United States gross estate solely by reason of such status.

(iii) Notwithstanding the provisions of subparagraphs (i) and (ii), the total amount of all credits allowed by the United States pursuant to this Article or pursuant to its laws or other conventions with respect to all property in respect of which a credit is allowable under subparagraphs (i) and (ii) shall not exceed that part of the tax of the United States which is attributable to such property.

(3) In determining the estate tax imposed by the United States, the estate of a decedent (other than a citizen of the United States) who was domiciled in France at the time of his death shall be allowed a unified credit equal to the greater of:

(a) The amount that bears the same ratio to the credit allowed under the law of the United States to the estate of a citizen of the United States as the value of the part of the decedent's gross estate that at the time of the decedent's death is situated in the United States bears to the value of the decedent's entire gross estate wherever situated; or

(b) The unified credit allowed under the law of the United States to the estate of a nonresident not a citizen of the United States.

The amount of any unified credit otherwise allowable under this paragraph shall be reduced by the amount of any credit previously allowed with respect to any gift made by the decedent.

For purposes of subparagraph (a), the part of the decedent's gross estate that is situated in the United States shall not exceed the part of the decedent's gross estate that may be taxed by the United States in accordance with this Convention. A credit otherwise allowable under subparagraph (a) shall be allowed only if all information necessary for the verification and computation of the credit is provided.

(4) In determining the gift or inheritance tax imposed by France with respect to transfers by reason of death or by gift by an individual, who at the time of the death or the making of the gift was a citizen of the United States or was domiciled in the United States, there shall be allowed the same deductions and credits as if the individual were domiciled in France. In determining the gift or inheritance tax imposed by France with respect to transfers by reason of death or by gift by an individual, who at the time of death or the making of the gift was domiciled in France, to an individual who is a citizen of the United States or is domiciled in the United States, there shall be allowed the same deductions and credits as if the recipient were domiciled in France.

(5) Any credits or deductions for tax imposed by a Contracting State allowable under this Article are in lieu of, and not in addition to, any such credits or deductions allowed by the laws of the other Contracting State and shall be computed in accordance with the provisions and subject to the limitations of the law of the other Contracting State, as it may be amended from time to time without changing the general principle thereof.

(6) If under this Convention any property would be taxable only in one Contracting State and tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, exclusion, credit, or allowance) in that State, tax may be imposed on that property in the other Contracting State notwithstanding any other provision to the contrary.

(7) Where in accordance with the provisions of the Convention property may not be taxed in a Contracting State, that Contracting State may nevertheless, in calculating the amount of tax on property that may be taxed in that Contracting State under the provisions of the Convention, take into account the exempted property that is taxable under the internal law of that Contracting State.

(8) The provisions of this Convention shall not result in an increase in the amount of the tax imposed by either Contracting State under its domestic laws. A reduction in the credit or deduction allowed against a Contracting State's tax for the tax paid to the other Contracting State which results from the application of this Convention shall not be construed as an increase in tax."

ARTICLE VIII

The last sentence of paragraph (2) of Article 15 (Filing of Returns and Exchange of Information) shall be deleted and replaced with the following:

"Any information furnished shall be treated as secret and shall not be disclosed to any persons other than those (including a court or administrative body) involved in the assessment,

collection, enforcement, or prosecution in respect of the taxes which are the subject of this Convention."

ARTICLE IX

1. The Contracting States shall notify each other when their respective constitutional and statutory requirements for the entry into force of this Protocol have been satisfied.

2. This Protocol shall enter into force on the date of receipt of the later of such notifications and shall have effect with respect to gifts made and deaths occurring after that date.

3. Notwithstanding paragraph (2) of this Article, paragraph (3) of Article 11 (Community Property and Marital Deduction) of the Convention and paragraph (3) of Article 12 (Exemptions and Credits) of the Convention, in each case as amended by this Protocol shall, notwithstanding any limitation imposed under the law of a Contracting State on the assessment or refund with respect to a person's or estate's return, have effect with respect to gifts made or deaths occurring after November 10, 1988, provided that (i) any claim for refund by reason of this Article IX is filed before the date that is one year after the first day of the second month following the date on which this Protocol enters into force or within the otherwise applicable period for filing such claims under domestic law, and (ii) the provisions of paragraph (4) of Article 1 (Estates and Gifts Covered) shall apply with respect to such claim for refund. In the case of an estate that, prior to the date on which this Protocol enters into force, was allowed a marital deduction by reason of a transfer to a qualified domestic trust, such estate may, within the time limit for filing a claim for refund referred to in the preceding sentence, elect to treat the qualified domestic trust as if it had not been established in order to claim the benefits of paragraph (3)

of Article 11 (Community Property and Marital Deduction) or paragraph (3) of Article 12 (Exemptions and Credits) of the Convention. If such an election is made, the property shall be treated as having been transferred to the surviving spouse at the time of the decedent's death for all purposes of this Convention.

IN WITNESS WHEREOF, the representatives of the governments, being duly authorized thereto, have signed this Protocol.

Done at Washington, this eighth day of December, 2004, in duplicate, in the English and French languages, each text being equally authentic.

FOR THE GOVERNMENT OF
THE UNITED STATES OF AMERICA

FOR THE GOVERNMENT OF
THE FRENCH REPUBLIC

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 9, 2004
JS-2136

Statement on Visit to India
John B. Taylor
Under Secretary for International Affairs
Mumbai, India

I just completed a five day visit to India, which included stops in New Delhi, Bangalore and Mumbai. The purpose of my visit was to pursue my government's commitment to economic engagement with India under the U.S.-India Economic Dialogue.

During this trip, I gave a speech at the World Economic Forum in New Delhi on India and its role in the global economic expansion. In addition, I visited several development projects in Uttar Pradesh, as well as a high-tech center in Bangalore. I also met with national and state-level financial officials, representatives of international financial institutions, and numerous business officials, including members of India's financial sector.

In my discussions with public officials, I emphasized the priority that our government places on establishing closer ties with India in the context of the U.S.-India Dialogue. I was very pleased by the level of enthusiasm expressed by India's economic leaders with respect to the adoption and implementation of India' new economic reform agenda. I am looking forward to release of the detailed plan outlining this agenda in the coming months. In addition, I welcomed their focus on the private sector, particularly the decision to create an investment commission in which prominent Indian business leaders will provide input on investment climate reforms.

During many of my meetings with economic and finance officials, we discussed the goal of India's new government to generate sustainable growth rates of 7-8 percent. I conveyed my government's strong support for this objective. We also discussed the kinds of reforms that can ensure that benefits of growth are extended to those who remain in poverty, and explored how the US-India Economic Dialogue can be supportive of this effort.

In this context, I stressed the importance of productivity growth, which will need to double in order to generate 7-8 percent growth. I commended the Government for its focus on second-generation reforms in support of this objective, such as tax reform and efforts to increase foreign direct investment in India.

I had the opportunity to see what the private sector can offer during a visit to farms and villages in Uttar Pradesh, where the introduction of new technology has led to substantial increases in output and incomes for farmers. I also learned about the contributions that the financial sector is making to support higher living standards. For example, I was very impressed by ICICI, a private bank that is providing a range of financial services to rural areas for the first time. Also impressive is the success of banks in dramatically lowering the cost of remittances in India. In addition, I learned about the benefits of new computer terminals in rural areas that provide information about prices of commodity futures, which is helping inform decisions on crop production.

I was impressed to hear about new efforts at the state level to combat fiscal problems. I discussed one plan in detail with officials in Karnataka who are working to eliminate their budget deficit and improve management of public finances with assistance from the Agency for International Development and the World Bank.

In the future, I am looking forward to working with India in the Doha Development Round. Further trade liberalization will be another important growth stimulus for India and other emerging markets.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 7, 2004
JS-2137

**From Karnataka to California: The Challenges of
State Fiscal Reform in a Federated System"
John B. Taylor
Under Secretary for International Affairs
United States Department of the Treasury
Institute of Management
Bangalore, India
December 7, 2004**

Good morning. I would like to thank Professor Apte for this unique opportunity to visit the India Institute of Management. As a former professor and current United States government official, I welcome this chance to talk with students and faculty who share my interest in public policy management and economic development.

As the Treasury Under Secretary for International Affairs, I frequently speak with officials from ministries of finance and central banks from countries around the world to discuss about the importance of sound fiscal policy. In fact, just yesterday, I had the pleasure of discussing fiscal matters with Finance Minister Chidambaram. Tomorrow, I will meet with Governor Reddy of the Reserve Bank of India in Mumbai.

The fact that I have chosen to speak on this topic in Karnataka – a state with a population of 50 million people -- is a reflection of the especially important role that state governments play in Indian fiscal policy. This is similar to my own country, where states also exercise substantial control over budgetary matters. In fact, I advised the Governor of California as a member of the state's Council of Economic Advisors, which addresses many of the same questions that Karnataka and other Indian states face regarding the management of public finances.

Like California, in recent years the government of Karnataka has been facing financial difficulties, which have important implications for the growth of the entire country. Here in southern India, the U.S. Agency for International Development and the World Bank are playing a leading role in promoting sound public financial management at the state level. I have been quite impressed with what I have learned so far about Karnataka's progress on budget reform, and understand that several of you at the IIM are actively supporting this effort. I strongly believe this partnership is critical for resolving Karnataka's fiscal challenges, and freeing up resources to support human investment.

Later today, I will be meeting with state finance officials, where I will stress that bringing budgets into balance requires policies to stimulate growth and reduce poverty, both in the rural and urban areas. These policies should not necessarily include subsidies. Rather, the key is to implement measures that generate productivity growth, and provide opportunities to those who have been left behind. I have already witnessed the benefits of productivity-enhancing measures in Upper Pradesh, where I visited a World Bank project designed to introduce farmers to new technology, with tremendous results.

Bangalore's story is a first-rate example of the impact that economic freedom can have on economic growth, and later today I will visit a world-class research and development facility that epitomizes this success. I am confident that with the extension of sound policies to other sectors, including agriculture, the kind of success so powerfully demonstrated in the IT and R&D, will be duplicated.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 9, 2004
js-2138

Media Advisory: Secretary Snow to Travel to Morocco This Week

Treasury Secretary John Snow and Secretary of State Colin Powell will lead a delegation from the United States to the Forum on the Future meeting to be held in Rabat, Morocco on Saturday, December 11. The meeting will bring together foreign ministry and finance ministry representatives from the region, the G-8, and other interested nations. The Forum will be co-chaired by the United States and Morocco.

The Forum on the Future is a cooperative effort by the states of the Broader Middle East and North Africa (BMENA) region, the G-8 industrialized countries, and other partners. Forum members are united around a common agenda that advances the universal values of human dignity, democracy, economic opportunity and social justice.

BMENA States: Afghanistan, Algeria, Arab League, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Oman, Pakistan, Palestinian Authority, Quatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, Yemen

G-8: Canada, France, Germany, Italy, Japan, United Kingdom, United States

Other states: Netherlands, Turkey

The following events are open to the media presenting media credentials and photo identification:

Friday, December 10

Press Availability with Moroccan Finance Minister Fathallah Oualalou
3:45 pm local time
Moroccan Ministry of Finance
Rabat, Morocco

Saturday, December 11

Opening Plenary Session
Opening Remarks
9:00 am local time
Moroccan Ministry of Foreign Affairs
Rabat, Morocco
** Top of meeting open to cameras only
** Text will be available

Joint Press Conference of Forum Co-Chairs
(Sec. Snow, Sec. Powell and Minister Oualalou and Minister Benaissa)
1:00 pm local time
Moroccan Ministry of Interior Annex
Rabat, Morocco
** Media must be set up by 12:00 pm local time for security sweeps

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 10, 2004
js-2139

Treasury Deputy Assistant Secretary Iannicola Addresses Coalition for Personal Financial Literacy

Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. today spoke to the Jump$tart Coalition for Personal Financial Literacy in Washington, DC. Iannicola addressed members representing nonprofit, private and government organizations focused on improving financial education for young people. He spoke about the www.MyMoney.gov Web site and the 1-888-mymoney toll-free hotline launched by the Financial Literacy and Education Commission. The free service provides the American public with easy access to federal financial education materials covering a wide-range of personal financial topics.

"For years the federal government has had a treasure of free financial education materials," said Iannicola. "But up until now it has been a hidden treasure. MyMoney is an excellent tool for consumers of all ages and those organizations, like Jump$tart members, who teach them at the grass roots level."

The Jump$tart Coalition for Personal Financial Literacy is a non-profit organization that seeks to improve the personal financial literacy of young people. Jump$tart's purpose is to evaluate the financial literacy of young people; develop, disseminate, and encourage the use of standards for grades K-12; and promote the teaching of personal finance.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 11, 2004
JS-2140

Forum for the Future
U.S. Treasury Secretary John W. Snow
Opening Statement
December 11, 2004
Rabat, Morocco

It's a great pleasure to be here with my colleague, Secretary of State Colin Powell. I want to thank our co-chairs, Ministers Oualalou and Benaissa, and the Government of Morocco for hosting this meeting. I am honored to join my colleagues from the G8 and Broader Middle East and North Africa (BMENA) region at this historic first meeting of the Forum for the Future.

The Forum represents a unique opportunity for foreign affairs, finance and economics ministers to share ideas on how to best meet the region's aspirations for greater economic opportunities, jobs and rising living standards. Our presence here today also highlights international support for the market-oriented, but politically difficult, reforms that many of you are advancing at home. The rejuvenated market-oriented reform programs we see in many countries in the region are home-grown, and we are here to support your efforts. My hope is that decisions we make today we will create a strong foundation for a continued and productive partnership between the leaders of the G8 and Broader Middle East and North Africa. The economic and political agendas are self-reinforcing; linking them in this forum will have the greatest impact.

As you know, for the finance and economics ministers of the G8 and the region, the Forum for the Future is the culmination of a process that we started over a year ago to deepen our partnership to promote financial sector development, capacity building and further integration of the region into the global economy. And this represents just a portion of our engagement, as last month's meeting of a regional group of the Financial Action Task Force to fight financial crimes attests. The overarching objective is to promote a level of sustained economic growth necessary to meet the employment demands of the region's rapidly growing population. We have all agreed that growth is essential and growth must be private sector led, relying the region's greatest resource – your people.

We have also agreed that we want this to be more than just dialogue, as a result, we're focusing on concrete results. I am pleased to note that the International Finance Corporation has made significant progress in creating a regional facility to provide training and technical assistance to small businesses. Total financing available for the Facility currently amounts to over $60 million, with the most recent pledge by the Islamic Development Bank. With your support, more is on the way. At our breakout session this morning, we will be discussing the facility's priorities and looking to target its activities where it can be the most effective.

We will also explore ways for greater cooperation among development finance institutions, both regionally based and global. These efforts build on existing institutions and collaboration to improve the effectiveness of official financing and serve as an advisory group for ministers in our discussions. Lastly, we will be discussing ideas to facilitate capital flows to the region, including through removing obstacles to the transfer of remittances.

Throughout our discussion today, we will be guided by priorities that emanate from the region. The role of the United States and the rest of the G8 is to support indigenous reform, and I look forward to continued discussions how to best do this.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 13, 2004
JS-2142

Treasury Issues Accounting Method Change Procedure

The Treasury Department and IRS today issued a revenue procedure that sets forth the exclusive administrative procedures that taxpayers must use to obtain automatic consent to change their method of accounting for the second taxable year ending on or after December 31, 2003, under the final regulations on capitalizing costs incurred in acquiring or creating intangible assets.

The procedures issued today generally are consistent with Rev. Proc. 2004-23, which provided for automatic changes in method of accounting for a taxpayer's first taxable year ending on or after December 31, 2003. As required in Rev. Proc. 2004-23, taxpayers that changed to a method of accounting provided in the final regulations without the consent of the Commissioner are not eligible to use the procedures issued today unless they amend their prior federal income tax returns to correct their unauthorized change in method of accounting. However, although Rev. Proc. 2004-23 waived certain limitations that may prevent taxpayers from qualifying to automatically change a method of accounting, the procedures issued today do not contain such a waiver.

The Service intends to issue future guidance for changes in methods of accounting made for subsequent taxable years, including automatic consent procedures for some or all of the methods of accounting provided in the final regulations.

REPORTS

- Rev. Proc. 2005-9

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 162, 263, 446, 461, 481; 1.167(a)-3(b), 1.263(a)-4, 1.263(a)-5, 1.446-1, 1.461-4, 1.461-5, 1.481-1)

Rev. Proc. 2005-9

SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 4 of this revenue procedure may obtain automatic consent for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in §§ 1.263(a)-4, 1.263(a)-5, and 1.167(a)-3(b) of the Income Tax Regulations (the "final regulations").

SECTION 2. BACKGROUND

.01 On January 5, 2004, the Internal Revenue Service and Treasury Department published final regulations in the Federal Register (TD 9107; 69 FR 436). Section 1.263(a)-4 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to acquire or create (or to facilitate the acquisition or creation of) intangibles. Section 1.263(a)-5 prescribes the extent to which taxpayers must capitalize amounts paid or incurred to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Section 1.167(a)-3(b) provides a safe harbor useful life for certain intangible assets. The final regulations

under §§ 1.263(a)-4 and 1.263(a)-5 are effective for amounts paid or incurred on or after December 31, 2003. The final regulations under § 1.167(a)-3(b) are effective for intangible assets created on or after December 31, 2003.

.02 Sections 1.263(a)-4(p) and 1.263(a)-5(n) provide that a taxpayer seeking to change to a method of accounting provided in the final regulations must secure the consent of the Commissioner in accordance with the requirements of § 1.446-1(e). In addition, §§ 1.263(a)-4(p) and 1.263(a)-5(n) provide that, for the taxpayer's first taxable year ending on or after December 31, 2003, the taxpayer is granted the consent of the Commissioner to change to a method of accounting provided in the final regulations, provided the taxpayer follows the administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9, 2002-1 C.B. 327, as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432). The final regulations further provide that any applicable § 481(a) adjustment for a change to a method of accounting provided in the final regulations for a taxpayer's first taxable year ending on or after December 31, 2003, is determined by taking into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The preamble to the final regulations states that the Service may issue additional guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the regulations.

.03 Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe

administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.04 Rev. Proc. 2002-9 provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002-9.

.05 Rev. Rul. 90-38, 1990-1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. The ruling further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.06 Rev. Proc. 2004-23, 2004-16 I.R.B. 785, provides the exclusive administrative procedures under which a taxpayer may obtain automatic consent for the taxpayer's first taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations and, if desired, to change to a method of utilizing the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5 in conjunction with a change to a method of accounting provided in the final regulations. Under Rev. Proc. 2004-23, a term and condition of the Commissioner's consent with respect to a change to a method of accounting provided in the final regulations is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. In addition, Rev. Proc. 2004-23 states that for taxable years subsequent to the first taxable year ending on or after December 31, 2003, a similar

term and condition will apply. (For further background, see Section 2 of Rev. Proc. 2004-23.)

.07 This revenue procedure applies only for a taxpayer's second taxable year ending on or after December 31, 2003. As in Rev. Proc. 2004-23, this revenue procedure grants taxpayers the Commissioner's consent to change to a method of utilizing the 3½ month rule or the recurring item exception only for the item for which the taxpayer is simultaneously changing to a method of accounting provided in the final regulations. In addition, a term and condition of obtaining the Commissioner's consent, whether or not automatic, is that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. The Service intends to issue future guidance for changes in methods of accounting made for subsequent taxable years, including automatic consent procedures for some or all methods of accounting provided in the final regulations. Such guidance will include as a term and condition of obtaining the Commissioner's consent, whether or not automatic, that any applicable § 481(a) adjustment take into account only amounts paid or incurred in taxable years ending on or after January 24, 2002.

.08 This revenue procedure constitutes the exclusive guidance for utilizing the automatic consent procedures to change to a method of accounting provided in the final regulations for a taxpayer's second taxable year ending on or after December 31, 2003. For any change in method of accounting to which this revenue procedure applies, a taxpayer may not file an application for a change in method of accounting under Rev. Proc. 97-27, 1997-21 I.R.B. 10 (as modified and amplified by Rev. Proc. 2002-19, 2002-13 I.R.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-35 I.R.B. 432).

See section 4.02(1) of Rev. Proc. 97-27.

SECTION 3. HOW THIS REVENUE PROCEDURE DIFFERS FROM REV. PROC. 2004-23

.01 Rev. Proc. 2004-23 applies to a taxpayer's first taxable year ending on or after December 31, 2003. This revenue procedure applies to a taxpayer's second taxable year ending on or after December 31, 2003.

.02 Rev. Proc. 2004-23 waives the scope limitations in section 4.02 of Rev. Proc. 2002-9. This revenue procedure does not waive those limitations.

.03 Rev. Proc. 2004-23 does not require taxpayers to complete many of the lines in Part II of Form 3115. Because this revenue procedure does not waive the scope limitations of Rev. Proc. 2002-9, this revenue procedure requires taxpayers to complete more of the lines in Part II of Form 3115. See section 5.02(2)(d) of this revenue procedure.

SECTION 4. SCOPE

.01 This revenue procedure applies to a taxpayer that seeks, for the taxpayer's second taxable year ending on or after December 31, 2003, to change to a method of accounting provided in the final regulations.

.02 This revenue procedure also applies to a taxpayer that, for the taxpayer's second taxable year ending on or after December 31, 2003, in addition to seeking a change to a method of accounting provided in the final regulations, also seeks to change its method of accounting to utilize the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or to utilize the recurring item exception authorized by § 1.461-5.

SECTION 5. APPLICATION

.01 *In general.* A taxpayer within the scope of this revenue procedure is, in accordance with section 6.01 of Rev. Proc. 2002-9, granted the consent of the Commissioner to change to a method of accounting provided in the final regulations (and, if desired, to also utilize the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5) provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002-9, with the following modifications:

(1) The taxpayer must prepare and file Form 3115, Application for Change in Accounting Method, in accordance with section 5.02 of this revenue procedure;

(2) The copy of Form 3115 must be sent to the following special address (note the special post office box number): Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005-9 Filing) P.O. Box 7616, Benjamin Franklin Station, Washington, D.C. 20044 (or in the case of a private delivery service or hand delivery to the courier's desk: Commissioner of Internal Revenue, Attention: CC:ITA (Automatic Rulings Branch, Rev. Proc. 2005-9 Filing), 1111 Constitution Avenue, N.W., Washington, D.C. 20224);

(3) The taxpayer must compute any applicable § 481(a) adjustment and take such adjustment into account in accordance with section 6 of this revenue procedure; and

(4) A taxpayer described in section 5.03(2) of this revenue procedure must file one or more amended federal income tax returns (amended returns) in accordance with section 5.03(3), (4), or (5), as applicable, of this revenue procedure.

.02 *Form 3115.* In preparing the Form 3115 referred to in section 5.01 of this

revenue procedure, a taxpayer must comply with the following procedures:

(1) The taxpayer may use one Form 3115 for all changes in method of accounting made pursuant to the final regulations;

(2) The taxpayer is required to complete only the following information on Form 3115:

(a) The identification section of Page 1 (above Part I);

(b) The signature section at the bottom of Page 1;

(c) Part I, Line 1(a). The designated automatic accounting method change number for changes in method of accounting made pursuant to this revenue procedure is No. "78";

(d) Part II, all lines except lines 11, 13, 14, 15, and 17 (for purposes of completing line 12, see section 6.02(2) of this revenue procedure if the taxpayer is making more than one change in method of accounting);

(e) Part IV, in accordance with section 6 of this revenue procedure; and

(f) Schedule E, if applicable;

(3) In addition to the other information required on line 12 of Form 3115, the taxpayer must include the citation to the paragraph of the final regulations that provides for the proposed method of accounting for each item (*e.g.,* § 1.263(a)-4(d)(6) or § 1.263(a)-4(f)), and, if applicable, whether the taxpayer is also proposing to change to a method that uses the 3½ month rule authorized by § 1.461-4(d)(6)(ii) or the recurring item exception authorized by § 1.461-5 with respect to the item;

(4) In addition to the other information required on Schedule E of Form

3115 (if applicable), the taxpayer must include a statement as to whether the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1) or § 1.167(a)-3(b)(1)(iv) and, if the useful life is the safe harbor useful life prescribed by § 1.167(a)-3(b)(1), a statement explaining why the intangible asset does not have a useful life the length of which can be estimated with reasonable accuracy; and

(5) A taxpayer that must file one or more amended returns as provided in section 5.03 of this revenue procedure to be eligible to use the automatic consent procedures of this revenue procedure must attach to the Form 3115 a written statement signed under penalties of perjury confirming that the taxpayer has filed the amended returns pursuant to section 5.03 of this revenue procedure.

.03 *Unauthorized change in a preceding year.*

(1) A taxpayer may change a method of accounting only with the consent of the Commissioner. § 1.446-1(e)(2). A taxpayer that changes a method of accounting without the consent of the Commissioner has made an unauthorized change in method of accounting. If a taxpayer makes an unauthorized change in method of accounting, the Service may adjust the taxpayer's taxable income during the examination of the taxpayer's income tax return for the taxable year the unauthorized change was made and for all affected subsequent years. In the notice of proposed rulemaking that preceded the publication of the final regulations (REG-125638-01; 67 FR 77701), the Service and Treasury Department advised taxpayers not to seek to change a method of accounting in reliance on rules contained in the notice of proposed rulemaking until the rules were published as final regulations. The Service and Treasury Department are aware that some taxpayers have made an unauthorized change in method of

accounting for an item the treatment of which is provided for in the final regulations. The Service and Treasury Department have determined that it is not appropriate for taxpayers that have made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations to obtain automatic consent under this revenue procedure without correcting such unauthorized change. Therefore, a taxpayer that made an unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations is eligible to use the automatic consent procedures provided in this revenue procedure only if the taxpayer amends prior federal income tax returns to correct the unauthorized change in method of accounting. However, as a matter of administrative grace, the Service and Treasury Department have limited the application of this section 5.03 to certain taxpayers described in section 5.03(2) of this revenue procedure.

(2) This section 5.03 applies to a taxpayer that –

(a) in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is after January 24, 2002 --

(i) made any unauthorized change in method of accounting for an item the treatment of which is provided for in the final regulations; or

(ii) impermissibly changed the treatment of an item that is provided for in the final regulations in the taxpayer's first taxable year ending on or after December 31, 2003, but has only used such treatment on one federal income tax return; or

(b) made an unauthorized change in method of accounting to a

method of accounting that is provided in the final regulations in a taxable year for which the due date of the federal income tax return (including extensions, regardless of whether such extension is automatic and whether or not actually requested) is on or before January 24, 2002, and for which the statute of limitations has not yet expired, if the taxpayer wishes to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting to which the taxpayer previously made the unauthorized change.

(3) A taxpayer described in section 5.03(2)(a)(i) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer changes back to the prior method of accounting (*i.e.*, the method of accounting used for an item prior to making the unauthorized change for the item) for each item referred to in section 5.03(2)(a) of this revenue procedure by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method (or methods) was used.

(4) A taxpayer described in section 5.03(2)(a)(ii) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to a method of accounting provided in the final regulations only if the taxpayer amends its federal income tax return for the preceding taxable year in which the unauthorized treatment was used to change the treatment of each item referred to in section 5.03(2)(a) of this revenue procedure to a treatment consistent with the taxpayer's historic method of accounting (*i.e.*, the method of accounting used for an

item prior to changing the treatment of the item).

(5) A taxpayer described in section 5.03(2)(b) of this revenue procedure is eligible to use the automatic consent procedures to obtain the Commissioner's consent to change to the same method of accounting provided in the final regulations to which the taxpayer previously made the unauthorized change only if the taxpayer changes back to its prior method of accounting for the item (*i.e.*, the method of accounting used for the item prior to making the unauthorized change for the item) by amending its federal income tax returns for all of the preceding taxable years in which the unauthorized method was used.

(6) A taxpayer filing one or more amended returns pursuant to section 5.03(3), (4), or (5) of this revenue procedure must file the amended returns on or before the date the taxpayer files a Form 3115 under this revenue procedure (including the copy of Form 3115 filed with the national office under section 5.01(2) of this revenue procedure) for the taxpayer's second taxable year ending on or after December 31, 2003. For this purpose, a taxpayer under examination will be considered to have filed an amended return by providing the amended return to the examining agent.

(7) In accordance with § 1.446-1(e)(3)(ii) and Rev. Rul. 90-38, consent is hereby granted for a taxpayer described in section 4.01 of this revenue procedure that also is described in section 5.03(2)(a)(i) or (b) of this revenue procedure to file the amended returns referred to in section 5.03(3) or (5) of this revenue procedure to retroactively change its method of accounting. This consent is granted for the taxable year for which the taxpayer made the unauthorized change and for any subsequent taxable year affected by the unauthorized change.

.04 *Prior change*. For purposes of this revenue procedure, a change in method of accounting made pursuant to Rev. Proc. 2004-23 (including a change required to be made on an amended return as provided by section 4.03 of Rev. Proc. 2004-23) for an item is not treated as a prior change of the same method of accounting within the meaning of section 4.02(6) of Rev. Proc. 2002-9 with respect to a different item covered by this revenue procedure. Thus, for example, a taxpayer that obtained automatic consent under Rev. Proc. 2004-23 to change to a method of applying the 12-month rule to prepaid property insurance is not prohibited by section 4.02(6) of Rev. Proc. 2002-9 from obtaining consent under this revenue procedure to change to a method of applying the 12-month rule to the taxpayer's prepaid licenses and permits.

SECTION 6. COMPUTATION OF SECTION 481(a) ADJUSTMENT

.01 *In general*. A taxpayer changing a method of accounting under this revenue procedure is required to take into account any applicable § 481(a) adjustment as provided in §§ 1.263(a)-4(p)(3) and 1.263(a)-5(n)(3). The § 481(a) adjustment is computed as of the first day of the taxpayer's second taxable year ending on or after December 31, 2003, and, as provided in the final regulations, takes into account only amounts paid or incurred in taxable years ending on or after January 24, 2002. Thus, the § 481(a) adjustment is computed by taking into account only amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003. The amount of the § 481(a) adjustment must include (i) as a reduction of taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last

day of the first taxable year ending on or after December 31, 2003, that were capitalized under the taxpayer's present method of accounting and are currently deductible under the taxpayer's proposed method of accounting, reduced by the amount of such capitalized costs recovered through amortization or depreciation under the taxpayer's present method of accounting, (ii) as an increase to taxable income, any amounts paid or incurred in the period beginning with the first day of the taxable year that includes January 24, 2002, and ending with the last day of the first taxable year ending on or after December 31, 2003, that were currently deducted under the taxpayer's present method of accounting and are capitalized under the taxpayer's proposed method of accounting, reduced by the amount of capitalized costs that would have been recovered through amortization or depreciation if the taxpayer's proposed method of accounting had been applied in taxable years ending on or after January 24, 2002, and (iii) as an increase or a reduction to taxable income, as appropriate, any other adjustments required as a result of the change in method of accounting. If under its present method of accounting a taxpayer capitalized costs incurred prior to the first taxable year that includes January 24, 2002, the taxpayer must continue to treat amortization or depreciation deductions attributable to those costs in accordance with the taxpayer's present method of accounting. Thus, for example, a taxpayer that files its federal income tax return on a calendar year basis continues to amortize or depreciate in 2004 an intangible created in 2001, even though the taxpayer has changed to a method of accounting provided in the final regulations under which the entire cost of the intangible would be currently deductible if incurred in 2004.

.02 *Reporting the section 481(a) adjustment on Form 3115.*

(1) *Netting.* For purposes of determining the adjustment period under section 2.05(2) of Rev. Proc. 2002-9, the § 481(a) adjustment is determined separately for each change in method of accounting being made under this revenue procedure. Thus, a positive adjustment attributable to a change in one method may not be netted against a negative adjustment attributable to a change in another method. However, in determining the adjustment attributable to a change in method, a taxpayer must net positive § 481(a) adjustments and negative § 481(a) adjustments resulting from that change in method (*e.g.*, if a taxpayer changes to a method of applying the 12-month rule to prepaid amounts, the taxpayer must net the resulting negative § 481(a) adjustment with the positive § 481(a) adjustment that results from including those amounts in inventory pursuant to the taxpayer's existing § 263A method of accounting for inventory).

(2) *Itemized listing on Form 3115.* The taxpayer must include on Form 3115, Part IV, line 25, the total § 481(a) adjustment for all changes in methods of accounting being made. If the taxpayer is making more than one change in method of accounting under the final regulations, the taxpayer must include on an attachment to Form 3115 –

(a) the information required by Part IV, line 25 for each change in method of accounting (including the amount of the § 481(a) adjustment for each change in method of accounting);

(b) the information required by Part II, line 12 of Form 3115 that is associated with each change; and

(c) the citation to the paragraph of the final regulations that provides for

each proposed method of accounting (*e.g.*, § 1.263(a)-4(d)(6) or § 1.263(a)-4(f)).

.03 *Example*: Y, a calendar year taxpayer that uses an accrual method of accounting, is a service provider not required to maintain inventories. Y wishes to change to a method of accounting provided in the final regulations for taxable year 2004, which is Y's second taxable year ending on or after December 31, 2003. Y incurred and capitalized $100x in taxable year 2001, $200x in taxable year 2002, and $250x in taxable year 2003. In addition, Y incurred $300x in taxable year 2004. The $100x, $200x, and $250x capitalized and depreciated by Y in 2001, 2002, and 2003 all relate to the same method of accounting and would be currently deductible under the final regulations if the amounts had been incurred on or after December 31, 2003. Y claimed a depreciation deduction of $10x in each of the taxable years 2001, 2002, and 2003 with respect to the $100x incurred and capitalized in 2001, a depreciation deduction of $20x in each of the taxable years 2002 and 2003 with respect to the $200x incurred and capitalized in 2002, and a depreciation deduction of $25x in taxable year 2003 with respect to the $250x incurred and capitalized in 2003. For taxable year 2004, Y may apply for an automatic change in method of accounting with respect to the method under which the amounts had been capitalized. Y's section 481(a) adjustment is a decrease in income of $385x ($160x relating to amounts capitalized in 2002 ($200x - $40 ($20 for 2002 and $20 for 2003)) + $225x relating to amounts capitalized in 2003 ($250x - $25x)). Y must continue to use its present method of accounting for the amount capitalized in 2001. Y uses its new method of accounting for the amount incurred in 2004.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include these automatic changes in method of accounting in section 3 of the APPENDIX.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for a taxpayer's second taxable year ending on or after December 31, 2003.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Matuszeski of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure call Ms. Matuszeski at (202) 622-7900 (not a toll free call).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 13, 2004
JS-2143

U.S. Treasury Official Promotes Financial Education in Puerto Rico

Sandra Pedroarias, Director of Outreach for Treasury's Office of Financial Education, today taught sixth graders at the Abraham Lincoln Elementary School in San Juan, Puerto Rico how to budget and save. While in Puerto Rico, Pedroarias met with officials from the Puerto Rico Department of Education and the Youth Affairs Agency to learn about their financial education initiatives. She also shared with them financial education best practices as well as tools and resources provided by the federal government.

"Teaching children to make good financial decisions like increasing their savings will serve them well throughout their lives," said Pedroarias. "I congratulate the Department of Education of Puerto Rico for advancing the cause for financial education and for their leadership in promoting financial education in Puerto Rico schools."

Through partnerships with the banking industry, the Department of Education of Puerto Rico provides financial education to elementary and high school students. The Department has also implemented a curriculum to train high school teachers in personal finance so that they are better prepared to teach students about money.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 11, 2004
JS-2144

Forum for the Future
U.S. Treasury Secretary John Snow
Opening Statement
December 11, 2004
Rabat, Morocco

I want to thank our co-chairs, Ministers Oualalou and Benaissa, and the Government of Morocco for hosting this meeting. I am honored to help bring together all my colleagues from the G8 and Broader Middle East and North Africa (BMENA) region at this historic first meeting of the Forum for the Future.

The Forum represents a unique opportunity for foreign affairs, finance and economics ministers to share ideas on how to best meet the region's aspirations for greater economic opportunities, jobs and rising living standards. Our presence today also highlights international support for the market-oriented, but politically difficult, reforms that many of you are advancing at home. The rejuvenated market-oriented reform programs we see in many countries in the region are home-grown, and we are here to support it, not impose anything from outside. My hope is that decisions we make today we will create a strong foundation for a continued and productive partnership between the leaders of the G8 and Broader Middle East and North Africa.

As you know, for the finance and economics ministers of the G8 and the region, the Forum for the Future is the culmination of a process that we started over a year ago to deepen our partnership to promote financial sector development, capacity building and further integration of the region into the global economy. And this is just part of a range of efforts to deepen our engagement, as last month's meeting of a regional group of the Financial Action Task Force to fight financial crimes attests. The overarching objective is to promote a level of sustained economic growth necessary to meet the employment demands of the region's rapidly growing population. We have all agreed that growth must be private sector led, relying our greatest resource – our people.

We have also agreed that we want this to be more than just dialogue and focus on advancing a few concrete results. As a result, I am pleased to note that the International Finance Corporation has made significant progress in creating a regional facility to provide training and technical assistance to small businesses. Donor commitments currently total $60 million, with the most recent pledge by the Islamic Development Bank. With your support, more is on the way. Today, I hope to hear your thoughts on the facility's priorities, to target its activities where it can be the most effective.

I also look forward to your thoughts on how we can facilitate cooperation among development finance institutions, both regionally based and global. Establishing a Network of Funds will build on existing institutions and collaboration to improve the effectiveness of official financing and serve as an advisory group for ministers in our discussions. Lastly, I look forward to your thoughts on how we can facilitate capital flows to the region, including through removing obstacles to the transfer of remittances.

Throughout our discussion today, we will be guided by priorities that emanate from the region. The role of the US and the rest of the G8 is to support indigenous

reform, and I look forward to continued discussions how to best do this.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 11, 2004
js-2145

John B. Taylor
Under Secretary for International Affairs
United States Treasury
American Chamber of Commerce in Morocco
Casablanca, Morocco

Encouraging Economic Freeedom
in the Broader Middle East and North Africa

Good evening. Thank you for inviting me to speak at the Chamber's Annual Gala Ball. Engaging with business leaders tonight is a fitting end to a day when finance and foreign ministers from the Broader Middle East and North African gathered in Rabat to discuss political and economic reform with their counterparts from the United States and the other G8 countries.

That finance ministers and foreign ministers were meeting together is of symbolic and substantive significance because it underscores the close link between economic and political reform. As Secretary Powell said in the meeting, "Political freedom and economic freedom go hand in hand." Our hope is that the decisions made today will create a strong foundation for both economic and political freedom that will benefit the people of the Broader Middle East and North Africa.

But tonight I want to focus on economic freedom. The overarching objective of economic reforms is to promote sustained economic growth strong enough to create jobs for the region's rapidly growing population, to raise incomes, and to reduce poverty. The broad consensus is that strong economic growth is achievable only when governments adopt economic policies that enable entrepreneurs to become the main driver of growth.

The Moroccan government has already demonstrated its recognition of the private sector's role in generating strong economic growth. The Moroccan government's commitment to the privatization of state-owned enterprises, its efforts to increase the transparency of government decision-making, and the liberalization of its trade policy are all visible examples of this recognition.

Moreover, Morocco can play a key leadership role in promoting economic reform throughout the Broader Middle East and North African region. Statist economic policies – embraced by Middle Eastern countries for so many years – have prevented the region from achieving its full economic potential. The most powerful advocates for economic change in the region are reform-oriented countries such as Morocco.

The United States and other developed nations also have an important role to play by supporting reforming countries and by encouraging further reform. The U.S.-Morocco Free Trade Agreement and Morocco's eligibility for funding from the Millennium Challenge Account are two examples of such support and encouragement. Morocco is the only country in the region that is both eligible for MCA funding and has negotiated a Free Trade Agreement with the United States.

The Millennium Challenge Account was specifically designed to target our development resources to those countries where economic reforms are taking place. Morocco was the only new country selected for MCA funding in 2005 thanks to its strong performance in the three broad policy categories: Ruling Justly, Investing in People, and Encouraging Economic Freedom. Morocco scored particularly high in the anti-corruption indicator.

Nonetheless there remains room for improvement. Within the Economic Freedom category, for instance, Morocco performed below the average on the fiscal policy indicator due to its high and rising fiscal deficit. Hence, the government must reform taxation and control spending in order to bring this indicator into line.

The business community can help ensure that MCA funding is directed towards projects that increase economic growth. The development of an MCA compact and specific proposals involves an open consultative process. I would encourage you to begin thinking about how the MCA can further the process of economic reform in Morocco.

The Free Trade Agreement, which was ratified by the United States in August and now awaits approval by your Parliament, is another indicator of U.S. support for Morocco's economic reform. The agreement, which would eliminate ninety-five percent of all tariffs on bilateral trade in industrial and consumer goods once in force, represents the best market access package of any U.S. Free Trade Area with a developing country signed to date. It falls to the Moroccan private sector to take advantage of this generous access and spur Moroccan growth through increased exports.

The agreement rewards the economic reforms undertaken by your government. In entering into the agreement, Morocco allowed financial firms greater access to the Moroccan market, thereby increasing competition in this key sector and supporting further liberalization. The agreement provides strong legal protections for U.S. investors, a framework which – if extended to all foreign investors – could help boost foreign investment flows to Morocco. The private sector benefits from the FTA therefore include not only the expanded trade opportunities arising from duty free access to U.S. markets, but also improved economic policies.

Morocco's commitment to reform sends a clear signal to other countries in the region that a market-oriented economy that is open to trade and investment is the surest path to sustainable growth – a theory that is borne out in recent economic data. From 2000 to 2003 Morocco's real GDP growth was about 4 percent per year, above the average of 3 percent for regional non-oil producing countries during the same period.

The work of economic reformers, however, never seems to be done. You – the leaders of Morocco's private sector – must continue to be forceful advocates for economic reform within Morocco. And the United States will continue to support Morocco's reform efforts and those of other countries in the Broader Middle East and North Africa region. Together we can encourage economic freedom that will improve people's lives here in Morocco and throughout the region.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 14, 2004
JS-2146

United States-Brazil to Hold "Group for Growth" Meetings in Washington, DC

On Wednesday, December 15, the United States and Brazil will hold the third meetings of the Group for Growth in Washington, DC. The meetings will begin at 9:30 AM in the Treasury Department's Media Room, 1500 Pennsylvania Avenue, NW.

The U.S. delegation will be chaired by John B. Taylor, Under Secretary for International Affairs at the Department of Treasury. The Brazilian delegation will be chaired by Joaquim V. Levy, Secretary of the National Treasury, Finance Ministry. *(Participant list attached.)*

Formation of the Group was announced at the June 2003 meeting between President Bush and President Lula with the goal of developing strategies to raise economic growth in both countries. Since then, meetings were held in August 2003 in Washington, and last April in Rio de Janeiro, Brazil.

The delegations will discuss the measures each country is taking to raise productivity growth and strategies for increasing growth in the future.

***The TOP of the meeting will be OPEN PRESS. Media wishing to cover the top of meeting should assemble at the Treasury Media Room (Room 4121) no later than 9:15 AM.**

***At 2:30 PM, Under Secretary Taylor and Secretary Levy will hold a brief Media Availability in the Media Room.**

Media without Treasury or White House press credentials planning to attend should contact Treasury's Office of Public Affairs at (202) 622-2960 with the following information: name, social security number, and date of birth. This information may also be faxed to (202) 622-1999 or email to *frances.anderson@do.treas.gov.*

U.S.-Brazil Group for Growth

Participants

United States

Dr. John Taylor, Under Secretary for International Affairs

Dr. Mark Warshawsky, Assistant Secretary for Economic Policy

Dr. Harvey Rosen, Council of Economic Advisers, Member-Designate

Dr. Nancy Lee Deputy Assistant Secretary, Europe, Eurasia, and the Western Hemisphere

Mr. James Derham, Principal Deputy Assistant Secretary, Western Hemisphere Affairs, State

Dr. Tom Connors, Senior Associate Director, Federal Reserve Board

Mr. Ramin Toloui, Director, Office of the Western Hemisphere, U.S. Treasury,

Mr. Mathew Haarsager, U.S. Treasury Representative for South America

Dr. Francisco Parodi, Brazil Economist, Office of the Western Hemisphere, U.S. Treasury,

Dr. Patrice Robitaille, Brazil Economist, Federal Reserve Board

Mr. David Edwards, Senior Brazil Desk Officer, State

Mr. Bill Block, Council of Economic Advisers

Mr. Anthony Curcio, Office of Management and Budget

Brazil

Dr. Joaquim V. Levy, Secretary of the National Treasury, Finance Ministry

Ambassador Roberto Abdenur, Embassy of Brazil

Mr. Nestor Forster, Embassy of Brazil, Financial Section

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 3, 2004
JS-2147

Press Statement of U.S. Treasury Assistant Secretary Randal Quarles
Manila, Philippines,
December 3, 2004

On this visit to the Philippines I am meeting with key members of President Arroyo's economic team, leading Philippine legislators, and members of the domestic and foreign business community to discuss the economic challenges facing the Philippines. I think that there is wide recognition within the Philippines of the challenges that the country faces. Prompt and decisive action will assure that the Philippines shares in the rapid growth of the Asian region.

The United States supports the goals of poverty reduction, fiscal deficit reduction, and the establishment of more rapid growth set out by President Arroyo in her inaugural address. Achieving these goals will require strong, and at times difficult, actions by both the Administration and the Congress.

Significant measures to reduce the fiscal deficit to a sustainable level are particularly urgent. Rising deficits, of both the national government and government-owned corporations and entities, have precluded government expenditure needed to support more rapid growth and poverty reduction, and have added to an already large public sector debt.

Strong leadership, by both the Arroyo administration and the Congress, is needed to take action now to significantly reduce the government deficit and place government finances on a sustainable basis. President Arroyo began that process in the fiscal measures that she proposed shortly after her election. I encourage the government and the Congress to work together to ensure that key revenue measures, sufficient to reach or exceed the original goals set out by the President, are taken as quickly as possible.

Longstanding problems in the power sector have discouraged investments in capacity necessary to support long-term growth and have become an increasingly large fiscal burden. There is an immediate need to reduce the losses in the power sector, including by adjusting tariffs to reflect the increased costs of generation. The recent decision of the Energy Regulatory Commission to adjust tariffs was a welcome step. Private sector investment is critical to assuring that future needs for power are met. This requires a legal and regulatory environment that is both stable and predictable, and one that assures investors of a reasonable expectation of profit. These principles are important for encouraging investment in other sectors as well, and this week's decision of the Supreme Court upholding the Mining Act is welcome.

A healthier and more efficient financial sector is also critical to assuring long term growth. Bank should be encouraged to dispose of non-performing loans and strengthen their capital positions. Financial supervision should also be strengthened, including by assuring that supervisors have the authority and legal protection necessary to intervene in insolvent institutions.

Fundamental reforms are required to meet the challenges that the Philippines faces in assuring rapid and sustained growth necessary to bring about employment growth and poverty reduction. But the potential rewards are very high. Strong actions by the Arroyo Administration and Congress – working together – are necessary to meet these challenges. The United States encourages and strongly supports the Philippines in those efforts to bring about sustained growth.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 11, 2004
JS-2148

G8/Broader Middle East and North Africa Forum for the Future Meeting
U.S. Treasury Secretary John Snow
December 11, 2004

First, let me thank His Royal Highness King Mohammed VI and the Government of Morocco for making the inaugural meeting of the Forum for the Future such a success. I am particularly grateful to Minister Oualalou for his tremendous involvement and leadership in the finance ministers' dialogue.

This morning Ministers Oualalou, Benaissa, Secretary Powell and I had the great pleasure of co-chairing the Forum for the Future meeting. Minister Oualalou and I then co-chaired a working session of finance and economic ministers from the countries of the Broader Middle East and North Africa (BMENA), the G8 and other partners. This Forum was the culmination of dialogue fostered among the G8 and the countries of the region, both at the Sea Island Summit and in meetings between finance ministers that began over a year ago to discuss how the G8 and other partners can support economic reforms to achieve faster growth and job creation in the region. This meeting reaffirms the commitment of the G8 to its partnership with the BMENA countries. Together we will continue to work toward supporting both political and home-grown, market-oriented economic reforms in the region. We must remember that economic freedom plays a critical role in allowing the citizens of our countries to improve living standards for their families and to realize their dreams. This is true in any country, in every corner of the globe. The momentum towards economic reforms in the BMENA region is the key to promoting sustained long-term economic growth.

Recognizing the important role of the private sector, Ministers reviewed progress in launching the International Finance Corporation's (IFC) facility for technical assistance to support small and medium enterprises (SMEs) in the region. Activities are underway in SME management training, financial institutions and markets, and promoting an enabling environment for business. Donors have pledged more than $40 million to the facility, including a recent $5 million from the Islamic Development Bank, in addition to the IFC's own $20 million – bringing the total level of financing to over $60 million so far – an impressive figure. I particularly appreciated a presentation by Minister Mohieldin of Egypt about the achievements and benefits of past IFC technical facilities in his country. The ministers endorsed an approach to assessing the success of the IFC facility through measurable targets. We also agreed to share experiences on improving business climates by focusing on improving key indicators for small business development.

Ministers discussed a strategy that would facilitate greater cooperation among development financial institutions in the region through a Network of Funds. Building on existing mechanisms, the Network of Funds would serve as an advisory group for G8 and BMENA governments on policies to promote cooperation and improve the effectiveness of the region's official financing. In his presentation, Minister Saif of Bahrain emphasized the importance of building on the existing coordination mechanisms and that the Network of Funds should be a regionally based cooperative framework that would respect the autonomy and accommodate the different strategic missions of participating institutions. The Ministers asked the Arab Monetary Fund to organize a meeting of concerned institutions to develop the network. We look forward to discussions among regional and international development institutions on launching the Network of Funds.

Ministers agreed to establish a regional, microfinance consultative group coordinated by the Consultative Group to Assist the Poor (CGAP). Ministers also agreed to establish a CGAP technical hub and training center in Jordan by mid-

2005 that aims to build capacity and introduce microfinance best practice principals to the region. Following a presentation by Jordan and Yemen, we reviewed and endorsed the initiative's first pilot program in Yemen, which could provide a strong demonstration effect for other BMENA countries.

We also had a very productive discussion on promoting financial flows for investment following a presentation by Commissioner Almunia of the European Commission. Remittances were identified as a significant component in these inflows. While it's clear that such inflows are making a substantial contribution to economic growth and development in the region, they are still impeded by inefficiencies in remittance markets. With this in mind, Ministers agreed to examine addressing impediments to these flows to allow remittances to play a more productive role in fostering sustainable development.

Finally, in order to move our discussions forward towards the practical and concrete steps necessary to realize the goals of market-oriented reforms that will promote sustained long-term economic growth, ministers agreed to form a sub-ministerial organizing committee to prepare for future meetings and to review the activities of a limited number of working groups.

I want to thank all the G8 and BMENA ministers who have taken part in the Forum for their participation in, and dedication to, our continuing dialogue. Ministers welcomed the Kingdom of Bahrain's offer to host the next meeting of the Forum of the Future in 2005, and we look forward to another productive meeting. As we look to the future, it is our hope that this Forum will provide the finance ministers' dialogue with a framework within which they can pursue sustained engagement and on-going discussions on economic issues of interest to the region.

IESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 14, 2004
2004-12-14-15-36-32-27618

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 $85,998 million as of the end of that week, compared to $87,028 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	December 3, 2004			December 10, 2004		
TOTAL		87,028			85,998	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	12,209	15,337	27,546	12,076	14,917	26,993
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,985	3,083	15,068	11,841	2,998	14,839
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			20,009			19,861
3. Special Drawing Rights (SDRs) [2]			13,361			13,262
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	December 3, 2004			December 10, 2004		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	December 3, 2004			December 10, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

/ 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 eposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are alued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any ecessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 15, 2004
JS-2149

Treasury International Capital (TIC) Data For October

Treasury International Capital (TIC) data for October are released today and posted on the U.S. Treasury web site (
which will report on data for November, is scheduled for January 18, 2005.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,222.7 billion in October, exceeding gross sales of dom
billion during the same month.

Foreign purchases of domestic securities reached $63.3 billion on a net basis in October, relative to $64.7 billion duri
reached $49.1 billion in October. Net private purchases of Treasury Bonds and Notes decreased to $3.5 billion from $
private purchases of Government Agency Bonds were $22.8 billion, up from $6.1 billion the previous month. Net priva
$18.3 billion from $42.7 billion the previous month. Net private purchases of Equities rose to $4.5 billion from minus $

Official net purchases of U.S. securities were $14.2 billion in October, relative to $13.0 billion in September. Official n
Notes of $14.8 billion more than accounted for the official inflows in October, up from $9.8 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $253.3 billion in October, relative to gross sales
$268.5 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $15.2 billion, highlighting net U.S. purchas
$3.2 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $48.1 billion in Oct
September. Net foreign purchases of long-term securities were $850.6 billion in the 12-months through October 2004
twelve months through October 2003.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical se
www.treas.gov/tic/.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through	
		2002	2003	Oct-03	Oct-04
1	Gross Purchases of Domestic Securities	13,022.9	14,922.1	14,772.7	15,852.3
2	Gross Sales of Domestic Securities	12,475.4	14,175.0	14,077.8	14,940.3
3	**Domestic Securities Purchased, net** (line 1 less line	**547.6**	**747.1**	**694.9**	**911.9**
4	**Private, net /2**	**508.3**	**607.7**	**569.4**	**669.7**

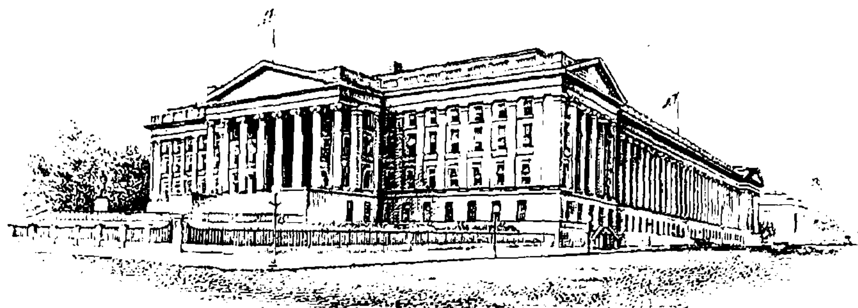
5	Treasury Bonds & Notes, net	112.8	168.8	148.0	168.0
6	Gov't Agency Bonds, net	166.6	136.1	144.3	191.5
7	Corporate Bonds, net	176.7	264.7	251.7	283.7
8	Equities, net	52.2	38.1	25.4	26.5
9	**Official, net**	**39.3**	**139.4**	**125.5**	**242.3**
10	Treasury Bonds & Notes, net	7.1	109.3	97.7	207.0
11	Gov't Agency Bonds, net	28.6	24.9	23.3	27.0
12	Corporate Bonds, net	5.6	5.5	4.6	9.3
13	Equities, net	-2.0	-0.4	-0.1	-1.1
14	Gross Purchases of Foreign Securities	2,640.0	3,037.8	2,962.3	3,393.8
15	Gross Sales of Foreign Securities	2,613.0	3,086.4	3,007.8	3,455.2
16	**Foreign Securities Purchased, net** (line 14 less line	**27.0**	**-48.7**	**-45.5**	**-61.4**
17	Foreign Bonds Purchased, net	28.5	22.3	23.0	6.8
18	Foreign Equities Purchased, net	-1.5	-71.0	-68.5	-68.2
19	**Net Long-Term Flows** (line 3 plus line 16)	**574.6**	**698.4**	**649.4**	**850.6**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. acquisitions of foreign securities (-)

Source: U.S. Department of the Treasury

REPORTS

- (PDF) Foreigners' Transactions in Long-Term Securities with U.S. Residents (Billions of dollars, not seasonal



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

December 15, 2004
EMBARGOED UNTIL 9:00 AM

Contact: **Tony Fratto**
202-622-2910

TREASURY INTERNATIONAL CAPITAL DATA FOR OCTOBER

Treasury International Capital (TIC) data for October are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release date, which will report on data for November, is scheduled for January 18, 2005.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,222.7 billion in October, exceeding gross sales of domestic securities by foreigners of $1,159.4 billion during the same month.

Foreign purchases of domestic securities reached $63.3 billion on a net basis in October, relative to $64.7 billion during the previous month. Private net flows reached $49.1 billion in October. Net private purchases of Treasury Bonds and Notes decreased to $3.5 billion from $6.0 billion the preceding month. Net private purchases of Government Agency Bonds were $22.8 billion, up from $6.1 billion the previous month. Net private purchases of Corporate Bonds fell to $18.3 billion from $42.7 billion the previous month. Net private purchases of Equities rose to $4.5 billion from minus $3.1 billion.

Official net purchases of U.S. securities were $14.2 billion in October, relative to $13.0 billion in September. Official net purchases of Treasury Bonds and Notes of $14.8 billion more than accounted for the official inflows in October, up from $9.8 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $253.3 billion in October, relative to gross sales of foreign securities to U.S. residents of $268.5 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $15.2 billion, highlighting net U.S. purchases of $12.0 billion in Foreign Equities and $3.2 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $48.1 billion in October compared with $67.5 billion in September. Net foreign purchases of long-term securities were $850.6 billion in the 12-months through October 2004 as compared to $649.4 billion during the twelve months through October 2003.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical series, can be found on the TIC web site, http://www.treas.gov/tic/.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2002	2003	Oct-03	Oct-04	Jul-04	Aug-04	Sep-04	Oct-04
1	Gross Purchases of Domestic Securities	13,022.9	14,922.1	14,772.7	15,852.3	1,231.1	1,233.1	1,281.5	1,222.7
2	Gross Sales of Domestic Securities	12,475.4	14,175.0	14,077.8	14,940.3	1,160.6	1,177.9	1,216.8	1,159.4
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**547.6**	**747.1**	**694.9**	**911.9**	**70.5**	**55.2**	**64.7**	**63.3**
4	**Private, net /2**	**508.3**	**607.7**	**569.4**	**669.7**	**61.5**	**36.1**	**51.7**	**49.1**
5	Treasury Bonds & Notes, net	112.8	168.8	148.0	168.0	7.6	-1.1	6.0	3.5
6	Gov't Agency Bonds, net	166.6	136.1	144.3	191.5	16.8	15.0	6.1	22.8
7	Corporate Bonds, net	176.7	264.7	251.7	283.7	27.3	23.3	42.7	18.3
8	Equities, net	52.2	38.1	25.4	26.5	9.7	-1.2	-3.1	4.5
9	**Official, net**	**39.3**	**139.4**	**125.5**	**242.3**	**9.0**	**19.2**	**13.0**	**14.2**
10	Treasury Bonds & Notes, net	7.1	109.3	97.7	207.0	5.6	15.5	9.8	14.8
11	Gov't Agency Bonds, net	28.6	24.9	23.3	27.0	2.5	2.5	2.0	-0.8
12	Corporate Bonds, net	5.6	5.5	4.6	9.3	0.8	1.1	1.2	0.9
13	Equities, net	-2.0	-0.4	-0.1	-1.1	0.1	0.1	0.0	-0.7
14	Gross Purchases of Foreign Securities	2,640.0	3,037.8	2,962.3	3,393.8	235.3	233.9	248.3	253.3
15	Gross Sales of Foreign Securities	2,613.0	3,086.4	3,007.8	3,455.2	244.7	234.9	245.6	268.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**27.0**	**-48.7**	**-45.5**	**-61.4**	**-9.4**	**-1.0**	**2.7**	**-15.2**
17	Foreign Bonds Purchased, net	28.5	22.3	23.0	6.8	-0.2	-1.9	1.4	-3.2
18	Foreign Equities Purchased, net	-1.5	-71.0	-68.5	-68.2	-9.3	0.9	1.3	-12.0
19	**Net Long-Term Flows** (line 3 plus line 16)	**574.6**	**698.4**	**649.4**	**850.6**	**61.1**	**54.2**	**67.5**	**48.1**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. acquisitions of foreign securities (-)

Source: U.S. Department of the Treasury

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 15, 2004
JS-2150

Treasury to Release Preliminary Report on U.S. Holdings of Foreign Securities

Preliminary data from the benchmark survey of U.S. portfolio holdings of foreign securities at year-end 2003 will be released on Friday, December 17 at 4:00 PM and posted on the U.S. Treasury web site (www.treas.gov/tic). Final survey results, including additional detail and revisions to the data, will be reported by March 31, 2005.

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The most recent preliminary survey was for year-end 2001, and some revisions from that survey are reported in this release. Future surveys are scheduled to be carried out annually and the next survey will be for year-end 2004.

A complementary benchmark survey measuring foreign holdings of U.S. securities is also carried out annually. Data from the most recent such survey, which reports on securities held on June 30, 2004, are currently being processed. Preliminary results are expected to be reported by July 31, 2005.

Previous benchmark surveys can be found at www.treas.gov/tic/fpis.html

- END -

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 15, 2004
JS-2151

The Honorable John W. Snow
Prepared Remarks: Opening Statement for the President's Economic Forum
Panel on Tax and Regulatory Burdens
December 15, 2004

Good morning and thank you all so much for being here. I especially appreciate the time and expertise that is being generously given by our panel members today. Each one of you is an expert, thanks to both study of these issues and your actual life experience. So thank you very much for participating. I look forward to hearing your ideas.

The purpose of this conference today is to talk about where our economy stands, the challenges we face and the steps we must take to ensure our economy will continue to grow, create jobs and meet the needs of American workers in a changing world. Discussions will cover everything from tax and regulatory burdens – which is our task here on this panel – to the impact of lawsuit abuse, the high costs of health care, the fiscal challenges we face near and long term, and the importance of preparing American workers for the jobs of the 21st Century.

I'm pleased to report that our nation is on track for sustained economic growth because of the resilience and determination of the American people and the pro-growth policies of this Administration. However, the President will not be satisfied until every American who wants to work can find a job, and all Americans have economic security.

The President believes a changing world can be a time of great opportunity for all Americans to earn a better living, have a rewarding career, and enjoy a fulfilling life. We must transform some of our most fundamental, but outdated, systems – the tax code, our health care system, worker training programs, and retirement plans – so all Americans are equipped and prepared to realize the American Dream.

As I mentioned already, our panel will address the burden of taxes and regulations on our economy. It is, and has been, a top priority of the Bush Administration to be mindful of those burdens, and to reduce them whenever possible. The President believes that this is critical in the effort to make America the best place in the world in which to invest and create jobs.

Tax rates are lower in America today because of the President's leadership, and as a result the economy is much stronger. The linkage between low tax rates and economic growth is clear and we see it in the greatly improved performance of the economy since the President's tax cuts took effect.

Today tax rates are lower for every American who pays taxes – lower for families, lower for workers and entrepreneurs alike and lower for investors. Tax rates on capital have been significantly reduced. The lower tax rates on dividends, on capital gains, on small business, on families and workers have put us on a path of economic growth and strong job creation.

High tax rates hurt an economy but so can regulation, which in many ways acts like a tax. The President knows this and has directed his Administration to make sure that new regulations do not cost our economy more than they are worth. Regulation can be particularly harmful to small businesses who don't have the resources – lawyers and accountants – to deal with the burdens.

Small businesses create most of the new jobs in the United States and excessive, burdensome regulation undercuts their ability to grow, expand and create jobs. So it is absolutely critical that we seek to reduce the burden of regulation wherever possible.

Since the President took office, his Administration has slowed the growth of burdensome new regulations by 75 percent, while still moving forward with crucial safeguards for homeland security, human health, and environmental protection. Thanks to the President's emphasis on protecting small business from excessive regulation, American small businesses were spared $6 billion in regulatory compliance costs in fiscal year 2003 and have saved more than $30 billion in regulatory costs since 2001, according the Small Business Administration's Office of Advocacy. When we look at our terrific economic growth, we have to consider the stimulating effect these actions have had as well, and keep that in mind as we set policy going forward.

Some in Washington, DC might question why we would combine a panel discussion on taxes and regulations. But I can promise you that it does not seem like an odd combination of topics to any business owner. The burdens imposed by both taxes and regulations feel very similar to the country's most modestly sized powerhouses of job creation. Both high taxes and excess regulations are a drag on their companies and a drag on our overall economy.

Economics tells us that anything you tax, you get less of. That's why high marginal taxes on investment and innovation are a bad idea--they kill jobs. And regulations implemented in a costly and burdensome manner act just like a tax--lowering our nation's productive capacity and costing jobs.

This Administration appreciates that government must wield the power of taxation and regulation very carefully because of the economic headwind they can produce. We know that when we are able to lighten the burden of taxes and regulations, our economy begins to soar.

Much of what we will discuss in this forum today is truly historic. This is an exciting moment for the country because we are embarking on something that Americans in every tax bracket have dreamed of for decades: reform of our tax code. Reform that will make the code simpler. More fair. A new code that will promote strong economic growth – growth that produces jobs and prosperity for our citizens.

The code is too complicated, and it needs to be overhauled. Ronald Reagan referred to it as a "daily mugging." Indeed, a complicated code robs citizens and business owners of precious resources: namely, their time and money. And it also allows too many people to find loopholes, which undermines our system of voluntary compliance.

Fundamental tax reform is a top priority of President Bush's second term in office. This administration is committed to the task, and we will get it done.

The President set out some very sound guidelines during his campaign, and I'd like us to keep them in mind today. His goals are to make the code simpler and to increase long-run economic growth and job creation. He believes taxes should be applied fairly, and that reform should recognize the importance of homeownership and charity in our American society.

We have a lot of work to do today, and over the coming four years; so let's get started.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 15, 2004
JS-2152

Treasury Issues General License for Publishing Activities

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today issued a new rule clarifying the extent to which publishing activities with persons in Cuba, Iran and Sudan are authorized, notwithstanding the U.S. embargoes against those countries. Today's action addresses a series of issues that have come to the attention of the Treasury during the past year.

"OFAC's previous guidance was interpreted by some as discouraging the publication of dissident speech from within these oppressive regimes. That is the opposite of what we want," said Stuart Levey, the Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI). "This new policy will ensure those dissident voices and others will be heard without undermining our sanctions policy."

The new rule enables U.S. persons to freely engage in most ordinary publishing activities with persons in Cuba, Iran and Sudan, while maintaining restrictions on certain interactions with the governments, government officials, and people acting on behalf of the governments of those countries. The rule entails the issuance of general licenses in the Cuban Assets Control Regulations, 31 CFR part 515, the Iranian Transactions Regulations, 31 CFR part 560, and the Sudanese Sanctions Regulations, 31 CFR part 538.

"Persons engaging in the activities authorized in the general licenses can do so without seeking permission from OFAC," said OFAC Director Robert Werner. "This rule provides clarity and promotes important policies aimed at the free exchange of ideas without undermining the national security objectives of these country sanctions."

Iran, Sudan, and Cuba are subject to U.S. sanctions under the International Emergency Economic Powers Act (IEEPA) and the Trading With the Enemy Act (TWEA) based on the threat they pose to the national security, foreign policy and economy of the United States.

IEEPA and TWEA give the president the authority to impose sanctions in times of war or national emergency. These statutes are critical to U.S. interests with respect to dangerous regimes, terrorists, narcotics traffickers and the proliferation of weapons of mass destruction. Embargoes established under IEEPA and TWEA often prohibit persons under U.S. jurisdiction from providing goods or services to persons in sanctioned countries, unless authorized by OFAC.

Economic sanctions against foreign states and groups whose actions pose significant threats to the United States are an integral part of our overall national security policy. OFAC is charged with implementing and administering the U.S. Government's economic sanctions programs to effectively put pressure on those posing such threats, while promoting real and positive change.

REPORTS

- A copy of the rule as submitted to the Federal Register

Billing Code 4810-25-P

DEPARTMENT OF THE TREASURY

Office of Foreign Assets Control

31 CFR Parts 515, 538 and 560

Cuban Assets Control Regulations

Sudanese Sanctions Regulations

Iranian Transactions Regulations

AGENCY: Office of Foreign Assets Control, Treasury

ACTION: Final rule.

SUMMARY: The Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury is revising the Cuban Assets Control Regulations, the Sudanese Sanctions Regulations, and the Iranian Transactions Regulations to add general licenses pertaining to certain publishing activities.

DATES: Effective Date: [insert date of publication]. Comments may be submitted at any time.

ADDRESSES: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Agency Web Site: http://www.treas.gov/offices/enforcement/ofac/comment.html.
- Fax: Chief of Records, 202/622-1657.
- Mail: Chief of Records, ATTN: Request for Comments, Office of Foreign Assets Control, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.

Instructions: All submissions received must include the agency name and the FR Doc. number that appears at the end of this document. Comments received will be posted without change to http://www.treas.gov/ofac, including any personal information provided. For detailed instructions on submitting comments and additional information on the

rulemaking process, see the "Public Participation" heading of the SUPPLEMENTARY INFORMATION section of this document. To read background documents or comments received, go to http://www.treas.gov/ofac.

FOR FURTHER INFORMATION CONTACT: Chief of Policy Planning and Program Management, tel. 202/622-2500, Chief of Licensing, tel.: 202/622-2480, Chief of Compliance, tel. 202/622-2490, or Chief Counsel, tel.: 202/622-2410, Office of Foreign Assets Control, Department of the Treasury, Washington, DC 20220 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Electronic and Facsimile Availability

This file is available for download without charge in ASCII and Adobe Acrobat readable (*.PDF) formats at *GPO Access*. *GPO Access* supports HTTP, FTP, and Telnet at fedbbs.access.gpo.gov. It may also be accessed by modem dialup at 202/512-1387 followed by typing "/GO/FAC." Paper copies of this document can be obtained by calling the Government Printing Office at 202/512-1530. This document and additional information concerning the programs of the Office of Foreign Assets Control are available for downloading from the Office's Internet Home Page:

http://www.treas.gov/ofac, or via FTP at ofacftp.treas.gov. Facsimiles of information are available through the Office's 24-hour fax-on-demand service: call 202/622-0077 using a fax machine, fax modem, or (within the United States) a touch-tone telephone.

Background

The Cuban Assets Control Regulations, 31 CFR part 515 (the "CACR"), were issued by the U.S. Government on July 8, 1963, under the Trading with the Enemy Act (50 U.S.C. App. 5 et seq.) (TWEA), in response to certain hostile actions by the Cuban Government. Since that time, U.S. policy toward Cuba has been to encourage a rapid and peaceful transition to democracy. The TWEA sanctions are intended to isolate the Cuban Government economically and deprive it of U.S. dollars that the Cuban Government would otherwise use to maintain or strengthen its repressive apparatus, enforce its information blockade on the Cuban people, and arrange for a succession and the continuation of the totalitarian Communist government.

The Sudanese Sanctions Regulations, 31 CFR part 538 (the "SSR"), implement Executive Order 13067, issued on November 3, 1997, pursuant to, inter alia, the International Emergency Economic Powers Act (50 U.S.C.

1701-1706)(IEEPA). In the order, the President declared a national emergency with respect to the policies and actions of the Government of Sudan, "including continued support for international terrorism; ongoing efforts to destabilize neighboring governments; and the prevalence of human rights violations, including slavery and the denial of religious freedom." To deal with this national emergency, Executive Order 13067 imposed trade sanctions with respect to Sudan and blocked all property and interests in property of the Government of Sudan in the United States or within the possession or control of U.S. persons.

The Iranian Transactions Regulations, 31 CFR part 560 (the "ITR"), implement a series of Executive orders, beginning with Executive Order 12957, issued on March 15, 1995. In that order, the President declared a national emergency pursuant to IEEPA to deal with the unusual and extraordinary threat to the national security, foreign policy, and economy of the United States constituted by the actions and policies of the Government of Iran, including its support for international terrorism, its efforts to undermine the Middle East peace process and its efforts to acquire weapons of mass destruction and the means to deliver them. To deal with this threat, Executive Order 12957 imposed prohibitions on certain transactions with

respect to the development of Iranian petroleum resources. On May 6, 1995, the President issued Executive Order 12959 imposing comprehensive trade sanctions to further respond to this threat, and on August 19, 1997, the President issued Executive Order 13059 consolidating and clarifying the previous orders.

The Treasury Department's Office of Foreign Assets Control ("OFAC") is amending the CACR, SSR and ITR to authorize certain activities relating to publishing that otherwise entail the prohibited exportation of services to, or prohibited importation of services from, Cuba, Sudan or Iran.

With certain exceptions, the exportation and importation of information and informational materials to or from any country are exempt from regulation by the President under TWEA and IEEPA. See 50 U.S.C. App 5(b)(4) and 50 U.S.C. 1702(b)(3), respectively. OFAC is issuing the new general licenses set forth at 31 C.F.R. § 515.577, 31 C.F.R. § 538.529 and 31 C.F.R. § 560.538 to authorize transactions not already exempt from regulation that directly support the publishing and marketing of manuscripts, books, journals, and newspapers, in paper or electronic format.

Each of the general licenses is similar in structure

and scope, authorizing a variety of activities relating to publishing with appropriate exceptions, such as those for the governments of each of the sanctioned countries. Section 515.545, a pre-existing general license pertaining to information and informational materials remains in effect, but is being revised to include a note referring to the further authorizations contained in § 515.577.

Public Participation

Because the amendment of the CACR, ITR and SSR involves a foreign affairs function, the provisions of Executive Order 12866 and the Administrative Procedure Act (5 U.S.C. 553) (the "APA") requiring notice of proposed rulemaking, opportunity for public participation, and delay in effective date, are inapplicable. Because no notice of proposed rulemaking is required for this rule, the Regulatory Flexibility Act (5 U.S.C. 601-612) does not apply. However, OFAC encourages interested persons who wish to comment to do so in writing. The address for submitting comments appears in the ADDRESSES section near the beginning of this document. OFAC will not accept public comments written in languages other than English or accompanied by a request that a part or all of the submission be treated confidentially because of its

business proprietary nature or for any other reason. OFAC will return such submissions to the originator. All public comments on these regulations will be a matter of public record. Copies of the public record concerning these regulations will be made available not sooner than [90 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER], and will be obtainable from OFAC's Internet Home Page at http://www.treas.gov/ofac. If that service is unavailable, written requests for copies may be sent to Office of Foreign Assets Control, U.S. Department of the Treasury, 1500 Pennsylvania Ave., N.W., Washington, D.C. 20220, Attn: Chief, Records Division.

Paperwork Reduction Act

The collections of information related to 31 CFR parts 31 CFR parts 560 and 538 are contained in 31 CFR part 501 (the "Reporting, Procedures and Penalties Regulations"). Pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3507), those collections of information have been approved by the Office of Management and Budget under control number 1505-0164. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of

information unless the collection of information displays a valid control number.

List of Subjects

31 CFR Part 515. Administrative practice and procedure, Cuba, Exports, Foreign trade, Imports, Information.

31 CFR Part 538. Administrative practice and procedure, Exports, Foreign trade, Imports, Information, Sudan.

31 CFR Part 560. Administrative practice and procedure, Exports, Foreign trade, Imports, Information, Iran.

For the reasons set forth in the Preamble, 31 CFR parts 515, 538 and 560 are amended as follows:

PART 515—CUBAN ASSETS CONTROL REGULATIONS

1. The authority citation for part 515 continues to read as follows:

Authority: 18 U.S.C. 2332d; 22 U.S.C. 2370(a), 6001-6010; 31 U.S.C. 321(b); 50 U.S.C. App 1-44; Pub. L. 101-410, 104 Stat. 890 (28 U.S.C. 2461 note); Pub. L. 106-387, 114 Stat. 1549; E.O. 9193, 7 FR 5205, 3 CFR, 1938-1943 Comp., p. 1147; E.O. 9989, 13 FR 4891, 3 CFR, 1943-1948 Comp., p. 748; Proc. 3447, 27 FR 1085, 3 CFR, 1959-1963 Comp., p. 157; E.O. 12854, 58 FR 36587, 3 CFR, 1993 Comp., p. 614.

Subpart E--Licenses, Authorizations, and Statements of Licensing Policy

2. Section 515.545 is amended by adding a note at the end of the section to read as follows:

§ 515.545 Transactions related to information and informational materials.

* * * * *

Note to § 515.545. With respect to transactions necessary and ordinarily incident to the publishing and marketing of manuscripts, books, journals and newspapers, see § 515.577.

3. Add a new § 515.577 to subpart E to read as follows:

§ 515.577 Authorized transactions necessary and ordinarily incident to publishing.

(a) To the extent that such activities are not exempt from this part, and subject to the restrictions set forth in paragraphs (b) through (d) of this section, persons subject to the jurisdiction of the United States are authorized to engage in all transactions necessary and ordinarily incident to the publishing and marketing of manuscripts, books, journals, and newspapers (collectively, "written publications"), in paper or electronic format. This section does not apply if the parties to the transactions described in this paragraph include the Government of Cuba. For the purposes of this section, the term "Government of Cuba" includes the state and the Government of Cuba, as well as any political subdivision, agency, or instrumentality thereof, including the Central Bank of Cuba; any person occupying the positions identified in § 515.570(a)(3); employees of the Ministry of Justice; and any person acting or purporting to act directly or indirectly on behalf of any of the foregoing with respect to the transactions described in this paragraph. For the

purposes of this section, the term "Government of Cuba" does not include any academic and research institutions and their personnel. Pursuant to this section, the following activities are not prohibited, provided that persons subject to the jurisdiction of the United States ensure that they are not engaging, without specific authorization, in the activities identified in paragraph (d) of this section:

(1) Commissioning and making advance payments for identifiable written publications not yet in existence, to the extent consistent with industry practice;

(2) Collaborating on the creation and enhancement of written publications;

(3) Augmenting written publications through the addition of items such as photographs, artwork, translation, and explanatory text;

(4) Substantive editing of written publications;

(5) Payment of royalties for written publications;

(6) Creating or undertaking a marketing campaign to promote a written publication; and

(7) Other transactions necessary and ordinarily incident to the publishing and marketing of written publications as described in this paragraph (a).

(b) This section does not authorize transactions involving the provision of goods or services not necessary and ordinarily incident to the publishing and marketing of written publications as described above. For example, this section does not authorize persons subject to the jurisdiction of the United States:

(1) To provide or receive individualized or customized services (including, but not limited to, accounting, legal, design, or consulting services), other than those necessary and ordinarily incident to the publishing and marketing of written publications, even though such individualized or customized services are delivered through the use of information and informational materials;

(2) To create or undertake for any person a marketing campaign with respect to any service or product other than a written publication, or to create or undertake a marketing campaign of any kind for the benefit of the Government of Cuba;

(3) To engage in the exportation or importation of goods, other than information and informational materials, to or from Cuba;

(4) To operate a publishing house, sales outlet, or other office in Cuba; or

(5) To engage in transactions related to travel to, from and within Cuba.

(c) This section does not authorize persons subject to the jurisdiction of the United States to engage the services of publishing houses or translators in Cuba unless such activity is primarily for the dissemination of written publications in Cuba.

(d) This section does not authorize:

(1) Transactions for the development, production, design, or marketing of software;

(2) Transactions for the development, production, design, or marketing of technology specifically controlled by the International Traffic in Arms Regulations, 22 C.F.R. parts 120 - 130 (ITAR), the Export Administration Regulations, 15 C.F.R. parts 730 - 774 (EAR), or the Department of Energy Regulations set forth at 10 C.F.R. part 810.

(3) The exportation of information or technology subject to the authorization requirements of 10 C.F.R. part 810, or Restricted Data as defined in section 11 y. of the Atomic Energy Act of 1954, as amended, or of other information, data, or technology the release of which is controlled under the Atomic Energy Act and regulations therein;

(4) The exportation of information subject to license application requirements under the EAR. These EAR license application requirements cover not only the exportation of information controlled on the Commerce Control List, 15 C.F.R. part 774, but also the exportation of any information subject to the EAR where a U.S. person knows or has reason to know that the information will be used, directly or indirectly, with respect to certain nuclear, missile, chemical and biological weapons, and nuclear-maritime end-uses. In addition, U.S. persons are precluded from exporting any information subject to the EAR to certain restricted end-users, as provided in the Commerce Department's end-user and end-use based controls set forth at 15 C.F.R. part 744; or

(5) The exportation of information subject to licensing requirements under the ITAR, or exchanges of information that are subject to regulation by other government agencies.

(e) Specific licenses may be issued on a case-by-case basis authorizing the travel-related transactions set forth in § 515.560(c) for purposes necessary and ordinarily incident to the publishing and marketing of written publications.

PART 538—SUDANESE SANCTIONS REGULATIONS

4. The authority citation for part 538 continues to read as follows:

Authority: 3 U.S.C. 301; 31 U.S.C. 321(b); 18 U.S.C. 2339B, 2332d; 50 U.S.C. 1601-1651, 1701-1706; Pub. L. 106-387, 114 Stat. 1549; E.O. 13067, 62 FR 59989; 3 CFR, 1997 Comp., p. 230.

Subpart E--Licenses, Authorizations, and Statements of Licensing Policy

5. Add a new § 538.529 to subpart E to read as follows:

§ 538.529 Authorized transactions necessary and ordinarily incident to publishing.

(a) To the extent that such activities are not exempt from this part, and subject to the restrictions set forth in paragraphs (b) through (d) of this section, U.S. persons are authorized to engage in all transactions necessary and ordinarily incident to the publishing and marketing of manuscripts, books, journals, and newspapers (collectively,

"written publications"), in paper or electronic format. This section does not apply if the parties to the transactions described in this paragraph include the Government of Sudan. For the purposes of this section, the term "Government of Sudan" includes the state and the Government of Sudan, as well as any political subdivision, agency, or instrumentality thereof, including the Central Bank of Sudan; and any person acting or purporting to act directly or indirectly on behalf of any of the foregoing with respect to the transactions described in this paragraph. For the purposes of this section, the term "Government of Sudan" does not include any academic and research institutions and their personnel. Pursuant to this section, the following activities are not prohibited, provided that U.S. persons ensure that they are not engaging, without specific authorization, in the activities identified in paragraph (d) of this section:

(1) Commissioning and making advance payments for identifiable written publications not yet in existence, to the extent consistent with industry practice;

(2) Collaborating on the creation and enhancement of written publications;

(3) Augmenting written publications through the addition of items such as photographs, artwork, translation, and explanatory text;

(4) Substantive and artistic editing of written publications;

(5) Payment of royalties for written publications;

(6) Creating or undertaking a marketing campaign to promote a written publication; and

(7) Other transactions necessary and ordinarily incident to the publishing and marketing of written publications as described in this paragraph (a).

(b) This section does not authorize transactions involving the provision of goods or services not necessary and ordinarily incident to the publishing and marketing of written publications as described above. For example, this section does not authorize U.S. persons:

(1) To provide or receive individualized or customized services (including, but not limited to, accounting, legal, design, or consulting services), other than those necessary and ordinarily incident to the publishing and marketing of written publications, even though such individualized or customized services are delivered through the use of information and informational materials;

(2) To create or undertake for any person a marketing campaign with respect to any service or product other than a written publication, or to create or undertake a marketing campaign of any kind for the benefit of the Government of Sudan;

(3) To engage in the exportation or importation of goods, other than information and informational materials, to or from Sudan; or

(4) To operate a publishing house, sales outlet, or other office in Sudan.

(c) This section does not authorize U.S. persons to engage the services of publishing houses or translators in Sudan unless such activity is primarily for the dissemination of written publications in Sudan.

(d) This section does not authorize:

(1) Transactions for the development, production, design, or marketing of software;

(2) Transactions for the development, production, design, or marketing of technology specifically controlled by the International Traffic in Arms Regulations, 22 C.F.R. parts 120 - 130 (ITAR), the Export Administration Regulations, 15 C.F.R. parts 730 - 774 (EAR), or the

Department of Energy Regulations set forth at 10 C.F.R. part 810.

(3) The exportation of information or technology subject to the authorization requirements of 10 C.F.R. part 810, or Restricted Data as defined in section 11 y. of the Atomic Energy Act of 1954, as amended, or of other information, data, or technology the release of which is controlled under the Atomic Energy Act and regulations therein;

(4) The exportation of information subject to license application requirements under the EAR. These EAR license application requirements cover not only the exportation of information controlled on the Commerce Control List, 15 C.F.R. part 774, but also the exportation of any information subject to the EAR where a U.S. person knows or has reason to know that the information will be used, directly or indirectly, with respect to certain nuclear, missile, chemical and biological weapons, and nuclear-maritime end-uses. In addition, U.S. persons are precluded from exporting any information subject to the EAR to certain restricted end-users, as provided in the Commerce Department's end-user and end-use based controls set forth at 15 C.F.R. part 744; or

(5) The exportation of information subject to licensing requirements under the ITAR, or exchanges of information that are subject to regulation by other government agencies.

PART 560--IRANIAN TRANSACTIONS REGULATIONS

6. The authority citation for part 560 continues to read as follows:

Authority: 3 U.S.C. 301; 18 U.S.C. 2339B, 2332d; 22 U.S.C. 2349aa-9; 31 U.S.C. 321(b);50 U.S.C. 1601-1651, 1701-1706; Pub. L. 101-410, 104 Stat.890 (28 U.S.C. 2461 note); Pub. L. 106-387, 114 Stat. 1549; E.O. 12613, 52 FR 41940, 3 CFR, 1987 Comp., p. 256; E.O. 12957, 60 FR 14615, 3 CFR, 1995 Comp., p. 332; E.O. 12959, 60 FR 24757, 3 CFR, 1995, Comp., 356; E.O. 13059, 62 FR 44531, 3 CFR, 1997 Comp., p. 217.

Subpart E--Licenses, Authorizations, and Statements of Licensing Policy

7. Add a new § 560.538 to subpart E to read as follows:

§ 560.538 Authorized transactions necessary and ordinarily incident to publishing.

(a) To the extent that such activities are not exempt from this part, and subject to the restrictions set forth in paragraphs (b) through (d) of this section, U.S. persons are authorized to engage in all transactions necessary and ordinarily incident to the publishing and marketing of manuscripts, books, journals, and newspapers (collectively, "written publications"), in paper or electronic format. This section does not apply if the parties to the transactions described in this paragraph include the Government of Iran. For the purposes of this section, the term "Government of Iran" includes the state and the Government of Iran, as well as any political subdivision, agency, or instrumentality thereof, which includes the Central Bank of Islamic Republic of Iran; and any person acting or purporting to act directly or indirectly on behalf of any of the foregoing with respect to the transactions described in this paragraph. For the purposes of this section, the term "Government of Iran" does not include any academic and research institutions and their personnel. Pursuant to this section, the following activities are not prohibited, provided that U.S. persons ensure that they are not engaging, without specific

authorization, in the activities identified in paragraph (d) of this section:

(1) Commissioning and making advance payments for identifiable written publications not yet in existence, to the extent consistent with industry practice;

(2) Collaborating on the creation and enhancement of written publications;

(3) Augmenting written publications through the addition of items such as photographs, artwork, translation, and explanatory text;

(4) Substantive editing of written publications;

(5) Payment of royalties for written publications;

(6) Creating or undertaking a marketing campaign to promote a written publication; and

(7) Other transactions necessary and ordinarily incident to the publishing and marketing of written publications as described in this paragraph (a).

(b) This section does not authorize transactions involving the provision of goods or services not necessary and ordinarily incident to the publishing and marketing of written publications as described above. For example, this section does not authorize U.S. persons:

(1) To provide or receive individualized or customized services (including, but not limited to, accounting, legal, design, or consulting services), other than those necessary and ordinarily incident to the publishing and marketing of written publications, even though such individualized or customized services are delivered through the use of information and informational materials;

(2) To create or undertake for any person a marketing campaign with respect to any service or product other than a written publication, or to create or undertake a marketing campaign of any kind for the benefit of the Government of Iran;

(3) To engage in the exportation or importation of goods, other than information and informational materials, to or from Iran; or

(4) To operate a publishing house, sales outlet, or other office in Iran.

(c) This section does not authorize U.S. persons to engage the services of publishing houses or translators in Iran unless such activity is primarily for the dissemination of written publications in Iran.

(d) This section does not authorize:

(1) Transactions for the development, production, design, or marketing of software;

(2) Transactions for the development, production, design, or marketing of technology specifically controlled by the International Traffic in Arms Regulations, 22 C.F.R. parts 120 - 130 (ITAR), the Export Administration Regulations, 15 C.F.R. parts 730 - 774 (EAR), or the Department of Energy Regulations set forth at 10 C.F.R. part 810.

(3) The exportation of information or technology subject to the authorization requirements of 10 C.F.R. part 810, or Restricted Data as defined in section 11 y. of the Atomic Energy Act of 1954, as amended, or of other information, data, or technology the release of which is controlled under the Atomic Energy Act and regulations therein;

(4) The exportation of information subject to license application requirements under the EAR. These EAR license application requirements cover not only the exportation of information controlled on the Commerce Control List, 15 C.F.R. part 774, but also the exportation of any information subject to the EAR where a U.S. person knows or has reason to know that the information will be used, directly or indirectly, with respect to certain nuclear, missile, chemical and biological weapons, and nuclear-maritime end-uses. In addition, U.S. persons are precluded

from exporting any information subject to the EAR to certain restricted end-users, as provided in the Commerce Department's end-user and end-use based controls set forth at 15 C.F.R. part 744; or

(5) The exportation of information subject to licensing requirements under the ITAR, or exchanges of information that are subject to regulation by other government agencies.

Dated: December , 2004.

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Robert W. Werner,

Director, Office of Foreign Assets Control.

Approved: December , 2004.

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Juan C. Zarate, Assistant Secretary, Terrorist Financing and Financial Crimes,

Department of the Treasury.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 15, 2004
2004-12-15-15-16-32-28542

Secretary John Snow moderates a panel on tax and regulatory burden at the White House Conference on the Economy

Secretary John Snow moderates a panel on tax and regulatory burden at the White House Conference on the Economy

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 15, 2004
JS-2153

Joint Press Release
U.S.-Brazil Group for Growth
December 15, 2004

The United States and Brazil held the third meeting of the Group for Growth today in Washington, D.C. Creation of the Group was announced at the June 2003 meeting between President Bush and President Lula with the purpose of developing strategies to raise economic growth in both countries. The previous meetings of the Group were in August 2003 in Washington and April 2004 in Rio de Janeiro, Brazil.

The meeting was co-chaired by John B. Taylor, Under Secretary for International Affairs at the U.S. Department of Treasury, and Joaquim V. Levy, Secretary of the Brazilian National Treasury. U.S. participants included Treasury Assistant Secretary for Economic Policy Mark Warshawsky and Council of Economic Advisors member Harvey Rosen.

During the meeting, the delegations reviewed the macroeconomic outlooks and policy agendas for both countries. The participants noted the solid economic performance in Brazil and the United States. In Brazil, real GDP grew 6.1% for the year ending in the third quarter--the highest growth rate since 1996. In the United States, economic growth continues to be robust and the strong job market performance has continued with more than 2 million jobs created since the beginning of the year.

"I am impressed by the strength of economic growth in Brazil," John Taylor said. "Employment has risen sharply, real salaries are up, and investment is growing at record levels. It is clear that the Lula Administration's policies--particularly disciplined fiscal and monetary policies--are yielding positive results and creating jobs. I am struck by our shared focus on priorities like promoting savings and making the tax system more supportive of growth and job creation."

"The Group for Growth is a very important part of our bilateral relations," Joaquim Levy said. "We discussed Brazil's strong and steady progress on our ambitious reform agenda, including passage of bankruptcy reform yesterday. These reforms will lay the basis for continued rapid growth in investment and jobs as interest rates come down. We also had a useful exchange about developments in the mortgage market and growth in construction and home ownership in both countries."

The Group agreed to reconvene in Brazil in the second quarter of 2005. Under Secretary Taylor and Treasury Secretary Levy agreed to invite business people to the next meeting to discuss how best to promote innovation and research & development.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 16, 2004
JS-2154

Operation Balkan Vice V: Treasury Designates Persons Obstructing the Dayton Peace Accords in Bosnia

In another step to help establish peace and stability in the Western Balkans, the U.S. Department of the Treasury today designated six individuals and three entities under Executive Order 13219, as amended by Executive Order 13304.

"Today's action furthers the steps taken by the President to act against those who bring strife to the Western Balkans and threaten international stabilization efforts," said Bob Werner, Director of the Treasury's Office of Foreign Assets Control (OFAC). The three entities designated today have obstructed implementation of the Dayton Peace Accords in Bosnia through the continued protection and material support of Persons Indicted for War Crimes (PIFWCs) by the International Criminal Tribunal for the former Yugoslavia (ICTY) and through organized criminal activity. In addition, six individuals, Ljubisa Beara, Miroslav Bralo, Vlastimir Djordjevic, Goran Hadzic, Vladimir Lazarevic, Sreten Lukic, all of whom are under open indictment by the ICTY, are being designated under E.O. 13304.

Today's designation effectively blocks any assets the designees have located in the United States and prohibits U.S. persons from engaging in business or transactions with them.

Under Executive Order 13219, the President of the United States exercised his statutory authority to declare a national emergency in response to the unusual and extraordinary threat to national security and foreign policy of the United States posed by persons who threaten international stabilization efforts in the Western Balkans, including, among others, those persons engaged in, assisting, sponsoring or supporting acts obstructing implementation of the Dayton Peace Accords in Bosnia.

REPORTS

- Entities

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 17, 2004
js-2155

Joint Press Release of the Council of Economic Advisors, the Department of the Treasury, and the Office of Management and Budget

The Administration today released its economic forecast for 2005, showing that the economy is fundamentally strong, with growth expected to continue at solid rates.

The forecast projects real GDP growth of 3.5 percent during the four quarters of 2005 and of 3.4 percent during 2006. Projected growth then tapers to 3.1 percent by 2009 and 2010. This forecast is consistent with the consensus of professional economic forecasters.

"Fiscal restraint and a strong economy are the two critical elements required to cut the budget deficit in half by 2009," said Director of the Office of Management and Budget Joshua B. Bolten. "This forecast shows that the pro-growth policies we've enacted will help generate the economic growth necessary to meet that goal."

The unemployment rate is projected to gradually decline from its current 5.4 percent level to 5.1 percent in 2007 and later years. Payroll employment has increased 185,000 per month during the first 11 months of 2004, according to preliminary estimates from the Bureau of Labor Statistics (BLS). The Bureau has announced that they expect to revise these numbers upward. Job growth during the four quarters of 2005 is estimated to be about 175,000 per month--a figure in line with the consensus forecast--so that payroll employment is estimated to average 133.4 million in 2005.

"Given the powerful contractionary forces at work since early 2000, the strength of our economy is remarkable" said Council of Economic Advisers Chairman Gregory Mankiw. "The United States faced the bursting of the high-tech bubble of the 1990s, corporate scandals, and slow growth among our trading partners, and today our economy is strong and growing."

The forecast projects that inflation, as measured by the price index for GDP, will remain near 2 percent for the entire forecast period. This matches the rate of core inflation over the last four quarters and is about the same as that expected by the consensus of private forecasters. Consumer price inflation has been temporarily boosted during the past year by high oil prices. As the impact of these oil price increases recedes, consumer price inflation is expected to come down and eventually stabilize around 2.4 percent.

The current slope of the yield curve (the difference between the yield on 10-year Treasury notes and the 91-day rate) suggests that market participants expect short-term interest rates to rise. The Administration interest rate projections reflect these views as well as those of the consensus of economic forecasters. By 2010, the rates on 10-year and 91-day Treasury securities relative to the rate of expected consumer price inflation are projected to be close to their historical average.

During the last four quarters (through the third quarter), real GDP has risen 4.0 percent, significantly above the average post-war growth rate. The rate of inflation remains low, with core consumer price inflation at 2.2 percent during the 12 months through November. The unemployment rate of 5.4 percent in November is down from 6.3 percent in June 2003 and is below the average of the past three decades.

"Today's forecast demonstrates that the substantial tax relief passed in President Bush's first term, together with expansionary monetary policy, provided economic stimulus and put the economy on the road to recovery and subsequent expansion,"

said Secretary of the Treasury John Snow.

The forecast was developed by a team from the Council of Economic Advisers, the Department of the Treasury, and the Office of Management and Budget, with assistance from other agencies.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 17, 2004
js-2156

Statement of Treasury Secretary John W. Snow
U.S.-Iraq Debt Reduction Agreement Signing Ceremony

Thank you, Secretary Powell. It is a great pleasure to be here today, participating in the signing of this historic agreement.

The Paris Club agreed last month that very deep debt reduction was needed for sustainability and economic reforms to be achieved in Iraq. That agreement was a significant milestone in Iraq's ongoing reintegration into the international community, and I believe it will open the door to broader international participation in Iraq's reconstruction.

I congratulate Finance Minister Mahdi and Central Bank Governor Shabibi for the work they did to achieve that successful outcome in the Paris Club.

Our action today in eliminating the Iraqi debt owed to our country is another critical milestone for Iraq and its people.

This agreement shows our unwavering commitment to the Iraqi people, and their efforts to achieve sustainable reforms and stability in their country.

And with the signing of this agreement the Iraqi government is demonstrating, once again, their commitment resolve to foster a sound economic environment that will be a source of stability within the region and a source of hope for Iraq's citizens.

The situation that Iraq faces is unprecedented and the response of the world community needs to be – and has been – unprecedented as well. Iraq's debt levels were simply unsustainable. The situation had to be addressed by the world community, and by this action today we are keeping faith with the high aspirations of the Iraqi people.

Today is an important step toward achieving economic restoration, but more will be needed. The U.S. is therefore ready to assist the Iraqis in implementing the Paris Club agreement, including seeking comparable treatment from sovereign creditors who do not participate in the Paris Club. I urge Iraq's other creditors to work quickly in forging agreements like this one to reduce Iraq's debt.

I also urge Iraq to move quickly in negotiating and implementing an IMF Stand-By Arrangement, which will trigger the full amount of debt reduction promised by Paris Club members.

The U.S. Treasury looks forward to working with the Iraqi government as you continue your historic efforts of reconstruction and economic reform.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 17, 2004
js-2157

Janjalani Designated for Leadership Position in the Abu Sayyaf Group

--Brutal Team of Separatists Operating in the Philippines--

The U.S. Department of the Treasury today designated Khadafi Abubakar Janjalani (Janjalani) for acting on behalf of the Abu Sayyaf Group (ASG). Today's action was taken pursuant to Executive Order 13224.

"Janjalani is a despicable terrorist, responsible for the kidnappings and beheadings of American civilians and other innocents. We must do everything in our power to cut off individuals like him from their support lines," said Stuart Levey, Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI).

The ASG has been named a Foreign Terrorist Organization (FTO) and a Specially Designated Global Terrorist (SDGT) by the U.S. Government. The group was formed in the early 1990s under the leadership of Janjalani's older brother, Abdurajak Abubakar Janjalani. Following the death of Abdurajak Abubakar Janjalani in a clash with Philippine police in 1998, the younger Janjalani was elevated to a leadership position in the ASG, heading one of its major factions.

Janjalani perpetrated brutal acts of terrorism against U.S. citizens and foreign nationals. On August 29, 2000, Jeffrey Schilling, an American citizen, was kidnapped and held hostage for more than seven months by members of the ASG, including Janjalani. Using Schilling as leverage, the ASG demanded the release of three individuals imprisoned by the U.S. Government, payment of $10 million in ransom and the cessation of military operations by the Government of the Philippines against the ASG. The ASG accompanied these demands with threats to behead or otherwise kill Schilling if they were not met. Schilling managed to escape from his captors on April 12, 2001.

On May 27, 2001, roughly six weeks after Schilling's escape, the ASG – led by Janjalani – kidnapped three American and 17 Philippine nationals from the Dos Palmas Island Resort on the island of Palawan in the Philippines. The ASG again threatened to behead or otherwise kill the hostages if their demands were not met.

On June 1, 2001, two of the Philippine hostages were beheaded, and days later the ASG announced that it had also beheaded one of the American hostages, Guillermo Sobero. American hostages Martin and Gracia Burnham and Filipino hostage Ediborah Yap were held hostage for another year before Gracia Burnham was rescued on June 7, 2002. Martin Burnham and Ediborah Yap were both killed during an encounter between the ASG and the Armed Forces of the Philippines.

In March 2000, Janjalani led efforts by the ASG to kidnap a number of students and their teachers – several of whom were tortured and killed.

Janjalani, along with four conspirators, is wanted to stand trial in the United States. He is charged with the following offenses:

- One count of conspiracy to commit hostage taking resulting in death;
- One count of hostage taking and aiding and abetting; and
- Three counts of hostage taking resulting in death and aiding and abetting.

Identifier Information

KHADAFI ABUBAKAR JANJALANI

AKAs: Khadafy Janjalani
Khaddafy Abubakar Janjalani
Abu Muktar

DOB: March 3, 1975
POB: Isabela, Basilan, Philippines
Nationality: Philippine

Janjalani was designated today pursuant to Executive Order 13224 under paragraphs 1(c) and 1(d) based on a determination that he acts for or on behalf of the ASG; assists in, sponsors or provides financial, material, or technological support for, or financial or other services to or in support of, the ASG and acts of terrorism; and is otherwise associated with the ASG, an entity listed as subject to E.O. 13224.

Blocking actions such as today's are critical to combating the financing of terrorism. When an action is put into place, any assets existing in the U.S. formal financial system at the time of the order are required to be frozen. Blocking actions serve additional functions as well, including acting as a deterrent that puts the public on notice that they are prohibited from having any business or other dealings with the blocked person. This serves as a warning to non-designated parties who might otherwise be willing to finance terrorist activity. Additionally, blocking actions expose terrorist financing "money trails" that may generate leads to previously unknown terrorist cells and financiers, disrupt terrorist financing networks by encouraging designated terrorist supporters to disassociate themselves from terrorist activity and renounce their affiliation with terrorist groups; terminate terrorist cash flows by shutting down the pipelines used to move terrorist-related assets; force terrorists to use alternative, more costly and higher-risk means of financing their activities; and engender international cooperation.

With this action, the United States has designated 394 individuals and entities as terrorists, their financiers or facilitators. In addition, the global community has frozen over $144 million in terrorist-related assets.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 15, 2004
js-2158

Treasury Officials Support Financial Literacy Efforts in Washington, DC Neighborhood

Under Secretary Brian Roseboro and Deputy Assistant Secretary Dan Iannicola today met with representatives of Operation Hope to discuss progress on bringing financial literacy to the inner city. The roundtable discussion brought together Operation Hope sponsors, supporters and community leaders to discuss financial literacy in general and the newest Hope Center scheduled to open in early 2005. The Hope Center model offers financial literacy and economic education, as well as hands-on financial case management and wealth building through homeownership and small business ownership.

Under Secretary Roseboro highlighted the organization's commitment to improving financial education in urban communities. "Operation Hope brings together expertise and passion to get results in urban America," said Roseboro.

Deputy Assistant Secretary Dan Iannicola recognized the new center's sponsors and supporters' commitment to improving financial education, as well as E*TRADE Bank's multi-year commitment to serve as the signature sponsor for Hope Center Anacostia in the Washington D.C. metro area. "The involvement of E*TRADE bank in establishing this center for the people of Anacostia shows the positive impact members of the lending community can have on financial literacy."

Operation HOPE is a national provider of financial literacy and economic empowerment programs. Through ongoing collaborations and long-term partnerships with leading government, private sector, and community interests, Operation HOPE works to bring self-sufficiency and a sustained spirit of revitalization to America's inner-city communities.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 17, 2004
JS-2159

Preliminary Annual Report on U.S. Holdings Of Foreign Securities

Preliminary data from an annual survey of U.S. portfolio holdings of foreign securities at year-end 2003 are released today and posted on the U.S. Treasury web site at (www.treas.gov/tic/fpis.html). Final survey results, which will include additional detail as well as revisions to the data, will be reported by March 31, 2005.

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The most recent survey was for year-end 2001, and some revisions from that survey are reported in this release. Future surveys are scheduled to be carried out annually and the next survey will be for year-end 2004.

A complementary survey measuring foreign holdings of U.S. securities will also be carried out annually. Data from the most recent such survey, which reports on securities held on June 30, 2004, are currently being processed. Preliminary results are expected to be reported by April 30, 2005.

Overall Preliminary Results

The survey measured U.S. holdings of foreign securities at year-end 2003 of approximately $3,153 billion, with $2,080 billion held in foreign equities, $874 billion in foreign long-term debt securities (original term-to-maturity in excess of one year), and $199 billion in foreign short-term debt securities. The previous survey, conducted as of year-end 2001, measured U.S. holdings of approximately $2,317 billion, with $1,613 billion held in foreign equities, $557 billion in foreign long-term debt securities (revised from $502 billion), and $147 billion in foreign short-term debt securities (see Table 1).

Table 1. U.S. holdings of foreign securities, by type of security, as of survey dates
(Billions of dollars, except as noted)

Type of Security	Dec. 31, 2001	Dec. 31, 2003
Long-term Securities	2,170	2,955
equity	1,613	2,080
long-term debt	557	874
Short-term debt securities	147	199
Total	2,317	3,153

U.S. Portfolio Investment by Country

Table 2. U.S. holdings of foreign securities, by country and type of security, for the countries attracting the most U.S. investment, as of December 31, 2003
(Billions of dollars)

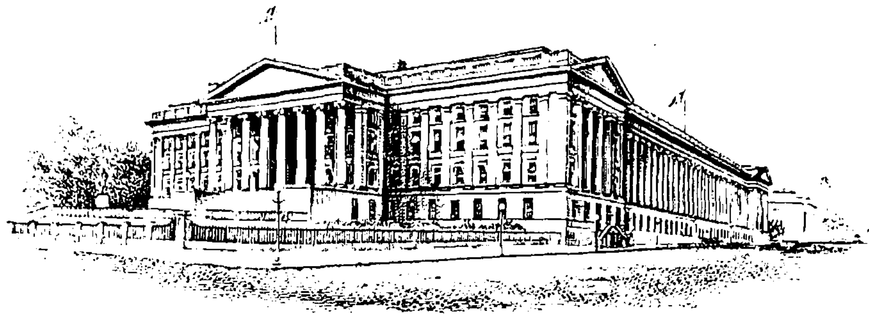
			Debt securities:	
	Total	Equities	Long-term	Short-term

1	United Kingdom	663	421	143	99
2	Japan	307	255	37	14
3	Canada	301	149	139	12
4	Germany	189	103	71	15
5	France	185	131	43	11
6	Netherlands	182	116	58	8
7	Cayman Islands	125	45	76	4
8	Switzerland	120	118	1	1
9	Bermuda	116	108	9	0
10	Australia	91	56	29	5
11	Italy	67	39	25	3
12	Mexico	56	29	28	0
13	South Korea	53	49	4	0
14	Spain	52	44	6	1
15	Brazil	50	32	18	0
16	Sweden	45	28	13	5
17	Finland	41	35	6	0
18	Hong Kong , S.A.R.	38	36	1	0
19	Ireland	33	22	8	3
20	Israel	29	16	12	0
21	Taiwan	27	27	0	0
22	Singapore	25	22	3	0
23	Netherlands Antilles	25	23	1	0
24	Luxembourg	23	6	15	2
25	Denmark	22	10	10	2
	Rest of world	288	160	116	12
	Total value of investment	3,153	2,080	874	199

The stock of foreign securities for December 31, 2003 reported in this survey may not, for a number or reasons, correspond to the stock of foreign securities on December 31, 2001 plus cumulative flows reported in Treasury's transactions reporting system. The final report on U.S. holdings of foreign securities as of end-year 2003 will contain an analysis of the relation between the stock and flow data.

REPORTS

- (PDF) Press Release for printing



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

December 17, 2004
EMBARGOED UNTIL 4:00 PM

Contact: Tony Fratto
202-622-2910

PRELIMINARY ANNUAL REPORT ON U.S. HOLDINGS OF FOREIGN SECURITIES

Preliminary data from an annual survey of U.S. portfolio holdings of foreign securities at year-end 2003 are released today and posted on the U.S. Treasury web site at (http://www.treas.gov/tic/fpis.html). Final survey results, which will include additional detail as well as revisions to the data, will be reported by March 31, 2005.

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The most recent survey was for year-end 2001, and some revisions from that survey are reported in this release. Future surveys are scheduled to be carried out annually and the next survey will be for year-end 2004.

A complementary survey measuring foreign holdings of U.S. securities will also be carried out annually. Data from the most recent such survey, which reports on securities held on June 30, 2004, are currently being processed. Preliminary results are expected to be reported by April 30, 2005.

Overall Preliminary Results

The survey measured U.S. holdings of foreign securities at year-end 2003 of approximately $3,153 billion, with $2,080 billion held in foreign equities, $874 billion in foreign long-term debt securities (original term-to-maturity in excess of one year), and $199 billion in foreign short-term debt securities. The previous survey, conducted as of year-end 2001, measured U.S. holdings of approximately $2,317 billion, with $1,613 billion held in foreign equities, $557 billion in foreign long-term debt securities (revised from $502 billion), and $147 billion in foreign short-term debt securities (see Table 1).

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5	France	185	131	43	11
6	Netherlands	182	116	58	8
7	Cayman Islands	125	45	76	4
8	Switzerland	120	118	1	1
9	Bermuda	116	108	9	0
10	Australia	91	56	29	5
11	Italy	67	39	25	3
12	Mexico	56	29	28	0
13	South Korea	53	49	4	0
14	Spain	52	44	6	1
15	Brazil	50	32	18	0
16	Sweden	45	28	13	5
17	Finland	41	35	6	0
18	Hong Kong, S.A.R.	38	36	1	0
19	Ireland	33	22	8	3
20	Israel	29	16	12	0
21	Taiwan	27	27	0	0
22	Singapore	25	22	3	0
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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 20, 2004
JS-2161

Treasury Announces Entry into Force of Protocol Amending .S.-Barbados Income Tax Treaty

Today Treasury Deputy Secretary Samuel Bodman and the Honorable Michael King, Ambassador to the United States from Barbados, exchanged the instruments of ratification for the protocol amending the income tax treaty between the United States and Barbados. This exchange of instruments brings the protocol into force today.

"This protocol reflects important improvements to the U.S.-Barbados tax treaty, demonstrating the commitments of our respective governments to keeping the provisions of the treaty up to date in light of economic developments," said Deputy Secretary Bodman. "We are pleased that our two countries were able to work together to make the changes necessary to preserve and enhance the tax treaty relationship."

The United States and Barbados signed the protocol at a ceremony at the Treasury Department on July 14, 2004. The United States Senate approved the protocol on October 11, 2004.

The protocol amends the existing tax treaty, which dates back to 1984. The protocol was negotiated to ensure that the U.S.-Barbados tax treaty operates to accomplish its intended purpose of addressing double taxation and cannot be used inappropriately to eliminate taxation altogether. The modifications reflected in the protocol prevent the potential for exploitation of the treaty by U.S. corporations to facilitate inappropriate U.S. tax reductions in connection with a corporate inversion transaction. The protocol also provides that the treaty's reductions in U.S. withholding taxes do not apply in the case of entities that are not subject to the generally applicable Barbados tax system and that benefit instead from a preferential tax regime.

With the entry into force today, the protocol generally will be effective for taxable years beginning on or after January 1, 2005. The provisions of the protocol relating to withholding taxes will be effective for amounts paid or credited on or after February 1, 2005.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe Acrobat Reader.

December 20, 2004
js-2162

Treasury and IRS Issue Guidance on Deferred Compensation

The Treasury Department and IRS issued Notice 2005-1 today which provides guidance regarding transition rules under section 409A. Section 885 of the recently enacted American Jobs Creation Act of 2004 added section 409A to the Internal Revenue Code, providing new rules for nonqualified deferred compensation plans. Section 409A provides that unless specified requirements are met, all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income, to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.

Under sections 885(e) and 885(f) of the legislation, Congress directed the Secretary of the Treasury to issue guidance regarding the termination and amendment of certain nonqualified deferred compensation arrangements and to define a change in ownership or control for purposes of Section 409A, within 60 days and 90 days respectively of enactment of the legislation. Notice 2005-1 addresses these guidance items. In addition, this guidance defines the arrangements that will be considered deferred compensation subject to the new rules. Finally, this guidance outlines the new reporting and employment tax obligations of employers in connection with section 409A.

IRS Chief Counsel Donald Korb said, "Given the significant changes that section 409A will require for nonqualified deferred compensation plans, we developed this guidance being mindful to avoid establishing rules that could become traps for the unwary."

Section 409A applies to amounts deferred on or after January 1, 2005, subject to several special effective date rules.

A copy of Notice 2005-1 is attached.

REPORTS

- Notice 2005-1

NOT-159640-04

Part IV – Items of General Interest

Guidance Under § 409A of the Internal Revenue Code

Notice 2005-1

I. Purpose and Overview

Section 885 of the recently enacted American Jobs Creation Act of 2004, Pub. Law No. 108-357, 118 Stat. 1418 (the Act), added § 409A to the Internal Revenue Code (Code). Section 409A provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. Section 409A also includes rules applicable to certain trusts or similar arrangements associated with nonqualified deferred compensation, where such arrangements are located outside of the United States or are restricted to the provision of benefits in connection with a decline in the financial health of the sponsor.

As explained more fully below, this notice provides the first part of what is expected to be a series of guidance with respect to the application of § 409A. The Treasury Department and the Internal Revenue Service (Service) intend to incorporate the principles of this notice into additional, more comprehensive guidance in 2005.

Taxpayers should note that although the statute makes a number of fundamental changes, § 409A does not alter or affect the application of any other provision of the Code or common law tax doctrine. Accordingly, deferred compensation not required to be included in income under § 409A may nevertheless be required to be included in income under § 451, the constructive receipt doctrine, the cash equivalency doctrine, § 83, the economic benefit doctrine, the assignment of income doctrine or any other applicable provision of the Code or common law tax doctrine.

A. Definitions and Coverage

This notice generally outlines the scope of coverage of § 409A. The notice first provides definitions of a nonqualified deferred compensation plan, a plan and the deferral of compensation. Guidance is provided on the application of § 409A to welfare plans, plans covered by § 457, stock appreciation rights, and arrangements between partners and partnerships. This notice provides a definition of a substantial risk of forfeiture.

The definition of nonqualified deferred compensation contains an exception for amounts actually or constructively received by the service provider within a short period following the lapse of a substantial risk of forfeiture. The exception is intended to address multi-year compensation arrangements, where the right to the compensation is or may be earned over multiple years but is payable at the end of the earning period. For example, a three-year bonus program requiring the performance of services over three years and entitling the service provider to a payment within a short specified period following the end of the third year generally would not constitute a deferral of compensation. The Treasury Department and the Service are, however, concerned about arrangements purported to involve a substantial risk of forfeiture and fixed payment date where the parties do not intend for the substantial risk of forfeiture or fixed payment date to be enforced. Accordingly, the Treasury Department and the Service are considering a more restrictive rule under which arrangements involving payments in later taxable years structured to coincide with a lapse in a substantial risk of forfeiture would constitute deferrals of compensation subject to § 409A. However, even under a more restrictive rule, the Treasury Department and the Service anticipate that a payment within a short period following a scheduled vesting date and, in specified circumstances, within a short period following an accelerated vesting date, would be permitted under the statutory authority provided to permit accelerated payments that are not inconsistent with the purposes of the statute. Comments are requested with respect to these issues and the extent to which additional guidance is required to prevent arrangements designed to evade application of § 409A.

This notice does not provide generally applicable methods for calculating the amount of deferrals for a given year. However, a rule is provided for calculation of the amount of deferrals before January 1, 2005 for purposes of applying the effective date provisions. The Treasury Department and the Service anticipate issuing guidance in 2005 providing methods for calculating the amount of deferrals for purposes of all deferrals to which § 409A applies, including deferrals preceding the issuance of the guidance. Until such guidance is issued, certain transition relief is provided to address information reporting and withholding requirements. However, nothing in this guidance should be interpreted to exempt amounts actually distributed to the taxpayer in 2005 from inclusion in income or from applicable reporting or withholding requirements.

B. Nonstatutory Stock Options and Stock Appreciation Rights

The definition of nonqualified deferred compensation contains an exception that generally excludes certain nonstatutory stock options from coverage under § 409A. This exception is consistent with the further exception covering transfers of restricted property, as the taxation of transfers of nonstatutory stock options and transfers of restricted property generally both are governed by § 83. Commentators have pointed out that under certain conditions, stock appreciation rights yield economically equivalent results to nonstatutory stock options exercised in a cashless transaction, and have requested that stock appreciation rights be treated similarly. However, the Treasury Department and the Service are concerned that a general exception for stock appreciation rights may be exploited as a method to avoid application of § 409A, particularly in regard to valuation of the underlying stock where the value is not established by and in an established securities market. In many respects, stock appreciation rights are similar to other forms of nonqualified deferred compensation, particularly where the recipient of a stock appreciation right may receive cash. In such cases, the taxation of stock appreciation rights generally is governed by § 451 and the constructive receipt doctrine. See Rev. Rul. 80-300, 1982-2 C.B. 165.

Accordingly, this notice provides limited exceptions from coverage under § 409A for certain stock appreciation rights which do not present potential for abuse or intentional circumvention of the purposes of § 409A. Under this exception, a stock appreciation right will not constitute a deferral of compensation if (1) the value of the stock the excess over which the right provides for payment upon exercise (the SAR exercise price) may never be less than the fair market value of the underlying stock on the date the right is granted, (2) the stock of the service recipient subject to the right is traded on an established securities market, (3) only such traded stock of the service recipient may be delivered in settlement of the right upon exercise, and (4) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. In addition, until further guidance is issued, a payment of stock or cash pursuant to the exercise of a stock appreciation right (or economically equivalent right), or the cancellation of such a right for consideration, where such right is granted pursuant to a program in effect on or before October 3, 2004 will not be treated as a payment of a deferral of compensation subject to the requirements of § 409A if: (1) the SAR exercise price may never be less than the fair market value of the underlying stock on the date the right is granted, and (2) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. The Treasury Department and the Service request comments on the extent to which stock appreciation rights should be excepted from coverage under § 409A, in light of the statutory purpose.

The Treasury Department and the Service also are concerned about the potential for taxpayers to avoid application of § 409A by combining an exception from

coverage under § 409A for nonstatutory stock options or stock appreciation rights with a requirement or right that the stock acquired by the service provider be repurchased by the service recipient. Accordingly, the Treasury Department and the Service are considering a restriction on the exception from coverage under § 409A for nonstatutory stock options or stock appreciation rights, to options or rights that are not accompanied by an arrangement or agreement under which the service recipient has an obligation or right to repurchase the acquired shares (including repurchases for an amount other than fair market value). In this context, the Treasury Department and the Service also request comments on appropriate techniques for valuation of stock subject to options or stock appreciation rights where the value of such stock is not established by and in an established securities market, in order to ensure that such valuation reflects the actual fair market value of the stock.

To the extent the additional guidance adopts a position on an issue addressed in this notice with respect to stock options or stock appreciation rights that is less favorable to taxpayers than provided in this notice, the Treasury Department and the Service anticipate that such a position will be applied only on a prospective basis with adequate transition relief to allow modification of plans to comply on a prospective basis.

C. Change in Control Events

This notice next addresses what constitutes a change in ownership or effective control of a corporation, or in the ownership of a substantial portion of the assets of a corporation (Change in Control Event) for purposes of § 409A. Section 885(e) of the Act requires that within 90 days of the enactment of the legislation, the Treasury Department and the Service issue guidance on what constitutes a Change in Control Event. Section 409A provides that, to the extent provided by the Treasury Department and the Service in guidance, a nonqualified deferred compensation plan may permit amounts deferred under the plan to be distributed upon a Change in Control Event.

D. Acceleration of Payments

Except under circumstances specified by the Treasury Department and the Service in guidance, a nonqualified deferred compensation plan may not permit the acceleration of payments under the plan. This notice provides circumstances under which payments under the plan may be accelerated, such as to meet the requirements of a domestic relations order or conflict of interest divestiture requirements. Comments are requested as to other circumstances under which a plan should be allowed to accelerate payments under the plan.

E. Effective Dates and Transition Relief

The notice provides guidance on the effective date provisions and transition relief. Section 409A generally is effective with respect to amounts deferred after December 31, 2004. Section 409A also is effective with respect to amounts deferred in taxable years beginning before January 1, 2005 if the plan under which the deferral is made is materially modified after October 3, 2004. This notice addresses what amounts will be considered deferred after December 31, 2004, generally providing that an amount will be treated as deferred on or before December 31, 2004 only if the service recipient has a binding legal obligation to pay an amount in a future taxable year and the service provider's right to the amount is earned and vested as of December 31, 2004. Methods of calculating amounts treated as deferred on or before December 31, 2004 are provided. This notice also addresses when a plan under which a deferral is made will be considered materially modified after October 3, 2004.

This notice addresses the requirements of § 885(f) of the Act, which provides that within 60 days of the enactment of the legislation, the Treasury Department and the Service must issue guidance providing that for a limited period and under certain conditions, a nonqualified deferred compensation plan may be amended without violating certain provisions of § 409A to (i) allow a participant to terminate participation in the plan, or cancel an outstanding deferral election with respect to amounts deferred after December 31, 2004, or (ii) conform the plan to the provisions of § 409A with respect to amounts deferred after December 31, 2004. This notice provides certain relief addressing the application of the initial deferral election requirements to compensation attributable, in whole or in part, to the performance of services in the years 2004 or 2005. This includes, for example, provisions addressing the deferral of bonuses, including bonuses for services performed in 2004.

F. Application of Information Reporting and Wage Withholding Requirements

This notice next addresses certain information reporting and wage withholding requirements imposed by § 885(b) of the Act with respect to deferred amounts. For information reporting purposes, the Act amends §§ 6041 and 6051 to require that all deferrals for the year under a nonqualified deferred compensation plan be separately reported on a Form 1099 (Miscellaneous Income) or a Form W-2 (Wage and Tax Statement). For wage withholding purposes, the Act amends § 3401(a) to provide that the term "wages" includes any amount includible in gross income of an employee under § 409A. Finally, for purposes of reporting nonemployee compensation, the Act further amends § 6041 to require that amounts includible in gross income under § 409A that are not treated as wages under § 3401(a) must be reported as gross income. This notice does not provide methods for calculating the amount of deferrals for the year or the amounts includible in gross income under § 409A and in wages under § 3401(a).

Consequently, interim guidance is provided with respect to an employer's withholding and reporting obligations where the employer furnishes an expedited Form W-2 prior to the issuance of additional guidance providing such methods.

II. Reliance on Transition Guidance; Good Faith, Reasonable Interpretation

This notice provides rules governing the application of § 409A. The Treasury Department and the Service anticipate issuing additional guidance that incorporates this notice. To the extent the additional guidance adopts a position on an issue addressed in this notice that is less favorable to taxpayers than provided in this notice, the Treasury Department and the Service anticipate that such a position will be applied only on a prospective basis with adequate transition relief to allow modification of plans to comply on a prospective basis.

This notice does not provide comprehensive guidance with respect to the application of § 409A. Until additional guidance is issued, to comply with the requirements of § 409A with respect to issues not addressed in this notice, taxpayers should base their positions upon a good faith, reasonable interpretation of the statute and its purpose, which includes consideration of the legislative history. Whether a taxpayer position constitutes a good faith, reasonable interpretation of the statutory language generally will be determined based upon all of the relevant facts and circumstances, including whether the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved unclear issues in the taxpayer's favor. In addition, certain provisions of § 409A provide definitive rules, but allow the Treasury Department and the Service to issue guidance providing exceptions to such rules. For example, § 409A(a)(3) provides that the Treasury Department and the Service may issue guidance providing an exception to the general prohibition against the acceleration of the time or schedule of any payment under a nonqualified deferred compensation plan. A taxpayer position based on an expected exception that the taxpayer speculates that the Treasury Department and the Service will adopt in future guidance is not a good faith, reasonable interpretation of the statutory language. In addition, as discussed above, the Treasury Department and the Service intend to issue guidance in 2005 providing methods for calculating the amount of deferrals for a year for purposes of all amounts of deferrals to which § 409A applies, including deferrals predating the issuance of the anticipated guidance. Accordingly, taxpayers will not be able to rely upon methods of calculation that differ from the methods provided in the 2005 guidance.

III. Request for Comments on Anticipated Guidance

A. Request for Comments

The Treasury Department and the Service request comments on all aspects of the application of § 409A, including but not limited to the topics addressed in this

notice. The Treasury Department and the Service specifically request comments with respect to the following:

(1) The application of § 409A to severance plans, including whether to exclude any specific types of severance plans or arrangements (see Q&A 19).

(2) Funding arrangements for nonqualified deferred compensation that involve foreign trusts or similar arrangements, and identification of arrangements that will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors for purposes of the potential exemption from the provisions of § 409A(b) that the Treasury Department and the Service are authorized to provide under § 409A(e)(3).

(3) The application of § 409A to arrangements involving partners and partnerships. Comments are specifically requested with respect to the applicability of § 409A to arrangements subject to § 736, and whether there should be a distinction between payments subject to § 736(a) and (b) and the coordination of the timing rules of § 1.736-1(b)(5) with the rules of § 409A for nonqualified deferred compensation plans. Comments are also specifically requested on whether there should be special rules in applying § 409A in the case of a putative allocation and distribution which is recast, under § 707(a)(2)(A), as a payment to a nonpartner under § 707(a)(1).

(4) Potential additional exclusions from coverage under § 409A with respect to contractual arrangements between businesses (see Q&A 8).

(5) Situations where the acceleration of benefits should be permitted under § 409A(a)(3) (see Q&A 15), particularly in light of the legislative history regarding accelerated payments required for reasons beyond the control of the participant.

All materials submitted will be available for public inspection and copying.

B. Submission of Comments

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2005-1), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington DC 20224, Attn: CC:PA:LPD:RU (Notice 2005-1), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2005-1) in the subject line.

IV. Guidance

A. Definitions and Coverage

Q-1 What does § 409A provide, in general?

A-1 Section 409A provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied. Section 409A also includes rules applicable to certain trusts or similar arrangements associated with nonqualified deferred compensation, where such arrangements are located outside of the United States or are restricted to the provision of benefits in connection with a decline in the financial health of the sponsor.

Q-2 What are the federal income tax consequences of a failure to satisfy the requirements of § 409A?

A-2 Generally, if at any time during a taxable year a nonqualified deferred compensation plan fails to meet the requirements of § 409A, or is not operated in accordance with those requirements, all amounts deferred under the plan for the taxable year and all preceding taxable years, by any participant with respect to whom the failure relates, are includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. If a deferred amount is required to be included in income under § 409A, the amount also is subject to interest and an additional income tax. The interest imposed is equal to the interest at the underpayment rate plus one percentage point, imposed on the underpayments that would have occurred had the compensation been includible in income for the taxable year when first deferred, or if later, when not subject to a substantial risk of forfeiture. The additional income tax is equal to 20 percent of the compensation required to be included in gross income.

Q-3 What is a nonqualified deferred compensation plan?

A-3 (a) In general. Except as otherwise provided in this A-3, the term nonqualified deferred compensation plan means any plan (within the meaning of Q&A 9) that provides for the deferral of compensation (within the meaning of Q&A 4). The application of § 409A is not limited to arrangements between an employer and an employee. For example, § 409A may apply to arrangements between a service recipient and an independent contractor, or arrangements between a partner and a partnership (see Q&A 7 and Q&A 8).

(b) Qualified employer plans. The term nonqualified deferred compensation plan does not include (i) any plan, contract, pension, account, or trust described in

subparagraph (A) or (B) of § 219(g)(5) (without regard to subparagraph (A)(iii)), (ii) any eligible deferred compensation plan (within the meaning of § 457(b)), and (iii) any plan described in § 415(m). Accordingly, the term nonqualified deferred compensation plan does not include a qualified retirement plan, tax-deferred annuity, simplified employee pension, SIMPLE or § 501(c)(18) trust.

(c) Certain welfare benefits. The term nonqualified deferred compensation plan does not include any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. For these purposes, the term disability pay has the same meaning as provided in § 31.3121(v)(2)-1(b)(4)(iv)(C) of the Employment Tax Regulations, and the term death benefit plan refers to a plan providing death benefits as defined in § 31.3121(v)(2)-1(b)(4)(iv)(C). The term nonqualified deferred compensation plan also does not include any Archer Medical Savings Account as described in § 220, any Health Savings Account as described in § 223, or any other medical reimbursement arrangement, including a health reimbursement arrangement, that satisfies the requirements of § 105 and § 106.

Q-4 What constitutes a deferral of compensation?

A-4 (a) Deferral of compensation defined. A plan provides for the deferral of compensation only if, under the terms of the plan and the relevant facts and circumstances, the service provider has a legally binding right during a taxable year to compensation that has not been actually or constructively received and included in gross income, and that, pursuant to the terms of the plan, is payable to (or on behalf of) the service provider in a later year. A service provider does not have a legally binding right to compensation if that compensation may be unilaterally reduced or eliminated by the service recipient or other person after the services creating the right to the compensation have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the compensation is available or exercisable only upon a condition that is unlikely to occur, or the discretion to reduce or eliminate the compensation is unlikely to be exercised, a service provider will be considered to have a legally binding right to the compensation. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of an objective provision creating a substantial risk of forfeiture (within the meaning of Q&A 10). Similarly, a service provider does not fail to have a legally binding right to compensation merely because the amount of compensation is determined under a formula that provides for benefits to be offset by benefits provided under a plan that is qualified under § 401(a), or because benefits are reduced due to actual or notional investment losses, or in a final average pay plan, subsequent decreases in compensation.

(b) Compensation payable pursuant to the service recipient's customary payment timing arrangement. A deferral of compensation does not occur solely

because compensation is paid after the last day of the service provider's taxable year pursuant to the timing arrangement under which the service recipient normally compensates service providers for services performed during a payroll period described in § 3401(b), or with respect to a non-employee service provider, a period not longer than the payroll period described in § 3401(b).

(c) Short-term deferrals. Until additional guidance is issued, a deferral of compensation does not occur if, absent an election to otherwise defer the payment to a later period, at all times the terms of the plan require payment by, and an amount is actually or constructively received by the service provider by, the later of (i) the date that is 2 ½ months from the end of the service provider's first taxable year in which the amount is no longer subject to a substantial risk of forfeiture (as defined in Q&A 10) or (ii) the date that is 2 ½ months from the end of the service recipient's first taxable year in which the amount is no longer subject to a substantial risk of forfeiture (as defined in Q&A 10). For these purposes, an amount that is never subject to a substantial risk of forfeiture is considered to be no longer subject to a substantial risk of forfeiture on the date the service provider has a legally binding right to the amount. For example, an employer with a calendar year taxable year who on November 1, 2006 awards a bonus so that the employee is considered to have a binding legally binding right to the payment as of November 1, 2006, will not be considered to have provided for a deferral of compensation if, in accordance with the terms of the bonus plan, the amount is paid or made available to the employee on or before March 15, 2007. An employer with a September 1 to August 31 taxable year who on November 1, 2006 awards a bonus so that the employee is considered to have a legally binding right to the payment as of November 1, 2006, will not be considered to have provided for a deferral of compensation if, in accordance with the terms of the bonus plan, the amount is paid or made available to the employee on or before November 15, 2007. Notwithstanding the foregoing, if an election is provided to the service provider with respect to the taxable year in which payment of the compensation will occur, and the service provider elects a taxable year later than the taxable year in which he or she obtained a legally binding right to the payment, the arrangement constitutes a deferral of compensation subject to § 409A, including the deferral election timing rules of § 409A(a)(4). In addition, the arrangement continues to be subject to applicable U.S. Federal tax principles which may require immediate income inclusion.

(d) Stock options, stock appreciation rights, and other equity-based compensation. (i) Except as provided in paragraphs (ii), (iii) and (iv), the grant of a stock option, stock appreciation right or other equity-based compensation provides for a deferral of compensation subject to § 409A. Stock appreciation rights generally will be covered by § 409A; however, stock appreciation rights may be structured to comply with the provisions of § 409A. For example, the terms of a stock appreciation right with a fixed payment date generally will comply with the provisions of § 409A.

(ii) Nonstatutory stock options. An option to purchase stock of the service recipient, other than an incentive stock option described in § 422 or an option granted under an employee stock purchase plan described in § 423, does not provide for a deferral of compensation if: (1) the amount required to purchase stock under the option (the exercise price) may never be less than the fair market value of the underlying stock on the date the option is granted, (2) the receipt, transfer or exercise of the option is subject to taxation under § 83, and (3) the option does not include any feature for the deferral of compensation other than the deferral of recognition of income until the later of exercise or disposition of the option under § 1.83-7. For purposes of the preceding sentence, the right to receive substantially nonvested stock (as defined in § 1.83-3(b)) upon the exercise of a stock option does not constitute a feature for the deferral of compensation. If under the terms of the option, the amount required to purchase the stock is or could become less than the fair market value of the stock on the date of grant, the grant of the stock option may provide for the deferral of compensation within the meaning of this A-4. For purposes of determining the fair market value of the stock at the date of grant, any reasonable valuation method may be used. Such methods include, for example, the valuation method described in § 20.2031-2 of the Estate Tax Regulations. To the extent an arrangement grants the recipient a right other than to purchase stock at a defined price and such additional rights allow for the deferral of compensation (for example, tandem arrangements involving options and stock appreciation rights), the entire arrangement provides for the deferral of compensation. If the requirements of § 1.424-1 would be met if the nonstatutory option were a statutory option, the substitution of a new option pursuant to a corporate transaction for an outstanding option or the assumption of an outstanding option will not be treated as the grant of a new option or a change in the form of payment for purposes of § 409A. For purposes of the preceding sentence, the requirement of § 1.424-1(a)(5)(iii) will be deemed to be satisfied if the ratio of the option price to the fair market value of the shares subject to the option immediately after the substitution or assumption is not greater than the ratio of the option price to the fair market value of the shares subject to the option immediately before the substitution or assumption.

(iii) Statutory stock options. The grant of an incentive stock option as described in § 422, or the grant of an option under an employee stock purchase plan described in § 423 (including the grant of an option with an exercise price discounted in accordance with § 423(b)(6) and the accompanying regulations), does not constitute a deferral of compensation.

(iv) Certain stock appreciation rights. A stock appreciation right with respect to stock of the service recipient does not provide for a deferral of compensation if: (1) the value of the stock the excess over which the right provides for payment upon exercise (the SAR exercise price) may never be less than the fair market value of the underlying stock on the date the right is granted, (2) the stock of the service recipient subject to the right is traded on an established securities

market, (3) only such traded stock of the service recipient may be delivered in settlement of the right upon exercise, and (4) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right. For purposes of the preceding sentence, the right to receive substantially nonvested stock (as defined in § 1.83-3(b)) upon the exercise of a stock appreciation right does not constitute a feature for the deferral of compensation. If, under the terms of the stock appreciation right, the SAR exercise price is or could become less than the fair market value of the underlying stock on the date of grant, the right may be settled upon exercise in a medium other than the traded stock of the service recipient, or there is an agreement or arrangement under which the service recipient will purchase the stock delivered in settlement of the right upon exercise, then the grant of the stock appreciation right may provide for the deferral of compensation within the meaning of this A-4. In addition, until further guidance is issued, a payment of stock or cash pursuant to the exercise of a stock appreciation right (or economically equivalent right), or the cancellation of such right for consideration, where such right is granted pursuant to a program in effect on or before October 3, 2004 will not be treated as a payment of a deferral of compensation subject to the requirements of § 409A if: (1) the SAR exercise price may never be less than the fair market value of the underlying stock on the date the right is granted, and (2) the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right.

(e) Restricted property. If a service provider receives property from, or pursuant to, a plan maintained by a service recipient, there is no deferral of compensation merely because the value of the property is not includible in income (under § 83) in the year of receipt by reason of the property being nontransferable and subject to a substantial risk of forfeiture, or is includible in income (under § 83) solely due to a valid election under § 83(b). However, a plan under which a service provider obtains a legally binding right to receive property (whether or not the property is restricted property) in a future year may provide for the deferral of compensation and, accordingly, may constitute a nonqualified deferred compensation plan. For purposes of this paragraph, a transfer of property includes the transfer of a beneficial interest in a trust or annuity plan, or a transfer to or from a trust or under an annuity plan, to the extent such a transfer is subject to § 83, § 402(b) or § 403(c).

(f) Earnings. References to the deferral of compensation include references to income (whether actual or notional) attributable to such compensation or such income.

Q-5 Who is the service recipient?

A-5 For purposes of § 409A, the service recipient refers to the person for whom the services are performed, and all persons with whom such person would be considered a single employer under § 414(b) (employees of controlled group of

corporations), and all persons with whom such person would be considered a single employer under § 414(c) (employees of partnerships, proprietorships, etc., which are under common control).

Q-6 How Does § 409A Apply to Arrangements Covered by § 457?

A-6 The rules of § 409A apply to nonqualified deferred compensation plans under § 457(f) in addition to any requirements already applicable to such plans under § 457(f). Eligible plans under § 457(b) are not subject to the requirements of § 409A. However, nonelective deferred compensation of nonemployees described in § 457(e)(12) and grandfathered plans under prior § 457 transition rules generally are subject to § 409A. Pending additional guidance, length of service awards to bona fide volunteers under § 457(e)(11)(A)(ii) are not subject to § 409A. Further, pending additional guidance, State and local government and tax exempt entities may rely on the definitions of bona fide vacation leave, sick leave, compensatory time, disability pay, and death benefit plans for purposes of § 457(f) as applicable for purposes of applying § 409A to nonqualified deferred compensation plans under § 457(f). However, State and local government and tax exempt entities may not rely upon the definition of a deferral of compensation for purposes of § 409A as applicable for purposes of the § 457(f) definition of a deferral of compensation. For example, for purposes of § 457(f), a deferral of compensation includes stock options (whether nonstatutory or under § 422 or § 423) and arrangements in which an employee or independent contractor of a State or local government or tax-exempt entity earns the right to future payments for services, even if those amounts are paid immediately upon vesting.

Q-7 How Does § 409A Apply to Arrangements Between a Partnership and a Partner of the Partnership?

A-7 The application of § 409A is not limited to arrangements between an employer and employee. Accordingly, § 409A may apply to arrangements between a partner and a partnership which provides for the deferral of compensation under a nonqualified deferred compensation plan. However, until additional guidance is issued, for purposes of § 409A taxpayers may treat the issuance of a partnership interest (including a profits interest), or an option to purchase a partnership interest, granted in connection with the performance of services under the same principles that govern the issuance of stock (see Q&A 4). Specifically, until additional guidance is issued, for purposes of § 409A, taxpayers may treat an issuance of a profits interest in connection with the performance of services that is properly treated under applicable guidance as not resulting in inclusion of income by the service provider at the time of issuance, as also not resulting in the deferral of compensation. Similarly, until additional guidance is issued, for purposes of § 409A, taxpayers may treat an issuance of a capital interest in connection with the performance of services in the same manner as an issuance of stock. The § 409A rules governing other stock-based

compensation may be applied by analogy to grants of equity-based compensation where the compensation is determined by reference to partnership equity. In addition, until further guidance is issued, taxpayers may treat arrangements providing for payments subject to § 736 as not being subject to § 409A, except that an arrangement providing for payments which qualify as payments to a partner under § 1402(a)(10) are subject to § 409A. Finally, § 409A may apply to payments covered by § 707(a)(1) (partner not acting in capacity as partner), if such payments otherwise would constitute a deferral of compensation under a nonqualified deferred compensation plan.

Q-8 To Which Service Providers Does § 409A Apply?

A-8 Until additional guidance is issued, a service provider for purposes of § 409A includes (i) an individual, (ii) a personal service corporation (as defined in § 269A(b)(1)), or a noncorporate entity that would be a personal service corporation if it were a corporation, or (iii) a qualified personal service corporation (as defined in § 448(d)(2)), or a noncorporate entity that would be a qualified personal service corporation if it were a corporation. Section 409A does not apply to arrangements between taxpayers all of whom use the accrual method of accounting. Section 409A also does not apply to arrangements between a service provider and a service recipient if (a) the service provider is actively engaged in the trade or business of providing substantial services, other than (I) as an employee or (II) as a director of a corporation; and (b) the service provider provides such services to two or more service recipients to which the service provider is not related and that are not related to one another. For purposes of the preceding sentence, a person is related to another person if (i) the persons bear a relationship to each other that is specified in § 267(b) or 707(b)(1), subject to the modifications that the language "20 percent" is used instead of "50 percent" each place it appears in §§ 267(b) and 707(b)(1), and § 267(c)(4) is applied as if the family of an individual includes the spouse of any member of the family; or (ii) the persons are engaged in trades or businesses under common control (within the meaning of § 52(a) and (b)). The Treasury Department and the Service intend to issue additional guidance addressing types of service providers not subject to § 409A.

Q-9 What constitutes a plan?

A-9 A plan includes any agreement, method or arrangement, including an agreement, method or arrangement that applies to one person or individual. A plan may be adopted unilaterally by the service recipient or may be negotiated among or agreed to by the service recipient and one or more service providers or service provider representatives. An agreement, method or arrangement may constitute a plan regardless of whether it is an employee benefit plan under § 3(3) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. 1002(3)). Unless otherwise specified in this notice, the requirements of § 409A are applied as if (a) a separate plan or plans is

maintained for each service provider, and (b) all compensation deferred with respect to a particular service provider under an account balance plan (as defined in § 31.3121(v)(2)-1(c)(1)(ii)(A)) is treated as deferred under a single plan, all compensation deferred under a nonaccount balance plan (as defined in § 31.3121(v)(2)-1(c)(2)(i)) is treated as deferred under a separate single plan, and all compensation deferred under a plan that is neither an account balance plan nor a nonaccount balance plan (for example, discounted stock options, stock appreciation rights or other equity-based compensation described in § 31.3121(v)(2)-1(b)(4)(ii)) is treated as deferred under a separate single plan. For these purposes a severance plan is either an account balance plan or a nonaccount balance plan, determined in accordance with the rules of this A-9.

Q-10 When is an amount subject to a substantial risk of forfeiture?

A-10 (a) Definition. Compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial. For purposes of this A-10, a condition related to a purpose of the compensation must relate to the service provider's performance for the service recipient or the service recipient's business activities or organizational goals (for example, the attainment of a prescribed level of earnings, equity value or a liquidity event). Any addition of a substantial risk of forfeiture after the beginning of the service period to which the compensation relates, or any extension of a period during which compensation is subject to a substantial risk of forfeiture, in either case whether elected by the service provider, service recipient or other person (or by agreement of two or more of such persons), is disregarded for purposes of determining whether such compensation is subject to a substantial risk of forfeiture. An amount is not subject to a substantial risk of forfeiture merely because the right to the amount is conditioned, directly or indirectly, upon the refraining from performance of services. For purposes of § 409A, an amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the amount subject to a substantial risk of forfeiture (ignoring earnings) is materially greater than the amount the recipient otherwise could have elected to receive. For example, a salary deferral generally may not be made subject to a substantial risk of forfeiture. However, where an election is granted to receive a materially greater bonus amount in a future year rather than a materially lesser bonus amount in an earlier year, the materially greater bonus may be made subject to a substantial risk of forfeiture.

(b) Enforcement of forfeiture condition. In determining whether the possibility of forfeiture is substantial in the case of rights to compensation granted to a service provider by the service recipient corporation, where the service provider owns a significant amount of the total combined voting power or value of all classes of stock of the service recipient corporation or of its parent corporation, there will be

taken into account (i) the service provider's relationship to other stockholders and the extent of their control, potential control and possible loss of control of the corporation, (ii) the position of the service provider in the corporation and the extent to which the service provider is subordinate to other service providers, (iii) the service provider's relationship to the officers and directors of the corporation, (iv) the person or persons who must approve the service provider's discharge, and (v) past actions of the service recipient in enforcing the restrictions. For example, if a service provider would be considered as having deferred compensation subject to a substantial risk of forfeiture, but for the fact that the service provider owns 20 percent of the single class of stock in the transferor corporation, and if the remaining 80 percent of the class of stock is owned by an unrelated individual (or members of such an individual's family) so that the possibility of the corporation enforcing a restriction on such rights is substantial, then such rights are subject to a substantial risk of forfeiture. On the other hand, if 4 percent of the voting power of all the stock of a corporation is owned by the president of such corporation and the remaining stock is so diversely held by the public that the president, in effect, controls the corporation, then the possibility of the corporation enforcing a restriction on the right to deferred compensation of the president is not substantial, and such rights are not subject to a substantial risk of forfeiture.

B. Change in Control Events

Q-11 Under what circumstances will payments be permitted upon a change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation?

A-11 (a) In general. Pursuant to § 409A(a)(2)(A)(v), a plan may permit a payment upon the occurrence of a change in the ownership of the corporation (as defined in Q&A 12), a change in effective control of the corporation (as defined in Q&A 13), or a change in the ownership of a substantial portion of the assets of the corporation (as defined in Q&A 14) (collectively referred to as a Change in Control Event). To qualify as a Change in Control Event, the occurrence of the event must be objectively determinable and any requirement that any other person, such as a plan administrator or board of directors compensation committee, certify the occurrence of a Change in Control Event must be strictly ministerial and not involve any discretionary authority. For purposes of this paragraph (a), a payment also will be treated as occurring upon a Change in Control Event if the right to the payment arises due to the corporation's exercise of discretion under the terms of the plan to terminate the plan and distribute the compensation deferred thereunder within 12 months of the Change in Control Event. The plan may provide for a payment on any Change in Control Event, and need not provide for a payment on all such events, provided that each event upon which a payment is provided qualifies as a Change in Control Event.

(b) Identification of relevant corporation(s). To constitute a Change in Control Event as to the plan participant, the Change in Control Event must relate to (i) the corporation for whom the participant is performing services at the time of the Change in Control Event, (ii) the corporation that is liable for the payment of the deferred compensation (or all corporations liable for the payment if more than one corporation is liable), or (iii) a corporation that is a majority shareholder of a corporation identified in (i) or (ii), or any corporation in a chain of corporations in which each corporation is a majority shareholder of another corporation in the chain, ending in a corporation identified in (i) or (ii). For example, assume Corporation A is a majority shareholder of Corporation B, which is a majority shareholder of Corporation C. A change in ownership of Corporation B will constitute a Change in Control Event to plan participants performing services for Corporation B or Corporation C, and to plan participants for which Corporation B or Corporation C is solely liable for payments under the plan (for example, former employees), but will not constitute a Change in Control Event as to Corporation A or any other corporation of which Corporation A is a majority shareholder. Notwithstanding the foregoing, a sale of Corporation B may constitute an independent Change in Control Event for Corporation A, Corporation B and Corporation C if the sale constitutes a change in the ownership of a substantial portion of Corporation A's assets (see Q&A 14). For purposes of this paragraph, a majority shareholder is a shareholder owning more than 50% of the total fair market value and total voting power of such corporation.

(c) Attribution of stock ownership. For purposes of this A-11, Q&A 12, Q&A 13 and Q&A 14, § 318(a) applies to determine stock ownership. Stock underlying a vested option is considered owned by the individual who holds the vested option (and the stock underlying an unvested option is not considered owned by the individual who holds the unvested option). For purposes of the preceding sentence, however, if a vested option is exercisable for stock that is not substantially vested (as defined by §§ 1.83-3(b) and (j)), the stock underlying the option is not treated as owned by the individual who holds the option. In addition, mutual and cooperative corporations are treated as having stock for purposes of this paragraph (c).

Q-12 What is a change in the ownership of a corporation?

A-12 (a) Change in the ownership of a corporation. For purposes of § 409A, a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group (as defined in paragraph (b)), acquires ownership of stock of the corporation that, together with stock held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the stock of such corporation. However, if any one person or more than one person acting as a group, is considered to own more than 50 percent of the total fair market value or total voting power of the stock of a corporation, the acquisition of additional stock by the same person or persons is not considered to cause a change in the ownership of the corporation (or to

cause a change in the effective control of the corporation (within the meaning of Q&A 13)). An increase in the percentage of stock owned by any one person, or persons acting as a group, as a result of a transaction in which the corporation acquires its stock in exchange for property will be treated as an acquisition of stock for purposes of this section. This A-12 applies only when there is a transfer of stock of a corporation (or issuance of stock of a corporation) and stock in such corporation remains outstanding after the transaction (see Q&A 14 for rules regarding the transfer of assets of a corporation).

(b) Persons acting as a group. For purposes of paragraph (a), persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation. See § 1.280G-1, Q&A 27(d), Example 4.

(c) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

Q-13 What is a change in the effective control of a corporation?

A-13 (a) Change in the effective control of the corporation. For purposes of § 409A, notwithstanding that a corporation has not undergone a change in ownership under Q&A 12, a change in the effective control of a corporation occurs on the date that either –

(i) Any one person, or more than one person acting as a group (as determined under paragraph (iv)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 35 percent or more of the total voting power of the stock of such corporation; or

(ii) a majority of members of the corporation's board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation's board of directors prior to the date of the appointment or election, provided that for purposes of this paragraph (ii) the term corporation refers solely to the relevant corporation identified in Q&A 11, paragraph (b) for which no other corporation is a majority shareholder for purposes of that paragraph (for example, if Corporation A is a publicly held corporation with no majority shareholder, and Corporation A is the

majority shareholder of Corporation B, which is the majority shareholder of Corporation C, the term corporation for purposes of this paragraph (ii) would refer solely to Corporation A).

In the absence of an event described in paragraph (i) or (ii), a change in the effective control of a corporation will not have occurred.

(b) Multiple Change in Control Events. A change in effective control also may occur in any transaction in which either of the two corporations involved in the transaction has a Change in Control Event under A-12 or A-14. Thus, for example, assume Corporation P transfers more than 40 percent of the total gross fair market value of its assets to Corporation O in exchange for 35 percent of O's stock. P has undergone a change in ownership of a substantial portion of its assets under A-14 and O has a change in effective control under this A-13.

(c) Acquisition of additional control. If any one person, or more than one person acting as a group, is considered to effectively control a corporation (within the meaning of this A-13), the acquisition of additional control of the corporation by the same person or persons is not considered to cause a change in the effective control of the corporation (or to cause a change in the ownership of the corporation within the meaning of Q&A 12).

(d) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only with respect to the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(e) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

Q-14 What is a change in the ownership of a substantial portion of a corporation's assets?

A-14 (a) Change in the ownership of a substantial portion of a corporation's assets. For purposes of § 409A, a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group (as determined in paragraph (c)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a

total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(b) Transfers to a related person. There is no Change in Control Event under this A-14 when there is a transfer to an entity that is controlled by the shareholders of the transferring corporation immediately after the transfer, as provided in this paragraph (b). A transfer of assets by a corporation is not treated as a change in the ownership of such assets if the assets are transferred to –

(i) A shareholder of the corporation (immediately before the asset transfer) in exchange for or with respect to its stock;

(ii) An entity, 50 percent or more of the total value or voting power of which is owned, directly or indirectly, by the corporation;

(iii) A person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of the corporation; or

(iv) An entity, at least 50 percent of the total value or voting power of which is owned, directly or indirectly, by a person described in paragraph (iii).

For purposes of this paragraph (b) and except as otherwise provided, a person's status is determined immediately after the transfer of the assets. For example, a transfer to a corporation in which the transferor corporation has no ownership interest before the transaction, but which is a majority-owned subsidiary of the transferor corporation after the transaction is not treated as a change in the ownership of the assets of the transferor corporation.

(c) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase assets of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of assets, or similar business transaction with the corporation. If a person, including an entity shareholder, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only to the extent of the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(d) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

C. Acceleration of Payments

Q-15 Under what conditions may a plan permit the acceleration of the time or schedule of any payment under the plan?

A-15 (a) In general. Except as provided in paragraphs (b) through (f) below, a plan may not permit the acceleration of the time or schedule of any payment under the plan. It is not an acceleration of the time or schedule of payment of a deferral of compensation if a service recipient waives or accelerates the satisfaction of a condition constituting a substantial risk of forfeiture applicable to such deferral of compensation, provided that the requirements of § 409A are otherwise satisfied with respect to such deferral of compensation. For example, if a nonqualified deferred compensation plan provides for a lump sum payment of the vested benefit upon separation from service, and the benefit vests under the plan only after 10 years of service, it is not a violation of the requirements of § 409A if the service recipient reduces the vesting requirement to 5 years of service, even if a service provider becomes vested as a result and qualifies for a payment in connection with a separation from service.

(b) Domestic relations order. A plan may permit such acceleration of the time or schedule of a payment under the plan to an individual other than the plan participant as may be necessary to fulfill a domestic relations order (as defined in § 414(p)(1)(B)).

(c) Conflicts of interest. A plan may permit such acceleration of the time or schedule of a payment under the plan as may be necessary to comply with a certificate of divestiture (as defined in § 1043(b)(2)).

(d) Section 457 plans. A plan subject to § 457(f) may permit an acceleration of the time or schedule of a payment to a participant to pay income taxes due upon a vesting event, provided that the amount of such payment is not more than an amount equal to the income tax withholding that would have been remitted by the employer if there had been a payment of wages equal to the income includible by the participant under § 457(f) at the time of the vesting.

(e) De minimis and specified amounts. A plan that does not otherwise provide for de minimis cashout payments may be amended to permit the acceleration of the time or schedule of a payment to a participant under the plan, provided that (i) the payment accompanies the termination of the entirety of the participant's interest in the plan; (ii) the payment is made on or before the later of (A) December 31 of the calendar year in which occurs the participant's separation from service from the service recipient or (B) the date 2 ½ months after the participant's separation from service from the service recipient; and (iii) the

payment is not greater than $10,000. Such an amendment may be made with respect to previously deferred amounts under the plan as well as amounts to be deferred in the future. In addition, a nonqualified deferred compensation plan that otherwise complies with § 409A may be amended with regard to future deferrals to provide that, if a participant's interest under the plan has a value below an amount specified by the plan at the time that amounts are payable under the plan, then the participant's entire interest under the plan shall be distributed as a lump sum payment.

(f) Payment of employment taxes. A plan may permit the acceleration of the time or schedule of a payment to pay the Federal Insurance Contributions Act (FICA) tax imposed under § 3101 and § 3121(v)(2) on compensation deferred under the plan (the FICA Amount). Additionally, a plan may permit the acceleration of the time or schedule of a payment to pay the income tax at source on wages imposed under § 3401 on the FICA Amount, and to pay the additional income tax at source on wages attributable to the pyramiding § 3401 wages and taxes. However, the total payment under this acceleration provision must not exceed the aggregate of the FICA Amount, and the income tax withholding related to such FICA amount.

(g) Definition of plan. For purposes of this A-15, the term plan has the meaning provided in Q&A 9, except that the provisions treating all account balance plans under which compensation is deferred as a single plan, all nonaccount balance plans under which compensation is deferred as a separate single plan, and all other nonqualified deferred compensation plans as a separate single plan, does not apply.

D. Effective Dates and Transition Guidance

Q-16 When does section 409A become effective?

A-16 (a) In general. Except as provided in Q&As 19 through 23, § 409A is effective with respect to (i) amounts deferred in taxable years beginning after December 31, 2004; and (ii) amounts deferred in taxable years beginning before January 1, 2005 if the plan under which the deferral is made is materially modified after October 3, 2004. Section 409A is effective with respect to earnings on amounts deferred only to the extent that § 409A is effective with respect to the amounts deferred. Accordingly, § 409A is not effective with respect to earnings on amounts deferred before January 1, 2005 unless § 409A is effective with respect to the amounts deferred.

(b) Date of deferral for effective date purposes. For purposes of determining whether § 409A is effective with respect to an amount, the amount is considered deferred before January 1, 2005 if (i) the service provider has a legally binding right to be paid the amount and (ii) the right to the amount is earned and vested. For purposes of this A-16, a right to an amount is earned and vested only if the

amount is not subject to either a substantial risk of forfeiture (as defined in § 1.83-3(c)) or a requirement to perform further services. Accordingly, amounts to which the service provider does not have a legally binding right before January 1, 2005 (for example because the service recipient retains discretion to reduce the amount), will not be considered deferred before January 1, 2005. In addition, amounts to which the service provider has a legaly binding right before January 1, 2005, but the right to which is subject to a substantial risk of forfeiture or a requirement to perform further services after December 31, 2004 are not considered deferred before January 1, 2005 for purposes of the effective date. Notwithstanding the foregoing, an amount to which the service provider has a legally binding right before January 1, 2005, but for which the service provider must continue performing services to retain the right only through the completion of the payroll period (as defined in Q&A 4) which includes December 31, 2004, shall not be treated as subject to a requirement to perform further services (or a substantial risk of forfeiture) for purposes of the effective date.

Q-17 For purposes of the effective date, how is the amount of compensation deferred under a nonqualified deferred compensation plan before January 1, 2005 determined?

A-17 (a) Nonaccount balance plans. The amount of compensation deferred before January 1, 2005 under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 31.3121(v)(2)-1(c)(2)(i)) equals the present value as of December 31, 2004 of the amount to which the participant would be entitled under the plan if the participant voluntarily terminated services without cause on December 31 of that taxable year, and received a full payment of benefits from the plan on the earliest possible date allowed under the plan following the termination of services, to the extent the right to the benefit is earned and vested (as defined in Q&A 16) as of December 31, 2004. For purposes of determining the present value of the benefit, the actuarial assumptions contained within the plan are used provided such assumptions are reasonable; otherwise, reasonable actuarial assumptions must be used. Amounts to which the participant would not be entitled upon termination, such as early retirement subsidies for which the participant would not have attained sufficient service if he or she terminated services on December 31, 2004, are not includible as compensation deferred under the plan as of December 31, 2004.

(b) Account balance plans. The amount of compensation deferred before January 1, 2005 under a nonqualified deferred compensation plan that is an account balance plan (as defined in § 31.3121(v)(2)-1(c)(1)(ii)) equals the portion of the participant's account balance as of December 31, 2004 the right to which is earned and vested (as defined in Q&A 16) as of December 31, 2004.

(c) Equity-based compensation plans. For purposes of determining the amounts deferred before January 1, 2005 under an equity-based compensation plan, the rules of paragraph (b) governing account balance plans are applied except that

the account balance is deemed to be the amount of the payment available to the participant on December 31, 2004 (or that would be available to the participant if the right were immediately exercisable) the right to which is earned and vested (as defined in Q&A 16) as of December 31, 2004. For this purpose, the payment available to the participant excludes any exercise price or other amount which must be paid by the participant.

(d) Earnings. Earnings on amounts deferred under a plan before January 1, 2005 include only income (whether actual or notional) attributable to the amounts deferred under a plan as of December 31, 2004 or such income. For example, notional interest earned under the plan on amounts deferred in an account balance plan as of December 31, 2004 generally will be treated as earnings on amounts deferred under the plan before January 1, 2005. Similarly, an increase in the amount of payment available under a stock option, stock appreciation right or other equity-based compensation above the amount of payment available as of December 31, 2004, due to appreciation in the underlying stock after December 31, 2004, is treated as earnings on the amount deferred. In the case of a nonaccount balance plan, earnings include the increase, due solely to the passage of time, in the present value of the future payments to which the service provider has obtained a legally binding right, the present value of which constituted the amounts deferred under the plan before January 1, 2005. Thus, for each year, there will be an increase (determined using the same interest rate used to determine the amounts deferred under the plan before January 1, 2005) resulting from the shortening of the discount period before the future payments are made, plus, if applicable, an increase in the present value resulting from the service provider's survivorship during the year. However, an increase in the potential benefits under a nonaccount balance plan due to, for example, an application of an increase in compensation after December 31, 2004 to a final average pay plan or subsequent eligibility for an early retirement subsidy, does not constitute earnings on the amounts deferred under the plan before January 1, 2005.

(e) Definition of plan. For purposes of this A-17, the term plan has the same meaning provided in Q&A 9, except that the provisions treating all nonaccount balance plans under which compensation is deferred as a single plan does not apply for purposes of the actuarial assumptions used in paragraph (b). Accordingly, different reasonable actuarial assumptions may be used to calculate the amounts deferred by a participant in two different arrangements each of which constitutes a nonaccount balance plan.

Q-18 When is a plan materially modified?

A-18 (a) In general. Except as otherwise provided in this A-18 and Q&A 19, a modification of a plan is a material modification if a benefit or right existing as of October 3, 2004 is enhanced or a new benefit or right is added. Such benefit enhancement or addition is a material modification whether it occurs pursuant to

an amendment or the service recipient's exercise of discretion under the terms of the plan. For example, an amendment to a plan to add a provision that payments may be allowed upon request if participants are required to forfeit 10 percent of the amount of the payment (a "haircut") would be a material modification to the plan. Similarly, a material modification would occur if a service recipient exercised discretion to accelerate vesting of a benefit under the plan to a date on or before December 31, 2004. However, it is not a material modification for a service recipient to exercise discretion over the time and manner of payment of a benefit to the extent such discretion is provided under the terms of the plan as of October 3, 2004. Also, it is not a material modification to change a notional investment measure to, or to add, an investment measure that qualifies as a predetermined actual investment within the meaning of § 31.3121(v)(2)-1(d)(2). It is not a material modification for a participant to exercise a right permitted under the plan as in effect on October 3, 2004. The amendment of a plan to bring the plan into compliance with the provisions of § 409A will not be treated as a material modification. However, a plan amendment or the exercise of discretion under the terms of the plan that enhances an existing benefit or right or adds a new benefit or right will be considered a material modification even if the enhanced or added benefit would be permitted under § 409A. For example, the addition of a right to a payment upon an unforeseeable emergency would be considered a material modification. The reduction of an existing benefit is not a material modification. For example, the removal of a "haircut" provision generally would not constitute a material modification.

(b) Adoption of new arrangement. It is presumed that the adoption of a new arrangement or the grant of an additional benefit under an existing arrangement after October 3, 2004 will constitute a material modification of a plan. However, the presumption may be rebutted by demonstrating that the adoption of the arrangement or grant of the additional benefit is consistent with the service recipient's historical compensation practices. For example, the presumption that the grant of a stock appreciation right on November 1, 2004 is a material modification of a plan may be rebutted by demonstrating that the grant was consistent with the historic practice of granting substantially similar stock appreciation rights (both as to terms and amounts) each November for a significant number of years. Notwithstanding paragraph (a) and this paragraph (b), the grant of an additional benefit under an existing arrangement that consists solely of a deferral of additional compensation not otherwise provided under the plan as of October 3, 2004 will be treated as a material modification of the plan only as to the additional deferral of compensation, if the plan explicitly identifies the additional deferral of compensation and provides that the additional deferral of compensation is subject to § 409A. A plan may be amended to comply with the provisions of the preceding sentence in accordance with the rules of Q&A 19.

(c) Suspension or termination of a plan. Amending an arrangement to stop future deferrals thereunder is not a material modification of the arrangement or

the plan. Amending an arrangement on or before December 31, 2005 to terminate the arrangement and distribute the amounts of deferred compensation thereunder will not be treated as a material modification, provided that all amounts deferred under the plan are included in income in the taxable year in which the termination occurs.

(d) Equity-based compensation. Provided that the cancellation and reissuance occurs on or before December 31, 2005, it will not be a material modification to replace a stock option or stock appreciation right otherwise providing for a deferral of compensation under Q&A 4 with a stock option or stock appreciation right that would not have constituted a deferral of compensation under § 409A if it had been granted upon the original date of grant of the replaced stock option or stock appreciation right. The preceding sentence only applies if (i) the number of shares which form the basis of the new stock option or new stock appreciation right corresponds directly to the number of shares subject to the original stock option or stock appreciation right; and (ii) the new stock option or new stock appreciation right does not provide any additional benefit to the service recipient (other than the benefit directly due to a change in form of the award to a form not treated as a deferral of compensation). A replacement stock option or replacement stock appreciation right will be treated as meeting the requirements of clause (i) of the preceding sentence if the new grant is made in accordance with the principles of § 1.424-1(a)(5) except to the extent necessary to ensure that the new grant does not violate § 409A. For example, a stock option originally issued with an exercise price discounted below the value of the shares subject to the option on the date of grant could be amended, without causing a material modification of the option, to be excluded from the definition of deferral of compensation by eliminating the discount on the exercise price below the value of the shares subject to the option on the original date of grant. Similarly, a stock appreciation right could be converted to a stock option or stock appreciation right that, based on its terms, would be excluded from the definition of deferral of compensation.

(e) Definition of plan. For purposes of this A-18, the term plan has the same meaning provided in Q&A 9, except that the provision treating all account balance plans under which compensation is deferred as a single plan, all nonaccount balance plans under which compensation is deferred as a separate single plan, and all other nonqualified deferred compensation plans as a separate single plan, does not apply.

Q-19 Under what conditions may a plan adopted before December 31, 2005 be operated and amended without violating the requirements of section 409A(a)(2), (3) and (4)?

A-19 (a) In general. A plan adopted before December 31, 2005 will not be treated as violating § 409A(a)(2), (3) or (4) only if (i) the plan is operated in good faith compliance with the provisions of § 409A and this notice during the calendar

year 2005, and (ii) the plan is amended on or before December 31, 2005 to conform to the provisions of § 409A with respect to amounts subject to § 409A.

(b) Good faith compliance. A plan will be treated as operated in good faith compliance during the calendar year 2005 if it is operated in accordance with the terms of this notice and, to the extent an issue is not addressed in this notice, a good faith, reasonable interpretation of § 409A, and, to the extent not inconsistent therewith, the plan's terms, provided that the plan sponsor does not exercise discretion under the terms of the plan, or that a participant does not exercise discretion with respect to that participant's benefits, in a manner that causes the plan to fail to meet the requirements of § 409A. For example, if an employer retains the discretion under the terms of the plan to delay or extend payments under the plan and exercises such discretion, the plan will not be considered to be operated in good faith compliance with § 409A with regard to any plan participant. However, an exercise of a right under the terms of the plan by a plan participant solely with respect to that participant's benefits under the plan, in a manner that causes the plan to fail to meet the requirements of § 409A, will not be considered to result in the plan failing to be operated in good faith compliance with respect to other participants. For example, the request for and receipt of an immediate payment permitted under the terms of the plan if the participant forfeits 10% of the participant's benefits (a "haircut") will be considered a failure of the plan to meet the requirements of § 409A with respect to that participant, but not with respect to all participants under the plan.

(c) Payment elections. With respect to amounts subject to § 409A, the plan may be amended to provide for new payment elections with respect to amounts deferred prior to the election and the election will not be treated as a change in the form and timing of a payment under § 409A(a)(4) provided that the plan is so amended and the participant makes the election on or before December 31, 2005. Similarly, an outstanding stock option or stock appreciation right that provides for a deferral of compensation subject to § 409A may be amended to provide for fixed payment terms consistent with § 409A, or to permit holders of such rights to elect fixed payment terms consistent with § 409A, and such amendment or election will not be treated as a change in the form and timing of a payment under § 409A(a)(4), provided that the option or right is so amended and any elections are made, on or before December 31, 2005.

(d) Severance plans. Provided that the plans are otherwise amended in compliance with paragraph (a), a plan that provides severance pay benefits, and that is either (i) a collectively bargained plan or (ii) covers no service providers who are key employees (as defined in § 416(i) and the regulations thereunder), is not required to meet the requirements of § 409A during the calendar year 2005 with respect to such severance pay benefits. Benefits that are provided under a severance pay arrangement (within the meaning of § 3(2)(B)(i) of ERISA (29 U.S.C. § 1002(2)(B)(i)) that satisfies the conditions in 29 CFR § 2510.3-2(b)(1)(i) through (iii) are considered severance pay for purposes of this paragraph (d).

Benefits provided under a severance pay arrangement (within the meaning of § 3(2)(B)(i) of ERISA) are in all cases severance pay within the meaning of this paragraph (d) if the benefits payable under the plan upon an employee's termination of employment are payable only if that termination is involuntary.

Q-20 Under what conditions may a plan adopted before December 31, 2005 provide a participant a right to terminate participation in the plan, or cancel an outstanding deferral election with regard to amounts subject to § 409A, and receive a payment of amounts subject to the termination or cancellation, without violating the requirements of § 409A(a)(2), (3) and (4)?

A-20 (a) Plan amendment. A plan adopted before December 31, 2005 may be amended to allow a participant during all or part of the calendar year 2005 to terminate participation in the plan or cancel a deferral election with regard to amounts deferred subject to § 409A, without causing the plan to fail to conform to the provisions of § 409A(a)(2), (3) or (4) with respect to amounts deferred after December 31, 2004, provided that (i) the amendment is enacted and effective on or before December 31, 2005, and (ii) the amounts subject to the termination or cancellation are includible in income of the participant in the taxable year in which the amounts are earned and vested (as defined in Q&A 16). Solely for purposes of effecting the relief provided in this A-20, neither the availability of the election to the participant nor the making of the election by the participant will be treated as resulting in a violation of the requirements of § 409A(a)(2), (3) or (4) or causing amounts the participant continues to defer to be includible in income under § 451 or the doctrine of constructive receipt (although these provisions may still apply for other reasons). There is no requirement that the opportunity to terminate participation in a plan or to cancel a deferral election be granted, or that if granted, be granted to all plan participants. A termination or cancellation may be made with respect to elective or nonelective deferred compensation and may be undertaken by the service recipient or at the election of the participant. A termination or cancellation under this paragraph may apply in whole or in part to one or more plans in which a participant participates and to one or more outstanding deferral elections the participant has made with regard to amounts subject to § 409A.

(b) Payments. Provided that the plan amendment is adopted in accordance with paragraph (a), a provision permitting a payment to a participant during calendar year 2005 or, if later, the taxable year in which the amount is earned and vested (as defined in Q&A 16), upon a termination of participation in the plan or the cancellation of a deferral election with regard to amounts subject to § 409A, will not be treated as causing a plan to violate the provisions of § 409A(a)(2), (3) or (4), and a payment from a plan pursuant to such an amendment will not be treated as a violation of the provision of § 409A(a)(2), (3) or (4), provided that the full amount of the distribution is included in the participant's income in calendar year 2005 or, if later, the participant's taxable year in which the amount is earned and vested (as defined in Q&A 16).

(c) Partial terminations and cancellations. For purposes of this Q&A 20, the termination of participation in the plan or the cancellation of an outstanding deferral election with regard to amounts subject to § 409A includes a termination or cancellation that results in a lower amount of deferrals for the period, without a complete elimination of the deferrals.

(d) Definition of plan. For purposes of this A-20, the definition of plan under Q&A 9 applies, except that the rule requiring the aggregation of all account balance plans, all nonaccount balance plans, and all other plans does not apply.

Q-21 Under what conditions will deferral elections under a plan in existence on or before December 31, 2004, made with respect to deferrals relating all or in part to services performed on or before December 31, 2005, be exempt from the requirements of § 409A(a)(4)(B) relating to the timing of elections?

A-21 With respect to deferrals subject to § 409A that relate all or in part to services performed on or before December 31, 2005, the requirements of § 409A(a)(4)(B) relating to the timing of elections will not be applicable to any elections made on or before March 15, 2005, provided that (a) the amounts to which the deferral election relate have not been paid or become payable at the time of election, (b) the plan under which the deferral election is or was made was in existence on or before December 31, 2004, (c) the elections to defer compensation are made in accordance with the terms of the plan in effect on or before December 31, 2005 (other than a requirement to make a deferral election after March 15, 2005), (d) the plan is otherwise operated in accordance with § 409A with respect to deferrals subject to § 409A and (e) the plan is amended to comply with the requirements of § 409A in accordance with Q&A 19. For purposes of this A-21, a nonqualified deferred compensation plan will be treated as in existence before December 31, 2004 only if a written plan document (a) identifies a specific amount or type of compensation that is subject to the plan and not otherwise payable at the time of the deferral election, and (b) provides that a participant in the plan may elect to defer the compensation beyond the taxable year in which the amount otherwise would have been payable. Solely for purposes of effecting the relief provided in this A-21, neither the availability of the election to the participant nor the making of the election by the participant will be treated as causing amounts the participant defers to be includible in income under § 451 or the doctrine of constructive receipt.

Q-22 Until additional guidance is issued, under what conditions may deferral elections be made with respect to bonus compensation?

A-22 Section 409A(a)(4)(B)(iii) provides that in the case of any performance-based compensation based on services performed over a period of at least 12 months, an election to defer such compensation may be made no later than 6

months before the end of the period. The Treasury Department and the Service anticipate issuing guidance that sets forth the requirements for compensation to qualify as performance-based compensation. The Treasury Department and the Service anticipate that those requirements will be more restrictive than the requirements outlined in this A-22. Until additional guidance is issued, a deferral election with respect to bonus compensation based on services performed over a period of at least 12 months will be treated as meeting the requirements of § 409A(a)(4) if the election is made at least 6 months before the end of the service period. For purposes of this transition relief, the term bonus compensation refers to compensation where (i) the payment of the compensation or the amount of the compensation is contingent on the satisfaction of organizational or individual performance criteria, and (ii) the performance criteria are not substantially certain to be met at the time a deferral election is permitted. Bonus compensation may include payments based upon subjective performance criteria, but (i) any subjective performance criteria must relate to the performance of the participant service provider, a group of service providers that includes the participant service provider, or a business unit for which the participant service provider provides services (which may include the entire organization); and (ii) the determination that any subjective performance criteria have been met must not be made by the participant service provider or a family member of the participant service provider (as defined in § 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family). Bonus compensation may also include payments based on performance criteria that are not approved by a compensation committee of the board of directors (or similar entity in the case of a non-corporate service recipient) or by the stockholders or members of the service recipient. Notwithstanding the foregoing, bonus compensation does not include any amount or portion of any amount that will be paid either regardless of performance, or based upon a level of performance that is substantially certain to be met at the time the criteria is established, or that is based solely on the value of, or appreciation in value of, the service recipient or the stock of the service recipient.

Q-23 Under what circumstances will payments be permitted based upon elections under a qualified plan for periods ending on or before December 31, 2005.

A-23 For periods ending on or before December 31, 2005, an election as to the timing and form of a payment under a nonqualified deferred compensation plan that is controlled by a payment election made by the participant under a qualified plan will not violate § 409A, provided that the determination of the timing and form of the payment is made in accordance with the terms of the nonqualified deferred compensation plan as of October 3, 2004 that govern payments. For purposes of this paragraph, a qualified plan means a retirement plan qualified under § 401(a). For example, where a nonqualified deferred compensation plan provides as of October 3, 2004 that the time and form of payment to a participant will be the same time and form of payment elected by the participant under a

related qualified plan, it will not be a violation of § 409A for the plan administrator to make or commence payments under the nonqualified deferred compensation plan on or after January 1, 2005 and on or before December 31, 2005 pursuant to the payment election under the related qualified plan. Notwithstanding the foregoing, other provisions of the Code and common law tax doctrines continue to apply to any election as to the timing and form of a payment under a nonqualified deferred compensation plan.

E. Information Reporting Requirements for Deferred Amounts

Q-24 What information reporting requirements are imposed by § 885(b) of the Act?

A-24 The Act adds §§ 6041(g)(1) and 6051(a)(13), which require that all deferrals for the year under a nonqualified deferred compensation plan be separately reported on a Form 1099 (Miscellaneous Income) or a Form W-2 (Wage and Tax Statement), respectively. The Act requires annual reporting of all compensation deferred under the plan for the year regardless of whether such compensation is includible in gross income pursuant to § 409A(a)(1)(A). However, neither § 6041(g)(1) nor § 6051(a)(13) requires the reporting of deferrals under a nonqualified deferred compensation plan that benefit a person with respect to whom a Form 1099-MISC or a Form W-2 is not required to be filed.

Q-25 What constitutes deferrals for the year under a nonqualified deferred compensation plan for purposes of §§ 6041(g)(1) and 6051(a)(13)?

A-25 Deferrals for the year under a nonqualified deferred compensation plan for purposes of §§ 6041(g)(1) and 6051(a)(13) generally include all deferrals of compensation within the meaning of § 409A that occur during the year and that are made under a nonqualified deferred compensation plan within the meaning of § 409A(d). See Q&A 4 (definition of a deferral of compensation) and Q&A 3 (definition of a nonqualified deferred compensation plan). The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for calculating the amount of deferrals for the year.

Q-26 Do the information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) apply with respect to amounts deferred under a nonqualified deferred compensation plan that is a nonaccount balance plan?

A-26 Yes. The information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) generally apply with respect to amounts deferred under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 31.3121(v)(2)-1(c)(2)). However, amounts deferred that are not reasonably ascertainable (as defined in § 31.3121(v)(2)-1(e)(4)) are not required

to be reported until such deferrals become reasonably ascertainable (regardless of whether the service provider is an employee). The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for calculating the amount of deferrals for the year under a nonqualified deferred compensation plan.

Q-27 Is there a minimum amount of aggregate deferrals for the year with respect to an individual employee below which the information reporting requirement imposed by § 6051(a)(13) does not apply?

A-27 Yes. The Act authorizes the Secretary of the Treasury, through regulations, to establish a minimum amount of deferrals below which the information reporting requirement imposed by § 6051(a)(13) does not apply. The Treasury Department and the Service anticipate providing the authorized guidance in future regulations. Until such guidance is provided, however, employers may rely on this notice to exclude from the information reporting requirement imposed by § 6051(a)(13) all deferrals for the year with respect to an individual employee under one or more nonqualified deferred compensation plans if the aggregate amount of such deferrals does not exceed $600.

Q-28 What is the effective date for the information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13)?

A-28 The information reporting requirements imposed by §§ 6041(g)(1) and 6051(a)(13) are effective for amounts actually deferred in calendar years beginning after December 31, 2004. Additionally, such information reporting requirements apply to income (whether actual or notional) attributable to amounts actually deferred in calendar years beginning after December 31, 2004. For purposes of §§ 6041(g)(1) and 6051(a)(13), amounts are considered actually deferred at the time the service provider has a legally binding right to the compensation as described in Q&A 4. Thus, the information reporting requirements are not effective for amounts actually deferred in calendar years beginning before January 1, 2005, (or for income attributable to such amounts) notwithstanding that § 885(d) of the Act may treat such amounts as having been deferred in a calendar year beginning on or after such date under the general effective date provisions.

Q-29 How should an employer report to an employee the total amount of deferrals for the year under a nonqualified deferred compensation plan as required by § 6051(a)(13)?

A-29 An employer should report to an employee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 12 of Form W-2 using code Y. The instructions for Form W-2 provide additional information relating to this reporting requirement. However, see Q&A 38 for interim guidance with respect to an employer's reporting requirements where the employer

furnishes an expedited Form W-2 prior to the issuance of additional guidance that will provide a method for calculating the amount of deferrals for the year. Neither § 6051(a)(13) nor this notice affect the rules for reporting deferred compensation in Box 11 of Form W-2.

Q-30 How should a payer report to a nonemployee the total amount of deferrals for the year under a nonqualified deferred compensation plan as required by § 6041(g)(1)?

A-30 A payer should report to a nonemployee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 15a of Form 1099-MISC. The instructions for Form 1099-MISC provide additional information relating to this reporting requirement. However, the information reporting requirement imposed by § 6041(g)(1) does not apply to deferrals that are required to be reported under § 6051(a)(13) (without regard to any de minimis exception). Additionally, § 6041(g)(1) does not require the reporting of deferrals under a nonqualified deferred compensation plan that benefit a person with respect to whom a Form 1099-MISC is not required to be filed.

F. Wage Withholding for Employees

Q-31 What wage withholding requirements are imposed by § 885(b) of the Act?

A-31 The Act amends § 3401(a) (defining wages for income tax withholding purposes) to provide that the term "wages" includes any amount includible in gross income of an employee under § 409A. The amount is treated as a payment of wages in the taxable year in which the amount is includible in the employee's gross income. The Treasury Department and the Service anticipate issuing additional guidance that will provide a method for computing the amount includible in gross income of an employee under § 409A.

Q-32 When are amounts that are includible in gross income under § 409A treated as a payment of wages for income tax withholding purposes?

A-32 For the calendar year 2005, amounts includible in gross income under § 409A but neither actually nor constructively received by an employee may be treated as having been paid by an employer for income tax withholding purposes on any date on or before December 31, 2005. However, nothing in § 409A prevents the inclusion of amounts in gross income and in wages for income tax withholding purposes under any other provision or rule of law on a date earlier than December 31, 2005. Thus, amounts includible in gross income under § 409A and either actually or constructively received by an employee during the calendar year 2005 are considered a payment of wages when received by the employee for purposes of withholding, depositing, and reporting the income tax at source on wages.

Q-33 How should an employer report to an employee amounts includible in gross income under § 409A and in wages under § 3401(a) as required by § 6051(a)(3)?

A-33 An employer should report amounts includible in gross income under § 409A and in wages under § 3401(a) in box 1 of Form W-2 as part of the total wages, tips, and other compensation paid to the employee during the year. Additionally, an employer should report such amounts in box 12 of Form W-2 using code Z. The amount reported in box 12 using code Z should include all amounts deferred under the plan for the taxable year and all preceding taxable years that are currently includible in gross income under § 409A and in wages under § 3401(a). The instructions for Form W-2 provide additional information relating to this reporting requirement. However, see Q&A 38 for interim guidance with respect to an employer's reporting requirements relating to an employee or business that is terminated prior to the issuance of additional guidance that will provide a method for calculating the amounts includible in gross income under § 409A and in wages under § 3401(a).

G. Reporting Nonemployee Compensation

Q-34 What reporting requirements relating to nonemployee compensation are imposed by § 885(b) of the Act?

A-34 The Act adds § 6041(g)(2), which requires a payer to report to a nonemployee any amount includible in gross income under § 409A that is not treated as wages under § 3401(a). However, § 6041(g)(2) does not require the reporting of amounts includible in gross income under § 409A that are treated as having been paid to a person with respect to whom a Form 1099-MISC is not required to be filed.

Q-35 How should a payer report to a nonemployee amounts includible in gross income under § 409A and not treated as wages under § 3401(a) as required by § 6041(g)(2)?

A-35 A payer should report the amounts includible in gross income under § 409A and not treated as wages under § 3401(a) in box 7 (nonemployee compensation) of Form 1099-MISC. Additionally, a payer should report such amounts in box 15b of Form 1099-MISC. The amount reported in box 15b should include only the amounts includible in gross income under § 409A and not included in wages under § 3401(a). The instructions for Form 1099-MISC provide additional information relating to this reporting requirement.

Q-36 What are the SECA tax consequences of a failure to satisfy the requirements of § 409A?

A-36 Gross income of a self-employed individual (for example, a nonemployee director, partner, or independent contractor) derived by the individual from any trade or business is generally subject to tax in accordance with the Self-Employment Contributions Act (SECA) when includible in gross income. See §§ 1401, 1402(a). Accordingly, an amount derived from an individual's trade or business that is includible in the self-employed individual's gross income under § 409A is generally subject to the application of SECA taxes at the time such amount is includible in gross income.

Q-37 Does § 885 of the Act affect the imposition of the employee tax and the employer tax under the Federal Insurance Contributions Act (FICA) with respect to wages paid and received for employment under a nonqualified deferred compensation plan within the meaning of § 409A(d)?

A-37 No. Section 885 of the Act does not affect the imposition of the employee tax and the employer tax under FICA with respect to wages paid and received for employment under a nonqualified deferred compensation plan within the meaning of § 409A(d). Thus, remuneration for employment constituting wages within the meaning of § 3121(a) is taken into account for FICA tax purposes in accordance with the rules for wage inclusion under §§ 3121(a) and 3121(v)(2).

H. Interim Reporting for Expedited Form W-2

Q-38 What are an employer's withholding and reporting obligations where an employee is terminated or a business files a final Form 941 prior to the issuance of further guidance providing methods for calculating the amount of deferrals for the year and the amounts includible in gross income under § 409A and in wages under § 3401(a)?

A-38 An employer is generally required to issue a Form W-2 reporting compensation paid during a calendar year no later than January 31 of the succeeding calendar year. However, if an employee's employment is terminated before the close of the calendar year, an employer must furnish an expedited Form W-2 if requested to do so by the employee. Additionally, an employer may, at its option, furnish a Form W-2 to such an employee at any time after the termination but no later than January 31 of the succeeding calendar year. See § 31.6051-1(d)(i). In addition, if an employer makes a final return on Form 941, the employer must furnish expedited Form W-2s to employees and file expedited Form W-2s with the Social Security Administration. See §§ 31.6051-1(d)(ii), 31.6071(a)-1. If an employer furnishes an expedited Form W-2 before the issuance of additional guidance providing methods for determining the amount of deferrals for the year or the amounts includible in gross income under § 409A and in wages under § 3401(a), the employer need not report an amount

described in Q&A-25 (deferrals for the year) or in Q&A-31 (amounts includible in gross income and wages) on the Form W-2. However, if an employer furnishes an expedited Form W-2 prior to the issuance of additional guidance that requires the employer to report a deferral for the year or an amount includible in gross income and wages, then the employer must subsequently furnish a corrected Form W-2. See § 31.6051(c).

IV. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) and, regarding the employment tax and information reporting requirements, Neil D. Shepherd of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the Service participated in its development. For further information regarding this notice, contact Stephen Tackney (202) 927-9639; or for further information regarding the employment tax and information reporting requirements, Neil D. Shepherd (202) 622-6040; or regarding the submission of comments, contact Lanita Van Dyke (202) 622-7180 (not toll-free calls).

FROM THE OFFICE OF PUBLIC AFFAIRS

December 21, 2004
2004-12-21-10-40-25-19862

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 $86,526 million as of the end of that week, compared to $85,998 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	December 10, 2004			December 17, 2004		
TOTAL		85,998			86,526	
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	12,076	14,917	26,993	12,131	15,084	27,215
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,841	2,998	14,839	11,910	3,032	14,942
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]			19,861			19,982
3. Special Drawing Rights (SDRs) [2]			13,262			13,343
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	December 10, 2004			December 17, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	December 10, 2004			December 17, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, 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 IMF data for the prior month end.

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 21, 2004
JS-2163

Department of the Treasury
First and Second Combined Quarterly Update of the
2004 - 2005 Priority Guidance Plan

Joint Statement by:

Eric Solomon
Deputy Assistant Secretary
(Regulatory Affairs)
U.S. Department of the Treasury

Mark W. Everson
Commissioner
Internal Revenue Service

Donald L. Korb
Chief Counsel
Internal Revenue Service

On July 26, 2004, we released the 2004 - 2005 Priority Guidance Plan listing 276 projects for the plan year beginning July 1, 2004 and ending June 30, 2005. In our Joint Statement that accompanied the release of the 2004 - 2005 Priority Guidance Plan, we emphasized our commitment to increased and more timely published guidance. We indicated that we would update the plan quarterly to reflect additional guidance that we intend to publish during the plan year. Updating the plan also provides flexibility to respond to developments arising during the year. On October 22, 2004, the American Jobs Creation Act of 2004 (AJCA) was enacted. In order to take account of the extensive guidance necessary to implement the AJCA, we have combined the first and second quarterly updates of the 2004 - 2005 Priority Guidance Plan in this document. This update includes 33 additional projects implementing the AJCA.

The attached update sets forth the guidance on the original 2004 - 2005 Priority Guidance Plan that we have published. Although the update may indicate that a particular item on the plan has been completed, it is possible that one or more additional projects may be completed in the plan year relating to that item. The update also includes 67 items of additional guidance (including the 33 AJCA-related projects mentioned above), some of which have already been published.

We continue to invite the public to provide us with comments and suggestions as we identify and write guidance throughout the plan year.

A copy of the update of the 2004 - 2005 Priority Guidance Plan is attached. The updated 2004 -2005 Priority Guidance Plan will also be republished on the IRS website on the Internet (www.irs.gov) under Tax Professionals, IRS Resources, Administrative Information and Resources, 2004 - 2005 Priority Guidance Plan. Copies can also be obtained by calling Treasury's Office of Public Affairs at (202) 622-2960.

REPORTS

- 2004-2005 Priority Guidance Plan

OFFICE OF TAX POLICY
AND
INTERNAL REVENUE SERVICE

2004-2005 PRIORITY GUIDANCE PLAN

DECEMBER 21, 2004 UPDATE

CONSOLIDATED RETURNS

Original PGP Projects:

1. Guidance under section 1502 regarding transactions involving obligations of consolidated group members.

2. Final regulations under section 1502 regarding indebtedness to nonmembers that is traceable to intercompany obligations.

3. Guidance under section 1502 regarding rate or discount subsidy payments.

4. Guidance under section 1502 regarding treatment of member stock.

5. Guidance under section 1502 regarding application of section 108 to members of a consolidated group.

6. Guidance under section 1502 regarding liquidations under section 332 into multiple members.

CORPORATIONS AND THEIR SHAREHOLDERS

Original PGP Projects:

1. Guidance regarding redemptions of corporate stock.

2. Guidance regarding transactions involving the transfer or receipt of no net equity value.

3. Guidance regarding selected issues under section 336(e).

4. Final regulations regarding taxable asset acquisitions and dispositions of insurance companies.

5. Guidance regarding the acquisition of businesses having certain nonqualified settlement funds.

- PUBLISHED 9/16/2004 in FR as TEMP 9158

6. Guidance under section 355.

7. Final regulations regarding plan issues under section 355(e).

8. Guidance regarding predecessors and successors under section 355(e).
   ? PUBLISHED 11/22/2004 in FR as NPRM REG-145535-02

9. Guidance regarding the assumption of liabilities.

10. Final regulations under section 358 regarding allocation of basis.

11. Revision of guidelines for estimating stock basis in reorganizations under section 368(a)(1)(B).

12. Guidance regarding the effect of pre-closing changes of acquiror stock value on continuity of interest.

13. Guidance regarding transfers of assets after putative reorganizations.

14. Guidance regarding statutory mergers.
    - PUBLISHED 12/17/2004 in FR as TEMP 9164

15. Guidance under section 368(a)(1)(F).

16. Guidance under section 382.

17. Guidance under section 1374.

EMPLOYEE BENEFITS

A. Retirement Benefits

Original PGP Projects:

1. Guidance under sections 106 and 401 on retiree health accounts in a profit sharing plan.

2. Guidance on coordination with Puerto Rico law for qualified plans.

3. Procedural guidance with respect to group trusts.

4. Guidance under section 401(a)(4).

5. Guidance under section 401(a)(31) on the default rollover of involuntary distributions.

6. Guidance under section 401(b) on the staggered remedial amendment period.
   - PUBLISHED 10/4/2004 in IRB 2004-40 as ANN. 2004-71 (released 9/13/2004)

7. Guidance under sections 401(k), 403(b), 415(c)(3), and 457(b) on post severance elective deferrals.

8. Final regulations under section 401(k) and (m).

9. Guidance under section 402 on the valuation of life insurance distributed from qualified plans.

10. Guidance under section 402A on Roth 401(k) elective contributions.

11. Additional guidance on the Pension Funding Equity Act of 2004.
    - PUBLISHED 9/7/2004 in IRB 2004-36 as NOTICE 2004-59 (released 8/19/2004)
    - ? PUBLISHED 11/29/2004 in IRB 2004-48 as NOTICE 2004-78 (released 11/12/2004)

12. Guidance on the deduction of foreign-sourced dividends by a U.S. subsidiary under section 404(k).

13. Guidance on IRA abuses.

14. Additional guidance relating to the section 409(p) requirements.

15. Guidance on amendments to suspension of benefits provisions.

16. Final regulations under section 411(d)(6) for defined benefit plans.

17. Final regulations under section 411(d)(6)(E).

18. Guidance under section 412 on mortality tables.

19. Proposed regulations under section 415.

20. Guidance on electronic communications.

21. Additional guidance on the relative value of optional forms of benefit.

22. Guidance under sections 457(b) and 501(c)(1) on plans established by federal credit unions.
23. Guidance on ESOPs.

Additional PGP Projects:

24. Notice on additional relief for certain employee benefits plans as a result of the Florida storms.
    ? PUBLISHED 10/4/2004 in IRB 2004-40 as NOTICE 2004-62 (released 9/15/2004)

25. Regulations on phased retirement arrangements.
    ? PUBLISHED 11/10/2004 in FR as NPRM REG-114726-04

26. Regulations on annuity plans under section 403(b).
    ? PUBLISHED 11/16/2004 in FR as NPRM REG-155608-02

27. Guidance under section 412 as amended by the Pension Funding Equity Act of 2004 regarding multiemployer plans.

28. Guidance under section 401(b) on the staggered remedial amendment period for individually designed plans.

29. Guidance under section 401(b) on the staggered remedial amendment period for master and prototype plans and volume submitter plans.

30. Guidance providing the cumulative guidance list for certain defined benefit plans.
    ? WILL BE PUBLISHED 12/27/2004 in IRB 2004-52 as NOTICE 2004-84 (released 12/14/2004)

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

Original PGP Projects:

1. Guidance under section 35 on health care insurance costs of eligible individuals.

2. Guidance on secular trusts.

3. Guidance on the value of term life insurance for split dollar and pension plans.

4. Revenue ruling on tool rental.

5. Guidance under section 79.

6. Revenue ruling on section 83(b) elections.

7. Revenue ruling on timing issues under section 83.
8. Guidance on Health Reimbursement Arrangements (HRAs).

9. Guidance on the election between taxable and nontaxable benefits.

10. Revenue ruling under section 280G on section 83(b) elections.

11. Guidance under section 419.

12. Guidance under section 419A.

13. Guidance on incentive stock options.

14. Guidance on the application of SECA to Conservation Reserve Program payments.

15. Guidance on FICA and FUTA tax with respect to incentive stock options under section 422 and employee stock purchase plans under section 423.

16. Guidance on the employment tax treatment of bonuses paid to employees on the signing of a collectively bargained agreement.
    - PUBLISHED 12/13/2004 in IRB 2004-50 as REV. RUL. 2004-109 (released 11/23/2004)

17. Guidance on tips paid to restaurant employees.

18. Final regulations on the student FICA exception.
    - WILL BE PUBLISHED 12/21/2004 in FR as TD 9167

19. Revenue procedure on the student FICA exception.
    ? WILL BE PUBLISHED 1/10/2005 in IRB 2005-2 as REV. PROC. 2005-11

20. Guidance on flat rate supplemental wage withholding.

21. Guidance under section 3504.

22. Guidance on withholding for domestic workers.

23. Proposed regulations under sections 4980E and 4980G on employer comparable contributions to HSAs.

24. Final regulations under section 9801.

Additional PGP Projects:

25. Revenue ruling on employer provided parking reimbursement arrangements.

? PUBLISHED 10/18/2004 in IRB 2004-42 as REV. RUL. 2004-98. (released 10/1/2004)

26. Announcement on Archer MSA Trustee Reports.
? PUBLISHED 11/8/2004 in IRB 2004-45 as ANN. 2004-82. (released 10/19/2004)

27. Temporary regulations under section 3121 regarding the definition of salary reduction agreement.
? PUBLISHED 11/16/2004 in FR as TEMP 9159

28. Notice on the effect of the Working Families Tax Relief Act of 2004 on employer-provided accident or health plans.
? PUBLISHED 12/6/2004 in IRB 2004-49 as NOTICE 2004-79 (released 11/17/2004)

29. Revenue ruling on the income and employment tax treatment of amounts paid to an employee as consideration for cancellation of an employment contract and relinquishment of contract rights.
? PUBLISHED 12/13/2004 in IRB 2004-50 as REV. RUL. 2004-110 (released 11/23/2004)

30. Guidance under section 409A as added by the American Jobs Creation Act of 2004 regarding the treatment of nonqualified deferred compensation plans.
? WILL BE PUBLISHED 1/10/2005 in IRB 2005-2 as NOTICE 2005-1 (released 12/20/2004)

31. Notice on income tax and self-employment tax consequences when a partnership makes contributions to its partners' HSAs or an S corporation makes contributions to its 2-percent shareholder-employees' HSAs.

EXCISE TAXES

Original PGP Projects:

1. Final regulations under section 4051 regarding the definition of highway vehicle in sections 145.4051 and 48.4061(a)-1.
? CLOSED WITHOUT PUBLICATION

2. Guidance under section 4051(a)(2) and (3) regarding suitability for use.

3. Guidance under section 4081 regarding the entry into the United States of taxable fuel.

4. Guidance under section 4221(e) regarding reciprocal privileges.

5. Final regulations under section 4252 regarding toll telephone services.

6. Guidance under section 4261 regarding resellers of air transportation.

7. Guidance under section 4261(e) regarding the exception for segments to or from rural airports.

8. Guidance under section 4291 regarding the duties of the collector of collected excise taxes.

9. Proposed regulations under section 6416(a)(4) regarding claims for gasoline tax.
   ? CLOSED WITHOUT PUBLICATION

Additional PGP Projects:

10. Guidance under section 4251 regarding the excise tax on communications services.
    - PUBLISHED 8/30/2004 in IRB 2004-35 as NOTICE 2004-57 (released 8/9/2004)

11. Guidance providing relief from the penalty under section 6715 for highway use of dyed diesel fuel in the state of Florida.
    - PUBLISHED 9/27/2004 in IRB 2004-39 as ANN. 2004-70 (released 9/3/2004)
    - PUBLISHED 10/12/2004 in IRB 2004-41 as ANN. 2004-77 (released 9/17/2004)

12. Guidance regarding various excise tax provisions added or amended by the American Jobs Creation Act of 2004.
    - WILL BE PUBLISHED 1/10/2005 in IRB 2005-2 as NOTICE 2005-4 (released 12/15/2004)

EXEMPT ORGANIZATIONS

Original PGP Projects:

1. Guidance on downpayment assistance organizations.

2. Guidance on low-income housing partnerships and section 501(c)(3) participation.

3. Guidance under sections 501(c)(3) and 4958 on revocation standards.

4. Guidance under section 501(c)(15).
   - PUBLISHED 10/12/2004 in IRB 2004-41 as NOTICE 2004-64 (released 9/24/2004)

5. Guidance concerning the internet and unrelated business income tax.
   ? PUBLISHED 12/20/2004 in IRB 2004-51 as REV. RUL. 2004-112 (released 12/1/2004)

6. Regulations under section 529 regarding qualified tuition programs.

Additional PGP Projects:

7. Announcements on suspension of tax exempt status.
   ? PUBLISHED 10/4/2004 in IRB 2004-40 as ANN. 2004-74 (released 9/17/2004)
   ? PUBLISHED 11/8/2004 in IRB 2004-45 as ANN. 2004-87 (released 10/18/2004)

FINANCIAL INSTITUTIONS AND PRODUCTS

Original PGP Projects:

1. Guidance for RICs and REITs concerning section1(h).

2. Guidance addressing the accrual of interest on nonperforming loans.

3. Final regulations under section 263(g).

4. Final regulations on notional principal contracts.

5. Proposed regulations addressing valuation under section 475.

6. Final regulations under sections 475(e) and (f).

7. Proposed regulations on the flow through of foreign tax credits for regulated investment companies.

8. Guidance on the application to foreign currency gains of the income and asset tests for real estate investment trusts.

9. Guidance on interest-only REMIC regular interests.

10. Regulations on the application of the TEFRA partnership audit procedures to REMICs.

11. Proposed regulations addressing foreign holders of REMIC residual interests.

12. Guidance under section 1256 on the definition of a dealer in securities futures contracts.
    - PUBLISHED 9/20/2004 in IRB 2004-38 as REV. RUL. 2004-94
    - PUBLISHED 9/20/2004 in IRB 2004-38 as REV. RUL. 2004-95

13. Guidance on credit card transactions.

14. Regulations regarding accruals for certain REMIC regular interests.

15. Guidance on system upgrade payments made to electric utilities.

16. Proposed regulations under section 7872.

Additional PGP Projects:

17. Guidance under section 1286(f) as added by the American Jobs Creation Act of 2004 regarding treatment of stripped interests in bond and preferred stock funds.

18. Guidance under section 1256 regarding over-the-counter foreign currency options.

19. Update of Rev. Proc. 2003-32 under section 851 regarding the application of the diversification test with respect to investments in eligible tax-exempt partnerships.

20. Guidance under sections 852 and 854, and section 871(k) as added by the American Jobs Creation Act of 2004, regarding dividend designations by RICs.

GENERAL TAX ISSUES

Original PGP Projects:

1. Proposed regulations under section 21 regarding the credit for household and dependent care expenses.

2. Notice under section 23 regarding the credit for adoption expenses.

3. Guidance under section 32.

4. Proposed regulations under section 41 regarding internal use software.

5. Regulations under section 41 regarding the computation of the research credit in a controled group.

6. Guidance under section 41 regarding gross receipts for purposes of computing the group credit under section 41(f).

7. Guidance under section 42 regarding the low income housing credit.
   - PUBLISHED 8/30/2004 in IRB 2004-35 as REV. RUL. 2004-82 (released 7/30/2004)

8. Guidance under section 42(h) regarding qualified contracts.

9. Guidance under section 44 regarding the disabled access credit for eligible small businesses.

10. Guidance under section 45 regarding state credit offsets.

11. Guidance under section 45D regarding the new markets tax credit.

12. Regulations under sections 46 and 167 relating to normalization.

13. Final regulations under section 59(e) regarding elections.

14. Revenue ruling regarding disaster relief payments to businesses.

15. Guidance regarding the tax treatment of repayments of Commodity Credit Corporation loans.

16. Revenue ruling under sections 61 and 162 on the proper treatment of Medicaid rebates paid by pharmaceutical companies.

17. Guidance regarding the treatment of employee relocation costs.

18. Revenue ruling under sections 121 and 1031 regarding like-kind exchanges of a principal residence.

19. Guidance under section 152 regarding the release of a claim for exemption for a child of divorced or separated parents.

20. Revenue ruling regarding the treatment of payments made by a tax-exempt organization upon its conversion to a taxable entity to satisfy its public-benefit obligations.

21. Final regulations under section 163(d) regarding the qualified dividend income election.

22. Regulations under section 167 regarding the income forecast method.

23. Final regulations under section 168 relating to like-kind exchanges.

24. Final regulations under sections 168 and 1400L regarding the special depreciation allowance.

25. Guidance under section 168 on asset classes and activity classes under Rev. Proc. 87-56.

26. Final regulations under section 168 regarding changes in classification of property.

27. Guidance under section 170.

28. Guidance under section 172 regarding specified liability losses.

29. Guidance under section 174 regarding the treatment of inventory property.

30. Guidance under section 174 regarding changes in method of accounting.

31. Final regulations under section 179 regarding elections.

32. Guidance under section 469 regarding the limitation on losses and credits relating to passive activities.

33. Final regulations under section 1031 regarding the use of SIC codes in like-kind exchanges of depreciable tangible property.

34. Revenue ruling under section 1241 on the cancellation of lease or distributor agreements.

35. Guidance on corporations chartered under Indian tribal law.

Additional PGP Projects:

36. Guidance under section 199 regarding the deduction for income attributable to domestic production activities.

37. Guidance under section 42 regarding relief from certain low income housing credit requirements for taxpayers affected by various hurricanes.
    - PUBLISHED 10/18/04 in IRB 2004-42 as NOTICE 2004-66 (released 9/16/04)
    - PUBLISHED 11/29/04 in IRB 2004-48 as NOTICE 2004-74 (released 11/04/04)
    - PUBLISHED 11/29/04 in IRB 2004-48 as NOTICE 2004-75 (released 11/04/04)
    - PUBLISHED 11/29/04 in IRB 2004-48 as NOTICE 2004-76 (released 11/04/04)

38. Revenue procedure under section 1400L(c) regarding the election out of the 5-year recovery period for depreciation of certain leasehold improvements.

39. Guidance under section 168 regarding property eligible for the extended placed-in-service date for the special depreciation allowance.

40. Guidance relating to payments made in termination of tobacco marketing quotas and related price supports under the American Jobs Creation Act of 2004.

41. Guidance under section 164(b)(5) as added by the American Jobs Creation Act of 2004 regarding the deduction for state and local sales taxes.

42. Guidance under section 170(m) as added by the American Jobs Creation Act of 2004 regarding the treatment of charitable contributions of patents and similar property.

43. Guidance under section 170(f)(12) as added by the American Jobs Creation Act of 2004 regarding charitable contributions of used motor vehicles, boats and airplanes.

44. Guidance under section 274(e) as amended by the American Jobs Creation Act of 2004.

45. Guidance under section 1301(a) as amended by the American Jobs Creation Act of 2004 regarding farmer and fisherman income averaging.

GIFTS, ESTATES AND TRUSTS

Original PGP Projects:

1. Update revenue procedures under section 664 containing sample charitable remainder unitrust provisions.

2. Final regulations under section 664 regarding dividends and capital gains for charitable remainder trusts.

3. Guidance under section 664 regarding the partial or complete termination of a charitable remainder unitrust.

4. Final regulations under section 671 regarding the reporting requirements for widely-held fixed investment trusts.

5. Guidance regarding family trust companies.

6. Guidance under section 691 regarding income in respect of a decedent and deferred annuity contracts.

7. Final regulations under section 2032 regarding section 301.9100 relief.

8. Guidance under section 2036 regarding transfers with retained life estates.

9. Guidance under section 2053 regarding post-death events.

10. Guidance under section 2056 regarding qualified terminable interest property.

11. Guidance under section 2518 regarding qualified disclaimers.

12. Final regulations under section 2632 regarding election out of the deemed allocation of the generation-skipping transfer tax exemption.

13. Final regulations under section 2642 regarding qualified severance.

14. Final regulations under section 2651 regarding the predeceased parent rule.

15. Final regulations under section 2702 regarding qualified interests.

16. Guidance under section 2704 regarding the liquidation of an interest.

INSURANCE COMPANIES AND PRODUCTS

Original PGP Projects:

1. Final regulations under section 817 on life insurance and annuity contracts.

2. Guidance on the application of the diversification look-through rule under section 817 to tiered investment companies.

3. Guidance on the 2001 CSO mortality tables.
    - PUBLISHED 10/12/2004 in IRB 2004-41 as NOTICE 2004-61

Additional PGP Projects:

4. Guidance concerning producer owned reinsurance companies as listed transactions.
   - PUBLISHED 10/12/2004 in IRB 2004-41 as NOTICE 2004-65

5. Revenue ruling regarding qualified additional benefits under section 7702.

6. Guidance regarding captive insurance companies.

INTERNATIONAL ISSUES

A. Subpart F/Deferral

Original PGP Projects:

1. Regulations on the allocation of subpart F income.

2. Regulations under section 959 on previously taxed earnings and profits.
3. Guidance on the PFIC provisions.

B. Inbound Transactions

Original PGP Projects:

1. Final regulations on the treatment of portfolio stock in a U.S. insurance branch.

2. Guidance under section 1441.
   - PUBLISHED 10/18/2004 in IRB 2004-42 as REV. PROC. 2004-59 (released 9/29/2004)

3. Guidance on securities lending.

4. Guidance on the treatment of certain financial products for withholding purposes.

5. Final regulations under section 1446.

6. Regulations relating to the reporting of bank deposit interest.

C. Outbound Transactions

Original PGP Projects:

1. Regulations on the application of section 304 in transactions involving foreign corporations.

2. Regulations relating to the carryover of tax attributes in certain international reorganizations.

3. Regulations on mergers involving foreign corporations.

4. Other guidance on international restructurings.
   - PUBLISHED 10/25/2004 in IRB 2004-43 as NOTICE 2004-68 (released 10/7/2004)

D. Foreign Tax Credits

Original PGP Projects:

1. Regulations on the change of taxable year and foreign tax credits.

2. Regulations on the allocation of foreign taxes.

3. Regulations on the look-through treatment for 10/50 company dividends (see Notice 2003-5).
4. Guidance under section 905(c).

E. Transfer Pricing

Original PGP Projects:

1. Regulations on the treatment of cross-border services.

2. Regulations on cost sharing under section 482.

3. Regulations and other guidance on global dealing.

4. Other guidance under section 482.
   - PUBLISHED 12/13/2004 in IRB 2004-50 as ANN. 2004-98 (released 12/10/2004)

F. Sourcing and Expense Allocation

Original PGP Projects:

1. Guidance on interest expense apportionment.

2. Regulations on the allocation and apportionment of charitable contributions.

3. Regulations and other guidance relating to the treatment of fringe benefits.

4. Guidance on the source of income from the cross-border use of property.

5. Regulations under sections 863(d) and (e).

6. Guidance on interest expense allocable to effectively connected income.

G. Treaties

Original PGP Project:

1. Guidance on reporting and other issues under treaties.
   - WILL BE PUBLISHED 1/10/2005 in IRB 2005-2 as ANN. 2005-3 (released 12/10/2004)

H. Other

Original PGP Projects:

1. Regulations and other guidance under section 1(h)(11) on the taxation of dividends from certain foreign corporations received by individuals.
   - PUBLISHED 11/1/2004 in IRB 2004-44 as NOTICE 2004-70 (released 10/8/2004)
   - PUBLISHED 11/8/2004 in IRB 2004-45 as NOTICE 2004-71 (released 10/22/2004)

2. Regulations under section 269B.

3. Guidance on cross-border banking and insurance issues.
   - PUBLISHED 9/27/2004 in IRB 2004-39 as REV. RUL. 2004-97

4. Guidance on possessions issues.

5. Regulations and other guidance concerning the treatment of currency gain or loss.

6. Regulations under section 1503(d).

7. Guidance on cross-border information reporting issues.
   - PUBLISHED 9/15/2004 in FR as TD 9161

Additional PGP Projects:

8. Update of Rev. Rul. 95-63 regarding countries described in section 901(j)(2)(A).

- PUBLISHED 11/8/2004 in IRB 2004-45 as REV. RUL. 2004-103 (released 10/20/2004)

9. Guidance under the American Jobs Creation Act of 2004 regarding the repeal of the exclusion for extraterritorial income.

10. Guidance under section 1354 as added by the American Jobs Creation Act of 2004 regarding the election to determine the corporate tax on certain international shipping activities using the per ton rate.

11. Guidance under the American Jobs Creation Act of 2004 regarding the look-through treatment for 10/50 company dividends.

12. Guidance under section 904(d)(2)(H)(ii) as added by the American Jobs Creation Act of 2004 regarding the election concerning the treatment of income tax base differences.

13. Guidance under section 986(a) as amended by the American Jobs Creation Act of 2004 regarding the translation of foreign income taxes.

14. Guidance under the American Jobs Creation Act of 2004 regarding the treatment of certain RIC dividends for withholding tax purposes.

15. Guidance under section 954(c) as amended by the American Jobs Creation Act of 2004 regarding the treatment of aircraft leasing and shipping income.

16. Guidance under section 965 as added by the American Jobs Creation Act of 2004 regarding the temporary dividends received deduction for foreign earnings reinvested in the United States.

17. Guidance under the American Jobs Creation Act of 2004 regarding the delayed effective date for Treas. Regs. sections 1.883-1 through 1.883-5.

18. Guidance under section 7874 as added by the American Jobs Creation Act of 2004 regarding the treatment of expatriated entities and their foreign parents.

19. Guidance under the American Jobs Creation Act of 2004 regarding the revision of the tax rules on expatriation of individuals.

20. Guidance under section 72(w) as added by the American Jobs Creation Act of 2004 regarding the application of the basis rules to nonresident aliens.

21. Guidance under section 937 as added by the American Jobs Creation Act of 2004 regarding the residence and source rules involving possessions.

PARTNERSHIPS

Original PGP Projects:

1. Guidance regarding partnership transactions under section 337(d).

2. Final regulations under section 704(b) regarding the allocation of foreign tax credits.

3. Guidance under section 704(b)(2) regarding whether partnership allocations have substantial economic effect.

4. Final regulations under section 704(c) regarding installment sales.

5. Guidance under section 706(d) regarding the determination of distributive share when a partner's interest changes.

6. Guidance under section 707 regarding disguised sales.
   - PUBLISHED 11/26/2004 in FR as NPRM REG-149519-03

7. Guidance under section 707(c) regarding guaranteed payments.

8. Proposed regulations under section 721 regarding partnership interests issued for services and the treatment of compensatory partnership options.
9. Update of the section 751 regulations.

10. Final regulations under section 752 regarding the assumption of partner liabilities.

11. Guidance under section 752 where a general partner is a disregarded entity.

12. Final regulations regarding the application of section 1045 to certain partnership transactions.

13. Final regulations under section 6031 regarding the reporting requirements of tax-exempt bond partnerships.

14. Final regulations under section 7701 regarding disregarded entities and collection issues.

Additional PGP Projects:

15. Notice regarding the amendments to sections 704, 734, 743, and 6031 that were enacted as part of the American Jobs Creation Act of 2004 relating to the partnership basis adjustments and electing investment partnerships.

SUBCHAPTER S

Original PGP Projects:

1. Guidance under section 678 regarding trusts that hold shares of a Subchapter S corporation.

2. Guidance under section 1363(d) regarding the treatment of LIFO recapture.

3. Guidance under section 1367 regarding adjustments in basis of indebtedness.

4. Final regulations under section 7701 on deemed corporate entity elections for electing S corporations.

TAX ACCOUNTING

Original PGP Projects:

1. Regulations under sections 162 and 263 regarding the deduction and capitalization of expenditures for tangible assets.

2. Regulations under section 263(a) regarding the subsequent treatment of capitalized transaction costs.

3. Update of Rev. Proc. 2004-23 regarding method of accounting changes for intangibles.

   - WILL BE PUBLISHED 1/10/2005 in IRB 2005-2 as REV. PROC. 2005-9 (released 12/13/2004)

4. Revenue ruling regarding the deduction and capitalization of costs incurred by utilities to maintain assets used to generate power.

5. Regulations under section 263A regarding the simplified service cost and simplified production methods.

6. Guidance under section 263A regarding "negative" additional section 263A costs.

7. Guidance regarding the treatment of post-production costs under section 263A.

8. Final regulations under section 263A(f).

9. Regulations under section 381 regarding changes in method of accounting.

10. Revenue procedure under section 446 regarding changes in method of accounting for rotable spare parts.

11. Regulations under section 446 regarding methods of accounting.

12. Final regulations under section 448 regarding nonaccrual of certain amounts by service providers.

13. Revenue ruling under section 461 regarding the proper year for the deduction of payroll taxes on deferred compensation by accrual method taxpayers.

14. Guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund.

15. Regulations under section 468B regarding certain escrow funds.

16. Guidance on the tax treatment of vendor allowances.

17. Revenue procedure regarding the valuation of parts inventory by heavy equipment distributors.

18. Guidance regarding the permissibility of a moving average cost method for valuing inventory.

19. Guidance under section 1.472-8 regarding the inventory price index computation (IPIC) method.

Additional PGP Projects:

20. Guidance under section 248 as amended by the American Jobs Creation Act of 2004 regarding the period allowed for deducting organizational expenditures of a corporation.

21. Revenue procedure providing an extension of time for filing the statement required by Rev. Proc. 2004-23 to obtain automatic consent to accounting method change for capitalizing amounts paid for intangible assets.
    - PUBLISHED 9/20/2004 in IRB 2004-38 as REV. PROC. 2004-57 (released 9/1/2004)

TAX ADMINISTRATION

Original PGP Projects:

1. Annual compilation of tax shelter listed transactions under section 6011.
    - PUBLISHED 10/12/2004 in IRB 2004-41 as NOTICE 2004-67

(released 9/24/2004)

2. Proposed regulations under section 6012 regarding the filing requirements for Subchapter T Cooperatives.

3. Guidance regarding information reporting under section 6041 for commissions paid to insurance agents.

4. Final regulations under section 6045(f) regarding the reporting of gross proceeds to attorneys.

5. Revenue procedure under section 6050S regarding changes in method of information reporting by eligible educational institutions for qualified tuition and related expenses.
   - PUBLISHED 10/12/2004 in IRB 2004-41 as NOTICE 2004-63 (released 9/17/2004)

6. Final regulations under section 6081 regarding the signature requirement to request an extension of time to file information returns.
   - PUBLISHED 12/7/2004 in FR as TD 9163

7. Proposed regulations under section 6103 regarding the disclosure of unrelated third party tax information in tax proceedings.

8. Temporary regulations under section 6103 regarding disclosures to the Department of Commerce.

9. Proposed regulations under section 6103 regarding disclosures to subcontractors.
10. Final regulations authorizing the imposition and collection of reproduction fees for furnishing section 6104 information.

11. Proposed regulations under section 6159 regarding installment agreements.

12. Update of Rev. Ruls. 75-365, 366 and 367 regarding interests in real estate held by a decedent.

13. Guidance under section 6213 regarding math error assessments based on a Form W-2.

14. Revenue ruling regarding the classification of items and the statute of limitations under the TEFRA partnership provisions.

15. Proposed regulations under sections 6320 and 6330 regarding collection due process.

16. Revenue procedure regarding the Collection Appeals Program.

17. Final regulations under section 6334 regarding the seizure of a principal residence.

18. Revenue ruling regarding the limitations on setoff.

19. Revenue ruling regarding setoff with respect to a taxpayer in bankruptcy.

20. Revenue ruling under section 6404 regarding the application of the interest suspension provisions when a taxpayer files an amended return.

21. Revenue procedure under section 6404 regarding the remedies available to taxpayers with respect to the interest suspension rules.

22. Proposed regulations under section 6502 regarding the extension of the statute of limitations on collection.

23. Final regulations under section 6503 regarding the suspension of the period of limitations for noncompliance with a designated summons.

24. Withdrawal of the regulations under former section 6015 regarding the declaration of estimated tax by individuals.

25. Regulations under section 6655 regarding estimated tax payments by corporations.

26. Revenue ruling regarding the definition of "pending" under section 6658.

27. Withdrawal of the regulations under former section 6661 regarding the substantial understatement penalty.

28. Regulations under section 6664 amending the definition of a qualified amended return.

29. Update of Rev. Proc. 94-69 regarding qualified amended returns for CIC taxpayers.

30. Guidance necessary to facilitate electronic tax administration.

31. Revenue ruling under section 7426 regarding refund suits by third parties.

32. Revenue ruling under section 7426 regarding refund claims in lieu of wrongful levy claims.

33. Proposed regulations under section 7430 regarding miscellaneous changes made by TRA 97 and RRA 98.

34. Proposed regulations under section 7477 regarding declaratory judgments relating to gift tax valuations.

35. Proposed regulations under section 7502 regarding the timely mailing/delivery of documents.
    - PUBLISHED 9/21/2004 in FR as NPRM REG-138176-02

36. Final regulations under section 7602 regarding the designation of IRS officers or employees to take summoned testimony or receive summoned information.

37. Revenue procedure regarding the early examination of questionable transactions.

38. Proposed regulations regarding third party and John Doe summonses.

39. Revisions to Circular 230 regarding practice before the IRS.
    - PUBLISHED 12/20/2004 in FR as TD 9165
    - PUBLISHED 12/20/2004 in FR as NPRM REG-159824-04

40. Revenue procedure expanding the prefiling agreement program.

41. Final regulations regarding testimony authorizations and requests for IRS information.

42. Guidance regarding frivolous arguments used by taxpayers in an attempt to avoid or evade tax.

<u>Additional PGP Projects:</u>

43. Final regulations under section 6302 regarding the minimum threshold for depositing FUTA taxes.
    - PUBLISHED 12/1/2004 in FR as TD 9162

44. Guidance under section 6043A as added by the American Jobs Creation Act of 2004 regarding the information reporting requirements relating to taxable mergers and acquisitions.

45. Guidance under section 6707A as added by the American Jobs Creation Act of 2004 regarding the penalty for failure to disclose reportable transactions.

46. Notice under section 6662A as added by the American Jobs Creation Act of 2004 regarding the accuracy-related penalty relating to understatements with respect to reportable transactions.

47. Guidance under section 6501 as amended by the American Jobs Creation Act of 2004 regarding the extension of the statute of limitations for assessment relating to failures to report required information concerning listed transactions.

48. Notice regarding sections 6111, 6112 and 6708 as amended by the American Jobs Creation Act of 2004 relating to the disclosure of reportable transactions and the maintenance of lists of advisees.
    - PUBLISHED 12/13/2004 in IRB 2004-50 as NOTICE 2004-80 (released 11/16/2004)

49. Guidance under section 6603 as added by the American Jobs Creation Act of 2004 regarding deposits made to suspend the running of interest on potential underpayments.

50. Guidance under section 6050L as amended by the American Jobs Creation Act of 2004 regarding the information reporting requirements relating to certain donated property.

51. Guidance updating Rev. Rul. 82-29 regarding the use of facsimile signatures on certain forms.

52. Guidance under section 6011 regarding alternative methods of disclosing transactions reportable under the book/tax difference category of reportable transactions.
    - PUBLISHED 8/2/04 in IRB 2004-31 as REV. PROC. 2004-45 (released 7/7/04)

53. Guidance under section 6011 regarding the exception from the reporting requirement in section 1.6011-4(b)(4) of the regulations for certain contractual protection transactions.
    - PUBLISHED 12/13/04 in IRB 2004-50 as REV. PROC. 2004-65 (released 11/16/04)

54. Guidance under section 6011 regarding the exception from the reporting requirement in section 1.6011-4(b)(5) of the regulations for certain loss transactions.
    - PUBLISHED 12/13/04 in IRB 2004-50 as REV. PROC. 2004-66 (released 11/16/04)

55. Guidance under section 6011 regarding the exception from the reporting

requirement in section 1.6011-4(b)(6) of the regulations for certain book-tax transactions.
- PUBLISHED 12/13/04 in IRB 2004-50 as REV. PROC. 2004-67 (released 11/16/04)

56. Guidance under section 6011 regarding the exception from the reporting requirement in section 1.6011-4(b)(7) of the regulations for certain brief asset holding period transactions.
    - PUBLISHED 12/13/04 in IRB 2004-50 as REV. PROC. 2004-68 (released 11/16/04)

TAX EXEMPT BONDS

Original PGP Projects:

1. Final regulations under section 141 on refundings.

2. Proposed regulations under section 141 regarding allocation and accounting provisions.

3. Final regulations under section 143 regarding mortgage insurance fees.

4. Revenue procedure under section 143 regarding average area purchase price.

5. Guidance on LIBOR-based swap transactions.

6. Guidance on arbitrage.

7. Final regulations under section 1397E regarding qualified zone academy bonds.

Additional PGP Projects:

8. Guidance under section 142 as amended by the American Jobs Creation Act of 2004 regarding the Brownfields demonstration program.

APPENDIX - Regularly Scheduled Publications

JULY 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.
   - PUBLISHED 7/6/2004 in IRB 2004-27 as REV. RUL. 2004-66

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in July 2004.
   - PUBLISHED 7/26/2004 in IRB 2004-30 as NOTICE 2004-51 (released 7/7/2004)

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.
   - PUBLISHED 8/9/2004 in IRB 2004-32 as REV. RUL. 2004-81

AUGUST 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.
   - PUBLISHED 8/9/2004 in IRB 2004-32 as REV. RUL. 2004-84

2. Revenue procedure providing the amounts of unused housing credit carryover allocated to qualified states under section 42(h)(3)(D) for the calendar year.
   - PUBLISHED 8/23/2004 in IRB 2004-34 as REV. PROC. 2004-52

3. Notice providing the inflation adjustment factor to be used in determining the enhanced oil recovery credit under section 43 for tax years beginning in the calendar year.
   - PUBLISHED 7/26/2004 in IRB 2004-30 as NOTICE 2004-49

4. Notice providing the applicable percentage to be used in determining percentage depleting for marginal properties under section 613A for the calendar year.
   - PUBLISHED 7/26/2004 in IRB 2004-30 as NOTICE 2004-48

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the second half of 2004 for use in valuing personal flights on employer-provided aircraft.
   - PUBLISHED 9/13/2004 in IRB 2004-37 as REV. RUL. 2004-70

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in August 2004.

   - PUBLISHED 8/30/2004 in IRB 2004-35 as NOTICE 2004-56 (released 8/4/2004)

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.
   - PUBLISHED 8/30/2004 in IRB 2004-35 as REV. RUL. 2004-91

SEPTEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.
   - PUBLISHED 9/7/2004 in IRB 2004-36 as REV. RUL. 2004-69

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2004.
   - PUBLISHED 8/23/2004 in IRB 2004-34 as REV. RUL. 2004-89

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period October through December 2004.
   - PUBLISHED 9/13/2004 in IRB 2004-37 as REV. RUL. 2004-92 (released 8/30/2004)

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in September 2004.
   - PUBLISHED 10/4/2004 in IRB 2004-40 as NOTICE 2004-60 (released 9/3/2004)

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.
   - PUBLISHED 9/13/2004 in IRB 2004-37 as REV. RUL. 2004-93

6. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal standard mileage amounts.
   - PUBLISHED 12/6/2004 in IRB 2004-49 as REV. PROC. 2004-64 (released 11/17/2004)

7. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal travel per diem amounts.
   - PUBLISHED 10/18/2004 in IRB 2004-42 as REV. PROC. 2004-60 (released 10/1/2004)

8. Update of Notice 2002-62 to add approved applicants for designated private delivery service status under section 7502(f). Will be published only if any new applicants are approved.
   - WILL BE PUBLISHED 12/27/2004 in IRB 2004-52 as NOTICE 2004-83

OCTOBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.
   - PUBLISHED 10/12/2004 in IRB 2004-41 as REV. RUL. 2004-96

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in October 2004.
   - PUBLISHED 10/25/2004 in IRB 2004-43 as NOTICE 2004-69 (released 10/6/2004)

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.
   - PUBLISHED 11/1/2004 in IRB 2004-44 as REV. RUL. 2004-101

4. Revenue procedure under section 1 and other sections of the Code regarding the inflation adjusted items for 2005.
   - PUBLISHED 12/13/2004 in IRB 2004-50 as REV. PROC. 2004-71 (released 11/19/2004)

5. Revenue procedure providing the loss payment patterns and discount factors for the 2004 accident year to be used for computing unpaid losses under section 846.
   - PUBLISHED 12/6/2004 in IRB 2004-49 as REV. PROC. 2004-69

6. Revenue procedure providing the salvage discount factors for the 2004 accident year to be used for computing discounted estimated salvage recoverable under section 832.
   - PUBLISHED 12/6/2004 in IRB 2004-49 as REV. PROC. 2004-70

7. Update of Rev. Proc. 2004-13 listing the tax deadlines that may be extended by the Commissioner under section 7508A in the event of a Presidentially-declared disaster or terrorist attack.

NOVEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.
   - PUBLISHED 11/8/2004 in IRB 2004-45 as REV. RUL. 2004-102

2. Revenue ruling providing the "base period T-Bill rate" as required by section 995(f)(4).
   - PUBLISHED 11/1/2004 in IRB 2004-44 as REV. RUL. 2004-99

3. Revenue ruling setting forth covered compensation tables for the 2005 calendar year for determining contributions to defined benefit plans and permitted disparity.
   - PUBLISHED 11/15/2004 in IRB 2004-46 as REV. RUL. 2004-104

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in November 2004.
   - PUBLISHED 11/22/2004 in IRB 2004-47 as NOTICE 2004-77 (released 11/5/2004)

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.
   - PUBLISHED 11/29/2004 in IRB 2004-48 as REV. RUL. 2004-105

6. Update of Rev. Proc. 2003-77 regarding adequate disclosure for purposes of the section 6662 substantial understatement penalty and the section 6694 preparer penalty.
   - PUBLISHED 12/20/2004 in IRB 2004-51 as REV. PROC. 2004-73

7. News release setting forth cost-of living adjustments effective January 1, 2005, applicable to the dollar limits on benefits under qualified defined benefit pension plans and other provisions affecting certain plans of deferred compensation.
   - PUBLISHED 11/15/2004 in IRB 2004-46 as NOTICE 2004-72 (released 10/20/2004 as IR-2004-127)

DECEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 2004.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period January through March 2005.
   ? PUBLISHED 12/20/2004 in IRB 2004-51 as REV. RUL. 2004-111
   (released 12/2/2004)

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in December 2004.
   ? PUBLISHED 12/20/2004 in IRB 2004-51 as NOTICE. 2004-82
   (released 12/3/2004)

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Revenue procedure setting forth, pursuant to section 1397E, the maximum face amount of Qualified Zone Academy Bonds that may be issued for each state during 2005.
   ? WILL BE PUBLISHED 12/27/2004 in IRB 2004-52 as REV. PROC. 2004-74
   (released 12/10/2004)

7. Federal Register notice on Railroad Retirement Tier 2 tax rate.
   ? PUBLISHED 12/7/2004 in FR as FRNT REG-161713-04.

JANUARY 2005

1. Revenue procedure updating the procedures for issuing private letter rulings, determination letters, and information letters on specific issues under the jurisdiction of the Chief Counsel.
   - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-1

2. Revenue procedure updating the procedures for furnishing technical advice, including technical expedited advice, to certain IRS offices, in the areas under the jurisdiction of the Chief Counsel.
   - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-2

3. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of certain Associates Chief Counsel other than the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

- WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-3

4. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.
   - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-7

5. Revenue procedure updating procedures for furnishing letter rulings, general information letters, etc. in employee plans and exempt organization matters relating to sections of the Code under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.
   - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-4

6. Revenue procedure updating procedures for furnishing technical advice in employee plans and exempt organization matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division.
   - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-5

7. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

8. Revenue ruling setting forth the prevailing state assumed interest rates provided for the determination of reserves under section 807 for contracts issued in 2004 and 2005.

9. Revenue ruling providing the dollar amounts, increased by the 2004 inflation adjustment, for section 1274A.
   - PUBLISHED 11/22/2004 in IRB 2004-47 as REV. RUL. 2004-107

10. Revenue ruling setting forth the amount that section 7872 permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest, adjusted for inflation.
    - PUBLISHED 11/22/2004 in IRB 2004-47 as REV. RUL. 2004-108

11. Revenue procedure providing procedures for limitations on depreciation deductions for owners of passenger automobiles first placed in service during the calendar year; amounts to be included in income by lessees of passenger automobiles first leased during the calendar year; and the maximum allowable value of employer-provided automobiles first made available to employees for personal use in the calendar year.

12. Revenue procedure providing the domestic asset/liability percentages and the domestic investment yield percentages for taxable years beginning after December 31, 2004, for foreign companies conducting insurance business in the U.S.

13. Revenue procedure updating procedures for issuing determination letters on the qualified status of employee plans under sections 401(a), 403(a), 409, and 4975.
    - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-6

14. Revenue procedure updating the user fee program as it pertains to requests for letter rulings, determination letters, etc. in employee plans and exempt organizations matters under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.
    - WILL BE PUBLISHED 1/3/2005 in IRB 2005-1 as REV. PROC. 2005-8

15. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in January 2005.
16. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

FEBRUARY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

3. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in February 2005.

MARCH 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing resident population of the states for determining the calendar year state housing credit ceiling under section 42(h), the private activity bond volume cap under section 146, and the qualified public educational facility bond volume cap under section 142(k).

3. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2005.

4. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period April through June 2005.

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the first half of 2005 for use in valuing personal flights on employer-provided aircraft.

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in March 2005.

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

8. Notice providing a tentative determination under section 809 of the differential earnings rate for 2004 for use by mutual life insurance companies to compute their income tax liabilities for 2004.

APRIL 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the average annual effective interest rates charged by each Farm Credit Bank District.

3. Notice providing the inflation adjustment factor, nonconventional fuel source credit, and reference price for the calendar year that determines the availability of the credit for producing fuel from a nonconventional source under section 29.

4. Revenue procedure providing a current list of countries and the dates those countries are subject to the section 911(d)(4) waiver and guidance to individuals who fail to meet the eligibility requirements of section 911(d)(1) because of adverse conditions in a foreign country.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in April 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

MAY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in May 2005.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

4. Revenue procedure providing guidance for use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio under section 145.

JUNE 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period April through June 2005.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period July through September 2005.

4. Notice providing the calendar year inflation adjustment factor and reference prices for the renewable electricity production credit under section 45.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in June 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 21, 2004
JS-2164

U.S. Treasury Designates Two Individuals with Ties to al Qaida, UBL Former BIF Leader and al-Qaida Associate Named Under E.O. 13224

The U.S Department of the Treasury today announced the designation of Adel Abdul Jalil Batterjee and Saad Rashed Mohammad al-Faqih for providing financial and material support to al Qaida and Usama bin Laden (UBL).

The U.S. is submitting both names to the United Nations 1267 Committee, which will consider adding them to the consolidated list of terrorists tied to al Qaida, UBL and the Taliban. Batterjee and al-Faqih are not linked to each other.

Today's action was taken pursuant to Executive Order 13224. The United States has now designated 396 individuals and entities as terrorists, their financiers or facilitators since September 2001. In addition, the global community has frozen over $144 million in terrorist-related assets.

Adel Abdul Jalil Batterjee served as the Executive Director and a member of the Board of Directors of Benevolence International Foundation (BIF), which was designated as a Specially Designated Global Terrorist (SDGT) by the Treasury in November 2002 for its support to al Qaida and UBL.

"Adel Batterjee has ranked as one of the world's foremost terrorist financiers, who employed his private wealth and a network of charitable fronts to bankroll the murderous agenda of al Qaida. A worldwide asset freeze, including in his home country of Saudi Arabia, will deal a serious blow to this key terrorist facilitator," said Stuart Levey, Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI).

In the late 1980s, Batterjee founded the precursor to BIF, Lajnat al-Birr al-Islamiah (LBI), in Saudi Arabia and Pakistan. LBI provided financial and operational support to mujahideen elements in Afghanistan and around the world, including fighters associated with UBL and Gulbuddin Hekmatyer, who was named a SDGT by the Treasury on February 18, 2003. LBI was affiliated with Maktab Al-Khidamat (MK), which was co-founded and financed by UBL and is the precursor organization of al Qaida. LBI later joined al Qaida upon the dissolution of MK.

In the early 1990s, LBI began operating under the name Benevolence International Foundation (BIF) in an effort to widen its appeal to the general public and increase its credibility with other governments. BIF and LBI remained one organization with interchangeable assets under Batterjee's control.

In 1993, Batterjee incorporated BIF in the United States, where it also provided financial and operational support to mujahideen fighters worldwide, including members of al Qaida in Afghanistan, the Sudan, Bosnia-Herzegovina and Chechnya. At one point, UBL confirmed to an associate that BIF was one of the non-governmental organizations providing funds to al Qaida.

According to information available to the U.S. Government, it was around that time that a BIF employee in the Sudan traveled to Saudi Arabia attempting to meet Batterjee. Instead, the employee reported he was detained and questioned by Saudi authorities regarding BIF links to UBL. Once released, he returned to the Sudan where he met with UBL and informed him of his detainment. As a result, BIF operations were curtailed for a period of time.

Batterjee subsequently resigned as Director of BIF and personally selected UBL confidant Enaam Arnaout to serve as the organization's head. Documents obtained by the U.S. Government demonstrate that Arnaout, while employed with LBI and BIF, worked with members of al Qaida to procure weapons for use in al Qaida training camps. While employed by Batterjee at LBI, Arnaout reported directly to Batterjee, which was outside the usual chain of command.

Batterjee remained active in BIF despite having officially resigned as Director. Evidence shows that Arnaout made an effort to conceal Batterjee's continued involvement in BIF. In 2002, when Arnaout learned that U.S. authorities were scrutinizing BIF's activities, he warned Batterjee through an intermediary against transferring funds to any BIF offices.

Evidence of BIF's ties to al Qaida surfaced in March 2002 searches by Bosnian authorities of the organization's Sarajevo offices. These searches uncovered numerous handwritten documents detailing the origin and history of the al Qaida organization. Among the recovered files was a copy of a 1988 handwritten draft listing wealthy financiers of UBL's mujahideen operations in Afghanistan, referred to within al Qaida as the "Golden Chain."

This list contains 20 names with a parenthetical after each name, likely indicating the person who received funds from the specified donor. "Usama" appears after seven of the listings and "Baterji" appears after an additional six listings.

Also uncovered from the Bosnian raid were photographs of Arnaout with UBL and an administrative diagram of UBL's close associates, along with cover names and assignments within al Qaida of mujahideen trained in Afghanistan.

In October 2002, Arnaout was indicted in the United States for operating BIF as a racketeering enterprise and providing material support to organizations, including al Qaida, that are engaged in violent activities. Batterjee was named as an un-indicted co-conspirator in the indictment. On February 10, 2003, Arnaout pled guilty to criminal racketeering conspiracy for diverting BIF funds to pay for supplies to armed jihadists in Bosnia and Chechnya.

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Adel Batterjee
`Adil `Abd al Jalil Batarji

DOB: July 1, 1946
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Address: 2 Helmi Kutbi Street, Jeddah, Saudi Arabia

Saad Rashed Mohammad al-Faqih has maintained associations with the al Qaida network since the mid-1990s, including an individual associated with the 1998 East Africa embassy bombings.

Al-Faqih has had contact with both UBL and Khaled al Fawwaz, who acted as UBL's de facto representative in the U.K. According to information available to the U.S. Government, al-Faqih and al Fawwaz shared an office in the late 1990s, and al-Faqih worked with and provided assistance to al Fawwaz, who served as the intermediary between UBL and al-Faqih.

Following the 1998 East African embassy bombings, al Fawwaz was arrested in the United Kingdom under an extradition request from the United States. At the U.S. trial of the East African embassy bombers, prosecutors provided evidence that al-Faqih paid for a satellite phone that al Fawwaz passed on to UBL, who allegedly used it to help carry out the attacks.

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Al-Faqih is head of the non-governmental organization Movement for Islamic Reform in Arabia (MIRA). Extremists utilize a website controlled by al-Faqih and MIRA to post al Qaida-related statements and images. While MIRA has issued disclaimers warning users to not attribute postings on MIRA message boards to al Qaida, information available to the U.S. and UK Governments shows that the messages are intended to provide ideological and financial support to al-Qaida affiliated networks and potential recruits. AQ-affiliated author, Lewis Attiyatullah, whose statements have been published on MIRA's website, has been directly associated with Al-Faqih for several years.

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Sa'd AL-FAQI
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Saad AL-FAKIH
Abu Uthman

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POB: Zubair, Iraq
Nationality: Saudi Arabian
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Batterjee and al-Faqih were designated today pursuant to Executive Order 13224 chiefly pursuant to paragraphs (d)(i) and (d)(ii) based on a determination that they assist in, sponsor or provide financial, material, or technological support for, or financial or other services to or in support of, or are otherwise associated with, persons listed as subject to E.O. 13224. The individuals also meet the standard for inclusion in the UN 1267 Sanctions Committee's consolidated list because of the support provided to UBL, al Qaida or the Taliban.

Inclusion on the 1267 Committee's list triggers international obligations on all member countries, requiring them to freeze the assets and prevent the travel of listed individuals and to block the sale of arms and military equipment. Publicly identifying these supporters of terrorism is a critical part of the international campaign to counter terrorism. Additionally, other organizations and individuals are put on notice that they are prohibited from doing business with them.

Blocking actions are critical to combating the financing of terrorism. When an action is put into place, any assets existing in the formal financial system at the time of the order are to be frozen. Blocking actions serve additional functions as well, acting as a deterrent for non-designated parties who might otherwise be willing to finance terrorist activity; exposing terrorist financing "money trails" that may generate leads to previously unknown terrorist cells and financiers, disrupting terrorist financing networks by encouraging designated terrorist supporters to disassociate themselves from terrorist activity and renounce their affiliation with terrorist groups; terminating terrorist cash flows by shutting down the pipelines used to move terrorist-related assets; forcing terrorists to use alternative, more costly and higher-risk means of financing their activities; and engendering international cooperation and compliance with obligations under UN Security Council Resolutions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 21, 2004
JS-2164

U.S. Treasury Designates Two Individuals with Ties to al Qaida, UBL Former BIF Leader and al-Qaida Associate Named Under E.O. 13224

The U.S Department of the Treasury today announced the designation of Adel Abdul Jalil Batterjee and Saad Rashed Mohammad al-Faqih for providing financial and material support to al Qaida and Usama bin Laden (UBL).

The U.S. is submitting both names to the United Nations 1267 Committee, which will consider adding them to the consolidated list of terrorists tied to al Qaida, UBL and the Taliban. Batterjee and al-Faqih are not linked to each other.

Today's action was taken pursuant to Executive Order 13224. The United States has now designated 396 individuals and entities as terrorists, their financiers or facilitators since September 2001. In addition, the global community has frozen over $144 million in terrorist-related assets.

Adel Abdul Jalil Batterjee served as the Executive Director and a member of the Board of Directors of Benevolence International Foundation (BIF), which was designated as a Specially Designated Global Terrorist (SDGT) by the Treasury in November 2002 for its support to al Qaida and UBL.

"Adel Batterjee has ranked as one of the world's foremost terrorist financiers, who employed his private wealth and a network of charitable fronts to bankroll the murderous agenda of al Qaida. A worldwide asset freeze, including in his home country of Saudi Arabia, will deal a serious blow to this key terrorist facilitator," said Stuart Levey, Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI).

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 21, 2004
JS-2165

Treasury and IRS Issue Final Regulations on Student Exception from Employment Taxes

-- Today, the Department of the Treasury and Internal Revenue Service issued final regulations on the exception from employment taxes for services provided by students when those services are performed for a school, college or university. The regulations were issued earlier this year in proposed form and a hearing was held on June 16.

Although wages paid to students for working for a school, college or university are subject to income tax, a special exception excludes the wages for such services from FICA and FUTA taxes if certain requirements are met. Questions have arisen regarding whether the exception is available in situations where the employment aspects of the student worker's relationship to the school, college or university predominate, especially in the case of medical residents receiving training in connection with the provision of health care services. These regulations address those questions.

The final regulations provide standards for determining whether an employer qualifies as a school, college, or university, and whether an employee is a student for purposes of exception from employment taxes. The final regulations also provide that full-time employees are not students for purposes of the exception, and outline relevant factors to be taken into account in determining if the exception applies to the services provided by other employees.

In addition to the final regulations, the Treasury and the IRS are issuing a revenue procedure providing a safe harbor for the student FICA exception. The revenue procedure replaces Rev. Proc. 98-16, 1998-1 C.B. 403; the new revenue procedure modifies the Rev. Proc. 98-16 safe harbor standards to be consistent with the final regulations.

REPORTS

- A copy of the new regulations

[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[TD 9167]

RIN 1545-BC81

Student FICA Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulation

SUMMARY: This document contains final regulations providing guidance regarding the employment tax exceptions for student services. These regulations affect schools, colleges, and universities and their employees.

DATES: Effective date: December 21, 2004.

Applicability date: These regulations are applicable for services performed on or after April 1, 2005.

FOR FURTHER INFORMATION CONTACT: John Richards of the Office of Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 31 under sections 3121(b)(10) and 3306(c)(10)(B) of the Internal Revenue Code (Code). These sections except from "employment" for Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) purposes, respectively,

service performed in the employ of a school, college, or university by a student who is enrolled and regularly attending classes at such school, college, or university. In addition, this document contains amendments to 26 CFR part 31 under section 3121(b)(2). This section excepts from employment for FICA purposes domestic service performed in a local college club, or local chapter of a college fraternity or sorority, by a student who is enrolled and is regularly attending cases at a school, college, or university.

Proposed regulations under sections 3121(b)(2), 3121(b)(10), and 3306(c)(10)(B) were published in the **Federal Register** on February 25, 2004 (69 FR 8604, 2004-10 I.R.B. 571). Written and electronic comments responding to the notice of proposed rulemaking were received. A public hearing was held on June 16, 2004. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation of Provisions and Summary of Comments

The final regulations provide rules for determining whether an organization is a school, college, or university (SCU) and whether an employee is a student for purposes of sections 3121(b)(10), 3121(b)(2), and 3306(c)(10)(B) of the Code. Many comments were received on the proposed regulations and several witnesses testified at the hearing which was held June 16, 2004. After consideration of the comments and testimony, the Treasury department and the IRS decided to make several significant changes described below.

1. School, College, or University

The exceptions from employment for student services apply only if the employee is a student enrolled and regularly attending classes at a SCU. Under the proposed regulations, whether an organization is a SCU is determined with reference to the organization's primary function. An organization whose primary function is to carry on educational activities qualifies as a SCU for purposes of the student exceptions from employment.

A few commentators suggested that an organization, such as a teaching hospital, that has embedded within it a division or function that carries on educational activities should be treated as a SCU for purposes of the student exceptions from employment.

The final regulations retain the primary function standard as described in the proposed regulations. As discussed in the preamble to the proposed regulations, the primary function standard is based upon the existing statutory and regulatory language under section 3121(b)(10), as well as the legislative history relating to the student exception from employment under section 3121(b)(10).

2. Enrolled and Regularly Attending Classes

The exceptions from employment for student services require that an employee be "enrolled and regularly attending classes" in order to have the status of a student. Under the proposed regulations, "a class is an instructional activity led by a knowledgeable faculty member for identified students following an established curriculum."

Commentators requested clarification regarding whether an instructional activity must be led by a regular faculty member in order to be considered a

class, or whether an activity led by an adjunct faculty member, graduate teaching assistant, or other qualified individual hired to lead the activity could be considered a class.

The final regulations clarify that a class is an instructional activity led by a faculty member "or other qualified individual" following an established curriculum. Thus, an instructional activity led by an adjunct faculty member, graduate assistant, or other qualified individual can qualify as a class for purposes of the student exceptions from employment.

3. Student Status

The existing student FICA regulations provide that an employee whose services are incident to and for the purpose of pursuing a course of study has the status of a student. §31.3121(b)(10)-2(c). The proposed regulations provide that in order for an employee's services to be considered incident to and for the purpose of pursuing a course of study, the educational aspect of the relationship between the employee and the employer, as compared to the service aspect, must be predominant. Under the proposed regulations, if an employee is a "career employee," then the service aspect of the employee's relationship with the employer is considered predominant, and thus the employee's services are not considered incident to and for the purpose of pursuing a course of study. The proposed regulations provide that the following employees are considered career employees: (1) employees who regularly perform services 40 hours or more per week; (2) professional employees; (3) employees who receive certain employment benefits; and (4) employees required to be licensed to work in the field in which the employees are performing services. The IRS requested

comments on the criteria used to identify employees having the status of a career employee.

Commentators expressed concern about using these criteria to make certain employees automatically ineligible for the student FICA exception. Rather, according to commentators, whether an employee's services are incident to and for the purpose of pursuing a course of study should be based upon all the relevant facts and circumstances.

The final regulations provide that the educational and service aspects of an employee's relationship with the employer are generally evaluated for an academic term based upon all the relevant facts and circumstances. Similar criteria to those identified in the proposed regulations are described in the final regulations as relevant factors, not dispositive criteria, in determining whether the educational or service aspect of an employee's relationship with the employer is predominant. Nevertheless, under the final regulations, if an employee is a "full-time employee," then the employee's services are not incident to and for the purpose of pursuing a course of study. In addition, based upon comments received, the criteria identified in the proposed regulations have been modified as described below.

A. Full-Time Employee and Hours Worked

The proposed regulations provide that an employee who "regularly performs services 40 hours or more per week" is a career employee, and is thus ineligible for the student exception from employment. Commentators expressed concern that the 40 hour criterion would be administratively impracticable because it would be difficult to monitor an employee's actual hours worked during

an academic term. In addition, commentators expressed concern that the meaning of "regularly" is unclear, making it difficult to assess the effect of changes in hours worked from week to week. Commentators also requested clarification on whether an employee's number of hours worked during academic breaks is considered in determining whether the employee is eligible for the student FICA exception.

The final regulations modify the hours worked criterion. The final regulations provide that the services of a "full-time employee" are not incident to and for the purpose of pursuing a course of study. Under the final regulations, a full-time employee is an employee who is considered a full-time employee based upon the employer's standards and practices, except that an employee whose "normal work schedule is 40 hours or more per week" is considered a full-time employee. This standard is intended to improve administrability for employers. Whether an employee is a full-time employee based upon the employer's standards and practices, or based upon the employee's normal work schedule, should be determinable by employers at the start of an academic term, thus reducing instances where an employee's status shifts from student to non-student during an academic term. An employee's normal work schedule does not change, for example, based upon changes in work demands that are unforeseen at the start of an academic term causing the employee to work additional hours beyond his normal work schedule. In addition, time spent performing services that have an educational or instructional aspect is considered in determining an employee's normal work schedule. Finally, the final regulations provide that an employee's work schedule during an academic break

is not considered in determining whether the employee's normal work schedule is 40 hours or more per week.

The final regulations provide that if an employee does not have the status of a full-time employee, then the employee's normal work schedule and actual number of hours worked per week are relevant factors in determining whether the service aspect or educational aspect of the employee's relationship with the employer is predominant. Thus, if an employee is normally scheduled to work 20 hours per week, but consistently works more than 40 hours per week, the amount of time actually worked is taken into account in determining whether or not the employee qualifies as a student.

B. Professional Employee and Licensure

1. Professional Employee

The proposed regulations provide that a "professional employee" is a career employee, and is thus ineligible for the student exception from employment. Under the proposed regulations, a professional employee is an employee who performs work: (1) requiring knowledge of an advanced type in a field of science or learning, (2) requiring the consistent exercise of discretion and judgment, and (3) that is predominantly intellectual and varied in character.

Commentators expressed concern that the professional employee criterion would inappropriately disqualify the services of many graduate research and teaching assistants from eligibility for the student exceptions from employment. Commentators maintained that graduate research and teaching assistants are primarily students, and thus their services should not automatically

be ineligible for the student exceptions based upon the professional employee criterion.

The final regulations provide that whether an employee is a professional employee is a relevant factor, not a dispositive criterion, in evaluating the service aspect of the employee's relationship with the employer. Under the final regulations, if an employee has the status of a professional employee, then that suggests the service aspect of the employee's relationship with the employer is predominant. Whether a professional employee is a student will depend upon al the facts and circumstances. Thus, under the final regulations, those graduate assistants and other employees whose work is described under the professional employee standard are not automatically ineligible for the student exception.

2. Licensure

The proposed regulations provide that an employee who is required to be licensed under state or local law to work in the field in which the employee performs services is a career employee, and is thus ineligible for the student exception. The preamble to the proposed regulations requested comments on the licensure criterion and whether this criterion should be further refined or clarified.

Commentators expressed concern that the licensure criterion under the proposed regulations is overly broad because it would cause employees licensed for health and safety reasons, such as van drivers and life guards, to be ineligible for student status.

Under the final regulations, an employee's licensure status is not a dispositive criterion. Instead, the final regulations provide if an employee is a

professional employee, then whether the employee is licensed is a relevant factor in determining whether the service aspect of the employee's relationship with the employer is predominant. The final regulations provide that if an employee has the status of a licensed, professional employee, then that fact further suggests that the service aspect of the employee's relationship with the employer is predominant. However, a worker who is a licensed, professional employee could be considered a student based upon all the relevant facts and circumstances.

C. Employment Benefits

The proposed regulations provide that an employee who is eligible to receive certain employment benefits is considered a career employee, and is thus ineligible for the student exception.

Commentators expressed concern that eligibility to receive employment benefits should not disqualify an individual from the student exception. Commentators noted that some state statutes make student employees eligible for retirement and other benefits, meaning that student employees in those states could not qualify as students under the proposed regulations. In addition, commentators noted that many colleges and universities permit student employees to make elective contributions to section 403(b) arrangements. Under the proposed regulations, offering this benefit would prohibit student employees from qualifying as students for purposes of the student exceptions from employment.

The final regulations provide that eligibility to receive employment benefits is a relevant factor, not a dispositive criterion, in determining whether the service

aspect of an employee's relationship with the employer is predominant. Thus, an employee who is eligible for employment benefits can still qualify as a student for purposes of the student exceptions from employment. In addition, the final regulations provide that eligibility to receive health insurance benefits is not considered in determining whether the service aspect is predominant, and eligibility for benefits mandated by state or local law is given less weight in determining whether the service aspect is predominant.

4. Effective Date

Commentators objected to the proposed effective date of February 25, 2004, asserting that it would take some time to adjust to the new rules set forth in the proposed regulations. In response to these comments, the final regulations are applicable with respect to services performed on or after April 1, 2005.

5. Revenue Procedure Replacing Rev. Proc. 98-16

When the IRS issued the proposed regulations, it also issued Notice 2004-12 (2004-10 I.R.B. 556) suspending Rev. Proc. 98-16 (1998-1 C.B. 403) and proposing to replace it with a revenue procedure that is consistent with the proposed regulations. The IRS solicited comments on the proposed revenue procedure. Comments were received and considered in conjunction with the comments on the proposed regulations. The proposed revenue procedure has been modified in response to comments, and in order to provide guidance that is consistent with the final regulations, is being issued in final form in Rev. Proc. 2005-11 (to be published in I.R.B. 2005-2) modifying and superseding Rev. Proc. 98-16. Rev. Proc. 2005-11 is applicable with respect to services performed on or

after April 1, 2005. Taxpayers may rely upon Rev. Proc. 98-16 with respect to services performed prior to April 1, 2005.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In addition, because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

Drafting Information

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

List of Subjects in 26 CFR Part 31

Employment taxes and collection of income tax at source.

Adoption of Amendment to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

Part 31--EMPLOYMENT TAXES

Paragraph 1. The authority citation for part 31 continues to read in part, as follows:

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

Par. 2. In § 31.3121(b)(2)-1, paragraph (d) is revised to read as follows:

§ 31.3121(b)(2)-1 Domestic service performed by students for certain college organizations.

* * * * *

(d) An organization is a school, college, or university within the meaning of section 3121(b)(2) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

* * * * *

Par. 3. Section 31.3121(b)(10)-2 is amended by:

1. Revising paragraphs (a), (b), (c) and (d).
2. Redesignating paragraph (e) as (g).
3. Adding paragraphs (e) and (f).

The revisions and additions read as follows:

§ 31.3121(b)(10)-2 Services performed by certain students in the employ of a school, college, or university, or of a nonprofit organization auxiliary to a school, college, or university.

(a) General rule. (1) Services performed in the employ of a school, college, or university within the meaning of paragraph (c) of this section (whether

or not the organization is exempt from income tax) are excepted from employment, if the services are performed by a student within the meaning of paragraph (d) of this section who is enrolled and is regularly attending classes at the school, college, or university.

(2) Services performed in the employ of an organization which is--

(i) Described in section 509(a)(3) and §1.509(a)-4;

(ii) Organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university within the meaning of paragraph (c) of this section; and

(iii) Operated, supervised, or controlled by or in connection with the school, college, or university; are excepted from employment, if the services are performed by a student who is enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university. The preceding sentence shall not apply to services performed in the employ of a school, college, or university of a State or a political subdivision thereof by a student referred to in section 218(c)(5) of the Social Security Act (42 U.S.C. 418(c)(5)) if such services are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act. For the definitions of "operated, supervised, or controlled by", "supervised or controlled in connection with", and "operated in connection with", see paragraphs (g), (h), and (i), respectively, of §1.509(a)-4.

(b) Statutory tests. For purposes of this section, if an employee has the status of a student within the meaning of paragraph (d) of this section, the amount of remuneration for services performed by the employee, the type of

services performed by the employee, and the place where the services are performed are not material. The statutory tests are:

(1) The character of the organization in the employ of which the services are performed as a school, college, or university within the meaning of paragraph (c) of this section, or as an organization described in paragraph (a)(2) of this section, and

(2) The status of the employee as a student enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university within the meaning of paragraph (c) of this section by which the employee is employed or with which the employee's employer is affiliated within the meaning of paragraph (a)(2) of this section.

(c) School, College, or University. An organization is a school, college, or university within the meaning of section 3121(b)(10) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) Student Status--general rule. Whether an employee has the status of a student performing the services shall be determined based on the relationship of the employee with the organization employing the employee. In order to have the status of a student, the employee must perform services in the employ of a school, college, or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section.

In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university. An employee who performs services in the employ of an affiliated organization within the meaning of paragraph (a)(2) of this section must be enrolled and regularly attending classes at the affiliated school, college, or university within the meaning of paragraph (c) of this section in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university.

(1) Enrolled and regularly attending classes. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c) of this section at which the employee is employed to have the status of a student within the meaning of section 3121(b)(10). An employee is enrolled within the meaning of section 3121(b)(10) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c) of this section for identified students following an established curriculum. Traditional classroom activities are not the sole means of satisfying this requirement. For example, research activities under the supervision of a faculty advisor necessary to complete the requirements for a

Ph.D. degree may constitute classes within the meaning of section 3121(b)(10). The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) Course of study. An employee must be pursuing a course of study in order to have the status of a student. A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted by a school, college, or university within the meaning of paragraph (c) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c) of this section. A course of study also includes one or more courses at a school, college or university within the meaning of paragraph (c) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) Incident to and for the purpose of pursuing a course of study. (i) General rule. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an employee's services are incident to and for the purpose of pursuing a course of study shall be determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship between the employer and the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the

purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) Student status determined with respect to each academic term. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. If the relevant facts and circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) Full-time employee. The services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time employee is based on the employer's standards and practices, except regardless of the employer's classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week. The determination of an employee's normal work schedule is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect.

(iv) Evaluating educational aspect. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The educational aspect of an employee's relationship with the employer is generally evaluated based on the employee's course workload. Whether an employee's course workload is sufficient in order for the employee's employment to be incident to and for the purpose of pursuing a course of study depends on the particular facts and circumstances. A relevant factor in evaluating an employee's course workload is the employee's course workload relative to a full-

time course workload at the school, college or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes.

(v) Evaluating service aspect. The service aspect of an employee's relationship with the employer is evaluated based on the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) Normal work schedule and hours worked. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of an employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the employee may have an educational, instructional, or training aspect.

(B) Professional employee.

(1) If an employee has the status of a professional employee, then that suggests the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee--

(i) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes;

(ii) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(iii) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) Employment Benefits. Whether an employee is eligible to receive one or more employment benefits is a relevant factor in evaluating the service aspect of an employee's relationship with the employer. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan or arrangement described in sections 401(a),

403(b), or 457(a); or eligibility to receive employment benefits such as reduced tuition (other than qualified tuition reduction under section 117(d)(5) provided to a teaching or research assistant who is a graduate student), or benefits under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is eligible for a particular employment benefit may vary depending on the type of benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students. Less weight is given to the fact that an employee is eligible to receive an employment benefit if eligibility for the benefit is mandated by state or local law.

(e) Examples. The following examples illustrate the principles of paragraphs (a) through (d) of this section:

Example 1. (i) Employee C is employed by State University T to provide services as a clerk in T's administrative offices, and is enrolled and regularly attending classes at T in pursuit of a B.S. degree in biology. C has a course workload during the academic term which constitutes a full-time course workload at T. C is considered a part-time employee by T during the academic term, and C's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term C works 40 hours or more

during a week. C is compensated by hourly wages, and receives no other compensation or employment benefits.

(ii) In this example, C is employed by T, a school, college, or university within the meaning of paragraph (c) of this section. C is enrolled and regularly attending classes at T in pursuit of a course of study. C is not a full-time employee based on T's standards, and C's normal work schedule does not cause C to have the status of a full-time employee, even though C may occasionally work 40 hours or more during a week due to unforeseen work demands. C's part-time employment relative to C's full-time course workload indicates that the educational aspect of C's relationship with T is predominant. Additional facts supporting this conclusion are that C is not a professional employee, and C does not receive any employment benefits. Thus, C's services are incident to and for the purpose of pursuing a course of study. Accordingly, C's services are excepted from employment under section 3121(b)(10).

Example 2. (i) Employee D is employed in the accounting department of University U, and is enrolled and regularly attending classes at U in pursuit of an M.B.A. degree. D has a course workload which constitutes a half-time course workload at U. D is considered a full-time employee by U under U's standards and practices.

(ii) In this example, D is employed by U, a school, college, or university within the meaning of paragraph (c) of this section. In addition, D is enrolled and regularly attending classes at U in pursuit of a course of study. However, because D is considered a full-time employee by U under its standards and practices, D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's services are not excepted from employment under section 3121(b)(10).

Example 3. (i) The facts are the same as in Example 2, except that D is not considered a full-time employee by U, and D's normal work schedule is 32 hours per week. In addition, D's work is repetitive in nature and does not require the consistent exercise of discretion and judgment, and is not predominantly intellectual and varied in character. However, D receives vacation, sick leave, and paid holiday employment benefits, and D is eligible to participate in a retirement plan maintained by U described in section 401(a).

(ii) In this example, D's half-time course workload relative to D's hours worked and eligibility for employment benefits indicates that the service aspect of D's relationship with U is predominant, and thus D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's services are not excepted from employment under section 3121(b)(10).

Example 4. (i) Employee E is employed by University V to provide patient care services at a teaching hospital that is an unincorporated division of V. These services are performed as part of a medical residency program in a

medical specialty sponsored by V. The residency program in which E participates is accredited by the Accreditation Counsel for Graduate Medical Education. Upon completion of the program, E will receive a certificate of completion, and be eligible to sit for an examination required to be certified by a recognized organization in the medical specialty. E's normal work schedule, which includes services having an educational, instructional, or training aspect, is 40 hours or more per week.

(ii) In this example, E is employed by V, a school, college, or university within the meaning of paragraph (c) of this section. However, E's normal work schedule calls for E to perform services 40 or more hours per week. E is therefore a full-time employee, and the fact that some of E's services have an educational, instructional, or training aspect does not affect that conclusion. Thus, E's services are not incident to and for the purpose of pursuing a course of study. Accordingly, E's services are not excepted from employment under section 3121(b)(10) and there is no need to consider other relevant factors, such as whether E is a professional employee or whether E is eligible for employment benefits.

Example 5. (i) Employee F is employed in the facilities management department of University W. F has a B.S. degree in engineering, and is completing the work experience required to sit for an examination to become a professional engineer eligible for licensure under state or local law. F is not attending classes at W.

(ii) In this example, F is employed by W, a school, college, or university within the meaning of paragraph (c) of this section. However, F is not enrolled and regularly attending classes at W in pursuit of a course of study. F's work experience required to sit for the examination is not a course of study for purposes of paragraph (d)(2) of this section. Accordingly, F's services are not excepted from employment under section 3121(b)(10).

Example 6. (i) Employee G is employed by Employer X as an apprentice in a skilled trade. X is a subcontractor providing services in the field in which G wishes to specialize. G is pursuing a certificate in the skilled trade from Community College C. G is performing services for X pursuant to an internship program sponsored by C under which its students gain experience, and receive credit toward a certificate in the trade.

(ii) In this example, G is employed by X. X is not a school, college or university within the meaning of paragraph (c) of this section. Thus, the exception from employment under section 3121(b)(10) is not available with respect to G's services for X.

Example 7. (i) Employee H is employed by a cosmetology school Y at which H is enrolled and regularly attending classes in pursuit of a certificate of completion. Y's primary function is to carry on educational activities to prepare

its students to work in the field of cosmetology. Prior to issuing a certificate, Y requires that its students gain experience in cosmetology services by performing services for the general public on Y's premises. H is scheduled to work and in fact works significantly less than 30 hours per week. H's work does not require knowledge of an advanced type in a field of science or learning, nor is it predominantly intellectual and varied in character. H receives remuneration in the form of hourly compensation from Y for providing cosmetology services to clients of Y, and does not receive any other compensation and is not eligible for employment benefits provided by Y.

(ii) In this example, H is employed by Y, a school, college or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Y in pursuit of a course of study. Factors indicating the educational aspect of H's relationship with Y is predominant are that H's hours worked are significantly less than 30 per week, H is not a professional employee, and H is not eligible for employment benefits. Based on the relevant facts and circumstances, the educational aspect of H's relationship with Y is predominant. Thus, H's services are incident to and for the purpose of pursuing a course of study. Accordingly, H's services are excepted from employment under section 3121(b)(10).

Example 8. (i) Employee J is a graduate teaching assistant at University Z. J is enrolled and regularly attending classes at Z in pursuit of a graduate degree. J has a course workload which constitutes a full-time course workload at Z. J's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term J works more than 40 hours during a week. J's duties include grading quizzes and exams pursuant to guidelines set forth by the professor, providing class and laboratory instruction pursuant to a lesson plan developed by the professor, and preparing laboratory equipment for demonstrations. J receives a cash stipend and employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b). In addition, J receives qualified tuition reduction benefits within the meaning of section 117(d)(5) with respect to the tuition charged for the credits earned for being a graduate teaching assistant.

(ii) In this example, J is employed by Z, a school, college, or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Z in pursuit of a course of study. J's full-time course workload relative to J's normal work schedule of 20 hours per week indicates that the educational aspect of J's relationship with Z is predominant. In addition, J is not a professional employee because J's work does not require the consistent exercise of discretion and judgment in its performance. On the other hand, the fact that J receives employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b) indicates that the employment aspect of J's relationship with Z is predominant. Balancing the relevant facts and circumstances, the educational aspect of J's relationship with Z is predominant. Thus, J's services are incident to and for the purpose of

pursuing a course of study. Accordingly, J services are excepted from employment under section 3121(b)(10).

(f) Effective date. Paragraphs (a), (b), (c), (d) and (e) of this section apply to services performed on or after April 1, 2005.

* * * *

Par. 4. In §31.3306(c)(10)-2:

1. Paragraph (c) is revised.

2. Paragraphs (d) and (e) are added.

The revision and addition read as follows:

§ 31.3306(c)(10)-2 Services of student in employ of a school, college, or university.

* * * * *

(c) General rule. (1) For purposes of this section, the tests are the character of the organization in the employ of which the services are performed and the status of the employee as a student enrolled and regularly attending classes at the school, college, or university described in paragraph (c)(2) of this section, in the employ of which the employee performs the services. If an employee has the status of a student within the meaning of paragraph (d) of this section, the type of services performed by the employee, the place where the services are performed, and the amount of remuneration for services performed by the employee are not material.

(2) School, college, or university. An organization is a school, college, or university within the meaning of section 3306(c)(10)(B) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and

curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) Student Status--general rule. Whether an employee has the status of a student within the meaning of section 3306(c)(10)(B) performing the services shall be determined based on the relationship of the employee with the organization for which the services are performed. In order to have the status of a student within the meaning of section 3306(c)(10)(B), the employee must perform services in the employ of a school, college, or university described in paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study at such school, college, or university within the meaning of paragraph (d)(3) of this section.

(1) Enrolled and regularly attending classes. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c)(2) of this section at which the employee is employed to have the status of a student within the meaning of section 3306(c)(10)(B). An employee is enrolled within the meaning of section 3306(c)(10)(B) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional

activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c)(2) of this section for identified students following an established curriculum. The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) Course of study. An employee must be pursuing a course of study in order to have the status of a student within the meaning of section 3306(c)(10)(B). A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted by a school, college, or university within the meaning of paragraph (c)(2) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c)(2) of this section. In addition, a course of study is one or more courses at a school, college or university within the meaning of paragraph (c)(2) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) Incident to and for the purpose of pursuing a course of study. (i) General rule. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an employee's services are incident to and for the purpose of pursuing a course of study shall be determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship between the employer and

the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) Student status determined with respect to each academic term. Whether an employee's services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. If the relevant facts and circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of

study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) Full-time employee. The services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time employee is based on the employer's standards and practices, except regardless of the employer's classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week. The determination of the employee's normal work schedule is not affected by the fact that the services performed by the individual may have an educational, instructional, or training aspect.

(iv) Evaluating educational aspect. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The educational aspect of an employee's relationship with the employer is generally evaluated based on the employee's course workload. Whether an employee's course workload is sufficient in order for the employee's employment to be incident to and for the purpose of pursuing a course of study depends on

the particular facts and circumstances. A relevant factor in evaluating an employee's course workload is the employee's course workload relative to a full-time course workload at the school, college or university within the meaning of paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes.

(v) Evaluating service aspect. The service aspect of an employee's relationship with the employer is evaluated based on the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) Normal work schedule and hours worked. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of the employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the individual may have an educational, instructional, or training aspect.

(B) Professional employee.

(1) If an employee has the status of a professional employee, then that suggests that the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee--

(i) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intelectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes;

(ii) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(iii) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) Employment Benefits. Whether an employee is eligible to receive employment benefits is a relevant factor in evaluating the service aspect of an

employee's relationship with the employer. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan described in section 401(a); or eligibility to receive employment benefits such as reduced tuition, or benefits under section 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is eligible for a particular benefit may vary depending on the type of employment benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students.

(e) Effective date. Paragraphs (c) and (d) of this section apply to services performed on or after April 1, 2005.

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: December 15, 2004

Gregory F. Jenner,

Acting Assistant Secretary of the Treasury.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 22, 2004
js-2166

Carroll and Solomon Assume Leadership Roles for Treasury Tax Policy

WASHINGTON, DC – The U.S. Treasury Department today announced that Deputy Assistant Secretary for Tax Analysis Robert Carroll and Deputy Assistant Secretary for Regulatory Affairs Eric Solomon will assume leadership roles for Treasury tax policy until a new Assistant Secretary for Tax Policy is named. Carroll will provide economic advice and analysis with regard to tax policy issues on behalf of the Department. Solomon will continue to direct the regulatory guidance process in his role as Deputy Assistant Secretary for Regulatory Affairs and also serve as the acting Deputy Assistant Secretary for Tax Policy.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 23, 2004
js-2167

Treasury and IRS Announce Final Regulations
Regarding The New Markets Tax Credit

The Department of the Treasury today announced that the Treasury Department and Internal Revenue Service have issued final regulations regarding the New Markets Tax Credit (NMTC).

The NMTC provides a tax credit to investors who make qualified equity investments in privately-managed investment vehicles called "Community Development Entities," or "CDEs." The CDEs are required to invest substantially all of the proceeds of the qualified equity investments in low-income communities.

The final regulations amend temporary regulations that were promulgated in December of 2001 and March of 2004. The final regulations clarify the application of the substantially-all requirement; establish a six-month cure period for correcting noncompliance; provide guidance on when a distribution by a CDE to an investor will not be treated as a redemption requiring the investor to recapture credits previously taken; and clarify when a business, or a portion of a business, will be eligible for NMTC financing.

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REPORTS

- Text of the final regulations

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

TD 9171

RINs 1545-AY87; 1545-BC03

New Markets Tax Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: These regulations finalize the rules relating to the new markets tax credit under section 45D and replace the temporary regulations which expire on December 23, 2004. A taxpayer making a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation may claim a 5-percent tax credit with respect to the qualified equity investment on each of the first 3 credit allowance dates and a 6-percent tax credit with respect to the qualified equity investment on each of the remaining 4 credit allowance dates.

DATES: Effective Date: These regulations are effective December 22, 2004.

Date of Applicability: For date of applicability see §1.45D-1(h).

FOR FURTHER INFORMATION CONTACT: Paul F. Handleman or Lauren R. Taylor, (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1765. Responses to this collection of information are mandatory so that a taxpayer may claim a new markets tax credit on each credit allowance date during the 7-year credit period and report compliance with the requirements of section 45D to the Secretary.

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

The estimated annual burden per respondent varies from 15 minutes to 5 hours, depending on individual circumstances, with an estimated average of 2.5 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP Washington, DC 20224, and 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.

Books or records relating to this 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 amends 26 CFR part 1 to provide rules relating to the new markets tax credit under section 45D of the Internal Revenue Code (Code). On December 26, 2001, the IRS published in the **Federal Register** temporary and proposed regulations (the 2001 temporary regulations) (66 FR 66307, 66 FR 66376). On March 11, 2004, the IRS published in the **Federal Register** temporary and proposed regulations revising and clarifying the 2001 temporary regulations (the 2004 temporary regulations) (69 FR 11507; 69 FR 11561). On March 14, 2002, and June 2, 2004, the IRS and Treasury Department held public hearings on the 2001 temporary regulations and the 2004 temporary regulations, respectively. Written and electronic comments responding to the temporary regulations and notices of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed below.

Section 45D was added to the Code by section 121(a) of the Community Renewal Tax Relief Act of 2000 (Pub. L. 106-554). The Secretary has delegated certain administrative, application, allocation, monitoring, and other programmatic functions relating to the new markets tax credit program to the Under Secretary (Domestic Finance), who in turn has delegated those functions to the Community Development Financial Institutions Fund.

Sections 221 and 223 of the American Jobs Creation Act of 2004 (Pub. L. 108-357) amended the definition of a low-income community under section 45D(e). This

document does not provide guidance on these amendments. The IRS and Treasury Department are studying the amendments for guidance in the near future.

Explanation of Provisions

General Overview

Taxpayers may claim a new markets tax credit on a credit allowance date in an amount equal to the applicable percentage of the taxpayer's qualified equity investment in a qualified community development entity (CDE). The credit allowance date for any qualified equity investment is the date on which the investment is initially made and each of the 6 anniversary dates thereafter. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the remaining credit allowance dates.

A CDE is any domestic corporation or partnership if: (1) the primary mission of the entity is serving or providing investment capital for low-income communities or low-income persons; (2) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity; and (3) the entity is certified by the Secretary for purposes of section 45D as being a CDE.

The new markets tax credit may be claimed only for a qualified equity investment in a CDE. A qualified equity investment is any equity investment in a CDE for which the CDE has received an allocation from the Secretary if, among other things, the CDE uses substantially all of the cash from the investment to make qualified low-income community investments. Under a safe harbor, the substantially-all requirement is treated as met if at

least 85 percent of the aggregate gross assets of the CDE are invested in qualified low-income community investments.

Qualified low-income community investments consist of: (1) any capital or equity investment in, or loan to, any qualified active low-income community business; (2) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; (3) financial counseling and other services to businesses located in, and residents of, low-income communities; and (4) certain equity investments in, or loans to, a CDE.

In general, a qualified active low-income community business is a corporation or a partnership if for the taxable year: (1) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community; (2) a substantial portion of the use of the tangible property of the entity is within any low-income community; (3) a substantial portion of the services performed for the entity by its employees is performed in any low-income community; (4) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain collectibles; and (5) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain nonqualified financial property.

A recapture event requiring an investor to recapture credits previously taken occurs for an equity investment in a CDE if the CDE: (1) ceases to be a CDE; (2) ceases to use substantially all of the proceeds of the equity investment for qualified low-income community investments; or (3) redeems the investor's equity investment. In addition, the

investor's basis in any qualified equity investment is reduced by the amount of the new markets tax credit.

Substantially All

As indicated above, a CDE must use substantially all of the cash from a qualified equity investment to make qualified low-income community investments. Section 1.45D-1T(c)(5)(i) provides that the substantially-all requirement is treated as satisfied for an annual period if either the direct-tracing calculation under §1.45D-1T(c)(5)(ii), or the safe harbor calculation under §1.45D-1T(c)(5)(iii), is performed every six months and the average of the two calculations for the annual period is at least 85 percent. The final regulations clarify that a CDE may choose the same two testing dates for all qualified equity investments regardless of the date each qualified equity investment was initially made. To conform the annual testing requirement with the 12-month time limit for making qualified low-income community investments, the final regulations provide that for the first annual period, the substantially-all calculation may be performed on a single testing date. The final regulations also amend the beginning of the 12-month period for making qualified low-income community investments to provide that the 12-month period begins on the same date as the beginning of the first annual period of the 7-year credit period.

Section 1.45D-1T(d)(3) provides that reserves (not in excess of 5 percent of the taxpayer's cash investment under §1.45D-1T(b)(4)) maintained by the CDE for loan losses or for additional investments in existing qualified low-income community investments are treated as invested in a qualified low-income community investment. In response to

comments, the final regulations provide that reserves include fees paid to third parties to protect against loss of all or a portion of the principal of, or interest on, on a loan that is a qualified low-income community investment.

Qualified Active Low-Income Community Business

As indicated above, qualified low-income community investments include any capital or equity investment in, or loan to, any qualified active low-income community business. Under §1.45D-1T(d)(4)(i)(B), an entity is a qualified active low-income community business only if, among other requirements, at least 40 percent of the use of the tangible property of such entity (whether owned or leased) is within any low-income community. In response to comments, the final regulations provide an example of how the tangible property test applies to property that is used both outside and inside a low-income community. The example demonstrates that use is measured based on the entity's business hours of operation and does not include non-business hours.

Under section 45D(d)(2)(C), a qualified active low-income community business includes any trade or business that would qualify as a qualified active low-income community business if such trade or business were separately incorporated. Commentators requested clarification of how this rules applies.

The final regulations provide that a CDE may treat any trade or business (or portion thereof) as a qualified active low-income community business if the trade or business (or portion thereof) would meet the requirements to be a qualified active low-income community business if the trade or business (or portion thereof) were separately incorporated and a complete and separate set of books and records is maintained for that

trade or business (or portion thereof). The final regulations further provide, however, that under this rule a CDE's capital or equity investment or loan is not a qualified low-income community investment to the extent the proceeds of the investment or loan are not used for the trade or business (or portion thereof) that is treated as a qualified active low-income community business.

Section §1.45D-1T(d)(4)(iv) provides that an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, receive donations) within 3 years after the date the investment or loan is made. The final regulations amend this rule with respect to a nonprofit corporation by providing that the nonprofit corporation must be engaged in an activity that furthers its purpose as a nonprofit corporation within the 3-year period.

Under §1.45D-1T(d)(4)(i)(E), an entity is a qualified active low-income community business only if, among other requirements, less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property (as defined in section 1397C(e)). Section 1397C(e)(1) contains an exception to the definition of nonqualified financial property for reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less. The final regulations provide that, for these purposes, the proceeds of a capital or equity investment or loan by a CDE that will be expended on construction of real property within 12 months after the date the investment or loan is made qualify as a reasonable amount of working capital.

Section 45D(d)(3)(A) provides that the rental to others of real property located in any low-income community is treated as a qualified business only if, among other requirements, there are substantial improvements located on such property. Commentators requested clarification of the term substantial improvements. The final regulations provide that the term substantial improvements means improvements the cost basis of which equals or exceeds 50 percent of the cost basis of the land on which the improvements are located and the costs of which are incurred after the date the CDE makes the investment or loan. In addition, the final regulations provide that a CDE's investment in or loan to a business engaged in the rental of real property is not a qualified low-income community investment to the extent any lessee of the real property is not a qualified business.

Recapture

As indicated above, there is a recapture event with respect to an equity investment in a CDE if such investment is redeemed by the CDE. Commentators requested clarification of when distributions by a CDE to its investors will be treated as redemptions. The final regulations provide guidance on when a distribution by a CDE that is a corporation for Federal tax purposes will be treated as a redemption.

Some commentators suggested that, in the case of a CDE that is treated as a partnership for Federal tax purposes, a redemption should be limited to purchases by the CDE of a partner's capital interest. Alternatively, commentators requested guidance on how to distinguish between a return of capital and a distribution of profits if a return of capital is treated as a redemption. In response to comments, the final regulations provide

a safe harbor under which cash distributions by a partnership will not be treated as a redemption. Under the safe harbor, a pro rata cash distribution by the CDE to its partners based on each partner's capital interest in the CDE during the taxable year will not be treated as a redemption if the distribution does not exceed the CDE's operating income (as defined in the final regulations) for the taxable year. In addition, a non-pro rata de minimis cash distribution by a CDE to a partner or partners during the taxable year will be not treated as a redemption. A non-pro rata de minimis cash distribution may not exceed the lesser of 5 percent of the CDE's operating income for that taxable year or 10 percent of the partner's capital interest in the CDE.

Commentators suggested that cure periods be provided to enable CDEs to correct any noncompliance with the requirements under section 45D. One commentator suggested that a cure period be provided to allow an investment that no longer qualifies as a qualified low-income community investment to be replaced with a qualifying investment by the end of the calendar year following the year the original investment lost its status as a qualified low-income community investment. Other commentators suggested that, if a qualified equity investment fails the substantially-all requirement, the failure should not be a recapture event if the CDE corrects the failure within 6 months after the date the CDE discovers (or reasonably should have discovered) the failure. The final regulations provide that, if a qualified equity investment fails the substantially-all requirement, the failure is not a recapture event if the CDE corrects the failure within 6 months after the date the CDE becomes aware (or reasonably should have become aware) of the failure. Only one correction is permitted for each qualified equity investment during the 7-year credit period.

Other Issues

Section 45D(i)(1) authorizes the Secretary to prescribe regulations as may be appropriate to carry out section 45D including regulations that limit the new markets tax credit for investments that are directly or indirectly subsidized by other Federal tax benefits (including the low-income housing credit under section 42 and the exclusion from gross income under section 103). The final regulations do not prohibit a CDE from purchasing tax-exempt bonds because tax-exempt financing provides a subsidy to borrowers and not bondholders. However, the final regulations provide that if a CDE makes a capital or equity investment or loan with respect to a qualified low-income building under section 42, the investment or loan is not a qualified low-income community investment to the extent the building's eligible basis under section 42(d) is financed by the proceeds of the investment or loan.

Effective Dates

The final regulations are effective December 22, 2004, and may be applied by taxpayers before December 22, 2004. However, both the definition of the term substantial improvements and the requirement that each lessee be a qualified business apply to qualified low-income community investments made on or after February 22, 2005.

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. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, 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, the notices of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Paul F. Handleman, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1--INCOME TAXES

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

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

Section 1.45D-1 also issued under 26 U.S.C. 45D(i); * * *

Par. 2. Section 1.45D-1 is added to read as follows:

§1.45D-1 New markets tax credit.

(a) Table of contents. This paragraph lists the headings that appear in §1.45D-1.

(a) Table of contents.
(b) Allowance of credit
(1) In general.
(2) Credit allowance date.
(3) Applicable percentage.
(4) Amount paid at original issue.
(c) Qualified equity investment.
(1) In general.
(2) Equity investment.
(3) Equity investments made prior to allocation.
(i) In general.
(ii) Exceptions.
(A) Allocation applications submitted by August 29, 2002.
(B) Other allocation applications.
(iii) Failure to receive allocation.
(iv) Initial investment date.
(4) Limitations.
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(ii) Allocation limitation.
(5) Substantially all.
(i) In general.
(ii) Direct-tracing calculation.
(iii) Safe harbor calculation.
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(6) Aggregation of equity investments.

(7) Subsequent purchasers.
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(i) Investment in a qualified active low-income community business.
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(C) Intermediary CDEs.
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(4) Qualified active low-income community business.
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(C) Farming.
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(ii) Control.
(A) In general.
(B) Definition of control.
(C) Disregard of control.
(7) Financial counseling and other services.
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(i) In general.
(ii) Example.
(e) Recapture.
(1) In general.
(2) Recapture event.
(3) Redemption.
(i) Equity investment in a C corporation.
(ii) Equity investment in an S corporation.
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(4) Bankruptcy.
(5) Waiver of requirement or extension of time.
(i) In general.
(ii) Manner for requesting a waiver or extension.
(iii) Terms and conditions.
(6) Cure period.
(7) Example.
(f) Basis reduction.
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(2) Adjustment in basis of interest in partnership or S corporation.
(g) Other rules.
(1) Anti-abuse.
(2) Reporting requirements.
(i) Notification by CDE to taxpayer.
(A) Allowance of new markets tax credit.
(B) Recapture event.
(ii) CDE reporting requirements to Secretary.
(iii) Manner of claiming new markets tax credit.
(iv) Reporting recapture tax.
(3) Other Federal tax benefits.
(i) In general.
(ii) Low-income housing credit.
(4) Bankruptcy of CDE.
(h) Effective dates.
(1) In general.

(2) Exception for certain provisions.

(b) Allowance of credit--(1) In general. For purposes of the general business credit under section 38, a taxpayer holding a qualified equity investment on a credit allowance date which occurs during the taxable year may claim the new markets tax credit determined under section 45D and this section for such taxable year in an amount equal to the applicable percentage of the amount paid to a qualified community development entity (CDE) for such investment at its original issue. Qualified equity investment is defined in paragraph (c) of this section. Credit allowance date is defined in paragraph (b)(2) of this section. Applicable percentage is defined in paragraph (b)(3) of this section. A CDE is a qualified community development entity as defined in section 45D(c). The amount paid at original issue is determined under paragraph (b)(4) of this section.

(2) Credit allowance date. The term credit allowance date means, with respect to any qualified equity investment--

(i) The date on which the investment is initially made; and

(ii) Each of the 6 anniversary dates of such date thereafter.

(3) Applicable percentage. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the other 4 credit allowance dates.

(4) Amount paid at original issue. The amount paid to the CDE for a qualified equity investment at its original issue consists of all amounts paid by the taxpayer to, or on behalf of, the CDE (including any underwriter's fees) to purchase the investment at its original issue.

(c) Qualified equity investment--(1) In general. The term qualified equity investment means any equity investment (as defined in paragraph (c)(2) of this section) in a CDE if--

(i) The investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash;

(ii) Substantially all (as defined in paragraph (c)(5) of this section) of such cash is used by the CDE to make qualified low-income community investments (as defined in paragraph (d)(1) of this section); and

(iii) The investment is designated for purposes of section 45D and this section by the CDE on its books and records using any reasonable method.

(2) Equity investment. The term equity investment means any stock (other than nonqualified preferred stock as defined in section 351(g)(2)) in an entity that is a corporation for Federal tax purposes and any capital interest in an entity that is a partnership for Federal tax purposes. See §§301.7701-1 through 301.7701-3 of this chapter for rules governing when a business entity, such as a business trust or limited liability company, is classified as a corporation or a partnership for Federal tax purposes.

(3) Equity investments made prior to allocation--(i) In general. Except as provided in paragraph (c)(3)(ii) of this section, an equity investment in an entity is not eligible to be designated as a qualified equity investment if it is made before the entity enters into an allocation agreement with the Secretary. An allocation agreement is an agreement between the Secretary and a CDE relating to a new markets tax credit allocation under section 45D(f)(2).

(ii) Exceptions. Notwithstanding paragraph (c)(3)(i) of this section, an equity investment in an entity is eligible to be designated as a qualified equity investment under paragraph (c)(1)(iii) of this section if–

(A) Allocation applications submitted by August 29, 2002.

(1) The equity investment is made on or after April 20, 2001;

(2) The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the Secretary no later than August 29, 2002; and

(3) The equity investment otherwise satisfies the requirements of section 45D and this section; or

(B) Other allocation applications.

(1) The equity investment is made on or after the date the Secretary publishes a Notice of Allocation Availability (NOAA) in the **Federal Register**;

(2) The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the Secretary under that NOAA; and

(3) The equity investment otherwise satisfies the requirements of section 45D and this section.

(iii) Failure to receive allocation. For purposes of paragraph (c)(3)(ii)(A) of this section, if the entity in which the equity investment is made does not receive an allocation pursuant to an allocation application submitted no later than August 29, 2002, the equity investment will not be eligible to be designated as a qualified equity investment. For

purposes of paragraph (c)(3)(ii)(B) of this section, if the entity in which the equity investment is made does not receive an allocation under the NOAA described in paragraph (c)(3)(ii)(B)(1) of this section, the equity investment will not be eligible to be designated as a qualified equity investment.

(iv) Initial investment date. If an equity investment is designated as a qualified equity investment in accordance with paragraph (c)(3)(ii) of this section, the investment is treated as initially made on the effective date of the allocation agreement between the CDE and the Secretary.

(4) Limitations--(i) In general. The term qualified equity investment does not include--

(A) Any equity investment issued by a CDE more than 5 years after the date the CDE enters into an allocation agreement (as defined in paragraph (c)(3)(i) of this section) with the Secretary; and

(B) Any equity investment by a CDE in another CDE, if the CDE making the investment has received an allocation under section 45D(f)(2).

(ii) Allocation limitation. The maximum amount of equity investments issued by a CDE that may be designated under paragraph (c)(1)(iii) of this section by the CDE may not exceed the portion of the limitation amount allocated to the CDE by the Secretary under section 45D(f)(2).

(5) Substantially all--(i) In general. Except as provided in paragraph (c)(5)(v) of this section, the term substantially all means at least 85 percent. The substantially-all requirement must be satisfied for each annual period in the 7-year credit period using

either the direct-tracing calculation under paragraph (c)(5)(ii) of this section, or the safe harbor calculation under paragraph (c)(5)(iii) of this section. For the first annual period, the substantially-all requirement is treated as satisfied if either the direct-tracing calculation under paragraph (c)(5)(ii) of this section, or the safe-harbor calculation under paragraph (c)(5)(iii) of this section, is performed on a single testing date and the result of the calculation is at least 85 percent. For each annual period other than the first annual period, the substantially-all requirement is treated as satisfied if either the direct-tracing calculation under paragraph (c)(5)(ii) of this section, or the safe harbor calculation under paragraph (c)(5)(iii) of this section, is performed every six months and the average of the two calculations for the annual period is at least 85 percent. For example, the CDE may choose the same two testing dates for all qualified equity investments regardless of the date each qualified equity investment was initially made under paragraph (b)(2)(i) of this section, provided the testing dates are six months apart. The use of the direct-tracing calculation under paragraph (c)(5)(ii) of this section (or the safe harbor calculation under paragraph (c)(5)(iii) of this section) for an annual period does not preclude the use of the safe harbor calculation under paragraph (c)(5)(iii) of this section (or the direct-tracing calculation under paragraph (c)(5)(ii) of this section) for another annual period, provided that a CDE that switches to a direct-tracing calculation must substantiate that the taxpayer's investment is directly traceable to qualified low-income community investments from the time of the CDE's initial investment in a qualified low-income community investment. For purposes of this paragraph (c)(5)(i), the 7-year credit period means the period of 7 years beginning on the date the qualified equity investment is initially made.

See paragraph (c)(6) of this section for circumstances in which a CDE may treat more than one equity investment as a single qualified equity investment.

(ii) Direct-tracing calculation. The substantially-all requirement is satisfied if at least 85 percent of the taxpayer's investment is directly traceable to qualified low-income community investments as defined in paragraph (d)(1) of this section. The direct-tracing calculation is a fraction the numerator of which is the CDE's aggregate cost basis determined under section 1012 in all of the qualified low-income community investments that are directly traceable to the taxpayer's cash investment, and the denominator of which is the amount of the taxpayer's cash investment under paragraph (b)(4) of this section. For purposes of this paragraph (c)(5)(ii), cost basis includes the cost basis of any qualified low-income community investment that becomes worthless. See paragraph (d)(2) of this section for the treatment of amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment.

(iii) Safe harbor calculation. The substantially-all requirement is satisfied if at least 85 percent of the aggregate gross assets of the CDE are invested in qualified low-income community investments as defined in paragraph (d)(1) of this section. The safe harbor calculation is a fraction the numerator of which is the CDE's aggregate cost basis determined under section 1012 in all of its qualified low-income community investments, and the denominator of which is the CDE's aggregate cost basis determined under section 1012 in all of its assets. For purposes of this paragraph (c)(5)(iii), cost basis includes the cost basis of any qualified low-income community investment that becomes worthless. See paragraph (d)(2) of this section for the treatment of amounts received by a CDE in

payment of, or for, capital, equity or principal with respect to a qualified low-income community investment.

(iv) Time limit for making investments. The taxpayer's cash investment received by a CDE is treated as invested in a qualified low-income community investment as defined in paragraph (d)(1) of this section only to the extent that the cash is so invested within the 12-month period beginning on the date the cash is paid by the taxpayer (directly or through an underwriter) to the CDE.

(v) Reduced substantially-all percentage. For purposes of the substantially-all requirement (including the direct-tracing calculation under paragraph (c)(5)(ii) of this section and the safe harbor calculation under paragraph (c)(5)(iii) of this section), 85 percent is reduced to 75 percent for the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section).

(vi) Examples. The following examples illustrate an application of this paragraph (c)(5):

Example 1. X is a partnership and a CDE that has received a $1 million new markets tax credit allocation from the Secretary. On September 1, 2004, X uses a line of credit from a bank to fund a $1 million loan to Y. The loan is a qualified low-income community investment under paragraph (d)(1) of this section. On September 5, 2004, A pays $1 million to acquire a capital interest in X. X uses the proceeds of A's equity investment to pay off the $1 million line of credit that was used to fund the loan to Y. X's aggregate gross assets consist of the $1 million loan to Y and $100,000 in other assets. A's equity investment in X does not satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section because the cash from A's equity investment is not used to make X's loan to Y. However, A's equity investment in X satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section because at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments.

Example 2. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A pays $100,000 for a capital interest in X. On August 5, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y. X controls Y within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y is a qualified active low-income community business (as defined in paragraph (d)(4) of this section). Thus, for that period, A's equity investment satisfies the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section. For the annual period ending July 31, 2006, Y no longer is a qualified active low-income community business. Thus, for that period, A's equity investment does not satisfy the substantially-all requirement using the direct-tracing calculation. However, during the entire annual period ending July 31, 2006, X's remaining assets are invested in qualified low-income community investments with an aggregate cost basis of $900,000. Consequently, for the annual period ending July 31, 2006, at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments. Thus, for the annual period ending July 31, 2006, A's equity investment satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section.

Example 3. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A and B each pay $100,000 for a capital interest in X. X does not treat A's and B's equity investments as one qualified equity investment under paragraph (c)(6) of this section. On September 1, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y and X uses the proceeds of B's equity investment to make an equity investment in Z. X has no assets other than its investments in Y and Z. X controls Y and Z within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y and Z are qualified active low-income community businesses (as defined in paragraph (d)(4) of this section). Thus, for the annual period ending July 31, 2005, A's and B's equity investments satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section or the safe harbor calculation under paragraph (c)(5)(iii) of this section. For the annual period ending July 31, 2006, Y, but not Z, is a qualified active low-income community business. Thus, for the annual period ending July 31, 2006--

(1) X does not satisfy the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section;

(2) A's equity investment satisfies the substantially-all requirement using the direct-tracing calculation because A's equity investment is directly traceable to Y; and

(3) B's equity investment does not satisfy the substantially-all requirement because B's equity investment is traceable to Z.

Example 4. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On November 1, 2004, A pays $100,000 for a capital interest in X. On December 1, 2004, B pays $100,000 for a capital interest in X. On December 31, 2004, X uses $85,000 from A's equity investment and $85,000 from B's equity investment to make a $170,000 equity investment in Y, a qualified active low-income community business (as defined in paragraph (d)(4) of this section). X has no assets other than its investment in Y. X determines whether A's and B's equity investments satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section on December 31, 2004. The calculation for A's and B's equity investments is 85 percent using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section or the safe harbor calculation under paragraph (c)(5)(iii) of this section. Therefore, for the annual periods ending October 31, 2005, and November 30, 2005, A's and B's equity investments, respectively, satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section. For the subsequent annual period, X performs its calculations on December 31, 2005, and June 30, 2006. The average of the two calculations on December 31, 2005, and June 30, 2006, is 85 percent using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section or the safe harbor calculation under paragraph (c)(5)(iii) of this section. Therefore, for the annual periods ending October 31, 2006, and November 30, 2006, A's and B's equity investments, respectively, satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section.

(6) Aggregation of equity investments. A CDE may treat any qualified equity investments issued on the same day as one qualified equity investment. If a CDE aggregates equity investments under this paragraph (c)(6), the rules in this section shall be construed in a manner consistent with that treatment.

(7) Subsequent purchasers. A qualified equity investment includes any equity investment that would (but for paragraph (c)(1)(i) of this section) be a qualified equity investment in the hands of the taxpayer if the investment was a qualified equity investment in the hands of a prior holder.

(d) Qualified low-income community investments--(1) In general. The term qualified low-income community investment means any of the following:

(i) Investment in a qualified active low-income community business. Any capital or equity investment in, or loan to, any qualified active low-income community business (as defined in paragraph (d)(4) of this section).

(ii) Purchase of certain loans from CDEs--(A) In general. The purchase by a CDE (the ultimate CDE) from another CDE (whether or not that CDE has received an allocation from the Secretary under section 45D(f)(2)) of any loan made by such entity that is a qualified low-income community investment. A loan purchased by the ultimate CDE from another CDE is a qualified low-income community investment if it qualifies as a qualified low-income community investment either--

(1) At the time the loan was made; or

(2) At the time the ultimate CDE purchases the loan.

(B) Certain loans made before CDE certification. For purposes of paragraph (d)(1)(ii)(A) of this section, a loan by an entity is treated as made by a CDE, notwithstanding that the entity was not a CDE at the time it made the loan, if the entity is a CDE at the time it sells the loan.

(C) Intermediary CDEs. For purposes of paragraph (d)(1)(ii)(A) of this section, the purchase of a loan by the ultimate CDE from a CDE that did not make the loan (the second CDE) is treated as a purchase of the loan by the ultimate CDE from the CDE that made the loan (the originating CDE) if--

(1) The second CDE purchased the loan from the originating CDE (or from another CDE); and

(2) Each entity that sold the loan was a CDE at the time it sold the loan.

(D) Examples. The following examples illustrate an application of this paragraph (d)(1)(ii):

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. Y, a corporation, made a $500,000 loan to Z in 1999. In January of 2004, Y is certified as a CDE. On September 1, 2004, X purchases the loan from Y. At the time X purchases the loan, Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Accordingly, the loan purchased by X from Y is a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (B) of this section.

Example 2. The facts are the same as in Example 1 except that on February 1, 2004, Y sells the loan to W and on September 1, 2004, W sells the loan to X. W is a CDE. Under paragraph (d)(1)(ii)(C) of this section, X's purchase of the loan from W is treated as the purchase of the loan from Y. Accordingly, the loan purchased by X from W is a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

Example 3. The facts are the same as in Example 2 except that W is not a CDE. Because W was not a CDE at the time it sold the loan to X, the purchase of the loan by X from W is not a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

(iii) Financial counseling and other services. Financial counseling and other services (as defined in paragraph (d)(7) of this section) provided to any qualified active low-income community business, or to any residents of a low-income community (as defined in section 45D(e)).

(iv) Investments in other CDEs--(A) In general. Any equity investment in, or loan to, any CDE (the second CDE) by a CDE (the primary CDE), but only to the extent that the second CDE uses the proceeds of the investment or loan--

(1) In a manner--

(i) That is described in paragraph (d)(1)(i) or (iii) of this section; and

(ii) That would constitute a qualified low-income community investment if it were made directly by the primary CDE;

(2) To make an equity investment in, or loan to, a third CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(1) of this section; or

(3) To make an equity investment in, or loan to, a third CDE that uses such proceeds to make an equity investment in, or loan to, a fourth CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(1) of this section.

(B) Examples. The following examples illustrate an application of paragraph (d)(1)(iv)(A) of this section:

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, X uses $975,000 to make an equity investment in Y. Y is a corporation and a CDE. On October 1, 2004, Y uses $950,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of X's equity investment in Y, $950,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(1) of this section.

Example 2. W is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, W uses $975,000 to make an equity investment in X. On October 1, 2004, X uses $950,000 from W's equity investment to make an equity investment in Y. X and Y are corporations and CDEs. On October 5, 2004, Y uses $925,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of W's equity investment in X, $925,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(2) of this section because X uses proceeds of W's equity investment to make an equity investment in Y, which uses $925,000 of the proceeds in a manner described in paragraph (d)(1)(iv)(A)(1) of this section.

Example 3. U is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, U uses $975,000 to make an equity investment in V. On October 1, 2004, V uses $950,000 from U's equity investment to make an equity investment in W. On October 5, 2004, W uses $925,000 from V's equity investment to make an equity investment in X. On November 1, 2004, X uses $900,000 from W's equity investment to make an equity investment in Y. V, W, X, and Y are

corporations and CDEs. On November 5, 2004, Y uses $875,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. U's equity investment in V is not a qualified low-income community investment because X does not use proceeds of W's equity investment in a manner described in paragraph (d)(1)(iv)(A)(1) of this section.

(2) Payments of, or for, capital, equity or principal--(i) In general. Except as otherwise provided in this paragraph (d)(2), amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment must be reinvested by the CDE in a qualified low-income community investment no later than 12 months from the date of receipt to be treated as continuously invested in a qualified low-income community investment. If the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount at least equal to such original cost basis, then an amount equal to such original cost basis will be treated as continuously invested in a qualified low-income community investment. In addition, if the amounts received by the CDE are equal to or greater than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests, in accordance with this paragraph (d)(2)(i), an amount less than such original cost basis, then only the amount so reinvested will be treated as continuously invested in a qualified low-income community investment. If the amounts received by the CDE are less than the cost basis of the original qualified low-income community investment (or applicable portion thereof), and the CDE reinvests an amount in accordance with this paragraph (d)(2)(i), then the amount treated as continuously invested in a qualified low-income community investment will equal the excess (if any) of

such original cost basis over the amounts received by the CDE that are not so reinvested. Amounts received by a CDE in payment of, or for, capital, equity or principal with respect to a qualified low-income community investment during the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section) do not have to be reinvested by the CDE in a qualified low-income community investment in order to be treated as continuously invested in a qualified low-income community investment.

(ii) Subsequent reinvestments. In applying paragraph (d)(2)(i) of this section to subsequent reinvestments, the original cost basis is reduced by the amount (if any) by which the original cost basis exceeds the amount determined to be continuously invested in a qualified low-income community investment.

(iii) Special rule for loans. Periodic amounts received during a calendar year as repayment of principal on a loan that is a qualified low-income community investment are treated as continuously invested in a qualified low-income community investment if the amounts are reinvested in another qualified low-income community investment by the end of the following calendar year.

(iv) Example. The application of paragraphs (d)(2)(i) and (ii) of this section is illustrated by the following example:

Example. On April 1, 2003, A, B, and C each pay $100,000 to acquire a capital interest in X, a partnership. X is a CDE that has received a new markets tax credit allocation from the Secretary. X treats the 3 partnership interests as one qualified equity investment under paragraph (c)(6) of this section. In August 2003, X uses the $300,000 to make a qualified low-income community investment under paragraph (d)(1) of this section. In August 2005, the qualified low-income community investment is redeemed for $250,000. In February 2006, X reinvests $230,000 of the $250,000 in a second qualified low-income community investment and uses the remaining $20,000 for operating expenses. Under paragraph (d)(2)(i) of this section, $280,000 of the proceeds of the

qualified equity investment is treated as continuously invested in a qualified low-income community investment. In December 2008, X sells the second qualified low-income community investment and receives $400,000. In March 2009, X reinvests $320,000 of the $400,000 in a third qualified low-income community investment. Under paragraphs (d)(2)(i) and (ii) of this section, $280,000 of the proceeds of the qualified equity investment is treated as continuously invested in a qualified low-income community investment ($40,000 is treated as invested in another qualified low-income community investment in March 2009).

(3) Special rule for reserves. Reserves (not in excess of 5 percent of the taxpayer's cash investment under paragraph (b)(4) of this section) maintained by the CDE for loan losses or for additional investments in existing qualified low-income community investments are treated as invested in a qualified low-income community investment under paragraph (d)(1) of this section. Reserves include fees paid to third parties to protect against loss of all or a portion of the principal of, or interest on, a loan that is a qualified low-income community investment.

(4) Qualified active low-income community business--(i) In general. The term qualified active low-income community business means, with respect to any taxable year, a corporation (including a nonprofit corporation) or a partnership engaged in the active conduct of a qualified business (as defined in paragraph (d)(5) of this section), if the requirements in paragraphs (d)(4)(i)(A), (B), (C), (D), and (E) of this section are met. Solely for purposes of this section, a nonprofit corporation will be deemed to be engaged in the active conduct of a trade or business if it is engaged in an activity that furthers its purpose as a nonprofit corporation.

(A) Gross-income requirement. At least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business (as defined in

paragraph (d)(5) of this section) within any low-income community (as defined in section 45D(e)). An entity is deemed to satisfy this paragraph (d)(4)(i)(A) if the entity meets the requirements of either paragraph (d)(4)(i)(B) or (C) of this section, if "50 percent" is applied instead of 40 percent. In addition, an entity may satisfy this paragraph (d)(4)(i)(A) based on all the facts and circumstances. See paragraph (d)(4)(iv) of this section for certain circumstances in which an entity will be treated as engaged in the active conduct of a trade or business.

(B) Use of tangible property--(1) In general. At least 40 percent of the use of the tangible property of such entity (whether owned or leased) is within any low-income community. This percentage is determined based on a fraction the numerator of which is the average value of the tangible property owned or leased by the entity and used by the entity during the taxable year in a low-income community and the denominator of which is the average value of the tangible property owned or leased by the entity and used by the entity during the taxable year. Property owned by the entity is valued at its cost basis as determined under section 1012. Property leased by the entity is valued at a reasonable amount established by the entity.

(2) Example. The application of paragraph (d)(4)(i)(B)(1) of this section is illustrated by the following example:

Example. X is a corporation engaged in the business of moving and hauling scrap metal. X operates its business from a building and an adjoining parking lot that X owns. The building and the parking lot are located in a low-income community (as defined in section 45D(e)). X's cost basis under section 1012 for the building and parking lot is $200,000. During the taxable year, X operates its business 10 hours a day, 6 days a week. X owns and uses 40 trucks in its business, which, on average, are used 6 hours a day outside a low-income community and 4 hours a day inside a low-income community

(including time in the parking lot). The cost basis under section 1012 of each truck is $25,000. During non-business hours, the trucks are parked in the lot. Only X's 10-hour business days are used in calculating the use of tangible property percentage under paragraph (d)(4)(i)(B)(1) of this section. Thus, the numerator of the tangible property calculation is $600,000 (4/10 of $1,000,000 (the $25,000 cost basis of each truck times 40 trucks) plus $200,000 (the cost basis of the building and parking lot)) and the denominator is $1,200,000 (the total cost basis of the trucks, building, and parking lot), resulting in 50 percent of the use of X's tangible property being within a low-income community. Consequently, X satisfies the 40 percent use of tangible property test under paragraph (d)(4)(i)(B)(1) of this section.

(C) Services performed. At least 40 percent of the services performed for such entity by its employees are performed in a low-income community. This percentage is determined based on a fraction the numerator of which is the total amount paid by the entity for employee services performed in a low-income community during the taxable year and the denominator of which is the total amount paid by the entity for employee services during the taxable year. If the entity has no employees, the entity is deemed to satisfy this paragraph (d)(4)(i)(C), and paragraph (d)(4)(i)(A) of this section, if the entity meets the requirement of paragraph (d)(4)(i)(B) of this section if "85 percent" is applied instead of 40 percent.

(D) Collectibles. Less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of business.

(E) Nonqualified financial property--(1) In general. Less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property. For purposes the preceding sentence, the term

nonqualified financial property means debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property except that such term does not include--

(i) Reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less (because the definition of nonqualified financial property includes debt instruments with a term in excess of 18 months, banks, credit unions, and other financial institutions are generally excluded from the definition of a qualified active low-income community business); or

(ii) Debt instruments described in section 1221(a)(4).

(2) Construction of real property. For purposes of paragraph (d)(4)(i)(E)(1)(i) of this section, the proceeds of a capital or equity investment or loan by a CDE that will be expended for construction of real property within 12 months after the date the investment or loan is made are treated as a reasonable amount of working capital.

(ii) Proprietorships. Any business carried on by an individual as a proprietor is a qualified active low-income community business if the business would meet the requirements of paragraph (d)(4)(i) of this section if the business were incorporated.

(iii) Portions of business--(A) In general. A CDE may treat any trade or business (or portion thereof) as a qualified active low-income community business if the trade or business (or portion thereof) would meet the requirements of paragraph (d)(4)(i) of this section if the trade or business (or portion thereof) were separately incorporated and a complete and separate set of books and records is maintained for that trade or business (or portion thereof). However, the CDE's capital or equity investment or loan is not a

qualified low-income community investment under paragraph (d)(1)(i) of this section to the extent the proceeds of the investment or loan are not used for the trade or business (or portion thereof) that is treated as a qualified active low-income community business under this paragraph (d)(4)(iii)(A).

(B) Examples. The following examples illustrate an application of paragraph (d)(4)(iii) of this section:

Example 1. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary. A pays $1 million for a capital interest in X. Z is a corporation that operates a supermarket that is not in a low-income community (as defined in section 45D(e)). X uses the proceeds of A's equity investment to make a loan to Z that Z will use to construct a new supermarket in a low-income community. Z will maintain a complete and separate set of books and records for the new supermarket. The proceeds of X's loan to Z will be used exclusively for the new supermarket. Assume that Z's new supermarket in the low-income community would meet the requirements to be a qualified active low-income community business under paragraph (d)(4)(i) of this section if it were separately incorporated. Pursuant to paragraph (d)(4)(iii)(A) of this section, X treats Z's new supermarket as the qualified active low-income community business. Accordingly, X's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of this section.

Example 2. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary. A pays $1 million for a capital interest in X. Z is a corporation that operates a liquor store in a low-income community (as defined in section 45D(e)). A liquor store is not a qualified business under paragraph (d)(5)(iii)(B) of this section. X uses the proceeds of A's equity investment to make a loan to Z that Z will use to construct a restaurant next to the liquor store. Z will maintain a complete and separate set of books and records for the new restaurant. The proceeds of X's loan to Z will be used exclusively for the new restaurant. Assume that Z's restaurant would meet the requirements to be a qualified active low-income community business under paragraph (d)(4)(i) of this section if it were separately incorporated. Pursuant to paragraph (d)(4)(iii) of this section, X treats Z's restaurant as the qualified active low-income community business. Accordingly, X's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of this section.

Example 3. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary. A pays $1 million for a capital interest in X. Z is a corporation that operates an insurance company in a low-income community (as defined in

section 45D(e)). Five percent or more of the average of the aggregate unadjusted bases of Z's property is attributable to nonqualified financial property under paragraph (d)(4)(i)(E) of this section. Z's insurance operations include different operating units including a claims processing unit. X uses the proceeds of A's equity investment to make a loan to Z for use in Z's claims processing operations. Z will maintain a complete and separate set of books and records for the claims processing unit. The proceeds of X's loan to Z will be used exclusively for the claims processing unit. Assume that Z's claims processing unit would meet the requirements to be a qualified active low-income community business under paragraph (d)(4)(i) of this section if it were separately incorporated. Pursuant to paragraph (d)(4)(iii) of this section, X treats Z's claims processing unit as the qualified active low-income community business. Accordingly, X's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of this section.

(iv) Active conduct of a trade or business--(A) Special rule. For purposes of paragraph (d)(4)(i) of this section, an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, engage in an activity that furthers its purpose as a nonprofit corporation) within 3 years after the date the investment or loan is made.

(B) Example. The application of paragraph (d)(4)(iv)(A) of this section is illustrated by the following example:

Example. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary on July 1, 2004. X makes a ten-year loan to Y. Y is a newly formed entity that will own and operate a shopping center to be constructed in a low-income community. Y has no revenues but X reasonably expects that Y will generate revenues beginning in December 2005. Under paragraph (d)(4)(iv)(A) of this section, Y is treated as engaged in the active conduct of a trade or business for purposes of paragraph (d)(4)(i) of this section.

(5) Qualified business--(i) In general. Except as otherwise provided in this paragraph (d)(5), the term qualified business means any trade or business. There is no

requirement that employees of a qualified business be residents of a low-income community.

(ii) Rental of real property. The rental to others of real property located in any low-income community (as defined in section 45D(e)) is a qualified business if and only if the property is not residential rental property (as defined in section 168(e)(2)(A)) and there are substantial improvements located on the real property. For purposes of the preceding sentence, the term substantial improvements means improvements the cost basis of which equals or exceeds 50 percent of the cost basis of the land on which the improvements are located and the costs of which are incurred after the date the CDE makes the investment or loan. However, a CDE's investment in or loan to a business engaged in the rental of real property is not a qualified low-income community investment under paragraph (d)(1)(i) of this section to the extent any lessee of the real property is not a qualified business under this paragraph (d)(5).

(iii) Exclusions--(A) Trades or businesses involving intangibles. The term qualified business does not include any trade or business consisting predominantly of the development or holding of intangibles for sale or license.

(B) Certain other trades or businesses. The term qualified business does not include any trade or business consisting of the operation of any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

(C) Farming. The term qualified business does not include any trade or business the principal activity of which is farming (within the meaning of section 2032A(e)(5)(A) or (B)) if, as of the close of the taxable year of the taxpayer conducting such trade or business, the sum of the aggregate unadjusted bases (or, if greater, the fair market value) of the assets owned by the taxpayer that are used in such a trade or business, and the aggregate value of the assets leased by the taxpayer that are used in such a trade or business, exceeds $500,000. For purposes of this paragraph (d)(5)(iii)(C), two or more trades or businesses will be treated as a single trade or business under rules similar to the rules of section 52(a) and (b).

(6) Qualifications--(i) In general. Except as provided in paragraph (d)(6)(ii) of this section, an entity is treated as a qualified active low-income community business for the duration of the CDE's investment in the entity if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business under paragraph (d)(4)(i) of this section throughout the entire period of the investment or loan.

(ii) Control--(A) In general. If a CDE controls or obtains control of an entity at any time during the 7-year credit period (as defined in paragraph (c)(5)(i) of this section), the entity will be treated as a qualified active low-income community business only if the entity satisfies the requirements of paragraph (d)(4)(i) of this section throughout the entire period the CDE controls the entity.

(B) Definition of control. Control means, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of more

than 50 percent of the entity. For purposes of the preceding sentence, the term management rights means the power to influence the management policies or investment decisions of the entity.

(C) Disregard of control. For purposes of paragraph (d)(6)(ii)(A) of this section, the acquisition of control of an entity by a CDE is disregarded during the 12-month period following such acquisition of control (the 12-month period) if--

(1) The CDE's capital or equity investment in, or loan to, the entity met the requirements of paragraph (d)(6)(i) of this section when initially made;

(2) The CDE's acquisition of control of the entity is due to financial difficulties of the entity that were unforeseen at the time the investment or loan described in paragraph (d)(6)(ii)(C)(1) of this section was made; and

(3) If the acquisition of control occurs before the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section), either--

(i) The entity satisfies the requirements of paragraph (d)(4) of this section by the end of the 12-month period; or

(ii) The CDE sells or causes to be redeemed the entire amount of the investment or loan described in paragraph (d)(6)(ii)(C)(1) of this section and, by the end of the 12-month period, reinvests the amount received in respect of the sale or redemption in a qualified low-income community investment under paragraph (d)(1) of this section. For this purpose, the amount treated as continuously invested in a qualified low-income community investment is determined under paragraphs (d)(2)(i) and (ii) of this section.

(7) Financial counseling and other services. The term financial counseling and other services means advice provided by the CDE relating to the organization or operation of a trade or business.

(8) Special rule for certain loans--(i) In general. For purposes of paragraphs (d)(1)(i), (ii), and (iv) of this section, a loan is treated as made by a CDE to the extent the CDE purchases the loan from the originator (whether or not the originator is a CDE) within 30 days after the date the originator makes the loan if, at the time the loan is made, there is a legally enforceable written agreement between the originator and the CDE which--

(A) Requires the CDE to approve the making of the loan either directly or by imposing specific written loan underwriting criteria; and

(B) Requires the CDE to purchase the loan within 30 days after the date the loan is made.

(ii) Example. The application of paragraph (d)(8)(i) of this section is illustrated by the following example:

Example. (i) X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On October 1, 2004, Y enters into a legally enforceable written agreement with W. Y and W are corporations but only Y is a CDE. The agreement between Y and W provides that Y will purchase loans (or portions thereof) from W within 30 days after the date the loan is made by W, and that Y will approve the making of the loans.

(ii) On November 1, 2004, W makes a $825,000 loan to Z pursuant to the agreement between Y and W. Z is a qualified active low-income community business under paragraph (d)(4) of this section. On November 15, 2004, Y purchases the loan from W for $840,000. On December 31, 2004, X purchases the loan from Y for $850,000.

(iii) Under paragraph (d)(8)(i) of this section, the loan to Z is treated as made by Y. Y's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of

this section. Accordingly, under paragraph (d)(1)(ii)(A) of this section, X's purchase of the loan from Y is a qualified low-income community investment in the amount of $850,000.

(e) Recapture--(1) In general. If, at any time during the 7-year period beginning on the date of the original issue of a qualified equity investment in a CDE, there is a recapture event under paragraph (e)(2) of this section with respect to such investment, then the tax imposed by Chapter 1 of the Internal Revenue Code for the taxable year in which the recapture event occurs is increased by the credit recapture amount under section 45D(g)(2). A recapture event under paragraph (e)(2) of this section requires recapture of credits allowed to the taxpayer who purchased the equity investment from the CDE at its original issue and to all subsequent holders of that investment.

(2) Recapture event. There is a recapture event with respect to an equity investment in a CDE if--

(i) The entity ceases to be a CDE;

(ii) The proceeds of the investment cease to be used in a manner that satisfies the substantially-all requirement of paragraph (c)(1)(ii) of this section; or

(iii) The investment is redeemed or otherwise cashed out by the CDE.

(3) Redemption--(i) Equity investment in a C corporation. For purposes of paragraph (e)(2)(iii) of this section, an equity investment in a CDE that is treated as a C corporation for Federal tax purposes is redeemed when section 302(a) applies to amounts received by the equity holder. An equity investment is treated as cashed out when section 301(c)(2) or section 301(c)(3) applies to amounts received by the equity holder.

An equity investment is not treated as cashed out when only section 301(c)(1) applies to amounts received by the equity holder.

(ii) Equity investment in an S corporation. For purposes of paragraph (e)(2)(iii) of this section, an equity investment in a CDE that is an S corporation is redeemed when section 302(a) applies to amounts received by the equity holder. An equity investment in an S corporation is treated as cashed out when a distribution to a shareholder described in section 1368(a) exceeds the accumulated adjustments account determined under §1.1368-2 and any accumulated earnings and profits of the S corporation.

(iii) Capital interest in a partnership. In the case of an equity investment that is a capital interest in a CDE that is a partnership for Federal tax purposes, a pro rata cash distribution by the CDE to its partners based on each partner's capital interest in the CDE during the taxable year will not be treated as a redemption for purposes of paragraph (e)(2)(iii) of this section if the distribution does not exceed the CDE's operating income for the taxable year. In addition, a non-pro rata de minimis cash distribution by a CDE to a partner or partners during the taxable year will not be treated as a redemption. A non-pro rata de minimis cash distribution may not exceed the lesser of 5 percent of the CDE's operating income for that taxable year or 10 percent of the partner's capital interest in the CDE. For purposes of this paragraph (e)(3)(iii), with respect to any taxable year, operating income is the sum of:

(A) The CDE's taxable income as determined under section 703, except that--

(1) The items described in section 703(a)(1) shall be aggregated with the non-separately stated tax items of the partnership; and

(2) Any gain resulting from the sale of a capital asset under section 1221(a) or section 1231 property shall not be included in taxable income;

(B) Deductions under section 165, but only to the extent the losses were realized from qualified low-income community investments under paragraph (d)(1) of this section;

(C) Deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k);

(D) Start-up expenditures amortized under section 195; and

(E) Organizational expenses amortized under section 709.

(4) Bankruptcy. Bankruptcy of a CDE is not a recapture event.

(5) Waiver of requirement or extension of time--(i) In general. The Commissioner may waive a requirement or extend a deadline if such waiver or extension does not materially frustrate the purposes of section 45D and this section.

(ii) Manner for requesting a waiver or extension. A CDE that believes it has good cause for a waiver or an extension may request relief from the Commissioner in a ruling request. The request should set forth all the relevant facts and include a detailed explanation describing the event or events relating to the request for a waiver or an extension. For further information on the application procedure for a ruling, see Rev. Proc. 2005-1 (2005-1 I.R.B. 1) or its successor revenue procedure (see §601.601(d)(2) of this chapter).

(iii) Terms and conditions. The granting of a waiver or an extension to a CDE under this section may require adjustments of the CDE's requirements under section 45D and this section as may be appropriate.

(6) Cure period. If a qualified equity investment fails the substantially-all requirement under paragraph (c)(5)(i) of this section, the failure is not a recapture event under paragraph (e)(2)(ii) of this section if the CDE corrects the failure within 6 months after the date the CDE becomes aware (or reasonably should have become aware) of the failure. Only one correction is permitted for each qualified equity investment during the 7-year credit period under this paragraph (e)(6).

(7) Example. The application of this paragraph (e) is illustrated by the following example:

Example. In 2003, A and B acquire separate qualified equity investments in X, a partnership. X is a CDE that has received a new markets tax credit allocation from the Secretary. X uses the proceeds of A's qualified equity investment to make a qualified low-income community investment in Y, and X uses the proceeds of B's qualified equity investment to make a qualified low-income community investment in Z. Y and Z are not CDEs. X controls both Y and Z within the meaning of paragraph (d)(6)(ii)(B) of this section. In 2003, Y and Z are qualified active low-income community businesses. In 2007, Y, but not Z, is a qualified active low-income community business and X does not satisfy the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section. A's equity investment satisfies the substantially-all requirement of paragraph (c)(1)(ii) of this section using the direct-tracing calculation of paragraph (c)(5)(ii) of this section because A's equity investment is traceable to Y. However, B's equity investment fails the substantially-all requirement using the direct-tracing calculation because B's equity investment is traceable to Z. Therefore, under paragraph (e)(2)(ii) of this section, there is a recapture event for B's equity investment (but not A's equity investment).

(f) Basis reduction--(1) In general. A taxpayer's basis in a qualified equity investment is reduced by the amount of any new markets tax credit determined under paragraph (b)(1) of this section with respect to the investment. A basis reduction occurs on each credit allowance date under paragraph (b)(2) of this section. This paragraph (f) does not apply for purposes of sections 1202, 1400B, and 1400F.

(2) Adjustment in basis of interest in partnership or S corporation. The adjusted basis of either a partner's interest in a partnership, or stock in an S corporation, must be appropriately adjusted to take into account adjustments made under paragraph (f)(1) of this section in the basis of a qualified equity investment held by the partnership or S corporation (as the case may be).

(g) Other rules--(1) Anti-abuse. If a principal purpose of a transaction or a series of transactions is to achieve a result that is inconsistent with the purposes of section 45D and this section, the Commissioner may treat the transaction or series of transactions as causing a recapture event under paragraph (e)(2) of this section.

(2) Reporting requirements--(i) Notification by CDE to taxpayer--(A) Allowance of new markets tax credit. A CDE must provide notice to any taxpayer who acquires a qualified equity investment in the CDE at its original issue that the equity investment is a qualified equity investment entitling the taxpayer to claim the new markets tax credit. The notice must be provided by the CDE to the taxpayer no later than 60 days after the date the taxpayer makes the investment in the CDE. The notice must contain the amount paid to the CDE for the qualified equity investment at its original issue and the taxpayer identification number of the CDE.

(B) Recapture event. If, at any time during the 7-year period beginning on the date of the original issue of a qualified equity investment in a CDE, there is a recapture event under paragraph (e)(2) of this section with respect to such investment, the CDE must provide notice to each holder, including all prior holders, of the investment that a recapture

event has occurred. The notice must be provided by the CDE no later than 60 days after the date the CDE becomes aware of the recapture event.

(ii) CDE reporting requirements to Secretary. Each CDE must comply with such reporting requirements to the Secretary as the Secretary may prescribe.

(iii) Manner of claiming new markets tax credit. A taxpayer may claim the new markets tax credit for each applicable taxable year by completing Form 8874, "New Markets Credit," and by filing Form 8874 with the taxpayer's Federal income tax return.

(iv) Reporting recapture tax. If there is a recapture event with respect to a taxpayer's equity investment in a CDE, the taxpayer must include the credit recapture amount under section 45D(g)(2) on the line for recapture taxes on the taxpayer's Federal income tax return for the taxable year in which the recapture event under paragraph (e)(2) of this section occurs (or on the line for total tax, if there is no such line for recapture taxes) and write NMCR (new markets credit recapture) next to the entry space.

(3) Other Federal tax benefits--(i) In general. Except as provided in paragraph (g)(3)(ii) of this section, the availability of Federal tax benefits does not limit the availability of the new markets tax credit. Federal tax benefits that do not limit the availability of the new markets tax credit include, for example:

(A) The rehabilitation credit under section 47;

(B) All deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k), and the expense deduction for certain depreciable property under section 179; and

(C) All tax benefits relating to certain designated areas such as empowerment zones and enterprise communities under sections 1391 through 1397D, the District of Columbia Enterprise Zone under sections 1400 through 1400B, renewal communities under sections 1400E through 1400J, and the New York Liberty Zone under section 1400L.

(ii) Low-income housing credit. If a CDE makes a capital or equity investment or a loan with respect to a qualified low-income building under section 42, the investment or loan is not a qualified low-income community investment under paragraph (d)(1) of this section to the extent the building's eligible basis under section 42(d) is financed by the proceeds of the investment or loan.

(4) Bankruptcy of CDE. The bankruptcy of a CDE does not preclude a taxpayer from continuing to claim the new markets tax credit on the remaining credit allowance dates under paragraph (b)(2) of this section.

(h) Effective dates--(1) In general. Except as provided in paragraph (h)(2) of this section, this section applies on or after December 22, 2004, and may be applied by taxpayers before December 22, 2004. The provisions that apply before December 22, 2004, are contained in §1.45D-1T (see 26 CFR part 1 revised as of April 1, 2003, and April 1, 2004).

(2) Exception for certain provisions. Paragraph (d)(5)(ii) of this section as it relates to the definition of the term substantial improvements and the requirement that each lessee must be a qualified business applies to qualified low-income community investments made on or after February 22, 2005.

§1.45D-1T [Removed]

Par. 3 Section 1.45D-1T is removed.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by removing the entry for "1.45D-1T" from the table.

Par. 6. In §602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.45D-1	1545-1765
* * * * *	

Mark E. Mathews,

Deputy Commissioner for Services and Enforcement.

Approved: December 21, 2004.

Eric Solomon,

Acting Deputy Assistant Secretary of the Treasury.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 28, 2004
2004-12-28-12-55-27-17604

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 $87,534 million as of the end of that week, compared to $86,526 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	December 17, 2004			December 24, 2004		
TOTAL		86,526			87,534	
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	12,131	15,084	27,215	12,359	15,176	27,535
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,910	3,032	14,942	12,130	3,050	15,180
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]			19,982			20,210
3. Special Drawing Rights (SDRs) [2]			13,343			13,566
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	December 17, 2004			December 24, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	December 17, 2004			December 24, 2004		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, 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 IMF data for the prior month end.

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 28, 2004
JS-2168

Treasury Issues Guidance Relating to Special Foreign Tax Restrictions no Longer Applicable to Iraq and Libya

-- Today the Treasury Department issued guidance updating the list of countries subject to the special foreign tax credit and other restrictions of section 901(j) of the Internal Revenue Code to reflect the recent waiver of such restrictions with respect to Libya. Treasury issued guidance earlier this year reflecting the removal of Iraq from the list of countries subject to such restrictions. In addition, today's guidance also updates the list of countries subject to the limitations on the foreign earned income exclusion imposed by Code section 911(d)(8) to reflect the recent removal of travel-related restrictions with respect to Iraq and Libya.

Section 901 generally allows taxpayers a credit against U.S. income tax for taxes paid to a foreign country. However, special rules in sections 901(j) and 952(a)(5) generally deny foreign tax credits and impose other restrictions in the case of income attributable to countries with which the United States does not conduct diplomatic relations or which have been identified as sponsors of international terrorism. The restrictions of section 901(j) and related provisions cease to apply with respect to a particular country when the Secretary of State certifies to the Secretary of the Treasury that the country no longer meets the criteria in that section or when the President waives the restrictions pursuant to section 901(j)(5). On December 10, 2004, the President issued a Presidential Determination which waives the application of section 901(j) with respect to Libya. Accordingly, the special foreign tax credit restrictions of section 901(j) no longer apply to income and taxes attributable to Libya. Revenue Ruling 2005-3 provides an updated list of countries subject to section 901(j) that reflects this development with respect to Libya and the earlier development with respect to Iraq.

Section 911 generally permits an individual who is a U.S. citizen or resident and who lives and works outside of the United States to exclude certain foreign earned income. However, special rules in section 911(d)(8) provide that the section 911 exclusion is not available for income earned in countries for which there are prohibitions on engaging in transactions related to travel to, from, or within that country. On July 29, 2004, the President issued an Executive Order which effectively lifted the sanctions against Iraq, effective July 30, 2004. On September 20, 2004, the President issued an Executive Order which effectively lifted the sanctions against Libya, effective September 21, 2004. Accordingly, the special restrictions on the foreign earned income exclusion no longer apply to income earned in those countries. Revenue Ruling 2005-3 updates the list of countries subject to section 911(d)(8) to reflect these recent developments with respect to Iraq and Libya.

REPORTS

- A copy of Rev. Rul. 2005-3

Part 1

Section 901.—Taxes of Foreign Countries and of Possessions of United States.

Rev. Rul. 2005-3

This ruling sets forth guidance regarding the application of section 901(j) of the Internal Revenue Code (Code) with respect to Libya and the application of section 911(d)(8) of the Code with respect to Iraq and Libya. This ruling modifies and supersedes Rev. Rul. 95-63, 1995-2 C.B. 85, which lists countries subject to special tax rules under sections 901(j) and 952(a)(5) of the Code, and also supersedes Rev. Rul. 2004-103, 2004-45 I.R.B. 783, which modified Rev. Rul. 95-63. This ruling also modifies and supersedes Rev. Rul. 92-63, 1992-2 C.B. 195, which lists countries subject to section 911(d)(8) of the Code.

SECTION 901(j)

LAW AND ANALYSIS

Sections 901, 902, and 960 of the Code generally allow U.S. taxpayers to claim a foreign tax credit for income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued) to any foreign country or to any possession of the United States. The foreign tax credit is subject to various limitations and restrictions under section 901.

Section 901(j)(1) imposes restrictions in the case of income and taxes attributable to certain countries. Section 901(j)(1)(A) denies the credit for taxes paid or accrued (or deemed paid or accrued under sections 902 or 960) to any country described in section 901(j)(2)(A) if the taxes are with respect to income attributable to a period during which section 901(j) applies. Section 901(j)(1)(B) requires taxpayers to apply subsections (a), (b), and (c) of section 904 and sections 902 and 960 separately with respect to income attributable to such a period from sources within such country. In addition, section 952(a)(5) provides that subpart F income includes income derived by a controlled foreign corporation from any foreign country during any period during which section 901(j) applies to that foreign country.

Pursuant to section 901(j)(5), the restrictions of section 901(j)(1) will not apply with respect to a country if the President determines that a waiver of the application of that paragraph is in the national interest of the United States and will expand trade and investment opportunities for U.S. companies in such country. This provision provides for the President, not less than 30 days before

the date on which a waiver is granted, to report to Congress the intention to grant such a waiver and the reason for the determination under section 901(j)(5)(A)(i).

The President issued Presidential Determination 2004-48 on September 20, 2004. In that Presidential Determination, the President determined that a waiver of the application of section 901(j)(1) with respect to Libya is in the national interest of the United States and will expand trade and investment opportunities for U.S. companies in Libya. The Presidential Determination directed the Secretary of the Treasury to report to Congress, in accordance with section 901(j)(5)(B), the President's intention to grant the waiver and the reasons for the determination. The Secretary of the Treasury submitted such report to Congress on October 7, 2004.

On December 10, 2004, the President issued Presidential Determination 2005-12 which waives the application of section 901(j)(1) with respect to Libya. Pursuant to Presidential Determination 2005-12, sections 901(j)(1) and 952(a)(5) no longer apply to Libya, effective December 10, 2004. Therefore, United States taxpayers may be entitled to claim a foreign tax credit for income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued under sections 902 and 960) to Libya, with respect to income attributable to the period beginning after December 9, 2004.

HOLDING AND EFFECTIVE DATES

Sections 901(j)(1) and 952(a)(5) apply to the following countries for the following periods:

Country	Starting Date	Ending Date
Afghanistan	January 1, 1987	August 4, 1994
Albania	January 1, 1987	March 15, 1991
Angola	January 1, 1987	June 18, 1993
Cambodia	January 1, 1987	August 4, 1994
Cuba	January 1, 1987	still in effect
Iran	January 1, 1987	still in effect
Iraq	February 1, 1991	June 27, 2004
Libya	January 1, 1987	December 9, 2004
North Korea	January 1, 1987	still in effect
South Africa	January 1, 1988	July 10, 1991
Sudan	February 12, 1994	still in effect
Syria	January 1, 1987	still in effect
Vietnam	January 1, 1987	July 21, 1995
People's Democratic Republic of Yemen	January 1, 1987	May 22, 1990

For guidance on issues arising in a taxable year when section 901(j) ceases to apply to a country, *see* Rev. Rul. 92-62, 1992-2 C.B. 193.

SECTION 911

LAW AND ANALYSIS

Section 911(a) of the Code allows a "qualified individual" to elect to exclude from gross income his or her "foreign earned income" (as defined in section 911(b)) and "housing cost amount" (as defined in section 911(c)). Section 911(d)(1) generally defines a "qualified individual" as a citizen or resident of the United States whose tax home is in a foreign country and who meets certain requirements of residence or presence in a foreign country.

Section 911(d)(8)(A) provides generally that if travel with respect to any foreign country (or any transaction in connection with such travel) is proscribed by certain regulations during any period, then: (1) foreign earned income does not include income from sources within that country attributable to services performed during that period; (2) housing expenses do not include any expenses allocable to such period for housing in that country, or for housing of the taxpayer's spouse or dependents in another country while the taxpayer is present in that country; and (3) an individual is not treated as a bona fide resident of, or as present in, a foreign country for any day during which the individual was present in that country.

Section 911(d)(8)(B) provides that the regulations described in section 911(d)(8) are those that have been adopted pursuant to the Trading With the Enemy Act, 50 U.S.C. App. 1 *et seq.*, or the International Emergency Economic Powers Act, 50 U.S.C. 1701 *et seq.*, and that include provisions generally prohibiting citizens and residents of the United States from engaging in transactions related to travel to, from, or within a foreign country. Section 911(d)(8)(C), however, provides that the limitations of section 911(d)(8)(A) do not apply to any individual during any period in which that individual's activities are not in violation of the regulations described in section 911(d)(8)(B).

Rev. Rul. 92-63, 1992-2 C.B. 195, identifies three countries subject to regulations described in section 911(d)(8)(B): Cuba (31 C.F.R. 515.560) (1989), Libya (31 C.F.R. 550.207) (1989), and Iraq (31 C.F.R. 575.207) (1991).

On July 29, 2004, the President issued Executive Order 13350 which effectively lifted the sanctions against Iraq effective July 30, 2004. On September 20, 2004, the President issued Executive Order 13357 which effectively lifted the sanctions against Libya, effective September 21, 2004.

HOLDING AND EFFECTIVE DATES

Section 911(d)(8) applies to the following countries for the following periods:

Country	Starting Date	Ending Date
Cuba	January 1, 1987	still in effect
Libya	January 1, 1987	September 20, 2004
Iraq	August 2, 1990	July 29, 2004

With respect to periods prior to (or ending on) the ending dates listed above for Libya and Iraq, individuals whose activities in Libya and Iraq were not in violation of the regulations described in section 911(d)(8)(B) are not subject to the limitations of section 911(d)(8). *See, e.g.*, Notice 2003-52, 2003-2 C.B. 296, which states that pursuant to section 911(d)(8)(C), the limitations of section 911(d)(8)(A) do not apply to individuals engaged in activities in Iraq that are permitted by a specific or general license issued by the United States Department of Treasury Office of Foreign Assets Control.

EFFECT ON OTHER ADMINISTRATIVE GUIDANCE

This ruling modifies and supersedes Rev. Rul. 95-63, 1995-2 C.B. 85, and supersedes Rev. Rul. 2004-103, 2004-45 I.R.B. 783, with respect to the list of countries for which section 901(j) is applicable. This ruling modifies and supersedes Rev. Rul. 92-63, 1992-2 C.B. 195, with respect to the list of countries for which section 911(d)(8) is applicable.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mark R. Pollard of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Mr. Pollard at (202) 622-3850 (not a toll-free call).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 28, 2004
JS-2170

Treasury and IRS Issue Guidance on New Automatic Rollovers from Qualified Retirement Plans

-- Today, the Treasury Department and the IRS issued guidance on the new automatic (or default) rollover rules for qualified retirement plans. These new rules were added to the Internal Revenue Code as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), but they will not be effective until March 28, 2005, which is the effective date of related final regulations published by the Department of Labor. The guidance issued today answers many questions regarding the application of the new requirement and will make it easier for plan sponsors to comply in a timely manner.

The new automatic rollover rule requires that mandatory distributions of more than $1,000 from a qualified retirement plan be paid in a direct rollover to an Individual Retirement Account (IRA) unless the distributee elects to have the amount rolled over to another retirement plan or to receive the distribution directly. EGTRRA also requires that the plan administrator notify the distributee in writing that the distribution may be paid in a direct rollover to an IRA.

The guidance issued today responds to comments received by the Department of Labor, Treasury, and the IRS. For example, the guidance clarifies that the automatic rollover requirement applies to governmental and church plans although a transition rule is provided for these plans to comply. The guidance provides that all plans have until the end of 2005 to establish administrative procedures for processing the automatic rollovers and clarifies that rollover IRAs can be set up without the participant's participation. Finally, the guidance includes a sample amendment that plan sponsors can use to amend their plans to comply with the new rule.

REPORTS

- The text of Notice 2005-5

Automatic Rollover

Notice 2005-5

I. PURPOSE

This notice provides guidance relating to automatic rollover provisions under § 401(a)(31)(B) of the Internal Revenue Code ("Code") as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 ("EGTRRA").

II. BACKGROUND

Section 401(a)(31)(A) of the Code and §1.401(a)(31)-1 of the Income Tax Regulations provide that a distributee of any eligible rollover distribution, as defined in § 402(f)(2)(A), may elect to have such distribution paid directly to an eligible retirement plan and that such distribution must be made in the form of a direct rollover to the specified eligible retirement plan. Section 402(f)(1) requires that the plan administrator provide a written explanation to the recipient of the provisions under which the recipient may have the distribution paid directly to an eligible retirement plan as defined in § 402(c)(8) in a direct rollover.

Sections 411(a)(11) and 417(e) permit plans qualified under § 401(a) to include provisions allowing for the immediate distribution of a separating participant's benefit without such participant's consent where the present value of the nonforfeitable accrued benefit is less than $5,000.

Section 657 of EGTRRA amended § 401(a)(31)(B) of the Code to require that mandatory distributions of more than $1,000 from a plan qualified under § 401(a) be paid in a direct rollover to an individual retirement plan (i.e., an individual retirement account as described in § 408(a) or an individual retirement annuity described in § 408(b)) of a designated trustee or issuer if the distributee does not make an affirmative election to have the amount paid in a direct rollover to an eligible retirement plan or to receive the distribution directly. Section 657(a) of EGTRRA also added a notice provision to § 401(a)(31)(B)(i) of the Code which requires that the plan administrator notify the distributee in writing (either separately or as part of the § 402(f) notice) that the distribution may be paid in a direct rollover to an individual retirement plan.

Section 657(c)(2)(A) of EGTRRA directed the Department of Labor to issue regulations providing safe harbors under which 1) a plan administrator's designation of an institution to receive the automatic rollover and 2) the initial

investment choice for the rolled-over funds would be deemed to satisfy the fiduciary responsibility provisions of § 404(a) of the Employee Retirement Income Security Act of 1974 ("ERISA").

Section 657(d) of EGTRRA provided that the § 401(a)(31)(B) of the Code requiring automatic rollovers of certain mandatory distributions to individual retirement plans will not become effective until the Department of Labor issues safe harbor regulations.

On September 28, 2004, the Department of Labor issued final regulations (29 CFR § 2550.404a-2) pursuant to § 657(c)(2)(A) of EGTRRA. 69 FR 58017. Section 2550.404a-2 of those regulations establishes a safe harbor under which a fiduciary ofan employee pension benefit plan subject to Title I of ERISA will be deemed to have satisfied his or her fiduciary duties under § 404(a) of ERISA in connection with an automatic rollover of a mandatory distribution described in § 401(a)(31)(B) of the Code. Section 2550.404a-2(c) provides the conditions under which a fiduciary qualifies for the safe harbor described in the preceding sentence. The safe harbor contained in § 2550.404a-2 applies only to employee pension benefit plans covered under Title I of ERISA. The safe harbor contained in § 2550.404a-2 also applies to automatic rollovers of $1,000 or less.

III. QUESTIONS AND ANSWERS

Q-1. To what distributions do the automatic rollover requirements of § 401(a)(31)(B) apply?

A-1. The automatic rollover requirements apply to any mandatory distribution that is more than $1,000 and is an eligible rollover distribution that is subject to the direct rollover requirements that are in § 401(a)(31). Thus, in order for a plan that provides for such mandatory distributions to be qualified under § 401(a), it must satisfy the automatic rollover provisions of § 401(a)(31)(B). Pursuant to Q&A-16 of § 1.401(a)(31)-1 of the Income Tax Regulations, an eligible rollover distribution in the form of a plan loan offset amount is not subject to the automatic rollover provisions of § 401(a)(31)(B).

Q-2. What is a mandatory distribution?

A-2. A mandatory distribution is a distribution that is made without the participant's consent and that is made to a participant before the participant attains the later of age 62 or normal retirement age. A distribution to a surviving spouse or alternate payee is not a mandatory distribution for purposes of the automatic rollover requirements of § 401(a)(31)(B). Although § 411(a)(11) generally prohibits mandatory distributions of accrued benefits attributable to employer contributions with a present value exceeding $5,000, the automatic rollover provisions of § 401(a)(31)(B) apply without regard to the amount of the distribution as long as the amount exceeds $1,000.

Q-3. How is the automatic rollover requirement of § 401(a)(31)(B) satisfied?

A-3. In order to satisfy the automatic rollover requirement of § 401(a)(31)(B), a plan must provide that, when making a mandatory distribution that exceeds $1,000 and that is an eligible rollover distribution, if, after receiving the notice described in § 402(f), a participant fails to elect to receive a mandatory distribution directly or have it paid in a direct rollover to an eligible retirement plan, the distribution will be paid in a direct rollover to an individual retirement plan.

Q-4. When do the automatic rollover provisions of § 401(a)(31)(B) become effective with respect to mandatory distributions?

A-4. The automatic rollover requirements of § 401(a)(31)(B) apply to mandatory distributions made on or after March 28, 2005. Thus, the automatic rollover requirements of § 401(a)(31)(B) do not apply to mandatory distributions made prior to March 28, 2005. Section 657(d) of EGTRRA provides that the requirements of § 401(a)(31)(B) of the Code requiring automatic rollovers of mandatory distributions to individual retirement plans do not become effective until the Department of Labor prescribes final regulations implementing a fiduciary safe harbor related to automatic rollovers. The final regulations issued by the Department of Labor on September 28, 2004, provide that the regulations apply to any rollover of mandatory distributions made on or after March 28, 2005.

Q-5. Do the automatic rollover requirements of § 401(a)(31)(B) apply to governmental plans as described in § 414(d)?

A-5. Yes, the automatic rollover requirements apply to governmental plans (within the meaning of § 414(d)) that are required to comply with § 401(a)(31), even though these plans are not subject to the provisions of § 411. Thus, for example, in order for a plan of a state or local government to be qualified under § 401(a), the plan must comply with § 401(a)(31)(B). However, governmental plans will not be treated as failing to satisfy the requirements of § 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plans that are made prior to the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2006.

Q-6. Do the automatic rollover provisions of § 401(a)(31)(B) apply to governmental eligible deferred compensation plans described in § 457(b)?

A-6. Yes, § 457(d)(1)(C) provides that, in order to satisfy the distribution requirements of § 457(b)(5), a governmental eligible deferred compensation plan described in subsection (e)(1)(A) must meet requirements similar to the requirements of § 401(a)(31). However, the delayed compliance date set forth in

Q&A-5 applies. The automatic rollover requirements of § 401(a)(31)(B) do not apply to non-governmental § 457(b) plans.

Q-7. Do the automatic rollover provisions of § 401(a)(31)(B) apply to § 403(b) plans?

A-7. Yes, § 403(b)(10) provides that rules similar to the rules of § 401(a)(31) apply to § 403(b) plans. Thus, the automatic rollover provisions of § 401(a)(31)(B) apply to annuity contracts described in § 403(b)(1), custodial accounts described in § 403(b) (7), and retirement income accounts described in § 403(b)(9). If a § 403(b) plan is a governmental plan within the meaning of § 414(d), then the delayed compliance date in A-5 applies.

Q-8. Do the automatic rollover provisions of § 401(a)(31)(B) apply to church plans within the meaning of § 414(e) with respect to which the election provided in § 410(d) has not been made?

A-8. Yes, the requirements of § 401(a)(31)(B) of the Code apply to non-electing church plans even though these plans are not subject to the provisions of § 411. However, a non-electing church plan maintained for which the authority to amend the plan is held by a church convention (within the meaning of § 414(e)(3)) will not be treated as failing to satisfy the requirements of § 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plan that are made prior to the date that is 60 days after the close of the earliest church convention that occurs on or after January 1, 2006.

Q-9. If a plan that provides for mandatory distributions does not make a distribution to a participant who fails to affirmatively elect direct payment or a direct rollover for a mandatory distribution on or after March 28, 2005, because the plan administrator has not sufficiently established administrative procedures that allow the plan administrator to accomplish the automatic rollover of a mandatory distribution by that date, will the plan be treated as failing to operate in accordance with its terms?

A-9. No, a plan will not be treated as failing to operate in accordance with its terms (including the automatic rollover provisions) with respect to mandatory distributions merely because it does not process mandatory distributions for which the participant does not affirmatively elect direct rollover or direct payment due to a lack of sufficient administrative procedures for automatic rollovers, including establishing individual retirement plans to accept automatic rollovers, provided the mandatory distributions are made on or before December 31, 2005.

Q-10. Can a plan administrator set up an individual retirement plan for a participant who is receiving a mandatory distribution and who has not elected to have such distribution paid directly to an eligible retirement plan in a direct rollover or to receive the distribution directly?

A-10. Yes, if a participant receiving a mandatory distribution fails to elect to have such distribution paid to an eligible retirement plan in a direct rollover or to receive the distribution directly, the plan administrator may execute the necessary documents to establish an individual retirement plan on the participant's behalf with a financial institution selected by the plan administrator.[1] For this purpose, the plan administrator may use the participant's most recent mailing address in the records of the employer and plan administrator. The trustee or issuer of the individual retirement plan must provide a disclosure statement to the participant and provide a revocation period as prescribed in § 1.408-6. The trustee or issuer of the individual retirement plan will not be treated as failing to satisfy the disclosure requirements of § 1.408-6 merely because the disclosure statement is returned by the United States Postal Service as undeliverable after it was mailed to the participant using the address for the participant provided by the plan administrator as the participant's most recent mailing address in the records of the employer and plan administrator.

Q-11. May a mandatory distribution be paid to an individual retirement account under § 408(c) or a deemed individual retirement account under § 408(q) that is part of the plan that is making the distribution?

A-11. Yes, a mandatory distribution may be paid to a participant's individual retirement account that meets the requirements of § 408(c) or to a participant's deemed individual retirement account that meets the requirements of § 408(q).

Q-12. Can a plan sponsor eliminate mandatory distributions from its plan without violating the anti-cutback provisions of § 411(d)(6) of the Code?

A-12. Yes, § 1.411(d)-4, A-2(b)(2)(v), provides that a plan sponsor may amend or change a plan to eliminate a provision which requires the plan to make a mandatory single-sum distribution to participants pursuant to § 411(a)(11) without violating § 411(d)(6).

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[1] The staffs of the federal functional regulators that issued joint regulations requiring financial institutions to implement customer identification programs ("CIP") pursuant to § 326 of the USA PATRIOT Act have interpreted these regulations to require that when a plan administrator transfers funds of a former employee to a financial institution pursuant to § 401(a)(31)(B), the financial institution will not be required to implement its CIP until the former employee first contacts such institution to assert ownership or exercise control over the account. Accordingly, CIP compliance is not required at the time an employee benefit plan establishes an account and transfers the funds to the bank or other financial institution for purposes of a complying with the automatic rollover requirements of § 401(a)(31)(B).

Q-13. If a plan is subject to the joint and survivor annuity and preretirement survivor annuity requirements of § 401(a)(11) and the plan provides that an accrued benefit greater than $1,000 but not greater than $5,000 will be distributed to a participant only with the consent of the participant, would a distribution of such an accrued benefit be subject to spousal consent requirements?

A-13. No. Section 1.417(e)-1(b)(2)(i) provides that no spousal consent is required before the annuity starting date if the present value of the nonforfeitable benefit is not more than the cash-out limit in effect under § 411(a)(11).

Q-14. Are amounts attributable to rollover contributions that exceed $5,000 subject to the automatic rollover provisions of § 401(a)(31)(B)?

A-14. Yes. Section 401(a)(31)(B) applies to the entire amount of a mandatory distribution. Thus, for example, the portion of the distribution attributable to a rollover contribution is subject to the automatic rollover requirements of § 401(a)(31(B), even if that amount is excludable (under § 411(a)(11)(D)) from the determination of whether the present value of the nonforfeitable accrued benefit exceeds $5,000.

Q-15. Is a plan administrator required to notify a participant to whom a mandatory distribution is going to be made that, absent the participant's affirmative election, the distribution will automatically be paid to an individual retirement plan in a direct rollover?

A-15. Yes. Section 401(a)(31)(B)(i) requires that the plan administrator notify the participant in writing (either separately or as part of the § 402(f) notice) that, absent an affirmative election by the participant, the distribution will be paid to an individual retirement plan. The notice must identify the trustee or issuer of the individual retirement plan. A plan administrator will not be treated as failing to satisfy this notice requirement merely because the notice is sent using electronic media in accordance with A-5 of § 1.402(f)-1. Further, for an eligible rollover distribution paid as an automatic direct rollover. a plan administrator will not be treated as failing to satisfy this notice requirement or section 402(f) with respect to an eligible rollover distribution merely because the notice is returned as undeliverable by the United States Postal Service after having been mailed to the participant using the participant's most recent mailing address in the records of the employer and plan administrator.

Q-16. When must a plan that provides for mandatory distributions be amended to include a provision that satisfies the requirements of § 401(a)(31)(B)?

A-16. Plans that provide for mandatory distributions and that do not already include the automatic rollover provisions must adopt a good faith plan amendment reflecting the automatic rollover requirements by the end of the first

plan year ending on or after March 28, 2005 (or in the case of a governmental plan in accordance with A-5). Included in the Appendix is a sample plan amendment that individual plan sponsors and sponsors (or volume submitter practitioners) of pre-approved plans can adopt or use in drafting individualized plan amendments. This sample plan amendment, or a plan amendment that is materially similar to this sample, will be a "good faith" plan amendment. The adoption of this sample amendment by a sponsor (or volume submitter practitioner) of a pre-approved plan will not cause such a plan to be treated as an individually designed plan. If a plan is amended by a timely good faith amendment reflecting the automatic rollover requirements, a plan amendment to a disqualifying provision related to the automatic rollover requirements can be made within the plan's EGTRRA remedial amendment period to the extent necessary to satisfy the automatic rollover requirements, as interpreted in published guidance. See § 2.03, Rev. Proc. 2004-25, 2004-16 IRB 791. To the extent necessary, such a remedial amendment may be made retroactively effective as of March 28, 2005, or, if later, the date on which the plan becomes subject to the automatic rollover requirements of § 401(a)(31)(B).

DRAFTING INFORMATION

The principal authors of this notice are Kathleen J. Herrmann and Angelique V. Carrington of Employee Plans, Tax Exempt and Government Entities Division. Ms. Herrmann and Ms. Carrington may be reached at (202) 283-9888 (not a toll-free number).

APPENDIX

Section 401(a)(31)(B) Sample Amendment

"In the event of a mandatory distribution greater than $1,000 in accordance with the provisions of section _____, if the participant does not elect to have such distribution paid directly to an eligible retirement plan specified by the participant in a direct rollover or to receive the distribution directly in accordance with section(s) _____, then the plan administrator will pay the distribution in a direct rollover to an individual retirement plan designated by the plan administrator."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 28, 2004
JS-2171

Treasury and IRS Finalize Comprehensive Rules for 401(k) Plans

-- Today, the Treasury Department and the IRS issued final regulations governing 401(k) plans. The 401(k) plan is the most common type of employer-sponsored retirement plan, providing retirement income security for millions of American workers and their families. The regulations apply to plans that permit employees to make pre-tax contributions and to plans that have employer matching contributions or employee after-tax contributions.

The existing regulations covering these plans were last updated in 1994. Since then, there have been significant statutory changes. Proposed regulations to comply with these changes were published on July 17, 2003.

These comprehensive final rules are the result of a long effort of gathering input from retirement plan participants, sponsors, and service providers. Specifically, they address many of the concerns raised by comments submitted in response to the proposed regulations. These final regulations will make it easier for employers to sponsor plans to help employees save for their retirement and will assist administrators in keeping the plans qualified.

The final regulations update and simplify many of the current rules for 401(k) plans. In addition, the new regulations strengthen the nondiscrimination rules that ensure benefits for rank-and-file employees. The regulations require certain employer contributions to be spread over a large group of rank-and-file employees before they can boost the ability of high-paid employees to defer income under the plan.

The regulations published today will be fully effective for plan years that begin on or after January 1, 2006, although employers are permitted to use these new rules for any plan year that ends after today.

REPORTS

- The text of the final regulations

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1 and 601

[TD 9169]

RINs 1545-AX26, 1545-AX43

Retirement plans; Cash or deferred arrangements under section 401(k) and matching contributions or employee contributions under section 401(m) Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance for certain retirement plans containing cash or deferred arrangements under section 401(k) and providing for matching contributions or employee contributions under section 401(m). These regulations affect sponsors of plans that contain cash or deferred arrangements or provide for employee or matching contributions, and participants in these plans.

EFFECTIVE DATE: December 29, 2004.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad or John T. Ricotta at (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 28, 2004
js-2172

Treasury Announces Entry Into Force of Protocol Amending U.S.-Netherlands Income Tax Treaty

WASHINGTON, DC -- The Treasury Department announced that the protocol amending the income tax treaty between the United States and the Netherlands entered into force today.

"I am very pleased that this important protocol improving the long-standing tax treaty relationship between the United States and the Netherlands is now in force," said Secretary Snow. "The enhancements reflected in the protocol will foster even closer ties between our two countries to the benefit of both our economies."

The United States and the Netherlands signed the protocol at a ceremony at the Treasury Department on March 8, 2004. The United States Senate approved the protocol on November 17, 2004.

The protocol amends the existing U.S.-Netherlands tax treaty, which entered into force in 1993, to take into account developments over the last decade. The protocol reflects a modernization of the anti-treaty shopping rules to prevent inappropriate exploitation of the treaty, including a tightening of the rules applicable to publicly-traded companies to ensure real nexus between the company and its residence country. The protocol also provides for the elimination of source-country withholding taxes on certain intercompany dividends, removing a remaining barrier to cross-border investment in both directions.

Under the terms of the protocol, each country was required to notify the other when its constitutional requirements for entry into force had taken place, with the protocol entering into force upon the second of the required notifications. This process was completed by delivery of the second such notification today.

With the entry into force today, the protocol generally will be effective for taxable periods beginning on or after January 1, 2005. The provisions of the protocol relating to withholding taxes will be effective for amounts paid or credited on or after February 1, 2005.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 29, 2004
JS-2173

Treasury Announces Successful Privatization of Sallie Mae

Treasury officials today completed the formal cutting of all ties of the Student Loan Marketing Association, commonly known as Sallie Mae or SLMA, with the federal government. Documents signed at the Treasury Department this afternoon effectively dissolved Sallie Mae, a government-sponsored enterprise subsidiary of SLM Corporation, completing a process that began in 1996. Today's action completed the transformation of Sallie Mae to a fully private corporation.

"The privatization of Sallie Mae was considered something of an experiment when proposed in 1996," said Treasury Assistant Secretary for Financial Institutions Wayne A. Abernathy, who signed the documents that made the transition final. "I am pleased that we have completed this transformation almost four years ahead of schedule. We applaud the transformation of Sallie Mae into a wholly private company, dynamically increasing its options to provide financing services to students. This is a mission well accomplished."

Congress originally established Sallie Mae in 1972 as a government-sponsored enterprise (GSE) to help students by facilitating a secondary market in federally guaranteed student loans. As a GSE, it had benefits such as exemptions from state and local taxes, but it was limited in the kinds of business it could enter.

In 1996, Congress enacted the SLMA Reorganization Act, which began the process of converting Sallie Mae into a private business while still meeting the needs of the borrowing student public. Sallie Mae's shareholders approved a reorganization that created SLM Corporation, a Delaware-chartered holding company, and the Sallie Mae GSE became its wholly-owned subsidiary. This process facilitated a smooth transition for the student loan market, culminating in the GSE's dissolution today. The Sallie Mae privatization included the establishment of a trust, satisfactory to Treasury, defeasing the remaining liabilities of the GSE. The dissolution of SLMA is well ahead of the September 30, 2008 deadline set by Congress.

The Treasury Department has exercised oversight responsibilities over Sallie Mae, including monitoring its privatization process. The document signed by Assistant Secretary Abernathy today is a formal recognition, required by the law, that the outstanding obligations of the now-dissolved GSE are sufficiently collateralized.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 29, 2004
JS-2174

**Treasury Provides Guidance on
Shipping Tax Regime Election**

Today the Treasury Department and the Internal Revenue Service issued guidance on the procedure for making an election to determine corporate tax on income from certain international shipping activities under the new tonnage tax regime.

The tonnage tax regime enacted by the American Jobs Creation Act of 2004 allows a corporation that is a qualifying vessel operator to elect to be subject to tax on notional income from qualifying shipping activities rather than on actual income from such activities. An election is effective only if it is made by a corporation that satisfies the specified requirements for eligibility to make the election. The election is available for taxable years beginning after October 22, 2004, and is effective for the taxable year for which it is made and for all succeeding taxable years until terminated.

REPORTS

- A copy of Notice 2005-2

Part III - Administrative, Procedural, and Miscellaneous

Election to Determine Corporate Tax on Certain International Shipping Activities Under Tonnage Tax Regime

Notice 2005-2

This notice provides guidance on the procedure for making an election to determine corporate tax on certain international shipping activities under the tonnage tax regime.

Code section 1354(a), as added by section 248 of the American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (October 22, 2004), allows a qualifying vessel operator to elect to be subject to the tonnage tax regime, under which tax is imposed on notional income from qualifying shipping activities rather than on actual income from such activities. A corporation is a qualifying vessel operator if the corporation operates one or more qualifying vessels within the meaning of section 1355(a)(4) and meets the shipping activity requirement of section 1355(c). Pursuant to section 1355(c)(2), the shipping activity requirement is satisfied with respect to the first year for which the election is made only if the requirement of section 1355(c)(4) is satisfied for the preceding taxable year. Thus, a corporation cannot be considered a qualifying vessel operator prior to the first day of the first year for which the election is made.

A corporation making the election is subject to tax with respect to its income from

qualifying shipping activities at the maximum corporate income tax rate on a notional amount based on the net tonnage of the corporation's qualifying vessels. An election made by a member of a controlled group, as defined in section 1355(a)(2)(B), applies to all qualifying vessel operators that are members of such group. The election is available for taxable years beginning after October 22, 2004, and is effective for the taxable year for which it is made and for all succeeding taxable years until terminated. If a corporation ceases to be a qualifying vessel operator, the election is terminated effective on or after the date of such cessation.

The election must be made before the due date (including extensions) of the income tax return for the year for which the corporation elects to be subject to the tonnage tax regime. An election may be made prior to the filing of such return by filing a statement with the Internal Revenue Service at the address where the corporation ordinarily files its income tax return. The statement must set forth the name, address, and employer identification number of the electing corporation and the taxable year for which the section 1354(a) election is being made. A copy of the statement must be attached to the income tax return for the year for which the corporation elects to be subject to the tonnage tax regime.

An election to be subject to the tonnage tax regime is effective only if the corporation is a qualifying vessel operator for the taxable year for which the election is made. If a corporation that files the statement does not satisfy the requirements to be a qualifying vessel operator, the election is not valid.

All electing corporations must provide such additional information relating to the tonnage tax as is required by the applicable corporate income tax return and the instructions thereto, which will include information regarding satisfaction of the requirements to be a qualifying vessel operator.

DRAFTING INFORMATION

The principal author of this notice is David L. Lundy of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Lundy at (202) 622-3880 (not a toll-free call).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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December 30, 2004
js-2175

Treasury Seeks Comment on New Information Reporting Provision

Today the Treasury Department and the IRS issued guidance and a request for comment relating to a new information reporting provision with respect to taxable corporate acquisitions enacted as part of the American Jobs Creation Act of 2004.

Existing temporary regulations require corporations to report to both the IRS and their shareholders following a transaction in which there is an acquisition of control or a substantial change in capital structure and which may be taxable under the rules of Internal Revenue Code section 367(a). These temporary regulations require information reporting with respect to corporate inversion transactions. Proposed regulations would extend this information reporting to other corporate acquisitions and substantial changes in capital structure. The new provision added by the AJCA providing for information reporting by an acquiring corporation in a taxable transaction supplements existing information reporting rules.

The notice indicates that Treasury and the IRS continue to consider comments regarding the proposed regulations and are considering the proper implementation of the new information reporting provision. The notice requests public comments regarding the implementation of the new provision, including coordination of the new rules with the requirements of the existing regulations.

A copy of Notice 2005-7 is attached.

REPORTS

- Notice 2005-7

Part III - Administrative, Procedural, and Miscellaneous

Section 6043A and Request for Comments

Notice 2005-7

Background

This Notice addresses the new information reporting rules provided in Section 6043A as enacted by the American Jobs Creation Act of 2004.

Temporary and Proposed Regulations under Sections 6043(c) and 6045

Proposed regulations under Sections 6043(c) and 6045 provide for information reporting in the case of an acquisition of control of a corporation or a substantial change in corporate structure of a corporation. Pursuant to these proposed regulations, information reporting would be required when there is an acquisition of control of a domestic corporation or a substantial change in capital structure of a domestic corporation, and shareholders are required to recognize gain (if any) from the transaction. The proposed regulations would require the reporting corporation (defined as the acquired corporation in the case of an acquisition) to file with the IRS Form 8806 describing the transaction on or before the 45th day following the transaction, and to file with the IRS and furnish to shareholders Form 1099-CAP with respect to cash, stock, and other property received by shareholders. Brokers holding stock for customers would be required to file with the IRS and furnish to shareholders Form 1099-B reporting the amounts received. Reporting would be required only with respect to transactions involving distributions of assets of $100 million or more, and certain reporting exceptions are provided with respect to specified shareholders.

Pursuant to temporary regulations §§ 1.6043-4T and 1.6045-3T, reporting rules have applied to any acquisition of control and any substantial change in capital structure occurring after December 31, 2001, if the reporting corporation or any shareholder is required to recognize gain (if any) as a result of the application of Section 367(a).

Section 6043A

Section 805 of the American Jobs Creation Act of 2004, Pub. L. 108-357, 118 Stat. 1418, added Section 6043A to the Internal Revenue Code. Section 6043A provides for information reporting by an acquiring corporation in any taxable acquisition, according to forms or regulations prescribed by the Secretary. Section 6043A supplements the information reporting provisions of sections 6043(c) and 6045.

Reporting and Request for Comments

Treasury and the IRS continue to consider comments regarding the proposed regulations under Sections 6043(c) and 6045. Treasury and the IRS also are considering the proper implementation of the additional information reporting provided in Section 6043A.

Treasury and the IRS request public comments relating to information reporting for acquisitions under Section 6043A, including, but not limited to, comments regarding:

(a) coordination with the requirements of the temporary and proposed regulations under Sections 6043(c) and 6045;

(b) rules for reporting by nominees;

(c) whether dollar thresholds (e.g., regarding the size of the acquisition or the amount received by a shareholder) should be adopted and, if so, the appropriate amount of such thresholds;

(d) design of forms; and

(e) appropriate filing deadlines.

Taxpayers required to report under Treas. Reg. §§ 1.6043-4T and 1.6045-3T must continue to report pursuant to those regulations.

Consideration will be given to written or electronic comments submitted by March 1, 2005. All comments will be made available for public inspection and copying. Send submissions to CC:PA:LPD:PR (NOT-156854-04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station,

Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR

(NOT-156854-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at [illegible].

The principal author of this notice is Michael Hara of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this notice contact Mr. Hara on (202) 622-4910 (not a toll-free number).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

December 31, 2004
JS-2176

Air Transportation Stabilization Board's Statement on Aloha Airlines' Decision to File for Chapter 11 Protection

The Air Transportation Stabilization Board (ATSB) has been in contact with Aloha Airlines over the past several months, working with the airline to avoid a Chapter 11 filing. In spite of these efforts and those of other stakeholders, Aloha has sought the protection of bankruptcy to finish its restructuring efforts. The Board will continue to work with Aloha through the bankruptcy process to ensure that the taxpayers' interests are protected.

-30-