Department of the Treasury
Library

AUG 2 5 2005

Treas.
HJ
10
.A13
P4
v.425

Department of the Treasury

PRESS RELEASES

The following numbers were not used:

JS-2506 through 2605

FROM THE OFFICE OF PUBLIC AFFAIRS

June 1, 2005
JS-2481

The Honorable John W. Snow Prepared Remarks NYU Center for Law and Business
New York, NY

Good evening, and thank you so much for having me here. It is an honor to speak with you about a subject that is near to my heart, and one that, by a necessity, became a hallmark of the Bush Administration.

Before I begin, I'd like to put the subject in the context of some recent history – economic history, to be specific.

Four years ago, we would have seen two great towers just south of here. We would have walked in their shadows on our way here tonight. And when our enemies felled those towers, our already-struggling economy was further battered, and all-important jobs were shed for months.

Corporate scandals – which I'll talk more about in a moment – weakened trust in markets and the timing of those eruptions literally kicked us when we were down.

Four short years later, this incredible, resilient American economy is once again the leader and the envy of the world.

Well-timed tax cuts, combined with sound monetary policy set by the Federal Reserve Board, got our economy moving when we needed it most. They gave business and industry the room you needed to grow, and you took over from there. As a result, economic growth was 4.4 percent last year, the strongest in five years.

We have had terrific news on jobs – 23 straight months of job growth. On the first Friday in May, the Labor Department announced that 274,000 jobs were created in April. The economy has created a total of 3.5 million new jobs since May 2003. That's great news – the best news – for 3.5 million families.

The American system of corporate capitalism is a key ingredient of our success. Modern American corporations are leading the world. They are a key source of innovation, modernization and advancement, and are essential to our success.

The continuing vitality of the corporate sector – making sure corporations can function effectively to carry out their critical role – is essential to our long-term prosperity.

It has been said often that after 9-11 the world will never be the same again. The same might be said for the world of corporate governance after the revelations of widespread misconduct that rocked the investment world in the spring of 2002. The scandals threatened to destroy this nation's confidence in corporate leadership and in those entrusted to safeguard our system of corporate capitalism.

Corporate leaders who had been lionized in the nineties came to be vilified. The corporate sector lost a large measure of its legitimacy and moral authority, and with that a large measure of its claim to national leadership. The American public was

understandably angered at what it saw as a massive breach of trust. People in authority, people charged with overseeing the interests of shareholders were found to be far more interested in advancing their own interests at the expense of those shareholders they were supposed to have been protecting. Corporate capitalism itself was being called into question.

Public support for the system of corporate capitalism, which had served our country so well for so long, was hanging in the balance. The system had been found wanting, and the guardians of the system had been found wanting. A clear, strong response became a political imperative in the summer of 2002.

Was the public reaction appropriate? After all, the scandals occurred in a relatively small number of public companies. Most of corporate America took their fiduciary duties seriously. If they had not, the economy could not have performed as well as it did throughout the nineties. GDP grew at a strong rate throughout the period. The real output of the economy was expanding. Jobs were being created, corporations were growing and investing and putting capital to good use. The strong results for the economy as a whole is completely at odds with the view that corporate malfeasance dominated corporate behaviors.

One could also argue that the market itself would have adjusted to the misconduct, with capital being diverted from firms with bad reputations to those known to play by the rules. It is also clear that the bulk of the misconduct was punishable under existing fraud statutes. Moreover, we know from long experience that misconduct is to be found in all aspects of human experiences and it cannot be legislated out of existence.

But as intellectually intriguing as these economic arguments might sound, on a practical level they were simply beside the point. We faced a crisis of confidence in those who were charged with the responsibility to oversee the corporate sector. Trust had been broken and trust is a precious thing. Trust under-girds our capital markets. It is perhaps the one single element without which an impersonal capital market cannot operate. Investors are both willing and able to invest on the basis of whether or not they think a particular business will make money. But they cannot, and will not, make that investment if they have no reliable information about the business. If we can't trust the numbers how can capital markets function, how do you know where to invest?

It would be difficult to overstate the importance of the role that corporations play in both the American economy and the American culture. They are creatures of the state and given a privileged position. By allowing large numbers of investors to combine their resources, corporations serve as vehicles to create vast pools of capital capable of exploiting economies of scale and scope. And investors will put their money into corporations based on the belief that those in charge of the corporation, the board of directors and the senior management, are bound both legally and ethically to use those combined investments for the benefit of the shareholders.

Investors can't be expected to vet the numbers themselves. They need to rely on CFOs and audit committees to give them accurate information, and they look to outside auditors and agencies like the SEC and stock exchanges to insure that the information is accurate.

So when the public trust is breached on such a spectacular scale in a system that is crucially dependent on trust, the political process calls out for answers; it calls out for a response.

The response we got of course is the Sarbanes-Oxley legislation. Considering the context in which it came about, Sarbanes-Oxley actually is in most respects quite a measured response. Despite its celebrated status as the most far-reaching capital market legislation since the creation of the SEC in the thirties, the fact is it essentially reaffirms established norms and codes of corporate governance, albeit with criminal penalties.

It underscores the need for corporate executives and boards to take their duties seriously. It calls for board independence. It reaffirms things that we had long taken to be the case – that boards should oversee the corporation; that the audit committee should retain the outside auditors; that the nominating committee, not the CEO, should select the board members; and so on.

Nothing here is revolutionary. Nothing here changes the fundamental norms of corporate governance that some of us learned about in law school decades ago. The overall thrust is to add specific procedures to insure that those traditional fundamental norms are followed. Not only is Sarbanes-Oxley a reasonable response, it was also in my view essential legislation to hold the system together. As somebody who spent most of my professional life in the corporate world, I am a great believer in our form of corporate capitalism. Anything that endangers it puts our prosperity, our national wealth and our future wellbeing in peril.

Our corporations are a unique American institution. They lie at the center of our enormous economic success. America simply could not be what it has become without a dynamic corporate sector that is continually marshalling capital and allocating it to promising uses. Putting capital to good use lies at the heart of economic success and rising living standards.

Using capital well is the essential function of corporations. Paraphrasing Adam Smith, while the modern corporation seeks to advance its shareholders' interests, it achieves far more than it intends. By putting capital in the right places and withdrawing it from the wrong places, by continuously making good judgments about how investments should be made, corporations lie at the center of the wealth creation process.

In fact, I think it is not an exaggeration to say that the modern American corporation ranks at the very forefront of all institutions that are shaping the world today. It is hard to think of any institution that is more adaptive or flexible, more innovative or creative, more focused on continuous improvement, more accountable for results.

They bring us new technologies, new products, new services, new management structures, new ways of organizing labor and capital, and they are under relentless pressure to continually produce better results, better products, better management structures, to widen their vistas.

Corporations today are the modern explorers. They are taking their management techniques, their capital and their resources to all the corners of the globe. They are continuously expanding the reach of the principles of comparative advantage. In the process they are uplifting the economic level of the entire world.

I would argue that there are no institutions in modern life that are more dynamic, more creative or more central to the kind of world we are today and the kind of world we will be tomorrow. In short, the modern business corporation is the most innovative, adaptive and flexible major institution of modern life.

With privileges go responsibilities. No institutions or set of institutions can survive if they lack integrity, if people don't play by the rules and rules aren't seen to be fair and appropriate to the overriding goals of the institution. The role of formal rules, though, in my view is of necessity secondary. A system that depends on outsiders to enforce rules and catch wrongdoers is not a system that encourages public support and investment. Ultimately, what holds the system together is not rules as such but trust, ethics, virtue. To flourish, corporations need to be rooted in the culture of high ethical behavior. They must exhibit the habits and practices of virtue.

Corporate cultures reflect the tone at the top. They reflect the ethical outlook of the people who run the institutions. They reflect their values. The scandals of 2002 did not occur in those great enterprises of America that had long exhibited a culture of ethical behavior.

And that brings me back to my principle point: Sarbanes-Oxley was an absolute

necessity. It played the crucial rule of giving the public confidence that somebody was in charge, somebody was looking out for their interests, and somebody would hold corporations accountable.

But the subtlety of Sarbanes-Oxley is that it did all of this by reaffirming the basic rules of corporate governance, not by transforming them.

Let's take a minute and look at what I call the basic rules. We start with the proposition that the shareholders, the owners, are owed a duty of loyalty by the managers of the enterprise. The group we know as professional managers today became commonplace of our culture a century or so ago when enterprises became too large to be overseen by the original owners. The owners in effect retained people to manage the business on their behalf. This has the huge additional advantage of allowing investors to become partial owners in a business without themselves needing to have the time and the right skills to manage that business.

Managers are supposed to run the enterprise primarily in the interest of shareholders; otherwise, the system would lack fundamental integrity; it would not hold together. How could capital markets function if investors didn't have confidence that their interests were being served?

Another fundamental proposition gives boards of directors the ultimate responsibility to oversee the corporation, its management and the strategic direction of its business. A corollary here of course is that to do this properly the directors must be independent. The role of the board is critical. Without a responsible board the system would lack integrity because management would lack accountability to anyone who could effectively oversee their conduct.

To perform its role, the board must act collectively. No single director has the authority to set corporate policy or take corporate action. While we need to be careful of cronyism, we also need to be sure that the board is capable of working together effectively as a collective body. The appointment of directors with individual agendas is less likely to result in better governance than it is to result in an uncooperative, deadlocked board that fails to provide effective direction for the corporation.

I am not aware of anyone coming up with a viable alternative to boards for overseeing management. Theoretically, perhaps, the government could serve as an effective watchdog over management, but we would not have corporate capitalism as we know it. We would have something else, something that would be inherently dangerous for a free society, something fundamentally at odds with the system that has served us so well for so long. Only the board of directors, which establishes the basic business policy and goals, has the necessary perspective to insist not only on scrupulous honesty but also on the achievement of the economic goals that were the real reason shareholders invested in the first place.

This brings us to a third tenet, that the shareholders get fairly rewarded from the wealth created from the activities of the business. Again, it is a matter of basic integrity. If managers can rig the game to gain a disproportionate share of the spoils, then the system falls apart and investors won't want to be part of it. The game won't be played.

It is also important that in our effort to reward shareholders, we don't confuse the goals of a few particular shareholders with the goals of shareholders as a whole. Whether you subscribe to the Lipton/ NYU school of thought or your personal economic corporate philosophy runs more to the Chicago school, everyone agrees that at its core the corporation is an economic engine.

As a whole, shareholders invest in the hopes of a financial return, and a corporation that decides to pursue other goals, however worthwhile some group may feel those goals are, needs to look hard at whether it is keeping faith with its shareholders. In fact, corporations that don't pursue economic objectives – that are not concerned with returns on capital – will find it hard to attract capital and survive. This is the discipline of the game of corporate capitalism. Only those who play it well in the

interest of shareholders can survive.

Finally--and this lies at the core of Sarbanes-Oxley--for the system to work well it is essential that the reported financial results of the enterprise reflect its true condition; in other words the numbers have to have integrity. Here is where CFOs, audit committees and outside auditors play a crucial role in making the system hold together. Again, if you can't trust the numbers the system falls apart. Investors won't have confidence and capital markets will be diminished.

Now what I have just laid out is the basic compact that underlies corporate capitalism – the basic duties and responsibilities of the various participants in the huge undertaking we call corporate capitalism.

In the context of the capital markets in the summer of 2002, two things stare out at you from what I just said. First, at every point key parts of the system were fraying badly and only would have gotten worse if we had not seen the spectacular implosions at some specific companies. A form of Gresham 's Law would come into play under which bad management practices drop out good management practices, at least in the short run.

I well remember being on the board of a major telecommunications company where we continuously wondered how a particular competitor could be doing so much better on its costs. Then we found out that it had nothing to do with superior management and everything to do with failure to live by the norms of accounting. Just think of it, at every juncture of the compact things broke down:

1. Managements forgot their duties to the corporation and its shareholders, running the corporation for their own benefit, and, in egregious cases lying to investors about the financial results.
2. Boards, sometimes blinded by conflicts of interest, failed to provide the required oversight, either in establishing business goals or seeing that they were really achieved.
3. Audit committees, compensation committees, CFOs and outside auditors, all fell far short in the special responsibilities that had taken on to look out for investors and to insure that the numbers were reported honestly.

The second large point I want to leave you with is the fact that Sarbanes-Oxley--important and celebrated as it is--has not altered the fundamental norms of good corporate governance. It has added criminal penalties. It has set up a separate oversight for the audit profession. But it essentially reaffirmed the norms of good corporate behavior and in doing so it made a critically important contribution at a critical point to restore confidence in the system and insure it would hold together.

Today we are still going through the learning process with Sarbanes-Oxley. Boards and managements are working their way through the requirements. All through corporate America it is clear things have changed. Boards are much more serious. The meetings are longer. Today there is no such thing as a 30 minute audit committee meeting. So in many ways things are getter.

At the same time, we need to maintain balance in our enforcement. We need to make sure the emphasis is on substance and not form. We need to make sure that innocent mistakes are not criminal. No one can know the future, and no one is right about every business decision. But there is a crucial difference between approving a project that turns out to be a business failure, on the one hand, and "cooking the books" to make a bad project look good, on the other. We must keep that fundamental distinction in mind. Mis-forecasting is not a criminal offense; misrepresenting the numbers is.

This is more than just a matter of fairness to the individuals involved. Our corporate system cannot work if boards of directors are so afraid of civil or even criminal liability that they simply refuse to make the tough business decisions, if they become so risk averse that only business plans with no possible downside get approved. The board has always played the dual role of both providing direction to the corporation and making sure that management was performing properly. If we

allow the system to be so skewed that all of the serious effort goes into oversight and second-guessing management, then the corporations will be hamstrung, legitimate business opportunities will be abandoned, and we will all suffer for it.

The American corporation has been and continues to be an extraordinary engine for economic development, innovation and change. Sarbanes-Oxley was a much needed and timely tool for keeping that engine on track and running properly. We need to make sure it is not inadvertently applied in a way that cripples that engine. I believe we can and will do just that.

-30-

FROM THE OFFICE OF PUBLIC AFFAIRS

June 1, 2005
JS-2482

Statement of Treasury Secretary John W. Snow on the Resignation of SEC Chairman William H. Donaldson

William Donaldson's leadership of the Securities and Exchange Commission during a crucial period for the U.S. financial markets will be remembered as the right leadership at the right time. With Chairman Donaldson at the helm of this critical agency, we have seen the shoring up of investor confidence and an extraordinary strengthening of corporate accountability. His efforts have provided increased protection for investors from unethical activity and enhanced disclosure and transparency to promote stronger corporate governance at mutual funds. He's sought out bad actors, held them accountable and brought them to justice. He has steadfastly pursued reforms to ensure that our nation's financial markets remain strong, fair and accessible for all Americans. Bill has been a highly effective and moral steward of the SEC, and the strength of his leadership will be missed.

-30-

FROM THE OFFICE OF PUBLIC AFFAIRS

June 1, 2005
2005-6-1-15-41-3-19716

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 $78,027 million as of the end of that week, compared to $77,291 million as of the end of the prior week.

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

	May 20, 2005			May 27, 2005		
TOTAL		77,291			78,027	
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,618	13,802	25,420	11,652	14,581	26,233
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,336	2,923	14,259	11,353	2,931	14,284
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]			15,159			15,100
3. Special Drawing Rights (SDRs) [2]			11,412			11,368
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	May 20, 2005			May 27, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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

	May 20, 2005			May 27, 2005		
	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.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 3, 2005
JS-2483

Statement of Treasury Secretary John W. Snow on May Employment Report

Today's labor market report shows that the economy keeps moving in the right direction. The unemployment rate has dropped to 5.1%, the lowest since September 2001, and 78,000 jobs were created in May. The number of payroll jobs is up by 3.5 million in the past two years and up by 900,000 in the past five months. In these numbers we see the results of the President's commitment to low taxes and economic growth. The underlying fundamentals of the economy are strong, with last week's GDP report showing 3.5 percent real growth and much higher wages and salaries than previously estimated. In this environment, it is no wonder that the federal budget outlook is also showing improvement.

President Bush is committed to keeping the economy on the path of healthy growth by making his tax cuts permanent, reducing the burden of frivolous lawsuits, passing a national energy policy, and strengthening Social Security.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 3, 2005
JS-2484

Treasury and IRS Announce New Rules On Tax Treatment Of Donations Of Automobiles To Charity

WASHINGTON, DC -- Today the Treasury Department and IRS released guidance on charitable deductions for donated vehicles. The American Jobs Creation Act (AJCA) generally limits the deduction for vehicles to the actual sales price of the vehicle when sold by the charity, and requires donors to get a timely acknowledgment from the charity in order to claim the deduction

The AJCA does provide some limited exceptions under which a donor may claim a fair market value deduction. Under the AJCA, if the charity makes a significant intervening use of a vehicle--such as regular use to deliver meals on wheels-- the donor may deduct the full fair market value. The guidance issued today explains what a significant intervening use may include. For example, driving a vehicle a total of 10,000 miles over a one year period to deliver meals is a significant intervening use.

The AJCA also allows a donor to claim a fair market value deduction if the charity makes a material improvement to the vehicle. Under the guidance, a material improvement means major repairs that significantly increase the value of a vehicle, and not mere painting or cleaning.

The guidance announced today also provides an additional exception to the sale price limit that was not included in the AJCA. Today's guidance permits a donor to claim a deduction for the fair market value of a donated vehicle if the charity gives or sells the vehicle at a significantly below-market price to a needy individual, as long as the transfer furthers the charitable purpose of helping a poor person in need of a means of transportation.

The guidance also explains how to determine fair market value if one of these three exceptions applies. Generally, vehicle pricing guidelines and publications differentiate between trade-in, private-party, and dealer retail prices. The guidance provides that the fair market value for vehicle donation purposes will be no higher than the private-party price.

The AJCA also requires a donor to substantiate a deduction with an acknowledgement from the charity that the deduction either reflects the sale price or that one of the three exceptions applies. The AJCA imposes a penalty on the charity for failure to provide a proper acknowledgement. The guidance also explains the requirements for the content and the due dates for acknowledgements.

The Treasury Department and IRS request comments on the guidance and suggestions for future guidance. The comment period will be open for the next 90 days.

A copy of the guidance is attached.

REPORTS

- Notice 2005-44

Part III - Administrative, Procedural, and Miscellaneous

Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes

Notice 2005-44

SECTION 1. PURPOSE

This notice provides interim guidance regarding section 884 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004), which adds §§ 170(f)(12) and 6720 to the Internal Revenue Code. Section 170(f)(12) contains rules for determining the amount that a donor may deduct for a charitable contribution of a qualified vehicle the claimed value of which is more than $500, and related substantiation and information reporting requirements. Section 6720 imposes penalties on a donee organization that receives a contribution of a qualified vehicle subject to § 170(f)(12) and knowingly furnishes a false or fraudulent acknowledgment of the contribution to the donor, or knowingly fails to furnish the acknowledgment. Sections 170(f)(12) and 6720 apply to contributions made after December 31, 2004. This notice also invites comments from the public regarding this notice and suggestions for future guidance under §§ 170(f)(12) and 6720. The rules provided in this notice apply until regulations are effective.

SECTION 2. BACKGROUND

Section 170(a) allows as a deduction, subject to certain limitations, any charitable contribution (as defined in § 170(c)), payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in § 170(e) and §§ 1.170A-4 and 1.170A-4A.

In general, § 1.170A-1(h) provides that if a taxpayer transfers to a charitable organization cash or property that is partly a charitable contribution and partly in consideration for goods or services, the taxpayer is allowed a charitable contribution deduction for the excess, if any, of the cash or fair market value of the property transferred over the fair market value of the goods or services the organization provides in return. See also *United States v. American Bar Endowment*, 477 U.S. 105, 117-118 (1986); Rev. Rul. 67-246, 1967-2 C.B. 104.

Section 170(f)(12)(A)(i) provides that no deduction is allowed under § 170(a) for a contribution of a qualified vehicle the claimed value of which is more than $500 unless the donor substantiates the contribution by a contemporaneous written acknowledgment that meets the requirements of § 170(f)(12)(B). Section 170(f)(12)(A)(i) also provides that the substantiation rules of § 170(f)(8) do not apply to a contribution of a qualified vehicle the claimed value of which is more than $500.

In general, to meet the requirements of § 170(f)(12)(B), the acknowledgment must include: the name and taxpayer identification number of the donor; the vehicle identification number; and certain certifications, depending on the use or disposition of the vehicle by the donee organization. See section 3.03 of this notice for all of the requirements applicable to acknowledgments. To be considered contemporaneous, the

acknowledgment must be obtained within 30 days of the contribution or the disposition of the vehicle by the donee organization, as applicable. See § 170(f)(12)(C) and section 3.03 of this notice. A copy of the acknowledgment must be included with the donor's tax return on which the deduction is claimed. Section 170(f)(12)(E) defines a qualified vehicle as any (i) motor vehicle manufactured primarily for use on public streets, roads, and highways, (ii) boat, or (iii) airplane, but the term does not include any property described in § 1221(a)(1) (*e.g.*, property held primarily for sale to customers).

If a donee organization sells a qualified vehicle without any significant intervening use or material improvement by the donee organization, the deduction allowed under § 170(a) may not exceed the gross proceeds received from the sale, which must be reported on the acknowledgment. See § 170(f)(12)(A)(ii). Section 170(f)(12)(F) provides that the Secretary may prescribe regulations or other guidance that exempts from the gross proceeds limitation and certain certification requirements sales by the donee organization that are in direct furtherance of the organization's charitable purpose. Section 170(f)(12)(F) also provides that the Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of § 170(f)(12).

SECTION 3. DEDUCTIONS IN EXCESS OF $500

3.01 *General rule*

If the claimed value of a donated qualified vehicle exceeds $500, the amount of the deduction may be limited under § 170(f)(12), depending on the use of the qualified vehicle by the donee organization (as described in section 3.02 of this notice). In

addition, under § 170(f)(12) the donor must obtain from the donee organization an acknowledgment that meets the requirements of section 3.03 of this notice, and include the acknowledgment with the tax return on which the deduction is claimed.

3.02 *Disposition or use by donee organization*

(1) *Qualified vehicle sold by donee organization*

If the qualified vehicle is sold by the donee organization without a significant intervening use or material improvement by the donee organization, then (except as provided in section 3.02(3) of this notice) the deduction claimed by the donor may not exceed the gross proceeds received from the sale of the qualified vehicle. In no event may the deduction for a donated vehicle exceed the amount that is otherwise allowable under § 170(a) (fair market value). The donor must obtain from the donee organization an acknowledgment that meets the requirements of section 3.03 of this notice.

(2) *Significant intervening use of or material improvement to a qualified vehicle*

If the donee organization makes a significant intervening use of (within the meaning of section 7.01(1) of this notice) or material improvement to (within the meaning of section 7.01(2) of this notice) a qualified vehicle, the donor is not subject to the gross proceeds limitation in section 3.02(1) of this notice. However, the deduction claimed by the donor may not exceed the fair market value of the qualified vehicle. The donor must obtain from the donee organization an acknowledgment that meets the requirements of section 3.03 of this notice. In addition, the donor must substantiate the fair market value as described in section 5 of this notice.

(3) *Qualified vehicle sold at a price significantly below fair market value (or*

gratuitously transferred) to needy individual in direct furtherance of donee organization's charitable purpose

Pursuant to § 170(f)(12)(F), the Internal Revenue Service and the Treasury Department hereby provide that the gross proceeds limitation in section 3.02(1) does not apply to a sale on or after January 1, 2005, of a qualified vehicle to a needy individual at a price significantly below fair market value, or a gratuitous transfer to a needy individual, in direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation. See H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 750 (2004). Mere application of the proceeds from the sale of a qualified vehicle to a needy individual to any charitable purpose does not directly further a donee organization's charitable purpose within the meaning of this section. The donor must obtain from the donee organization an acknowledgment that meets the requirements of section 3.03 of this notice. In addition, the donor must substantiate the fair market value as described in section 5 of this notice.

3.03 *Contemporaneous written acknowledgment under § 170(f)(12)*

(1) *General rule*

Under § 170(f)(12), a donor must obtain a contemporaneous written acknowledgment from the donee organization, and include the acknowledgment with the tax return on which the deduction is claimed. All acknowledgments under § 170(f)(12) must include the name and taxpayer identification number of the donor, the vehicle identification number, and the date of the contribution. Additional information is

required depending on the use of the qualified vehicle by the donee organization, as described in sections 3.03(2) through 3.03(4) of this notice.

(2) *Qualified vehicle sold by donee organization*

For a contribution of a qualified vehicle that is sold by the donee organization without any significant intervening use or material improvement by the donee organization in a sale that is not described in section 3.02(3) of this notice, the acknowledgment also must contain the date the qualified vehicle was sold, a certification that the qualified vehicle was sold in an arm's length transaction between unrelated parties, a statement of the gross proceeds from the sale, and a statement that the deductible amount may not exceed the amount of the gross proceeds. The acknowledgment is considered contemporaneous if the donee organization furnishes the acknowledgment to the donor no later than 30 days after the date of the sale.

Example 1. On October 1, 2005, A contributes a qualified vehicle with a fair market value of $1,300 to O, an organization that is described in § 170(c). On December 1, 2005, the qualified vehicle is sold without any significant intervening use or material improvement in a sale not described in section 3.02(3) of this notice. Gross proceeds from the sale are $1,000. On or before December 31, 2005, O provides an acknowledgment to A containing A's name and taxpayer identification number, the vehicle identification number, a statement that the date of the contribution was October 1, 2005, a statement that the date of the sale was December 1, 2005, a certification that the qualified vehicle was sold in an arm's length transaction between unrelated parties, a statement that the gross proceeds of the sale are $1,000, and a statement that the

amount of A's deduction may not exceed the amount of the gross proceeds. The acknowledgment meets the requirements of § 170(f)(12).

(3) *Significant intervening use of or material improvement to a qualified vehicle*

For a contribution of a qualified vehicle for which the donee organization intends a significant intervening use or material improvement within the meaning of section 7.01 of this notice, the acknowledgment also must contain: 1) a certification and detailed description of a) the intended significant intervening use by the donee organization and the intended duration of the use, or b) the intended material improvement by the donee organization; and 2) a certification that the qualified vehicle will not be sold before completion of the use or improvement. The acknowledgment is considered contemporaneous if the donee organization furnishes the acknowledgment to the donor within 30 days of the date of the contribution.

Example 2. On October 1, 2005, B contributes a qualified vehicle to O, an organization that is described in § 170(c). O intends to use the vehicle in its charitable activities, and the intended use is a significant intervening use within the meaning of section 7.01(1) of this notice. On or before October 31, 2005, O provides an acknowledgment to B containing B's name and taxpayer identification number, the vehicle identification number, a statement that the date of the contribution was October 1, 2005, a certification stating that O intends to make a significant intervening use of the qualified vehicle and stating the duration of this use, a detailed description of the significant intervening use, and a certification that the qualified vehicle will not be transferred in exchange for money, other property, or services before completion of the

use by O. The acknowledgment meets the requirements of § 170(f)(12).

(4) *Qualified vehicle sold at a price significantly below fair market value (or gratuitously transferred) to needy individual in direct furtherance of donee organization's charitable purpose*

For a contribution of a qualified vehicle that meets the requirements of section 3.02(3) of this notice, the acknowledgment also must contain a certification that the donee organization will sell the qualified vehicle to a needy individual at a price significantly below fair market value (or, if applicable, that the donee organization gratuitously will transfer the qualified vehicle to a needy individual) and that the sale (or transfer) will be in direct furtherance of the donee organization's charitable purpose of relieving the poor and distressed or the underprivileged who are in need of a means of transportation. The acknowledgment is considered contemporaneous if the donee organization furnishes the acknowledgment to the donor no later than 30 days after the date of the contribution.

Example 3. On October 1, 2005, C contributes a qualified vehicle to O, an organization that is described in § 170(c). O's charitable purposes include helping needy individuals who are unemployed develop new job skills, finding job placements for these individuals, and providing transportation for these individuals who need a means of transportation to jobs in areas not served by public transportation. O determines that, in direct furtherance of its charitable purpose, O will sell the qualified vehicle at a price significantly below fair market value to a trainee who needs a means of transportation to a new workplace. On or before October 31, 2005, O provides an acknowledgment to C containing C's name and taxpayer identification number, the

vehicle identification number, a statement that the date of the contribution was October 1, 2005, a certification that O will sell the qualified vehicle to a needy individual at a price significantly below fair market value, and a certification that the sale is in direct furtherance of O's charitable purpose as described above. The acknowledgment meets the requirements of § 170(f)(12).

SECTION 4. DEDUCTIONS OF $500 OR LESS

4.01 *Contemporaneous written acknowledgment required to substantiate a qualified vehicle contribution of $250 but not more than $500*

A contribution of a qualified vehicle with a claimed value of at least $250 (as determined in accordance with section 5 of this notice) must be substantiated by a contemporaneous written acknowledgment of the contribution by the donee organization. For a qualified vehicle with a claimed value of at least $250 but not more than $500, the acknowledgment must contain the following information as required by § 170(f)(8): the amount of cash and a description (but not value) of any property other than cash contributed; whether the donee organization provided any goods or services in consideration, in whole or in part, for the cash or property contributed; and a description and good faith estimate of the value of any goods or services provided by the donee organization in consideration for the contribution, or, if such goods or services consist solely of intangible religious benefits, a statement to that effect. To meet the contemporaneous requirement of § 170(f)(8)(C), the acknowledgment must be obtained by the donor on or before the earlier of the date on which the donor files a return for the taxable year in which the contribution was made, or the due date

(including extensions) of that return.

4.02 *Sale of qualified vehicle yields gross proceeds of $500 or less*

If a donor contributes a qualified vehicle that is subsequently sold, in a sale not described in section 3.02(3) of this notice, without any significant intervening use or material improvement by the donee organization, and the sale yields gross proceeds of $500 or less, the donor may be allowed a deduction equal to the lesser of the fair market value of the qualified vehicle on the date of the contribution or $500, subject to the terms and limitations of § 170. Under these circumstances, the donor must substantiate the fair market value (see section 5 of this notice), and, if the fair market value is $250 or more, must substantiate the contribution with an acknowledgment that meets the requirements of § 170(f)(8).

Example 4. D, an individual who itemizes tax deductions, contributes a qualified vehicle to O, an organization that is described in § 170(c). The qualified vehicle is sold without any significant intervening use or material improvement by O, and gross proceeds of $400 are received. In accordance with section 5 of this notice, D determined that the fair market value of the qualified vehicle at the time of the contribution was $800. Provided that D timely obtains a written acknowledgment that meets the requirements of § 170(f)(8) (see section 4.01 of this notice), and subject to the terms and limitations of § 170, D may be allowed a deduction not to exceed $500.

Example 5. The facts are the same as in *Example 4*, except that in accordance with section 5 of this notice D determined that the fair market value of the qualified vehicle at the time of the contribution was $450. Provided that D timely obtains a

written acknowledgment that meets the requirements of § 170(f)(8) (see section 4.01 of this notice), and subject to the terms and limitations of § 170, D may be allowed a deduction not to exceed $450.

SECTION 5. FAIR MARKET VALUE

A donor claiming a deduction for the fair market value of a qualified vehicle must be able to substantiate the fair market value. Section 1.170A-1(c)(2) provides that fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each having reasonable knowledge of relevant facts.

A reasonable method of determining the fair market value of a qualified vehicle is by reference to an established used vehicle pricing guide. Many factors must be taken into account when using a used vehicle pricing guide to determine fair market value. A used vehicle pricing guide establishes the fair market value of a particular vehicle only if the guide lists a sales price for a vehicle that is the same make, model, and year, sold in the same area, in the same condition, with the same or substantially similar options or accessories, and with the same or substantially similar warranties or guarantees, as the vehicle in question. *See, e.g.*, Rev. Rul. 2002-67, 2002-1 C.B. 873.

The Service and the Treasury Department intend to issue regulations under § 170 clarifying that for purposes of § 170, the dealer retail value listed in a used vehicle pricing guide for a particular vehicle is not an acceptable measure of fair market value of a similar vehicle. The regulations will clarify that, for purposes of § 170, an acceptable measure of the fair market value of a vehicle, for contributions made after June 3, 2005,

and before the date regulations become effective, is an amount not in excess of the price listed in a used vehicle pricing guide for a private party sale of a similar vehicle. The regulations limiting the fair market value of a vehicle to an amount not in excess of the private party sale price will apply to contributions of vehicles made after June 3, 2005. In addition, the Service and the Treasury Department will consider whether other values, such as the dealer trade-in value, are appropriate measures of the fair market value of a vehicle for purposes of § 170. Any regulations limiting the fair market value of a vehicle to an amount less than the private party sale value will not apply to contributions made prior to the date that regulations to that effect become effective.

SECTION 6. QUALIFIED APPRAISAL

A qualified appraisal is required for a deduction in excess of $5,000 for a qualified vehicle if the deduction is not limited to gross proceeds from the sale of the vehicle. See § 170(f)(11)(A)(ii)(I). For the definition of qualified appraisal, see § 1.170A-13.

SECTION 7. ACKNOWLEDGMENTS BY DONEE ORGANIZATIONS

7.01 *Requirements of significant intervening use; material improvement; sale or gratuitous transfer to needy individual in direct furtherance of donee organization's charitable purpose*

As described in section 3.03 of this notice, the contents of the acknowledgment required under § 170(f)(12) depend upon whether the donee organization sells a qualified vehicle without any significant intervening use or material improvement, intends to make a significant intervening use of or material improvement to a qualified vehicle prior to sale, or, in direct furtherance of a charitable purpose of the organization of relieving the poor and distressed or the underprivileged who are in need of a means

of transportation, intends to sell a qualified vehicle to a needy individual at a price significantly below fair market value, or gratuitously transfer a qualified vehicle to a needy individual. This section provides rules for donee organizations to use in determining the contents of the acknowledgments required under § 170(f)(12).

(1) *Significant intervening use*

To constitute a significant intervening use, a donee organization must actually use the qualified vehicle to substantially further the organization's regularly conducted activities, and the use must be significant. Incidental use by an organization is not a significant intervening use. Whether a use is a significant intervening use depends on its nature, extent, frequency, and duration. See H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 750-751 (2004). For this purpose, use by the donee organization includes use of the qualified vehicle to provide transportation on a regular basis for a significant period of time or significant use directly related to instruction in vehicle repair. However, use by the donee organization does not include use of the qualified vehicle to provide training in general business skills, such as marketing and sales.

Example 6. E contributes a qualified vehicle to O, an organization that is described in § 170(c). As part of its regularly conducted activities, O delivers meals to needy individuals. O uses the qualified vehicle only a few times to deliver meals and then sells the qualified vehicle. Because O's use is infrequent and incidental, there is no significant intervening use.

Example 7. The facts are the same as in *Example 6*, except that O uses the qualified vehicle to deliver meals every day for one year. Because O's use is significant

and substantially furthers a regularly conducted activity of O, there is a significant intervening use.

Example 8. The facts are the same as in *Example 6*, except that O does not use the qualified vehicle to deliver meals every day. However, O drives the qualified vehicle a total of 10,000 miles over a 1-year period while delivering meals. Because O's use is significant and substantially furthers a regularly conducted activity of O, there is a significant intervening use.

(2) *Material improvement*

Material improvement includes a major repair or improvement that improves the condition of the qualified vehicle in a manner that significantly increases the value. Cleaning, minor repairs, and routine maintenance are not considered material improvements. See H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 751 (2004). To be a material improvement of a qualified vehicle, the improvement may not be funded by an additional payment to the donee organization from the donor of the qualified vehicle.

For purposes of § 170(f)(12), services that are not considered material improvements include: 1) application of paint or other types of finishes (such as rustproofing or wax); 2) removal of dents and scratches; 3) cleaning or repair of upholstery; and 4) installation of theft deterrent devices.

(3) *Sale or gratuitous transfer to needy individual in direct furtherance of donee organization's charitable purpose*

As provided in section 3.02(3) of this notice, the gross proceeds limitation does not apply to a sale of a qualified vehicle at a price significantly below fair market value

(as described in section 5 of this notice), or a gratuitous transfer of a qualified vehicle, to a needy individual if supplying a vehicle to a needy individual is in direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation.

7.02 *Information reporting by donee organizations*

Section 170(f)(12)(D) requires a donee organization to provide to the Secretary the information given to the donor in the acknowledgment required under § 170(f)(12). The time and manner rules for information reporting required under § 170(f)(12)(D) will be addressed in separate guidance. See section 3.03 of this notice for guidance on the content of the acknowledgment.

7.03 *Penalties for false or fraudulent acknowledgments and for knowing failure to furnish proper acknowledgment*

Section 6720 imposes penalties on any donee organization required under § 170(f)(12)(A) to furnish an acknowledgment to a donor that knowingly furnishes a false or fraudulent acknowledgment, or knowingly fails to furnish an acknowledgment in the manner, at the time, and showing the information required under § 170(f)(12) or regulations thereunder. An acknowledgment containing a certification described in section 3.03(3) or (4) of this notice shall be presumed to be false or fraudulent, and therefore subject to a penalty under § 6720, if the qualified vehicle is sold to a buyer, other than a needy individual as described in section 7.01(3) of this notice, without a significant intervening use or material improvement within six months of the date of the contribution. The penalty applicable to an acknowledgment relating to a qualified

vehicle described in section 3.02(1) of this notice is the greater of (1) the product of the highest rate of tax specified in § 1 (currently 35%) and the sales price stated on the acknowledgment, or (2) the gross proceeds from the sale of the qualified vehicle. The penalty applicable to an acknowledgment relating to any other qualified vehicle the claimed value of which is more than $500 is the greater of (1) the product of the highest rate of tax specified in § 1 and the claimed value of the qualified vehicle, or (2) $5,000.

Example 9. O, an organization that is described in § 170(c), receives a contribution of a qualified vehicle that is a subcompact car that has been driven more than 100,000 miles. The substance of O's charitable activities involves regularly delivering food and other needed goods to the rural poor at remote locations. For this purpose, O needs three large vehicles suitable for delivering heavy loads across rugged terrain. Among many contributed qualified vehicles, O has identified three suitable vehicles that O intends to use for this purpose. The subcompact car is not suitable for O's use. O provides an acknowledgment to the donor of the subcompact car in which O knowingly makes a false certification of the intended use of the qualified vehicle and the duration of such intended use. The donor of the qualified vehicle claims a deduction of $2,300. O is subject to a penalty under § 6720 for knowingly furnishing a false or fraudulent acknowledgment to the donor. The amount of the penalty is $5,000, because that amount is greater than $805, the product of the claimed value ($2,300) and 35%.

Example 10. O, an organization that is described in § 170(c), receives a contribution of a qualified vehicle. The qualified vehicle is sold without any significant intervening use or material improvement by O. Gross proceeds from the sale are $300.

O provides an acknowledgment to the donor in which O knowingly includes a false or fraudulent statement that the gross proceeds from the sale of the vehicle were $1,000. O is subject to a penalty under § 6720 for knowingly furnishing a false or fraudulent acknowledgment to the donor. The amount of the penalty is $350, the product of the sales price stated in the acknowledgment ($1,000) and 35%, because that amount is greater than the gross proceeds from the sale of the vehicle ($300).

7.04 *Sections 170(f)(12)(D) and 6720 inapplicable if donor claims deduction of $500 or less*

For contributions within the scope of the rules described in section 4 of this notice (regarding deductions of $500 or less), §§ 170(f)(12)(D) and 6720 do not apply.

SECTION 8. EFFECTIVE DATE AND INTERIM GUIDANCE FOR DONORS AND DONEE ORGANIZATIONS

8.01 *Effective date and transition rules.*

This notice generally is effective for contributions made on or after January 1, 2005. However, the following transition rules are provided. A contemporaneous written acknowledgment that is obtained on or before July 3, 2005, will be treated as satisfying the requirements of § 170(f)(12)(A) if the acknowledgment contains all of the information specified in § 170(f)(12)(B), even if the acknowledgment does not include the date the qualified vehicle is sold (as required by section 3.03(2) of this notice), or a detailed description of the intended significant intervening use or material improvement by the donee organization (as required by section 3.03(3) of this notice). In the case of contributions described in section 3.02(3) of this notice regarding qualified vehicles sold at a price significantly below fair market value (or gratuitously transferred) to needy

individuals, the requirement of section 3.03(4) of this notice that an acknowledgment contain the information described in that section is effective for contributions made on or after January 1, 2005. For such contributions made on or before September 1, 2005, the acknowledgment must be obtained by the donor on or before October 1, 2005.

8.02 *Extension of time to obtain acknowledgments under § 170(f)(12) for contributions made on or before September 1, 2005*

Pursuant to § 170(f)(12)(F), the Service and the Treasury Department have determined that it is appropriate to provide donors an extension of time to obtain the contemporaneous written acknowledgment required by § 170(f)(12)(A). Therefore, for contributions made on or before September 1, 2005, a written acknowledgment will be considered contemporaneous for purposes of § 170(f)(12)(C) if it is obtained within the time specified in § 170(f)(12)(C) or, if later, on or before October 1, 2005.

8.03 *Form of acknowledgment*

A donee organization may provide an acknowledgment to a donor containing the information required under § 170(f)(12) in any reasonable manner. The Service and the Treasury Department will be providing Form 1098-C for reporting to the Service the information required to be reported under § 170(f)(12)(D). A copy of Form 1098-C may be used by a donee organization to provide a contemporaneous written acknowledgment to a donor pursuant to § 170(f)(12).

8.04 *Satisfaction of contemporaneous requirement for purposes of § 6720*

Section 6720 imposes penalties on any donee organization that knowingly fails to furnish an acknowledgment within the time required under § 170(f)(12) or the

regulations thereunder. See section 7.03 of this notice. A donee organization that provides a contemporaneous written acknowledgment that is treated as contemporaneous under sections 8.01 and 8.02 of this notice will be treated as having furnished the acknowledgment within the time required under § 170(f)(12) for purposes of § 6720.

SECTION 9. REQUEST FOR COMMENTS

The Service and the Treasury Department invite comments regarding this notice and suggestions for future guidance under §§ 170(f)(12) and 6720. In particular, comments are requested on which markets are appropriate for measuring the fair market value of vehicles for purposes of § 170, and for determining whether a sale was at a price significantly below fair market value for purposes of sections 3.02(3) and 7.01(3) of this notice. Commentators already have suggested that the most appropriate market for measuring the fair market value of vehicles is the market either for private party sales or for dealer trade-in transactions. Comments should address the factors that distinguish private party sales and dealer trade-in transactions, and which type of transaction is most similar to a charitable contribution. As discussed in section 5 of this notice, any regulations limiting the fair market value of a qualified vehicle for purposes of § 170 will not require use of a value less than the private party sale value for contributions made before the date the regulations become effective, but may require use of a value less than the private party sale value after that date. Comments should refer to Notice 2005-44 and be submitted by September 1, 2005, to:

Internal Revenue Service

P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044
Attn: CC:PA:LPD:PR
Room 5203

Alternatively, comments may be submitted electronically via e-mail to the following address: Notice.Comments@irscounsel.treas.gov. All comments will be available for public inspection and copying.

SECTION 10. PAPERWORK REDUCTION ACT

The collections of information in this notice have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1942.

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 OMB control number.

The collections of information in this notice are in sections 3, 4, 7, and 8. The collections of information in sections 3, 4, and 8 are required from donors to satisfy the substantiation requirements of § 170(f)(12). The collections of information are required from donors to obtain a benefit. The likely respondents are individual donors.

The collections of information in sections 3, 4, 7, and 8 are required from donee organizations to satisfy the donee reporting requirements of § 170(f)(12) and avoid the penalties in § 6720. The collections of information are mandatory. The likely respondents are tax-exempt charitable organizations.

The estimated total annual reporting burden is 3,041 hours for donors and

21,500 hours for donee organizations.

The estimated annual burden per donor varies from 1 minute to 5 minutes. The estimated annual burden per donee organization varies from 30 minutes to 16 hours, depending on individual circumstances. The estimated average annual burdens are 1 minute for donors and 5 hours for donee organizations. The estimated number of donors is 182,500 and the estimated number of donee organizations is 4,300.

The estimated annual frequency of responses (used for reporting requirements only) is annually.

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

SECTION 11. DRAFTING INFORMATION

The principal author of this notice is Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax & Accounting). For information regarding whether a transfer is in direct furtherance of a donee organization's charitable purpose, contact Sean Barnett of the Tax Exempt and Government Entities Division at (202) 283-8913. For information regarding penalties under § 6720, contact Donnell Rini-Swyers of the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622-4910. For information regarding information reporting by a donee organization, contact Mr. Barnett or Ms. Rini-Swyers. For further information regarding the remainder of this notice, contact Ms. Zweibel at (202) 622-5020 (not a toll-free call).

FROM THE OFFICE OF PUBLIC AFFAIRS

June 7, 2005
js-2485

Statement of
Acting Under Secretary for International Affairs Randal K. Quarles
before the Senate Banking Committee
Subcommittee on International Trade and Finance

IMF Reform - Toward an Institution for the Future

Thank you Chairman Crapo, Ranking Member Bayh, and other members of the Subcommittee. I am pleased to be here today to talk about our agenda as a shareholder of the International Monetary Fund (IMF).

Reform of the IMF has been a high priority since the start of the first Bush Administration. Former Under Secretary John Taylor appeared before the full Committee last May and summarized our work to date in both the IMF and World Bank. He laid out the underlying rationale for our quest to update these institutions - noting the growing role of international debt securities, the increase in the volume of private capital flows, and the increasing interconnection between financial markets. As he said at the time, those factors, combined with the crises of the late 1990s, made abundantly clear that greater predictability, accountability and more systematic behavior on the part of the official sector were vital to enhance the international financial policy framework.

The Path of Reform

The International Financial Institutions Advisory Commission (IFIAC), chaired by Dr. Allan Meltzer, helped provide impetus for reform. The Commission's report in March 2000 provided important insights about how the IMF and other international financial institutions could better realize their goals. The Commission's recommendations contributed to a serious debate about IMF reform, in which this Committee was an active participant. With strong advocacy from Treasury, the IMF has acted on reform. Specific steps by the IMF have been detailed in a series of annual reports to Congress - most recently in October 2004. Let me summarize some of the highlights over the last five years:

- The international community has clarified the limits and criteria for large-scale official sector lending. Consistent with the Meltzer recommendations, there has been no quota increase in the IMF. With IMF liquidity at historic highs, there is no need to add to its resources. Further, we have encouraged the presumption that the IMF, rather than governments, is responsible for providing large scale loan financing in the face of crises. This presumption provides an overall budget constraint and thereby an overall limit on loan assistance. Further, requests for large loans that represent exceptional access to IMF resources now face new procedures, including a higher burden of proof in the form of a special report that documents how IMF financing will support strong policies and a rapid return to private markets by the borrowing country.
- IMF programs are now more focused on its core macroeconomic areas of expertise. In work on lending programs, the IMF is more tightly focused on its core areas of monetary policy, fiscal policy, the balance of payments, exchange rates, and the financial sector. Further, the IMF relies more heavily on more robust analytical tools, particularly for risk assessment, enhancing its capacity to anticipate and deter financial crises.

- We achieved changes to reorient IMF lending to focus more on short-term financing, discourage casual or excessive use, and provide incentives to repay as quickly as possible. This includes higher interest rates for higher levels of access to discourage excessive reliance on Fund resources. It also includes limited use of Extended Arrangements, to reinforce the focus on making resources available only for the short term. These changing incentives are having an effect.
- The IMF is much more transparent than it was five years ago. Seventy-eight percent of staff reports for lending arrangements and Article IVs are made public. The IMF provides extensive information publicly about its financial operations. And the IMF has a permanent, independent evaluation office that has been producing high-quality reviews of specific IMF policies and activities.
- As part of the effort to correct incentives and prepare for more effective resolution of crises that occur, there has also been a major step forward on making the process of restructuring sovereign bonds more orderly. In that regard, the Administration worked closely with other countries to make routine the use of collective action clauses (CACs) in sovereign bond documentation to promote orderly restructuring and reduce disruption. One year after the launch of this initiative, Mexico responded by including CACs in its New York law governed bonds. Brazil, Korea, South Africa, and Turkey soon followed, and inclusion of CACs quickly became standard market practice.

These are major steps forward. Yet we are not prepared to relax our efforts. More needs to be done to ensure that the IMF is positioned for the challenges off the 21st century. In partnership with the G-7 and others, the United States has called for a strategic review to identify changes needed to make the IMF (and the World Bank) more responsive, relevant, and helpful to their members. The IMF has taken up this charge and is now undertaking a review of its role and strategy for the medium term.

Pushing the Next Wave of Reform - U.S. Priorities

Like any other institution, the IMF must continually examine itself to make sure that it is doing the best it can to achieve its core objectives. Fostering international monetary cooperation and balance of payments adjustment to support international financial stability and economic growth clearly remains its key aim. The purpose of this review is to make sure the institution is doing all it can to advance this goal.

As we engage in this review with other members of the IMF, the United States has several key priorities: strengthening IMF surveillance and crisis prevention; creating a more effective way for the IMF to actively support strong policies without lending; and realigning the IMF's role in low income countries to achieve better results. Let me explain what we have in mind in each of these areas.

Strengthening Surveillance and Crisis Prevention

The IMF's core mission is to oversee the international monetary system to ensure its effective operation, and for that purpose to exercise surveillance of the macroeconomic and exchange rate policies of its members. In this way the IMF should help prevent crises and foster adjustment in global imbalances.

This process offers the IMF a unique opportunity to assess risks, influence policy and help prevent crises. Indeed, surveillance has proven a very useful tool. Yet the execution of surveillance needs further enhancement. Action is needed, for instance, to further tighten the focus and selectivity of analysis. We also believe that the IMF needs to integrate more fully capital market and financial sector analysis into the daily life of the Fund. In addition, the IMF has a critical role to play in exercising firm surveillance over its members' exchange rate policies to promote international adjustment. In recent months the IMF has called for multilateral actions, including greater exchange rate flexibility in emerging Asia, and particularly in China.

Promoting Strong Policies without Lending

The IMF has traditionally had two levels of engagement with member countries - either the IMF reviews economic performance and policies annually through surveillance or, at the member's request, the IMF provides financial support conditioned on implementation of economic reforms that the IMF helps design and monitor. There is no middle ground between routine review and conditional finance.

The United States strongly believes that the IMF needs a new tool to provide for structured engagement in support of strong economic policies where there is no need for borrowing. We have proposed a new non-borrowing program to serve this role. Participation would be voluntary for member countries. The process of laying out an economic program would be led by each participating country, with the opportunity for country authorities to engage closely with IMF staff as they work to strengthen their country's macroeconomic policy framework and macroeconomic institutions.

The proposal now has the support of our partners in the G-7, and we expect it to be taken up by the IMF's Executive Board this summer. Demand for such an arrangement is already emerging from IMF member countries. We expect that some countries may actively seek to convert their borrowing relationship with the IMF to this basis and that others will welcome such a non-lending arrangement once their existing program expires, as a way of maintaining a signal from the IMF about the strength of their economic policies. This signal could be particularly useful to countries with strong macroeconomic foundations that nonetheless continue to depend on other donors for development financing or that are transitioning to market-based financing away from development finance. And it should help protect IMF resources for those countries with specific balance of payments needs.

Supporting Low Income Countries Effectively

Low-income countries face enormous economic and development challenges. Engaging with these countries to help them achieve macroeconomic stability - through policy advice, technical assistance, and financing when appropriate - is a vital part of the IMF's mission. Yet the Fund is not a development institution, and its financial operations should reflect its mission to provide short-term balance of payments financing rather than longer-term development aid.

While there is disagreement among economists about the impact of IMF assistance on economic growth in low income countries, the growth performance of many of these countries has been disappointing over the past two decades. A central challenge for the IMF is to improve the effectiveness of its own engagement in low income countries to help them achieve sustained improvement in economic outcomes.

Prolonged use of IMF resources is a serious problem, particularly for low-income borrowers, and is exacerbated by the Fund's practice of rolling-over existing exposure. Nearly all (30 of 32) countries with PRGF programs at the start of 2005 had at least two prior PRGF arrangements, each of which lasts three years. Prolonged reliance on IMF support can impede domestic ownership of economic policies and the development of institutions and can blur the IMF's short-term balance of payments role vs. the longer-term development finance role of the MDBs.

We have encouraged the IMF to undertake a close examination of its approach in low-income countries - with a view to helping these countries achieve better economic results. Good economic policies are fundamental to the efforts of low income countries to increase economic growth and improve the lives of their citizens. The IMF needs to find a way to support good policies more effectively, and in a way that is consistent with its role as providing temporary and short-term assistance in response to balance of payments shocks.

As a top priority, the IMF needs to establish and maintain high standards for its support for countries' economic programs. Weak or half-hearted policy efforts

should not merit IMF financial support, in emerging markets or low-income cases.

When countries are pursuing strong policies, the PRGF should be flexible enough to respond to countries facing short-term adverse developments in their balance of payments. The PRGF also needs to be available to support needed macroeconomic reform over the medium term. It should not, however, be geared to provide long-term development finance. Indeed, we believe that the proposed non-borrowing program that I have described for you above would offer a particularly important tool for low-income countries that have progressed through stabilization and no longer need to rely on IMF financing.

And perhaps most important, helping low-income countries depends on ending the lend-and-forgive cycle, so that they can move into an era of sustainable debt. The IMF has recently implemented a new debt sustainability framework, which establishes new standards for determining whether countries can or should take on additional debt.

It is critical that the IMF and other lenders integrate this framework into their operations. This, along with increased use of grants in IDA and the AfDF, as well as further bilateral and multilateral debt relief in those institutions for the HIPC countries, can provide a clear path to end the cycle of repeat lending and debt problems holding back the poorest countries.

With respect to debt relief, the Bush Administration has put forward a bold proposal that would relieve the debt burdens of poor countries. The proposal calls for immediate action to provide up to 100 percent relief on IDA and AfDF loans to the Heavily Indebted Poor countries (HIPCs). Action on this debt is critical to putting these poor countries on a sustainable path.

Any debt relief in the IMF would need to be financed from existing resources in the IMF.

We do not believe that gold sales - whether they were to be executed in the market or "off-market" - are necessary or warranted. I know that the issue of gold is of particular interest. Treasury has repeatedly voiced our opposition to a sale of IMF gold. Gold provides important underlying strength to the IMF's financial position. Selling IMF gold requires an 85 percent majority vote; since the United States has a 17.1 percent voting share in the IMF, our agreement is required before such a sale can go forward. Congressional approval is required for the U.S. Executive Director to vote in favor of such an IMF gold sale.

Modernizing the IMF's Governance

The IMF is accountable to its 184 member governments through a weighted voting structure aligned with countries' global economic standing. However, change in the world economy has outpaced that in the IMF's voting structure, particularly given fast-paced growth in emerging market economies and integration in Europe.

We feel strongly that the IMF is a financial and shareholder institution the governance of which should evolve along with the world economy. If countries are growing strongly and making increasing contributions to the global economy, then there should be a parallel enhancement of their position in the IMF. This is vital to maintaining the goodwill of members, on which the IMF relies to make its lending possible, and to preserving the centrality of the IMF in the global financial system.

Beginning in October 2004, Secretary Snow has emphasized that change is needed to address the growing disparity between the IMF's governance structure and the realities of the world economy. In April, he took a further step when he asserted that it is time to examine these issues now - and that progress should not, and indeed need not, be linked to an increase in the IMF's quota resources, which is not necessary given the current strength of the IMF's financial position. In particular, he has suggested that shifting quotas within the existing total could yield substantial progress. This could allow for quota shares to reflect the advent of

monetary union in Europe and the increasing role of fast-growing emerging markets, especially in Asia.

Change will not come quickly or easily. The issues are complex, and extensive dialogue and cooperation will be needed to find a way forward. Yet we believe the effort is worthwhile - and indeed essential to the long-term effectiveness of the institution. An IMF for the future must be an IMF in which all have a stake.

Argentina

One of the important tasks that has faced the IMF over the last four years has been dealing with the situation in Argentina, so let me say a few words about Argentina's economy and engagement with the IMF.

The Argentine economy continues to recover from the sharp contraction that accompanied the 2001-2 financial crisis. Real GDP grew 9% in 2004, following growth of 8.8% in 2003. Inflation ended 2004 at 6% after spiking to 41% at the end of 2002. The exchange rate has been roughly stable since mid-2003 and reserves have grown $11.5 billion since the end of 2002.

These positive results have been underpinned by better macroeconomic policy since the crisis. The federal government increased its primary surplus to nearly 4% of GDP in 2004 from a zero balance in 2001. Monetary policy succeeded in limiting the growth of the money supply to prevent an upward inflationary spiral.

The United States has supported IMF engagement with Argentina through the transitional program launched in January 2003 and the three-year program launched in September 2003. The purpose of these programs was to lock in macroeconomic stability and attack impediments to growth. These programs include essential reforms addressing Argentina's fiscal problems related to federal-provincial fiscal relations and weak tax administration, restoring the health of the banking sector, and improving the investment climate. The IMF program helped establish a basis for facilitating the normalization of Argentina's relations with its external creditors.

Argentina has continued to perform strongly on its macroeconomic targets. However, concerns remain regarding the implementation of its structural policy commitments under its IMF program. The IMF has not made any disbursements to Argentina since March 2004.

With respect to the debt restructuring, in January 2005 Argentina launched a debt exchange offer to restructure its $82 billion in principal claims of defaulted debt. Over 76% of creditors accepted Argentina's offer, while 24% (representing $20 billion in principal claims) did not.

With the recent settlement of the debt exchange, Argentina is now returning its focus to negotiating a new arrangement with the IMF. A key issue will be the development of an Argentine strategy to resolve the rest of the defaulted debt.

In addition to completing its debt restructuring, Argentina needs policies that support sustained growth so that it can continue to raise living standards and meet its financial obligations. Sustained growth requires improving the investment climate in order to attract private capital. Resolving the situation in the utilities sector will be an especially important signal to investors in this regard. Growth also requires locking-in fiscal improvements by fixing federal-provincial fiscal relations to prevent the provincial overborrowing that contributed to the 2001 financial crisis. Finally, continued strengthening of the banking sector will be important for providing the credit Argentina needs to grow.

Conclusion

I appreciate the opportunity to reflect on the path of IMF reform and lay out for you the Administration's priorities as we continue to press for change in this vital

institution. I believe that important progress has been made. Yet there is more to be done to ensure that the IMF operates effectively. I hope my remarks today make clear our commitment to maintain the momentum of reform.

I welcome your questions.

-30-

FROM THE OFFICE OF PUBLIC AFFAIRS

June 8, 2005
JS-2486

Prepared Remarks of Acting Under Secretary for International Affairs Randal K. Quarles Press Conference: Pre-G8 Finance Ministers Meetings

Good morning. Secretary Snow will attend a meeting of Finance Ministers in London on Friday and Saturday to help prepare for the Gleneagles Summit.

Our primary focus in these discussions remains growth. The global expansion remains robust, yet there are challenges to be faced to sustain strong growth going forward.

The U.S. economy is on sound footing, and growth is strong. First quarter performance was robust at 3.5 percent. Solid gains in consumer expenditures, prompted by increased hiring and strong household net worth, have supported GDP growth. The labor market has improved substantially, with payroll jobs up 3.5 million in the last two years and the unemployment rate at its lowest level since September 2001. In sum, growth is well balanced, with expanding business and residential investment, and strong household demand each contributing.

America's economy is moving in the right direction. President Bush is committed to keeping the economy on the path of healthy growth. Fiscal consolidation is a top priority. Already, we are seeing progress. Increased hiring, growth in demand, and expanding profits have led to a sizable increase in tax revenue so far this fiscal year. As a result, the Federal budget balance is likely to come in well below the $427 billion that had been projected for fiscal year 2005. The Administration remains steadfast in its effort to create the conditions for strong growth well into the future by making the tax cuts permanent, reducing the burden of frivolous lawsuits, passing a national energy policy, and strengthening social security.

Japan's economy had a welcome rebound in the first quarter, although growth forecasts remain modest and deflation persists. Growth in Europe has been generally disappointing, and the outlook for domestic demand is weak.

As the Secretary has emphasized, global adjustment is a shared responsibility. The United States is doing its part by addressing the fiscal deficit. But our actions alone will not be sufficient to unwind global imbalances. Europe and Japan must continue to adopt and implement vigorous and necessary structural reforms to lay the foundation for vibrant growth.

During the course of the weekend, Secretary Snow and his colleagues will meet with Finance Ministers from key emerging market countries – India, Brazil, South Africa, and China. These countries represent an increasing share of the global economy and will play an ever larger role over time. They will bring important experience and perspectives to the discussion. The Secretary also looks forward to meeting bilaterally with a number of these Ministers.

I expect that development will be a key focus of discussions this weekend. The plight of the poorest countries is a high priority for all of us. The United States is keenly aware of the challenges faced by these countries, and we are actively engaged in supporting economic reform and promoting long-term growth in Africa

and beyond. Through our Millennium Challenge Corporation, we have taken the lead in identifying and implementing more effective ways to provide development assistance. The MCC aims to assist countries that govern justly, invest in people, and encourage economic freedom – policies that are fundamental to achieving growth, catalyzing investment, and ensuring that foreign assistance has a real effect. Furthermore, through the President's Emergency Plan for AIDS Relief (PEPFAR), the United States is leading the international fight against the debilitating HIV/AIDS epidemic.

Helping low-income countries depends on ending the lend-and-forgive cycle, so that they can move into an era of sustainable debt. The Bush Administration has put forward a bold proposal to provide up to 100 percent relief on IDA and African Development Fund loans to the Heavily Indebted Poor countries. This plan also would include additional resources for low-income countries, which will both finance important new development projects and preserve the long-term financial strength of these international financial institutions. The removal of unsustainable external debt and the delivery of additional development resources will provide significant support for countries' efforts to reach the development goals of the Millennium Declaration.

Free trade is also fundamental to a vibrant world economy. Fully open financial services sectors can make important contributions for growth. I expect this is an issue that Secretary Snow will raise with other Ministers, with the goal of working together for an ambitious result at the Hong Kong WTO Ministerial. Similarly, the Secretary will likely also take notice of the role free trade can play in solidifying the gains in democracy, such as in the Administration's Middle East free trade agreements (e.g., Morocco, Bahrain) and DR-CAFTA, which is currently being considered by Congress. We will also address the importance of the financial services agenda with European finance ministries and key EU regulators in a trip to The Netherlands, Belgium, France and Germany immediately following our Ministers' meeting in London.

Let me close by drawing to your attention our ongoing work to combat terrorist financing. This will be another key item on the Ministers' agenda. I expect Ministers will review the progress made by Financial Experts to implement their Action Plan to strengthen the process of multilateral asset freezing, improve information sharing, and explore the possibility of broadening the application of new financial tools to disrupt serious crime. In regard to the latter, Secretary Snow will share with his colleagues the tools that we, in the United States, have available via Section 311 of the U.S. Patriot Act. These tools enable us to adopt a graduated approach, ranging from enhanced due diligence to the closure of correspondence accounts.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 9, 2005
JS-2487

Syrian Company, Nationals Designated by Treasury for Support to Former Saddam Hussein Regime

The U.S. Department of the Treasury today announced the designation of a Syrian-based company and two senior officials that acted on behalf of Saddam Hussein's fallen regime.

SES International Corp., based in Damascus, General Zuhayr Shalish and Asif Shalish were designated today pursuant to Executive Order 13315, which is aimed at blocking property of the former Iraqi regime, its senior officials and their family members and those who act for or on their behalf.

"Zuhayr and Asif used SES as a vehicle to put military goods into the hands of Saddam Hussein and his regime, all while evading UN sanctions," said Stuart Levey, the Treasury's Under Secretary for Terrorism and Financial Intelligence.

SES, which is owned by Zuhayr and managed by Asif, acted as a "false end user" for Iraq, helping to procure defense-related goods for the Iraqi military. As a Syrian company, SES was able to provide exporters in multiple countries with end-user certificates indicating Syria, rather than Iraq, as the final destination for the exported goods. SES would then arrange for the items to be transshipped to Iraq, which allowed the Iraqi regime to obtain military goods in contravention of UN sanctions.

Zuhayr and Asif acted on behalf of the former Iraqi regime and several of its senior officials. Zuhayr and Asif provided personal assistance to Hussein's oldest son, Uday Saddam Hussein, and to former Iraqi Presidential Secretary, Abid Hamid Mahmud al-Tikriti, both of whom were previously designated under EO 13315.

Information shows that Uday greatly benefited from his relationship with Zuhayr, Asif and SES. Notably, Zuhayr and Asif reportedly worked at the request of Uday to repatriate Adib Shaban, Uday's assistant, after Adib had fled from Iraq.

According to information available to the U.S. Government, Zuhayr was involved in efforts to help Abid Hamid Mahmud al-Tikriti flee Iraq during Operation Iraqi Freedom. There is reason to believe he offered to help Hussein's younger son, Qusay Saddam Hussein, leave Iraq.

U.S. Government information also indicates that before October 2003, al-Tikriti allegedly transferred large amounts of money to Zuhayr, who in turn earmarked the money as a monthly allowance for Abid Hamid Mahmud al-Tikriti's family.

Information available to the U.S. Government indicates that, since the fall of the former Iraqi regime, SES has employed or supported a number of former regime officials, notably Munir Mamduh Awad al-Qubaisi, the director of the Al Basha'ir Trading Company. Al Basha'ir was one of Iraq's largest arms procurement front companies. Both Munir and Al Basha'ir were previously designated under EO 13315.

Identifying Information

General Zuhayr Shalish
AKAs: Brigadier General Thu AL-HEMMEH
AL-SHALISH, Brigadier General Dhu Al-Himma

Major General Dhu Himma SHALEESH
Thu Al Hima SHALEESH
Dhu Al-Himma SHALISH
Dhuil Himma SHALISH
Zuhilma SHALISH
DOB: Circa 1956
POB: Al-Ladhiqiyah, Syria
Nationality: Syrian
Address: Damascus, Syria

Asif Shalish
AKA: Dr. Asef AL-SHALISH
AKA: Assef ISSA
AKA: Asef Isa SHALEESH
AKA: Dr. Assef Essa SHALEESH
DOB: January 1, 1959
PPN: 4713277 (Syria)
Nationality: Syrian
Address: Damascus, Syria

SES International Corp.
AKA: SES Automobile
AKA: SES Group
Address 1: Harasta Homs Highway
P.O. Box 241
Damascus, Syria

Address 2: Harsta Hams Road
P.O. Box 291
Damascus, Syria

Today's action is taken pursuant to Executive Order 13315 which blocks property and interests in property of senior officials of the former Iraqi regime, and those acting for or on their behalf, within the possession or control of U.S. persons.

For more information on additional Treasury actions against the former Iraqi regime, please visit the following links:

Treasury Designates 16 Family Members of the Former Iraqi Regime, Submits 191 Iraqi Entities to United Nations
http://www.treas.gov/press/releases/js1242.htm

Treasury Designates Front Companies, Corrupt Officials Controlled by Saddam Hussein's Regime
http://www.treas.gov/press/releases/js1331.htm

Uday Saddam Hussein's Inner Circle Designated by Treasury
http://www.treas.gov/press/releases/js1600.htm

U.S., Iraq, U.K. Jointly Designate Ambassadors Intel Ops of the Former Hussein Regime
http://www.treas.gov/press/releases/js1821.htm

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 8, 2005
JS-2488

**Joint Press Release of the Council of Economic Advisers,
the Department of the Treasury,
and the Office of Management and Budget**

The Administration today released an updated economic forecast that shows the economic expansion is expected to continue at a healthy and sustainable pace.

The updated economic forecast – which will be used for the Mid-Session Review of the Budget later this summer – is similar to the forecast released last December and used for the President's FY 2006 budget. Early indicators of activity suggest the 3.4 percent forecast for real gross domestic product (GDP) growth during the four quarters of 2005 remains on track. This forecast is consistent with the consensus of professional economic forecasters.

"The updated forecast remains largely the same as what we projected six months ago," said Harvey S. Rosen, Chairman of the Council of Economic Advisers. "The economic expansion is continuing."

The forecast for the labor market in 2005 is also on track. Payroll employment has increased 180,000 per month during the first 5 months of 2005, in line with the forecast of 175,000 jobs per month released in December. The revised forecast now predicts an average of 178,000 payroll jobs being added per month in 2005. The unemployment rate is now expected to be a tenth of a percentage point lower than previously projected.

"Economic growth is steady, it is strong, and our economy's underlying fundamentals are robust. All signs indicate that the President's economic policies are working, especially for job-seekers. With the unemployment rate at a low that we've rarely seen in history and 3.5 million new jobs created over the past two years, there is considerable good news to report on, as well as to look forward to," remarked Treasury Secretary John W. Snow.

The Administration's economic forecast shows moderate inflation. Inflation has been higher than expected so far this year, but most of the increase has been concentrated in volatile energy prices. The forecast for inflation, as measured by the price index for GDP, is revised up slightly to 2.3 percent during the four quarters of 2005; it then drops to 2.1 percent as previously projected.

Overall inflation in the consumer price index (CPI) has similarly been elevated by rapid energy price increases. The overall CPI increased by 3.5 percent during the 12 months through April, a rate that is not expected to persist. The core CPI (which excludes food and energy) increased only 2.2 percent during the past 12 months. As a result, the forecast of CPI inflation during the four quarters of 2005 has been revised up to 2.9 percent, but the Administration still forecasts overall CPI inflation to stabilize around 2.4 percent in 2006 and beyond. Again, the inflation forecasts are in line with the consensus of economic forecasters.

Recent trading in financial futures markets suggests that market participants expect short-term interest rates to rise a bit further, and the Administration's interest rate

projections reflect those views. The rate on 91-day Treasury bills, which closed at 3.01 percent on June 3, is expected to gradually increase to 3½ percent by 2007. The forecast shows rates on 10-year Treasury notes rising as well, from about 4 percent on June 3 to about 5.2 percent in 2007. By 2010, the difference between the rates on 10-year and 91-day Treasury securities is projected to be close to its historical average.

"With the President's focus on spending discipline, we are seeing positive signs for the American economy, and for the federal government's balance sheet," said Joshua B. Bolten, Director of the Office of Management and Budget.

Real GDP growth is expected to slow over the projection period, from 3.4 percent during 2005 and 2006, and eventually to taper off to 3.1 percent in 2009 and 2010. The predicted slowdown reflects slower anticipated growth in the working-age population and the retirement of the baby-boom generation.

The forecast was developed by a team from the Council of Economic Advisers, the Department of the Treasury, the Office of Management and Budget, with assistance from other agencies.

REPORTS

- Table 1-1 Administration

Table 1-1. —*Administration Forecast* <1>

	Nominal GDP	Real GDP (chain-type)	GDP price index (chain-type)	Consumer price index (CPI-U)	Unemployment rate (percent)	Interest rate, 91-day Treasury bills <2> (percent)	Interest rate, 10-year Treasury notes (percent)	Nonfarm payroll employment (millions)
	Percent change, fourth quarter to fourth quarter				Level, calendar year			
2004 (actual)	6.4	3.9	2.4	3.4	5.5	1.4	4.3	131.5
2005	5.9	3.4	2.3	2.9	5.2	3.0	4.3	133.6
2006	5.5	3.4	2.1	2.4	5.1	3.4	4.8	135.8
2007	5.5	3.3	2.1	2.4	5.1	3.5	5.2	137.8
2008	5.4	3.2	2.1	2.4	5.0	3.6	5.4	139.6
2009	5.3	3.1	2.1	2.4	5.0	3.8	5.5	141.1
2010	5.3	3.1	2.1	2.4	5.0	4.0	5.6	142.6

<1> Based on data available as of June 6, 2005.

<2> Discount basis.

Sources: Council of Economic Advisers, Department of Commerce (Bureau of Economic Analysis), Department of Labor (Bureau of Labor Statistics), Department of the Treasury, and Office of Management and Budget.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 9, 2005
JS-2489

Commerce Secretary Gutierrez and Treasury Secretary Snow Laud Oecd Study on the Benefits of Transatlantic Free Trade and Investment

U.S. Secretary of Commerce Carlos Gutierrez and Secretary of Treasury John W. Snow applaud the Organization for Economic Cooperation and Development (OECD)'s release of a report indicating the importance of reducing regulatory barriers between the United States and the European Union. The report finds that further work could result in benefits of up to $300 billion for the United States and a similar - or even greater- benefit for the European Union.

"The American consumer is currently picking up the tab for duplicative regulations at the grocery store, the electronics store, car dealerships and department stores," Secretary Gutierrez said. "As this study displays, creating greater efficiency in transatlantic trade and investment, while maintaining high standards of safety, will put more money back in the pocket of American consumers: The publication of this report is particularly timely as the U.S. and EU are developing a roadmap for revitalizing the transatlantic marketplace."

The OECD report, entitled, "The Benefits Of Liberalizing Markets and Reducing Barriers to International Trade and Investment: The Case of the United States and the European Union," sheds new light on the mutual benefits to greater liberalization and deregulation in the transatlantic economic relationship. The study concludes that reducing State control on the business environment, cutting tariff barriers and easing restrictions on foreign direct investment could generate great benefits for the United States, the European Union and all OECD Member Countries.

"The most striking part of the study is that it highlights the importance of domestic regulatory reforms for increasing trade, productivity and growth," Secretary Snow said. "This is especially true in Europe where deregulation would account for three-fourths of the total benefits. Deregulation would allow businesses to provide services on an EU-wide scale, and to make competitive business decisions – such as, for example, on retail shop hours."
For more information on the OECD report, entitled, "The Benefits Of Liberalizing Markets and Reducing Barriers to International Trade and Investment: The Case of the United States and the European Union, please visit http://www.oecd.org/.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 9, 2005
js-2490

Statement of Treasury Secretary John W. Snow Regarding Introduction of Pension Reform Legislation

The introduction of comprehensive pension reform legislation by Education and Workforce Committee Chairman John Boehner, Ways and Means Commitee Chairman Bill Thomas, and Employer-Employee Relations Subcommittee Chairman Subcommittee Chairman Sam Johnson is a significant step forward towards strengthening and securing pensions for American workers. I am pleased that their bill employs the essential structure of the Administration's proposal.

To ensure that worker's benefits are adequately funded, we continue to believe that pension plan assets and liabilities must be measured accurately, based on current market and credit conditions. Therefore, we will continue to work with the Congress to achieve pension reforms that ensure that the pension promises made are promises kept.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 11, 2005
JS-2491

Statement by Secretary John W. Snow
Pre G8 Summit Finance Ministers' Meeting
June 11, 2005

Good afternoon. I was pleased to meet with my fellow Finance Ministers in London these last two days as we prepared for Leaders to gather in Gleneagles.

We have just concluded what I think will be viewed as a very successful and even historic meeting in preparation for the Gleneagles Summit next month.

As you know, development was a key focal point of our meetings. The Ministers were able to come to agreement on a proposal put forth by the United States and United Kingdom to cancel 100 percent of the debt obligations owed to the World Bank (IDA), African Development Bank (AfDF), and International Monetary Fund (IMF) by countries eligible for the Heavily Indebted Poor Countries (HIPC) initiative – building on the landmark agreement by President Bush and Prime Minister Blair earlier this week. Relieving poor countries from their debt burdens so that they can focus on meeting their development goals is an important element of President Bush's comprehensive development strategy for Africa.

It is my hope today that this reform will conclusively end the destabilizing lend-and-forgive approach to development assistance in low-income countries. The removal of unsustainable debt combined with additional development resources will provide significant support for countries' efforts to reach their development goals. We are making remarkable strides in delivering assistance to Africa in more robust and smarter ways, and this agreement builds on those efforts. President Bush has tripled America's development assistance budget for Africa so that today nearly a quarter of every dollar of assistance in the region comes from America, when four years ago only 10% of assistance to the region came from America. So we are proud of our record. And with the Millennium Challenge Account program and President's Emergency Plans for AIDS Relief more assistance is on the way – especially if countries continue to implement economic reforms, end corruption, and invest resources in their people.

We also agreed that grants would be used to ensure that countries do not quickly re-accumulate unsustainable debts. The eighteen countries that have already reached the initiative's "completion point" requirements would see their debts immediately cancelled. Other HIPCs would be eligible for debt forgiveness as they fulfill their obligations under the program -- improving governance, reducing corruption, and completing a program with the IMF that demonstrates a commitment to sound economic policies.

Importantly, under this agreement donors have committed to preserve the financial integrity of the IMF, World Bank (IDA), and African Development Bank (AfDF). This would this include additional contributions IDA and AfDF that would be available to all low-income countries based on existing performance-based allocation mechanisms.

The eighteen countries that have already reached Completion Point will have their debt stock owed to the IMF immediately cancelled. The remaining HIPCs would also be eligible for relief upon reaching Completion Point. IMF debt relief would be

financed by existing IMF resources and would require no use of gold. The G-8 are also committed that the IMF's financing capacity for low-income countries going forward will not be diminished.

Our discussions this weekend also centered on the imperative to generate growth. And, in fact, the importance of growth is not unrelated to the discussion of development assistance. It is striking to note that if the developed economies had grown as rapidly as the United States over the past ten years, up to $100 billion more in development assistance would have been generated -- without countries increasing the share of their GDP reserved for development.

Growth among all the G7 countries is also essential for citizens in the G7 countries and to sustain and strengthen the global economic expansion.

The United States is doing its part. I reported on the recent performance of the U.S. economy, which expanded by 3.5 percent in the first quarter. Growth is broad-based, with expanding business and residential investment and strong household demand. The economy has added 3.5 million jobs in the last two years, and the unemployment rate is at its lowest level since September 2001.

I also detailed for my colleagues our strong commitment to fiscal discipline – and the results already being demonstrated in this area. With tax revenue showing sizable increases this year, I was able to indicate that we now expect the Federal budget balance to come in well below the $427 billion that had been projected for fiscal year 2005. In fact, many private forecasters are projecting that the federal deficit this fiscal year will come in under 3 percent of GDP. But I also reiterated that we continue to press ahead to further enhance the conditions for strong growth well into the future – by making the tax cuts permanent, reducing the burden of frivolous lawsuits, passing a national energy policy, and strengthening social security.

I listened carefully to my colleagues about the prospects for their economies. Many of them face modest forecasts at best and confront challenges in their efforts to strengthen the prospects for growth.

All of us need to act to achieve strong growth. We all understood that global adjustment is a shared responsibility. U.S. action alone cannot do this job. Vigorous structural reforms are needed in Europe and Japan to lay the foundation for vibrant growth, as well as increased exchange rate flexibility in emerging Asia.

I welcomed the opportunity to meet with Finance Ministers from key emerging market countries – India, Brazil, South Africa, and China – a number of whom I also met with bilaterally. We can learn a great deal from these countries' experiences. Their Ministers brought an important perspective to our discussion. I look forward to continuing to work with them going forward.

We also discussed the fundamental importance of free trade to the global economy. I underscored the contribution that fully open financial services sectors can make to growth. We discussed the importance of working together for an ambitious result at the Hong Kong WTO Ministerial. Contributions by all countries is essential to achieving wide-spread liberalization of trade in goods and services and a successful conclusion to the Doha Development Round in 2006. I emphasized the role free trade can play in solidifying the gains in democracy, such as in the Administration's Middle East free trade agreements (e.g., Morocco, Bahrain) and CAFTA, which is currently being considered by Congress. I will continue to stress the importance of the financial services agenda with European finance ministries and key EU regulators when I visit the Netherlands, Belgium, France and Germany over the next few days.

Finally, ongoing work to combat terrorist financing was also a key item of discussion. We took note of the progress made by Financial Experts to implement their Action Plan to strengthen the process of multilateral asset freezing, improve information sharing, and explore the possibility of broadening the application of new financial tools to disrupt serious crime. In this context, I described for my colleagues the tools that we, in the United States, have available to identify, block and freeze

the sources of terrorist financing. We believe that efforts to disrupt the financing of terror are succeeding and must continue.

Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 11, 2005
js-2492

Pre Summit Statement by G8 Finance Ministers

We met to prepare the annual Summit of G8 Heads of Government and had productive discussions with colleagues from key emerging economies on a range of global economic issues.

Global growth in 2004 was strong, supported by robust growth in trade along with increasing regional and global integration. Growth is expected to remain robust, although at a more moderate pace, in 2005. Challenges remain, especially: persistent global imbalances and high and volatile oil prices as well as a more balanced distribution of the benefits of globalization. Vigorous action is required by each country to support a smooth adjustment to more balanced growth. The key priorities in achieving this remain: continued fiscal consolidation in the United States; further structural reforms in Europe and Russia; and further structural reforms, including fiscal consolidation, in Japan. An ambitious result at the Hong Kong WTO Ministerial, including financial services, with a view to concluding the Doha Development Round by end 2006, is crucial for global growth.

Sustained high energy prices are of significant concern since they hamper global economic growth. We welcome efforts to reduce market volatility by improving data to make it more transparent and timely. We call on relevant international institutions to develop a global framework for reporting of oil reserves, which is essential for better informed market decisions, and to undertake further analysis of the workings of the oil market. We urge oil producing countries and companies and consumers to recognize their common interest in ensuring investment in sufficient future supplies of oil and refining capacity, and call on countries and international institutions to work to remove barriers and create a climate conducive to investment throughout the supply chain. We stress the importance of energy efficiency, technology and innovation in ensuring energy security. To help meet the challenge of climate change, we urge the World Bank and other multilateral development banks to increase dialogue with major borrowers on energy issues and put forward specific proposals at their Annual Meetings that encourage cost effective investments in lower carbon energy infrastructure. We agree the IFIs have a role in helping address the impact of higher oil prices on adversely affected developing countries and encourage the IMF to include oil prices in the development of facilities to respond to shocks.

We discussed the continuing challenges of meeting the Millennium Development Goals and have published an update to the Conclusions on Development we published in February.

We committed to further action to enhance the effectiveness of international efforts to counter terrorist financing by improving the process of freezing assets in line with UN resolutions, improving information sharing, and exploring new financial tools to disrupt serious crime.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 11, 2005
js-2493

G8 Finance Ministers' Conclusions on Development

1. We reaffirm the commitments we made at our meeting in February this year to help developing countries achieve the Millennium Development Goals by 2015, to make particular efforts in Africa, which on current rates of progress will not meet any of the Millennium Development Goals by 2015, and to set out for G8 Heads of Government and States the steps we believe can be taken to further implement the Monterrey Consensus on an open world trade system; increased aid effectiveness; absorptive capacity; increased levels of aid; and debt relief.
2. We reaffirm our view that in order to make progress on social and economic development, it is essential that developing countries put in place the policies for economic growth, sustainable development and poverty reduction: sound, accountable and transparent institutions and policies; macroeconomic stability; the increased fiscal transparency essential to tackle corruption, boost private sector development, and attract investment; a credible legal framework; and the elimination of impediments to private investment, both domestic and foreign.
3. We reaffirm our view of February that it is crucial that the international community improves the effectiveness of aid. In particular bilateral and multilateral donors need to: harmonize their operational procedures; align aid behind country-owned priorities for growth and poverty reduction; and provide for measurable results. Donors must also: focus their aid on poverty reduction; enhance efforts to untie aid, based on DAC principles; and deliver aid in a more predictable way. We welcome the progress made at the Paris OECD DAC High Level Forum in March, and call on the OECD DAC to set by September this year, ambitious and credible targets against all the indicators of progress agreed at the March meeting.
4. A successful outcome for the Doha Development Agenda, our highest common priority in trade policy for the year ahead, will bring real and substantial benefits to poor countries. The Hong Kong Ministerial in December will be a critical step towards a successful outcome of the DDA in 2006, which delivers substantial increases in market access for developing countries; establishes a timetable for the elimination of all trade-distorting export support in agriculture; and provides effective special and differential treatment for developing countries.
5. However, not all countries will benefit in the short term from reductions in trade barriers. Some countries lack the capacity to produce and deliver goods to international markets competitively; for others, the transitional costs of moving to more open markets may be substantial. We also recognize that poor countries face particular problems and need the flexibility to decide, plan and sequence reforms to their trade policies to fit with country-owned development programs. We commit to provide support to enable developing countries to benefit from trade opportunities. We call on the IFIs to submit proposals for the Annual Meetings for additional assistance to countries to develop their capacity to trade and ease adjustment in their economies, based on a systematic analysis of transition costs, so they can take advantage of more open markets.
6. Tackling diseases that undermine growth and exacerbate poverty in developing countries will require not only strengthened health systems, but also improved treatment, including universal access for AIDS treatment by 2010 and development of vaccines, including for HIV and malaria. We have made progress this year in implementing the Global HIV Vaccine Enterprise agreed at Sea Island, and are committed both to taking this

further; and to scaling up our support for vaccines and medicines research through the successful Public Private Partnerships model. We call for a report on progress by the end of the year. We recognize also that advance purchase commitments (APCs) are potentially a powerful mechanism to incentivize research, development and the production of vaccines for HIV, malaria and other diseases. We asked Minister Siniscalco to consult the relevant institutions, governments and industry, with the aim of developing concrete proposals by the end of this year.

7. The Enhanced HIPC Initiative has to date significantly reduced the debt of 27 countries, and we reaffirm our commitment to the full implementation and financing of the Initiative. Moreover, individual G8 countries have gone further, providing up to 100 per cent relief on bilateral debt. However, we recognize that more still needs to be done and we have agreed the attached proposal. We call upon all shareholders to support these proposals which we will put to the Annual Meetings of the IMF, World Bank and African Development Bank.
8. We also recognized at Monterrey that a substantial increase in ODA and private capital flows will be required to assist developing countries to achieve the Millennium Development Goals. We acknowledge the efforts of all donors, especially those who have taken leading roles in providing and increasing ODA and committing to further increases.
9. Specifically we welcome: the progress the EU has made towards the 0.39 per cent ODA/GNI target agreed at Barcelona; the announcements by France and the UK of timetables to reach 0.7 per cent ODA/GNI by 2012 and 2013 respectively; and the recent EU agreement to reach 0.7 per cent ODA/GNI by 2015 with an interim target of 0.56 per cent ODA/GNI by 2010 - a doubling of EU ODA between 2004 and 2010. In line with the EU agreement, Germany (supported by innovative instruments) and Italy undertake to reach 0.51 per cent ODA/GNI in 2010 and 0.7 per cent ODA/GNI in 2015. We welcome the tripling of US ODA to Sub-Saharan Africa and the near doubling of US ODA to all developing countries since 2000. The US now accounts for roughly 25% of all ODA to Sub-Saharan Africa. In addition, we welcome the launch of the Millennium Challenge Account and the President's Emergency Plan for AIDS Relief. We welcome Japan's commitment to double its ODA to Africa over the next three years and Canada's budget plans to finance its commitment to double aid levels from 2001 to 2010, and to double aid to Africa by 2008. In addition, we welcome Russia's $2.2 billion contribution to the HIPC Initiative.
10. As we prepare for decisions at the G8 Summit in Gleneagles we continue our work program on: the IFF and its pilot, the IFF for Immunization; some of the revenue proposals from the Landau Report, including a pilot project, supported and led by France and Germany, for a contribution on air travel tickets to support specific development projects and to refinance the IFF; the Millennium Challenge Account; the Enhanced Private Sector Assistance with the African Development Bank; and other financing measures; so that decisions can be made on how to deliver and bring forward the financing urgently needed to achieve the Millennium Development Goals.
11. Nigeria is key to the prosperity of the whole continent of Africa. We welcomed Nigeria's progress in economic reform as assessed in the IMF's intensified surveillance framework, noted its move to IDA-only status, and encouraged them to continue to reform. We are prepared to provide a fair and sustainable solution to Nigeria's debt problems in 2005, within the Paris Club.

G8 Proposals for HIPC debt cancellation

Donors agree to complete the process of debt relief for the Heavily Indebted Poor Countries by providing additional development resources which will provide significant support for countries' efforts to reach the goals of the Millennium Declaration (MDGs), while ensuring that the financing capacity of the IFIs is not reduced. This will lead to 100 per cent debt cancellation of outstanding obligations of HIPCs to the IMF, World Bank and African Development Bank. Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the MDGs and ensure that assistance is based on country performance. We ask the World Bank and IMF to report to us on improvements on transparency on all sides and on the drive against corruption so as to ensure that all

resources are used for poverty reduction. We believe that good governance, accountability and transparency are crucial to releasing the benefits of the debt cancellation. We commit to ensure this is reaffirmed in future bilateral and multilateral assistance to these countries.

Key elements:

- Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems.
- 100 per cent IDA, AfDF and IMF debt stock relief for Completion Point HIPCs.
- For IDA and AfDF debt, 100 per cent stock cancellation will be delivered by relieving post-Completion Point HIPCs that are on track with their programs of repayment obligations and adjusting their gross assistance flows by the amount forgiven. Donors would provide additional contributions to IDA and AfDF, based on agreed burden shares, to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled. Additional funds will be made available immediately to cover the full costs during the IDA-14 and AfDF-10 period. For the period after this, donors will commit to cover the full costs for the duration of the cancelled loans, by making contributions additional to regular replenishments of IDA and AfDF.
- The costs of fully covering IMF debt stock relief, without undermining the Fund's financing capacity, should be met by the use of existing IMF resources. In situations where other existing and projected debt relief obligations cannot be met from the use of existing IMF resources (e.g. Somalia, Liberia, and Sudan), donors commit to provide the extra resources necessary. We will invite voluntary contributions, including from the oil-producing states, to a new trust fund to support poor countries facing commodity price and other exogenous shocks.
- Globally and on this basis we are committed to meeting the full costs to the IMF, World Bank and African Development Bank. We will provide on a fair burden share basis resources to cover difficult-to-forecast costs, in excess of existing resources, to the IMF, IDA and AfDF over the next three years. Subject to further analysis by the institutions we will provide up to $350-500 million for this purpose. We are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens. We will also seek equivalent contributions from other donors to ensure all costs are covered and we will not jeopardize the ability of these institutions to meet their obligations.
- Utilize appropriate grant financing as agreed to ensure that countries do not immediately re-accumulate unsustainable external debts, and are eased into new borrowing.

We call upon all shareholders to support these proposals which would be put to the Annual Meetings of the IMF, World Bank and African Development Bank by September.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 13, 2005
2005-6-13-16-6-48-23414

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 $77,740 million as of the end of that week, compared to $78,027 million as of the end of the prior week.

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

	May 27, 2005			June 3, 2005		
TOTAL		78,027			77,740	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,652	14,581	26,233	11,363	14,586	25,949
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,353	2,931	14,284	11,050	2,932	13,982
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]			15,100			15,393
3. Special Drawing Rights (SDRs) [2]			11,368			11,464
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	May 27, 2005			June 3, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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

	May 27, 2005			June 3, 2005		
	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.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 14, 2005
js-2494

U.S. Treasury Secretary John Snow
at the
Center for European Policy Studies
Brussels, Belgium
June 14, 2005
US-EU Cooperation for Growth

It is a pleasure to be in Brussels. As President Bush made clear during his visit in February, the United States and the European Union share deep common interests.

For me, this visit comes in the middle of a five country tour of Europe – beginning in London for the G8 finance ministers meeting, then the Netherlands; from here I will travel to Paris and Frankfurt. As you can imagine, I have been asked a number of times what America thinks of the recent votes on the constitution.

My view is that Europe will find its way forward, but it's crucial that it do so quickly. America wants and needs a dynamic, vibrant Europe that is a strong partner in our shared challenge to spread the fruits of freedom, democracy and economic opportunity throughout the world. And a Europe that is economically weak is less able to fulfill its role in that partnership.

As the world's two largest economies, the US and EU have a special responsibility for the global economy. When we grow together, our economic leadership fosters development around the world and serves as a good model for economic cooperation.

Today, I would like to talk about my perspectives on US economic growth, global adjustment, and how a more integrated EU financial system can contribute to economic growth in Europe, the United States and the world.

Economic Growth and the United States

If there is one word that sums up the Bush Administration's approach to economic management, that word is "growth". Growth leads to higher living standards and fosters individual freedom. The private sector drives growth. But for this to happen, government must create the right climate with good macroeconomic and microeconomic policies.

During my visit to Europe last November, I was reminded of these basic truths. In Ireland, I met with a number of the leaders who laid the foundation for the creation of the "Celtic Tiger" that has moved Ireland from one of Europe's lowest income countries to one of its highest. In Warsaw, I met Finance Ministers from Poland, Slovakia, Hungary and the Czech Republic. These countries are on the economic move, adopting market-oriented polices and enjoying extraordinary growth. They show that Europe can be a global leader on growth.

The United States is doing its part to foster good growth, both at home and globally. Real GDP rose 4.4 percent last year. The first quarter came in at a strong 3.5 percent annual rate. Since the employment trough of May 2003 the economy

has generated 3.5 million new jobs. Well-timed monetary and fiscal policies have contributed to this improved outlook. More fundamentally, our higher growth and productivity stem from the resilience and flexibility of our factor markets, highly motivated workforce and investors, and open, competitive goods markets.

Let me say a word about our fiscal situation. Before joining government, I was not a fan of large deficits. And I'm still not! Some things never change. The current budget deficit is unwelcome but understandable given the extraordinary shocks we endured: the bursting tech bubble, 9/11, and corporate scandals. This was a "perfect economic storm." Since then, we have made strides to trim the budget deficit. Our solution is not to raise taxes. Spending restraint, combined with economic growth, is the key to a lower deficit.

Last fiscal year, the deficit came in at 3.6%, nearly a full percentage point lower than initially projected. Due to good growth, many private forecasters are estimating that the fiscal deficit this year will come in under 3%. Perhaps we will meet the Maastricht target this year! Both personal income and corporate profits are coming in well ahead of forecast. Labor's share of national income is rising and should rise even further in the year ahead. From the budget perspective this is very encouraging and suggests we are on a good path to halve the budget as a share of GDP -- well below 2% in a few years.

This will not be easy. But let me assure you -- I am personally committed to make fiscal consolidation a reality in the United States. Doing so is critical for the health of the US economy and for reinforcing the continued stability of the international monetary system. Longer term, we face serious issues with unfunded obligations represented by Social Security and Medicare. That's why President Bush is beginning to tackle them now.

Working Toward a Stronger Global Economy

The global economy is now stronger than in many decades. The outlook remains solid, despite higher oil prices. But the aggregate strength of the world economy masks large global imbalances. The international community recognizes that the adjustment of these imbalances is a shared responsibility, requiring a three-part strategy.

The first part is raising national saving in the United States. I have already stated that we are fully cognizant of our responsibility and the deficit is being cut. But there is no one-to-one correspondence between reductions in our fiscal and current account deficits. Further, it is in no one's interest that US economic growth decline sharply to reduce our current account deficit. We do not have a current account deficit target, nor should we. The best contribution the US can make to the world economy is to continue our record of good growth, predicated on sound macroeconomic management, vibrant factor markets, and openness.

Another part of the strategy is greater flexibility in exchange rates in emerging Asia, and especially in China. Constrained flexibility in Asian currencies should not shift the burden of global adjustment to Europe. Because of great progress in improving its financial sector, China is now ready to take immediate and significant action to achieve currency flexibility.

The other part of the strategy is directly relevant to this audience – structural reform in Europe, as well as Japan. Let us face reality: growth in the key continental European economies has been, and continues to be, weak. European and Japanese GDP together exceed that of the United States. Europe and Japan have a critical role to play in maintaining global economic strength, but they have not been doing their part of late. European and Japanese growth rates must strengthen, first and foremost to improve the lives of their people, but also to help address global imbalances.

That strengthened European growth requires deep structural reform is not news to anyone in Brussels. European officials have long recognized this reality, as reflected in the Stockholm Declaration and the Lisbon Agenda. Further, these

officials have also long recognized that the EU was not living up to its potential for growth and that structural reforms lag far behind well-publicized plans and objectives.

The EU Heads of State and Governments renewed their commitment to growth in their mid-term review of the Lisbon Agenda. The United States applauds this.

I appreciate that key structural reforms need to be taken by member states. Throughout Europe, many good reforms have already been undertaken and further plans are being developed. Many of the reforms being considered are similar to those we face – pensions, taxes, over regulation of businesses. Some have blamed the mobility of international capital itself for undermining economic performance. I disagree. The growth of private international capital flows has greatly increased the growth of countries with the policies to attract those flows on a sustained basis. The empirical evidence shows that a key foundation for growth and job creation is business-friendly policies that welcome and reward capital and investment.

I am not here to tell you what to do. Through my discussions with the finance ministers of Europe, it is clear that Europe knows what needs to be done. And beyond knowing what needs to be done, through the G7 Agenda for Growth, they have identified specific actions that are already underway. For instance, pension reform in France, labor reform in Germany, tax reforms in Italy. For us in the United States, it is clear we have a lot of things we need to work on. We are working hard to get them done. I am here to encourage these positive steps that have already been identified and to pledge our support for these initiatives.

I hope that when the member states submit their national action plans under the renewed Lisbon agenda, they outline not only their reform intentions, but also demonstrate the governments' resolve to muster the necessary support to make those reforms a reality. What is needed is clear, concrete action.

The potential benefits for Europe's citizens are clear and quantifiable. A recent OECD study determined that deregulating EU countries would raise EU GDP per capita by 2.8%. Putting this in personal terms, this mean an average worker gets a year's extra wages over a working life.

Given the strong trade interests of the United States and the EU, it is natural that we work closely together in the Doha Development Agenda to promote free trade that will help drive global economic growth. Completion of the Round before the end of 2006 will be a challenge. We need to intensify the pace of negotiations and commit to meeting key milestones along the way. Developed and developing countries alike need to be prepared to reduce their trade barriers and subsidies.

We have worked closely with our EU counterparts on the financial services negotiations. Together we have called for a "floor" level of liberalization to be complemented by disciplines on regulatory transparency. Financial services liberalization offers particular promise to be a key element to a successful conclusion of the negotiations. In view of the fact that financial services has a leveraging impact on growth and development and facilitates the flow of capital to labor, it is essential that establishing open financial sectors be at the center of the Doha Development Agenda, especially for the poorer nations.

US-EU Financial Cooperation

The United States is committed to working with the EU on financial cooperation across a number of fronts.

Financial Markets and Regulation

Further integration of EU financial markets is one structural reform that holds real promise to promote growth. With the advent of the euro, bringing together national capital markets into one is a natural way to promote efficiency. This is precisely the

aim of the EU's Financial Sector Action Plan (FSAP). Studies suggest that a liberal and integrated European financial market could increase EU GDP by as much as one percent per annum over time. It is for this reason that the US Treasury has long supported the FSAP.

Not surprisingly, in an era of global capital markets, legislation adopted by the United States or EU may spill over into each of our markets. The EU's Financial Conglomerates Directive required an assessment that large financial entities operating in Europe were supervised soundly at the consolidated level by their home supervisor.

Our Sarbanes-Oxley legislation sought to ensure that firms listed on U.S. stock exchanges and their auditors adhere to strong corporate governance. I hear complaints that the cost of doing business in the United States is now too high, and there is no doubt we can do better. But we must remember that there were serious corporate governance weaknesses in the United States that had to be tackled. We are not unique. Investor confidence is crucial for growth. Sarbanes-Oxley was a necessary response. We must adhere to the letter and spirit of the law, while implementing it in a manner that is not overly onerous and costly. The US capital markets are among the deepest and most dynamic and attractive in the world. I am committed to make sure that remains the case.

To manage "spillover" issues, the US Treasury, joined by the SEC and Fed, and the European Commission, established the US-EU financial markets regulatory dialogue three years ago. When I met Charlie McCreevy in April, we agreed that the dialogue had produced good results. Its informal nature -- with experts and officials working together, identifying looming issues, and sharing perspectives -- has led to confidence building and to problem solving. The talks have highlighted that we share the same objective of sound financial markets, though we may have different ways of achieving them.

The dialogue is moving from problem solving to a more forward looking agenda and deepened cooperation. The US is discussing such issues as re-insurance, solvency rules for insurance, clearing and settlement, retail banking, and corporate governance issues in the EU. On the US side, the EU is raising such issues as SEC de-registration, regulation of credit rating agencies, implementation of Basle II, and re-insurance collateral. Both sides are reaching out to business and academic communities.

The support of legislatures is critical for the Dialogue and for ensuring acceptance of financial regulation. In the United States, the dialogue has benefited tremendously from Congressional support, especially from Rep. Mike Oxley, Chairman of the House Financial Services Committee, as well as from his counterpart, Senator Richard Shelby. This afternoon, I look forward to meeting with members of the European Parliament's Monetary Affairs Committee.

Much hard work remains for Europe to achieve the FSAP's promise. As Commissioner McCreevy explained to me, his first priority is to ensure implementation in a way that promotes efficient markets. He doesn't want to overburden markets with regulation and wants to ensure that any new proposal shows clear benefits. Implementation will be key. If 25 different supervisors implement directives 25 different ways, the promise of a more integrated EU financial market will not be realized and it will be hard for the US and the EU to achieve convergence. I am meeting the heads of the Committee of European Securities Regulators and Banking Supervisors to learn how implementation is proceeding.

But the US-EU financial market dialogue is tapping into a deeper reservoir. The recent IMF Global Financial Stability Report shows that the sum of stock market capitalization, debt securities and bank assets in the EU and US was nearly two-thirds of the world total.

All of us at times talk about the Transatlantic Financial Market. But what does that mean? The last decades have witnessed enormous changes in financial markets.

In the United States, interstate banking allowed tremendous consolidation in our financial market, which enormously benefited the dynamism of our economy and consumer welfare. Consolidation is happening now in Japan. And in Europe, several major players now stand out.

Large consolidated financial institutions have become global players. They increasingly see themselves as global firms, whose profits are linked to their worldwide business, not just their activities at home. In contrast, regulation and supervision have always been inherently national. But when global institutions -- financial and commercial -- face different regulatory and supervisory regimes in every country they operate, it is burdensome, costly, and simply an inefficient use of resources.

Financial regulation must also continuously attune to market developments. Markets are dynamic, innovative, and creative human endeavors that produce new ways to deal with risk. They are to be encouraged. There is no doubt that over the last few decades or so, derivative instruments play a much larger role in financial markets than we could have ever anticipated. Derivatives disaggregate risks and make markets more efficient. In the US, we have monitored these developments closely, but taken a light regulatory approach, instead relying on counterparties. Were the government to regulate derivatives, we are concerned that counterparty due diligence could be diminished. If it were, it is hard to see how government regulation could supplant it.

Another new development is the role of hedge funds. Here too, we have taken a relatively light touch, avoiding financial regulation of the funds themselves, but requiring registration.

In our view, regulators can use markets – and market discipline – to help produce desired results. Markets are themselves self-policing mechanisms.

In talking with European regulators like Callum McCarthy and Charlie McCreevy, I am impressed with the focus on risk-based regulation. To enable markets to produce better results, regulators must always ask themselves where is our value added; what are we doing; and why we are doing it. This is also a question that we in the United States need to continually ask ourselves.

These trends and realities place an enormous responsibility on financial policy-makers and regulators. Of course, it will always be the case that our foremost responsibility is to our own citizens. But simply put, in protecting our investors, our vision must not only be market-friendly, but it must be global. We must work together responsibly to transcend national borders.

Thus, regulation and supervision should converge on high-quality global standards. This process is proceeding well, though there is much work to be done. Let me cite several factors and examples.

· One fundamental change is the revolution in transparency. All of us now acknowledge that disclosure and transparency are crucial for good rule-making. Further, given the dynamism of financial markets, regulators are always behind and must work with markets to get their job done. This means active consultation. In the past years, the EU has done a good job in consulting market participants. I have even heard of "consultation fatigue", but in my view better "consultation fatigue" than "consultation deprivation." This is a case where more is better than less.

· Another area of progress has been in the evolution of standard setting. Groups like the Basle Committee of Banking Supervisors, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors are bringing authorities together to forge common best practices for supervision.

· Regulation is increasingly focused on the consolidated entity. This is mirrored

in Europe's Financial Conglomerates Directive, as well as in our legislation such as the Gramm-Leach-Bliley Act and the SEC's recent Consolidated Supervised Entity rule. It is also reflected in some ways in Basle II.

· Accounting is another area where the trend toward convergence is firmly in place. Several weeks ago, SEC Chairman Bill Donaldson and Charlie McCreevy agreed on a "roadmap" for the United States to accept statements using international accounting standards as a basis for listings in the US market as early as 2007 and no later than 2009. This is an enormously positive development. In so doing, the SEC set forth several markers, especially consistent implementation and enforcement across the 25 European member states. The ball is in Europe's court to make this a reality. I am confident Charlie McCreevy will make it happen. Within a few years time, accounting in the US and Europe could become a similar exercise.

· The move toward "convergence" is also evident in the collaboration emerging between US regulators and the new EU supervisory implementation bodies. The Federal Reserve has established a dialogue with CEBS, the SEC a dialogue with CESR, and the NAIC with CEIOPS.

Combating Terrorist Financing

Another example of cooperation is our work together on combating terrorist financing. We have seen that terrorism does not discriminate against race or religion and the threat of terrorist financing does not stop at borders or coastlines. That is why the partnership between the United States and the EU in combating terrorist financing is critical. We must continue to work together to financially isolate terrorists and their financiers and shut down channels used to move money to al Qaida, Hezbollah, Hamas and other deadly groups.

We are seeing the fruits of our labor. Intelligence reporting - although anecdotal - speaks to the greater difficulty which terrorists encounter in raising, moving, and storing money. We are seeing terrorist groups avoiding formal financing channels and instead resorting to riskier and more cumbersome conduits like bulk cash smuggling. Therefore, it is important that we continue to work together to address terrorist financing vulnerabilities introduced by informal channels, such as alternative remittance and underground banking systems.

We also know that the enemies we face are motivated, patient and ruthless. Terrorist groups still want to attack us, and they are very focused on our economy and financial systems in particular. An act of terrorism is perhaps the greatest threat facing our economy today. The further we get from September 11, 2001, the harder it may be to keep our sense of urgency, but we must never let our guard down.

There can be no doubt – the competitive forces blowing across the U.S. and European financial landscape are global in nature. So, we need rules for the global marketplace, not just for the US and Europe. Thus, in the final analysis, when we talk about a Transatlantic Financial Market, what we are really talking about is the reality of global financial markets, the EU creating a single financial market in place of 25, and the US and EU converging on high-level global standards. The Transatlantic Financial Market must fundamentally be anchored in the global system and in best global practice. That is what the US-EU financial market dialogue is all about – a new architecture for the global financial system.

Promoting economic growth and getting our financial houses in order at home while pursuing structural reforms, trade liberalization, and more efficient cross-border capital markets and regulation are part of a progressive US-EU economic agenda. Together, the United States and the European Union must lead.

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 15, 2005
js-2495

Treasury International Capital Data for April

Treasury International Capital (TIC) data for April 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 May, is scheduled for July 18, 2005.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,413.8 billion in April, exceeding gross sales of domestic securities by foreigners of $1,360.1 billion during the same month.

Foreign purchases of domestic securities reached $53.6 billion on a net basis in April, relative to $58.9 billion during the previous month. Private net flows reached $42.1 billion in April. Net private purchases of Treasury Bonds and Notes decreased to $10.7 billion from $42.8 billion the preceding month. Net private purchases of Government Agency Bonds were $8.4 billion, up from $6.5 billion the previous month. Net private purchases of Corporate Bonds were $18.1 billion, down from $22.3 billion the previous month. Net private purchases of Equities rose to $5.0 billion from $1.7 billion.

Official net purchases of U.S. securities were $11.5 billion in April, relative to minus $14.4 billion in March. Official net purchases of Treasury Bonds and Notes of $14.0 billion accounted for the bulk of official flows in April, up from a negative $15.0 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $286.3 billion in April, relative to gross sales of foreign securities to U.S. residents of $292.5 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $6.2 billion, highlighting a net U.S. acquisition of $1.6 billion in Foreign Equities and $4.6 billion in Foreign Bonds.

Net Long-Term Securities Flows

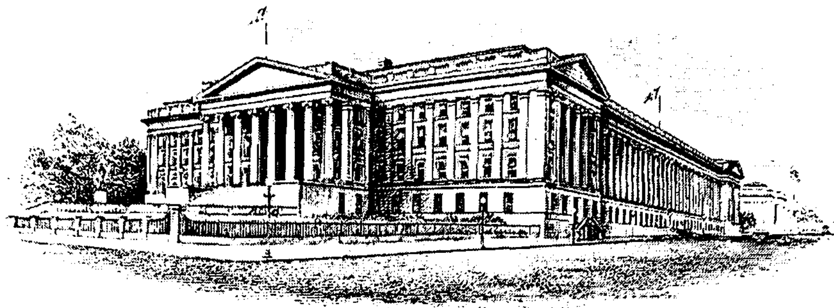
Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $47.4 billion in April compared with $40.6 billion in March. Net foreign purchases of long-term securities were $750.1 billion in the twelve months through April 2005 as compared to $798.8 billion during the twelve months through April 2004.

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/.

-30-

REPORTS

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



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9 a.m. EDT
June 15, 2005

Contact: Brookly McLaughlin
(202) 622-2960

TREASURY INTERNATIONAL CAPITAL DATA FOR APRIL

Treasury International Capital (TIC) data for April 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 May, is scheduled for July 18, 2005.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,413.8 billion in April, exceeding gross sales of domestic securities by foreigners of $1,360.1 billion during the same month.

Foreign purchases of domestic securities reached $53.6 billion on a net basis in April, relative to $58.9 billion during the previous month. Private net flows reached $42.1 billion in April. Net private purchases of Treasury Bonds and Notes decreased to $10.7 billion from $42.8 billion the preceding month. Net private purchases of Government Agency Bonds were $8.4 billion, up from $6.5 billion the previous month. Net private purchases of Corporate Bonds were $18.1 billion, down from $22.3 billion the previous month. Net private purchases of Equities rose to $5.0 billion from $1.7 billion.

Official net purchases of U.S. securities were $11.5 billion in April, relative to minus $14.4 billion in March. Official net purchases of Treasury Bonds and Notes of $14.0 billion accounted for the bulk of official flows in April, up from a negative $15.0 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $286.3 billion in April, relative to gross sales of foreign securities to U.S. residents of $292.5 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $6.2 billion, highlighting a net U.S. acquisition of $1.6 billion in Foreign Equities and $4.6 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 $47.4 billion in April compared with $40.6 billion in March. Net foreign purchases of long-term securities were $750.1 billion in the twelve months through April 2005 as compared to $798.8 billion during the twelve months through April 2004.

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					
		2003	2004	Apr-04	Apr-05	Jan-05	Feb-05	Mar-05	Apr-05
1	Gross Purchases of Domestic Securities	14,383.6	15,270.2	15,293.1	15,801.4	1,305.3	1,376.3	1,529.5	1,413.8
2	Gross Sales of Domestic Securities	13,644.9	14,366.2	14,424.6	14,916.3	1,213.5	1,278.2	1,470.6	1,360.1
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**738.8**	**904.0**	**868.6**	**885.1**	**91.8**	**98.1**	**58.9**	**53.6**
4	**Private, net /2**	**595.7**	**669.9**	**632.5**	**736.4**	**77.2**	**79.4**	**73.3**	**42.1**
5	Treasury Bonds & Notes, net	163.2	150.9	208.0	185.9	23.1	31.2	42.8	10.7
6	Gov't Agency Bonds, net	135.1	206.1	140.2	192.2	19.9	10.9	6.5	8.4
7	Corporate Bonds, net	261.5	286.5	247.6	303.9	17.3	29.9	22.3	18.1
8	Equities, net	35.9	26.4	36.7	54.4	17.0	7.4	1.7	5.0
9	**Official, net**	**143.1**	**234.2**	**236.1**	**148.7**	**14.5**	**18.7**	**-14.4**	**11.5**
10	Treasury Bonds & Notes, net	113.5	201.1	205.5	118.1	7.6	11.3	-15.0	14.0
11	Gov't Agency Bonds, net	24.3	20.3	23.8	18.7	6.1	5.2	1.0	-1.7
12	Corporate Bonds, net	5.6	11.4	7.0	11.8	1.3	2.1	-0.4	-0.1
13	Equities, net	-0.3	1.4	-0.2	0.1	-0.6	0.1	0.0	-0.7
14	Gross Purchases of Foreign Securities	2,893.8	3,119.8	3,174.8	3,132.8	250.7	281.2	327.6	286.3
15	Gross Sales of Foreign Securities	2,959.7	3,228.6	3,244.6	3,267.8	250.2	295.2	346.0	292.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-65.9**	**-108.9**	**-69.8**	**-135.0**	**0.5**	**-14.0**	**-18.3**	**-6.2**
17	Foreign Bonds Purchased, net	18.9	-25.5	25.1	-38.6	5.5	1.4	-3.9	-4.6
18	Foreign Equities Purchased, net	-84.8	-83.4	-94.9	-96.4	-5.0	-15.3	-14.5	-1.6
19	**Net Long-Term Flows** (line 3 plus line 16)	**672.9**	**795.2**	**798.8**	**750.1**	**92.3**	**84.1**	**40.6**	**47.4**

/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

June 10, 2005
JS-2496

Deputy Assistant Secretary Iannicola Discusses U.S. Financial Literacy Efforts with International Panel

Treasury's Deputy Assistant Secretary for Financial Education Dan Iannicola Jr. today spoke about American efforts to improve financial education at Canada's first-ever National Symposium on Financial Capability in Ottawa. He discussed U.S. financial education strategies and programs and commended the Financial Consumer Agency of Canada for facilitating the international dialogue.

Also on the panel, which was entitled "Policies to Support Financial Capability: International Perspectives," were representatives of the United Kingdom's Financial Services Authority and the Organization for Economic Cooperation and Development which represents thirty countries and has relationships with seventy other countries.

Iannicola said "America is making strides towards financial literacy, but we are not alone on that path. Today shows us that Canada, the United Kingdom and many other nations are also working to educate their people on managing their money."

Panel members discussed the experiences of their home countries in trying to financially educate their citizens. They discussed what has been effective, what hasn't worked, and what their countries plan to do in the future.

"When we engage in an international dialogue like this we receive as much as we share, and learn as much as we teach. The lessons we take from today will help us make more effective use of our financial education resources and do more for Americans back home," said Iannicola.

The Financial Consumer Agency of Canada, Policy Research Initiative and Social and Enterprise Development Innovations worked in collaboration to establish the National Symposium on Financial Capability. The two-day National Symposium featured leading national and international experts and engaged government, non-profit and business sector representatives in discussions regarding the current state of policy and practice surrounding financial capability.

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.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 16, 2005
js-2497

Treasury Secretary John Snow
Remarks at Conclusion of Europe Trip
Amerkia Haus, Frankfurt, Germany
June 16, 2004

As you know, I have been traveling throughout Europe for the past week – starting with meetings in London for the G8 pre-Summit Finance Ministers meetings, then in the Netherlands, Brussels, Paris, and today in Frankfurt.

In London last weekend we had the great pleasure to announce a landmark agreement to eliminate the debt stock that highly indebted poor countries owe to the IMF, IDA and African Development Fund. This historic agreement – which built upon the discussions between President Bush and Prime Minister Blair last week, will eliminate the debts of the poorest indebted countries. It had been more than a year since we at the U.S. Treasury had developed the proposal for 100% debt cancellation, so I was very pleased that the G8 agreed to support our plan. It is also important that the agreement preserves the financial integrity of the institutions. Going forward, we must all work together to provide these countries with grants and ensure that they do not again build up unsustainable debts.

Today, I would like to focus on my visits this week in The Hague, Brussels, Paris and Frankfurt to discuss European economic performance and the contribution that US-EU cooperation on financial markets and regulation can make to global growth. My message on this trip is clear: America wants our economic partnership to results in an economically dynamic and vibrant Europe that contributes to the global expansion. This is not a zero-sum game.

I was able to report this week that the US is doing its part to contribute to the global expansion with real GDP rising 4.4 percent last year, first quarter growth this year at 3.5%, and an outlook for continued robust expansion. Our strong growth is also working to boost revenues and the fiscal deficit is contracting sharply. Private forecasters now project that the U.S. deficit this year will come in under 3% of GDP -- even on a consolidated basis that includes federal, state and local fiscal budgets. I am confident that in the coming years, we will bring our federal deficit much further down to below 2 % of GDP. Reducing our fiscal deficit, along with efforts to increase domestic savings, are integral to limiting US current account imbalances. The best contribution the United States can make to the world economy is to keep our house in order, to sustain strong growth, and to continue to maintain our openness and the flexibility of our markets.

Unfortunately, economic growth in key continental European countries has been persistently weak for too long. We discussed this topic at the G8 meetings, and I was able to discuss it in further detail with European economic leaders this week. On Tuesday I met with President Barroso and Commisioner Almunia in Brussels to emphasize the need for Europe to implement vigorous structural reforms to boost its potential growth, jobs and incomes. It is clear that adjustments of global imbalances will be difficult when US rates of growth are substantially higher than those in Europe. And it is in nobody's interest to see US growth decline, even though this would be a quick way to cut global imbalances.

I know that European leaders know what is needed to get the job done so I came to Europe to listen, not to lecture. How Europe chooses to reform is for Europe to

decide, and the plan outlined in the Lisbon Agenda is an appropriate roadmap. I am encouraged that many good reforms steps are already being put in place throughout the continent – pension reform in France, labor reform in Germany, and tax reforms in Italy. But I do urge Europe to move steadily on its reform path.

Throughout my trip, I have focused my talks on one area of the European reform program -- financial market and regulatory issues. We know that financial liberalization is one of the most critical drivers of our countries' economic vitality. Our Trans-Atlantic relationship is the nexus for the lion's share of the world's financial market participation, so we have a unique and shared responsibility to ensure for the efficient performance of markets and smooth adjustments in global accounts. Europe is now working to converge twenty-five different financial systems into one single market. This is an enormous challenge, and the topic was a focal point in my talks with EU Commissioner Charlie McCreevy and financial leaders across the continent this week. I believe that this is an area where Europe is demonstrating that it is up to the challenge.

The Financial Services Action Plan is a major step forward in creating an integrated European financial market, which the United States supports and welcomes. The Treasury Department has worked closely with Europe on financial markets through the US-EU Financial Markets Regulatory Dialogue. This will be good for global growth, for anchoring European financial legislation in the evolving global financial architecture and for furthering the globalization of markets. The challenge now facing Europe is not new financial market legislation, but implementation.

I learned a great deal about these challenges at my meetings in Brussels, as well with the Committee of European Banking Supervisors in London, and the Committee for European Securities Regulators in Paris.

We know that when Europe puts forward financial measures such as the Financial Conglomerates Directive, it affects US markets and firms. Similarly, when the US puts implements legislation such as Sarbanes-Oxley, it can affect Europe. So we have a wide range of issues to discuss between the US and Europe, and we are doing so in an effective way and with a sincere spirit of cooperation.

In the last days, I also had the opportunity to exchange views with my counterparts on important issues such as accounting convergence and the recent roadmap agreed between the SEC and the EU, hedge funds, Basle II, and reinsurance. These issues do not often find their way to the front-page of newspapers, but progress on them is vital to our economic and financial relationship.

Our dialogue is working and it aims to look forward, identify issues, and build a basis for the convergence of financial markets on both sides of the Atlantic on the highest quality standards.

Financial markets in particular have gone global. But regulation has always been an inherently national activity. It is too costly when increasingly global firms face multiple, overlapping sets of national regulations. Policy-makers and regulators need to provide their citizens with proper investor protection. In doing so, the realities of the global financial marketplace dictate that they work together to transcend national borders. This requires that we rely on markets and market disciplines, and a regulatory light touch.

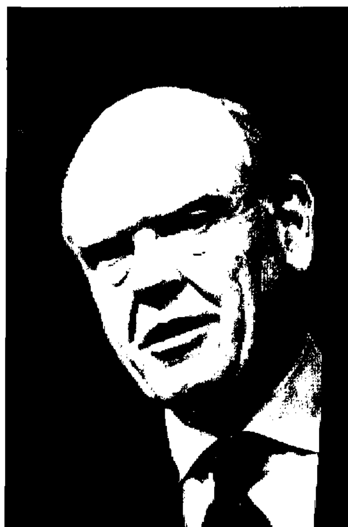
I leave Europe heartened by what I have learned and seen. I believe that Europe is on the right track in its efforts to bring 25 financial markets into one, and that the US and EU – working together through our Dialogue – can and will converge on best global practices.

The benefits to all of us will be enormous. Various studies indicate that the integration of European capital markets alone will boost European GDP by one percentage point per year. Further, a recent OECD study concluded that deregulating European economies would raise EU GDP per capita by 2.8%. This means an average worker would get a year's extra wages over a working life.

The gains from US-European cooperation on growth and financial markets are potentially enormous. The US and Europe, as the world's two largest economies, must seize this opportunity and lead.

FROM THE OFFICE OF PUBLIC AFFAIRS

June 16, 2005
js2498



Snow Concludes Europe Trip

"The gains from US-European cooperation on growth and financial markets are potentially enormous. The US and Europe, as the world's two largest economies, must seize this opportunity and lead," Secretary Snow said today in Frankfurt.

- Read Secretary Snow's Full Remarks

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 16, 2005
JS-2499

Statement of Janice B. Gardner
Nominee to be Assistant Secretary for Intelligence and Analysis
U.S. Department of the Treasury
Before the Senate Select Committee on Intelligence

Chairman Roberts, Ranking Member Rockefeller and distinguished members of this committee, it is an honor for me to appear before you today. It is a privilege to have been nominated by President Bush to be the first Assistant Secretary of the Treasury for Intelligence and Analysis. I thank him, Secretary John Snow and DNI Negroponte for their confidence in recommending me for this important position. If confirmed, I look forward to working closely with this committee, the United States Senate and your colleagues in the House of Representatives to disrupt financing for terrorism and other national security threats.

I'd also like to thank my friends and colleagues who are here with me today. This work is truly a team effort, and I greatly appreciate their support. Although my parents are not here today, I'd also like to thank them for all their encouragement and support over the years.

I am a career intelligence professional with over 20 years of experience. I first came to the Department of the Treasury in November 2002 as the Secretary's intelligence briefer and senior liaison officer. When the Office of Terrorism and Financial Intelligence (TFI) was created last year, I became the Deputy Assistant Secretary for the new Office of Intelligence and Analysis (OIA). Over the past year, I have helped Under Secretary Levey lead the effort to stand up the new office.

I've been fortunate to have a variety of challenging analytical and managerial assignments throughout my career. I started as an intelligence analyst working on East Asia, primarily Japan and Korea. I served on a rotation to the State Department as an economic officer in the U.S. Embassy in Tokyo. My first management assignment came in 1993 as chief of the Persian Gulf Branch in the Office of Near East and South Asian Analysis. I have also served in some key staff positions, including the executive assistant in the Office of the Director of Central Intelligence, the DCI representative to the National Security Council and staff officer in the Vice President's office. Prior to being assigned to the Treasury Department, I served as Deputy Director of the Foreign Broadcast Information Service, where I oversaw roughly 1000 U.S. and foreign national staff and independent contractors.

Mr. Chairman, if confirmed, I would focus on five key strategic areas:

- For the first time, the Department's intelligence office is producing all-source intelligence analysis on terrorist financing and other national security threats. Prior to the creation of OIA, the intelligence office served primarily as a liaison office for senior policymakers in the Department. The new office is now working to provide insightful intelligence analysis that is focused on supporting the full range of Treasury's authorities to cut off illicit financing. While the office has already developed a current intelligence process, if confirmed, I would build a capability to produce strategic intelligence analysis that supports long-term policy development directed at national security threats to the financial system.
- The Office is also working to enhance intelligence support to the Department on the full range of political and economic issues. As a member

of the National Security Council, Treasury needs timely intelligence on fast-breaking events, as well as in-depth analysis from experts from the intelligence community. Thus, if confirmed, I would work to better integrate intelligence into the policy process and improve support to all aspects of the Department's mission.

- As a member of the Intelligence Community, the Department needs to reinvigorate its relationship with the rest of the community. The Secretary has already met with the new Director of National Intelligence, and, if confirmed, I plan to devote much of my focus and energy to reengage Treasury in IC forums. As you know, our office is the smallest component in the IC, but I believe that it can make a significant contribution to the community on both collection and production issues.
- Under the Treasury Order that created the Office of Terrorism and Financial Intelligence, the Office of Intelligence and Analysis was designated to coordinate and oversee all intelligence analysis within the Department. The Department houses the bulk of the financial information in the U.S. Government, as well as expertise on the global financial system. OIA will serve as the focal point that fuses financial data from the Office of Foreign Assets Control (OFAC) and Financial Crimes Enforcement Network (FinCEN), as well as the Intelligence Community.
- As a new office, OIA must make a significant investment in its future, particularly in its human resources and information technology infrastructure. I've been spending a large portion of my time as the Deputy Assistant Secretary trying to ensure that we have the capability to produce the kind of sophisticated analytical products that OIA is uniquely positioned to provide. If confirmed, I will work closely with Under Secretary Levey, the Assistant Secretary for Management and the Chief Information Officer to ensure that the office has the tools necessary to get the job done.

Mr. Chairman, Senator Rockefeller, I am grateful for this opportunity to appear before you today. I would be pleased to answer any questions you and the other members of the committee may have.

-30-

FROM THE OFFICE OF PUBLIC AFFAIRS

June 17, 2005
JS-2500

Treasury Designates Financial Supporter of Iraqi Insurgency

Muhammad Yunis Ahmad was designated today pursuant to Executive Order 13315, which is aimed at blocking property of the former Iraqi regime, its senior officials and their family members and those who act for or on their behalf.

According to information available to the U.S. Government, Ahmad is currently a financial facilitator and operational leader of the New Regional Command of the reconstituted Ba'ath Party. He is instrumental in providing guidance, financial support and coordination of insurgent attacks throughout Iraq.

"Ahmad was a party to the violence and oppression of the former Hussein regime," said Stuart Levey, Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI). "He still seeks to sabotage the hopes of the Iraqi people by supporting the insurgents' brutal attacks against coalition forces and Iraqis alike. Designations like today's help cut off the money supporting those efforts."

The Iraqi government has charged Ahmad with providing funding, leadership and support to several insurgent groups conducting attacks against the Iraqi people, the Interim Iraqi Government, Iraqi National Guard, the Iraqi Police and Coalition Forces.

"Ahmad is first among the U.S. Central Command's list of key insurgent leaders, and the Multi National Forces in Iraq are offering a reward of $1 million for information leading to his capture," said Robert Werner, Director of Treasury's Office of Foreign Assets Control (OFAC). "Today's designation is the result of the strong support and coordination of Treasury's interagency partners in the U.S. Government, notably the U.S. Central Command."

Information available to the U.S. Government indicates that Ahmad was a high-ranking member of the former Ba'ath Party in Iraq. Ahmad served as the Governor of the Al-Muthana Governorate prior to the 1990 Gulf War. After the war, he was promoted to a senior Ba'ath Party position in Northern Iraq.

Ahmad is described as a former Ba'ath Party regional command member responsible for party activities in the Salah Ad Din, the Al-Ta'mim and the Al-Sulaymaniyah Governorates. He held this position until the fall of the regime in 2003, when he allegedly fled to Syria and became a senior leader in the insurgency against the Coalition Provisional Authority (CPA).

Ahmad also reportedly has relationships with other senior members of the former Iraqi regime, including Izzat Ibrahim al-Duri, the former Vice Chairman of the Revolutionary Command Council of Iraq. Al-Duri was previously listed in the Annex to E.O. 13315 and named to the UN 1483 committee list.

Following the CPA's disestablishment of the Iraqi Ba'ath Party after Operation Iraqi Freedom, the party began to reconstitute itself under new leadership. According to information available to the U.S. Government, the reconstituted Iraqi Ba'ath Party was allegedly operating with Al-Duri as the head of the party and Ahmad as his deputy. Recently, Ahmad was reportedly elected General Secretary of this party.

U.S. Government information also indicates that Al-Duri headed up the military wing of an anti-Coalition group formed after the fall of the Saddam regime, while Ahmad ran the political wing of the group.

Identifier Information

Muhammad Yunis Ahmad

AKAs: AHMED, Muhammad Yunis
AL-AHMED, Muhammad Yunis
AL-BADRANI, Muhammad Yunis Ahmad
AL-MOALI, Mohammed Yunis Ahmed
DOB: 1949
POB: Al-Mowall, Mosul, Iraq
Nationality: Iraqi

Address: Al-Dawar Street
Bludan, Syria

Address: Damascus, Syria

Address: Mosul, Iraq

Address: Wadi Al-Hawi, Iraq

Address: Dubai, United Arab Emirates

Address: Al-Hasaka, Syria

Today's action is taken pursuant to Executive Order 13315 which blocks property and interests in property of senior officials of the former Iraqi regime within the possession or control of U.S. persons. The United States is also submitting the name of this individual to the U.N. with the recommendation they be listed by the 1518 Committee under U.N. Security Council Resolution (UNSCR) 1483. UNSCR 1483 requires U.N. member states to identify, freeze and transfer to the Development Fund for Iraq (DFI) assets of senior officials of the former Iraqi regime and their immediate family members, including entities owned or controlled by them or by persons acting on their behalf.

For more information on additional Treasury actions against the former Iraqi regime, please visit the following links:

Syrian Company, Nationals Designated by Treasury for Support to Former Saddam Hussein Regime
http://www.treasury.gov/press/releases/js2487.htm

Treasury Designates 16 Family Members of the Former Iraqi Regime, Submits 191 Iraqi Entities to United Nations
http://www.treas.gov/press/releases/js1242.htm

Treasury Designates Front Companies, Corrupt Officials Controlled by Saddam Hussein's Regime
http://www.treas.gov/press/releases/js1331.htm

Uday Saddam Hussein's Inner Circle Designated by Treasury
http://www.treas.gov/press/releases/js1600.htm

U.S., Iraq, U.K. Jointly Designate Ambassadors Intel Ops of the Former Hussein Regime
http://www.treas.gov/press/releases/js1821.htm

FROM THE OFFICE OF PUBLIC AFFAIRS

June 17, 2005
JS-2501

Remarks of
Deputy Assistant Secretary for Critical Infrastructure
Protection D. Scott Parsons
Beating Identity Crime: How the Public and Private
Sectors are
Working Together to Help Consumers and Put Fraudsters
Behind Bars
FDIC Identity Theft Symposium
Los Angeles, California

Good morning, ladies and gentlemen. It is a privilege to be here.

President Bush aptly stated, "The crime of identity theft undermines the basic trust on which our economy depends." I know that all of you understand that trust is at the heart of our financial system.

This morning I want to talk with you about the risks of identity theft; outline the actions of the public and private sectors; and finally, challenge each of you to accelerate your efforts to protect personal information.

Identity theft is fraud, plain and simple. But it's fraud in an often sophisticated fashion with a vast web of victims. According to the Federal Trade Commission, in 2003, about 10 million Americans had their identities stolen by criminals. Secretary Snow has stated that "it is important to realize that such crimes exact a heavy toll on our economy. Every such crime weighs on our entire system of credit, raising the cost of doing business and subtly but surely impeding economic growth." The ability to collect, use, and disclose reliable information securely is essential to the effectiveness of our financial system.

For example, record numbers of Americans have bought or refinanced a home in the past few years. Securing a mortgage at a favorable interest rate likely required the lender--many of you in the audience today--to check the credit rating. The rating was based in part on information in credit reports. Hopefully, that was a relatively quick and painless process for the consumer. But we know that the mortgage lending process would cost more, would take longer, and would be more difficult if that underlying information about our credit worthiness were not reliable and accessible.

Another risk of identity theft is the potential "chilling effect" on e-commerce. Surveys suggest that some consumers are wary of buying online because they fear identity theft. When fraud discourages Americans from taking advantage of one of the greatest innovations of our age, we all suffer. Online banking, for example, not only enables efficiency and cost-savings for financial institutions, these electronic transactions increase the consumers' power of choice and enhance competition in the industry. An erosion of trust can threaten the effectiveness of our financial system.

Collectively, we understand the concern of our citizens, customers, and business partners. We must communicate, though, that millions and millions of financial transactions are processed daily without incident. Americans, as well as our trading partners around the globe, should know that our financial system is the most

reliable in the world.

There is no single solution to this challenge. Nor is there a "one size fits all" solution. Fighting identity theft requires a cooperative effort among all of the stakeholders. There is an army of protectors in the public and private sectors. Businesses large and small, technology vendors, financial institutions, government agencies and consumers all play a vital role in winning the fight against this 21st century form of fraud.

President Bush recognized the threat of identity theft early in his first term and has displayed a record of leadership in combating it. The President signed the Fair and Accurate Credit Transactions Act, known as the FACT Act in December of 2003. For consumers, it provides preventive resources and also help to "clean up" your record if you become a victim of identify theft.

By September 1 of this year, anyone may obtain a free copy of his credit report from each of the three nationwide credit bureaus by contacting a centralized request system. You will find the information needed to do this at www.annualcreditreport.com. Reviewing one's credit record is one of the best ways to catch identity theft early.

Every American can put fraud alerts on his or her credit files with the major credit bureaus if you believe that you may be a victim of identity theft or become one.

Victims of identity theft can get additional free credit reports. And with proper documentation, consumers can stop financial institutions and credit bureaus from passing along information resulting from an identity theft incident.

The President also signed into law the Identity Theft Penalty Enhancement Act in 2004. This statute created a new crime of "aggravated identity theft" and increased federal criminal penalties for this crime. Identity thieves can be sentenced for an underlying crime, like mail fraud, and face an additional, consecutive sentence for identity theft. This encourages prosecutors to pursue the identity crime as well as the underlying or related ones.

Recently, the federal banking regulatory agencies issued guidance about the response plans that banks need to combat unauthorized access to or misuse of customer information. The response plans must address when customers will be notified that sensitive information about them has been breached.

As you know, banks are highly regulated institutions when it comes to the collection, use, and disclosure of consumer data. The Gramm-Leach-Bliley Act governs the disclosure of consumer information to non-affiliated third parties. It also requires policies and procedures for the security of customer information, and prohibits obtaining information from financial institutions under false pretenses.

The Fair Credit Reporting Act (FCRA) can also have an impact on financial institutions' disclosure of information to affiliated entities. And the FACT Act amendments help consumers enhance the accuracy of information about them and restrict its disclosure.

While regulation influences financial institutions' responses to identity theft, the actions freely chosen by financial institutions are significant. We appreciate the financial sector's effort and investment to preserve confidence in the security of all financial transactions, online and off.

Today you would be hard pressed to find a financial institution that does not offer its customers information on how to prevent identity theft and what to do about it. The financial sector trains employees to protect the security of customer information and to assist customers who become victims.

Members of the Financial Services Roundtable and others developed the Identity Theft Assistance Center (ITAC). Supported by about 50 of the largest financial

services companies, ITAC offers individualized assistance to customers of the member institutions and to victims who find that accounts have been opened at those institutions due to an identity theft crime.

We have also seen an explosion of promising technological innovation. Anti-phishing and anti-spyware software, software updates, and firewalls all exist to help spot and detect crimeware before it gets to your computer.

Financial institutions also have developed sophisticated, automated anti-fraud technologies that can spot unusual or risky transactions and stop them quickly.

From a legal perspective, there are federal criminal and civil statutes for prosecuting identity thieves, including criminal penalties for computer, wire, and mail fraud, as well as anti-spam penalties. Many states have anti-fraud statutes as well.

Law enforcement is committed to stopping ID thieves and capturing those who commit crimes. Networks of anti-fraud and identity theft task forces bring federal, state, and local law enforcement together to tackle some of the largest or most complex cases. There are encouraging signs that other countries recognize the problem of identity theft, and there has been significant progress in getting international cooperation in the pursuit of these criminals.

Identity theft knows no borders. We've become a "connected world" and benefited enormously from the Internet. But unparalleled access has spawned previously unimaginable threats. I've seen cases of crooks from one country using computers from a series of other countries to create an elusive criminal organization that is difficult to find and then prosecute across geographic boundaries. Fighting cyber-crime in the global theatre is a daily challenge for law enforcement.

Some of you here today are financial services providers. Others are corporate security experts or technology innovators. But we are all consumers. And we are empowered to help protect ourselves. Understanding the crime, acting to protect your identity, and knowing what to do quickly if you become a victim is the most critical defense. Informed, proactive consumers will enable us to win the war on identity theft.

At the Treasury, we are passionate about fighting fraud. From partnership with the private sector to direct consumer education we are committed to equipping our country to protect personal information. And each of you is at the center of the action. We need innovative ideas, game-changing technology and a cooperative spirit. I challenge you today to continue to work cooperatively to assure the confidence that fuels our economic engine.

Thank you all for your attention.

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 17, 2005
JS-2502

Treasury and IRS Issue Guidance on Single Insurer Arrangements

Today the Treasury Department and the IRS issued guidance on the qualification of arrangements as "insurance" for federal income tax purposes.

Today's ruling does not call into question the vast majority of insurance contracts, which are issued by commercial insurance companies in the ordinary course of business. Instead, it reminds taxpayers who are parties to smaller one-on-one arrangements that the requirement of risk distribution must be met for the arrangements to qualify as insurance. The ruling was accompanied by a notice soliciting comments from the public on other insurance-related topics.

Since the Supreme Court's 1941 decision in Helvering v. LeGierse, both risk shifting and risk distribution have been required for an arrangement to constitute insurance for Federal income tax purposes. Revenue Ruling 2005-40 concludes that an arrangement with an entity that "insures" the risks of only one policyholder does not qualify as insurance for tax purposes because the risks are not distributed among other policyholders. The ruling also explains how this conclusion applies to single-member limited liability companies, which in some cases are treated as entities separate from their owners and in other cases are disregarded. Qualification of an arrangement as insurance may effect whether the issuer is taxed as an insurance company and whether or when amounts paid under the arrangement may be deductible. If an arrangement does not qualify as insurance, it may instead be characterized as a deposit, a loan, a contribution to capital, or an indemnity arrangement other than an insurance contract.

A copy of the guidance is attached.

REPORTS

- Tax on Insurance Companies other than Life Insurance Companies
- Administrative, Procedural, and Miscellaneous Qualification of certain arrangements as insurance

Part I

Section 831.--Tax on Insurance Companies other than Life Insurance Companies

(Also § 162; 1.162-1.)

Rev. Rul. 2005-40

ISSUE

Do the arrangements described below constitute insurance for federal income tax purposes? If so, are amounts paid to the issuer deductible as insurance premiums and does the issuer qualify as an insurance company?

FACTS

Situation 1. X, a domestic corporation, operates a courier transport business covering a large portion of the United States. X owns and operates a large fleet of automotive vehicles representing a significant volume of independent, homogeneous risks. For valid, non-tax business purposes, X entered into an arrangement with Y, an

unrelated domestic corporation, whereby in exchange for an agreed amount of "premiums," Y "insures" X against the risk of loss arising out of the operation of its fleet in the conduct of its courier business.

The amount of "premiums" under the arrangement is determined at arm's length according to customary insurance industry rating formulas. Y possesses adequate capital to fulfill its obligations to X under the agreement, and in all respects operates in accordance with the applicable requirements of state law. There are no guarantees of any kind in favor of Y with respect to the agreement, nor are any of the "premiums" paid by X to Y in turn loaned back to X. X has no obligation to pay Y additional premiums if X's actual losses during any period of coverage exceed the "premiums" paid by X. X will not be entitled to any refund of "premiums" paid if X's actual losses are lower than the "premiums" paid during any period. In all respects, the parties conduct themselves consistent with the standards applicable to an insurance arrangement between unrelated parties, except that Y does not "insure" any entity other than X.

Situation 2. The facts are the same as in Situation 1 except that, in addition to its arrangement with X, Y enters into an arrangement with Z, a domestic corporation unrelated to X or Y, whereby in exchange for an agreed amount of "premiums," Y also "insures" Z against the risk of loss arising out of the operation of its own fleet in connection with the conduct of a courier business substantially similar to that of X. The amounts Y earns from its arrangements with Z constitute 10% of Y's total amounts earned during the taxable year on both a gross and net basis. The arrangement with Z accounts for 10% of the total risks borne by Y.

Situation 3. X, a domestic corporation, operates a courier transport business covering a large portion of the United States. X conducts the courier transport business through 12 limited liability companies (LLCs) of which it is the single member. The LLCs are disregarded as entities separate from X under the provisions of § 301.7701-3 of the Procedure and Administration Regulations. The LLCs own and operate a large fleet of automotive vehicles, collectively representing a significant volume of independent, homogeneous risks. For valid, non-tax business purposes, the LLCs entered into arrangements with Y, an unrelated domestic corporation, whereby in exchange for an agreed amount of "premiums," Y "insures" the LLCs against the risk of loss arising out of the operation of the fleet in the conduct of their courier business. None of the LLCs account for less than 5%, or more than 15%, of the total risk assumed by Y under the agreements.

The amount of "premiums" under the arrangement is determined at arm's length according to customary insurance industry rating formulas. Y possesses adequate capital to fulfill its obligations to the LLCs under the agreement, and in all respects operates in accordance with the licensing and other requirements of state law. There are no guarantees of any kind in favor of Y with respect to the agreements, nor are any of the "premiums" paid by the LLCs to Y in turn loaned back to X or to the LLCs. No LLC has any obligation to pay Y additional premiums if that LLC's actual losses during the arrangement exceed the "premiums" paid by that LLC. No LLC will be entitled to a refund of "premiums" paid if that LLC's actual losses are lower than the "premiums" paid during any period. Y retains the risks that it assumes under the agreement. In all

respects, the parties conduct themselves consistent with the standards applicable to an insurance arrangement between unrelated parties, except that Y does not "insure" any entity other than the LLCs.

Situation 4. The facts are the same as in Situation 3, except that each of the 12 LLCs elects pursuant to § 301.7701-3(a) to be classified as an association.

LAW

Section 831(a) of the Internal Revenue Code provides that taxes, computed as provided in § 11, are imposed for each taxable year on the taxable income of each insurance company other than a life insurance company. Section 831(c) provides that, for purposes of § 831, the term "insurance company" has the meaning given to such term by § 816(a). Under § 816(a), the term "insurance company" means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

Section 162(a) provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162-1(a) of the Income Tax Regulations provides, in part, that among the items included in business expenses are insurance premiums against fire, storms, theft, accident, or other similar losses in the case of a business.

Neither the Code nor the regulations define the terms "insurance" or "insurance contract." The United States Supreme Court, however, has explained that in order for an arrangement to constitute insurance for federal income tax purposes, both risk

shifting and risk distribution must be present. Helvering v. Le Gierse, 312 U.S. 531 (1941).

The risk transferred must be risk of economic loss. Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190, 1193 (7th Cir.), cert. denied, 439 U.S. 835 (1978). The risk must contemplate the fortuitous occurrence of a stated contingency, Commissioner v. Treganowan, 183 F.2d 288, 290-91 (2d Cir.), cert. denied, 340 U.S. 853 (1950), and must not be merely an investment or business risk. Le Gierse, at 542; Rev. Rul. 89-96, 1989-2 C.B. 114.

Risk shifting occurs if a person facing the possibility of an economic loss transfers some or all of the financial consequences of the potential loss to the insurer, such that a loss by the insured does not affect the insured because the loss is offset by a payment from the insurer. Risk distribution incorporates the statistical phenomenon known as the law of large numbers. Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as premiums and set aside for the payment of such a claim. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smooths out losses to match more closely its receipt of premiums. Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987).

Courts have recognized that risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. Humana, Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989). See also Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135, 1153 (Fed. Cir. 1993) ("Risk

distribution involves spreading the risk of loss among policyholders."); Beech Aircraft Corp. v. United States, 797 F.2d 920, 922 (10th Cir. 1986) ("'[R]isk distributing' means that the party assuming the risk distributes his potential liability, in part, among others."); Treganowan, at 291 (quoting Note, *The New York Stock Exchange Gratuity Fund: Insurance that Isn't Insurance*, 59 Yale L. J. 780, 784 (1950)) ("'By diffusing the risks through a mass of separate risk shifting contracts, the insurer casts his lot with the law of averages. The process of risk distribution, therefore, is the very essence of insurance.'"); Crawford Fitting Co. v. United States, 606 F. Supp. 136, 147 (N.D. Ohio 1985) ("[T]he court finds . . . that various nonaffiliated persons or entities facing risks similar but independent of those faced by plaintiff were named insureds under the policy, enabling the distribution of the risk thereunder."); AMERCO and Subsidiaries v. Commissioner, 96 T.C. 18, 41 (1991), aff'd, 979 F.2d 162 (9th Cir. 1992) ("The concept of risk-distributing emphasizes the pooling aspect of insurance: that it is the nature of an insurance contract to be part of a larger collection of coverages, combined to distribute risk between insureds.").

ANALYSIS

In order to determine the nature of an arrangement for federal income tax purposes, it is necessary to consider all the facts and circumstances in a particular case, including not only the terms of the arrangement, but also the entire course of conduct of the parties. Thus, an arrangement that purports to be an insurance contract but lacks the requisite risk distribution may instead be characterized as a deposit arrangement, a loan, a contribution to capital (to the extent of net value, if any), an

indemnity arrangement that is not an insurance contract, or otherwise, based on the substance of the arrangement between the parties. The proper characterization of the arrangement may determine whether the issuer qualifies as an insurance company and whether amounts paid under the arrangement may be deductible.

In Situation 1, Y enters into an "insurance" arrangement with X. The arrangement with X represents Y's only such agreement. Although the arrangement may shift the risks of X to Y, those risks are not, in turn, distributed among other insureds or policyholders. Therefore, the arrangement between X and Y does not constitute insurance for federal income tax purposes.

In Situation 2, the fact that Y also enters into an arrangement with Z does not change the conclusion that the arrangement between X and Y lacks the requisite risk distribution to constitute insurance. Y's contract with Z represents only 10% of the total amounts earned by Y, and 10% of total risks assumed, under all its arrangements. This creates an insufficient pool of other premiums to distribute X's risk. See Rev. Rul. 2002-89, 2002-2 C.B. 984 (concluding that risks from unrelated parties representing 10% of total risks borne by subsidiary are insufficient to qualify arrangement between parent and subsidiary as insurance).

In Situation 3, Y contracts only with 12 single member LLCs through which X conducts a courier transport business. The LLCs are disregarded as entities separate from X pursuant to § 301.7701-3. Section 301.7701-2(a) provides that if an entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch or division of the owner. Applying this rule in Situation 3, Y has entered into an

"insurance" arrangement only with X. Therefore, for the reasons set forth in Situation 1 above, the arrangement between X and Y does not constitute insurance for federal income tax purposes.

In Situation 4, the 12 LLCs are not disregarded as entities separate from X, but instead are classified as associations for federal income tax purposes. The arrangements between Y and each LLC thus shift a risk of loss from each LLC to Y. The risks of the LLCs are distributed among the various other LLCs that are insured under similar arrangements. Therefore the arrangements between the 12 LLCs and Y constitute insurance for federal income tax purposes. See Rev. Rul. 2002-90, 2002-2 C.B. 985 (similar arrangements between affiliated entities constituted insurance). Because the arrangements with the 12 LLCs represent Y's only business, and those arrangements are insurance contracts for federal income tax purposes, Y is an insurance company within the meaning of §§ 831(c) and 816(a). In addition, the 12 LLCs may be entitled to deduct amounts paid under those arrangements as insurance premiums under § 162 if the requirements for deduction are otherwise satisfied.

HOLDINGS

In Situations 1, 2 and 3, the arrangements do not constitute insurance for federal income tax purposes.

In Situation 4, the arrangements constitute insurance for federal income tax purposes and the issuer qualifies as an insurance company. The amounts paid to the issuer may be deductible as insurance premiums under § 162 if the requirements for deduction are otherwise satisfied.

DRAFTING INFORMATION

The principal author of this revenue ruling is John E. Glover of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling contact Mr. Glover at (202) 622-3970 (not a toll-free call).

Part III - Administrative, Procedural, and Miscellaneous

Qualification of certain arrangements as insurance

Notice 2005-49

This notice requests comments on additional guidance concerning the standards for determining whether an arrangement constitutes insurance for federal income tax purposes.

In Rev. Rul. 2001-31, 2001-1 C.B. 1348, the Internal Revenue Service announced that it would no longer raise the "economic family theory" set forth in Rev. Rul. 77-316, 1977-2 C.B. 53, in addressing whether captive insurance transactions constitute insurance for federal income tax purposes. Since 2001, the Service and the Treasury Department have published four revenue rulings providing guidance on the standards to be used to determine whether a particular arrangement constitutes insurance. Most recently, Rev. Rul. 2005-40, page___, this Bulletin, explains that (1) in order for an arrangement to qualify as insurance, both risk shifting and risk distribution must be present, and (2) the risk distribution requirement is not satisfied if the issuer of an "insurance" contract enters into such a contract with only one policyholder. See also Rev. Rul. 2002-89, 2002-2 C.B. 984 (setting forth circumstances under which arrangements between a domestic parent corporation and its wholly owned subsidiary constitute insurance); Rev. Rul. 2002-90, 2002-2 C.B. 985 (setting forth circumstances under which payments for professional liability coverage by a number of operating

subsidiaries to an insurance subsidiary of a common parent constitute insurance); Rev. Rul. 2002-91, 2002-2 C.B. 991 (setting forth circumstances under which amounts paid to a group captive of unrelated insureds are deductible as insurance premiums and in which the group captive qualifies as an insurance company).

The Service and the Treasury Department are aware that further guidance is needed in this area and request comments on issues that should be addressed. In particular, comments are requested regarding (1) the factors to be taken into account in determining whether a cell captive arrangement constitutes insurance and, if so, the mechanics of any applicable federal tax elections; (2) circumstances under which the qualification of an arrangement between related parties as insurance may be affected by a loan back of amounts paid as "premiums;" (3) the relevance of homogeneity in determining whether risks are adequately distributed for an arrangement to qualify as insurance, and (4) federal income tax issues raised by transactions involving finite risk.

Comments should be submitted in writing on or before October 3, 2005 and should include a reference to Notice 2005-49. Comments may be submitted to CC:PA:LPD:PR (Notice 2005-49), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, comments may be submitted electronically via the following e-mail address: Notice.Comments@irscounsel.treas.gov. Please include "Notice 2005-49" in the subject line of any electronic communications.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2005-49), Courier's Desk, Internal

Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

For further information regarding this notice, contact William Sullivan or Thomas Preston of the Office of Associate Chief Counsel (Financial Institutions & Products) at (202) 622-3970 (not a toll-free call).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

June 20, 2005
2005-6-20-17-25-39-25359

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 $77,502 million as of the end of that week, compared to $77,460 million as of the end of the prior week.

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

	June 10, 2005			June 17, 2005		
TOTAL		**77,460**			**77,502**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,278	13,490	24,768	11,369	14,454	25,823
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	10,963	3,930	14,893	11,070	2,905	13,975
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]			15,387			15,332
3. Special Drawing Rights (SDRs) [2]			11,371			11,330
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	June 10, 2005			June 17, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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

	June 10, 2005			June 17, 2005		
	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.

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 21, 2005
JS-2503

Treasury and IRS Clarify Tax Treatment of USDA Tobacco Payments to Quota Holders

WASHINGTON -- Today the Treasury Department and IRS provided guidance that explains how payments to tobacco quota holders (owners) under the Tobacco Transition Payment Program (TTPP) are to be treated for federal income tax purposes.

Under the American Jobs Creation Act of 2004, the Department of Agriculture (USDA) will begin making payments to owners and in exchange for ending the tobacco marketing quotas and related price support programs. The tax treatment of these payments generally follows the precedent of the peanut program.

A tobacco quota is considered an interest in land, so payments for quotas generally will be taxed at the capital gains rate. Payments to an owner will result in a gain if the payments are more than the owner's adjusted basis in the quota, and will result in a loss if the payments are less than the owner's adjusted basis. The guidance explains how to determine the adjusted basis, how to determine whether a portion of the payments is treated as interest, and how to determine whether the gain or loss is ordinary or capital.

An owner may postpone reporting the gain or loss from the termination of a quota by entering into a like-kind exchange if the owner complies with the requirements of § 1031 of the Internal Revenue Code.

The amount received by an owner under the TTPP in a taxable year will be reported by the USDA on Form 1099-S, Proceeds From Real Estate Transactions, if the amount is $600 or more. The amount representing interest paid in a taxable year to an owner generally will be reported by the USDA on Form 1099-INT, Interest Income, if the interest is $600 or more.

The TTPP also provides for payments to tobacco producers. The Treasury Department and IRS expect to issue subsequent guidance regarding the treatment of those payments for federal income tax purposes.

REPORTS

- A copy of the guidance

Part III - Administrative, Procedural, and Miscellaneous

Termination of Tobacco Quotas and Price Support Programs

Notice 2005-51

PURPOSE

This notice provides answers to frequently asked questions regarding the tax treatment of federal payments made pursuant to § 622 of the Fair and Equitable Tobacco Reform Act of 2004, Title VI of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, 1521-36 (2004) (the Act).

BACKGROUND

Sections 611 and 612 of the Act terminate the tobacco marketing quota program and the tobacco price support program. Section 622 of the Act provides that the United States Department of Agriculture (USDA) will offer to enter into a contract with an eligible tobacco quota holder (Owner) under which the Owner may receive total payments of $7 per pound of quota in 10 equal annual payments in fiscal years 2005 through 2014 (Owner Payments) in exchange for the termination of the tobacco marketing quotas and related price support. Section 622 does not provide for stated interest on payments due under the contracts.

For federal income tax purposes, Owner Payments are the proceeds from a sale of the Owner's tobacco quota as of the effective date applicable to the Owner. The

effective date applicable to an Owner is the earlier of (1) June 30, 2005, for flue-cured tobacco and September 30, 2005, for all other types of tobacco, or (2) the date on which an Owner and USDA enter into a contract for Owner Payments with respect to the quota.

QUESTIONS AND ANSWERS

Q-1. *Are Owner Payments received under the Act subject to federal income tax?*

A-1. Yes, Owner Payments are subject to federal income tax. If the amounts received by the Owner are more than the Owner's adjusted basis in the quota, the Owner has a taxable gain; if the Owner receives less than the Owner's adjusted basis, the Owner has a loss that may be deductible for tax purposes if the requirements for deduction under § 165 of the Internal Revenue Code are satisfied. In determining an Owner's gain or loss, the amount received for the quota does not include any amount treated as interest for federal tax purposes. See Q & A-7 for help in determining whether any portion of an Owner Payment is treated as interest for federal tax purposes.

Q-2. *How does an Owner determine the adjusted basis of a quota?*

A-2. The adjusted basis of a quota is determined differently depending upon how the Owner acquired the quota.

- An Owner who holds a quota that is derived from an original grant by the federal government has a basis of zero in the quota.
- The basis of a purchased quota is the price the Owner paid for it.

- Generally an Owner who received a quota as a gift has the same basis in the quota as the person who gave the quota to the Owner. Under certain circumstances, the basis is increased by an amount related to the amount of gift tax paid. If the basis is greater than the fair market value of the quota at the time of the gift, the basis for determining loss is that fair market value.
- The basis of a quota that an Owner inherited generally is the fair market value of the quota at the time of the decedent's death.

The basis of a tobacco quota is not subject to adjustment through amortization, depletion, or depreciation. However, if an Owner improperly has deducted any amount for these purposes, the Owner must reduce the basis by the amount deducted before determining the Owner's gain or loss. A similar reduction in the basis of a quota must be made for any amount previously deducted as a loss because of a reduction in the number of pounds of tobacco allowable under the quota. If an Owner purchased a quota and deducted the entire cost in the year of purchase, then the Owner's basis in the quota is zero.

Q-3. If an Owner has a gain and reports Owner Payments under the installment method, when must the gain be included in income?

A-3. The installment method may be used to report gain if an Owner receives at least one Owner Payment after the close of the Owner's taxable year that includes the effective date applicable to the Owner. The amount of the gain is the excess of the total amount of Owner Payments to be received, reduced by any amount treated as interest, over the Owner's adjusted basis in the quota. Under the installment method, a

proportionate amount of the gain is taken into account in each year in which an Owner Payment is received. See the instructions for Form 6252, *Installment Sale Income*.

Q-4. If an Owner has a gain and elects not to report Owner Payments under the installment method, when must the gain be included in income?

A-4. The Owner must report the entire gain on the Owner's federal income tax return for the taxable year that includes the effective date applicable to the Owner.

Q-5. Is the gain or loss with respect to a quota ordinary or capital gain or loss?

A-5. Whether the gain or loss with respect to a quota is ordinary or capital depends on how the Owner used the quota.

- If an Owner used a quota in the trade or business of farming and, on the effective date applicable to the Owner, the Owner's holding period for the quota was more than one year, then the transaction is reported under § 1231 on Form 4797, *Sales of Business Property*. If an Owner has no other § 1231 transactions reportable on Form 4797, any gain is treated as long-term capital gain and any loss is treated as ordinary loss. Even if an Owner has other reportable § 1231 transactions, the net result of all § 1231 transactions reported generally is either long-term capital gain or ordinary loss. See the instructions for Form 4797 for more detailed information.
- If an Owner held a quota for investment purposes, or for the production of income, but did not use the quota in a trade or business, any gain or loss is capital gain or loss.

Under certain circumstances, some or all of the gain must be recharacterized and reported as ordinary income. If an Owner previously deducted (1) the cost of acquiring a quota, (2) amounts for amortization, depletion, or depreciation, or (3) amounts to reflect a reduction in the quota pounds, any gain is taxed as ordinary income up to the amount previously deducted. The Owner must report this amount of ordinary income on the Owner's return for the taxable year that includes the effective date applicable to the Owner, even if the Owner uses the installment method to report the remainder of the gain.

Q-6. Are Owner Payments received under the Act subject to Self-Employment Contributions Act (SECA) tax (see § 1402)?

A-6. No.

Q-7. Is any portion of an Owner Payment treated as interest for federal tax purposes?

A-7. (a) If the total amount to be paid under a contract does not exceed $3,000, no portion of an Owner Payment is treated as interest for federal tax purposes.

(b) If § 483 applies to a contract, a portion of each Owner Payment (other than an Owner Payment due within six months of the effective date applicable to the Owner) is treated as interest for federal tax purposes. For example, § 483 generally applies to a contract if the total amount to be paid under the contract does not exceed $250,000 or if a cash method election is made under §§ 1274A and 1.1274A-1(c). A contract is eligible for the cash method election only if the total amount to be paid under the contract does not exceed the inflation-adjusted amount for a cash method debt instrument ($3,202,100 for 2005).

(c) In all situations not described in (a) or (b) above, a portion of each Owner Payment is treated as interest for federal tax purposes under § 1274.

(d) In general, to determine the amount of an Owner Payment that is treated as interest, see § 483 or § 1274, whichever is applicable, and the regulations thereunder. You may wish to consult a tax advisor for assistance in determining the portion of an Owner Payment that is treated as interest and the taxable year in which the interest is includible in income.

Q-8. Does an individual Owner's gain or loss from Owner Payments qualify for farm income averaging?

A-8. No. A tobacco quota is considered an interest in land, and farm income averaging is not available for gain or loss arising from the sale or other disposition of land.

Q-9. Are Owner Payments subject to information reporting?

A-9. Yes. Because a tobacco quota is considered an interest in land, the total amount received under a contract by an owner in a taxable year generally will be reported by USDA on Form 1099-S, *Proceeds From Real Estate Transactions*, if the amount is $600 or more. In addition, any portion of an Owner Payment treated as interest for federal tax purposes generally will be reported by USDA on Form 1099-INT, *Interest Income*, if the total amount of interest received in a taxable year is $600 or more.

Q-10. Is the termination of a tobacco quota under the Act an involuntary conversion of the quota?

A-10. No.

Q-11. May an Owner enter into a like-kind exchange of a quota?

A-11. Yes. An Owner may postpone reporting the gain or loss from the termination of a quota by entering into a like-kind exchange if the Owner complies with the requirements of § 1031 and the regulations thereunder. For purposes of § 1031, the date on which an Owner is deemed to relinquish a quota is the effective date applicable to the Owner.

SUBSEQUENT GUIDANCE

Section 623 of the Act provides that USDA will offer to enter into a contract with an eligible tobacco producer (Grower) under which the Grower may receive total payments of up to $3 per pound of quota in 10 equal annual payments in fiscal years 2005 through 2014 (Grower Payments) in exchange for the termination of the tobacco marketing quotas and related price support. Grower Payments are determined by reference to the amount of quota under which the Grower produced (or planted) tobacco during the 2002, 2003, and 2004 tobacco marketing years and are prorated based on the number of years that the Grower produced (or planted) quota tobacco during those years. The federal tax treatment of Grower Payments is expected to be addressed in subsequent guidance.

DRAFTING INFORMATION

The principal author of this notice is Marnette M. Myers of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding Q & A-7 of this notice, contact Pamela Lew of the Office of Associate Chief Counsel (Financial Institutions and Products) at (202) 622-3950 (not a toll-free call). For further information

regarding the remainder of this notice, contact Ms. Myers at (202) 622-4920 (not a toll-free call).

FROM THE OFFICE OF PUBLIC AFFAIRS

June 22, 2005
JS-2504

Treasurer to Discuss Strengthening Social Security in Portland, Maine

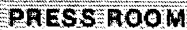
U.S. Treasurer Anna Escobedo Cabral will be in Portland, Maine this week to discuss President Bush's efforts to ensure the permanent solvency of Social Security and strengthen and preserve the system. The following event is open to the media:

WHO U.S. Treasurer Cabral (http://www.treasury.gov/organization/bios/cabral-e.html)

WHAT Panel on the Future of Social Security
Sponsored by the Portland Regional Chamber & U.S. Chamber of Commerce

WHERE Portland Marriott Hotel
200 Sable Oaks Drive
South Portland, Maine

WHEN Thursday, June 23
12:30 p.m. – 1:45 p.m. EDT



June 23, 2005
JS-2505

Testimony of Treasury Secretary John W. Snow before the Senate Committee on Finance

Chairman Grassley, ranking member Baucus, members of the Committee, it is a pleasure to appear before you to testify on the matter of our economic relations with China. This hearing could not be more timely. China is playing a larger and larger role in the global economy and the Treasury Department has been intensely engaged on a broad range of Chinese financial and economic issues over the course of the last several years, particularly on the question of the yuan and flexible exchange rates. It is important that China move to a more flexible exchange rate regime, we have urged them to do so, and they have agreed that it is in their interest to adopt greater exchange rate flexibility. While it is in China's interest that they do so, it is also in the interest of the global adjustment process, which is a shared responsibility.

I appreciate the chance to address the issue of our economic relations with China in the context of this shared responsibility among major economic regions for tackling imbalances in the global economy. I had the opportunity to address some of these issues when I released my report last month on the foreign exchange practices of America's major trading partners and I look forward to revisiting these issues today. China's role in the global economy and its impact on this country are receiving a great deal of attention here at home and among traders and investors in financial markets around the world.

Although U.S. trade with China represents only about 10% of our overall trade, China is beginning to play a more significant role in the global economy. For the past decade China has pegged its currency to the value of the U.S. dollar. There was a time when such a policy may have contributed to global economic stability, but that is no longer the case today.

In my report to Congress, I determined that China did not meet the technical requirements for designation under the statute. However, it would be wrong to interpret this as acquiescence with China's currency regime. We have made it clear to China's economic leadership that reform of its currency policy is in its own interest, and in the interest of global financial system. After two years of intense engagement, it is clear that China today is prepared to introduce greater currency flexibility. China's currency regime contributes to distortions in its own economy and blocks the smooth adjustment of global imbalances. Furthermore, if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation. China is now ready and should move without delay in a manner and magnitude that is sufficiently reflective of underlying market conditions.

Members of this Committee and many others in Congress have expressed to me their own dissatisfaction with China's currency policy. I take these concerns very seriously and I have enormous sympathy with these concerns. In addition, China, like all trading partners of the United States, must play by the rules. China's economy must be open to competition. Intellectual property rights have to be honored and violations effectively prosecuted under Chinese law.

But I cannot overstate my firm belief that resorting to isolationist trade policies would be ineffective, disruptive to markets and damaging to America's special role as the world's leading advocate for open markets and fair trade.

Acting on any of the punitive legislative proposals before Congress now would be counterproductive to our efforts at this time. The unintended consequence would be to delay the concrete steps on currency reform that China should take for its own sake and for the sake of the global economy.

In addition, implementation of trade sanctions would lead to retaliatory policies against our exports, damaging the U.S. and the global economy. Walls will not protect America's workers and industry. We succeed not with barriers, but with the openness and dynamism which has always characterized our nation.

It is appropriate to consider China's role in the global adjustment process.

Addressing imbalances in the global economy is a shared responsibility among the major economic regions of the world. While imbalances occur as the patterns of trade and investment flows shift between economic regions, uneven rates of growth in the major economies and inefficient or distortionary policies restrict adjustments and put stress on the global financial systems. Economic policymakers must address these imbalances now; delay increases the risk that adjustments will occur abruptly.

The international economy performs best when large economies embrace free trade, the free flow of capital, and flexible currencies. Obstacles in any of these areas prevent smooth adjustments. At best, such obstacles result in less than maximum growth; at worst, they create distortions and increase risks.

The United States is doing its part to address imbalances by aggressively tackling our fiscal deficit and our long-term liabilities. Because of strong growth and appropriate fiscal policy, the U.S. budget deficit in 2004 was well below projections, and with recent data, I expect further improvement in our fiscal deficit position this year. Some private forecasters predict that our fiscal deficit will be below 3% of GDP this year if we continue to hold the line on spending. We are also working to put in place innovative policies to increase the savings rate.

Our actions are important, but they alone will not be sufficient to unwind global imbalances. Simply put, large imbalances will continue if growth in our major trading partners continues to lag. European and Japanese GDP together exceeds that in the United States. These economies must continue to adopt and implement vigorous and necessary structural reforms to establish robust rates of growth – both for the good of their own citizens and to contribute to reduction in the imbalances in the global economy.

Greater flexibility in China is also a necessary component of the global adjustment process. Concerns of competitiveness with China also constrain neighboring economies in their adoption of more flexible exchange policies.

China's rigid currency regime has become highly distortionary. We know that it poses risks to the health of the Chinese economy, such as sowing the seeds for excess liquidity creation, asset price inflation, large speculative capital flows, and over-investment. It also poses risks to its neighbors, since their ability to follow more independent and anti-inflationary monetary policies is constrained by competitiveness considerations relative to China. Sustained, non-inflationary growth in China is important for maintaining strong global growth and a more flexible and market-based renminbi exchange rate would help the Chinese achieve this goal.

A more flexible system will also support economic stability in China. Currently, China relies largely on administrative controls to manage its economy – controls that are cumbersome and increasingly ineffective. An independent monetary policy will allow China to more easily and effectively pursue price stability, stabilize growth, and respond to economic shocks.

A more flexible system will allow for a more efficient allocation of resources and higher productivity. The current system is fueling over-investment and excessive reliance on export-led growth while under-emphasizing domestic consumption.

Moreover, much of the investment and capital flows into these favored sectors and projects may not prove profitable under market-determined prices, which could lead to another investment hard landing, more non-performing loans and a weakened banking sector.

And a more flexible system would also quell speculative capital inflows that are costly to China's government and increasingly likely to prove disruptive. China's sterilization of capital inflows has limited effectiveness and is harmful to its banking sector.

Finally, recent history has taught us that it's better to move from a fixed to a flexible currency system during a period of strength, and not when economic weakness compels reform.

In September of 2003, I began an intensive engagement with China, aimed at hastening China's move to a more flexible exchange rate. I believe that this financial diplomacy has yielded important results. Since then, China has taken critical steps to establish the necessary financial environment and infrastructure to support exchange rate flexibility.

- It has introduced a foreign currency trading system permitting onshore spot trades in eight foreign currency pairs and allowing banks to act as market makers.
- It has adopted measures to increase the volume of foreign exchange trading, for example: eliminating the foreign exchange surrender requirement for many commercial firms; allowing domestic Chinese insurance firms and the national social security fund to invest in overseas capital markets; and increasing the amount of foreign currency business travelers can take out of the country.
- It has taken steps to develop foreign exchange market instruments and increase financial institutions' experience in dealing with fluctuating currencies. Foreign exchange forward contracts can now be offered in China; foreign exchange futures are being developed; and domestic Chinese banks can now trade dollars against other foreign currencies, not just remnimbi.
- It has also acted to strengthen its financial sector and regulation, so that this sector is more resilient to any fluctuations in exchange rates.

As a result, China is prepared to introduce flexibility and should do so now.

China should take intermediate steps that reflect underlying market conditions and allow for a smooth transition – when appropriate – to a full float. A flexible system will provide China with a more sophisticated array of policy tools – namely an independent monetary policy – that will prove much more effective in achieving price stability and the ability to adjust to shocks. Today, I believe that the risks associated with delaying reform far outweigh any concerns with immediate action. The current system poses a risk to China's economy, its trading partners, and global economic growth.

It is critical that we address the issues of imbalances aggressively with the goal of raising global growth. Nothing would do more damage to the prospects of increasing living standards throughout the world than efforts to inhibit the flow of trade. However, it is incumbent on China to address concerns before mounting pressures worldwide to restrict trade harm the openness of the international trading system.

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 23, 2005
JS-2506

Treasury and IRS Issue Draft Version of 2005 Schedule M-3 and Instructions for Corporate Tax Returns

Today, the Treasury Department and Internal Revenue Service released a draft version of the 2005 Schedule M-3, Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More, and related instructions for use by certain corporate taxpayers filing Form 1120, U.S. Corporation Income Tax Return. The 2005 Form 1120 Schedule M-3 is for use with Form 1120 returns filed for calendar year 2005, fiscal years that begin in 2005 and end in 2006, and tax years of less than twelve months that begin and end in 2006.

The draft 2005 Schedule M-3 includes two new line items – one line for the new domestic production activities deduction and another line for interest expense. The draft 2005 Schedule M-3 also reflects other minor modifications to the 2004 Schedule M-3 that are described in the "What's New" section of the draft 2005 Schedule M-3 instructions. The draft 2005 Schedule M-3 instructions reflect the Schedule M-3 Frequently Asked Questions that are posted weekly on www.irs.gov.

The Treasury Department and IRS do not anticipate any further changes to the draft 2005 Schedule M-3 and instructions and expect that the final version of the form and instructions will be available this fall and posted on www.irs.gov.

Comments are requested regarding the draft 2005 Schedule M-3 and instructions. Comments should be submitted by August 31, 2005, to:

Judy McNamara
Internal Revenue Service
860 E. Algonquin Road
Schaumburg, IL 60173
Email address: PFTG2@irs.gov (Preferred)
Telephone number: 312-566-2001, Ext. 9380

The Schedule M-3 and related instructions are attached and may be accessed on www.irs.gov or
http://www.irs.gov/businesses/corporations/article/0,,id=119992,00.html.

REPORTS

- Draft 2005 Schedule M-3
- Draft 2005 Schedule M-3 instructions

2005 **DRAFT**

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.

What's New

- If the corporation does not prepare financial statements, check Part I, line 1c "No" and report 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 4, Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1. Instructions for 2004 Schedule M-3 required that such amount be reported on Part I, line 11.
- Report on Part I, lines 5a through 10, all adjustment amounts required to adjust worldwide net income (loss) reported on Part I, line 4 (whether taken from financial statements or books and records), to net income (loss) of includible corporations that must be reported on Part I, line 11.
- Part I, line 10 and Part II, lines 7 and 26 have been clarified with respect to the reporting of intercompany dividends in statutory income for insurance companies. In addition instructions at Part I, line 11, clarify that, for insurance companies included in consolidated Forms 1120, the amounts reported in column (a) of Parts II and III, must be reported on the same accounting method as is used to report the amount of net income (loss) on Part I, line 11, which for insurance companies is usually statutory accounting.
- Indicate on the line after the common parent's name on Part II and Part III, whether the Schedule M-3 is for the: (1) U.S. consolidated tax group; (2) Parent corporation; (3) Consolidation eliminations; or (4) Subsidiary corporation, by checking the appropriate box.
- The word "optional" has been removed from the caption at the top of columns (a) and (d) in Part II and Part III. Columns (a) and (d) in Part II and Part III were optional for all taxpayers in 2004. However, columns (a) and (d) may no longer be optional for certain taxpayers beginning in 2005. See the instructions below for "When To Complete Columns (a) and (d)".

- On Part II, line 5, Gross foreign distributions previously taxed, column (d) is now shaded.
- The caption of the line item for Part II, line 17 has been changed to "Cost of goods sold" from "Inventory valuation adjustments".
- Part III, line 8, Interest expense, is new.
- Part III, line 9, Stock option expense, is the combination of Part III, line 8, Incentive stock options, and Part III, line 9, Nonqualified stock options, from the 2004 Schedule M-3.
- The caption of the line item for Part III, line 13 has been changed to "Judgments, damages, awards, similar cost" from "Punitive damages".
- Part III, line 21, Charitable contribution limitation/carryforward, is the combination of Part III, line 21, Charitable contribution limitation, and Part III, line 22, Charitable contribution carryforward used, from the 2004 Schedule M-3.
- Part III, line 22, Domestic production activities deduction, is new.

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 must 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. Regardless of the option chosen, amounts reported in column

(a) of Parts II and III must be reported on the same accounting method as is used to report the amount of net income (loss) per income statement of includible corporations on Part I, line 11, which for insurance companies is usually statutory accounting. (For insurance companies included in the consolidated U.S. federal income tax return, see instructions for Part I, lines 10 and 11 and Part II, lines 7 and 26.) 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 choose to either 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 but not included on the consolidated Schedule L.

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.

A. U.S. corporation A owns U.S. subsidiary B and foreign subsidiary F. For its 2005 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 2005 tax year.

B. U.S. corporation C owns U.S. subsidiary D. For its 2005 tax year, C prepares consolidated financial statements with D but C and D file separate U.S. federal income tax returns. The consolidated accrual basis financial statements for C and D report total assets at the end of the taxable year of $12 million after intercompany eliminations. C reports separate company total year-end assets on its Schedule L of $7 million. D reports separate company total year-end assets on

its Schedule L of $6 million. Neither C nor D is required to file Schedule M-3 for the 2005 tax year.

C. Foreign corporation A owns 100 percent of both U.S. corporation B and U.S. corporation C. C owns 100 percent of U.S. corporation D. For its 2005 tax year, A prepares a consolidated worldwide financial statement for the ABCD consolidated group. The ABCD consolidated financial statement reports total year-end assets of $25 million. A is not required to file a U.S. federal income tax return. B files a separate U.S. federal income tax return and reports separate company total year-end assets on its Schedule L of $12 million. C files a consolidated U.S. federal income tax return with D and, after eliminating intercompany transactions between C and D, reports consolidated total year-end assets on Schedule L of $8 million. B is required to file Schedule M-3 because its total year-end assets reported on Schedule L exceed $10 million. The CD U.S. consolidated tax group is not required to file Schedule M-3 because its total year-end assets reported on Schedule L do not exceed $10 million.

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 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 consolidated U.S. federal income 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 consolidated U.S. federal income 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).

Note. Indicate on the line after the common parent's name on Part II and Part III, whether the Schedule M-3 is for the: (1) U.S. consolidated tax group; (2) Parent corporation; (3) Consolidation eliminations; or (4) Subsidiary corporation, by checking the appropriate box.

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 in 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.

All required line item detailed schedules for Part II and Part III of Schedule M-3 must be attached for each separate entity included in the Consolidated Part II and Part III,

including those for the parent company and the eliminations entity, if applicable. It is not required that the same supporting detailed information be presented on the separate consolidated supporting schedules for Part II and Part III of the consolidated Schedule M-3.

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) prepares its own financial statements but is controlled by another corporation (U.S. or foreign) that prepares financial statements that include the U.S. corporation, the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must use for its Schedule M-3, Part I, its own financial statements and not the financial statements of the controlling corporation.

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 no financial statements are prepared for a 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 Schedule M-3, 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 2a through 3c, 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 4, Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1.

If no financial statements are prepared for a 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 Schedule M-3, and the U.S. corporation is owned by a foreign corporation that prepares financial statements that includes the U.S. corporation (or the U.S. parent corporation's consolidated group), the U.S. corporation (or the U.S. parent corporation of the U.S. consolidated tax group) must enter "No" on questions 1a, 1b, and 1c, skip Part I, lines 2a through 3c, 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 4, Worldwide consolidated net

income (loss) from income statement source identified in Part I, line 1.

If a U.S. corporation (a) has net income (loss) included on Part I, line 4, and removed on Part I, line 6a or 6b, on another U.S. corporation's Schedule M-3, (b) files its own Form 1120 (separate or consolidated), (c) does not have a separate financial statement (certified or otherwise) of its own, and (d) reports on Schedule L of its own Form 1120 total consolidated assets that equal or exceed $10,000,000 at the end of the corporation's tax year, 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, the amount for the corporation's net income (loss) that is removed on Part I, line 6a or 6b of the other corporation's Schedule M-3. 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 Part I, line 4, of the other U.S. corporation, 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 annual income statement period ending with or within this tax year.

The questions on Part I, lines 2b and 2c, regarding income statement restatements refer to the worldwide consolidated income statement issued by the 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). Answer "Yes" on lines 2b and/or 2c if the corporation's annual income statement has been restated for any reason. Attach a short explanation of the reasons for the restatement in net income for each annual income statement period that is restated, including the original amount and restated amount of each annual statement period's net income. The attached schedule is not required to report restatements on an entity-by-entity basis.

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 and the trading symbol and the nine-digit CUSIP number of each class.

Line 4. Worldwide Consolidated Net Income (Loss) per Income Statement
Report on Part I, line 4, the worldwide consolidated net income (loss) per the income statement (or books and records, if applicable) of the corporation.

In completing Schedule M-3, the corporation must use financial statement amounts from

the financial statement type checked "Yes" on Part I, line 1, or from its books and records if Part I, line 1c is checked "No". 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, check "No" on Part I, line 1c, 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 4, Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1.

Report on Part I, lines 5a through 10, as instructed below, all adjustment amounts required to adjust worldwide net income (loss) reported on this Part I, line 4 (whether from financial statements or books and records), to net income (loss) of includible corporations that must be reported on Part I, line 11.

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 between any nonincludible foreign entity and any includible corporation. 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 net income (loss) per the financial statement or books and records included on line 4 that is removed on this line 5 for each separate nonincludible foreign entity. The amounts of income (loss) detailed on the supporting schedule should be reported for each separate nonincludible foreign entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible foreign entities whose income (loss) is reported on the attached schedule that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be

reported on a separate line on the attached schedule, so that the separate financial accounting income (loss) of each nonincludible foreign entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a nonincludible foreign sub-consolidated group is being reported on line 5a, the attached supporting schedule should report the income (loss) of each separate nonincludible foreign legal entity from each such entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting schedule as a net amount on a line separate and apart from lines that report each nonincludible foreign entity's separate net income (loss).

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 between any nonincludible U.S. entity and any includible corporation. 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, and net income (loss) per the financial statement or books and records included on line 4 that is removed on this line 6 for each separate nonincludible U.S. entity. The amounts of income (loss) detailed on the supporting schedule should be reported for each separate nonincludible U.S. entity without regard to the effect of consolidation or elimination entries. If there are consolidation or elimination entries relating to nonincludible U.S. entities whose income (loss) is reported on the attached schedule that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached schedule, so that the separate financial accounting income (loss) of each nonincludible U.S. entity remains separately stated. For example, if the net income (after consolidation and elimination entries) of a nonincludible U.S. sub-consolidated group is being reported on line 6a, the attached supporting schedule should report the income (loss) of each separate nonincludible U.S. legal entity from each such entity's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting schedule as a net amount on a line separate and apart from lines that report each nonincludible U.S. entity's separate net income (loss).

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 such other includible corporations.

Attach a supporting schedule that provides the name, EIN, and net income (loss) per the financial statement or books and records on this line 7 for each separate other includible corporation. The amounts of income (loss) detailed on the supporting schedule should be reported for each separate other includible corporation without regard to the effect of consolidation or elimination entries solely between or among the entities listed. If there are consolidation or elimination entries relating to such other includible corporations whose income (loss) is reported on the attached schedule that are not reportable on Part I, line 8, the net amounts of all such consolidation and elimination entries must be reported on a separate line on the attached schedule, so that the separate financial accounting income (loss) of each other includible corporation remains separately stated. For example, if the net income (after consolidation and elimination entries) of a sub-consolidated U.S. group of other includible corporations is being reported on line 7a, the attached supporting schedule should report the income (loss) of each separate other includible corporation from each corporation's own financial accounting net income statement or books and records, and any consolidation or elimination entries (for intercompany dividends, minority interests, etc.) not reportable on Part I, line 8, should be reported on the attached supporting schedule as a net amount on a line separate and apart from lines that report each other includible corporation's separate net income (loss).

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

Adjustments on Part I, line 8, to consolidation or elimination entries are necessary to ensure that transactions between includible corporations and nonincludible U.S. or foreign entities are not eliminated, in order to report the correct total amount on Part I, line 11. Also, additional consolidation entries and eliminations entries may be necessary on Part I, line 8 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 but that are reported on Part I, line 7, in order to report the correct total amount on Part I, line 11.

Include on Part I, line 8, the total of the following: (i) amounts of any adjustments to consolidation entries and elimination entries that are contained in the amount reported on Part I, line 4, required as a result of removing amounts on Part I, line 5 or 6; and (ii) amounts of any additional consolidation entries and elimination entries that are required as a result of including amounts on Part I, line 7. This is necessary in order that the consolidation entries and intercompany eliminations entries included in the amount reported on Part I, line 11 are only those applicable to the financial net income (loss) of includible corporations for the financial statement period. For example, adjustments must be reported on line 8 to remove minority interest and to reverse the elimination of intercompany dividends included on Part I, line 4 that relate to the net income of entities removed on Part I, line 5 or 6, because the income to which the consolidation or elimination entries relate has been removed. Also, for example, consolidation or

elimination entries must be reported on line 8 to reflect any minority interest ownership in the net income of other includible corporations reported on Part I, line 7, and to eliminate any intercompany dividends between corporations whose income is included on Part I, line 7 and other corporations included in the consolidated U.S. federal income tax return.

The attached supporting schedule for Part I, line 8, must identify the type (e.g., minority interest, intercompany dividends, etc.) and amount of consolidation or elimination entries reported, as well as the names of the entities to which they pertain. It is not necessary, but it is permitted, to report intercompany eliminations that net to zero on Part I, line 8, such as intercompany interest income and expense.

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. Attach a schedule describing the adjustment.

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) on Part I, line 11.

Note that, normally, all intercompany dividends will have been eliminated in financial accounting consolidation eliminations included on Part I, line 4. However, an insurance company may be required to include intercompany dividends on Part I, Line 11, so that the amount reported there agrees with statutory accounting net income (Annual Statement). If the net income (loss) of a corporation that files Form 1120-PC or Form 1120-L is included on Part I, line 4 or line 7, and is computed on a basis other than statutory accounting, include on line 10 the adjustments necessary such that Part I, line 11, includes intercompany dividends in the net income (loss) for such corporation to the extent required by statutory accounting principles. (For insurance companies included in the consolidated U.S. federal income tax return, see instructions for Part I, line 11 and Part II, lines 7 and 26.)

For any adjustments reported on Part I, line 10, attach a supporting schedule that provides, for each corporation to which an adjustment relates: the name and EIN of the corporation, the amount of net income included in Part I before any adjustments on line 10, the amount of net income included on Part I, line 11, the amount of the net adjustment that is attributable to intercompany dividends (in the case of insurance companies), and the amount of the remainder of the net adjustment.

Line 11. Net Income (Loss) per Income Statement of Includible Corporations
Report on line 11 the net income (loss) per the income statement (or books and records, if applicable) of the corporation. In the case of a U.S. consolidated tax group, report the consolidated income statement net income (loss) of all corporations listed on Form 851

and included in the consolidated U.S. federal income tax return for the tax year. Amounts reported in column (a) of Parts II and III (see instructions below) must be reported on the same accounting method as is used to report the amount of net income (loss) per income statement of includible corporations on Part I, line 11, which for insurance companies is usually statutory accounting. (For insurance companies included in the consolidated U.S. federal income tax return, see instructions for Part I, line 10 and Part II, lines 7 and 26.)

Do not, in any event, report on this line 11 the net income of entities not listed on Form 851 and not included in the consolidated U.S. federal income tax return for the tax year. For example, it is not permissible to remove the income of non-includible entities on lines 5 and/or 6, above, then to add back such income on lines 7 through 10, such that the amount reported at line 11 includes the net income of entities not includible in the consolidated U.S. federal income tax return. A principal purpose of Schedule M-3 is to report on this Part I, line 11, only the financial accounting net income of only the corporations included in the consolidated U.S. federal income tax return.

Whether or not the corporation prepares financial statements, Part I, line 11, must include all items that impact the net income (loss) of the corporation even if they are not recorded in the profit and loss accounts in the corporation's general ledger, including, for example, all post-closing adjusting entries (including workpaper adjustments) and dividend income or other income received from non-includible corporations.

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 75 U.S. corporations, DS1 through DS75 (DS1-DS75), between 51% and 79% of the stock of 25 U.S. corporations DS76 through DS100 (DS76-DS100), and 100% of the stock of 50 foreign subsidiaries FS1 through FS50 (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, if any, 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 consolidated U.S. federal income 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: (i) the elimination of dividends received by P and DS1-DS75 from DS76-DS100 and FS1-FS50; and (ii) the recognition of minority interests' share of the net income (loss) of DS76-DS100. (Note: The minority interests' share, if any, of the income of DS1-DS75 must be reported in Part II, line 8, Minority interest for includible corporations.)

P reports on Part I, line 11, the consolidated financial statement net income (loss) attributable to the includible corporations P and DS1-DS75. 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 since the elimination of those transactions were reversed on line 8.

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 consolidated U.S. federal income tax return with DS1.

P must not complete Schedule M-3, Part I, with reference to the financial statements of its foreign parent F. P must check "No" on Part I, lines 1a, 1b, and 1c, skip lines 2a through 3c of Part I, and enter worldwide net income (loss) per the books and records of the includible corporations (P and DS1) on Part I, line 4. P must enter any necessary adjustments on lines 5a through 10 in order for Part I, line 11, to report the net income (loss) of includible corporations P and DS1, net of eliminations for transactions between P and DS1.

Example 4.

A. U.S. corporation P owns 60% of corporation DS1 which is fully consolidated in P's financial statements. DS1 has net income of $100 (before minority interests) and pays dividends of $50, of which P receives $30. The dividend is eliminated in the consolidated financial statements. In its financial statements, P consolidates DS1 and includes $60 of net income ($100 less the minority interest of $40) on Part I, line 4.

P must remove the $100 net income of DS1 on Part I, line 6a. P must reverse on Part I, line 8, the elimination of the $40 minority interest net income of DS1. In addition, P reverses its elimination of the $30 intercompany dividend in its financial statements line 8. The net result is that P includes the $30 dividend from DS1 at Part I, line 11.

B. 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 DS. DS is included in P's consolidated federal income tax return, even though DS is not included in P's consolidated financial statements on either a consolidated basis or on the equity method. DS has current year net income of $100 after taking into account its $40 interest payment to P. P has net income of $1,040 after recognition of the interest income from DS. Because DS is an includible corporation, 100% of the net income of both P and DS must be reported on Form 1120, page 1 of the PDS consolidated U.S. federal income tax return, and the intercompany interest income and expense must be removed by consolidation elimination entries.

P must report its financial statement net income of $1,040 on Part I, line 4, and reports D's net income of $100 on Part I, line 7. Then, in order to reflect the full consolidation of the financial accounting net income of P and DS at Part I, line 11, Net income (loss) per income statement of includible corporations, the following consolidation and elimination entries are reported on Part I, line 8: (a) offsetting entries to remove the $40 of interest income received from DS included by P on line 4, and to remove the $40 of interest expense of DS included in line 7 for a net change of zero; and (b) an entry to reflect the $20 minority interest in the net income of DS (DS net income of $100 × 20% minority interest). The result is that Part 1, line 11, reports $1,120: $1,040 from line 4, $100 from line 7, and ($20) from line 8. Stated another way, Part I, line 11, includes the entire $1,000 net income of P, measured before recognition of the intercompany interest income from DS and the consolidation of DS operations, plus the entire $140 net income of DS, measured before interest expense to P, less the minority interest ownership of $20 in DS's separate net income ($100). The PDS consolidated U.S. federal income tax group is required to include on the attached supporting schedule for Part, line 8, the details of the adjustment to the minority interest in the net income of DS, but is not required to report the offsetting adjustment to the intercompany elimination of interest income and interest expense (though it is permitted to do so).

Specific Instructions for Parts II and III

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

Indicate on the line after the common parent's name on Part II and Part III, whether the Schedule M-3 is for the: (1) U.S. consolidated tax group; (2) Parent corporation; (3) Consolidation eliminations; or (4) Subsidiary corporation, by checking the appropriate box.

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 on Form 1120, page1, line 28.

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, and for all subsequent years the corporation is required to file Schedule M-3, the corporation must complete Schedule M-3 in its entirety. Accordingly, 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. For example, if a corporation was required to file Schedule M-3 as a member of a U.S. consolidated tax group and the corporation leaves the U.S. consolidated tax group, the corporation is required to complete Schedule M-3 in its entirety in any succeeding tax year that the corporation is required to complete Schedule M-3. However, if the corporation joins in filing a different consolidated U.S. federal income tax return, then the corporation must complete its Schedule M-3 in its entirety in any year that the U.S. consolidated tax group must complete its Schedule M-3 in its entirety.

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 Consolidated U.S. federal income 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 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

Except as otherwise provided in this paragraph, 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, and report on line 2, column (a), the amount of dividends from any foreign corporation included in Part I, line 11. Do not report on Part I, line 2, any amounts that must be reported on Part II, lines 3 or 4, or dividends that were previously taxed and must be reported on Part II, line 5. (See the instructions below for Part II, lines 3, 4 and 5.)

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, column (a), any distributions received from foreign corporations that were included in Part I, line 11, and that were previously taxed for U.S. federal income tax purposes. For example, include in column (a) amounts that are excluded from taxable income under sections 959 and 1293(c). Remove such amount in column (b) or (c), as applicable. Report the full amount of the distribution before any withholding tax. Since previously taxed foreign distributions are not currently taxable, line 5, column (d) is shaded. (Also, see instructions above for Part II, line 2, Gross foreign dividends not previously taxed.)

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 included in Part I, line11 that were received from any U.S. corporation. Report on line 7, column (d), the amount of any U.S. dividends included in taxable income on Form 1120, page 1, line 28.

Usually, the amounts included on line 7, columns (a) and (d) include only dividends received from U.S. corporations that are not included in the U.S. consolidated tax group because intercompany dividends received from includible corporations listed on Form 851 are eliminated for financial accounting purposes and for the calculation of U.S. taxable income. However, in the case of an insurance company included in the consolidated U.S. federal income tax return that is required to report intercompany dividends received as part of statutory accounting net income (and is fully completing Parts II and III of Schedule M-3 (see instructions for Part II, line 26 for alternative reporting)), include such intercompany dividends on Part II, line 7 column (a) and the taxable amount of those dividends on Part II, line 7 column (d). (For insurance companies included in the consolidated U.S. federal income tax return, see instructions for Part I, lines 10 and 11.)

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 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 consolidated U.S. federal income tax return with DS1 as the GDS1 U.S. consolidated group. 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 the consolidated Schedule M-3, Part I, line 4, Worldwide consolidated net income (loss) per income statement, and on line 11, Net income (loss) per income statement of includible corporations, the U.S. consolidated tax group GDS1 must report $900 of financial statement net income ($1,000 net income less $100 minority interest).

The GDS1 group must prepare one consolidated Schedule M-3, Parts II and III and three additional Schedules M-3, Parts II and III: one for G, one for DS1, and one for consolidation eliminations.

On the Schedule M-3, Parts II and III for DS1, $1,000 is reported on Part II, line 29 and line 30, in both columns (a) and (d). On G's Schedule M-3, Parts II and III, zero is reported on Part II, line 30, in both columns (a) and (d). On the consolidation eliminations Schedule M-3, Parts II and III, on Part II, line 8 and line 30, the minority interest elimination for the U.S. consolidated tax group is reported as ($100) in column (a), $100 in column (c), and $0 in column (d).

On the Schedule M-3, Parts II and III for the U.S. consolidated tax group, on Part II, line 8, Minority interest for includible corporations, ($100) is reported 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, 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.

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/carryforward, 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

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, that is not required to be reported elsewhere on Schedule M-3. In columns (b) or (c), as applicable, adjust for any amounts treated for U.S. federal income tax purposes as interest income that are treated as some other form of income in the financial statements, or vice versa. For example, adjustments to interest income resulting from adjustments made in accordance with instructions for Part II, line 18, Sale versus lease (for sellers and/or lessors), should be made in columns (b) and (c) of this line 13.

Do not report on this line 13 amounts reported in accordance with instructions for Part II, lines 9, 10 and 11, Income (loss) from U.S. partnerships, foreign partnerships and other pass-through entities, Part II, line 12, Items relating to reportable transactions, and Part II line 22, Original issue discount and other imputed interest.

Line 14. Total Accrual to Cash Adjustment

This line is completed by a corporation that prepares financial statements (or books and records) 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 as defined in section 1221 (b)(2). 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, Cost of goods sold.

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 certain 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. Cost of Goods Sold

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.

Do not report the following on this line 17:

(a) any gain or loss from inventory hedging transactions reportable on Part II, line 15, Hedging transactions;

(b) mark-to-market income or (loss) associated with the inventories of dealers in securities under section 475 reportable on Part II, line 16, Mark-to-market income (loss);

(c) section 481(a) adjustments related to cost of goods sold or inventory valuation reportable on Part II, line 19, Section 481(a) adjustments;

(d) fines and penalties reportable on Part III, line 12, Fines and penalties; and

(e) judgments, damages, awards and similar costs, reportable on Part III, line 13, Judgments, damages, awards, similar costs.

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

Report on line 20, column (a), amounts of revenues included in Part I, line 11, that were deferred from a prior financial accounting year. Report on line 20, column (d), amounts of revenues recognizable for U.S. federal income tax purposes in the current tax year that are recognized for financial accounting purposes in a different year. Also report on line 20, column (d), any amount of revenues reported on line 20, column (a), that are recognizable for U.S. federal income tax purposes in the current tax year. Use columns (b) and (c) of line 20, as applicable, to report the differences between column (a) and (d).

Line 20 must not be used to report income recognized from long-term contracts. Instead, use line 21, Income recognition from long-term contracts.

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 striped 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 Pass-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 pass-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 Pass-Through Entities
Report on line 23b, gross capital gains reported on Schedule D, excluding capital gains from pass-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 Pass-Through Entities, Abandonment Losses, and Worthless Stock Losses
Report on line 23c, gross capital losses reported on Schedule D, excluding capital losses from (a) pass-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 pass-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) pass-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 consolidated 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 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 must 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 this Part II, line 26, and separately state and adequately disclose each difference in a supporting schedule. Regardless of the option chosen, amounts reported in column (a) of Parts II and III must be reported on the same accounting method as is used to report the amount of net income (loss) per income statement of includible corporations on Part I, line 11, which for insurance companies is usually statutory accounting. (For insurance companies included in the consolidated U.S. federal income tax return, see instructions for Part I, lines 10 and 11, and Part II, line 7.) 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 choose to either classify all differences as permanent in column (c) or identify each difference as temporary or permanent, as appropriate.

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."

Whether an item of income (loss) is reported on this line 26, or is reported on Part II, line

29, Other income (loss) and expense/deduction items with no differences, is determined separately by each member of the U.S. consolidated tax group and not at the U.S. consolidated tax group level. For example, U.S. Corporation P has two subsidiaries, Corporation A and B, that are included in P's consolidated financial statements and in P's consolidated U.S. federal income tax return. For financial statement purposes, P, A, and B recognize revenue from the sale of inventory upon delivery to the customer. For U.S. federal income tax purposes, P and A recognize such revenue consistent with the method used for financial statement purposes, whereas B recognizes such revenue based upon customer acceptance. P and A must report this revenue in column (a) and (d) on Part II, line 29, Other income (loss) and expense/deduction items with no differences. B must report the following on Part II, line 26, Other income (loss) items with differences: in column (a), B's revenue recognized in the financial statements based upon delivery to the customer; in column (d), B's revenue recognized for U.S. federal income tax purposes based upon customer acceptance; and in column (b) or (c), as applicable, the difference between B's revenue recognized in its financial statements and in its U.S. federal taxable income.

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. Interest Expense

Report on Part III, line 8, column (a), the total amount of interest expense included on Part I, line 11, and report on Part III, line 8, column (d), the total amount of interest deduction included on Form 1120, page 1, line 28, that is not required to be reported elsewhere on Schedule M-3. In columns (b) or (c), as applicable, include any adjustments for any amounts treated for U.S. federal income tax purposes as interest deduction that are treated as some other form of expense in the financial statements, or vice versa. For example, adjustments to interest expense/deduction resulting from adjustments made in accordance with the instructions for Part III, line 34, Purchase

versus lease (for purchasers and/or lessees), should be made in columns (b) and (c), as applicable, on this line 8.

Do not report on this line 8 amounts reported in accordance with the instructions for (i) Part II, lines 9, 10, and 11, Income (loss) from U.S. partnerships, foreign partnerships, and other pass-through entities, and (ii) Part II, line 12, Items relating to reportable transactions.

Line 9. Stock Options Expense

Report on line 9, column (a), amounts expensed on Part I, line 11, net income per the income statement, that are attributable to all stock options. Report on line 9, column (d), deduction amounts attributable to all stock options.

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, line 9, Stock options expense). 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 non-employees, 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, Cost of goods sold).

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. Also report on line 12, column (a) the reversal of any overaccrual of any amount

described in this paragraph. See section 162(f) for additional guidance.

Report on line 12, column (d), any such amounts as are described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c) as appropriate.

Do not report on this Part III, line 12, amounts required to be reported in accordance with instructions for Part III, line 13, Judgments, damages, awards, and similar costs.

Do not report on this Part III, line 12, amounts recovered from insurers or any other indemnitors for any fines and penalties described above.

Line 13. Judgments, Damages, Awards, and Similar Costs
Report on line 13, column (a), the amount of any estimated or actual judgments, damages, awards, settlements, and similar costs, however named or classified, included in financial accounting income, regardless of whether the amount deducted was attributable to an estimate of future anticipated payments or actual payments. Also report on line 13, column (a) the reversal of any overaccrual of any amount described in this paragraph.

Report on line 13, column (d), any such amounts as are described in the preceding paragraph that are includible in taxable income, regardless of the financial accounting period in which such amounts were or are included in financial accounting net income. Complete columns (b) and (c) as appropriate.

Do not report on this Part III, line 13, amounts required to be reported in accordance with instructions for Part III, line 12, Fines and penalties.

Do not report on this Part III, line 13, amounts recovered from insurers or any other indemnitors for any judgments, damages, awards, or similar costs described above.

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 IIII, 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 (loss) amount reported in Part I, line 11 that is not deductible for U.S. federal income tax purposes in the current tax year and 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 was not included in the net income (loss) amount reported in Part I, line 11 for the current tax year and that is not reportable elsewhere on Schedule M-3. For example, report originations and reversals of deferred compensation subject to section 409A on line 18.

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/Carryforward
Report as a negative amount on this 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.

If the corporation *utilizes* a contribution carryforward in the current tax year, report the carryforward *utilized* as a positive amount on columns (b), (c), and (d), as applicable.

When a consolidated federal income tax return is being filed, Schedule M-3 adjustments for the amount of charitable contributions in excess of the limitation, or for charitable contribution carryforward utilized, 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. Domestic Production Activities Deduction

Report on Part III, line 22, column (d) the amount of the domestic production activities deduction included in taxable income on Form 1120, page 1, line 28. Complete columns (b) and (c) as appropriate.

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 U.S. federal income tax purposes. Report on Part III, line 34, column (d), gross rental deductions for a transaction treated as a lease for U.S. federal income tax purposes but as a purchase for income statement purposes. Report interest expense for such transactions on Part III, line 8, Interest expense, 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 8, 31, and 34, as applicable, to report the differences between column (a) and (d) for such recharacterized transactions.

Example 20. U.S. corporation X acquired property 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 treated for U.S. federal income tax purposes 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 income tax treatment of this transaction as a temporary difference. During 2005, X reports in its financial statements $1,000 of gross rental expense that, for U.S. 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 8, X reports zero in column (a) and $300 in columns (b) and (d) for the interest deduction. On Part III, line 31, X reports zero in column (a) and $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.

Whether an expense/deduction item is reported on this line 35, or reported on Part II, line 29, Other income (loss) and expense/deduction items with no differences, is determined separately by each member of the U.S. consolidated tax group and not at the U.S. consolidated tax group level. For example, U.S. Corporation P has two subsidiaries, A and B, that are included in P's consolidated financial statements and in P's consolidated U.S. federal income tax return. For financial statement purposes, P, A, and B recognize real estate tax expense when accrued. For U.S. federal income tax purposes, P and A recognize such expense consistent with the method used for financial statement purposes, whereas B recognizes such deduction based on a method different from that used for financial statement purposes. P and A must report this expense/deduction in column (a) and (d) on Part II, line 29, Other income (loss) and expense/deduction items with no differences. B must report the following on Part III, line 35, Other expense/deduction items with differences: in column (a), B's expense recognized in the financial statements when accrued; in column (d), B's real estate tax expense recognized for U.S. federal income tax purposes; and in column (b) or (c), as applicable, the difference between B's real estate tax expense in its financial statements and its real estate tax deduction recognized for U.S. federal taxable income purposes.

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, Costs of goods sold.

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 consolidated 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

2005

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 3c and enter the corporation's net income (loss) per its books and records on line 4.

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 preceding 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

If consolidated return, check applicable box: (1) ☐ Consolidated group (2) ☐ Parent corporation (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corporation

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	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
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 Cost of goods sold				
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 pass-through entities				
23b Gross capital gains from Schedule D, excluding amounts from pass-through entities				
23c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
23d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-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

If consolidated return, check applicable box: (1) ☐ Consolidated group (2) ☐ Parent corporation (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corporation

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	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
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	Interest expense				
9	Stock option expense				
10	Other equity-based compensation				
11	Meals and entertainment				
12	Fines and penalties				
13	Judgments, damages, awards, and similar costs				
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/carryforward				
22	Domestic production activities deduction				
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				

Printed on recycled paper

PRESS ROOM

June 24, 2005
JS-2607

UPDATED
MEDIA ADVISORY
Treasury Secretary Snow Visits Connecticut and New York to Discuss the Economy and Social Security Reform

U.S. Treasury Secretary John W. Snow will Travel to Trumbull, Connecticut, and New York, New York June 27-28 to discuss the economy and President Bush's efforts to strengthen and preserve the U.S. Social Security system.

The following events are open to credentialed media with photo identification:

Monday June 27, 2005

NASDAQ
NE Technology Center
Trumbull, CT
2:15 PM EST
**** Media must RSVP to Angelic Valentino (212) 401-8949**
**** Media must arrive by 1:45 PM EST**

Tuesday June 28, 2005

Guest Host on CNBC
CNBC Studios
900 Sylvan Avenue
Englewood Cliffs, NJ
8:00 – 10:00 AM EST

Remarks to Council of Foreign Relations
58 E. 68th Street
New York, NY
5:30 PM EST
**** Media must RSVP to Marie Strauss (212) 434-9536**
**** Media must arrive by 5:30 PM EST**

PRESS ROOM

June 27, 2005
JS-2608

The Honorable John W. Snow
Prepared Remarks to NASDAQ employees
Trumbull, CT

Good afternoon; it's great to be here and I appreciate the chance to talk with you about the historic effort that is going on in Washington, DC to save and strengthen our nation's Social Security system.

The time to make meaning and permanent change to the system is now for two important reasons.

First, waiting to fix the problem is terribly expensive, and I believe irresponsible considering that younger generations will be left paying the bill. Every year we delay permanently reforming the system, $600 billion is added to the shortfall – which, according to the non-partisan Social Security actuaries is $11.1 trillion on a permanent basis.

Second, our outstanding economic health presents us with an excellent opportunity to move forward with meaningful reform.

We are enjoying terrific economic strength, with more Americans working today than at any time in our history. Since 2002, America has added more than 3.5 million new jobs; the unemployment rate is 5.1 percent and real after-tax income is up by more than 10 percent. More Americans own their homes than at any time in our history. More Americans are going to college and own their own businesses than at any time in our history -- and a recent economic report shows that inflation is in check.

Saving and improving Social Security will mean a positive change, but a change of enormous proportions nonetheless. And significant change is best done from a position of economic strength like the one that we currently enjoy.

Because of your economic and financial expertise, as employees of NASDAQ, I know you appreciate these points. You are especially informed, sharp observers and participants in this national discussion.

Most of you are likely taking a smart, three part approach to your own retirement. I know that NASDAQ has a pension plan and offers a 401(k) with a match, so that's one piece.

Depending on your age, you may or may not be counting on Social Security as the second piece. The younger folks, I'll bet, aren't counting on it – an interesting cultural phenomenon that should *not* discourage young people from being involved in this national dialogue, by the way. In fact, Social Security reform is primarily about, and for, the youngest generations of workers.

The third piece of the retirement picture would be your own savings, investment and IRAs.

You are probably among those Americans most prepared for their retirement years. Many don't have all three pieces in place and rely heavily on Social Security. It was with that fact in mind that the President took this issue to the public, and to

Congress. He knew that we simply couldn't turn a blind eye to the looming problems with a program this important.

Since the President raised this issue to the top of the nation's domestic policy agenda, a lot of terrific ideas have been discussed – at lunch counters and dinner tables, from college dining halls to the halls of Congress – and today we're getting much closer to having significant legislation move on Capitol Hill.

The President has welcomed all ideas – other than raising the payroll tax rate or changing benefits for those older than age 55 – to help solve the challenges facing the Social Security system.

He is strongly committed to giving workers the option of a voluntary personal account so they can save their own money in a nest egg – because it's the best way to ensure that Social Security money is spent on Social Security. As you all know, Social Security surplus funds are spent every day, by Congress, on everything under the sun other than Social Security.

The President is encouraged, as I am, by the increasing pace of activity in Congress on how to save and strengthen Social Security for future generations. He appreciates the Members who have introduced legislation, and who have supported his objectives in this effort.

Your own Senator Lieberman, for example, has been superbly open in his acknowledgment that that Social Security has serious problems. There are still plenty of Members of Congress who still won't face up to the plain mathematical facts!

Joe has also pointed out to his Democratic colleagues that "It is not enough to oppose the President's plan." He is encouraging those colleagues to come up with a plan of their own to protect the program.

Senator Bennett introduced a bill a few days ago that contained progressive benefit growth, which is one of the elements of reform that the President has been promoting. Progressive benefit growth would mean that the lowest income seniors would have the fastest-growing benefits while benefits for those who are more well-off grow more slowly, with protection from inflation.

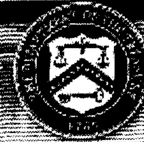
The President has also welcomed plans from other Members like Senator DeMint and Congressman Bill Thomas. Every time legislation is introduced, it advances this issue – and that is what the President wants.

This is fascinating time in government history. Enacting real reform of Social Security this year – which I believe we will – holds great promise for generations of American workers and retirees. If done right, reform will benefit our economy and end the decades-long tradition of hiking payroll taxes every time the Social Security formula is off-balance.

I'm extremely proud to be helping the President as we seek to achieve a safe and promising financial future for all Americans.

Thanks again; I'd be happy to take your questions now.

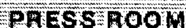
PRESS ROOM



June 28, 2005
JS-2609

Statement of Treasury Secretary John W. Snow on the Passage of Energy Legislation in the U.S. Senate

"I'm encouraged to see that the Senate has now acted on a bi-partisan basis on comprehensive energy legislation that reflects the priorities of the President's 2001 proposal. The passage of this bill is needed to address high energy prices, decrease our dependence on foreign oil, and increase energy efficiency and conservation. Now we need swift action by the House and Senate conference to deliver a bill to the President before the August recess."



PRESS ROOM

June 28, 2005
JS-2610

The Honorable Mark W. Warshawsky
Prepared Remarks
American Bankers Association
June 28, 2005
Washington, DC

Thank you for such a welcome introduction. I appreciate the opportunity the American Bankers Association has given me to discuss the Administration's proposal to permanently fix Social Security and reform and strengthen the single-employer defined benefit pension system against the background of the larger issue of promoting national savings.

President Bush said in his February State of the Union address that he wanted to engender a national dialogue about Social Security. Regardless of where you stand on the solution to address the looming Social Security insolvency, one thing is for sure, the national dialogue has been raised. Now, people are talking about it, not only in the halls of Congress – but it is the topic at lunch counters and kitchen tables, college dining halls and office water coolers all over the country.

Social Security Reform

President Bush has made Social Security reform a major priority of his second term. Today I'll explain why it is so important that responsible Social Security reform occur now, and why one element of a successful reform plan must be personal retirement accounts that give individuals more control over their financial futures.

The Size of Social Security's Financial Shortfall

How big is Social Security's current funding gap? The most widely cited measure of that gap is the 75-year actuarial imbalance, which is now estimated at $4.3 trillion or 1.92 percent of taxable payroll. This measure suggests that immediately raising the payroll tax rate by 1.92 percentage points, to 14.32 percent, would permanently fix Social Security. But as many of you are aware, that is not true. With each passing year, the Trustees would report an ever larger financial imbalance as the 75-year scoring window is moved forward to include years with ever larger gaps between expected system costs and income.

As this example makes clear, estimates made over a 75 year horizon do not fully capture the financial status of the Social Security program. In fact, no finite forecast period completely embodies the financial status of the program because people pay taxes in advance of receiving benefits; at any finite cutoff date, people will have accrued benefits that have not yet been paid.

In order to get a complete picture of Social Security's permanent financial problem, the time horizon for calculating income and costs must be extended to the indefinite future. Such a calculation is provided in the 2005 Trustees Report; it is estimated there 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 $11.1 trillion. To put this in perspective, eliminating the permanent deficit could be accomplished with an immediate and permanent 3.5 percentage point increase in the payroll tax rate (to 15.9 percent), or with a 22 percent reduction in all current and future benefits. In both cases, it would be worth noting, there would be massive near-term Trust Fund accumulations.

Intergenerational Equity: Why Social Security Must be Reformed Now

It is clear that the Social Security system is not financially viable and must be fixed. How to close the permanent financing gap raises difficult questions over how the net benefits of Social Security should be shared across generations. In this context, it is important to recognize that the large unfunded obligations in the system are primarily the consequence of the past system generosity to generations that are now either dead or retired. Of course, those early generations are beyond reform's reach, so the entitlement reforms needed to close the financing gap must fall entirely on later generations.

Viewing Social Security from the perspective of how it affects generations and individuals explains why it is imperative that Social Security be reformed now. Delaying reform only reduces the options for fairly distributing the benefits of Social Security across generations. Most people agree that it would not be fair to alter Social Security's promises to retirees and near retirees. The longer reform is delayed, the fewer generations that are left to participate in a reformed entitlement system so as to close Social Security's funding gap, and the more severe those reforms will be.

To make this point more concretely, consider a policy of closing Social Security's permanent financing gap by immediately increasing the payroll tax rate by 3.5 percentage points. If the tax increase were instead delayed until 2041 when the trust fund is depleted, the requisite tax increase would be 6.3 percentage points. Clearly, I do not advocate any of these policies. My point is that there is no doubt that fairness to future generations requires that action be taken now.

I would also point out that purely pay-as-you go financing of Social Security would be grossly unfair to future generations. For example, one way to make Social Security solvent would be to leave benefits unchanged and to raise payroll taxes year by year beginning when the Trust Fund is exhausted. According to current projections, the payroll tax rate under that policy would steadily rise beginning in 2041 and reach 19 percent at the end of the 75-year projection period and would continue to rise thereafter. No reasonable person would view that as a fair policy. I conclude that any reform that is fair across generations would avoid pay-as-you go financing and therefore would at least partially pre-fund Social Security benefits.

Administration Proposal: Permanently Fixing Social Security

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. One important component of reform is the introduction of personal retirement accounts (PRAs). PRAs provide individual control, ownership, and are an effective vehicle for pre-funding more of our Social Security benefits. PRAs also offer individuals the opportunity to build a nest-egg that the government cannot take away. They allow individuals to partake in the benefits of investing in the financial markets. Individual control and ownership means that people would be free to pass any unused portion of accounts to their heirs.

Today I'll briefly discuss the Administration's proposals for how PRAs will be phased in, how they interact with the traditional Social Security benefits, and then I'll discuss the administrative structure, the investment choices, and the distribution options in more detail.

Let me make two critical points up front. First, the system needs to be reformed to make it permanently sustainable. The President is committed to doing this while maintaining the progressivity of the system. The second critical point is that personal retirement accounts will be voluntary. At any time a worker can "opt in" by making a one-time election to put a portion of his or her payroll taxes into a personal retirement account. A worker who chooses not to opt in will receive traditional Social Security benefits, reformed to be permanently sustainable.

To ease the transition to a personal retirement account system, participation will be phased in according to the age of the worker. In the first year of implementation,

2009, workers currently between the age of 40 and 54 (born between 1950 and 1965) would have the option of establishing personal retirement accounts. In the second year, 2010, workers currently between the age of 26 and 54 (born between 1950 and 1978) would be given the option and by the end of the third year, 2011, all workers born in 1950 or later who want to participate in personal retirement accounts would be able to do so.

Even after the initial implementation, personal retirement accounts will start gradually. Although all participants will eventually be allowed to contribute 4 percentage points of their payroll taxes to a personal account, the annual contributions to personal retirement accounts initially would be capped at $1,000 per year. The cap would rise gradually over time, growing $100 per year, plus growth in average wages. Starting with the full 4 percentage point PRA contribution ensures that low-income workers can get appreciable gains from the accounts. If we started out with a lower percentage contribution, the potential dollar gains for low-income workers would be much more limited.

There has been a great deal of discussion about how PRAs will interact with the traditional Social Security benefit. The PRA structure that the President has proposed is a "carve out" or "offset" PRA. An offset PRA simply means that workers who choose to contribute payroll taxes to a PRA will have their defined Social Security benefit adjusted by an actuarially fair amount. The government borrowing rate is the appropriate and fair offset rate or assumed rate of return.

As proposed by the President, PRAs are designed to hold down administrative costs, encourage careful and cautious investing, and provide a reliable income for the full length of retirement.

Centralized administration and limited choice will hold down administrative costs. The PRA administration and investment options will be modeled on the Thrift Savings Plan (TSP). TSP is a voluntary retirement savings plan offered to federal employees, including members of Congress. TSP offers comparable benefits and features to those available to private sector employees in 401(k) retirement plans. The Social Security Administration's actuaries project that the ongoing administrative costs for a TSP-style personal account structure would be roughly 30 basis points or 0.3 percentage points.

The PRAs will limit the risk of investments with low-risk, low-cost options like the broad index funds available to federal employees in TSP. Similarly to TSP, the index funds could include, for instance, a government securities fund; an investment-grade corporate bond index fund; a small-cap stock index fund; a large-cap stock index fund; and an international stock index fund. In addition to these TSP-type funds, workers could choose a Treasury Inflation-Protected Securities fund.

Workers will also be able to choose a "life cycle portfolio" that would automatically adjust the level of risk of the investments as the worker aged. As the individual neared retirement age, the life cycle fund automatically and gradually shifts the allocation of investment funds so that it is weighted more heavily toward bonds. The President's plan includes a mechanism that will protect near-retirees from sudden market swings on the eve of retirement. PRA balances would be automatically invested in the "life cycle portfolio" when a worker reaches age 47, unless the worker and his or her spouse specifically opted out by signing a waiver form stating they are aware of the risks involved.

Because these are specifically designed as retirement accounts, PRAs would not be accessible prior to retirement. Workers who choose personal retirement accounts would not be allowed to make withdrawals from, take loans from, or borrow against their accounts prior to retirement.

The distribution options for PRAs will include restrictions on withdrawals to discourage outliving ones assets. Procedures would be established to govern how account balances would be withdrawn at retirement. This would involve some combination of inflation indexed annuities to ensure a stream of monthly income

over the worker's life expectancy, phased withdrawals indexed to life expectancy, and lump sum withdrawals. Individuals would not be permitted to withdraw funds from their personal retirement accounts as lump sums if doing so would result in their moving below the poverty line. Account balances in excess of the poverty-protection threshold requirement could be withdrawn as a lump sum for any purpose or left in the account to accumulate investment earnings.

Some have raised concerns about the public borrowing that might be needed to help finance PRA contributions. Such an increase in public borrowing is often referred to as a "transition cost," but I want to argue here that the term is a misnomer; the increased public borrowing does not represent an increase in the cost of paying retirement benefits and hence is not a cost in the sense that people would normally believe. PRAs increase public debt in the short term, but ultimately leave public debt unchanged when factoring in the outlay reductions deriving from the reduction in defined benefits. Because long-term public debt is unchanged, the policy is neutral with respect to the long-term cost of paying retirement benefits.

Most importantly, PRAs 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. Personal accounts serve as private and therefore effective "lock boxes". When pre-funding is done using a personal account, there is no pressure to increase government spending, because this pre-funding belongs to individuals and does not appear on the government balance sheet as budget surpluses.

In addition to addressing Social Security's solvency, this administration is also proposing ways to encourage national savings and ensuring that the pensions workers have earned will be honored.

Encouraging National Savings

As far back as 1776, Adam Smith identified capital accumulation as the key force in promoting growth in the wealth of nations. Smith also identified the key force in capital accumulation: increasing national savings. Since Smith's time, almost all economists have come to understand the vital nature of national saving, and increasing saving has become a standard policy prescription for enhancing economic growth and raising living standards.

We know the U.S. faces a challenge as the economy works through the implications of the retirement of the Baby Boom generation. With the growth in the workforce set to slow and the average age of the population rising, maintaining steady growth in the standard of living will become more difficult. The Smith prescription shows the way out. Increase our savings, which will increase our accumulated capital, which will give each worker more and better tools to work with, which will raise productivity and secure a growing standard of living.

Despite the fact that this prescription is well-known, the evidence suggests it is exceptionally hard to follow. Net private saving (gross private saving less depreciation on plant, equipment, and housing stock) as a share of national income averaged about 11 percent from 1955 through 1985, but since then has trended steadily down. Over the past ten years, it has averaged about 5-1/2 percent of GDP, or about 5 percentage points below where it was during the decades of the 1950s, 60s, 70s, and most of the 80s.

One reason the saving prescription is difficult to follow is that incentives work against it. Our tax system, for example, has, for a long time, encouraged Americans to spend first and save second. To reverse, this, the Administration has worked hard to set in place the incentives that encourage saving. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) cut the top tax rates which raised the after-tax rate of return on capital income – encouraging savings. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) cut taxes on

capital income.

But even with these positive changes, the Federal income tax code still discourages saving. To combat this, the President has proposed Retirement Savings Accounts, which would replace the complex array of retirement saving incentives currently in the tax code, such as IRAs, Roth IRAs, and similar saving vehicles. The President has also proposed Employer Retirement Savings Accounts to simplify the saving opportunities individuals have through their employers. The President's Lifetime Savings Accounts would, for the first time, allow individuals to save on a tax-preferred basis for any purpose. This can be especially important to low-income individuals and families who need to save, but cannot afford to lock up funds for retirement that may be needed for an emergency in the near-term. The President also proposed Individual Development Accounts that would give extra financial incentive to certain low-income families to set aside funds for major purchases, such as a first home.

Pensions also play a critical role in saving. Accumulating financial assets for future retirement is one of the main reasons households save at all. If individuals and households believe they will receive a pension in retirement, that influences their saving and asset accumulation behavior. If, in fact, those promised benefits are not available because of pension under funding, then the household's saving, and, in aggregate, national saving, is less than it otherwise would have been had their pension been adequately funded.

The single employer pension system is in serious financial trouble. Many plans are badly under funded, jeopardizing the pensions of millions of American workers, and the insurance system which protects those workers in the event that their own pension plans fail has a substantial deficit.

Administration Proposal: Pension Reform

The primary goal of any pension reform effort should be to ensure that retirees and workers receive the pension benefits they have earned. Clearly the current funding rules have failed to meet this goal. As part of its reform proposal the Administration has designed a new set of funding rules that we think will ensure that participants receive the benefits they have earned from their pension plans.

For any set of funding rules to function well, assets and liabilities must be measured accurately. The system of smoothing embodied in current law serves only to mask the true financial condition of pension plans. Under our proposal, assets will be marked to market. Liabilities will be measured using a current spot yield curve that takes account of the timing of future benefit payments summed across all plan participants. Discounting future benefit cash flows using the rates from the spot yield curve is the most accurate way to measure a plan's liability. Liabilities computed using the yield curve match the timing of obligations with discount rates of appropriate maturities. Proper matching of discount rates and obligations is the most accurate way to measure today's cost of meeting pension obligations.

The Administration recognizes that the current minimum funding rules have contributed to funding volatility. Particular problem areas are the deficit reduction contribution mechanism and the limits on tax deductibility of contributions. Our proposal is designed to remedy these issues by giving plans the tools needed to smooth contributions over the business cycle. These tools include:

- Increasing the deductible contribution limit will give plan sponsors additional ability to fund during good times.
- Increasing the amortization period for funding deficits to seven years compared to a period as short as four years under current law, and
- The freedom plans already have to choose prudent pension fund investments. Plan sponsors may choose to limit volatility by choosing an asset allocation strategy or conservative funding level so that financial market changes will not result in large increases in minimum contributions.

These are appropriate methods for dealing with risk; it is inappropriate to limit

contribution volatility by transferring risk to plan participants and the PBGC.

Under our proposal, plan funding targets for healthy plan sponsors will be established at a level that reflects the full value of benefits earned to date under the assumption than plan participant behavior remains largely consistent with the past history of an on-going concern. Plans sponsored by firms with below investment grade credit will be required to fund to a higher standard that reflects the increased risk that these plans will terminate. Pension plans sponsored by firms with poor credit ratings pose the greatest risk of default. It is only natural that pension plans with sponsors that fall into this readily observable high risk category should have more stringent funding standards. Credit ratings are used throughout the economy and in many government regulations to measure the risk that a firm will default on its financial obligations. A prudent system of pension regulation and insurance would be lacking if it did not use this information.

Credit balances are created when a plan makes a contribution that is greater than the required minimum. Under current law, a credit balance, plus an assumed rate of return, can be used to offset future contributions. We see two problems with this system. First, the assets that underlie credit balances may lose rather than gain value. Second, and far more important, credit balances allow plans that are seriously under funded to take funding holidays. In our view every under funded plan should make minimum annual contributions.

Under our proposal, contributions in excess of the minimum still reduce future minimum contributions. The value of these contributions is added to the plan's assets and, all other things equal, reduces the amount of time that the sponsor must make minimum contributions to the plan. In combination with the rest of the proposal, there is more than adequate incentive for plan sponsors to fund above the minimum. In fact here are four other reasons that employers might choose to contribute more than the minimum: (1) The increased deductibility provisions allow sponsors to accumulate on a pre-tax basis; (2) Disclosure of funded status to workers will encourage better funding; (3) A better funded status results in lower PBGC premiums, and (4) A better funded status make benefit restrictions less likely.

The current rules often fail to ensure adequate plan funding – recent history has made this obvious. Formally we might say that the current set of rules has created a partially *pay-as-you-go* private pension system by allowing some accrued liabilities to be unfunded. That is, in general, when plans are not fully funded, the system basically operates by transferring contributions associated with younger workers to the current retired workers.

The funding rules proposed by the Administration, whereby sponsors that fall below the accurately measured minimum funding levels are required to fund up towards their target in a timely manner, move the system in the direction of being *fully-funded*. In a fully-funded system the contributions associated with each generation of workers are invested and fund their own retirements. A basic result in macroeconomics is that a pay-as-you-go system results in less saving, a slower rate of capital accumulation, and a lower steady state capital stock. Therefore the Administration's proposal – through the move towards more fully funded private defined benefit pensions – is consistent with the Administration goal of increasing saving and greater capital accumulation.

Our lump-sum proposal would replace the use of 30-year Treasury rates for purposes of determining lump sum settlements under qualified plans with a yield curve approach. Current law use of the 30-year treasury rate to determine the minimum lump sum amount often inflates the lump sums in comparison with the value of the annuity that the employee would otherwise receive. Under our proposal, lump sum settlements would be calculated using the same interest rates that are used in discounting pension liabilities: interest rates that are drawn from a zero-coupon corporate bond yield curve based on the interest rates for high quality corporate bonds. This reform will include a transition period, so that employees who are expecting to retire in the near future are not subject to an abrupt change in the amount of their lump sums as a result of changes in law. The new basis would not apply to distributions in 2005 and 2006 and would be phased in for distributions in

2007 and 2008, with full implementation beginning only in 2009.

We also want to make improvements to defined contribution retirement plans. Congress successfully passed two proposals originally set forth in the President's Retirement Security Plan with the enactment of the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act (1) guarantees that workers will now receive notice 30 days prior to a pension plan blackout period and (2) prohibits corporate officers from selling their own company stock during blackout periods.

The other components of the President's reform plan are to:

Improve choice by allowing participants to diversify their investments by selling their company stock after three years. The use of employer stock allows companies to be more generous with their matching contributions. Workers, however, should also have the right to choose how they want to invest their retirement savings. The President's plan would ensure that workers could sell company stock and diversify into other investment options after three years of participation in the plan.

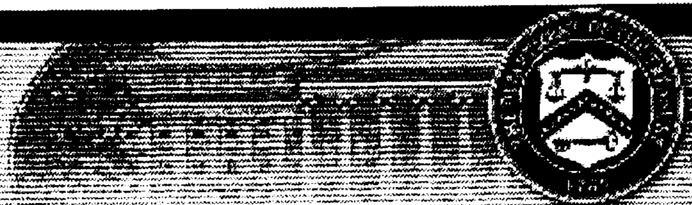
Enhance information by requiring quarterly benefit statements to be sent to participants. A meaningful ability to change investments also depends on workers receiving timely information about their 401(k) accounts. The President's plan would require companies to provide workers with quarterly benefit statements with information about their accounts including the value of their assets, their rights to diversify, and the importance of maintaining a diversified portfolio.

Increase confidence by providing participants with increased access to professional investment advice. Current ERISA law raises barriers against employers and investment firms providing individual investment advice to workers. The President's plan would increase workers' access to professional investment advice. By relying on expert advisers who assume full fiduciary responsibility for their counsel and disclose relationships and fees associated with investment alternatives, American workers will have the information to make better retirement decisions.

Conclusion

Defined benefit plans are a vital source of retirement income for millions of Americans. The Administration is committed to ensuring that these plans remain a viable retirement option for those firms that wish to offer them to their employees. The long run viability of the system, however, depends on ensuring that it is financially sound. The Administration's proposal is designed to put the system on secure financial footing in order to safeguard the benefits that plan participants have earned and will earn in the future. We are committed to working with Congress to ensure that effective defined benefit pension reforms that protect worker's pensions are enacted into law.

It has been my pleasure to provide this discussion of this administration's proposal to permanently address Social Security's solvency; encourage national savings; and protect workers' pensions.



June 28, 2005
2005-6-28-15-41-27-9129

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 $77,110 million as of the end of that week, compared to $77,502 million as of the end of the prior week.

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

	June 17, 2005			June 24, 2005		
TOTAL		**77,502**			**77,110**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,369	14,454	25,823	11,259	14,402	25,661
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,070	2,905	13,975	10,937	2,895	13,832
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]			15,332			15,282
3. Special Drawing Rights (SDRs) [2]			11,330			11,293
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	June 17, 2005			June 24, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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

	June 17, 2005			June 24, 2005		
	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.

June 28, 2005
js-2611

The Honorable John W. Snow
Prepared Remarks to
The Council on Foreign Relations
New York, NY

Good evening, and thank you so much for having me here tonight. It is an honor and a pleasure to speak to this group; I look forward to our discussion.

The timing for this visit couldn't be better. I recently returned from the G8 Finance Ministers meeting in London where we discussed some of the leading economic challenges facing the global economy, including the challenges facing the developing world – especially those in Africa.

The most notable achievement of our meetings was for the G8 nations to agree to support President Bush's proposal for 100% debt stock cancellation. It was about a year ago that we put this idea on the table, and there were many people along the way who were skeptical of our motives, or not convinced that it could be achieved – but, clearly, a year of hard work on this has paid off. When Prime Minister Blair met with President Bush, the UK agreed to support the US principle of 100% debt stock cancellation, and the US affirmed its commitment to preserve the financial integrity of the development institutions. This important agreement between President Bush and Prime Minister Blair paved the way for the historic achievement among the entire G8 in London a week later. The G8 Leaders will build on this achievement in Gleneagles next week.

To many people who have followed the G8 over the years, a focus on debt cancellation and development in Africa may seem incongruous. The G8 has most often been associated with issues related to currencies, or financial crises, and not with development.

The role of the G8 is to monitor and address the key economic issues of the day. Among the many issues we discuss, today there are two prominent challenges confronting the world's economic leaders – what I call the two great "growth deficits."

The first "growth deficit" has to do with uneven rates of growth between the United States and its major trading partners. For some time now, the United States has been growing at a far more rapid pace than our major trading partners in Europe and Japan. Lagging growth in these two major economic areas contributes to imbalances which should be addressed.

The second "growth deficit" has to do with lagging growth in the poorest nations of the world – most starkly evidenced in Africa where living standards relative to the rest of the world have actually declined.

The G8 has an important leadership role to play in addressing both of these major challenges.

* * *

Let's look at the first challenge.

We know that the global economy is performing relatively well with the strongest overall growth in decades, low inflation, low interest rates, and no apparent financial crises. But the pace of growth is unbalanced, and this phenomenon can be problematic.

The United States continues to demonstrate strong economic growth. Real GDP rose 4.4 percent last year. The first quarter this year came in at a strong 3.5 percent annual rate. Since the employment trough of May 2003 the economy has generated 3.5 million new jobs. Well-timed monetary and fiscal policies have contributed to this improved outlook. More fundamentally, our higher growth and productivity stem from the resilience and flexibility of our factor markets, highly motivated workforce and investors, and open, competitive goods markets.

But this strong growth presents problems when our major trading partners are growing slowly. Europe and Japan have posted chronically low levels of growth for most of the past decade, so that Americans with more disposable income are purchasing more goods and services from our trading partners than they purchase from the U.S. When combined with lower savings rates in the United States (or a savings glut elsewhere) and a lack of currency flexibility in the Asia region, the result has been larger and growing current account imbalances.

The G8 – and in particular, the G7 finance ministers – have worked together to execute plans to deal with these imbalances. Addressing imbalances in the global economy is a shared responsibility among the major economic regions of the world. The international economy performs best when large economies embrace free trade, the free flow of capital, and flexible currencies. Obstacles in any of these areas prevent smooth adjustments. At best, such obstacles result in less than maximum growth; at worst, they create distortions and increase risks.

The United States is doing its part to address imbalances by aggressively tackling our fiscal deficit and our long-term liabilities. Because of strong growth and appropriate fiscal policy, the U.S. budget deficit in 2004 was well below projections, and with recent data, I expect further improvement in our fiscal deficit position this year. Some private forecasters predict that our fiscal deficit will be below 3% of GDP this year if we continue to hold the line on spending. We are also working to put in place innovative policies to increase the savings rate.

Our actions alone will not be sufficient to unwind global imbalances. Simply put, large imbalances will continue if growth in our major trading partners continues to lag. European and Japanese GDP together exceeds that in the United States.

These economies must continue to adopt and implement vigorous and necessary structural reforms to establish robust rates of growth – both for the good of their own citizens and to contribute to reduction in the imbalances in the global economy. Greater flexibility in China is also a necessary component of the global adjustment process – especially as concerns of competitiveness with China also constrain neighboring economies in Asia from adopting more flexible exchange policies.

During my recent visit to Brussels we discussed ways in which Europe could raise growth, including through the EU's efforts to integrate its capital markets.

The potential benefits for Europe's citizens of implementing structural reforms are clear and quantifiable. A recent OECD study determined that deregulating EU countries would raise EU GDP per capita by 2.8%.

The G8 nations have taken an active role in addressing the issue of imbalances. The G7 Agenda for Growth calls on each of the nations to make structural reforms to increase growth – especially in Europe and Japan. The U.S., as I mentioned, is working to reduce deficits and raise savings. And we have called on major economies to increase currency flexibility.

* * *

The second growth deficit confronting economic leaders in the G8 involves the conditions of improving living standards for the billions of poor people today who live on less than $2 a day.

U.K. Prime Minister Tony Blair has put development – with a particular emphasis on Africa – at the forefront of this year's G8. We applaud this effort as it has been President Bush's view that more can and should be done to assist less developed nations raise living standards. Africa's struggles are particularly poignant, as countries on the continent deal with disease, conflict, insufficient investment in health and education, lack of economic freedom, and unstable or unaccountable governments.

Many people are focusing this week on how wealthy nations can direct more development assistance to countries in Africa. This is an important discussion, and it's not a discussion in which the United States is shy to participate, because we are very proud of our record. I will have more to say in a minute about the dramatic increases in assistance to sub-Saharan Africa by the Bush Administration.

But the role of the G8 today, following the mixed results of 50 years of development assistance, is not just to do more, but to do better – to continue to improve how development assistance is both delivered and received in order to ensure the biggest bang for each buck of development assistance.

While headline writers and advocacy campaigns and rock concerts tend to focus on numerical targets for assistance, there is, unfortunately not sufficient attention paid to the conditions in which development assistance is delivered. And yet, this is not for lack of study and analysis – the World Bank has a library full of research papers citing the importance of good governance and sound economic policies. It is easy for people to focus on simple dollar targets, rather than the specific goals and results of assistance.

Increased development assistance is vitally important. During this Administration, development assistance overall has nearly doubled and assistance to sub-Saharan Africa has tripled. Today, nearly a quarter of every dollar of official assistance in the region comes from America.

In key sectors, America's commitment is unparalleled. The U.S. is the world's recognized leader in vaccine research and development and immunization funding. In 2004, the U.S. provided roughly 70% of total HIV vaccine research funding - $450 million out of $650 million total. U.S. funding will increase to $510 million in 2005 and $600 million in 2006. In addition, the U.S. accounts for approximately 45% of all government contributions to the Global Alliances for Vaccines and Immunizations. As of February 2005, the U.S. government had contributed roughly $220 million.

Notably, America's dramatic increase in development assistance in recent years has come before disbursements from the President's Millennium Challenge Corporation (MCC) program. The program, while a model for how development assistance should be delivered, is only this year beginning to make disbursements and has billions of dollars in the pipeline. More importantly, this program is setting a standard in delivering assistant to those countries that are helping themselves – by investing in the health and needs of its people, fighting corruption, and demonstrating a commitment to economic freedom.

Less than 18 months following the establishment of the MCC, four compacts have been approved valued at over $600 million and several more are expected in the coming months. Moreover, evidence indicates countries are already taking action to improve policies so they can become eligible for MCC funds.

This fiscal year the America has committed $2.8 billion to the President's Emergency Plan for HIV/AIDS Relief. As of March 31 of this year, the program has supported anti-retroviral drug treatment for approximately 235,000 men, women and children in 15 of the most afflicted countries in Africa, Asia and the Caribbean – exceeding the treatment target for the year months ahead of schedule.

But even with these dramatic increases in development funding, we have tried to change the focus both with our bilateral assistance and multilateral assistance away from simplistic numeric targets, and toward a greater focus on ensuring that assistance is well spent and goes into environments where it can have a great impact in lifting people out of poverty. Money alone is not the answer.

One way we have worked to reform the way that assistance was to encourage the greater use of grants instead of loans at the multilateral development banks. As President Bush recognized, it is counterproductive to continually add to the already unsustainable debt burdens of poor countries. Combined with our landmark agreement to cancel debt, the increased use of grants within a clear debt-sustainability framework will ensure that poor countries do not find themselves again in the lend-forgive-lend trap.

Sometimes the test for determining where to deliver assistance is aided by the use of non-traditional measures of government effectiveness. For example, one of the tests now utilized by both the World Bank and MCC measures how long it takes to start a business in a country. This simple measure tells a donor a great deal about a country's commitment to economic freedom and relative absence of corruption. If it takes 32 days to start a business in Benin, and 146 days to start a business in Angola, then you can clearly presume that Benin encourages entrepreneurial activity and has stripped away cumbersome levels of bureaucracy where corruption is often entrenched. (Of course we would like to see all countries improve to levels of developed nations – like Australia's 2 days, or Canada's 3 days.)

By working through the G8 we are also trying to focus more attention on other factors in growth-enhancing development – especially through a greater focus on private sector development. Here is an area that frequently sends many aid advocates scurrying for the exits, yet we know that the quickest way to lift someone out of poverty is to create a job. So we have focused greater attention on micro-lending programs for small and medium enterprises.

Private sector resources also have a role to play and these resources dwarf traditional development assistance – specifically trade and remittances. President Bush considers it crucial that we complete the Doha Development Round to increase economic opportunity for all trading nations, especially developing nations. But even without global trade liberalization, America's Africa Growth and Opportunity Act trade preference system has generated a striking increase in trade flows between the United States and participating African nations. The U.S. purchased 24 percent of all sub-Saharan African exports in 2003, more than any other country; in 2004, African exports to the U.S. increased to almost $36 billion. President Bush extended the AGOA program to 2015 in order to further increase the U.S.-Africa trade relationship.

Through the G8 we are also working to reduce the costs associated when workers send remittance back to their families in their home countries. This instant source of assistance from the United States alone exceeds the combined aid contributions of all donor nations every year. Until the United States pointed to remittance flows, most nations failed to measure the flows, let alone encourage reforms to reduce the costs of transmitting them.

My predecessor in this job, Secretary Paul O'Neill often pointed out that the funding we provide for overseas aid came from the taxes of plumbers and carpenters in America. If we want to go back to those plumbers and carpenters for more money for development, we need to demonstrate that we're putting it to the best uses and producing real results for the people we intend to help.

I'm encouraged that as the leaders convene in Gleneagles next week for the G8 Summit that real progress is being made to address these important imbalances in the global economy. By working in concert we all stand to benefit.

- 30 -

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 29, 2005
JS-2612

Treasury Issues Final Regulations on State and Local Government Series Securities

The Treasury Department today released final regulations on State and Local Government Series (SLGS) securities. The regulations will be published in the Federal Register on June 30, 2005, and will be effective 45 days after publication. SLGS securities are non-marketable Treasury securities that are only available for purchase by issuers of tax-exempt securities.

The final regulations address certain aspects of the existing SLGS program that provide SLGS investors cost-free options or arbitrage opportunities that are not available in marketable securities. These features of the existing SLGS program are costly for taxpayers as they impose substantial costs on the federal government. The final regulations will make investments in SLGS securities more closely resemble investment opportunities available in Treasury marketable securities, while maintaining simplicity and flexibility for the users of the SLGS program.

The final regulations are substantially similar to proposed regulations that were published on September 30, 2004. In addition, the new regulations increase the interest rates on SLGS securities to rates 1 basis point below current Treasury borrowing rates. SLGS securities rates currently are 5 basis points below current Treasury borrowing rates.

The final regulations also will require the use of ***SLGSafe*** (www.publicdebt.treas.gov/spe/spe.htm), a web-based application, for all SLGS securities transactions.

REPORTS

- The text of the regulations

4810-39W

DEPARTMENT OF THE TREASURY

Fiscal Service

31 CFR Part 344

(Department of the Treasury Circular, Public Debt Series No. 3-72)

U.S. Treasury Securities--State and Local Government Series

AGENCY: Bureau of the Public Debt, Fiscal Service, Treasury.

ACTION: Final rule.

SUMMARY: The Department of the Treasury (Treasury) is issuing this final rule to revise the regulations governing State and Local Government Series (SLGS) securities. SLGS securities are non-marketable Treasury securities that are only available for purchase by issuers of tax-exempt securities. The changes in the final rule prohibit issuers of tax-exempt securities from engaging in certain practices

that in effect use the SLGS program as a cost-free option. The final rule also makes other changes that are designed to improve the administration of the SLGS program.

DATES: This final rule is effective [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

Keith Rake, Deputy Assistant Commissioner, Office of the Assistant Commissioner for Public Debt Accounting, Bureau of the Public Debt, 200 3rd St., P.O. Box 396, Parkersburg, WV 26106-0396, (304) 480-5101 (not a toll-free number), or by e-mail at <opda-sib@bpd.treas.gov> or Edward Gronseth, Deputy Chief Counsel, Elizabeth Spears, Senior Attorney, or Brian Metz, Attorney-Adviser, Office of the Chief Counsel, Bureau of the Public Debt, Department of the Treasury, P.O. Box 1328, Parkersburg, WV 26106-1328, (304) 480-8692 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Overview of Rulemaking

On September 30, 2004, Treasury published a notice of proposed rulemaking (NPRM) with request for comments (69 FR 58756, September 30, 2004), proposing changes to the regulations governing U.S. Treasury securities of the State and Local Government Series (SLGS). Treasury intended those changes to address certain practices of investors in SLGS securities that Treasury considered to be an inappropriate use of the SLGS securities program. The comment period was extended to November 16, 2004 (69 FR 62229, October 25, 2004). Treasury received 20 comments by the end of the comment period. After careful consideration of the comments, Treasury is now issuing a final rule that will be effective on [INSERT DATE 45 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

In the NPRM, Treasury proposed three main changes to the SLGS program: that it would be impermissible to invest an amount received from the redemption before maturity of a SLGS Time Deposit security at a higher yield, or to use an amount received from the sale of a marketable security to purchase a SLGS security at a higher yield; that subscriptions for purchase of SLGS securities, once submitted, could not be canceled; and that investors in SLGS securities would be required to use the SLGSafe

service, Treasury's Internet site for SLGS securities transactions.

In the final rule, Treasury is adopting these proposed changes, but has made some modifications in response to the concerns raised in the comments. In addition, Treasury is changing how the SLGS rates are set. Currently, the SLGS rates are 5 basis points below the current Treasury borrowing rates, as shown in the daily SLGS rate table. In the final rule, SLGS securities rates are defined as 1 basis point below current Treasury borrowing rates, as released daily by Treasury in the SLGS rate table.

The following discussion provides background on the rulemaking, including a more detailed explanation of the specific proposals, addresses most of the comments on those proposals, and describes the changes in the final rule.

II. Background

SLGS securities are a type of non-marketable Treasury security that is available for purchase by state and local governments and other issuers of tax-exempt bonds. SLGS securities have been issued by Treasury since 1972. The purpose of the SLGS program is to assist state and local government issuers in complying with yield restriction and

rebate requirements applicable to tax-exempt bonds under the Internal Revenue Code.

Generally, the arbitrage requirements under the Internal Revenue Code provide that with certain exceptions, the proceeds of a tax-exempt bond may not be invested at a yield that is materially higher than the yield on the bond. In the limited circumstances in which bond proceeds may be invested above the bond yield, the bond issuer generally is required to rebate to the Federal Government any earnings in excess of the bond yield.

SLGS securities may only be purchased with eligible funds. Purchasers of SLGS Time Deposit securities that bear interest may generally select any maturity period from 30 days to 40 years, and any interest rate that does not exceed the applicable SLGS rate for that maturity published in the daily SLGS rate table. Since 1996, the maximum SLGS rates have been set at the current Treasury borrowing rate less 5 basis points. Purchasers of SLGS securities have the flexibility to structure the securities with specified payment dates and yields.

In 1996, Treasury revised the regulations governing SLGS securities to eliminate certain requirements that had been introduced at various times since 1972, and to make the program a more flexible and competitive investment

vehicle for issuers (61 FR 55690, October 28, 1996). Under the 1996 regulations, Treasury also made a change to permit issuers to subscribe for SLGS securities and subsequently cancel the subscription, without a penalty, under certain circumstances.

In 1997, Treasury amended the regulations to prohibit the use of the SLGS program to create a cost-free option in certain circumstances (62 FR 46444, September 3, 1997). Treasury stated that it was inappropriate to use the SLGS securities program as an option and provided examples of unacceptable practices. These practices included, among others, subscribing for SLGS securities for an advance refunding escrow and simultaneously purchasing marketable securities for the same escrow, with the plan that the marketable securities would be sold if interest rates declined or the SLGS subscription would be canceled if interest rates did not decline.

In the proposed rule published on September 30, 2004 at 69 FR 58756, we indicated that we had become aware of several other practices involving SLGS securities that are also inappropriate uses of the securities and contrary to the purpose of the program. A number of regulatory changes were proposed to address these practices and other miscellaneous items.

One type of practice the NPRM addressed involves the redemption before maturity or sale of securities to reinvest at a higher yield. The "current Treasury borrowing rates" and corresponding SLGS rates are set once a day, whereas market interest rates may change throughout the day. In addition, although the SLGS rate table is released at 10:00 a.m. each day, SLGS rates have been set based on a Treasury yield curve determined the previous day. Some market participants have noted that the combination of a constant Treasury borrowing rate and fluctuating market interest rates creates arbitrage opportunities. SLGS investors have utilized these arbitrage opportunities by redeeming SLGS securities before maturity and investing the redemption proceeds in higher-yielding SLGS or marketable securities, and by selling marketable securities and investing the sale proceeds in higher-yielding SLGS securities.

Another type of practice the NPRM addressed involves the cancellation of subscriptions for the purchase of SLGS securities. A purchaser of SLGS securities may submit a subscription for purchase up to 60 days before the issue date. The subscriber locks in an interest rate based on the daily SLGS rate table on the day the subscription for purchase is submitted. If interest rates rise, subscribers

often cancel their subscriptions in accordance with the current regulations and re-subscribe at a higher yield.

The NPRM and this final rule address these and other practices that provide to SLGS investors cost-free options or arbitrage opportunities that are not available in marketable securities. These practices impose substantial costs on the Federal Government. The changes in this final rule will make investments in SLGS securities more closely resemble investment opportunities available in Treasury marketable securities.

III. Proposals, Comments, and Final Rule

As noted above, by the close of the comment period, Treasury had received 20 comment letters on the NPRM. Commenters included state and local issuers, industry associations, financial advisors, and bond counsel. In general, most commenters disagreed with Treasury's proposals to limit the yield on reinvestments and to prohibit cancellation of subscriptions for purchase. A number of commenters made suggestions for modification of those requirements. Some commenters expressed approval of Treasury's proposal to require the use of the SLGSafe®

Service ("SLGSafe"). Most of the comments are described in more detail below.

A. Proposals to Address Sale/Redemption Before Maturity and Reinvestment and Related Practices.

The current regulations do not prohibit the redemption before maturity of SLGS securities for the purpose of reinvestment at a higher yield. In the NPRM, Treasury stated that it had concluded that the practice of requesting redemption of SLGS securities before maturity to take advantage of relatively infrequent SLGS pricing was an inappropriate use of SLGS securities. Even if undertaken to eliminate negative arbitrage (where bond proceeds have been invested at a yield that is less than the yield on the issuer's bond), Treasury considered the practice to be a cost-free option and inconsistent with the purpose of the program. Treasury stated that there is a direct cost to Treasury because Treasury is not being compensated for the value of the option; that the practice results in volatility in Treasury's cash balances and increases the difficulty of cash balance forecasting and thereby increases Treasury's borrowing costs; and that there are

administrative costs. These same concerns apply to transactions in which an issuer sells marketable securities to acquire higher-yielding SLGS securities.

To eliminate these practices, the NPRM proposed several changes. First, the NPRM proposed several changes referred to below as "yield restrictions." Second, the NPRM proposed reducing the number of hours during which subscriptions and certain other transactions could be received in SLGSafe. Third, Treasury indicated that it planned to implement a non-regulatory change to make the rates specified in the daily SLGS rate table more current. Fourth, the NPRM proposed a new provision making it impermissible to purchase a SLGS security with a maturity longer than is reasonably necessary to accomplish a governmental purpose of the issuer.

1. Yield Restrictions.

The proposed rule stated that for SLGS securities subscribed for on or after the date of publication of the final rule, it would be impermissible to invest any amount received from the redemption before maturity of a SLGS Time Deposit security at a yield that exceeds the yield used to

determine the amount of redemption proceeds for such Time Deposit security. It would also be impermissible to purchase a SLGS security with any amount received from the sale or redemption (at the option of the holder) before maturity of any marketable security, if the yield on such SLGS security being purchased exceeds the yield at which such marketable security is sold or redeemed.

In addition, upon starting a subscription for a SLGS security, a subscriber would be required to certify that (A) if the issuer is purchasing a SLGS security with the proceeds of the sale or redemption (at the option of the holder) before maturity of any marketable security, the yield on such SLGS security does not exceed the yield at which such marketable security was sold or redeemed; and (B) if the issuer is purchasing a SLGS security with proceeds of the redemption before maturity of a Time Deposit security, the yield on the SLGS security being purchased does not exceed the yield used to determine the amount of redemption proceeds for such redeemed security. Upon submission of a request for redemption before maturity of a Time Deposit security subscribed for on or after the date of publication of the final rule, the issuer would be required to certify that no amount received from the redemption would be invested at a yield that exceeds the

yield used to determine the amount of redemption proceeds for such Time Deposit security. Treasury also proposed a definition of "yield" that would apply to the certifications and would require that, in comparing the yield of a SLGS security to the yield of a marketable debt instrument, the yield of the marketable debt instrument would be computed using the same compounding intervals and financial conventions used to compute interest on the SLGS security.

The majority of the commenters addressed this proposal. Thirteen commenters suggested that the proposed yield restrictions were unnecessary, given the other changes. One comment, for example, stated that municipalities should be able to redeem SLGS securities for the mitigation of negative arbitrage. The commenters also stated that the yield restriction provisions would have the unintended consequence of making the SLGS program less attractive for issuers. Several commenters expressed concerns that the proposed changes would prevent issuers from restructuring escrows.

One commenter asked for clarification of the prohibition on the sale of marketable securities to purchase higher-yielding SLGS securities and suggested that it is a common practice for issuers to liquidate sinking

fund and debt service reserve fund investments for refunded bonds for use in a refunding escrow, a practice that is recognized in the current Income Tax Regulations. Another commenter noted that 26 CFR 1.148-5(d)(6)(iii) provides a safe harbor for the purchase of open market securities for a yield-restricted investment only if the lowest cost bona fide bid is not greater than the cost of the most efficient portfolio comprised exclusively of SLGS securities at the time bids are received. This commenter stated that the interplay between the SLGS regulations and the safe harbor bidding rules could, under certain market conditions, force an issuer to invest in SLGS securities with negative arbitrage with no prospect of being able to recoup any of the negative arbitrage (as a result of the yield restrictions on redemption of the SLGS securities before maturity).

In addition to these general concerns, several commenters offered suggestions for specific modifications to the yield restriction proposals. Four commenters suggested that the yield restrictions on reinvestment should expire after the original maturity date of the investment that is sold or redeemed before maturity. Some commenters proposed excluding zero interest Time Deposit securities from the yield restriction provisions. Two

commenters also suggested substituting the definition of "yield" in 26 CFR 1.148-5 for the definition proposed in the NPRM. Treasury also received comments that certain provisions, including the provisions on yield certifications, should have a delayed effective date to allow subscribers time to adjust their practices and systems.

After consideration of these comments, Treasury has decided to retain the NPRM provisions on yield restrictions and corresponding certifications, with some modifications. In Treasury's view, these restrictions are necessary to curb the use of the SLGS program as a cost-free option. Other alternatives do not achieve this goal or may be unworkable for other reasons.

The final rule does not provide that the yield restrictions expire after the original maturity date of the investment that is sold or redeemed. Such an approach could be difficult to administer in the case of multiple sales or redemptions and re-investments, and in some cases could be overly-restrictive. However, the final rule contains two new examples that clarify that if amounts received from the sale or redemption of an investment (the first investment) are invested in a second investment with a maturity date that precedes the maturity date of the

first investment, and the investor holds the second investment to maturity, then the yield restrictions expire at the maturity of the second investment if the other requirements of the final rule are met (including the requirement that the SLGS program not be used to create a cost-free option). Thus, an issuer that invests tax-exempt bond proceeds in SLGS securities that produce negative arbitrage is not precluded from subsequently investing those proceeds in higher-yielding marketable securities (for example, marketable securities that have a lower credit rating than Treasury securities) if the requirements of the final rule are met.

In addition, the final rule does not preclude issuers from restructuring escrows, provided that the yield restrictions are met. Under the final rule, marketable securities in a sinking fund or debt service reserve fund for refunded bonds are subject to the same yield restrictions that apply to other marketable securities.

The final rule also specifically excludes zero interest Time Deposit securities from the yield certification provisions in § 344.2(e)(2)(i)(B) and (e)(2)(ii) and the yield restrictions in the impermissible practice provision in § 344.2(f). Thus, under the final rule, the yield restriction provisions will not apply to

amounts received from the redemption of zero interest Time Deposit securities.

In response to comments about the definition of yield, the final regulations incorporate the definition of "yield" in 26 CFR 1.148-5.

As noted above, given the number of changes that the final rule encompasses, Treasury has decided to make the final rule effective on [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. This delayed effective date is intended to provide investors with sufficient time to review the final rule and make any necessary adjustments to their systems or processes.

2. SLGSafe Hours.

Under the current rule, the SLGSafe service is available for most transactions from 8:00 a.m., Eastern time until 10:00 p.m., Eastern time. (Subscribers currently may submit subscriptions by facsimile at any time.) The NPRM proposed that SLGSafe subscriptions, requests for early redemption of Time Deposit securities, and requests for redemption of Demand Deposit securities would only be received from 10:00 a.m. to 6:00 p.m.,

Eastern time on business days. This proposal, combined with the proposal to make SLGSafe mandatory, shortened the window during which transactions could be effected.

Treasury received 12 comments expressing concern that the reduction in hours would not allow enough time for subscribers to complete their verification processes. Some commenters also indicated that West coast issuers would be at some disadvantage with narrower trading hours.

In response to these concerns, Treasury has revised § 344.3(g) of the final rule to extend the amount of time in which the SLGSafe window will be open. All SLGSafe subscriptions, requests for early redemption of Time Deposit securities, and requests for redemption of Demand Deposit securities must be received on business days no earlier than 10:00 a.m. and no later than 10:00 p.m., Eastern time.

3. SLGS Rates More Current.

Under the current rule, the SLGS rate table is released to the public by 10:00 a.m., Eastern time, each business day. Treasury did not propose any change to this

rule but indicated in the NPRM that it intended to make the rates specified in the daily SLGS rate table more current.

Although most commenters did not disagree with the administrative proposal to make the SLGS rates more current, several commenters suggested that such a change was sufficient to address Treasury's concerns in the rulemaking and that other proposed changes were therefore unnecessary. These commenters suggested that the establishment of more current SLGS rates would minimize opportunities to take advantage of differences between SLGS rates and market rates. However, the potential to take advantage of these differences will still exist even after the administrative change to make SLGS rates more current is effected, because SLGS rates will be held constant for twelve hours, from 10 a.m. to 10 p.m., Eastern time. Therefore, the administrative change will not address these issues entirely.

4. Maturity Longer than Necessary.

The NPRM proposed a new provision making it impermissible to purchase a SLGS security with a maturity longer than is reasonably necessary to accomplish a

governmental purpose of the issuer. Treasury received 2 comments stating that the provision was vague or would be difficult to administer.

The NPRM was intended to address a practice where an issuer, apparently acting on the basis of its view on the direction of interest rates, would purchase a SLGS security with a maturity much longer than necessary for its governmental purpose, and then redeem the security before maturity. After further consideration, we have deleted this provision from the final rule, particularly in light of the risk to the issuer of purchasing a SLGS security with a maturity longer than reasonably necessary to accomplish a governmental purpose.

B. Proposals to Address Cancellations of SLGS Securities Subscriptions and Related Practices.

Under the current rule, SLGS investors may subscribe for SLGS securities up to 60 days in advance of the issue date and lock in the SLGS rate on the subscription date. Subscriptions may be canceled, up to 5 or 7 days prior to issuance (depending on the amount involved), without penalty.

In the NPRM, Treasury noted that a large volume of cancellations of SLGS subscriptions had been submitted for the apparent purpose of re-subscribing at a higher yield. Treasury also noted that issuers had also submitted multiple initial subscriptions for a single issue date and had later canceled some of those subscriptions, apparently because of reductions in the size of advance refunding transactions due to changes in market conditions. Other investors had subscribed for SLGS securities, later canceling the subscription or amending the size when rates moved favorably or unfavorably. In other cases, subscriptions were canceled because agents had subscribed for SLGS securities even though the issuer had not authorized the issuance of tax-exempt bonds.

Currently, nearly half of all SLGS subscriptions are canceled. Between October 1, 2003, and September 30, 2004, 48 percent of the 14,317 subscriptions were canceled; the dollar volume of cancellations was $309 billion. This compares to about $160 billion in total SLGS securities outstanding. (By way of comparison as to volume, the federal deficit in fiscal year 2004 was $413 billion.)

The NPRM proposed several changes to address cancellations. First, cancellations would be prohibited unless the subscriber established, to the satisfaction of

Treasury, that the cancellation was required for reasons unrelated to the use of the SLGS program to create a cost-free option. Second, for all subscriptions submitted for SLGS securities on or after the date of publication of the final rule, a change in the aggregate principal amount originally specified in the subscription could not exceed ten percent. Third, the NPRM proposed that once an issuer selects an issue date for SLGS securities, it cannot be changed. Fourth, the NPRM proposed that a subscriber be required to certify, upon starting a SLGS subscription, that the issuer has authorized the issuance of the state or local bonds. The subscriber would also be required to enter a description of the tax-exempt bond issue in SLGSafe.

1. Prohibition on Cancellations.

Treasury received 15 comments addressing the proposed prohibition on cancellations. All of these comments disagreed with this change and most expressed a desire to retain some form of the current cancellation option, even if more limited than under the current provisions.

Treasury received comments to the effect that an implicit option is an incentive for investment in SLGS

securities, and that issuers will be forced to purchase marketable securities. The commenters pointed out that this is a potentially undesirable outcome for Treasury because Treasury has an interest in preventing yield-burning and other unacceptable practices involving marketable securities. In other words, if investors are not encouraged to use the SLGS program, the IRS may be required to devote additional resources to compliance and enforcement.

Treasury also received comments suggesting that the SLGS program reduces Treasury's borrowing costs by virtue of the 5 basis point differential that exists between SLGS rates and Treasury borrowing rates. One commenter estimated that Treasury's cost savings from the SLGS program was about $80 million per year, based on current rates and SLGS outstanding. The commenter stated that eliminating the cancellation option might reduce SLGS program participation and impact that cost savings.

The commenters also suggested a variety of alternatives to the prohibition on cancellations, including allowing cancellations up to a maximum dollar amount and prohibiting multiple subscriptions for the same bond issue; limiting the number of cancellations that can be submitted with respect to a given bond issue; allowing the use of the

highest of the daily SLGS rates within a specified number of days; and providing for one or a certain number of allowable cancellations. In addition, one comment asked for clarification as to how issuers would satisfy the requirement that a cancellation is not related to the use of the program to create a cost-free option.

After consideration of these comments, Treasury remains concerned that the current option to cancel a subscription imposes substantial costs on Treasury and U.S. taxpayers. These costs include not only the costs of the option and administrative costs, but also the costs to Treasury as an issuer of marketable securities.

In Fiscal Year 2004, Treasury held 215 auctions of marketable Treasury securities and issued $4.6 trillion in securities. Because of the size of its issuance, Treasury accomplishes its goal of financing government borrowing needs at the lowest cost over time by issuing debt in a regular and predictable pattern. Treasury seeks to minimize uncertainty about the supply of a security being issued. Uncertainty in supply causes bidders in Treasury auctions to demand a risk premium, which Treasury pays in the form of higher interest rates on the securities it issues. Given the size of Treasury's issuance of marketable Treasury securities, even small risk premiums

can create large additional interest costs. For this reason, volatility in cash balances is undesirable. Cancellations of SLGS subscriptions increase cash balance volatility, which has an adverse impact on the certainty of the supply of marketable securities, and which in turn results in increased borrowing costs for marketable securities.

We note that the submission of subscriptions on or shortly before the subscription deadline (5 or 7 days before the issue date) results in Treasury having the same notice of subscriptions as it currently does for cancellations. However, the impact of an unexpected increase in cash balances from SLGS subscriptions that settle within five to seven days is significantly less than the impact of unexpected cancellations, particularly since the cancellations are rate sensitive and tend to come in clusters when rates move dramatically over a short period of time. In the case of unexpected cancellations, additional unexpected marketable securities have to be issued to make up for the decline in expected SLGS securities. This additional issuance generally increases Treasury's borrowing costs.

With respect to the 5 basis point differential between SLGS rates and Treasury borrowing rates, that is only one

portion of the entire cost structure that must be considered in evaluating the potential impact of the cancellation option on the SLGS program. Other costs include the option costs, the impact on marketable borrowing, and administrative costs.

The 5 basis point differential does not represent an option price. As Treasury stated in the 1997 revision to the regulations, the prices established by Treasury for the SLGS securities do not include the cost of an option (62 FR 46444, September 3, 1997). Prior to 1996, the differential was 12.5 basis points. As the costs of administering the program have decreased, Treasury has decreased the amount of the differential. In 1996, it was reduced to 5 basis points. As noted above, in the final rule, Treasury is reducing the basis point differential to 1 basis point below current Treasury borrowing rates. This change reflects increased efficiencies in the program, primarily through the use of SLGSafe, and will make SLGS investments more closely resemble marketable securities. Treasury is making a comparable change reducing the amount of Treasury's administrative costs for administering demand deposit SLGS securities in a Federal Register notice that will be published before the effective date of this final rule.

Concerning the various suggestions in the comments for alternatives to the prohibition on cancellations, Treasury has considered these alternatives, but has concluded that even a limited use of the option can have significant adverse effects on cash balances and cash balance forecasts. This is because, as explained above, large numbers of SLGS investors often tend to use the option at the same time, in reaction to interest rate movements. Treasury has also examined the possibility of pricing the option and has determined that establishing a pricing structure would not be feasible.

For all of the above reasons, Treasury is adopting the proposed rule prohibiting cancellations. The final rule provides that a subscriber cannot cancel unless it is established, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option.

2. Changing Principal Amounts.

Under the current rule, a subscriber may change the aggregate principal amount specified in the initial subscription up to $10 million or ten percent, whichever is

greater. The NPRM proposed that subscribers could only change the principal amount by 10 percent above or below the amount originally specified.

Treasury received 10 comments disagreeing with the proposed change. Many commenters indicated they did not understand the reason Treasury was considering this change. Many commenters also expressed concern that on the subscription date, issuers can estimate, but may not be able to precisely identify, the exact dollar amount of the SLGS securities needed to fund a transaction. Some commenters also suggested that the proposed rule would disproportionately and adversely impact the activities of smaller issuers, who typically issue small amounts.

After careful consideration of these comments, Treasury has decided to adopt the size amendment provision set forth in the proposed rule. The proposal was intended to preclude a practice by some investors who used the dollar amount limits on amendment of subscriptions to structure option transactions designed to capitalize on interest rate movements during the subscription period. In addition, by limiting the amount of possible change of subscriptions to 10 percent of the principal, Treasury is able to ensure that its cash balance forecasting will not be adversely

impacted by more than a certain, predetermined percentage. Furthermore, a set dollar amount limit, as opposed to a percentage limit, would leave open the possibility for subscribers to break up their subscriptions into multiple smaller subscriptions in order to avoid the cap on changes to the aggregate principal amount.

3. Issue Date Changes.

Under the current rule, investors are allowed to amend a Time Deposit subscription by extending the issue date up to seven days after the issue date originally specified. Investors are asked to notify Treasury by 3:00 p.m., Eastern time, one business day before the original issue date of any changes. The proposed rule would no longer permit a change to the issue date.

Treasury received 15 comments disagreeing with this change. Commenters were concerned about having a 6-month penalty imposed upon them for not taking delivery on the issue date and pointed out that the issue date must sometimes be delayed due to circumstances beyond their control.

The final rule permits a change to the issue date up to

seven days after the original issue date if it is established to the satisfaction of Treasury that the change is required as a result of circumstances that were unforeseen at the time of the subscription and are beyond the issuer's control (for example, a natural disaster).

4. Mandatory Certification that Municipal Bonds have been Authorized.

The NPRM proposed a new requirement that a subscriber certify, upon starting a SLGS subscription, that the issuer had authorized the issuance of the state or local bonds. Treasury received 2 comments in favor of this proposal and 2 comments disagreeing with this proposal. Some commenters suggested that the term "authorization" has different meanings in various jurisdictions and that applying the term uniformly across the jurisdictions was problematic.

Because Treasury has retained in the final rule the provision prohibiting cancellations of subscriptions, we have determined that this certification is unnecessary. We are therefore eliminating it from the final rule. Treasury is adopting the requirement proposed in the NPRM that issuers briefly describe the underlying bond transaction

when beginning a subscription in SLGSafe.

C. Administrative Changes.

In the NPRM, Treasury also noted that it had reviewed other aspects of the SLGS program and proposed several changes to better administer the program.

1. Pricing Longer-Dated SLGS Securities.

Under the current rule, SLGS rates are determined based upon the current Treasury borrowing rate. Because the current Treasury borrowing rate is based on the prevailing market rate for a Treasury security with the specified period to maturity and SLGS securities are offered for terms in excess of the currently issued Treasury securities, Treasury examined whether it needed to alter the manner in which it sets the SLGS rate for these longer-dated securities.

In the proposed rule, Treasury proposed broadening the definition of "current Treasury borrowing rate" to allow Treasury to use suitable proxies and/or a different rate-

setting methodology where SLGS rates are needed for maturities which are not currently being issued by Treasury. Two comments were received on this change, both of which supported Treasury's proposal. In the final rule, Treasury is adopting the provision for pricing longer-dated SLGS securities as it was set forth in the NPRM. We contemplate no changes in methodology at this time.

2. Notices of Redemption.

In the current rule, a notice of redemption must be received by Treasury no less than 10 days and no more than 60 days before the requested redemption date. In the proposed rule, Treasury proposed changing the 10-day advance notice requirement for early redemption of Time Deposit securities to a 14-day advance notice requirement. Treasury received one comment, which agreed that a 14-day notice period is beneficial for Treasury. In the final rule, Treasury adopts the provision as it was set forth in the NPRM.

The existing rule prohibits cancellation of redemption notices. The proposed rule made no change to that provision. Treasury received one comment suggesting that

cancellation of redemption notices should be allowed, provided sufficient notice is given to Treasury. This suggestion, if adopted, would create a cost-free option. Accordingly, we have made no changes to the final rule in this regard.

Furthermore, Treasury is also clarifying § 344.6(c) to explicitly provide that Treasury will not accept a request for early redemption for a security that has not yet been issued.

3. Mandating SLGSafe Transactions.

Under the current rule, subscribers are able to submit their subscriptions to Treasury either via SLGSafe or through the use of paper forms that are either faxed or mailed in. The proposed rule stated that the use of the SLGSafe service would be mandatory as of the effective date of the final rule.

Treasury received 5 favorable comments agreeing that use of the SLGSafe service should be mandatory and that it will improve efficiency in the SLGS program. One comment characterized this change as constructive and workable; another said that it would streamline operations and would not impair local governments' access to the program.

Another current SLGSafe user commented that it is convenient and easy to use. Treasury also received 5 comments inquiring about SLGSafe implementation, which are described below.

Two comments stated that owners of SLGS securities issued before the effective date of the final rule should be allowed to administer these securities via fax or mail. By introducing SLGSafe, Treasury fulfilled the requirement under the Government Paperwork Elimination Act, Sec. 1701-1710, Pub. L. 105-277, 112 Stat. 2681-749 to 2681-751 (44 U.S.C. 3504 note) that executive agencies provide for the option of electronic submissions instead of paper. We note that SLGS securities may be issued for periods of up to 40 years. To allow all current owners of outstanding SLGS securities to continue to use fax and mail instead of SLGSafe for those securities could prevent full implementation of the SLGSafe program for up to 40 years.

One comment expressed a concern that certain technical issues must be addressed before making SLGSafe mandatory. Although the exact nature of the access issues was not identified, we note that BPD has successfully enrolled 1,100 current users of SLGSafe. Any specific access issues should be addressed directly to BPD.

Another comment stated that there should be a "good cause" exception that allows users to perform transactions via fax or mail when a valid reason for the exception exists. One comment stated that individual users and one-time agents should not be required to use the SLGSafe service. The NPRM and the final rule contemplate in § 344.3(f)(3) that Treasury will permit SLGS program users to submit fax and mail transactions if you establish that good cause exists for not using SLGSafe. However, given the ease of becoming a SLGSafe user, we do not anticipate granting waivers based on a user's status as a small firm or infrequent subscriber.

One comment stated that SLGSafe should not become mandatory for at least 180 days so that users can learn how the SLGSafe service operates. Because the SLGSafe service was introduced in 2000, we do not believe that a delayed implementation date of 180 days is necessary (65 FR 55399, September 13, 2000). Moreover, in the NPRM, we encouraged subscribers to seek SLGSafe access as soon as possible (69 FR 58756, September 30, 2004). Treasury therefore adopts the provision of the proposed rule that makes SLGSafe mandatory. However, in order to mitigate any access concerns, SLGSafe will not become mandatory until [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL

REGISTER]. We encourage potential users to contact BPD about any access or training difficulties as soon as possible so that they can be addressed before the effective date.

4. Miscellaneous Changes.

Eligible source of funds for purchasing SLGS securities. Under the current rule, SLGS securities are offered for sale to provide issuers of tax-exempt securities with investments from any amounts that (1) constitute gross proceeds of an issue (within the meaning of 26 CFR 1.148-1) or (2) assist in complying with applicable provisions of the Internal Revenue Code relating to the tax exemption. In the NPRM, Treasury proposed deleting the language relating to amounts that assist in complying with applicable provisions of the Internal Revenue Code relating to the tax exemption because this language proved to be difficult to administer. Treasury received 13 comments stating that the permissible sources of funds allowable to purchase SLGS securities should not be altered or should be amended to accommodate certain transactions. The comments noted, for example, that

certain amounts that are not "gross proceeds" at the time of subscription may be characterized as gross proceeds at a later time, and that certain funds may not be gross proceeds at all times as a result of the "universal cap" on the maximum amount treated as gross proceeds under 26 CFR 1.148-6(b)(2). In response to these comments, the final regulations provide that issuers may purchase SLGS securities using any of the following "eligible sources of funds": (1) any amounts that constitute gross proceeds of a tax-exempt bond issue or are reasonably expected to become gross proceeds of a tax-exempt bond issue; (2) any amounts that formerly were gross proceeds of a tax-exempt bond issue, but no longer are treated as gross proceeds of such issue as a result of the operation of the universal cap on the maximum amount treated as gross proceeds under 26 CFR 1.148-6(b)(2); (3) amounts held or to be held together with gross proceeds of one or more tax-exempt bond issues in a refunding escrow, defeasance escrow, parity debt service reserve fund, or commingled fund (as defined in 26 CFR 1.148-1(b)); (4) proceeds of a taxable bond issue that refunds a tax-exempt bond issue or is refunded by a tax-exempt bond issue; or (5) any other amounts that are subject to yield limitations under the rules applicable to tax-exempt bonds under the Internal Revenue Code.

Definition of Issuer. Only issuers of tax-exempt securities are eligible to purchase SLGS securities. Under the current rule, an issuer is defined as the Governmental body that issues state or local government bonds described in section 103 of the Internal Revenue Code. The NPRM did not propose any alteration to this definition. However, one commenter raised a concern that a nonprofit entity that issues bonds on behalf of a state or local government in compliance with Revenue Ruling 63-20, 1963-1 C.B. 24, and Revenue Procedure 82-26, 1982-1 C.B. 476, might not qualify as an "issuer." In response to this comment, Treasury is amending the definition of "issuer" in the final rule to mean the Government body or other entity that issues state or local government bonds described in section 103 of the Internal Revenue Code. Thus, under the final rule, an "issuer" includes not only a state or local government that issues tax-exempt bonds, but also an entity that issues tax-exempt bonds on behalf of a state or local government.

Debt Limit. Although the NPRM did not address debt limit issues, several commenters suggested that Treasury should provide advance notice before suspending the issuance of SLGS securities during a period when Treasury determines that the issuance of obligations sufficient to conduct the orderly financing operations of the United

States cannot be made without exceeding the statutory debt limit. While Treasury notes these concerns, and appreciates the difficulties issuers may face in these circumstances, Treasury must retain the flexibility that the current rules provide to deal with the various issues that arise during periods when sales are suspended because of debt limit constraints. Accordingly, we have made no change to the final rule in this regard. If feasible under the circumstances, however, we will attempt to provide SLGS purchasers with advance notice of a suspension in sales.

Subscriptions for Zero-Interest SLGS Securities. The current regulations provide that an issue date cannot be more than 60 days after the date that the subscription is received. Two commenters suggested that subscribers be permitted to submit subscriptions for zero-interest SLGS securities more than 60 days before the issue date. These commenters indicated that such a change would assist in tax compliance because issuers' agents would be able to avoid an inadvertent failure to invest, at some future date, the proceeds of maturing securities in an escrow in zero-interest SLGS securities. This suggestion is beyond the scope of this rulemaking, but Treasury is studying this matter.

Sanctions for Erroneous Certifications. The existing rule requires an agent of the issuer to certify that it is acting under the issuer's specific authorization when subscribing for SLGS securities. The proposed rule made no change to this provision, but required other certifications discussed above.

One commenter raised a concern that the proposed rule was not clear on whether an agent would be subject to sanctions for improper certifications. The concern is that subscribers for SLGS securities, who frequently are escrow agents operating under the authority of issuers, may be required to make the certifications.

The final rule clarifies that under § 344.2(m)(4), Treasury reserves the right to declare either a subscriber or issuer ineligible to subscribe for securities under the offering if deemed to be in the public interest and a security is issued on the basis of an improper certification or other misrepresentation (other than as the result of an inadvertent error).

The final rule also clarifies the language of the certification in § 344.2(e)(1) to cover an agent's performance related to other transactions in addition to the submission of subscriptions on the issuer's behalf.

Significance of Rule. In the preamble to the proposed rule, Treasury stated that the rulemaking is not a significant regulatory action under Executive Order 12866, dated September 30, 1993, and is not a major rule under 5 U.S.C. 804. Treasury received several comments disagreeing with these conclusions. The rulemaking is not a significant regulatory action or major rule because the SLGS program is a voluntary program to assist state and local government issuers in complying with yield restriction and rebate requirements applicable to tax-exempt securities under the Internal Revenue Code. The SLGS rule sets the terms and conditions for the SLGS program.

Treasury received no comments on the other proposed changes affecting §§ 344.0(b), 344.2(d), 344.2(h)(2), 344.2(i), 344.2(m), 344.3(d), 344.3(f), 344.3(g), 344.4(a), 344.5, 344.6(a), 344.6(c), 344.6(f), 344.7(a), 344.9(a), 344.9(c), and 344.11. Treasury is implementing all of these administrative revisions as they appeared in the NPRM.

IV. Procedural Requirements.

A. Executive Order 12866.

This final rule is not a significant regulatory action for purposes of Executive Order 12866, dated September 30, 1993.

B. Regulatory Flexibility Act.

This final rule relates to matters of public contract and procedures for United States securities. Therefore, under 5 U.S.C. 553(a)(2), the notice and public procedure requirements of the Administrative Procedure Act are inapplicable. Because a notice of proposed rulemaking is not required, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., do not apply.

C. Paperwork Reduction Act.

Collections of Information on SLGSafe and Cancellations. The collections of information in the proposed regulation were submitted to the Office of Management and Budget for review in accordance with the

Paperwork Reduction Act (44 U.S.C. 3501 et seq.). In the preamble to the proposed regulation, we explained that the collections of information, which are in §§ 344.3(f)(3), 355.5(c), and 344.8, are required (1) to determine whether there is good cause for an investor to submit subscriptions by fax or mail rather than electronically in SLGSafe and (2) to establish that a cancellation of a subscription is required for reasons unrelated to the use of the SLGS program to create a cost-free option. The estimated annual burden per respondent/recordkeeper is .25 hours, depending on individual circumstances, with an estimated total annual burden of 250 hours. No comments were received concerning the collections of information.

The final rule contains the same information collection requirements that Treasury proposed in the NPRM. They have been approved by OMB under OMB control numbers 1535-0091 (the collection of information to establish a valid reason for a waiver of the requirements of the SLGS regulations) and 1535-0092 (the collection of information taken from subscribers on the forms associated with the SLGS program). Comments on the accuracy of our burden estimate, and suggestions on how this burden may be reduced, may be sent to BPD, attention Keith Rake, Deputy Assistant Commissioner, Office of the Assistant Commissioner, Bureau

of the Public Debt, 200 3rd St., P.O. Box 396, Parkersburg, WV 26106-0396.

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.

Collection of Information on a Change of Issue Date. The final rule also contains a new collection of information that was not in the proposed rule. This new collection has been reviewed and, pending the receipt of public comments, approved by OMB under control number 1535-0091.

The current rule permits issuers to select the issue date of SLGS securities. The issuer may change the issue date up to seven days after the original issue date initially requested, provided that BPD is notified one business day before the original issue date. The proposed rule stated that issue dates could not be changed. The final rule retains some flexibility for an issuer to change the issue date up to seven days after the original issue date if it is established to the satisfaction of Treasury that the change is required as a result of circumstances that were unforeseen at the time of the subscription and

which are beyond the issuer's control (for example, a natural disaster).

The new collections of information in the final rule are in §§ 344.5(d) and 344.8(a). By collecting information about these circumstances, BPD will be able to evaluate if the regulatory standard of unforeseen circumstances has been met. The likely respondents are state or local governments.

Because of the limited number of instances when a change in issue date may be sought, Treasury estimates that 500 investors will each make one request annually for a total of 500 requests.

The information required by Treasury in connection with a change in issue date is similar to the type of information contemplated in the proposed rule in §§ 344.3(f)(3), 344.5(c), and 344.8(c). Because of the familiarity of SLGS investors with the current procedures and the infrequency of the instances in which a change in issue date will be sought, the burden associated with compiling and submitting such information to Treasury is relatively modest.

Estimated total annual reporting and/or recordkeeping burden: 125 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: .250 hours.

Estimated number of respondents and/or recordkeepers: 500.

Organizations and individuals desiring to submit comments concerning the collection of information in the final rule should direct them to the Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503 (preferably by FAX to 202-395-6974, or by email to <Alexander_T._Hunt@omb.eop.gov>). A copy of the comments should also be sent to the Bureau of the Public Debt at the addresses previously specified. Comments on the collection of information should be received by [INSERT 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

Treasury specifically invites comments on: (a) whether the new collection of information is necessary for the proper performance of the mission of Treasury, and whether the information will have practical utility; (b) the accuracy of the estimate of the burden of the collections of information; (c) ways to enhance the quality, utility, and clarity of the information collection; (d) ways to

minimize the burden of the information collection, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

List of Subjects in 31 CFR Part 344.

Bonds, Government Securities, Securities.

For the reasons set forth in the preamble, we amend 31 CFR part 344 by revising subparts A through D to read as follows (Appendixes A and B to part 344 remain unchanged):

PART 344--U.S. TREASURY SECURITIES--STATE AND LOCAL GOVERNMENT SERIES.

Subpart A--General Information

Sec.
344.0 What does this part cover?
344.1 What special terms do I need to know to understand this part?
344.2 What general provisions apply to SLGS securities?
SLGSafe® Service
344.3 What provisions apply to the SLGSafe Service?

Subpart B--Time Deposit Securities

Sec.

344.4 What are Time Deposit securities?

344.5 What other provisions apply to subscriptions for Time Deposit securities?

344.6 How do I redeem a Time Deposit security before maturity?

Subpart C--Demand Deposit Securities

Sec.

344.7 What are Demand Deposit securities?

344.8 What other provisions apply to subscriptions for Demand Deposit securities?

344.9 How do I redeem a Demand Deposit security?

Subpart D--Special Zero Interest Securities

Sec.

344.10 What are Special Zero Interest securities?

344.11 How do I redeem a Special Zero Interest security before maturity?

Appendix A to Part 344--Early Redemption Market Charge Formulas and Examples for Subscriptions from December 28, 1976, through October 27, 1996.

Appendix B to Part 344--Formula for Determining Redemption Value for Securities Subscribed for and Early-Redeemed on or after October 28, 1996.

Authority: 26 U.S.C. 141 note; 31 U.S.C. 3102, 3103, 3104, and 3121.

Subpart A--General Information

§ 344.0 What does this part cover?

(a) What is the purpose of the SLGS securities offering? The Secretary of the Treasury (the Secretary)

offers for sale non-marketable State and Local Government Series (SLGS) securities to provide issuers of tax-exempt securities with investments from any eligible source of funds (as defined in § 344.1).

(b) What types of SLGS securities are governed by this part? This part governs the following SLGS securities:

(1) Time Deposit securities--may be issued as:

(i) Certificates of indebtedness;

(ii) Notes; or

(iii) Bonds.

(2) Demand Deposit securities--may be issued as certificates of indebtedness.

(3) Special Zero Interest securities. Special Zero Interest securities, which were discontinued on October 28, 1996, were issued as:

(i) Certificates of indebtedness; or

(ii) Notes.

(c) In what denominations are SLGS securities issued? SLGS securities are issued in the following denominations:

(1) Time Deposit securities--a minimum amount of $1,000, or in any larger whole dollar amount; and

(2) Demand Deposit securities--a minimum amount of $1,000, or in any larger amount, in any increment.

(d) How long is the offering in effect? The offering continues until terminated by the Secretary.

§ 344.1 What special terms do I need to know to understand this part?

As appropriate, the definitions of terms used in this part are those found in the relevant portions of the Internal Revenue Code and the Income Tax Regulations.

BPD's website refers to <http://www.slgs.gov>.

Business day(s) means Federal business day(s).

Current Treasury borrowing rate means the prevailing market rate, as determined by Treasury, for a Treasury security with the specified period to maturity. In the case where SLGS rates are needed for maturities currently not issued by Treasury, at our discretion, suitable proxies for Treasury securities and/or a rate setting methodology, as determined by the Secretary, may be used to derive a current Treasury borrowing rate. At any time that the Secretary establishes such proxies or a rate-setting method or determines that the methodology should be revised, we will make an announcement.

Day(s) means calendar day(s).

Eligible source of funds means:

(1) Any amounts that constitute gross proceeds of a tax-exempt bond issue or are reasonably expected to become gross proceeds of a tax-exempt bond issue;

(2) Any amounts that formerly were gross proceeds of a tax-exempt bond issue, but no longer are treated as gross proceeds of such issue as a result of the operation of the universal cap on the maximum amount treated as gross proceeds under 26 CFR 1.148-6(b)(2);

(3) Amounts held or to be held together with gross proceeds of one or more tax-exempt bond issues in a refunding escrow, defeasance escrow, parity debt service reserve fund, or commingled fund (as defined in 26 CFR 1.148-1(b));

(4) Proceeds of a taxable bond issue that refunds a tax-exempt bond issue or is refunded by a tax-exempt bond issue; or

(5) Any other amounts that are subject to yield limitations under the rules applicable to tax-exempt bonds under the Internal Revenue Code.

Issuer refers to the Government body or other entity that issues state or local government bonds described in section 103 of the Internal Revenue Code.

SLGS rate means the current Treasury borrowing rate, less one basis point, as released daily by Treasury in a SLGS rate table.

SLGS rate table means a compilation of SLGS rates available for a given day.

"We," "us," or "the Secretary" refers to the Secretary and the Secretary's delegates at the Department of the Treasury (Treasury), Bureau of the Public Debt (BPD). The term also extends to any fiscal or financial agent acting on behalf of the United States when designated to act by the Secretary or the Secretary's delegates.

Yield on an investment means "yield" as computed under 26 CFR 1.148-5.

You or your refers to a SLGS program user or a potential SLGS program user.

§ 344.2 What general provisions apply to SLGS securities?

(a) What other regulations apply to SLGS securities? SLGS securities are subject to:

(1) The electronic transactions and funds transfers provisions for United States securities, part 370 of this

subchapter, "Electronic Transactions and Funds Transfers Related to U.S. Securities"; and

(2) The Appendix to subpart E to part 306 of this subchapter, for rules regarding computation of interest.

(b) Where are SLGS securities held? SLGS securities are issued in book-entry form on the books of BPD.

(c) Besides BPD, do any other entities administer SLGS securities? The Secretary may designate selected Federal Reserve Banks and Branches, as fiscal agents of the United States, to perform services relating to SLGS securities.

(d) Can SLGS securities be transferred? No. SLGS securities issued as any one type, i.e., Time Deposit, Demand Deposit, or Special Zero Interest, cannot be transferred for other securities of that type or any other type. Transfer of securities by sale, exchange, assignment, pledge, or otherwise is not permitted.

(e) What certifications must the issuer or its agent provide?

(1) Agent Certification. When a commercial bank or other agent submits a subscription, or performs any other transaction, on behalf of the issuer, it must certify that it is acting under the issuer's specific authorization. Ordinarily, evidence of such authority is not required.

(2) Yield Certifications.

(i) Purchase of SLGS Securities. Upon submitting a subscription for a SLGS security, a subscriber must certify that:

(A) Marketable Securities to SLGS Securities. If the issuer is purchasing a SLGS security with any amount received from the sale or redemption (at the option of the holder) before maturity of any marketable security, the yield on such SLGS security does not exceed the yield at which such marketable security was sold or redeemed; and

(B) Time Deposit Securities to SLGS Securities. If the issuer is purchasing a SLGS security with any amount received from the redemption before maturity of a Time Deposit security (other than a zero interest Time Deposit security), the yield on the SLGS security being purchased does not exceed the yield that was used to determine the amount of redemption proceeds for such redeemed Time Deposit security.

(ii) Early Redemption of SLGS Securities. Upon submission of a request for redemption before maturity of a Time Deposit security (other than a zero interest Time Deposit security) subscribed for on or after [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], the

subscriber must certify that no amount received from the redemption will be invested at a yield that exceeds the yield that is used to determine the amount of redemption proceeds for sucn redeemed Time Deposit security.

(f) What are some practices involving SLGS securities that are not permitted?

(1) In General. For SLGS securities subscribed for on or after [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], it is impermissible:

(i) To use the SLGS program to create a cost-free option;

(ii) To purchase a SLGS security with any amount received from the sale or redemption (at the option of the holder) before maturity of any marketable security, if the yield on such SLGS security exceeds the yield at which such marketable security is sold or redeemed; or

(iii) To invest any amount received from the redemption before maturity of a Time Deposit security (other than a Zero Percent Time Deposit security) at a yield that exceeds the yield that is used to determine the amount of redemption proceeds for such Time Deposit security.

(2) Examples.

(i) Simultaneous Purchase of Marketable and SLGS Securities. In order to fund an escrow for an advance refunding, the issuer simultaneously enters into a purchase contract for marketable securities and subscribes for SLGS securities, such that either purchase is sufficient to pay the cash flows on the outstanding bonds to be refunded, but together, the purchases are greatly in excess of the amount necessary to pay the cash flows. The issuer plans that, if interest rates decline during the period between the date of starting a SLGS subscription and the requested date of issuance of SLGS securities, the issuer will enter into an offsetting agreement to sell the marketable securities and use the bond proceeds to purchase SLGS securities to fund the escrow. If, however, interest rates do not decline in that period, the issuer plans to use the bond proceeds to purchase the marketable securities to fund the escrow and cancel the SLGS securities subscription. This practice violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used to create a cost-free option. In addition, this practice is prohibited under paragraph (f)(1)(i) of this section.

(ii) Sale of Marketable Securities Conditioned on Interest Rates. The existing escrow for an advance refunding contains marketable securities which produce a negative arbitrage. In order to reduce or eliminate this negative arbitrage, the issuer subscribes for SLGS securities at a yield higher than the yield on the existing escrow, but less than the permitted yield. At the same time, the issuer agrees to sell the marketable securities in the existing escrow to a third party and use the proceeds to purchase SLGS securities if interest rates decline between the date of subscribing for SLGS securities and the requested date of issuance of SLGS securities. The marketable securities would be sold at a yield which is less than the yield on the SLGS securities purchased. The issuer and the third party further agree that if interest rates increase during this period, the issuer will cancel the SLGS securities subscription. This practice violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used to create a cost-free option. In addition, this practice is prohibited under paragraphs (f)(1)(i) and (ii) of this section.

(iii) Sale of Marketable Securities Not Conditioned on Interest Rates. The facts are the same as in paragraph (f)(2)(ii) of this section, except that in this case, the agreement entered into by the issuer with a third party to sell the marketable securities in order to obtain funds to purchase SLGS securities is not conditioned upon changes in interest rates on Treasury securities. This practice violates the yield gain prohibition in paragraph (f)(1)(ii) of this section and is prohibited.

(iv) Simultaneous Subscription for SLGS Securities and Sale of Option to Purchase Marketable Securities. The issuer holds a portfolio of marketable securities in an account that produces negative arbitrage. In order to reduce or eliminate this negative arbitrage, the issuer subscribes for SLGS securities for purchase in sixty days. At the same time, the issuer sells an option to purchase the portfolio of marketable securities. If interest rates increase, the holder of the option will not exercise its option and the issuer will cancel the SLGS securities subscription. On the other hand, if interest rates decline, the option holder will exercise the option and the issuer will use the proceeds to purchase SLGS securities. This practice violates the prohibition on cancellation under § 344.5(c) or § 344.8(c), and no exception or waiver would be

granted under this part because the ability to cancel in these circumstances would result in the SLGS program being used to create a cost-free option. In addition, this practice is prohibited under paragraph (f)(1)(i) of this section.

(v) Early Redemption of Time Deposit Security and Subsequent Purchase of Marketable Security. On February 6, 2006, an issuer purchases a Time Deposit security using tax-exempt bond proceeds in a debt service reserve fund. The Time Deposit security has a principal amount of $7 million, an interest rate of 3.63 percent, and a maturity date of February 6, 2009. On March 1, 2007, the issuer submits a request to redeem the Time Deposit security on March 15, 2007. The yield used to determine the amount of redemption proceeds is 3.21 percent. On March 5, 2007, the issuer subscribes for the purchase, on March 15, 2007, of a second Time Deposit security. The issuer pays for the second Time Deposit security on March 15, 2007, with the redemption proceeds of the first Time Deposit security. The second Time Deposit security has an interest rate of 2.77 percent and a maturity date of April 16, 2007. On April 9, 2007, the issuer enters into a contract to purchase, on April 16, 2007, a ten-year, marketable Treasury security using the principal and interest to be received at the maturity of the

second Time Deposit security. The marketable Treasury security has a yield of 4.02 percent. This transaction satisfies the yield limitation in paragraph (f)(1)(iii) of this section because:

(A) The yield on the second Time Deposit security does not exceed the yield that is used to determine the amount of redemption proceeds for the first Time Deposit security; and

(B) The second Time Deposit security is not redeemed before maturity and therefore the re-investment of the principal and interest received on the second Time Deposit security is not subject to the yield limitation in paragraph (f)(1)(iii) of this section. This transaction constitutes a permissible use of the SLGS program.

(vi) Early Redemption of Time Deposit Security and Simultaneous Purchase of Marketable Security. The facts are the same as in paragraph (f)(2)(v) of this section, except that the issuer subscribes for the second Time Deposit security on March 1, 2007, and enters into the contract to purchase the marketable Treasury security on March 1, 2007. This transaction, if permitted, would enable the issuer to redeem the first Time Deposit security at a yield that is held constant for 12 hours based on the "current Treasury borrowing rate" for March 1, 2007, and to re-invest the

redemption proceeds based on a market yield that may fluctuate during that 12-hour period. The use of the SLGS program in this manner would create a cost-free option. Accordingly, this transaction is impermissible under paragraph (f)(1)(i) of this section.

(g) When and how do I pay for SLGS securities? You must submit full payment for each subscription to BPD no later than 4:00 p.m., Eastern time, on the issue date. Submit payments by the Fedwire funds transfer system with credit directed to the Treasury's General Account. For these transactions, BPD's ABA Routing Number is 051036476.

(h) What happens if I need to make an untimely change or do not settle on a subscription? An untimely change to a subscription can only be made in accordance with § 344.2(n) of this part. The penalty imposed for failure to make settlement on a subscription that you submit will be to render you ineligible to subscribe for SLGS securities for six months beginning on the date the subscription is withdrawn, or the proposed issue date, whichever occurs first.

(1) Upon whom is the penalty imposed? If you are the issuer, the penalty is imposed on you unless you provide the Taxpayer Identification Number of the conduit borrower that is the actual party failing to make settlement of a

subscription. If you provide the Taxpayer Identification Number for the conduit borrower, the six-month penalty will be imposed on the conduit borrower.

(2) What occurs if Treasury exercises the option to waive the penalty? If you settle after the proposed issue date and we determine that settlement is acceptable on an exception basis, we will waive, under § 344.2(n), the six-month penalty under paragraph (h) of this section. You shall be charged a late payment assessment. The late payment assessment equals the amount of interest that would have accrued on the SLGS securities from the proposed issue date to the date of settlement plus an administrative fee of $100 per subscription, or such other amount as we may publish in the Federal Register. We will not issue SLGS securities until we receive the late payment assessment, which is due on demand.

(i) What happens at maturity? Upon the maturity of a security, we will pay the owner the principal amount and interest due. A security scheduled for maturity on a non-business day will be redeemed on the next business day.

(j) How will I receive payment? We will make payment by the Automated Clearing House (ACH) method for the owner's account at a financial institution as designated by the

owner. We may use substitute payment procedures, instead of ACH, if we consider it to be necessary. Any such action is final.

(k) How do I contact BPD? BPD's contact information is posted on BPD's website.

(l) Will the offering be changed during a debt limit or disaster contingency? We reserve the right to change or suspend the terms and conditions of the offering (including provisions relating to subscriptions for, and issuance of, SLGS securities; interest payments; early redemptions; and rollovers) at any time the Secretary determines that the issuance of obligations sufficient to conduct the orderly financing operations of the United States cannot be made without exceeding the statutory debt limit, or that a disaster situation exists. We will announce such changes by any means that the Secretary deems appropriate.

(m) What are some of the rights that Treasury reserves in administering the SLGS program? We may decide, in our sole discretion, to take any of the following actions. Such actions are final. Specifically, Treasury reserves the right:

(1) To reject any SLGSafe Application for Internet Access;

(2) To reject any electronic message or other message or request, including requests for subscription and redemption, that is inappropriately completed or untimely submitted;

(3) To refuse to issue any SLGS securities in any case or class of cases;

(4) To revoke the issuance of any SLGS securities and to declare the subscriber or the issuer ineligible thereafter to subscribe for securities under the offering if the Secretary deems that such action is in the public interest and any security is issued on the basis of an improper certification or other misrepresentation (other than as the result of an inadvertent error) or there is an impermissible transaction under § 344.2(f); or

(5) To review any transaction for compliance with this part, including requiring a subscriber or the issuer to provide additional information, and to determine an appropriate remedy under the circumstances.

(n) Are there any situations in which Treasury may waive these regulations? We reserve the right, at our discretion, to waive or modify any provision of these regulations in any case or class of cases. We may do so if such action is not inconsistent with law and will not

subject the United States to substantial expense or liability.

(o) Are SLGS securities callable by Treasury? No. Treasury cannot call a SLGS security for redemption before maturity.

SLGSafe® Service

§ 344.3 What provisions apply to the SLGSafe Service?

(a) What is the SLGSafe Service? SLGSafe is a secure Internet site on the World Wide Web through which subscribers submit SLGS securities transactions. SLGSafe Internet transactions constitute electronic messages under 31 CFR part 370.

(b) Is SLGSafe use mandatory? Yes. Except as provided in paragraph(f)(3) or (f)(4) of this section, you must submit all transactions through SLGSafe.

(c) What terms and conditions apply to SLGSafe? The terms and conditions contained in the following documents, which may be downloaded from BPD’s website and which may change from time to time, apply to SLGSafe transactions:

(1) SLGSafe Application for Internet Access and SLGSafe User Acknowledgment; and

(2) SLGSafe User's Manual.

(d) Who can apply for SLGSafe access? If you are an owner or a potential owner of SLGS securities, or act as a trustee or other agent of the owner, you can apply to BPD for SLGSafe access. Other potential users of SLGSafe include, but are not limited to, underwriters, financial advisors, and bond counsel.

(e) How do I apply for SLGSafe access? Submit to BPD a completed SLGSafe Application for Internet Access. The form is found on BPD's website.

(f) What are the conditions of SLGSafe use? If you are designated as an authorized user, on a SLGSafe application that we've approved, you must:

(1) Assume the sole responsibility and the entire risk of use and operation of your electronic connection;

(2) Agree that we may act on any electronic message to the same extent as if we had received a written instruction bearing the signature of your duly authorized officer;

(3) Submit electronic messages and other transaction requests exclusively through SLGSafe, except to the extent you establish to the satisfaction of BPD that good cause exists for you to submit such subscriptions and requests by other means; and

(4) Agree to submit transactions manually if we notify you that due to problems with hardware, software, data transmission, or any other reason, we are unable to send or receive electronic messages through SLGSafe.

(g) When is the SLGSafe window open? All SLGSafe subscriptions, requests for early redemption of Time Deposit securities, and requests for redemption of Demand Deposit securities must be received by BPD on business days no earlier than 10:00 a.m. and no later than 10:00 p.m., Eastern time. The official time is the date and time as shown on BPD's application server. Except as otherwise provided in § 344.5(d) and § 344.8(d), all other functions may be performed during the extended SLGSafe hours, from 8:00 a.m. until 10:00 p.m., Eastern time.

Subpart B--Time Deposit Securities

§ 344.4 What are Time Deposit securities?

Time Deposit securities are issued as certificates of indebtedness, notes, or bonds.

(a) What are the maturity periods? The issuer must fix the maturity periods for Time Deposit securities, which are issued as follows:

(1) Certificates of indebtedness that do not bear interest. For certificates of indebtedness that do not bear interest, the issuer can fix a maturity period of not less than fifteen days and not more than one year.

(2) Certificates of indebtedness that bear interest. For certificates of indebtedness that bear interest, the issuer can fix a maturity period of not less than thirty days and not more than one year.

(3) Notes. For notes, the issuer can fix a maturity period of not less than one year and one day, and not more than ten years.

(4) Bonds. For bonds, the issuer can fix a maturity period of not less than ten years and one day, and not more than forty years.

(b) How do I select the SLGS rate? For each security, the issuer shall designate an interest rate that does not exceed the maximum interest rate shown in the daily SLGS rate table as defined in § 344.1.

(1) When is the SLGS rate table released? We release the SLGS rate table to the public by 10:00 a.m., Eastern time, each business day. If the SLGS rate table is not available at that time on any given business day, the SLGS rate table for the preceding business day applies.

(2) How do I lock-in a SLGS rate? The applicable daily SLGS rate table for a SLGSafe subscription is the one in effect on the business day that you start the subscription process. This table is shown on BPD's Application server.

(3) Where can I find the SLGS rate table? The SLGS rate table can be obtained at BPD's website.

(c) How are interest computation and payment dates determined? Interest on a certificate of indebtedness is computed on an annual basis and is paid at maturity with the principal. Interest on a note or bond is paid semi-annually. The issuer specifies the first interest payment date, which must be at least thirty days and less than or equal to one year from the date of issue. The final interest payment date must coincide with the maturity date of the security. Interest for other than a full interest period is computed on the basis of a 365-day or 366-day year (for certificates of indebtedness) and on the basis of the exact number of days in the half-year (for notes and bonds). See the appendix to subpart E to part 306 of this subchapter for rules regarding computation of interest.

§ 344.5 What other provisions apply to subscriptions for Time Deposit securities?

(a) When is my subscription due? The subscriber must fix the issue date of each security in the subscription. The issue date must be a business day. The issue date cannot be more than sixty days after the date BPD receives the subscription. If the subscription is for $10 million or less, BPD must receive a subscription at least five days before the issue date. If the subscription is for over $10 million, BPD must receive the subscription at least seven days before the issue date.

EXAMPLE to paragraph (a): If SLGS securities totaling $10 million or less will be issued on November 16th, BPD must receive the subscription no later than November 11th. If SLGS securities totaling more than $10 million will be issued on November 16th, BPD must receive the subscription no later than November 9th. In all cases, if SLGS securities will be issued on November 16th, BPD will not accept the subscription before September 17th.

(b) How do I start the subscription process? A subscriber starts the subscription process by entering into SLGSafe the following information:

(1) The issue date;

(2) The total principal amount;

(3) The issuer's name and Taxpayer Identification Number;

(4) The title of an official authorized to purchase SLGS securities;

(5) A description of the tax-exempt bond issue; and

(6) The certification required by § 344.2(e)(1), if the subscription is submitted by an agent of the issuer.

(c) Under what circumstances can I cancel a subscription? You cannot cancel a subscription unless you establish, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option.

(d) How do I change a subscription? You can change a subscription on or before 3:00 p.m., Eastern time, on the issue date. Changes to a subscription are acceptable with the following exceptions:

(1) You cannot change the issue date to require issuance earlier or later than the issue date originally specified; provided, however, you may change the issue date up to seven days after the original issue date if you establish to the satisfaction of Treasury that such change is required as a result of circumstances that were unforeseen at the time of

the subscription and are beyond the issuer's control (for example, a natural disaster);

(2) You cannot change the aggregate principal amount originally specified in the subscription by more than ten percent; and

(3) You cannot change an interest rate to exceed the maximum interest rate in the SLGS rate table that was in effect for a security of comparable maturity on the business day that you began the subscription process.

(e) How do I complete the subscription process? The completed subscription must:

(1) Be dated and submitted electronically by an official authorized to make the purchase;

(2) Separately itemize securities by the various maturities, interest rates, and first interest payment dates (in the case of notes and bonds);

(3) Not be more than ten percent above or below the aggregate principal amount originally specified in the subscription;

(4) Not be paid with proceeds that are derived, directly or indirectly, from the redemption before maturity of SLGS securities subscribed for on or before December 27, 1976;

(5) Include the certifications required by § 344.2(e)(2)(i) (relating to yield); and

(6) Include the information required under paragraph (b), if not already provided.

(f) When must I complete the subscription? BPD must receive a completed subscription on or before 3:00 p.m., Eastern time, on the issue date.

§ 344.6 How do I redeem a Time Deposit security before maturity?

(a) What is the minimum time a security must be held?

(1) Zero percent certificates of indebtedness of 16 to 29 days. A zero percent certificate of indebtedness of 16 to 29 days can be redeemed, at the owner's option, no earlier than 15 days after the issue date.

(2) Certificates of indebtedness of 30 days or more. A certificate of indebtedness of 30 days or more can be redeemed, at the owner's option, no earlier than 25 days after the issue date.

(3) Notes or bonds. A note or bond can be redeemed, at the owner's option, no earlier than 30 days after the issue date.

(b) Can I request partial redemption of a security balance? You may request partial redemptions in any whole dollar amount; however, a security balance of less than $1,000 must be redeemed in total.

(c) Do I have to submit a request for early redemption? Yes. An official authorized to redeem the securities before maturity must submit an electronic request in SLGSafe. The request must show the Taxpayer Identification Number of the issuer, the security number, and the dollar amount of the securities to be redeemed. Upon submission of a request for redemption before maturity of a security subscribed for on or after [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], the request must include a yield certification under § 344.2(e)(2)(ii). BPD must receive the request no less than 14 days and no more than 60 days before the requested redemption date. You cannot submit a request for early redemption for a security which has not yet been issued and you cannot cancel a request once it has been submitted.

(d) How do I calculate the amount of redemption proceeds for subscriptions on or after October 28, 1996? For securities subscribed for on or after October 28, 1996, the amount of the redemption proceeds is calculated as follows:

(1) Interest. If a security is redeemed before maturity on a date other than a scheduled interest payment date, Treasury pays interest for the fractional interest period since the last interest payment date.

(2) Redemption value. The remaining interest and principal payments are discounted by the current Treasury borrowing rate for the remaining term to maturity of the security redeemed. This may result in a premium or discount to the issuer depending on whether the current Treasury borrowing rate is unchanged, lower, or higher than the stated interest rate of the early-redeemed SLGS securities. There is no market charge for the redemption of zero interest Time Deposit securities subscribed for on or after October 28, 1996. Redemption proceeds in the case of a zero-interest security are a return of the principal invested. The formulas for calculating the redemption value under this paragraph, including examples of the determination of premiums and discounts, are set forth in appendix B of this part.

(e) How do I calculate the amount of redemption proceeds for subscriptions from September 1, 1989, through October 27, 1996? For securities subscribed for from September 1, 1989, through October 27, 1996, the amount of the redemption proceeds is calculated as follows:

(1) Interest. If a security is redeemed before maturity on a date other than a scheduled interest payment date, Treasury pays interest for the fractional interest period since the last interest payment date.

(2) Market charge. An amount shall be deducted from the redemption proceeds if the current Treasury borrowing rate for the remaining period to original maturity exceeds the rate of interest originally fixed for such security. The amount shall be the present value of the future increased borrowing cost to the Treasury. The annual increased borrowing cost for each interest period is determined by multiplying the principal by the difference between the two rates. For notes and bonds, the increased borrowing cost for each remaining interest period to original maturity is determined by dividing the annual cost by two. Present value is determined by using the current Treasury borrowing rate as the discount factor. When you request a redemption date that is less than thirty days before the original maturity date, we will apply the rate of a one month security as listed on the SLGS rate table issued on the day you make a redemption request. The market charge under this paragraph can be computed by using the formulas in appendix A of this part.

(f) How do I calculate the amount of redemption proceeds for subscriptions from December 28, 1976, through August 31, 1989? For securities subscribed for from December 28, 1976, through August 31, 1989, the amount of the redemption proceeds is calculated as follows:

(1) Interest. Interest for the entire period the security was outstanding shall be recalculated if the original interest rate of the security is higher than the interest rate that would have been set at the time of the initial subscription had the term of the security been for the shorter period. If this results in an overpayment of interest, we will deduct from the redemption proceeds the aggregate amount of such overpayments, plus interest, compounded semi-annually thereon, from the date of each overpayment to the date of redemption. The rate used in calculating the interest on the overpayment will be one-eighth of one percent above the maximum rate that would have applied to the initial subscription had the term of the security been for the shorter period. If a bond is redeemed before maturity on a date other than a scheduled interest payment date, no interest is paid for the fractional interest period since the last interest payment date.

(2) Market charge. An amount shall be deducted from the redemption proceeds in all cases where the current

Treasury borrowing rate for the remaining period to original maturity of the security prematurely redeemed exceeds the rate of interest originally fixed for such security. You can compute the market charge under this paragraph by using the formulas in appendix A of this part.

(g) How do I calculate the amount of redemption proceeds for subscriptions on or before December 27, 1976? For bonds subscribed for on or before December 27, 1976, the amount of the redemption proceeds is calculated as follows:

(1) Interest. The interest for the entire period the bond was outstanding shall be recalculated if the original interest rate at which the bond was issued is higher than an adjusted interest rate reflecting both the shorter period during which the bond was actually outstanding and a penalty. The adjusted interest rate is the Treasury rate which would have been in effect on the date of issue for a marketable Treasury bond maturing on the semi-annual maturity period before redemption reduced by a penalty which must be the lesser of:

(i) One-eighth of one percent times the number of months from the date of issuance to original maturity, divided by the number of full months elapsed from the date of issue to redemption; or

(ii) One-fourth of one percent.

(2) Deduction. We will deduct from the redemption proceeds, if necessary, any overpayment of interest resulting from previous payments made at a higher rate based on the original longer period to maturity.

Subpart C--Demand Deposit Securities

§ 344.7 What are Demand Deposit securities?

Demand Deposit securities are one-day certificates of indebtedness that are automatically rolled over each day until you request redemption.

(a) How are the SLGS rates for Demand Deposit securities determined? Each security shall bear a variable rate of interest based on an adjustment of the average yield for three-month Treasury bills at the most recent auction. A new rate is effective on the first business day following the regular auction of three-month Treasury bills and is shown in the SLGS rate table. Interest is accrued and added to the principal daily. Interest is computed on the balance of the principal, plus interest accrued through the preceding day.

(1) How is the interest rate calculated?

(i) First, you calculate the annualized effective Demand Deposit rate in decimals, designated "I" in Equation 1, as follows:

$$I = \left[\left(\frac{100}{P} \right)^{Y/DTM} - 1 \right] \times (1 - MTR) - TAC$$

(Equation 1)

where:

I =Annualized effective Demand Deposit rate in decimals.

P =Average auction price for the most recently auctioned 13-week Treasury bill, per hundred, to six decimals.

Y =365 (if the year following issue date does not contain a leap year day) or 366 (if the year following issue date does contain a leap year day).

DTM =The number of days from date of issue to maturity for the most recently auctioned 13-week Treasury bill.

MTR =Estimated marginal tax rate, in decimals, of purchasers of tax-exempt bonds.

TAC =Treasury administrative costs, in decimals.

(ii) Then, you calculate the daily factor for the Demand Deposit rate as follows:

$$DDR = (1 + I)^{1/Y} - 1$$

(Equation 2)

(2) Where can I find additional information? Information on the estimated average marginal tax rate and Treasury administrative costs for administering Demand Deposit securities, both to be determined by Treasury from time to time, will be published in the Federal Register.

(b) What happens to Demand Deposit securities during a Debt Limit Contingency? At any time the Secretary determines that issuance of obligations sufficient to conduct the orderly financing operations of the United States cannot be made without exceeding the statutory debt limit, we will invest any unredeemed Demand Deposit securities in special ninety-day certificates of indebtedness. Funds invested in the ninety-day certificates of indebtedness earn simple interest equal to the daily factor in effect at the time Demand Deposit security issuance is suspended, multiplied by the number of days outstanding. When regular Treasury borrowing operations resume, the ninety-day certificates of indebtedness, at the owner's option, are:

(1) Payable at maturity;

(2) Redeemable before maturity, provided funds are available for redemption; or

(3) Reinvested in Demand Deposit securities.

§ 344.8 What other provisions apply to subscriptions for Demand Deposit securities?

(a) When is my subscription due? The subscriber must fix the issue date of each security in the subscription. You cannot change the issue date to require issuance earlier or later than the issue date originally specified; provided, however, you may change the issue date up to seven days after the original issue date if you establish to the satisfaction of Treasury that such change is required as a result of circumstances that were unforeseen at the time of the subscription and are beyond the issuer's control (for example, a natural disaster). The issue date must be a business day. The issue date cannot be more than sixty days after the date BPD receives the subscription. If the subscription is for $10 million or less, BPD must receive the subscription at least five days before the issue date. If the subscription is for more than $10 million, BPD must receive the subscription at least seven days before the issue date.

(b) How do I start the subscription process? A subscriber starts the subscription process by entering into SLGSafe the following information:

(1) The issue date;

(2) The total principal amount;

(3) The issuer's name and Taxpayer Identification Number;

(4) The title of an official authorized to purchase SLGS securities;

(5) A description of the tax-exempt bond issue; and

(6) The certification required by § 344.2(e)(1), if the subscription is submitted by an agent of the issuer.

(c) Under what circumstances can I cancel a subscription? You cannot cancel a subscription unless you establish, to the satisfaction of Treasury, that the cancellation is required for reasons unrelated to the use of the SLGS program to create a cost-free option.

(d) How do I change a subscription? You can change a subscription on or before 3:00 p.m., Eastern time, on the issue date. You may change the aggregate principal amount specified in the subscription by no more than ten percent,

above or below the amount originally specified in the subscription.

(e) How do I complete the subscription process? The subscription must:

(1) Be dated and submitted electronically by an official authorized to make the purchase;

(2) Include the certifications required by § 344.2(e)(2)(i) (relating to yield); and

(3) Include the information required under paragraph (b) of this section, if not already provided.

§ 344.9 How do I redeem a Demand Deposit security?

(a) When must I notify BPD to redeem a security? A Demand Deposit security can be redeemed at the owner's option, if BPD receives a request for redemption not less than:

(1) One business day before the requested redemption date for redemptions of $10 million or less; and

(2) Three business days before the requested redemption date for redemptions of more than $10 million.

(b) Can I request partial redemption of a security balance? You may request partial redemptions in any

amount. If your account balance is less than $1,000, it must be redeemed in total.

(c) Do I have to submit a request for redemption? Yes. An official authorized to redeem the securities must submit an electronic request through SLGSafe. The request must show the Taxpayer Identification Number of the issuer, the security number, and the dollar amount of the securities to be redeemed. BPD must receive the request by 3:00 p.m., Eastern time on the required day. You cannot cancel the request.

Subpart D--Special Zero Interest Securities

§ 344.10 What are Special Zero Interest securities?

Special zero interest securities were issued as certificates of indebtedness and notes. The provisions of subpart B of this part (Time Deposit securities) apply except as specified in Subpart D of this part. Special Zero Interest securities were discontinued on October 28, 1996. The only zero interest securities available after October 28, 1996, are zero interest Time Deposit securities that are subject to subpart B of this part.

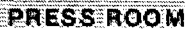
§ 344.11 How do I redeem a Special Zero Interest Security before maturity?

Follow the provisions of § 344.6(a) through (g) except that no market charge or penalty will apply when you redeem a special zero interest security before maturity.

____

Donald V. Hammond,

Fiscal Assistant Secretary.



June 29, 2005
JS-2613

Statement of Secretary Snow on WMD Proliferation Financing Executive Order

U.S. Treasury Secretary John Snow made the following remarks today in response to President George W. Bush's issuance of the WMD Proliferation Financing Executive Order:

"I applaud President Bush for today issuing the WMD Proliferation Financing Executive Order, aimed at freezing the assets of proliferators of weapons of mass destruction (WMD) and the missiles that carry them.

"This Order sends a clear message: if you deal in weapons of mass destruction, you're not going to use the U.S. financial system to bankroll or facilitate your activities.

"The Treasury's unique authorities allow us to target the financial underpinnings of a range of national security threats, from terrorism to narcotics traffickers to rogue regimes. By applying these powers against weapons of mass destruction, we deny proliferators and their supporters access to the U.S. financial system and starve them of funds needed to build deadly weapons and threaten innocents around the globe.

"Today's Order carries with it an annex that designates eight organizations in North Korea, Iran and Syria responsible for WMD and missile programs. The designation freezes any property the organizations may have under U.S. jurisdiction and prohibits U.S. persons from doing business with them. Today's action is just the first step in our efforts to dismantle the financial and support networks that facilitate WMD proliferation, and we will continue to designate individuals and entities under this Order found to be playing a role in the proliferation of WMD.

"The effectiveness of economic sanctions grows exponentially when they are applied multilaterally. I urge our partners around the globe to put into place similar systems that allow for the freezing of proliferators' assets. We must do all we can to financially isolate those threatening peace and security through the proliferation of WMD," said Snow.

Note: Click here for a list of the eight organizations named in the annex: http://www.treas.gov/offices/enforcement/ofac/actions/20050629.shtml.

The WMD Proliferation Financing Executive Order builds on E.O. 12938 (http://www.treas.gov/offices/enforcement/ofac/legal/eo/12938.pdf)) issued November 14, 1994, and implements an important recommendation outlined by the Silberman-Robb WMD Commission.

-30-

WMD Proliferation Financing Executive Order

Today's Presidential Action

President Bush has signed an Executive Order to combat trafficking of weapons of mass destruction (WMD) and related materials by cutting off financing and other

support for proliferation networks.

The Executive Order:

- Provides a new tool to defeat WMD proliferation by authorizing the freezing of assets of WMD proliferators and their supporters, thereby prohibiting U.S. persons from engaging in transactions with them;
- Lays the foundation for expanded international cooperation against WMD networks, including through the Proliferation Security Initiative; and
- Implements a key recommendation of the Silberman-Robb WMD Commission.

The EO Disrupts WMD Proliferation Networks by:

- Blocking WMD proliferators access to U.S. commercial and financial systems;
- Allowing the Treasury Department to freeze U.S. assets and block U.S. transactions of proliferators and persons who provide support or services to such proliferators;
- Establishing the ability to block U.S. assets of, and deny U.S. market access to, those foreign banks that refuse to freeze assets of designated WMD proliferators; and
- Complementing existing authorities related to WMD proliferation that prohibit certain economic transactions and assistance

The EO Advances International Cooperative Efforts to Defeat WMD Trafficking by:

- Taking new steps to shut down illicit WMD financial flows, as called for by G-8 Leaders at Sea Island in 2004;
- Establishing a basis for further efforts in the G-8 and among Proliferation Security Initiative partners to identify, track, and freeze assets of WMD proliferators and their supporters; and
- Providing a model for other nations to follow in adopting laws to cut off the funds and services that enable WMD proliferation, as required by United Nations Security Council Resolution 1540.

The EO Establishes Targets for U.S. Action by:

- Designating eight organizations in North Korea, Iran, and Syria responsible for WMD and missile programs;
- Prohibiting U.S. transactions with designated entities; and
- Authorizing the Secretary of State and the Secretary of the Treasury to designate additional WMD proliferators and persons that provide support or services to those entities.

LINKS

- WMD Proliferation Financing Executive Order

President George W. Bush

For Immediate Release
Office of the Press Secretary
June 29, 2005

Executive Order: Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.) (IEEPA), the National Emergencies Act (50 U.S.C. 1601 et seq.), and section 301 of title 3, United States Code,

I, George W. Bush, President of the United States of America, in order to take additional steps with respect to the national emergency described and declared in Executive Order 12938 of November 14, 1994, regarding the proliferation of weapons of mass destruction and the means of delivering them, and the measures imposed by that order, as expanded by Executive Order 13094 of July 28, 1998, hereby order:

Section 1. (a) Except to the extent provided in section 203(b)(1), (3), and (4) of IEEPA (50 U.S.C. 1702(b)(1), (3), and (4)), or in regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date of this order, all property and interests in property of the following persons, that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of United States persons, are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in:

(i) the persons listed in the Annex to this order;

(ii) any foreign person determined by the Secretary of State, in consultation with the Secretary of the Treasury, the Attorney General, and other relevant agencies, to have engaged, or attempted to engage, in activities or transactions that have materially contributed to, or pose a risk of materially contributing to, the proliferation of weapons of mass destruction or their means of delivery (including missiles capable of delivering such weapons), including any efforts to manufacture, acquire, possess, develop, transport, transfer or use such items, by any person or foreign country of proliferation concern;

(iii) any person determined by the Secretary of the Treasury, in consultation with the Secretary of State, the Attorney General, and other relevant agencies, to have provided, or attempted to provide, financial, material, technological or other support for, or goods or services in support of, any activity or transaction described in paragraph (a)(ii) of this section, or any person whose property and interests in property are blocked pursuant to this order; and

(iv) any person determined by the Secretary of the Treasury, in consultation with the Secretary of State, the Attorney General, and other relevant agencies, to be owned or controlled by, or acting or purporting to act for or on behalf of, directly or indirectly, any person whose property and interests in property are blocked pursuant to this order.

(b) Any transaction or dealing by a United States person or within the United States in property or interests in property blocked pursuant to this order is prohibited, including, but not limited to, (i) the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of, any person whose property and interests in property are blocked pursuant to this order, and (ii) the receipt of any contribution or provision of funds, goods, or services from any such person.

(c) Any transaction by a United States person or within the United States that evades or avoids, has the purpose of evading or avoiding, or attempts to violate any of the prohibitions set forth in this order is prohibited.

(d) Any conspiracy formed to violate the prohibitions set forth in this order is prohibited.

Sec. 2. For purposes of this order:

(a) the term "person" means an individual or entity;

(b) the term "entity" means a partnership, association, trust, joint venture, corporation, group, subgroup, or other organization; and

(c) the term "United States person" means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States.

Sec. 3. I hereby determine that the making of donations of the type of articles specified in section 203(b)(2) of IEEPA (50 U.S.C. 1702(b)(2)) by, to, or for the benefit of, any person whose property and interests in property are blocked pursuant to this order would seriously impair my ability to deal with the national emergency declared in Executive Order 12938, and I hereby prohibit such donations as provided by section 1 of this order.

Sec. 4. Section 4(a) of Executive Order 12938, as amended, is further amended to read as follows:

"Sec. 4. Measures Against Foreign Persons.

(a) Determination by Secretary of State; Imposition of Measures. Except to the extent provided in section 203(b) of the International Emergency Economic Powers Act (50 U.S.C. 1702(b)), where applicable, if the Secretary of State, in consultation with the Secretary of the Treasury, determines that a foreign person, on or after November 16, 1990, the effective date of Executive Order 12735, the predecessor order to Executive Order 12938, has engaged, or attempted to engage, in activities or transactions that have materially contributed to, or pose a risk of materially contributing to, the proliferation of weapons of mass destruction or their means of delivery (including missiles capable of delivering such weapons), including any efforts to manufacture, acquire, possess, develop, transport, transfer, or use such items, by any person or foreign country of proliferation concern, the measures set forth in subsections (b), (c), and (d) of this section shall be imposed on that foreign person to the extent determined by the Secretary of State, in consultation with the implementing agency and other relevant agencies. Nothing in this section is intended to preclude the imposition on that foreign person of other measures or sanctions available under this order or under other authorities."

Sec. 5. For those persons whose property and interests in property are blocked pursuant to section 1 of this order who might have a constitutional presence in the United States, I find that because of the ability to transfer funds or other assets instantaneously, prior notice to such persons of measures to be taken pursuant to this order would render these measures ineffectual. I therefore determine that for these measures to be effective in addressing the national emergency declared in Executive Order 12938, as amended, there need be no prior notice of a listing or determination made pursuant to section 1 of this order.

Sec. 6. The Secretary of the Treasury, in consultation with the Secretary of State, is hereby authorized to take such actions, including the promulgation of rules and regulations, and to employ all powers granted to the President by IEEPA as may be

necessary to carry out the purposes of this order. The Secretary of the Treasury may redelegate any of these functions to other officers and agencies of the United States Government, consistent with applicable law. All agencies of the United States Government are hereby directed to take all appropriate measures within their authority to carry out the provisions of this order and, where appropriate, to advise the Secretary of the Treasury in a timely manner of the measures taken.

Sec. 7. The Secretary of the Treasury, in consultation with the Secretary of State, is hereby authorized to determine, subsequent to the issuance of this order, that circumstances no longer warrant the inclusion of a person in the Annex to this order and that the property and interests in property of that person are therefore no longer blocked pursuant to section 1 of this order.

Sec. 8. This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies,

instrumentalities, or entities, its officers or employees, or any other person.

Sec. 9. (a) This order is effective at 12:01 a.m. eastern daylight time on June 29, 2005.

(b) This order shall be transmitted to the Congress and published in the Federal Register.

GEORGE W. BUSH

THE WHITE HOUSE,

June 28, 2005.

# # #

ANNEX

Korea Mining Development Trading Corporation

Tanchon Commercial Bank

Korea Ryonbong General Corporation

Aerospace Industries Organization

Shahid Hemmat Industrial Group

Shahid Bakeri Industrial Group

Atomic Energy Organization of Iran

Scientific Studies and Research Center

Return to this article at:
http://www.whitehouse.gov/news/releases/2005/06/20050629.html

PRESS ROOM

June 29, 2005
js-2614

U.S. and Guatemala Launch Summit of the Americas Remittance Partnership

The U.S. Treasury Department and the Guatemalan government today announced the launch of a remittance partnership to facilitate the reduction of the cost of sending remittances and create an environment where their potential contribution to economic and financial-sector development is maximized.

"Our bilateral work will be focused on concrete actions designed to foster the realization of this commitment and will help create a template for future bilateral remittance work in the region," said U.S. Treasury Secretary John W. Snow. "This initiative will focus on fostering competition, efficiency and accessibility in the remittance market. Financial literacy programs, payment system modernization, and appropriate modifications to the regulatory environment are expected to be important elements of the work. We will aim to modernize the Guatemalan payment system while laying the groundwork for eventual harmonization with the U.S. system. Our governments will address relevant policy issues and seek to eliminate unnecessary regulatory obstacles to competition in the remittance market."

Guatemalan Vice-President Eduardo Stein and U.S. Ambassador John R. Hamilton will hold a press conference in Guatemala today to launch this initiative.

Guatemala has been selected as the first pilot country in this broad regional initiative. The Administration joined Western Hemisphere counterparts in committing to this goal at the Special Summit of the Americas in January of 2004 as an avenue to foster growth throughout the Hemisphere. The specific goal of the Summit of the Americas is to take concrete actions to create the conditions to bring down the cost of sending remittances by 50 percent by 2008.

-30-

May 19, 2005
js-2615

Statement by Bobby Pittman Deputy Assistant Secretary of the U.S. Treasury At the Annual Meeting of the African Development Bank Group

President Kabbaj, ladies and gentlemen, it is an honor for me to be here in Abuja for the Annual Meeting of the African Development Bank and I extend my deepest thanks to our Nigerian hosts.

Prospects for Africa

We meet in Abuja at a very positive point in Africa's history. Sub-Saharan Africa's economic growth reached 5% in 2004, an 8-year high, and inflation is at historical lows, finishing the year in the single digits for the first time in over a quarter of a century. Improved fiscal policies in many African countries played an important role in this welcome economic performance. A favorable external environment as well as higher commodity prices also helped. For example, several net oil exporters, applying fiscal rules, saved a significant portion of their oil revenues, marking a break with past practices of running pro-cyclical fiscal policies during times of high oil prices. At the same time, many net oil importers allowed increases in international oil prices to flow through to domestic oil prices rather than increasing generalized government subsidies, while others also allowed their exchange rates to absorb the oil price shock.

Looking ahead, those policies, combined with more sustainable debt burdens, mean that many African countries are probably in a better position than before to weather economic downturns. In fact, many oil exporters could further increase their ability to withstand future negative shocks by using oil savings to repay debt. It is also desirable for central banks to nip in the bud inflationary pressures that may be building from recent supply-side price shocks. Quick action would serve to limit inflation volatility and build central bank credibility; thereby supporting the confidence of private-sector investors and consumers, the main economic agents for achieving long run growth and poverty reduction in Africa.

The U.S. as Partner

The U.S. is helping to stimulate Africa's growth and increase economic resilience, particularly in those countries that are pursuing good policies. The Millennium Challenge Account is a prime example of our commitment. The MCA's goal is to reduce poverty through growth. But even outside of MCA, the US has tripled its assistance to Africa since 2000 to more than $3 billion last year. As a result, the US share of Africa's total assistance from donor countries has doubled over this same period, now reaching more than 20%. African countries have also been the primary beneficiaries of the President's $15 billion program to fight HIV/AIDS. We also believe 100% forgiveness of both bilateral and IDA and ADF debt for the poorest countries - as well as grants going forward - are needed to end the cycle of "lend and forgive" once and for all.

In addition, the Africa Growth and Opportunity Act (AGOA) - which is designed to spur economic development and expedite the integration of African economies into the world trading system - has led to significant increases in trade volumes between the United States and AGOA-eligible countries. The AGOA Forum in Dakar, Senegal, this July, will allow the U.S. and African officials as well as members of the private sector and civil society to discuss how African countries can further tap the benefits of AGOA.

The Next Era for the African Development Bank

The African Bank has a critical role to play to help countries grow faster and become more flexible through greater private sector investment. We see many opportunities for the Bank to enhance its effectiveness as the leading development finance institution in Africa.

First, the recently concluded AfDF-10 agreement recognizes that **private sector** development is critical for accelerating economic growth and urges the Fund to place a high priority in this area. Thus, we ask the Bank's next President to be creative and aggressive in identifying opportunities to support and advance Africa's private sector, including through increasing the availability of finance to the unbanked. In that vein, we very much look forward to considering the Bank's updated micro-finance strategy and any other initiatives the Bank can undertake to strengthen Africa's financial sector.

In addition, the AfDF-10 agreement acknowledged that excessive debt burdens only harm growth prospect and as a result, the AfDF will only extend **grants** to those countries already facing such debt burdens, namely two-thirds of the AfDF countries. We trust that the AfDF will work closely with IDA in implementing this new debt sustainability framework.

We are also pleased by the Bank's recent steps to fight **corruption** and enhance **transparency**. The Bank must be a role model to its clients in this arena, particularly by proactively sharing the Bank's proposals, decisions, and progress toward achieving results. We are pleased by the Bank's proposal to establish an Anti-Fraud and Corruption Unit and Whistleblower system, and urge that it be fully operational by the end of 2005.

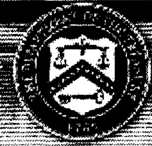
We all agree that the African Bank is uniquely placed to support **regional integration** in Africa and NEPAD. Project development facilities - like the NEPAD Infrastructure Project Preparation Special Fund under consideration at the Bank – can fill a large void in helping to guide potential projects through the critical preparation stage. That said, such facilities are necessary, but not sufficient. African countries themselves need to prioritize their infrastructure needs to ensure that limited capacity, time, and financing are put toward projects that have the greatest impact.

More broadly, we would like to see the Bank become an institution truly driven by **results**. While the Bank has made some progress, it has not been nearly as timely or as demonstrable as it should be. The Bank needs to proceed with results-based country strategies and implement its internal results management system to ensure that staff and management are working toward the same measure of success, rather than on approval volumes or internal processes and procedures.

Conclusion

In conclusion, I would like to thank President Kabbaj for his steady and firm leadership through the most difficult era ever to face a multilateral development institution. Thanks to his tireless efforts to regain the Bank's financial strength, the Bank stands ready to move ahead in ways that we could not have imagined ten years ago. We look forward to working closely with the Bank's new President and our fellow shareholders to ensure that the Bank can better meet the needs and aspirations of the African people

PRESS ROOM

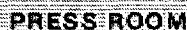


June 29, 2005
JS-2616

Statement of Treasury Secretary John W. Snow on Revised First Quarter GDP Growth

"I am delighted – but not surprised – by today's GDP announcement, which showed that the American economy grew at a rate of 3.8 percent in the first quarter of this year. This number illustrates that U.S. workers and businesses are producing more goods and services every day, and that is a terrific sign of economic health. This type of expansion means more opportunity for more American workers, particularly those who need jobs.

"President Bush is committed to keeping the economy on the path of healthy growth by making his tax cuts permanent, reducing the burden of frivolous lawsuits, passing a national energy policy and saving and strengthening Social Security. His economic agenda seeks to achieve an economy that will continue to be resilient and productive for generations to come."



June 30, 2005
JS-2617

Treasury Designation Targets Individuals
Leading Syria's Military Presence in Lebanon

The U.S. Department of the Treasury today named Ghazi Kanaan and Rustum Ghazali Specially Designated Nationals (SDNs) of Syria pursuant to Executive Order 13338, which is aimed at financially isolating individuals and entities contributing to the Government of Syria's problematic behavior.

"Actions like today's are intended to financially isolate bad actors supporting Syria's efforts to destabilize its neighbors," said Treasury Secretary John W. Snow.

"We are seeing democracy take hold in Lebanon and other places in the Middle East, yet Syria continues to support violent groups and political strife. Syria needs to join its neighbors in embracing the progress towards liberty," Snow continued.

Information available to the U.S. Government indicates that Kanaan and Ghazali have directed the Syrian Arab Republic Government's (SARG) military and security presence in Lebanon and/or contributed to the SARG's support for terrorism. Both Ghazali and Kanaan allegedly engaged in a variety of corrupt activities and were reportedly the beneficiaries of corrupt business deals during their respective tenures in Lebanon.

Today's designation freezes any assets the designees may have located in the United States, and prohibits U.S. persons from engaging in transactions with these individuals.

Identifying Information

Ghazi Kanaan
DOB: circa 1943
POB: Near Qerdaha, Syria
Nationality: Syria
Address: Damascus, Syria
Position: Minister of Interior

According to information available to the U.S. Government, prior to his brief appointment as Chief of the Syrian Political Security Directorate and his current position as SARG Interior Minister, Ghazi Kanaan served as Syrian Military Intelligence (SMI) Chief for Lebanon for approximately 20 years. He was replaced by Ghazali in late 2002. During his command of SMI in Lebanon, Kanaan ensured that Syrian military intelligence officers remained deeply involved in Lebanese political and economic affairs.

Information available to the U.S. Government indicates that as an SMI commander in Lebanon, Kanaan contributed to the SARG's provision of support to Specially Designated Global Terrorist groups (SDGT), such as Hizballah. In 2002, three rockets in a convoy allegedly escorted by Kanaan were personally delivered across the Syrian-Lebanese border to Hizballah in Lebanon. In May 2001, in a meeting between Kanaan and Hizballah security leaders, Hizballah agreed to Syria's request that Hizballah refrain from executing any military operations without first notifying Syria, according to information available to the U.S. Government. However, in the same meeting, Hizballah also agreed to continue its casing and reconnaissance operations.

Information available to the U.S. Government indicates that Kanaan also enjoyed extensive influence over Lebanon's military and security services. In late December 2001, a Lebanese Armed Forces (LAF) commander reportedly declared that effective January 2002, weapons permits and security passes issued by Syrian institutions would no longer be valid except for those passes and permits issued by Kanaan. Only those passes and permits issued by Kanaan would continue to allow the holder to carry weapons and to pass through LAF and Syrian military checkpoints in Lebanon without being questioned or searched.

Allegedly, in August 2001, the SARG believed that the Lebanese prime minister, the speaker of the Lebanese parliament, and a sectarian leader had created a new alliance that was, in Syria's assessment, a violation of Syria's long-standing policy to prevent any one political party or bloc from dominating Lebanese politics. Furthermore, Syria believed that the new alliance could weaken Lebanese political parties' dependence on Damascus and diminish SARG influence within Lebanese politics. In response to this alliance, Kanaan met with the speaker of parliament to remind him that his best interests lay with the Syrians and that he should impress that fact upon others within parliament with whom the speaker had influence.

Additionally, press accounts observed that during the 2000 Lebanese parliamentary elections, Kanaan appeared to oversee the entire electoral process.

Rustum Ghazali
DOB: circa 1949
Nationality: Syria
Address: Syria
Position: Chief of Syrian Military Intelligence for Lebanon

Ghazali assumed command of Syrian Military Intelligence in Lebanon after replacing Ghazi Kanaan, his mentor, in late 2002. U.S. Government information reports that Ghazali was the implementing agent of Syrian policies in Lebanon until Syria's withdrawal from Lebanon in April 2005. During his command, Ghazali directed and significantly contributed to the SARG's military and security presence in Lebanon. Information available to the U.S. Government indicates that Ghazali, in his responsibilities for Lebanese affairs, reported directly to President Asad and then-SMI Director Hasan Khalil.

Information available to the U.S. Government indicates that Ghazali manipulated Lebanese politics to ensure that Lebanese officials and public policy remained committed to the SARG's goals and interests. In late 2004, Ghazali reportedly warned that Syria was determined to physically harm anyone who interfered with Lebanon's economic situation and caused a crisis of confidence. Also, as of late 2004, Lebanese President Lahoud allegedly consulted with Ghazali before selecting positions within his cabinet.

Reportedly, Ghazali could influence a number of the Lebanese members of parliament, and did so notably on the renewal of Lebanese President Lahoud's term in office. After the Lebanese constitution was amended to allow President Lahoud to renew his term, some commentators noted that this appeared to be the second time that Damascus had imposed a president on Beirut. Press reports indicate that in 1995, the presidential term of Elias Hrawi was also extended for three years at the urging of Syria.

Information available to the U.S. Government indicates that Ghazali also has exerted considerable control over the Lebanese military. As of mid-2003, SMI did not need to maintain as large a presence among the mid-levels of each of the Lebanese security services, because Ghazali allegedly required the heads of the LAF Directorate of Intelligence, the Internal Security Forces and the Directorate of General Security to report to him on a daily, and at times hourly, basis. In a further indication of his influence over security and political issues in Lebanon, as of late 2003, Ghazali had significant input into all internal matters in the LAF, including promotions and assignments to key positions.

Allegedly, in November 2003, senior LAF Intelligence Directorate officers continued

to stress to their subordinates the importance of strengthening ties between LAF and SMI. Furthermore, they encouraged subordinates to coordinate even more closely than previously with SMI on all issues.

Background on Executive Order 13338

President George W. Bush signed E.O. 13338 on May 11, 2004 in response to the Syrian government's continued support of international terrorism, sustained occupation of Lebanon, pursuit of weapons of mass destruction and missile programs and undermining of U.S. and international efforts in Iraq. Syria's acts threaten the national security, foreign policy and economy of the United States.

The Order declared a national emergency with respect to Syria, and authorized the Secretary of the Treasury to block the property of certain persons and directing other U.S. Government agencies to impose a ban on exports to Syria.

The Treasury may designate individuals and entities found to be or to have been:

- Directing or otherwise significantly contributing to the Government of Syria's provision of safe haven to or other support for any person whose property or interests in property are blocked under United States law for terrorism-related reasons, including, but not limited to, Hamas, Hizballah, Palestinian Islamic Jihad, the Popular Front for the Liberation of Palestine, the Popular Front for the Liberation of Palestine-General Command, and any persons designated pursuant to Executive Order 13224 of September 23, 2001;
- Directing or otherwise significantly contributing to the Government of Syria's military or security presence in Lebanon;
- Directing or otherwise significantly contributing to the Government of Syria's pursuit of the development and production of chemical, biological, or nuclear weapons and medium- and long-range surface-to-surface missiles;
- Directing or otherwise significantly contributing to any steps taken by the Government of Syria to undermine United States and international efforts with respect to the stabilization and reconstruction of Iraq; or
- Owned or controlled by, or acting or purporting to act for or on behalf of, directly or indirectly, any person whose property or interests in property are blocked pursuant to this order.

Click the following link for the full text of E.O. 13338:
http://www.whitehouse.gov/news/releases/2004/05/20040511-6.html

For Immediate Release
Office of the Press Secretary
May 11, 2004

Executive Order

Blocking Property of Certain Persons and Prohibiting the Export of Certain Goods to Syria

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.) (IEEPA), the National Emergencies Act (50 U.S.C. 1601 et seq.) (NEA), the Syria Accountability and Lebanese Sovereignty Restoration Act of 2003, Public Law 108-175 (SAA), and section 301 of title 3, United States Code,

I, GEORGE W. BUSH, President of the United States of America, hereby determine that the actions of the Government of Syria in supporting terrorism, continuing its occupation of Lebanon, pursuing weapons of mass destruction and missile programs, and undermining United States and international efforts with respect to the stabilization and reconstruction of Iraq constitute an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States and hereby declare a national emergency to deal with that threat. To address that threat, and to implement the SAA, I hereby order the following:

Section 1. (a) The Secretary of State shall not permit the exportation or reexportation to Syria of any item on the United States Munitions List (22 C.F.R. part 121).

(b) Except to the extent provided in regulations, orders, directives, or licenses that may be issued pursuant to the provisions of this order in a manner consistent with the SAA, and notwithstanding any license, permit, or authorization granted prior to the effective date of this order, (i) the Secretary of Commerce shall not permit the exportation or reexportation to Syria of any item on the Commerce Control List (15 C.F.R. part 774); and (ii) with the exception of food and medicine, the Secretary of Commerce shall not permit the exportation or reexportation to Syria of any product of the United States not included in section 1(b)(i) of this order.

(c) No other agency of the United States Government shall permit the exportation or reexportation to Syria of any product of the United States, except to the extent provided in regulations, orders, directives, or licenses that may be issued pursuant to this order in a manner consistent with the SAA, and notwithstanding any license, permit, or authorization granted prior to the effective date of this order.

Sec. 2. The Secretary of Transportation shall not permit any air carrier owned or controlled by Syria to provide foreign air transportation as defined in 49 U.S.C. 40102(a)(23), except that he may, to the extent consistent with Department of Transportation regulations, permit such carriers to charter aircraft to the Government of Syria for the transport of Syrian government officials to and from the United States on official Syrian government business. In addition, the Secretary of Transportation shall prohibit all takeoffs and landings in the United States, other than those associated with an emergency, by any such air carrier when engaged in scheduled international air services.

Sec. 3. (a) Except to the extent provided in section 203(b)(1), (3), and (4) of the IEEPA (50 U.S.C. 1702(b)(1), (3), and (4)), and the Trade Sanctions Reform and Export Enhancement Act of 2000 (title IX, Public Law 106387) (TSRA), or regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date of this order, all property and interests in property of the following persons, that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of United States persons, including their overseas branches, are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in: persons who are determined by the Secretary of the Treasury, in consultation with the Secretary of State,

(i) to be or to have been directing or otherwise significantly

contributing to the Government of Syria's provision of safe haven to or other support for any person whose property or interests in property are blocked under United States law for terrorism-related reasons, including, but not limited to, Hamas, Hizballah, Palestinian Islamic Jihad, the Popular Front for the Liberation of Palestine, the Popular Front for the Liberation of Palestine-General Command, and any persons designated pursuant to Executive Order 13224 of September 23, 2001;

(ii) to be or to have been directing or otherwise significantly contributing to the Government of Syria's military or security presence in Lebanon;

(iii) to be or to have been directing or otherwise significantly contributing to the Government of Syria's pursuit of the development and production of chemical, biological, or nuclear weapons and medium- and long-range surface-to-surface missiles;

(iv) to be or to have been directing or otherwise significantly contributing to any steps taken by the Government of Syria to undermine United States and international efforts with respect to the stabilization and reconstruction of Iraq; or

(v) to be owned or controlled by, or acting or purporting to act for or on behalf of, directly or indirectly, any person whose property or interests in property are blocked pursuant to this order.

(b) The prohibitions in paragraph (a) of this section include, but are not limited to, (i) the making of any contribution of funds, goods, or services by, to, or for the benefit of any person whose property or interests in property are blocked pursuant to this order; and (ii) the receipt of any contribution or provision of funds, goods, or services from any such person.

Sec. 4. (a) Any transaction by a United States person or within the United States that evades or avoids, has the

purpose of evading or avoiding, or attempts to violate any of the prohibitions set forth in this order is prohibited.

(b) Any conspiracy formed to violate the prohibitions set forth in this order is prohibited.

Sec. 5. I hereby determine that the making of donations of the type of articles specified in section 203(b)(2) of the IEEPA (50 U.S.C. 1702(b)(2)) would seriously impair the ability to deal with the national emergency declared in this order, and hereby prohibit, (i) the exportation or reexportation of such donated articles to Syria as provided in section 1(b) of this order; and (ii) the making of such donations by, to, or for the benefit of any person whose property and interests in property are blocked pursuant to section 3 of this order.

Sec. 6. For purposes of this order:

(a) the term "person" means an individual or entity;

(b) the term "entity" means a partnership, association, trust, joint venture, corporation, group, subgroup, or other organization;

(c) the term "United States person" means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States;

(d) the term "Government of Syria" means the Government of the Syrian Arab Republic, its agencies, instrumentalities, and controlled entities; and

(e) the term "product of the United States" means: for the purposes of subsection 1(b), any item subject to the Export Administration Regulations (15 C.F.R. parts 730-774); and for the purposes of subsection 1(c), any item subject to the export licensing jurisdiction of any other United States Government agency.

Sec. 7. With respect to the prohibitions contained in section 1 of this order, consistent with subsection 5(b) of the SAA, I hereby determine that it is in the national security interest of the United States to waive, and hereby waive application of subsection 5(a)(1) and subsection 5(a)(2)(A) of the SAA so as to permit the exportation or reexportation of certain items as specified in the Department of Commerce's General Order No. 2 to Supplement No. 1, 15 C.F.R. part 736, as issued consistent with this order and as may be amended pursuant to the provisions of this order and in a manner consistent with the SAA. This waiver is made pursuant to the SAA only to the extent that regulation of such exports or reexports would not otherwise fall within my constitutional authority to conduct the Nation's foreign affairs and protect national security.

Sec. 8. With respect to the prohibitions contained in section 2 of this order, consistent with subsection 5(b) of the SAA, I hereby determine that it is in the national security interest of the United States to waive, and hereby waive, application of subsection 5(a)(2)(D) of the SAA insofar as it pertains to: aircraft of any air carrier owned or controlled by Syria chartered by the Syrian government for the transport of Syrian government officials to and from the United States on official Syrian government business, to the extent consistent with Department of Transportation regulations; takeoffs or landings for non-traffic stops of aircraft of any such air carrier that is not engaged in scheduled international air services; takeoffs and landings associated with an emergency; and overflights of United States territory.

Sec. 9. I hereby direct the Secretary of State to take such actions, including the promulgation of rules and regulations, as may be necessary to carry out subsection 1(a) of this order. I hereby direct the Secretary of Commerce, in consultation with the Secretary of State, to take such actions, including the promulgation of rules and regulations, as may be necessary to carry out subsection 1(b) of this order. I direct the Secretary of Transportation, in consultation with the Secretary of State, to take such actions, including the promulgation of rules and regulations, as may be necessary to carry out section 2 of this order. The Secretary of the Treasury, in consultation with the Secretary of State, is hereby authorized to take such actions, including the promulgation of rules and regulations, and to employ all powers granted to the President by the IEEPA as may be necessary to carry out sections 3, 4, and 5 of this order. The Secretaries of State, Commerce, Transportation, and the Treasury may redelegate any of these functions to other officers and agencies of the United States Government consistent with applicable law. The Secretary of State, in consultation with the Secretaries of Commerce, Transportation, and the Treasury, as appropriate, is authorized to exercise the functions and authorities conferred upon the

President in subsection 5(b) of the SAA and to redelegate these functions and authorities consistent with applicable law. All agencies of the United States Government are hereby directed to take all appropriate measures within their authority to carry out the provisions of this order and, where appropriate, to advise the Secretaries of State, Commerce, Transportation, and the Treasury in a timely manner of the measures taken.

Sec. 10. This order is not intended to create, and does not create, any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, instrumentalities, or entities, its officers or employees, or any other person.

Sec. 11. For those persons whose property or interests in property are blocked pursuant to section 3 of this order who might have a constitutional presence in the United States, I find that because of the ability to transfer funds or assets instantaneously, prior notice to such persons of measures to be taken pursuant to this order would render these measures ineffectual. I therefore determine that for these measures to be effective in addressing the national emergency declared in this order, there need be no prior notice of a listing or determination made pursuant to this order.

Sec. 12. The Secretary of the Treasury, in consultation with the Secretary of State, is authorized to submit the recurring and final reports to the Congress on the national emergency declared in this order, consistent with section 401(c) of the NEA, 50 U.S.C. 1641(c), and section 204(c) of the IEEPA, 50 U.S.C. 1703(c).

Sec. 13. (a) This order is effective at 12:01 eastern daylight time on May 12, 2004.

(b) This order shall be transmitted to the Congress and published in the Federal Register.

GEORGE W. BUSH

THE WHITE HOUSE,

May 11, 2004.

###

Return to this article at:
http://www.whitehouse.gov/news/releases/2004/05/20040511-6.html

Click to Print this document

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 30, 2005
JS-2618

Treasury Releases Report on Terrorism Risk Insurance Act of 2002

The Treasury Department today released a report on the Terrorism Risk Insurance Act of 2002, as required by Congress. The text of the letter sent by Treasury Secretary John W. Snow to Senate Banking Committee Chairman Richard Shelby and Ranking Member Paul Sarbanes and House Financial Services Committee Chairman Michael Oxley and Ranking Member Barney Frank follows. The full report is attached.

June 30, 2005

The Honorable Michael G. Oxley
House of Representatives
Washington, DC 20515

Dear Chairman Oxley:

The Terrorism Risk Insurance Act of 2002 (TRIA) required the Treasury Department, as administrator of the Terrorism Risk Insurance Program, to assess features of the program and its environment, and report to Congress on its findings by June 30, 2005. As required by law, I am submitting to you an assessment of TRIA.

President Bush signed TRIA into law to help safeguard America's economy in the wake of the terrorist attacks of September 11, 2001. TRIA established a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting from foreign acts of terrorism.

The Treasury Department was required by TRIA to specifically assess the effectiveness of the program, the availability and affordability of such insurance for various policyholders, and the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after the expiration of the program. The attached report, based in part on surveys of the insurers and policyholders that were developed after extensive consultations with the National Association of Insurance Commissioners, policyholders, the insurance industry, and other experts in the insurance field, evaluates the effectiveness of TRIA in the context of the purpose of the legislation. The report finds that TRIA has achieved its goals of supporting the industry during a transitional period and stabilizing the private insurance market.

While TRIA has been effective in achieving its temporary objectives, the economy is more robust today than when TRIA was enacted. GDP growth is up from 2.3 percent in 2002 to 3.9 percent in 2004 (fourth quarter over fourth quarter). Unemployment, which reached 6.0 percent in December 2002, is down to 5.1 percent in May 2005. Construction jobs, taking residential and nonresidential together, now stand at a record high 7.2 million. Extending TRIA would have little impact on the economy given its current strength.

It is our view that continuation of the program in its current form is likely to hinder the further development of the insurance market by crowding out innovation and capacity building. Consistent with its original purpose as a temporary program

scheduled to end on December 31, 2005, and the need to encourage further development of the private market, the Administration opposes extension of TRIA in its current form.

Any extension of the program should recognize several key principles, including the temporary nature of the program, the rapid expansion of private market development (particularly for insurers and reinsurers to grow capacity), and the need to significantly reduce taxpayer exposure. The Administration would accept an extension only if it includes a significant increase to $500 million of the event size that triggers coverage, increases the dollar deductibles and percentage co-payments, and eliminates from the program certain lines of insurance, such as Commercial Auto, General Liability, and other smaller lines, that are far less subject to aggregation risks and should be left to the private market.

It is also important to keep in mind that the program would cover damages awarded in litigation against policyholders following a terrorist attack. Current litigation rules would allow unscrupulous trial lawyers to profit from a terrorist attack and would expose the American taxpayer to excessive and inappropriate costs. The Administration supports reasonable reforms to ensure that injured plaintiffs can recover against negligent defendants, but that no person is able to exploit the litigation system.

We look forward to further discussions with the Congress on this very important issue.

Sincerely,

John W. Snow

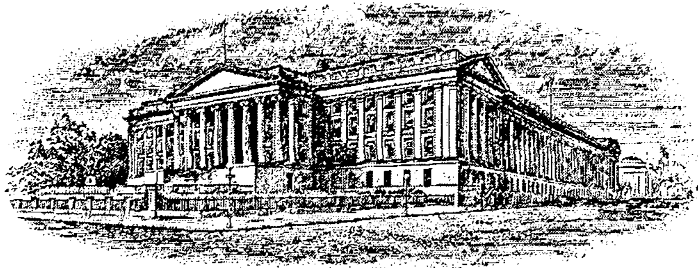
REPORTS

- Assessment Terrorism Risk Insurance Act of 2002

REPORT TO CONGRESS

Assessment:

The Terrorism Risk Insurance Act of 2002



THE UNITED STATES DEPARTMENT OF THE TREASURY

June 30, 2005

REPORT TO CONGRESS

ASSESSMENT:
THE TERRORISM RISK INSURANCE ACT OF 2002

JUNE 30, 2005

THE UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF ECONOMIC POLICY
WASHINGTON D.C.

PRESS ROOM

June 30, 2005
JS-2005-06-24

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 $77,110 million as of the end of that week, compared to $77,502 million as of the end of the prior week.

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

	June 17, 2005			June 24, 2005		
TOTAL		77,502			77,110	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,369	14,454	25,823	11,259	14,402	25,661
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,070	2,905	13,975	10,937	2,895	13,832
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]			15,332			15,282
3. Special Drawing Rights (SDRs) [2]			11,330			11,293
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	June 17, 2005			June 24, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

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

	June 17, 2005			June 24, 2005		
	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.

June 30, 2005
JS-2619

Statement of
Bobby Pittman, Jr., Deputy Assistant Secretary of the Treasury for International Development Finance and Debt
House Committee on International Relations
Subcommittee on Africa, Global Human Rights and International Operations

Thank you Chairman Smith, Ranking Member Payne, and other members of the Subcommittee. I am very pleased to be here today to talk about the G8 Summit and Africa's Development from the perspective of the Treasury Department. I am particularly excited to brief you on the G8's decision to support the President's proposal for 100 percent debt cancellation for the poorest countries.

Before getting into the details, I would like to put this proposal into perspective. Since the beginning of President Bush's time in office he has pushed an aggressive agenda on development. This was first defined in the lead up to Monterrey, when the President proposed a New Compact for Development. This Compact was a proposal to increase aid, but with a clear purpose and in countries where it could be most effectively used to stimulate growth and reduce poverty. It was recognition that it's not enough to give more aid; we also needed to improve the way we deliver aid.

Historic Increases in Assistance...

Since Monterrey, we've seen an amazing evolution of U.S. official development assistance. While others are delivering promises, the U.S. has been delivering substantial increases. For some thirty years prior to this Administration, the U.S. provided roughly 15 percent of all official aid to Africa. Over the past two years the U.S. represented nearly a quarter of all official assistance to the continent. The increase has been dramatic, both in absolute terms and in terms of the U.S. share.

I should note that this dramatic increase in development assistance in recent years has come prior to disbursements from the President's Millennium Challenge Corporation (MCC) program. This year, the program is beginning to make disbursements and has billions of dollars in the pipeline. More importantly, this program is setting a new standard for delivering assistance to those countries that are helping themselves – by investing in the health and education needs of their people, fighting corruption, and demonstrating a commitment to economic freedom.

These increases also do not include the full implementation of the President's Emergency Plan for HIV/AIDS Relief. As of March 31st of this year, the Plan had already supported anti-retroviral drug treatment for approximately 230,000 men, women and children through bilateral programs in the most afflicted countries in Sub-Saharan Africa. This is a great start, but the goal is to treat some 2 million afflicted people in Africa, Asia and the Caribbean by 2008.

... with More Effective Delivery.

The manner in which aid is delivered is also changing dramatically. America has tried to change the focus of both our bilateral assistance and multilateral assistance away from simplistic numeric targets, and toward a greater focus on ensuring that assistance is well spent and channeled to environments where it can have the greatest possible impact in lifting people out of poverty.

For the Treasury Department, this has meant reforming the Multilateral Development Banks (MDBs) and the way in which they deliver assistance. As a result, the MDBs now deliver significantly more assistance to countries that are well governed and enact pro-growth policies. For example, the World Bank's International Development Association (IDA) now has one of the most selective systems for providing assistance of any donor, bilateral or multilateral, in the world. The Bank's strategy for FY06-08 envisions providing the top 10% of country performers with nearly 7 times as much assistance on a per capita basis as the lowest 10%, reflecting the heavy weight of governance in the allocation system. All of the MDBs with concessional windows -- with the exception of the GEF --have put similar systems in place as a result of strong U.S. leadership.

We have also been working to change the culture and standards by which the MDBs judge the effectiveness of their assistance. For many of these institutions, success was measured in the volume of loans going out the door. We are working to ensure that success is instead measured by measurable results on the ground. These efforts have already begun to pay dividends. For example the World Bank has now committed to have measurable targets for all country assistance strategies, all African Development Fund projects will have results-based frameworks, and the Asian Development Bank has begun instituting a performance review system that judges staff on project results. Also, as a result of strong U.S. leadership all of the MDBs now have independent evaluation units that are charged with examining the impact and effectiveness of their institutions' work and making the results publicly available.

Finally, we've worked to make sure that more assistance is given in the form of grants. It would be unwise, if not counter-productive, to continue to add to already unsustainable debt burdens in the poorest countries. Combined with our landmark agreement to cancel debt, the increased use of grants in the World Bank's IDA, Asian Development Fund (AsDF) and African Development Fund (AfDF) will ensure that poor countries do not find themselves again in the lend-forgive-lend trap. Due to strong U.S. leadership during the IDA-14 and AfDF-10 negotiations, there will be significantly more grants given to the poorest and most debt- vulnerable countries, including most Heavily Indebted Poor Countries (HIPCs).

A Bold Proposal – 100 Percent Debt Cancellation

For some forty years, many of the poorest countries have been getting loans for projects to support health, education and other basic development needs. Although the U.S. and most other countries now provide nearly all of their assistance to the MDBs in the form of grants, the banks continued to provide loans to the poorest countries in desperate need of development assistance. The result is that for many important projects without near-term financial returns, such as building schools, these poor countries were burdened with additional debt that needs to be repaid by future generations. Shifting to grants going forward ends this cycle. However, this alone would not have been enough. There also needed to be a correction of history, a cleaning of the balance sheets for future generations.

For many of the poorest countries, there has been a history of lend and forgive cycles. The HIPCs alone have accounted for nearly 250 debt relief treatments in the Paris Club over the last 25 years. This means that many countries have been getting debt reschedulings, or partial debt reduction, every two or three years. At the same time the MDBs have been increasing their lending volumes to fill up any space created by the temporary debt treatments. Between 1989 and 2002, debt relief to HIPC countries totaled $40 billion while new loans totaled more than twice that - $93 billion.

The international community has been pursuing a series of well intentioned, but ultimately stop-gap measures to address debt in the poorest countries. This started in 1979 with small amounts of relief, about $6 billion. In 1987, there was the establishment of "Venice terms" in the Paris Club whereby some countries would qualify for interest rate relief. This was followed by numerous rounds in the Paris Club of increasingly generous treatments (Toronto, London and Naples terms). Then in 1996, the HIPC Initiative, which for the first time incorporated debt relief from the international financial institutions, was announced. This was followed by

the "Enhanced HIPC Initiative" in 1999. All of these initiatives helped to reduce the burden of debt in the poorest countries, yet the cycle of lend and forgive was still churning.

To end the cycle once and for all, the U.S. proposed a complete write-off of all official debt to the poorest countries. This included as much as $60 billion in HIPC countries' debt owed to the World Bank's IDA, the AfDF and the IMF.

I want to stress that many Members of Congress, including Members sitting in this subcommittee, along with representatives of civil society, have been extremely supportive and helpful in this campaign from the start. The U.S. has presented a very united front to the world on this issue, and that has been critical in convincing other countries to join us.

The Mechanics

The key to the U.S. proposal was to focus on the net flows from the institutions to the countries. As with our bilateral aid flows, the payments from the recipients are netted out from the new aid flows. Focusing on net transfers allows the proposal to maintain equity among the poorest countries. Under the HIPC initiative, HIPC countries received large increases in net transfers while non-HIPCs saw their net transfers decline. Focusing on the net flows was also important for cleaning the balance sheets of the MDBs. The International Financial Institutions were often giving loans to help ensure payment on old existing loans. This contributed to a lack of transparency and an exacerbation of the lend and forgive cycle.

When our ideas were first proposed nearly one year ago, they were met with considerable skepticism. This was primarily because they did not involve additional funding requests. With respect to the MDBs, we pointed out that the concessional windows are structured and funded such that they could forgive the debt of the HIPCs without impairing their ability to provide the same amount of net new funding for ongoing projects. Using 2003 as an example, we showed that the scale of reflows is small compared to disbursements. This is primarily because of the concessionality of IDA's financing and the significant nominal growth in disbursements over history. In 2003, the reflows from the HIPCs to IDA were roughly $200 million, compared to $3.4 billion in new disbursements. In fact, HIPC reflows accounted for only 3% of IDA's total new disbursements in 2003.

Though IDA lending represents the bulk of the remaining debt stock for HIPC countries, it was also important to have a strategy for IMF debt, which represents a significant portion of debt service in the short term given its much shorter repayment terms. In the IMF, many were calling for gold sales or off-market transactions. Significant work by our staff uncovered that there were existing resources within the Fund that could be used to effect debt relief. Moreover, this approach allows the fund to continue to engage effectively in low income countries while preserving its financial strength.

While the U.S. proposal ensured that net transfers to poor countries would not decline, many shareholders were worried about the long-term financial strength of the institutions. At the meeting between President Bush and Prime Minister Blair early this month, the United Kingdom agreed to support the U.S. proposal for 100 percent debt cancellation and the U.S. affirmed its commitment to the financial strength of the institutions. We will be able to do this by utilizing flexibility in the timing of payments of previously planned funding requests. Additional contributions will ensure the financial strength of the institutions, while being delivered based on performance, not historic debt obligations. This means that net transfers will in fact increase for countries that are performing well and using aid effectively.

The Historic Agreement

The agreement between Prime Minister Blair and President Bush was a critical breakthrough in the fight to cancel the debt for the poorest countries. This led to an agreement on June 11 by G8 Finance Ministers to a debt relief plan that largely reflects the one we began to discuss one year ago. As Treasury Secretary John

Snow stated, "President Bush's commitment to lift the crushing debt burden on the world's poorest countries has been achieved. This is an achievement of historic proportions." The G8 Agreement calls for 100 percent cancellation of debt obligations owed to the World Bank (IDA), African Development Bank (AfDF), and International Monetary Fund by countries eligible for the HIPC Initiative.

The key elements of the G-8 agreement include:

- ***100 percent IDA, AfDF, and IMF Debt Stock Relief.*** For IDA and AfDF debt, 100 percent stock cancellation will be delivered by offsetting gross assistance flows by the amount forgiven. IMF debt relief will be financed from existing IMF resources.
- ***Additional Donor Contributions to IDA and AfDF.*** Donors will provide additional contributions, based on agreed burden shares, to offset foregone debt repayments (principal and interest) to IDA and AfDF. Additional funds will be made available immediately to cover the IDA-14 and AfDF-10 period and through regular replenishments for subsequent periods.
- ***Focus on Strong Performance***. The additional donor contributions will be allocated to all IDA-only countries based upon the existing IDA and AfDF performance-based allocation systems. This approach ensures equity between HIPCs and non-HIPCs – since all countries receive additional assistance commensurate with performance – and creates an incentive for countries to pursue responsible, pro-growth policies. Based upon existing performance levels, we estimate that roughly half of the additional contributions will be allocated to non-HIPC countries.
- ***Utilize grant financing from IDA and AfDF to ensure that countries do not immediately re-accumulate unsustainable external debts***. During this time period, HIPCs will gradually be eased into new borrowing based upon their capacity to repay. This transition period will enable countries to focus on developing the necessary environment for promoting economic growth and poverty reduction.

Under the plan, eighteen countries will be immediately eligible for IDA, AfDF, and IMF debt forgiveness: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia. The remaining HIPCs will also become eligible as they reach their HIPC Completion Point.

The total amount forgiven for the eighteen HIPC completion point countries will be $40.4 billion in nominal terms, of which IDA accounts for $32.9 billion, the AfDF $3.2 billion and the IMF $4.3 billion. The full application of the cancellation of existing debt repayments could amount to as much as $60 billion as countries complete the process.

Going Forward

The agreement by the G8 Finance Ministers this month was truly a historic occasion. That said, we still have significant work ahead. We will be presenting the proposal to the broader shareholders of the World Bank, AfDB and the IMF this fall to seek their agreement. We also need the support of Congress. The commitments to the financial strength of the institutions come first and foremost through our current and future appropriations requests. I would like to take this opportunity to thank the House of Representatives, following the lead of Subcommittee Chairman Kolbe and Ranking Member Lowey, for fully funding these requests for FY2006. This, however, is the first of many steps. It is my both my plea and my hope that we continue this close coordination among the Administration, Congress and civil society as we move forward in implementing this truly historic agreement.

I want to once again thank the subcommittee for giving me this opportunity to testify and for all the support for debt cancellation in the context of helping the poorest countries that are committed to pro-growth policies and poverty reduction.

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

June 30, 2005
JS-2620

Procedures Released for Examining OFAC Compliance

The Federal Financial Institutions Examination Council (FFIEC) today released a Bank Secrecy Act/Anti-Money Laundering Manual (FFIEC BSA/AML Examination Manual). The manual includes audit procedures for use when examining financial institutions for compliance with the sanctions programs administered by the Treasury Department's Office of Foreign Assets Control (OFAC). The manual is expected to serve as an OFAC model for federal and state regulators in other areas, such as the securities industry.

"The publication of this guidance will further ensure consistency and provide additional clarity in relation to OFAC compliance," said Robert Werner, the Director of OFAC. "This is one more step in our continuing efforts to assist U.S. Banks and other U.S. Industries in complying with those economic sanctions programs that are so critical to furthering our country's national security and foreign policy interests."

As outlined in the manual, OFAC emphasizes that financial institutions should take a risk-based approach when considering the likelihood of encountering a "match" or "hit" to the list of Specially Designated Nationals and Blocked Persons (SDN List), a targeted country or other OFAC sanctions.

The manual recognizes that a fundamental element of sound OFAC compliance is a bank's assessment of its product lines, its customer base, its geographic location, the nature of its transactions and the identification of high-risk areas for OFAC transactions. It states that banks should establish and maintain an effective, written OFAC program commensurate with their OFAC risk profile. Programs should:

- Identify high-risk areas;
- Provide for appropriate internal controls for screening and reporting;
- Establish independent testing for compliance;
- Designate a bank employee or employees as responsible for OFAC compliance and
- Create training programs for appropriate personnel in all relevant areas of the bank.

The manual also notes that "an effective risk assessment should be a composite of multiple factors, and depending upon the circumstances, certain factors may be weighed more heavily than others."

The functional regulators will be examining financial institutions to determine the adequacy of each institution's OFAC program and the effectiveness of its risk management.

Recognizing that the primary goal of OFAC's enforcement actions is remediation, OFAC is working toward an updated version of its own Enforcement Guidelines which will be published in the *Federal Register*. The new Guidelines will incorporate risk-based compliance. OFAC will implement an institutional – rather than only a transactional – approach into its enforcement calculus, which will take into account the efforts of financial institutions to assure OFAC compliance, as well as any violations that might occur.

OFAC realizes that every violation does not rise to the same level of egregiousness. It is committed to and will be involved in an ongoing dialogue with the functional regulators about institutions and violations. It will actively seek their opinion about OFAC compliance programs at institutions under enforcement review and will also be participating in numerous training sessions, including teleconferences, with financial institutions.

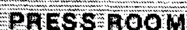
The BSA/AML Examination Manual material is accessible via the following link: http://www.treas.gov/offices/enforcement/ofac/civpen/ofac_sec_frb.pdf.

Also available on OFAC's website are expanded risk matrices for banks to consider as they review their compliance procedures: http://www.treas.gov/offices/enforcement/ofac/faq/matrix.pdf.

June 30, 2005
JS-2621

Statement by Treasury Secretary John Snow following meeting with Senators Lindsay Graham and Chuck Schumer

"I appreciate the accommodation shown by Senators Graham and Schumer in agreeing to postpone a vote on the China tariff legislation. It is important that China move to a more flexible exchange rate regime, we have urged them to do so, and they have agreed that it is in their interest to adopt greater exchange rate flexibility. While it is in China's interest that they do so, it is also in the interest of the global adjustment process. I believe that our longstanding efforts are beginning to come to fruition and we are making progress toward achieving this goal. I appreciate the strong interest of Senators Graham and Schumer on this issue. Our cooperation with Congress can be constructive and I hope to continue to work with both Senators, and other Members, as we move forward."



PRESS ROOM

June 30, 2005
JS-2622

Report On Foreign Portfolio Holdings Of U.S. Securities At End-June 2004

The final results from the annual survey of foreign portfolio holdings of U.S. securities at end-June 2004 are released today and posted on the U.S. Treasury web site at (http://www.treas.gov/tic/fpis.html).

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 report covered the survey for end-June 2003. Surveys are carried out annually, and the next survey will be for end-June 2005.

Complementary surveys measuring U.S. portfolio holdings of foreign securities are also carried out annually. Data from the most recent such survey, which reports on securities held at year-end 2004, are currently being processed. Preliminary results are expected to be reported by September 30, 2005.

Overall Results

The survey measured foreign holdings as of June 30, 2004, of $6,006 billion, with $1,904 billion held in U.S. equities, $3,515 billion in U.S. long-term debt securities (securities with an original term-to-maturity in excess of one year), and $588 billion in U.S. short-term debt securities. The previous such survey, conducted as of June 30, 2003, measured foreign holdings of $4,979 billion, with $1,564 billion in U.S. equities, $2,939 billion in U.S. long-term debt securities, and $475 billion in short-term U.S. debt securities.

Table 1. Foreign holdings of U.S. securities, by type of security, as of survey dates
(Billions of dollars, except as noted)

Type of Security	June 30, 2003	June 30, 2004
Long-term Securities	4,503	5,418
Equity	1,564	1,904
Long-term Debt	2,939	3,515
Short-term Debt Securities	475	588
Total	4,979	6,006

Table 2. Foreign holdings of U.S. securities, by economy and type of security, for the economies having major portfolio investment in the U.S., as of June 30, 2004
(Billions of dollars)

		Total	Equities	Long-term	Short-term
1	Japan	1,019	162	736	121
2	United Kingdom	488	250	221	16
3	Luxembourg	392	130	230	31
4	Cayman Islands	376	115	230	31
5	China , Mainland	341	3	320	18

6	Belgium	308	18	285	5
7	Canada	291	210	67	15
8	Netherlands	203	127	70	6
9	Switzerland	199	120	68	11
10	Germany	190	76	107	8
11	Bermuda	180	52	113	15
12	Ireland	164	52	66	46
13	Taiwan	124	9	113	2
14	Middle East Oil-exporters /1	121	69	34	18
15	Singapore	120	72	42	6
16	France	117	62	41	15
17	South Korea	90	1	81	8
18	Hong Kong	89	22	43	23
19	Australia	74	47	21	6
20	Sweden	73	46	26	1
21	British Virgin Islands	65	36	27	3
22	Mexico	65	9	30	25
23	Norway	59	29	29	2
24	Italy	58	35	20	3
25	Russia	48	0	8	40
	Country Unknown	224	3	218	3
	Rest of world	528	149	269	110
	Total	6,006	1,904	3,515	588

/1 Bahrain , Iran , Iraq , Kuwait , Oman , Qatar , Saudi Arabia , and the United Arab Emirates .

1482 8809 11
08/02/05 MAB