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PRESS RELEASES

The following Press Release numbers were not used:

3095, 4015, 4017, 4018 and 4024 through 4043

PRESS ROOM

February 1, 2006
JS-3094

Assistant Secretary for Financial Institutions Emil W. Henry Jr. February 2006 Quarterly Refunding Statement

We are offering $48.0 billion of Treasury securities to refund approximately $17.3 billion of privately held securities maturing on February 15 and to raise approximately $30.7 billion. The securities are:

- A new 3-year note in the amount of $21.0 billion, maturing February 15, 2009;
- A new 10-year note in the amount of $13.0 billion, maturing February 15, 2016;
- A new 30-year bond in the amount of $14.0 billion, maturing February 15, 2036.

These securities will be auctioned on a yield basis at 1:00 PM EST on Tuesday, February 7, Wednesday, February 8, and Thursday, February 9, respectively. All of these auctions will settle on Wednesday, February 15.

The balance of our financing requirements will be met with weekly bills, monthly 2-year and 5-year notes, the March 10-year note reopening, the April 10-year TIPS reopening, and the sale of 5-year TIPS in April. Treasury also is likely to issue cash management bills in early March and April. Additional cash management bills may be required to manage volatility associated with debt ceiling restrictions.

Debt Limit

Securities issued during the Quarterly Refunding will not be affected due to debt limit constraints. All securities auctioned during the Refunding will settle as normal on February 15, 2006.

While Treasury is working with Congress to promptly pass legislation to raise the debt ceiling, Treasury market participants should be prepared for possible delays in the auction schedule if Congress does not enact legislation to raise the debt limit.

Thirty-Year Coupon Cycle

Based on our initial consultations with market participants, Treasury will consider issuing 30-year bonds on the May-November coupon cycle to facilitate trading in the STRIPS market. We will continue to examine how our calendar can best accommodate both coupon cycles. We expect to announce any change in the issuance calendar for the 30-year bond on August 2, 2006. No calendar change would occur before calendar year 2007.

Cash Balance Management

With the shift of the 5-year note to month end, Treasury's usual pattern of issuing cash management bills at the beginning of the first and third months of a quarter may change. While we expect to issue cash management bills at the beginning of March and April, issuance in the future may not follow the same patterns. Treasury will continue to provide market participants with as much advance notice as possible when issuing cash management bills.

Debt Limit Consequences for the Sales of State and Local Government Securities

If the debt ceiling is not raised within the next two weeks, the Treasury Department will begin to take extraordinary measures to stay beneath the ceiling, including suspension of sales of State and Local Government series (SLGS) securities. The suspension of SLGS sales during debt ceiling impasses facilitates Treasury's management of debt levels.

If SLGS sales are suspended, the suspension would apply to demand deposit and time deposit securities. New subscriptions for SLGS would not be accepted until the suspension is lifted. Treasury will make an advance public announcement of the effective time and date of any suspension. During the suspension period, Treasury will not accept submissions of new subscriptions.

The Internal Revenue Service has issued guidance to affected entities in Rev. Proc. 95-47, 1995-47 I.R.B. 12 which is available in the "Tax Exempt Bond Tax Kit" which can be found by following the link labeled "TEB Tax Kit" at www.irs.gov/bonds.

Other Policy Matters Under Consideration

Treasury Securities Lending Facility

For several months, Treasury has been studying the idea of creating a securities lending facility. Treasury will continue to consult with market participants regarding a proposed standing, nondiscretionary securities lending facility, and welcomes more detailed market discussion on the structure of a lending facility.

Please send comments and suggestions on these subjects or others relating to Treasury debt management to debt.management@do.treas.gov.

The next quarterly refunding announcement will take place on Wednesday, May 3, 2006.

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PRESS ROOM

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February 1, 2006
JS-3096

Report To The Secretary Of The Treasury From The Treasury Borrowing Advisory Committee Of The Bond Market Association

Dear Mr. Secretary:

Since the Committee's last meeting in November, economic releases continue to show the impact of record energy prices in the wake of Hurricane Katrina. For the year, 2005 GDP growth was near its long-term trend of 3.2%, even though it ended the year with weak 1.1% growth in Q4. Much of this decline was due to a sharp drop-off in automobile purchases, which followed a rise in such purchases in Q3 due to massive discounting. Despite the weakest consumption growth since Q2 2001, investment spending continued to expand, supported by investment in capital equipment. Going forward, moderation in home sales from their peak has the potential to subtract from residential investment growth and bring GDP growth below trend, but businesses' strong cash position should enable capital spending to move ahead moderately.

Employment rebounded from weak job gains post-Katrina during September and October. In the last two months of 2006, the economy added 413,000 jobs, just below the 425,000 jobs added in the months before Hurricane Katrina. In addition, the unemployment rate has reached a cyclical low of 4.9%, leading some, including the FOMC, to worry about the potential impact on inflation from tighter labor markets. However, wage gains remain tame, with average hourly earnings ending 2005 just 3.1% above the previous year. In addition, taking into account the impact of record energy prices, real disposable income ended the year just 0.4% above the previous year.

Although energy prices moderated following the hurricanes, they have begun to rise in 2006 due to instability in foreign oil-producing countries. Headline CPI inflation ended 2005 at 3.4% down from its peak of 4.7% in September. Price increases outside of energy were modest. The Fed's favored measure of inflation, the core PCE deflator, increased at a 2.2% annualized pace in Q4, putting its year-over-year (Y/Y) change in Q4 to 1.9%. The pass-through of higher energy prices and tight labor markets raise the risk that increases in core inflation may lie ahead. However, with energy prices unlikely to increase as drastically as they did in 2005, headline inflation will likely moderate in 2006. Foreign demand looks to have little impact on inflation, as the trade-weighted dollar remains close to its year-ago level.

After rising before the first FOMC tightening in June 2004, long-term Treasury yields have declined almost 50 bps since this tightening cycle began. As the FOMC increased its short-term target by 350 bps, the yield curve has flattened substantially, even compared to previous tightening cycles of 1994 and 1999. A flat or inverted yield curve is a historically rare occurrence and is weighing on the Financials sector. Two-year yields and 10-year yields have now converged, as two-year yields are nearly 300 bps higher than the lows observed in mid-March 2004, while 10-year yields have risen only 75 bps. The market is currently pricing in just above an 80% probability that the FOMC will raise rates by 25 basis points at its March 28 meeting.

Corporate profits continue to rise. As of January 31, with slightly more than half of S&P 500 companies reporting, 79% had met or exceeded expectations for the fourth quarter.

The fiscal year (FY) 2005 deficit fell to $319 billion, the lowest deficit since FY 2002. However, the hurricanes have reversed the improving trend in the federal deficit, a

result of both reconstruction spending and lower receipts due to job losses. Assuming half of the $62 billion appropriated for reconstruction is spent in FY 2006 and adding that to the CBO's baseline budget projection, the FY 2006 deficit will likely be $345 billion (2.7% of GDP), in line with OMB projections and a slight worsening in the government's budget position. The Treasury will easily be able to finance this slightly higher budget deficit with its current financing schedule.

In the first section of the charge, Treasury asked the Committee for its views regarding the development of guidelines on the composition of the debt portfolio. Specifically, is the composition of bills relative to coupon securities in the appropriate balance at current levels of issuance? What other factors should Treasury use in its determination of debt portfolio composition?

Treasury presented the Committee with charts describing the flexibility, capacity and cost characteristics of bill financing. Characteristics of coupon financing were also shown including interest cost volatility, rollover risk, operational risk and investor base considerations. Additionally, charts demonstrating bill issuance as a percentage of total marketable outstandings, distribution of bills versus coupons, interest rate differentials across the maturity curve and average maturity of outstandings were presented. Committee members discussed numerous portfolio considerations and the viability or attractiveness of managing debt issuance around specific guidelines, including average maturity or bills as a percentage of total outstandings. While some felt that more specific guidelines might be worthwhile, others cautioned against this and proposed having a list of considerations to manage against without giving up Treasury's current issuance flexibility. These considerations included interest cost and volatility over time, issue size and auction frequency capacity, liquidity, responsiveness to the investor base and rollover risk. One member suggested to Treasury that it conduct further statistical analysis of its portfolio to determine an optimal barbell strategy to balance long-duration issuance and bills. In general most members favored a focus on average maturity of the debt while maintaining a relatively high percentage of bills as guiding principles for the objective of achieving the lowest cost of borrowing over time.

In the second part of the charge, Treasury asked for the Committee's views on resumed issuance of the 30-year bond. In particular they asked for the Committee's views on future auction sizes, potential impacts on the STRIPS market and the desirability of quarterly issuance. Treasury did not indicate when they would offer guidance as to what amounts of issuance they plan in bonds but indicated maintaining similar amounts of issuance through 2007. Committee members differed as to preference of auction size, though many thought that there was strong enough demand to accommodate auction sizes near $15 billion. Others thought that a more gradual approach to reintroduction would result in lower borrowing costs. These members suggested that the underwriting process may need some time to form and that Dutch auctions of long duration instruments may be initially an obstacle for market participants. Similarly, another member suggested that Treasury consider auction taps periodically as is common practice in the U.K. The Committee strongly preferred consideration of cycles which included auctions held in both May and November citing stronger stripping demand historically for bonds auctioned at that time of year. One member suggested auctions in February and August this year followed by May and November auctions in 2007. Members also encouraged Treasury to be sensitive to potential shortages of coupon STRIPS as they consider auction cycles as well.

In the third section of the charge, Treasury asked for the Committee's views with regard to relevance of yield curve shape at current levels, on the financial markets and the various types of participants within the broad industry group. A member responded to Treasury's pre-assigned charge which is appended to this letter. The member's response to the charge was organized in two basic parts: a discussion of the shape of the curve's impact on the general economy and its predictive ability of real output, and an analysis of the yield curve's shape on a variety of types of institutions. The member began his presentation by citing a reduced impact on the real economy from very flat yield curves than had been observed in the 1980's. He showed slides suggesting a coincidence of recessions with flat yield curves but noted that correlations between the two had diminished over time. Other members described a flat or inverted yield curve as a necessary but not sufficient predictor of economic slowdown. The presenting member showed slides depicting an increasing burden of financial obligations of homeowners due to the increase in short rates and higher incidence of adjustable rate mortgages. In general, while not minimizing the large increase in leverage of homeowners and associated debt

service, the member felt that the yield curve at current shape and level may facilitate a shift in preference from shorter-term borrowing to long. Other members concurred with this view, describing consumers as efficient borrowers. The presenting member then turned to a discussion of a variety of financial market participants and the impact of the curve on their operating businesses. For the insurance industry as a whole, he cited increased pressure on earnings as yield spreads have contracted and long Treasury yields declined. The result has been pressure on earnings and a greater reliance on lesser credits and structured credit products, sacrificing liquidity for yield. Turning to the banking sector, the member showed slides illustrating a decline in net interest margins associated with both secular earnings trends and a flat yield curve. In general he felt that the larger banking institutions had and would be able to withstand the earnings pressures as their sources of revenues had been diversified by fee income. While larger banks still enjoy reasonable loan growth, and the efficiencies of a consolidated industry, the shape of the curve will pressure earnings. Lastly, the presenting member discussed the impact of a flatter curve on the hedge fund industry noting that increased risk tolerance was observed in many participants and that risk in illiquid markets was growing as a result of fewer opportunities in the yield curve. Members discussed the increased exposure in riskier asset classes as common, which represents a tradeoff of liquidity for returns by a majority of investors.

In the last section of the charge, the Committee considered the composition of marketable financing for the January-March quarter to refund $17.3 billion of privately held notes and bonds maturing on February 15, 2006, as well as the composition of Treasury marketable financing for the remainder of the January-March quarter and the April-June 2006 quarter. To refund $17.3 billion of privately held notes and bonds maturing February 15, 2006, the Committee recommended a $20 billion 3-year note maturing February 15, 2009, a $13 billion 10-year note due February 15, 2016, and a $15 billion 30-year bond due February 15, 2036. For the remainder of the quarter, the Committee recommended a $22 billion 2-year note issued in February, a $15 billion 5-year note issued in February, an $8 billion reopening of the 10-year note issued in March, a $22 billion 2-year note issued in March, and a $15 billion 5-year note issued in March. The Committee also recommended a $20 billion 13-day cash management bill issued on March 2, 2006 and maturing on March 15, 2006. For the April-June quarter, the Committee recommended financing as found in the attached table. Relevant features include three 2-year note issuances monthly, one 3-year note issuance in May, three 5-year note issuances monthly, a 10-year issuance in May with a June reopening, a 10-year TIPS reopening in April and a 5-year TIPS issue in April.

Respectfully submitted,
Ian G. Banwell
Chairman

Thomas G. Maheras
Vice Chairman

Attachments (2)

REPORTS

- Q1 Tables
- Q2 Tables

US TREASURY FINANCING SCHEDULE FOR 1st QUARTER 2006
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	OFFERED AMOUNT 6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND 3&6 MONTH BILLS	12/29	1/3	1/5	8.00	17.00	15.00	47.00	-7.00
	1/5	1/9	1/12	8.00	18.00	16.00	47.00	-5.00
	1/12	1/17	1/19	8.00	20.00	17.00	45.00	0.00
	1/19	1/23	1/26	12.00	20.00	17.00	46.00	3.00
	1/26	1/30	2/2	12.00	20.00	17.00	43.00	6.00
	2/2	2/6	2/9	*18.00*	*20.00*	*17.00*	*43.00*	*12.00*
	2/9	2/13	2/16	*21.00*	*20.00*	*17.00*	*42.00*	*16.00*
	2/16	2/21	2/23	*25.00*	*20.00*	*17.00*	*46.00*	*16.00*
	2/23	2/27	3/2	*25.00*	*20.00*	*17.00*	*45.00*	*17.00*
	3/2	3/6	3/9	*25.00*	*20.00*	*17.00*	*51.00*	*11.00*
	3/9	3/13	3/16	*25.00*	*20.00*	*17.00*	*54.00*	*8.00*
	3/16	3/20	3/23	*25.00*	*18.00*	*16.00*	*58.00*	*1.00*
	3/23	3/27	3/30	*20.00*	*18.00*	*16.00*	*57.00*	*-3.00*
					699.00		624.00	75.00
CASH MANAGEMENT BILLS								
13-DAY BILL	2/28 Matures 3/15	3/1	3/2		*20.00*		*20.00*	*0.00*
								0.00

COUPONS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT	CHANGE IN SIZE	MATURING AMOUNT	NEW MONEY
5-Year Note	1/9	1/11	1/16	13.00			13.00
10-Year TIPS (R)	1/9	1/12	1/16	9.00			9.00
20-Year TIPS (R)	1/19	1/24	1/31	10.00			10.00
2-Year Note	1/23	1/25	1/31	22.00	2.00	25.61	-3.61
3-Year Note	2/1	2/7	2/15	*20.00*	*2.00*		*20.00*
10-Year Note	2/1	2/8	2/15	*13.00*			*13.00*
30-Year Bond	2/1	2/9	2/15	*15.00*	*15.00*	*17.28*	*-2.28*
2-Year Note	2/16	2/22	2/28	*22.00*			*22.00*
5-Year Note	2/16	2/23	2/28	*15.00*	*2.00*	*26.00*	*-11.00*
10-Year Note (R)	3/6	3/9	3/15	*8.00*			*8.00*
2-Year Note	3/23	3/27	3/31	*22.00*			*22.00*
5-Year Note	3/23	3/29	3/31	*15.00*		*26.01*	*-11.01*
				184.00		94.88	89.11

Estimates are italicized

NET CASH RAISED THIS QUARTER: 164.11

R = Reopening

US TREASURY FINANCING SCHEDULE FOR 2nd QUARTER 2006
BILLIONS OF DOLLARS

JE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	3-MO	6-MO	MATURING AMOUNT	NEW MONEY
EEK AND MONTH BILLS	3/30	4/3	4/6	*20.00*	*18.00*	*16.00*	*57.00*	*-3.00*
	4/6	4/10	4/13	*12.00*	*17.00*	*15.00*	*59.00*	*-15.00*
	4/13	4/17	4/20	*8.00*	*17.00*	*15.00*	*61.00*	*-21.00*
	4/20	4/24	4/27	*8.00*	*17.00*	*15.00*	*57.00*	*-17.00*
	4/27	5/1	5/4	*10.00*	*17.00*	*15.00*	*57.00*	*-15.00*
	5/4	5/8	5/11	*14.00*	*17.00*	*15.00*	*49.00*	*-3.00*
	5/11	5/15	5/18	*20.00*	*18.00*	*16.00*	*44.00*	*10.00*
	5/18	5/22	5/25	*20.00*	*18.00*	*16.00*	*44.00*	*10.00*
	5/25	5/30	6/1	*18.00*	*18.00*	*16.00*	*46.00*	*6.00*
	6/1	6/5	6/8	*14.00*	*18.00*	*16.00*	*50.00*	*-2.00*
	6/8	6/12	6/15	*12.00*	*18.00*	*16.00*	*56.00*	*-10.00*
	6/15	6/19	6/22	*10.00*	*18.00*	*16.00*	*54.00*	*-10.00*
	6/22	6/26	6/29	*10.00*	*18.00*	*16.00*	*51.00*	*-7.00*
					608.00		685.00	-77.00
;H MANAGEMENT BILLS								
)AY BILL	3/29 Matures 4/17	3/30	4/3		*25.00*		*25.00*	*0.00*
)AY BILL	4/5 Matures 4/17	4/6	4/7		*15.00*		*15.00*	*0.00*
)AY BILL	5/30 Matures 6/15	5/31	6/1		*15.00*		*15.00*	*0.00*
\Y BILL	6/5 Matures 6/15	6/6	6/7		*12.00*		*12.00*	*0.00*
								0.00
)PONS						CHANGE IN SIZE		
'ear TIPS (R)	4/10	4/12	4/17		*9.00*			*9.00*
:ar TIPS	4/20	4/25	4/28		*10.00*	*1.00*		*10.00*
:ar Note	4/24	4/26	5/1		*24.00*	*2.00*		
:ar Note	4/24	4/27	5/1		*16.00*		*26.02*	*13.98*
·ar Note	5/3	5/9	5/15		*22.00*	*2.00*		
'ear Note	5/3	5/11	5/15		*15.00*	*2.00*	*59.95*	*-22.95*
ar Note	5/22	5/24	5/31		*24.00*			
ar Note	5/22	5/25	5/31		*16.00*	*1.00*	*24.25*	*15.75*
ear Note (R)	6/5	6/8	6/15		*9.00*	*1.00*		*9.00*
ar Note	6/22	6/26	6/30		*25.00*	*1.00*		
ar Note	6/22	6/27	6/30		*16.00*	*1.00*	*24.57*	*16.43*
					186.00		134.78	51.21

nates are italicized

NET CASH RAISED THIS QUARTER: -25.79

Reopening

PRESS ROOM

February 1, 2006
JS-3097

Minutes of The Meeting Of The Treasury Borrowing Advisory Committee Of The Bond Market Association January 31, 2006

January 31, 2006

The Committee convened in closed session at the Hay-Adams Hotel at 3:00 p.m. All Committee members were present. Assistant Secretary Emil Henry, Deputy Assistant Secretary James Clouse and Office of Debt Management Director Jeff Huther welcomed the Committee and gave them the charge.

The Committee addressed the first question in the Committee charge (attached) regarding the appropriate composition of Treasury's debt portfolio and how to further develop guidelines on portfolio composition. Director Huther presented a series of charts describing the Treasury's portfolio considerations and the characteristics of bill and coupon financing. Since 1977, bills as a percent of total Treasury debt outstanding have averaged approximately 26 percent; currently bills are 23 percent of total debt outstanding. Director Huther showed charts describing the composition of the Treasury's current portfolio, and a chart showing that historically bills carry lower interest rates on average than coupons, but higher interest cost volatility. Director Huther indicated that bill issuance provides the Treasury with greater flexibility and is used first to address short-term changes in the deficit.

One member of the Committee asked whether Treasury should be looking at the new cash raised through bills versus coupons rather than the percent of total debt outstanding. Director Huther indicated that Treasury looks at average maturity of debt outstanding and the average maturity of issuance, and that both measures are of interest.

One Committee member noted that Treasury issues bills in large part for flexibility, but that with the flatness of the yield curve, it should not cost Treasury to move further out the curve and that it would be prudent to do so in part to avoid rollover risk. Another Committee member noted that the number of Treasury auctions per year (which is currently higher than average, particularly in bills) and the number of available days to auction securities could be a real constraint. Other members noted that this was a constraint that Treasury could manage. One Committee member noted that, out of the list of portfolio considerations, the primary considerations are flexibility, interest cost and liquidity. The Committee agreed that the list of portfolio considerations shown in the chart were reasonable.

One Committee member asked if Treasury should be looking at the division between bills and coupons in the portfolio, or if Treasury should be focusing on the average maturity of the debt. The Committee member noted that the Treasury has large financing needs going forward (forecasted deficits), that there is unprecedented demand for longer-dated securities, but that the average maturity of the debt outstanding was near its lowest level in twenty years. The Committee member noted that extending the average maturity of the debt may be advisable.

The Committee then discussed Treasury's rationale for not having a stated policy on the appropriate level for the average maturity of debt outstanding or a publicly stated ceiling or floor for this measure. Several Committee members suggested that Treasury should not set an explicit target or band for the average maturity of debt outstanding or for bills as a percent of debt outstanding. One Committee member noted that Treasury should only set explicit targets if they relate directly to the stated portfolio considerations such as lowest interest cost. Some Committee members noted that setting bands for an appropriate average maturity of debt

would be arbitrary. One Committee member noted that having the list of portfolio considerations was a better option and that the importance of each consideration may change over time. Other Committee members suggested that having a target would generate speculation in the market about what actions Treasury might take if Treasury were nearing its targets.

One Committee member suggested that Treasury needs to do more analysis on its investor base as it has changed substantially over the past twenty years. The member suggested more work needs to be done on the depth of demand, particularly at the very short and long end of the curve.

The Committee then addressed the second question in the charge regarding the Committee's views on resumed issuance of the 30-year bond. The Committee was asked about the initial auction size for the bond, coupon cycles for the STRIPS market and the consequences of a commitment to both coupon cycles on bond issuance in future years. Director Huther showed charts depicting the amount of bonds currently held in stripped form. Several members of the Committee asked why Treasury would wait to fill out the May/November STRIPS rather than addressing the issue now. One Committee member noted the recent increase in stripping activity and the gap in maturities between 2031 and 2036, and suggested that having February/August and May/November STRIPS would make a more complete curve. Other Committee members noted that Treasury should look at both the principal and coupon STRIPS and that analyzing just principal STRIPS does not convey the full story. Other Committee members suggested that Treasury should address STRIPS as the bond program matures rather than making a decision immediately. Director Huther noted that Treasury would like to have as much flexibility as possible, while maintaining transparency with the market.

The Committee then moved to discussing the size of the February 30-year bond issue. Director Huther reminded the Committee that Treasury had stated they would be issuing $20 to $30 billion in a 30-year bond in 2006. The Committee had differing views on whether Treasury should consider issuing a larger or smaller first bond. Some Committee members suggested that a $15 billion initial offering was on the large side and that Treasury should be more cautious with its first bond offering in five years. Members suggested that Treasury should ease back into the market because some market participants were concerned about the duration and risk at auction. Other Committee members argued for a larger first offering, arguing that there was large demand for the 30-year bond, particularly from the pension fund community, and that this demand should warrant a larger issue size. These members noted that even if the first auction was a bit "bumpy," demand for the issue would most likely cause the issue to trade well going forward in the secondary market. They suggested that the marginal cost to Treasury was lower than the risk of having too small an issue, and having it tighten up and trade poorly in the market.

Next the Committee addressed the third question in the Committee charge regarding the relationship between the shape of the yield curve and the outlook for financial markets. One Committee member presented a series of charts discussing the shape of the Treasury yield curve and the impact on the housing market, insurance companies, banks and leveraged accounts. The charts showed that the general economic climate in 2006 should remain favorable and argued that the shape of the yield curve has less predictive power today than in the past. The presentation showed that consumers have been expanding their spending capacity by extracting wealth from their homes, and that the shape of the yield curve and level of rates has had an impact on this phenomenon. The presentation showed that financial institutions, such as insurance companies, banks and leveraged accounts were taking on more risk and that risk appetite was growing.

The Committee was asked if flat yield curve was indicative of a slowdown or a recession. Several Committee members agreed that the flattening yield curve may not be predicting a slowdown or recession, but that other factors, such as heavy demand for longer-dated securities, were helping create the curve flattening. Several Committee members agreed that the flat yield curve and low level of rates had increased risk appetite, as market participants sought out higher returns.

Finally, the Committee discussed its borrowing recommendations for the February refunding and the remaining financing for this quarter as well as the April – June quarter. Charts containing the Committee's recommendations are attached. The Committee consensus was to recommend a $15 billion 30-year issue, though the Committee chairman noted the differing views.

The meeting adjourned at 4:30 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:30 p.m. All the Committee members were present. The Chairman presented the Committee report to Assistant Secretary Henry. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:45 p.m.

____

Jeff Huther
Director
Office of Debt Management
January 31, 2006

Certified by:

____

Ian Banwell, Chairman
Treasury Borrowing Advisory Committee
Of The Bond Market Association
January 31, 2006

Attachments:
Link to the Treasury Borrowing Advisory Committee discussion charts
U.S. Treasury - Office of Domestic Finance

Treasury Borrowing Advisory Committee Quarterly Meeting Committee Charge – January 31, 2006

Bills/Coupon Composition

We seek to develop guidelines for the appropriate composition of Treasury's debt portfolio based on the share of the portfolio devoted to bills relative to coupon securities. We would like the Committee's views on charts that we present and Committee suggestions on how to further develop guidelines on portfolio composition.

30-Year Bond

We would like the Committee's views on resumed issuance of the 30-year bond; initial sizes, coupon cycles for the STRIPS market and the consequences of a commitment to both coupon cycles on bond issuance in future years.

Shape of the Yield Curve

The recent flattening of the yield curve has led to questions about the relationship between the shape of the yield curve and the outlook for financial markets. We would like the Committee's views on the relevance of curve shape, at current levels, on the financial markets and institutions.

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes to refund approximately $17.3 billion of privately held notes and bonds maturing on February 15, 2006.
- The composition of Treasury marketable financing for the remainder of the January– March quarter, including cash management bills.
- The composition of Treasury marketable financing

PRESS ROOM

February 1, 2006
JS-3098

Treasury Secretary Snow to Visit Philadelphia to Discuss the State of the U.S. Economy

U.S. Treasury Secretary John W. Snow will travel to Philadelphia, Pennsylvania tomorrow to discuss the state of the U.S. economy. While in Philadelphia, Secretary Snow will visit Centocor, a biotechnology company located in Radnor, Pennsylvania, where he will make note of the contributions that innovation and technology make to the economy and to standards of living for the American people. Secretary Snow will also deliver remarks to the 2006 Greater Philadelphia Investment Conference.

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

Wednesday, February 1, 2006
2:15 PM EST
Centocor
Tour of Centocor facility
145 King of Prussia Road
Radnor, Pennsylvania
***** Media please RSVP to Melissa Katz at 215-514-0957**
***** Media must arrive no later than 1:30 PM EST**

2:45 PM EST
Centocor
Remarks to employees
145 King of Prussia Road
Radnor, Pennsylvania
***** Media please RSVP to Melissa Katz at 215-514-0957**
***** Remarks to employees will be immediately followed by a 15 minute press availability**

6:45 PM EST
Remarks to the 2006 Greater Philadelphia Investment Conference
Radisson Plaza - Warwick Hotel
1701 Locust Street
Philadelphia, Pennsylvania
***** Media please RSVP to Robert Powelson at 610-725-9100 ext - 17**
***** Media must RSVP no later than 12:00 noon Wednesday, February 1, 2006**
***** Media must arrive no later than 5:30 PM EST**

PRESS ROOM

February 1, 2006
JS-3099

MEDIA ADVISORY
Treasury Secretary Snow to Visit Charlotte, North Carolina to Discuss American Competitiveness and the U.S. Economy

U.S. Treasury Secretary John W. Snow will travel to Charlotte, North Carolina Thursday to discuss American competitiveness and the U.S. economy. While in Charlotte, Secretary Snow will visit the North Carolina Research Campus where he will participate in a discussion on the contributions that innovation and technology make to the economy and to standards of living for the American people.

The following event is open to credentialed media with photo identification:

Friday, February 3, 2006
11:00 AM EST
North Carolina Research Campus
Site Visit and Roundtable
Cannon Village Visitors Center
Auditorium
200 West Avenue
Kannapolis, NC
Media please RSVP to Phyllis Beaver at 704-273-1181 or
pbeaver@castlecooke.com

PRESS ROOM

February 1, 2006
JS-4000

The Honorable John W. Snow
Prepared Remarks
The Greater Philadelphia Investment Conference

Good evening; thank you so much for having me here tonight. As always, it's great to be in Philadelphia. And I truly cannot imagine a better city in which to discuss the topic that I have come here with. Because Philadelphia, the historic political birthplace of our nation, is also the place where an economic marvel began. Born just 230 years ago, today it is the unrivaled envy of the world: the American economy.

Philadelphia is also celebrating the 300th birthday of your favorite son, Benjamin Franklin – one of the great innovators of all time. That tradition of creativity and innovation is alive and well in this region today. I saw it in action this afternoon at a company called Centocor, where research and development are leading to products and medicines that improve the quality of life for people not only in this country, but also people all over the world.

There's an important connection here – the President highlighted it last night – between our ability to create, discover and innovate, and America's remarkable ability to compete in a changing global economy. We've been doing it for all of our history, and with the focus on good policies, we will continue to achieve higher and higher standards of living far into the future.

It was an important message the President delivered last night. He told America, correctly, that our economy is performing very well – far better than other major economies. But, as the President said, we live in a new world and are facing competition from new economic players like China, India, and other "emerging market" countries. In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: health, energy, and America's competitiveness.

Affordable and Accessible Health Care. The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts – putting patients in charge of their health care – will contribute to this goal. We need to make health insurance portable, make the system more efficient, and lower costs.

Advanced Energy Initiative. The President has said that the best way to break America's dependence on foreign sources of energy is through new technology. So the President announced the Advanced Energy Initiative, which provides for a 22 percent increase in clean-energy research at the Department of Energy. This initiative also builds on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

American Competitiveness Initiative. This ambitious strategy by the President will significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now. A current snapshot of this economy illustrates its strength: GDP growth was over 3.5 percent last year. Over four and a half million new jobs have been created since May of 2003, two million of them in the last year alone. Unemployment is running lower than the 1970s, 1980s and 1990s, U.S. equity markets are rising, and household wealth is at an all-time high.

The picture of our economy was not as good a few years ago, and I'm proud to be part of an Administration that has a deep understanding of what makes the American economy work. The President has advanced a rich and varied set of policies – from tax cuts to trade, energy to health care – that put entrepreneurs and consumers in the drivers' seat, where they belong. Based on principles and proven theory, these policies have helped our economy – which is naturally buoyant in its structure – to get solidly back on track.

Everywhere I go in this world, and every time I host finance ministers and colleagues from other countries, I am asked the same question: how does the U.S. do it? How do you keep your economy so robust?

And while there are plenty of current policies that I can point to, it's important to remember the answer actually begins here in Philadelphia. The words written by our founding fathers here in this city, without a doubt, created the environment in which innovation, productivity and economic growth could and would occur for hundreds of years to come. And no one understands that better than the President. In fact, a lot of what his agenda aims to accomplish is a devotion to the excellent structure that our economy is built on.

It is worth noting that the words of the constitution were not written in a vacuum. Not in a quiet or pastoral setting. They were written here, in a city that was booming with commerce and innovation. The City of Brotherly Love was, at that time, the largest city on the east coast, teeming with shipping and trading, buying and selling, production and innovation.

The basic structure of the United States was a profound theory – but maybe in part thanks to the success of a young Philadelphia, the men who laid it out already knew this theory would work.

As the President often says, government does not create wealth. Government creates an environment in which economic growth and progress can occur.

This is how the country, and the economy, was set up. We have a stable economic and political system that is checked and balanced. It's bicameral and federalist so that no one group – legislative or political – can gain too much power. It means that the power resides with the people when it comes to government, and with consumers when it comes to business.

Both property and intellectual rights are protected because our founders valued the individual, and we have stuck by that principle, as a nation, decade after decade.

Although people on my side of the aisle are forever trying to shrink the influence of government – or maybe because we are forever trying – the fact is that the U.S. remains a land of relatively low rates of both regulation and taxation, which is absolutely critical for business growth, innovation and job creation.

Americans, beginning with the founders, have a value for the individual and more than a tendency toward independence.

Truly free free-enterprise has, over the years, given rise to capital markets that are very well-developed and deep.

Credible, low-inflation monetary policy provides steady foundation for all of this, of course. The fact that the Federal Reserve Board is independent and well-run is an economic factor whose importance cannot be over-emphasized. We were fortunate to have Alan Greenspan at its helm for as long as we did, and I have the utmost confidence that my friend and colleague Ben Bernanke is going to be a successor worthy of the Greenspan legacy.

Another critical economic element is the United States' openness to free trade. As the President often points out, 95 percent of the world's customers live outside of the U.S. And in a country that thoroughly embraces free enterprise, customers and products alike have no borders.

A literal openness to people led to high levels of immigration. We have been a

beacon of light to those who wish to live in true freedom and independence, and the assimilation of foreign-born entrepreneurs has given us an enormous advantage when it comes to innovation. It helps to explain why we are by far the world's innovation leader.

The opportunity to take a risk and succeed has not only drawn people to the United States, it has enabled each generation of Americans to live better than the generation before. Entrepreneurship may look different from the days of the founders (who were virtually all entrepreneurs, by the way – farmers, businessmen, merchants, shippers, even land and securities speculators!), but the golden opportunity to take a risk and make a living off of your own ideas and sweat is just the same.

This is one of the reasons that I find news stories that predict a lack of financial opportunity for the up-and-coming generation to be just this side of absurd. Every generation worries about the next, but every generation has soared past their parents. We look back on 20 straight decades of more, better jobs each decade than the last. The evolution of our flexible and dynamic economy has made that possible, and I encourage all of you to take those stories for what they are: entertainment. They remind me of stories that once predicted massive failures of the banking system due to a lack of capable technology. Or, even further back, of a concern that half the population would need to be employed as telephone operators to connect all the calls that were being made.

We look back at those fears today and laugh! And we will again. You see, we've overcome every hurdle, every time. And if we keep our economy flexible and open we'll keep on doing just that.

The American economy owes much of its success to the embrace of entrepreneurship, which breeds the critical innovation that I'm talking about. The entrepreneurial spirit is exceptional in this country, and although we can always do better the government has done pretty well at staying out of that powerful spirit's way. This is a point of great pride for our President, whose economic agenda is largely a small-business agenda.

We may be known, internationally, for the names of our biggest companies, but it is small business that has kept our economic engine running strong and smooth. It has also given us incredible stability because it avoids situations where too many people's livelihood depends on just a few big employers. Most of our new jobs (around three quarters) are actually created by small business, and that's a sign of tremendous stability and forward-movement in an economy.

This is something other governments are picking up on and hoping to emulate. I've had very productive dialogue on the topic of entrepreneurship, and how to foster it, with government colleagues in Europe and Brazil, just to give two examples, in recent months.

We must always keep in mind that the foundations of our economy are always vulnerable to a chipping-away effect that comes from well-intentioned governing. As an institution, government sometimes can't help but intrude, here and there, on a free-market system. Taxes are necessary. Some regulation is necessary. But finding how much of each can be tough. And when government goes too far and starts acting like a drag on the economy, it's time to roll it back.

President Bush has rolled back taxes on individuals and entrepreneurs, capital and investors. This has helped the economy recover from what was a really difficult period just a few years ago.

The last time I was in government, at the Department of Transportation, we rolled back regulation on the trucking industry which was another important step toward a better economic environment.

The urge of government to tinker with the free market is almost irresistible, so we've always got to keep an eye on it.

Every new rule, regulation or tax must be scrutinized for the impact it could have on the economic structure that has served the country so very well for so long.

Are there bumps on the free market road? Of course. And government does have a role in protecting citizens when they are at risk of drowning in the tide of change.

But the tide is also, as John Kennedy said, what will ultimately cause their boats to rise.

How does all of this impact today's public policy debate? Primarily I'm concerned with keeping taxes low. The President's tax cuts have clearly benefited the economy and he's not about to accept tax increases now. I'm helping him communicate that plain fact to Congress. This also keeps American businesses competitive so that they can continue to invest and create jobs.

Keeping budgets under control is a current area of focus for the Administration as well. We'll unveil a budget next week that is true to the President's goals of reducing the deficit and keeping the growth of government in check by holding overall discretionary spending below the rate of inflation. It proposes cutting programs that aren't delivering their promises to the taxpayers and proposes tens of billions of dollars of savings on entitlement programs. It is a budget that works to ensure that future generations of Americans will have the opportunity to live in a Nation that is more prosperous and more secure.

Education and worker training policies – to point out one part of that budget – must be constantly adapted to the changing times and the changing, growing economy. As the President said in announcing the American Competitiveness Initiative last night, a strong economy depends on a skilled and talented workforce. The President sees great success and potential in the ability of community colleges to provide relevant, focused training for jobs that exist today – jobs that may not have existed even five years ago because of innovation. And workers should be able to continue to learn new skills for the changing business environment. This is an investment in our future that is more important than venture capital itself!

Health care costs have got to be brought down, and we've included some mechanisms in the budget to address that pressing issue. As the President pointed out in his State of the Union Address last night, it's time to allow Americans to save more in their Health Savings Accounts. We hope this will encourage more people to start HSAs, which put patients back in charge of their health-care purchasing decisions while saving money on a tax-preferred basis.

So I'm not recommending a static environment. Keeping that environment open and flexible will take great effort, and great restraint, from every level of government on every day of our history.

In closing I want to say, unequivocally, that the future of the American economy is very bright. As Ronald Reagan once said, "there are no great limits to growth because there are no limits of human intelligence, imagination, and wonder." That's what this country, and this terrific economy, is all about.

Thanks so much for having me here tonight.

PRESS ROOM

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February 2, 2006
JS-4001

Testimony of
Patricia A. Brown, Deputy International Tax Counsel (Treaty Affairs),
United States Department of the Treasury
Before the Senate Committee on Foreign Relations
on Pending Income Tax Agreements

Mr. Chairman and distinguished Members of the Committee, I appreciate the opportunity to appear today at this hearing to recommend, on behalf of the Administration, favorable action on four tax agreements that are pending before this Committee. We appreciate the Committee's interest in these agreements and in the U.S. tax treaty network, as demonstrated by the scheduling of this hearing.

As you expressed so well, Mr. Chairman, tax treaties are "part of the basic infrastructure of the global marketplace". The international network of over 2000 bilateral tax treaties has established a stable framework that allows international trade and investment to flourish. The success of this framework is evidenced by the fact that countless cross-border transactions, from investments in a few shares of a foreign company by an individual to multi-billion dollar purchases of operating companies in a foreign country, take place each year, with only a relatively few disputes regarding the allocation of tax revenues between governments. Individuals, too, benefit from the rules regarding allocation of investment income, but also from the rules regarding income from employment, the tax treatment of cross-border pension contributions and distributions, and, of course, the estate tax rules.

Just like our physical infrastructure, our tax treaty network requires constant attention. Countries introduce new preferential taxing regimes, or tighter anti-abuse rules; they may introduce bank secrecy or abolish it; or they may enter into an agreement with another country that is more advantageous than the agreement they have with the United States. Any of these situations may create an opportunity or a risk that needs to be addressed by a new or revised agreement. We must be creative and flexible in how we approach issues to find solutions to particular problems that are consistent with our overall goals. We are also becoming more efficient, concluding short protocols in order to update an agreement without calling into question every one of its provisions. Of course, this Committee's willingness to consider these agreements quickly has been a tremendous help in this regard. It can change the entire tone (and pace) of a treaty negotiation when the other side discovers that an advantageous change can be approved and implemented within the space of a year.

Three of the four agreements that are before you now are updates to relatively recent agreements. The fourth, the full treaty with Bangladesh, is an updated version of a 1980 treaty that never entered into force because of Senate concerns about several provisions. The Administration believes that these agreements with Bangladesh, France and Sweden will serve to further the goals of our tax treaty network. We urge the Committee and the Senate to take prompt and favorable action on all of these agreements.

Purposes and Benefits of Tax Treaties

Tax treaties provide benefits to both taxpayers and governments by setting out clear ground rules that will govern tax matters relating to trade and investment between the two countries. A tax treaty is intended to mesh the tax systems of the two countries in such a way that there is little potential for dispute regarding the amount of tax that should be paid to each country. The goal is to ensure that taxpayers do not end up caught in the middle between two governments, each of

which claims taxing jurisdiction over the same income. A treaty with clear rules addressing the most likely areas of disagreement minimizes the time the two governments (and taxpayers) spend in resolving individual disputes.

One of the primary functions of tax treaties is to provide certainty to taxpayers regarding the threshold question with respect to international taxation: whether the taxpayer's cross-border activities will subject it to taxation by two or more countries. Treaties answer this question by establishing the minimum level of economic activity that must be engaged in within a country by a resident of the other country before the first country may tax any resulting business profits. In general terms, tax treaties provide that if the branch operations in a foreign country have sufficient substance and continuity, the country where those activities occur will have primary (but not exclusive) jurisdiction to tax. In other cases, where the operations in the foreign country are relatively minor, the home country retains the sole jurisdiction to tax its residents.

Tax treaties protect taxpayers from potential double taxation through the allocation of taxing rights between the two countries. This allocation takes several forms. First, the treaty has a mechanism for resolving the issue of residence in the case of a taxpayer that otherwise would be considered to be a resident of both countries. Second, with respect to each category of income, the treaty assigns the "primary" right to tax to one country, usually (but not always) the country in which the income arises (the "source" country), and the "residual" right to tax to the other country, usually (but not always) the country of residence of the taxpayer. Third, the treaty provides rules for determining which country will be treated as the source country for each category of income. Finally, the treaty provides rules limiting the amount of tax that the source country can impose on each category of income and establishes the obligation of the residence country to eliminate double taxation that otherwise would arise from the exercise of concurrent taxing jurisdiction by the two countries.

As a complement to these substantive rules regarding allocation of taxing rights, tax treaties provide a mechanism for dealing with disputes or questions of application that arise after the treaty enters into force. In such cases, designated tax authorities of the two governments – known as the "competent authorities" in tax treaty parlance – are to consult and reach an agreement under which the taxpayer's income is allocated between the two taxing jurisdictions on a consistent basis, thereby preventing the double taxation that might otherwise result. The U.S. competent authority under our tax treaties is the Secretary of the Treasury. That function has been delegated to the Director, International (LMSB) of the Internal Revenue Service.

In addition to reducing potential double taxation, treaties also reduce potential "excessive" taxation by reducing withholding taxes that are imposed at source. Under U.S. domestic law, payments to non-U.S. persons of dividends and royalties as well as certain payments of interest are subject to withholding tax equal to 30 percent of the gross amount paid. Most of our trading partners impose similar levels of withholding tax on these types of income. This tax is imposed on a gross, rather than net, amount. Because the withholding tax does not take into account expenses incurred in generating the income, the taxpayer that bears the burden of withholding tax frequently will be subject to an effective rate of tax that is significantly higher than the tax rate that would be applicable to net income in either the source or residence country. The taxpayer may be viewed, therefore, as suffering "excessive" taxation. Tax treaties alleviate this burden by setting maximum levels for the withholding tax that the treaty partners may impose on these types of income or by providing for exclusive residence-country taxation of such income through the elimination of source-country withholding tax.

Because of the excessive taxation that withholding taxes can represent, the United States seeks to include in tax treaties provisions that substantially reduce or eliminate source-country withholding taxes.

Tax treaties also include provisions intended to ensure that cross-border investors do not suffer discrimination in the application of the tax laws of the other country. This is similar to a basic investor protection provided in other types of agreements, but the non-discrimination provisions of tax treaties are specifically tailored to tax matters and therefore are the most effective means of addressing potential discrimination in the tax context. The relevant tax treaty provisions provide guidance about what "national treatment" means in the tax context by explicitly prohibiting types of discriminatory measures that once were common in some tax

systems. At the same time, tax treaties clarify the manner in which possible discrimination is to be tested in the tax context. Particular rules are needed here, for example, to reflect the fact that foreign persons that are subject to tax in the host country only on certain income may not be in the same position as domestic taxpayers that may be subject to tax in such country on all their income.

In addition to these core provisions, tax treaties include provisions dealing with more specialized situations, such as rules coordinating the pension rules of the tax systems of the two countries or addressing the treatment of Social Security benefits and alimony and child support payments in the cross-border context. These provisions are becoming increasingly important as the number of individuals who move between countries or otherwise are engaged in cross-border activities increases. While these matters may not involve substantial tax revenue from the perspective of the two governments, rules providing clear and appropriate treatment are very important to the individual taxpayers who are affected.

Tax treaties also include provisions related to tax administration. A key element of U.S. tax treaties is the provision addressing the exchange of information between the tax authorities. Under tax treaties, the competent authority of one country may request from the other competent authority such information as may be relevant for the proper administration of the country's tax laws; the requested information will be provided subject to strict protections on the confidentiality of taxpayer information. Because access to information from other countries is critically important to the full and fair enforcement of the U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would operate to prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not conclude a treaty with that country. Indeed, the need for appropriate information exchange provisions is one of the treaty matters that we consider non-negotiable.

Tax Treaty Negotiating Priorities and Process

In establishing our negotiating priorities, our primary objective is the conclusion of tax treaties or protocols that will provide the greatest economic benefit to the United States and to U.S. taxpayers. We communicate regularly with the U.S. business community, seeking input regarding the areas in which treaty network expansion and improvement efforts should be focused and information regarding practical problems encountered by U.S. businesses with respect to the application of particular treaties and the application of the tax regimes of particular countries.

The United States has a network of 57 bilateral income tax treaties covering 65 countries. This network includes all 29 of our fellow members of the OECD. It also covers the vast majority of foreign trade and investment of U.S. businesses. Because the coverage of our treaty network is already quite comprehensive, it frequently will make more sense, as an economic matter, for the United States to negotiate an update to an existing agreement, rather than to negotiate a full treaty with a new treaty partner. Such a full agreement will require the potential treaty partner to grapple with many of the complexities of U.S. domestic and international tax rules and U.S. tax treaty policy, and how it interacts with its own domestic law and policies. Thus, the primary constraint on the size of our tax treaty network may be the complexity of the negotiations themselves. The various functions performed by tax treaties and most particularly the need to mesh the particular tax systems of the two treaty partners, make the negotiation process exacting and time-consuming.

A country's tax policy reflects the sovereign choices made by that country. Numerous features of the treaty partner's particular tax legislation and its interaction with U.S. domestic tax rules must be considered in negotiating an appropriate treaty. Examples include whether the country eliminates double taxation through an exemption system or a credit system, the country's treatment of partnerships and other transparent entities, and how the country taxes contributions to pension funds, earnings of the funds, and distributions from the funds. A treaty negotiation must take into account all of these and many other aspects of the particular treaty partner's tax system in order to arrive at an agreement that accomplishes the United States' tax treaty objectives.

A country's fundamental tax policy choices are reflected not only in its tax legislation but also in its tax treaty positions. The choices in this regard can and do

differ significantly from country to country, with substantial variation even across countries that seem to have quite similar economic profiles. A treaty negotiation also must reconcile differences between the particular treaty partner's preferred treaty positions and those of the United States.

Obtaining the agreement of our treaty partners on provisions of importance to the United States sometimes requires other concessions on our part. Similarly, the other country sometimes must make concessions to obtain our agreement on matters that are critical to it. In most cases, the process of give-and-take produces a document that is the best tax treaty that is possible with that other country. In other cases, we may reach a point where it is clear that it will not be possible to reach an acceptable agreement. In those cases, we simply stop negotiating with the understanding that negotiations might restart if circumstances change. Each treaty that we present to the Senate represents not only the best deal that we believe we can achieve with the particular country, but also constitutes an agreement that we believe is in the best interests of the United States.

In some situations, the right result may be no tax treaty at all or may be a substantially curtailed form of tax agreement. With some countries a tax treaty may not be appropriate because of the possibility of abuse. With other countries there simply may not be the type of cross-border tax issues that are best resolved by treaty. For example, with a country that does not impose significant income taxes, where there is little possibility of the double taxation of income in the cross-border context that tax treaties are designed to address, an agreement that is focused on the exchange of tax information may be most valuable. Alternatively, a bifurcated approach may be appropriate in situations where a country has a special preferential tax regime for certain parts of the economy that is different from the tax rules generally applicable to the country's residents. In those cases, the residents benefiting from the preferential regime do not face potential double taxation and so should not be entitled to the reductions in U.S. withholding taxes accorded by a tax treaty, while a full treaty relationship might be useful and appropriate in order to avoid double taxation in the case of the residents who do not receive the benefit of the preferential regime.

Prospective treaty partners must evidence a clear understanding of what their obligations would be under the treaty, including those with respect to information exchange, and must demonstrate that they would be able to fulfill those obligations. Sometimes a tax treaty may not be appropriate because a potential treaty partner is unable to do so. In other cases, a tax treaty may be inappropriate because the potential treaty partner is not willing to agree to particular treaty provisions that are needed in order to address real tax problems that have been identified by U.S. businesses operating there.

The U.S. commitment to including comprehensive limitation of benefits provisions designed to prevent "treaty shopping" in all of our tax treaties is one of the keys to improving our overall treaty network. Our tax treaties are intended to provide benefits to residents of the United States and residents of the particular treaty partner on a reciprocal basis. The reductions in source-country taxes agreed to in a particular treaty mean that U.S. persons pay less tax to that country on income from their investments there and residents of that country pay less U.S. tax on income from their investments in the United States. Those reductions and benefits are not intended to flow to residents of a third country. If third-country residents are able to exploit one of our tax treaties to secure reductions in U.S. tax, the benefits would flow only in one direction as third-country residents would enjoy U.S. tax reductions for their U.S. investments but U.S. residents would not enjoy reciprocal tax reductions for their investments in that third country.

Moreover, such third-country residents may be securing benefits that are not appropriate in the context of the interaction between their home country's tax systems and policies and those of the United States. This use of tax treaties is not consistent with the balance of the deal negotiated. Preventing this exploitation of our tax treaties is critical to ensuring that the third country will sit down at the table with us to negotiate on a reciprocal basis, so that we can secure for U.S. persons the benefits of reductions in source-country tax on their investments in that country.

Update on the Treasury Department's Position on Inter-Company Dividends

In earlier testimony before this Committee, Treasury Department representatives

have discussed the decision, first made in connection with the negotiation of the treaty with the United Kingdom in 2001, to eliminate the source-country withholding tax on certain inter-company dividends. The position of the Treasury Department has been, and continues to be, that this decision is made independently with respect to every treaty negotiation. The United States will agree to the provision only if the agreement includes limitation on benefits and information exchange provisions that meet the highest standards, and if the overall balance of the agreement is appropriate.

Since we first expressed our willingness to eliminate the source-country withholding tax on inter-company dividends, a number of treaty relationships that had been at best stagnant and at worst problematic have changed for the better. Suddenly, there was some leverage to achieve goals that had seemed out of reach for one reason or another. Thus, although the new policy has been in place for only about five years, it has enabled us to achieve the following goals in one or more treaties:

- Strengthening our provisions to prevent treaty shopping, including the introduction of rules that prevent the use of tax treaties after a corporate inversion transaction;
- Significantly improving information exchange provisions, allowing access to information even when the treaty partner does not need the information for its own tax purposes;
- Reducing withholding taxes on interest and royalties to levels lower than those to which those treaty partners had ever previously agreed;
- Eliminating withholding taxes on dividends paid to pension funds, a tax that otherwise would inevitably lead to double taxation; and
- Protecting U.S. companies against the retaliatory re-imposition of withholding taxes on inter-company dividends.

The reductions we have achieved in our own treaties also are influencing the negotiation of agreements between other countries. U.S. companies benefit from those agreements as well, as many of them have subsidiaries that may benefit if similar reductions in rates are adopted under a new U.K.-Japan treaty, for example.

We believe that these significant achievements demonstrate that the current policy is having very positive effects and will continue to do so in the foreseeable future.

Discussion of Proposed New Treaties and Protocols

I now would like to discuss the four agreements that have been transmitted for the Senate's consideration. We have submitted Technical Explanations of each agreement that contain detailed discussions of the provisions of each treaty and protocol. These Technical Explanations serve as an official guide to each agreement.

Sweden

The proposed Protocol amends the income tax treaty between the United States and Sweden that was signed in 1994. The most significant provisions in the Protocol relate to the treatment of dividends and limitation on benefits. The Protocol also rectifies a mistake that was made in the 1994 treaty that caused a great deal of hardship for a number of former employees of the U.S. government. It also makes a number of necessary updates to the treaty.

Like a number of recent agreements, the Protocol will eliminate the source-country withholding tax on most inter-company dividends and on dividends paid to pension funds. The provision dealing with inter-company dividends was very important to Sweden, because it had unilaterally eliminated its withholding tax on inter-company dividends. The legislative history to that domestic law change makes it clear that the main beneficiaries of that change were expected to be U.S. companies. In fact, it refers specifically to assurances given to the Swedish negotiators that the United States would not agree to eliminate the withholding tax on inter-company dividends in any bilateral agreement with any country. Now that U.S. policy has changed, failure to provide a reciprocal benefit for Swedish companies would have jeopardized the exemption from Swedish withholding tax that currently benefits U.S. companies. We believe that securing that protection, as well as eliminating the withholding tax on dividends paid to pension funds, is a sufficient quid pro quo.

Nevertheless, we also took this opportunity to add anti-inversion provisions to the limitation on benefits provisions of the treaty. The new provision represents a somewhat simplified version of a similar provision introduced in the recent protocol with the Netherlands. Although we have no reason to believe that Sweden would be an attractive destination for an inverted U.S. corporation, including the provision in a mainstream agreement such as this helps to establish a precedent that will be extremely useful in other treaty negotiations.

The Protocol also resolves a long-standing problem regarding the taxation of local employees of the Embassy in Stockholm and consulate in Gothenburg. The Protocol provides a grandfather rule to eliminate the unintended consequences resulting from a change made by the 1994 U.S.-Sweden income tax treaty regarding the taxation of local employees (or former employees) of the Embassy in Stockholm and consulate in Gothenburg. To rectify this problem, the Protocol provides that Sweden may not tax a pension under the U.S. Civil Service Retirement Pension Plan paid by the United States to employees of the U.S. embassy in Stockholm or the U.S. consulate general in Gothenburg if the individual was hired prior to 1978.

Other provisions in the Protocol reflect changes in U.S. domestic law or are intended to bring it into closer conformity with current U.S. treaty practice. For example, the current treaty preserves the U.S. right to tax former citizens whose loss of citizenship had, as one of its principal purposes, the avoidance of tax. The proposed Protocol updates this provision to reflect legislative changes since 1994. In order to reflect 1996 changes to the Internal Revenue Code, the Protocol provides that a former citizen or long-term resident of the United States may, for the period of ten years following the loss of such status, be taxed in accordance with the laws of the United States.

United States and Sweden will notify each other through the diplomatic channel, accompanied by an instrument of ratification, when their respective requirements for entry into force have been completed. The proposed Protocol will enter into force on the thirtieth day after the later of the notifications. It will have effect, with respect to taxes withheld at source, on or after the first day of the second month next following the date upon which the Protocol enters into force. With respect to other taxes, it will have effect for taxable years beginning on or after the first day of January next following the date upon which the Protocol enters into force.

French Income Tax Protocol

The proposed income tax protocol amends the 1994 income tax treaty between the United States and France, which entered into force in 1995.

The primary impetus for the negotiation of the income tax Protocol was to clarify the treatment of investments made in France by U.S. investors through partnerships located in the United States, France, or third countries. Because France taxes French partnerships on their worldwide income, and does not treat them as fiscally transparent, the Protocol confirms that France maintains taxing rights with respect to French partnerships. However, the Protocol provides that French treaty benefits will apply to U.S. residents who invest through U.S. partnerships or partnerships located in certain third countries. These partnership provisions will eliminate uncertainty and provide significant benefits to U.S. investors.

The income tax Protocol also reforms the treatment of certain French investment vehicles, which would have been entitled to U.S. treaty benefits under the 1994 treaty. Under the revised provision, a "fonds commun de placement" will not itself qualify for U.S. treaty benefits, but holders of interests in such an investment vehicle may qualify for treaty benefits if they are residents of France or of a third country that has an appropriate tax treaty with the United States.

The income tax Protocol modifies the provisions of the treaty dealing with pensions and pension contributions in order to achieve parity given the two countries' fundamentally different pension systems. The French pension system relies almost entirely on the state social security system with much more limited use of private pension arrangements such as employer plans and individual plans. The provisions in the 1994 treaty that treated private pension payments and social security payments differently are replaced in the proposed Protocol with provisions that treat the two systems the same. Under the proposed Protocol, the country of

source is assigned taxing rights with respect to both state social security payments and private pension payments. The proposed Protocol also includes a provision that allows U.S. persons to deduct voluntary contributions to the French social security system to the same extent that contributions to a U.S. plan would be deductible, which is comparable to the provision in the 1994 treaty that allows French residents deductions for contributions to U.S. private pension plans.

The proposed Protocol makes other changes to the1994 treaty to reflect more closely current U.S. treaty policy. The proposed Protocol updates the treatment of dividends paid by U.S. REITs to reflect a change in approach adopted in 1997, which is intended to prevent the use of structures designed to avoid U.S. withholding taxes on outbound dividends while providing appropriate benefits to portfolio investors in REITs. The proposed Protocol also extends the provision in the 1994 treaty preserving U.S. taxing rights with respect to certain former citizens to cover certain former long-term residents in order to reflect 1996 changes to the Internal Revenue Code.

Each state will notify the other when it has completed the necessary steps to bring the proposed Protocol into force. The Protocol will enter into force upon the receipt of the later of those two notices. In general, it will have effect, with respect to taxes withheld at source, for amounts paid or credited on or after the first day of the second month following the date on which the Protocol enters into force and, with respect to other taxes, for taxable periods beginning on or after the first day of January following entry into force. However, because the rules benefiting U.S. residents investing through partnerships are intended to ensure that the treaty provides results that are consistent with the intent of the negotiators of the 1995 treaty, those changes will be applicable as of the effective dates of the 1994 treaty.

French Estate Tax Protocol

The proposed estate tax Protocol amends the estate and gift tax treaty between the United States and France, which was signed in 1978 and entered into force in 1980.

In 1988, U.S. estate tax law was changed to tax currently transfers of property to non-citizen surviving spouses. France, along with several other countries with which the United States has estate tax treaties, objected to this change.

Although the U.S. rejected claims by estate tax treaty partners that the 1988 change violated treaty nondiscrimination clauses, we indicated our willingness to amend our estate tax treaties with certain treaty partners to provide relief to surviving non-citizen spouses in appropriate cases. Accordingly, the proposed Protocol eases the impact of the 1988 provisions upon certain estates of limited value. Pursuant to the Protocol, transfers of non-community property from a French domiciliary to a spouse who is not a United States citizen that may be taxed by the United States solely on the basis of situs under the treaty can be included in the tax base only to the extent that the value of the property, after applicable deductions, exceeds 50 percent of the value of all property that may be taxed by the United States.

In addition to the allowance of the marital exclusion, the Protocol also provides for a limited elective estate tax marital deduction which, if elected, waives the right to any available marital deduction that would be allowed under United States domestic law. The election is available only where the spouses satisfy certain domiciliary and citizenship requirements and only to "qualifying property" (generally, property that passes to the surviving spouse and that would have qualified for the marital deduction if the surviving spouse had been a United States citizen). The amount of the deduction is equal to the lesser of the value of the qualifying property or the "applicable exclusion amount" (generally, the amount which the unified credit shelters from estate tax) for the year of the decedent's death.

The United States, in a 1995 protocol to the U.S.-Canada income tax treaty and a 1998 protocol to the U.S.-Germany estate tax treaty, provided similar relief to certain estates of limited value involving Canadians and Germans. The United States' willingness to enter into the proposed Protocol was a significant factor in France's ratification of the current U.S.-France income tax treaty, which was signed in 1994.

The proposed Protocol also provides a pro rata unified credit to the estate of a French domiciliary for purposes of computing the U.S. estate tax. Under this provision, a French domiciliary is allowed a credit against U.S. estate tax ranging from the amount ordinarily allowed to the estate of a nonresident under the Code ($13,000) to the amount of credit allowed to the estate of a U.S. citizen under the Code ($555,800 in 2004 and 2005), based on the extent to which the assets of the estate are situated in the United States (with either amount reduced to the extent of any credit previously allowed with respect to lifetime gifts). Congress anticipated the negotiation of such pro rata unified credits in Internal Revenue Code section 2102(c)(3)(A), and a similar credit was included in the 1995 U.S.-Canada income tax protocol and the 1998 German estate tax treaty protocol.

The proposed Protocol also modernizes the provisions dealing with the elimination of double taxation. In determining the French tax, if the transferor was a French domiciliary at the time of the transfer, France may tax any property which may also be taxed by the United States, but must allow a deduction from that tax in an amount equal to the United States tax paid upon such transfer.

If the transferor is a domiciliary or citizen of the United States and a transfer of property is subject to situs taxation by France, the United States must allow a credit equal to the amount of tax imposed by France with respect to such property. If the transferor is a United States citizen (or former citizen or long-term resident who lost such status with a principal purpose of tax avoidance) but a French domiciliary, the United States must allow a credit for the amount of tax imposed by France (after allowance for the deduction from French tax referred to in the first paragraph) with respect to such property. All of the credits allowed under the Protocol are limited to the tax imposed (and actually paid) on the property for which the credit is claimed.

The proposed estate tax Protocol also makes other changes to the Convention to reflect more closely current U.S. treaty policy. For example, the proposed Protocol extends the United States' ability to tax former citizens and long-term residents to conform with 1996 legislative changes to the Internal Revenue Code. The proposed Protocol also defines the term "real property" in a manner consistent with the definition provided in Treas. Reg. § 1.897-1(b) and our income tax treaties. The proposed Protocol adds a rule that allows source state taxation of stock in real property holding companies.

Each state will notify the other when it has completed the necessary steps to bring the proposed estate tax Protocol into force. The Protocol will enter into force upon the receipt of the later of those two notices. Although the proposed Protocol generally will be effective with respect to gifts made and deaths occurring after the exchange of instruments of ratification, the relief provided with respect to surviving non-citizen spouses and the pro rata unified credit will be effective with respect to gifts made and deaths occurring after November 10, 1988 (the effective date of the 1988 legislative changes). Claims for refund asserting the benefits of the proposed Protocol that otherwise would be barred by the statute of limitations must be made within one year of entry of the Protocol, however, and all claims for retroactive relief are subject to the rules regarding the United States' ability to tax former citizens and long-term residents.

The negotiators believed that retrospective relief was not inappropriate, given the fact that the 1988 legislative changes were the impetus for negotiation of the proposed Protocol and negotiations commenced soon after the enactment of those changes. The United States agreed to similar retrospective relief in the 1995 U.S.-Canada income tax treaty protocol and the 1998 U.S.-Germany estate tax treaty protocol.

Bangladesh

The United States does not currently have an income tax treaty with Bangladesh. The proposed income tax treaty with Bangladesh was signed in Dhaka September 26, 2004.

The proposed treaty generally follows the pattern of the U.S. model treaty, while incorporating some provisions found in other U.S. treaties with developing countries. The maximum rates of source-country withholding taxes on investment income provided in the proposed treaty are generally equal to or lower than the maximum rates provided in other U.S. treaties with developing countries (and some

developed countries).

The proposed treaty generally provides a maximum source-country withholding tax rate on dividends of 15 percent. Direct investment dividends are subject to taxation at source at a 10-percent rate. The proposed treaty requires a 10-percent ownership threshold for application of the 10-percent tax rate.

The proposed treaty provides for a 10 percent rate of tax at source on most interest payments. However, interest received by any financial institution (including an insurance company) and interest earned on trade credits are subject to a 5 percent rate of tax at source. In addition, interest derived by the Governments of the Contracting States and instrumentalities of those Governments, as well as debt guaranteed by government agencies (e.g., the U.S. Export-Import Bank) is exempt from tax at source.

The proposed treaty provides that royalties are subject to a 10 percent tax at source. Consistent with the U.S. and OECD Model treaties, income from the rental of tangible personal property is not treated as a royalty, but as business profits, thus eliminating any withholding tax at source.

The standard U.S. anti-abuse rules are provided for certain classes of investment income. For example, dividends paid by non-taxable conduit entities, such as U.S. RICs and REITs, are subject to special rules to prevent the use of these entities to transform what'is otherwise high-taxed income into lower-taxed income.

The proposed treaty follows the standard rules for taxation by the source country of the business profits of a resident of the other country. The source country's right to tax such profits is generally limited to cases in which the profits are attributable to a permanent establishment located in that country. The proposed treaty, however, defines a "permanent establishment" in a way that grants rights to tax business profits that are somewhat broader than those found in the U.S. and OECD Models. However, these rules are quite similar to rules found in our tax treaties with other developing countries.

In the case of shipping and aircraft, the proposed Convention, consistent with current U.S. treaty policy, provides for exclusive residence-country taxation of profits from the international operation of ships or aircraft. Like the U.S. Model, only the country of residence may tax profits from the rental or maintenance of containers used in international traffic.

The proposed treaty provides rules that are similar to the U.S. Model with respect to the taxation of income from the performance of personal services. However, like some other U.S. treaties with developing countries, the proposed treaty grants a taxing right to the host country with respect to some classes of personal services income that is broader in a few respects than in the OECD or U.S. Model.

The proposed treaty contains a comprehensive limitation on benefits article, which provides detailed rules designed to deny "treaty shoppers" the benefits of the treaty. These rules are comparable to the rules contained in the U.S. model and recent U.S. treaties.

The proposed treaty also sets out the manner in which each country will relieve double taxation. Both the United States and Bangladesh will provide such relief through the foreign tax credit mechanism. The proposed Convention does not include a "tax sparing credit", since such credits are contrary to U.S. treaty policy. At Bangladesh's request, the exchange of notes provides that, if the United States alters its policy regarding the granting of tax sparing credits or provides for such credits in another treaty, negotiations will be reopened with a view to concluding a protocol that would offer similar benefits to Bangladesh.

The proposed treaty provides for non-discriminatory treatment (i.e., national treatment) by one country to residents and nationals of the other. Also included in the proposed treaty are rules necessary for administering the treaty, including rules for the resolution of disputes under the treaty.

The proposed treaty includes an exchange of information provision that generally follows the U.S. model. Under these provisions, Bangladesh will provide U.S. tax

officials such information as is relevant to carry out the provisions of the treaty and the domestic tax laws of the United States.

The proposed Convention is subject to ratification. It will enter into force upon the exchange of instruments of ratification. It will have effect, with respect to taxes withheld at the source, for amounts paid or credited on or after the first day of the second month following entry into force. In other cases the Convention will have effect with respect to taxable periods beginning on or after the first day of January following the date on which the Convention enters into force.

Treaty Program Priorities

We continue to maintain a very active calendar of tax treaty negotiations. We currently are in ongoing negotiations with Canada, Chile, Germany, Hungary, Iceland, Korea and Norway. In addition, we are beginning negotiations with Bulgaria. We also have substantially completed work on agreements with Denmark and Finland and look forward to their conclusion.

A key continuing priority is updating the few remaining U.S. tax treaties that provide for low withholding tax rates but do not include the limitation on benefits provisions needed to protect against the possibility of treaty shopping. We have also had informal exploratory discussions with several countries in Asia; we hope that those discussions will lead to productive negotiations later in 2006 or in 2007.

Work on the U.S. Model was well advanced last year but was delayed due to other commitments. However, we expect to forward a draft text to the staffs of the Senate Foreign Relations Committee and Joint Committee on Taxation within the next month. We look forward to working with them on this project.

Conclusion

Let me conclude by again thanking the Committee for its continuing interest in the tax treaty program, and the Members and staff for devoting time and attention to the review of these new agreements. We greatly appreciate the assistance and cooperation of the staffs of this Committee and of the Joint Committee on Taxation in the tax treaty process.

We urge the Committee to take prompt and favorable action on the agreements before you today.

REPORTS

- Technical Explanation: Protocol with Sweden
- Technical Explanation: Income Tax Protocol with France
- Technical Explanation: Estate Tax Protocol with France
- Technical Explanation: Treaty with Bangladesh

DEPARTMENT OF THE TREASURY
TECHNICAL EXPLANATION OF THE PROTOCOL SIGNED AT WASHINGTON ON SEPTEMBER 30, 2005 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF SWEDEN FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT WASHINGTON ON SEPTEMBER 1, 1994

This is a technical explanation of the Protocol signed at Washington on September 30, 2005 (the "Protocol"), amending the Convention between the United States of America and the Government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on September 1, 1994 (the "Convention").

Negotiations took into account the U.S. Department of the Treasury's current tax treaty policy and Treasury's Model Income Tax Convention, published on September 20, 1996 (the "U.S. Model"). Negotiations also took into account the Model Tax Convention on Income and on Capital, published by the Organization for Economic Cooperation and Development (the "OECD Model"), and recent tax treaties concluded by both countries.

This Technical Explanation is an official guide to the Protocol. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol. This technical explanation is not intended to provide a complete guide to the Convention as amended by the Protocol. To the extent that the Convention has not been amended by the Protocol, the Technical Explanation of the Convention remains the official explanation. References in this technical explanation to "he" or "his" should be read to mean "he or she" or "his or her."

Article I

Article I of the Protocol modifies Article 1 (Personal Scope) of the Convention with respect to the last sentence of paragraph 4, which permits the United States to tax as U.S. citizens former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax. To reflect 1996 and 2004 amendments to U.S. tax law in this area, the Protocol provides that, notwithstanding other provisions of the Convention, a former citizen or long-term resident of the United States may, for the period of ten years following the loss of such status, be taxed in accordance with the laws of the United States.

Section 877 of the Internal Revenue Code of 1986 (the "Code") generally applies to a former citizen or long-term resident of the United States who relinquishes citizenship

or terminates long-term residency if either of the following criteria exceed established thresholds: (a) the average annual net income tax of such individual for the period of 5 taxable years ending before the date of the loss of status, or (b) the net worth of such individual as of the date of the loss of status. The thresholds are adjusted annually for inflation. The United States defines "long-term resident" as an individual (other than a U.S. citizen) who is a lawful permanent resident of the United States in at least 8 of the prior 15 taxable years. An individual is not treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and the individual does not waive the benefits of such treaty applicable to residents of the foreign country.

Paragraph b) of Article I of the Protocol also addresses special issues presented by fiscally transparent entities such as partnerships and certain trusts and estates. In general, paragraph b) of Article I relates to entities that are not subject to tax at the entity level, as distinct from entities that are subject to tax, but with respect to which tax may be relieved under an integrated system. This paragraph applies to any resident of a Contracting State who is entitled to income derived through an entity that is treated as fiscally transparent under the laws of either Contracting State. Entities falling under this description in the United States include partnerships, common investment trusts under section 584 and grantor trusts. This paragraph also applies to U.S. limited liability companies ("LLCs") that are treated as partnerships for U.S. tax purposes.

Under paragraph b) of Article I of the Protocol, an item of income, profit or gain derived by such a fiscally transparent entity will be considered to be derived by a resident of a Contracting State if a resident is treated under the taxation laws of that State as deriving the item of income. For example, if a Swedish company pays interest to an entity that is treated as fiscally transparent for U.S. tax purposes, the interest will be considered derived by a resident of the U.S. only to the extent that the taxation laws of the United States treats one or more U.S. residents (whose status as U.S. residents is determined, for this purpose, under U.S. tax law) as deriving the interest for U.S. tax purposes. In the case of a partnership, the persons who are, under U.S. tax laws, treated as partners of the entity would normally be the persons whom the U.S. tax laws would treat as deriving the interest income through the partnership. Also, it follows that persons whom the United States treats as partners but who are not U.S. residents for U.S. tax purposes may not claim a benefit for the interest paid to the entity under the Convention, because they are not residents of the United States for purposes of claiming this treaty benefit. (If, however, the country in which they are treated as resident for tax purposes, as determined under the laws of that country, has an income tax convention with Sweden, they may be entitled to claim a benefit under that convention.) In contrast, if, for example, an entity is organized under U.S. laws and is classified as a corporation for U.S. tax purposes, interest paid by a Swedish company to the U.S. entity will be considered derived by a resident of the United States since the U.S. corporation is treated under U.S. taxation laws as a resident of the United States and as deriving the income.

The same result obtains even if the entity were viewed differently under the tax laws of the country of source (*e.g.*, as not fiscally transparent in Sweden in the first example above where the entity is treated as a partnership for U.S. tax purposes). Similarly, the characterization of the entity in a third country is also irrelevant, even if the entity is organized in that third country. The results follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for U.S. tax purposes and as a corporation for Swedish tax purposes. These results also obtain regardless of where the entity is organized (*i.e.*, in the United States, in Sweden, or, as noted above, in a third country).

For example, income from U.S. sources received by an entity organized under the laws of the United States, which is treated for Swedish tax purposes as a corporation and is owned by a Swedish shareholder who is a Swedish resident for Swedish tax purposes, is not considered derived by the shareholder of that corporation even if, under the tax laws of the United States, the entity is treated as fiscally transparent. Rather, for purposes of the treaty, the income is treated as derived by the U.S. entity.

Article II

Article II of the Protocol modifies Article 2 (Taxes Covered) of the Convention by replacing subparagraph b) of paragraph 1, which identifies the Swedish taxes to which the Convention applies. Subparagraph b) of paragraph 1 applies to the following Swedish taxes: (1) the national income tax, (2) the withholding tax on dividends, (3) the income tax on non-residents, (4) the income tax on non-resident artistes and athletes, (5) the national capital tax (for purposes of paragraph 3 of Article 2), (6) the excise tax on insurance premiums paid to foreign insurers, and (7) the municipal income tax.

Article III

Article III of the Protocol replaces paragraph 1 of Article 4 (Residence) of the Convention. The term "resident of a Contracting State" is defined in subparagraph a) of paragraph 1. In general, this definition incorporates the definitions of residence in U.S. and Swedish law by referring to a resident as a person who, under the laws of a Contracting State, is subject to tax there by reason of his domicile, residence, citizenship, place of management, place of incorporation or any other similar criterion and also includes that State and any political subdivision or local authority thereof. Thus, residents of the United States include aliens who are considered U.S. residents under Code section 7701(b). Subparagraphs b) and c) address special cases that may arise in the context of Article 4.

Certain entities that are nominally subject to tax but that in practice are rarely required to pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, a U.S. Regulated Investment Company (RIC), U.S. Real Estate Investment Trust (REIT) and U.S. Real Estate Mortgage Investment Conduit are all residents of the United States for purposes of the treaty. Although the income earned

by these entities normally is not subject to U.S. tax in the hands of the entity, they are taxable to the extent that they do not currently distribute their profits, and therefore may be regarded as "liable to tax." They also must satisfy a number of requirements under the Code in order to be entitled to special tax treatment.

A person who is liable to tax in a Contracting State only in respect of income from sources within that State or capital situated therein or of profits attributable to a permanent establishment in that State will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, a consular official of Sweden who is posted in the United States, who may be subject to U.S. tax on U.S. source investment income, but is not taxable in the United States on non-U.S. source income, would not be considered a resident of the United States for purposes of the Convention. (See Code section 7701(b)(5)(B)). Similarly, an enterprise of Sweden with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise generally is subject to U.S. tax only with respect to its income that is attributable to the U.S. permanent establishment, not with respect to its worldwide income, as it would be if it were a U.S. resident.

Subparagraph b) of paragraph 1 contains an exception to the general rule of paragraph 1 a) that residence under internal law also determines residence under the Convention. The exception applies with respect to a U.S. citizen or alien lawfully admitted for permanent residence (*i.e.*, a "green card" holder). Under paragraph 1 a), a person is considered a resident of the United States for purposes of the Convention if he is liable to tax in the United States by reason of citizenship. In addition, aliens admitted to the United States for permanent residence ("green card" holders) qualify as U.S. residents under the first sentence of paragraph 1 because they are taxed by the United States as residents, regardless of where they physically reside.

Under the exception of paragraph 1 b), a U.S. citizen or green card holder will be treated as a resident of the United States for purposes of the Convention, and, thereby entitled to treaty benefits, only if he has a substantial presence (see section 7701(b)(3)), permanent home or habitual abode in the United States. This rule requires that the U.S. citizen or green card holder have a reasonably strong economic nexus with the United States. If such a person is a resident of both the United States and Sweden, whether or not he is to be treated as a resident of the United States for purposes of the Convention is determined by the tie-breaker rules of paragraph 2.

Thus, for example, an individual resident of Mexico who is a U.S. citizen by birth, or who is a Mexican citizen and holds a U.S. green card, but who, in either case, has never lived in the United States, would not be entitled to benefits under the Convention. However, a U.S. citizen who is transferred to Mexico for two years would be entitled to benefits under the Convention if he maintains a permanent home or habitual abode in the United States and is not a resident of Mexico for purposes of the Sweden-Mexico tax treaty.

The fact that a U.S. citizen who does not have close ties to the United States may not be treated as a U.S. resident under the Convention does not alter the application of the

saving clause of paragraph 4 of Article 1 (Personal Scope) to that citizen. For example, a U.S. citizen who pursuant to the "citizen/green card holder" rule is not considered to be a resident of the United States still is taxable on his worldwide income under the generally applicable rules of the Code.

Subparagraph (c) of paragraph 1 of Article 4 of the Convention provides that certain tax-exempt entities such as pension funds and charitable organizations will be regarded as residents of a Contracting State regardless of whether they are generally liable to income tax in the State where they are established. Subparagraph (c) applies to legal persons organized under the laws of a Contracting State and established and maintained in that State: to provide pensions or other similar benefits pursuant to a plan; or exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and that is a resident of a Contracting State. Thus, an exempt section 501(c) organization (such as a U.S. charity) that is generally exempt from tax under U.S. law is a resident of the United States for all purposes of the Convention.

Article IV

Article IV of the Protocol replaces Article 10 (Dividends) of the Convention. Article 10 provides rules for the taxation of dividends paid by a company that is a resident of one Contracting State to a beneficial owner that is a resident of the other Contracting State. The Article provides for full residence country taxation of such dividends and a limited source-State right to tax.

Paragraph 1

The right of a shareholder's country of residence to tax dividends arising in the source country is preserved by paragraph 1, which permits a Contracting State to tax its residents on dividends paid to them by a company that is a resident of the other Contracting State.

Paragraph 2

The State of source also may tax dividends beneficially owned by a resident of the other State, subject to the limitations of paragraphs 2 and 3. Paragraph 2 generally limits the tax in the State of source on the dividend paid by a company resident in that State to 15 percent of the gross amount of the dividend. If, however, the beneficial owner of the dividend is a company that is a resident of the other State and that directly owns shares representing at least 10 percent of the voting power of the company paying the dividend, then the withholding tax in the State of source is limited to 5 percent of the gross amount of the dividend. Shares are considered voting shares if they provide the power to elect, appoint or replace any person vested with the powers ordinarily exercised by the board of directors of a U.S. corporation.

The benefits of paragraph 2 may be granted at the time of payment by means of reduced withholding at source. It also is consistent with the paragraph for tax to be

withheld at the time of payment at full statutory rates, and the treaty benefit to be granted by means of a subsequent refund so long as refund procedures are applied in a reasonable manner.

The term "beneficial owner" is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (*i.e.*, the source country). The beneficial owner of the dividend for purposes of Article 10 is the person to which the dividend income is attributable for tax purposes under the laws of the source State. Thus, if a dividend paid by a corporation that is a resident of one of the States (as determined under Article 4 (Residence)) is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the dividend is not entitled to the benefits of this Article. However, a dividend received by a nominee on behalf of a resident of that other State would be entitled to benefits. These interpretations are confirmed by paragraph 12 of the Commentary to Article 10 of the OECD Model. See also paragraph 24 of the Commentary to Article 1 of the OECD Model.

Companies holding shares through fiscally transparent entities such as partnerships are considered for purposes of this paragraph to hold their proportionate interest in the shares held by the intermediate entity. As a result, companies holding shares through such entities may be able to claim the benefits of subparagraph (a) under certain circumstances. The lower rate applies when the company's proportionate share of the shares held by the intermediate entity meets the 10 percent threshold. Whether this ownership threshold is satisfied may be difficult to determine and often will require an analysis of the partnership or trust agreement.

The determination of whether the ownership threshold for subparagraph 2(a) is met for purposes of the 5 percent maximum rate of withholding tax is made on the date on which entitlement to the dividend is determined. Thus, in the case of a dividend from a U.S. company, the determination of whether the ownership threshold is met generally would be made on the dividend record date.

Paragraph 3

Paragraph 3 provides exclusive residence-country taxation (*i.e.*, an elimination of withholding tax) with respect to certain dividends distributed by a company that is a resident of one Contracting State to a resident of the other Contracting State. As described further below, this elimination of withholding tax is available with respect to certain inter-company dividends and with respect to tax-exempt pension funds.

Subparagraph (a) of paragraph 3 provides for the elimination of withholding tax on dividends beneficially owned by a company that has owned 80 percent or more of the voting power of the company paying the dividend for the 12-month period ending on the date entitlement to the dividend is determined. The determination of whether the beneficial owner of the dividends owns at least 80 percent of the voting power of the paying company is made by taking into account stock owned both directly and stock owned indirectly through one or more residents of either Contracting State.

Eligibility for the elimination of withholding tax provided by subparagraph (a) is subject to additional restrictions based on, but supplementing, the rules of Article 17 (Limitation on Benefits). Accordingly, a company that meets the holding requirements described above will qualify for the benefits of paragraph 3 only if it also: (1) meets the "publicly traded" test of subparagraph 2(c) of Article 17 (Limitation of Benefits), (2) meets the "ownership base erosion" and "active trade or business" test described in subparagraph 2(e) and subparagraph 4 of Article 17 (Limitation of Benefits), (3) meets the "derivative benefits" test of paragraph 3 of Article 17 (Limitation of Benefits), or (4) is granted the benefits of subparagraph 3(a) of Article 10 by the competent authority of the source State pursuant to paragraph 6 of Article 17 (Limitation on Benefits).

These restrictions are necessary because of the increased pressure on the Limitation on Benefits tests resulting from the fact that the United States has relatively few treaties that provide for such elimination of withholding tax on inter-company dividends. The additional restrictions are intended to prevent companies from re-organizing in order to become eligible for the elimination of withholding tax in circumstances where the Limitation on Benefits provision does not provide sufficient protection against treaty-shopping.

For example, assume that ThirdCo is a company resident in a third country that does not have a tax treaty with the United States providing for the elimination of withholding tax on inter-company dividends. ThirdCo owns directly 100 percent of the issued and outstanding voting stock of USCo, a U.S. company, and of SCo, a Swedish company. SCo is a substantial company that manufactures widgets; USCo distributes those widgets in the United States. If ThirdCo contributes to SCo all the stock of USCo, dividends paid by USCo to SCo would qualify for treaty benefits under the active trade or business test of paragraph 4 of Article 17. However, allowing ThirdCo to qualify for the elimination of withholding tax, which is not available to it under the third state's treaty with the United States (if any), would encourage treaty-shopping.

In order to prevent this type of treaty-shopping, paragraph 3 requires SCo to meet the ownership-base erosion requirements of subparagraph 2(e) of Article 17 in addition to the active trade or business test of paragraph 4 of Article 17. Thus, SCo would not qualify for the exemption from withholding tax unless (i) on at least half the days of the taxable year, at least 50 percent of each class of its shares was owned by persons that are residents of Sweden and eligible for treaty benefits under certain specified tests and (ii) less than 50 percent of SCo's gross income is paid in deductible payments to persons that are not residents of either Contracting State. Because SCo is wholly owned by a third country resident, SCo could not qualify for the elimination of withholding tax on dividends from USCo under the ownership-base erosion test and the active trade or business test. Consequently, SCo would need to qualify under another test or obtain discretionary relief from the competent authority under Article 17(6). For purpose of Article 3(a)(ii), it is not sufficient for a company to qualify for treaty benefits generally under the active trade or business test or the ownership-base erosion test unless it qualifies for treaty benefits under both.

Alternatively, companies that are publicly traded or subsidiaries of publicly-traded companies will generally qualify for the elimination of withholding tax. Thus, a company that is a resident of Sweden and that meets the requirements of Article 17(2)(i) or (ii) will be entitled to the elimination of withholding tax, subject to the 12-month holding period requirement of Article 10(3)(a).

In addition, under Article 10(3)(a)(iii), a company that is a resident of a Contracting State may also qualify for the elimination of withholding tax on dividends if it satisfies the derivative benefits test of paragraph 3 of Article 17. Thus, a Swedish company that owns all of the stock of a U.S. corporation may qualify for the elimination of withholding tax if it is wholly-owned, for example, by a U.K., Dutch, or a Mexican publicly-traded company and the other requirements of the derivative benefits test are met. At this time, ownership by companies that are residents of other European Union, European Economic Area or North American Free Trade Agreement countries or that are resident in Switzerland would not qualify the Swedish company for benefits under this provision, as the United States does not have treaties that eliminate the withholding tax on inter-company dividends with any other of those countries. If the United States were to negotiate such treaties with more of those countries, residents of those countries could then qualify as equivalent beneficiaries for purposes of this provision.

The derivative benefits test may also provide benefits to U.S. companies receiving dividends from Swedish subsidiaries, because of the effect of the Parent-Subsidiary Directive in the European Union. Under that directive, inter-company dividends paid within the European Union are free of withholding tax. Under subparagraph (h) of paragraph 7 of Article 17, that directive will also be taken into account in determining whether the owner of a U.S. company receiving dividends from a Swedish company is an "equivalent beneficiary." Thus, a company that is a resident of a member state of the European Union will, by definition, meet the requirements regarding equivalent benefits with respect to any dividends received by its U.S. subsidiary from a Swedish company. For example, assume USCo is a wholly-owned subsidiary of ICo, an Italian publicly-traded company. USCo owns all of the shares of SCo, a Swedish company. If SCo were to pay dividends directly to ICo, those dividends would be exempt from withholding tax in Sweden by reason of the Parent-Subsidiary Directive, even though the tax treaty between Italy and Sweden otherwise would allow Sweden to impose a withholding tax at the rate of 5 percent. If ICo meets the other conditions of subparagraph 7(g) of Article 17, it will be treated as an equivalent beneficiary by reason of subparagraph 7(h) of that article.

A company also may qualify for the elimination of withholding tax pursuant to Article 10(3)(a)(iii) if it is owned by seven or fewer U.S. or Swedish residents who qualify as an "equivalent beneficiary" and meet the other requirements of the derivative benefits provision. This rule may apply, for example, to certain Swedish corporate joint venture vehicles that are closely-held by a few Swedish resident individuals.

Article 10(3) contains a specific rule of application intended to ensure that certain joint ventures, not just wholly-owned subsidiaries, can qualify for benefits. For example, assume that the United States were to enter into a treaty with Country X, a member of the European Union, that includes a provision identical to Article 10(3). USCo is 100 percent owned by SCo, a Swedish company, which in turn is owned 49 percent by PCo, a Swedish publicly-traded company, and 51 percent by XCo, a publicly-traded company that is resident in Country X. In the absence of a special rule for interpreting the derivative benefits provision, each of the shareholders would be treated as owning only their proportionate share of the shares held by SCo. If that rule were applied in this situation, neither shareholder would be an equivalent beneficiary, because neither would meet the 80 percent ownership test with respect to USCo. However, since both PCo and XCo are residents of countries that have treaties with the United States that provide for elimination of withholding tax on inter-company dividends, it is appropriate to provide benefits to SCo in this case.

Consequently, Article 10(3) provides that, when determining whether a person is an equivalent beneficiary, each of the shareholders is treated as owning shares with the same percentage of voting power as the shares held by SCo for purposes of determining whether it would be entitled to an equivalent rate of withholding tax. This rule is necessary because of the high ownership threshold for qualification for the elimination of withholding tax on inter-company dividends.

If a company does not qualify for the elimination of withholding tax under any of the foregoing objective tests, it may request a determination from the relevant competent authority pursuant to paragraph 6 of Article 17. Benefits will be granted with respect to an item of income if the competent authority of the Contracting State in which the income arises determines that the establishment, acquisition or maintenance of such resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention.

In making its determination under Article 17(6) with respect to income arising in the United States, the U.S. competent authority will consider the obligations imposed upon Sweden by its membership in the European Union. In particular, the United States will have regard for any legal requirements for the facilitation of the free movement of capital among member states of the European Union. The competent authority will also consider the differing internal tax systems, tax incentive regimes and tax treaty practices of the relevant member states.

For example, in the case above where SCo was denied the zero rate of withholding tax because it was wholly owned by ThirdCo, the competent authority would consider whether ThirdCo was a resident of a member state of the European Union or European Economic Area. If it were, that would be a factor in favor of a determination that SCo is entitled to the benefits of the zero rate of withholding tax on dividends. However, that positive factor could be outweighed by negative factors. One negative factor could be a determination by the U.S. competent authority that ThirdCo benefited from a tax incentive regime that eliminated any domestic taxation. The competent

authority would also consider facts that might indicate that ThirdCo acquired SCo not "under ordinary business conditions" but instead to interpose SCo between ThirdCo and USCo, creating a Sweden-U.S. "bridge." These might include the fact that existing U.S. operations were restructured in an attempt to benefit from the elimination of withholding tax on dividends; or the fact that ThirdCo was owned by residents of a country that is not a member state of the European Communities. Finally, another significant negative factor would be if the U.S. competent authority faced difficulties in learning the identity of ThirdCo's owners, such as an uncooperative taxpayer or legal barriers such as "economic espionage" or other limitations on the effective exchange of information in the country of which ThirdCo is a resident.

Subparagraph (b) of paragraph 3 of Article 10 of the Convention provides for exclusive taxation by the Contracting State of residence (*i.e.*, the elimination of source-country withholding tax) for dividends beneficially owned by a pension fund (as defined in paragraph 11 of this Article) provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by the pension fund or through an associated enterprise and such fund does not sell or make a contract to sell the holdings from which such dividend is derived within two months of the date the pension fund acquired the holding.

Paragraph 4

Paragraph 4 provides rules for the treatment of dividends paid by RIC or a REIT that are consistent with U.S. treaty policy.

The first sentence of subparagraph 4(a) provides that dividends paid by a RIC or REIT are not eligible for the 5 percent rate of withholding tax of subparagraph 2(a) or the elimination of source-country withholding tax of subparagraph 3(a).

The second sentence of subparagraph 4(a) provides that the 15 percent maximum rate of withholding tax of subparagraph 2(b) applies to dividends paid by RICs and that the elimination of source-country withholding tax of subparagraph 3(b) applies to dividends paid by RICs and beneficially owned by a pension fund.

The third sentence of subparagraph 4(a) provides that the 15 percent rate of withholding tax also applies to dividends paid by a REIT and that the elimination of source-country withholding tax of subparagraph 3(b) applies to dividends paid by REITs and beneficially owned by a pension fund, provided that one of the three following conditions is met. First, the beneficial owner of the dividend is an individual or a pension fund, in either case holding an interest of not more than 10 percent in the REIT. Second, the dividend is paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT's shares. Third, the beneficial owner of the dividend holds an interest in the REIT of not more than 10 percent and the REIT is "diversified." A REIT is diversified if the gross value of no single interest in real property held by the REIT exceeds 10 percent of the gross value of the REIT's total interest in real property.

Foreclosure property is not considered an interest in real property, and a REIT holding a partnership interest is treated as owning its proportionate share of any interest in real property held by the partnership.

The restrictions set out above are intended to prevent the use of these entities to gain inappropriate U.S. tax benefits. For example, a company resident in Sweden that wishes to hold a diversified portfolio of U.S. corporate shares could hold the portfolio directly and would bear a U.S. withholding tax of 15 percent on all of the dividends that it receives. Alternatively, it could hold the same diversified portfolio by purchasing 10 percent or more of the interests in a RIC. If the RIC is a pure conduit, there may be no U.S. tax cost to interposing the RIC in the chain of ownership. Absent the special rule in paragraph 4, such use of the RIC could transform portfolio dividends, taxable in the United States under the Convention at a 15 percent maximum rate of withholding tax, into direct investment dividends taxable at a 5 percent maximum rate of withholding tax or eligible for the elimination of source-country withholding tax.

Similarly, a resident of Sweden directly holding U.S. real property would pay U.S. tax upon the sale of the property either at a 30 percent rate of withholding tax on the gross income or at graduated rates on the net income. As in the preceding example, by placing the real property in a REIT, the investor could, absent a special rule, transform income from the sale of real estate into dividend income from the REIT, taxable at the rates provided in Article 10, significantly reducing the U.S. tax that otherwise would be imposed. Paragraph 4 prevents this result and thereby avoids a disparity between the taxation of direct real estate investments and real estate investments made through REIT conduits. In the cases in which paragraph 4 allows a dividend from a REIT to be eligible for the 15 percent rate of withholding tax, the holding in the REIT is not considered the equivalent of a direct holding in the underlying real property.

Paragraph 5

Paragraph 5 provides a broad and flexible definition of the term "dividends." The definition is intended to cover all arrangements that yield a return on an equity investment in a corporation as determined under the tax law of the state of source, including types of arrangements that might be developed in the future.

The term dividends includes income from shares, or other corporate rights that are not treated as debt under the law of the source State, that participate in the profits of the company. The term also includes income that is subjected to the same tax treatment as income from shares by the law of the State of residence of the dividend paying company. Thus, a constructive dividend that results from a non-arm's length transaction between a corporation and a related party is a dividend under paragraph 5.

In the case of the United States, the term dividends includes amounts treated as a dividend under U.S. law upon the sale or redemption of shares or upon a transfer of shares in a reorganization. See, *e.g.*, Rev. Rul. 92-85, 1992-2 C.B. 69 (sale of foreign subsidiary's stock to U.S. sister company is a deemed dividend to extent of subsidiary's

and sister's earnings and profits). Further, a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. law, is a dividend for purposes of Article 10. However, a distribution by a limited liability company is not characterized by the United States as a dividend and, therefore, is not a dividend for purposes of Article 10, provided the limited liability company is not taxable as a corporation under U.S. law.

Finally, a payment denominated as interest that is made by a thinly capitalized corporation may be treated as a dividend to the extent that the debt is recharacterized as equity under the laws of the source State. In the case, of the United States, these rules include section 163(j) of the Code.

The term dividends also includes income from arrangements, including debt obligations, carrying the right to participate in profits. In the case of the United States, this includes contingent interest that is not portfolio interest.

Paragraph 6

Paragraph 6 provides that the general source country limitations under paragraph 2 and 3 on dividends do not apply if the beneficial owner of the dividends is a permanent establishment situated in the source country, or performs in that other State independent personal services from a fixed base situated therein, and the dividends are attributable to such permanent establish or fixed base. In such case, the rules of Article 7 (Business Profits) or Article 14 (Independent Personal Service) shall apply, as the case may be. Accordingly, such dividends will be taxed on a net basis using the rates and rules of taxation generally applicable to residents of the Contracting State in which the permanent establishment or fixed base is located, as modified by the Convention. An example of dividends paid with respect to the business property of a permanent establishment would be dividends derived by a dealer in stock or securities from stock or securities that the dealer held for sale to customers.

Paragraph 7

The right of a Contracting State to tax dividends paid by a company that is a resident of the other Contracting State is restricted by paragraph 7 to cases in which the dividends are paid to a resident of that Contracting State or are attributable to a permanent establishment or fixed base in that Contracting State. Thus, a Contracting State may not impose a "secondary" withholding tax on dividends paid by a nonresident company out of earnings and profits from that Contracting State. In the case of the United States, the secondary withholding tax was eliminated for payments made after December 31, 2004 in the American Jobs Creation Act of 2004.

Paragraph 8

Paragraph 8 provides an exemption from U.S. excise taxes on private foundations in the case of a religious, scientific, literary, educational, or charitable organization which

is resident in Sweden, but only if such organization has received substantially all of its support from persons other than citizens or residents of the United States. This provision is designed to ensure that the Nobel Foundation, a Swedish charitable organization, will not be subject to U.S. excise taxes.

Paragraphs 9 and 10

Paragraph 9 permits a Contracting State to impose a branch profits tax on a company resident in the other Contracting State. The tax is in addition to other taxes permitted by the Convention. The term "company" is defined in subparagraph 1(b) of Article 3 (General Definitions).

A Contracting State may impose a branch profits tax on a company if the company has income attributable to a permanent establishment in that Contracting State, derives income from real property in that Contracting State that is taxed on a net basis under Article 6 (Income from Real Property), or realizes gains taxable in that State under paragraph 1 of Article 13 (Gains). In the case of the United States, the imposition of such tax is limited, however, to the portion of the aforementioned items of income that represents the amount of such income that is the "dividend equivalent amount." This is consistent with the relevant rules under the U.S. branch profits tax, and the term dividend equivalent amount is defined under U.S. law. Section 884 defines the dividend equivalent amount as an amount for a particular year that is equivalent to the income described above that is included in the corporation's effectively connected earnings and profits for that year, after payment of the corporate tax under Articles 6 (Income from Real Property), 7 (Business Profits) or 13 (Gains), reduced for any increase in the branch's U.S. net equity during the year or increased for any reduction in its U.S. net equity during the year. U.S. net equity is U.S. assets less U.S. liabilities. See Treas. Reg. section 1.884-1.

Sweden currently does not impose a branch profits tax. If Sweden were to impose such a tax, the base is limited to the portion of the income described in subparagraph 9(a) that is comparable to the amount that would be distributed as a dividend by a locally incorporated subsidiary.

Paragraph 10 limits the rate of the branch profits tax allowed under paragraph 9 to 5 percent. Paragraph 10 also provides that the branch profits tax will not be imposed, however, if certain requirements are met. In general, these requirements provide rules for a branch that parallel the rules for when a dividend paid by a subsidiary will be subject to exclusive residence-country taxation (i.e., the elimination of source-country withholding tax). Accordingly, the branch profits tax may not be imposed in the case of a company that: (1) meets the "publicly traded" test of subparagraph 2(c) of Article 17 (Limitation of Benefits), (2) meets the "ownership base erosion" and "active trade or business" test described subparagraph 2(e) and subparagraph 4 of Article 17, (3) meets the "derivative benefits" test of paragraph 3 of Article 17, or (4) is granted the benefits of subparagraph 3(a) of Article 10 by the competent authority pursuant to paragraph 6 of Article 17.

Thus, for example, if a Swedish company would be subject to the branch profits tax with respect to profits attributable to a U.S. branch and not reinvested in that branch, paragraph 10 may apply to eliminate the branch profits tax if the company either met the "publicly traded" test, met both the "ownership-base erosion" *and* "active trade or business" tests, or the derivative benefits test. If, by contrast, a Swedish company did not meet those tests, then the branch profits tax would apply at a rate of 5 percent, unless the Swedish company is granted benefits with respect to the elimination of the branch profits tax by the competent authority pursuant to paragraph 6 of Article 17.

Paragraph 11

Paragraph 11 defines a pension fund to mean a person (as defined in Article 3 (General Definitions)) that is organized under the laws of a Contracting State who is established and maintained in that State primarily to administer or provide pensions or other similar remuneration, including social security payments, and is exempt from tax in that Contracting State with respect to such activities.

Relation to Other Articles

Notwithstanding the foregoing limitations on source country taxation of dividends, the saving clause of paragraph 4 of Article 1 (Personal Scope) permits the United States to tax dividends received by its residents and citizens as if the Convention had not come into effect.

The benefits of this Article are also subject to the provisions of Article 17 (Limitation on Benefits). Thus, if a resident of Sweden is the beneficial owner of dividends paid by a U.S. company, the shareholder must qualify for treaty benefits under at least one of the tests of Article 17 in order to receive the benefits of this Article.

Paragraph 2 of Article III of the Protocol makes a conforming change to the cross-reference in paragraph 5 of Article 24 (Non-Discrimination) of the Convention.

Article V

Article V of the Protocol replaces Article 17 (Limitation on Benefits) of the Convention.

Structure of the Article

Article 17 follows the form used in other recent U.S. income tax treaties. Paragraph 1 states the general rule that a resident of a Contracting State is entitled to benefits otherwise accorded to residents only to the extent that the resident satisfies the requirements of the Article. Paragraph 2 lists a series of attributes of a resident of a Contracting State, any one of which suffices to make such entitled to all the benefits of the Convention. Paragraph 3 provides a so-called "derivative benefits" test under which certain categories of income may qualify for benefits. Paragraph 4 sets forth the active

trade or business test, under which a person not entitled to benefits under paragraph 2 may nonetheless be granted benefits with regard to certain types of income. Paragraph 5 provides special rules for so-called "triangular cases" notwithstanding the other provisions of Article 17. Paragraph 6 provides that benefits may also be granted if the competent authority of the State from which the benefits are claimed determines that it is appropriate to grant benefits in that case. Paragraph 7 defines the terms used specifically in this Article.

Even if a person satisfies the requirements of Article 17, benefits shall be granted only if the resident of a Contracting State satisfies any other specified conditions for claiming benefits. This means, for example, that a publicly-traded company that satisfies the conditions of subparagraph 2(c) will be eligible for the elimination of withholding tax on dividends at source only if it also owns 80 percent or more of the voting power of the paying company and satisfies the 12-month holding period requirement of subparagraph 3(a) of Article 10, and satisfies any other conditions specified in Article 10 or any other articles of the Convention.

Paragraph 1

Paragraph 1 provides that a resident of a Contracting State will be entitled to all the benefits of the Convention otherwise accorded to residents of a Contracting State only to the extent provided in this Article.

The benefits otherwise accorded to residents under the Convention include all limitations on source-based taxation, the treaty-based relief from double taxation, and the protection afforded to residents of a Contracting State under Article 24 (Non-Discrimination). Some provisions do not require that a person be a resident in order to enjoy the benefits of those provisions. Article 25 (Mutual Agreement Procedure) is not limited to residents of the Contracting States, and Article 20 (Government Service) applies to government employees regardless of residence. Article 17 accordingly does not limit the availability of treaty benefits under this provisions.

Article 17 and the anti-abuse provisions of domestic law complement each other, as Article 17 effectively determines whether an entity has a sufficient nexus to a Contracting State to be treated as a resident for treaty purposes, while domestic anti-abuse provisions (*e.g.*, business purpose, substance-over-form, step transaction or conduit principles) determine whether a particular transaction should be recast in accordance with its substance. Thus, internal law principles of the source Contracting State may be applied to identify the beneficial owner of an item of income, and Article 17 then will be applied to the beneficial owner to determine if that person is entitled to the benefits of the Convention with respect to such income.

Paragraph 2

Paragraph 2 has five subparagraphs, each of which describes a category of residents that are entitled to all benefits of the Convention. It is intended that the

provisions of paragraph 2 will be self-executing. Claiming benefits under paragraph 2 does not require an advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Individuals -- Subparagraph 2(a)

Subparagraph (a) provides that individual residents of a Contracting State will be entitled to all the benefits of the Convention. If such an individual receives income as a nominee on behalf of a third country resident, benefits may be denied under the applicable articles of the Convention by the requirement that the beneficial owner of the income be a resident of a Contracting State.

Governments -- Subparagraph 2(b)

Subparagraph (b) provides that the Contracting States and any political subdivision or local authority thereof will be entitled to all the benefits of the Convention.

Publicly-Traded Corporations -- Subparagraph 2(c)

Subparagraph (c) applies to two categories of companies: publicly traded companies and subsidiaries of publicly traded companies. A company resident in a Contracting State is entitled to all the benefits of the Convention under clause (i) of subparagraph (c) if the principal class of its shares, and any disproportionate class of shares, is regularly traded on one or more recognized stock exchanges and the company satisfies at least one of the following additional requirements. First, the company's principal class of shares is primarily traded on a recognized stock exchange located in a Contracting State of which the company is a resident; or, in the case of a company resident in Sweden, on a recognized stock exchange located within the European Union, any other European Economic Area country or Switzerland; or, in the case of a company resident in the United States, on a recognized stock exchange located in another state that is a party to the North American Free Trade Agreement. Second, the company's primary place of management and control is in its State of residence.

The term "recognized stock exchange" is defined in subparagraph (d) of paragraph 7. It includes the NASDAQ System and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934. It also includes the Stockholm Stock Exchange, the Nordic Growth Market, and any other exchange subject to regulation by the Swedish Financial Supervisory Authority. The term also includes the Irish Stock Exchange and the stock exchanges of Amsterdam, Brussels, Copenhagen, Frankfurt, Hamburg, Helsinki, London, Madrid, Milan, Oslo, Paris, Reykjavik, Riga, Tallinn, Toronto, Vienna, Vilnius and Zurich, and any other stock exchange agreed upon by the competent authorities of the Contracting States.

The term "principal class of shares" is defined in subparagraph (a) of paragraph 7 to mean the ordinary or common shares of the company representing the majority of the aggregate voting power and value of the company. If the company does not have a class of ordinary or common shares representing the majority of the aggregate voting power and value of the company, then the "principal class of shares" is that class or any combination of classes of shares that represents, in the aggregate, a majority of the voting power and value of the company. In addition, subparagraph (c) of paragraph 7 defines the term "shares" to include depository receipts for shares.

The term "disproportionate class of shares" is defined in subparagraph (b) of paragraph 7. A company has a disproportionate class of shares if it has outstanding a class of shares which is subject to terms or other arrangements that entitle the holder to a larger portion of the company's income, profit, or gain in the other Contracting State than that to which the holder would be entitled in the absence of such terms or arrangements. Thus, for example, a company resident in Sweden meets the test of subparagraph (b) of paragraph 7 if it has outstanding a class of "tracking stock" that pays dividends based upon a formula that approximates the company's return on its assets employed in the United States.

A company whose principal class of shares is regularly traded on a recognized stock exchange will nevertheless not qualify for benefits under subparagraph (c) of paragraph 2 if it has a disproportionate class of shares that is not regularly traded on a recognized stock exchange. The following example illustrates this result.

Example. SCo is a corporation resident in Sweden. SCo has two classes of shares: Common and Preferred. The Common shares are listed and regularly traded on the Stockholm Stock Exchange. The Preferred shares have no voting rights and are entitled to receive dividends equal in amount to interest payments that SCo receives from unrelated borrowers in the United States. The Preferred shares are owned entirely by a single investor that is a resident of a country with which the United States does not have a tax treaty. The Common shares account for more than 50 percent of the value of SCo and for 100 percent of the voting power. Because the owner of the Preferred shares is entitled to receive payments corresponding to the U.S. source interest income earned by SCo, the Preferred shares are a disproportionate class of shares. Because the Preferred shares are not regularly traded on a recognized stock exchange, SCo will not qualify for benefits under subparagraph (c) of paragraph 2.

A class of shares will be "regularly traded" in a taxable year, under subparagraph (e) of paragraph 7, if the aggregate number of shares of that class traded on one or more recognized exchanges during the twelve months ending on the day before the beginning of that taxable year is at least six percent of the average number of shares outstanding in that class during that twelve-month period. For this purpose, if a class of shares was not listed on a recognized stock exchange during this twelve-month period, the class of shares will be treated as regularly traded only if the class meets the aggregate trading requirements for the taxable period in which the income arises. Trading on one or more recognized stock exchanges may be aggregated for purposes of meeting the "regularly

traded" standard of subparagraph (e). For example, a U.S. company could satisfy the definition of "regularly traded" through trading, in whole or in part, on a recognized stock exchange located in Sweden or certain third countries. Authorized but unissued shares are not considered for purposes of subparagraph (e).

A company whose principal class of shares is regularly traded on a recognized exchange but cannot meet the primarily traded test may claim treaty benefits if its primary place of management and control is in its country of residence. This test should be distinguished from the "place of effective management" test which is used in the OECD Model and by many other countries to establish residence. In some cases, the place of effective management test has been interpreted to mean the place where the board of directors meets. By contrast, the primary place of management and control test looks to where day-to-day responsibility for the management of the company (and its subsidiaries) is exercised. The company's primary place of management and control will be located in the State in which the company is a resident only if the executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including direct and indirect subsidiaries) in that State than in the other State or any third state, and the staffs that support the management in making those decisions are also based in that State.

A company resident in a Contracting State is entitled to all the benefits of the Convention under clause (ii) of subparagraph (c) of paragraph 2 if five or fewer publicly traded companies described in clause (i) are the direct or indirect owners of at least 50 percent of the aggregate vote and value of the company's shares (and at least 50 percent of any disproportionate class of shares). If the publicly-traded companies are indirect owners, however, each of the intermediate companies must be a resident of one of the Contracting States. Thus, for example, a Swedish company, all the shares of which are owned by another Swedish company, would qualify for benefits under the Convention if the principal class of shares (and any disproportionate classes of shares) of the Swedish parent company are regularly and primarily traded on the London stock exchange. However, a Swedish subsidiary would not qualify for benefits under clause (ii) if the publicly traded parent company were a resident of Ireland, for example, and not a resident of the United States or Sweden. Furthermore, if a Swedish parent company indirectly owned a Swedish company through a chain of subsidiaries, each such subsidiary in the chain, as an intermediate owner, must be a resident of the United States or Sweden for the Swedish subsidiary to meet the test in clause (ii).

Tax-Exempt Organizations and Pensions -- Subparagraph 2(d)

A tax-exempt organization other than a tax-exempt pension fund is entitled to all the benefits of the Convention, without regard to the residence of its beneficiaries or members. Entities qualifying under this subparagraph are those that generally are exempt from tax in their Contracting State of residence and that are established and maintained exclusively to fulfill religious, charitable, educational, scientific, artistic, cultural, or public purposes.

A tax-exempt pension fund is entitled to all the benefits of the Convention if, as of the close of the end of the prior taxable year, more than 50 percent of the beneficiaries, members or participants of the tax-exempt pension are individuals resident in either Contracting State or if the organization sponsoring the tax-exempt pension is entitled to all the benefits of the Convention under Article 17. For purposes of this provision, the term "beneficiaries" should be understood to refer to the persons receiving benefits from the pension fund.

Ownership/Base Erosion -- Subparagraph 2(e)

Subparagraph 2(e) provides an additional method to qualify for treaty benefits that applies to any form of legal entity that is a resident of a Contracting State. The test provided in subparagraph (e), the so-called ownership and base erosion test, is a two-part test. Both prongs of the test must be satisfied for the resident to be entitled to treaty benefits under subparagraph 2(e).

The ownership prong of the test, under clause (i), requires that 50 percent or more of each class of shares or other beneficial interests in the person is owned, directly or indirectly, on at least half the days of the person's taxable year by persons who are residents of the Contracting State of which that person is a resident and that are themselves entitled to treaty benefits under certain parts of paragraph 2 -- subparagraphs (a), (b), (d), or clause (i) of subparagraph (c).

Trusts may be entitled to benefits under this provision if they are treated as residents under Article 4 (Residence) and they otherwise satisfy the requirements of this subparagraph. For purposes of this subparagraph, the beneficial interests in a trust will be considered to be owned by its beneficiaries in proportion to each beneficiary's actuarial interest in the trust. The interest of a remainder beneficiary will be equal to 100 percent less the aggregate percentages held by income beneficiaries. A beneficiary's interest in a trust will not be considered to be owned by a person entitled to benefits under the other provisions of paragraph 2 if it is not possible to determine the beneficiary's actuarial interest. Consequently, if it is not possible to determine the actuarial interest of the beneficiaries in a trust, the ownership test under clause i) cannot be satisfied, unless all possible beneficiaries are persons entitled to benefits under the other subparagraphs of paragraph 2.

The base erosion prong of clause (ii) of subparagraph (e) is satisfied with respect to a person if less than 50 percent of the person's gross income for the taxable year is paid or accrued to persons who are not residents of either Contracting State, in the form of payments deductible for tax purposes in the payer's State of residence. These amounts do not include arm's-length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the payor. To the extent they are deductible from the taxable base, trust distributions are deductible payments. However, depreciation and amortization deductions, which do not represent payments or accruals to other persons, are disregarded

for this purpose. In the case of Sweden, such amounts do not include the amount of so-called group contributions, if any, paid to a Swedish resident or permanent establishment. Sweden taxes companies on an entity rather than consolidated group basis and therefore, tax consolidation is not allowed. Qualifying companies may exchange group contributions, which are deductible by the payor and taxable to the payee. Through these contributions, tax consolidation can be effectively achieved.

Paragraph 3

Paragraph 3 sets forth a derivative benefits test that is potentially applicable to all treaty benefits, although the test is applied to individual items of income. In general, a derivative benefits test entitles the resident of a Contracting State to treaty benefits if the owner of the resident would have been entitled to the same benefit had the income in question flowed directly to that owner. To qualify under this paragraph, the company must meet an ownership test and a base erosion test.

Subparagraph (a) sets forth the ownership test. Under this test, seven or fewer equivalent beneficiaries must own shares representing at least 95 percent of the aggregate voting power and value of the company and at least 50 percent of any disproportionate class of shares. Ownership may be direct or indirect. The term "equivalent beneficiary" is defined in subparagraph (g) of paragraph 7. This definition may be met in two alternative ways, the first of which has two requirements.

Under the first alternative, a person may be an equivalent beneficiary because it is entitled to equivalent benefits under a treaty between the country of source and the country in which the person is a resident. This alternative has two requirements.

The first requirement is that the person must be a resident of a member state of the European Union, a European Economic Area state, a party to the North American Free Trade Agreement, or Switzerland (collectively, "qualifying States").

The second requirement of the definition of "equivalent beneficiary" is that the person must be entitled to equivalent benefits under an applicable treaty. To satisfy the second requirement, the person must be entitled to all the benefits of a comprehensive treaty between the Contracting State from which benefits of the Convention are claimed and a qualifying State under provisions that are analogous to the rules in paragraph 2 of this Article regarding individuals, qualified governmental entities, publicly-traded companies or entities, and tax-exempt organizations and pensions. If the treaty in question does not have a comprehensive limitation on benefits article, this requirement only is met if the person would be entitled to treaty benefits under the tests in paragraph 2 of this Article applicable to individuals, qualified governmental entities, publicly-traded companies or entities, and tax-exempt organizations and pensions.

In order to satisfy the second requirement necessary to qualify as an "equivalent beneficiary" under paragraph 7(g)(i)(B) with respect to insurance premiums, dividends, interest, royalties or branch tax, the person must be entitled to a rate of excise,

withholding or branch tax that is at least as low as the excise, withholding or branch tax rate that would apply under the Convention to such income. Thus, the rates to be compared are: (1) the rate of tax that the source State would have imposed if a qualified resident of the other Contracting State was the beneficial owner of the income; and (2) the rate of tax that the source State would have imposed if the third State resident received the income directly from the source State. For example, USCo is a wholly owned subsidiary of SCo, a company resident in Sweden. SCo is wholly owned by ICo, a corporation resident in Italy. Assuming SCo satisfies the requirements of paragraph 3 of Article 10 (Dividends), SCo would be eligible for the elimination of dividend withholding tax. The dividend withholding tax rate in the treaty between the United States and Italy is 5 percent. Thus, if ICo received the dividend directly from USCo, ICo would have been subject to a 5 percent rate of withholding tax on the dividend. Because ICo would not be entitled to a rate of withholding tax that is at least as low as the rate that would apply under the Convention to such income (*i.e.*, zero), ICo is not an equivalent beneficiary within the meaning of paragraph 7(g)(i) of Article 17 with respect to the elimination of withholding tax on dividends.

Subparagraph 7(h) provides a special rule to take account of the fact that withholding taxes on many inter-company dividends, interest and royalties are exempt within the European Union by reason of various EU directives, rather than by tax treaty. If a U.S. company receives such payments from a Swedish company, and that U.S. company is owned by a company resident in a member state of the European Union that would have qualified for an exemption from withholding tax if it had received the income directly, the parent company will be treated as an equivalent beneficiary. This rule is necessary because many European Union member countries have not re-negotiated their tax treaties to reflect the rates applicable under the directives.

The requirement that a person be entitled to "all the benefits" of a comprehensive tax treaty eliminates those persons that qualify for benefits with respect to only certain types of income. Accordingly, the fact that a French parent of a Swedish company is engaged in the active conduct of a trade or business in France and therefore would be entitled to the benefits of the U.S.-France treaty if it received dividends directly from a U.S. subsidiary of the Swedish company is not sufficient for purposes of this paragraph. Further, the French company cannot be an equivalent beneficiary if it qualifies for benefits only with respect to certain income as a result of a "derivative benefits" provision in the U.S.-France treaty. However, it would be possible to look through the French company to its parent company to determine whether the parent company is an equivalent beneficiary.

The second alternative for satisfying the "equivalent beneficiary" test is available only to residents of one of the two Contracting States. U.S. or Swedish residents who are eligible for treaty benefits by reason of subparagraphs (a), (b), (c)(i), or (d) of paragraph 2 are equivalent beneficiaries for purposes of the relevant tests in Article 17. Thus, a Swedish individual will be an equivalent beneficiary without regard to whether the individual would have been entitled to receive the same benefits if it received the income directly. A resident of a third country cannot qualify for treaty benefits under these

provisions by reason of those paragraphs or any other rule of the treaty, and therefore do not qualify as equivalent beneficiaries under this alternative. Thus, a resident of a third country can be an equivalent beneficiary only if it would have been entitled to equivalent benefits had it received the income directly.

The second alternative was included in order to clarify that ownership by certain residents of a Contracting State would not disqualify a U.S. or Swedish company under this paragraph. Thus, for example, if 90 percent of a Swedish company is owned by five companies that are resident in member states of the European Union who satisfy the requirements of clause (i), and 10 percent of the Swedish company is owned by a U.S. or Swedish individual, then the Swedish company still can satisfy the requirements of subparagraph (a) of paragraph 3.

Subparagraph (b) of paragraph 3 sets forth the base erosion test. A company meets this base erosion test if less than 50 percent of its gross income for the taxable period is paid or accrued, directly or indirectly, to a person or persons who are not equivalent beneficiaries in the form of payments deductible for tax purposes in company's State of residence. These amounts do not include arm's-length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the payor. This test is the same as the base erosion test in clause (ii) of subparagraph (e) of paragraph 2, except that deductible payments made to equivalent beneficiaries, rather than amounts paid to residents of a Contracting State, are not counted against a company for purposes of determining whether the company exceeded the 50 percent limit.

As in the case of base erosion test in subparagraph (e) of paragraph 2, deductible payments in subparagraph (b) of paragraph 3 also do not include arm's length payments in the ordinary course of business for services or tangible property or with respect to financial obligations to banks that are residents of either Contracting State.

Paragraph 4

Paragraph 4 sets forth a test under which a resident of a Contracting State that does not qualify for treaty benefits under paragraph 2 may receive treaty benefits with respect to certain items of income that are connected to an active trade or business conducted in its State of residence.

Subparagraph (a) sets forth the general rule that a resident of a Contracting State engaged in the active conduct of a trade or business in that State may obtain the benefits of the Convention with respect to an item of income, profit, or gain derived in the other Contracting State. The item of income, profit, or gain, however, must be derived in connection with or incidental to that trade or business.

The term "trade or business" is not defined in the Convention. Pursuant to paragraph 2 of Article 3 (General Definitions), when determining whether a resident of Sweden is entitled to the benefits of the Convention under paragraph 4 of this Article

with respect to an item of income derived from sources within the United States, the United States will ascribe to this term the meaning that it has under the law of the United States. Accordingly, the U.S. competent authority will refer to the regulations issued under section 367(a) for the definition of the term "trade or business." In general, therefore, a trade or business will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities.

The business of making or managing investments for the resident's own account will be considered to be a trade or business only when part of banking, insurance or securities activities conducted by a bank, an insurance company, or a registered securities dealer. Such activities conducted by a person other than a bank, insurance company or registered securities dealer will not be considered to be the conduct of an active trade or business, nor would they be considered to be the conduct of an active trade or business if conducted by a bank, insurance company or registered securities dealer but not as part of the company's banking, insurance or dealer business.

An item of income is derived in connection with a trade or business if the income-producing activity in the State of source is a line of business that "forms a part of" or is "complementary" to the trade or business conducted in the State of residence by the income recipient.

A business activity generally will be considered to form part of a business activity conducted in the State of source if the two activities involve the design, manufacture or sale of the same products or type of products, or the provision of similar services. The line of business in the State of residence may be upstream, downstream, or parallel to the activity conducted in the State of source. Thus, the line of business may provide inputs for a manufacturing process that occurs in the State of source, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the trade or business carried on in the State of source.

Example 1. USCo is a corporation resident in the United States. USCo is engaged in an active manufacturing business in the United States. USCo owns 100 percent of the shares of SCo, a company resident in Sweden. SCo distributes USCo products in Sweden. Because the business activities conducted by the two corporations involve the same products, SCo's distribution business is considered to form a part of USCo's manufacturing business.

Example 2. The facts are the same as in Example 1, except that USCo does not manufacture. Rather, USCo operates a large research and development facility in the United States that licenses intellectual property to affiliates worldwide, including SCo. SCo and other USCo affiliates then manufacture and market the USCo-designed products in their respective markets. Because the activities conducted by SCo and USCo involve

the same product lines, these activities are considered to form a part of the same trade or business.

For two activities to be considered to be "complementary," the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in success or failure for the other. Where more than one trade or business is conducted in the State of source and only one of the trades or businesses forms a part of or is complementary to a trade or business conducted in the State of residence, it is necessary to identify the trade or business to which an item of income is attributable. Royalties generally will be considered to be derived in connection with the trade or business to which the underlying intangible property is attributable. Dividends will be deemed to be derived first out of earnings and profits of the treaty-benefited trade or business, and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method.

Example 3. Americair is a corporation resident in the United States that operates an international airline. SSub is a wholly-owned subsidiary of Americair resident in Sweden. SSub operates a chain of hotels in Sweden that are located near airports served by Americair flights. Americair frequently sells tour packages that include air travel to Sweden and lodging at SSub hotels. Although both companies are engaged in the active conduct of a trade or business, the businesses of operating a chain of hotels and operating an airline are distinct trades or businesses. Therefore SSub's business does not form a part of Americair's business. However, SSub's business is considered to be complementary to Americair's business because they are part of the same overall industry (travel), and the links between their operations tend to make them interdependent.

Example 4. The facts are the same as in Example 3, except that SSub owns an office building in Sweden instead of a hotel chain. No part of Americair's business is conducted through the office building. SSub's business is not considered to form a part of or to be complementary to Americair's business. They are engaged in distinct trades or businesses in separate industries, and there is no economic dependence between the two operations.

Example 5. USFlower is a company resident in the United States. USFlower produces and sells flowers in the United States and other countries. USFlower owns all the shares of SHolding, a corporation resident in Sweden. SHolding is a holding company that is not engaged in a trade or business. SHolding owns all the shares of three corporations that are resident in Sweden: SFlower, SLawn, and SFish. SFlower distributes USFlower flowers under the USFlower trademark in Sweden. SLawn markets a line of lawn care products in Sweden under the USFlower trademark. In addition to being sold under the same trademark, SLawn and SFlower products are sold in the same stores and sales of each company's products tend to generate increased sales of the other's products. SFish imports fish from the United States and distributes it to fish wholesalers in Sweden. For purposes of paragraph 4, the business of SFlower forms a

part of the business of USFlower, the business of SLawn is complementary to the business of USFlower, and the business of SFish is neither part of nor complementary to that of USFlower.

An item of income derived from the State of source is "incidental to" the trade or business carried on in the State of residence if production of the item facilitates the conduct of the trade or business in the State of residence. An example of incidental income is the temporary investment of working capital of a person in the State of residence in securities issued by persons in the State of source.

Subparagraph (b) of paragraph 4 states a further condition to the general rule in subparagraph (a) in cases where the trade or business generating the item of income in question is carried on either by the person deriving the income or by any associated enterprises. Subparagraph (b) states that the trade or business carried on in the State of residence, under these circumstances, must be substantial in relation to the activity in the State of source. The substantiality requirement is intended to prevent a narrow case of treaty-shopping abuses in which a company attempts to qualify for benefits by engaging in de minimis connected business activities in the treaty country in which it is resident (*i.e.*, activities that have little economic cost or effect with respect to the company business as a whole).

The determination of substantiality is made based upon all the facts and circumstances and takes into account the comparative sizes of the trades or businesses in each Contracting State (measured by reference to asset values, income and payroll expenses), the nature of the activities performed in each Contracting State, and the relative contributions made to that trade or business in each Contracting State. In any case, in making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Swedish economies.

The determination in subparagraph (b) also is made separately for each item of income derived from the State of source. It therefore is possible that a person would be entitled to the benefits of the Convention with respect to one item of income but not with respect to another. If a resident of a Contracting State is entitled to treaty benefits with respect to a particular item of income under paragraph 4, the resident is entitled to all benefits of the Convention insofar as they affect the taxation of that item of income in the State of source.

The application of the substantiality requirement only to income from related parties focuses only on potential abuse cases, and does not hamper certain other kinds of non-abusive activities, even though the income recipient resident in a Contracting State may be very small in relation to the entity generating income in the other Contracting State. For example, if a small U.S. research firm develops a process that it license to a very large, unrelated, Swedish pharmaceutical manufacturer, the size of the U.S. research firm would not have to be tested against the size of the Swedish manufacturer. Similarly, a small U.S. bank that makes a loan to a very large unrelated Swedish business would not have to pass a substantiality test to receive treaty benefits under Paragraph 4.

Subparagraph (c) of paragraph 4 provides special rules for determining whether a resident of a Contracting State is engaged in the active conduct of a trade or business within the meaning of subparagraph (a). Subparagraph (c) attributes the activities of a partnership to each of its partners. Subparagraph (c) also attributes to a person activities conducted by persons "connected" to such person. A person ("X") is connected to another person ("Y") if X possesses 50 percent or more of the beneficial interest in Y (or if Y possesses 50 percent or more of the beneficial interest in X). For this purpose, X is connected to a company if X owns shares representing fifty percent or more of the aggregate voting power and value of the company or fifty percent or more of the beneficial equity interest in the company. X also is connected to Y if a third person possesses fifty percent or more of the beneficial interest in both X and Y. For this purpose, if X or Y is a company, the threshold relationship with respect to such company or companies is fifty percent or more of the aggregate voting power and value or fifty percent or more of the beneficial equity interest. Finally, X is connected to Y if, based upon all the facts and circumstances, X controls Y, Y controls X, or X and Y are controlled by the same person or persons.

Paragraph 5

Paragraph 5 deals with the treatment of insurance premiums, royalties and interest in the context of a so-called "triangular case."

The term "triangular case" refers to the use of the following structure by a resident of Sweden to earn, in this case, interest income from the United States. The resident of Sweden, who is assumed to qualify for benefits under one or more of the provisions of Article 17 (Limitation on Benefits), sets up a permanent establishment in a third jurisdiction that imposes only a low rate of tax on the income of the permanent establishment. The Swedish resident lends funds into the United States through the permanent establishment. The permanent establishment, despite its third-jurisdiction location, is an integral part of a Swedish resident. Therefore the income that it earns on those loans, absent the provisions of paragraph 5, is entitled to exemption from U.S. withholding tax under the Convention. Under a current Swedish income tax treaty with the host jurisdiction of the permanent establishment, the income of the permanent establishment is exempt from Swedish tax. Thus, the interest income is exempt from U.S. tax, is subject to little tax in the host jurisdiction of the permanent establishment, and is exempt from Swedish tax.

Because the United States does not exempt the profits of a third-jurisdiction permanent establishment of a U.S. resident from U.S. tax, either by statute or by treaty, the paragraph only applies with respect to U.S. source insurance premiums, interest, or royalties that are attributable to a third-jurisdiction permanent establishment of a Swedish resident.

Paragraph 5 replaces the otherwise applicable rules in the Convention for insurance premiums, interest and royalties with a 15 percent U.S. withholding tax for

interest and royalties and the rules of U.S. domestic law for insurance premiums under the following circumstances. First, the actual tax paid on the U.S. source premiums, interest or royalties in the third state is subject is less than 60 percent of the tax that would have been payable in Sweden if the income were earned in Sweden by the enterprise and were not attributable to the permanent establishment in the third state.

In general, the principles employed under Code section 954(b)(4) will be employed to determine whether the profits are subject to an effective rate of taxation that is above the specified threshold.

Notwithstanding the level of tax on interest and royalty income of the permanent establishment, paragraph 5 will not apply under certain circumstances. In the case of interest (as defined in Article 11(Interest)), paragraph 5 will not apply if the interest is derived in connection with, or is incidental to, the active conduct of a trade or business carried on by the permanent establishment in the third state. The business of making, managing or simply holding investments is not considered to be an active trade or business, unless these are banking or securities activities carried on by a bank or registered securities dealer. In the case of royalties, paragraph 5 will not apply if the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by a permanent establishment itself.

Paragraph 6

Paragraph 6 provides that a resident of one of the States that is not entitled to the benefits of the Convention as a result of paragraphs 1 through 5 still may be granted benefits under the Convention at the discretion of the competent authority of the State from which benefits are claimed. In making determinations under paragraph 6, that competent authority will take into account as its guideline whether the establishment, acquisition, or maintenance of the person seeking benefits under the Convention, or the conduct of such person's operations, has or had as one of its principal purposes the obtaining of benefits under the Convention. Thus, persons that establish operations in one of the States with a principal purpose of obtaining the benefits of the Convention ordinarily will not be granted relief under paragraph 6.

The competent authority may determine to grant all benefits of the Convention, or it may determine to grant only certain benefits. For instance, it may determine to grant benefits only with respect to a particular item of income in a manner similar to paragraph 4. Further, the competent authority may set time limits on the duration of any relief granted.

For purposes of implementing paragraph 6, a taxpayer will be permitted to present his case to the relevant competent authority for an advance determination based on the facts. In these circumstances, it is also expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later.

A competent authority is required by paragraph 6 to consult the other competent authority before denying benefits under this paragraph. According to the notes, the competent authority will consider the obligations of Sweden by virtue of its membership in the European Union in making a determination under paragraph 6. In particular, the competent authority will consider any legal requirements for the facilitation of the free movement of capital and persons, together with the differing internal tax systems, tax incentive regimes and existing tax treaty policies among member states of the European Union. As a result, where certain changes in circumstances otherwise might cause a person to cease to be a eligible for treaty benefits under paragraphs 2 of Article 17, for example, such changes need not result in the denial of benefits.

The changes in circumstances contemplated include, all under ordinary business conditions, a change in the State of residence of a major shareholder of a company; the sale of part of the stock of a Swedish company to a resident in another member state of the European Union; or an expansion of a company's activities in other member states of the European Union. So long as the relevant competent authority is satisfied that those changed circumstances are not attributable to tax avoidance motives, they will count as a factor favoring the granting of benefits under paragraph 6, if consistent with existing treaty policies, such as the need for effective exchange of information.

Paragraph 7

Paragraph 7 defines several key terms for purposes of Article 17. Each of the defined terms is discussed in the context in which it is used.

Article VI

The Protocol adds an additional paragraph to Article 20 (Government Services) of the Convention. This paragraph provides a grandfather rule to eliminate the unintended consequences resulting from the 1994 U.S.-Sweden income tax treaty regarding the taxation of local employees (or former employees) of the Embassy in Stockholm and consulate in Gothenburg.

The 1939 U.S.-Sweden income tax treaty generally provided that wages, salaries and similar compensation and pensions paid by one Contracting State to individuals in another Contracting State were exempt from tax in the latter State. The U.S. government reduced the salaries paid to Swedish residents and citizens working at the U.S. Embassy in Stockholm or consulate in Gothenburg to take account of the fact that they were exempt from Swedish income tax. Accordingly, their pensions, which were based on "high-three," were also reduced.

The 1994 U.S.-Sweden income tax treaty generally provides that remuneration (other than a pension) paid by a Contracting State to an individual in respect of services rendered to that State is taxable only that State unless the person was already a resident of the other State before he began working for the first-mentioned State. The 1994 treaty

also generally provides that a pension paid by a Contracting State to an individual in respect of services to that State are taxable only in the other Contracting State if the individual is a resident and citizen of that State.

Under the 1994 U.S.-Sweden tax treaty, Sweden does tax the pensions of Swedish residents or citizens who worked in the U.S. Embassy in Stockholm and consulate in Gothenburg. The 1994 U.S.-Sweden tax treaty failed to provide a grandfather for former employees whose pension benefits are based on a "high three" that took into account the exemption from Swedish income tax provided for in the 1939 U.S.-Sweden tax, thereby significantly reducing the expected benefits to these former employees.

To rectify this problem, the Protocol adds an additional paragraph to Article 20 (Government Service) of the Convention to provide that Sweden may not tax a pension under the U.S. Civil Service Retirement Pension Plan paid by the United States to employees of the U.S. embassy in Stockholm or the U.S. consulate general in Gothenburg if the individual was hired prior to 1978.

Article VII

The Protocol makes conforming changes to Article 23 (Relief from Double Taxation) to reflect the amendments made to the saving clause of paragraph 4 Article 1 (Personal Scope) and to reflect amendments to section 877 of the Code in 1996.

Article VIII

Article VIII of the Protocol contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their applicable procedures. Each State must notify the other as soon as its requirements for ratification have been complied with. The Convention will enter into force on the thirtieth day after the later of such notifications accompanied by an instrument of ratification.

In the United States, the process leading to ratification and entry into force is as follows: Once a protocol or treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the protocol or treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice of the Senate Committee on Foreign Relations to hold hearings on the protocol or treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the Senate's advice and consent to ratification, the protocol or treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraph 2 contains rules that determine when the provisions of the treaty will have effect.

Under subparagraphs (a)(i) and (b)(ii), the provisions of the Protocol relating to taxes withheld at source will have effect with respect to amounts paid or credited on or after the first day of the second month next following the date on which the Protocol enters into force. For example, if instruments of ratification are exchanged on April 25 of a given year, the withholding rates specified in paragraphs 2 and 3 of Article 10 (Dividends) would be applicable to any dividends paid or credited on or after June 1 of that year. Similarly, the revised Limitation on Benefits provisions of Article 5 of the Protocol would apply with respect to any payments of interest, royalties or other amounts on which withholding would apply under the Code if those amounts are paid or credited on or after June 1.

This rule allows the benefits of the withholding reductions to be put into effect as soon as possible, without waiting until the following year. The delay of one to two months is required to allow sufficient time for withholding agents to be informed about the change in withholding rates. If for some reason a withholding agent withholds at a higher rate than that provided by the Convention (perhaps because it was not able to re-program its computers before the payment is made), a beneficial owner of the income that is a resident of Sweden may make a claim for refund pursuant to section 1464 of the Code.

Under subparagraph (b)(i) the provision of Article VI of the Protocol relating to the taxation of pensions of certain employees of the U.S. embassy in Stockholm or the U.S. consulate general in Gothenburg by Sweden is effective for income derived on or after January 1, 1996.

For all other taxes, subparagraphs (a)(ii) and (b)(iii) specify that the Protocol will have effect for any taxable period beginning on or after January 1 of the year next following entry into force.

DEPARTMENT OF THE TREASURY
TECHNICAL EXPLANATION OF THE PROTOCOL BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC SIGNED AT WASHINGTON ON DECEMBER 8, 2004 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL SIGNED AT PARIS ON AUGUST 31, 1994

This is a technical explanation of the Protocol signed at Washington on December 8, 2004 (the "Protocol"), amending the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Paris on August 31, 1994 (the "Convention").

Negotiations took into account the U.S. Department of the Treasury's current tax treaty policy and Treasury's Model Income Tax Convention, published on September 20, 1996 (the "U.S. Model"). Negotiations also took into account the Model Tax Convention on Income and on Capital, published by the Organization for Economic Cooperation and Development, and recent tax treaties concluded by both countries.

This Technical Explanation is an official guide to the Protocol. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol. This technical explanation is not intended to provide a complete guide to the Convention as amended by the Protocol. To the extent that the Convention has not been amended by the Protocol, the Technical Explanation of the Convention remains the official explanation. References in this technical explanation to "he" or "his" should be read to mean "he or she" or "his or her."

Article I

Article I of the Protocol revises Article 4 (Resident) of the Convention by adding two subparagraphs to paragraph 2(b), and by replacing subparagraphs (b)(iii) and (iv). These changes clarify the meaning of "resident" in certain cases, and address the treatment of cross-border investments made through partnerships and other similar forms of entity. The changes were necessary because of differences in the way France and the United States view such entities.

In general, subparagraphs 2(b)(iv) through (b)(vi) provide specific rules in the case of income derived through fiscally transparent entities such as partnerships and

certain estates and trusts. In general, fiscally transparent entities are entities the income of which is taxed at the beneficiary, member, or participant level. Entities falling under this description in the United States include partnerships, common investment trusts under Internal Revenue Code section 584, and grantor trusts. This paragraph also applies to U.S. limited liability companies ("LLCs") that are treated as partnerships for U.S. tax purposes. Entities that are subject to tax, but with respect to which tax may be relieved under an integrated system, are not considered fiscally transparent entities.

The Protocol revises paragraph 2(b) by moving a "fonds commun de placement" from subparagraph (b)(iii) to (b)(iv). Thus, a "fonds commun de placement" is no longer an automatic resident under the Convention; instead, it is treated as a partnership for purposes of claiming U.S. tax benefits under the Convention. Thus, it will be considered a "resident of a Contracting State," but only to the extent that the income it derives is treated in that Contracting State as the income of a resident. This is consistent with the rule allowing for specific identification of an entity by the treaty partners as a resident entitled to claim treaty benefits. See Treas. Reg. § 1.894-1(d)(1).

The Protocol clarifies that under subparagraph (b)(iv), an item of income, profit or gain derived by a fiscally transparent entity will be considered to be derived by a resident of a Contracting State if a resident is treated under the taxation laws of that State as deriving the item of income. In the case of income or gains arising in France, treaty benefits are available only if the conditions set forth in subparagraphs (b)(iv)(aa) through (dd) are also met: there is no contrary position in a double taxation convention between either Contracting State and the third state; the fiscally transparent entity is not treated as a corporation for tax purposes, or otherwise liable to tax on French source income in its own hands or in the hands of its partners, beneficiaries, or grantors under the tax laws of the third State; a partner's, beneficiary's or grantor's share of income or gain is generally taxed in the same manner as it would have been were that income or gain derived directly, except to the extent resulting from differences in accounting methods, accounting periods, or other similar differences; and information concerning the fiscally transparent entity, or its partners, beneficiaries, or grantors, may be exchanged under the terms of a double tax convention between the Contracting State in which the income arises and the third State.

For example, if a French company pays interest to an entity that is treated as fiscally transparent for U.S. tax purposes, the interest will be considered derived by a resident of the United States only to the extent that the taxation laws of the United States treats one or more U.S. residents (whose status as U.S. residents is determined, for this purpose, under U.S. tax law) as deriving the interest for U.S. tax purposes. In the case of a partnership, the persons who are, under U.S. tax laws, treated as partners of the entity would normally be the persons whom the U.S. tax laws would treat as deriving the interest income through the partnership. Also, it follows that persons whom the United States treats as partners but who are not U.S. residents for U.S. tax purposes may not claim a benefit for the interest paid to the entity under the Convention, because they are not residents of the United States for purposes of claiming this treaty benefit. (If, however, the country in which they are treated as resident for tax purposes, as determined

under the laws of that country, has an income tax convention with France, they may be entitled to claim a benefit under that convention.) In contrast, if, for example, an entity is organized under U.S. laws and is classified as a corporation for U.S. tax purposes, interest paid by French company to the U.S. entity will be considered derived by a resident of the United States since the U.S. corporation is treated under U.S. taxation laws as a resident of the United States and as deriving the income.

The same result obtains even if the entity is viewed differently under the tax laws of France (e.g., as not fiscally transparent in the first example above where the entity is treated as a partnership for U.S. tax purposes). Similarly, the characterization of the entity in a third country is also irrelevant, even if the entity is organized in that third country. The results follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for U.S. tax purposes and as a corporation for French tax purposes. These results also obtain regardless of whether the entity is organized in the United States or, subject to the limitations above, in a third country).

For example, income from U.S. sources received by an entity organized under the laws of the United States, which is treated for French tax purposes as a corporation and is owned by a French shareholder who is a French resident for French tax purposes, is not considered derived by the shareholder of that corporation even if, under the tax laws of the United States, the entity is treated as fiscally transparent.

These principles also apply to trusts to the extent that they are fiscally transparent in either Contracting State. For example, if X, a resident of France, creates a revocable trust in the United States and names persons resident in a third country as the beneficiaries of the trust, X would be treated under U.S. law as the beneficial owner of income derived from the United States. In that case, the trust's income would be regarded as being derived by a resident of France only to the extent that the laws of France treat X as deriving the income for French tax purposes.

New subparagraph (iv) is not an exception to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). Accordingly, subparagraph (iv) does not prevent a Contracting State from taxing an entity that is treated as a resident of that State under its tax law. For example, if a U.S. LLC with French members elects to be taxed as a corporation for U.S. tax purposes, the United States will tax that LLC on its worldwide income on a net basis, and will impose withholding tax, at the rate provided in Article 10, on dividends paid by the LLC, without regard to whether France views the LLC as fiscally transparent.

New subparagraph (b)(v) applies to a fiscally transparent entity organized in the United States that derives income from the United States and France. In the United States, the fiscally transparent entity is treated as a resident in proportion to the income it derives from both Contracting States. Such entity will also be treated as a resident of France to the extent that it derives French source income allocable to French resident partners, beneficiaries or grantors. The purpose of the latter provision is to ensure that

France will not be denied the ability to tax the income of a French partner in a U.S. partnership, even though France otherwise might treat the U.S. entity as an entity that is not fiscally transparent.

New subparagraph (b)(vi) clarifies that, for purposes of subparagraphs (b)(iv) and (v), the income derived by a fiscally transparent entity is considered to be treated under the tax laws of one of the Contracting States as the income of a resident to the extent it benefits a partner, beneficiary, or grantor that is a pension trust, other organization, or not-for-profit organization referred to in subparagraph (b)(ii), even if such income is exempt from tax under the laws of that State.

Article II

Article II of the Protocol modifies Article 10 (Dividends) of the Convention by deleting and replacing the last sentence in the final paragraph of paragraph 2. Article 10 provides rules for the taxation of dividends paid by a company that is a resident of one Contracting State to a beneficial owner that is a resident of the other Contracting State.

Paragraph 2 limits the right of the source State to tax dividends beneficially owned by a resident of the other Contracting State. In the case of dividends paid by a U.S. real estate investment trust ("REIT"), the U.S. tax is limited to 15 percent of the gross amount of dividends in certain circumstances; otherwise, the statutory rate of thirty percent applies. The Protocol broadens the scope of paragraph 2 by enlarging the class of shareholders that qualify for the reduced rate of withholding tax. These changes are consistent with provisions in recent U.S. treaties.

Under new paragraph 2, the 15 percent maximum rate of withholding tax is applicable to dividends paid by a U.S. REIT if one of three conditions is satisfied: the beneficial owner of the dividend is an individual holding an interest in the REIT of not more than 10 percent; the dividend is paid on a class of stock that is publicly traded and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT's stock; or the beneficial owner of the dividend is a person holding an interest in the REIT of not more than 10 percent and the value of no single interest in real property owned by the REIT exceeds 10 percent of the value of the REIT's total interest (i.e., the REIT is diversified). If none of these conditions are met, dividends paid by the REIT will be subject to the U.S. domestic withholding rate of 30 percent.

Article III

Article III of the Protocol replaces Article 18 (Pensions) of the Convention. Article 18 provides rules for the taxation of pensions and social security benefits.

Paragraph 1

Paragraph 1 provides for exclusive source country taxation of social security benefits, pension distributions and other similar remuneration paid by a pension or other retirement arrangement established in one Contracting State to a resident of the other Contracting State. The rule applies to both periodic and lump sum payments.

Paragraph 2

Subparagraph (a)(i) of paragraph 2 allows an individual who exercises employment or self-employment in a Contracting State to deduct or exclude from income in that Contracting State contributions made by or on behalf of the individual during the period of employment or self-employment to an exempt pension trust established in the other Contracting State. Thus, for example, if a participant in a U.S. qualified plan goes to work in France, the participant may deduct or exclude from income in France contributions to the U.S. qualified plan made while the participant works in France. Paragraph 2, however, applies only to the extent of the relief allowed by the host State (e.g., France in the example) for contributions to an exempt pension trust established in that State.

Subparagraph (a)(ii) provides that, in the case of employment, accrued benefits and contributions by or on behalf of the individual's employer, during the period of employment in the host State, will not be treated as taxable income to the employee in that State. Subparagraph (a)(ii) also allows the employer a deduction in computing business profits in the host State for contributions to the plan. For example, if a participant in a U.S. qualified plan goes to work in France, the participant's employer may deduct from its business profits in France contributions to the U.S. qualified plan for the benefit of the employee while the employee renders services in France.

As in the case of subparagraph (a)(i), subparagraph (a)(ii) applies only to the extent of the relief allowed by the host State for contributions to pension funds established in that State. Therefore, where the United States is the host State, the exclusion of employee contributions from the employee's income under this paragraph is limited to elective contributions not in excess of the amount specified in section 402(g). Deduction of employer contributions is subject to the limitations of sections 415 and 404. The section 404 limitation on deductions is calculated as if the individual were the only employee covered by the plan.

France has both mandatory and non-mandatory pension plans. The relevant comparison, for purposes of determining the amount and timing of deductions for French tax purposes of amounts contributed to a U.S. retirement arrangement, is to the French mandatory plans, provided that the French competent authority agrees that the U.S. arrangement in question generally corresponds to the French mandatory plan (even though the U.S. arrangement may not be mandatory).

Subparagraph (b) of paragraph 2 limits the availability of benefits under subparagraph (a). Under subparagraph (b), subparagraph (a) does not apply to contributions to an exempt pension trust unless the participant already was contributing to the trust, or his employer already was contributing to the trust with respect to that individual, before the individual began exercising employment in the State where the services are performed (the "host State"). This condition would be met if either the employee or the employer was contributing to an exempt pension trust that was replaced by the exempt pension trust to which he is contributing. The rule regarding successor trusts would apply if, for example, the employer has been taken over by a company that replaces the existing pension plan with its own plan, rolling membership in the old plan and assets in the old trust over into the new plan and trust.

In addition, under subparagraph (b), the competent authority of the host State must determine that the recognized plan to which a contribution is made in the other Contracting State generally corresponds to the plan in the host State. Subparagraph (c) enumerates plans that are considered to "generally correspond" such that they are automatically eligible for treaty benefits under paragraph 2(a). The competent authorities may agree that distributions from other plans that generally meet similar criteria to those applicable to other plans established under their respective laws also qualify for the benefits of paragraph 2(a).

In the United States, the plans that are automatically eligible for benefits under paragraph 2 include a French pension or other retirement arrangement organized under the French social security legislation.

In France, the plans that are automatically eligible for benefits under paragraph 2 include qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, and section 408(p) accounts), section 403(a) qualified annuity plans, and section 403(b) plans. Social security or other similar legislation of the United States is also automatically eligible for benefits under paragraph 2. Although not specifically mentioned in the Protocol, Roth IRAs under section 408A are of course a type of individual retirement plan and therefore also automatically eligible for benefits under paragraph 2.

Relationship to other Articles

Paragraph 1 of Article 18 is an exception to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) by virtue of paragraph 3(a) of Article 29 as revised by this Protocol. Thus, a U.S. citizen who resides in the United States and receives distributions from a pension plan established in France will be subject to tax solely in France on that distribution.

Paragraph 2 of Article 18 is an exception to the saving clause of paragraph 2 of Article 29 by virtue of paragraph 3(b) of Article 29 as revised by this Protocol, but only

in the case of individuals who are neither citizens of, nor have immigrant status in, the United States. The term "immigrant status" refers to a person admitted to the United States as a permanent resident under U.S. immigration laws (i.e., holding a "green card"). Accordingly, a U.S. resident (who is not a citizen or a green card holder) who is a beneficiary of a French pension plan will not be subject to tax in the United States on the earnings and accretions of, or the contributions made to, a French exempt pension trust with respect to that U.S. resident.

Article IV

Article IV of the Protocol makes changes to Article 19 (Public Remuneration) of the treaty. These changes are necessary because of the revisions made by the Protocol to Article 18 (Pensions).

The Protocol deletes paragraph 2, which deals with the taxation of pensions paid in respect of government services described in paragraph 1. The provisions of new Article 18 now govern the treatment of such pensions.

Paragraph 3 of Article 19 provides cross-references to treaty Articles that apply to remuneration for services performed in connection with a business carried on by a governmental body. The Protocol updates paragraph 3 by deleting the reference to Article 18, and renumbers it paragraph 2.

Article V

The Protocol deletes subparagraph (b)(iv) of paragraph 2 [Paragraph 1 in French language] of Article 24 (Relief From Double Taxation) of the treaty, which allows a U.S. citizen and resident of France a credit equal to the amount of French tax attributable to income dealt with in subparagraph (a) of paragraph 1 of Article 18 (Pensions) that was also subject to tax in the United States. Subparagraph (b)(iv) is rendered obsolete by the provisions of Article 18 as amended by the Protocol.

The Protocol renumbers subparagraphs (b)(v) and (vi) of paragraph 2 [Paragraph 1 in French language] of Article 24 subparagraphs (b)(iv) and (v) respectively to account for the deletion of subparagraph (b)(iv).

The Protocol replaces subparagraph (c) of paragraph 1 [Paragraph 2 in French language] of Article 24 to omit the reference to paragraph 2 of Article 19 (Public Remuneration). This change conforms to revisions made to Article 18 and Article 19 (Public Remuneration) by the Protocol.

Article VI

Article VI of the Protocol makes changes to paragraphs 2 and 3 of Article 29 (Miscellaneous Provisions).

The Protocol revises paragraph 2 of Article 29, which permits the United States to continue to tax as U.S. citizens former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss. To reflect 1996 amendments to U.S. tax law in this area, the Protocol extends this treatment to former long-term residents whose loss of such status had as one of its principal purposes the avoidance of tax.

Section 877 of the Internal Revenue Code provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds.

The AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in the last sentence of paragraph 2 of Article 29.

The Protocol also replaces paragraph 3 of Article 29. Paragraph 3 provides exceptions to the saving clause set forth in paragraph 2 of Article 29. The Protocol updates paragraph 3 to account for changes made in Article 18 (Pensions).

Article VII

Article VII contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their constitutional and statutory requirements. Each State must notify the other as soon as its requirements for ratification have been complied with. The Convention will enter into force on the date of the later of such notifications.

In the United States, the process leading to ratification and entry into force is as follows: Once a protocol or treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the protocol or treaty to the President who formally transmits it to the Senate for its advice and consent to ratification,

which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice of the Senate Committee on Foreign Relations to hold hearings on the protocol or treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the Senate's advice and consent to ratification, the protocol or treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraphs 2 and 3 contain rules that determine when the provisions of the treaty will have effect.

Under subparagraph (a) of paragraph 2, the provisions of the Protocol relating to taxes withheld at source will have effect with respect to amounts paid or credited on or after the first day of the second month following the date on which the Protocol enters into force. For example, if instruments of ratification are exchanged on April 25 of a given year, the withholding rates specified in paragraph 2 of Article 10 (Dividends) as provided in Article II would be applicable to any dividends paid or credited on or after June 1 of that year.

This rule allows the benefits of the withholding reductions to be put into effect as soon as possible, without waiting until the following year. The delay of one to two months is required to allow sufficient time for withholding agents to be informed about the change in withholding rates. If for some reason a withholding agent withholds at a higher rate than that provided by the Convention (perhaps because it was not able to re-program its computers before the payment is made), a beneficial owner of the income that is a resident of France may make a claim for refund pursuant to section 1464 of the Code.

For all other taxes, subparagraph (b) of paragraph 2 specifies that the Protocol generally will have effect for any taxable period beginning on or after January 1 of the year following entry into force.

Paragraph 3 provides special effective dates with respect to the provisions of Article I, paragraph 2 of the protocol relating to the treatment of fiscally transparent entities. In general, these rules will have effect in respect of taxes withheld at source, for any amount paid or credited on or after February 1, 1996. For all other taxes, subparagraph (b) specifies that the Protocol will have effect for any taxable period beginning on or after January 1, 1996. These dates are when such provisions in the current treaty became effective. These special effective dates do not apply to the portion of Article I that treats a "fonds commun de placement" as a partnership for purposes of U.S. tax benefits under the treaty. That rule, therefore, will be effective in accordance with the general rules of paragraph 2 of Article VII.

DEPARTMENT OF THE TREASURY
TECHNICAL EXPLANATION OF THE PROTOCOL BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC SIGNED AT WASHINGTON ON DECEMBER 8, 2004 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES, INHERITANCES, AND GIFTS, SIGNED AT WASHINGTON ON NOVEMBER 24, 1978

Introduction

This is a technical explanation of the Protocol signed at Washington on December 8, 2004 (the "Protocol"), which amends the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts, signed at Washington on November 24, 1978 (the "Convention").

This Technical Explanation is an official guide to the Protocol. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol. This technical explanation is not intended to provide a complete guide to the Convention as amended by the Protocol. To the extent that the Convention has not been amended by the Protocol, the Technical Explanation of the Convention remains the official explanation. References in this technical explanation to "he" or "his" should be read to mean "he or she" or "his or her."

Article I

Article I of the Protocol amends Article 1 (Estates and Gifts Covered) of the Convention by adding a "saving" clause as new paragraph 4. Pursuant to the saving clause, the United States reserves its rights, subject to certain exceptions, to tax certain estates or donors as provided in its internal laws, notwithstanding any provisions of the Convention to the contrary.

First, the United States reserves the right to tax under its domestic law the estate or gift of a U.S. citizen. The United States also retains the right to tax the estate of a decedent or the gift of a donor who, at the time of his death or at the making of the gift, was domiciled (within the meaning of Article 4 (Fiscal Domicile) of the Convention) in the United States. Finally, the

United States retains the right to tax the estate of a decedent or the gift of a donor who, at the time of his death or at the making of the gift, was a former citizen or long-term resident of the United States whose loss of such status had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss.

The provision regarding former citizens and long-term residents is consistent with the United States' reservation of its taxing rights provided for in sections 877, 2107, and 2501(a)(3) and (5) of the Internal Revenue Code. The Protocol provides that the determination of whether there was a principal purpose of tax avoidance with respect to former citizens or long-term residents of the United States is made under the laws of the United States, which would include, for example, the irrebuttable presumptions based on average annual net income tax liability and net worth under section 877.

Section 877 of the Internal Revenue Code provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds.

The AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in paragraph 4(a)(iii) of the Convention.

Some provisions of the Convention and Protocol are intended to provide benefits to citizens and residents even if such benefits do not exist under internal law. Article I of the Protocol sets forth certain exceptions to the saving clause that preserve certain obligations of the United States under the Convention. For example, the saving clause will not override the obligation of the United States, in accordance with Article 12 (Exemptions and Credits), to credit taxes paid to France on either a domiciliary or a situs basis.

Article I of the Protocol also provides that the saving clause shall not affect the benefits conferred by the United States under Article 10 (Charitable Exemptions and Deductions), relating to deductions for contributions to charitable organizations, paragraph 2 of Article 11,

relating to the marital exclusion for interspousal transfers of certain types of noncommunity property, Article 13 (Time Limitations on Claims for Credit or Refund), Article 14 (Mutual Agreement Procedure), or Article 17 (Diplomatic and Consular Officials).

Finally, Article I of the Protocol also provides that the saving clause shall not affect the benefits conferred by the United States under paragraph 3 of Article 11, relating to a limited estate tax marital deduction when property passes to a spouse who is not a United States citizen. This exception to the saving clause does not apply, however, to former U.S. citizens or long-term residents whose loss of citizenship or residence status had as a principal purpose the avoidance of tax, for a period of 10 years following such loss.

Article II

Article II of the Protocol replaces paragraph 2 of Article 3 (General Definitions) of the Convention and provides that any term not otherwise defined in the Convention shall, unless the context otherwise requires or the competent authorities agree to a common meaning, have the meaning which it has under the law of the Contracting State for the purposes of the taxes to which the Convention applies. The amendment also makes clear that any meaning under the tax laws of such Contracting State will prevail over a meaning given under other laws of that state.

Article III

Article III of the Protocol replaces Article 5 of the existing Convention. Paragraph 1 provides that real property may be taxed in a Contracting State if such property is situated in that State. This is a primary, but not exclusive, taxing right. Nothing in the Convention, for example, precludes the United States from taxing the transfer of French situs real property by an individual domiciled, for purposes of the Convention, in the United States, provided the United States allows a credit for the French tax. Paragraph 4 provides that the rules of paragraph 1 apply to real property of an enterprise and to real property used for the performance of independent personal services. That is, real property may be taxed by the State where it is located, even if different from where the enterprise is located or where the independent personal services are performed.

According to paragraph 2, the term "real property" is defined in accordance with the laws of the Contracting State in which such property is situated, but it does not include claims secured by real property (such as mortgages). In the case of the United States, the term "real property" has the meaning given to it by Treas. Reg. section 1.897-1(b). Consistent with section 1.897-1(b), paragraph 2 provides that the term "real property" shall include: property accessory to real property; livestock and equipment used in agriculture and forestry; rights to which the provisions of general law respecting landed property apply; usufruct of real property; and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Paragraph 2 also provides that ships and aircraft are not regarded as real property.

Pursuant to paragraph 3, the term "real property" also includes shares, participations and other rights in a company or legal person at least 50 percent of the assets of which consist, directly or indirectly, of real property situated in one of the Contracting States or of rights pertaining to such property. Such shares, participations and other rights are considered to be situated in the Contracting States where the real property is located. Thus, this provision encompasses real property interests other than the real property itself, so that taxation in the Contracting State in which the property is situated cannot be avoided by holding real property indirectly.

Article IV

Under Article 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services) of the Convention, except as provided in Article 5 (Real Property), and with the exception of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, assets forming part of the business property of a permanent establishment of an enterprise may be taxed by a Contracting State if the permanent establishment is situated in that State.

Paragraph 2 of Article 6 of the Convention defines the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Article IV of the Protocol amends the last sentence of paragraph 2 by changing the phrase "partnership or other association that is not a corporation" to "partnership or other similar pass-through entity." The revision takes account of 1996 changes in entity classification regulations by the United States and makes clear that an individual member of any type of pass-through entity which is engaged in industrial or commercial activity through a fixed place of business will also be deemed to have been so engaged to the extent of his interest therein.

Article V

Under paragraph 1 of Article 10 (Charitable Exemptions and Deductions) of the Convention, a transfer to a legal entity created or organized in a Contracting State is exempt from tax, or fully deductible from the gross value liable to tax, in the other Contracting State, with respect to taxes referred to in Article 2 (Taxes Covered), if the transfer would be eligible for such exemption or deduction if the legal entity had been created or organized in the other Contracting State. Under paragraph 2, the provisions of paragraph 1 apply only if the legal entity to which property is transferred (a) has tax exempt status in the State in which it is created or organized by reason of which transfers to it are exempt or fully deductible from the taxes described in Article 2; (b) is organized and operated exclusively for certain enumerated purposes; and (c) receives a substantial part of its support from contributions from the public or from government funds.

Article V of the Protocol amends paragraph 2(b) of Article 10 to add "cultural" to the list of enumerated exclusive purposes for which the legal entity must be organized and operated. Thus, a transfer to a legal entity created or organized in France is exempt from tax, or fully

deductible from the gross value liable to tax, in the United States, with respect to the taxes referred to in Article 2 if the French entity is organized and operated exclusively for the same purposes as a U.S. charity generally exempt from tax under section 501(c).

Article VI

Marital Exclusion

Paragraph 1 of Article VI of the Protocol amends paragraph 2 of Article 11 (Community Property and Marital Deduction) of the Convention, which provides rules for determining the marital deduction allowed for transfers by a French domiciliary. The amendment obligates the United States to give a marital deduction for interspousal transfers of noncommunity property from domiciliaries of France to a spouse who is not a U.S. citizen. It provides that noncommunity property that may be taxed by the United States solely on the basis of situs (i.e., under Article 5 (Real Property), Article 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services), or Article 7 (Tangible Movable Property)) may be included in the taxable base of the United States only to the extent its value (taking into account any applicable deductions) exceeds 50 percent of the value of all the property which may be taxed by the United States. Thus, noncommunity property taxable in the United States under these Articles transferred from a French domiciliary to a spouse who is not a U.S. citizen may be taxed by the United States only to the extent it exceeds 50 percent of the net value of all property which may be taxed by the United States.

The marital deduction provided for by this amendment does not apply to a United States citizen domiciled in France or a former citizen or long-term resident of the United States whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under United States law), but only for a period of 10 years following such loss. As a result, the United States is not obligated to provide the benefits of new paragraph 2 of Article 11 of the Convention to the estate of or a gift made by such a person. For example, a United States citizen who is domiciled in France under French law could, for purposes of the Convention, be determined to have his fiscal domicile in France under the tie-breaking rules of paragraph 2 of Article 4 (Fiscal Domicile). As a result of Article VI of the Protocol, the United States is not required to provide the marital exclusion of new paragraph 2 of Article 11 of the Convention with respect to interspousal transfers from that U.S. citizen to a spouse who is not a U.S. citizen. (If the spouse is a U.S. citizen, the transfer might be eligible for the unlimited marital exclusion provided under U.S. law).

Marital Deduction

Article VI of the Protocol also renumbers existing paragraph 3 of Article 11 as paragraph 4, and adds a new paragraph 3. New paragraph 3 allows a marital deduction in connection with transfers satisfying each of five conditions. First, the property transferred must be "qualifying property." Second, the decedent must have been, at the time of death, domiciled in either France or the United States, or a citizen of the United States. Third, the surviving spouse must have

been, at the time of the decedent's death, domiciled in either France or the United States. Fourth, if both the decedent and the surviving spouse were domiciled in the United States at the time of the decedent's death, at least one of them must have been a citizen of France. Finally, in order to limit the benefits of new paragraph 3 to relatively small estates, the executor of the decedent's estate is required to elect the benefits of new paragraph 3 and to waive irrevocably the benefits of any estate tax marital deduction that would be allowed under U.S. domestic law, on a U.S. Federal estate tax return filed by the deadline for making a qualified domestic trust election under Internal Revenue Code section 2056A(d). In the case of the estate of a decedent for which the U.S. Federal estate tax return is filed on or before the date on which this Protocol enters into force, this election and waiver must be made on any return filed to claim a refund pursuant to the special effective date applicable to such estates (discussed below with respect to Article IX of the Protocol).

In order for property to be "qualifying property," it must pass to the surviving spouse (within the meaning of U.S. domestic law) and be property that would have qualified for the estate tax marital deduction under U.S. domestic law if the surviving spouse had been a U.S. citizen and all applicable elections specified by U.S. domestic law had been properly made. Because one of the requirements for property to qualify for the marital deduction under U.S. domestic law is that the property be included in determining the value of the gross estate, property will not qualify for the marital deduction of new paragraph 3 to the extent the property is excluded from the decedent's gross estate by reason of paragraph 2 of Article 11 of the Convention. The second example under Article VII of the Protocol (below) illustrates the interaction of the two provisions.

The amount of the marital deduction allowed under new paragraph 3 of Article 11 of the Convention equals the lesser of (i) the value of the qualifying property, or (ii) the "applicable exclusion amount" (within the meaning of the law of the United States, determined without regard to any gift previously made by the decedent). The "applicable exclusion amount" is determined under section 2010 of the Internal Revenue Code with respect to the year in which the decedent dies. For decedents dying in 2004 or 2005, the applicable exclusion amount for estate tax purposes is $1,500,000. The applicable exclusion amount under section 2010 is scheduled to increase to $2,000,000 for estates of decedents dying during 2006, 2007, or 2008, and to $3,500,000 for estates of decedents dying in 2009.) Estates of decedents dying during 2010 are not subject to the estate tax. However, under a "sunset" provision effective January 1, 2011, this one-year "repeal" of the estate tax terminates and the applicable exclusion amount reverts to $1,000,000 for estates of decedents dying after the year 2010.

In certain cases, the provisions of new paragraph 3 may affect the U.S. estate taxation of a trust that would meet the requirements for a qualified terminable interest property ("QTIP") election (for example, a trust with a life income interest for the surviving spouse and a remainder interest for other family members) or a qualified domestic trust ("QDOT") election. If, in lieu of making the QTIP election or the QDOT election, the decedent's executor makes the election described in new subparagraph 3(b), the provisions of Internal Revenue Code sections 2044 (regarding inclusion in the estate of the second spouse of certain property for which the marital

deduction was previously allowed), 2056A (regarding qualified domestic trusts), and 2519 (regarding dispositions of certain life estates) will not apply. To obtain this treatment, however, the executor is required, under new paragraph 3, to irrevocably waive the benefit of any marital deduction allowable under the Internal Revenue Code with respect to the trust.

Article VII

Article VII of the Protocol replaces Article 12 (Exemptions and Credits) of the existing Convention. Under paragraph 1, each Contracting State is required, except as otherwise provided in the Convention, to impose its tax, and to allow exemptions, deductions, credits, and other allowances, in accordance with its own internal laws.

Paragraph 2 provides specific rules for relieving double taxation. Paragraph 2(a) applies when France imposes tax on the basis of the domicile (as determined under Article 4 (Fiscal Domicile)) of the decedent or donor. Under paragraph 2(a), France will tax the entire property comprising the estate or the gift, but must allow a deduction from that tax (i.e., a credit) for any U.S. tax imposed in accordance with the Convention (e.g., in accordance with Article 5 (Real Property), Article 6 Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services), Article 7 (Tangible Movable Property), or the saving clause of paragraph 4 of Article 1 (Estates and Gifts Covered)) upon the transfer of any property in relation to the same event. Such deduction, however, shall not exceed that part of the French tax (computed before any deduction is made) attributable to the property in respect of which the deduction is to be allowed.

Under French law, the rates of the inheritance and gift tax are determined on the basis of the proximity of relationship between the deceased or the donor and the beneficiary or the donee. In general, graduated rates are imposed where there is a close proximity of relationship and flat rates are imposed where there is not a close proximity. Where the amount of the French tax is computed by applying graduated rates, France must allow a deduction for any U.S. tax imposed in accordance with the Convention, up to the amount computed by multiplying the taxable net value of the property in respect of which the deduction is to be allowed by the ratio of the French tax actually payable on the total property taxable in accordance with French law to the net value of that total property. In other words, the upper limit on the deduction France must allow is computed by multiplying the amount of the property also subject to U.S. tax by the average rate of French tax actually payable on all the property comprising the estate or the gift. Where the amount of the French tax is computed by a applying a flat rate, however, the upper limit on the deduction France must allow is computed by multiplying the amount of the property also subject to U.S. tax by the rate actually applicable to the property in respect of which the deduction is to be allowed.

Under paragraph 2(a)(iii), the taxes for which France must allow a deduction, as described above, include the United States Federal estate and gift tax, except where such taxes are imposed solely pursuant to the saving clause of paragraph 4 of Article 1 (Estate and Gifts Covered). In addition, where the United States imposes its tax on the basis of situs, France is

obligated to allow a deduction for such tax (subject to the limitations discussed earlier) only if the decedent (at the time of his death) or the donor (at the time of the gift) was a United States citizen and the tax is actually paid.

Under paragraph 2(b)(i), where both States impose a tax with respect to property which is taxable by France in accordance with Articles 5, 6, or 7, the United States must allow a credit equal to the amount of the tax imposed by France with respect to such property. Under paragraph 2(b)(ii), if a decedent or donor was a citizen of the United States at the time of his death or the making of a gift, and such person is considered under Article 4 as having been domiciled in France, the United States must allow a credit equal to the amount of the tax imposed by France, net of any deduction from tax allowed under paragraph 2(a). In addition, if the United States includes property in a decedent's estate solely because he was a former citizen or long-term resident of the United States whose loss of such status (within 10 years of the date of death) had as one of its principal purposes the avoidance of tax, the United States must allow a credit equal to the amount of the tax imposed by France in respect of all such property. Under paragraph 2(b)(iii), notwithstanding the provisions of paragraph 2(b)(i) and (ii), the total amount of all credits allowed by the United States pursuant to Article 12 or pursuant to its own laws or other conventions with respect to all property in respect of which a foreign tax credit is allowable under paragraph 2(b)(i) and (ii) is not to exceed that part of the United States tax which is attributable to such property. The part of the tax deemed to be so attributable is to be determined in accordance with the principles of section 2014(b)(2) of the Code and section 20.2014-3 of the Estate Tax Regulations.

Pro Rata Unified Credit

Paragraph 3 grants a "pro rata" unified credit to the estate of a decedent (other than a United States citizen) domiciled in France for purposes of computing the U.S. estate tax. Provisions similar to this and the marital deduction against U.S. estate tax in respect of certain transfers to a surviving spouse (discussed above as new paragraph 3 of Article 11 (Community Property and Marital Deduction) of the Convention, added by Article VI of the Protocol) were included in the Third Protocol to the U.S.-Canada Income Tax Treaty and the Protocol to the U.S.-Germany Estate, Inheritance, and Gift Tax Treaty.

Under the Internal Revenue Code, the estate of a nonresident not a citizen of the United States is subject to U.S. estate tax only on its U.S. situs assets and is entitled to a unified credit of $13,000, while the estate of a U.S. citizen or U.S. resident is subject to U.S. estate tax on its entire worldwide assets and is entitled to a unified credit in an amount determined under Internal Revenue Code section 2010. For decedents dying in 2004 or 2005, the unified credit under section 2010 for estate tax purposes is $555,800. The unified credit under section 2010 for estate tax purposes is scheduled to increase to $780,800 for estates of decedents dying during 2006, 2007, or 2008, and to $1,455,800 for estates of decedents dying in 2009. As noted earlier, estates of decedents dying during 2010 are not subject to the estate tax. Pursuant to a "sunset" provision, this one-year repeal of the estate tax terminates and the unified credit reverts to $345,800 for estates of decedents dying after the year 2010. A lower unified credit is provided

for the estate of a nonresident not a citizen because it is assumed that such estates generally will hold fewer U.S. situs assets, as a percentage of the estate's total assets, and thus will have a lower U.S. estate tax liability.

Subject to certain limitations, the pro rata unified credit provisions of paragraph 3 increase the credit allowed to the estate of a non-U.S. citizen domiciled in France to an amount between $13,000 and the unified credit available to a U.S. citizen, to take into account the extent to which the assets of the estate are situated in the United States. Paragraph 3 also provides that the amount of the unified credit allowed to the estate of a non-U.S. citizen decedent domiciled in France will in no event be less than the $13,000 allowed under the Internal Revenue Code to the estate of a nonresident not a citizen of the United States (subject to the adjustment for prior gift tax unified credits, discussed below). Paragraph 3 does not apply to the estates of U.S. citizen decedents, whether resident in France or elsewhere, because such estates receive the unified credit under section 2010 of the Internal Revenue Code.

Subject to the adjustment for any gift tax unified credit previously allowed against gift tax liability, the pro rata credit allowed under paragraph 3 is determined by multiplying the unified credit available to a U.S. citizen under section 2010 of the Internal Revenue Code for the year in which the decedent dies (e.g., $555,800 in 2004 or 2005) by a fraction, the numerator of which is the value of the part of the gross estate situated in the United States and the denominator of which is the value of the entire gross estate wherever situated. Thus, if a non-U.S. citizen domiciled in France died in 2005 and half of his entire gross estate (by value) were situated in the United States, the estate would be entitled to a pro rata unified credit of $277,900 (provided that the U.S. estate tax due is not less than that amount). The entire gross estate wherever situated (i.e., the worldwide estate, determined under U.S. domestic law) is to be taken into account in computing the denominator. For purposes of computing the numerator, an estate's assets will be treated as situated in the United States if they are so treated under U.S. domestic law. However, an estate's assets will not be treated as situated in the United States for purposes of this computation if the United States is precluded from taxing them by reason of obligations elsewhere in the treaty.

Paragraph 3 restricts the availability of the pro rata unified credit in two respects. First, the amount of the unified credit otherwise allowable under paragraph 3 is reduced by the amount of any unified credit previously allowed against U.S. gift tax imposed on any gift by the decedent. This rule reflects the fact that, under U.S. domestic law, a U.S. citizen or U.S. resident individual is allowed a unified credit against the U.S. gift tax on lifetime transfers. However, as a result of the estate tax computation, the individual is entitled only to a total unified credit against estate tax of $555,800 (for decedents dying in 2004 or 2005), and the amount of the unified credit available for use against U.S. estate tax on the individual's estate is effectively reduced by the amount of any unified credit that has been allowed in respect of gifts by the individual. (Note that the unified credit against gift tax liability is capped at $345,800 for all years after 2001.) Pursuant to this rule, the amount of the pro rata unified credit otherwise allowed to the estate of a deceased individual under paragraph 3 is reduced by the amount of any unified credit previously allowed with respect to lifetime gifts by that individual. Under U.S.

law, the only circumstance under which any unified credit would have been previously allowed is where the decedent made gifts subject to the U.S. gift tax while a U.S. citizen or U.S. resident (as defined under the Internal Revenue Code for U.S. gift tax purposes).

Paragraph 3 also conditions allowance of the pro rata unified credit upon the provision of all information necessary to verify and compute the credit. Thus, for example, the estate's representatives will be required to demonstrate satisfactorily both the value of the worldwide estate and the value of the U.S. portion of the estate. Substantiation requirements also apply, of course, with respect to other provisions of the Protocol and the Convention. However, the negotiators believed it advisable to emphasize the substantiation requirements in connection with this provision, because the computation of the pro rata unified credit involves certain information not otherwise relevant for U.S. estate tax purposes.

In addition, the amount of the pro rata unified credit is limited to the amount of U.S. estate tax imposed on the estate. See section 2102(b)(4) of the Internal Revenue Code.

The following examples illustrate the operation of the pro rata unified credit and the marital deduction of new paragraph 3 of Article 11 of the Convention and their interaction with the marital exclusion of new paragraph 2 of Article 11. Unless otherwise stated, assume for purposes of illustration that: H, the decedent, and W, his surviving spouse, are French citizens resident in France at the time of the decedent's death; H dies in 2005, when the unified credit for estate tax purposes under section 2010 of the Internal Revenue Code is $555,800 and the applicable exclusion amount under section 2010 is $1,500,000; all conditions set forth in paragraph 3 of Article 11 and paragraph 3 of Article 12 of the Convention, as added by the Protocol, are satisfied (including the condition that the executor waive the estate tax marital deduction allowable under U.S. domestic law); no deductions are available under the Internal Revenue Code in computing the U.S. estate tax liability; there are no adjusted taxable gifts within the meaning of Internal Revenue Code section 2001(b) or 2101(c); and the applicable U.S. domestic estate and gift tax laws are those that were in effect on the date the Protocol was signed.

Example 1. (i) H has U.S. real property worth $4,000,000, all of which he bequeaths to W. The remainder of H's estate consists of $6,000,000 of French situs property.

(ii) Pursuant to new paragraph 2 of Article 11, the U.S. gross estate equals $2,000,000 (the amount by which the $4,000,000 of U.S. real property bequeathed to W exceeds $2,000,000 (50% of the total value of U.S. property taxable by the United States under the Convention)). H's worldwide gross estate equals $8,000,000 ($2,000,000 plus $6,000,000 of French situs property).

(iii) The $2,000,000 U.S. gross estate is reduced by the $1,500,000 marital deduction of new paragraph 3 of Article 11, resulting in a $500,000 U.S. taxable estate. The tentative tax on the taxable estate equals $155,800. H's estate would also be entitled to the pro rata unified credit allowed by new paragraph 3 of Article 12 of $138,950 ($555,800 (the full unified credit)

multiplied by a fraction equal to the $2,000,000 U.S. gross estate over the $8,000,000 worldwide gross estate). Thus, the total U.S. estate tax liability is $16,850 ($155,800 - $138,950).

Example 2. (i) The facts are the same as in Example 1, except that H bequeaths $1,200,000 of his U.S. real property to W and $2,800,000 of his U.S. real property to C, H's child.

(ii) The $2,800,000 of U.S. real property bequeathed to C is included in H's U.S. gross estate. Pursuant to new paragraph 2 of Article 11, none of the U.S. real property bequeathed to W is included in the gross estate, because such property would be included only to the extent its value (i.e., $1,200,000) exceeded 50% of the $4,000,000 total U.S. situs property taxable under Articles 5, 6 or 7 of the Convention. H's worldwide gross estate equals $8,800,000 ($2,800,000 plus $6,000,000 of French situs property).

(iii) Because none of the U.S. situs property bequeathed to W is included in the U.S. gross estate, the property is not "qualifying property", and therefore no marital deduction is allowed with respect to that property under new paragraph 3 of Article 11. The tentative tax on the $2,800,000 gross estate equals $1,156,800. H's estate would also be entitled to the pro rata unified credit allowed by new paragraph 3 of Article 12, which equals $176,845 ($555,800 (the full unified credit), multiplied by a fraction equal to the $2,800,000 U.S. gross estate over the $8,800,000 worldwide gross estate). Thus, the total U.S. estate tax liability is $979,955 ($1,156,800 - $176,845).

Paragraph 4 provides that in determining the French gift or inheritance tax with respect to transfers by a donee or decedent who, at the time of making the gift or at death, was a citizen of the U.S. or was domiciled in the U.S., the same deductions and credits must be allowed as if the individual were domiciled in France. In addition, in determining the French gift or inheritance tax with respect to transfers by a donee or decedent who, at the time of making the gift or at death, was domiciled in France to an individual who is a U.S. citizen or is domiciled in the U.S., the same deductions and credits must be allowed as if the individual were domiciled in France.

Under paragraph 5, the credits or deductions for tax imposed by a Contracting State allowable under Article 12 are in lieu of, and not in addition to, any credits or deductions for such taxes allowed by the internal laws of the other Contracting State and must be computed according to and subject to the limitations of the law of such other Contracting State, as amended from time to time without changing the general principle thereof.

Paragraph 6 provides that a Contracting State is not prohibited from imposing tax where property, under the rules of the Convention, is taxable only in the other Contracting State but tax, though chargeable, is not paid. A tax, however, shall be deemed paid where tax liability is reduced or eliminated by means of a specific exemption, deduction, exclusion, credit, or allowance.

Under paragraph 7, where, pursuant to the provisions of the Convention, property may not be taxed in a Contracting State, that Contracting State may nevertheless take into account such exempted property that is otherwise taxable under its internal law in calculating the amount of tax on the property that may be taxed in that Contracting State pursuant to the Convention. In other words, such exempted property may be included in the tax base for purposes of determining the applicable marginal rate of tax.

Under paragraph 8, the provisions of the Convention may not result in an increase in the amount of the tax imposed by either Contracting State under its domestic laws. A reduction in the credit allowed against a Contracting State's tax for tax paid to the other Contracting State, which reduction results from the application of the Convention, is not for these purposes to be construed as an increase in tax. This prevents the argument, for example, that an estate would have received a higher foreign tax credit without the treaty, because it would have paid more French taxes, and thus should be allowed the higher foreign tax credit even though the treaty reduced the estate's French tax.

Article VIII

Article VIII of the Protocol amends Article 15 (Filing of Returns and Exchange of Information) of the Convention by modifying the last sentence of paragraph 2. Under paragraph 2, the competent authority of each Contracting State is required to exchange two specific categories of information with the competent authority of the other Contracting State. As amended by the Protocol, the last sentence of paragraph 2 provides that any information furnished must be treated as secret by the recipient State. Such information may not be disclosed to persons other than those "involved in the" assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of the Convention. This is a change from the current language, which refers to persons "concerned with" such activities.

Article IX

Article IX contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their constitutional and statutory requirements. Each State must notify the other as soon as its requirements for ratification have been complied with. Paragraph 2 provides that the Convention will enter into force on the date of the later of such notifications.

In the United States, the process leading to ratification and entry into force is as follows: Once a protocol or treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the protocol or treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice of the Senate Committee on Foreign Relations to hold hearings on the protocol or

treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the Senate's advice and consent to ratification, the protocol or treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraphs 2 and 3 contain rules that determine when the provisions of the treaty will have effect.

Pursuant to paragraph 2, the Protocol will generally have effect with respect to gifts made and deaths occurring after such date.

Paragraph 3 contains special retrospective effective date provisions for paragraph 3 of Article 11 (Community Property and Marital Deduction) of the Convention and paragraph 3 of Article 12 (Exemptions and Credits) of the Convention, in each case as amended by the Protocol. These paragraphs will take effect with respect to deaths occurring and gifts made after November 10, 1988. However, the benefits of those provisions will be available with respect to gifts made or deaths occurring after November 10, 1988, and prior to the general effective date of paragraph 2, only if a claim for refund due as a result of those paragraphs is filed before the date that is one year after the first day of the second month following the date on which the Protocol enters into force or within the otherwise applicable period for filing such a claim expires under the domestic law of the Contracting State concerned. Additionally, the saving clause of paragraph 4 of Article 1 (Estates and Gifts Covered) applies to any such claim for refund. Where an estate, prior to entry into force of the Protocol, was allowed a marital deduction for a transfer to a qualified domestic trust under Internal Revenue Code section 2056A(d), such estate may elect to treat the qualified domestic trust as if it had never been established in order to claim the benefits of paragraph 3 of Article 11 or paragraph 3 of Article 12, as long as it does so within the time for filing a claim for refund referred to in the preceding sentence. Where such an election is made, the property is treated as having been transferred to the surviving spouse at the time of the decedent's death for all purposes of the Convention.

DEPARTMENT OF THE TREASURY
TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BANGLADESH FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME SIGNED AT DHAKA, SEPTEMBER 26, 2004

This is a technical explanation of the Convention between the United States and Bangladesh signed at Dhaka on September 26, 2004(the "Convention"). Negotiations with respect to the Protocol took into account the U.S. Department of the Treasury's current tax treaty policy and Treasury's Model Income Tax Convention published September 20, 1996 (the "U.S. Model").

Negotiations also took into account the Model Income Tax Convention on Income and on Capital, published by the Organization for Economic Cooperation and Development (the "OECD Model"), the United Nations Model Double Taxation Convention Between Developed and Developing Countries (the "UN Model"), and recent tax treaties concluded by both countries.

The Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention. References in the Technical Explanation to "he" or "his" should be read to mean "he or she" and "his or her."

ARTICLE 1 (PERSONAL SCOPE)

Paragraph 1

Paragraph 1 of Article 1 provides that the Convention applies to residents of the United States or Bangladesh except where the terms of the Convention provide otherwise. Under Article 4 (Fiscal Domicile) a person is generally treated as a resident of a Contracting State if that person is, under the laws of that State, liable to tax therein by reason of his domicile or other similar criteria. If, however, a person is considered a resident of both Contracting States, a single state of residence is assigned under Article 4. This definition governs for all purposes of the Convention.

Certain provisions are applicable to persons who may not be residents of either Contracting State. For example, Article 20 (Government Service) may apply to an employee of a Contracting State who is resident in neither State. Paragraph 1 of Article 24 (Nondiscrimination) applies to nationals of the Contracting States. Under Article 26

(Exchange of Information and Administrative Assistance), information may be exchanged with respect to residents of third states.

Paragraph 2

Paragraph 2 contains the traditional saving clause found in all U.S. treaties. Under subparagraph (a) of paragraph 2, Contracting States reserve their rights, except as provided in paragraph 3, to tax their residents and citizens as provided in their internal laws, notwithstanding any provisions of the Convention to the contrary. For example, if a resident of Bangladesh performs independent personal services in the United States and the individual is not present in the United States for 183 days in a 12-month period, and the income from the services is not attributable to a fixed base in the United States, Article 15 (Independent Personal Services) would normally prevent the United States from taxing the income. If, however, the resident of Bangladesh is also a citizen of the United States, the saving clause permits the United States to include the remuneration in the worldwide income of the individual and subject it to tax under the Internal Revenue Code of 1986 ("Code") rules (i.e., without regard to Code section 894(a)). For special foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in Bangladesh, see paragraph 3 of Article 23 (Relief from Double Taxation).

For purposes of the saving clause, "residence" is determined under Article 4 (Fiscal Domicile). Thus, if an individual who is not a U.S. citizen is a resident of the United States under the Code, and is also a resident of Bangladesh under its law, and that individual has a permanent home available to him in Bangladesh and not in the United States, he would be treated as a resident of Bangladesh under Article 4 and for purposes of the saving clause. The United States would not be permitted to apply its statutory rules to that person if they are inconsistent with the treaty. Thus, an individual who is a U.S. resident under the Code but who is deemed to be a resident of Bangladesh under the tie-breaker rules of Article 4 (Fiscal Domicile) would be subject to U.S. tax only to the extent permitted by the Convention. However, the person would be treated as a U.S. resident for U.S. tax purposes other than determining the individual's U.S. tax liability. For example, in determining under Code section 957 whether a foreign corporation is a controlled foreign corporation, shares in that corporation held by the individual would be considered to be held by a U.S. resident. As a result, other U.S. citizens or residents might be deemed to be United States shareholders of a controlled foreign corporation subject to current inclusion of Subpart F income recognized by the corporation. See, Treas. Reg. section 301.7701(b)-7(a)(3).

Under subparagraph (b) of paragraph 2 each Contracting State also reserves its right to tax former citizens and long-term residents whose loss of citizenship or long-term residence had as one of its principal purposes the avoidance of tax. The subparagraph defines "long-term resident", consistent with U.S. law, as an individual (other than a U.S. citizen) who is a lawful permanent resident of the United States in at least 8 of the prior 15 taxable years. An individual shall not be treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country under the

provisions of a tax treaty between the United States and the foreign country and the individual does not waive the benefits of such treaty applicable to residents of the foreign country.

In the United States, such a former citizen or long-term resident is taxable in accordance with the provisions of section 877 of the Code. Section 877 provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds. AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in subparagraph (b) of paragraph 2.

Paragraph 3

Some treaty provisions are intended to provide benefits to citizens and residents that do not exist under internal law. Paragraph 3 sets forth certain exceptions to the saving clause that preserve these benefits for citizens and residents of the Contracting States.

Subparagraph (a) lists certain provisions of the Convention that are applicable to all citizens and residents of a Contracting State, despite the general saving clause rule of paragraph 2:

(1) Paragraph 2 of Article 9(Associated Enterprises) grants the right to a correlative adjustment with respect to income tax due on profits reallocated under Article 9.

(2) Paragraphs 2 and 5 of Article 19(Pensions, Et Cetera) deal with social security benefits and child support payments, respectively. The inclusion of paragraph 2 in the exceptions to the saving clause means that the grant of exclusive taxing right of social security benefits to the paying country applies to deny, for example, to the United States the right to tax its citizens and residents on social security benefits paid by Bangladesh. The inclusion of paragraph 5, which exempts child-support-payments from taxation by the State of residence of the recipient, means that if a resident of Bangladesh pays child

support to a citizen or resident of the United States, the United States may not tax the recipient.

(3) Article 23 (Relief from Double Taxation) confirms the benefit of a credit to citizens and residents of one Contracting State for income taxes paid to the other, even if such a credit is not available under the domestic law of the first State.

(4) Article 24(Nondiscrimination) requires one Contracting State to grant national treatment to residents and citizens of the other Contracting State in certain circumstances. Excepting this Article from the saving clause requires, for example, that the United States give such benefits to a resident or citizen of Bangladesh even if that person is also a citizen of the United States.

(5) Article 25 (Mutual Agreement Procedure) may confer benefits on citizens and residents of the Contracting States. For example, the statute of limitations may be waived for refunds and the competent authorities are permitted to use a definition of a term that differs from the internal law definition. As with the foreign tax credit, these benefits are intended to be granted by a Contracting State to its citizens and residents.

Subparagraph (b) of paragraph 3 provides a different set of exceptions to the saving clause. The benefits referred to are all intended to be granted to temporary residents of a Contracting State (for example, in the case of the United States, holders of non-immigrant visas), but not to citizens or to persons who have acquired permanent residence in that State. If beneficiaries of these provisions travel from one of the Contracting States to the other, and remain in the other long enough to become residents under its internal law, but do not acquire permanent residence status (i.e., in the U.S. context, they do not become "green card" holders) and are not citizens of that State, the host State will continue to grant these benefits even if they conflict with their statutory rules. The benefits preserved by this paragraph are the host country exemptions for the following items of income: government service salaries and pensions under Article 20 (Government Service); certain income of visiting teachers, students and trainees under Article 21 (Teachers, Students and Trainees); and the income of diplomatic agents and consular officers under Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws and Other Treaties).

The provisions dealing with the relationship between the Convention and other laws and treaties of the Contracting States, normally dealt with in Article 1 of U.S. treaties are found in Article 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws and Other Treaties) of the Convention.

ARTICLE 2 (TAXES COVERED)

This Article specifies the U.S. taxes and the taxes of Bangladesh to which the convention applies. With one exception, the taxes specified in Article 2 are the covered taxes for all purposes of the Convention. A broader coverage applies, however, for purposes of Article 24 (Nondiscrimination). Article 24 applies with respect to all taxes, including those imposed by state and local governments.

Paragraph 1

Paragraph 1 is based on the OECD Model and provides that the Convention applies to income taxes imposed on behalf of either Contracting State; this covers taxes on total income or any part of income and includes tax on gains derived from property. The Convention does not apply to payroll taxes. Nor does it apply to property taxes, except with respect to Article 24 (NonDiscrimination).

Paragraph 2

Subparagraph 2(a) provides that the United States covered taxes are the Federal income taxes imposed by the Code. Social security taxes (Code sections 1401, 3101, 3111 and 3301) are not covered taxes. Although, unlike the U.S. Model, the Convention does not specify the exclusion of social security taxes, the Commentary to Article 2 of the OECD Model state that social security taxes are not income taxes for these purposes. Except with respect to Article 24 (Nondiscrimination), state and local taxes in the United States are not covered by the Convention.

Subparagraph 1(b) specifies the existing taxes of Bangladesh that are covered by the Convention. This is the income tax, and it includes any surcharges that are calculated by reference to the income taxes.

Paragraph 3

Under paragraph 3, the Convention will apply to any taxes that are identical, or substantially similar, to those enumerated in paragraph 2, and which are imposed in addition to, or in place of, the existing taxes after the date of signature of the Convention. The paragraph also provides that the competent authorities of the Contracting States will notify each other of changes in their taxation laws or of other laws that significantly affect their obligations under the Convention. The use of the term "significantly" means that changes must be reported that are of significance to the operation of the Convention. Other laws that may affect a Contracting State's obligations under the Convention may include, for example, laws affecting bank secrecy.

ARTICLE 3 (GENERAL DEFINITIONS)

Paragraph 1

Paragraph 1 defines a number of basic terms used in the Convention. Certain others are defined in other articles of the Convention. For example, the term "resident of a Contracting State" is defined in Article 4 (Fiscal Domicile). The term "permanent establishment" is defined in Article 5 (Permanent Establishment). The terms "dividends," "interest," and "royalties" are defined in Articles 10, 11 and 12, respectively. The introduction to paragraph 1 makes clear that the definitions in this paragraph apply for all purposes of the Convention, unless the context requires otherwise. This latter condition

allows flexibility in the interpretation of the treaty in order to avoid unintended results. Terms that are not defined in the Convention are dealt with in paragraph 2.

Subparagraph 1(a) defines the term "person" to include an individual, a partnership, a company, an estate, a trust, and any other body of persons. The definition is significant for a variety of reasons. For example, under Article 4 (Fiscal Domicile), only a "person" can be a "resident" and therefore eligible for most benefits under the treaty. Also, all "persons" are eligible to claim relief under Article 25 (Mutual Agreement Procedure).

The term "company" is defined in subparagraph 1(b) as a body corporate or an entity treated as a body corporate for tax purposes in the state where it is organized or has its place of effective management.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" are defined in subparagraph 1(c) as an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State. The term "enterprise" is not defined in the Convention. The OECD Model defines the term as applying to the carrying on of any business. This meaning of the term applies for purposes of the Convention as well.

Although subparagraph 1(c) does not include the U.S. Model's explicit reference to fiscally transparent enterprises, it is understood that the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" encompass an enterprise conducted through an entity (such as a partnership) that is treated as fiscally transparent in the Contracting State where the entity's owner is resident. In accordance with Article 4 (Fiscal Domicile), entities that are fiscally transparent in the country in which their owners are resident are not considered to be residents of a Contracting State (although income derived by such entities may be taxed as the income of a resident, if taxed in the hands of resident partners or other owners). This treatment ensures that an enterprise conducted by such an entity will be treated as carried on by a resident of a Contracting State to the extent its partners or other owners are residents. This approach is consistent with the Code, which under section 875 attributes a trade or business conducted by a partnership to its partners and a trade or business conducted by an estate or trust to its beneficiaries.

An enterprise of a Contracting State need not be carried on in that State. It may be carried on in the other Contracting State or a third state (e.g., a U.S. corporation doing all of its business in Bangladesh would still be a U.S. enterprise).

Subparagraph 1(d) defines the term "international traffic." The term means any transport by a ship or aircraft except when the vessel is operated solely between places within a Contracting State. This definition is applicable principally in the context of Article 8 (Shipping and Air Transport). The definition in the OECD Model refers to the operator of the ship, or aircraft having its place of effective management in a Contracting State (i.e., being a resident of that State). The U.S. Model does not include this limitation.

The broader definition combines with paragraphs 2 and 4 of Article 8 to exempt from tax by the source State income from the rental of aircraft or containers that is earned both by lessors that are operators of aircraft and by those lessors that are not (e.g., a bank or a container leasing company).

The exclusion from international traffic of transport solely between places within a Contracting State means, for example, that carriage of goods or passengers solely between New York and Chicago would not be treated as international traffic, whether carried by a U.S. or a Bangladesh carrier. If, however, goods or passengers are carried by a carrier resident in Bangladesh from a non-U.S. port to, for example, New York, and some of the goods or passengers continue on to Chicago, the entire transport would be international traffic. This would be true if the international carrier transferred the goods at the U.S. port of entry from an aircraft to a land vehicle, or even if the overland portion of the trip in the United States was handled by an independent carrier under contract with the original Bangladesh carrier, so long as both parts of the trip were reflected in original bills of lading. For this reason, the Convention refers, in the definition of "international traffic," to "such transport" being solely between places in a Contracting State, while the OECD Model refers to the ship or aircraft being operated solely between such places. The language in the Convention is intended to make clear that, as in the above example, even if the goods are carried on a different aircraft for the internal portion of the international voyage than is used for the overseas portion of the trip the definition applies to that internal portion as well as the external portion.

Finally, a "cruise to nowhere," i.e., a cruise beginning and ending in a port in the same Contracting State with no stops in a foreign port, would not constitute international traffic.

Subparagraphs 1(e)(i) and (ii) define the term "competent authority" for the United States and Bangladesh, respectively. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who in turn has delegated the authority to the Director, International (LMSB) and, with respect to interpretative issues, the Director, International (LMSB) with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service.

The term "United States" is defined in subparagraph 1(f) to mean the United States of America, including the states, the District of Columbia and the territorial sea of the United States. The term does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. This Convention explicitly includes certain areas under the sea within the definition of the United States. For certain purposes, the definition is extended to include the sea bed and subsoil of undersea areas adjacent to the territorial sea of the United States. This extension applies to the extent that the United States exercises sovereignty in accordance with international law for the purpose of natural resource exploration and exploitation of such areas. This extension of the definition applies, however, only if the person, property or activity to which the Convention is being applied is connected with such natural resource exploration or

exploitation. Thus, it would not include any activity involving the sea floor of an area over which the United States exercised sovereignty for natural resource purposes if that activity was unrelated to the exploration and exploitation of natural resources.

The term "Bangladesh" is defined in subparagraph 1(g) to mean the People's Republic of Bangladesh. The term is defined to include the territorial sea, sea bed and subsoil adjacent to the territorial sea over which Bangladesh exercises its sovereign rights in accordance with international law.

The term "national" as it relates to Bangladesh and to the United States, is defined in subparagraphs 1(h)(i) and (ii), respectively. This term is relevant for purposes of Articles 20 (Government Service) and 24 (Nondiscrimination). A national of one of the Contracting States is (1) an individual who is a citizen or national of that State, and (2) any legal person, partnership or association deriving its status, as such, from the law in force in the State where it is established.

Paragraph 2

Paragraph 2 provides that in the application of the Convention, any term used but not defined in the Convention will have the meaning that it has under the law of the Contracting State whose tax is being applied, unless the context requires otherwise. If the term is defined under both the tax and nontax laws of a Contracting State, the definition in the tax law will take precedence over the definition in the non-tax laws.

Finally, there also may be cases where the tax laws of a State contain multiple definitions of the same term. In such a case, the definition used for purposes of the particular provision at issue, if any, should be used.

If the meaning of a term cannot be readily determined under the law of a Contracting State, or if there is a conflict in meaning under the laws of the two States that creates difficulties in the application of the Convention, the competent authorities, as indicated in paragraph 3(e) of Article 25 (Mutual Agreement Procedure), may establish a common meaning in order to prevent double taxation or to further any other purpose of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

The reference in paragraph 2 to the internal law of a Contracting State means the law in effect at the time the treaty is being applied, not the law as in effect at the time the treaty was signed. This use of "ambulatory definitions" has been clarified in this paragraph by the use of the phrase "at that time."

The use of "ambulatory" definitions, however, may lead to results that are at variance with the intentions of the negotiators and of the Contracting States when the treaty was negotiated and ratified. The reference in both paragraphs 1 and 2 to the "context otherwise requiring" a definition different from the treaty definition, in paragraph 1, or from the internal law definition of the Contracting State whose tax is

being imposed, under paragraph 2, refers to a circumstance where the result intended by the Contracting States is different from the result that would obtain under either the paragraph 1 definition or the statutory definition. Thus, flexibility in defining terms is necessary and permitted.

ARTICLE 4 (FISCAL DOMICILE)

This Article sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. As a general matter only residents of the Contracting States may claim the benefits of the Convention. The treaty definition of residence is to be used only for purposes of the Convention. The fact that a person is determined to be a resident of a Contracting State under Article 4 does not necessarily entitle that person to the benefits of the Convention. In addition to being a resident, a person also must qualify for benefits under Article 17 (Limitation on Benefits) in order to receive benefits conferred on residents of a Contracting State.

The determination of residence for treaty purposes looks first to a person's liability to tax as a resident under the respective taxation laws of the Contracting States. As a general matter, a person who, under those laws, is a resident of one Contracting State and not of the other need look no further. That person is a resident for purposes of the Convention of the State in which he is resident under internal law. If, however, a person is resident in both Contracting States under their respective taxation laws, the Article provides tie-breaker rules pursuant to which a person is assigned, where possible, a single State of residence for purposes of the Convention.

Paragraph 1

The term "resident of a Contracting State" is defined in paragraph 1. In general, this definition incorporates the definitions of residence in U.S. law and that of Bangladesh by referring to a resident as a person who, under the laws of a Contracting State, is subject to tax there by reason of his domicile, residence, citizenship, place of management, place of incorporation or any other similar criterion. Thus, residents of the United States include aliens who are considered U.S. residents under Code section 7701(b).

Paragraph 1 also addresses special cases that may arise in the context of Article 4.

The paragraph makes explicit the generally understood practice of including within the term "resident of a Contracting State" the Government of that state as well as any political subdivisions or local authorities of that State.

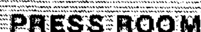
Certain entities that are nominally subject to tax but that in practice rarely pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, a U.S. Regulated Investment Company (RIC), U.S. Real Estate Investment Trust (REIT) and U.S. Real Estate Mortgage Investment Conduit (REMIC) are all residents of the United States for purposes of the treaty. Although the income earned by

these entities normally is not subject to U.S. tax in the hands of the entity, they are taxable to the extent that they do not currently distribute their profits, and therefore may be regarded as "liable to tax." They also must satisfy a number of requirements under the Code in order to be entitled to special tax treatment.

Subparagraph (a) provides that a person who is liable to tax in a Contracting State only in respect of income from sources within that State will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, a consular official of Bangladesh who is posted in the United States, who may be subject to U.S. tax on U.S. source investment income, but is not taxable in the United States on non-U.S. source income, would not be considered a resident of the United States for purposes of the Convention. (See Code section 7701(b)(5)(B)). Similarly, although not explicitly stated in the Convention, an enterprise of Bangladesh with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise generally is subject to U.S. tax only with respect to its income that is attributable to the U.S. permanent establishment, not with respect to its worldwide income, as is a U.S. resident.

Subparagraph (b) addresses special problems presented by partnerships, trusts or estates (i.e., fiscally transparent entities). This subparagraph applies to any resident of a Contracting State who is entitled to income derived through an entity that is treated as an entity that is a partnership, trust, or estate under the laws of either Contracting State. Entities falling under this description in the United States would include partnerships, common investment trusts under section 584 and grantor trusts. This paragraph also applies to U.S. limited liability companies ("LLCs") that are treated as partnerships for U.S. tax purposes.

Subparagraph (b) provides that an item of income derived by such a fiscally transparent entity is considered to be derived by a resident of a Contracting State to the extent that the resident is treated under the taxation laws of the State where he is resident as deriving the item of income. For example, if a corporation resident in Bangladesh distributes a dividend to an entity that is treated as fiscally transparent for U.S. tax purposes, the dividend will be considered derived by a resident of the United States only to the extent that the taxation laws of the United States treat one or more U.S. residents (whose status as U.S. residents is determined, for this purpose, under U.S. tax laws) as deriving the dividend income for U.S. tax purposes. In the case of a partnership, the persons who are, under U.S. tax laws, treated as partners of the entity would normally be the persons whom the U.S. tax laws would treat as deriving the dividend income through the partnership. Thus, it also follows that persons whom the U.S. treats as partners but who are not U.S. residents for U.S. tax purposes may not claim a benefit for the dividend paid to the entity under the Convention. Although these partners are treated as deriving the income for U.S. tax purposes, they are not residents of the United States for purposes of the treaty. If, however, they are treated as residents of a third country under the provisions of an income tax convention which that country has with Bangladesh, they may be entitled to claim a benefit under that convention. In contrast, if an entity is organized under U.S. laws and is classified as a corporation for U.S. tax purposes,



February 2, 2006
JS-4002

Remarks by
Under Secretary for International Affairs Tim Adams
At AEI Seminar
Working with the IMF to Strengthen Exchange Rate Surveillance

Introduction

Let me thank Desmond Lachman and the American Enterprise Institute for inviting me to speak to this seminar on the IMF's role in foreign exchange surveillance.

First, though, I want to discuss the overarching questions facing the Fund. The IMF is the world's central institution for global monetary cooperation. A strong IMF serves the interests of the United States and the world economy. Over the past decades, the Fund has done remarkably well, tackling the debt crises of the 1980s, helping transform the former Soviet Union and Central Europe, and addressing the emerging market crises of the 1990s. The IMF is indispensable.

But in a rapidly evolving global economic and financial system, the Fund faces the continuous challenge of re-tooling itself. Already, this decade, many new and fundamental questions have emerged regarding the IMF's future and relevance. Will the global community resolve imbalances in an orderly manner? With large emerging market countries across the world putting in place sound macroeconomic policy frameworks, adopting pro-growth policies, relying on private finance, and accumulating large stocks of foreign exchange reserves, will the Fund be needed as a major balance of payments lender? Crises will always happen, but can the Fund do better on *ex ante* crisis prevention? When crises erupt, how can they be best managed, especially when the dynamics of global capital flows are not fully appreciated? IMF transparency has been substantially enhanced, but is there more to be done?

The Fund's major shareholders and Management are tackling these issues and many others through the Managing Director's Strategic Review. The Managing Director will soon bring forward his ideas on how to strengthen the Fund's surveillance activities including exchange rate surveillance and broader integration of financial markets issues into surveillance. We welcome this exercise and we look forward to working with him constructively to achieve concrete results.

Today, I would like to offer my own thoughts on the very high priority issue of the IMF's role in foreign exchange surveillance. My objective is to table ideas for reforming IMF foreign exchange surveillance procedures to make surveillance more effective, to contribute to the debate which the Managing Director's Strategic Review is stimulating, and to help galvanize action by the Fund's shareholders – who set the tone and direction for the IMF – to better allow Rodrigo de Rato and the IMF's excellent staff to play their role as the world's preeminent monetary institution.

The Role of Exchange Rates

The IMF – its management, staff, and shareholders – has long struggled to strike the right balance in providing advice on the role of exchange rates. I recognize that this is not an easy issue to resolve as there are so many complicating factors. For example:

- The interaction between the exchange rate and domestic policies can run both ways. In a fixed exchange rate regime, the exchange rate is the central target of monetary policy. In a flexible exchange rate regime, the exchange rate is an outcome from other policies.

- Exchange rate changes can be influenced as much by developments abroad as at home.
- Countries' exchange rate regime preferences differ depending on whether an economy is relatively closed or open to tradable goods and financial flows, the extent of pass-through from exchange rate changes to domestic inflation, the flexibility of labor and other factor markets, the concentration of its trade, or the sophistication, credibility, and quality of a country's institutions.
- Imbalances themselves can be adjusted through domestic policy measures, exchange rate adjustment, or some combination thereof.

And, of course, we struggle with who should bear the burden of adjustment and by how much.

The international monetary system has also generally been characterized by an asymmetric bias, where pressures are more acute on deficit than surplus countries to bear the burden of global adjustment.

John Maynard Keynes, in particular, devoted himself to the issue of asymmetric bias when he worked on the initial plans for something that would eventually be known as the International Monetary Fund. Keynes worried about the potentially damaging effects of global current account imbalances and the fact that market forces were not very strong in compelling surplus countries to adjust. He believed that the IMF should have the ability to pressure surplus countries to play their part in resolving imbalances and developed what was then known as the "scarce currency clause." That clause faded into history as an unused relic of the Bretton Woods system of fixed exchange rate regimes, but the need for a lever on surplus countries remained. The asymmetric bias of the international monetary system was evident in the late 1960s ahead of the demise of the Bretton Woods system. It is also present today in discussion of the need for more flexible exchange rate regimes – including in emerging Asia.

IMF and Exchange Rate Surveillance

Today's global imbalances are not so dissimilar from the past in the sense that they require a shared, multilateral solution to achieve an orderly resolution. Let me be clear, the United States has its part to play in this process by raising national saving, and in particular continuing on the path of deficit reduction. The Administration does not and will never shy away from this point.

But the solution also requires an IMF capable of demonstrating strong leadership on multilateral exchange rate surveillance. The IMF membership should endorse such an enhanced role for the IMF, restoring its central role on exchange rates. There are four areas where our experience clearly points to the need for concrete improvements: clarifying exchange rate surveillance principles; Article IV reviews; the special consultation mechanism; and multilateral surveillance reforms.

Clarifying Principles of IMF Surveillance over Exchange Rate Policies

First is clarifying the IMF exchange rate surveillance principles. The fact is that the IMF has a good foundation of principles for members' exchange rate policies. These include the idea that "members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene." Moreover, the principles of Fund surveillance over exchange rate policies contain warnings against "protracted large-scale intervention in one direction" and "excessive" reserve accumulation.

These principles, which enjoy broad support among IMF membership, mandate active IMF involvement in exchange rate issues. And these principles are not new – they were spelled out in the late 1970s. Still, the principles of Fund surveillance could be sharpened with more procedural guidance on such issues as how long is "protracted" intervention? How much is "large-scale"? What constitutes and what are the costs of "excessive" build-up of reserves?

When the principles of surveillance were first drawn up, they were intentionally left vague so that experience could shape their interpretation. Nearly thirty years later, I believe we have that experience.

Article IVs

Second is improving the Article IV review, the core of IMF surveillance since the end of the Bretton Woods regime of fixed exchange rates. These reviews were originally designed to enable the IMF to exercise "firm surveillance" over the exchange rate policies of its members.

As I mentioned, assessing a member's balance of payments and its exchange rate regime and practices requires a comprehensive analysis of the general economic policies and performance of a country.

But my central point is that the pendulum has swung too far in Article IVs. In its bilateral surveillance, the Fund focuses very heavily on domestic economic developments and policies, especially fiscal policy, and addresses structural, demographic, and longer-term factors in considerable detail. These items are admittedly important. But increasingly what is missing is a thorough assessment of exchange rate issues.

Article IV reports need substantial and pointed discussions of exchange rate issues on a consistent basis. The IMF's Articles very reasonably allow a member to adopt the exchange rate regime of its choice. But at the same time, certain regimes may not be appropriate to a country's circumstances, and the Fund – with its wealth of expertise and experience across the globe – is well positioned to discuss this issue with authorities and advocate change. I propose four specific reforms to improve the quality of the foreign exchange element of the Article IV process.

1. *Article IV reports should explicitly discuss the* ***consistency*** *of a country's exchange rate policy with* ***domestic policies*** *as well as the* ***international system and the IMF's principles for members' exchange rate policies***. The IMF should never accept uncritically a country's choice of exchange rate regime and simply posit what domestic policies or external circumstances would be required for the regime to be sustainable. Instead the Fund should ask tough questions, such as whether a fixed exchange rate is consistent with a realistic outlook for a country's fiscal policy, or increased integration into international capital markets.
2. *Evaluation of exchange rate policies should consider* ***whether alternative arrangements or regimes might be more appropriate***. For example, flexible exchange rates are the clear choice for "larger" emerging markets. While not a substitute for sound domestic policies, currency flexibility can limit the one-way betting that results in rapid depletion of reserves; it better allows the external sector to bear a portion of the needed adjustment, rather than imposing an undue burden on domestic demand; and it provides signals of policy inconsistency in advance of crisis.
3. *The IMF should improve its tools and advocacy to persuade countries to* ***exit unsustainable exchange regimes early on****, rather than waiting for perfect circumstances that never come*. Too many countries wait until circumstances are dire before abandoning an inappropriate exchange arrangement, ratcheting up the costs to the country and to the global community. Earlier analysis and more forceful advice could help encourage smoother transitions.
4. *Article IV reviews should* ***draw more heavily from*** *the Fund's World Economic Outlook and excellent* ***multilateral analysis***. Multilateral analysis should be integrated into and consistent with Article IV reports. This should result in better consideration of the international environment and improve the evaluation of specific country policies. So far visible progress along these lines has been made mostly in bilateral surveillance of the United States. Other countries – systemically important countries in particular – would benefit from this treatment.

In making these recommendations I am aware that some Article IV reports in the past have moved quite far in these directions. But this has not been consistent in scope or in tone, and there has been considerable ambiguity about the degree of shareholder support for such a robust role. It is time for the Fund – the only institution with a mandate to assure a smoothly functioning international monetary system – to reach judgments about the consistency of exchange rate policies with members' international obligations, and to do that consistently across the membership, particularly in systemically important countries. The Fund is not only a trusted advisor to each of its members but the protector of the system as a whole.

De-stigmatizing the Special Consultation Mechanism

Third, we must finally de-stigmatize the special consultation mechanism. In 1979, the IMF developed a "special consultation" mechanism under which the Managing Director could consult with members whose exchange rate policies might not be in accord with the Fund's principles. Used only twice, revised in 1993 to broaden its application and promote greater use, but never used since – the special consultations mechanism is not working. There is nothing wrong with the concept of special consultations, but in practice the tool has been used so rarely that its use today would be perceived as a huge stigma for the country and might have market ramifications.

As a means of enhanced engagement in Article IV reviews, a process for more regular consultations should be undertaken to provide a realistic means of intensifying exchange rate surveillance. The regularity of this process could lessen the perceived stigma associated with special consultations, and encourage better compliance with IMF principles for exchange rate policies.

The procedures for these regular consultations should require the Managing Director to undertake intensified consultations pro-actively whenever an Article IV review raises serious questions about the compatibility of a member's exchange rate policy with IMF exchange rate principles or domestic policies, or when the exchange rate regime otherwise appears unsustainable. If such consultations have not been undertaken, the Executive Board should be able to call for them after reviewing the Article IV report and subsequently discuss the results of the intensified consultations.

Multilateral Surveillance Reform

Finally, multilateral surveillance should be enhanced. Since the 1980s, the IMF's multilateral surveillance has centered on the *World Economic Outlook* publication, which provides the Fund staff's globally consistent forecast and a broad view of trends that cut across countries and regions. Multilateral analysis can be extremely helpful by providing an overview of the global economy, and can be helpful for bilateral surveillance efforts, in particular, by identifying the ways local policies and systemic forces influence one another.

Considerable academic work, informal reasoning, and modeling have been applied to exchange rate determination. Many types of models exist, from a simple deviation from long-term averages to more state-of-the-art techniques. All of these models have critics. No approach or model has been able to predict exchange rate behavior, and we must be humble regarding our knowledge on this front.

It would be wholly unrealistic to think that countries would or could agree on what constitutes a precise "right" exchange rate level. Nor should the IMF be placed in the position of determining what the "right" exchange rate level is.

Nonetheless, quantitative efforts at exchange rate determination have helped enhance understanding of exchange rate issues, and I believe that multilateral surveillance could benefit from greater use of models and data that assess exchange rate trends. The presentation of many different estimates, using many different methodologies, alongside the relevant data, can be helpful in developing a *qualitative* assessment of a country's exchange rate policies and improving the information content for – and the functioning of – markets.

Therefore the IMF should deepen its work in developing techniques for assessing exchange rate behavior, extend this work more to emerging markets, and regularly publish its results. It should also seek to identify problematic or inappropriate exchange rate behavior. Some have said that publishing such data could trigger market instability. I do not agree. Properly presented, I think the routine publication of data would provide added information to reach fundamental judgments about exchange rate regimes.

To present the analysis, the Fund should have a regular report dedicated to exchange rate developments across many countries. This could take the form of a stand-alone report or an annex to the *World Economic Outlook*. In addition to presenting the foregoing data, the report would focus on analysis and assessments

of exchange rate policies that contribute to the build-up of unsustainable bilateral or multilateral imbalances or that threaten to impede the orderly adjustment of imbalances. Furthermore, the Fund report should include its most current analysis on the conditions for exchange rate regime sustainability – including appropriate domestic and external circumstances for fixed regimes, floating regimes, and how to transition from one to another.

This report would achieve several goals. It would strengthen the IMF's focus on exchange rate surveillance and the resources it devotes to these issues. It could prompt debate, which could contribute to the development and refinement of analytical techniques. And the presentation of multiple models and judgmental interpretation of them would provide policymakers as well as market participants with a view of the richness and complexity of exchange rate dynamics – even for an individual currency. But most importantly, the report would facilitate identification of exchange rate policies that damage other members or pose a risk to the international financial system.

Conclusion

Taken together, these reforms would strengthen the IMF and improve the Fund's work as the preeminent monetary institution. As you know, the United States is engaged in discussions with certain countries regarding their exchange rate policies, and these discussions may color the interpretation of the surveillance reform proposals I have outlined today. Indeed, the IMF may fear being perceived as doing the bidding of the United States. But the ideas I proposed today go beyond immediate U.S. policy concerns. They are a reflection of the enduring concerns that led to the establishment of the IMF itself. I believe a strong IMF role on exchange rate issues is central to the stability and health of the international economy.

Thank you.

February 2, 2006
JS-4003

The Honorable John W. Snow
Prepared Remarks to
The National Association of Wholesaler-Distributors' Executive Summit

Good afternoon; thanks so much for having me here today and thank you for the honor of receiving your Distinguished Leadership Award. I am deeply flattered that your group has chosen me for this tribute.

Providing economic leadership is a challenge. And, in fact, I think that companies like yours do it best. Those of us in government generally need to think about staying out of your way!

I am a great admirer of the leadership the President has shown on the economy. He has a keen understanding and a deep respect for what makes the American economy so special, and his policies are based on a respect for free enterprise, entrepreneurship and, as he so often says, simply "letting people keep more of the money they earn."

It was an important message the President delivered in his State of the Union Address this week. He told America, correctly, that our economy is performing very well – far better than other major economies. But, as the President said, we live in a new world and are facing competition from new economic players like China, India, and other "emerging market" countries. In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: health, energy, and America's competitiveness.

The President is seeking to make health care more affordable and accessible. An expansion of opportunities within Health Savings Accounts – which patients in charge of their health care – will contribute to this goal. We also need to make health insurance portable, make the system more efficient, and lower costs. Allowing Association Health Plans would address many these concerns in the small-business community.

The President said this week that the best way to break America's dependence on foreign sources of energy is through new technology. His Advanced Energy Initiative would provide for a 22 percent increase in clean-energy research at the Department of Energy and would build on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

In his Tuesday night address, the President also talked about an ambitious strategy we are calling the American Competitiveness Initiative. It would significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now. Over the past two to three years, economic indicators have been a steady drumbeat of good news. It's really amazing to look back on the past five years. When President Bush took office just five years ago he was inheriting an economy in decline. The bursting of the stock market bubble pushed the economy into recession and then the terrible shock of September 11th made economic matters even worse.

Thanks to responsible economic leadership from the President and Federal Reserve Board, our economy is now unmistakably in a trend of expansion. GDP growth grew at over 3.5 percent last year. Four and a half million new jobs have been created since May of 2003; two million of them in the last year alone.

Unemployment is running lower than the 1970s, 1980s and 1990s, payrolls are rising and household wealth is at an all-time high.

The contributions to the economy of the wholesale trade – your productivity and job creation in particular – are greatly appreciated. Thanks to businesses and workers like yours, the U.S. is both the economic envy of, and inspiration to, the world.

When we look at the underlying fundamentals of the economy, we can see that businesses and workers have every reason to be optimistic about the future.

For example, we see that productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since 2001, faster than any five-year period in the 1970s, 1980s or 1990s.

Consumer net worth – that's assets minus debts – is at a record high, and not just because of housing. Deposits – the money in checking accounts, savings accounts, and money market funds – are at a record high and are larger as a share of disposable income than at any time since 1993.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years new claims for unemployment insurance have almost never been as low as they have been recently, the only exception being the peak of the high-tech bubble from November 1999 to June 2000.

Core inflation remains low, and that's good news for everyone.

It is also noteworthy that new orders for non-defense capital goods were 20 percent higher in 2005 than in 2004 This tells us that the capacity of American businesses to produce in the future is rising. Meanwhile, the capacity utilization rate is 80.7 percent, which is below the level that in the past has been associated with rising inflation. In other words, American businesses are increasing capacity and at the same time have room to more intensively use the capacity they have, suggesting low inflation in the future plus pent-up demand for labor.

Independent private-sector forecasts point to continuing good news. For 2006, they predict a nice increase in real wages. Inflation-adjusted hourly wages are in fact already beginning their rise, growing 1.6 percent between September and December.

We are, right now, likely witnessing the tipping point on wages – when incomes rise for workers and business combined, but workers once again increase their incomes faster than businesses. As employers, you are familiar with the scenario: once businesses have been doing well for a while, they ultimately compete those increases in income away by competing harder for labor. The result is higher wages and higher standards of living for workers.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that business and government should look at is this: why is our economy performing so well and what can we do to continue these positive trends?

Put in the simplest of terms, you – the business community – create the jobs, develop the new products and services and so on. And we – the government – are responsible for creating an environment in which you can succeed.

The Federal Reserve has added to a favorable environment by implementing sound monetary policy. And there can be no doubt that the President's economic policies of lower taxes on income and capital have given both businesses and individuals the room they needed to grow and prosper.

The approach of this administration has been to implement the type of policies that have always, historically, enabled this nation to thrive. Ours is a country that is unique in its freedoms and we owe our prosperity to those freedoms. The simple fact that we operate as a free market is central to our success. The U.S. has tended to encourage small-business ownership, innovation and entrepreneurship, and that's essential for a thriving economy. Policies that let entrepreneurs and workers

simply do what they do best have always enabled our economy to be more open, flexible, adaptive and resilient than any other in the world.

The President's tax cuts tapped into this proven, and I think uniquely American, economic theory on promoting growth, and effectively lightened the burden on individuals and businesses, leaving you to spend and invest, grow and create jobs. His American Competitiveness Initiative, with its increases in federal investment in critical research, will complement this entrepreneurial, creative and innovative environment.

The reduced burden on the cost of capital and investment was critical because it is the lifeblood of a free market economy. And as you are well aware, there is a risk right now that taxes on investment and job creation could be raised. That would be a terrible mistake, given the economic success that lower rates precipitated.

With more Americans working than ever before, more Americans owning stock than ever before and with federal tax revenues at an all-time high to boot, there is simply no reason for the Congress to accept a tax increase from the Congress. And I'm confident the President won't accept one, period.

But this fight to keep taxes low on business, families and individuals will take an extra effort from you and our friends on the Hill. They've got to make all of the President's tax cuts permanent; letting them expire would be a tax increase – there is simply no other way to put it. And tax increases would be bad for the economy, bad for every American who still needs a job or seeks a better job.

According to our own Treasury estimates, the lower tax rate on dividends and capital gains will ultimately increase national output by $35 billion. This is significant because it illustrates the real point of these policies: they increase savings and investment, increase labor productivity through this higher capital formation, and, ultimately, increase jobs, the size of our economy and raise livings standards.

We still have a federal budget deficit – one that is too large and that the President is firmly committed to reducing. But our deficits are not the result of lower receipts – tax revenues are coming in strong. Deficits matter and one of our highest priorities is to achieve the President's goal of reducing our deficit in half to below 2.3 percent of GDP by 2009. Even in the face of increased costs to deal with last summer's hurricanes, I am confident that we will achieve this goal through spending restraint and continued economic growth.

Good news on spending restraint came before the holidays, with final approval in Congress of the FY2006 appropriations bills. The President worked with Congress to reduce non-security discretionary spending below last year's level, terminate or reduce funding for 89 lower-priority or poor-performing programs, and rein in mandatory spending for the first time in nearly a decade. And yesterday the Congress wrapped up work on the budget reconciliation bill that reduced the rate of growth of entitlement spending for the first time in eight years.

The President's proposed FY 2007 budget will be released next week that is true to the President's goals of reducing the deficit and keeping the growth of government in check by holding overall discretionary spending below the rate of inflation. It proposes cutting 141 programs that aren't delivering their promises to the taxpayers and proposes tens of billions of dollars of savings on entitlement programs. It is a budget that works to ensure that future generations of Americans will have the opportunity to live in a Nation that is more prosperous and more secure.

The prescription for the near future, for our economy, is straightforward: if we keep on doing what we're doing, policy-wise, we should keep getting what we're getting – in this case, excellent economic growth, millions of new jobs and a deficit that is in decline.

Can we do even better? You bet. Policies that reduce the number of baseless lawsuits would be a great way to further free-up business and entrepreneurs to produce and create jobs.

Asbestos legislation may come to the Senate floor next week, and the

Administration would like to see a bill get off the floor and into conference so the Congress can work on a final bill that brings certainty to the marketplace, allows actual victims to get payments and stops trial lawyers from stealing productivity and jobs from the American economy in the name of innocent victims' health.

Nearly $74 billion has been lost on the inefficient and ruinous asbestos litigation system, and nearly $30 billion of those dollars went to wealthy trial lawyers at the expense of asbestos victims. When you consider that these costs have already bankrupted 77 companies, cost America 60,000 jobs and caused workers to lose $200 million in wages it is unthinkable that we could go on without fixing the system. The President will be calling on the Senate to get this issue into committee quickly.

Another issue that I know impacts the cost of doing business for this group especially is the cost of energy. The President understands that impact, and it's why he fought so hard for last year's historic energy bill. There's work ahead on energy issues, and a reduced dependency on foreign sources is at the top of the President's energy agenda.

The President also appreciates the drag that excessive regulation can put on business, and therefore on job creation and innovation. That's why he tasks his cabinet with taking a close look at their agencies, at their regulations, and making sure that the benefits and protections of regulation are achieved without putting an undue hardship on you. We want you to be able to do what you do best, and that's create jobs. So there's a balance to achieve on regulation, and this entire administration is dedicated to achieving that balance.

Similar in some ways to excessive regulation is excessive complexity in our tax code. The code is not where it should be. After nearly three years as Treasury Secretary I have yet to find anyone who is happy with the tax code – unless you are in the tax preparation business, that is. Just to navigate it, millions of Americans have to enlist professional help. I know you've heard – and lived – the statistics – billions of hours of paperwork for tax filers and businesses, $140 billion dollars in lost time and money just trying to comply with our increasingly unwieldy tax code. This is a drag on economic growth in America and an unnecessary burden we all share.

The President's Tax Reform Panel did excellent work under the leadership of the two co-chairmen, former Senators John Breaux and Connie Mack, and we're reviewing their proposals now. We only get the chance to reform the code every twenty years or so, so we've got to make sure it's done right. We're not going to rush the reform process because America deserves a tax code that meets the President's goals for fairness, simplicity, and economic growth.

The rising cost of health care is another critical issue that I know you all deal with every day, and we still need common-sense medical liability reform to help address those costs. Health care costs have got to be brought down, and we've included some mechanisms in the budget to address that pressing issue. As the President pointed out in his State of the Union Address this week, it's time to allow Americans to save more in their Health Savings Accounts. We hope this will encourage more people to start HSAs, which put patients back in charge of their health-care purchasing decisions while saving money on a tax-preferred basis.

For the longer term, we have economic issues that loom and the sooner we address them, the better. The President did the right thing by leading on Social Security reform. We appreciate your support for it. It remains the right thing to do.

I also appreciate, and share, the concern of this group when it comes to the skills and preparation of the American workforce. Education and worker training policies must be constantly adapted to the changing times and the changing, growing economy. As the President said in announcing the American Competitiveness Initiative Tuesday night, a strong economy depends on a skilled and talented workforce. The President sees great success and potential in the ability of community colleges to provide relevant, focused training for jobs that exist today – jobs that may not have existed even five years ago because of innovation. And workers should be able to continue to learn new skills for the changing business environment. This is an investment in our future that is more important than venture capital itself!

Our workers are already competing with workers all around the globe, and when the playing field is level both our workforce and our businesses will always prove themselves. That's why a level playing field is central to the President's free and fair trade agenda. This underscores the importance of the Doha trade round which has the potential to boost American jobs by reducing and eliminating tariffs and other barriers on farm and industrial goods, ending unfair subsidies and opening the global market to American services. The U.S. will push for a bold, wide-ranging agreement, and the President will continue to use the American influence to bring American workers even greater opportunities. With 95 percent of America's potential customers living abroad, opening up new markets is extremely important.

I would never advise anyone to bet against the American worker, American business or the American economy overall. When businesses, families and individuals are allowed to pursue their goals – with opportunities to invest and enjoy the rewards of innovation, risk-taking and entrepreneurship – our economy is incredibly resilient and powerful.

Again, I appreciate the chance to talk with you today about the prospects for our economy. I look forward to taking your questions.

February 2, 2006
JS-4004

MEDIA ADVISORY
Treasury Secretary Snow to Visit Charlotte, North Carolina to Discuss American Competitiveness and the U.S. Economy

U.S. Treasury Secretary John W. Snow will travel to Charlotte, North Carolina Thursday to discuss American competitiveness and the U.S. economy. While in Charlotte, Secretary Snow will visit the North Carolina Research Campus where he will participate in a discussion on the contributions that innovation and technology make to the economy and to standards of living for the American people.

The following event is open to credentialed media with photo identification:

Friday, February 3, 2006
8:00 AM EST
Breakfast with Charlotte Chamber of Commerce
Charlotte Chamber of Commerce
330 South Tryon Street
Charlotte, NC 28202
****Media please RSVP to Erica Johnson at (704) 378-1354**

11:00 AM EST
North Carolina Research Campus
Site Visit and Roundtable
Cannon Village Visitors Center
Auditorium
200 West Avenue
Kannapolis, NC
****Media please RSVP to Phyllis Beaver at 704-273-1181 or**
pbeaver@castlecooke.com

February 3, 2006
JS-4005

The Honorable John W. Snow
Prepared Remarks to the Charlotte
Chamber of Commerce

Good morning, everyone; it's great to be with you here in Charlotte. Thanks to businesses like yours all over the country, the American economy is doing very well, and I want you to know that the President is dedicated to the policies that create a good environment for job creation and innovation.

From lower tax rates for individuals and investors to the creation of low-cost, high-savings health care options, President Bush has been working to remove the obstacles that can to hold back independent businesses like the ones this Chamber represents.

He knows that your ability to invest in your business – and then deduct that expense from your taxes – is critically important to your ability to grow and hire more workers.

And he knows that affording a health-care plan on a small-business budget is a struggle and a challenge that needs a light at the end of the tunnel. I hope that Health Savings Accounts (HSAs) are offering that light already. I know that employers both large and small are taking advantage of HSAs, and I think they are a break-through health-care product.

But I want to be clear when I say that the President doesn't feel sorry for small and medium-sized employers. No. He *admires* them. He knows where job creation and innovation comes from, and he wants to encourage as much of those things as possible.

I'm glad to see that the Charlotte economy is doing well, and I'm proud to report on the robust health of the national economy. In his State of the Union Address this week, the President told America about our healthy economy, which is performing far better than other major economies. But, as the President said and you well know, we live in a new world and are facing competition from new economic players like China, India, and other "emerging market" countries. In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: health, energy, and America's competitiveness.

He believes that the best way to break America's dependence on foreign sources of energy is through new technology. That's why he is proposing an Advanced Energy Initiative that would provide for a 22 percent increase in clean-energy research at the Department of Energy and would build on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

In his Tuesday night address, the President also talked about an ambitious strategy we are calling the American Competitiveness Initiative. It would significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now, with excellent GDP growth, steady job creation and low unemployment.

I'm happy to be sharing the President's economic policy proposals with you today,

but I'm also looking forward to hearing your thoughts, observations and questions about the economy. America's economy is the envy of the world, but we'll only maintain that status if we keep working on it, every day.

I'd be delighted to take your questions now.

February 3, 2006
JS-4006

Treasury Assistant Secretary Warshawsky to Hold Economic Briefing

U.S. Treasury Assistant Secretary for Economic Policy Mark Warshawsky will hold a media briefing today to discuss the state of the U.S. Economy. The event is open to credentialed media:

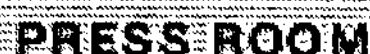
Who
U. S. Treasury Assistant Secretary Mark Warshawsky

What
Economic Media Briefing

When
Friday, February 3, 1:30 p.m. (EST)

Where
Media Room – Main Treasury
1500 Pennsylvania Ave, NW
Washington, DC

Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number and date of birth.



February 3, 2006
JS-4007

The Honorable John W. Snow
Prepared Remarks: The North Carolina Research Campus

Good morning, everyone; it's great to be with you here in North Carolina, especially at this wonderful center of research and innovation. I'm really impressed with the partnership that exists here among state government, higher education and private enterprise.

We have a vibrant, dynamic economy in this country that is made up of all those ingredients: business, education, and government. When all three excel in their purpose is when our naturally resilient economy does its best.

We had terrific economic news this morning: the unemployment rate has now dropped to 4.7 percent – the lowest it has been since July of 2001 – and 193,000 new jobs were created in January. On average, 200,000 jobs have been created each month over the past three months and 4.7 million new jobs have been created since May of 2003. These are uniformly good numbers. In addition to the numbers for January, there were also revisions to the prior months, December and November, which added some 80,000 additional jobs.

The fact that the unemployment rate has fallen to 4.7 From the 4.9 is a really a very positive indicator about the strength of the labor markets. Also, the duration of unemployment is dropping and dropping fairly smartly. What this all tells us is that our labor markets are performing well and that we can expect rising employment and we can expect rising wage levels for Americans.

It's important to stay on this positive economic path, this path of job creation, and I commend the Senate for action they took last night on tax cuts. They moved the process forward, voting to extend some of the President's tax cuts, but I really want to encourage Congress to go further by making the President's tax cuts *permanent*. I hope the United States Congress will look closely at the good direction of our economy and resist calls to increase taxes on the American people.

I know I don't need to tell this crowd about the dynamism of the American economy. Changes in the job market here have been recent and swift. Ultimately, I believe, each decade of economic success brings better jobs and a better quality of life to American citizens, but it is possible for workers to get overwhelmed in the tide of change. Centers like this work to ensure that people are benefiting from a rising tide instead.

Where there was once fear of old jobs being lost, this center represents new jobs found. Research on health, nutrition and biotechnology holds incredible promise for the quality of life for the people of this country and of the world.

I hope you were as excited as I was to hear President Bush's dedication to innovation in his State of the Union address this week. First, he told America about our healthy economy, which is performing far better than other major economies. But he also acknowledged that we live in a new world and are facing competition from new economic players like China, India, and other "emerging market" countries. In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: health, energy, and America's competitiveness.

The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts – putting patients in charge of their health care – will contribute to this goal. We need to make health insurance portable,

make the system more efficient, and lower costs.

President Bush believes that the best way to break America's dependence on foreign sources of energy is through new technology. That's why he is proposing an Advanced Energy Initiative that would provide for a 22 percent increase in clean-energy research at the Department of Energy and would build on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

In his Tuesday night address, the President also talked about an ambitious strategy we are calling the American Competitiveness Initiative. It would significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

With a focus on these and other good policies, and the work of terrific centers of innovation like this one, we'll keep America competitive in the world and keep our economy strong as it has been for some time now, with excellent GDP growth, steady job creation and low unemployment.

I'm happy to be sharing the President's economic policy proposals with you today, but I'm also looking forward to hearing your thoughts, observations and questions about the economy. America's economy is the envy of the world, but we'll only maintain that status if we keep working on it, every day.

I'd be delighted to take your questions now.

February 3, 2006
JS-4008

Statement of Treasury Secretary John W. Snow
On the January Employment Report

"Today we have terrific news that the unemployment rate has now dropped to 4.7 percent – the lowest it has been since July of 2001 – and that 193,000 new jobs were created in January. On average, 200,000 jobs have been created each month over the past three months. People who have been unemployed are finding it easier and easier to find jobs. These numbers are a positive indicator that the American economy continues to hold great promise for all Americans who are seeking employment.

"The strength of the American economy has created 4.7 million jobs since May of 2003, and I am optimistic that we will remain on a good path and expect to see rising employment and wages in the months ahead.

"I commend the Senate for moving the process forward towards extending the President's tax cuts, but encourage Congress to go further by making the President's tax cuts permanent. I encourage the United States Congress to look closely at the good direction of our economy and resist calls to increase taxes on the American people."

February 3, 2006
JS-4009

Treasury to Hold Technical Briefing on Blue Book

U.S. Treasury will hold a media briefing of the General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals, also known as the "Blue Book."

Who
Assistant Secretary for Public Affairs Tony Fratto
Deputy Assistant Secretary for Tax Analysis Robert Carroll
Deputy Assistant Secretary for Regulatory Affairs Eric Solomon

What
Technical Briefing on Blue Book

When
Monday, February 6, 11:30 a.m. – 12:30 p.m. (EST)

Where
Media Room – Main Treasury
1500 Pennsylvania Ave, NW
Washington, DC

Note
***Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number and date of birth.**

February 6, 2006
js-4010

Proposed Treasury Budget for FY 2007

The President's proposed budget for Treasury in fiscal year 2007 reflects the Department's dedication to promoting economic opportunity, strengthening national security and exercising fiscal discipline.

"The President's proposed budget for FY 2007 is a budget that works to ensure that future generations of Americans will have the opportunity to live in a nation that is more prosperous and more secure," said Treasury Secretary John W. Snow. "Treasury's budget request reflects this Department's ongoing commitment to fiscal discipline and pursuit of the President's economic and security goals."

The Treasury appropriations request for FY 2007 is $11.605 billion, a 0.2 percent increase over the FY 2006 enacted budget of $11.581 billion.

Promoting Economic Opportunity

The Treasury Department, through offices including Economic Policy, International Affairs, Tax Policy and Domestic Finance, provides analysis, economic forecasting and policy guidance on issues ranging from tax policy to international financial crises.

The FY 2007 budget provides an additional $0.5 million to the Tax Policy Office to enable the Department to build effective models for dynamic analysis of revenue proposals.

Additional funds of $9.4 million are requested to fund Treasury's overseas presence – providing the U.S. government with unique access to economic ministries in foreign capitals, enhancing our ability to assess and mitigate financial risks, and furthering Treasury's work on the ground to counter the financing of terrorism and weapons of mass destruction.

Strengthening National Security

The Office of Terrorism and Financial Intelligence supports Treasury's national security efforts by safeguarding the U.S. financial systems against illicit use. To support these efforts, Treasury requests an increase of $12.5 million for the Financial Crimes Enforcement Network to enhance its regulatory outreach and strengthen analytical capabilities. An increase of $7.8 million is requested to enable Treasury to continue to enhance its abilities to identify, disrupt, and dismantle the financial infrastructure of terrorists, proliferators of weapons of mass destruction, narco-traffickers, criminals and other threats.

Exercising Fiscal Discipline

One of Secretary Snow's highest priorities is keeping the U.S. on the path to achieve the President's goal of cutting our deficit in half, to below 2.3 percent of GDP, by 2009. The Treasury Department is committed to reducing the deficit by exercising fiscal discipline and ensuring the most efficient and effective use of taxpayer dollars while at the same time boosting revenues through continued economic growth.

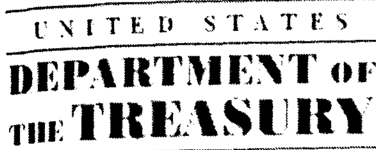
Enforcing the Nation's Tax Laws Fairly and Efficiently

The budget requests $10.591 billion for the Internal Revenue Service. An in-depth

press briefing on the revenue proposals, including release of the "Blue Book" will be held at 11:30 a.m. (EST) today in room 4121 of the Treasury Building. (Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with: name, Social Security number and date of birth.)

LINKS

- Summary of Treasury's FY 2007 Budget Request



OFFICE OF MANAGEMENT

Office of Performance Budgeting and Strategic Planning

BUDGET DOCUMENTS

Budget-in-Brief

Congressional Justification

President's Budget

Last Updated: February 3, 2006

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February 6, 2006
js-4011

Treasury Releases FY 2007 Blue Book

Washington, DC – The U.S. Treasury Department today released its General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals, otherwise known as the Blue Book. In addition to permanent extension of the President's tax relief enacted in 2001 and 2003, the President's FY 2007 Budget includes several new initiatives, including:

- Increased expensing for small businesses;
- A set of proposals to improve access to health care and expand Health Savings Accounts (HSAs);
- Proposals to increase compliance, simplify the tax laws and reduce taxpayer burden; and
- A proposal to create a new Dynamic Analysis Division within the Treasury Department's Office of Tax Policy.

Increase Small Business Expensing

Small businesses are an important source of innovation and risk taking in today's economy. Small businesses also create three-quarters of the nation's net new jobs. The President's FY 2007 Budget would permanently allow small businesses to deduct up to $200,000 of investment in equipment (section 179 property).

This provision would encourage investment and capital formation by lowering the cost of capital purchases. This additional expensing would build on the lower marginal tax rates and the provision allowing up to $100,000 of section 179 expensing enacted as part of the President's tax relief in 2001 and 2003 and proposed to be permanently extended by the President's FY 2007 Budget.

More investment by small businesses means more jobs created by this important sector of the economy. Expensing is also simpler than claiming regular depreciation deductions, which is particularly helpful for small businesses. This expansion of section 179 expensing would extend the benefits of expensing to more taxpayers and would also simplify tax accounting for them. Making this expansion permanent would allow these businesses to better plan their future investments.

Improve Access to Health Care and Expand Health Savings Accounts (HSAs)

The President's budget has important new proposals that will make health insurance coverage more accessible and affordable to Americans. The Treasury Department estimates that these proposals would increase the projected number of Americans with HSA's by 50 percent. In 2010, the Treasury Department projects an increase in the number of HSAs from 14 million to 21 million. The experience with HSAs so far is that 37 percent of new HSA enrollees were previously uninsured. If this trend continues, the President's proposals to expand HSAs could result in a substantial reduction in the number of uninsured.

These proposals will lead to a more consumer driven, market-orientated health care system that makes more efficient use of resources and reduces the rise in health care costs.

The President's FY 2007 Budget includes proposals that would help make insurance more available and more affordable by putting employer insurance, individually-purchased insurance, and out-of-pocket health spending on an equal

tax footing for those purchasing high deductible health plans.

- An above-the-line deduction and credit for payroll taxes paid (up to 15.3 percent) would be provided for high deductible insurance premiums to place employer provided insurance on an equal footing with individually-purchased insurance.
- HSA contributions would be allowed up to a plan's out-of-pocket limit and a credit for payroll taxes paid (up to 15.3 percent) on HSA contributions would be allowed to place out-of-pocket spending on equal footing with health insurance.
- A refundable health insurance tax credit for premiums paid on high deductible health plans would be provided for lower income individuals to help them purchase catastrophic coverage. This credit would cover up to 90 percent of the cost of a high deductible insurance premium up to $1,000 for individuals and up to $3,000 for families.
- Other proposals included in the FY 2007 Budget would generally make HSAs more flexible and accessible.

Health care costs continue to rise rapidly in the United States. Empowering health care consumers to play a more direct role in their health care decisions, rather than third party payors, would help to stem this trend. A health care system that is more market-oriented and consumer driven will help control costs and result in health care that is more affordable and accessible.

The Federal tax code's treatment of medical care has been a fundamental factor in the development of the third party system of financing health care in the United States. However, the tax code does not treat the self-employed, unemployed, and workers for companies that do not offer health insurance (most of whom are small businesses) the same as companies that do offer health insurance.

- Current incentives in the tax code encourage people to insure against predictable and routine expenses (not just unpredictable, large-scale expenses) and, thus, are less sensitive to the cost of the health care they consume.
- The tax subsidy is generally not available to the uninsured or to individual insurance purchasers.
- Employees may be reluctant to leave their jobs for fear of losing their insurance. Portability of health insurance is increasingly important in today's dynamic labor markets where workers choose to change jobs with increasing frequency.

Simplify the Tax Laws, Reduce Taxpayer Burden and Increase Voluntary Compliance

Simplify the Tax Laws for Families:

The President's budget includes proposals to make the tax code simpler for families with children.

Clarify the Uniform Definition of a Child. A taxpayer may be eligible to claim a qualifying child for various tax benefits, including the dependent exemption, head of household filing status, the child tax credit, the child and dependent care tax credit, and the earned income tax credit (EITC). The 2004 tax relief act created a uniform definition of qualifying child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. However, the 2004 tax relief act had some unintended consequences. To ensure that deserving taxpayers receive child-related tax benefits, the President's FY 2007 Budget proposes to clarify the uniform definition of a child.

Simplify EITC Eligibility Requirements. To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, and their work and immigration status in the United States. These rules are confusing, require significant record keeping, and are costly to administer. The President's FY 2007 Budget proposes to make certain simplifying changes to these rules.

Reduce Computational Complexity of Refundable Child Tax Credit. Taxpayers with

earned income in excess of $11,300 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About 70% of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of their additional child tax credit. The President's FY 2007 Budget proposes certain changes to the additional child tax credit rules to address these issues.

AMT Relief

The President's FY 2007 Budget proposes to temporary provisions in current law for one year, through 2006, to address the rapid rise in the number of taxpayers affected by the AMT in the near term. The Administration believes that a longer term solution to the problems associated with the individual AMT should be addressed within the context of fundamental tax reform.

The alternative minimum tax (AMT) imposes substantial burdens upon taxpayers who were not the originally intended targets of the individual AMT. A temporary provision, effective through 2005, increased the AMT exemption amounts to $40,250 for a single taxpayer, and $58,000 for a married couple filing a joint return. Beginning in 2006, the AMT exemption amounts decline to $33,750 for a single taxpayer, and $45,000 for a married couple filing a joint return. Another temporary provision effective through 2005, permits nonrefundable personal tax credits to offset both regular tax and the AMT.

Without any change in the tax law, the number of taxpayers subject to the AMT would increase by 20.4 million (from 5.5 million in 2005 to 25.9 million in 2006).

Improving Voluntary Compliance with the Tax Laws

While the vast majority of American taxpayers pay their taxes timely and accurately, the nation still has a significant tax gap -- the difference between what taxpayers should pay and what they actually pay on a timely basis. The net so-called "tax gap" is roughly $300 billion annually (15 percent of all taxes collected) and means that taxes are higher for compliant taxpayers. In an effort to reduce the tax gap with minimum taxpayer burden, the President's FY 2007 Budget proposes to:

- Clarify the circumstances in which employee leasing companies and their clients can be held jointly liable for Federal employment taxes.
- Require debit and credit card issuers to report to the IRS gross reimbursements paid to certain businesses.
- Require increased information reporting for certain non-wage payments made by Federal, State and local governments to procure property and services.
- Amend collections due process procedures applicable to Federal employment taxes.
- Expand return preparer identification and penalty provisions.

In addition, the Treasury Department will study the standards used to distinguish between employees and independent contractors for purposes of withholding and paying Federal employment taxes.

Create New Dynamic Analysis Division within Treasury's Office of Tax Policy

In addition to the tax proposals outlined above, the President's FY 2007 Budget would create a new Dynamic Analysis Division within the Treasury Department's Office of Tax Policy. This Division would prepare dynamic analyses of major tax policy changes. Dynamic analysis emphasizes the potential economic benefits of tax changes for increasing and promoting economic growth. It is particularly important for evaluating broad changes to the tax system. Dynamic analysis recognizes a more comprehensive range of behavioral responses to tax changes, including how tax changes affect the size of the economy. The Treasury Department will likely be in a position to conduct a dynamic analysis of the President's tax proposals included in the FY 2007 Mid-Session Review (released in mid-July).

Improve Productivity to Constrain Costs at Internal Revenue Service

The President's FY 2007 Budget proposes an IRS operating budget of more than $10.7 billion, supporting the Administration's goal to restrain spending and increase tax receipts. As part of this budget proposal, the IRS will constrain costs by improving productivity, offsetting costs with user fees and other adjustments to operations. The budget proposal would enable the IRS to stay aligned with its strategic plan of balancing service and enforcement and the goal of improving compliance. Toward this end, the budget proposal holds steady resources for both taxpayer service and enforcing tax laws.

-30-

REPORTS

- FY 2007 Blue Book

PRESS ROOM

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 $64,993 million as of the end of that week, compared to $65,622 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	January 27, 2006			February 3, 2006		
TOTAL	65,622			64,993		
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,328	10,856	22,184	11,230	10,691	22,921
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,111	5,267	16,378	11,016	5,188	16,204
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]			7,775			7,621
3. Special Drawing Rights (SDRs) [2]			8,242			8,203
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	January 27, 2006			February 3, 2006		
	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						
	January 27, 2006			February 3, 2006		
	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.

February 7, 2006
JS-4012

Secretary John W. Snow
Opening Statement
The President's FY 2007 Budget
Senate Finance Committee
February 7, 2006

Good morning. Thank you Chairman Grassley, Ranking Member Baucus, for having me here this morning.

I'm pleased to be here today to talk with you about the President's Fiscal Year 2007 budget. This budget represents the President's dedication to fiscal discipline, an efficient federal government and the continuation of a thriving U.S. economy.

Across the board, agencies were asked by the President to look closely at their budgets and make tough decisions, because fiscal restraint is not only necessary for deficit reduction, it is a necessary component of government that is responsible to the people who employ it.

Those tough decisions were made at all levels of government management, and as a result the President's budget holds the growth of discretionary spending below the rate of inflation and cuts spending in non-security discretionary programs below 2006 levels.

The Administration has identified 141 programs that should be terminated or significantly reduced in size because they aren't performing or could perform better with consolidation; they aren't giving taxpayers their money's worth. The savings for the American taxpayer would be 14 billion dollars.

Cutting the programs that aren't working and improving the efficiency of the ones that are is all part of accountability to the taxpayer. To assist lawmakers in this shared effort, the Administration launched ExpectMore.gov, a website that provides candid information about programs that are successful and programs that fall short, and in both situations, what they are doing to improve their performance next year. I encourage the members of this Committee and those interested in our programs to visit ExpectMore.gov, see how we are doing, and hold us accountable for improving.

This budget, with its policies of economic growth and spending restraint, keeps us on track to meet the President's steadfast goal of cutting the deficit in half by 2009.

It also seeks to avoid a tax increase by making the President's tax cuts permanent; I want to take a moment to explain why that is entirely consistent with our deficit-cutting goals.

In short, lower tax rates are good for the economy and a growing economy is good for Treasury receipts. Indeed, our rate of economic growth led to record levels of Treasury receipts in 2005. And, going forward, we project that receipts will rise every year. In 2011 we will again reach, as a percentage of GDP, the levels we've seen over the average of the last 40 years.

And there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. The American economy is now unmistakably in a trend of expansion, and those trend lines can clearly be traced to the enactment of the tax relief.

Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone. We found out on Friday that unemployment has fallen from 4.9 percent to 4.7 percent, running lower than the average for the 1970s, 1980s and 1990s. GDP growth was three and a half percent last year. U.S. equity markets have risen, and household wealth is at an all-time high.

The U.S. is, as the President often notes, the economic envy of the world.

When we look at the underlying fundamentals of the economy, its strength proves deep and solid, and we can see that businesses and workers have every reason to be optimistic about the future.

For example, we see that productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since the end of 2000, faster than any five-year period in the 1970s, 1980s or 1990s.

Household net worth – that's assets minus debts – is a record high, and not just because of housing. Deposits – the money in checking accounts, savings accounts, and money market funds – are at a record high and are larger as a share of disposable income than at any time since 1993. Defaults on residential mortgage loans at commercial banks are at historic lows.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Core inflation remains low, and that's good news for everyone.

Independent private-sector forecasts point to continuing good news, and inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

We are, it appears, witnessing the tipping point on wages – when incomes rise for workers and business combined, but workers once again increase their incomes faster than businesses. Once businesses have been doing well for a while, they ultimately compete those increases in income away by competing harder for labor. The result is higher wages and higher standards of living for workers.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: *why* is our economy performing so well and what can we do to continue these positive trends?

It is a sweeping and important question, so today we'll ask a more focused question: what can our *budget* do, or not do, to keep the economy on track?

The answer to that is twofold: first, control spending. Second, don't increase taxes – let taxpayers keep as much of their money as possible to invest and spend.

And of course I use the term "taxpayer" quite broadly. I ask you to think of the individual and family budgets that benefit from lower taxes, but also of the small-business budgets. Lower marginal rates, for example, help small firms because they tend to file their taxes as individuals, not as corporations. We are proposing to allow small businesses to be able to deduct up to $200,000 of business-expanding investment as a permanent feature of the tax code, for example. This tax benefit encourages expansion and job creation in the sector that produces three-quarters of the nation's net new jobs.

Lower rates and a degree of certainty in the system are absolutely critical to keeping our economy, and our excellent rate of job creation, on track. And I cannot say this strongly enough: we can't beat the budget deficit without a strong economy. Tax increases carry an enormous risk of economic damage and I can tell you today that the President will not accept that risk. He will not accept a tax increase on the

American people.

Fiscal discipline, combined with economic growth, is the correct path to deficit reduction, period, and we cannot let difficult decisions run us off of that path that we know is right.

Our government does, of course, face economic demands that are exceptional, from fighting the war on terror to helping the victims of devastating hurricanes put their lives back together. These are costly events that lead to unwelcome, brief deficits. They should be regarded as temporary as they are entirely surmountable with continued economic strength and spending restraint in the areas where it is possible and appropriate.

The second way for the budget to help keep the economy on track is to focus the taxpayers' precious resources on things that we know will make a difference.

In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: healthcare, energy, and America's competitiveness.

Affordable and Accessible Health Care. The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts – putting patients in charge of their health care – will contribute to this goal. We need to make health insurance portable, make the system more efficient, and lower costs. We also need to level the playing field for individuals and the employees of small business by allowing small businesses to form Association Health Plans.

The expansion of high deductible health plans and HSAs is something I'd particularly like to emphasize. Combined with a high deductible health plan, HSAs allow people to save for future health care expenses while providing immediate protection against catastrophic health expenses. Furthermore, by giving people more control over their health care spending, they offer a more affordable alternative to traditional health insurance.

Today, millions of Americans – many of whom were previously uninsured –are enjoying access to more affordable health insurance because of the increased availability of HSA-qualified HD health plans. These plans are more available and becoming more popular, because saving for health care needs in an HSA now has the same tax advantages as a traditional health insurance plan.

It only makes sense to expand the scope of HSA qualified health insurance by making their premiums deductible from income taxes and payroll taxes when purchased by individuals. This is an important innovation that will significantly reduce the cost of health insurance purchased by individuals, particularly important for working people who don't have a federal income tax liability. As many of my friends on the Democratic side of the aisle have pointed out to me - payroll taxes are one of the most significant tax burdens for the poor. This innovation will enable more individuals to purchase affordable health insurance. Expanding HSAs so that policy holders and their employers can make annual contributions to cover all out-of-pocket costs under their HSA policy will further encourage adoption of qualified HDHP plans.

All told, the President's HSA proposals are projected to increase the number of HSAs from the current projected for 14 million to 21 million.

Advanced Energy Initiative. The President has said that the best way to break America's dependence on foreign sources of energy is through new technology. So the President announced the Advanced Energy Initiative, which provides for a 22 percent increase in clean-energy research at the Department of Energy. This initiative also builds on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

American Competitiveness Initiative. This ambitious strategy by the President will significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

This budget also gives us an opportunity to look at the other ways – in addition to keeping tax rates low – that the federal government can make adjustments that add to a growth-friendly environment for the businesses, entrepreneurs and workers that produce that economic growth. Tax code reform remains a priority for this President and the President's Advisory Panel on Federal Tax Reform provided us this year with a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of our dynamic, 21st century economy. I appreciate the fine work of Senators Mack and Breaux, for their outstanding leadership of the Panel. This issue is also reflected in the budget through the proposed creation of a new Dynamic Analysis Division within Treasury's Office of Tax Policy. Understanding the full range of behavioral responses to tax changes, including how tax changes affect the size of the economy and, subsequently, tax revenues, is critical to designing meaningful, effective tax reform, and we believe this small expenditure will have an enormous pay-off for the American taxpayer.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now.

In closing, I want to point out that a lot of good can come from a smart federal budget, and a considerable amount of harm can come from a bad one. Let's use the FY 2007 budget to make good policy – restrained as the circumstances dictate on spending but aggressive on the expansion of opportunity.

I look forward to working with all of you on enacting this budget. Thank you for having me here today; I'm pleased to take your questions now.

February 1, 2006
JS-4013

Treasurer to Visit Edinburg, Texas to Discuss the U.S. Economy and Financial Education

U.S. Treasurer Anna Escobedo Cabral will travel to Edinburg, Texas on Friday to discuss the U.S. economy and the importance of financial education.

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

Friday, February 3, 2006

1:30 PM CST
Freddy Gonzalez Elementary School
Remarks
2401 South Sugar Road
Edinburg, TX
****Media please rsvp to Sandra Quintanilla at (956) 381-2742 or**
sandraq@panam.edu

6:00 PM CST
Third National Minority Serving Institutions Research Partnerships Conference
Keynote Speech
Hidalgo County Historical Museum
121 East Mcintyre Street
Edinburg, TX
****Media please rsvp to Sandra Quintanilla at (956) 381-2742 or**
sandraq@panam.edu

Treasurer Cabral's bio: http://www.treasury.gov/organization/bios/cabral-e.html
History of the Treasurer's Office: http://www.treas.gov/offices/treasurer/office-history.shtml

January 30, 2006
JS-4014

Under Secretary Adams Meets with AfDB and Local Officials in Tunisia

Following the World Economic Forum in Davos, Switzerland, Treasury International Affairs Under Secretary Tim Adams traveled to Tunis, Tunisia to meet today with local finance and African Development Bank (AfDB) officials.

Adams met with AfDB President Kaberuka, AfDB U.S. Executive Director Cynthia Perry, and the AfDB Board of Directors to discuss the economic challenges and opportunities Africa faces and the role of the U.S. and AfDB in promoting growth and development. He also met with African ambassadors based in Tunisia, as well as Tunisian Minister of Development and International Cooperation, Mohamed Nouri Jouini.

"I'm very pleased to be in Tunis to demonstrate the United States' strong support for the critically important work of the African Development Bank," said Adams. "President Kaberuka is bringing some important new ideas and energy to the bank, and we very much support efforts to enhance the Bank's work in the private sector, and deliver real results to the African people that need them most and fight corruption – which acts like a tax on the poor - inside or outside the Bank."

Adams discussed with local media the U.S.'s support for President Keberuka's efforts to make the Bank more effective and efficient as well as the U.S.'s strong aid and development commitments in the region. The U.S. is the largest provider of development assistance to sub-Saharan Africa. Since 2000, U.S. assistance has tripled – from $1.1 billion to $3.5 billion in 2004 – with assistance going to 32 countries at least doubling in this period.

February 8, 2006
JS-4016

Treasury Designates UK-Based Individuals, Entities Financing Al Qaida-Affiliated LIFG

The U.S. Department of the Treasury today designated five individuals and four entities for their role in financing the Libyan Islamic Fighting Group (LIFG), an al Qaida affiliate known for engaging in terrorist activity in Libya and cooperating with al Qaida worldwide.

"The Libyan Islamic Fighting Group threatens global safety and stability through the use of violence and its ideological alliance with al Qaida and other brutal terrorist organizations," said Patrick O'Brien, the Treasury's Assistant Secretary for Terrorist Financing and Financial Crime. "Through a sophisticated charitable front operation and other companies, the individuals designated today have financially supported LIFG's activities."

Today's designation, which is carried out by the Treasury's Office of Foreign Assets Control (OFAC), was executed under Executive Order 13224, an authority that targets the assets of terrorists and their financiers.

The individuals and entities supported the LIFG through various financial means, primarily in the United Kingdom. The LIFG was formed in the early 1990s in Afghanistan, and formally announced its existence in 1995. The group relocated to Libya where it sought to overthrow Mu'ammar Qadhafi and replace his regime with a hard-line Islamic state. The LIFG mounted several operations inside Libya including a 1996 attempt to assassinate Qadhafi, but these failed to topple the regime. Following a Libyan government security campaign against LIFG in the mid- to late 1990s, the group abandoned Libya and continued its activities in exile.

The group is part of the wider al Qaida-associated movement that continues to threaten global peace and security. Accordingly, LIFG was designated pursuant to Executive Order 13224 on September 23, 2001. On October 6, 2001, the United Nations Security Council also added LIFG to its consolidated list of entities associated with al Qaida.

Identifying Information

Abd Al-Rahman Al-Faqih
AKAs: Mohammed Albashir
Muhammad Al-Bashir
Bashir Mohammed Ibrahim al-Faqi
Al-Basher Mohammed
Abu Mohammed
Mohammed Ismail
Abu Abd Al Rahman
Abd Al Rahman Al-Khatab
Mustafa
Mahmud
Abu Khalid
DOB: December 15, 1959
POB: Libya
ADDRESS: Birmingham, United Kingdom

Abd al-Rahman al-Faqih is a senior leader of the LIFG and is involved in the provision of false passports and money to LIFG members worldwide.

Al-Faqih has been tried and found guilty in absentia by the Rabat, Morocco Criminal Court of Appeals for his involvement in the series of suicide bombings in

Casablanca, Morocco on May 16, 2003 that killed over 40 people and caused more than 100 injuries. It was strongly suspected that the Moroccan Islamic Combat Group (GICM) carried out that attack. GICM was designated pursuant to Executive Order 13224 on November 22, 2002.

Al-Faqih has a history of GICM-related activity, notably representing the LIFG during meetings held in Turkey in the late 1990s with GICM. During these meetings, LIFG agreed to host weapons training and jihad indoctrination at LIFG camps in Afghanistan for Moroccans.

Ghuma Abd'rabbah
AKAs: Ghunia Abdurabba
Ghoma Abdrabba
Abd'rabbah
Abu Jamil
DOB: September 2, 1957
POB: Benghazi, Libya
NATIONALITY: British
ADDRESS: Birmingham, United Kingdom

Ghuma Abd'rabbah is an associate of LIFG leader Abd' al-Rahman al-Faqih. Abd'rabbah is "Charity Correspondent" and one of three trustees for Sanabel Relief Agency Limited (SRA), an international charity organization controlled by the LIFG and used to transfer documents and funds for terrorist activities overseas. SRA was also designated today.

Abdulbaqi Mohammed Khaled
AKAs: Abul Baki Mohammed Khaled
Abd' al-Baki Mohammed
Abul Baki Khaled
Abu Khawla
DOB: August 18, 1957
POB: Tripoli, Libya
NATIONALITY: British
ADDRESS: Birmingham, United Kingdom

Abdulbaqi Mohammed Khaled is a member of the LIFG and was a director of SRA.

Tahir Nasuf
AKAs: Tahir Mustafa Nasuf
Tahar Nasoof
Taher Nasuf
Al-Qa'qa
Abu Salima El Libi
Abu Rida
DOB: November 4, 1961
ALT. DOB: April 11, 1961
POB: Tripoli, Libya
ADDRESS: Manchester, United Kingdom

Tahir Nasuf is a middle-ranking member of the LIFG. He was previously associated with senior UK-based Libyans tied to the al-Qaida-affiliated Armed Islamic Group (GIA). The GIA was designated pursuant to Executive Order 13224 on September 23, 2001.

Nasuf is one of three trustees and a director of SRA.

Mohammed Benhammedi
AKAs: Mohamed Hannadi
Mohamed Ben Hammedi
Muhammad Muhammad Bin Hammidi
Ben Hammedi
Panhammedi
Abu Hajir
Abu Hajir Al Libi
Abu Al Qassam
DOB: September 22, 1966

POB: Libya
NATIONALITY: Libyan
ADDRESS: Midlands, United Kingdom

Mohammed Benhammedi is a key financier for the LIFG and believed to provide funds for the LIFG through Sara Properties Limited, Meadowbrook Investments Limited and Ozlam Properties Limited. These three businesses were also designated today. Benhammedi is also a member of what was identified as the LIFG economic committee.

During Operation Enduring Freedom, in early 2002, Benhammedi was detained, along with several others, by Iranian officials when he attempted to illegally enter Iran from Afghanistan.

Sara Properties Limited
AKA: Sara Properties
ADDRESS 1: 104 Smithdown Road, Liverpool, Merseyside L7 4JQ (United Kingdom)
ADDRESS 2: 2a Hartington Road, Liverpool L8 0SG (United Kingdom)
WEBSITE: http://www.saraproperties.co.uk
REGISTRATION #: 4636613

Sara Properties Limited is a real estate agency trading in residential property sale and leasing. Mohammed Benhammedi, the co-director of Sara Properties Limited, is a 75 percent shareholder of Sara Properties Limited and the owner of the Internet domain for the Sara Properties Limited website. Through his ownership of several businesses in the UK, including Sara Properties Limited, Benhammedi is known to provide funds for the LIFG.

Meadowbrook Investments Limited
ADDRESS: 44 Upper Belgrave Road, Clifton, Bristol, BS8 2XN (United Kingdom)
COMPANY #: 05059698

Meadowbrook Investments Limited is registered as a Bristol-based real estate company. Mohammed Benhammedi is a director of Meadowbrook Investments Limited and has been in that position since April 27, 2004. Through his ownership of several businesses in the UK, including Meadowbrook Investments Limited, Benhammedi is known to provide funds for the LIFG.

Ozlam Properties Limited
ADDRESS: 88 Smithdown Road, Liverpool, L7 4JQ (United Kingdom)
REGISTRATION #: 05258730

Ozlam Properties Limited, a property company, is co-directed by Mohammed Benhammedi. He was appointed director on October 13, 2005. Through his ownership of several businesses in the UK, including Ozlam Properties Limited, Benhammedi is known to provide funds for the LIFG.

Sanabel Relief Agency Limited
AKAs: Sanabel Relief Agency
Sanabel l'il-Igatha
SRA
SARA
Al-Rahama Relief Foundation Limited
ADDRESS 1: 63 South Rd, Sparkbrook, Birmingham B11 1EX (United Kingdom)
ADDRESS 2: 1011 Stockport Rd, Levenshulme, Manchester M9 2TB (United Kingdom)
ADDRESS 3: P.O. Box 50, Manchester M19 2SP (United Kingdom)
ADDRESS 4: 98 Gresham Road, Middlesbrough (United Kingdom)
ADDRESS 5: 54 Anson Road, London, NW2 6AD (United Kingdom)
WESBITE: http://www.sanabel.org.uk
EMAIL: info@sanabel.org.uk
CHARITY #: 1083469
REGISTRATION #: 3713110

SRA was incorporated on February 12, 1999, and subsequently registered with the UK charity commission on November 17, 2000 as a charity with objectives "to

relieve poverty, sickness and distress and to advance education of persons who are in need of such relief as a result of a natural disaster in particular, but not exclusively, by the provision of funds."

While SRA characterizes itself to the public as a charitable organization, its first priority is providing support to the LIFG's jihadist activities. LIFG's fundraising charity is SRA, which is controlled by leaders of the LIFG. Directors of SRA use the charity as a vehicle to transfer money and documents for terrorist activities overseas.

Prior to September 11, 2001, SRA had an office in Taliban-ruled Afghanistan, where the former head of SRA in Kabul was known to have ties to the LIFG. He was later believed to be arrested in Pakistan with three other LIFG members and al Qaida leader Abu Zubaydah. Further, the director of SRA in Afghanistan received help from senior LIFG facilitator, Adnan al-Libi.

These individuals and entities were designated today pursuant to Executive Order 13224 chiefly pursuant to paragraphs (d)(i) and (d)(ii) based on a determination that they assist in, sponsor or provide financial, material, or technological support for, or financial or other services to or in support of, or are otherwise associated with, persons listed as subject to E.O. 13224.

Blocking actions are critical to combating the financing of terrorism. When an action is put into place, any assets existing in the formal financial system at the time of the order are to be frozen. Blocking actions serve additional functions as well, acting as a deterrent for non-designated parties who might otherwise be willing to finance terrorist activity; exposing terrorist financing "money trails" that may generate leads to previously unknown terrorist cells and financiers; disrupting terrorist financing networks by encouraging designated terrorist supporters to disassociate themselves from terrorist activity and renounce their affiliation with terrorist groups; terminating terrorist cash flows by shutting down the pipelines used to move terrorist-related assets; forcing terrorists to use alternative and more costly and higher-risk means of financing their activities.

The United States is also taking action today pursuant to United Nations Security Counsel Resolution 1617, which requires member states to financially isolate individuals and entities added to the UN 1267 Committee's consolidated list of terrorists tied to the Taliban, al Qaida and UBL.

February 9, 2006
JS-4019

U.S. TREASURER TO VISIT BOSTON AREA TO DISCUSS FINANCIAL EDUCATION AND THE IMPORTANCE OF SAVINGS

U.S. Treasurer Anna Escobedo Cabral will travel to Dorchester, Mass. this Friday to discuss financial education and the importance of savings. While in Dorchester, Treasurer Cabral will visit the TechBoston Academy at the Dorchester Education Complex where she will deliver keynote address to TechBoston Academy staff and students. The following event is open to credentialed media:

WHO
U. S. Treasurer Anna Escobedo Cabral
Treasurer Cabral's bio: http://www.treasury.gov/organization/bios/cabral-e.html
History of the Treasurer's Office: http://www.treas.gov/offices/treasurer/office-history.shtml

WHAT
Keynote address at TechBoston Academy

WHEN
Friday, February 10, 10 a.m. (EST)

WHERE
9 Peacevale Road
Dorchester, MA
NOTE Media should RSVP to Erica Johnson at (704) 378-1354

PRESS ROOM

February 9, 2006
JS-4020

TREASURY TO HOLD MEDIA BRIEFING ON PROPOSED DIVISION OF DYNAMIC ANALYSIS

U.S. Treasury Deputy Assistant Secretary for Tax Analysis Robert Carroll will host a media briefing to explain and answer questions regarding the further development of its new Division of Dynamic Analysis, as proposed in the FY2007 Budget.

WHO
Deputy Assistant Secretary for Tax Analysis Robert Carroll

WHAT
The President's FY 2007 Budget proposed to create a new Dynamic Analysis Division within the Treasury Department's Office of Tax Policy. The Deputy Assistant Secretary will provide comments on the further development of the new division and how it would prepare dynamic analyses of major tax policy changes.

WHEN
Friday, February 10, 11:00 – 11:30 a.m. (EST)

WHERE
Media Room – Main Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220

NOTE
***Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number and date of birth.**

February 9, 2006
2006-2-9-15-38-29-7838

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 $64,993 million as of the end of that week, compared to $65,622 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	January 27, 2006			February 3, 2006		
TOTAL	65,622			64,993		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,328	10,856	22,184	11,230	10,691	21,921
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,111	5,267	16,378	11,016	5,188	16,204
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]			7,775			7,621
3. Special Drawing Rights (SDRs) [2]			8,242			8,203
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	January 27, 2006			February 3, 2006		
	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						
	January 27, 2006			February 3, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						

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

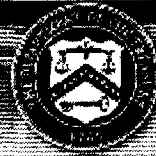
Notes:

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

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

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

PRESS ROOM



February 10, 2006
JS-4021

Treasury Assistant Secretary to Hold Weekly Press Briefing

U.S. Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, February 13 in Treasury's Media Room. The event is open to all credentialed media.

Who
Assistant Secretary for Public Affairs Tony Fratto

What
Weekly Briefing to the Press

When
Monday, February 13, 11:00 AM (EST)

Where
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

Note: Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

February 10, 2006
js-4022

Treasury Official to Visit Louisville to Discuss the U.S. Economy and American Competitiveness

Deputy Assistant Secretary for Critical Infrastructure Protection D. Scott Parsons will visit Louisville, Kentucky Monday to discuss the President's agenda to maintain the economy's momentum and the American Competitiveness Initiative which is aimed to encourage American innovation and strengthen our nation's ability to compete in the global economy. This ambitious strategy will increase federal investment in critical research, ensure that the United States continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science. The American Competitiveness Initiative commits $5.9 billion in FY 2007, and more than $136 billion over 10 years, to increase investments in research and development (R&D), strengthen education, and encourage entrepreneurship and innovation. While in Louisville, Deputy Assistant Secretary Parsons will give remarks to the Greater Louisville Inc. The following event is open to credentialed media:

Who: Deputy Assistant Secretary for Critical Infrastructure Protection
D. Scott Parsons

Deputy Assistant Secretary Parsons' bio

What: Remarks to the Greater Louisville Inc.

When: Monday, February 13, 11:30 a.m. (EST)

Where: Federal Reserve Bank of St. Louis
101 South Fifth Street
Suite 1920 (National city Tower)
Louisville, KY

Note: Media must RSVP to Leslie Dorris at (502) 625-0012 or
LDorris@GreaterLouisville.com

Treasury Officials

< BACK

D. Scott Parsons
Deputy Assistant Secretary
Office of Critical Infrastructure Protection and Compliance Policy

Open Print Version

D. Scott Parsons was appointed Deputy Assistant Secretary for Critical Infrastructure Protection and Compliance Policy in June 2004. In this position, Mr. Parsons is responsible for ensuring the resilience of the critical physical and cyber infrastructures of the financial services sector, implementing Bank Secrecy Act regulations, and identifying means to protect personal financial information, privacy, and identity theft. The office also provides daily staff support to the Financial and Banking Information Infrastructure Committee (FBIIC), a standing committee of the President's Working Group on Financial Markets. He previously served as Senior Advisor to the Assistant Secretary for Management and Chief Financial Officer.

Mr. Parsons has a record of accomplishment and leadership in the public and private sectors. He returned to Washington, DC in 2002, after working for more than a decade in the finance and technology industries. He served in management positions with Xerox Corporation, Digital Equipment Corporation and Compaq Computer Corporation. During his tenure at Compaq, Mr. Parsons was responsible for the launch of a joint venture among Compaq, Cable & Wireless and Microsoft. He was also responsible for building a new go-to-market model for the startup application service provider, and led a cross functional rapid action team that re-engineered all aspects of business processes including financial management, marketing communications, professional services processes and support, product viability, and operational capabilities.

Mr. Parsons studied business at the University of Kentucky where he earned a bachelor degree in finance.

His community involvement includes serving as a partner for Cornerstone, a school dedicated to providing academic excellence for high-potential, underprivileged children in Washington, D.C.

Last Updated: February 13, 2006

PRESS ROOM

February 11, 2006
JS-4023

TREASURY SECRETARY JOHN W. SNOW PREPARED STATEMENT FOLLOWING THE MEETING OF THE G-8 FINANCE MINISTERS

Good afternoon. We had an excellent meeting with G-8 Finance Ministers today, hosted for the first time by Russia and Minister Kudrin. We also had the opportunity to have a working lunch meeting with President Putin. I think we all benefited from the discussion that included a review of G-8 agenda. The primary purpose of the meeting today was to set the financial agenda for the G-8 Leaders Summit. Based on the thorough preparation by Minister Kudrin and his staff, I think the leaders of the G-8 countries will have a meaningful and productive meeting in July.

I appreciated the hospitality of our hosts this weekend and look forward to a successful Russian Presidency.

Our first concern is strengthening economic growth. The U.S. economy continues to be a major driver of the global economy, with solid growth expected to continue in 2006. I was able to report to the ministers that the U.S. unemployment rate fell to 4.7 percent, which returns us to pre-September 11 levels. Inflation has been restrained despite pressure from high energy prices. The budget deficit fell in the past fiscal year, but the U.S. recognizes that there is still much more hard work to be done to bring it down in the medium- to long-term. The deficit will likely widen this fiscal year due to spending on hurricane recovery, but we are committed to meeting President Bush's goal of cutting the deficit in half to about 2% of GDP by the end of his term. I have every expectation that we will meet that goal.

The global economy remains strong and there are signs that the expansion will continue. However, relative growth performance, especially among the larger economies, continues to be uneven. More progress is needed to implement reform policies that will raise growth potential and promote high sustainable growth of the world economy. All countries, including the United States, but also the countries of Europe, Japan, developing Asia and even the oil exporters, bear a responsibility to help effect global adjustment in a way that maximizes and sustains global growth. I continue to emphasize to my colleagues the importance of this shared responsibility.

The positive outlook for the world economy makes this an opportune time to push for progress on trade liberalization. The potential rise of protectionism represents the most significant risk to the global economy. In our discussions, we saw clearly the need to obtain an ambitious outcome from the Doha Development Round by the end of 2006. I welcomed progress made at the Hong Kong Ministerial meeting but recognize that further urgent efforts are necessary. We need to make significant progress on market access in agriculture and industrial products. In addition, if this round is to be truly development-focused, substantial progress on services is essential, since gains from services liberalization are estimated to be over four times greater than the gains from goods trade alone. Financial services trade, in particular, is important because it acts as a link to increased economic growth and development.

I think this it's appropriate that Minister Kudrin is placing a heavy emphasis on energy security in these discussions because of the risk high energy prices pose for the global economy. There are many sides to energy security, but, as Finance Ministers, we emphasized market-based solutions, transparency, and the institutional framework necessary to encourage a friendly investment climate in energy development and infrastructure. Energy is a high priority issue for President Bush, and I had the opportunity to review his ambitious new Advanced Energy Initiative to increase clean-energy research at the U.S. Department of Energy. In developing countries the lack of energy access is a critical obstacle to development.

We were all pleased with the recent implementation of the G-8 debt agreement at the IMF. As a result, 19 poor countries have received 100 percent irrevocable IMF debt cancellation. Ministers had extensive discussions on the importance of moving ahead with implementation at the World Bank and the African Development Bank. We noted the unprecedented commitment provided to ensure that the Bank's financial integrity remains unchanged – including specific commitments by G-8 Heads of State to provide additional contributions to offset foregone debt repayments on a dollar-for-dollar basis. The G-8 ministers encouraged World Bank President Wolfowitz to seize upon the shareholder agreement reached during the Annual Meetings and bring forward an acceptable final package for approval in the very near future.

Ministers also discussed ways to address infectious diseases, which have a significant economic impact on developed and developing economies. We continued our discussion of the concept of Advance Market Commitments (AMCs) for vaccines and agreed to continue to work toward developing a workable proposal. We also discussed efforts currently underway to prevent the further spread of Avian influenza. The spread of this virus has potentially severe human and economic impacts, and we agreed that every nation must take all necessary steps to help prevent a pandemic from occurring and to help mitigate its impact.

A key item on the agenda was fighting the financing of terrorism and illicit finance. Under Russia's leadership, we committed to push forward implementation of the action plan adopted last year. This means continuing to improve multilateral asset freezing systems and to enhance information sharing. It also means enhancing our financial tools for taking multilateral action against illicit activity like weapons of mass destruction (WMD) networks. The fight against AML/CFT is a global undertaking, and we support the IMF and WB's continued commitment to this effort as a regular part of their work. It will be particularly important that the IMF's commitment not waiver as a result of its internal AML/CFT reorganization.

PRESS ROOM

February 13, 2006
JS-4044

U.S. Treasury Names Chief Economist for International Affairs

The Treasury Department announced today that Marvin J. Barth has been named Chief Economist for International Affairs and Director of Research and Risk Analysis. He brings to the Department a breadth of international experience from public, private and multilateral institutions, with a strong background in economics, finance, and markets.

Prior to joining the Department of the Treasury, Barth was the Global Currency Economist at Citigroup (2003-2006), where he was responsible for fundamental analysis of major currency markets, forecasting exchange rates, and advising Citigroup's top financial and corporate customers on risks and opportunities in foreign exchange markets. As an Economist in the Division of International Finance at the Federal Reserve Board (1998-2001 and 2002-2003), Barth monitored all non-U.S. financial markets and reported to the Board on developing risks, with an emphasis on emerging markets. Early in his tenure at the Board, Barth analyzed and forecast real economic developments in Southeast Asian economies. From 2001-2002, Barth was a visiting scholar at the Bank for International Settlements in Basel, Switzerland, where he studied developments in the global economy and financial markets.

Barth's education in Economics includes a Ph.D. (1998, University of California, San Diego), an M.A. (1996, University of California, San Diego), and a B.A. (1992, University of California, Berkeley).

This is a new position in the International Affairs Office.

PRESS ROOM

February 13, 2006
js-4045

Remarks of U.S. Treasury Assistant Secretary for International Affairs Clay Lowery before the National Center for the Asia-Pacific Economic Cooperation

Seattle, Wash. – Thank you for having me here today. This is my first visit to Seattle since I was confirmed last fall as the Assistant Secretary for International Affairs at the Treasury Department. In that job it is my responsibility to help represent the economic interests of the American people to the world.

I especially appreciate the opportunity to speak at the National Center for APEC. APEC is the cornerstone of American involvement in Asia. The rest of the country is coming to realize what the Pacific coast has long known, our economic relationship with Asia is critical to our economic strength and prosperity. As competition from Asia increases, it is all the more important that America implements the right policies here at home. Turning to isolationism and retreating behind protectionist trade barriers is not the answer.

In his State of the Union Address two weeks ago, President Bush set out a positive agenda for America in a competitive global economy. I am here to echo that same message so that there will be no doubt that America can and will compete with confidence and extend our economic leadership in the world.

First, let's take stock of where we are. The American economy is healthy and growing. In the last two and a half years, the economy has created more than 4.7 million new jobs – more than Japan and the European Union combined. The unemployment rate has fallen to 4.7 percent – lower than the average for the 1970s, 1980s, and 1990s. And GDP growth was a solid 3.5 percent in 2005 while core inflation remains low.

When you look at the underlying fundamentals of the economy, it's plain to see that this strength is deep and solid. Productivity growth is strong, growing 3.2 percent since the end of 2000, which is faster than any five-year period in the 1970s, 1980s, or 1990s. Inflation-adjusted hourly wages are growing – registering over 1.5 percent between September and December, a trend that is expected to continue.

Household net worth – that's assets minus debts – is at a record high, and not just because of housing. Deposits – the money in checking accounts, savings accounts, and money market funds – are at a record high and are larger as a share of disposable income than at any time since 1993. Defaults on residential mortgage loans at commercial banks are at historic lows.

In the State of the Union address the President laid out a broad agenda for maintaining this strength, including: reducing health care costs; improving education; reforming our legal system; breaking America's dependence on oil; reducing non-security, discretionary spending; and making the tax cuts permanent.

To provide one example, a centerpiece of American competitiveness is our rapid development and adoption of technology to improve efficiency and create entirely new fields of human industry. Here in the Pacific Northwest you know a bit about technological innovation. To support the innovative heart of the American economy, the President has announced $5.9 billion in his 2007 Budget to increase investments in research and development, strengthen education, and encourage entrepreneurship. These investments in things like basic research will help keep America on the technological cutting edge.

In addition, the President emphasized the importance of reforming our immigration system and opening markets for American trade. Let me discuss each of these in more detail.

On trade, this Administration has pursued an aggressive bilateral and multilateral agenda for opening new markets to American goods and services. The Treasury Department is a full participant in the Administration's trade agenda, focusing on services, especially financial services where we have the lead responsibility within the U.S. government.

The first five years of the Bush Administration have seen a rapid expansion of America's trade liberalization efforts. In 2001, the U.S. was party to only a handful of free trade agreements. Today we have completed or are in serious negotiations for FTAs with over 30 countries, including several in the Asia-Pacific region. We have signed FTAs with Australia and Singapore and are working toward an agreement with Thailand. Washington is witnessing firsthand the benefits of free trade, with Singapore becoming one of the fastest growing export markets for the state's goods and services. And just two weeks ago we announced that we are starting negotiations with South Korea, America's seventh largest trading partner.

The fact is that these agreements are creating export opportunities for Americans and lowering the costs of imports for Americans here at home. U.S. exports to FTA partners grew at an average annual rate of almost 21 percent between 2001 and 2005, while exports to non-FTA partners grew only 10 percent over that period.

While we continue to pursue openings bilaterally and through regional agreements like the Central America Free Trade Agreement, we are also focused on making progress in the WTO's Doha Round of trade negotiations. To put the importance of the Doha Round to the American economy into context, the University of Michigan recently did a study showing that if the Doha round is successful, there could be a dramatic impact on annual incomes here in the United States. The study concluded that if we eliminate trade barriers all together that a family of four would see a $7,500 per year increase in their income. If we were to just reduce barriers by one-third, then we would have a $2,500 annual income gain for an American family of four.

The reason for these benefits is that America can compete with anyone in the international economy, and we are especially competitive in services and manufacturing. In services we have almost a $50 billion surplus. In the Asia-Pacific region alone, sales of services by foreign affiliates of U.S. multinationals have more than doubled since 1996.

At Treasury, we take the lead on promoting financial services in the Trade Agenda. Financial services account for over 8 percent of U.S. GDP – more importantly, financial services have grown in importance by roughly 70 percent since 1980. For this reason, Treasury continues to pursue an the lifting of sector caps to allow more competition from U.S. industry in places like China, India, Korea, and Thailand.

With a comparatively low average tariff on manufactured goods of about 4.5%, we have very little to give up and a great deal to gain from increased liberalization. The United States continues to be the number one exporter of manufactured products in the world. The state of Washington is the fifth largest merchandise exporter in the country and export-related jobs account for one in nine jobs in the private sector here.

There is still a great deal to be done to complete the Doha Round, but this Administration is committed to success, because all the American worker needs to succeed is a level playing field.

In conclusion, there are a lot of reasons to be optimistic about the American economy. The government is doing its part, making sure that the fundamentals for growth are in place and keeping the burden of taxation low so the rewards for risk taking remain high. As the President has said, Americans should not fear the future, because we are shaping it.

Thank you, I'd be happy to take a few questions.

-30-

PRESS ROOM

February 13, 2006
2006-2-13-17-29-54-22010

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 $64,943 million as of the end of that week, compared to $64,993 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	February 3, 2006			**February 10, 2006**		
TOTAL	**64,993**			**64,943**		
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,230	10,691	21,921	11,148	10,804	21,952
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,016	5,188	16,204	10,929	5,246	16,175
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]			7,621			7,597
3. Special Drawing Rights (SDRs) [2]			8,203			8,176
4. Gold Stock [3]			11,043			11,043
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	February 3, 2006			February 10, 2006		
	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						
	February 3, 2006			February 10, 2006		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						

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

Notes:

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

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

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

PRESS ROOM

February 13, 2006
JS-4046

Tax Relief Legislation

U.S. Treasury Secretary Snow will be joined by Senators Allard (R-CO) and Bennett (R UT) for a press conference to discuss the benefits of Congress passing tax relief legislation. The press conference will take place in the Dirksen Senate Office Building on Capitol Hill prior to the Secretary's testimony before the Senate Budget Committee.

Who: U.S. Secretary John Snow

What: Press conference to discuss benefits of Congress passing tax relief legislation.

When: Tuesday, February 14, 9:30 - 9:45 a.m. (EST)

Where: Dirksen Senate Office Building
6th Floor Center Hallway/Elevator Alcove
Washington, DC

-30-

PRESS ROOM

February 14, 2006
js-4047

U.S. Treasury Secretary John W. Snow Statement Retail Sales and U.S. Economic Strength

"Today's report on retail sales is yet another unmistakable sign that the U.S. economy is strong, it is heading in the right direction and Americans are confident. With a jump of 2.3 percent for January, this was one of the biggest month-to-month increases in over a decade and a half.

"Today's news is what we expect to see when consumers are confident about the economy and optimistic about the future. And it is no wonder they are feeling that way, given the strength in the job market, with low unemployment, new claims for unemployment insurance at the lowest level since the peak of the high-tech boom and real wages rising.

"There can be no question that the American economic expansion is continuing and that's good news for the American people. But, to remain on this positive path we must maintain the good economic policies that led us here. Low tax rates on income and investment must be made permanent. Now is not the time for a tax increase."

PRESS ROOM

February 14, 2006
js-4048

The Honorable John W. Snow
Statement on Extension Lower Tax Rate
on Capital Gains and Dividends

"I commend the U.S. Senate for resisting misguided calls to increase taxes. Today's Senate vote to support an extension of the President's lower rates on capital gains and dividends was a step in the right direction toward lower tax rate permanency, which is vital to maintaining the strength of the American economy: 3.5 percent growth rate, more than 4.7 million new jobs, and unprecedented Federal revenues of $2.15 trillion.

"We know that you always get less of something you tax. By lowering the taxes on capital, the Jobs and Growth Act of 2003 encourages increased long-term investment. Increased long-term investment in turn improves the long-turn outlook of the economy. It makes the economy more productive. With additional capital, labor output rises. And with rising labor output the demand for labor increases and living standards rise.

"Since the President signed the Jobs and Growth Act of 2003, we have seen a remarkable turn-around in the US economy, and unemployment is quite low. After nine consecutive declining quarters of real annual business investment, we have had ten straight quarters of rising business investment. While many factors contributed to the improved performance of the economy, the tax reductions on capital have been at the heart of the progress we have seen. By lowering the cost of capital the President's proposals improved the inherent efficiency of the economy, and this will prove effective for both the short and long term.

"I encourage the House and Senate Conferees to extend the 15 percent rate on capital gains and dividends that was put in place by the Jobs and Growth Act of 2003 indefinitely. Congress owes this to all Americans who benefit from a strong and growing economy.

"If Congress fails to extend the 15% rate on capital gains and dividends, the effective increase would strike at the heart of the American economy with damaging long-term effects on economic growth. A slow down in investment would be inevitable, and a slow-down in job growth more than likely to follow."

-30-

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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February 15, 2006
JS-4049

Treasury International Capital Data for December

Treasury International Capital (TIC) data for December are released today and posted on the U.S. Treasury web site (www.treas.gov/tic
date, which will report on data for January, is scheduled for March 15, 2006.

Net foreign purchases of long-term securities were $56.6 billion.

- Net foreign purchases of long-term domestic securities were $74.2 billion, $10.4 billion of which were net purchases by foreign c $63.8 billion of which were net purchases by private foreign investors.
- U.S. residents purchased a net $17.6 billion in foreign issued securities.

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

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

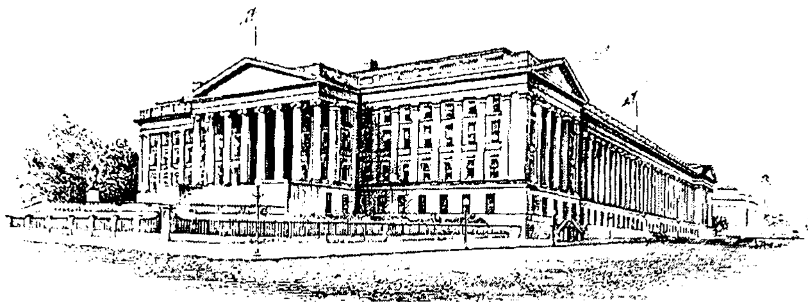
		2003	2004	2005	Sep-	Oct-	Nov-
1	Gross Purchases of Domestic Securities	13526.0	15178.9	17049.2	1654.1	1445.7	14[illegible]
2	Gross Sales of Domestic Securities	12806.1	14262.4	16000.7	1538.6	1336.9	13[illegible]
3	**Domestic Securities Purchased, net** (line 1 less line	**719.9**	**916.5**	**1048.5**	**115.5**	**108.8**	**1[illegible]**
4	**Private, net /2**	**585.0**	**680.9**	**933.7**	**111.2**	**95.9**	[illegible]
5	Treasury Bonds & Notes, net	159.7	150.9	289.6	22.9	25.0	[illegible]
6	Gov't Agency Bonds, net	129.9	205.7	192.6	18.6	28.7	
7	Corporate Bonds, net	260.3	298.0	372.9	47.7	34.4	[illegible]
8	Equities, net	35.0	26.2	78.7	22.0	7.8	
9	**Official, net**	**134.9**	**235.6**	**114.7**	**4.3**	**13.0**	
10	Treasury Bonds & Notes, net	103.8	201.1	61.2	-1.1	4.9	
11	Gov't Agency Bonds, net	25.9	20.8	34.2	2.2	6.2	
12	Corporate Bonds, net	5.4	11.5	18.9	2.2	1.7	
13	Equities, net	-0.3	2.2	0.5	1.0	0.2	
14	Gross Purchases of Foreign Securities	2761.8	3123.1	3688.9	319.4	374.3	3[illegible]
15	Gross Sales of Foreign Securities	2818.4	3276.0	3826.8	335.6	377.5	3[illegible]
16	**Foreign Securities Purchased, net** (line 14 less line	**-56.5**	**-152.8**	**-137.8**	**-16.2**	**-3.2**	**-[illegible]**
17	Foreign Bonds Purchased, net	32.0	-67.9	-16.2	-9.7	2.8	
18	Foreign Equities Purchased, net	-88.6	-85.0	-121.6	-6.5	-6.0	-[illegible]

19	**Net Long-Term Flows** (line 3 plus line 16)	**663.3**	**763.6**	**910.7**	**99.3**	**105.6**

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

REPORTS

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



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9 A.M. (EST) February 15, 2006
CONTACT Brookly McLaughlin (202) 622-1996

TREASURY INTERNATIONAL CAPITAL DATA FOR DECEMBER

Treasury International Capital (TIC) data for December 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 January, is scheduled for March 15, 2006.

Net foreign purchases of long-term securities were $56.6 billion.

- Net foreign purchases of long-term domestic securities were $74.2 billion, $10.4 billion of which were net purchases by foreign official institutions and $63.8 billion of which were net purchases by private foreign investors.
- U.S. residents purchased a net $17.6 billion in foreign issued securities.

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

		2003	2004	2005	Sep-05	Oct-05	Nov-05	Dec-05
1	Gross Purchases of Domestic Securities	13526.0	15178.9	17049.2	1654.1	1445.7	1426.6	1207.7
2	Gross Sales of Domestic Securities	12806.1	14262.4	16000.7	1538.6	1336.9	1320.9	1133.5
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**719.9**	**916.5**	**1048.5**	**115.5**	**108.8**	**105.7**	**74.2**
4	**Private, net /2**	**585.0**	**680.9**	**933.7**	**111.2**	**95.9**	**99.8**	**63.8**
5	Treasury Bonds & Notes, net	159.7	150.9	289.6	22.9	25.0	50.8	12.7
6	Gov't Agency Bonds, net	129.9	205.7	192.6	18.6	28.7	8.7	7.4
7	Corporate Bonds, net	260.3	298.0	372.9	47.7	34.4	35.6	34.9
8	Equities, net	35.0	26.2	78.7	22.0	7.8	4.7	8.8
9	**Official, net**	**134.9**	**235.6**	**114.7**	**4.3**	**13.0**	**5.9**	**10.4**
10	Treasury Bonds & Notes, net	103.8	201.1	61.2	-1.1	4.9	3.7	5.6
11	Gov't Agency Bonds, net	25.9	20.8	34.2	2.2	6.2	0.4	2.4
12	Corporate Bonds, net	5.4	11.5	18.9	2.2	1.7	1.7	2.4
13	Equities, net	-0.3	2.2	0.5	1.0	0.2	0.1	-0.1
14	Gross Purchases of Foreign Securities	2761.8	3123.1	3688.9	319.4	374.3	338.3	324.9
15	Gross Sales of Foreign Securities	2818.4	3276.0	3826.8	335.6	377.5	352.4	342.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-56.5**	**-152.8**	**-137.8**	**-16.2**	**-3.2**	**-14.1**	**-17.6**
17	Foreign Bonds Purchased, net	32.0	-67.9	-16.2	-9.7	2.8	2.2	-3.7
18	Foreign Equities Purchased, net	-88.6	-85.0	-121.6	-6.5	-6.0	-16.4	-13.8
19	**Net Long-Term Flows** (line 3 plus line 16)	**663.3**	**763.6**	**910.7**	**99.3**	**105.6**	**91.6**	**56.6**

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

PRESS ROOM

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February 15, 2006
js-4050

Secretary John W. Snow
Opening Statement
The President's FY 2007 Budget
House Committee on Ways and Means

Good morning. Thank you Chairman Thomas and Ranking Member Rangel for having me here this morning.

I'm pleased to be here today to talk with you about the President's Fiscal Year 2007 budget. This budget represents the President's dedication to fiscal discipline, an efficient federal government and the continuation of a thriving U.S. economy.

Across the board, agencies were asked by the President to look closely at their budgets and make tough decisions, because fiscal restraint is not only necessary for deficit reduction, it is a necessary component of government that is responsible to the people who employ it.

Those tough decisions were made at all levels of government management, and as a result the President's budget holds the growth of discretionary spending below the rate of inflation and cuts spending in non-security discretionary programs below 2006 levels.

The Administration has identified 141 programs that should be terminated or significantly reduced in size because they aren't performing or could perform better with consolidation; they aren't giving taxpayers their money's worth. The savings for the American taxpayer would be 14 billion dollars.

Cutting the programs that aren't working and improving the efficiency of the ones that are is all part of accountability to the taxpayer. To assist lawmakers in this shared effort, the Administration launched ExpectMore.gov, a website that provides candid information about programs that are successful and programs that fall short, and in both situations, what they are doing to improve their performance next year. I encourage the members of this Committee and those interested in our programs to visit ExpectMore.gov, see how we are doing, and hold us accountable for improving.

This budget, with its policies of economic growth and spending restraint, keeps us on track to meet the President's steadfast goal of cutting the deficit in half by 2009.

The budget also seeks to avoid a tax increase by making the President's tax cuts permanent; I want to take a moment to explain why that is entirely consistent with our deficit-cutting goals.

In short, lower tax rates are good for the economy and a growing economy is good for Treasury receipts. Indeed, our rate of economic growth led to record levels of Treasury receipts in 2005. And, going forward, we project that receipts will rise every year. In 2011 we will again reach, as a percentage of GDP, the levels we've seen over the average of the last 40 years.

And there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. Tax relief encouraged investment, which has ultimately led to job growth. The American economy is now unmistakably

in a trend of expansion, and those trend lines can clearly be traced to the enactment of the tax relief.

Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone.

That's a lot of job growth, and there are a lot of very good jobs in that number. Industries with above-median hourly earnings and particularly large jobs gains since August 2003 include: specialty trade contractors (463,000 workers paying an average hourly wage of $19.55), ambulatory health care services (394,000 workers $17.86), and building construction (167,000 paying $19.05).

We found out the week before last that unemployment has fallen from 4.9 percent to 4.7 percent, running lower than the average for the 1970s, 1980s and 1990s. GDP growth was three and a half percent last year.

U.S. equity markets have risen, and household wealth is at an all-time high.

Additionally, real per capita disposable (after-tax) income has risen by 7.3 percent from 2000 to 2005 and that's very good news for workers.

The U.S. is, as the President often notes, the economic envy of the world.

When we look at the underlying fundamentals of the economy, its strength proves deep and solid, and we can see that businesses and workers have every reason to be optimistic about the future.

For example, we see that productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since the end of 2000, faster than any five-year period in the 1970s, 1980s or 1990s.

Household net worth – that's assets minus debts – is a record high, and not just because of housing. Deposits – the money in checking accounts, savings accounts, and money market funds – are at a record high and are larger as a share of disposable income than at any time since 1993. Defaults on residential mortgage loans at commercial banks are at historic lows.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Core inflation remains low, and that's good news for everyone.

Independent private-sector forecasts point to continuing good news, and inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

We are, it appears, witnessing the tipping point on wages – when incomes rise for workers and business combined, but workers once again increase their incomes faster than businesses. Once businesses have been doing well for a while, they ultimately compete those increases in income away by competing harder for labor. The result is higher wages and higher standards of living for workers.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: *why* is our economy performing so well and what can we do to continue these positive trends?

It is a sweeping and important question, so today we'll ask a more focused question: what can our *budget* do, or not do, to keep the economy on track?

The answer to that is twofold: first, control spending. Second, don't increase taxes – let taxpayers keep as much of their money as possible to invest and spend.

And of course I use the term "taxpayer" quite broadly. I ask you to think of the individual and family budgets that benefit from lower taxes, but also of the small-business budgets. Lower marginal rates, for example, help small firms because they tend to file their taxes as individuals, not as corporations. We are proposing to allow small businesses to be able to deduct up to $200,000 of business-expanding investment as a permanent feature of the tax code, for example. This tax benefit encourages expansion and job creation in the sector that produces three-quarters of the nation's net new jobs.

Lower rates and a degree of certainty in the system are absolutely critical to keeping our economy, and our excellent rate of job creation, on track. And I cannot say this strongly enough: we can't beat the budget deficit without a strong economy. Tax increases carry an enormous risk of economic damage and I can tell you today that the President will not accept that risk. He will not accept a tax increase on the American people.

Fiscal discipline, combined with economic growth, is the correct path to deficit reduction, period, and we cannot let difficult decisions run us off of that path that we know is right.

Our government does, of course, face economic demands that are exceptional, from fighting the war on terror to helping the victims of devastating hurricanes put their lives back together. These are costly events that lead to unwelcome, brief deficits. They should be regarded as temporary as they are entirely surmountable with continued economic strength and spending restraint in the areas where it is possible and appropriate.

The second way for the budget to help keep the economy on track is to focus the taxpayers' precious resources on things that we know will make a difference.

In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: healthcare, energy, and America's competitiveness.

Affordable and Accessible Health Care. The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts – putting patients in charge of their health care – will contribute to this goal. We need to make health insurance portable, make the system more efficient, and lower costs. We also need to level the playing field for individuals and the employees of small business by allowing small businesses to form Association Health Plans.

The expansion of high deductible health plans and HSAs is something I'd particularly like to emphasize. Combined with a high deductible health plan, HSAs allow people to save for future health care expenses while providing immediate protection against catastrophic health expenses. Furthermore, by giving people more control over their health care spending, they offer a more affordable alternative to traditional health insurance.

Today, millions of Americans – many of whom were previously uninsured –are enjoying access to more affordable health insurance because of the increased availability of HSA-qualified HD health plans. These plans are more available and becoming more popular, because saving for health care needs in an HSA now has the same tax advantages as a traditional health insurance plan.

It only makes sense to expand the scope of HSA qualified health insurance by making their premiums deductible from income taxes and payroll taxes when purchased by individuals. This is an important innovation that will significantly reduce the cost of health insurance purchased by individuals, particularly important for working people who don't have a federal income tax liability. As many of my friends on the Democratic side of the aisle have pointed out to me - payroll taxes are one of the most significant tax burdens for the poor. This innovation will enable more individuals to purchase affordable health insurance. Expanding HSAs so that policy holders and their employers can make annual contributions to cover all out-of-pocket costs under their HSA policy will further encourage adoption of

qualified HDHP plans.

All told, the President's HSA proposals are projected to increase the number of HSAs from the current projected for 14 million to 21 million.

Advanced Energy Initiative. The President has said that the best way to break America's dependence on foreign sources of energy is through new technology. So the President announced the Advanced Energy Initiative, which provides for a 22 percent increase in clean-energy research at the Department of Energy. This initiative also builds on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

American Competitiveness Initiative. This ambitious strategy by the President will significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

This budget also gives us an opportunity to look at the other ways – in addition to keeping tax rates low – that the federal government can make adjustments that add to a growth-friendly environment for the businesses, entrepreneurs and workers that produce that economic growth. Tax code reform remains a priority for this President and the President's Advisory Panel on Federal Tax Reform provided us this year with a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of our dynamic, 21st century economy. I appreciate the fine work of Senators Mack and Breaux, for their outstanding leadership of the Panel.

You'll notice that the budget provides for a one-year patch to protect the middle class from the AMT. It is a temporary fix because the AMT needs to be resolved through broader tax reform.

This issue is also reflected in the budget through the proposed creation of a new Dynamic Analysis Division within Treasury's Office of Tax Policy. Understanding the full range of behavioral responses to tax changes, including how tax changes affect the size of the economy and, subsequently, tax revenues, is critical to designing meaningful, effective tax reform, and we believe this small expenditure will have an enormous pay-off for the American taxpayer.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now.

In closing, I want to point out that a lot of good can come from a smart federal budget, and a considerable amount of harm can come from a bad one. Let's use the FY 2007 budget to make good policy – restrained as the circumstances dictate on spending but aggressive on the expansion of opportunity.

I look forward to working with all of you on enacting this budget. Thank you for having me here today; I'm pleased to take your questions now.

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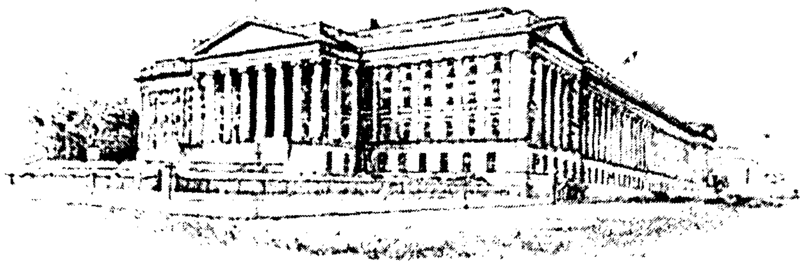
REPORTS

- Secretary John W. Snow Opening Statement The President's FY 2007 Budget House Committee on Ways and Means (charts included)



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE February 15, 2006
CONTACT Tony Fratto (202) 622-2910

SECRETARY JOHN W. SNOW
OPENING STATEMENT
THE PRESIDENT'S FY 2007 BUDGET
HOUSE COMMITTEE ON WAYS AND MEANS

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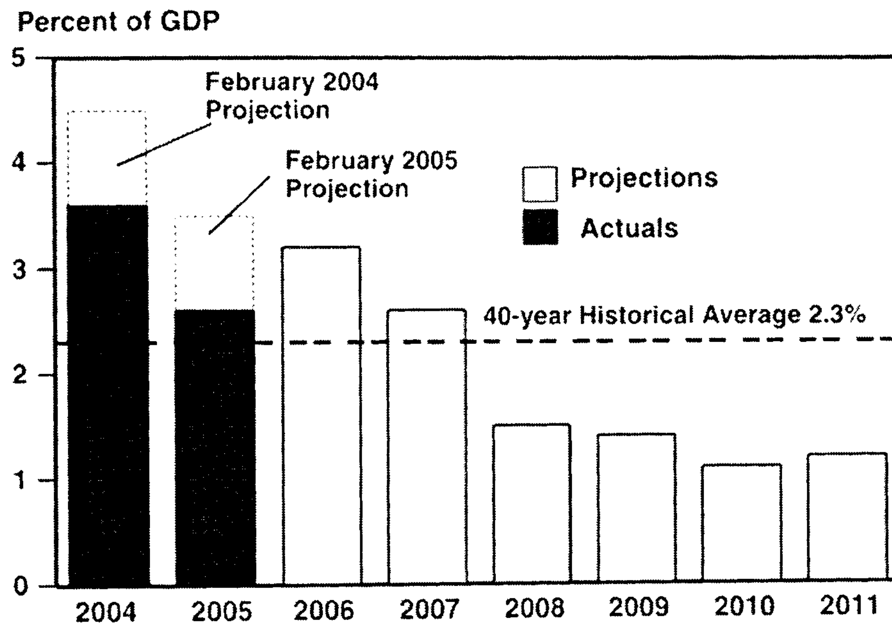

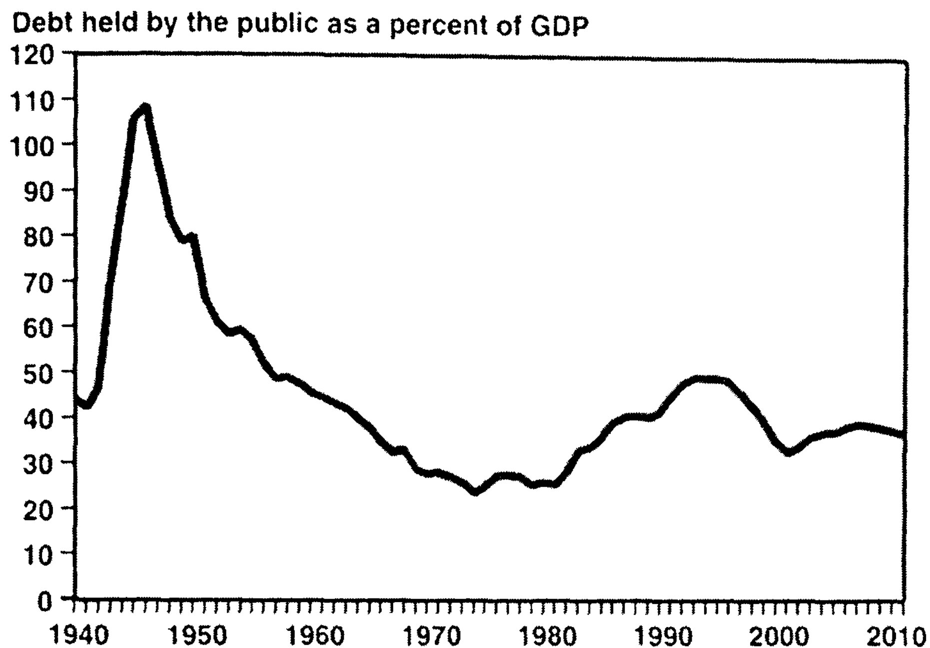

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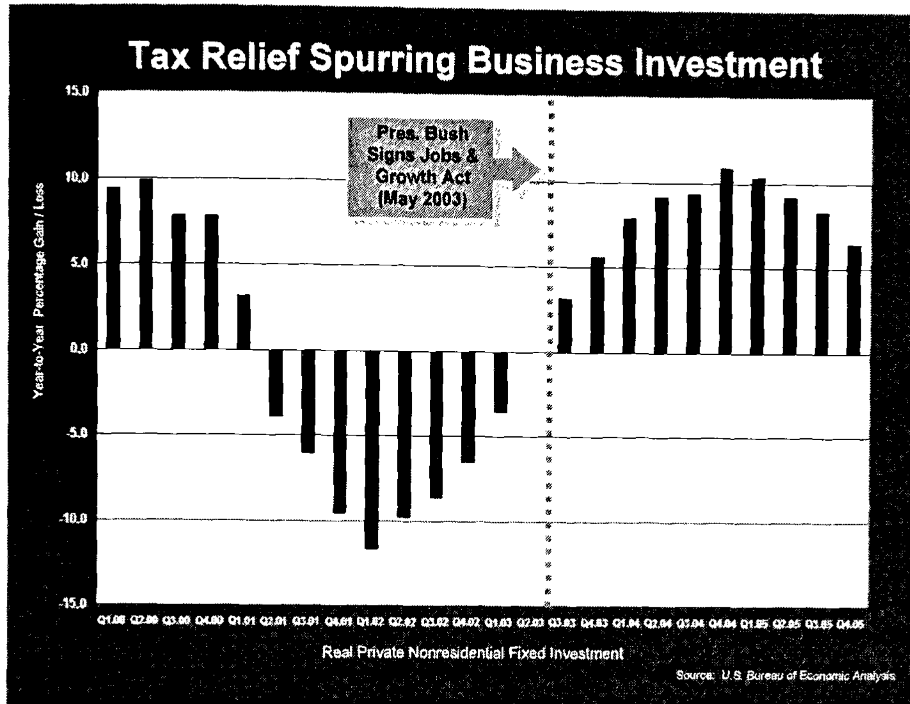

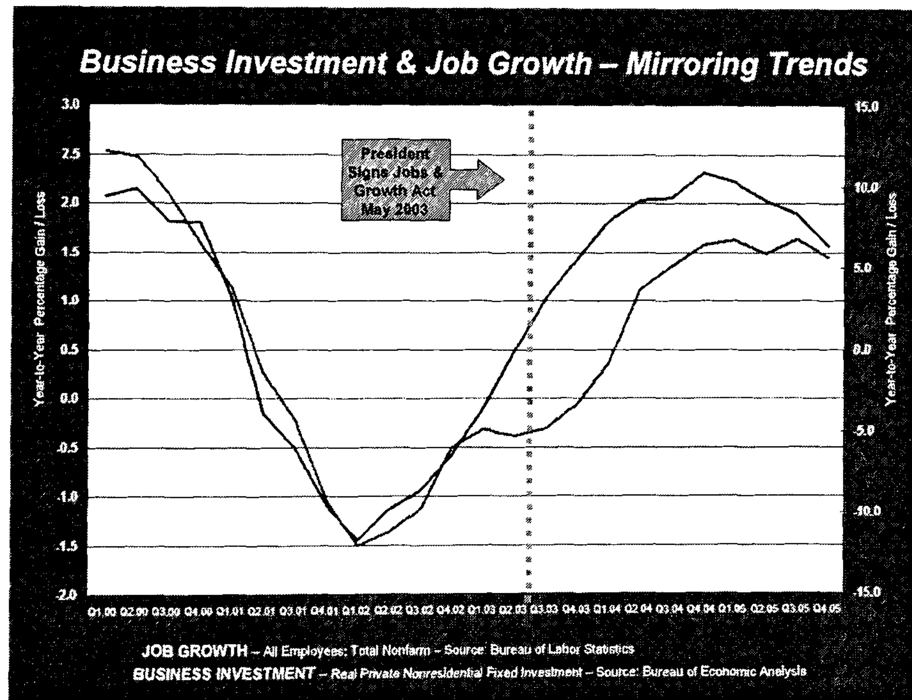

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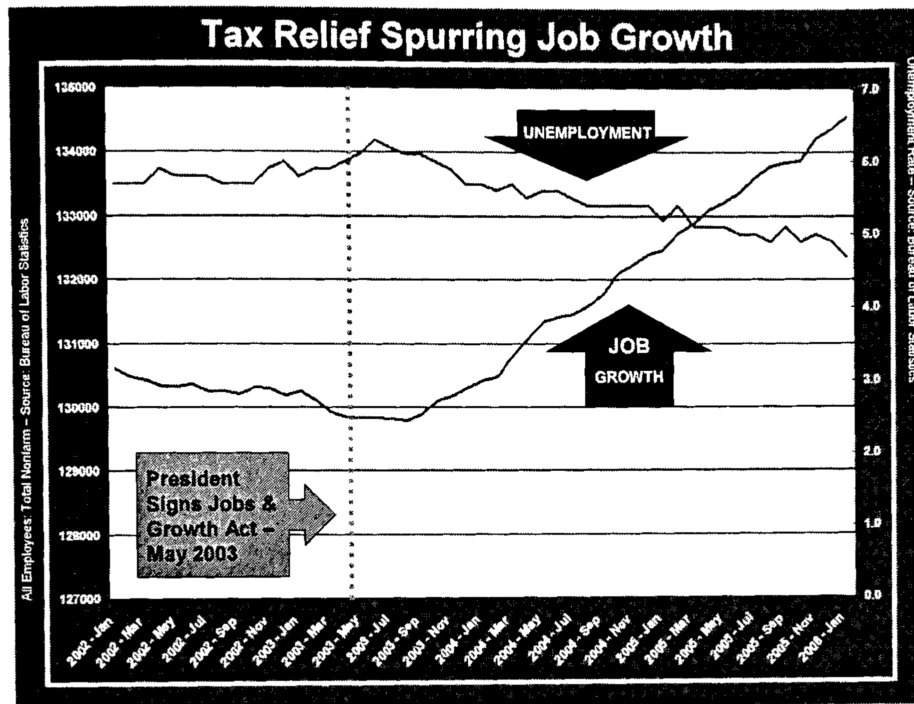

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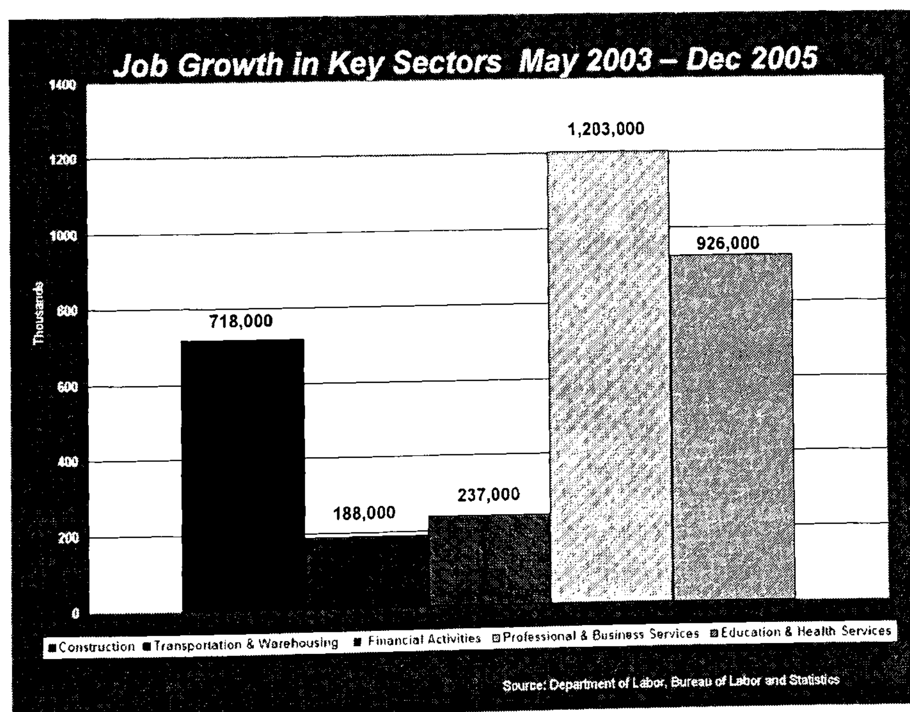

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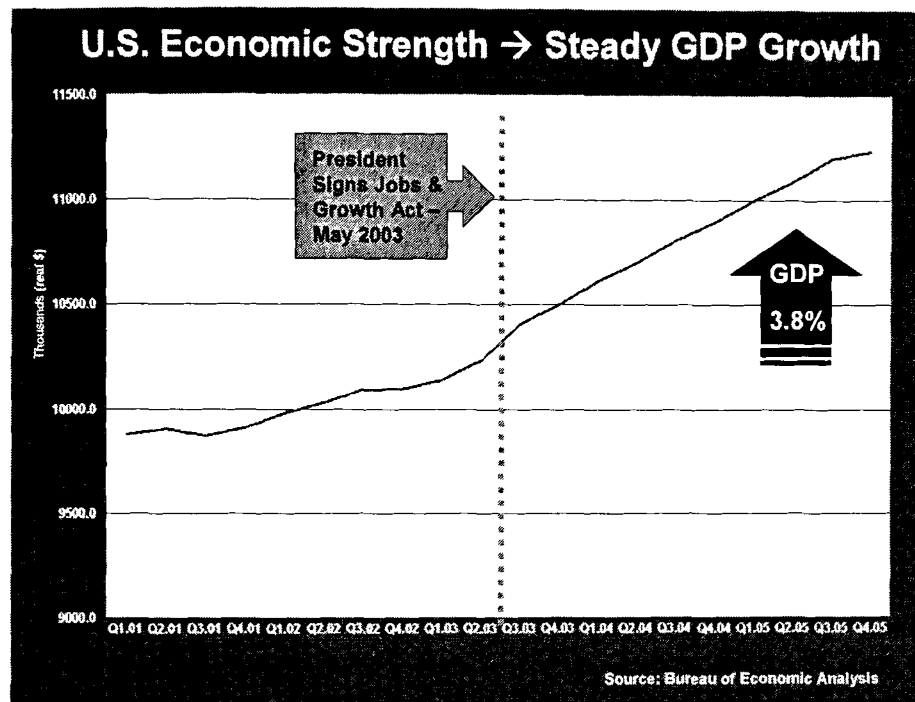

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I look forward to working with all of you on enacting this budget. Thank you for having me here today; I'm pleased to take your questions now.

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PRESS ROOM

February 15, 2006
js-4051

Treasury Assistant Secretary to Speak to Hartford Area Business Economists

U.S. Treasury Assistant Secretary for Economic Policy Mark Warshawsky will speak to Harford Area Business Economists (HABE) on the Administration's economic policies as well as the current strength of the U.S. economy.

Who Assistant Secretary for Economic Policy
Mark Warshawsky

What Speech to Hartford Area Business Economists

When Thursday, February 16, 8:00 – 9:00 a.m. (EST)

Where Connecticut Business and Industry Association
Conference Center
350 Church St. Hartford, CT

Note **contact sean.kevelighan@do.treas.gov to schedule interviews.**

-30-

PRESS ROOM

February 16, 2006
js-4052

Speech to Hartford Area Business Economists
Assistant Secretary Mark J. Warshawsky

The US Economy and the Administration's Health Care Policies

In recent years, the economy's resilience in the face of a range of unprecedented shocks has been perhaps its most outstanding characteristic. That resilience was evident once again this year in the face of the energy price shock generated by the Gulf of Mexico hurricanes. Despite, at times, record high oil prices, the expansion has continued with solid growth of real GDP, steady job creation, and low core inflation. The economy remains well-positioned to maintain healthy economic and employment growth with benign inflation.

The year 2005 marked the fourth straight year of expansion and, in our view, economic performance was right on target. Real GDP grew 3.5 percent on an annual average basis, in line with the Administration's projection of 3.6 percent growth made at the beginning of the year. Personal consumption expenditures grew by 3.6 percent while business investment in equipment and software rose at a double-digit pace for the second straight year. Residential building was a source of strength again in 2005: housing starts hit a 33-year high, and single family homes sales posted a fresh record. The economy generated 2 million jobs in 2005, and the unemployment rate trended down throughout the year.

This performance was particularly remarkable given the continued hike in energy prices. The energy component of the consumer price index rose by 17 percent during 2005 for the second straight year, as hurricanes battered oil- and gas-producing facilities in the Gulf of Mexico. While headline consumer price inflation was 3.4 percent last year, core price inflation (excluding food and energy) remained low at 2.2 percent, the same as in 2004. The ability of the economy to grow strongly in the face of the energy price increases without these costs being passed into other prices is a tribute to the flexibility and ingenuity of American business. The economy recovered quickly from the hurricanes and the related spike in energy prices and is now on firm footing.

Although real gross domestic product rose by a fairly modest 1.1 percent annual rate in the fourth quarter, a deeper look at the GDP numbers shows that growth was restrained by a number of special factors. Real consumer spending slowed sharply after employee pricing incentives in the auto industry pulled motor vehicle sales into the third quarter; oil imports surged to replace domestic oil production disrupted by the hurricanes; and defense spending plunged temporarily because of budget and accounting issues. All of these developments are expected to be transitory. Indeed, consumer spending already appears on track for a significant rebound in the first quarter of 2006, oil imports are slowing as domestic production comes back on line, and the drop in defense spending is unlikely to be repeated.

Labor market statistics for January were favorable. The economy created 193,000 jobs in January, and job gains have averaged 229,000 in the three months since October. From the low point in labor market activity in August 2003, the economy has generated almost 4.8 million new jobs. The unemployment rate dropped to 4.7 percent in January, the lowest since July 2001.

The recent data on labor earnings has also been good. Real average hourly earnings of production and non-supervisory workers increased 1.6 percent during the last three months of 2005, when declining energy prices lowered the overall CPI inflation rate. The longer-term trend in real hourly earnings is positive: real average hourly earnings are up 1.5 percent since December 2000. During the same period in the previous business cycle, real average hourly earnings were down 2.5

percent.

A more comprehensive measure of labor compensation published by the Bureau of Labor Statistics is the Employment Cost Index, which allows us to separate the compensation package into wages and salaries, and benefits. For private industry workers, total compensation grew 3.0 percent over the four quarters of 2005, down from 3.8 percent during 2004. Wages and salaries increased 2.5 percent during 2005, an improvement over the 2.4 percent rise in 2004. The slowdown in overall compensation was due to a deceleration in benefit costs from 6.9 percent during 2004 to 4.1 percent last year, the lowest rate since 1999. Growth in employer contributions for health insurance slowed from 7.3 percent during 2004 to 6.4 percent during 2005.

Benefit cost growth has exceeded wage and salary growth every year since 1999, taking a progressively larger bite out of the overall compensation package and leaving a smaller share for wages and salaries. In the third quarter of 2005 – the latest data available – wages and salaries accounted for about 70 percent of labor compensation, compared with about 72.5 percent in 1999. Health care costs made up about 5.8 percent of total compensation in 1999 but have jumped to 7.6 percent of compensation in the latest data.

The rise in benefit costs poses a problem for employers, employees, and government alike. For employers, benefit costs put upward pressure on the whole business cost structure, and potentially reduce profits, which immediately affects stockholders and could reduce expansion plans. For employees, as businesses resist raising the overall compensation package, the effect of rising benefit costs is a reduction in discretionary income. Government also faces significant costs not only for its employees but also for citizens covered by Medicare and Medicaid. Getting a handle on rising health care costs poses a special challenge for policymakers, but also an opportunity to raise worker discretionary income, reduce downward pressure on profits, and control government costs.

This is a long-term challenge. Health care cost growth has been exceeding GDP growth by two percentage points annually since 1940. Health care spending currently stands at 16 percent of GDP, and it is predicted to come to 18.7 percent of GDP by 2014. Thus, the strain of high and rising health care costs on the government, among employers, and on consumers is not projected to go away anytime soon. And if we do not begin to face these challenges, the strain on our society will become far worse than anything we are seeing today. Over the next 75 years, the Medicare program is expected to cost taxpayers $29.7 trillion more than the revenue dedicated to it; that's 4.7 percent of the GDP over that time period. Thus, we have to begin to find ways to reduce the growth of unproductive health care spending while preserving the incentives for the health care sector to innovate to provide people with longer and healthier lives.

We are already witnessing one important consequence of rapidly rising health insurance costs in the continued erosion of the group health insurance market, particularly in the small group market. According to the Kaiser Family Foundation's annual survey, nearly 100 percent of firms with 200 or more workers offer health insurance to their employees, yet only 59 percent of firms with between 3 and 199 workers do, a drop of 9 percentage points from 2000. Rising health insurance costs and concerns about access are a significant public policy challenge. The experience of the early 1990s showed that the American public has little appetite for a wholesale overhaul of the health system to fix the gaps in insurance coverage. In addition, this Administration is very cognizant of the problems that ensue when the government crowds out the private sector. Therefore, the Administration is proposing a set of incremental reforms that will help restrain health care spending and help people get and maintain insurance coverage despite income, health, or employment shocks.

Many of the proposals are anchored in the expansion of health savings accounts, and because HSAs are a relatively new product innovation, I would like to explain a little about what these accounts are and why the Administration believes they hold promise.

Health savings accounts are accounts that individuals can contribute tax free to save for future medical expenses. Contributions can be made to them as long as you have an HSA-qualified high-deductible health plan, what I'll call an HDHP, a

comprehensive health insurance policy with deductibles of at least $1,050 for self-only coverage and $2,100 for family coverage. Annual out-of-pocket expenses associated with the HDHP are limited to $5,250 for self-only coverage and $10,500 for family coverage. Annual contributions can currently be made up to the amount of the deductible. Withdrawals from the HSA can be made, tax free, at any time for qualified health expenses, which includes most out-of-pocket medical expenses. Thus, someone with an HDHP can contribute, every year, an amount equal to the deductible to his HSA and use those funds, which are exempt from income taxes, to meet the deductible. Any amount remaining in his HSA at the end of the year is rolled over to future years, to be used for future health care expenses.

The reason we believe these accounts should be encouraged is to correct the distortions created by the tax code that incent an inefficiently large amount of sometimes wasteful health care consumption, and to help people better plan for future health care needs.

The tax code encourages health insurance take-up by allowing employer contributions to insurance premiums to be excluded from taxable income. The combined income and payroll tax deductibility leads to discounts for health insurance of over 40 percent in some cases relative to other forms of consumption. The effect of this is to encourage over-insurance among the working population, so that people are encouraged to purchase insurance through their employers that has generous coverage and little cost-sharing.

This trend wipes out any notion of a market for routine or non-emergency expenses. The "first-dollar" or close-to-it structure of employer provided coverage – a structure induced by rational responses to tax incentives - leads to over-consumption of health care. Because of the coverage, people make health care decisions without comparing the price of the good or service to the benefit they receive from it.

HSAs reduce the incentive to purchase overly generous health insurance by equalizing the tax treatment of out-of-pocket expenses and covered care. If routine or non-emergency expenses purchased out-of-pocket are taxed the same way routine expenses are under health insurance, then the demand for insurance coverage for those goods and services falls, and people will consume those services in a way that takes into account the price and benefit they receive. HSAs still encourage insurance take-up, but they also discourage over-insurance that effectively removes market signals from the health care sector and inefficiently drives up the price of health care. Obviously, people may have concerns about whether individuals will stop getting needed care once they are in an HDHP. The famous RAND health experiment of the 1970s found that people in high deductible plans had 40 percent lower expenditures than those who paid no deductible, but there were no measurable differences in health status. This evidence suggests that people can distinguish between low value care and high value care at low levels of expenditures.

And because I have already spoken at length about the burdens associated with the rising cost of health insurance, I would like to bring up another characteristic of HSAs that often gets lost in discussions--that they actually encourage savings for future health care needs. Obviously, the funds in an HSA can be used to pay for health care consumed while enrolled in a health plan to meet the deductible or to pay for coinsurance. But after accumulating, they can serve as savings that may insulate an individual from the shock of losing employer-sponsored health insurance.

The uninsurance rate is twice for the unemployed than it is for the employed, and less than a quarter of the COBRA-eligible population takes up COBRA coverage. It's no surprise, with average family insurance premiums now exceeding $10,000 a year that someone without employment would forego health insurance. With health care consuming 16 percent of the economy, public policy is finally recognizing and addressing the shock of losing one's employer-sponsored health insurance subsidy by giving people an incentive to save for that possibility, because HSA-accumulated funds may be used to pay for COBRA premiums or for someone receiving unemployment insurance to pay for health insurance premiums on the individual market. Or, for that matter, to purchase long-term care insurance to insulate against post-retirement health shocks.

With the benefits of HSAs in mind, the Administration has crafted a set of proposals to further encourage HSA/HDHP participation. The Administration is proposing that the limit on annual HSA contributions be raised from the deductible to the policy's out-of-pocket maximum. Next, the Administration proposes full income tax deductibility of premiums on all HSA-qualified policies, whether the premiums are paid for by an employer or by an individual. These proposals are designed to encourage people to move into HSA-qualified plans, for the reasons I outlined above, and to encourage health insurance take-up by people without group insurance. This is important because millions of taxpayers have no access to health insurance through their employer. Small business owners are also not on equal footing with workers who get their insurance through the employer system.

A further expansion of deductibility being proposed by the Administration would allow for an income tax credit equivalent to the payroll tax on premiums for HSA-qualified plans and HSAs, whether the plan is purchased on the individual or group market. This, we hope, will make health insurance more affordable to the low-income populations -- groups that often have significant payroll tax liability but little income tax liability. Another proposal to help the low-income population has been in the President's budget for several years. It is a refundable tax credit to help low-income people purchase health insurance on the individual market. As structured in this year's budget, low-income families could get up to $3,000 in a refundable tax credit to purchase HSA-qualified insurance. If enacted, we believe the tax credits will be a significant help to low-income individuals who would otherwise be unable to afford health insurance.

Taken together, we expect these proposals to increase take-up of HDHP/HSA plans from a projected 14 million to 21 million by 2010.

The Administration is not only looking at HSA expansions to address the shortcomings of the health insurance market. One of the major changes accompanying the run-up in health care costs is the greater emphasis on treating people with chronic health problems, who now account for 75 percent of the health care expenses in this country. This group, of course, is more difficult to insure because of their predictably high expenses.

One new proposal in this year's budget to help these people get health insurance coverage is a new fund of $500 million annually that would provide competitive grants to up to ten states to find innovative ways to increase health insurance coverage among the chronically ill. States are trying various approaches to cover the chronically ill, such as with high risk pools and reinsurance, and the Administration believes these grants can accelerate the process of testing other solutions to covering the chronically ill.

Another new idea that we are developing is one that would allow greater portability of health insurance. Although COBRA and HIPAA provide some portability, the Administration would like to go further to allow people to maintain the same health insurance policy regardless of their employment status. We recognize that this is not an easy undertaking, but the payoff is potentially great. Workers would no longer fear losing insurance coverage if they left a job that provided it, reducing job lock and improving long-term access to the health insurance market.

In a world in which people assume more responsibility for their health care expenses, they need better information about prices and quality to make more informed decisions. The Administration is encouraging private providers of health care to publicize information that allows consumers to make informed decisions. And the Administration is using public programs to help collect quality information, through programs like the hospital quality reporting program in Medicare. I'd also like to point out that we are impressed by the efforts of private insurers like Aetna, who are making price and quality information more available to their enrollees.

And while we believe it is important for consumers to have better information about quality, we also believe the government has a role in promoting quality itself. One of the greatest opportunities for improving health care quality, reducing errors and unnecessary tests and procedures, and lowering costs is through the greater application of health information technology. We've got 21st century clinical care, but a 19th century paperwork system. The Administration is pursuing a broad range of policy initiatives to further the President's vision of widespread adoption of electronic health records within 10 years.

The policy initiatives underway include demonstrating success with high-tech electronic health record systems for the Veterans and Defense communities, removing regulatory barriers, establishing standards for health data transmission, and certifying health IT systems to high standards of interoperability, privacy, and functionality. Guiding this agenda is the American Health Information Community, of which I am fortunate to be a member. We are a group of government officials, health care professionals, and business executives who are giving HHS recommendations on how to implement electronic health records smoothly and effectively.

In conclusion, I would like to emphasize that the situation we find ourselves in -- high, rising health care costs, some people consuming too much health care, while others are consuming too little -- is not hopeless. And there are many features about our health care system -- innovation, widespread availability of technological advances, strong degree of consumer choice of providers and treatment -- that are worth preserving. We need to address the shortcomings in the health care system so as to make business and government finances sustainable now and in the long-run.

PRESS ROOM

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Testimony of Robert W. Werner, Director
Office of Foreign Assets Control
U.S. Department of the Treasury
Before the House Financial Services Subcommittee on
Oversight and Investigations

Chairwoman Kelly, Ranking Member Gutierrez and distinguished members of the Subcommittee, thank you for this opportunity to discuss the Administration's efforts to combat the financial underpinnings of the proliferation of weapons of mass destruction (WMD). The Office of Foreign Assets Control (OFAC), through the leadership and guidance of Treasury's Office of Terrorism and Financial Intelligence (TFI), is responsible for implementing the President's Executive Order targeting WMD proliferators and their support structures (Executive Order 13382). The Office of Intelligence Analysis (OIA), established in 2004, provides considerable support and expertise to this effort as well.

In addition to a brief general discussion of OFAC's sanctions authorities and programs, my testimony today will review the background, scope and process by which OFAC, in conjunction with other executive branch departments and agencies, carries out Executive Order 13382. I will also discuss, to the extent possible given the short period in which this program has been in effect, our assessment of its impact to date. Although the obvious sensitivities of the WMD program preclude, in an open forum, my ability to provide detailed information, I believe it is important to review with the Committee the steps Treasury and OFAC are taking to help protect American citizens from the threat of weapons of mass destruction. I thank you for your longstanding leadership and support in fostering an on-going dialogue on this and other national security issues that affect all Americans.

Mission and Jurisdiction

OFAC, through its workforce of approximately 125 staff, is dedicated to carrying out the complex mission of administering and enforcing economic sanctions based on U.S. foreign policy and national security goals.

OFAC administers approximately 30 economic sanctions programs against foreign countries, targeted regimes, and entities and individuals, including residual enforcement actions associated with programs that have been lifted. Although these many programs differ in terms of their scope and application, they all involve the exercise of the President's national emergency powers to impose controls on transactions and trade and to freeze foreign assets that come within the jurisdiction of the United States. Most of the programs administered and enforced by OFAC presently arise from the President's authorities under the International Emergency Economic Powers Act (IEEPA), the Trading with the Enemy Act (TWEA), the Foreign Narcotics Kingpin Designation Act (Kingpin Act), and the United Nations Participation Act (UNPA). In administering and enforcing these economic sanctions, it is imperative that OFAC maintain a close working relationship with other federal departments and agencies in order to ensure both that these programs are implemented in a manner consistent with U.S. national security and foreign policy interests and that they are enforced effectively. To fulfill its mission, OFAC works directly with the Departments of State (State); Commerce; and Justice, including the Federal Bureau of Investigation and the Drug Enforcement Administration; the Department of Homeland Security's U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement; the Department of Defense; bank regulatory agencies; and other law enforcement and intelligence community agencies.

I would also note, Madam Chair, that all of the programs we administer require that we work closely with a broad range of industries. We are presently making efforts to

expand and improve our communication with our diverse constituencies, ranging from the financial and services sectors to manufacturing and agricultural industries. In turn, the cooperation we receive from U.S. corporations in complying with sanctions is generally excellent.

I would now like to turn to the primary reason we are gathered here today: to discuss Executive Order 13382, the President's new Order targeting proliferators of WMD and their supporters. I will provide you with some background on circumstances leading to the issuance of the new Order, its objectives, its implementation by OFAC, the impact we are seeing from it, and what future impact we aim to achieve based on our experience in other economic sanctions programs.

Background to Executive Order 13382

In the aftermath of the September 11, 2001 attacks, the horrifying prospect of WMD falling into the hands of terrorists or rogue regimes has become all the more real to each of us. Recent events involving the nuclear weapons programs of North Korea and Iran demonstrate the challenge we face. The exposure of the WMD proliferation network headed by A. Q. Khan – father of Pakistan's nuclear bomb and, more recently, nuclear technology dealer to Libya, Iran, and North Korea – provided the world with a concrete example of how a network of individuals, with access to sensitive technology and expert knowledge, motivated by greed and personal ambition, can endanger our security by peddling WMD-related wares to rogue regimes.

Prior to the President issuing the new Order, the U.S. government had imposed a variety of other sanctions to counter the proliferation of WMD. For example, Executive Order 12938 of November 14, 1994, as amended by Executive Order 13094 of July 28, 1998, authorized the Secretary of State to impose certain measures against foreign entities and individuals determined to have contributed materially to the proliferation efforts of any foreign country, project, or entity of proliferation concern. The measures that the Secretary of State may choose to impose under Executive Order 12938, as amended, are a ban on U.S. government procurement from designated foreign parties; a ban on U.S. government assistance to designated foreign parties; and a ban on imports into the United States from designated foreign parties. The ban on imports called for in Executive Order 12938 is implemented by OFAC through the Weapons of Mass Destruction Trade Control Regulations, 31 C.F.R. Part 539.

With very real threats confronting us, however, the question for policy makers was whether we were doing all we could to address these threats. In examining the existing arsenal of financial sanctions tools available to combat proliferation, the President and others, including the members of the Silberman-Robb WMD Commission, believed that more could be done. Recognizing the need for additional financial sanctions tools to combat the threat posed by proliferation networks, the President issued Executive Order 13382 on June 29, 2005.

Overview of Executive Order 13382

In the broadest sense, Executive Order 13382 adds powerful tools – a broad based transactions prohibition and an asset freeze – to the array of options available to combat WMD trafficking. The strong new blocking (freezing) provisions imposed by the President apply to property and interests in property of entities and individuals designated under the Order. By prohibiting U.S. persons from engaging in transactions with entities and individuals targeted by the Order, we can effectively deny proliferators and their supporters access to the U.S. financial and commercial systems, cutting them off from the benefits of our economy and trade. An essential element to understanding the importance of the President's new Order is that it provides us with broad new authorities to target not only those engaged in proliferation activities, but also the network of entities and individuals providing support or services to proliferators. As part of issuing Executive Order 13382, in June 2005, the President also identified and targeted eight entities in North Korea, Iran, and Syria, thereby prohibiting U.S. persons from engaging in transactions with them and requiring any assets of those entities within the control of U.S. persons to be frozen. The President also authorized the Secretary of State and the Secretary of the Treasury to designate additional proliferators of WMD and their supporters under the new authorities provided by the Order.

This new sanctions program also underscores the President's commitment to work with our international partners to foster cooperative efforts against WMD proliferation, including those undertaken through the Proliferation Security Initiative (PSI). In addition, we hope that this program can provide a model for other nations to draw upon as they develop their own laws to stem the flow of financial and other support for proliferation activities as called for in United Nations Security Council Resolution 1540. Moreover, the G-8 has been even more specific in its call for action; in July 2005, at the Gleneagles Summit, G-8 leaders called on countries to enhance "efforts to combat proliferation networks and illicit financial flows by developing, on an appropriate legal basis, co-operative procedures to identify, track and freeze relevant financial transactions and assets." In this regard, Treasury, State, and other federal agencies have been engaged in aggressive international outreach in order to promote this important concept.

Targets Identified by the President in the Annex to Executive Order 13382

The eight entities initially identified by the President, based on evidentiary packages developed by OFAC investigators in close cooperation with colleagues in various agencies, reflect some of our government's primary proliferation concerns, namely the development of WMD and their means of delivery.

With respect to North Korea, the President designated three entities involved in proliferation:

- The **Korea Mining Development Trading Corporation** (KOMID) is Pyongyang's premier arms dealer and main exporter of goods and equipment related to ballistic missiles and conventional weapons. KOMID offices are located in multiple countries with the main goal of facilitating weapons sales while seeking new customers for its weapons. U.S. sanctions for trading in missile technology have been repeatedly applied to the KOMID organization in the past ten years.
- The North Korean defense conglomerate **Korea Ryonbong General Corporation** specializes in acquisition for North Korean defense industries and support to Pyongyang's military-related sales. It is identified in export control watch lists in the United States and among U.S. allies. The Ryonbong trade group has been a focus of U.S. and allied efforts to stop the proliferation of controlled materials and weapons related goods, particularly ballistic missiles.
- **Tanchon Commercial Bank**, headquartered in Pyongyang, inherited from the Korea Changgwang Credit Bank Corporation (KCCBC) the role as the main North Korean financial agent for sales of conventional arms, ballistic missiles, and goods related to the assembly and manufacture of such weapons. Since the late 1980s, Tanchon's predecessor, KCCBC, collected revenue from weapons-related sales that were concentrated in a handful of countries mainly located in the Mid-East and several African states. These revenues provide North Korea with a significant portion of its export earnings and financially aid Pyongyang's own weapons development and arms-related purchases.

With respect to Iran, the President designated four entities in the annex to Executive Order 13382:

- The **Atomic Energy Organization of Iran** (AEOI), which reports directly to the Iranian President, is the main Iranian institute for research and development activities in the field of nuclear technology, including Iran's centrifuge enrichment program and experimental laser enrichment of uranium program, and manages Iran's overall nuclear program.
- The **Aerospace Industries Organization** (AIO), a subsidiary of the Iranian Ministry of Defense and Armed Forces Logistics, is the overall manager and coordinator of Iran's missile program. AIO overseas all of Iran's missile industries.
- The **Shahid Hemmat Industrial Group** (SHIG) is responsible for Iran's ballistic missile programs, most notably the Shahab series of medium range ballistic missiles which are based on the North Korean-designed No Dong missile. The Shahab is capable of carrying chemical, nuclear, and biological warheads and has a range of at least 1500 kilometers. SHIG has received help from China and North Korea in the development of this missile.
- **The Shahid Bakeri Industrial Group** (SBIG) is an affiliate of Iran's AIO. SBIG is also involved in Iran's missile programs. Among the weapons SBIG

produces are the Fateh-110 missile, with a range of 200 kilometers, and the Fajr rocket systems, a series of North Korean-designed rockets produced under license by SBIG with ranges of between 40 and 100 kilometers. Both systems are capable of being armed with at least chemical warheads.

With respect to Syria, the President designated the Scientific Studies and Research Center (SSRC). SSRC is the Syrian government agency responsible for developing and producing non-conventional weapons and the missiles to deliver them. SSRC also has an overtly promoted civilian research function; however, its activities focus substantively on the development of biological and chemical weapons.

Executive Order 13382 Designation Criteria and OFAC's Approach

By publicly designating entities and individuals that engage in proliferation activities and those that support them, the WMD sanctions program is designed to complement existing proliferation-related authorities by blocking proliferators' assets and prohibiting U.S. persons from engaging in transactions with them. In taking these steps we aim to:

- **Expose** their activities publicly, removing the veil of legitimacy behind which proliferators and their supporters hide. Through public designation we intend to inform third parties, who may be unwittingly facilitating proliferation through what they believe to be legitimate business activity, of their association with WMD proliferators and deter others from engaging in business with proliferators.
- **Isolate** proliferators financially and commercially by denying them access to the benefits of trade and transactions with the United States; and
- **Disrupt and impede** the operations of WMD proliferators and their supporters.

While the public identification of these entities by the President, which exposes their illegitimate activities to the light of public scrutiny, is very important, OFAC's continuing role as part of administering the sanctions program is to look behind these entities. For our investigators, the entities named by the President represent a starting point as we seek to unravel the support networks that enable these entities to function. In addition, the subsequent designation of any entity or individual serves as an additional basis for aggressive investigation by OFAC in pursuit of designating additional parties. We refer to these as derivative designations, and it is this approach – targeting the broader support network – that has, over time, proved to be a critical factor behind successful designations in many OFAC-administered programs.

I would like to spend a few moments explaining how we are implementing this new Executive Order and where we intend to go with it. As you already know, the Order blocks the property and interests in property in the United States, or in the possession or control of U.S. persons, of:

(1) Those listed in the Annex to the Order (i.e., the eight organizations originally identified by the President)

(2) Any foreign entity or individual 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 WMD or their means of delivery (including missiles capable of delivering such weapons) by any entity or individual or foreign country of proliferation concern;

(3) Any entity or individual 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, proliferation-related activities or any entity or individual whose property has been blocked pursuant to the Order; and

(4) Any entity or individual 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 blocked party.

What does this mean in practical terms and how do we strive to implement it successfully? The simplified answer, as I mentioned earlier, is that we target the underlying support networks of identified proliferators. With decades of experience in administering and enforcing dozens of economic sanctions programs, one lesson is clear to OFAC: true success is based not on isolated designation actions, actions undertaken only once with no follow-up. Quite the contrary – our greatest areas of success have been based on sustained, aggressive action over time that evolves and adapts to match the ever-changing methods of our adversaries. As we apply the designation criteria of the Order to strike our adversaries again and again, we disrupt their attempts to disguise their illicit activities in the stream of legitimate commerce. In the context of this new program, this means we target not only the missile or bomb maker, but also the procurement fronts, the brokers and middlemen, the logistical apparatus used to move dangerous weapons to market, and the financiers that provide the financial mechanisms that facilitate proliferation activities.

Designations to Date under Executive Order 13382

Though an open forum does not permit me to give you details of our ongoing investigations, I can assure you that more designations are on the way. Despite the fact that this new program came mid-budget cycle, OFAC has committed substantial resources to the effort. We have also leveraged resources from OIA and sister agencies. As a result of this commitment, since the end of June 2005, OFAC has already designated ten additional entities under the new authorities provided by the Order. In addition to continuing OFAC's efforts in this critical area, the President's FY2007 Budget provides for ten additional positions to continue to implement and administer E.O. 13382 as well as 15 additional positions for other areas of OFAC.

On October 21, 2005, Treasury announced the designation of eight North Korean entities that were determined to be owned or controlled by, or acting for or on behalf of, two North Korean entities named by the President. More specifically, we determined that KOMID, which was identified by the President, is the parent company of two Pyongyang-based entities, Hesong Trading Corporation and Tosong Technology Trading Corporation. These direct associations met the criteria for designation because the entities are owned or controlled by, or act or purport to act for or on behalf of, KOMID. In addition, we determined that Korea Ryonbong General Corporation, also named in the annex to the Order, is the parent company of six Pyongyang-based entities: Korea Complex Equipment Import Corporation, Korea International Chemical Joint Venture Company, Korea Kwangsong Trading Corporation, Korea Pugang Trading Corporation, Korea Ryongwang Trading Corporation, and Korea Ryonha Machinery Joint Venture Corporation. As subsidiaries of KOMID and Korea Ryonbong General Corporation, many of these entities have engaged in proliferation-related transactions.

On January 4, 2006, we announced the designation of two Tehran-based entities – Novin Energy Company and Mesbah Energy Company – that we determined are owned or controlled by, or acting for or on behalf of, the Atomic Energy Organization of Iran (AEOI), an entity named by the President in the annex to the Order. Novin has transferred millions of dollars on behalf of the AEOI to entities associated with Iran's nuclear program. Novin is owned and operated by the AEOI and is located at an address associated with AEOI. Mesbah is a state-owned company subordinate to the AEOI. Through its role as a front for the AEOI, Mesbah has been used to procure products for Iran's heavy water project. Heavy water is essential for Iran's heavy-water-moderated reactor, which will provide Iran with a potential source of plutonium well suited for nuclear weapons. Heavy water is believed to have no credible use in Iran's civilian nuclear power program, which is based on light-water reactor technology.

The Designation Process

As previously discussed, one of the primary components in the implementation of

this program is the need to investigate WMD proliferators and their networks of front companies and individuals. Those investigations lead to the compilation of an administrative record that serves as the factual basis for designating targets under the broad authorities provided by the new Executive Order. Although simplified for purposes of discussion, we follow a three-step process in accomplishing this task, which consists of:

1) identifying the target;

2) construction and deconfliction of an evidentiary package; and

3) public announcement of the designation.

Let me walk you through these three broad stages in more detail. Like our colleagues in law enforcement and the intelligence community, we follow leads. Those leads may present themselves in a variety of ways, ranging from highly classified intelligence reporting, tips received from the public, and law enforcement referrals, to open source media reports. In pursuing any lead, our investigators consider whether the lead may be a candidate for designation by reviewing the information they can identify in the context of whether it fits within the criteria of the Executive Order and appears sufficient to meet the required evidentiary burden. In addition, investigators, assisted by the information and expertise of our interagency partners, consider whether designation of the candidate would actually assist in disrupting or impeding the activities of a larger target, such as a proliferation network. If the initial investigation of a lead shows promise, then OFAC investigators move into the second stage of the designation process – the evidentiary process.

In the WMD proliferation context, as well as our other programs, such as the highly successful counter-narcotics programs, we engage in "all-source" investigation and research and, quite often, extensive field work. By "all-source" investigation, I mean to say that our investigators seek to use any and all information available to them. Historically, this has included corporate records, from both open sources and those that may be seized in the course of law enforcement or intelligence operations, law enforcement reports redacted to protect sources, foreign law enforcement reports gained through cooperation in the field with foreign counterparts, foreign and domestic indictments or court transcripts, and intelligence reports from across the spectrum of the intelligence community. An additional source of information, which has proved to be key to our efforts in other programs, is source statements derived from debriefings conducted by U.S. law enforcement investigators and OFAC investigators. This very sensitive information requires excellent cooperation between OFAC and its law enforcement colleagues combined with careful implementation.

Of course, in reviewing these evidentiary sources, we are also sorting through reams of information for facts and data that permit us to conclude, as a legal matter, that there is a reasonable basis for believing that a target meets the specific criteria for designation under the terms of the Executive Order. For example, for a targeted entity we would typically look for information that substantiates ownership or control by another designated party or that a target is acting for or on behalf of, or providing material, financial, technological or other support for, or goods or services in support of, a designated party. To help us assess ownership or control we ask such questions as: Who are the shareholders? Who are the officers, directors, or managers? What is the entity's current address? What is its taxpayer ID number?

Similarly, for individuals, we look for information indicating that they are acting for, or on behalf of, or providing material support to a designated party. To help us assess this, we try to understand their exact relationships with designated parties. Moreover, and this cannot be overstated, in order to make our sanctions effective, we have to have adequate unclassified identifiers for our targets that can be included in publication of the designation. This is essential in order to enable the private sector to distinguish among individuals and companies with similar names, so that they can interdict or reject transactions that are prohibited by the designation while, at the same time, avoiding interference with their ability to process their normal business transactions efficiently and effectively. There will be occasions when we need to proceed without particular bits of information, but ideally our identifiers will include a target's known aliases and such information as date of birth, place of birth, address, passport numbers, or other national

identification numbers.

Once this evidence is collected, our investigators draft an evidentiary document summarizing the various exhibits acquired through their investigation and research. This "summary" document – which can run into hundreds of pages of text and supporting exhibits – meticulously lays out how the information provides us with reason to believe that the target meets the specific criteria for designation. Once drafted, the evidentiary packages undergo internal review by senior OFAC investigators, and a back and forth process of editing and the collection of additional evidence begins.

After an evidentiary package has been thoroughly reviewed within OFAC, it is then reviewed for legality by Treasury's attorneys. Based on the feedback from the attorneys, who are examining the case to ensure that among other things we have met our evidentiary threshold and our investigators may engage in further investigation and research and revise the package to address any legal concerns. The Department of Justice's Civil Division, which represents OFAC in court if our designations are challenged by our targets, also gives the case a thorough legal review.

The next formal stage of our evidentiary process involves interagency coordination. In most of our cases, it is somewhat misleading to present this as a distinct stage because we are normally very engaged with colleagues, in a variety of agencies, throughout the investigation process. In fact, initial targets are suggested through an interagency working group, and closely coordinated and vetted within appropriate agencies in the early stages of development. Depending on the amount of intelligence involved in constructing a case, we also work closely with colleagues in OIA and from elsewhere in the intelligence community to develop our case. Nonetheless, we do go through a more formal coordination phase designed to de-conflict our proposed designations with the operational and policy interests of other agencies, and to ensure that the targets are consistent with and further the strategic national security and foreign policy goals of the United States In fact, such coordination is required by the language of Executive Order 13382. The Order specifically directs that designations by Treasury or State be undertaken in consultation with one another, as well as in consultation with Justice and other relevant agencies.

Interagency coordination is clearly a critical part of the process because it ensures that our public designation of entities and individuals comprising a network do not jeopardize the ongoing operations of our colleagues in the law enforcement or the intelligence communities, and are consistent with our government's foreign policy and national security objectives and interests. We are acutely mindful of the importance of ensuring that we do not compromise sensitive sources or methods that would harm our national interest, and that our actions are coordinated with ongoing diplomatic efforts in order to achieve effectively our national security and foreign policy objectives. Our experience is that any potential conflicts can be fully and successfully resolved by fostering the early and ongoing working-level contacts between our investigators and their counterparts in the law enforcement and the intelligence communities.

Once this very thorough interagency review process has been completed, the final evidentiary package is presented for my signature. Among my chief concerns in reviewing a completed evidentiary package is verifying that we have, in fact, received concurrences from our interagency colleagues. Moreover, at the same time that the package is moving to me for my consideration, two other important processes are in motion.

First, OFAC's team of compliance officers and information technology professionals are working closely with our investigators to prepare the information about a target for possible public release. If I approve the proposed designation and sign a related blocking order, our team moves into action to push the critical information on the target – the names, the aliases, the locations, the identifying information such as dates of birth, passport numbers, national identification numbers, etc. – to the public through OFAC's List of Specially Designated Nationals and Blocked Persons (SDN list). This list is used by thousands of companies around the country and around the world to screen real-time transactions and accounts for the possible involvement of one of our targets.

The second process, which is similarly complex, arises when our investigators become aware of a designation target having a presence in the United States. If such a presence is detected, our investigators from both the Designation Investigations Division and our Enforcement Division work to prepare an operation to block any property that can be identified. Often this involves serving blocking orders or cease and desist orders on U.S. persons involved with a designation target. It can also involve blocking homes, commercially leased space, and vehicles, possibly at several locations throughout the country. As you can imagine, informing someone that they can no longer deal in blocked property – which may mean they have to cease doing business or apply to OFAC for a license to continue residing in a now-blocked property – can elicit a strong response. For the protection of all involved, we closely coordinate our domestic enforcement operations with law enforcement officers from other federal agencies and local authorities. At times, we are also able to coordinate our action with a law enforcement action, such as the execution of a search warrant.

Impact of OFAC Designations

Although the sanctions program established by Executive Order 13382 is in its early stages, and while I am limited in what I can say in this public forum, I am pleased to be able to assure you that we are already seeing a true impact on our targets.

More importantly, our successes in many other programs, especially our highly effective counter-narcotics programs, provide us with a roadmap for effectively implementing new programs called for by the President or the Congress The lesson we have learned, in more than 10 years of work in the narcotics arena, is that success is not the result of limited, isolated action. It is the result of aggressive implementation sustained over a period of years. It is grounded in tenacious follow-up to previous designations, adapting our target list to meet the ever-changing face of our adversary, and it is based on targeting the entire network. Though our resources are relatively limited, I believe that OFAC, Treasury and our interagency partners have the experience and tenacity to make our new WMD proliferation program successful.

Again, thank you for this opportunity to address OFAC's role in the new WMD sanctions program. I look forward to answering any questions you may have at this time.

PRESS ROOM

February 16, 2006
js-4054

The Honorable John W. Snow Prepared Remarks to: The Chicago Council on Foreign Relations

Thank you, Tom and Marshall, and thank you all for having me here tonight. It's a pleasure to be in Chicago, and I'm delighted to be spending some time with this fine group.

I had the opportunity today to visit with members and traders at two of the great exchanges you have here in Chicago – the Chicago Mercantile Exchange and the Chicago Board of Options Exchange – and tomorrow I'll be stopping by to visit with the Chicago Board of Trade. Seeing these operations in action is such a clear reminder to all of us how this American economy of ours, which is the envy of the world, continues to be so dynamic and productive. What all of our exchanges do, through millions upon millions of transactions every day, is direct investment capital to its best use in the most efficient way possible. These exchanges provide such an enormous benefit to our economy that we should never take them for granted.

I'd like most of our time together to be spent in dialogue, but I'll begin with a few thoughts and, I hope, some perspective.

As you know, I've recently returned from the G8 meetings in Moscow. We had an excellent meeting, hosted for the first time by Russia and Minister Kudrin. We also had the opportunity to have a working lunch meeting with President Putin.

The meetings in Moscow reminded me, as they often do, of the leadership responsibility of the United States. We are the undisputed economic leader of the world, and my G8 and G7 colleagues consistently look to our economic policies for direction when crafting their own. I'm encouraged by that, particularly considering the fact that we do face a growth imbalance in the world today. It is critical for our trading partners to stimulate economic growth in their countries.

Our leadership, of course, goes beyond economics – but our economic strength is tied to our founding, and guiding, principles. We represent freedom and justice to the world community, and with that honor comes a level of responsibility.

We are living up to that responsibility in Iraq and Afghanistan. We do so not only for the safety and security of our own citizens, but for the good and safety of the citizens of the world. As the President pointed out in his State of the Union Address, "The only way to protect our people, the only way to secure the peace, the only way to control our destiny is *by our leadership* – so the United States of America will continue to lead."

He went on to point out that "Abroad, our nation is committed to an historic, long-term goal – we seek the end of tyranny in our world."

A key part of that historic effort involves economic proficiency that leads to higher levels of standards of living throughout the world. Where there is economic opportunity, tyranny will not last.

At home, we seek to implement and maintain policies that are conducive to growth – in other words, our growth is not an accident and I'd like to get back to that topic in a moment – and the steady path of growth in the U.S. also enhances international economic stability.

The President has also been a tireless supporter of free trade and of debt relief – two more areas that enhance economic freedom and therefore both opportunity and

stability abroad. The current positive outlook for the world economy has made this an opportune time to push for progress on trade liberalization, and that has been a priority of mine at the G8 meetings. The potential rise of protectionism represents the most significant risk to the global economy today. In our discussions in Moscow we saw clearly the need to obtain an ambitious outcome from the Doha Development Round by the end of 2006. I welcomed progress made at the Hong Kong Ministerial meeting but recognize that further urgent efforts are necessary. We need to make significant progress on market access in agriculture and industria products. In addition, if this round is to be truly development-focused, substantial progress on services is essential, since gains from services liberalization are estimated to be over four times greater than the gains from goods trade alone. Financial services trade, in particular, is important because it acts as a link to increased economic growth and development.

I also want to mention that I thought it was appropriate that Minister Kudrin placed a heavy emphasis on energy security in the G8 discussions because of the risk high energy prices pose for the global economy. There are many sides to energy security, but, as Finance Ministers, we emphasized market-based solutions, transparency, and the institutional framework necessary to encourage a friendly investment climate in energy development and infrastructure. Energy is a high priority issue for President Bush, and I had the opportunity in Moscow to review his ambitious new Advanced Energy Initiative to increase clean-energy research at the U.S. Department of Energy. In developing countries the lack of energy access is a critical obstacle to development.

Getting back to the international significance of economic growth, I believe, and my G8 colleagues believe, that the U.S. is playing its economic leadership role very well. Our policies and our growth are admired. But we all know that it is not enough, that the U.S. cannot be the lone engine of growth in this world.

There is good news beyond our borders, of course. The global economy is strong, and there are signs that the expansion will continue. However, relative growth performance, especially among the larger economies, continues to be uneven. More progress is needed to implement reform policies that will raise potential growth and to promote high sustainable growth of the world economy. All countries, including the United States, but also the countries of Europe, Japan, developing Asia and even the oil exporters, bear a responsibility to help effect global adjustment in a way that maximizes and sustains global growth. An increased rate of growth among our trading partners will also increase the investment opportunities in their countries, and citizens should be able to invest in opportunity at home. Today, they are investing here in this country and that adds to the current account imbalance.

I continue to emphasize to my G8 colleagues the importance of this shared responsibility of global growth and the importance of their growth to the current account balancing act.

And although the U.S. is currently fulfilling its end of that shared responsibility, we must be ever-vigilant if we are to continue to be an economic success and an economic leader.

It all comes back to good, smart economic policy for us, just like it does for our trading partners. Looking back, there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. Tax relief encouraged investment, which has ultimately led to job growth. The American economy is now unmistakably in a trend of expansion, and those trend lines can clearly be traced to the enactment of tax relief.

A couple weeks ago we learned that unemployment has fallen from 4.9 percent to 4.7 percent -- lower than the average for the 1970s, 1980s and 1990s. Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment

insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Good, steady job growth is no surprise, given that GDP growth was three and a half percent last year. Core inflation also remains low, and that's good news for everyone.

U.S. equity markets have risen, and household wealth is at an all-time high. Additionally, real per capita disposable (after-tax) income has risen by 7.3 percent from 2000 to 2005 and that's very good news for workers.

This week's report on retail sales was yet another unmistakable sign that the U.S. economy is strong, it is heading in the right direction and Americans are confident. With a jump of 2.3 percent for January, this was one of the biggest month-to-month increases in over a decade and a half. That's the kind of number we expect to see when consumers are confident about the economy and optimistic about the future. And it is no wonder they are feeling that way, given the strength in the job market.

Independent private-sector forecasts point to continuing good news. Inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: what can we do to continue these positive trends?

The answers as I see them: First, keep taxes lower on both incomes and investment. Since the implementation of a lower, 15 percent rate on investment capital in May of 2003 we have seen a remarkable turn-around in the economy. After nine consecutive declining quarters of real annual business investment, we have had 10 straight quarters of rising business investment. This business expansion led to a substantial increase in employment, as I just mentioned – 4.7 million new jobs. There can be no question that we need to keep the tax rate on capital gains and dividends where it is; a tax increase would be a terrible mistake. While many factors contributed to the improved performance of the economy, the tax reductions on capital have been at the heart of the progress we have seen.

Lower tax rates on individual income are important because, as the President says, they let the people make their own decisions about their own money – and individuals make better financial decisions than governments.

There is also a significant small-business component to lower marginal rates. Since small-business owners often file their business income on personal forms, lower marginal rates help this sector that creates two-thirds of the country's net new jobs.

The President is also placing an emphasis on affordable health care, innovation competitiveness (with an emphasis on education) and reducing our dependency on foreign energy through new technology. These are all central to keeping our economy on track for generations to come.

As I've said, our growth here in America is important to us, but it's also important to the global economy. When I meet my finance minister colleagues – at the G8 and elsewhere – the first question they ask me is, "How is the U.S. economy doing? Will it continue to be strong?" They know that a slowdown here affects all of their economies, whether in the major industrialized countries, in emerging market countries like China, India or Brazil, or in the developing countries of Latin America, central and eastern Asia, or in Africa.

My response, fortunately, has been that we're doing quite well, but that they need to make the structural reforms necessary to generate growth in their own economies. Since improvements in standards of living can only come from increased economic growth, I can't help but wonder how many of the world's citizens would be lifted out of poverty if the other major economies – in particular Europe and Japan – were growing at the same rate of the United States. Conversely, how many people would see declining standards of living if the United States had posted the same anemic growth rates of other major economies? We have a responsibility to keep our

economy strong, and that's the focus I keep every day I'm on this job.

Before I take your questions, I want to express my gratitude for the work that you do here in Chicago to keep the economy healthy and job creation strong. The people here tonight represent the energy and the backbone of the most high-powered economy in the world, and you are to be commended. In government, our goal is to provide you with a good environment for innovation and growth and then, simply, let you do what you do best.

Thanks for having me here tonight; I'd be happy to take your questions now.

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PRESS ROOM

February 17, 2006
JS-4055

Secretary Snow Names Robert W. Werner as the New Director of FinCEN

U.S. Treasury Secretary John W. Snow today named Robert W. Werner as the new Director of the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Treasury Department. Werner currently serves as the Director of the Treasury's Office of Foreign Assets Control (OFAC).

"OFAC and FinCEN are two premier agencies at the heart of an unparalleled campaign to combat terrorist financing and financial crime across the globe. Fortunately, the Treasury will continue to benefit from Bob's talents and vision, as he takes over FinCEN's critical efforts to safeguard the financial sector from illicit activity," said Snow.

"Bob's expertise and steady leadership brought OFAC into the 21st Century by enhancing the Office's administration of economic and trade-based sanctions and highlighting its potential to address a wide range of threats to our national and economic security," Snow continued. "Under Bob's leadership, OFAC has greatly strengthened its relationships with the financial sector and other U.S. Government agencies, as well as with foreign counterparts around the world."

"I have full confidence that Bob will continue to protect our country against terrorist financiers, money launderers and other financial criminals in his new role as Director of FinCEN," said Snow.

As Director of OFAC, Werner oversaw the administration and enforcement of the U.S. Government's economic and trade sanctions, based on foreign policy and national security goals. Beforehand, Werner served as the Treasury's Assistant General Counsel for Enforcement and Intelligence and as the Chief of Staff of the Financial Crimes Enforcement Network. Werner began his career at the Treasury Department in the Office of the General Counsel, including serving as Counselor to the General Counsel.

Before coming to the Treasury, Werner served in the Justice Department's Office of Legal Counsel. He also served as a federal prosecutor in the U.S. Attorney's Office in Connecticut, Associate Attorney General in the State of Connecticut, and he headed Connecticut's gaming regulatory agency.

His private sector experience includes work as a partner at Bingham Dana LLP (now Bingham McCutchen) and as an officer at The Phoenix Home Life Mutual Insurance Company (now The Phoenix Companies). Werner is also a former law clerk to Associate Justices Lewis F. Powell, Jr. (retired) and Anthony M. Kennedy.

Werner earned his Juris Doctorate from New York University School of Law, his masters from Columbia University and his bachelors from Amherst College. He graduated with honors from each institution. Werner currently resides in Virginia with his wife and three children.

The Financial Crimes Enforcement Network is a bureau within the Treasury Department charged with safeguarding the financial system from money laundering and other illicit financial activity through the administration of the Bank Secrecy Act. FinCEN supports the law enforcement and intelligence communities, as well as the regulatory agencies, through the sharing and analysis of financial intelligence.

Werner replaces William Fox, who departed FinCEN in January to pursue a career in the private sector. Barbara Hammerle will serve as Acting OFAC Director.

PRESS ROOM

February 17, 2006
JS-4056

**Treasury Secretary Visits Associated Material Handling Industries, Inc.
Company to Offer Health Savings Accounts to Employees**

Chicago, Ill. – Treasury Secretary John Snow visited Associated Material Handling Industries in Carol Stream, Illinois this morning for the company's announcement that it will be offering Health Savings Accounts (HSAs) as a health-coverage option to their employees beginning this summer.

"With the addition of HSAs to your health coverage options, Associated Material Handling Industries is joining large and small employers across America who are choosing to offer this affordable option to their employees," Snow said. "I think it's a great option to have because choosing an HSA over traditional insurance plans puts patients in charge of their health-care purchasing decisions. That's why the creation of HSAs was so important – it was historic, really, because it embraces a philosophy that favors the individual, versus an employer or the government."

In remarks to company employees, Secretary Snow also detailed the President's proposals to expand Health Savings Accounts by making premium costs deductible from income and payroll taxes when purchased by individuals, raising the cap on the amount of money that can be saved in an HSA and making the high-deductible insurance plan that accompanies an HSA fully portable.

"HSAs are a good product. They're working," Snow said. "Savvy employers are offering them to their employees, and they are opening up an affordable option to small employers that might not have been able to afford health insurance otherwise. I'm thrilled that the employees of Associated Material Handling Industries, Inc. are going to have the option of HSAs soon, and I hope that in the near future all Americans have a chance to start HSAs that have all the tax benefits of traditional health insurance."

February 17, 2006
js-4057

Media Advisory:
Treasury Secretary John W. Snow to Visit Connecticut to Discuss Innovation and Home Building Tax Credits

U.S. Treasury Secretary John W. Snow will travel to Danbury and Torrington, Connecticut next Wednesday to discuss innovation and the Administration's energy initiative including home building tax credits. While in Connecticut, Secretary Snow will visit FuelCell Energy, Inc. and T&M Building Company. The following events are open to credentialed media:

Who: U. S. Treasury Secretary John W. Snow

What: Site Visit

When: Wednesday, February 22, 9:30 a.m. (EST)

Where: FuelCell Energy, Inc.
3 Great Pasture Road
Danbury, CT

Note: Media must RSVP to Steven Eschbach at 203-825-6000 or seschbach@fce.com

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What: Site Visit

When: Wednesday, February 22, 11:30 a.m. (EST)

Where: T&M Building Company
2270 Torringford West St.
Torrington, CT

PRESS ROOM

February 19, 2006
js-4058

Treasury Freezes Assets of Organization Tied to Hamas

The U.S. Department of the Treasury today blocked pending investigation accounts of KindHearts, an NGO operating out of Toledo, Ohio, to ensure the preservation of its assets pending further investigation.

"KindHearts is the progeny of Holy Land Foundation and Global Relief Foundation, which attempted to mask their support for terrorism behind the façade of charitable giving," said Stuart Levey, Treasury Under Secretary for Terrorism and Financial Intelligence. "By utilizing this specialized designation tool, we're able to prevent asset flight in support of terrorist activities while we further investigate the activities of KindHearts."

This action was taken pursuant to E.O. 13224, which is aimed at denying financial and material support to terrorists and their facilitators.

Following the December 2001 asset freeze and law enforcement actions against the Hamas-affiliated Holy Land Foundation for Relief and Development (HLF) and the al Qaida-affiliated Global Relief Foundation (GRF), former GRF official Khaled Smaili established KindHearts from his residence in January 2002. Smaili founded KindHearts with the intent to succeed fundraising efforts of both HLF and GRF, aiming for the new NGO to fill a void caused by the closures. KindHearts leaders and fundraisers once held leadership or other positions with HLF and GRF.

Support to Hamas in Lebanon

KindHearts officials and fundraisers have coordinated with Hamas leaders and made contributions to Hamas-affiliated organizations. Specially Designated Global Terrorist (SDGT) Usama Hamdan, a leader of Hamas in Lebanon, reportedly phoned a top fundraiser for KindHearts during a September 2003 KindHearts fundraiser. During the call, Hamas leader Hamdan reportedly communicated to the fundraiser his gratitude for KindHearts' support. The KindHearts fundraiser reportedly also provided advice to Hamdan, telling him not to trust the United Nations Relief and Works Agency.

Information developed from abroad corroborates connections between KindHearts and Hamas in Lebanon. As of late December 2003, KindHearts was supporting Hamas and other Salafi groups in the Palestinian refugee camps in Lebanon. Haytham Fawri was identified as a KindHearts official who reportedly collected funds and sent them to Hamas and other Salafi groups. Haytham Fawri is believed to be a reference to Haytham Maghawri, who has served as KindHearts' manager in Lebanon, and is one of a number of HLF officials indicted by a federal grand jury in Dallas, Texas on charges of providing material support to Hamas. From 1998 - 2000, during his tenure as Social Services Director for the HLF, Maghawri approved fifty wire transfers by the HLF in the amount of $407,512 USD, to nine zakat committees identified as being owned, controlled, or directed by Hamas.

According to the information source from abroad, KindHearts began working secretly and independently in the camps in Lebanon after the closure of the offices of the Sanabil Association for Relief and Development (Sanabil), a Hamas-affiliated entity in Lebanon that was named an SDGT in August 2003. KindHearts reportedly attempted to maintain a distance from Hamas to avoid drawing attention to its support for the terrorist organization. In early 2003, KindHearts president Smaili complained that scrutiny by U.S. law enforcement and intelligence officials was making it almost impossible for KindHearts to assist Hamas.

Between July and December 2002, KindHearts sent more than $100,000 USD to

the Lebanon-based SDGT Sanabil, according to information available to the U.S. Financial investigation revealed that between February 2003 and July 2003, KindHearts transferred over $150,000 USD to Sanabil. KindHearts deposited the funds into the same account used by HLF when it was providing funds to the Hamas-affiliated Sanabil, according to FBI analysis.

Support to Hamas in the West Bank

In addition to providing support to Hamas in Lebanon, KindHearts reportedly provides support to Hamas in the West Bank. An individual identified as integral to assisting KindHearts deliver aid to Palestinians in the West Bank, also reportedly was responsible for dividing money raised by KindHearts in the U.S to ensure that some funds went to Hamas. KindHearts founder and president Smaili told a Texas-based associate that his organization was raising funds to support the Palestinian *Intifada*.

Cooperation with U.S.-Based Hamas Leader

Mohammed El-Mezain, who coordinated KindHearts' fundraising, is a former HLF official indicted by a federal grand jury in Dallas, Texas on charges of providing material support to Hamas. Information indicates that SDGT Khalid Mishaal, Hamas' Secretary General based in Damascus, Syria, identified El-Mezain as the Hamas leader for the U.S. At the time, Mishaal advised that all financial contributions to Hamas from individuals in the U.S. should be channeled through El-Mezain.

Following the closure of HLF, U.S.-based Hamas leader El-Mezain transferred his fundraising skills to Kindhearts. El-Mezain assisted other KindHearts senior leaders in directing the coordination of KindHearts' fundraising strategy. During a 2003 Islamic conference, KindHearts leaders, including Smaili, met with El-Mezain to discuss KindHearts fundraisers. The leaders concluded that there would be only two fundraising dinners for KindHearts in September 2003 and thereafter, all fundraising efforts would target Friday prayers at mosques and Islamic centers throughout the U.S.

At a September 2003 KindHearts fundraising event, a KindHearts fundraiser spoke and encouraged the crowd to appreciate the efforts of the terrorist group Hizballah in supporting Hamas. The fundraiser then encouraged the crowd to give money and manpower as support against Israel. El-Mezain also spoke at this KindHearts fundraiser, encouraging people to donate to KindHearts.

In October 2003, El-Mezain spoke at an event held in Baton Rouge Louisiana where $500,000 was pledged. Though El-Mezain's speech reportedly focused almost entirely on raising funds for a new mosque in Baton Rouge, only a small amount was to be retained locally and the vast majority was to be sent to Hamas overseas.

Today's action freezes any assets KindHearts may have under U.S. jurisdiction and prohibits U.S. persons from engaging in transactions with the NGO.

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PRESS ROOM

February 21, 2006
2006-2-21-15-36-56-23727

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 $64,742 million as of the end of that week, compared to $64,943 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	February 10, 2006			February 17, 2006		
TOTAL	64,943			64,742		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,148	10,804	21,952	11,142	10,728	21,870
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	10,929	5,246	16,175	10,920	5,211	16,131
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]			7,597			7,560
3. Special Drawing Rights (SDRs) [2]			8,176			8,137
4. Gold Stock [3]			11,043			11,044
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	February 10, 2006			February 17, 2006		
	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						
	February10, 2006			February 17, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						

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

Notes:

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

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

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

PRESS ROOM

February 22, 2006
JS-4059

Statement by Under Secretary for International Affairs
Timothy D. Adams
Manila

First let me express my deepest condolences and sympathy for those who lost loved ones in the disaster in Leyte. Our thoughts and prayers are with those families.

While here in Manila, I've met with President Arroyo, members of her economic team, senior members of Congress, and leaders of the Philippine and U.S. business communities. I also met with Asian Development Bank President Kuroda and senior members of the ADB staff.

The message that I gave to all was this: The United States remains deeply engaged in East Asia. Our relationship with this region is long and deep, and I want to ensure that it remains vibrant. Our longest, and in many ways our strongest relationship in the region is with the Philippines, and I am pleased that this is the first country I visited on this trip.

I congratulated President Arroyo and the congressmen I met on difficult but necessary measures they introduced in the last year to reduce the fiscal deficit and the cut losses in the power sector. The importance of these decisions is clear in the strong and positive response of the financial markets. The resulting appreciation of the peso has lowered the cost of petroleum and other products for Philippine citizens and the reduction of interest spreads have lowered the cost of servicing Philippine debt.

But all whom I met agreed that much work remains to be done - both in further reducing the deficit and in bringing about more rapid growth in incomes and employment in the Philippines. Raising investment is key to boosting growth, and this requires greater confidence and willingness to invest in the Philippines by domestic residents, by foreign companies like those from the U.S., and by Filipinos living overseas.

There are many steps that need to be taken in order to raise investment. The first is achieving macroeconomic stability, for which the fiscal and energy measures of the last year were critical. A commercially run, vibrant, and privately-owned power sector, one that invests in the capacity required for Philippine growth is a second.

A sound and efficient financial sector is also a requirement for robust growth. This requires financial institutions that are adequately capitalized, have the skills to assess risk, and have supervisors who are able and willing to act at an early stage to force prompt corrective action before problems grow. Participation by foreign firms can greatly contribute to the efficiency and health of financial markets. It is important that the Philippines finally ratify the WTO financial services commitments that it made in 1997, as well as making, and ratifying, new commitments in the Doha Round.

Finally, raising investment requires creating an environment in which the rules are clear and transparent, contracts are enforced, and intellectual property is protected. The Philippines has taken important steps in the protection of intellectual property rights and we look forward to continued progress in this area.

By building on and extending the momentum created over the past year, the Arroyo Administration and Congress can continue to raise the level of Philippine economic performance.

PRESS ROOM

February 22, 2006
JS-4060

Treasury Secretary Visits Hydrogen Fuel Cell Manufacturer

Danbury, Conn. – Furthering the Administration's dedication to improving innovation and energy efficiency, Treasury Secretary John W. Snow this morning visited FuelCell Energy Inc., a developer and manufacturer of high-temperature hydrogen fuel cells. During his visit, he discussed the importance of hydrogen fuel cell technology with company owners, managers and employees.

"The potential for hydrogen-powered fuel cells to power vehicles, homes and businesses with no pollution or greenhouse gases is tremendous, and it is important to the U.S. from environmental, economic and national security perspectives," Snow said. "That's why the President is dedicated to promoting the development of commercially-viable cells, announcing in his State of the Union Address a $1.2 billion Hydrogen Fuel Initiative aimed at developing the technology for hydrogen fuel cells."

Snow went on to say that "The work being done here at FuelCell Energy, Inc. is a wonderful example of how American innovation and technology will lead us to a new day of reduced reliance on foreign sources of energy. Clean, efficient alternative sources of energy for our vehicles, homes and businesses are of vital importance to America's ability to remain competitive and safe, and those energy sources will be developed and produced by American scientists and entrepreneurs like the folks here at FuelCell Energy, Inc."

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PRESS ROOM

February 21, 2006
JS-4061

Treasury Secretary John W. Snow to Visit Memphis to Discuss Innovation

U.S. Treasury Secretary John W. Snow will travel to Memphis, Tennessee Wednesday to discuss innovation and the Administration's energy initiative. While in Memphis, Secretary Snow will visit Sharp Electronics. The following event is open to credentialed media:

WHO
U. S. Treasury Secretary John W. Snow

WHAT
Site Visit

WHEN
Thursday, February 23, 11:15 a.m. (EST)

WHERE
Sharp Electronics
4050 South Mendenhall
Memphis, TN

NOTE
Media must arrive no later than 10:45 a.m. and rsvp to Chris Loncto at Lonctoc@sharpesec.com or 201-529-8680 or Ryan Murphy at rmurphy@stantoncrenshaw.com or 646-502-3569.

PRESS ROOM

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February 22, 2006
JS-4062

Treasury Secretary Promotes Energy-Efficient Home Construction

Torrington, Conn. – Treasury Secretary John W. Snow visited T&M Building Company in Torrington, Conn. this morning to discuss the availability of new tax credits for homebuilders that construct energy-efficient homes and homeowners who improve the energy efficiency of their existing homes.

"Improving the energy-efficiency of new homes and increasing the energy-efficiency of existing homes are both highly effective ways of reducing our national energy consumption, which is a priority that the President set forth in his State of the Union Address this year," Snow said. "Guidance for two new tax credits, issued yesterday by the IRS, will provide incentive and reward for these energy-saving efforts."

The tax credits described by Snow are part of the Energy Policy Act signed by President Bush last summer. Snow pointed out that "Homes and homeowners who qualify for these credits will showcase a win-win scenario where precious energy is conserved while families also save money on heating and cooling bills – both goals of the President's Energy Policy Act of 2005."

After touring the T&M facilities, Snow spoke to company managers and employees. "I applaud the owners and employees of T&M for the contributions they have made by building homes in over 40 Connecticut communities, and I encourage them – and builders all over the country – to continue with efforts to make new homes more energy-efficient. As the President has said, the power of technology and the innovative spirit of America – through both energy production and efficiency – will reduce our reliance on foreign sources of energy, which will help ensure a growing and prosperous America in the 21st Century," Snow continued. "There can be no question that energy savings should start at home – and that's what these tax credits are all about."

Homebuilder Credit Guidance

- **Timing**: Credits available in 2006 and 2007.
- **Who Qualifies & How Much**:
  - Site-built homes qualify for a $2,000 credit if they reduce energy consumption by 50 percent (relative to the International Energy Conservation Code standard).
  - Manufactured homes qualify for a $1,000 or $2,000 credit depending on the level of energy savings achieved.
- **IRS Guidance:**
  - Establishes a process that homebuilders can use to obtain a certification that they are entitled to the credit.
  - Provides certainty to homebuilders who will be permitted to rely on certifications by independent experts when claiming the credit on their returns.
  - Supplies a public list of software programs that may be used to calculate energy savings.

Homeowner Credit Guidance

- **Timing: Credits can be claimed in 2006 or 2007.**

- **Who/What Qualifies & How Much**:
-
    - Homeowners may claim up to $500 in credits over the two-year period.
    - Energy-efficient improvements to the building envelope qualify for a 10 percent credit, e.g. insulation, exterior windows and doors (including storm windows and doors), and metal roofs (International Energy Conservation Code or the Environmental Protection Agency's Energy Star program standards may apply).
    - Certain heating and cooling equipment that meets the energy-efficiency standards specified in the Internal Revenue Code.
- **IRS Guidance**:
    - Establishes a process that manufacturers can use to certify their product(s) qualifies for the credit.
    - Affords certainty to homeowners, who will be permitted to rely on the manufacturer's certification when claiming the credit on their returns.

Relating IRS News Releases:

Treasury and IRS Provide Guidance for energy Credits for Homeowners
IR-2006-34, Feb. 21, 2006 -- Homeowners can rely on certifications from manufacturers of energy efficient items to claim tax credits.

Treasury and IRS Issue Guidance for Coal Project Credit and Gasification Project Credit

IR-2006-33, Feb. 2 2006 -- Companies are provided guidance for engaging in getting tax credit for Coal Project Program and Gasification Project Program.

Treasury and IRS Provide Guidance on Energy Credit To Home Builders

IR-2006-32, Feb 21, 2006 -- Homebuilders may be eligible for up to $2,000 for credits related to building homes that are more energy efficient.

IRS Has $2 Billion for People Who Have Not Filed a 2002 Tax Return

IR-2006-31, Feb. 21, 2006 -- The deadline for filing a 2002 income tax return to claim a refund for that year is April 17, 2006.

REPORTS

- Energy Guidance Homeown
- Energy Guidance Homebuild 1
- Energy Guidance Homebuild 2

Part III – Administrative, Procedural, and Miscellaneous

Credit for Nonbusiness Energy Property

Notice 2006-26

SECTION 1. PURPOSE

This notice sets forth interim guidance, pending the issuance of regulations, relating to the credit for nonbusiness energy property under § 25C of the Internal Revenue Code. Specifically, this notice provides procedures that manufacturers may follow to certify property as either an Eligible Building Envelope Component or Qualified Energy Property, as well as guidance regarding the conditions under which taxpayers seeking to claim the § 25C credit may rely on a manufacturer's certification (or, in the case of certain windows, an Energy Star label). The Internal Revenue Service and the Treasury Department expect that the regulations will incorporate the rules set forth in this notice.

SECTION 2. BACKGROUND

.01 Section 1333 of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), added § 25C to the Internal Revenue Code. Section 25C provides a credit against tax for the taxable year in an amount equal to the sum of--

(1) Ten percent of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements (that is, property described in section 4.01 of this notice) installed during the taxable year; and

(2) The amount of expenditures for residential energy property (that is, property described in section 5.01 of this notice) paid or incurred by the taxpayer during the taxable year.

.02 Under § 25C(b), the maximum amount of the credit allowable to a taxpayer under § 25C(a) for all taxable years is $500 ($200 in the case of amounts paid or incurred for exterior windows (including storm windows and skylights)). In addition, the maximum amount of credit allowed is--

(1) $50 for any advanced main air circulating fan;

(2) $150 for any qualified natural gas, propane, or oil furnace or hot water boiler; and

(3) $300 for any item of energy-efficient building property (that is, property described in section 5.01(1)-(7) of this notice).

.03 Section 25C(g) and § 1333(c) of the Energy Policy Act provide that the credit applies to property placed in service after December 31, 2005, and before January 1, 2008.

SECTION 3. REFERENCES TO INTERNATIONAL ENERGY CONSERVATION CODE

Manufacturers and taxpayers may treat any reference in this notice to the International Energy Conservation Code (IECC) as a reference to either the 2001

Supplement of the 2000 International Energy Conservation Code or the 2004 Supplement of the 2003 International Energy Conservation Code.

SECTION 4. QUALIFIED ENERGY EFFICIENCY IMPROVEMENTS

.01 *Eligible Building Envelope Components.*

The credit for qualified energy efficiency improvements is allowed with respect to the following building envelope components (Eligible Building Envelope Components):

(1) An insulation material or system (including any vapor retarder or seal to limit infiltration) that--

(a) Is specifically and primarily designed (within the meaning of section 4.04 of this notice) to reduce heat loss or gain of a dwelling unit when installed in or on the dwelling unit; and

(b) May be taken into account in determining whether the building thermal envelope requirements established by the IECC are satisfied;

(2) An exterior window, skylight, or door (other than a storm window or storm door) that meets or exceeds the prescriptive criteria established by the IECC for the climate zone in which the window, skylight, or door is installed;

(3) A storm window that, in combination with the exterior window over which it is installed, meets or exceeds the prescriptive criteria established by the IECC for the climate zone in which such storm window is installed;

(4) A storm door that, in combination with a wood door assigned a default U-factor by the IECC, does not exceed the default U-factor requirement assigned to such combination by the IECC; and

(5) Any metal roof that--

(a) Has appropriate pigmented coatings that are specifically and primarily designed to reduce the heat gain of a dwelling unit when installed on the dwelling unit; and

(b) Meets or exceeds Energy Star program requirements (as in effect at the time of installation).

.02 *Manufacturer's Certification.*

(1) *Requirements Applicable to Manufacturer.* The manufacturer of a building envelope component may certify to a taxpayer that the component is an Eligible Building Envelope Component by providing the taxpayer with a certification statement that satisfies the requirements of section 4.02(4) of this notice. The certification statement may be provided by including a written copy of the statement with the packaging of the component, in printable form on the manufacturer's website, or in any other manner that will permit the taxpayer to retain the certification statement for tax recordkeeping purposes.

(2) *Taxpayer Reliance.* Except as provided in section 4.02(3) and (6) of this notice, a taxpayer may rely on a manufacturer's certification that a building envelope component is an Eligible Building Envelope Component. A taxpayer is not required to attach the certification statement to the return on which the credit is claimed. However, § 1.6001-1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any credit claimed by the taxpayer. Accordingly, a taxpayer claiming a credit for an Eligible Building Envelope Component should retain the certification statement as part of the taxpayer's records for purposes of § 1.6001-1(a).

(3) *Reliance Permitted Only for Installation Consistent with Certification.* A taxpayer may rely on a manufacturer's certification that a building envelope component is an Eligible Building Envelope Component--

(a) In the case of an exterior window, skylight, or door (other than a storm window or storm door), only if the component is installed in a climate zone identified in the certification statement; and

(b) In the case of a storm window, only if the component is installed over an exterior window of a class identified in the certification statement and in a climate zone identified for that class of exterior window.

(4) *Content of Manufacturer's Certification Statement.* A manufacturer's certification statement must contain the following:

(a) The name and address of the manufacturer;

(b) Identification of the component as an insulation material or system, an exterior window or skylight, an exterior door, or a metal roof;

(c) The make, model number, and any other appropriate identifiers of the component;

(d) A statement that the component is an Eligible Building Envelope Component that qualifies for the credit allowed under § 25C;

(e) In the case of an exterior window, skylight, or door (other than a storm window or storm door), the climate zone or zones for which the applicable prescriptive criteria are satisfied;

(f) In the case of a storm window--

(i) The classes of exterior window (e.g., single pane; double pane, clear glass; double pane, Low-E coating) over which the storm window may be installed and that, in combination with the storm window, satisfy the applicable prescriptive criteria for one or more climate zones; and

(ii) For each such class of exterior window, the climate zone or zones for which the applicable prescriptive criteria are satisfied; and

(g) A declaration, signed by a person currently authorized to bind the manufacturer in such matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification statement, and to the best of my knowledge and belief, the facts are true, correct, and complete."

(5) *Manufacturer's Records.* A manufacturer that certifies to a taxpayer that a component is an Eligible Building Envelope Component must retain in its records documentation establishing that the component satisfies the applicable conditions of section 4.01 of this notice including, in the case of an exterior window, its National Fenestration Rating Council (NFRC) rating. The manufacturer must, upon request, make such documentation available for inspection by the Service.

(6) *Effect of Erroneous Certification or Failure to Satisfy Documentation Requirements.* The Service may, upon examination (and after any appropriate consultation with the Department of Energy (DOE) or Environmental Protection Agency (EPA)), determine that a component that has been certified under this section is not an Eligible Building Envelope Component. In that event, or if the component's manufacturer fails to satisfy the requirements relating to documentation in section 4.02(5)

of this notice, the manufacturer's right to provide a certification on which future purchasers of the component can rely will be withdrawn, and taxpayers purchasing the component after the date on which the Service publishes an announcement of the withdrawal may not rely on the manufacturer's certification. Taxpayers may continue to rely on the certification for components purchased on or before the date on which the announcement of the withdrawal is published (including in cases in which the component is not installed and the credit is not claimed until after the announcement of the withdrawal is published). Manufacturers are reminded that an erroneous certification statement may result in the imposition of penalties--

(a) Under § 7206 for fraud and making false statements; and

(b) Under § 6701 for aiding and abetting an understatement of tax liability (in the amount of $1,000 per return on which a credit is claimed in reliance on the certification).

(7) *Availability of Certification Information.* Manufacturers are encouraged to provide a listing of qualified components and applicable certification information on their websites to facilitate taxpayer identification of qualified components.

.03 *Special Rule for Energy Star Windows and Skylights.* A taxpayer may treat an exterior window or skylight that bears an Energy Star label and is installed in the region identified on the label as an Eligible Building Envelope Component and may rely on such Energy Star label, rather than on a manufacturer's certification statement, in claiming the § 25C credit.

.04 *Specifically and Primarily Designed.* A component is not specifically and primarily designed to reduce heat loss or gain of a dwelling unit if its principal purposes are to provide structural support, to provide a finished surface, as in the case of drywall or siding, or to serve any other function unrelated to the reduction of heat loss or gain. The principal purpose of a component serves functions unrelated to the reduction of heat loss or gain if production costs attributable to features other than those that reduce heat loss or gain exceed production costs attributable to features that reduce heat loss or gain.

.05 *Additional Requirements.* A taxpayer may claim a credit with respect to amounts paid or incurred for an Eligible Building Envelope Component only if the following additional requirements are satisfied:

(1) The component is installed in or on a dwelling unit located in the United States and, at the time of installation, the dwelling unit is owned and used by the taxpayer as the taxpayer's principal residence (within the meaning of § 121);

(2) The original use of the component commences with the taxpayer; and

(3) The component reasonably can be expected to remain in use for at least five years. For this purpose, a component will be treated as reasonably expected to remain in use for at least five years if the manufacturer offers, at no extra charge, at least a two-year warranty providing for repair or replacement of the component in the event of a defect in materials or workmanship. If the manufacturer does not offer such a warranty, all relevant facts and circumstances are taken into account in determining whether the component reasonably can be expected to remain in use for at least five years.

.06 *Installation Costs.* With respect to Eligible Building Envelope Components, the credit is allowed only for amounts paid or incurred to purchase the components. The

credit is not allowed for amounts paid or incurred for the onsite preparation, assembly, or original installation of the components.

SECTION 5. RESIDENTIAL ENERGY PROPERTY

.01 *Qualified Energy Property.* The credit for residential energy property expenditures is allowed with respect to the following property (Qualified Energy Property):

(1) An electric heat pump water heater that yields an energy factor of at least 2.0 in the standard DOE test procedure;

(2) An electric heat pump that has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13;

(3) A closed loop geothermal heat pump that has an EER of at least 14.1 and a heating coefficient of performance (COP) of at least 3.3;

(4) An open loop geothermal heat pump that has an EER of at least 16.2 and a heating COP of at least 3.6;

(5) A direct expansion geothermal heat pump that has an EER of at least 15 and a heating COP of at least 3.5;

(6) A central air conditioner that achieves the highest efficiency tier that has been established by the Consortium of Energy Efficiency and is in effect on January 1, 2006;

(7) A natural gas, propane, or oil water heater that has an energy factor of at least 0.80;

(8) A natural gas, propane, or oil furnace or hot water boiler that achieves an annual fuel utilization efficiency rate of not less than 95; and

(9) A fan that is used in a natural gas, propane, or oil furnace and has an annual electricity use of no more than 2 percent of the total annual site energy use of the furnace (as determined in the standard DOE test procedure).

.02 *Manufacturer's Certification.* —

(1) *Requirements Applicable to Manufacturer.* The manufacturer of a product may certify to a taxpayer that the product is Qualified Energy Property by providing the taxpayer with a certification statement that satisfies the requirements of section 5.02(3) of this notice. The certification statement may be provided by including a written copy of the statement with the packaging of the product, in printable form on the manufacturer's website, or in any other manner that will permit the taxpayer to retain the certification statement for tax recordkeeping purposes.

(2) *Taxpayer Reliance.* Except as provided in section 5.02(5) of this notice, a taxpayer may rely on a manufacturer's certification that a product is Qualified Energy Property. A taxpayer is not required to attach the certification statement to the return on which the credit is claimed. However, § 1.6001-1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any credit claimed by the taxpayer. Accordingly, a taxpayer claiming a credit for Qualified Energy Property should retain the certification statement as part of the taxpayer's records for purposes of § 1.6001-1(a).

(3) *Content of Manufacturer's Certification Statement.* A manufacturer's certification statement to be provided to taxpayers who purchase Qualified Energy Property must contain the following:

(a) The name and address of the manufacturer;

(b) The class of Qualified Energy Property (as listed in section 5.01 of this notice) in which the product is included;

(c) The make, model number, and any other appropriate identifiers of the product;

(d) A statement that the product is Qualified Energy Property that qualifies for the credit allowed under § 25C; and

(e) A declaration, signed by a person currently authorized to bind the manufacturer in these matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification statement, and to the best of my knowledge and belief, the facts presented are true, correct, and complete."

(4) *Manufacturer's Records.* A manufacturer that certifies to a taxpayer that a product is Qualified Energy Property must retain in its records documentation establishing that the product satisfies the applicable conditions of section 5.01 of this notice. The manufacturer must, upon request, make such documentation available for inspection by the Service. The documentation--

(a) In the case of the EER for a central air conditioner or electric heat pump, must include measurements based on published data that are the result of manufacturer tests at 95 degrees Fahrenheit and may be based on the certified data of the

Air Conditioning and Refrigeration Institute that are prepared in partnership with the Consortium for Energy Efficiency; and

(b) In the case of a geothermal heat pump, must be based on testing under the conditions of ARI/ISO Standard 13256-1 for Water Source Heat Pumps or ARI 870 for Direct Expansion GeoExchange Heat Pumps, as appropriate, and include evidence that water heating services have been provided through a desuperheater or integrated water heating system connected to the storage water heater tank.

(5) *Effect of Erroneous Certification or Failure to Satisfy Documentation Requirements.* The Service may, upon examination (and after any appropriate consultation with DOE or EPA), determine that a product that has been certified under this section is not Qualified Energy Property. In that event, or if the product's manufacturer fails to satisfy the requirements relating to documentation in section 5.02(4) of this notice, the manufacturer's right to provide a certification on which future purchasers of the product can rely will be withdrawn, and taxpayers purchasing the product after the date on which the Service publishes an announcement of the withdrawal may not rely on the manufacturer's certification. Taxpayers may continue to rely on the certification for products purchased on or before the date on which the announcement of the withdrawal is published (including in cases in which the product is not installed and the credit is not claimed until after the announcement of the withdrawal is published). Manufacturers are reminded that an erroneous certification statement may result in the imposition of penalties--

(a) Under § 7206 for fraud and making false statements; and

(b) Under § 6701 for aiding and abetting an understatement of tax liability (in the amount of $1,000 per return on which a credit is claimed in reliance on the certification).

(6) *Availability of Certification Information.* Manufacturers are encouraged to provide a listing of qualified products and applicable certification information on their websites to facilitate taxpayer identification of qualified products.

.03 *Additional Requirements.* A taxpayer may claim a credit with respect to expenditures paid or incurred for Qualified Energy Property only if the following additional requirements are satisfied:

(1) The property is installed on or in connection with a dwelling unit located in the United States and, at the time of installation, the dwelling unit is owned and used by the taxpayer as the taxpayer's principal residence (within the meaning of § 121); and

(2) The property is originally placed in service by the taxpayer.

.04 *Installation Costs.* The credit is allowed for amounts paid or incurred to purchase Qualified Energy Property and for expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of the property.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1989.

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 4 and 5. This information is required to be collected and retained in order to ensure that property meets the requirements for the Nonbusiness Energy Credit under § 25C. This information will be used to determine whether the property for which manufacturers provide certifications is property that qualifies for the credit. The collection of information is required to obtain a benefit from manufacturers' certification statements that property qualifies for the credit. The likely respondents are corporations, partnerships, and individuals.

The estimated total annual reporting burden is 350 hours.

The estimated annual burden per respondent varies from 2 hours to 3 hours, depending on individual circumstances, with an estimated average burden of 2.5 hours to complete the requests for certification required under this notice. The estimated number of respondents is 140.

The estimated annual frequency of responses is on occasion.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Kelly R. Morrison-Lee of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Jennifer Bernardini at (202) 622-3120 (not a toll-free call).

Part III - Administrative, Procedural, and Miscellaneous

Certification of Energy Efficient Home Credit

Notice 2006-27

SECTION 1. PURPOSE

This notice sets forth a process under which an eligible contractor who constructs a dwelling unit (other than a manufactured home) may obtain a certification that the dwelling unit is an energy efficient home that satisfies the requirements of § 45L(c)(1)(A) and (B) of the Internal Revenue Code. This notice also provides for a public list of software programs that may be used in calculating energy consumption for purposes of obtaining a certification that satisfies the requirements of § 45L(d). Guidance relating to manufactured homes will be provided in a separate notice.

SECTION 2. BACKGROUND

.01 In General. Section 45L provides a credit to an eligible contractor who constructs a qualified new energy efficient home. For qualified new energy efficient homes (other than manufactured homes), the amount of the credit is $2,000. A dwelling unit qualifies for the credit if--

(1) It is located in the United States;

(2) Its construction is substantially completed after August 8, 2005;

(3) It meets the energy saving requirements of § 45L(c)(1); and

(4) It is acquired from the eligible contractor after December 31, 2005, and before January 1, 2008, for use as a residence.

.02 Energy Saving Requirements. To meet the energy saving requirements of § 45L(c)(1), a dwelling unit must be certified to provide a level of heating and cooling energy consumption that is at least 50 percent below that of a comparable dwelling unit constructed in accordance with the standards of section 404 of the 2004 Supplement to the 2003 International Energy Conservation Code (2004 IECC Supplement), and to have building envelope component improvements that provide for a level of heating and cooling energy consumption that is at least 10 percent below that of a comparable dwelling unit. For this purpose, heating and cooling energy and cost savings must be calculated in accordance with the procedures prescribed in Residential Energy Services Network (RESNET) Publication No. 05-001 (Nov. 17, 2005).

SECTION 3. CERTIFICATION

A contractor must obtain the certification required under § 45L(c)(1) with respect to a dwelling unit (other than a manufactured home) from an eligible certifier before claiming the energy efficient home credit with respect to the dwelling unit. A contractor is not required to file the certification with the return on which the credit is claimed. However, § 1.6001-1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any credit claimed by the taxpayer. Accordingly, an eligible contractor

claiming a $2,000 credit under § 45L should retain the certification as part of the eligible contractor's records to satisfy this requirement. The certification will be treated as satisfying the requirements of § 45L(c)(1) if all construction has been performed in a manner consistent with the design specifications provided to the eligible certifier and the certification contains all of the following:

.01 The name, address, and telephone number of the eligible certifier.

.02 The address of the dwelling unit.

.03 A statement by the eligible certifier that--

(1) The dwelling unit has a projected level of annual heating and cooling energy consumption that is at least 50 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone;

(2) Building envelope component improvements alone account for a level of annual heating and cooling energy consumption that is at least 10 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone; and

(3) Heating and cooling energy and cost savings have been calculated in the manner prescribed in section 2.02 of this notice.

.04 A statement by the eligible certifier that field inspections of the dwelling unit (or of other dwelling units under the sampling protocol described below) performed by the eligible certifier during and after the completion of construction have confirmed that all features of the home affecting such heating and cooling energy consumption comply with the design specifications provided to the eligible certifier. With respect to builders

who build at least 85 homes a year or build subdivisions with the same floor plan using the same subcontractors, the eligible certifier may use the sampling protocol found in the current ENERGY STAR® for Homes Sampling Protocol Guidelines instead of inspecting all of the homes. The sampling protocols can be found at the following web address:

http://www.energystar.gov/index.cfm?c=bldrs_lenders_raters.pt_homes_policies#SamplingProtocol

.05 A list identifying--

(1) The dwelling unit's energy efficient building envelope components and their respective energy performance rating as required by section 401.3 of the 2004 IECC Supplement; and

(2) The energy efficient heating and cooling equipment installed in the dwelling unit and the energy efficiency performance of such equipment as rated under applicable Department of Energy Appliance Standards test procedures.

.06 Identification of the listed software program used to calculate energy consumption (see section 5 of this notice).

.07 A declaration, applicable to the certification and any accompanying documents, signed by a person currently authorized to bind the eligible certifier in these matters, in the following form:

> "Under penalties of perjury, I declare that I have examined this certification, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this certification are true, correct, and complete."

SECTION 4. DEFINITIONS

The following definitions apply for purposes of this notice:

(1) Building envelope components are basement walls, exterior walls, floor, roof, and any other building element that encloses conditioned space, including any boundary between conditioned space and unconditioned space.

(2) A climate zone is a geographical area within which all locations have similar long-term climate conditions as defined in Chapter 3 of the 2004 IECC Supplement.

(3) A dwelling unit is a single unit providing complete independent living facilities for one or more persons, including permanent provisions for living, sleeping, eating, cooking, and sanitation, within a building that is not more than three stories above grade in height.

(4) An eligible certifier is a person that is not related (within the meaning of § 45(e)(4)) to the eligible contractor and has been accredited or otherwise authorized by RESNET (or an equivalent rating network) to use energy performance measurement methods approved by RESNET (or the equivalent rating network). An employee or other representative of a utility or local building regulatory authority may qualify as an eligible certifier if the employee or representative has been accredited or otherwise authorized by RESNET (or an equivalent rating network) to use the approved energy performance measurement methods.

(5) An eligible contractor is the person that constructed a qualified new energy efficient home.

(6) A manufactured home is a dwelling unit constructed in accordance with the

Federal Manufactured Home Construction and Safety Standards (24 C.F.R § 3280).

(7) A reference dwelling unit is a dwelling unit that is comparable to the dwelling unit constructed by the eligible contractor except that--

(a) The comparable dwelling unit is constructed in accordance with the minimum standards of Chapter 4 of the 2004 IECC Supplement;

(b) The comparable dwelling unit's air conditioners have a Seasonal Energy Efficiency Ratio (SEER) of 13, measured in accordance with 10 C.F.R. 430.23(m); and

(c) The comparable dwelling unit's heat pumps have a SEER of 13 and a Heating Seasonal Performance Factor (HSPF) of 7.7, measured in accordance with 10 C.F.R. 430.23(m).

SECTION 5. SOFTWARE PROGRAMS

.01 In General. The Internal Revenue Service will create and maintain a public list of software programs that may be used to calculate energy consumption for purposes of providing a certification under section 3 of this notice. A software program will be included on the original list if the software developer submits the following information to the Service and RESNET:

(1) The name, address, and telephone number of the software developer;

(2) The name or other identifier of the program as it will appear on the list;

(3) The test results, test runs, and the software program with which the test was conducted; and

(4) A declaration by the developer of the software program, made under

penalties of perjury, that the software program has satisfied all tests required to conform to the software accreditation process prescribed in RESNET Publication No. 05-001 (Nov. 17, 2005).

.02 Addresses. Submissions under this section must be addressed as follows:

Submissions to the Service submitted by U. S. mail:

Internal Revenue Service
Attn: Program Administrator
CC:PSI:7, Room 4315
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Submissions to the Service submitted by a private delivery service:

Internal Revenue Service
Attn: Program Administrator
CC:PSI:7, Room 4315
1111 Constitution Ave., N.W.
Washington, DC 20224

Submissions to RESNET:

Residential Energy Services Network
P.O. Box 4561
Oceanside, CA 92052-4561

.03 Original and Updated Lists. A software program will be included on the original list if the software developer's submission is received before March 1, 2006. The list will be updated as necessary to reflect submissions received after February 28, 2006.

.04 Removal from Published List. The Service may, upon examination (and after appropriate consultation with the Department of Energy), determine that a software program is not sufficiently accurate to justify its use in calculating energy consumption for purposes of providing a certification under section 3 of this notice and remove the

software program from the published list. The Service may undertake an examination on its own initiative or in response to a public request supported by appropriate analysis of the software program's deficiencies.

.05 Effect of Removal from Published List. A software program may not be used to calculate energy consumption for purposes of providing a certification that satisfies the requirements of § 45L after the date on which the software is removed from the published list. The removal will not affect the validity of any certification provided with respect to a dwelling unit on or before the date on which the software is removed from the published list.

.06 Public Availability of Information. RESNET may make available for public review any information provided to it under section 5.01 of this notice.

SECTION 6. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545 -1995.

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 and 5. This information is required to be collected and retained in order to ensure that a dwelling unit (other than a manufactured home) meets the requirements for the energy efficient home credit under § 45L. This information will be used to determine whether property

for which certifications are provided is property that qualifies for the credit. The collection of information is required to obtain a benefit. The likely respondents are corporations and partnerships.

The estimated total annual reporting burden is 180 hours.

The estimated annual burden per respondent varies from 2.5 hours to 4 hours, depending on individual circumstances, with an estimated average burden of 3 hours to complete the certification required under this notice. The estimated number of respondents is 45.

The estimated annual frequency of responses is on occasion.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Jennifer C. Bernardini at (202) 622-3120 (not a toll-free call).

Part III – Administrative, Procedural, and Miscellaneous

Energy Efficient Home Credit; Manufactured Homes

Notice 2006-28

SECTION 1. PURPOSE

This notice sets forth a process under which an eligible contractor who constructs a manufactured home may obtain a certification that the dwelling unit is an energy efficient home that satisfies the requirements of § 45L(c)(2) or (3) of the Internal Revenue Code. This notice also provides for a public list of software programs that may be used in calculating energy consumption for purposes of providing a certification that satisfies the requirements of § 45L(d). Guidance relating to other dwelling units will be provided in a separate notice.

SECTION 2. BACKGROUND

.01 In General. Section 45L provides a credit to an eligible contractor who constructs a qualified new energy efficient home. For qualified new energy efficient homes that are manufactured homes, the amount of the credit is $1,000 or $2,000, depending on the energy savings that are achieved. A manufactured home qualifies for the credit if:

(1) It is located in the United States;

(2) Its construction is substantially completed after August 8, 2005;

(3) It meets the energy saving requirements of § 45L(c)(2) or (3); and

(4) It is acquired, directly or indirectly, from the eligible contractor after December 31, 2005, and before January 1, 2008, for use as a residence.

.02 Energy Saving Requirements. To meet the energy saving requirements of § 45L(c)(2) or (3), a manufactured home must meet one of the following standards:

(1) To meet the energy saving requirements of § 45L(c)(2) and qualify for the $2,000 credit, a manufactured home must be certified to provide a level of heating and cooling energy consumption that is at least 50 percent below that of a comparable manufactured home constructed in accordance with the standards of section 404 of the 2004 Supplement to the 2003 International Energy Conservation Code (2004 IECC Supplement), and to have building envelope component improvements that provide for a level of heating and cooling energy consumption that is at least 10 percent below that of a comparable dwelling unit (see section 3 of this notice); or

(2) To meet the energy saving requirements of § 45L(c)(3) and qualify for the $1,000 credit, a manufactured home must either--

(a) be certified to provide a level of heating and cooling energy consumption that is at least 30 percent below that of a comparable manufactured home constructed in accordance with the standards of section 404 of the 2004 IECC Supplement, and to have building envelope component improvements that provide for a

level of heating and cooling energy consumption that is at least 10 percent below that of a comparable dwelling unit; or

(b) meet the current requirements established by the Administrator of the Environmental Protection Agency under the ENERGY STAR® Labeled Homes Program in effect on the date construction is substantially completed (See section 4 of this notice).

.03 For purposes of section 2.02 of this notice, heating and cooling energy and cost savings must be calculated in accordance with the procedures prescribed in Residential Energy Services Network (RESNET) Publication No. 05-001 (Nov. 17, 2005).

SECTION 3. REQUIREMENTS TO CLAIM THE $2,000 CREDIT

An eligible contractor must obtain the certification required under § 45L(c)(2) with respect to a manufactured home from an eligible certifier before claiming the $2,000 energy efficient home credit with respect to the manufactured home. An eligible contractor is not required to attach the certification to the return on which the credit is claimed. However, § 1.6001-1(a)of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any deduction claimed by the taxpayer. Accordingly, an eligible contractor claiming a $2,000 credit under § 45L should retain the certification as part of the eligible contractor's records to satisfy this requirement. The certification will be treated as satisfying the requirements of § 45L(c)(2) if all construction has been

performed in a manner consistent with the design specifications provided to the eligible certifier and the certification contains all of the following:

.01 The name, address, and telephone number of the eligible certifier;

.02 The dwelling unit's serial or other identification number;

.03 A statement by the eligible certifier that--

(1) The dwelling unit has a projected level of annual heating and cooling energy consumption that is at least 50 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone;

(2) Building envelope component improvements alone account for a level of annual heating and cooling energy consumption that is at least 10 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone; and

(3) Heating and cooling energy and cost savings have been calculated in the manner prescribed in section 2.02(3) of this notice;

.04 A statement by the eligible certifier that field inspections of the dwelling unit (or of other dwelling units under the sampling protocol described below) performed by the eligible certifier after installation on the permanent site have confirmed that such heating and cooling energy consumption complies with the design specifications provided to the eligible certifier. With respect to manufacturers who manufacture at least 85 homes a year, the certifier may use the sampling protocol found in the current standards of the ENERGY STAR® Qualified Manufactured Homes – Design, Manufacturing, Installation, and Certification Procedures, located at the following web

address:

http://www.energystar.gov/index.cfm?c=bldrs_lenders_raters.pt_builder_manufactured

.05 A list identifying--

(1) The dwelling unit's energy efficient building envelope components and their respective energy performance rating as required by section 401.3 of the 2004 IECC Supplement; and

(2) The energy efficient heating and cooling equipment installed in the dwelling unit and the energy efficiency performance of such equipment as rated under applicable Department of Energy Appliance Standards test procedures;

.06 A statement identifying the listed software program used to calculate energy consumption (see section 6 of this notice); and

.07 A declaration, applicable to the certification and any accompanying documents, signed by a person currently authorized to bind the eligible certifier in such matters, in the following form:

> "Under penalties of perjury, I declare that I have examined this certification, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this certification are true, correct, and complete."

SECTION 4. REQUIREMENTS TO CLAIM THE $1,000 CREDIT

.01 Certified Homes. Except as provided in section 4.02 of this notice, an eligible contractor must obtain the certification required under § 45L(c)(3)(A) with respect to a manufactured home from an eligible certifier before claiming the $1,000 energy efficient

home credit with respect to the manufactured home. An eligible contractor is not required to attach the certification to the return on which the credit is claimed. However, § 1.6001-1(a) requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any deduction claimed by the taxpayer. Accordingly, an eligible contractor claiming a $1,000 credit under § 45L should retain the certification as part of the eligible contractor's records to satisfy this requirement. The certification will be treated as satisfying the requirements of § 45L(c)(3)(A) if all construction has been performed in a manner consistent with the design specifications provided to the eligible certifier and the certification contains all of the following:

(1) The name, address, and telephone number of the eligible certifier;

(2) The dwelling unit's serial or other identification number;

(3) A statement by the eligible certifier that--

(a) The dwelling unit has a projected level of annual heating and cooling energy consumption that is at least 30 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone;

(b) Building envelope component improvements alone account for a level of annual heating and cooling energy consumption that is at least 10 percent below the annual level of heating and cooling energy consumption of a reference dwelling unit in the same climate zone; and

(c) Heating and cooling energy and cost savings have been calculated in the manner prescribed in section 2.02(3) of this notice;

(4) A statement by the eligible certifier that field inspections of the dwelling unit (or of other dwelling units under the sampling protocol described below) performed by the eligible certifier after installation on the permanent site have confirmed that such heating and cooling energy consumption complies with the design specifications provided to the eligible certifier. With respect to manufacturers who manufacture at least 85 homes a year, the certifier may use the sampling protocol found in the current standards of the current ENERGY STAR® Qualified Manufactured Homes: Guide for Retailers, located at the following web address: *http://www.energystar.gov/index.cfm?c=bldrs_lenders_raters.pt_builder_manufactured*

(5) A list identifying--

(a) The dwelling unit's energy efficient building envelope components and their respective energy performance rating as required by section 401.3 of the 2004 IECC Supplement; and

(b) The energy efficient heating and cooling equipment installed in the dwelling unit and the energy efficiency performance of the equipment as rated under applicable Department of Energy Appliance Standards test procedures;

(6) A statement identifying the listed software program used to calculate energy consumption (see section 6 of this notice); and

(7) A declaration, applicable to the certification and any accompanying documents, signed by a person currently authorized to bind the eligible certifier in these matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of this certification are true, correct, and complete."

.02 Energy Star Homes. An eligible contractor may claim the $1,000 energy efficient home credit with respect to a manufactured home by meeting the applicable certification requirements established by the Administrator of the Environmental Protection Agency under the ENERGY STAR® Labeled Homes Program in effect on the date construction is substantially completed.

SECTION 5. DEFINITIONS

The following definitions apply for purposes of this notice:

.01 Building envelope components are basement walls, exterior walls, floor, roof, and any other building element that encloses conditioned space, including any boundary between conditioned space and unconditioned space;

.02 A climate zone is a geographical area within which all locations have similar long-term climate conditions as defined in Chapter 3 of the 2004 IECC Supplement;

.03 A dwelling unit is a single unit providing complete independent living facilities for one or more persons, including permanent provisions for living, sleeping, eating, cooking, and sanitation, within a building that is not more than three stories above grade in height;

.04 An eligible certifier is a person that is not related (within the meaning of

§ 45(e)(4)) to the eligible contractor and has been accredited or otherwise authorized by RESNET (or an equivalent rating network) to use energy performance measurement methods approved by RESNET (or an equivalent rating network). An employee or other representative of a utility or local building regulatory authority may qualify as an eligible certifier if the employee or representative has been accredited or otherwise authorized by RESNET (or an equivalent rating network) to use the approved energy performance measurement methods;

.05 An eligible contractor in the case of a qualified new energy efficient home that is a manufactured home is the manufactured home producer of the home;

.06 A manufactured home is a dwelling unit constructed in accordance with the Federal Manufactured Home Construction and Safety Standards (24 C.F.R. § 3280); and

.07 A reference dwelling unit is a dwelling unit that is comparable to the manufactured home produced by the eligible contractor except that--

(a) The comparable dwelling unit is constructed in accordance with the minimum standards of Chapter 4 of the 2004 IECC Supplement;

(b) The comparable dwelling unit's air conditioners have a Seasonal Energy Efficiency Ratio (SEER) of 13, measured in accordance with 10 C.F.R. 430.23(m); and

(c) The comparable dwelling unit's heat pumps have a SEER of 13 and a Heating Seasonal Performance Factor (HSPF) of 7.7, measured in accordance with 10 C.F.R. 430.23(m).

SECTION 6. SOFTWARE PROGRAMS

.01 In General. The Internal Revenue Service will create and maintain a public list of software programs that may be used to calculate energy consumption for purposes of providing a certification under section 3 or 4 of this notice. A software program will be included on the list if the software developer submits the following information to the Service and RESNET:

(1) The name, address, and telephone number of the software developer;

(2) The name or other identifier of the program as it will appear on the list;

(3) The test results, test runs, and the software program with which the test was conducted; and

(4) A declaration by the developer of the software program, made under penalties of perjury, that the software program has satisfied all tests required to conform to the software accreditation process prescribed in RESNET Publication No. 05-001 (Nov. 17, 2005).

.02 Addresses. Submissions under this section must be addressed as follows:

Submissions to the Service submitted by U. S. mail:

Internal Revenue Service
Attn: Program Administrator
CC:PSI:7, Room 4315
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Submissions to the Service submitted by a private delivery service:

Internal Revenue Service
Attn: Program Administrator
CC:PSI:7, Room 4315

1111 Constitution Ave., N.W.
Washington, DC 20224

Submissions to RESNET: Residential Energy Services Network
P.O. Box 4561
Oceanside, CA 92052-4561

.03 Original and Updated Lists. A software program will be included on the original list if the software developer's submission is received before March 1, 2006. The list will be updated as necessary to reflect submissions received after February 28, 2006.

.04 Removal from Published List. The Service may, upon examination (and after appropriate consultation with the Department of Energy), determine that a software program is not sufficiently accurate to justify its use in calculating energy consumption for purposes of providing a certification under sections 3 and 4 of this notice and remove the software from the published list. The Service may undertake an examination on its own initiative or in response to a public request supported by appropriate analysis of the software program's deficiencies.

.05 Effect of Removal from Published List. A software program may not be used to calculate energy consumption for purposes of providing a certification that satisfies the requirements of § 45L after the date on which the software is removed from the published list. The removal will not affect the validity of any certification provided with respect to a dwelling unit on or before the date on which the software is removed from the published list.

.06 Public Availability of Information. RESNET may make available for public review any information provided to it under section 6.01 of this notice.

SECTION 7. SALES TO DEALERS

.01 In General. In the case of a manufactured home sold by an eligible contractor to a dealer of manufactured homes, the eligible contractor may rely on a statement by the dealer to establish the date on which a manufactured home is acquired, that it is located in the United States, and that it is acquired for use as a residence. The eligible contractor is not required to attach the statement to the return on which the credit is claimed. However, § 1.6001-1(a) requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any deduction claimed by the taxpayer. Accordingly, an eligible contractor claiming a $1,000 credit under § 45L should retain the statement as part of its records to satisfy this requirement, and is not entitled to rely on the statement unless the statement is so retained.

.02 Content of Statement. The eligible contractor may not rely on the statement by the dealer unless the statement specifies the date of the retail sale of the manufactured home, that the dealer delivered the manufactured home to the purchaser at an address in the United States, and that the dealer has no knowledge of any information suggesting that the purchaser will use the manufactured home other than as a residence. The statement must also contain the following information:

(1) The name, address, and telephone number of the dealer; and

(2) A declaration, applicable to the statement made by a dealer and any accompanying documents, signed by a person currently authorized to bind the dealer in such matters, in the following form:

"Under penalties of perjury, I declare that to the best of my knowledge and belief, the facts presented with respect to this sale transaction are true, correct, and complete."

SECTION 8. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1994.

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, 6, and 7. This information is required to be collected and retained in order to ensure that a manufactured home meets the requirements for the energy efficient home credit under § 45L. This information will be used to determine whether property for which certifications are provided is property that qualifies for the credit. The collection of information is required to obtain a benefit. The likely respondents are corporations, partnerships, and individuals.

The estimated total annual reporting burden is 75 hours.

The estimated annual burden per respondent varies from 3.5 hours to 5 hours, depending on individual circumstances, with an estimated average burden of 4 hours to complete the certification required under this notice. The estimated number of respondents is 15.

The estimated annual frequency of responses is on occasion.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Jennifer C. Bernardini at (202) 622-3120 (not a toll-free call).

PRESS ROOM

February 23, 2006
js-4063

MEDIA ADVISORY:
Press Briefing: Treasury Department Reaction to the Rudman Report

Please join Randy Quarles, the Treasury Department's Under Secretary for Domestic Finance, for a press briefing on the Rudman Report on Government Sponsored Enterprises.

WHO: Randy Quarles, Under Secretary for Domestic Finance

WHAT: Press Briefing

WHEN: **TODAY, February 23 at 10:30 AM EST**

WHERE: Department of the Treasury, Media Room - 4121

Media without Treasury press credentia.s (including media with White House credentials) planning to attend should contact Carmen Alvarado in Treasury's Office of Public Affairs at (202) 622-2920 or Carmen.alvarado@do.treas.gov. Please be prepared to provide her with the following information: full name, social security number, citizenship and date of birth.

-30-

PRESS ROOM

February 23, 2006
JS-4064

Statement by Under Secretary for International Affairs Timothy D. Adams Kuala Lumpur, Malaysia

Thank you for coming today. Malaysia is my second stop on an extended trip through East Asia. I met and will meet today with senior economic officials as well as members of the Malaysian and international business community. What I told them, and what I will emphasize throughout this trip, is that the United States remains committed to East Asia. Our relationships here are deep and strong and we will continue to maintain these critical partnerships.

The past few years have been very good ones for the world economy, with high and widespread growth and low inflation. Economies in East Asia have made a very large contribution to this good performance. In my meetings with government officials I congratulated them on the sound monetary and fiscal policies that have underpinned Malaysia's growth.

I encourage Malaysia to continue with structural reforms, improvements to the investment climate and strengthening of the financial services sector. One important way that Malaysia can continue to strengthen its financial services sector is through increased foreign participation. It is essential that Malaysia continue the opening of this market in the context of the ongoing Doha trade round.

The trade relationship between our two countries is deep: the U.S. has been Malaysia's top trade partner since 1999 and Malaysia is the tenth largest trade partner for the U.S. I look forward to discussing ways to provide new trade opportunities that will benefit both the U.S. and Malaysia.

I am also here to discuss the July 21 changes to the Malaysian exchange rate regime and the contributions that exchange rate policy could make to sustaining future growth. While recognizing the value of a stable exchange rate for a highly open economy like Malaysia,

I believe that greater exchange rate flexibility under the new regime would help Malaysia adjust to changes in the world economy and help ensure continued economic growth.

We at U.S. Treasury feel strongly that continuing to open the doors to vibrant trade relations, as well as ensuring the free flow of capital and market-based exchange rates, are the keys to strong global growth.

-30-

PRESS ROOM

February 23, 2006
js-4065

Statement of Under Secretary Randy Quarles on Treasury's Reaction to the Rudman Report

The Rudman report lays bare the earnings-at-any-cost culture that had developed over many years at Fannie Mae, and the substantial abuses that resulted. A principal vehicle for generating these earnings was the enormous growth in the portfolio of retained mortgages, and that remains the principal legacy of this decade of abuse. While Senator Rudman's report indicates that a number of the specific accounting violations and corporate governance problems are in the process of repair, the broad systemic risks inherent in the retained portfolio that was at the heart of the process remain unchanged. In addition, the retained portfolio provides little added value to achieving the GSE's mission. That is why we need legislative reform. Treasury remains committed to seeing the presence of a world class regulator for the GSEs and ensuring a legislative mandate for reduction of the retained portfolios to reduce systemic risk.

- 30 -

PRESS ROOM

February 23, 2006
js-4066

TREASURY SECRETARY VISITS MEMPHIS SOLAR PANEL MANUFACTURER

MEMPHIS, TENN. – Treasury Secretary John Snow is in Memphis, Tenn. this morning, where he toured Sharp Electronics and discussed tax incentives for solar energy with company leaders.

"Solar energy is one of the many alternative energy sources that President Bush would like to see developed and used more in the coming years as we seek to reduce our dependence on foreign oil," Snow said. "It's wonderful to see the innovation and research going on here at Sharp Electronics – from here it's easy to see how much promise there is in this clean, abundant, widespread and renewable energy resource."

Snow went on to speak about the President's commitment alternative energy resources, such as innovative technologies that can harness the energy of the sun. "As part of his Advanced Energy Initiative, the President proposed a new $148 million Solar America Initiative in his 2007 Budget to accelerate the development of advanced photovoltaic (PV) materials that convert sunlight directly to electricity. The goal there is to make solar PV cost-competitive with other forms of renewable electricity by 2015," Snow explained.

The Secretary also emphasized that tax incentives for solar energy were included in Energy Policy Act that President Bush signed last summer. "The President's commitment to the expanded use and further development of solar energy was evident in his Energy Policy Act, and it continues today."

ENERGY POLICY ACT SOLAR TAX INCENTIVES:

Residential:
• A 30-percent tax credit, subject to a $2,000 annual cap is available through the end of 2007.

Businesses:
• Temporary increase in the tax credit allowed to business investments in solar energy equipment – 30 percent credit for 2006 & 2007, 10 percent after 2007.

"Solar energy will be a vital part of the Nation's energy supply for future generations, and tax incentives for American consumers and businesses developing solar technologies like Sharp is the best thing our government can do to spur innovation and increase demand," Snow concluded.

For more information on the President's Advanced Energy Initiative go to: www.whitehouse.gov/stateoftheunion/2006/energy/index.html

- 30 -

PRESS ROOM

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February 23, 2006
js-4067

Snow Letters to Tax Relief Conferees

To: Members of the Press
From: Tony Fratto
Assistant Secretary of Public Affairs
U.S. Department of the Treasury

Re: Letters to Tax Relief Conferees

Please find, attached, copies of letters from Treasury Secretary John Snow to the conference committee on tax relief reconciliation. This letter was sent today to Chairmen Grassley and Thomas as well as Senators Baucus and Kyl, Congressmen Stark, Rangel, McCrery and Camp.

REPORTS

- Chairmen Grassley
- Chairmen Thomas

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 23, 2006

The Honorable Charles Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Grassley:

As you work through the conference on tax relief reconciliation, I write to offer the Administration's views on major issues raised by this important legislation. In particular, I would like to reaffirm the position expressed in our Statements of Administration Policy to the House and Senate of the Administration's strong support for the extension in this legislation of dividends and capital gains tax relief included in the House-passed bill.

Since the dividends and capital gains tax relief was enacted in 2003, it has contributed directly to the strengthening of our economy, helping to create over four and a half million new jobs and raise living standards. Business investment has rebounded and grown for 10 straight quarters, and, since higher investment brings jobs, it is not surprising that we have also had 10 straight quarters of steady job growth. And most of these jobs are paying above the median wage. With the unemployment rate now at 4.7%, there can be little doubt that this tax relief has benefited American workers, families, and businesses. This is in addition to the direct benefit seen by the 50% of American households that own equities, many of whom are seniors and approximately 40% of whom earn less than $50,000 per year. It is essential that this tax relief be extended for as long as possible and that Congress prevent a tax increase on the American people that would damage the very engine of job creation.

The Senate-passed bill contains a number of provisions that are consistent with the President's objective to promote charitable giving. Enactment of charitable giving incentives, such as those included in the President's FY 2007 Budget, is a high priority for the Administration. We look forward to working with the conferees on these provisions.

The Administration has significant concerns with a number of revenue offset provisions in the Senate-passed bill, especially those that increase the complexity of the tax code or target taxpayers in specific industries. For example, the Administration has strong concerns with the provision in the Senate-passed bill that would codify the "economic substance" doctrine and urges Congress to eliminate this provision from the final legislation. The Administration also opposes the provision in the Senate-passed bill that would disallow use of the last-in, first-out (LIFO) method of accounting for certain taxpayers. This provision would result in a retroactive

tax increase by changing a long-accepted accounting practice. As we have stated previously, the President's senior advisors would recommend that the President veto the legislation if this provision remains in the final legislation.

The Administration supports the extension of a number of important expired or expiring tax provisions, as provided for in both the House and Senate-passed bills. The Administration strongly supports extension of the Research and Experimentation tax credit for as long a period of time as possible. We will work with the conferees to ensure that any extension of this important provision is properly crafted and improves the effectiveness of the credit. The Administration also strongly supports extension of increased expensing for small businesses, which would provide a number of benefits to small business taxpayers and the economy.

Both the House and Senate have passed measures that would provide relief from the alternative minimum tax (AMT) for 2006. As outlined in the FY 2007 Budget, the Administration supports a one-year "patch" for the AMT. We urge Congress to enact an AMT patch this year.

Finally, the Administration has serious concerns with non-tax-related items in the Senate-passed tax relief bill that are unrelated to the purposes of the bill and strongly urges that such items not be included in the final legislation.

On behalf of the Administration, let me express our willingness to provide assistance during the deliberations of the conference committee. I look forward to working with you to enact legislation that will ensure that the tax relief for dividends and capital gains passed in 2003 continues to be an engine for economic growth.

Sincerely,

John W. Snow

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 23, 2006

The Honorable William M. Thomas
Chairman
Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Thomas:

As you work through the conference on tax relief reconciliation, I write to offer the Administration's views on major issues raised by this important legislation. In particular, I would like to reaffirm the position expressed in our Statements of Administration Policy to the House and Senate of the Administration's strong support for the extension in this legislation of dividends and capital gains tax relief included in the House-passed bill.

Since the dividends and capital gains tax relief was enacted in 2003, it has contributed directly to the strengthening of our economy, helping to create over four and a half million new jobs and raise living standards. Business investment has rebounded and grown for 10 straight quarters, and, since higher investment brings jobs, it is not surprising that we have also had 10 straight quarters of steady job growth. And most of these jobs are paying above the median wage. With the unemployment rate now at 4.7%, there can be little doubt that this tax relief has benefited American workers, families, and businesses. This is in addition to the direct benefit seen by the 50% of American households that own equities, many of whom are seniors and approximately 40% of whom earn less than $50,000 per year. It is essential that this tax relief be extended for as long as possible and that Congress prevent a tax increase on the American people that would damage the very engine of job creation.

The Senate-passed bill contains a number of provisions that are consistent with the President's objective to promote charitable giving. Enactment of charitable giving incentives, such as those included in the President's FY 2007 Budget, is a high priority for the Administration. We look forward to working with the conferees on these provisions.

The Administration has significant concerns with a number of revenue offset provisions in the Senate-passed bill, especially those that increase the complexity of the tax code or target taxpayers in specific industries. For example, the Administration has strong concerns with the provision in the Senate-passed bill that would codify the "economic substance" doctrine and urges Congress to eliminate this provision from the final legislation. The Administration also opposes the provision in the Senate-passed bill that would disallow use of the last-in, first-out (LIFO) method of accounting for certain taxpayers. This provision would result in a retroactive

tax increase by changing a long-accepted accounting practice. As we have stated previously, the President's senior advisors would recommend that the President veto the legislation if this provision remains in the final legislation.

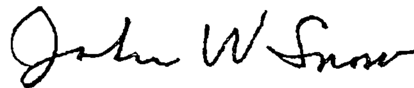
The Administration supports the extension of a number of important expired or expiring tax provisions, as provided for in both the House and Senate-passed bills. The Administration strongly supports extension of the Research and Experimentation tax credit for as long a period of time as possible. We will work with the conferees to ensure that any extension of this important provision is properly crafted and improves the effectiveness of the credit. The Administration also strongly supports extension of increased expensing for small businesses, which would provide a number of benefits to small business taxpayers and the economy.

Both the House and Senate have passed measures that would provide relief from the alternative minimum tax (AMT) for 2006. As outlined in the FY 2007 Budget, the Administration supports a one-year "patch" for the AMT. We urge Congress to enact an AMT patch this year.

Finally, the Administration has serious concerns with non-tax-related items in the Senate-passed tax relief bill that are unrelated to the purposes of the bill and strongly urges that such items not be included in the final legislation.

On behalf of the Administration, let me express our willingness to provide assistance during the deliberations of the conference committee. I look forward to working with you to enact legislation that will ensure that the tax relief for dividends and capital gains passed in 2003 continues to be an engine for economic growth.

Sincerely,



John W. Snow

PRESS ROOM

February 23, 2006
js-4068

U.S. Treasury Secretary John W. Snow to Visit Richmond to Promote New Tax Credits for Home Energy Efficiency

U.S. Treasury Secretary John W. Snow will visit Richmond, Virginia Friday, February 24, 2006 to promote new tax credits for home energy efficiency. While in Richmond, Secretary Snow will visit the home of the Charles Donato family to discuss the availability of new tax credits for homeowners who improve the energy efficiency of their existing homes. The new tax credits are part of President Bush's Energy Policy Act. The following event is open to credentialed media:

Who U. S. Treasury Secretary John W. Snow

What Site Visit

When Friday, February 24, 10 a.m. (EST)

Where Home of the Charles Donato family
2906 Brixham Drive
Richmond, VA

Note: Media must RSVP to Jim Norvelle or Daisy Pridgen of Dominion at (804) 771-6115

- 30 -

PRESS ROOM

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February 24, 2006
JS-4069

Treasury Secretary Encourages Energy Efficiency at Home

Richmond, Va – Treasury Secretary John W. Snow, accompanied by a weatherization expert from Dominion, visited the home of Charles and Martha Donato today to discuss energy efficiency in the home. Snow highlighted the availability of new tax credits for homeowners who take steps to improve the energy efficiency of their homes.

"Improving the energy-efficiency of our homes is a highly effective ways of reducing our national energy consumption, which is a priority that the President set forth in his State of the Union Address this year," Snow said. "Guidance for two new tax credits, issued this week by the IRS, will provide incentive and reward for energy-saving efforts."

The tax credits described by Snow are part of the Energy Policy Act signed by President Bush last summer. Snow pointed out that "There can be no question that energy savings should start at home – and that's what these tax credits are all about. Homeowners who qualify for these credits will showcase a win-win scenario where precious energy is conserved while families also save money on heating and cooling bills – both goals of the President's Energy Policy Act of 2005."

Homeowner Credit Guidance

- **Timing:** Credits can be claimed in 2006 or 2007.
- **Who/What Qualifies & How Much:**
  - Homeowners may claim up to $500 in credits over the two-year period.
  - Energy-efficient improvements to the building envelope qualify for a 10 percent credit, e.g. insulation, exterior windows and doors (including storm windows and doors), and metal roofs (International Energy Conservation Code or the Environmental Protection Agency's Energy Star program standards may apply).
  - Certain heating and cooling equipment that meets the energy-efficiency standards specified in the Internal Revenue Code.
- **IRS Guidance:**
  - Establishes a process that manufacturers can use to certify their product(s) qualifies for the credit.
  - Affords certainty to homeowners, who will be permitted to rely on the manufacturer's certification when claiming the credit on their returns.

For more information on the President's Advanced Energy Initiative go to: www.whitehouse.gov/stateoftheunion/2006/energy/index.html

REPORTS

- Energy Guidance Homeown

Part III – Administrative, Procedural, and Miscellaneous

Credit for Nonbusiness Energy Property

Notice 2006-26

SECTION 1. PURPOSE

This notice sets forth interim guidance, pending the issuance of regulations, relating to the credit for nonbusiness energy property under § 25C of the Internal Revenue Code. Specifically, this notice provides procedures that manufacturers may follow to certify property as either an Eligible Building Envelope Component or Qualified Energy Property, as well as guidance regarding the conditions under which taxpayers seeking to claim the § 25C credit may rely on a manufacturer's certification (or, in the case of certain windows, an Energy Star label). The Internal Revenue Service and the Treasury Department expect that the regulations will incorporate the rules set forth in this notice.

SECTION 2. BACKGROUND

.01 Section 1333 of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), added § 25C to the Internal Revenue Code. Section 25C provides a credit against tax for the taxable year in an amount equal to the sum of--

(1) Ten percent of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements (that is, property described in section 4.01 of this notice) installed during the taxable year; and

(2) The amount of expenditures for residential energy property (that is, property described in section 5.01 of this notice) paid or incurred by the taxpayer during the taxable year.

.02 Under § 25C(b), the maximum amount of the credit allowable to a taxpayer under § 25C(a) for all taxable years is $500 ($200 in the case of amounts paid or incurred for exterior windows (including storm windows and skylights)). In addition, the maximum amount of credit allowed is--

(1) $50 for any advanced main air circulating fan;

(2) $150 for any qualified natural gas, propane, or oil furnace or hot water boiler; and

(3) $300 for any item of energy-efficient building property (that is, property described in section 5.01(1)-(7) of this notice).

.03 Section 25C(g) and § 1333(c) of the Energy Policy Act provide that the credit applies to property placed in service after December 31, 2005, and before January 1, 2008.

SECTION 3. REFERENCES TO INTERNATIONAL ENERGY CONSERVATION CODE

Manufacturers and taxpayers may treat any reference in this notice to the International Energy Conservation Code (IECC) as a reference to either the 2001

Supplement of the 2000 International Energy Conservation Code or the 2004 Supplement of the 2003 International Energy Conservation Code.

SECTION 4. QUALIFIED ENERGY EFFICIENCY IMPROVEMENTS

.01 *Eligible Building Envelope Components.*

The credit for qualified energy efficiency improvements is allowed with respect to the following building envelope components (Eligible Building Envelope Components):

(1) An insulation material or system (including any vapor retarder or seal to limit infiltration) that--

(a) Is specifically and primarily designed (within the meaning of section 4.04 of this notice) to reduce heat loss or gain of a dwelling unit when installed in or on the dwelling unit; and

(b) May be taken into account in determining whether the building thermal envelope requirements established by the IECC are satisfied;

(2) An exterior window, skylight, or door (other than a storm window or storm door) that meets or exceeds the prescriptive criteria established by the IECC for the climate zone in which the window, skylight, or door is installed;

(3) A storm window that, in combination with the exterior window over which it is installed, meets or exceeds the prescriptive criteria established by the IECC for the climate zone in which such storm window is installed;

(4) A storm door that, in combination with a wood door assigned a default U-factor by the IECC, does not exceed the default U-factor requirement assigned to such combination by the IECC; and

(5) Any metal roof that--

(a) Has appropriate pigmented coatings that are specifically and primarily designed to reduce the heat gain of a dwelling unit when installed on the dwelling unit; and

(b) Meets or exceeds Energy Star program requirements (as in effect at the time of installation).

.02 *Manufacturer's Certification.*

(1) *Requirements Applicable to Manufacturer.* The manufacturer of a building envelope component may certify to a taxpayer that the component is an Eligible Building Envelope Component by providing the taxpayer with a certification statement that satisfies the requirements of section 4.02(4) of this notice. The certification statement may be provided by including a written copy of the statement with the packaging of the component, in printable form on the manufacturer's website, or in any other manner that will permit the taxpayer to retain the certification statement for tax recordkeeping purposes.

(2) *Taxpayer Reliance.* Except as provided in section 4.02(3) and (6) of this notice, a taxpayer may rely on a manufacturer's certification that a building envelope component is an Eligible Building Envelope Component. A taxpayer is not required to attach the certification statement to the return on which the credit is claimed. However, § 1.6001-1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any credit claimed by the taxpayer. Accordingly, a taxpayer claiming a credit for an Eligible Building Envelope Component should retain the certification statement as part of the taxpayer's records for purposes of § 1.6001-1(a).

(3) *Reliance Permitted Only for Installation Consistent with Certification.* A taxpayer may rely on a manufacturer's certification that a building envelope component is an Eligible Building Envelope Component--

(a) In the case of an exterior window, skylight, or door (other than a storm window or storm door), only if the component is installed in a climate zone identified in the certification statement; and

(b) In the case of a storm window, only if the component is installed over an exterior window of a class identified in the certification statement and in a climate zone identified for that class of exterior window.

(4) *Content of Manufacturer's Certification Statement.* A manufacturer's certification statement must contain the following:

(a) The name and address of the manufacturer;

(b) Identification of the component as an insulation material or system, an exterior window or skylight, an exterior door, or a metal roof;

(c) The make, model number, and any other appropriate identifiers of the component;

(d) A statement that the component is an Eligible Building Envelope Component that qualifies for the credit allowed under § 25C;

(e) In the case of an exterior window, skylight, or door (other than a storm window or storm door), the climate zone or zones for which the applicable prescriptive criteria are satisfied;

(f) In the case of a storm window--

(i) The classes of exterior window (e.g., single pane; double pane, clear glass; double pane, Low-E coating) over which the storm window may be installed and that, in combination with the storm window, satisfy the applicable prescriptive criteria for one or more climate zones; and

(ii) For each such class of exterior window, the climate zone or zones for which the applicable prescriptive criteria are satisfied; and

(g) A declaration, signed by a person currently authorized to bind the manufacturer in such matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification statement, and to the best of my knowledge and belief, the facts are true, correct, and complete."

(5) *Manufacturer's Records.* A manufacturer that certifies to a taxpayer that a component is an Eligible Building Envelope Component must retain in its records documentation establishing that the component satisfies the applicable conditions of section 4.01 of this notice including, in the case of an exterior window, its National Fenestration Rating Council (NFRC) rating. The manufacturer must, upon request, make such documentation available for inspection by the Service.

(6) *Effect of Erroneous Certification or Failure to Satisfy Documentation Requirements.* The Service may, upon examination (and after any appropriate consultation with the Department of Energy (DOE) or Environmental Protection Agency (EPA)), determine that a component that has been certified under this section is not an Eligible Building Envelope Component. In that event, or if the component's manufacturer fails to satisfy the requirements relating to documentation in section 4.02(5)

of this notice, the manufacturer's right to provide a certification on which future purchasers of the component can rely will be withdrawn, and taxpayers purchasing the component after the date on which the Service publishes an announcement of the withdrawal may not rely on the manufacturer's certification. Taxpayers may continue to rely on the certification for components purchased on or before the date on which the announcement of the withdrawal is published (including in cases in which the component is not installed and the credit is not claimed until after the announcement of the withdrawal is published). Manufacturers are reminded that an erroneous certification statement may result in the imposition of penalties--

(a) Under § 7206 for fraud and making false statements; and

(b) Under § 6701 for aiding and abetting an understatement of tax liability (in the amount of $1,000 per return on which a credit is claimed in reliance on the certification).

(7) *Availability of Certification Information.* Manufacturers are encouraged to provide a listing of qualified components and applicable certification information on their websites to facilitate taxpayer identification of qualified components.

.03 *Special Rule for Energy Star Windows and Skylights.* A taxpayer may treat an exterior window or skylight that bears an Energy Star label and is installed in the region identified on the label as an Eligible Building Envelope Component and may rely on such Energy Star label, rather than on a manufacturer's certification statement, in claiming the § 25C credit.

.04 *Specifically and Primarily Designed.* A component is not specifically and primarily designed to reduce heat loss or gain of a dwelling unit if its principal purposes are to provide structural support, to provide a finished surface, as in the case of drywall or siding, or to serve any other function unrelated to the reduction of heat loss or gain. The principal purpose of a component serves functions unrelated to the reduction of heat loss or gain if production costs attributable to features other than those that reduce heat loss or gain exceed production costs attributable to features that reduce heat loss or gain.

.05 *Additional Requirements.* A taxpayer may claim a credit with respect to amounts paid or incurred for an Eligible Building Envelope Component only if the following additional requirements are satisfied:

(1) The component is installed in or on a dwelling unit located in the United States and, at the time of installation, the dwelling unit is owned and used by the taxpayer as the taxpayer's principal residence (within the meaning of § 121);

(2) The original use of the component commences with the taxpayer; and

(3) The component reasonably can be expected to remain in use for at least five years. For this purpose, a component will be treated as reasonably expected to remain in use for at least five years if the manufacturer offers, at no extra charge, at least a two-year warranty providing for repair or replacement of the component in the event of a defect in materials or workmanship. If the manufacturer does not offer such a warranty, all relevant facts and circumstances are taken into account in determining whether the component reasonably can be expected to remain in use for at least five years.

.06 *Installation Costs.* With respect to Eligible Building Envelope Components, the credit is allowed only for amounts paid or incurred to purchase the components. The

credit is not allowed for amounts paid or incurred for the onsite preparation, assembly, or original installation of the components.

SECTION 5. RESIDENTIAL ENERGY PROPERTY

.01 *Qualified Energy Property.* The credit for residential energy property expenditures is allowed with respect to the following property (Qualified Energy Property):

(1) An electric heat pump water heater that yields an energy factor of at least 2.0 in the standard DOE test procedure;

(2) An electric heat pump that has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13;

(3) A closed loop geothermal heat pump that has an EER of at least 14.1 and a heating coefficient of performance (COP) of at least 3.3;

(4) An open loop geothermal heat pump that has an EER of at least 16.2 and a heating COP of at least 3.6;

(5) A direct expansion geothermal heat pump that has an EER of at least 15 and a heating COP of at least 3.5;

(6) A central air conditioner that achieves the highest efficiency tier that has been established by the Consortium of Energy Efficiency and is in effect on January 1, 2006;

(7) A natural gas, propane, or oil water heater that has an energy factor of at least 0.80;

(8) A natural gas, propane, or oil furnace or hot water boiler that achieves an annual fuel utilization efficiency rate of not less than 95; and

(9) A fan that is used in a natural gas, propane, or oil furnace and has an annual electricity use of no more than 2 percent of the total annual site energy use of the furnace (as determined in the standard DOE test procedure).

.02 *Manufacturer's Certification.* —

(1) *Requirements Applicable to Manufacturer.* The manufacturer of a product may certify to a taxpayer that the product is Qualified Energy Property by providing the taxpayer with a certification statement that satisfies the requirements of section 5.02(3) of this notice. The certification statement may be provided by including a written copy of the statement with the packaging of the product, in printable form on the manufacturer's website, or in any other manner that will permit the taxpayer to retain the certification statement for tax recordkeeping purposes.

(2) *Taxpayer Reliance.* Except as provided in section 5.02(5) of this notice, a taxpayer may rely on a manufacturer's certification that a product is Qualified Energy Property. A taxpayer is not required to attach the certification statement to the return on which the credit is claimed. However, § 1.6001-1(a) of the Income Tax Regulations requires that taxpayers maintain such books and records as are sufficient to establish the entitlement to, and amount of, any credit claimed by the taxpayer. Accordingly, a taxpayer claiming a credit for Qualified Energy Property should retain the certification statement as part of the taxpayer's records for purposes of § 1.6001-1(a).

(3) *Content of Manufacturer's Certification Statement.* A manufacturer's certification statement to be provided to taxpayers who purchase Qualified Energy Property must contain the following:

(a) The name and address of the manufacturer;

(b) The class of Qualified Energy Property (as listed in section 5.01 of this notice) in which the product is included;

(c) The make, model number, and any other appropriate identifiers of the product;

(d) A statement that the product is Qualified Energy Property that qualifies for the credit allowed under § 25C; and

(e) A declaration, signed by a person currently authorized to bind the manufacturer in these matters, in the following form:

"Under penalties of perjury, I declare that I have examined this certification statement, and to the best of my knowledge and belief, the facts presented are true, correct, and complete."

(4) *Manufacturer's Records.* A manufacturer that certifies to a taxpayer that a product is Qualified Energy Property must retain in its records documentation establishing that the product satisfies the applicable conditions of section 5.01 of this notice. The manufacturer must, upon request, make such documentation available for inspection by the Service. The documentation--

(a) In the case of the EER for a central air conditioner or electric heat pump, must include measurements based on published data that are the result of manufacturer tests at 95 degrees Fahrenheit and may be based on the certified data of the

Air Conditioning and Refrigeration Institute that are prepared in partnership with the Consortium for Energy Efficiency; and

(b) In the case of a geothermal heat pump, must be based on testing under the conditions of ARI/ISO Standard 13256-1 for Water Source Heat Pumps or ARI 870 for Direct Expansion GeoExchange Heat Pumps, as appropriate, and include evidence that water heating services have been provided through a desuperheater or integrated water heating system connected to the storage water heater tank.

(5) *Effect of Erroneous Certification or Failure to Satisfy Documentation Requirements*. The Service may, upon examination (and after any appropriate consultation with DOE or EPA), determine that a product that has been certified under this section is not Qualified Energy Property. In that event, or if the product's manufacturer fails to satisfy the requirements relating to documentation in section 5.02(4) of this notice, the manufacturer's right to provide a certification on which future purchasers of the product can rely will be withdrawn, and taxpayers purchasing the product after the date on which the Service publishes an announcement of the withdrawal may not rely on the manufacturer's certification. Taxpayers may continue to rely on the certification for products purchased on or before the date on which the announcement of the withdrawal is published (including in cases in which the product is not installed and the credit is not claimed until after the announcement of the withdrawal is published). . Manufacturers are reminded that an erroneous certification statement may result in the imposition of penalties--

(a) Under § 7206 for fraud and making false statements; and

(b) Under § 6701 for aiding and abetting an understatement of tax liability (in the amount of $1,000 per return on which a credit is claimed in reliance on the certification).

(6) *Availability of Certification Information.* Manufacturers are encouraged to provide a listing of qualified products and applicable certification information on their websites to facilitate taxpayer identification of qualified products.

.03 *Additional Requirements.* A taxpayer may claim a credit with respect to expenditures paid or incurred for Qualified Energy Property only if the following additional requirements are satisfied:

(1) The property is installed on or in connection with a dwelling unit located in the United States and, at the time of installation, the dwelling unit is owned and used by the taxpayer as the taxpayer's principal residence (within the meaning of § 121); and

(2) The property is originally placed in service by the taxpayer.

.04 *Installation Costs.* The credit is allowed for amounts paid or incurred to purchase Qualified Energy Property and for expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of the property.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1989.

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 4 and 5. This information is required to be collected and retained in order to ensure that property meets the requirements for the Nonbusiness Energy Credit under § 25C. This information will be used to determine whether the property for which manufacturers provide certifications is property that qualifies for the credit. The collection of information is required to obtain a benefit from manufacturers' certification statements that property qualifies for the credit. The likely respondents are corporations, partnerships, and individuals.

The estimated total annual reporting burden is 350 hours.

The estimated annual burden per respondent varies from 2 hours to 3 hours, depending on individual circumstances, with an estimated average burden of 2.5 hours to complete the requests for certification required under this notice. The estimated number of respondents is 140.

The estimated annual frequency of responses is on occasion.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Kelly R. Morrison-Lee of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Jennifer Bernardini at (202) 622-3120 (not a toll-free call).

PRESS ROOM

February 24, 2006
JS-4070

Treasury Assistant Secretary to Hold Weekly Press Briefing

U.S. Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, February 27 in Treasury's Media Room. The event is open to all credentialed media.

Who
Assistant Secretary for Public Affairs Tony Fratto

What
Weekly Briefing to the Press

When
Monday, February 27, 3:00 PM (EST)

Where
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

PRESS ROOM

February 24, 2006
JS-4071

CFIUS and the Protection of the National Security in the Dubai Ports World Bid for Port Operations

History of the Dubai Ports World proposed acquisition of P&O

All members of the Committee on Foreign Investment in the United States (CFIUS) understand that their top priority is to protect our national security, including homeland security.

On November 29 of last year, two companies publicly announced a proposed transaction: Dubai Ports World (DPW), a state-owned company located in the United Arab Emirates, proposed to acquire The Peninsular and Oriental Steam Navigation Company (P&O), a British firm that operates in a number of U.S. ports and other ports around the world. The acquisition would include terminal port operations at a number of U.S. ports – not the ports themselves. The Department of Homeland Security (DHS), particularly the Coast Guard and U.S. Customs and Border Protection, is in charge of port security.

DPW and P&O believed that this proposed transaction could raise national security issues that should appropriately be reviewed by the U.S. Government. The companies contacted CFIUS on October 17 and voluntarily told the Committee of their intention to file a notification with CFIUS for a national security review. They also held a complete briefing for DHS and other CFIUS members with security, defense, or law enforcement responsibilities on October 31.

Each of the CFIUS 12 members (departments and agencies) conducts its own internal analysis. In this case, the Departments of Transportation and Energy were also brought in to the CFIUS review to widen the scope and to add the expertise of those agencies reviewing the transaction.

On November 2, well before DP World and P&O filed with Treasury, CFIUS requested an intelligence assessment of the foreign acquirer. A little more than 30 days later -- still well before the companies formally filed with CFIUS or the review began -- the intelligence community provided CFIUS with a threat assessment regarding whether the foreign acquirer -- DPW – has the intention or capability to threaten U.S. national security.

On December 6, the companies held another pre-filing briefing for all CFIUS agencies.

On December 16, the companies officially filed their formal notice with CFIUS, requesting a review. The 30-day formal review began on December 17. During that 30-day review period, DHS, which is the CFIUS agency with specific expertise on port security, negotiated an assurances letter with the companies. DHS also consulted with all other CFIUS members before the assurances letter was finalized on January 6.

On January 17, roughly 90 days after the parties to the transaction first approached CFIUS about the transaction and roughly 75 days after a thorough investigation of the transaction had begun, all CFIUS members agreed that this particular transaction should be allowed to proceed, pending any other regulatory hurdles before the companies.

Background on the Committee (CFIUS):

CFIUS operates under the authority granted by Congress in the Exon-Florio

amendment (Section 721 of the Defense Production Act of 1950).

CFIUS brings together twelve department and agencies with diverse expertise to ensure that transactions are considered from a variety of perspectives and that all national security issues are identified and considered in the review of a foreign acquisition.

The Secretary of the Treasury serves as the Chair of CFIUS. Other CFIUS member agencies are: The Departments of State, Defense, Commerce, Homeland Security, and Justice, and the Office of Management and Budget, the Council of Economic Advisors, the National Security Council, the National Economic Council, the Office of Science and Technology Policy, and the US Trade Representative.

The Departments of Energy and Transportation, the Nuclear Regulatory Agency, and other U.S. agencies sometimes participate in the consideration of transactions that have an impact on the industries under their respective jurisdictions.

Treasury receives notices of transactions, serves as the contact point for the private sector, establishes a calendar for review of each transaction, and coordinates the interagency process.

The intelligence community also provides CFIUS with an independent assessment of whether the foreign acquirer poses a threat to the national security.

Upon receipt of a filing, CFIUS conducts a 30-day review, during which time each CFIUS member agency conducts its own internal analysis of the effects on national security implications of the notified transaction, and particularly an analysis of the foreign acquirer. The agency(ies) with primary concern with a particular transaction will take the lead in negotiations with the foreign company.

All CFIUS decisions are made by consensus of the entire committee. The review process allows for any agency that sees a potential threat to the national security, as is its obligation, to raise those concerns within the review process. In such a case, an extended 45-day investigation period would commence.

The Exon-Florio amendment prohibits disclosure to the public of any documents or information about a transaction that is provided to CFIUS or the President pursuant to Exon-Florio. Federal employees could be subject to criminal and other sanctions for making an unauthorized disclosure of such information.

G:ITICFIUS Case 05-60 Dubai-P&OE-F Fact Sheet wit

PRESS ROOM

February 26, 2006
JS-4072

CFIUS Welcomes Dubai Ports World's Announcement to Submit to New Review

The Committee on Foreign Investment in the United States (CFIUS) today welcomed the announcement by Dubai Ports World (DPW) that it will submit for review its proposed acquisition of control of U.S. port terminal operations.

Specifically, DPW has asked for a CFIUS review, including the 45-day investigation under the Exon-Florio amendment, based on a restructured transaction that the company intends to file with the Committee. Upon receipt of the new notification, CFIUS will promptly initiate the review process and fulfill DPW's request for a full investigation.

Over a nearly three-month period starting in October 2005, representatives of the 12 departments and agencies that comprise CFIUS, with assistance from the Intelligence Community, thoroughly investigated the transaction for national security concerns. CFIUS brought the Departments of Transportation and Energy into the review process to widen the scope and expertise of the national security scrutiny. These agencies will again be invited to participate in this new review process.

Background on CFIUS

CFIUS operates under the authority granted by Congress in the Exon-Florio amendment (Section 721 of the Defense Production Act of 1950). CFIUS brings together 12 departments and agencies with diverse expertise to ensure that all national security issues are identified and considered in the review of a foreign acquisition.

CFIUS member agencies are: The Departments of Treasury (Chair), State, Defense, Justice, Commerce, and Homeland Security, as well as the National Security Council, National Economic Council, United States Trade Representative, Office of Management and Budget, Council of Economic Advisors, and the Office of Science and Technology Policy.

The Departments of Energy and Transportation and other U.S. agencies are invited to participate in the consideration of transactions that have an impact on the industries under their respective jurisdictions.

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For more information on CFIUS, the DP World Transaction and securing U.S. ports, please visit the following links:

LINKS

- The White House
- U.S. Department of the Treasury
- U.S. Department of Homeland Security

For Immediate Release
Office of the Press Secretary
February 22, 2006

Fact Sheet: The CFIUS Process And The DP World Transaction

"If there was any chance that this transaction would jeopardize the security of the United States, it would not go forward. The company has been cooperative with the United States government. The company will not manage port security. The security of our ports will continue to be managed by the Coast Guard and Customs. The company is from a country that has been cooperative in the war on terror, been an ally in the war on terror. The company operates ports in different countries around the world, ports from which cargo has been sent to the United States on a regular basis."

- President George W. Bush, February 21, 2006

President Bush Strongly Supports The Decision To Move Forward With The DP World Transaction

The Administration, As Required By Law, Has Reviewed The Transaction To Make Certain That It Does Not In Any Way Jeopardize National Security. Under the process conducted by the Committee on Foreign Investment in the United States (CFIUS), officials carefully reviewed the national security issues raised by the transaction and its effect on our national security. Twelve Federal agencies and the government's counterterrorism experts closely and carefully reviewed the transaction to make certain it posed no threat to national security.

DP World Has Provided Strong Security Assurances To The United States. DP World has signed a letter of assurances making commitments to meet and maintain security standards for the port terminals that they will own and operate in the United States. There are a number of safeguards that are in place in the agreement, and the American people should feel confident that the transaction will in no way harm the security of the Nation's ports.

DP World's Bid For The London-Based Peninsular And Oriental (P&O) Steam Navigation Company Was Announced Last Fall. DP World, a UAE-based commercial entity, is purchasing the U.S. subsidiary of the London-based P&O Steam Navigation Company. The announcement of DP World's bid for P&O was made in November 2005, and the news was widely reported in the press and international financial trade publications. The formal CFIUS process was set into motion in December, and the Federal government conducted a thorough review to ensure that port security would in no way be compromised by the deal.

The Administration Has Taken A Principled Position Based On The Security Of Our Nation And Careful Review Of The Transaction. The President has made clear that he stands firmly behind the decision to allow the DP World transaction to move forward. Preventing this transaction by a reputable company to go forward after careful review would send a terrible signal to friends and allies that investments in the United States from certain parts of the world are not welcome.

The Port Security Of the United States Is The Administration's First And Foremost Concern

The Department of Homeland Security (DHS) Is Always In Charge Of The Nation's Port Security, Not The Private Company That Operates Facilities Within The Ports. Nothing will change with this transaction. DHS, along with the U.S. Coast Guard, U.S. Customs and Border Protection, and other Federal agencies, sets the standards for port security and ensures that all port facility owners and operators comply with these standards.

- January 2002
- December 2001
- November 2001
- October 2001
- September 2001
- August 2001
- July 2001
- June 2001
- May 2001
- April 2001
- March 2001
- February 2001
- January 2001

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- Nominations
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West Wing
- History

The Transaction Is Not About Port Security Or Even Port Ownership, But Only About Operations In Port. DP World will not manage port security, nor will it own any ports. DP World would take on the functions now performed by the British firm P&O - basically the off- and on-loading of cargo. Employees will still have to be U.S. citizens or legal permanent residents. No private company currently manages any U.S. port. Rather, private companies such as P&O and DP World simply manage and operate individual terminals within ports.

Background On The CFIUS Process

The CFIUS Process Was Rigorously Followed, And CFIUS Agencies Carefully Reviewed The Transaction. Ensuring the protection of our national security is the top priority of all members of CFIUS. In reviewing a foreign transaction, CFIUS brings together 12 Federal agencies with diverse expertise to consider transactions from a variety of perspectives and identify and analyze all national security issues.

- The Department of the Treasury, which chairs CFIUS, receives notices of transactions, serves as the contact point for the private sector, establishes a calendar for review of each transaction, and coordinates the interagency process.
- During the initial 30-day review, each CFIUS member agency conducts its own internal analysis of the national security implications of the transaction under review. CFIUS also consults with the intelligence community. In this case, the Departments of Transportation and Energy were also brought in to widen the scope and add to the expertise of the CFIUS agencies involved in the review process.
- All CFIUS decisions are made by consensus of the entire committee. The review process allows any agency that sees a potential credible threat to the national security to raise those concerns.
- In the course of the review of this transaction, DHS reached an agreement with DP World to mitigate security concerns.

DP World Has Played By The Rules, Has Cooperated With The United States, And Is From A Country That Is A Close Ally In the War on Terror. The United Arab Emirates (UAE) has been a solid partner in the War on Terror. The UAE has been extremely cooperative on counter-terrorism and counter-proliferation and has provided considerable support to U.S. forces in the Gulf and to the governments and people of Iraq and Afghanistan.

- The UAE Is A Partner In Shutting Down Terror Finance Networks. The UAE has worked with us to stop terrorist financing and money laundering, including by freezing accounts, enacting aggressive anti-money-laundering and counter-terrorist financing laws and regulations, and exchanging information on people and entities suspected of being involved in those actions.
- The UAE Is An Established Partner In Protecting America's Ports. Dubai was the first Middle Eastern entity to join the Container Security Initiative (CSI) - a multinational program to protect global trade from terrorism. Dubai was also the first Middle Eastern entity to join the Department of Energy's Megaports Initiative, a program aimed at stopping illicit shipments of nuclear and other radioactive material.

Port Security Begins Abroad. U.S. Customs and Border Protection (CBP) created the CSI to enable CBP to inspect 100% of high-risk containers at foreign seaports before they are loaded onboard vessels destined for the United States. Dubai was the first Middle Eastern entity to join CSI. Cooperation with Dubai has been outstanding and a model for other operations.

- DP World currently manages 19 container terminals and has operations in 14 countries. The United States government has a strong working relationship with DP World.

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PRESS ROOM

February 24, 2006
JS-4071

CFIUS and the Protection of the National Security in the Dubai Ports World Bid for Port Operations

History of the Dubai Ports World proposed acquisition of P&O

All members of the Committee on Foreign Investment in the United States (CFIUS) understand that their top priority is to protect our national security, including homeland security.

On November 29 of last year, two companies publicly announced a proposed transaction: Dubai Ports World (DPW), a state-owned company located in the United Arab Emirates, proposed to acquire The Peninsular and Oriental Steam Navigation Company (P&O), a British firm that operates in a number of U.S. ports and other ports around the world. The acquisition would include terminal port operations at a number of U.S. ports – not the ports themselves. The Department of Homeland Security (DHS), particularly the Coast Guard and U.S. Customs and Border Protection, is in charge of port security.

DPW and P&O believed that this proposed transaction could raise national security issues that should appropriately be reviewed by the U.S. Government. The companies contacted CFIUS on October 17 and voluntarily told the Committee of their intention to file a notification with CFIUS for a national security review. They also held a complete briefing for DHS and other CFIUS members with security, defense, or law enforcement responsibilities on October 31.

Each of the CFIUS 12 members (departments and agencies) conducts its own internal analysis. In this case, the Departments of Transportation and Energy were also brought in to the CFIUS review to widen the scope and to add the expertise of those agencies reviewing the transaction.

On November 2, well before DP World and P&O filed with Treasury, CFIUS requested an intelligence assessment of the foreign acquirer. A little more than 30 days later -- still well before the companies formally filed with CFIUS or the review began -- the intelligence community provided CFIUS with a threat assessment regarding whether the foreign acquirer -- DPW – has the intention or capability to threaten U.S. national security.

On December 6, the companies held another pre-filing briefing for all CFIUS agencies.

On December 16, the companies officially filed their formal notice with CFIUS, requesting a review. The 30-day formal review began on December 17. During that 30-day review period, DHS, which is the CFIUS agency with specific expertise on port security, negotiated an assurances letter with the companies. DHS also consulted with all other CFIUS members before the assurances letter was finalized on January 6.

On January 17, roughly 90 days after the parties to the transaction first approached CFIUS about the transaction and roughly 75 days after a thorough investigation of the transaction had begun, all CFIUS members agreed that this particular transaction should be allowed to proceed, pending any other regulatory hurdles before the companies.

Background on the Committee (CFIUS):

CFIUS operates under the authority granted by Congress in the Exon-Florio

amendment (Section 721 of the Defense Production Act of 1950).

CFIUS brings together twelve department and agencies with diverse expertise to ensure that transactions are considered from a variety of perspectives and that all national security issues are identified and considered in the review of a foreign acquisition.

The Secretary of the Treasury serves as the Chair of CFIUS. Other CFIUS member agencies are: The Departments of State, Defense, Commerce, Homeland Security, and Justice, and the Office of Management and Budget, the Council of Economic Advisors, the National Security Council, the National Economic Council, the Office of Science and Technology Policy, and the US Trade Representative.

The Departments of Energy and Transportation, the Nuclear Regulatory Agency, and other U.S. agencies sometimes participate in the consideration of transactions that have an impact on the industries under their respective jurisdictions.

Treasury receives notices of transactions, serves as the contact point for the private sector, establishes a calendar for review of each transaction, and coordinates the interagency process.

The intelligence community also provides CFIUS with an independent assessment of whether the foreign acquirer poses a threat to the national security.

Upon receipt of a filing, CFIUS conducts a 30-day review, during which time each CFIUS member agency conducts its own internal analysis of the effects on national security implications of the notified transaction, and particularly an analysis of the foreign acquirer. The agency(ies) with primary concern with a particular transaction will take the lead in negotiations with the foreign company.

All CFIUS decisions are made by consensus of the entire committee. The review process allows for any agency that sees a potential threat to the national security, as is its obligation, to raise those concerns within the review process. In such a case, an extended 45-day investigation period would commence.

The Exon-Florio amendment prohibits disclosure to the public of any documents or information about a transaction that is provided to CFIUS or the President pursuant to Exon-Florio. Federal employees could be subject to criminal and other sanctions for making an unauthorized disclosure of such information.

G:ITICFIUS Case 05-60 Dubai-P&OE-F Fact Sheet wit

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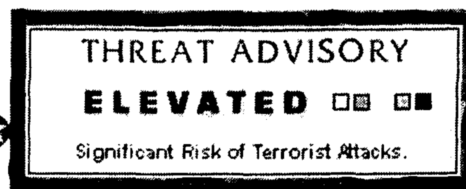

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February 2006

January 2006

December 2005

November 2005

October 2005

September 2005

August 2005

July 2005

June 2005

May 2005

April 2005

Archive

Press Room

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Fact Sheet: Securing U.S. Ports

The Administration has dramatically strengthened port security since 9/11.

- Funding has increased by more than 700% since September 11, 2001.
- Funding for port security was approximately $259 million in FY 2001.
- DHS spent approximately $1.6 billion on port security in FY 2005.

Following 9/11, the federal government has implemented a multi-layered defense strategy to keep our ports safe and secure. New technologies have been deployed with additional technologies being developed and $630 million has been provided in grants to our largest ports, including $16.2 million to Baltimore; $32.7 million to Miami; $27.4 million to New Orleans, $43.7 million to New York/New Jersey; and $15.8 million to Philadelphia.

Who Secures The Ports:

U.S. Customs and Border Protection (CBP): CBP's mission is to prevent terrorists and terrorist weapons from entering the United States by eliminating potential threats before they arrive at our borders and ports.

CBP uses intelligence and a risk-based strategy to screen information on 100% of cargo before it is loaded onto vessels destined for the United States. All cargo that is identified as high risk is inspected, either at the foreign port or upon arrival into the U.S.

Coast Guard: The Coast Guard routinely inspects and assesses the security of U.S. ports in accordance with the Maritime Transportation and Security Act and the Ports and Waterways Security Act. Every regulated U.S. port facility is required to establish and implement a comprehensive security plan that outlines procedures for controlling access to the facility, verifying credentials of port workers, inspecting cargo for tampering, designating security responsibilities, training, and reporting of all breaches of security or suspicious activity, among other security measures. Working closely with local port authorities and law enforcement agencies, the Coast Guard regularly reviews, approves, assesses and inspects these plans and facilities to ensure compliance.

Terminal Operator: Whether a person or a corporation, the terminal operator is responsible for operating its particular terminal within the port. The terminal operator is responsible for the area within the port that serves as a loading, unloading, or transfer point for the cargo. This includes storage and repair facilities and management offices. The cranes they use may be their own, or they may lease them from the port authority.

Port Authority: An entity of a local, state or national government that owns, manages and maintains the physical infrastructure of a port (seaport, airport or bus terminal) to include wharf, docks, piers, transit sheds, loading equipment and warehouses.

Ports often provide additional security for their facilities.

The role of the Port Authority is to facilitate and expand the movement of cargo through the port, provide facilities and services that are competitive, safe and commercially viable. The Port manages marine navigation and safety issues within port boundaries and develops marine-related businesses on the lands that it owns or manages.

A Layered Defense:

Screening and Inspection: CBP screens 100% of all cargo before it arrives in the U.S.- using intelligence and cutting edge technologies. CBP inspects all high-risk cargo.

CSI (Container Security Initiative): Enables CBP, in working with host government Customs Services, to examine high-risk maritime containerized cargo at foreign seaports, before they are loaded on board vessels destined for the United States. In addition to the current 42 foreign ports participating in CSI, many more ports are in the planning stages. By the end of 2006, the number is expected to grow to 50 ports, covering 90% of transpacific maritime containerized cargo shipped to the U.S.

24-Hour Rule: Under this requirement, manifest information must be provided 24 hours prior to the sea container being loaded onto the vessel in the foreign port. CBP may deny the loading of high-risk cargo while the vessel is still overseas.

C-TPAT (Customs Trade Partnership Against Terrorism): CBP created a public-private and international partnership with nearly 5,800 businesses (over 10,000 have applied) including most of the largest U.S. importers -- the Customs-Trade Partnership Against Terrorism (C-TPAT). C-TPAT, CBP and partner companies are working together to improve baseline security standards for supply chain and container security. (We review the security practices of not only the company shipping the goods, but also the companies that provided them with any services.)

Use of Cutting-Edge Technology: CBP is currently utilizing large-scale X-ray and gamma ray machines and radiation detection devices to screen cargo. Presently, CBP operates over 680 radiation portal monitors at our nation's ports (including 181 radiation portal monitors at seaports), utilizes over 170 large scale non-intrusive inspection devices to examine cargo, and has issued 12,400 hand-held radiation detection devices. The President's FY 2007 budget requests $157 million to secure next-generation detection equipment at our ports of entry. Also, over 600 canine detection teams, who are capable of identifying narcotics, bulk currency, human beings, explosives, agricultural pests, and chemical weapons are deployed at our ports of entry.

UAE/Dubai Ports World Acquisition

DP World will not, nor will any other terminal operator, control, operate or manage any United States port. DP World will only operate and manage specific, individual terminals located within six ports.

- The recent business transaction taken by DP World, a United Arab Emirates based company, to acquire British company Peninsular and Oriental Steam Navigation Company (P&O) does not change the operations or security of keeping our nation's ports safe. The people working on the docks also will not change as a result of this transaction.
- This transaction is not an issue of controlling United States' ports. It is an issue of operating some terminals within U.S. ports.
- DP World will operate at the following terminals within the six United States' ports currently operated by the United Kingdom company, P & O:
  o Baltimore - 2 of 14 total
  o Philadelphia - 1 of 5 (does not include the 1 cruise vessel terminal)
  o Miami - 1 of 3 (does not include the 7 cruise vessel terminals)
  o New Orleans - 2 of 5 (does not include the numerous chemical plant terminals up and down the Mississippi River, up to Baton Rouge)

o Houston – 4 of 12 (P&O work alongside other stevedoring* contractors at the terminals)
o Newark/Elizabeth – 1 of 4
o (Note: also in Norfolk - Involved with stevedoring activities at all 5 terminals, but not managing a specific terminal.)
*Stevedoring – provides labor, carries physical loading and unloading of cargo.

- P&O and DP World made a commitment to comply with current security programs, regulations and partnerships to which P&O currently subscribes, including:
o The Customs-Trade Partnership Against Terrorism (C-TPAT);
o The Container Security Initiative (CSI);
o The Business Alliance on Smuggling and Counterfeiting (BASC); and,
o The Megaports Initiative MOU with the Department of Energy.

- All P&O security arrangements will remain intact, including cargo security cooperation with CBP, compliance with USCG regulations (ISPS and MTSA) regarding port facilities/terminals, and foreign terminal operations within CSI ports.

- Dubai was the first Middle Eastern entity to join the Container Security Initiative (March 2005). As a result, CBP officer are working closely with Dubai Customs to screen containers destined for the U.S. Cooperation with Dubai officials has been outstanding and a model for other operation within CSI ports.

U.S. Recommended Standards for Container Security Initiative (CSI)

The Container Security Initiative consists of four core elements. These are: (1) establishing security criteria to identify high-risk containers; (2) pre-screening those containers identified as high-risk before they arrive at U.S. ports; (3) using technology to quickly pre-screen high-risk containers; and (4) developing and using smart and secure containers.

In order to be eligible to participate in CSI, the Member State's Customs Administration and the seaport must meet the following three requirements:

1. The Customs Administration must be able to inspect cargo originating, transiting, exiting, or being transshipped through a country.
2. Non-intrusive inspectional (NII) equipment (including gamma or X-ray imaging capabilities) and radiation detection equipment must be available and utilized for conducting such inspections. This equipment is necessary in order to meet the objective of quickly screening containers without disrupting the flow of legitimate trade.
3. The seaport must have regular, direct, and substantial container traffic to ports in the United States.

   As part of agreeing to participate in CSI, a Member State's Customs Administration and the seaport must also:

4. Commit to establishing a risk management system to identify potentially high-risk containers, and automating that system. This system should include a mechanism for validating threat assessments and targeting decisions and identifying best practices.
5. Commit to sharing critical data, intelligence, and risk management information with the United States Customs Service in order to do collaborative targeting, and developing an automated mechanism for these exchanges.
6. Conduct a thorough port assessment to ascertain vulnerable links in a port's infrastructure and commit to resolving those vulnerabilities.
7. Commit to maintaining integrity programs to prevent lapses in employee integrity and to identify and combat breaches in integrity.

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Feb. 22, 2006

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U.S. Department of Homeland Security

PRESS ROOM

February 27, 2006
JS-4073

The Honorable JohnW. Snow
Prepared Remarks
Credit Union National Association (CUNA)
Government Affairs Conference

Thank you so much for having me here today.

This is the fourth year that I've been able to come to this great conference, and it's always a pleasure to work with your group.

I meet and work with financial leaders every day, but I can easily say that Credit Unions have the most heart. Your motto rings true to your culture: "not for charity, not for profit, but for service."

You do good work: loans to small business, home mortgages, financial education and working in partnership with the government to fight the financial war on terror. You were wonderful in your response to hurricane Katrina, in a time when American's helping each other meant so very much.

Each one of these efforts is critical to our country's economic health and strength, and I applaud you for doing good while you do business.

I believe I told you last year that this administration understands the basic economic principle that you get less of anything you tax -- and we don't want less of what you do. Well, that principle, and that position, remains true today.

We don't want less small-business lending. We don't want fewer home mortgages. We want a continuation of your tax exemption and we want to continue to have a strong relationship with a group of financial institutions that are dedicated to their communities, who want to see their customers educated and financially literate.

And we want to continue working with you as we cut off the flow of blood money to the terrorists who seek to do our country harm. While hatred fuels the terrorist agenda, cash helps to make it possible. America's credit unions have shown tremendous resolve in this fight, and I want to personally thank you for your efforts.

After the 9/11 terrorist attacks, the dark side of the threat we face became terribly clear, and the U.S. Government needed to focus on protecting itself through proactive, preventive policies. This shift included the need for greater domestic and international accountability – including financial accountability. Ensuring the integrity - the safety, soundness, and security - of our financial system was viewed clearly as a national security issue. In this new environment, the private sector had an obligation not only to facilitate the movement of capital around the world, but also to prevent that capital from supporting terrorism or crime. And in this charge, you have been a true partner.

For the U.S. financial sector, this has meant the need to adjust to a more vigilant mindset. The application of the Bank Secrecy Act (BSA) – principally aimed at achieving the appropriate level of financial transparency to detect and prevent illicit financial activities – is absolutely critical. We are, of course, also sensitive to the burdens on financial institutions and seek to ensure that those burdens are never unnecessary.

Fighting the financial war on terror also meant the need for acute awareness of the USA PATRIOT Act (Patriot Act) and applying targeted financial sanctions to ensure that dirty money is kept out of the U.S. and out of the hands of rogue actors.

Our efforts are working. We are driving terrorist financiers out of the traditional financial sector by making it harder, costlier and riskier for them to move money. We are seeing terrorist groups avoiding formal financing channels and instead resorting to riskier and more cumbersome conduits, like bulk cash smuggling. Our work is by no means complete, but we've made considerable strides under these authorities. Our commitment to identifying and disrupting terrorist funding has been and continues to be very robust.

Our country must be safe in order to be prosperous and create jobs. I emphasized loans for small-business start-ups and expansions because that leads to job creation, which is the ultimate goal of a strong economy.

Credit unions have been there for entrepreneurs when they needed you most. You understand their needs, and our President does, too. When small business needed tax relief to grow and create new jobs, President Bush responded with reduced marginal rates, an increase in expensing and a whack at the death tax. Small business has responded with growth and job creation.

The first time I spoke to this group, you may remember, our economy was struggling. But look at the U.S. economy today. Looking back, there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. Tax relief encouraged investment, which has ultimately led to job growth. The American economy is now unmistakably in a trend of expansion, and those trend lines can clearly be traced to the enactment of tax relief.

Early this month we learned that unemployment has fallen from 4.9 percent to 4.7 percent -- lower than the average for the 1970s, 1980s and 1990s. Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Good, steady job growth is no surprise, given that GDP growth was three and a half percent last year. Private forecasters, like the National Association for Business Economics and others, are expecting very strong growth to continue this quarter.

Core inflation also remains low, and that's good news for everyone. U.S. equity markets have risen, and household wealth is at an all-time high. Additionally, real per capita disposable (after-tax) income has risen by 7.3 percent from 2000 to 2005 and that's very good news for workers.

A recent report on retail sales was yet another unmistakable sign that the U.S. economy is strong, it is heading in the right direction and Americans are confident. With a jump of 2.3 percent for January, this was one of the biggest month-to-month increases in over a decade and a half. That's the kind of number we expect to see when consumers are confident about the economy and optimistic about the future. And it is no wonder they are feeling that way, given the strength in the job market.

Independent private-sector forecasts point to continuing good news. Inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: what can we do to continue these positive trends?

The answers as I see them: First, keep taxes lower on both incomes and investment. I sent a letter last week to the conference committee on tax relief reconciliation urging them to do so.

I know that, in your business, you see the economic benefits of investment every day. Money for business expansion or development improves the communities where it's invested. So I'm sure it's no surprise to people in this room that since the implementation of a lower, 15 percent rate on investment capital in May of 2003 we have seen a remarkable turn-around in the economy. After nine consecutive declining quarters of real annual business investment, we have had 10 straight quarters of rising business investment. This business expansion led to a substantial increase in employment, as I just mentioned – 4.7 million new jobs. There can be no question that we need to keep the tax rate on capital gains and dividends where it is; a tax increase would be a terrible mistake. While many factors contributed to the improved performance of the economy, the tax reductions on capital have been at the heart of the progress we have seen.

Lower tax rates on individual income are important because, as the President says, they let the people make their own decisions about their own money – and individuals make better financial decisions than governments.

There is also a significant small-business component to lower marginal rates. Since small-business owners often file their business income on personal forms, lower marginal rates help this sector that creates two-thirds of the country's net new jobs.

The President is also placing an emphasis on affordable health care, innovation competitiveness (with an emphasis on education) and reducing our dependency on foreign energy through new technology. These are all central to keeping our economy on track for generations to come.

Our economic challenges are not over, of course; we still have plenty of work to do.

Credit unions are in an excellent position to help their customers – both small businesses and individuals – to afford health-care coverage. You can do that by offering Health Savings Accounts (HSAs) as a product to your customers.

HSAs are really rising in popularity and I wouldn't be surprised if a lot more of you are offering them than when I saw you last.

I think HSAs are a great option to have because choosing an HSA over traditional insurance plans puts patients in charge of their health-care purchasing decisions. That's why the creation of HSAs was so important – it was historic, really, because it embraces a philosophy that favors the individual, versus an employer or the government.

As you know, the President's is proposing to expand HSAs by making premium costs deductible from income and payroll taxes when purchased by individuals, raising the cap on the amount of money that can be saved in an HSA and making the high-deductible insurance plan that accompanies an HSA fully portable.

Congress should help him make that broader vision of HSAs a reality. It would be very good news for Americans struggling to afford health insurance.

As you know, the President supports this type individual control and ownership in many areas. He wants to see as many Americans as possible own their own homes, their own businesses if they want, their own health care and their own retirement savings.

As credit union operators, you are also dedicated to individual ownership and savings, so I know the concept is not a new one to you.

You understand as well as anyone in the financial community the benefits that come from financial ownership and independence. It's one of the reasons you've been such a great partner in the effort to increase financial literacy in this country.

Of course credit unions have long been known for their strong commitment to meeting the needs of their members, and you know that financial literacy is one of those needs. And I'm proud to say that Treasury has been at the forefront of the cause of financial literacy. Since 2002 Treasury has had an office dedicated to financial education and more recently I've been pleased to chair the Financial

Literacy and Education Commission, a group of 20 federal agencies committed to spreading financial literacy. I'm sure many of you use and link to the Commission's web site *mymoney.gov* for free financial literacy materials.

We are proud to count the credit union industry as a valued partner in the continuing efforts to help Americans learn about money. Whether it is saving for a college education or a first home, learning how to manage credit or avoiding fraud, financial education is the way so many Americans can live better lives. We hope your industry continues to play a key role in financial education when Treasury launches its National Strategy for Financial Literacy this spring. I'd like to see CUNA and individual credit unions work with us to implement that strategy so we can help all Americans understand and manage their money.

As with so many other things, we accomplish the most when we work together. Whether it's fighting terrorists, or teaching teenagers about financial responsibility, or helping entrepreneurs pursue their American Dreams.

I'm glad to work with the nation's credit unions on all these efforts.

I thank you for the work you do, and the chance to speak to you today.

Have a great conference.

PRESS ROOM

February 27, 2006
JS-4074

U.S. Treasurer to Visit Denver to Discuss Competitiveness and the U.S. Economy

U.S. Treasurer Anna Escobedo Cabral will travel to Denver, Colorado Tuesday to discuss American competitiveness and the President's agenda to maintain the economy's momentum and ensure that America remains the leader of the global economy. While in Denver, Treasurer Cabral will visit the 2nd National Head Start Hispanic Institute. The following event is open to credentialed media:

WHO
U. S. Treasurer Anna Escobedo Cabral
Treasurer Cabral's bio: http://www.treasury.gov/organization/bios/cabral-e.html
History of the Treasurer's Office: http://www.treas.gov/offices/treasurer/office-history.shtml
WHAT
Keynote address to 2nd National Head Start Hispanic Institute
WHEN
Tuesday, February 28, 9:00 a.m. (MST)
WHERE
Denver Convention Center
700 14th Street
Denver, CO
NOTE
Media should RSVP to Darlene Fisher at (301) 512-6592

PRESS ROOM

February 27, 2006
2006-2-27-16-42-42-25294

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 $64,959 million as of the end of that week, compared to $64,742 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	February 17, 2006			February 24, 2006		
TOTAL	64,742			64,959		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,142	10,728	21,870	11,113	10,865	21,978
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	10,920	5,211	16,131	10,903	5,281	16,184
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]			7,560			7,587
3. Special Drawing Rights (SDRs) [2]			8,137			8,166
4. Gold Stock [3]			11,044			11,044
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	February 17, 2006			February 24, 2006		
	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						
	February 17, 2006			February 24, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						

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

Notes:

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

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

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

PRESS ROOM

February 28, 2006
JS-4075

Assistant Secretary for Financial Institutions Emil Henry
Prepared Remarks
Credit Union National Association (CUNA)
Government Affairs Conference

Good morning. I appreciate you having me here today. When Dan Mica asked me to speak, I was delighted to accept. He continues to be a great advocate for credit unions and cares deeply about the mission of CUNA and I appreciate his continued leadership.

Before assuming my position as Assistant Secretary of the Treasury for Financial Institutions last October, I had spent more than 20 years on Wall Street. Since then, I am learning quickly that there are many great organizations – such as CUNA – working to provide financial services to so many hard working Americans. I would like to thank you for your hard work in communities all over the United States.

I would like to spend my time here on a few topics. Today, I am thrilled to be able to announce the creation of a new federal forum to focus on consumer financial issues. Next, I want to discuss an issue that is important to CUNA and Treasury: data security and its effect on consumer confidence. I would be negligent if I didn't add issues that I know are close to your hearts – regulatory burden and National Credit Union Administration's (NCUA) prompt corrective action (PCA) proposal. But first, let me start out with a few thoughts on the economy.

General Economic Overview
As we sit here today, I am pleased to say that our economy is robust on so many levels. And in my travels around the country, I find more and more that the skeptics about our economy these days are both fewer and a lot quieter. The data are just too compelling. It's impossible to refute the overwhelming evidence that indicates our economy is firing on all cylinders. Quickly, let me give you some of these facts:

- Our GDP expanded at a solid 3.5 percent pace last year.
- More than 4.6 million new jobs have been created since May of 2003; two million of them in the last year.
- Unemployment is 4.7 percent, running lower than the 1970s, 1980s and 1990s, payrolls are rising and household wealth is at an all-time high.
- Productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since 2001, faster than any five-year period in the 1970s, 1980s or 1990s.
- More Americans than ever own their own homes
- Tax revenues are surging to the highest levels ever
- And inflation-adjusted hourly wages are in fact beginning to rise, growing 1.6 percent between September and December.
- The Dow Jones Industrials at 11,100's touching all time highs
- And our home values reflect underlying growth, low interest rates and confidence about future economic prospects.

It should be heartening to all of us to think for a moment of how we got to this place amidst all the obstacles that stood in our way. Let us spend a minute on some history, and please indulge me while I give you a perspective on this history from my former perch on Wall Street.

The President took office in January of 2001, a time when it had become clear that the lofty valuations of the technology, internet and telecommunications boom that peaked in early 2000 had been premised on forecasts and assumptions that were unrealistic and unsustainable. As you all saw in the spike and subsequent drop in your 401(k) statements, stock market valuations in the period immediately

preceding this administration were, indeed, a bubble.

So, it is a fact that the President inherited an economy in retrenchment. The consensus is that the recession began in March of 2001 tied to the natural process of squeezing out the excesses and exuberance of the latter 1990s. So, it is just not credible to pin the economic decline of that period on this Administration.

Then of course there were the attacks of September 11th.

As you heard in my introduction, I spent over 20 years on Wall Street as an investment banker and manager of investment funds before coming to Washington. One of the benefits of sitting at a prominent Wall Street firm is that when you deal with the largest most sophisticated corporations in the world, you have a window into their most sensitive, non-public financial and strategic plans. You often hold and review the most sensitive forecasts of key indicators such as earnings and capital spending. You deal directly with CEOs and CFOs and are privy to their key strategic thinking. Indeed, you help mold it.

When there is a dislocation like September 11th, investment bankers have a quick and clear view of how wrenching such a dislocation will be by virtue of their access to information at the highest level. Let me give you a sense of what we saw.

First, we witnessed a phenomenon across Wall Street referred to as "pencils down" which means every banker, every lawyer, every consultant, and every financial service provider simply stopped working on the financial imperatives of corporate America. Merger negotiations ceased. IPOs came to a full stop. Debt financings were put on hold.

Then, and as we all know, we witnessed economic activity slow to a snail's pace. Travelers stopped getting on airplanes, and destination spots of the hotel and leisure industry saw bookings plummet. And all the attendant spending associated with these activities slowed demonstrably.

And from that window I mentioned, we slowly began to see a ripple effect as the strategic plans of industry were adjusted to reflect a new paradigm. Capital spending was reduced. Expansion was limited. Growth plans were curtailed.

Then, as if a recession followed by an attack impacting trillions of dollars of net worth were not enough, the markets were dealt further uncertainty: two of their highest flying, most highly valued, most entrepreneurial, most forward thinking non-bubble companies built in the midst of the bubble were suddenly shown to be pure fiction. I am speaking of course of Enron and WorldCom. When these companies were shown to be laden with fraud, the market further suffered.

The impact of this realization on the confidence of our markets cannot be overstated. I sat in my office in the summer of 2002 and watched the markets react in full plummet. June and July saw equity prices fall 8-9% each month. Credit spreads blew out to unprecedented levels. We felt like we had been punched in the stomach. As an investment manager, there simply was no place to hide.

Enron and WorldCom cast a pall over the markets that impaired investor confidence and reduced financial asset valuations, resulting in a substantial hit to household net worth. When it was all said and done, the NASDAQ dropped about 75% from its peak level in early 2000 to its lowest point in 2002. More broadly, equities did something they have never done in history: they declined for three years in a row (2000, 2001, and 2002). I would bet there are few in this room without a personal story of their net worth being impacted by these events.

Of course, Enron and WorldCom like the recession of 2001 were born of the bubble and, like the recession of 2001, their legacies were inherited by this Administration.

Think once again of the sequence of events: recession and industry retrenchment, terrorist attacks, further retrenchment, fraud and further retrenchment, market uncertainty, net worths declining. In response, as you know, the President showed his fine leadership in 2003 to stem this negative tide by passing the Jobs and Growth Act with resulting tax relief. This leadership helped create the impressive economic statistic that I mentioned earlier. We are fighting hard today to make sure

that tax relief is permanent to keep our economy on the right track.

One final note: when this Administration lowered taxes, the hue and cry from our political opponents, of course, was that revenues would decline and that we were being irresponsible. The opposite happened. Tax receipts at the Treasury for the past 3 quarters have been at their highest level in recorded history. Tax cuts are not placed under a mattress or locked in a safe. They are spent, invested or saved--all of which produces or supports economic activity which, of course, leads to further tax revenue.

Consumer Forum

So, there is good news in the past and I have some good news to announce today. The strength of our economy and financial services sector depends on confidence in the system on the part of consumers. Your unique relationship with your members and their millions of customers makes this a great opportunity to announce an exciting new endeavor undertaken by the Treasury Department - the creation of an interagency forum that focuses exclusively on consumer financial abuses. The name of this group is simply the Consumer Financial Protection Forum. The goal of the Forum is straightforward - bring senior Treasury officials, federal regulators, and state regulators together to share information and discuss evidence of consumer financial abuse by financial institutions. I am happy to report that your regulator, the NCUA, is a member of this Forum.

The Forum will provide a mechanism for sharing information about patterns of abuses, including emerging trends and on-going problems at financial institutions that are subject to federal or state supervision. The Forum will encourage discussion about consumer protection issues affecting financial institutions. This will assure that the most effective and pervasive remedies are pursued. The Forum will review how consumer complaints are handled by the participating agencies, including how the process currently operates, and develop suggestions as to how it can be improved. It will also support public education efforts to help consumers recognize and avoid abusive practices in the financial institutions arena.

The Forum's first meeting will take place at the Treasury Department next month. We are excited about this effort and we will keep you apprised of the Forum's activities.

Data Security

Another critical consumer issue that Treasury plays a key role in is data security. Consumer confidence in our financial system is enhanced if the operating activities of our financial system are safe and sound. The crime of identify theft, which can exploit lax data security, is a growing problem that significantly undermines consumer confidence in our financial system.

Let me share some troubling information. Between 9 and 10 million consumers per year are victims of identity theft. I am one of them. I imagine that others in this room have had their identities stolen from them. Collectively, identity theft victims spend millions of hours trying to restore their records. The Federal Trade Commission estimated that the costs business is at least $50 billion. Therefore, this is a problem that requires our attention.

The President recognized the importance of data security and the threat of identify theft when he recently noted "the crime of identity theft undermines the basic trust on which our economy depends." Secretary Snow built on the President's wise remarks when he stated that identify theft presents the most serious threat to financial consumers today.

In recognizing the importance of data security to foster consumer confidence, Treasury has partnered with financial services organizations, financial regulators, and consumer groups to support prudent and safe personal financial management and to provide education and best practices and safeguards against identity theft.

I think it is fair to say that most agree that data security is important and identify theft is a serious problem. The more difficult question is what can and should be done to address these issues? At the outset, I must note that protecting consumer information is the responsibility of both businesses and consumers. Most of the legislative attention on this issue revolves around businesses' responsibility, but I

do not want to ignore the responsibility and opportunity for consumers to protect their identities. Like many people, I get annoyed when my computer prompts me to change my password or requires that I use a "powerful" password instead of an easy-to-remember password like 1-2-3-4-5-6. However, these mild annoyances are nothing when compared to the time and expense necessary to reclaim your identify once its stolen. Consumers cannot ignore their responsibility to protect their identities. A person's identity is an incredibly valuable asset. It must be treated as such.

I brought with me some copies of a DVD that Treasury produced about protecting yourself from identity theft. It is called "Identity Theft – Outsmarting the Crook". It is an excellent product, and you can go to our website at www.Treasury.gov to find out how to get your copy. I encourage you to notify your members of this valuable tool.

As we approach legislative proposals to strengthen businesses' data security requirements, we must balance the need to take all reasonable steps to ensure that people are not unnecessarily vulnerable to identity theft and related frauds with the need to ensure that government requirements do not inhibit the innovation that is vital to our free enterprise system.

Data security is a complex issue. The best way to deal with these complexities is a combination of awareness and education, technology, and an increased interest and effort to punish those who commit these crimes.

Currently, there are a number of legislative proposals that address these issues. These proposals put forth interesting ideas that have merit and are worth further study. However, as we move towards a legislative solution to this complex problem, we must be mindful of a few important considerations.

First, there can be benefits to establishing a uniform, Federal standard of data security. This could prevent a fragmented approach to an issue that is clearly of national importance. Because of the absence of a uniform standard, states are currently filling the void and adopting their own data security standards. This could lead to inconsistent rules across multiple jurisdictions. Considering a uniform standard could standardize the process and reduce undue compliance and notification costs. Of course, if we consider a uniform standard, we should not sacrifice substance simply to streamline costs and build in efficiencies.

Second, we should recognize that financial institutions are already highly regulated and actively supervised entities. Any solution should take this into consideration and avoid duplicative requirements and unnecessary overlap with current regulatory regimes.

Third, when determining whether and how to notify an affected party of a data security breach, many factors should be taken into account. Risk-based notifications, as opposed to arbitrarily-mandated notifications, might provide consumers with more meaningful and manageable information.

Of course, businesses have an absolute responsibility to protect the information of their customers. Thus, businesses must quickly notify their customers if they believe that their customer will be exposed to fraud. That being said, a highly prescriptive notification requirement, with no room for judgment, could create a situation in which consumers become overwhelmed by "defensive" notifications in situations in which they face no reasonable likelihood of harm. Notifications sent to satisfy a rigid regulatory requirement could load up a consumer's inbox with information that the consumer does not need or want, similar to the situation we currently have with privacy notices. Further, if notifications must be sent out prior to an institution being able to assess or describe the risk associated with the breach, it might unnecessarily undermine confidence and existing business relationships, or disrupt a law enforcement investigation into the incident.

Finally, it might be premature to consider instant file freeze on demand. An "on demand" file freeze system allows consumers to lift and impose a credit file freeze instantly. On its face, this approach appears to be elegant for its simplicity. However, this approach is extremely resource-intensive and could lull consumers into complacency believing that such a file freeze is adequate protection against

fraud. Before we go down this road, should we first examine the data gleaned from fraud alerts, which were mandated under the Fair and Accurate Credit Transactions Act in 2003? We must give this system time to work and see what lessons can be learned from it.

Credit Union Issues

I also want to take the opportunity to discuss how you all – credit unions - enjoy a special place in the financial institution marketplace by offering access to financial services to millions of Americans. As you know, credit unions have long provided their 86 million members with valuable financial services that help them to achieve financial security and enable them to own their own home, automobile, or business. As a result of strong local ties, credit unions are uniquely situated to meet the financial services needs of our Nation's communities and encourage economic growth, job creation, and savings.

Particularly noteworthy in this regard are credit unions' activities promoting economic development and financial education in their local communities. Both your organization and the Treasury Department share a strong commitment to financial education. Treasury is working hard to fulfill the President's vision of an Ownership Society and an important part of that is equipping people with the skills they need to understand their money.

As you probably know, to help make Americans more financially literate, Treasury set up an Office of Financial Education in 2002. I know several of your members have worked with that office. Under the FACT Act, that office got another job in 2003 – leading a Commission of 19 other federal agencies tasked with raising the level of financial literacy nationwide. The Commission launched a federal government web site & hotline in 2004 dedicated to financial education – the web site is located at mymoney.gov and the number is 1-888-mymoney. We encourage you take make use of those resources.

In April, the Commission will be launching a National Strategy for Financial Literacy. That strategy will recognize the essential role of private sector players, especially credit unions. I invite you to help Treasury implement this important policy initiative when we launch it in April.

Currently, there a number of efforts underway in Congress to address unnecessary regulatory burdens imposed on financial institutions. To promote the efficient operations of our Nation's financial institutions, it is important that we continue to evaluate the structure of our regulatory oversight. We need to keep an eye towards eliminating outdated regulations and unnecessary requirements. At the same time, we must remain aware of the fundamental purpose of existing regulations, both in terms of chartering differences among financial institutions and basic safety and soundness requirements.

We understand that there are a number of regulatory burden relief provisions that credit unions are concerned about:

- For example, we understand that FASB's new merger accounting guidance creates problems for credit unions. The new rule will require credit unions to use the purchase method for pooling the assets, liabilities, and equity of a merged institution, thus not allowing the "acquiring" credit union to count the retained earnings of the "acquired" credit union as part of net worth. Such an outcome could cause a misstatement of the net worth of the "acquiring" credit union, and we support a targeted fix of this problem.
- Another example is H.R. 749, which would authorize federal credit unions to provide check cashing and money transfer services to a non-member of the credit union as long as the individual is within the credit union's field of membership. This provision could help in Treasury's longstanding efforts to increase access to money transfer services throughout our Nation's communities.
- Finally, there have been renewed calls to temporarily waive Prompt Corrective Action (PCA) requirements for depository institutions in the areas impacted by Hurricane Katrina. Such a waiver could provide an opportunity for regulators to fully assess the situation before taking action and time for financial institutions to develop business plans to restart operations. Of course, any waiver should not persist beyond such a time frame as is necessary to evaluate the current situation, should only apply to those institutions directly affected by the hurricanes, and should preserve the

power of the depository institution regulators to take other enforcement actions or apply the actions prescribed under PCA if necessary.

Beyond this type of temporary PCA waiver, another area that often falls under the regulatory relief heading is the overall reform of the PCA rules that apply to credit unions. The NCUA, CUNA, and other credit union trade associations have been actively working to develop proposals that alter credit union capital requirements. This work has led to a number of positive proposals, such as applying a risk-based framework to more credit unions and properly accounting for credit unions' investment in the NCUSIF. Thank you for your hard work on this front.

As you know, credit unions are subject to a higher minimum leverage capital requirement than is required for other insured depository institutions, and the risk-based capital framework that applies to credit unions operates in a slightly different manner than the framework for other insured depository institutions. One common thread in capital requirements across types of financial institutions is that either the leverage or the risk-based requirement is the binding constraint. While the leverage requirement is currently the binding constraint for most credit unions, this is also the case for other insured depository institutions that have a relatively low-risk portfolio of assets.

While often discussed in the context of PCA, the core issue is the minimum capital standards that apply to credit unions. The most challenging aspect of this debate is what to do after the credit unions' investment in the National Credit Union Share Insurance Fund (NCUSIF) is properly accounted for?

The general rationale for imposing a higher minimum leverage capital requirement on credit unions is that, unlike many other insured depository institutions, credit unions can generally only build capital through increases in retained earnings. Other factors that have been cited for imposing a higher leverage capital requirement surround the proper accounting for credit unions' investment in the NCUSIF and their investments in corporate credit unions.

So, should credit unions be subject to the same minimum leverage capital requirements as other insured depository institutions?

In considering this and other issues related to credit unions, let me make a few observations:

- There are fundamental differences between credit unions and other depository institutions that lead to different types of treatment across these institutions. Of course, these fundamental differences support the varied tax treatment of credit unions. Therefore, I feel comfortable reiterating the Administration's support of credit unions' tax exemption which is based firmly on the principle that the business models and organizational structures of credit unions are different from other insured depository institutions.
- There are also important differences in the capital structure of credit unions vis a vis other depository institutions. In general, credit unions can only raise equity capital by increasing retained earnings. This is an important feature that is grounded in the cooperative nature of credit unions. Thus, unlike other depository institutions, credit unions do not have access to other sources of capital to build a capital cushion when financial conditions are good. Since the basic goal of a minimum leverage capital requirement is to encourage financial institutions to maintain sufficient capital levels so that the PCA requirements are not triggered, this argues for somewhat differing capital requirements between credit unions and other institutions.

Our analysis of this issue is ongoing and we appreciate the assistance that you have provided to us thus far.

Conclusion

As you can see, we have a full plate of issues and a lot of work to do in 2006 and I'm looking forward to continuing the dialogue with you all. Thank you again for the opportunity to be with you this morning and I would be happy to take any questions you might have at this time.

PRESS ROOM

February 28, 2006
JS-4076

Statement of Treasury Secretary John W. Snow
On Gross Domestic Product Growth

"The American economy continues to be on a very solid path of economic growth and job creation, with low unemployment claims, strong retail sales, orders for core capital goods continuing to grow at a robust rate and today's upward revision of fourth-quarter 2005 GDP growth.

"With so much good economic news so far this quarter, it is no surprise that private forecasters expect solid growth for the first quarter of this year.

"The longer this strong growth path continues, the more Americans will be finding jobs, so it is critically important that Congress extend the lower tax rates that made this sustained growth possible. Lower rates on investment capital and income have helped create over four and a half million new jobs and raise living standards. Now is not the time to raise taxes."

PRESS ROOM

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February 28, 2006
JS-4077

President's Working Group on Financial Markets Seeks Comments on Long-Term Availability and Affordability of Terrorism Risk Insurance

Washington, DC– The Treasury Department, as chair of the President's Working Group on Financial Markets, is submitting for publication a Notice in the Federal Register today seeking comments on the long-term availability and affordability of terrorism risk insurance, including terrorism risk insurance coverage for group life and for chemical, nuclear, biological, and radiological events. The comment period closes 45 days after the Notice's date of publication in the Federal Register.

The Terrorism Risk Insurance Extension Act of 2005 was enacted on December 22, 2005. It requires the President's Working Group on Financial Markets, in consultation with the National Association of Insurance Commissioners, representatives of the insurance industry, representatives of the securities industry, and representatives of policy holders, to perform an analysis regarding the long-term availability and affordability of insurance for terrorism risk, including group life coverage and coverage for chemical, nuclear, biological, and radiological events. The Federal Register notice seeks comment from these and any other interested parties as a means of satisfying the consultation requirement in the most open and efficient manner. The President's Working Group must report its findings to Congress by September 30, 2006.

The President's Working Group on Financial Markets (established by Executive Order 12631) is comprised of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Chairman of the Securities and Exchange Commission, and the Chairman of the Commodity Futures Trading Commission. The Secretary of the Treasury chairs the President's Working Group.

REPORTS

- Working Group on Financial Markets

BILLING CODE 4811-37

DEPARTMENT OF THE TREASURY

Analysis by the President's Working Group on Financial Markets on the long-term availability and affordability of insurance for terrorism risk.

AGENCY: Department of the Treasury, Departmental Offices.

ACTION: Notice; request for comments.

SUMMARY: The Terrorism Risk Insurance Extension Act of 2005 requires the President's Working Group on Financial Markets to perform an analysis regarding the long-term availability and affordability of insurance for terrorism risk, including group life coverage and coverage for chemical, nuclear, biological, and radiological events.

As chair of the President's Working Group, Treasury is issuing this notice seeking public comment to assist the President's Working Group in its analysis.

DATES: Comments must be in writing and received by [INSERT DATE THAT IS 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Please submit comments (if hard copy, preferably an original and two copies) to Treasury's Office of Financial Institutions Policy, Attention: President's Working Group on Financial Markets Public Comment Record, Room 3160 Annex, Department of the Treasury, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220. Because postal mail may be subject to processing delay, we recommend that comments

be submitted by electronic mail to: PWGComments@do.treas.gov. All comments should be captioned with "President's Working Group on Financial Markets: Terrorism Risk Insurance Analysis." Please include your name, affiliation, address, e-mail address and telephone number(s) in your comment. Where appropriate, comments should include a short Executive Summary (no more than five single-spaced pages). All comments received will be available for public inspection by appointment only at the Reading Room of the Treasury Library. To make appointments, please call one of the numbers below.

FOR FURTHER INFORMATION CONTACT: C. Christopher Ledoux, Senior Policy Analyst, Office of Financial Institutions Policy, 202-622-6813; or Mario Ugoletti, Director, Office of Financial Institutions Policy, 202-622- 2730 (not toll free numbers).

SUPPLEMENTARY INFORMATION: On November 26, 2002, the President signed into law the Terrorism Risk Insurance Act of 2002 (Pub. L. 107-297, 116 Stat. 2322) (hereinafter referenced as "TRIA"). TRIA's purposes are to address market disruptions, ensure the continued widespread availability and affordability of commercial property and casualty insurance for terrorism risk, and to allow for a transition period for the private markets to stabilize and build capacity while preserving state insurance regulation and consumer protections. Title I of TRIA established a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting from an act of terrorism, as defined in the Act. TRIA authorized Treasury to administer and implement the Terrorism Risk Insurance Program (Program),

including the issuance of regulations and procedures. As originally enacted, the Program was to end on December 31, 2005.

Congress subsequently approved and on December 22, 2005, the President signed into law the Terrorism Risk Insurance Extension Act of 2005 (Pub. L. 109-144, 119 Stat. 2660) (the Extension Act). The Extension Act continued the Program for two years until December 31, 2007, revised several structural aspects of the Program, and required an analysis of the availability and affordability of terrorism risk insurance. Specifically, the Extension Act amended Section 108 of TRIA to require the President's Working Group on Financial Markets,[1] in consultation with the National Association of Insurance Commissioners, representatives of the insurance industry, representatives of the securities industry, and representatives of policy holders, to perform an analysis regarding the long-term availability and affordability of insurance for terrorism risk, including group life coverage and coverage for chemical, nuclear, biological, and radiological events. This Notice seeks comment from these and any other interested parties as a means of satisfying the consultation requirement in the most open and efficient manner. TRIA, as amended by the Extension Act, requires the President's Working Group on Financial Markets to submit a report to Congress on its findings no later than September 30, 2006.

Treasury, on behalf of the President's Working Group, is soliciting comments, including empirical data and other information in support of such comments, where appropriate and available, regarding the long-term availability and affordability of

[1] The President's Working Group on Financial Markets (established by Executive Order 12631) is comprised of the Secretary of the Treasury (who serves as its Chairman), the Chairman of the Federal Reserve Board, the Chairman of the Securities and Exchange Commission, and the Chairman of the Commodity Futures Trading Commission.

insurance for terrorism risk, including terrorism risk insurance coverage for group life and for chemical, nuclear, biological, and radiological events. We request that submitters distinguish between risk from foreign and domestic terrorism in their comments. In addition, we seek and solicit comment in response to the following specific questions:

I. Long-term Availability and Affordability of Terrorism Risk Insurance

1.1 In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage? How can these factors be measured and projected?

1.2 What improvements have taken place in the ability of insurers to measure and manage their accumulation of terrorism risk exposures? How will this evolve in the long-term?

1.3 What improvements have taken place in the ability of insurers to price terrorism risk insurance, including in the development and use of modeling? How will this evolve in the long-term?

1.4 How, if at all, were primary insurers' pricing decisions affected by the anticipated expiration of TRIA at the end of 2005, particularly for insurance policies extending into 2006 that cover terrorism risk? What role did the pricing and availability of reinsurance play in those decisions?

1.5 What role do mitigation efforts related to terrorism risk play in an insurer's underwriting and pricing decisions? How will this evolve in the long-term?

1.6 What is the current availability of reinsurance to cover terrorism risk? Please distinguish by line or type of insurance being reinsured and on what basis (treaty or facultative). How will this evolve in the long-term?

1.7 At what policyholder retention levels are insurance programs being structured to cover terrorism risk; and, with regard to insurers, how are reinsurance programs likewise being structured? Please comment on the availability and affordability at each level.

1.8 In the long-term, what are the key factors that will determine the amount of private-market insurer and reinsurer capacity available for terrorism risk insurance coverage? How will this evolve in the long-term? Please comment on potential entry of new capital into insurance markets.

1.9 To what extent have alternate risk transfer methods (*e.g.*, catastrophe bonds or other capital market instruments) been used for terrorism risk insurance, and what is the potential for the long-term development of these products?

1.10 To what extent have captive insurance companies been used for terrorism risk insurance, and what is the potential for the use of captive insurers to insure against such risk long-term?

1.11 Have state approaches made coverage more or less available and affordable, such as through permitted exclusions and rate regulation? To what extent will the long-term availability and affordability of terrorism risk insurance be influenced by state insurance regulation? Please comment on state approaches to ensure the continued availability and

affordability of terrorism risk insurance in the absence of the TRIA Program being in-place (include state approaches after September 11, 2001 and before TRIA became law on November 24, 2002, as well as state approaches in preparation for the expiration of the TRIA Program).

1.12 What are the differences in availability and affordability of terrorism risk insurance between the licensed/admitted market and the non-admitted/surplus lines market, and, if so, to what degree are those changes attributable to the degree and manner in which each market is regulated?

1.13 What are the differences in availability and affordability of terrorism risk insurance coverage for losses at US locations as compared to such coverage for losses at non-US locations?

II. Long-term Availability and Affordability of Group Life Insurance Coverage

2.1 What impact, if any, does terrorism risk have on the availability and affordability of group life insurance coverage to the policy holder (*e.g.*, employer) and certificate holders (*e.g.*, employees)? How will this evolve in the long-term?

2.2 To what extent is an insurer's decision to issue group life coverage influenced by aggregation or accumulation risk in certain locations? What steps have group life insurance providers taken or do they plan to take to offset any aggregation or accumulation risk?

2.3 Has terrorism risk made group life coverage less affordable to the policy or certificate holder? Have group life insurance rates increased or decreased as compared to rates before and since September 11, 2001?

2.4 Please explain how group life insurance coverage may be bundled with other coverages and benefits provided through an employee-benefits program, and how group life coverage is priced, either separately or collectively, through such programs. Please describe any effects competition has on such pricing.

2.5 Are group life providers voluntarily providing coverage for loss of life arising out of or resulting from acts of terrorism, or is coverage mandated by any state or federal laws? Are group life providers prohibited by law from excluding terrorism risk from group life insurance policies?

2.6 Has terrorism risk affected segments of the group life market differently, such as in the case of small/medium sized employers, and if so, why?

2.7 In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage for group life insurance?

III. Long-Term Availability and Affordability of Insurance Coverage for Chemical, Nuclear, Biological, and Radiological (CNBR)[2] Events caused by Terrorism

3.1 What is the current availability and affordability of coverage for CNBR events, and for what perils is coverage available, subject to what limits, and under what policy

[2] Though CNBR is commonly used to refer collectively to chemical, nuclear, biological, and radiological losses, comments can be narrow in addressing any of the coverages. If the comment makes such a distinction, please make clear which coverage is being addressed.

terms and conditions? Is there a difference in the availability and affordability of coverage for CNBR events caused by acts of terrorism?

3.2 What was the general availability of coverage for CNBR events prior to the terrorist attack of September 11, 2001? To what extent, subject to what limits, and for what perils was coverage available? Did it cover acts of terrorism?

3.3 If coverage for CNBR events caused by acts of terrorism is available, please describe generally to what extent (*i.e.*, limits, locations, exclusions, *etc.*) for what kinds of insurance and from what types of insurers (*i.e.*, large/ small, admitted/surplus lines, *etc.*). How will this evolve in the long-term?

3.4 To what extent is terrorism risk coverage available and affordable for nuclear facilities and for chemical plants, manufacturers, and industrial chemical users?

3.5 To what extent, both prior to and since September 11, 2001, have various states allowed insurers to exclude coverage for CNBR events? Please comment on requirements for workers' compensation and fire-following coverage.

3.6 It appears that some insurers are unwilling to provide coverage for CNBR events caused by acts of terrorism even with the federal loss sharing provided by the TRIA Program. Why would this be the case given that TRIA limits an insurer's maximum loss exposure?

3.7 In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage for CNBR events?

Dated:

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Emil W. Henry, Jr.
Assistant Secretary of the Treasury

PRESS ROOM

February 28, 2006
js-4078

MEDIA ADVISORY:
Treasury Assistant Secretary Warshawsky to Hold "February In Review" Economic Briefing

U.S. Treasury Assistant Secretary for Economic Policy Mark Warshawsky will hold a media briefing to review economic indicators from the month of February as well as discuss the state of the U.S. Economy. The event is open to credentialed media:

Who U. S. Treasury Assistant Secretary Mark Warshawsky

What Economic Media Briefing

When Thursday, March 2, 2:00 p.m. (EST)

Where Media Room – Main Treasury
1500 Pennsylvania Ave, NW
Washington, DC

Note ***Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number and date of birth.**

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