Thank you very much for the opportunity to talk with you today. There are several tax issues before the Congress that I would like to address.

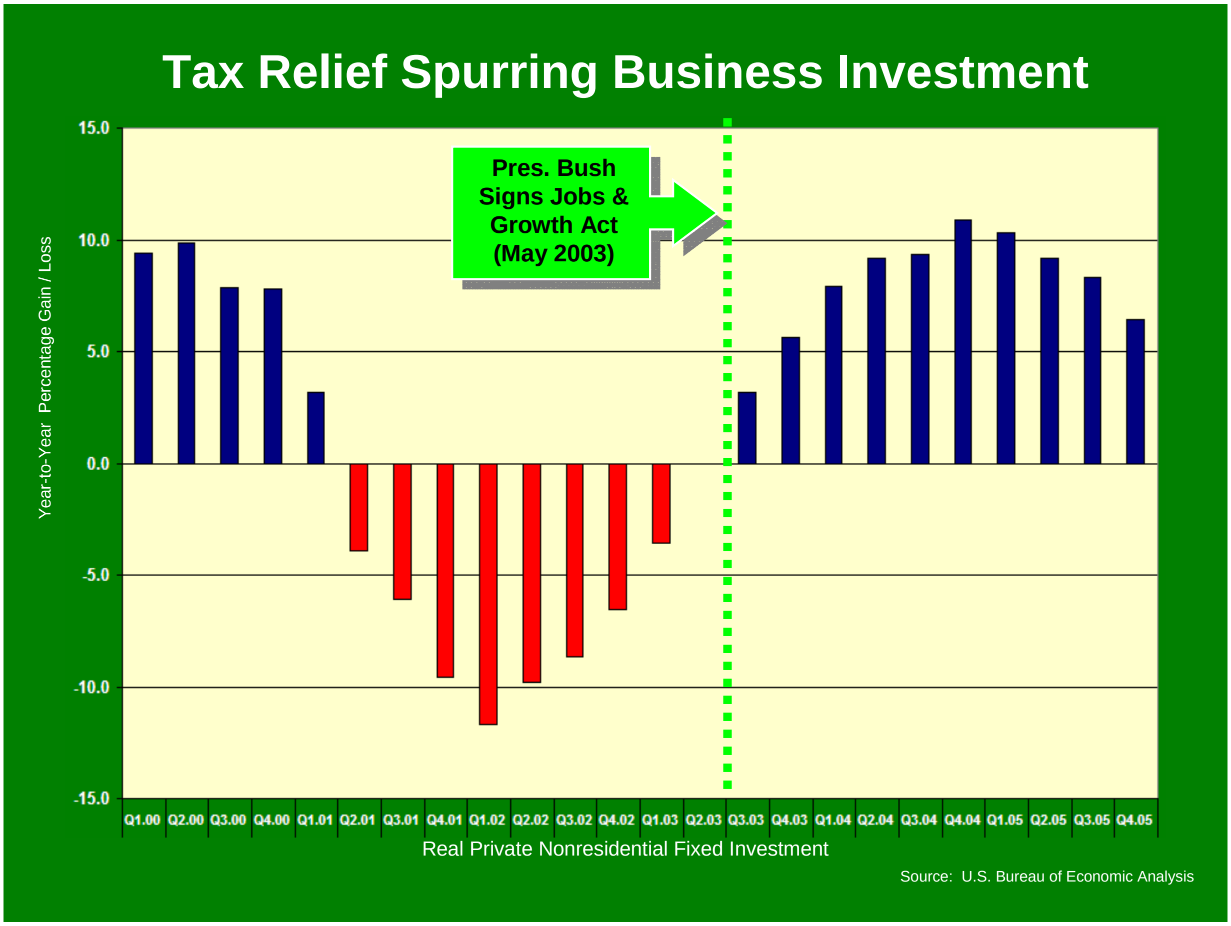
Preserving the lower tax rates on dividends and capital gains is an issue that is at the center of the current discussions on tax reconciliation. Preserving these lower tax rates is a top priority of the Administration. As you know, conferees were named several weeks ago and deliberations are underway.

It is important to consider the lower tax rates on dividends and capital gains against the backdrop of the current strength of the economy. When this tax relief was enacted in May 2003, there were some who suggested that this policy would not contribute to economic growth, would not boost investment, and would not support government revenues. Over the past few years we have seen a very different story emerge.

This is a policy that has met expectation. In a phrase, the economy is doing remarkably well. By virtually every indicator, the economy shows robust and continuing growth. We are now in a period where the economy has grown at an average rate of more than 3.9 percent for 10 consecutive quarters. Americans net worth is the highest ever. Homeownership rates are the highest ever. Inflation is not a concern and long-term interest rates remain at historic lows.

We have come a long way in the past several years. We have gone from a period of several substantial shocks to the economy – the bursting of the high-tech bubble and a loss of $7 trillion dollars in the equity markets, the 9/11 attacks and the loss of several million jobs over the next several months, the corporate scandals, the uncertainty in the aftermath of 9/11 and the war in Iraq.

Investment was a weak spot in the economy in 2001 and 2002 and the beginning of 2003. After nine consecutive quarters of declining business investment, we have now seen eleven straight quarters of growth in investment averaging 8.7 percent.



While the recession officially ended in late 2001, the President recognized that the recovery was too slow. Growth was anemic and business confidence low. Capital investment was weak and jobs were not being created.

The President acted to overcome those headwinds, and, in particular, create a more favorable climate for capital investment. The lower tax rates on dividends and capital gains encouraged investment by lowering the tax on investment returns. By Treasury Department estimates, the tax relief enacted in 2003 lowered the effective marginal tax rate on business investment by roughly 15 percent.

Not only have we seen a rebound in investment, but the economic expansion has led to a substantial increase in employment. Since May of 2003, 4.9 million jobs have been created and the unemployment rate, which was 6.3 percent in May 2003, is now at 4.8 percent, lower than the average of the 1970s, 1980s, and 1990s.

But the lower tax rates on dividends and capital gains have accomplished much more. The Treasury Department held a symposium yesterday where a number of experts described the economic distortions associated with the tax on dividends and capital gains and the economic benefits of the lower tax rates.

The tax on dividends and capital gains reflects a second layer of tax imposed on income earned in the corporate sector. Corporate profits are taxed once through the corporate income tax, and then again when the income is received by shareholders as dividends or realized as capital gains. This double tax can lead to very high tax rates on income earned through the corporate form. The effective tax rate is nearly 45 percent for income distributed to shareholders as dividends. Without the benefit of the lower tax rate on dividends enacted in 2003, the effective tax rate can reach 58 percent (and even higher when state and local taxes are included).

It is important to contrast this high rate of tax to income received in other forms to fully appreciate how the double tax on corporate profits distorts economic decisions. Business income earned outside of the corporate sector is subject to only one layer of tax at the individual level when the income is received by owners. That is, business income received outside of the corporate sector is taxed at a maximum rate of 35 percent. Consequently, the double tax on corporate profits will discourage investment in the corporate sector and lead to an inefficient allocation of capital in the economy. Put another way, reducing the double tax reduces this distortion and means capital will be allocated throughout the economy based more on economic merit than its taxation.

The high rate of tax on dividends that was in effect prior to 2003, also meant that firms were discouraged form distributing income to shareholders as dividends. While the effective tax rate on income received as dividends prior to 2003 could be as high as 58 percent, income retained by firms and taxed to shareholders when realized as capital gains would generally face a much lower effective tax rate of about 40 percent, depending on the benefits of tax deferral. The 2003 tax relief taxes dividends and retained earnings more evenly, which has reduced the tax bias against dividend payout.

More firms are now choosing to pay dividends for the first time. Dividend payments by S&P 500 companies have increased by 36.5 percent in 2005 as compared to 2002. In 2004, dividends paid by S&P 500 firms companies reached $181 billion – a record and not including Microsoft's special one-time payout of $32.6 billion. In 2005, dividend payments set another record of $203 billion, a 12.4 percent increase over 2004.

The double tax on corporate profits also distorts financing decisions. The double tax falls on equity-financed investments and leads to an over-reliance on debt finance for corporate investment. Higher debt burdens increase a firm's risk of bankruptcy, particularly during temporary industry or economy-wide downturns. Over reliance on debt finance also leads to a misallocation of capital in the economy. The lower tax rates on dividends and capital gains help reduce the tax distortion between debt and equity finance which improves the allocation of capital and reduces the economic waste created by the tax system.

The double tax on corporate profits also makes the United States less competitive relative to our major trading partners. All of the G-7 countries make at least some attempt to integrate their corporate and individual income taxes. A comparison of the United States to the other G-7 countries finds that without the lower tax on dividend and capital gains the United States would have the second highest tax on corporate profits paid out as dividends. France would have had a higher combined effective tax on corporate profits paid out as dividends had they not implemented a 50 percent dividend exclusion beginning in 2005. Only Japan would have had a higher combined effective tax on corporate profits paid out as dividends.

Tax Rates on Corporate Income Paid Out as Dividends in G-7 Countries, 2004 1/

Country	Type of dividend treatment	Corporate Tax Rate on Distributed Profits	Net Personal Tax Rate	Combined Corporate and Personal Tax Rate
Japan	Partial imputation	40.9	40	64.5
France 2/	Partial exclusion	35.4	33.9	57.3 (52.5)
Canada	Partial imputation	36.1	31.3	56.1
Germany	Partial exclusion	38.9	23.7	53.4
United Kingdom	Partial imputation	30	25	47.5
Italy	Partial exclusion	33	18.4	45.4
Average of other G-7 Countries		35.7	28.7	54
United States:				
Current Law	Lower rate	39.3	18.7	50.6
Without lower tax rates on dividends and capital gains	Lower rate	39.3	28.6	56.7

Source: OECD Tax Database, www.oecd.org.

Notes:

1/ Tax rates reflect statutory tax rates on corporate income paid out as dividends and include taxes of subnational governments. The net personal rate incorporates any exclusions or imputation credits for taxes paid by corporations.

2/ France implemented a 50 percent dividend exclusion starting in 2005 that lowered the combined maximum rate on corporate dividends to 52.5 percent. This would also reduce the average for the other G-7 countries to 53.2 percent.

Partial imputation: dividend tax credit at shareholder level for part of underlying corporate profits tax.

Partial exclusion: part of received dividends is excluded from taxable income at the shareholder level.

Many factors have contributed to the economic growth we see today. The reduction in interest rates by the Federal Reserve Board – the 11 reductions in the federal funds target rate in 2001 alone – clearly played a role. But the tax reductions on dividends and capitals gains were crucial.

This policy did not only have the goal of providing economic stimulus in the near-term, but was also intended to lay the groundwork for continued economic growth and higher livings standards. From the period of 1973 through 1995 productivity growth averaged 1.4 percent annually. Compensation and livings standards are tied directly to productivity growth. When productivity growth rises by 1.4 percent annually, its takes 50 years for living standards to double. Since President Bush has taken office, productivity growth has averaged 3.2 percent. While productivity growth at this level may not be sustainable, if productivity growth can be kept at around 2.8 percent annually, living standards would double in half the time – 25 years rather than 50.

The Congress will likely consider whether to extend the lower tax rates on dividends and capital gains over the next several weeks. This is an issue that is important to all Americans because without this extension, the tax rate on dividends and capital gains increase, which could have exactly the opposite effect of the changes made in 2003. Investment would be discouraged, which would adversely affect the economy and lower living standards over the longer term.

The Congress is also considering a provision concerning the alternative minimum tax (AMT). Of course, the AMT is a tax system that runs parallel to the regular income tax. It is bad enough that taxpayers need to understand and navigate our current income tax system. It is quite another thing to ask them to comply with two parallel tax systems.

The AMT was created in the late 1960s to address the problem of just a few hundred taxpayers with high incomes, but who paid no income tax because they took extraordinary use of a few narrowly available tax provisions in the code. In tax year 2005, some 4 million people were subject to the AMT. In 2006, this number could exceed 22 million, unless the Congress acts to extend tax provisions that provided temporary relief from the AMT – a higher AMT exemption and allowing personal credits to be claimed against the AMT. The President proposed in his FY 2007 Budget to extend these provisions through 2006 to prevent a large increase in the number of taxpayers caught by the AMT.

The AMT is also a long-term problem. If left unchanged, Treasury estimates that by 2016 the number of taxpayers subject to the AMT will grow to 56 million or nearly one-half of all taxpayers who owe individual income taxes. Because of the way the AMT is intertwined with the rest of the tax system, the Administration believes the best way to address this longer-term problem is through fundamental reform of the entire income tax system. This is a project that we are actively engaged in at the Treasury Department.

Finally, I would like to draw your attention to one other initiative the President has included in his FY 2007 Budget. The President has put forward an initiative to help make health care more affordable and accessible and to update our institutions to better reflect the economy’s dynamic labor markets. Expanding access to Health Savings Accounts (HSAs) helps contribute to this goal by putting patients more in control of their health care. This initiative will help make the health care system more efficient, more portable, and help reduce health care costs.

Currently, about 3.2 million people have high deductible health plans even though HSAs have been available for only a few years. The growth in HDHPs has been dramatic – a three-fold increase in less than a year. Importantly, 37 percent of those who have HSAs were previously uninsured and over 40 percent have incomes below $50,000. HSAs provide an additional option to individuals that helps reduce the number of uninsured and helps lower income Americans.

The President’s initiative would expand HSAs so that people who purchase insurance directly have the same tax advantage as those who receive their insurance through their employers. Many of the uninsured work for small businesses, who cannot afford to offer insurance. But those who work for larger companies receive a significant tax advantage: They pay neither income taxes nor payroll taxes on their health insurance premiums. In contrast, those who purchase insurance directly – for example those who work for a small business that does not offer insurance – pay for insurance with after-tax dollars after paying income and payroll taxes. Owners of small businesses are also disadvantaged. They can deduct their insurance premiums for income tax purposes, but only after paying payroll taxes. The President's proposals would eliminate this inequity.

Simply, this initiative would provide health care purchased directly by individuals with a high deductible health plan with the same tax advantages already provided to insurance purchased through employers.

The President's initiative not only addresses an inequity in the tax code, but it also gives individuals a greater stake in health care decisions. When they are making their own health care decisions with their own money, we can expect those decisions to be better ones. Also, and importantly, HSAs are portable. When workers change jobs, they take their HSAs with them. With the increasing frequency that workers choose to change jobs today – to gain more experience, pursue better paying jobs, get more flexibility in the workplace – portability is more and more important. Again, it is just a matter of letting our institutions evolve and adapt to our increasingly dynamic economy.

I'd be happy to take any questions.