Joint Committee on Taxation
October 31, 1995
JCX-49-95

S. 1318, the "Amtrak and Local Rail Revitalization Act of 1995"

Scheduled for Markup by the Senate Committee on Finance on November 2, 1995

S. 1318, the "Amtrak and Local Rail Revitalization Act of 1995" was reported by the Senate Committee on Commerce, Science, and Transportation ("Commerce") on October 12, 1995 (S. Rept. 104-157). The bill, as reported by Commerce, includes several Federal tax provisions (Title X) within the jurisdiction of the Committee on Finance ("Finance"). On October 19, 1995, the bill was referred to Finance for a period of 15 calendar days for consideration of these tax provisions. Finance has scheduled a markup on November 2, 1995.

Part I of this document provides an overview of the non-tax provisions of S. 1318 as reported by Commerce; Part II is a brief description of the tax provisions in Title X of S. 1318 as reported by Commerce; and Part III is a possible option for Finance markup of S. 1318.

I. Overview of Non-Tax Provisions of S. 1318, as Reported

Authorization of appropriations

S. 1318, as reported, would authorize annual appropriations during the period through fiscal year 1999 for: (1) Amtrak's general operating expenses and capital expenditures; (2) certain northeast corridor rail improvements; (3) Amtrak's participation in a $1 billion loan guarantee program created by the Railroad Revitalization and Regulatory Reform Act of 1976; and (4) the Local Rail Freight Assistance program.

Amtrak reforms

S. 1318, as reported, also would make various operational reforms applicable to Amtrak. The bill: (1) would allow contracting out of certain services now performed by Amtrak employees; (2) would provide for certain changes in Amtrak service operations, including notice requirements when service is discontinued; (3) would authorize Amtrak to limit its liability to passengers; (4) would permit Amtrak to increase non-Federal revenues through sale of concessions and use of vending machines and audio/video equipment on trains; and (5) would create an Amtrak Reform Council to develop a plan for Amtrak's continuation without Federal support or its liquidation after five years if such a continuation is not fiscally viable.

Disbursement of Federal appropriations

The bill, as reported, would provide that Federal payments to Amtrak would be disbursed immediately upon appropriation.

Exemption from State and local transportation taxes

The bill, as reported, would exempt Amtrak services from State and local government taxes and fees on interstate transportation.

Establishment of Intercity Rail Passenger Account

S. 1318, as reported, would direct Amtrak to establish an "Intercity Rail Passenger Account" (the "Rail Account") to provide a source of capital for Amtrak and for rail passenger services in States that are not currently served by Amtrak. The Rail Account would receive five percent of Amtrak's ticket revenues for fiscal years 1995 through 1999 and the Federal excise tax revenue, described below. Amtrak further would be permitted to deposit in the Rail Account (1) payments it receives for the use of Amtrak equipment or facilities; (2) claims recovered by Amtrak; and (3) taxes refunded to Amtrak. The Federal tax revenues dedicated to the Rail Account would be transferred to Amtrak for deposit in the Rail Account without appropriation, i.e., would be treated as new direct spending under the Budget Enforcement Act.

II. Tax Provisions in S. 1318, as Reported

Title X of S. 1318, as reported by Commerce, includes the following tax provisions relating to Amtrak.

On-time performance incentives

Amtrak uses track owned and controlled by other, primarily freight, railroads. Amtrak contracts with these railroads provide for incentive payments if the railroads allow Amtrak priority use to this track to assist in Amtrak's on-time performance. Under present law, these incentive payments, as well as other payments for track use made by Amtrak, are taxable income to the railroads.

Under the bill, as reported, incentive payments made by Amtrak to other railroads for ensuring Amtrak's on-time performance would be exempted from Federal income tax.

Transfer of certain amounts to Intercity Rail Passenger Account

A 4.3 cents-per-gallon excise tax is imposed on diesel fuel used in most transportation modes, including rail. Diesel fuel used in trains is subject to an additional 1.25-cents-per-gallon tax through September 30, 1999. Revenues from both of these taxes are retained in the General Fund of the Treasury for deficit reduction. Amtrak, like other rail carriers, is subject to these taxes on fuel used in its trains.

Under the bill, as reported, an amount equal to gross revenues from Federal excise taxes paid by Amtrak on diesel fuel used in its trains would be transferred from general revenues to the new Intercity Rail Passenger Account, described above.

Transfer of certain Highway Trust Fund revenues to Intercity Rail Passenger Account

The Federal Highway Trust Fund receives amounts equivalent to gross revenues from gasoline, special fuels, and diesel fuel taxes imposed on highway vehicles and certain other excise taxes imposed on highway vehicles and tires. Highway Trust Fund revenues from the motor fuels taxes are divided between a Highway Account and a Mass Transit Account, and are available, subject to appropriation, to finance programs provided for in specified highway and mass transit authorization Acts. Since October 1, 1995, the Mass Transit Account receives 2.0 cents per gallon of the highway fuels tax revenues; the balance of the fuels tax revenues and revenues from the other Highway Trust Fund taxes are deposited in the Highway Account. Spending from the Highway Trust Fund is classified as discretionary domestic spending under the Budget Enforcement Act.

S. 1318, as reported, would reallocate the portion of the highway fuels tax revenues currently deposited in the Mass Transit Account of the Highway Trust Fund. Under the bill, as reported, 1.5 cents per gallon of these taxes would continue to go to the Highway Trust Fund's Mass Transit Account; the remaining 0.5 cent per gallon would be deposited in the new Intercity Rail Passenger Account, described above. As stated above, spending from this new Rail Account would be classified as direct spending under the Budget Enforcement Act.

Safe-harbor leasing of intercity rail passenger equipment and facilities

In general, only the owner of property for tax purposes is allowed to claim any cost recovery (depreciation) deductions or tax credits attributable to that property. Between 1981 and 1982, special provisions existed in the Internal Revenue Code (the "Code") allowing parties that were unable to realize tax benefits (e.g., because they had insufficient tax liability) to enter into special lease transactions, known as "safe-harbor leases," under which another taxpayer (with sufficient tax liability) was allowed to claim tax benefits attributable to the leased property. These safe-harbor leasing rules were repealed by the Tax Equity and Fiscal Responsibility Act of 1982.

Under the bill, as reported, Amtrak would be permitted to enter into safe-harbor lease transactions to transfer the tax benefits attributable to its property to other taxpayers.

Tax-exemption for interest on certain Amtrak debt

Interest on debt of the Federal Government like debt of private businesses is taxable to lenders. Interest on debt issued by States and local governments generally is tax-exempt. State and local government debt ("bonds") may be issued to finance direct activities of these governmental units or for private purposes specified in the Code ("private activity bonds"). Tax-

exempt bonds for actual governmental activities and for private activities both must be issued by a State or local government (in the latter case, as a conduit borrower).

To ensure that tax-exempt State and local government debt is not a superior instrument to Federal Government debt, interest on State or local government bonds is taxable if the bonds are directly or indirectly guaranteed by the Federal Government.

S. 1318, as reported, would allow Amtrak to directly issue up to $100 million per year of private activity tax-exempt bonds, and would waive the prohibition on Federally guaranteed tax-exempt debt in the case of these bonds. (Such a guarantee could arise because of the appropriated operating subsidies and new direct Federal spending to be received by Amtrak.)

Exception to certain cost recovery restrictions

The Code generally provides an accelerated cost recovery system ("MACRS") for calculating the regular income tax depreciation deductions. For shorter-lived property (e.g., railroad rolling stock), these deductions are determined using a method that results in larger deductions in the initial years after property is placed in service (e.g., 200-percent declining balance) as well as a statutory recovery period that is shorter than the economic life of the property.

Certain property is not eligible for MACRS deductions. Rather, the cost of this property is recovered using a straight-line method over the property's economic life (the "alternative system"). Cost recovery deductions for property that is financed with tax-exempt bonds are calculated using the alternative system.

S. 1318, as reported, would waive the general rule requiring use of the alternative system to compute cost recovery deductions for tax-exempt bond-financed property in the case of Amtrak's property.

III. Possible Finance Committee Option

A. Delete Title X of S. 1318

The tax provisions (Title X) of S. 1318 would be deleted from the bill.

B. Report Separate Bill Containing Tax Provisions Affecting Amtrak and Revenue Offsets

Tax provisions affecting Amtrak

Tax-exemption for on-time performance incentives.--As provided in S. 1318, as reported by Commerce, incentive payments made by Amtrak to other railroads for ensuring Amtrak's on-time performance would be exempted from Federal income tax, but only during the period January 1, 1996, through December 31, 2000.

Tax-exemption for interest on certain Amtrak debt.--Up to $100 million per year of tax-exempt private activity bonds could be issued for the benefit of Amtrak during the period January 1, 1996, through December 31, 2000. This debt could be issued by the State in which Amtrak is incorporated or by the State or States (a) in which the bond-financed property was to be located or (b) in which Amtrak had a substantial presence.

Establish new Intercity Passenger Rail Trust Fund.--In lieu of the Intercity Rail Passenger Account established by S.1318, as reported by Commerce, a new Intercity Passenger Rail Trust Fund (the "Rail Trust Fund") would be established in the Trust Fund Code of the Internal Revenue Code. Amounts equal to 0.5 cent per gallon of the excise taxes on highway motor fuels (currently deposited in the Mass Transit Account of the Highway Trust Fund) would be deposited in the Rail Trust Fund during the period January 1, 1996, through September 30, 2000. Amounts in the new Trust Fund would be available for expenditure by the Department of Transportation to finance capital improvements for Amtrak and other passenger rail carriers in States not served by Amtrak. Spending from the new Rail Trust Fund would not be subject to appropriation (i.e., would be classified as direct spending under the Budget Enforcement Act) up to the following annual amounts:

Fiscal Year	Amount
1996	$ 125 million
1997	650 million
1998	650 million
1999	650 million
2000	650 million

Disallow interest deduction for corporate-owned life insurance policy loans

The option would impose identical restrictions to those included in H.R. 2491, as passed by the Senate, on interest deductions for corporate-owned life insurance policy loans.

Present law.--No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup"). Further, an exclusion from Federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured. The policyholder may borrow with respect to the life insurance contract without affecting these exclusions, subject to certain limitations.

The limitations on borrowing with respect to a life insurance contract under present law provide that no deduction is allowed for any interest paid or accrued on any indebtedness with respect to one or more life insurance policies owned by the taxpayer covering the life of any individual who (1) is an officer or employee of, or (2) is financially interested in, any trade or business carried on by the taxpayer to the extent that the aggregate amount of such debt with respect to policies covering the individual exceeds $50,000.

Further, no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, endowment or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract. An exception to the latter rule is provided, permitting deductibility of interest on bona fide debt that is part of such a plan, if no part of 4 of the annual premiums due during the first 7 years is paid by means of debt (the "4-out-of-7 rule"). Provided the transaction gives rise to debt for Federal income tax purposes, and provided the 4-out-of-7 rule is met, a company may under present law borrow up to $50,000 per employee, officer, or financially interested person to purchase or carry a life insurance contract covering such a person, and is not precluded by the statutory disallowance rules from deducting the interest on the debt, even though the earnings inside the life insurance contract (inside buildup) are tax-free, and in fact the taxpayer has full use of the borrowed funds.

Possible Finance option.--Subject to an exception described below, the option would eliminate any deduction for any amount paid or accrued on any indebtedness with respect to life insurance, endowment or annuity policies owned by the taxpayer covering any individual who is either an officer or employee of, or financially interested in, any trade or business carried on by the taxpayer, regardless of the aggregate amount of debt with respect to policies covering the individual.

An exception would be provided retaining present law for interest on indebtedness with respect to life insurance policies covering up to 25 key persons. A key person would be an individual who is either an officer or a 20-percent owner of the taxpayer. The taxpayer could designate a number of key persons equal to the greater of 5 people or 5 percent of the number of officers and employees, but not more than 25. All members of a controlled group would be treated as one taxpayer for this purpose. Interest paid or accrued on debt with respect to a life

insurance contract covering a key person would be deductible only if the rate of interest does not exceed Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month interest is paid or accrued.

Effective date.--With respect to debt incurred after December 31, 1995, no deduction would be allowed except with respect to policies that satisfy the key person exception. In addition, as described below, a grandfather rule would be provided with respect to certain interest on contracts issued on or before June 20, 1986.

With respect to debt incurred on or before December 31, 1995, any interest paid or accrued after October 13, 1995, and before January 1, 2001, would be allowed to the extent the rate of interest does not exceed the lesser of (1) the borrowing rate specified in the contract as of October 13, 1995, or (2) a percentage of Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month the interest is paid or accrued. For interest paid or accrued after October 13, 1995, and before January 1, 1997, the percentage of the Moody's rate would be 100 percent; for interest paid or accrued in 1997, the percentage would be 95 percent; for 1998, the percentage would be 90 percent; for 1999, the percentage would be 85 percent; for 2000, the percentage would be 80 percent; and for 2001 and thereafter, the percentage would be 0 percent.

Any amount included in income during 1996, 1997, 1998, 1999, 2000 or 2001, that is received under a contract described in the proposal on the complete surrender, redemption or maturity of the contract or in full discharge of the obligation under the contract that is in the nature of a refund of the consideration paid for the contract, would be includable ratably over the first four taxable years beginning with the taxable year the amount would otherwise have been includable. Utilization of this 4-year income-spreading rule would not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of failure to meet the 4-out-of-7 rule.

In the case of an insurance company, the unamortized balance of policy expenses attributable to a contract with respect to which the 4-year income-spreading treatment is allowed to the policyholder would be deductible in the year in which the transaction giving rise to income-spreading occurs.

The option generally would not apply to interest on debt with respect to contracts purchased on or before June 20, 1986 (thus continuing the effective date provision of the $50,000 limitation enacted in the 1986 Act), except that interest on such contracts paid or accrued after October 13, 1995 would be allowable only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average - Monthly Average Corporates for each month the interest is paid or accrued.

Under the option, there would be no inference as to the tax treatment of interest paid or accrued under present law.