

**DESCRIPTION OF THE REVENUE PROVISIONS OF H.R. 1631,  
THE “RAIL INFRASTRUCTURE DEVELOPMENT  
AND EXPANSION ACT FOR THE 21ST CENTURY”**

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By the  
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Prepared by  
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## INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on February 1, 2006, on the revenue provisions of H.R. 1631, the “Rail Infrastructure Development and Expansion Act for the 21st Century.”<sup>1</sup> This document<sup>2</sup> provides a description of present law and the revenue provisions of H.R. 1631.

H.R. 1631 authorizes States to issue \$12 billion in tax-exempt bonds and \$12 billion in tax-credit bonds to finance infrastructure for high-speed rail transportation projects.<sup>3</sup>

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<sup>1</sup> H.R. 1631 was referred to the Committee on Ways and Means and the Committee on Transportation and Infrastructure, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned. The Committee on Transportation and Infrastructure reported the bill on November 18, 2005. See H.R. Rep. No. 109-314, Part I, for provisions included in the bill as reported by the Committee on Transportation and Infrastructure.

<sup>2</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of the Revenue Provisions of H.R. 1631, The “Rail Infrastructure Development and Expansion Act for The 21st Century,”* (JCX-5-06), January 26, 2006.

<sup>3</sup> In addition to authorizing bonds, H.R. 1631 expands the Railroad Rehabilitation and Improvement program and authorizes the appropriation of \$100 million each year over the period of 2006-2013 to provide grants to public agencies for developing high-speed rail corridors, and for improving the technology for high-speed rail systems.

## A. Present Law

### 1. Tax-exempt bonds

#### In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds. Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person, is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called “private activity bonds.” The term “private person” includes the Federal Government and all other individuals and entities other than States or local governments.

#### Private activities eligible for financing with tax-exempt private activity bonds

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities.

States or local governments may issue tax-exempt “exempt facility bonds” to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, water, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated low-income rental housing; and certain private facilities for the local furnishing of electricity or gas. Bonds issued to finance “environmental enhancements of hydro-electric generating facilities,” qualified public educational facilities, qualified green building and sustainable design projects and qualified highway or surface freight transfer facilities also may qualify as exempt facility bonds.

Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers, local redevelopment activities, and eligible empowerment zone and enterprise community businesses. Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code may be financed with tax-exempt private activity bonds (“qualified 501(c)(3) bonds”).

In most cases, the aggregate volume of private activity tax-exempt bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2005, these annual volume limits, which are indexed for inflation, equal \$80 per resident of the State, or \$239,180,000 million, if greater.<sup>4</sup>

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<sup>4</sup> Rev. Proc. 2004-71.

### Exempt facility bonds for high-speed intercity rail facilities

Private activity bonds can be issued for high-speed intercity rail facilities.<sup>5</sup> A facility qualifies as a high-speed intercity rail facility if it is a facility (other than rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas.<sup>6</sup> The facilities must use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops and the facilities must be made available to members of the general public as passengers. If the bonds are to be issued for a nongovernmental owner of the facility, such owner must irrevocably elect not to claim depreciation or credits with respect to the property financed by the net proceeds of the issue.<sup>7</sup>

The Code imposes a special redemption requirement for these types of bonds. Any proceeds not used within three years of the date of issuance of the bonds must be used within the following six months to redeem such bonds.<sup>8</sup>

Seventy-five percent of the principal amount of the bonds issued for high-speed rail facilities is exempt from the volume limit.<sup>9</sup> If all the property to be financed by the net proceeds of the issue is to be owned by a governmental unit, then such bonds are completely exempt from the volume limit.

### Arbitrage and other requirements

The tax exemption for State and local bonds does not apply to any arbitrage bond.<sup>10</sup> An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.<sup>11</sup> In general, arbitrage profits may be earned only during specified periods (e.g., defined “temporary periods”) before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., “reasonably required reserve or replacement funds”). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal government.

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<sup>5</sup> Sec. 142(a)(11) and sec. 142(i).

<sup>6</sup> A metropolitan statistical area for this purpose is defined by reference to section 143(k)(2)(B). Under that provision, the term metropolitan statistical area includes the area defined as such by the Secretary of Commerce.

<sup>7</sup> Sec. 142(i)(2).

<sup>8</sup> Sec. 142(i)(3).

<sup>9</sup> Sec. 146(g)(4).

<sup>10</sup> Sec. 103(a) and (b)(2).

<sup>11</sup> Sec. 148.

An issuer must file with the IRS certain information in order for a bond issue to be tax-exempt.<sup>12</sup> Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

## **2. Tax-credit bonds**

### In general

As an alternative to traditional tax-exempt bonds, the Code permits three types of tax-credit bonds. States and local governments have the authority to issue “qualified zone academy bonds,” “clean renewable energy bonds,” and “Gulf tax credit bonds.”<sup>13</sup>

### Qualified zone academy bonds

“Qualified zone academy bonds” are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a “qualified zone academy,” and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A total of \$400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2005. The \$400 million aggregate bond cap is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate at a rate estimated to allow issuance of the qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond was 50 percent of the face value of the bond.

Qualified zone academy bonds are subject to neither arbitrage nor spending requirements. Treasury regulations require that the proceeds of a qualified zone academy bond be spent with

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<sup>12</sup> Sec. 149(e).

<sup>13</sup> Sec. 1397E, sec. 54, and sec. 1400N(1). Clean renewable energy bonds also may be issued by a clean renewable energy bond lender, an Indian tribal government, or a cooperative electric company.

due diligence. Issuers of qualified zone academy bonds are not required to file information returns with the Treasury.

### Clean renewable energy bonds

Clean renewable energy bonds (“CREBs”) are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for facilities that qualify for the tax credit under section 45 (“qualified projects” other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section. There is a national CREB limitation of \$800,000,000. Bonds must be issued before December 31, 2007.

Like qualified zone academy bonds, CREBs are not interest-bearing obligations. Rather, the taxpayer holding CREBs on a credit allowance date would be entitled to a tax credit. The amount of the credit is determined by multiplying the bond’s credit rate by the face amount on the holder’s bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of CREBs without discount and interest cost to the qualified issuer. The credit accrues quarterly and is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

CREBs are subject to a maximum maturity limitation. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a CREBs being equal to 50 percent of the face amount of such bond. Moreover, the provision requires level amortization of CREBs during the period such bonds are outstanding.

CREBs also are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to CREBs.

In addition, to qualify as CREBs, the qualified issuer must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any “nonqualified bonds.” The five-year spending period may be extended by the Secretary upon the qualified issuer’s request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Unlike qualified zone academy bonds, issuers of CREBs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

### Gulf tax credit bonds

Gulf tax credit bonds may be issued by the States of Louisiana, Mississippi, and Alabama. To qualify as Gulf tax credit bonds, 95 percent or more of the proceeds of such bonds must be used to (i) pay principal, interest, or premium on a bond (other than a private activity bond) that was outstanding on August 28, 2005, and was issued by the State issuing the Gulf tax credit bonds, or any political subdivision thereof, or (ii) make a loan to any political subdivision of such State to pay principal, interest, or premium on a bond issued by such political subdivision. In addition, the issuer of Gulf tax credit bonds must provide additional funds to pay principal, interest, or premium on outstanding bonds equal to the amount of Gulf tax credit bonds issued to repay such outstanding bonds. Gulf tax credit bonds must be a general obligation of the issuing State and must be designated by the Governor of such State. The maximum maturity on Gulf tax credit bonds is two years. In addition, present-law arbitrage rules that restrict the ability of State and local governments to invest bond proceeds apply to Gulf tax credit bonds.

Gulf tax credit bonds must be issued in calendar year 2006. The maximum amount of Gulf tax credit bonds that may be issued is \$200 million in the case of Louisiana, \$100 million in the case of Mississippi, and \$50 million in the case of Alabama. Gulf tax credit bonds may not be used to pay principal, interest, or premium on any bond with respect to which there is any outstanding refunded or refunding bond. Moreover, Gulf tax credit bonds may not be used to pay principal, interest, or premium on any prior bond if the proceeds of such prior bond were used to provide any property described in section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises).

As with CREBs, issuers of Gulf tax credit bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

## **B. Description of Sections 2 and 3 of H.R. 1631**

### **Section 2 of H.R. 1631: High-speed rail infrastructure bonds**

Section 2 amends Chapter 261 of Title 49 by adding a new section 26106. This section permits the Secretary of Transportation to designate bonds for funding the development of high-speed rail in the United States. The Secretary of Transportation may designate two types of bonds: private-activity bonds, the interest on which is exempt from Federal taxes, and tax-credit bonds, for which the government provides the holder a credit rather than the issuer paying interest to the holder.

The Secretary of Transportation may designate high-speed rail infrastructure bonds if six requirements are met.

- First, a State, group of States, or compact of States, depending on the circumstances, must be the proposed issuer of the bonds.
- Second, the bonds must finance projects that make a substantial contribution to providing the infrastructure and equipment required to complete a high-speed rail transportation corridor that the Secretary of Transportation determines are part of a viable and comprehensive high-speed rail transportation corridor design for intercity passenger service. Those projects include, but are not limited to, the financing or refinancing of equipment and capital improvements, the elimination of grade crossings, the development of intermodal facilities, improvement of train speeds or safety, or station rehabilitation and construction. Projects for the Alaska Railroad are also qualified projects.
- Third, if the rail corridor includes the use of rights-of-way owned by a freight railroad, the State applicant must demonstrate that it has entered into a written agreement with such freight railroad regarding the use of the rights-of-way, and that collective bargaining agreements with freight railroad employees (including terms regarding the contracting of work) shall remain in full force and effect.
- Fourth, the corridor design submitted by the applicant must eliminate existing railway-highway grade crossings that the Secretary of Transportation determines would impede high-speed rail operations.
- Fifth, the applicant must comply with the existing Amtrak prevailing wage standards and the labor protection benefits applicable under section 504 of the Railroad Revitalization and Regulatory Reform Act of 1976.
- Sixth, the applicant must agree not to pay the principal or interest on any bonds using funds from the Highway Trust Fund, except as permitted by law on the date of enactment.

The amount of bonds the Secretary of Transportation may designate to be issued in each year is limited to \$1.2 billion per year from 2006 to 2015 of private activity tax-exempt bonds and \$1.2 billion per year from 2006 to 2015 of tax-credit bonds. Any amount that the Secretary of Transportation does not designate in a year may be carried over and designated in subsequent years (through fiscal year 2019).

When designating bonds, the Secretary of Transportation is to give preference to projects that: (1) are funded through a combination of both tax-exempt and tax-credit bonds; (2) propose to link rail passenger service to other passenger transportation modes, such as public transportation or air service; (3) are expected to have a significant impact on air traffic congestion; (4) are expected to improve commuter rail operations; (5) have completed all environmental work and the project is ready to begin construction; or (6) have received all financial commitments and other support from State and local governments.

The Secretary of Transportation is to grant or deny the applicant's request within nine months after receiving the application.

The issuer of the bonds is to report annually to the Secretary of Transportation. That report must include statements about the terms of the outstanding designated bonds and about the progress made on the project financed with the bonds. In addition, the bill requires the Secretary of Transportation, in consultation with the Secretary of the Treasury, to submit to the Congress an annual report including the reports provided by the issuers and an assessment of the progress made toward completion of high-speed rail transportation corridors resulting from projects financed with the bonds designated.

Interest on bonds designated by the Secretary of Transportation and issued by a State, States, or compact of States is exempt from Federal taxation, notwithstanding section 149(c) of the Code.<sup>14</sup> In addition, the bill provides that such bonds are exempt from the volume limitation on private activity bonds.

Bonds designated by the Secretary of Transportation may be issued for refinancing projects if certain requirements are met.

The bill makes entities providing intercity high-speed rail passenger service that use property acquired through bonds designated by the Secretary of Transportation subject to rail statutes, such as the Railway Labor Act and the Railroad Retirement Act of 1974. This rule does not apply to projects for the Alaska Railroad. Any entity providing high-speed rail service commencing after the date of enactment which replaces another intercity carrier must enter a collective bargaining agreement covering employees of the displaced carrier. The agreement must further provide for priority hiring by new entities providing intercity high-speed rail passenger service of workers of an incumbent rail passenger provider who are displaced because of projects financed by bonds designated by the Secretary. The agreement must also establish a process for implementing such hiring priority, pay, work rules and working conditions. A process for negotiating new labor arrangements is also provided by the bill.

The Secretary of Transportation is to issue implementing regulations within six months after the date of enactment.

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<sup>14</sup> Under present law, section 149(c) of the Code provides that "no interest on any bond shall be exempt from taxation under [the Code] unless such interest is exempt from tax under [the Code] without regard to any provision of law which is not contained in [the Code] and which is not contained in a revenue Act."

### **Section 3 of H.R. 1631: Tax Credit to Holders of Qualified High-Speed Rail Infrastructure Bonds**

Section 3 amends the Code to create the tax-credit bonds that the Secretary may designate pursuant to the newly created section 26106 of Title 49. It also imposes additional requirements on exempt facility bonds for high-speed intercity rail facilities.

#### Qualified high-speed rail infrastructure tax-credit bonds

The bill creates a new type of tax-credit bond, qualified high-speed rail infrastructure bonds. In lieu of interest, the bondholder receives a tax credit equal to the applicable credit rate multiplied by the outstanding face amount of the bond. The “credit rate” for the qualified high-speed rail infrastructure bonds is the rate equal to the average market yield (as of the day before the date of sale of the issue) on outstanding long-term corporate debt obligations. Credits accrue quarterly and are includable in the gross income of the taxpayer. The credit is allowable against regular income tax and alternative minimum tax liability. Unused credits may be carried over to succeeding taxable years. Unlike qualified zone academy bonds, any taxpayer would be eligible to be a holder of a qualified high-speed rail infrastructure bond and thereby claim the credit.

To be a qualified high-speed rail infrastructure bond, five requirements must be met: (1) the issuer must certify that the Secretary of Transportation has designated the bond under the new section 26106 of Title 49 for purposes of the tax-credit provision; (2) 95 percent or more of the proceeds from the sale of the issue are to be used for expenditures incurred after the date of enactment for a qualified project (as defined in the new section 26106 of Title 49 described above); (3) the term of each bond that is part of the issue cannot exceed 20 years; (4) the payment of the principal with respect to such bond is the obligation solely of the issuer; and (5) the issue meets certain spending and arbitrage requirements.

If any qualified high-speed rail infrastructure bond ceases to be such a qualified bond, the issuer is required to reimburse the Treasury for all tax credits (including interest) that accrued within three years of the date of noncompliance. If the issuer fails to make a full and timely reimbursement of tax credits, holders of the bonds would be liable for any remaining amounts.

#### Additional requirements for exempt facility bonds for high-speed intercity rail facilities authorized by section 142(a)(11) of the Code

The bill reduces the train speed requirements from 150 miles per hour to 110 miles per hour for exempt facility bonds issued for high-speed intercity rail. In addition, a bond will not be treated as an exempt facility bond for high-speed intercity rail unless such bond meets the six requirements described above for high-speed rail infrastructure bonds (e.g. designation by the Secretary of Transportation, and meets requirements relating to qualified projects, rights-of-way agreements, railway-highway grade crossings, prevailing wage standards and labor protection benefits, and an agreement not to pay interest or principal using funds derived from the Highway Trust Fund except as permitted by law).