

**DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO  
H.R. 2571, THE "RAIL INFRASTRUCTURE DEVELOPMENT AND  
EXPANSION ACT FOR THE 21<sup>ST</sup> CENTURY," AS INTRODUCED AND  
ORDERED REPORTED BY THE COMMITTEE ON TRANSPORTATION  
AND INFRASTRUCTURE**

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## CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
I. OVERVIEW OF RULES GOVERNING ISSUANCE OF TAX-EXEMPT AND TAX-CREDIT BONDS AND DESCRIPTION OF SECTIONS 2 AND 3 OF H.R. 2571 .....	2
A. Tax-Exempt Bonds and Tax-Credit Bonds.....	2
B. Description of Sections 2 and 3 of H.R. 2571, as Introduced and as Ordered Reported by the Committee on Transportation and Infrastructure.....	5
II. DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO H.R. 2571 .....	8

## INTRODUCTION

This document<sup>1</sup> provides a description of present law and of the Chairman's Modification to H.R. 2571, the "Rail Infrastructure Development and Expansion Act for the 21<sup>st</sup> Century," as introduced and ordered reported by the Committee on Transportation and Infrastructure.

H.R. 2571 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. In addition to authorizing bonds, H.R. 2571 expands the Railroad Rehabilitation and Improvement program. H.R. 2571 also authorizes the appropriation of \$100 million each year over the 2004-2011 period to provide grants to public agencies for developing high-speed rail corridors, and for improving the technology for high-speed rail systems.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification To H.R. 2571, The "Rail Infrastructure Development and Expansion Act for The 21st Century," as Introduced And Ordered Reported by the Committee On Transportation and Infrastructure*, (JCX-92-03), October 22, 2003.

# I. OVERVIEW OF RULES GOVERNING ISSUANCE OF TAX-EXEMPT AND TAX-CREDIT BONDS AND DESCRIPTION OF SECTIONS 2 AND 3 OF H.R. 2571

## A. Tax-Exempt Bonds and Tax-Credit Bonds

### Present Law

#### 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” and qualified public educational 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. These

annual volume limits, which are indexed for inflation, currently equal to \$75 per resident of the State, or \$228,580,000 million, if greater.<sup>2</sup>

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

Private activity bonds can be issued for high-speed intercity rail facilities.<sup>3</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>4</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>5</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>6</sup>

Seventy-five percent of the principal amount of the bonds issued for high-speed rail facilities is exempt from the volume limit.<sup>7</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.

#### **Tax-credit bonds for qualified zone academies**

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue “qualified zone academy bonds” (“QZAB”).<sup>8</sup> “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

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<sup>2</sup> Rev. Proc. 2002-70.

<sup>3</sup> Sec. 142(a)(11) and sec. 142(i).

<sup>4</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>5</sup> Sec. 142(i)(2).

<sup>6</sup> Sec. 142(i)(3).

<sup>7</sup> Sec. 146(g)(4).

<sup>8</sup> Sec. 1397E.

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 was authorized to be issued annually in calendar years 1998 through 2003. 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 set 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 was 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.

**B. Description of Sections 2 and 3 of H.R. 2571, as Introduced  
and as Ordered Reported by the  
Committee on Transportation and Infrastructure**

**Section 2 of H.R. 2571: 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, on 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 eventually complete a high-speed rail transportation corridor design that the Secretary of Transportation determined viable. Those projects include, but are not limited to, some specifically enumerated project types such as financing or refinancing equipment and capital improvements, eliminating grade crossings, or station rehabilitation and construction. The Secretary of Transportation must also determine that the projects are part of a comprehensive corridor design for intercity passenger rail. 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 railroad grade crossings that 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 2004 to 2013 of private activity tax-exempt bonds and \$1.2 billion per year from 2004 to 2013 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 2017).

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) expect to have a significant impact on air traffic congestion; (4) expect to also improve commuter rail operations; (5) have completed all environmental work and the project is ready to begin construction; and (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, it requires the Secretary of Transportation, in consultation with the Secretary of the Treasury, to submit to the Congress an annual report on the program and 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>9</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

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<sup>9</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."

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 6 months after the date of enactment.

### **Section 3 of H.R. 2571: 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.

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); (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 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.

## **II. DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO H.R. 2571**

The Chairman's Modification strikes sections 2 and 3 of H.R. 2571 from the bill.