OVERVIEW OF SELECTED TAX PROVISIONS RELATING TO THE FINANCING OF SURFACE TRANSPORTATION INFRASTRUCTURE

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on May 6, 2014

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION AND SUMMARY

The Senate Committee on Finance has scheduled a public hearing on May 6, 2014, to examine public financing of highways and transit. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present-law provisions relating to the Highway Trust Fund and its dedicated taxes, and an overview of public-private partnerships and related tax considerations, and a description of tax-exempt financing that is available for certain transportation infrastructure. The document also briefly describes tax-credit and direct-pay bonds, a proposal to create a tax-credit bond program for infrastructure, and proposals to create a national infrastructure bank.

The Highway Trust Fund was established in 1956. It is divided into two accounts, a Highway Account and a Mass Transit Account, each of which is the funding source for specific programs. The Highway Trust Fund is funded by taxes on motor fuels (*i.e.*, gasoline, kerosene, diesel fuel, and certain alternative fuels), a manufacturer's tax on heavy vehicle tires, a retail sales tax on certain trucks, highway trailers and tractors, and an annual use tax for heavy highway vehicles.

In addition to infrastructure projects financed through the use of Federal trust funds, such projects may be financed through the use of public-private partnerships. The Department of Transportation defines public-private partnerships broadly to include "contractual agreements formed between a public agency and private sector entity that allow for greater private sector participation in the delivery and financing of transportation projects."[2] For example, a public-private partnership might contemplate a private firm taking on all the design and construction risks for a new project, or a private firm operating a project for a period of years following construction, and obtaining an economic return based on the relative success of its management. State and local governments have shown increasing interest in public-private partnership arrangements as the cost of infrastructure development and maintenance continues to increase. Tax benefits associated with public-private partnerships include depreciation of tangible infrastructure assets and amortization of intangible assets.

Debt also may be used to finance infrastructure projects. Tax-exempt bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Present law does not limit the types of facilities that can be financed with governmental bonds. Thus, State and local governments can issue tax-exempt governmental bonds to finance a broad range of transportation infrastructure projects, including highways, railways, airports, etc. However, while the types of projects eligible for governmental bond financing are not circumscribed, present law imposes restrictions on the extent to which private parties may

[1] This document may be cited as follows: Joint Committee on Taxation, *Overview of Selected Tax Provisions Relating to the Financing of Surface Transportation Infrastructure*, (JCX-49-14), May 5, 2014. This document also can be found on our website at www.jct.gov.

[2] U.S. Department of Transportation, Federal Highway Administration, Office of Innovative Program Delivery, *Fact Sheet: Public-Private Partnerships Transportation Finance Innovations*, http://www.fhwa.dot.gov/ipd/fact_sheets/p3.htm.

benefit from such financing. State and local governments may issue qualified private activity bonds for certain transportation infrastructure such as airports, port facilities, mass commuting facilities, high-speed intercity rail facilities and qualified highway or surface freight transfer facilities.

Another form of tax-preferred financing is the tax-credit bond. A taxpayer holding a tax credit bond on a credit allowance date is entitled to a tax credit. Examples of tax-credit bonds are qualified zone academy bonds, qualified school construction bonds, new clean renewable energy bonds, and qualified energy conservation bonds. Among the proposals for tax-credit bonds to finance infrastructure is S. 1250, the Transportation and Regional Infrastructure Project Bonds Act of 2013 (the "TRIP Bonds Act"). The TRIP Bonds Act would provide authority for the issuance of tax-credit bonds to assist State and local governments in funding transportation infrastructure, including roads, bridges, transit, rail, ports and inland waterways.

The American Recovery and Reinvestment Act of 2009 ("ARRA") created a new category of bond, the Build America Bond. There are two types of Build America Bonds, the "tax-credit" Build America Bond and the "direct-pay" Build America Bond. The tax-credit Build America Bond provides a Federal tax credit to the bondholder equal to 35 percent of the interest payable by the issuer.[3] At the election of the issuer, a direct-pay Build America Bond provides the State or local government issuer with a 35 percent interest subsidy, in the form of a cash payment from the Federal Government, in lieu of providing a tax credit to the bondholder. Tax-credit Build America Bonds may be issued to finance any governmental purpose for which tax-exempt governmental bonds (excluding private activity bonds) could be issued. The eligible uses of proceeds and types of financings for direct-pay Build America Bonds are more limited than for tax-credit Build America Bonds. Direct-pay Build America Bonds are to finance only capital expenditures that could have been financed with tax-exempt governmental bonds. Authority to issue all types of Build America Bonds expired on December 31, 2010.

To supplement bonds issued by State and local governments and other financing mechanisms, there are proposals to create a national infrastructure bank to provide financing to infrastructure projects of national and/or regional significance. Most recently, versions of the infrastructure bank proposal have been included in S.1716, the "Building and Renewing Infrastructure for Development and Growth in Employment Act" or the "BRIDGE Act," in S. 1957, the "Partnership to Build America Act of 2014" and in the President's fiscal year 2015 budget proposal.

[3] Although Build America Bonds could have been issued as traditional tax-credit bonds, affording a tax credit to the bondholder, it is understood generally that this authority was not used and that most, if not all, Build America Bonds were issued as direct-pay bonds.

I. OVERVIEW OF THE HIGHWAY TRUST FUND AND RELATED EXCISE TAXES

The Highway Trust Fund was established in 1956 to coordinate the Federal role in highway construction and maintenance activities, including the development of the then-new Interstate Highway System. The Highway Trust Fund is divided into two accounts, a Highway Account and a Mass Transit Account, each of which is the funding source for specific programs.[4] Highway Trust Fund expenditure purposes have been revised with the passage of each authorization Act enacted since the establishment of the Highway Trust Fund in 1956. In general, expenditures authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act) are approved Highway Trust Fund expenditure purposes under the Code. Expenditures from the Highway Trust Fund are authorized through September 30, 2014.

Most Federal surface transportation programs funded by the Highway Trust Fund span four major areas of investment: highway infrastructure, transit infrastructure and operations, highway safety, and motor carrier safety.[5] The funds are distributed either by formula or on a discretionary basis through several individual grant programs.[6]

Revenue sources for the Highway Trust Fund

Six separate excise taxes are imposed to finance the Federal Highway Trust Fund program. Three of these taxes are imposed on highway motor fuels and the substantial majority of the revenues produced by the Highway Trust Fund excise taxes are derived from the taxes on motor fuels. The remaining three are a retail sales tax on heavy highway vehicles (trucks, trailers and certain tractors), a manufacturers' excise tax on heavy vehicle tires, and an annual use tax on heavy vehicles. Except for 4.3 cents per gallon of the Highway Trust Fund fuels tax rates, these taxes generally do not apply after September 30, 2016. The 4.3-cents-per-gallon portion of the fuels tax rates is permanent.[7] The annual use tax expires on October 1, 2017. The taxes dedicated to the Highway Trust Fund are summarized below.

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[4] Sec. 9503. All section references are to the Internal Revenue Code of 1986 ("the Code") unless otherwise indicated.

[5] Government Accountability Office, *Surface Transportation: Restructured Federal Approach Needed for More Focused, Performance-Based and Sustainable Programs* (GAO-08-400), March 2008, p. 6.

[6] *Ibid*. pp. 6-7.

[7] This portion of the tax rates was enacted as a deficit reduction measure in 1993. Receipts from it were retained in the General Fund until 1997 legislation provided for their transfer to the Highway Trust Fund.

Highway motor fuels taxes

The Highway Trust Fund motor fuels tax rates are as follows:[8]

Gasoline	18.3 cents per gallon
Diesel fuel and kerosene	24.3 cents per gallon[9]
Alternative fuels	24.3 and 18.3 cents per gallon[10]

The Code imposes tax on gasoline, diesel fuel, and kerosene ("taxable fuels") upon removal from a refinery or on importation, unless the fuel is transferred in bulk by registered pipeline or barge to a registered terminal facility.[11] Typically, these fuels are transferred by pipeline or barge in large quantities ("bulk") to terminal storage facilities that are located closer to destination retail markets. The fuel is then taxed when it "breaks bulk," *i.e.*, when it is removed from the terminal, typically by truck or rail car, for delivery to a smaller wholesale facility or a retail outlet. The majority of the fuel taxes are imposed upon removal at the terminal. The party liable for payment of the taxes is the "position holder," *i.e.*, the person shown on the records of the terminal facility as controlling the fuel.[12]

All persons controlling taxable fuels before tax is imposed must be registered with the IRS.[13] Additionally, terminal facilities must register with the IRS as a condition of storing untaxed (or undyed) taxable fuels.[14] The sale or other transfer of fuel to an unregistered party or removal to an unregistered facility before the fuel breaks bulk results in the imposition of tax on

8 These fuels are subject to an additional 0.1-cent-per-gallon excise tax to fund the Leaking Underground Storage Tank ("LUST") Trust Fund (secs. 4041(d) and 4081(a)(2)(B)). That tax is imposed as an "add-on" to other existing taxes.

9 Diesel-water emulsions are taxed at 19.7 cents per gallon (sec. 4081(a)(2)(D)).

10 The rate of tax is 24.3 cents per gallon in the case of liquefied natural gas, any liquid fuel (other than ethanol or methanol) derived from coal, and liquid hydrocarbons derived from biomass. Other alternative fuels sold or used as motor fuel are generally taxed at 18.3 cents per gallon. For purposes of this pamphlet "alternative fuel" includes compressed natural gas. The rate for compressed natural gas is 18.3 cents per energy equivalent of a gallon of gasoline. *See* sec. 4041(a)(2) and (3).

11 Sec. 4081(a)(1).

12 A special rule applies to "two-party exchanges" (sec. 4105). It is common practice for oil companies to serve customers of other oil companies under exchange agreements, *e.g.*, where Company A's terminal is more conveniently located for wholesale or retail customers of Company B. In such cases, the exchange agreement party (Company B in the example) is treated as owning the fuel when sold to B's customer if the requirements of section 4105 are met.

13 Sec. 4101.

14 Kerosene or diesel fuel that has been dyed generally indicates that such fuel is destined for a use for which tax is not imposed.

that transaction. If the fuel subsequently is entered into and removed from a registered terminal, a second tax is imposed. Refund claims are allowed to prevent double taxation.

In general, fuel removed from a registered terminal facility is subject to tax without regard to whether the ultimate use of the fuel is taxable (*e.g.*, non-taxable use for heating or on a farm for farming purposes). Exceptions are provided allowing diesel fuel and kerosene to be removed for a non-taxable use if the fuel is indelibly dyed at the time of removal.[15]

The tax on alternative fuels accounts for a relatively small portion of the tax on motor fuels. The tax is imposed when the fuels are sold for use or used as a fuel in a motor vehicle or motorboat. The person liable for the tax is either the retailer making the sale or, in some cases, the user of the fuel.

<u>Non-taxable uses of fuel</u>

In general, refunds or income tax credits may be claimed for fuels on which tax has been imposed and which ultimately are used for a non-taxable purpose. Present law includes numerous exemptions (including partial exemptions) for specified uses. Because the fuel taxes generally are imposed before the end use of the fuel is known, many of these exemptions are realized through refunds to end users of tax paid by a party that held the fuel earlier in the distribution chain. Non-taxable uses of fuel include: (1) use on a farm for farming purposes; (2) off-highway business use; (3) export; (4) use in a boat engaged in commercial fishing; (5) use in certain intercity and local buses; (6) use in a school bus; (7) exclusive use by a qualified blood collector organization; (8) exclusive use by a nonprofit educational organization; (9) exclusive use by a State; (10) use in an aircraft or vehicle owned by an aircraft museum; and (11) use of diesel fuel other than as a fuel in a propulsion engine of a diesel-powered highway vehicle (*e.g.*, home heating oil).

The rules governing how and by whom a refund is claimed differ by type of fuel, by end use, and by dollar amount of the claim. In general, no more than one claim per quarter may be filed. Refund claims may be filed only if prescribed dollar thresholds are satisfied. If the dollar amounts are not satisfied in a calendar year, refunds must be claimed as credits on income tax returns. Unlike income tax refunds, excise tax refunds generally do not bear interest if they are not paid within set periods. The Highway Trust Fund does not reimburse the General Fund for the payments of nontaxable use refunds.[16]

<u>Fuel excise tax credits</u>

The Code provided per-gallon tax credits and payments for the following qualified fuels through December 31, 2013: biodiesel (including agri-biodiesel), renewable diesel, and certain

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[15] *See* sec. 4082(b). However, such fuel generally is still subject to the LUST Trust Fund tax.

[16] The requirement that transfers be made from the Highway Trust Fund to the General Fund to cover amounts paid by the General Fund for nontaxable use refund claims was repealed by section 444(a) of Pub. L. No. 111-147 (the Hiring Incentives to Restore Employment Act, discussed *infra*).

alternative fuels.[17] If the qualified fuel is part of a qualified fuel mixture, the incentives apply only to the amount of qualified fuel in the mixture.

For qualified fuel mixtures, the excise tax credits are taken against the taxes imposed by section 4081 (relating to the taxes on gasoline, diesel fuel, and kerosene). The alternative fuel excise tax credit was taken against the tax imposed by section 4041 (relating to the back-up tax on diesel fuel and alternative fuels). Although taken as credits against excise taxes supporting the Highway Trust Fund, the credits do not reduce the amount of fuel tax transferred to the Highway Trust Fund.[18] Similarly, if a person has insufficient excise tax liability to use the credits, the incentive may be taken as a payment.[19] The Highway Trust Fund does not reimburse the General Fund for these payments.

Non-fuels excise taxes

Tax on heavy vehicle tires

The Code imposes a tax on taxable tires sold by the manufacturer, producer or importer of the tire. The rate is 9.45 cents for each 10 pounds of maximum rated load capacity over 3,500 pounds.[20] A "taxable tire" is any tire of the type used on highway vehicles if made of rubber (in whole or in part) and if marked according to Federal regulations for highway use.[21] "Rubber" includes synthetic and substitute rubber. For biasply tires, and super single tires (other than those designed for steering), the rate of tax is half the regular rate, 4.725 cents for each 10 pounds of maximum rated load capacity over 3,500 pounds.[22]

[17] *See* secs. 40A, 6426, and 6427(e). The tax credit and payment provisions relating to liquified hydrogen expire September 30, 2014.

[18] Sec. 9503(b)(1).

[19] Sec. 6427(e). These claims for payment may be made on a weekly basis if the claim is for $200 or more (no dollar threshold if filed electronically), and if such claims are not paid within the specified time parameters, the claim is paid with interest. Sec. 6427(i)(3).

[20] Sec. 4071(a). In general, these parameters would exclude tires for passenger automobiles and light trucks.

[21] Sec. 4072(a). "Tires of the type used on highway vehicles" means tires of the type used on motor vehicles that are highway vehicles, or vehicles of the type used in connection with motor vehicles that are highway vehicles (sec. 4072(c)). However, the term does not include the kind of tires used exclusively on mobile machinery vehicles, as defined in section 4053(8).

[22] Sec. 4071(a). The term "biasply tire" means a pneumatic tire on which the ply cords that extend to the beads are laid at alternative angles substantially less than 90 degrees to the centerline of the tread. A "super single tire" means a single tire greater than 13 inches in cross section width designed to replace two tires in a dual fitment. It does not include any tire designed for steering.

The tax does not apply to tire carcasses not suitable for commercial use, or to tires for use on qualifying intercity, local and school buses.[23] In addition, tires sold for the exclusive use of the Department of Defense or the Coast Guard are not subject to tax.[24] Nor does the tax apply to tires of a type used exclusively on mobile machinery vehicles. The Code also provides exemptions for tires that have been exported, sold to a State or local government for its exclusive use, sold to a nonprofit educational organization for its exclusive use, sold to a qualified blood collector organization for its exclusive use in connection with a vehicle the organization certifies will be primarily used in the collection, storage or transportation of blood, or used or sold for use as supplies for vessels.[25]

Retail sales tax on tractors, heavy trucks, and heavy trailers

A 12-percent retail sales tax is imposed on the first retail sale of heavy trucks (over 33,000 pounds), trailers (over 26,000 pounds) and certain highway tractors.[26] The taxable weight is the "gross vehicle weight," which is the maximum total weight of a loaded vehicle (all equipment, fuel body, payload, driver, etc.). The tax is imposed on chassis and bodies. The sale of a truck or trailer is considered a sale of a chassis and a body. However, the price of certain equipment unrelated to the highway transportation function of the vehicle is excluded from the tax base.[27] Additionally, a credit against the tax is allowed for the amount of tire excise tax imposed on manufacturers of new tires installed on the vehicle.

The Code also imposes the 12-percent tax on the price of parts or accessories installed on a taxable vehicle within six months of the date the vehicle was placed in service.[28]

Annual use tax for heavy vehicles

An annual use tax is imposed on heavy highway vehicles, at the rates shown below.[29]

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[23] Sec. 4221(e)(3). A qualifying intercity or local bus is a bus which is used predominantly in furnishing (for compensation) passenger transportation available to the general public on a schedule with a regular route or has a seating capacity of at least 20 adults (not including the driver) (sec. 4221(d)(7)(B)). A school bus is a bus substantially all the use of which is to transport students and employees of schools (sec. 4221(d)(7)(C)).

[24] Sec. 4073.

[25] *See* sec. 4221 and Internal Revenue Service, Publication 510, *Excise Taxes (Including Fuel Tax Credits and Refunds)* (2013) p. 33.

[26] Sec. 4051. The tax does not apply to tractors weighing 19,500 pounds or less that, in combination with a trailer or semitrailer, has a gross combined weight of 33,000 pounds or less.

[27] Sec. 4053.

[28] A vehicle is treated as placed in service on the date on which the owner of the vehicle took actual possession of the vehicle.

[29] Sec. 4481.

Under 55,000 pounds	No tax
55,000-75,000 pounds	$100 plus $22 per 1,000 pounds over 55,000 pounds
Over 75,000 pounds	$550

The annual use tax is imposed for a taxable period of July 1 through June 30. Generally, the tax is paid by the person in whose name the vehicle is registered. Exemptions and reduced rates are provided for certain "transit-type buses," trucks used for fewer than 5,000 miles on public highways (7,500 miles for agricultural vehicles), logging trucks, mobile machinery and qualified blood collector vehicles.

Legislation regarding the Highway Trust Fund balance

In recent years, trends in Highway Trust Fund receipts and spending have resulted in projections of significant shortfalls. As discussed below, several provisions have been enacted transferring money from the General Fund to the Highway Trust Fund to avoid a shortfall.

Public Law No. 111-46, an Act to restore funds to the Highway Trust Fund, provided that out of money in the Treasury not otherwise appropriated, $7 billion was appropriated to the Highway Trust Fund effective August 7, 2009.

The Hiring Incentives to Restore Employment Act (the "HIRE Act") contained several provisions affecting the Highway Trust Fund.[30] From September 30, 1998, the Highway Trust Fund did not earn interest on its unexpended balances. The HIRE Act repealed the requirement that obligations held by the Highway Trust Fund not be interest-bearing. The HIRE Act permits amounts in the Trust Fund to be invested in interest-bearing obligations of the United States and have the interest be credited to, and form a part of, the Highway Trust Fund. Thus, the Highway Trust Fund now accrues interest on its unexpended balances, which serves as a continuing transfer from the General Fund.[31] The HIRE Act also provides that out of money in the Treasury not otherwise appropriated, $14,700,000,000 is appropriated to the Highway Trust Fund and $4,800,000,000 is appropriated to the Mass Transit Account in the Highway Trust Fund, and made those amounts available without fiscal year limitation. The HIRE Act also terminated required transfers from the Highway Trust Fund into the general fund for certain repayments and credits, relating to amounts paid in respect of gasoline used on farms, amounts paid in respect of gasoline used for certain non-highway purposes or by local transit systems, amounts relating to fuels not used for taxable purposes, and income tax credits for certain uses of fuels. The HIRE Act provisions generally were effective as of March 18, 2010.

[30] Pub. L. No. 111-147, secs. 441 - 444.

[31] See sec. 9602(b)(1) and (b)(3), ". . . It shall be the duty of the Secretary of the Treasury to invest such portion of any Trust Fund established by subchapter A as is not, in his judgment, required to meet current withdrawals. Such investments may be made only in interest-bearing obligations of the United States. . . .The interest . . . on any obligations held in a Trust Fund. . .shall be credited to and form a part of the Trust Fund."

The following table reflects the Congressional Budget Office's ("CBO") projections of the Highway Trust Fund's balance for fiscal years 2013 through 2024.

Table 1.−Estimates of Revenue and Outlays for the Highway Trust Fund
Fiscal Years 2013-2024
[billions of dollars]

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Highway Account												
Start-of-Year Balance	10	4	2	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Revenues & Interest[b]	32	33	34	34	34	34	34	34	34	34	34	34
Intragovernmental Transfers[c]	6	10	0	0	0	0	0	0	0	0	0	0
Outlays	43	45	45	45	45	46	46	46	47	48	48	49
End of Year Balance**	4	2	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Transit Account												
Start-of-Year Balance	5	2	1	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Revenues and Interest[b]	5	5	5	5	5	5	5	5	5	5	5	5
Intragovernmental Transfers[c]	0	2	0	0	0	0	0	0	0	0	0	0
Outlays[d]	7	8	8	8	8	9	9	9	10	10	10	10
End-of-Year Balance	2	1	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Memorandum												
Cumulative Shortfall[a]												
Highway Account Shortfall	n.a.	n.a.	-10	-21	-32	-43	-55	-67	-79	-92	-106	-120
Transit Account Shortfall	n.a.	n.a.	-2	-6	-9	-13	-18	-22	-27	-32	-38	-44

Notes: Details may not add to totals because of rounding
n.a. = not applicable

a. Under CBO’s baseline projections, the highway and transit accounts of the Highway Trust Fund will have insufficient revenues to meet obligations starting in fiscal year 2015. Under current law, the Highway Trust Fund cannot incur negative balances and has no authority to borrow additional funds. However, following the rules in the Deficit Control Act of 1985, CBO’s baseline for highway spending incorporates the assumption that obligations incurred by the Highway Trust Fund will be paid in full. The cumulative shortfalls shown in this table are estimated on the basis of spending consistent with the obligation limitations contained in CBO’s April 2014 baseline for highway and transit spending. The obligation limitations contained in CBO's baseline are projected by adjusting the 2014 limitations for inflation. The Department of Transportation has indicated that it needs at least $4 billion in cash balances available in the highway account and at least $1 billion in the transit account to meet obligations as they are due. As a result, under CBO's baseline projections, the highway account may have to delay some of its payments during the latter half of 2014.

b. Some of the taxes that are credited to the Highway Trust Fund are scheduled to expire on September 30, 2016. Those include taxes on certain heavy vehicles and tires and all but 4.3 cents of federal taxes levied on fuels. However, under the rules governing baseline projections, these estimates reflect the assumption that all of the expiring taxes credited to the fund continue to be collected.

c. Sections 40201 and 40251 of the Moving Ahead for Progress in the 21st Century Act (Public Law 112-140) require certain intragovernmental transfers, mostly from the general fund of the Treasury, to the Highway Trust Fund.

d. Outlays include amounts “flexed,” or transferred, between the highway and transit accounts. CBO estimates that those amounts would total about $1 billion annually.

II. SELECTED METHODS FOR INFRASTRUCTURE PROJECT FINANCE

A. Public-Private Partnerships

In general

The Department of Transportation defines public-private partnerships broadly to include "contractual agreements formed between a public agency and private sector entity that allow for greater private sector participation in the delivery of transportation projects."[32] The private sector historically has participated in the design and construction of U.S. highways, most commonly as contractors to the public sector. A public-private partnership, however, generally is understood as shifting more of the economic risks (and attendant rewards) of a transportation project to the private sector than would be the case in a traditional public owner-private contractor relationship. For example, a public-private partnership might contemplate a private firm taking on all the design and construction risks for a new project, or a private firm operating a project for a period of years following construction, and obtaining an economic return based on the relative success of its management. State and local governments have shown increasing interest in public-private partnership arrangements as the cost of infrastructure development and maintenance continues to increase.[33]

Examples of public-private partnerships[34]

Some private firms have acquired economic interests in the financing, maintenance, and operation of public highways after they are built.[35] Two arrangements, involving the Chicago Skyway and the Indiana Toll Road, illustrate how the public-private partnership concept can be applied to transfers of economic interests in existing highways from the public sector to private firms. The Chicago Skyway and Indiana Toll Road deals are structured as very long-term arrangements: 99 years in the former case, and 75 years in the latter. For tax purposes, each

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[32] U.S. Department of Transportation, Federal Highway Administration, *Innovative Program Delivery* (website), "P3 Defined" http://www.fhwa.dot.gov/ipd/p3/defined/index.htm.

[33] For background on infrastructure investment, see Congressional Budget Office, *Issues and Options in Infrastructure Investment* (May 2008) (public-private partnership discussion p. 32).

[34] For purposes of discussion, this pamphlet focuses on public-private partnerships involving long-term leases of infrastructure assets by a private party. The Department of Transportation classifies public-private partnerships into six categories. For new facilities, there are three categories: design-build, design-build-operate, and design-build-finance-operate. For existing facilities, there are two categories: operations and maintenance concessions, and long-term leases. In a hybrid situation, involving both an existing facility and the expansion of such facility, there is the lease-develop-operate category in which a private party is grated a long-term lease to operate and expand an existing facility. U.S. Department of Transportation, Federal Highway Administration, *Innovative Program Delivery* (website), "P3 Defined" http://www.fhwa.dot.gov/ipd/p3/defined/index.htm.

[35] For background on public-private partnerships, see CRS Report RL34567, *Public-Private Partnerships in Highway and Transit Infrastructure Provision*, by William J. Mallett (February 22, 2010); Government Accountability Office, *Highway Public-Private Partnerships, More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, GAO-08-44 (Washington, DC: February 2008).

transaction can be seen as comprising three operating relationships, each of which in turn runs for the length of the overall arrangement:

1. A lease of the existing infrastructure (the highway itself and associated improvements) from the public owner to the private firm;

2. A grant by the public owner to the private firm of a right-of-way on the public lands underlying that infrastructure; and

3. A grant of a franchise from the public entity permitting the private party to collect tolls on the highway.

In return, the private party paid a large up-front amount to the public owner, and agreed to operate and maintain the road, to invest specified amounts in future improvements, and to accept restrictions on the maximum tolls it could charge.[36] An umbrella concession agreement sets out the long-term rights and obligations of each party including dispute resolution mechanisms.

More specifically, in 2004, the City of Chicago leased the Chicago Skyway, a 7.8 mile toll road south of downtown Chicago that connects two major highways, in the first long-term lease of an existing toll road in the United States. Under the 99-year concession agreement with Skyway Concession Company Holdings LLC, a joint venture between Cintra of Madrid, Spain, and Macquarie of Sydney, Australia,[37] the City of Chicago received a $1.8 billion up-front payment in exchange for granting the private concessionaire the exclusive right to use, possess, operate, manage, maintain, rehabilitate, and collect tolls from the Chicago Skyway.

In 2006, the Indiana Finance Authority ("IFA") entered into a 75-year concession agreement with ITR Concession Company LLC ("ITR"), also a joint venture between Cintra and Macquarie, in respect of the Indiana Toll Road. IFA received a $3.8 billion up-front payment in exchange for granting ITR the exclusive right to operate, manage, maintain, rehabilitate, and collect tolls from the Indiana Toll Road.

Tax treatment of certain public-private partnerships

Overall characterization of arrangement

The parties to the representative public-private partnerships summarized above entered into an umbrella concession agreement that describes the overall business relationship. In general, the deals generally are structured not to constitute partnerships for tax purposes. (If the

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[36] See summaries of these arrangements at U.S. Department of Transportation, Federal Highway Administration, *Innovative Program Delivery* (website) "Case Studies," http://www.fhwa.dot.gov/ipd/p3/casestudies/index.htm**.**

[37] "Cintra" and "Macquarie" refer to these companies generally. In the case of Skyway Concession Company Holdings LLC, the investment is owned, indirectly, by Cintra Concesiones de Infraestructuras de Transporte, SA and Macquarie Infrastructure Group.

transaction were characterized as a constructive tax partnership, there would be many adverse consequences for the parties, including the possible application of section 470 which limits deductions allocable to property used by governments and tax-exempt entities as well as differences in the tax depreciation rules for the assets.) Instead, and as described above, the arrangements are intended to be treated for tax purposes as transfers of three separate bundles of property rights from the public owner to the private firm, all in exchange for the lump sum cash payment:

1. A "lease" of the infrastructure assets;

2. A lease of the land underlying the infrastructure assets (the right of way); and

3. A grant of an intangible "franchise" right to collect tolls.

Under tax principles, the "lease" of the infrastructure assets generally is characterized as an outright purchase of those assets by the private firm for tax purposes because the "lessee" has acquired all the benefits and burdens of ownership of those assets for a term that significantly exceeds their expected remaining useful life.[38] Land, by contrast, is deemed for tax purposes to have a perpetual useful life, and as a result the long-term ground lease would be expected to be characterized as such.

The concession agreement signed by the parties generally is for a period much longer than the economic useful life of the highway assets, which (along with operating control) is the critical question in determining whether a purported lease should be recharacterized as a purchase of assets for tax purposes. The Bureau of Economic Analysis estimates the service life of highways and streets to be 45 years,[39] while the Chicago Skyway and Indiana Toll Road

[38] To the extent the property under the concession agreement is owned directly or indirectly by non-U.S. persons, the U.S. business operations related to the property generally is subject to net-basis U.S. taxation in the same manner as if the property were owned by U.S. persons. If those U.S. business operations were conducted through a domestic corporation, the corporation would be subject to corporate tax on the income from the operations. Sec. 11. Certain payments (such as dividends) to foreign owners of the corporation would be subject to U.S. withholding tax (subject to reduction or elimination under bilateral income tax treaties). If the U.S. business operations were conducted through a foreign corporation, the corporation would be subject to U.S. tax on its effectively connected income. Sec. 882. Moreover, the foreign corporation could be subject to branch profits tax and branch interest tax on, respectively, dividend-like withdrawals from the U.S. business and certain interest payments allocable to the business. Sec. 884(a), (f). "Earnings stripping" rules also could apply to disallow deductions for certain interest payments to related parties and interest payments on debt guaranteed by related parties.

Finally, the special U.S. tax rules applicable to foreign investment in U.S. real estate (the "FIRPTA" rules of section 897) may affect the U.S. tax treatment of foreign investors. Some advisors have taken the position that the intangible franchise right is an interest in real property for purposes of section 897. Other advisors have taken a contrary view. Treating the franchise right as an interest in real property would make it more likely that a domestic corporation that owned the right would be a U.S. real property holding corporation under section 897(c)(2) and, therefore, that tax under section 897 would be triggered by, for example, a sale of the corporation by foreign investors.

[39] U.S. Department of Commerce, Bureau of Economic Analysis, *BEA Depreciation Estimates*, http://www.bea.gov/national/FA2004/Tablecandtext.pdf.

agreements were for terms of 99 years and 75 years, respectively. The private party's responsibilities under the agreement may include all operations of the toll road, payment of utilities, maintenance, taxes, capital improvements, risk of loss, and liabilities that arise during the term.[40] Accordingly, while the facts and circumstances of each transaction will control its tax treatment, these arrangements most likely will be viewed by the parties as a sale and purchase of a trade or business, and the concession agreement can be expected to include a provision describing the intended tax treatment in this manner.[41]

Allocation of up-front payment

The large up-front payment made by the private party to the transaction is treated as paid to acquire different bundles of business assets. As a result, the parties must allocate the initial consideration to the following categories: (1) the acquisition of infrastructure assets, such as land improvements, computers, toll booths, and other property used to operate and maintain the highway; (2) a lease of the underlying land; and (3) the acquisition of intangible assets, such as a franchise and license for the right to collect tolls (along with any generally unstated goodwill or going concern value).

The tax treatment of the assets in each of these categories varies. The tax allocation of the consideration therefore will determine the timing of the tax deductions associated with the investment. The tax rules provide that the parties must allocate purchase price in accordance with the relative fair market value of the assets acquired.[42]

Recovery of investment (depreciation and amortization)

Depreciation of tangible infrastructure assets

For Federal income tax purposes, a taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned

[40] The terms of an agreement will vary depending on the particular arrangement. For example, the private party may not be required to pay certain real estate, sales, and other taxes. This discussion is not intended to be an exhaustive list of responsibilities.

[41] For example, Section 2.8 of the *Indiana Toll Road Concession and Lease Agreement*, (April 12, 2006) states: "This Agreement is intended for U.S. Federal and State income tax purposes to be a sale of the Toll Road Facilities and Toll Road Assets to Concessionaire and the grant to the Concessionaire of an exclusive franchise and license for and during the Term to provide Toll Road Services within the meaning of sections 197(d)(1)(D) and (E) of the Internal Revenue Code of 1986, as amended, and sections 1.197-2(b)(8) and (10) of the Income Tax Regulations thereunder," http://www.in.gov/ifa/files/4-12-06-Concession-Lease-Agreement.pdf.

[42] Section 1060 sets out detailed rules for the allocation of consideration in certain asset acquisitions.

applicable recovery periods and depreciation methods. The MACRS depreciation categories generally are set out in the Internal Revenue Code and Internal Revenue Service guidance.[43]

The MACRS recovery periods applicable to most tangible personal property range from three to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the taxpayer's depreciation deduction would be maximized. Nonresidential real property and residential rental property are assigned lives of 39 years and 27.5 years, respectively, using the straight-line method.

The most significant tangible infrastructure assets acquired by the private party in a public-private partnership are the highway and any related bridges.[44] To the extent the assets are classified as land improvements,[45] these assets generally are depreciated under MACRS over a 15-year recovery period using the 150-percent declining balance method. The roadbed underlying the highway, however, is treated as having an indefinite useful life, and therefore its value is not recovered through depreciation at all.[46]

Other tangible assets that may be acquired include computers, equipment, toll booths, building structures, and other tangible assets associated with operating and maintaining a toll highway. As with the land improvements, these assets generally are recovered through accelerated depreciation under MACRS using various recovery periods, generally five to seven years, or through straight line depreciation over 39 years in the case of certain structures.[47]

To the extent any of these assets were originally constructed or acquired with proceeds of tax-exempt bonds,[48] depreciation is calculated under the alternative depreciation system ("ADS") using the straight-line method generally over longer recovery periods.[49] For example, land improvements are recovered over 20 years using the straight-line method if the project is

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[43] Sec. 168. Rev. Proc. 87-56, 1987-2 C.B. 674.

[44] In addition to acquired tangible assets, the private party will incur capital improvement costs throughout the lease term. The cost of newly constructed assets will also be recovered through depreciation deductions.

[45] Asset class 00.3 of Rev. Proc. 87-56 provides examples of "land improvements" that include sidewalks, roads, canals, waterways, bridges, fencing, and landscaping.

[46] Rev. Rul. 88-99, 1988-2 C.B. 3. In a public-private partnership transaction, the roadbed is likely included as part of the right-of-way lease of the underlying land.

[47] To the extent several requirements are met (including the property acquired being qualified property, as well as the acquisition date and the original placed in service date being within the requisite timeframe), an additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property placed in service after December 31, 2011, and before January 1, 2014 (January 1, 2015, for certain longer-lived and transportation property). Sec. 168(k).

[48] See discussion of tax-exempt financing below.

[49] Secs. 168(g)(1)(C) and 168(g)(5).

financed with tax-exempt bonds, instead of 15 years under MACRS using the 150-percent declining balance method. The treatment of assets as tax-exempt bond financed property in the hands of the original owner (resulting in use of the longer recovery periods and the straight line method) continues even if the tax-exempt bonds are no longer outstanding or are redeemed.[50] Furthermore, any subsequent owners who acquire the property while the tax-exempt bonds are outstanding also are subject to the ADS.[51]

Amortization of intangible assets

As previously noted, significant value generally is assigned in public-private partnership arrangements to the intangible franchise right; that is, the right of the private party to collect tolls from users of the highway. The taxpayer's rationale for this allocation likely is that the right to collect tolls is the main revenue source and is the primary economic driver of the transaction.[52]

Under section 197, when a taxpayer acquires an operating business, any value properly attributable to a franchise right is amortizable on a straight-line basis over 15 years.[53] Additionally, any value attributable to licenses, permits, and other rights granted by governmental units is subject to 15-year amortization, even if the right is granted for an indefinite period or is reasonably expected to be renewed indefinitely.[54] Goodwill and going concern value similarly are amortized on the same schedule. However, interests in land, including leases, easements, grazing rights, and mineral rights granted by a government, may not be amortized over the 15-year period provided in section 197, but instead must be amortized over the period of the grant of the right.[55]

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[50] Treas. Reg. sec. 1.168(i)-4(d)(2)(ii)(B).

[51] H.R. Rep. No. 97-760, 516 (1982). State and local governments may redeem outstanding tax-exempt bonds prior to the public-private partnership arrangement so that the acquired assets are not subject to ADS rules. To the extent State and local governments retire tax-exempt bonds and taxable bonds are issued or other taxable debt is incurred to finance the private party payment pursuant to a public-private partnership arrangement, the migration from tax-exempt to taxable financing may result in increased Federal tax receipts.

[52] There also may be value in a license by the government for the right of the private party to use the name of the highway.

[53] Secs. 197(d)(1)(F) and 197(f)(4). A franchise is defined "an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area." Sec. 1253(b)(1).

[54] Sec. 197(d)(1)(D). Examples include a liquor license, a taxi-cab medallion, an airport landing or take-off right, a regulated airline route, or a television or radio broadcasting license. Renewals of such governmental rights are treated as the acquisition of a new 15-year asset. Treas. Reg. sec. 1.197-2(b)(8). A license, permit, or other right granted by a governmental unit is a franchise if it otherwise meets the definition of a franchise. Treas. Reg. sec. 1.197-2(b)(10). Section 197 intangibles do not include certain rights granted by a government not considered part of the acquisition of a trade or business. Sec. 197(e)(4)(B) and Treas. Reg. sec. 1.197-2(c)(13).

[55] Sec. 197(e)(2). Treas. Reg. sec. 1.197-2(c)(3). An interest in land does not include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television service. The cost of acquiring a

Some toll road transactions have been reported to include revenue-sharing provisions not unlike royalty payments of a typical business franchise. These revenue-sharing provisions are viewed by some as a method for the public party to share in possible future economic upside from toll collections.[56] To the extent payments are made by the private party pursuant to the arrangement, the revenue-sharing payments may be considered "contingent serial payments" and deductible in the year paid or incurred.[57] If a payment does not meet the requirements for contingent serial payments, the amount may be treated as contingent purchase price allocated to the franchise and recovered over the remaining life of the franchise intangible asset.[58]

<u>Recovery of investment in lease of land</u>

The amount of any up-front consideration allocated to the lease of land generally is deductible to the lessee for tax purposes over the term of the lease under section 467. Very generally, those rules take time value of money concepts into account, and effectively convert the lump-sum payment into a constructive loan used to fund a stream of level rent payments.[59]

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license, permit, or other land improvement right, such as a building construction or use permit, is taken into account in the same manner as the underlying improvement. Treas. Res. Sec. 1.197-2(c)(3).

[56] Government Accountability Office, *Highway Public-Private Partnerships, More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, GAO-08-44 (Washington, DC: February 2008), p. 44.

[57] Sec. 1253(d)(1).

[58] Treas. Reg. sec. 1.197-2(f)(2).

[59] Sec. 467(a).

B. Tax-Exempt Financing for Transportation Infrastructure

Overview

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes. Because of the income exclusion, investors generally are willing to accept a lower rate on tax-exempt bonds than they might otherwise accept on a taxable investment. This, in turn, lowers the borrowing cost for the beneficiaries of such financing.

Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other requirements of the Code are met.

Like other activities carried out and paid for by State and local governments, the construction, renovation, and operation of governmental transportation infrastructure projects such as public highways or governmental mass commuting systems (*e.g.*, rail and bus) are eligible for financing with the proceeds of governmental bonds. In addition, certain privately-used transportation infrastructure projects may be financed with qualified private activity bonds.

Tax-exempt governmental bonds

In general

Present law does not limit the types of facilities that can be financed with governmental bonds. Thus, State and local governments can issue tax-exempt, governmental bonds to finance a broad range of transportation infrastructure projects, including highways, railways, airports, etc. However, while the types of projects eligible for governmental bond financing are not circumscribed, present law imposes restrictions on the parties that may benefit from such financing. For example, present law limits the amount of governmental bond proceeds that can be used by nongovernmental persons. Use of bond proceeds by nongovernmental persons in excess of amounts permitted by present law may result in such bonds being treated as taxable private activity bonds, rather than governmental bonds. The Code defines a private activity bond as any bond that satisfies (1) the private business use test and the private security or payment test ("the private business test"); or (2) "the private loan financing test."[60] Generally, private activity bonds are taxable unless issued as qualified private activity bonds.

[60] Sec. 141.

Generally, governmental bonds are not subject to restrictions that apply to bonds used to finance private activities. For example, governmental bonds are not subject to issuance cost, maturity, and annual volume limitations that generally apply to qualified private activity bonds.

Private business tests

Under the private business tests, a bond is a private activity bond if it is part of an issue in which both:

1. More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit ("private business use test"); and

2. More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").[61]

A bond is not a private activity bond unless both parts of the private business tests (*i.e.*, the private business use test and the private payment test) are met. Thus, a facility that is 100 percent privately used does not cause the bonds financing such facility to be private activity bonds if the bonds are not secured by or paid with private payments. For example, land improvements that benefit a privately-owned factory may be financed with governmental bonds if the debt service on such bonds is not paid by the factory owner or other private parties.

In general, for purposes of the private business use test, a broad standard applies under which private business use includes use of bond-financed property by a nongovernmental person as a result of ownership of property, a lease of property, or other actual or beneficial use of property under certain management or incentive payment contracts, output-type contracts, or certain other arrangements in which a nongovernmental person has legal contractual rights to use property.[62]

A contract between a private management or other service company and a governmental unit to operate bond-financed governmental facilities may result in private business use depending on the terms of the contract.[63] In general, a management contract gives rise to private business use if the compensation under the contract is based on net profits. For example, a management contract with respect to a commuter rail facility that compensates the management company based on the profits of such facility would result in private use. The IRS has provided safe harbor guidelines under which certain management contract arrangements are treated as not

[61] The 10-percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

[62] Treas. Reg. sec. 1.141-3(b).

[63] Treas. Reg. sec. 1.141-3(b)(4).

giving rise to private business use, depending on the term of the contract and the nature of the management compensation arrangement.[64] Under these safe harbors, the permitted term of the contract depends on the compensation arrangement. Thus, for example, these safe harbors permit a 15-year contract in which 95 percent of the management compensation consists of periodic fixed fees and a 5-year contract in which 50 percent of the management compensation consists of periodic fixed fees. Contracts for service incidental to the facility's primary functions, such as janitorial, office equipment repair and similar services, are not considered management contracts.

For purposes of the private payment test, both direct and indirect payments made by any private person treated as using the financed property are taken into account. Payments by a person for the use of proceeds generally do not include payments for ordinary and necessary expenses (within the meaning of section 162) attributable to the operation and maintenance of financed property.[65]

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons. Private loans include both business and other (*e.g.*, personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments that are subject to the private business test.

Qualified private activity bonds

Qualified private activity bonds are tax-exempt bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility bond, or a qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.[66]

To qualify as an exempt facility bond, 95 percent of the net proceeds must be used to finance an eligible facility.[67] Business facilities eligible for this financing include transportation (*i.e.*, airports, ports, local mass commuting, high-speed intercity rail facilities, and qualified highway or surface freight transfer facilities); privately owned and/or operated public works facilities (*i.e.*, sewage, solid waste disposal, water, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated residential rental housing; and certain private facilities for the local furnishing of electricity or gas. Bonds issued to finance

[64] Rev. Proc. 97-13, 1997-1 C.B. 632.

[65] Treas. Reg. sec. 1.141-4(c)(3).

[66] Sec. 141(e).

[67] Sec. 142(a).

"environmental enhancements of hydro-electric generating facilities," qualified public educational facilities, and qualified green building and sustainable design projects also may qualify as exempt facility bonds.

Generally, qualified private activity bonds are subject to a number of restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the "State volume cap").[68] For 2014, the State volume limit is the greater of $100 multiplied by the State population, or $296,825,000.[69]

Qualified private activity bonds also are subject to additional limitations on issuance cost and length of maturity. In general, the interest income from qualified private activity bonds (other than qualified 501(c)(3) bonds) is a preference item for purposes of calculating the alternative minimum tax ("AMT").[70]

Rules governing private activity bonds for transportation infrastructure

Airports

Exempt facility bonds may be issued to finance airports. Exempt facility bonds for airports are not subject to the State volume cap. However, all tax-exempt-bond-financed airport property must be governmentally owned. Property eligible for this financing includes land, terminals, runways, public parking facilities, and related equipment. Airplanes are not eligible for tax-exempt financing. Additionally, certain real property facilities (and related equipment) are excluded from this financing:

1. Hotels and other lodging facilities;

2. Retail facilities (including food and beverage facilities) located in a terminal, if the facilities are in excess of a size necessary to serve passengers and employees at the airport;

3. Retail facilities for passengers or the general public (including, but not limited to, rental car lots) located outside the terminal;

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[68] The following private activity bonds are not subject to the State volume cap: qualified 501(c)(3) bonds; exempt facility bonds for airports, docks and wharves; environmental enhancements for hydroelectric generating facilities; and exempt facility bonds for solid waste disposal facilities that are to be owned by a governmental unit. The State volume cap does not apply to 75 percent of exempt facility bonds issued for high speed intercity rail facilities; 100 percent if the high speed intercity rail facility is to be owned by a governmental unit. Qualified veterans mortgage bonds, qualified public educational facility bonds, qualified green building and sustainable project design bonds, and qualified highway or surface freight transfer facility bonds also are not subject to the State volume cap, but the Code subjects such bonds to volume limitations specific to the category of bonds.

[69] Rev. Proc. 2013-35, 2013-47 I.R.B. 537 (November 18, 2013).

[70] Sec. 57(a)(5).

4. Office buildings for individuals who are not employees of a governmental unit or of the public airport operating authority; and

5. Industrial parks or manufacturing facilities.

Port facilities

Exempt facility bonds may be issued to finance port ("dock and wharf") facilities and related storage and training facilities. Facilities that are specifically ineligible for financing with airport bonds may not be financed with port bonds. Further, ships and other vessels are not eligible for private activity tax-exempt bond financing. All property financed with these bonds must be governmentally owned. Exempt facility bonds issued for ports are not subject to the State volume cap.

Mass commuting facilities

Exempt facility bond financing for mass commuting facilities is subject to similar restrictions as those which apply to such bonds for airports and ports. All property financed with these bonds must be governmentally owned. Further, "rolling stock" (*e.g.*, buses and rail cars) is not eligible for financing with exempt facility bonds.

High-speed intercity rail facilities

The definition of an exempt facility bond includes bonds issued to finance high-speed intercity rail facilities.[71] 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.[72] The facilities must use vehicles that are reasonably expected to be capable of attaining a maximum speed 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.

Unlike other bond-financed transportation facilities, high-speed intercity rail facilities may be privately owned. However, 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.[73]

[71] Sec. 142(a)(11) and sec. 142(i).

[72] 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.

[73] Sec. 142(i)(2).

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.[74]

Seventy-five percent of the principal amount of the bonds issued for high-speed rail facilities is exempt from the volume limit.[75] 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.

Qualified highway or surface freight transfer facility bonds

Present law authorizes the issuance of tax-exempt private activity bonds to finance qualified highway or surface freight transfer facilities. A qualified highway facility or surface freight transfer facility is any surface transportation or international bridge or tunnel project (for which an international entity authorized under Federal or State law is responsible) which receives Federal assistance under title 23 of the United States Code or any facility for the transfer of freight from truck to rail or rail to truck which receives Federal assistance under title 23 or title 49 of the United States Code.

Qualified highway or surface freight transfer facility bonds are not subject to the State volume limitations. Rather, the Secretary of Transportation is authorized to allocate a total of $15 billion of issuance authority to qualified highway or surface freight transfer facilities in such manner as the Secretary determines appropriate.[76]

Similar to the requirement for high-speed intercity rail facilities, the Code imposes a special redemption requirement for qualified highway or surface freight transfer facility bonds. Under present law, the proceeds of qualified highway or surface freight transfer facility bonds must be spent on qualified projects within five years from the date of issuance of such bonds. Proceeds that remain unspent after five years must be used to redeem outstanding bonds.

The qualified highway or surface freight transfer facility bond provision was enacted in 2005 as part of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users ("SAFETEA-LU").[77] As reflected in the following chart, as of April 18, 2014, the Department of Transportation has made allocations of approximately $9.8 billion of the $15

[74] Sec. 142(i)(3).

[75] Sec. 146(g)(4).

[76] See Department of Transportation, *Notice of Solicitation for Requests for Allocations of Tax-exempt Financing and Request for Comments*, 71 Fed. Reg. 642 (January 5, 2006) and Internal Revenue Service, Notice 2006-45, *Exempt Facility Bonds for Qualified Highway or Surface Freight Transfer Facilities*, 2006-20 I.R.B. 891 (May 15, 2006).

[77] Section 11143 of Pub. L. No. 109-59.

billion it is authorized to allocate. Of the $9.8 billion that has been allocated, approximately $4.6 billion of bonds have been issued.[78]

[78] Federal Highway Administration, *Innovative Program Delivery* (website), *Tools & Programs: Federal Debt Financing Tools, Private Activity Bonds*, http://www.fhwa.dot.gov/ipd/finance/tools_programs/federal_debt_financing/private_activity_bonds.

Table 2.−Qualified Highway or Surface Freight Transfer Facility Bond Projects[1]

Project	Amount
Bonds Issued	
Capital Beltway HOT Lanes	$589,000,000
North Tarrant Expressway, TX	$400,000,000
H 635 (LBJ Freeway), TX	$615,000,000
Denver RTD Eagle Project (East Corridor & Gold Line	$397,835,000
CenterPoint Intermodal Center, Joliet, Illinois	$225,000,000
Downtown Tunnel/Midtown Tunnel, Norfolk, VA	$675,004,000
I-95 HOT/HOV Project	$252,648,000
East End Crossing, Ohio River Bridges	$676,805,000
North Tarrant Expressway 3A & 3B	$274,030,000
Goethals Bridge	$460,915,000
US 36 Managed Lanes/BRT Phase 2	$20,360,000
Subtotal	**$4,586,597,000**
Allocations	
Knik Arm Crossing, AL	$600,000,000
CenterPoint Intermodal Center, Joliet	$700,000,000
I-77 Managed Lanes	$350,000,000
I-4 Ultimate Project	$2,000,000,000
I-69 Section 5	$400,000,000
Portsmouth Bypass, OH	$610,000,000
SH-288	$600,000,000
Subtotal	$5,260,000,000
Grand Total	**$9,846,597,000**

[1] As of April 18, 2014. U.S. Department of Transportation, Federal Highway Administration, Office of Innovative Program Delivery, *Tools & Programs: Federal Debt Financing Tools*, *Private Activity Bonds*, "Current Status" http://www.fhwa.dot.gov/ipd/finance/tools_programs/federal_debt_financing/private_activity_bonds/#current.

C. Other Methods and Proposals for Infrastructure Project Finance

1. Overview: tax-credit bonds and direct-pay bonds

Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. Current tax-credit bonds include qualified tax credit bonds, which have certain common general requirements, and include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy ("QZABs"), and qualified school construction bonds. The authority to issue two other types of tax-credit bonds, recovery zone economic development bonds and Build America Bonds, expired on January 1, 2011.

General rules applicable to qualified tax-credit bonds[79]

Unlike tax-exempt bonds, qualified tax-credit bonds generally are not interest-bearing obligations. Rather, the taxpayer holding a qualified tax-credit bond on a credit allowance date is 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 for an issue of qualified tax credit bonds is determined by the Secretary and is estimated to be a rate that permits issuance of the qualified tax-credit bonds without discount and interest cost to the qualified issuer.[80] 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. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds. Qualified tax-credit bonds are subject to a maximum maturity limitation, a three-year spending requirement, arbitrage restrictions, and IRS reporting requirements.

Direct-pay bonds and expired tax-credit bond provisions

The Code provides that an issuer may elect to issue certain tax credit bonds as "direct-pay bonds." Instead of a credit to the holder, with a "direct-pay bond" the Federal government pays the issuer a percentage of the interest on the bonds. The following tax credit bonds may be issued as direct-pay bonds: new clean renewable energy bonds, qualified energy conservation bonds, and qualified school construction bonds. QZAB may be issued as direct-pay bonds but such an election is not available regarding any allocation of the national zone academy bond allocation after 2010 or any carryforward of such allocations. The ability to issue Build America Bonds and Recovery Zone bonds, which have direct-pay features, has expired. The Build America Bond program is discussed below.

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[79] Separate rules apply in the case of tax-credit bonds which are not qualified tax-credit bonds (*e.g.*, "recovery zone economic development bonds," and "Build America Bonds").

[80] However, for new clean renewable energy bonds and qualified energy conservation bonds, the applicable credit rate is 70 percent of the otherwise applicable rate.

Build America Bonds

The Build America Bond program, part of the American Recovery and Reinvestment Act of 2009 ("ARRA"[81]), provided a subsidy to State and local governments to finance capital projects, including the development of surface transportation infrastructure. The authority to issue bonds under the program expired December 31, 2010.

Under the Build America Bond program, an issuer could elect to have an otherwise tax-exempt bond, issued prior to January 1, 2011, treated as a "Build America Bond."[82] In general, Build America Bonds are taxable governmental bonds, the interest on which is subsidized by the Federal government by means of a tax credit to the holder ("tax-credit Build America Bonds") or, in the case of certain qualified bonds, a direct payment to the issuer ("direct-pay Build America Bonds").[83]

The holder of a tax-credit Build America Bond accrues a tax credit in the amount of 35 percent of the interest paid on the interest payment dates of the bond during the calendar year.[84] The interest payment date is any date on which the holder of record of the Build America Bond is entitled to a payment of interest under such bond.[85] The sum of the accrued credits is allowed against regular and alternative minimum tax; unused credits may be carried forward to succeeding taxable years.[86] The credit, as well as the interest paid by the issuer, is included in gross income, and the credit may be stripped under rules similar to those provided for qualified tax-credit bonds.[87]

Although the authority existed to issue Build America Bonds that provided for a tax credit to the bond holder, most Build America Bonds were issued as "direct-pay Build America Bonds." Under a special rule, in lieu of the tax credit to the holder, the issuer is allowed a refundable credit equal to 35 percent of each interest payment made under such bond.[88]

[81] Pub. L. No. 111-5.

[82] Sec. 54AA.

[83] Tax-credit Build America Bonds may be issued to finance any governmental purpose for which tax-exempt governmental bonds (excluding private activity bonds under section 141) could be issued under section 103. The eligible uses of proceeds and types of financings for direct-pay Build America Bonds are more limited than for tax-credit Build America Bonds. Direct-pay Build America Bonds are to finance only capital expenditures that could have been financed with tax-exempt governmental bonds.

[84] Sec. 54AA(a) and (b).

[85] Sec. 54AA(e).

[86] Sec. 54AA(c).

[87] Sec. 54AA(f).

[88] Sec. 54AA(g)(1).

2. Tax-credit bonds for infrastructure proposals

S. 1250, the "Transportation and Regional Infrastructure Projects Bonds Act of 2013" or the "TRIP Bonds Act," was introduced on June 27, 2013. The TRIP Bonds Act creates a new category of qualified tax credit bonds called TRIP bonds. TRIP bonds must meet four requirements: (1) the bond is issued by a State infrastructure bank; (2) bond proceeds must be used for capital improvements to any transportation infrastructure project; (3) projects financed with bond proceeds must comply with a State contribution requirement; and (4) bond proceeds are subject to a five-year spending requirement plus a binding commitment to spend 10 percent of proceeds or commence construction within 12 months of the date of issuance. In addition, the bonds must be designated as TRIP bonds by the State infrastructure bank and issued in registered form, the appropriate State agency relating to the qualified project must utilize updated construction technologies, and the term of the bond cannot exceed 30 years. The credit rate on the bonds is equal to the average market yield on outstanding comparable-term corporate debt (as of the date before the sale of the issue). There is a national limitation on the amount of qualified TRIP bonds that may be issued: $5 billion for the first year, $5 billion for the second year, $10 billion for the third year, $10 billion for the fourth year, and $10 billion for the fifth year. Each calendar year, the national limitation is to be allocated among the States by the Secretary of the Treasury so that each State receives two percent of the national limitation. Unused allocation may be carried forward to succeeding years until used by issuance of TRIP bonds. The TRIP Bonds Act also provides rules for TRIP Bonds Trust Accounts for each State infrastructure bank.

3. National infrastructure bank proposals

As a supplement to existing financing mechanisms for infrastructure, there have been proposals put forth in the last several years to create a "national infrastructure bank" or fund to provide additional financing for infrastructure projects of national and/or regional significance. Such assistance could take the form of loans, loan guarantees or grants. Generally, the proposals initially capitalize the bank with Federal funds. Some proposals would allow the bank to issue debt to provide financing for infrastructure projects. Some of the most recent proposals are briefly described below.

On November 14, 2013, Senator Warner introduced S. 1716, the "Building and Renewing Infrastructure for Development and Growth in Employment Act" or the "BRIDGE Act." The bill establishes the Infrastructure Financing Authority as a wholly-owned government corporation. The authority is to provide direct loans and loan guarantees for certain transportation, water, and energy infrastructure projects. The projects are required to have reasonably anticipated costs that equal or exceed $50 million ($10 million for rural infrastructure projects).

On January 16, 2014, Senator Bennet introduced S. 1957, the "Partnership to Build America Act of 2014." The bill establishes the American Infrastructure Fund ("AIF") as a wholly-owned government corporation. The AIF is authorized to issue up to $50 billion in bonds to provide loans and loan guarantees for certain transportation, energy, water, communications, and educational infrastructure projects, as well as provide equity investments in such projects (not to exceed 20 percent of the total project cost).

As part of the fiscal year 2015 budget proposal, the Administration proposed the creation of a $10 billion national infrastructure bank that would provide loans and loan guarantees for transportation, energy, and water projects.