

U.S. Senate Committee on Finance

For Immediate Release

Thursday, March 4, 2004

Grassley, Baucus Urge Budget Leaders to Consider Impact of Leasing Deals

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, today urged the leaders of the Senate budget and appropriations committees to consider that city infrastructure leasing tax shelters drain the U.S. Treasury. The senators said the budget leaders should remember this impact when approving federal funds for city infrastructure needs.

The latest findings from Grassley and Baucus show that such leasing deals cost the federal fisc \$2 for every \$1 the cities and their agencies receive in fees from the promoters of such deals. City infrastructure items, such as transit systems, are often built with federal funds. Therefore, the U.S. Treasury takes a double hit under leasing deals: one hit for contributing to the project construction, and another hit for federal taxes lost via such tax shelters.

For months, Grassley and Baucus have been investigating how major U.S. companies receive huge tax deductions by pretending to lease the infrastructure of cities and foreign countries and then pretending to lease them back. These arrangements have resulted in U.S. taxpayers picking up the tab for a huge portion of Europe's transit infrastructure and are now proliferating in cities across the country as tax shelter promoters shop their wares to cash-strapped local governments.

Following are:

- (1) <http://www.ci.rochester.mn.us/mayor/leaseutility.htm> – a Web link describing the potential lease/leaseback financing program for the City of Rochester, Minn., municipal water and wastewater systems
- (2) <http://www.assetfinance.com/contents/publications/afi/qte/qte12.pdf> – a Web link to a source of information on large leasing deals
- (3) the text of Senator Grassley's Nov. 17, 2003, letter to Transportation Secretary Norman Mineta asking for details of leasing deals approved or funded by the department
- (4) the text of Sens. Grassley and Baucus' letters today to Senate Budget and Appropriations Committee leaders

Attachments include:

- (1) the response to Sen. Grassley's letter from Secretary Mineta

(2) a list of leasing deals reviewed by the Federal Transit Administration since 1988

(3) description of current law and the Grassley-Baucus-Administration proposal from the Joint Committee on Taxation

November 17, 2003

Norman Y. Mineta
Secretary of Transportation
Department of Transportation
400 Seventh Street, S.W.
Washington, DC 20590

Dear Mr. Secretary:

I am writing to enlist the assistance of the Department of Transportation in our ongoing investigation of abusive tax shelters. On October 21, 2003, the Committee on Finance held a hearing regarding the continuing proliferation of abusive tax shelters. During that hearing, we learned that shelter promoters are engaging in transactions with U.S. municipalities and other state and local governmental units, which allow major U.S. corporations to depreciate state and local infrastructure assets, such as railways, subways, dams, water lines, and air traffic control systems. Our subsequent investigations have disclosed that the Department of Transportation has endorsed these transactions, even though the Department of Treasury had classified them as abusive tax shelters.

Under this scheme, municipalities are paid an up-front cash fee to enter into a long-term lease of their infrastructure to the tax shelter promoters. The cash received by the municipality, however, pales in comparison to the federal tax benefits received by the corporations, which will be able to depreciate taxpayer-funded bridges, subways, and rail systems as a result of the lease. As part of the same agreement, the promoters will agree to simultaneously lease the assets back to the municipality. The obligations of the promoters and municipalities are prepaid through “phantom” debt, and neither the tax promoters nor the municipality assumes any credit or ownership risk. At the end of the lease term, the infrastructure assets revert back to the municipality. In reality, nothing changes regarding the ownership or use of the infrastructure. One municipal manager described these transactions as, “People giving him money which he never had to pay back, for doing something that he was already doing.”

In March 1999, the Department of Treasury under the Clinton Administration initiated enforcement actions against these transactions, which are called LILOs - an abbreviation of their industry name “lease-in-lease-out” transactions. You can imagine our surprise when we discovered that in February 2000, the Federal Transit Administration issued guidance entitled “Financing Techniques for Public Transit,” which listed LILOs as a funding technique. That guidance stated that in fiscal 1999, the Federal Transit Administration reviewed over \$1 billion in leasehold transactions. We have further learned that these transactions have continued, albeit in a different

form, and that the Department of Transportation may be approving these transactions. The LILO transactions have now been replicated through service agreement contracts and transactions called SILOs -- "sales-in-lease-out." Other variations on these transactions have involved qualified technology equipment (QTEs). We have been advised that state and local infrastructure projects which receive federal funding must obtain the review and approval of the Department of Transportation in order to enter into these transactions. Several tax shelter promoters have defended their deals on the basis that they were approved by the Department of Transportation. This is why I wanted to bring this matter to your attention.

I am certain that you share my concern that bridges, water lines, sports stadiums, and subway systems constructed with taxpayer dollars are being used by big corporations to shelter billions of dollars in taxes through bogus depreciation deductions. In order to assist us in assessing the scope and scale of this problem, I request that the Department of Transportation submit to the Committee on Finance copies of all LILOs, SILOs, QTEs, and similar transactions that have been approved, funded, or otherwise reviewed by the Department of Transportation from the year 1995 to present.

I appreciate your cooperation in our ongoing efforts to combat abusive tax shelters, and look forward to receiving these materials as soon as possible.

With best personal regards,

Charles E. Grassley

March 4, 2004

The Honorable Ted Stevens
Chairman
Senate Committee on Appropriations
U.S. Capitol, Room 128
Washington, DC 20510

The Honorable Robert C. Byrd
Ranking Member
Senate Committee on Appropriations
U.S. Capitol, Room 128
Washington, DC 20510

Dear Senators Stevens and Byrd:

We are writing to alert you to an ongoing tax shelter that will adversely impact the Federal budget for the 2005 fiscal year and subsequent years. This tax shelter is particularly important as the Budget Committee and the Appropriations Committee struggle to close the current budget deficit. We are specifically referring to the tax-exempt use leasing transaction that has been described by the Administration and previously in the Committee Report to S. 1637. In many of these shelters, U.S. taxpayers subsidize the purchase of property for a foreign government or business for which the U.S. taxpayers obtains no benefit. In other cases, domestic municipal property is used in the shelter. The

U.S. municipalities and transit authorities that have approved these transactions have failed to consider the impact of their decisions on their own State or the Federal budget, but rather have turned a blind eye and acted as an accommodator in these shelters. Even more troubling is that, in many cases, the assets used have been acquired or built with taxpayer dollars.

The Administration estimates that this abuse will cost the federal government over \$33 billion during the next 10 years. The magnitude of this abuse has forced the CBO to reduce the corporate tax receipts baseline for shelter transactions that have already occurred and for the anticipated future reductions in corporate tax receipts if this abuse is not stopped.

As background, we have attached a general explanation of these transactions. In addition, we have attached the Joint Committee on Taxation's analysis of the President's Fiscal Year 2005 Budget Proposal. The Joint Committee had several observations regarding the impact of these abusive leasing transactions on the federal budget and appropriations process. Rather than reiterate their analysis, we enclose copies of the relevant analysis for your review. However, two points must be made. First, these abusive leasing shelters represent an open-ended, unsupervised drain that double-dips from the Federal trough: once in the form of federal aid and again in the form of federal tax fraud. We find this particularly troubling given that the Senate recently passed a highway reauthorization bill which increases transit funding 40 percent above the current baseline. Second, city managers often cite their ability to use these leasing shelters to avoid legislative and voter approval for capital acquisitions. We believe these abuses should not be condoned or continued.

Because of your important roles in the budget and appropriation process, we thought it also was important to report to you additional information, beyond the total impact on the Federal fisc, with respect to a segment of these transactions. Many of the domestic shelter transactions have involved transportation assets. To appreciate the magnitude of this activity, we have enclosed a list provided by the Federal Transit Administration of all federally funded transit projects that have been the subject of these abusive leasing shelters since 1988, along with the names of the promoters, banks, and advisors that have been involved in these transactions. As can be seen from these documents, only a discrete group of cities is engaging in these leases. We have also enclosed a copy of a letter from Department of Transportation Secretary Norman Mineta describing the Department of Transportation's history with the shelter leases, along with a letter from the Department of Treasury asking Secretary Mineta to cease his agency's approval of such leases.

In addition, we requested the Joint Committee on Taxation to compare the benefit obtained by a municipality to the loss in Federal income tax revenues. Under its most conservative measurements, the Joint Tax Committee estimates that at least \$2 of federal tax revenues is lost for every \$1 of benefit that is received by a municipality or transit agency in the form of a shelter promoter accommodation payment. The Joint Committee estimates that, over the next 10 years, local governments will receive \$5.4 billion of promoter accommodation payments. Using the Joint Committee's most conservative estimates, this translates into a federal loss of nearly \$11 billion.

Just as important as the federal loss is the impact on State and local governments. Many states permit depreciation deductions based upon the depreciation claimed in the federal corporate income tax return. The Joint Committee estimates that state treasuries will lose approximately \$6 billion

over the next 10 years if the leasing transactions are not stopped. Thus, the shelter accommodation fees paid to municipalities and transit authorities are being more than offset by the reduction in income tax revenue to such governments.

We believe it is an abuse of the public trust for city managers to allow corporations to claim tax deductions on bridges, waterlines, public stadiums, or subways that are paid for with taxpayer dollars. When highly visible public assets, such as municipal courthouses, athletic stadiums, or transit assets are used in transactions solely to generate corporate tax deductions, the public questions the integrity of the tax system.

We believe the better process to address the proper federal subsidies for state and local government is through the appropriations and budget process. We hope you will consider the enclosed information as you continue your efforts to reduce our nation's budget deficit.

With best personal regards,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member

Enclosures

March 4, 2004

The Honorable Don Nickles
Chairman
Senate Committee on the Budget
624 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Kent Conrad
Ranking Member
Senate Committee on the Budget
624 Dirksen Senate Office Building
Washington, DC 20510

Dear Senators Nickles and Conrad:

We are writing to alert you to an ongoing tax shelter that will adversely impact the Federal budget for the 2005 fiscal year and subsequent years. This tax shelter is particularly important as the Budget Committee and the Appropriations Committee struggle to close the current budget deficit. We are specifically referring to the tax-exempt use leasing transaction that has been described by the Administration and previously in the Committee Report to S. 1637. In many of these shelters, U.S. taxpayers subsidize the purchase of property for a foreign government or business for which the U.S. taxpayers obtains no benefit. In other cases, domestic municipal property is used in the shelter. The U.S. municipalities and transit authorities that have approved these transactions have failed to

consider the impact of their decisions on their own State or the Federal budget, but rather have turned a blind eye and acted as an accommodator in these shelters. Even more troubling is that, in many cases, the assets used have been acquired or built with taxpayer dollars.

The Administration estimates that this abuse will cost the federal government over \$33 billion during the next 10 years. The magnitude of this abuse has forced the CBO to reduce the corporate tax receipts baseline for shelter transactions that have already occurred and for the anticipated future reductions in corporate tax receipts if this abuse is not stopped.

As background, we have attached a general explanation of these transactions. In addition, we have attached the Joint Committee on Taxation's analysis of the President's Fiscal Year 2005 Budget Proposal. The Joint Committee had several observations regarding the impact of these abusive leasing transactions on the federal budget and appropriations process. Rather than reiterate their analysis, we enclose copies of the relevant analysis for your review. However, two points must be made. First, these abusive leasing shelters represent an open-ended, unsupervised drain that double-dips from the Federal trough: once in the form of federal aid and again in the form of federal tax fraud. We find this particularly troubling given that the Senate recently passed a highway reauthorization bill which increases transit funding 40 percent above the current baseline. Second, city managers often cite their ability to use these leasing shelters to avoid legislative and voter approval for capital acquisitions. We believe these abuses should not be condoned or continued.

Because of your important roles in the budget and appropriation process, we thought it also was important to report to you additional information, beyond the total impact on the Federal fisc, with respect to a segment of these transactions. Many of the domestic shelter transactions have involved transportation assets. To appreciate the magnitude of this activity, we have enclosed a list provided by the Federal Transit Administration of all federally funded transit projects that have been the subject of these abusive leasing shelters since 1988, along with the names of the promoters, banks, and advisors that have been involved in these transactions. As can be seen from these documents, only a discrete group of cities is engaging in these leases. We have also enclosed a copy of a letter from Department of Transportation Secretary Norman Mineta describing the Department of Transportation's history with the shelter leases, along with a letter from the Department of Treasury asking Secretary Mineta to cease his agency's approval of such leases.

In addition, we requested the Joint Committee on Taxation to compare the benefit obtained by a municipality to the loss in Federal income tax revenues. Under its most conservative measurements, the Joint Tax Committee estimates that at least \$2 of federal tax revenues is lost for every \$1 of benefit that is received by a municipality or transit agency in the form of a shelter promoter accommodation payment. The Joint Committee estimates that, over the next 10 years, local governments will receive \$5.4 billion of promoter accommodation payments. Using the Joint Committee's most conservative estimates, this translates into a federal loss of nearly \$11 billion.

Just as important as the federal loss is the impact on State and local governments. Many states permit depreciation deductions based upon the depreciation claimed in the federal corporate income tax return. The Joint Committee estimates that state treasuries will lose approximately \$6 billion over the next 10 years if the leasing transactions are not stopped. Thus, the shelter accommodation

fees paid to municipalities and transit authorities are being more than offset by the reduction in income tax revenue to such governments.

We believe it is an abuse of the public trust for city managers to allow corporations to claim tax deductions on bridges, waterlines, public stadiums, or subways that are paid for with taxpayer dollars. When highly visible public assets, such as municipal courthouses, athletic stadiums, or transit assets are used in transactions solely to generate corporate tax deductions, the public questions the integrity of the tax system.

We believe the better process to address the proper federal subsidies for state and local government is through the appropriations and budget process. We hope you will consider the enclosed information as you continue your efforts to reduce our nation's budget deficit.

With best personal regards,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member

Enclosures