



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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For Immediate Release

Friday, March 5, 2004

Senators Expand Leasing Tax Shelters Probe to FAA, EPA

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, have expanded their inquiry into federal agencies that may have played a role in approving abusive tax shelter leases using infrastructure assets. This week, the senators wrote to the Federal Aviation Administration and the Environmental Protection Agency asking for details of any such deals those agencies have approved. The letters follow an earlier letter to the federal Transportation Department; the senators released the results of that inquiry earlier this week.

Grassley and Baucus also wrote to the leaders of the House Appropriations Subcommittee On Transportation, Treasury, and Independent Agencies to share their findings so far. The letter came after press reports reflected the appropriators' interest in the issue.

Following is the text of the senators' latest letters.

March 4, 2004

The Honorable Marion C. Blakey
Administrator
Federal Aviation Administration
800 Independence Avenue, S.W. Room 1022
Washington, DC 20591

Dear Ms. Blakey:

We are writing to enlist the assistance of the Federal Aviation Administration 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 federal agencies have endorsed these transactions, even though the Department of the 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 through a pre-funded repurchase arrangement. 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 the 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. We have further learned that these transactions have continued, albeit in a different form, and that other federal agencies 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 Federal Aviation Administration in order to enter into these transactions.

We are certain that you share our concern that water lines, waste treatment plants, and air traffic control 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, we request that the Federal Aviation Administration submit to the Committee on Finance copies of all documents relating to LILOs, SILOs, QTEs, and similar transactions that have been approved, funded, or otherwise reviewed by the Federal Aviation Administration from the year 1995 to present.

We 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
Chairman

Max Baucus
Ranking Member

March 4, 2004

The Honorable Mike Leavitt
Administrator
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, N.W. Room 3428 ARN
Washington, DC 20460

Dear Mr. Leavitt:

We are writing to enlist the assistance of the Environmental Protection Agency 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 federal agencies have endorsed these transactions, even though the Department of the 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 through a pre-funded repurchase arrangement. 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.”

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We are certain that you share our concern that water lines, waste treatment plants, and air

traffic control 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, we request that the Environmental Protection Agency submit to the Committee on Finance copies of all documents relating to LILOs, SILOs, QTEs, and similar transactions that have been approved, funded, or otherwise reviewed by the Environmental Protection Agency from the year 1995 to present.

We 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
Chairman

Max Baucus
Ranking Member

March 5, 2004

The Honorable Ernest J. Istook
Chairman
House Appropriations Subcommittee
On Transportation, Treasury, and
Independent Agencies
2404 Rayburn House Office Bldg.
Washington, DC 20515

The Honorable John W. Olver
Ranking Member
House Appropriations Subcommittee
On Transportation, Treasury, and
Independent Agencies
1027 Longworth House Office Bldg.
Washington, DC 20515

Dear Congressmen Istook and Olver:

We read in the press about your interest in addressing the ongoing abuses involving leasing tax shelters. We wanted to provide you the new information we have on this abuse. 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