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Accountability \* Integrity \* Reliability

United States General Accounting Office  
Washington, DC 20548

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June 25, 2001

The Honorable Wayne Allard  
The Honorable Robert F. Bennett  
The Honorable Christopher S. Bond  
The Honorable Phil Gramm  
The Honorable John McCain  
The Honorable Richard C. Shelby  
The Honorable Bob Smith  
United States Senate

Subject: The High-Speed Rail Investment Act of 2001 (S. 250)

The High-Speed Rail Investment Act of 2001 (S. 250) would allow the National Railroad Passenger Corporation (Amtrak) to issue up to \$12 billion in “tax credit bonds” over 10 years, primarily for capital improvement projects on designated high-speed rail corridors and on Amtrak’s Northeast Corridor.<sup>1</sup> (See encl. I for a summary of the bill.) You asked us to assess selected aspects of the bill, including (1) the cost of the bond-financing mechanism and alternatives to the U.S. Treasury, (2) the degree to which bond proceeds would meet the capital needs of federally designated high-speed rail corridors, and (3) the extent of the federal oversight role. On May 16, 2001, we provided representatives of your offices with the preliminary results of our review. Enclosure II contains the briefing slides that formed the basis of our presentation.

In summary, we estimate that the tax credit for Amtrak bonds would cost the U.S. Treasury between \$16.6 billion and \$19.1 billion (in nominal dollars) over 30 years.<sup>2</sup> In present value terms, we estimate that the cost of these tax credits to the Treasury would be between \$7.7 billion and \$10 billion.<sup>3</sup> The total cost of the bond program

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<sup>1</sup>Amtrak is a private corporation that provides the nation’s intercity passenger rail service. Under the bill, bondholders would receive tax credits rather than interest payments. Ten high-speed rail corridors (with train speeds of at least 90 miles per hour) have been designated either by legislation or by the Department of Transportation. Amtrak’s Northeast Corridor runs from Boston to Washington, D.C. (See fig. I in encl. II.)

<sup>2</sup>The tax credit that bondholders would receive is the product of the interest rate on outstanding long-term corporate debt and the outstanding face amount of the bond.

<sup>3</sup>A present value computation adjusts the value of dollars spent (or received) in the future to make them comparable with dollars spent (or received) today. Among other things, this adjustment is important when comparing the costs of a program that extends over 30 years, such as the S. 250 bond program, with a program whose costs to the government occur much sooner, such as one funded with annual appropriations.

could increase to about \$11.2 billion (in present value terms) if states finance their contributions with tax-exempt borrowing and Amtrak uses its accumulated losses to offset otherwise taxable earnings in the trust account established for the repayment of bond principal. We estimate that the cost of providing equivalent annual appropriations would be between \$7.3 billion and \$8.2 billion in present value terms.<sup>4</sup> As a result, the cost of the tax credits to the U.S. Treasury under the bond approach would be at least \$400 million greater and could be more than \$3 billion greater (in present value terms) than providing annual appropriations of an equivalent amount.

The overall capital needs of fully developed federally designated high-speed rail corridors are unknown because these initiatives are in various stages of planning. However, a preliminary estimate by Amtrak puts the capital costs for fully developed high-speed rail corridors and its Northeast Corridor at between \$50 billion to \$70 billion over 20 years.

Regarding the federal oversight role, the bill provides specific responsibilities to the Departments of the Treasury and Transportation. Specifically, the Secretary of the Treasury is required to report annually on whether the amount of money in the trust account is sufficient to repay the bonds.<sup>5</sup> Another responsibility is to determine, as part of its overall responsibilities under the Internal Revenue Code, whether tax credits claimed by taxpayers qualify under S. 250. According to Treasury and Internal Revenue Service officials, the bill and other provisions of the Internal Revenue Code provide them with sufficient authority to do so. The Department of Transportation's role is to approve projects from those selected by Amtrak prior to Amtrak's issuing the bonds. In approving the projects, the Department may give preference to projects with state matching contributions above the required 20 percent and shall consider the regional balance for infrastructure investment and the national interest in developing high-speed passenger rail projects.<sup>6</sup> Federal Railroad Administration officials told us that more specific criteria could aid the Department in approving projects. Finally, the bill provides Amtrak with significant programmatic responsibilities for the development of high-speed passenger rail, including selecting projects to be funded. The bill requires that projects funded through Amtrak bonds be likely to financially benefit Amtrak. Yet, projects that might make the most

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<sup>4</sup>Under the annual appropriations approach, the federal government would provide \$960 million a year for 10 years and states would contribute \$240 million a year for 10 years, resulting in \$12 billion becoming available for passenger rail projects. The state contribution that we assumed is identical to the contribution required under S. 250.

<sup>5</sup>States provide at least 20 percent of the cost of the project to be financed with bond proceeds. State matching contributions, temporary period investment earnings on bond proceeds, and earnings on these amounts would be held in a trust account by a trustee independent of Amtrak. Amounts in the trust account would be used to redeem the bonds.

<sup>6</sup>The Department's approval includes a determination by its Inspector General that projects would be financially beneficial to Amtrak and that Amtrak's investment evaluation process includes consideration of the return on investment, leveraging of funds, cost effectiveness, safety and mobility improvements, and feasibility.

important contributions to national transportation goals may not necessarily make the greatest (or any) financial contributions to Amtrak and vice versa.

S. 250 is being proposed as one means of providing increased federal funding for intercity passenger rail and high-speed rail. Amtrak's most recent capital and finance plan calls for \$30 billion (as measured in 2000 dollars) in federal funding over 20 years to upgrade its operations and to invest as seed money in high-speed rail corridors. Also, as discussed earlier in this letter, the capital needs to fully develop Amtrak's Northeast Corridor and the federally designated high-speed corridors could be in the \$50 billion to \$70 billion range, with much of this funding expected to come from the federal government. In March 2001, we testified that a number of benefits—such as reducing congestion and increasing travel choices—have been attributed to Amtrak and high-speed passenger rail systems.<sup>7</sup> These claimed benefits need to be realistically examined to guide the Congress in its decisions over the potentially large funding of such systems.

### **Agency Comments and Our Evaluation**

We sent a draft of this report to Amtrak, the Department of the Treasury, the Internal Revenue Service, and the Department of Transportation for their review and comment.

We met with several Amtrak officials on June 7, 2001, including a Senior Director for Finance and a Director for Government Affairs. Amtrak supplemented its comments with a letter on June 14. (See encl. IV.) In its letter, Amtrak stated that it concurred with many of our observations on the bill. Amtrak emphasized that it believes that the bill is an important first step in providing seed money and building the partnerships with states, localities, and freight railroads critical to the development of high-speed rail in the United States. Amtrak believes that a bond approach is a viable way to provide such funds, especially since the prospects of receiving appropriations are not encouraging. In addition, Amtrak stated that the bond approach is attractive because it generates a considerable amount of funds in a relatively short period of time.

In its letter Amtrak commented on our observation that if the amount in the trust account is inadequate to repay the bonds upon maturity, the federal government may be asked to make up any shortfall. Amtrak stated that the bill makes it clear that the obligation to repay the principal of the bonds at maturity rests with Amtrak and not the federal government. We agree that the United States would not be legally liable for these obligations. Nevertheless, we recognize that bondholders could attempt to recover losses from the federal government. To address this issue a provision could be added to the bill stating that the federal government does not explicitly or implicitly guarantee repayment of bond principal.

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<sup>7</sup>*Intercity Passenger Rail: Assessing the Benefits of Increased Federal Funding for Amtrak and High-Speed Passenger Rail Systems* (GAO-01-480T, Mar. 21, 2001).

In our June 7 meeting, Amtrak offered a number of specific comments on our draft report. First, Amtrak stated that we overstated the bond bill's cost to the Treasury since the tax credits received by bondholders are treated as taxable income under S. 250. Thus, Amtrak believes that the cost to the Treasury of the bond program is the cost of the tax credits less the increased income tax liability of the bondholders who take the tax credits. We disagree. We assumed that if investors did not invest in S. 250 bonds they would have invested in other taxable instruments. Thus, the investor would have incurred a similar additional tax liability in either case, and there would be no additional tax revenue as a result of the credit.

Second, in our June 7 meeting, Amtrak receded from its statement that an important consideration in its selection of high-speed rail projects would be the degree to which the projects are financially beneficial to Amtrak. Among other things, Amtrak said that it cannot determine selection criteria—and which of the criteria will have greater weight—until legislative action on the bill has been completed. We agree with Amtrak's comment and have deleted Amtrak's previous view from our report.

Third, during our review Amtrak told us that it was more appropriate to compare the cost of another guaranteed source of funds to the bond program, rather than annual appropriations. To address Amtrak's view, we provided an example of a guaranteed source of funds in our draft report because Amtrak did not offer one of its own. In our June 7 meeting, Amtrak offered a sinking fund approach as a guaranteed source of funds to compare with the bond program. Under this approach, the Congress would provide Amtrak with a single appropriation. These funds would then be invested and the investment earnings would be added to the fund. Amtrak would draw down \$960 million a year for 10 years from the fund. States would provide \$240 million a year, thus making \$1.2 billion a year available for high-speed rail projects, an amount equal to the amount that could become available under the bond program (not considering that bond proceeds may be used to defray bond issuance and other costs). We substituted Amtrak's approach for the example that we had devised. Depending on the rate of return assumed, we estimate that the Congress would have to appropriate between \$7 billion and \$8.3 billion (in present value terms) for the sinking fund.<sup>8</sup> In present value terms, we estimate that the S. 250 bond program would cost the Treasury from at least \$700 million more to over \$2.9 billion more (in present value terms) than Amtrak's sinking fund approach (see encl. II and III).

Fourth, in our June 7 meeting, Amtrak said that we should have contacted investment firms as part of our work because these firms could provide insights into how the investment community might view the bonds as investments. We did not do so because we assumed that investors would view the Amtrak bonds as similar to other risk-adjusted taxable bonds. Finally, Amtrak officials offered a number of clarifying and technical comments and we made changes to the report where appropriate.

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<sup>8</sup>These amounts assume that states finance their contributions with tax-exempt borrowing and Amtrak uses its accumulated losses to offset otherwise taxable earnings in the sinking fund.

Neither the Department of the Treasury nor the Internal Revenue Service chose to comment on our draft report. The Department of Transportation commented that the portion of the draft transmittal letter summarizing the cost of the bond program was confusing and appeared to unfairly compare the cost of the program with the face value of the bonds. We agree with the Department and revised our presentation to improve its clarity.

### **Scope and Methodology**

To carry out our work, we reviewed the High-Speed Rail Investment Act of 2001, as introduced on February 6, 2001. We discussed the bill with officials from the Federal Railroad Administration within the Department of Transportation, the Internal Revenue Service and the Office of Tax Analysis within the Department of the Treasury, Amtrak, four of the seven large freight railroad systems over which high-speed rail service might operate, and representatives from 20 states within federally designated high-speed rail corridors. We also reviewed Amtrak's February 2001 finance and capital plan, the Amtrak Reform Council's 2001 annual report, the Federal Railroad Administration's May 2000 report on high-speed rail systems, and selected project descriptions for high-speed rail corridors. In addition, we interviewed tax officials from five states and obtained property tax data on railroad property. Enclosure III describes how we estimated lost tax revenue associated with these bonds and the cost of alternative grant approaches.

We performed our work from March through June 2001 in accordance with generally accepted government auditing standards.

We are sending copies of this report to congressional committees with responsibilities for transportation issues; the Secretary of the Treasury; the Commissioner of Internal Revenue; the Secretary of Transportation; the Acting Administrator of the Federal Railroad Administration; the Director, Office of Management and Budget; and the President and Chief Executive Officer of Amtrak. We will also make copies available to others upon request and on our home page at <http://www.gao.gov>.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days after the date of this letter. If you or your staff have any questions about this report, please contact me at (202) 512-2834. Key contributors to this report were Kevin Daly, Helen Desaulniers, Paul Posner, Teresa Russell, James Ratzenberger, and James Wozny.

A handwritten signature in black ink that reads "John H. Anderson, Jr." with a stylized flourish at the end.

John H. Anderson, Jr.  
Managing Director, Physical  
Infrastructure Issues

Enclosures - 4

### **A General Description of the High-Speed Rail Investment Act of 2001**

- The bill authorizes Amtrak to issue up to \$1.2 billion in tax credit bonds each year from 2002 through 2011.<sup>9</sup> Unused bond authority in any 1 year can be carried over to the following year, through 2015.
- Bondholders receive a credit on their federal income taxes instead of interest payments. The credit is the product of the interest rate on outstanding long-term corporate debt and the outstanding face amount of the bond.

### **Bond Funds for Capital Projects**

- With limited exceptions, bond proceeds are to be used for the acquisition, financing, or refinancing of equipment, rolling stock, and other capital improvements, including station rehabilitation or construction, track or signal improvements, or the elimination of grade crossings (the intersection of railroad tracks and roads).
- No more than \$3 billion in bond authority may be used for Amtrak's Northeast Corridor or any one designated high-speed rail corridor. No more than \$100 million may be used in any 1 year for projects on other intercity passenger rail corridors (for increasing speeds up to 90 miles per hour). Finally, the Secretary of Transportation may allocate a portion of the bond authority to the Alaska Railroad.
- At least 95 percent of bond proceeds must be used on qualified projects. Bond proceeds may be used for independent assessments of projects' costs and benefits (see below). Amtrak must reasonably expect to spend at least 95 percent of the proceeds of a bond issue on qualified projects within 5 years and must exercise due diligence to complete projects and spend such proceeds.

### **Project Selection and Approval**

- The Secretary of Transportation must approve projects selected by Amtrak for funding before Amtrak issues bonds. The Secretary may give preference to those projects with state contributions exceeding 20 percent of the projects' costs (see below). The Secretary shall consider regional balance in infrastructure investment and the national interest in ensuring the development of a nationwide high-speed rail transportation network.
- In addition, the Department's Inspector General must find that there is a reasonable likelihood that proposed projects will result in a positive financial return to Amtrak and that the investment evaluation process includes

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<sup>9</sup>As introduced (the "star print" on Feb. 6, 2001). The provisions of the bill could change during the legislative process. For example, the bill's sponsors expect that the provisions on state and local tax exemption and the ability of states to use federal funds for their matching contributions, summarized below, will be removed.

## Enclosure I

consideration of the return on investment, the leveraging of funds, cost effectiveness, safety and mobility improvements, and feasibility.

- For certain projects, Amtrak must enter into agreements on the scope and the estimated cost of the projects and their impact on freight capacity with the freight railroads whose properties are to be improved by the projects.

### **State Contributions to Redeem the Bonds**

- A state whose high-speed rail project is to be funded with bond proceeds must contribute at least 20 percent of the project's cost. This contribution is to be held in a trust account and used, along with investment earnings on bond proceeds and other earnings, to redeem the bonds issued for the project. Excess state contributions must be used to fund other projects or redeem other qualified Amtrak bonds.
- States may use federal funds, including amounts made available from the Highway Trust Fund, for their contributions, as well as the value of land contributed for a high-speed rail right-of-way.

### **Oversight of the Use of Bond Funds**


- The Internal Revenue Service determines whether amounts claimed as tax credits qualify under S. 250. If a bond issued under the act ceases to be a qualified Amtrak bond in any 1 year, Amtrak must repay the amounts allowed as tax credits for that year plus amounts allowed for the preceding 2 years (plus interest). If Amtrak fails to repay these amounts, the bondholders become liable.
- The Secretary of the Treasury is to report annually to the Congress on whether amounts in the trust account are sufficient to repay the bonds.
- Amtrak is required to contract for an annual independent assessment of the costs and the benefits of the projects undertaken, including an assessment of the corporation's investment evaluation process.

### **Other Provisions**

- Freight railroads are not liable for taxes and fees imposed by the Internal Revenue Code or by any state or local government with respect to the acquisition, improvement, or ownership of (1) personal or real property funded by the proceeds of the bonds or any state or local bond or revenues or income from such acquisition, improvement, or ownership and (2) rail lines in designated high-speed rail corridors that are leased by Amtrak.



**Financial and Oversight Issues Associated  
With the High-Speed Rail Investment Act of 2001**




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**High-Speed Rail Investment Act  
of 2001 (S. 250)**

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**Objectives**


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To assess

- the total cost of the proposed financing mechanism;
- the cost of the proposed financing mechanism as compared to a grant program funded by annual appropriations;
- the degree to which \$12 billion would meet the capital needs of high-speed rail projects;
- the extent of the federal oversight role;

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## Objectives

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- the financial impact of the tax exemption provisions on states;
- the financial impact of the bill on freight railroads;
- the extent to which federal funds, including highway trust fund monies, can be used for the state matching requirement; and
- the extent to which prior debt incurred by Amtrak and the states could be reimbursed or paid off.

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## Background

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S. 250 allows Amtrak to issue up to \$12 billion in tax credit bonds (\$1.2 billion each year) from 2002 through 2011. Bondholders receive a credit against their federal income taxes instead of interest payments.

With limited exceptions, bond proceeds are to be used for the acquisition, financing, or refinancing of equipment, rolling stock and other capital improvements, including station rehabilitation or construction, track or signal improvements, or the elimination of grade crossings.

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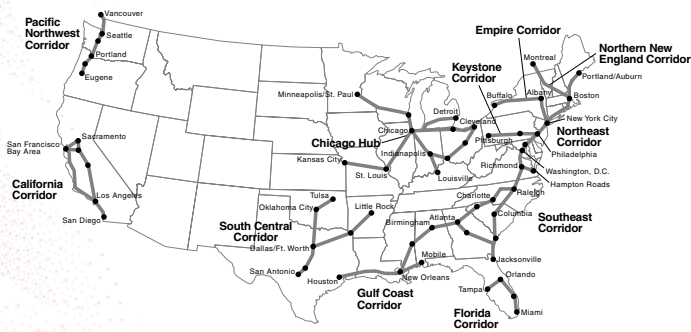
## Background


Eligible projects must be located on

- Amtrak’s Northeast Corridor,
- corridors designated by legislation or the Secretary of Transportation as high-speed corridors (see fig. 1),
- other intercity passenger rail corridors (for increasing speeds up to 90 miles per hour), and
- the Alaska Railroad.

## Background

Figure 1: Designated High-speed Rail Corridors and Amtrak’s Northeast Corridor





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## Background

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With the exception of projects for the Alaska Railroad, participating states must contribute at least 20 percent of the cost of the project to be financed with bond proceeds. These contributions, along with investment earnings on bond proceeds and earnings on these amounts, are to be held in a trust account by an independent trustee and used to redeem the bonds.

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## Valuing the Costs of the 30-Year Bond Program


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Federal budget numbers are stated in “nominal” dollars, meaning that no distinction is made between dollars spent (or received) today and dollars spent (or received) in future years.

However, costs of long-term programs should be compared in present value terms. A present value computation adjusts the value of dollars spent (or received) in future years to make them comparable to dollars spent (or received) today.

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## Valuing Costs


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For example, current interest rates on long-term bonds indicate that, to the government and investors, the present value of a dollar to be spent 30 years from now is less than 25 cents. As a result, those dollars should not be treated as equivalent to dollars spent today, or in the next few years.

Among other things, this adjustment is important when comparing the costs of a program that extends over 30 years, such as the S. 250 bond program, with a program under which the costs to the government occur much sooner, such as one funded with annual appropriations.

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## Tax Credit Bond Program Estimated to Cost More Than \$16 Billion


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We estimate that over the 30-year life span of the bond program the Treasury would forgo revenues amounting to between \$16.6 billion and \$19.1 billion in nominal dollars (between \$7.7 billion and \$10 billion in present value) due to the tax credits.

- The size of this loss will depend on future interest rates, which will determine the amounts of the tax credits.

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## Cost of the Bond Program


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The Treasury could incur an additional revenue loss if states increased their tax exempt borrowing to finance their matching contributions. We estimate that this loss would be less than \$1 billion in nominal dollars (less than \$0.6 billion in present value).

- If states do not issue additional tax exempt bonds, there would be no additional loss.

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## Cost of the Bond Program

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The Treasury would incur a further revenue loss if Amtrak used its accumulated losses to offset the taxable earnings of the trust account. We estimate that if Amtrak's entire accumulated losses to date (in excess of \$5 billion) were used to offset these earnings, the additional revenue loss could be as much as \$0.4 billion in nominal dollars (\$0.6 billion in present value), depending on:

- the size of the account's earnings;
- the extent to which money in the account would have earned a taxable return elsewhere, in the absence of S. 250.

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## Cost of the Bond Program

If in the future Amtrak accumulates additional losses that can only be used to offset income of the trust account, then the additional revenue cost to the Treasury could be greater.

However, if future federal subsidies are treated as taxable income to Amtrak and these subsidies are large enough to make Amtrak profitable, then this additional revenue loss may not occur and there may even be a revenue offset to the federal costs.

- Amtrak's most recent financial statement notes that (in the absence of S. 250) it is unlikely to be able to use its accumulated losses.

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## Appropriations Could Be Less Costly Than the Bond Program

We estimate that the tax credit bonds could cost the Treasury from \$0.4 billion to over \$3 billion more than a grant program funded through annual appropriations (in present value). Annual appropriations are typically the mechanism used to fund Amtrak's capital improvements.

- As discussed earlier, the cost of the bond program could be as low as \$7.7 billion in present value.

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## Appropriations

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- We estimate that the Congress could provide the same amount of funding for high-speed rail through annual appropriations, at a cost as low as \$7.3 billion in present value--or \$0.4 billion less than the lower estimate of the bond program. (We assume that state contributions would remain the same as under S. 250.)
- Also as discussed earlier, the cost of the bond program could exceed \$11.2 billion in present value if (1) future interest rates are higher than current projections; (2) states finance all of their contributions with additional tax exempt bonds; and (3) Amtrak uses at least \$5 billion of (otherwise unusable) accumulated losses to offset the income of the fund.

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## Appropriations


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- Using the same assumptions about the financing of state contributions for the higher bond program estimate, we estimate that providing the same amount of funding through annual appropriations (with state contributions) could cost as much as \$8.2 billion in present value--or \$3 billion less than the higher estimate for the bond program.

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## Appropriations


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Amtrak believes that the appropriate comparison would be another guaranteed funding source (e.g., appropriating about \$7 billion at one time, which could be invested and used as a sinking fund, with state contributions the same as under S. 250).

- We estimate that the cost of this sinking fund alternative would be between about \$7 billion and \$8.3 billion (in present value terms) depending on assumptions relating to the rate of return earned by the fund, the states' issuance of tax-exempt bonds to finance their contributions, and Amtrak's ability to offset the fund's earnings with its tax losses.

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## Appropriations

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- We estimate that the bond program would cost the Treasury at least \$700 million more and could cost over \$2.9 billion more than Amtrak's sinking fund approach in present value terms.

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## Appropriations


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Both the bond program and the appropriations alternative would provide about \$12 billion in funding for high-speed rail (worth between \$9.1 billion and \$9.6 billion in present value).

- The exact amount of money provided for high-speed rail projects through the bond program depends on (1) bond-issuance costs and (2) whether the bonds will be sold at, above, or below par value.

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## Appropriations


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Financing through the tax code can be a means of achieving certain federal objectives. However, several budgetary implications arise from adopting this approach.

- Using S. 250's funding mechanism, high-speed rail is funded without competing for resources within the appropriations process. (Funding high-speed rail through the appropriations process could result in lower spending for other discretionary programs.)
- Under the Budget Enforcement Act, other entitlement spending would have to be cut or taxes increased if S. 250 is enacted. If the rules are waived, the surplus would be lower.

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## Appropriations

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- Once enacted, programs funded through the tax code typically receive less scrutiny than those that receive annual appropriations.

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## \$12 Billion Will Not Meet the Capital Needs of High-Speed Rail Corridors

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Estimates of the total capital costs are incomplete because of the status and changing nature of the federally designated corridor initiatives.

- Some of the projects identified within the designated corridors might be cancelled or might be altered.
- Some states within existing corridors do not have an estimate of their capital costs. For example, four of the states we contacted could not provide us with an estimate because they had just begun planning.
- Some states have said their estimates of capital needs may increase if additional corridors were identified.

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## Capital Needs


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Although a reliable estimate of the capital needs is not available, \$12 billion will not be enough. Amtrak's preliminary estimate to fully develop the 10 federally designated corridors and its Northeast Corridor is between \$50 billion and \$70 billion in capital over the next 20 years.

- Representatives from 16 states within the designated corridors told us they currently estimate their total capital needs at \$18.2 billion. Thirty-four states are participating in the development of high-speed rail.

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## Departments of the Treasury and Transportation Have Specified Roles

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The bill assigns specific responsibilities to the Departments of the Treasury and Transportation.

The Secretary of the Treasury monitors the use of the bonds as a financing mechanism.

- The bill requires the Secretary of the Treasury to report annually on whether or not the amount of money in Amtrak's trust fund is sufficient to pay off the issued bonds.

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## Federal Roles

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- According to Treasury and IRS officials, the bill and other provisions of the Internal Revenue Code provide them with sufficient authority to determine whether amounts claimed as tax credits qualify under S. 250.
- IRS officials told us they would have to write tax regulations for S. 250 but the 90 days provided in the bill would not be enough time.

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## Federal Roles


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The Secretary of Transportation approves projects selected by Amtrak prior to bond issuance.

- The Secretary's approval includes the Inspector General's determination that projects would be financially beneficial to Amtrak and that Amtrak's investment evaluation process includes consideration of the return on investment, leveraging of funds, cost effectiveness, safety and mobility improvements, and feasibility.

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## Federal Roles

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In approving qualified projects, the Secretary

- may give preference to projects with state matching contributions above the required 20 percent.
- shall consider regional balance for infrastructure investment and the national interest in ensuring the development of high-speed passenger rail when approving projects.

Federal Railroad Administration officials told us more specific criteria would aid the Secretary in approving projects.

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## Federal Roles


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The bill provides Amtrak with significant programmatic responsibility for the development of high-speed passenger rail.

- Amtrak officials told us they will consider the factors identified in S. 250 in selecting projects--financial benefits to Amtrak, the amount of the state match (more than 20 percent), and improvements to mobility and safety, among other things.
- Amtrak is required to contract for an annual independent assessment of the costs and the benefits of projects receiving bond financing.

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## Impact on State and Local Government Revenues Cannot Be Reliably Estimated

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S. 250 exempts railroads from certain state and local taxes. Bill sponsors expect that these provisions will be removed.

The impact of S. 250 on state and local tax revenues cannot be reliably estimated because:

- the exemptions are subject to varying interpretations,
- it is unclear how states would implement the exemptions, and
- it is unknown what property would be acquired or improved with the proceeds of the Amtrak bonds and the state or local tax exempt bonds and what rail lines would be leased by Amtrak.

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## Exemptions are Subject to Different Interpretations


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One provision of S. 250 clearly exempts railroads from state and local taxes attributable to acquisitions and improvements funded by proceeds of Amtrak bonds or state or local bonds, and from taxes otherwise due on revenues or income from the acquired or improved property.

- Under a broader (and less reasonable) interpretation, the exemption might also apply to state and local taxes on the total value of the property improved.

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## Exemptions


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A second provision of S. 250 would exempt Amtrak-leased rail lines (presumably roadbed and track) in designated corridors from state and local property taxes. The exemption would not be limited to improvements on these lines.

- Under a broader (and less reasonable) interpretation, the exemption might also apply to taxes in addition to property taxes.

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## How the Property Tax Exemption Would Be Implemented Is Unclear


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How states would value improvements of railroad property is unclear because an improvement at one location in the rail system may also be viewed as an improvement in the performance (and therefore the value) of other parts of the system.

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## Implementation


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The valuation of improvements and acquisitions would pose additional difficulties for the states that use the unitary method of property valuation (under which the total value of the railroad is determined nationwide and allocated by formulas to specific states, then to localities within the states). Thirty-nine states use this approach.

- It is not clear how these states would adjust the formulas or otherwise change the unitary method to ensure that an improvement or acquisition funded with bond proceeds is not taxed.

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## Property Tax Exemption’s Impact Would Vary by Locality and Type of Property

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Current property tax collections indicate that the revenue effect of the exemption would vary by locality and type of property.

For example:

- Revenue from the property tax on roadbed and track in the Southeast Corridor (Washington, D.C., to Richmond) ranged from a low of 0.01 percent of total property tax revenue in Fairfax County to 3.6 percent of total property tax revenue in Caroline County.
- The localities in this portion of the Southeast Corridor collected a total of \$3.1 million in property tax on railroad property, with \$1.5 million, or about 50 percent of the total, coming from the tax on the roadbed and track.

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## The Effect on Other State and Local Tax Revenues Is Unclear


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S. 250's effect on other tax revenue is unclear because

- state corporate income tax revenues will depend on how income will be attributed to the exempt railroad property,
- sales tax revenue will depend on any existing exemptions or special rates for the acquired property, and
- revenue from sales and corporate income taxes (as well as the property tax) will depend on what properties would be acquired or improved with the proceeds of the Amtrak bonds and state or local tax exempt bonds issued to support these projects and what rail lines would be leased by Amtrak.

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## The Financial Benefits to Freight Railroads Appear to Be Limited


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The freight railroads we contacted do not see large financial benefits from participating in high-speed passenger rail systems.

The bill could exempt freight railroads from certain local, state, and federal taxes. As stated previously, it is unclear how the state and local exemptions would be implemented and to what they would apply. This is also the case with the federal exemptions.

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## Freight Railroads

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- IRS and Treasury officials said it would be difficult to implement the federal tax exemption as written. Neither the bill nor existing tax laws provides guidance on how to determine the amount of income attributable to the “acquisition, improvement, or ownership of” property “funded” by Amtrak bonds. IRS would have to develop an approach for making this determination.
- Amtrak interprets the federal exemption as simply excluding any amounts paid for an acquisition or improvement from the incomes of freight railroads in the year that the acquisition or improvement occurs.

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## Freight Railroads

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- Clarification of the bill’s wording would resolve the potential differing interpretations.

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## Freight Railroads


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The four major freight railroads we contacted were unsure if tax-exemption provisions in the bill would provide significant financial benefits.

- While the railroads recognized that some tax relief could be realized from S. 250, they said the tax benefits did not appear to be significant.
- The railroads stated they were unlikely to lease additional rail lines to Amtrak, even though they could receive tax exemptions, if they had to give up train dispatching rights. Bill sponsors expect that these provisions will be removed.

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## Freight Railroads


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The freight railroads provided examples of how passenger rail could have a negative financial impact on operations including increased maintenance costs, increased equipment costs not necessary for freight operations, and reduced time available to move freight.

As a result, the freight railroads had mixed reactions about participating in high-speed passenger rail projects.

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## Freight Railroads


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Two of the railroads stated they would work with the states in further developing passenger rail service.

- One railroad stated it currently has agreements with three states to participate in passenger rail projects.
- Another railroad stated it preferred to work with states on projects that did not require it to share its track.

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## Freight Railroads


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However, the remaining two railroads were reluctant to participate in additional high-speed passenger rail projects.

- They stated there would be no room for additional passenger trains in some of their urban areas.
- One freight railroad stated it would not allow passenger trains traveling at speeds higher than 90 mph to share its right-of-way.
- The other freight railroad stated it would not enter into any passenger rail agreements unless another party assumed 100 percent of the increased maintenance costs.

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## States Can Use Federal Funds for Matching Contributions

S. 250 has two provisions that when read together would allow states to use federal funds for their matching contributions for projects on designated corridors.

- One provision prohibits states from using federal funds, including amounts made available from the Highway Trust Fund, for matching contributions required for bond issuance, subject to a specific exception.


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## Use of Federal Funds

- The exception largely defeats the prohibition. This exception appears to allow states to use federal funds for their matching contributions for projects on designated high-speed rail corridors, as well as the value of land to be contributed for right-of-way.
- Bill sponsors expect that revisions to the bill will prohibit states from using federal funds, including amounts made available from the Highway Trust Fund, for matching contributions.

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## Bond Proceeds Appear Unavailable for Prior Amtrak and State Debt

The bill implies that bond proceeds would not be available for costs or indebtedness incurred by Amtrak prior to enactment.

- The bill does not explicitly prohibit Amtrak from using the bond proceeds for prior debts, except in connection with refinancing. However, the general principle against retroactive application of statutes, together with the bill's language and purpose, support this interpretation.
- An explicit provision on the issue would remove any doubt.


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## Prior Debt

- In addition, while the bill implies that bond proceeds are to be invested, it does not expressly direct Amtrak to make investments (or specify the types of investments), segregate bond proceeds from other funds, or separately account for these amounts. An explicit provision covering the treatment and use of bond proceeds between the date of receipt and expenditure for qualified projects would help to eliminate the possibility that bond proceeds would be available to Amtrak for other purposes, including prior debt.

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## Prior Debt


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The bill similarly suggests that bond proceeds would not be available to states for costs incurred prior to enactment for reasons like those applicable to Amtrak.

- Bond proceeds would clearly be available for state costs incurred after enactment but prior to bond issuance to fulfill statutory requirements necessary for project implementation.
- Amtrak believes that proceeds would be available to states for costs incurred prior to enactment to fulfill such statutory requirements.
- An explicit provision on this issue would eliminate the lack of clarity.

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## Observations

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In March 2001, we testified that a number of benefits to the public--such as reducing congestion and increasing travel choices--have been attributed to high-speed passenger rail systems. These claimed benefits need to be realistically examined to guide the Congress in its decisions over potentially large funding of such systems.

The bill provides DOT's Inspector General with a programmatic role--determining that selected projects would be financially beneficial to Amtrak. This role may affect the IG's independence in auditing the bond program.

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## Observations

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The bill provides that projects to be funded with Amtrak bonds are to be expected to result in positive financial contributions to Amtrak. However, those projects that might make the greatest contributions to national transportation goals may not necessarily make the greatest (or any) financial contribution to Amtrak and vice versa.

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## Observations


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Several uncertainties are associated with this funding mechanism.

- The bonds might generate more (less) than the expected amounts for high-speed rail projects if the bonds are issued at a premium (discount). It is not known whether any premiums or discounts would be significant.
- Project costs could grow beyond bond proceeds.

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## Observations


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- There are reasonable scenarios where the amount of money in the trust fund would be sufficient to repay the bonds' principal. Under other scenarios, the amount in the trust fund would not be sufficient. If the amount in the trust fund is insufficient to repay the bonds' principal, the federal government could be asked to honor Amtrak's obligation to the bond holders, despite the absence of a federal guarantee.

Investors may be reluctant to purchase bonds until IRS issues its regulations. This could delay the start of the bond program.

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## Scope and Methodology

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- Interviewed officials from Amtrak, IRS, the Treasury, FRA and DOT's Office of Inspector General.
- Interviewed representatives from four major freight railroads,
- Obtained capital estimates from representatives of 20 states within the federally designated corridors. We did not review or verify these estimates.
- Reviewed S. 250, Amtrak's 2001 capital and finance plan, FRA reports on high-speed rail, and selected state passenger rail improvement plans.

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## Scope and Methodology Cont.

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- Estimated total cost to Treasury under a number of plausible assumptions.
- Interviewed tax officials from 5 states and obtained property tax data on railroad property.

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### **Methodology for Estimating the Cost of the Bond Program and Annual Appropriations as an Alternative**

We estimated three separate components of the potential revenue loss to the Treasury as a result of the bond financing program that S. 250 would establish. The predominant cost of the program would be the tax credits that Treasury would give to bond purchasers in lieu of interest payments from the bond issuer. Smaller additional revenue losses could also arise from the issuance of tax-exempt bonds by state governments to finance their matching contributions and Amtrak's use of accumulated operating losses to offset income generated by the trust account that would be used to pay off the bonds. We also estimate the costs of a hypothetical alternative grant program funded and a sinking fund arrangement, both funded by annual appropriations which would provide the same amount of money for high-speed rail projects as S. 250. We computed all of our estimates in both nominal dollars and present values.<sup>10</sup>

#### **The Cost of the Tax Credits**

We estimated the amounts of credits that the Treasury would pay by obtaining projections of the future rates of credit and then multiplying these rates by the amount of bonds that we assumed would be outstanding each year. S. 250 sets the rate of credit on the Amtrak bonds equal to "an average market yield (as of the day before the date of sale of the issue) on outstanding long-term corporate debt obligations." A Treasury official told us that the credit rate would likely be set equal to an average of the corporate AA 20-year bond rate. To get projections of this average rate, we obtained the latest AAA corporate bond projections from the Congressional Budget Office and adjusted these projections for the historical difference between AAA corporate bond rates and AA corporate bond rates. Given the uncertainty surrounding future interest rates, we computed alternative estimates using interest rates that were 0.5 percentage points above and below this adjusted projection. Our computation of the number of bonds outstanding in each of the next 30 years is based on the assumptions that (1) Amtrak would issue bonds up to the full limit and (2) Amtrak would use the longest allowable term for each issue—20 years.<sup>11</sup>

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<sup>10</sup>The discount rate that we used for our present value computations is the interest rate on Treasury debt with a maturity that is equal to the length of the stream of benefits/costs of the activity being examined. Given that these rates change from year to year, we computed alternative estimates using discount rates that were 0.5 percentage points above and below the relevant interest rates.

<sup>11</sup>To reflect normal start-up delays, we assume that only one-fourth of the annual limit would be reached in the first fiscal year that the bonds were allowed. The remainder of the limit would be reached in the following fiscal year. For each of the next nine annual tranches of issuance authority, we assume that half of the limit would be reached in the first fiscal year and the remainder of the limit would be reached in the following year.

### **Potential Cost of Additional Tax-Exempt Financing**

To estimate a likely upper bound for any revenue loss that would occur if states financed their matching contributions by issuing tax-exempt bonds, we used the following assumptions:

- States would issue \$2.4 billion of tax-exempt bonds (that they would not otherwise have issued) over a 10-year period and that each bond would have a 20-year term.
- If the new tax-exempt bonds were not available to investors, those investors would have purchased assets yielding an 8-percent taxable rate of return. This rate is approximately equal to the upper bound projections we use for the corporate bond rate.
- The average marginal tax rate of the bond purchasers is 31 percent.<sup>12</sup>

The loss to Treasury is equal to the tax rate multiplied by the taxable return that the investors otherwise would have earned.

### **Potential Cost Associated With the Use of Amtrak's Accumulated Losses**

State matching contributions and Amtrak's earnings from the temporary investment of unspent bond proceeds are to be placed in a trust account. Amtrak intends to offset the income of the trust account with accumulated and future net operating losses, thereby avoiding the payment of tax on that income. In the absence of S. 250, the money in the trust account might be held by private sector investors who would earn a taxable return on those funds. This shifting of funds from taxable investments into a tax-sheltered investment would result in a revenue loss to the Treasury equal to the difference between any tax that Amtrak might pay on fund earnings and the amount of tax that otherwise would have been paid by the private investors.

The size of the revenue loss would depend on three factors:

1. the extent to which Amtrak has losses available to use that (in the absence of S. 250) it would not otherwise be able to use;<sup>13</sup>
2. the extent to which the money placed in the trust account is obtained from the private sector, where it would otherwise be earning a taxable return;<sup>14</sup> and
3. the amount of earnings that the trust account generates.

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<sup>12</sup>Purchasers of tax-exempt bonds tend to be in higher income tax brackets. Other analysts have assumed the average marginal tax rate for these bond holders to be about 28 percent. We use a slightly higher rate to ensure that our estimate is an upper bound.

<sup>13</sup>If Amtrak could use the losses even without S. 250, then the bill would not result in an additional loss for the Treasury.

<sup>14</sup>If states were to finance their contributions by cutting back on other spending that they would have done, rather than by raising taxes or borrowing, then those contributions would not take money out of the private sector.

## Enclosure III

To estimate a likely upper bound for the revenue loss that could occur if Amtrak had \$5 billion in tax losses that it otherwise could not use,<sup>15</sup> we assumed the following:

- State contributions would equal 25 percent of bond proceeds (because Amtrak expects that states will contribute more than the minimum match).
- All of these contributions would be obtained by taxing or borrowing money from private individuals whose average marginal tax rates are 31 percent.
- For each issue of bonds, 90 percent of the proceeds would remain unspent in the first year, and this amount gradually would be reduced to zero by the end of the sixth year. Amtrak assumes that a maximum of 20 percent of the bond funds would be spent in the first year and not more than 40 percent in the next year. In this upper-bound scenario, we estimate what would happen if Amtrak were to generate higher earnings for the trust account by spending the bond proceeds more slowly.
- The funds in the account would earn an annual rate of return slightly over 6 percent, which we assume is the same return that the private sector investors would have earned in the absence of S. 250.<sup>16</sup>

We computed how much tax would be paid on the investible funds under these assumptions if S. 250 were adopted and how much would be paid if S. 250 were not adopted. The revenue loss to Treasury equals the difference between the two amounts.

### **Cost of the Alternative Grant Program**

To estimate the present value cost of the grant program funded by annual appropriations, we assumed that the timing of the grant payments would be the same as the timing of the bond issues. We then applied the discount rates identified above.

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<sup>15</sup>Amtrak's latest financial statement notes that, as of the September 30, 2000, the company had accumulated over \$5 billion in net operating losses, which it does not expect to use (in the absence of S. 250). Prior to 1998, Amtrak issued preferred stock to the Department of Transportation in amounts equal to all federal operating subsidies and most federal capital subsidies that it received. For this reason, Amtrak's accounts did not treat these subsidies as income. The Amtrak Reform and Accountability Act of 1997 established that Amtrak would no longer issue preferred stock in exchange for federal grants. If future federal subsidies are treated as taxable income to Amtrak and these subsidies were large enough to offset future operating losses, including depreciation, then Amtrak would not accumulate further losses for tax purposes.

<sup>16</sup>This is the rate of return that would maximize the loss, given the combination of other assumptions used in this scenario. A higher rate of return could reduce the revenue loss if Amtrak does not generate additional operating losses (including depreciation) in the future. This is because, once Amtrak uses up all of its losses, the income in the trust account could be subject to a 35-percent corporate tax rate, while the private sector investors are assumed to pay tax at a rate of no more than 31 percent. Amtrak would pay tax only if it actually became profitable on its own account or if the federal government subsidized it beyond the break-even point.

### **Cost of Amtrak's Sinking Fund Alternative**

To estimate the cost of Amtrak's sinking fund alternative, we calculated the size of the appropriation that would be needed to generate \$960 million of spending in each of the next 10 years, using both the 6 percent rate of return that Amtrak assumed and an 8 percent rate of return (roughly equivalent to the upper bound we use for the AA corporate bond rate). We also varied our assumption concerning Amtrak's ability to offset the income of the fund with its accumulated tax losses. One assumption was that Amtrak could offset all of the fund's earnings with its accumulated losses; the alternative assumption was that it could not offset any of the earnings.<sup>17</sup> As it turned out, varying the assumption about the accumulated losses did not have a significant effect on our results. If Amtrak were able to offset the fund's earnings, then the size of the required appropriation would be smaller; however, this benefit to the government would be offset by the additional revenue loss associated with Amtrak's use of accumulated losses that would otherwise expire. The total cost to the Treasury of the sinking fund alternative could be as low as \$7 billion if the fund could earn an 8 percent rate of return or as high as \$8.4 billion if the fund earned only a 6 percent rate of return.<sup>18</sup> The higher cost estimate includes the potential cost associated with states issuing tax-exempt bonds to finance their matching contributions.

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<sup>17</sup>The losses that Amtrak has accumulated to date would be more than sufficient to offset all of the earnings of the fund, unless Amtrak generated other significant sources of income against which the losses could be used. We used the same assumptions regarding the average tax rate of private sector investors that we used for our other revenue loss estimates.

<sup>18</sup>The lower cost estimate for the sinking fund is less than the lower cost estimate for the annual appropriations because the 8-percent rate of return is higher than the government's discount rate.

## Comments from Amtrak

NATIONAL RAILROAD PASSENGER CORPORATION  
60 Massachusetts Avenue, NE, Washington, DC 20002



June 14, 2001

Mr. John H. Anderson, Jr.  
Managing Director  
Physical and Infrastructure  
U.S. General Accounting Office  
441 G Street, NW, Room 2T23  
Washington, DC 20548

Dear Mr. Anderson:

Amtrak has reviewed the General Accounting Office's (GAO) draft report on the High Speed Rail Investment Act of 2001 (HSRIA) and appreciates the opportunity to comment formally on GAO's findings.

Generally, Amtrak concurs with many of the observations that the GAO has made about the HSRIA. There are a few areas, however, where Amtrak would evaluate the bill differently than the approach taken by the GAO in its review. In particular, Amtrak wishes to emphasize that the HSRIA is an important first step in providing seed money and building the partnerships with states, localities, and the freight railroads critical to the development of high-speed rail in the United States. High speed, intercity passenger rail will become a vital part of the nation's transportation system over the next several decades, and reliable sources of funding will be necessary in order to provide the initial stimulus for high-speed rail transportation improvements. Given the options available to policymakers, the bond mechanism provided in the HSRIA provides a viable option for the types of partnerships necessary to develop those corridors. Further, as the legislation moves through the process toward enactment, Congress will have ample opportunity to refine the criteria for the selection of high-speed rail projects to be developed and the federal oversight role in connection with these projects. Amtrak would like to further emphasize that since the introduction of S.250 in February, we have worked closely with key Senators and other interested parties to address concerns that have been raised about the bill's current language.

The GAO suggests that a comparison should be made between the costs of the HSRIA to the Federal Government and the costs of providing annual appropriations as an alternate means of financing high-speed rail investment. We believe there is general agreement that, should we as a nation make the decision to invest in high-speed rail corridors, a reliable and consistent level of capital will be needed. The question is "What is the best approach to accomplish this goal?" We agree with the GAO that to provide funding for corridor development through the annual appropriations process under the same





*Mr. John H. Anderson, Jr.  
June 14, 2001  
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timeframe and spending levels, will cost less than the HSRIA. However, it is our view that the current appropriations environment with regard to available discretionary funding for corridor development is not encouraging. The bonding mechanism does provide the opportunity to generate a considerable amount of funds in a relatively short period of time to satisfy the initial development of these corridors. Over the life of the bond program, as the GAO's report details, the total costs will be higher than if the money had been given in the form of a grant. It is important to note that the bond program, if fully implemented, will generate \$12 billion of capital investment over a ten-year period at a cost during this period to the U.S. Treasury in revenue forgone of about \$4 billion. At least in the initial stages, this is a very good return on investment. It is particularly so, both in the short and long-term, when weighed against the other benefits that will accrue from the development of these corridors. These include local economic development activity, additional mobility, and opportunities to lessen highway and airport congestion. Given the options available to us in the current environment, we believe that the HSRIA provides the most effective and reasonable approach to begin funding corridor development activities.

The GAO comments also reflect the version of the HSRIA as originally introduced on February 6, 2001. The bill, as introduced, raised some concerns that, in our view, have now been addressed. In particular, the bill, which will be considered in committee will not create any new provision for exemption from state and local taxes and will protect and will maintain the integrity of highway trust funds. The GAO comments about provisions in the February 6 bill, which created concern in these areas have been addressed.

In addition, while the bill includes criteria necessary for project selection and evaluation at all levels in the process, Congress will have ample opportunity during consideration of the bill to add or delete criteria as it may deem necessary. Given the fact that the process for consideration of the legislation has only just started, no one at Amtrak is in a position to say with absolute certainty what the criteria will be, let alone which of the final criteria will have the greatest weight during the selection of projects. Amtrak would welcome suggestions from the DOT for additional specific criteria that it feels would strengthen the project selection process and further welcome the DOT's evaluation of the public benefits to be derived from high-speed rail development.

Finally, the GAO suggests that if the amount in the trust account is inadequate to repay the bonds upon maturity, the United States Government may be asked to make up any shortfall. The obligation to repay the principal at maturity will be Amtrak's and not the United States Government. This should be sufficiently clear from the provisions of the bill as currently drafted. For instance, the bill requires that the Secretary of the Treasury must certify to Congress annually that the trust account is sufficient to repay at maturity to principal of the boards. Therefore, Amtrak believes that there is no risk that the United States Government would be legally responsible for any shortfall.

Enclosure IV



*Mr. John H. Anderson, Jr.  
June 14, 2001  
Page Three*

Again, we want to express our appreciation to GAO for soliciting our views and input to their report. We look forward to working with GAO and other interested parties as we move forward with this legislation.

Sincerely,

A handwritten signature in black ink, appearing to read "Joe McHugh". The signature is fluid and cursive, with a large loop at the beginning and a long, sweeping tail that extends downwards and to the right.

Joe McHugh  
Acting Vice President  
Government Affairs

(392007)