Fox Rothschild LLP
ATTORNEYS AT LAW

FEBRUARY 2009

INFRASTRUCTURE PRACTICE

ALERT

STIMULUS PLAN PROVIDES $2 BILLION FOR HIGH-SPEED RAIL AND MAKES TAX CHANGES TO BENEFIT PUBLIC-PRIVATE PARTNERSHIPS

By Alan F. Wohlstetter and Nevena Simidjiyska

The Senate and the House of Representatives reached a compromise on a $789 billion economic stimulus bill (the Stimulus Plan) on February 11, 2009. The Stimulus Plan includes provisions modeled after the High-Speed Rail for America Act (the Act), introduced by Senators John Kerry and Arlen Specter on November 19, 2008, to bring American rail infrastructure up-to-date with current world standards. Specifically, the Stimulus Plan provides $2 billion for rail projects related to trains reaching at least 110 miles per hour and exempts interest incurred from private activity bonds for high-speed rail from the Alternative Minimum Tax. By providing this tax incentive, the Stimulus Plan will promote public-private partnerships (P3s) between government agencies and private sector companies by giving them a financing vehicle to access the tax-exempt capital markets.

Though the Act on which the Stimulus Plan bases its high-speed rail provisions was not passed in Congress in 2008, it is expected that Senator Kerry will re-introduce the Act to Congress during its current session. The Act would supplement the Stimulus Plan to further encourage the development of high-speed passenger rail transportation in the United States by financing two types of private activity bonds – tax credit rail bonds for infrastructure and rail projects related to trains reaching at least 150 miles per hour and tax-exempt rail facility bonds for rail projects related to trains reaching at least 110 miles per hour. If passed, the Stimulus Plan and the Act will promote involvement of P3s in the development of the nation's first high-speed train system reaching speeds of over 150 miler per hour.

The Stimulus Plan

The Stimulus Plan includes two provisions modeled after the Act that finance high-speed rail development. First, the Stimulus Plan provides a $2 billion grant for high-speed rail projects that will remain available until September 30, 2011. The grant will be distributed among applicant states, interstate compacts, public agencies having responsibility for providing high-speed rail service and Amtrak for capital projects associated with inter-city passenger rail services reasonably expected to reach speeds of at least 110 miles per hour. The Secretary of Transportation will have discretion to award grants based on an extensive set of criteria, including the legal, financial and technical capacity of the applicant to carry out the project; compatibility with relevant national plans; and anticipated economic, environmental and transportation effects.

The Stimulus Plan also encourages tax-free financing for high-speed rail projects by modifying Section 142(i) of the Internal Revenue Code to allow for greater flexibility in issuing high-speed rail facilities bonds and

by providing certain tax incentives for issuing private activity bonds, including exempt facility bonds for high-speed rail projects.

Exempt facility bonds are a form of private activity bonds issued by local or state government for the purpose of financing the project of a private user. Interest on exempt facility bonds is excluded from gross income for federal income tax purposes. Section 142(i) lists "High-Speed Rail Facilities Bonds" as one type of exempt facility bonds. The Stimulus Plan redefines High-Speed Rail Facilities under Section 142(i) of the Internal Revenue Code as any inter-city passenger rail that is capable of *attaining* a maximum speed in excess of 150 miles per hour, rather than rail that *operates* at speeds in excess of 150 miles per hour as required under current law. Further, the Stimulus Plan exempts interest incurred from private activity bonds (including High-Speed Rail Facilities Bonds) issued in 2009 and 2010 from the Alternative Minimum Tax. The Stimulus Plan therefore promotes tax-exempt financing of a greater range of rail projects for private users by expanding the definition of Section 142(i) and by providing exemption from the Alternative Minimum Tax for related private activity bonds. This tax treatment – coupled with $2 billion in grants – provides an opportunity for P3s to leverage their investment while accessing the tax-exempt capital markets.

The High-Speed Rail for America Act

If not significantly changed upon reintroduction, the adoption of the Act would further encourage the development of high-speed passenger rail by creating a new category of tax credit rail bonds used to finance trains that reach speeds of at least 150 miles per hour as well as rail infrastructure. Unlike a conventional tax-exempt bond where the issuer pays interest to the bondholder, tax credit rail bonds offer the bondholder a federal tax credit instead of an interest payment. The Treasury Department sets the rate of the tax credit on a daily basis and the bondholder can deduct the amount of the tax credit from his total income tax liability. The Act would provide financing for tax credit rail bonds, which will be allocated by the Secretary of the Office of High-Speed Passenger Rail – an office the Act creates to oversee high-speed passenger rail – among projects that the Secretary determines are most appropriate for the financing. By funding tax credit rail bonds, the Act promotes private tax-advantaged investment, which will advance involvement of P3s in the development of the nation's first rail transportation projects for trains traveling at a speed of at least 150 miles per hour.

The Act would supplement the Stimulus Plan's expansion of the private sector's ability to issue exempt facility bonds for high-speed rail projects by further modifying Section 142(i) of the Internal Revenue Code. In contrast to the Stimulus Plan, the Act expands the current definition of High-Speed Rail Facilities in Section 142(i) by giving the Secretary of High-Speed Passenger Rail the discretion to determine what projects qualify for tax-exemption based on an extensive set of criteria. The Act may also redefine High-Speed Rail Facilities to further expand the definition proposed by the Stimulus Plan and to include a greater range of passenger rail projects. The Act would therefore promote tax-exempt financing of a greater range of rail projects for private users.

Benefits for P3s

Modernizing the nation's rail system through private activity bonds facilitates creation of P3s between government agencies and private sector companies by giving them a financing vehicle to access the tax-exempt capital markets. P3s expedite project completion, improve project quality through the use of innovative materials, construction techniques and management, and allow access to new sources of private capital. Providing a tax-exempt investment vehicle for such transactions should lessen the cost of capital.

Designated Corridors

If passed, the Stimulus Plan and the Act would encourage P3s to access the tax-exempt capital markets in funding high-speed inter-city passenger rail. The Federal Rail Administration already has designated rail corridors that rail facility bonds and tax credit rail bonds could help fund, including connecting the cities of the Midwest through Chicago, the cities of the Northwest, major cities within Texas and Florida, and all cities up and down the East Coast. Improvements and expansions to the Northeast, Empire and Keystone Corridors would reduce travel times between cities such as Washington, Philadelphia, Pittsburgh, New York and Boston. Development of the California high-speed rail system – a project approved by California voters on

November 5, 2008 – may lead to the creation of an 800-mile statewide 220-mile-per-hour train system. As a result of the Stimulus Plan and the involvement of P3s, such rail development across the nation would reduce travel time, nonrail traffic congestion and greenhouse gas emission, and would promote safer travel with decreased fatality rates.

For more information about this *Alert*, contact Alan Wohlstetter, chair of the Infrastructure Practice at 215.299.2834 or awohlstetter@foxrothschild.com, or Nevena Simidjiyska at 215.299.2093 or nsimidjiyska@foxrothschild.com. Visit us on the web at www.foxrothschild.com.

Fox Rothschild LLP
ATTORNEYS AT LAW