



**Regional  
Transportation  
Authority**

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October 25, 2006

The Honorable Charles E. Grassley  
Committee on Finance  
United States Senate  
219 Dirksen Senate Office Building  
Washington D.C. 20510

Dear Chairman Grassley:

The Regional Transportation Authority would appreciate the opportunity to share with you our concerns regarding the application of the newly enacted section 4965 of the Internal Revenue Code to the Regional Transportation Authority and its service operators as a result of the Regional Transportation Authority's service operators' role as a lessee in transactions commonly referred to as LILOs and SILOs.

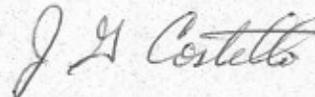
The Regional Transportation Authority is concerned that the excise tax (The Tax Increase Protection and Reconciliation Act, Section 516) may be applied retroactively to transactions that were entered into prior to the IRS issuing any guidance or stating any concern that certain transactions may be tax shelters. The Regional Transportation Authority's service operators were the lessees in several LILO and SILO transactions involving assets with an appraised fair market value of approximately \$2.2 billion. Retroactive imposition of a substantial excise tax could have a material adverse impact on the Regional Transportation Authority and its service operators' ability to serve our riding public.

The Tax Increase Protection and Reconciliation Act and its legislative history does not provide a clear definition of "proceeds." As a result, the Regional Transportation Authority is also concerned that the Treasury and the IRS have insufficient guidance in defining this term during the regulatory process and may promulgate regulations with an overly broad definition of this key term. We believe that the Senate Finance Committee has the opportunity to provide the U.S. Department of the Treasury with a clear definition of "proceeds" while the Treasury drafts the implementing regulations. Therefore, the Regional Transportation Authority asks the Committee to focus on the economics of the transaction and provide a technical clarification of the definition of proceeds that is also consistent with the position taken by the IRS in Revenue Rulings and court filings. Additionally, the Regional Transportation Authority requests that the Chairman consider adding a provision to the recently introduced Tax Technical Correction bill (H.R. 6264) that would clarify the meaning of net income and

proceeds and would provide guidance on the allocation of both net income and proceeds that is consistent with the treatment of net income and proceeds by the IRS.

Thank you for your consideration of our views. For a more detailed explanation of the issue, we have attached a copy of the Government Finance Officers Association comment letter to the Treasury Department and IRS. If you have any further questions, please feel free to contact me.

Very Truly Yours,

A handwritten signature in cursive script that reads "J G Costello".

Joseph G. Costello  
Chief Financial Officer



**Government Finance Officers Association**

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August 11, 2006

CC:PA:LDP:PR  
Notice 2006-65  
Room 5203  
Internal Revenue Service  
PO Box 7604  
Ben Franklin Station  
Washington, DC 20004

Dear Sir or Madam:

On behalf of the 16,500 members of the Government Finance Officers Association (GFOA), we appreciate the opportunity to comment on the newly created IRC Section 4965 as requested under Treasury notice 2006-65. The GFOA is a professional association of state and local government finance officers dedicated to the sound management of government financial resources. Many of our members will be impacted by these regulations.

Based on our analysis, this provision would impose an excise tax on state and local governments and their agencies that have entered into many types of transactions such as Sale In/Lease Out or Lease In/Lease Out (SILOs or LILOs) transactions prior to the date of enactment of the *Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA)* (P.L.109-222). *TIPRA* also allows a retroactive excise tax to be applied to future state and local government and governmental agency financings if they become listed transactions by the U.S. Department of the Treasury and the Internal Revenue Service.

To combat tax shelter concerns with SILO and LILO transactions, both Congress and the IRS have acted to abolish these types of transactions from occurring. This includes the 2004 *American Jobs Creation Act (JOBS)*, which eliminated the tax incentives for SILO and LILO transactions. Additionally, the U.S. Department of the Treasury issued two Revenue Rulings on this issue that curtailed these transactions - the 1999 IRS Revenue Ruling 1999-14 which disallowed the depreciation and interest deductions for LILOs and the 2002 IRS Revenue Ruling 2002-69 that listed LILO transactions as abusive tax shelters or transactions.

Despite complying with evolving standards on lease-related transactions, Section 4965 imposes a new punitive excise tax on state and local governments and their agencies that entered into these transactions in good faith before such transactions were prohibited. Additionally, many SILO and LILO transactions were entered into by transit authorities and municipalities with the encouragement and approval of the U.S. Department of Transportation. Depending on forthcoming regulatory guidance, many of the affected state and local governments and their agencies could face significant tax liabilities, in some cases in the millions of dollars, even though the proceeds of these transactions were typically invested in the capital and operating budgets of these public agencies long ago.

Beyond the retroactive application of Section 4965, we are also very concerned about its open-ended nature that will allow an excise tax to be applied to future transactions that may become listed by the Treasury and the IRS. This creates an ominous cloud over current state and local government and governmental agency financings by imposing great uncertainty regarding what could become a listed transaction in the future. While we believe Congress, the Treasury, and the IRS should do everything possible to rid the marketplace of abusive transactions, we are concerned that future application of this provision may cause unintended consequences, and disrupt the most commonly used market for the state and local government financing, the tax-exempt bond arena.

To deter unfair application of Section 4965 on state and local governments and their agencies, we would like to make the following suggestions with respect to forthcoming regulatory actions of the Department of the Treasury.

1. Retroactive application of an excise tax on transactions that were completed prior to enactment of TIPRA, should not be imposed. Due to the fact that most SILO/LILO transactions closed before the 2004 *JOBS Act*, and were done in good faith, generally adhering to U.S. Department of Transportation guidelines (*Innovative Financing Techniques for America's Transit Systems* -1998), and other accepted tax practices, Treasury should consider these transactions completed with no net income/proceeds outstanding. As was suggested at our meeting with Treasury and IRS officials on July 21, if net income and gross proceeds are defined consistently with existing Code, there is currently no project income to which the excise tax could apply. Alternatively, these transactions could simply be delisted as is the case for nearly a dozen transactions noted in *TIPRA*. Those delisted transactions were originally grandfathered in the *JOBS Act*, due to the fact that they were awaiting approval from the Department of Transportation at the time the legislation was introduced in 2003. The types of grandfathered/delisted financings are no different than the types of transactions that occurred prior to 2003, thus none of the SILO/LILO transactions that were completed prior to 2004 should be penalized by an excise tax.

2. Uniform definitions of net income and proceeds should be applied. Treasury should seek to define 'net income' and 'gross proceeds' in a manner that is consistent with current IRS Code, and reflective of the true nature of SILO/LILO transactions. Below are some technical suggestions.

#### **Net Income**

- The IRS takes the position that lessors must be taxed in accordance with the substance of the LILO/SILO transaction and such substance is (i) an up-front payment by the lessor to the lessee and (ii) a loan by the lessor to the lessee (the "Deemed Loan") in the amount that the lessee sets aside to purchase highly-rated securities (the "Equity Collateral") that defease certain obligations of the lessee under the LILO/SILO or, alternatively, in the case of a LILO, a purchase of a future leasehold interest in the leased property. The IRS takes the position that cash flows in respect of the debt financing must be disregarded as circular because the lessee uses the debt proceeds to defease the debt-portion of its obligations with an entity related to the lender.

- The lessee would have income on receipt of the up front payment in the year the LILO/SILO closes and, in the case of a SILO, income in respect of earnings on the Equity Collateral that would be offset, in timing and amount, by interest deductions attributable to the Deemed Loan throughout the term of the transaction. In the case of a LILO, the lessee would have either on-going interest income offset by an interest deduction, as is the case in SILO transactions, or, alternatively, income in the year of closing with respect to the sale of a future interest in the property. The only net income from the transaction is the Accommodation Fee received by the lessee on closing of the transaction, and under an alternative IRS argument with respect to LILOs, the payment for the future interest in the property. Under normal tax accounting rules, these up-front payments would be taken into income on closing of the transaction and would not be allocable to subsequent years. In the absence of legislative direction to apply different tax accounting principles, normal tax accounting rules should apply.

#### Proceeds

- Section 4965 and its legislative history are silent on how the "proceeds" of a transaction to which the excise tax applies are to be determined. The proper approach would be to treat the up front payment as the proceeds of the transaction. The up front payment represents the lessee's "free cash" from the transaction after payment of transaction costs and provision for the defeasance of the lessee's obligations and purchase option payment.
- Under the proceeds prong of the measure of the excise tax, the tax-exempt entity's tax for a particular year is measured by reference to "the proceeds received by the entity for the taxable year," and then only to the extent the proceeds received for that year are attributable to the transaction. The predicate to the proceeds prong is that an amount must be received by the tax-exempt entity for the year in question; if no amount is received by the tax-exempt for the year, the inquiry stops: no tax is imposed under the proceeds prong. In the context of LILO/SILO transactions, no amounts are received by the lessee for any year, other than the year the transactions closed.

Additionally, creating uniform definitions will also assist the Department of the Treasury with their workload by not having to produce new regulations every time a listed transaction is established.

3. Future application of Section 4965 should only be applied prospectively. Procedures should be developed regarding how the Section would apply to future transactions. This includes creating a procedure so that the excise tax is not automatically applied to newly listed transactions. Instead, penalties should only be applied prospectively to transactions or at the very least, state and local governments and their agencies should be able to provide comments on the newly listed transactions and then only in extreme circumstances have the excise tax apply to these transactions in a retroactive manner. An independent judicial review mechanism should also be sought.

4. Section 4965 should not apply to tax-exempt bond transactions. A regime for compliance in the tax-exempt bond marketplace currently exists at the IRS. This includes the relatively recently (1999) created "Tax-Exempt Bond Office" which focuses solely on tax-exempt bond transactions with an emphasis on abusive practices. It is unlikely that Congress intended the Section to apply to tax-exempt bond financings, and it unduly places the potential for substantially greater penalties to be imposed upon state and local governments than currently exist, or that are in line with possible purported abuses. State and local governments and their agencies have little recourse in the tax-exempt bond audit program, because

of a lack of independent judicial review, which is a problem in and of itself, without the further added threat of an excise tax penalty regime being imposed upon the same transaction, again without an independent judicial review mechanism.

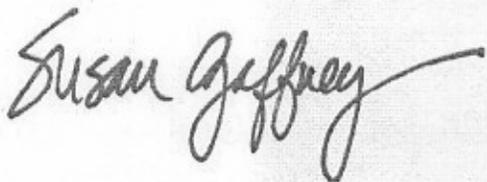
5. Guidance is needed with respect to the disclosure requirements in Section 4965. While the Section requires state and local governments and governmental agencies to disclose existing transactions, the legislative language does not provide for the specific timing and form such disclosure must be made ("in such form and manner and such time as determined by the Secretary."). Ample time and guidance should be provided for governments to fulfill this requirement, and Treasury should consider exempting the disclosure requirement from applying to transactions where there is no current income or proceeds subject to the excise tax.

#### Conclusion

We are very concerned with the application of Section 4965 on state and local governments and governmental authorities. This provision from *TIPRA* creates a turning point in long standing federal/state/local government relations, by having a federal excise tax imposed upon state and local governments in the manner of a penalty, specifically in a retroactive manner. Many governments entered into LILO and SILO transactions from the late 1990's through 2004, most with the approval of the U.S. Department of Transportation. Having these past transactions now taxed is an unfair application of the penalty, and could cost state and local governments and agencies millions of dollars even though the proceeds of these transactions were generally spent at the time the transactions were closed on public infrastructure and services. By creating an atmosphere where an excise tax can be applied to governments and agencies at any time in the future on transactions that occur in the past, the ability of governments to enter into financing transactions will be undermined and become more costly, as tax lawyers strive to protect the transactions from possible – and currently undefined - tax exposure. Clear guidance from Treasury is imperative in order for governments to continue to provide the essential infrastructure and services that the public demands.

Thank you for the opportunity to comment on the forthcoming guidance.

Sincerely,

A handwritten signature in cursive script that reads "Susan Gaffney". The signature is written in black ink on a light-colored background.

Susan Gaffney  
Director, Federal Liaison Center