



For Immediate Release
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**Floor Statement of Senator Max Baucus (D-Mont.)
Regarding the SILO Tax Shelter Provision in the Auto Industry Financing and
Restructuring Bill**

Mr. President, the bill before us contains a provision that causes me great concern. The provision would make the U.S. Government an active participant in an abusive tax shelter transaction.

In the past, Congress has voted to shut that tax shelter down. And this week, I sought to offer an amendment to strike the provision from this bill. But I have been prevented from offering that amendment. That this provision will remain in the bill makes this bill a far less attractive measure.

Section 18 of the bill requires the United States to serve as a guarantor of obligations incurred by domestic subway and other transportation systems. These obligations arise from the systems' participation in leasing arrangements called Lease In/Lease Out, or LILOs, and Sale In/Lease Out, or SILOs.

LILOs and SILOs are sham transactions. The IRS has designated them as "listed" tax shelters. That means that these tax shelters are among the most egregious abuses of the tax law.

LILOs and SILOs are very complicated deals, designed to look like legitimate leasing transactions. But in reality, they are shams.

In a SILO, a tax-exempt entity nominally "sells" an asset, like a subway system. The other party to the deal is an investor who is subject to taxation and who needs a tax write-off. The investor nominally "buys" the asset. The investor then nominally "leases" the asset back to the tax-exempt entity.

In truth, the benefits and burdens of ownership never shift. And the sale and the lease have no economic reality.

These parties purport to make purchase payments and rent payments. But in reality, these payments are just paper entries, facilitated by a bank that is in on the deal. The investor pays the tax exempt entity an up-front fee in exchange for its willingness to participate in the deal. But other than that, no real money changes hands.

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There is little, if any, risk to any party to these transactions. That's because the deal is cooked from the beginning. It's planned so as to eliminate any risk.

But there are significant tax benefits to the investor. The investor gets interest and depreciation deductions. And those deductions generate tax losses. Employing these tax losses, the investor pays less tax on income that the investor earns elsewhere.

This chart illustrates how a SILO transaction works. You don't have to understand all the details to see how complicated the transaction is.

As Chairman of the Finance Committee, I have had these deals on my radar screen for quite some time. In 2003, the Finance Committee held a hearing with a confidential informant. The witness risked his professional reputation to tell us how abusive LILO and SILO transactions are.

I pushed for legislation to shut these deals down. The 2004 Jobs Act eliminated the tax benefits for most of the investors who had entered into these transactions.

Since 2005, I have worked to shut down the remaining deals that the Jobs Act failed to address. Unfortunately, our efforts have met with resistance. Some argue that shutting down these transactions would be applying law retroactively. But I believe that these transactions always violated the law, as they lack any economic substance.

In the Tax Increase Prevention and Reconciliation Act of 2005, Congress imposed excise taxes on tax-exempt entities and their managers who entered into tax shelter transactions. That law recognized the role that some tax exempt entities, including transit agencies, played as "accommodating parties" to tax shelter deals.

Since 1999, the IRS has devoted considerable resources to shutting down these deals. The IRS has designated both LILOs and SILOs as "listed" tax shelter transactions. The IRS has audited every one of these transactions that it could find. The IRS has litigated four cases, and won every time. Recently, the IRS announced a settlement initiative to shut down the remaining cases and reports an 80 percent participation rate.

We have been trying to stop these tax shelters for years. So how does the Government end up guaranteeing this kind of tax shelter? The complicated structure of LILOs and SILOs plays a part.

Under the terms of the agreements, transit agencies are required to obtain a guarantee from an insurer. The insurer guarantees that the agencies will be able to buy back the subway at the end of the lease period. The agreements require that the insurer have a very high credit rating.

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The current economic crisis has caused downgrades of insurers' credit ratings. That has put the tax-exempt entities into technical default on their agreements. Under the agreements, when the tax-exempt entities default, the investors have a right to terminate the lease.

The investors are taking advantage of this legal opportunity. They are trying to cash in. The investors are attempting not just to recoup the nominal purchase price of the assets. They are also demanding that the transit agencies pay over the value of the tax benefits that the investor will lose as a result of the premature unwinding of the deal. The value of the tax benefits can be many times the putative purchase price.

This chart that I referred to earlier is an exhibit from a lawsuit, Hoosier Energy v. John Hancock Life Insurance. In that case, the Monroe County Circuit Court in Indiana issued a temporary injunction barring John Hancock from collecting on the technical default.

Transit agencies do not have lots of excess money just sitting around. So they have come to the Congress asking for a guarantee from the U.S. Government.

Now I do not want our nation's subway systems to be at risk. I am open to considering ways to help keep them financially sound.

But I am unwilling to do so at the expense of American taxpayers. The bill before us today asks taxpayers to put their tax dollars at risk. The bill asks taxpayers to guarantee transit agencies who knowingly and willfully entered into deals that had no economic substance and were designed for the sole purpose of avoiding taxes.

The Government has come under much criticism for actions it has taken to jump-start our economy. Deliberately involving the U.S. Government in a tax shelter scam would add fuel to that fire.

We must not add legitimacy to an abusive transaction that the Congress, the courts, the Treasury, and the IRS have spent years trying to shut down.

We must not undermine the good efforts of the IRS to prosecute these cases. We need the IRS to accomplish as much work as it can to eliminate these and other scams.

We must not ask American taxpayers who struggle to pay their taxes to underwrite deals set up to help wealthy investors attempting to shelter their income.

The approach in the bill before us today is not a solution. Stepping in to guarantee these deals exposes American taxpayers to ongoing risk. Some event could trigger a requirement that the Government pay the investors. This bill puts taxpayers on the hook for a long time.

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In addition, I understand that this proposal applies to only 80 percent of the transit agencies that entered into these tax shelter deals. What about the other 20 percent of the systems who are not covered? What happens to them? We need a fair and balanced approach to resolve this issue.

We would do better to figure out a way to discourage investors from acting on the technical default simply because the insurer's credit rating has been downgraded. A downgrade does not mean that the insurer is not good for the money. I intend to explore options with this goal in mind. We need a solution that protects both the transit agencies and the American taxpayer.

Finally, this is an auto bill. We should not forfeit the opportunity to bolster our automotive industry by cluttering up the bill with unrelated and controversial proposals.

There is a proper time and place for everything. This is neither the time nor the place to divert attention from our immediate task — helping our automakers.

This provision has no business in the auto bill. The Senate should take the provision out. And if the Senate does not take the provision out, it will only add to the burdens that are weighing this bill down.

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