Calendar No. 225

104TH CONGRESS, 1st Session — SENATE — REPORT 104–168

INTERCITY PASSENGER RAIL ACT OF 1995

NOVEMBER 3, 1995.—Ordered to be printed

Mr. ROTH, from the Committee on Finance,
submitted the following

REPORT

[To accompany S. 1395]

The Committee on Finance, reported an original bill (S. 1395) to amend the Internal Revenue Code of 1986 to provide for the establishment of an intercity passenger rail trust fund, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

CONTENTS

I. LEGISLATIVE BACKGROUND AND SUMMARY

A. LEGISLATIVE BACKGROUND

The Committee on Finance marked up an original bill (the "Intercity Passenger Rail Act of 1995") on November 2, 1995, and ordered the bill favorably reported by voice vote.

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In a related legislative matter, the Committee marked up S. 1318 (the "Amtrak and Local Rail Revitalization Act of 1995") on November 2, 1995, and ordered S. 1318 favorably reported by striking Title X (revenue provisions).

B. SUMMARY

The bill includes provisions relating to (1) establishment of a new Intercity Passenger Rail Trust Fund ("Rail Trust Fund") funded by revenues attributable to 0.5 cent per gallon of the highway motor fuels taxes and (2) disallowance of interest deductions on corporate-owned life insurance policy loans. (The latter provision is the same as included in the Senate-passed amendment to H.R. 2491.)

II. EXPLANATION OF THE BILL

A. ESTABLISHMENT OF INTERCITY PASSENGER RAIL TRUST FUND AND TRANSFER OF MOTOR FUELS TAX REVENUES (SEC. 2 OF THE BILL AND NEW SEC. 9512 OF THE CODE)

Present Law

Present law imposes Federal excise taxes totaling 18.4 cents per gallon on gasoline and special motor fuels and 24.4 cents per gallon on diesel fuel. These taxes are comprised of multiple component rates, part of which are dedicated to financing Federal trust fund programs. In general, component tax rates that fund Federal trust fund programs are only imposed on transportation uses that benefit from the programs. A 4.3-cents-per-gallon rate (5.55 cents per gallon in the case of rail) is imposed as a general revenue deficit reduction tax. This deficit reduction component rate applies generally to all transportation modes subject to any other component rate.

In general, the gasoline, special motor fuels, and diesel fuel excise taxes do not apply to non-transportation uses of these fuels. Off-highway business uses are included within this exemption: uses such as on-farm equipment operation and operation of other off-highway business equipment such as oil-drilling equipment. Use as heating oil also is exempt. (Most fuel commonly referred to as heating oil is diesel fuel.) The tax also does not apply to fuel used by State and local governments, to exported fuels, and to fuel used in commercial shipping other than in the inland waterway system). Fuel used by intercity buses is partially exempt from the diesel fuel tax.

The Federal Highway Trust Fund is financed with 14 cents per gallon of the gasoline and special motor fuels taxes attributable to highway motor vehicle use and 20 cents per gallon of those diesel fuel tax revenues.[1] The Highway Trust Fund program consists of two parts, funded through separate accounts within the Trust Fund: a highway program funded through the Highway Account and a mass transit program funded through the Mass Transit Account. Two cents per gallon of the fuels tax revenues dedicated to

[1] The Highway Trust Fund also receives revenues from certain other excise taxes imposed primarily on heavy trucks. These revenues are deposited in the Highway Account of the Highway Trust Fund.

the Highway Trust Fund are deposited in the Mass Transit Account; the balance of these revenues go to the Highway Account.[2]

Spending from the Highway Trust Fund is classified as domestic discretionary spending under the Budget Enforcement Act, and thereby subject to annual appropriation.

Explanation of Provision

The bill establishes a new Intercity Passenger Rail Trust Fund (the "Rail Trust Fund") in the Trust Fund Code of the Internal Revenue Code. This Rail Trust Fund will be funded by revenues attributable to 0.5 cent per gallon of the excise taxes imposed on gasoline, special motor fuel, and diesel fuel used in highway motor vehicles. These revenues are deposited in the Highway Trust Fund's Mass Transit Account under present law.

The Rail Trust Fund will receive these revenues only during the period January 1, 1996, through September 30, 2000. Taxes imposed on fuel before and after these dates will continue to be dedicated to the Highway Trust Fund's Mass Transit Account. In addition, revenues will not be deposited in the Rail Trust Fund during any fiscal year to the extent that the deposit is estimated to result in available revenues[3] in the Mass Transit Account being insufficient to satisfy that year's estimated appropriation levels.

Monies in the Rail Trust Fund generally will be available to the Secretary of Transportation, to fund, on a reimbursement basis, capital expenditures incurred by the National Rail Passenger Corporation ("Amtrak"). However, an amount equal to one percent of each year's revenues times the number of States in which Amtrak did not provide service during the preceding year are reserved for use by those States to fund capital expenditures related to rail operations within the State. Each State qualifying for these funds will receive an equal portion of these revenues, also on a reimbursement basis by the Secretary of Transportation, for capital expenditures incurred.

Spending from the Rail Trust Fund will not be subject to annual appropriation (i.e., is classified as direct spending under the Budget Enforcement Act) up to the following amounts:

[In millions of dollars]

Fiscal year:	*Amount*
1996	131
1997	663
1998	667
1999	670
2000	672

Amounts in the Rail Trust Fund in excess of these levels will be available for expenditure subject to appropriations (i.e., are classified as discretionary domestic spending under the Budget Enforcement Act).

No later than October 1, 2000, the Secretary of the Treasury will determine the portion of the Rail Trust Fund that is required to satisfy all obligations incurred before October 1, 2000. Excess reve-

[2] Before October 1, 1995, only 1.5 cents per gallon went to Mass Transit Account.

[3] Available revenues include the beginning cash balance in the account (after provision for outlays to liquidate prior unpaid appropriated amounts) plus estimated tax revenues and interest income for the fiscal year.

nues if any, are to be transferred to the Mass Transit Account of the Highway Trust Fund.

Effective Date

The provision is effective on January 1, 1996.

B. DISALLOW INTEREST DEDUCTION FOR CORPORATE-OWNED LIFE INSURANCE (SEC. 3 OF THE BILL AND SEC. 264 OF THE CODE)

Present Law

No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup").[4] Further, an exclusion from Federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured (sec. 101(a)). The policyholder may borrow with respect to the life insurance contract without affecting these exclusions, subject to certain limitations.

The limitations on borrowing with respect to a life insurance contract under present law provide that no deduction is allowed for any interest paid or accrued on any indebtedness with respect to one or more life insurance policies owned by the taxpayer covering the life of any individual who (1) is an officer or employee of, or (2) is financially interested in, any trade or business carried on by the taxpayer to the extent that the aggregate amount of such debt with respect to policies covering the individual exceeds $50,000 (sec. 264(a)(4)).

Further, no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, endowment or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract.[5] An exception to the latter rule is provided, permitting deductibility of interest on bona fide debt that is part of such a plan, if no part of 4 of the annual premiums due during the first 7 years is paid by means of debt (the "4-out-of-7 rule") (sec. 264(c)(1)). Provided the transaction gives rise to debt for Federal income tax purposes, and provided the 4-out-of-7 rule is met,[6] a company may under present law bor-

[4] This favorable tax treatment is available only if a life insurance contract meets certain requirements designed to limit the investment character of the contract (sec. 7702). Distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income, to the extent that the amounts distributed exceed the taxpayer's basis in the contract; such distributions generally are treated first as a tax-free recovery of basis, and then as income (sec. 72(e)). In the case of a modified endowment contract, however, in general, distributions are treated as income first, loans are treated as distributions (i.e., income rather than basis recovery first), and an additional ten percent tax is imposed on the income portion of distributions made before age 59½ and in certain other circumstances (secs. 72 (e) and (v)). A modified endowment contract is a life insurance contract that does not meet a statutory "7-pay" test, i.e., generally is funded more rapidly than seven annual level premiums (sec. 7702A).

[5] The statute provides that the $50,000 limitation applies only with respect to contracts purchased after June 20, 1986. However, additional limitations are imposed on the deductibility of interest with respect to single premium contracts (sec. 264(a)(2)), and on the deductibility of premiums paid on a life insurance contract covering the life of any officer or employee or person financially interested in a trade or business of the taxpayer when the taxpayer is directly or indirectly a beneficiary under the contract (sec. 264(a)(1)).

[6] Interest deductions are disallowed if any of the disallowance rules of section 264(a)(2)–(4) apply. The disallowance rule of section 264(a)(3) is not applicable if one of the exceptions of section 264(c), such as the 4-out-of-7 rule (sec. 264(c)(1)) is satisfied. In addition to the specific disallowance rules of section 264, generally applicable principles of tax law apply.

row up to $50,000 per employee, officer, or financially interested person to purchase or carry a life insurance contract covering such a person, and is not precluded under section 264 from deducting the interest on the debt, even though the earnings inside the life insurance contract (inside buildup) are tax-free, and in fact the taxpayer has full use of the borrowed funds.

Explanation of Provision

Under the bill, subject to an exception for key person insurance, no deduction is allowed for interest paid or accrued on any indebtedness with respect to one or more life insurance policies or annuity or endowment contracts owned by the taxpayer covering any individual who is (1) an officer or employee of, or (2) financially interested in any trade or business carried on by the taxpayer, regardless of the aggregate amount of debt with respect to policies or contracts covering the individual.[7]

An exception is provided retaining present law for interest on indebtedness with respect to life insurance policies covering up to 25 key persons. A key person is an individual who is either an officer or a 20-percent owner of the taxpayer. The number of individuals that can be treated as key persons may not exceed the greater of (1) five individuals, or (2) the lesser of 5 percent of the total number of officers and employees of the taxpayer, or 25 individuals. It is intended that employees be full-time employees, for this purpose. A 20-percent owner is an individual who directly owns 20 percent or more of the total combined voting power of the corporation. If the taxpayer is not a corporation, a 20-percent owner is an individual who directly owns 20 percent or more of the capital or profits interest of the taxpayer. It is not intended that indirect ownership interests be attributed to an individual for this purpose. For determining who is a 20-percent owner, all members of a controlled group are treated as one taxpayer. The 25-person limit may be allocated among members of the controlled group as provided in regulations. In the absence of such guidance, the 25-person limit is to be allocated among members of a group in a reasonable manner. Interest paid or accrued on debt with respect to a life insurance contract covering a key person is deductible only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average—Monthly Average Corporates for each month interest is paid or accrued.

In promulgating regulations or other guidance under the provision, it is anticipated that the Treasury Department will take into account the purpose of the provision to eliminate the deduction for interest on borrowing by businesses with respect to life insurance, endowment and annuity products covering persons in whom the taxpayer has an insurable interest. For example, it is not intended that a taxpayer should be able to circumvent the purpose of the provision by borrowing under a life insurance, endowment or annuity contract with respect to a director who is not also an officer of the taxpayer.

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[7] The provision disallows the deduction for interest even if the deduction would not be disallowed under any other rule. Thus, for example, if a deduction would not be disallowed under section 264(a)(3) because the 4-out-of-7 rule is met, this provision nevertheless disallows the deduction.

Effective Date

With respect to debt incurred after December 31, 1995, no deduction is allowed for interest paid or accrued after December 31, 1995, except with respect to policies that satisfy the key person exception. In addition, as described below, a grandfather rule is provided with respect to certain interest on contracts purchased on or before June 20, 1986.

With respect to debt incurred on or before December 31, 1995, any otherwise deductible interest paid or accrued after October 13, 1995, and before January 1, 2001, is allowed to the extent the rate of interest does not exceed the lesser of (1) the borrowing rate specified in the contract as of October 13, 1995, or (2) a percentage of Moody's Corporate Bond Yield Average—Monthly Average Corporates for each month the interest is paid or accrued. For interest paid or accrued after October 13, 1995, and before January 1, 1997, the percentage of the Moody's rate is 100 percent; for interest paid or accrued in 1997, the percentage is 95 percent; for 1998, the percentage is 90 percent; for 1999, the percentage is 85 percent; for 2000, the percentage is 80 percent; and for 2001 and thereafter, the percentage is 0 percent.

Any increase in the amount of debt under the policy on or after December 31, 1995 is treated as debt incurred on or after that date, and interest on the increased amount of debt is not allowed as a deduction under the phase-in of the interest disallowance rule described in the previous paragraph. Only interest that would have been allowed as a deduction but for the amendment made by the bill is allowed under the phase-in. Thus, for example, debt that is otherwise qualified debt under a life insurance policy cannot exceed the $50,000 limit of present-law section 264(a)(4), in order for interest on the debt to be allowed as a deduction under the phase-in. As another example, interest on debt that is disallowed as a deduction under present-law section 264(a)(3) because the 4-out-of-7 rule is not satisfied (and none of the other sec. 264(c) exceptions are satisfied) is not allowed under the phase-in.

Any amount included in income during 1996, 1997, 1998, 1999, 2000 or 2001, that is received under a contract described in the proposal on the complete surrender, redemption or maturity of the contract or in full discharge of the obligation under the contract that is in the nature of a refund of the consideration paid for the contract, is includable ratably over the first four taxable years beginning with the taxable year the amount would otherwise have been includable. Utilization of this 4-year income-spreading rule does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of failure to meet the 4-out-of-7 rule. Similarly, utilization of this 4-year income-spreading rule does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract within the meaning of section 264(b)(1) (i.e., a contract in which substantially all of the premiums are paid within 4 years after the date of purchase). In addition, the lapse of a contract after October 13, 1995, due to nonpayment of premiums, does not cause interest paid or accrued prior to January 1, 2001, to be nondeductible solely by reason of causing the contract to be treated as a single premium contract within the meaning of section 264(b)(1) or by reason of failure to meet the 4-out-of-7 rule.

In the case of an insurance company, the unamortized balance of policy expenses attributable to a contract with respect to which the 4-year income-spreading treatment is allowed to the policyholder is deductible in the year in which the transaction giving rise to income-spreading occurs.

The provision generally does not apply to interest on debt with respect to contracts purchased on or before June 20, 1986 (thus continuing the effective date provision of the $50,000 limitation enacted in the 1986 Act), except that interest on such contracts paid or accrued after October 13, 1995, is allowable only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average—Monthly Average Corporates for the month the interest is paid or accrued.

Under the provision, there is no inference as to the tax treatment of interest paid or accrued under present law.

III. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the bill as reported.

ESTIMATED BUDGET EFFECTS OF FINANCE COMMITTEE BILL

[By fiscal years, in millions of dollars]

Provision	Effective	1996	1997	1998	1999	2000	2001	2002	1996–00	1996–02	1996–05
1. Transfer to the Intercity Passenger Rail Trust Fund 0.5 cents/gallon of the excise taxes on all highway motor fuels[1] [2].	1/1/96	No Revenue Effect									
2. Authorize direct spending from the Intercity Passenger Rail Trust Fund[3]	DOE	Estimate to be Provided by the Congressional Budget Office									
3. Disallow interest deduction for corporate-owned life insurance policy loans; modify treatment of deferred acquisition costs for surrendered policies.	ipoaa 10/13/95	134	372	594	802	966	1,539	2,005	2,868	6,412	12,314
Net totals		134	372	594	802	966	1,539	2,005	2,868	6,412	12,314

[1] Estimate provided by the Congressional Budget Office.

[2] Revenue transfer would apply to amounts received from January 1, 1996 through September 30, 2000. Transfer of revenues from the Mass Transit Account of the Highway Trust Fund to the Intercity Passenger Rail Trust Fund would have no revenue effect. The Congressional Budget Office has estimated that the following amounts would be transferred: 1996: 543; 1997: 736; 1998: 751; 1999: 766; 2000: 781; 2001:—; 2002:—; 1996–00: 3,577; 1996–02: 3,577; 1996–05: 3,577.

[3] The provision would provide budget authority for new direct spending of $131 million in fiscal year 1996, $663 million in fiscal year 1997, $667 million in fiscal year 1998, $670 million in fiscal year 1999, and $672 million in fiscal year 2000.

Legend for ''Effective'' column: bia=bonds issued after; ipoaa=interest paid or accrued after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. BUDGET AUTHORITY AND TAX EXPENDITURES

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the bill involves new budget authority (as direct spending) from the new Rail Trust Fund of up to $131 million in fiscal year 1996, $663 million in fiscal year 1997, $667 million in fiscal year 1998, $670 million in fiscal year 1999, and $672 million in fiscal year 2000. Amounts in the Rail Trust Fund in excess of these levels will be available for expenditure subject to appropriations (as discretionary spending).

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the bill involves no new or increased tax expenditures.

C. CONSULTATION WITH CONGRESSIONAL BUDGET OFFICE

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on this bill at the time of filing this report.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following is a listing of the votes taken during Committee markup of the bill.

Motion to report the bill

The Committee ordered the bill favorably reported by voice vote (12 Members, a quorum, were present for this voice vote).

Votes on amendments

The Committee defeated (by voice vote) an amendment by Senator Graham to redirect 2.5 cents per gallon of the Highway Trust Fund fuels tax revenue to deficit reduction.

The Committee defeated (6 yeas and 13 nays) an amendment by Senator Grassley to make the new Rail Trust Fund subject to annual appropriations. The vote was as follows:

Yeas—Dole (proxy), Grassley, Murkowski (proxy), Nickles, Gramm, and Graham.

Nays—Roth, Chafee, Hatch (proxy), Simpson (proxy), Pressler, D'Amato (proxy), Moynihan, Baucus (proxy), Pryor (proxy), Rockefeller (proxy), Breaux (proxy), Conrad, and Moseley-Braun (proxy).

V. REGULATORY IMPACT

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the bill as reported.

Impact on individuals and businesses

Section 2 of the bill establishes a new Intercity Passenger Rail Trust Fund ("Rail Trust Fund") in the Internal Revenue Code to be funded by revenues attributable to 0.5 cent per gallon of the existing excise taxes on highway motor fuels for the period January 1, 1996 through September 30, 2000. Thus, there will be no new tax impact on individuals or businesses.

Section 3 of the bill disallows a deduction for interest corporate-owned life insurance policy loans. This provision will reduce the interest deduction of some business taxpayers that borrow with respect to life insurance policies (subject to the key person exception and the phase-in rule).

Impact on personal privacy and paperwork

The bill will have no impact on personal privacy and little impact on taxpayer paperwork.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

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