



Alternative Minimum Tax on Airport Bonds

The Issue

Airports play a vital role in the economy of the United States, providing for the efficient movement of people and goods to both domestic and international destinations. In order to ensure this critical flow of commerce is not encumbered by delays or outdated facilities, airports have planned and invested in enhanced airside and landside capacity projects.

However, the sub-prime mortgage situation and resultant credit crisis have recently caused serious problems for airports and other municipal borrowers. Over the last few months, the cost of auction and variable rate debt has spiked to levels never seen before. Further, most bond insurance firms were downgraded to levels where their policies were virtually worthless. The flight of investors from these securities initially forced airports to draw down lines of credit from commercial banks but in the last few weeks even those funds have dried up or the cost of credit has doubled or tripled. While airports continue to receive partial-year Airport Improvement Program (AIP) funding, Passenger Facility Charges (PFCs) user fees and on-going revenue from aeronautical and non-aeronautical operations, airports rely heavily on the issuance of debt to provide the majority of the capital necessary to expand capacity. Not only is it virtually impossible to finance new projects, many existing airport projects are now threatened due to lack of ongoing financing.

The challenging market for airport bonds is made even more difficult by the fact that since 1986, the majority of bonds issued by airports are classified as private activity bonds (PABs), interest payments on which are subject to the Alternative Minimum Tax (AMT). This results in investors demanding an interest rate premium to compensate for the additional tax liability. Also, PABs cannot be advance refunded to take advantage of lower rates in the future. This discrimination hampers airports' ability to implement essential capacity projects and updates to keep pace with the demand for air travel and increase efficiency through the use of the latest technology.

With an increasing number of tax payers becoming subject to the AMT, the number of investors willing to directly purchase AMT airport bonds decreases significantly. Further, in the current market environment the demand for AMT bonds has dramatically decreased with investors demanding a premium of 80 basis points or more, when bonds can be sold.¹

Impact on Airports and the Traveling Public

Very few airport AMT bonds have been sold in the primary market in the last month, including airports with very favorable ratings by the credit agencies. Before that, the AMT penalty had reached 150 basis points above Municipal Market Data (MMD). As a result, an airport would face an additional \$20 million in financing costs on a \$250 million deal- costs that would be passed on to the airlines and the traveling public.

¹ Market characteristics as of the middle of November 2008

During these challenging times, airports understand they are the public face of aviation in their communities and are working hard to ensure price and service competition for their constituents and contribute to the community's economic growth. In light of the current environment, airports are taking action to increase operational efficiency to keep costs low to prevent airlines from reducing flights.

Airports Need the Same Relief as Housing

Although airports are doing all they can, there is a role for the federal government to ensure communities maintain a vital economic asset in reliable access to the national air transportation network. We encourage Congress to provide the same assistance to airports as was provided to the housing industry in July 2008 in the Housing and Economic Recovery Act of 2008 (H.R. 3221). Effective August 2008, housing bonds are now a special class of non-AMT bonds, where the interest is not subject to the AMT, but there is no advance refunding granted as in pure governmental bonds. Airports require similar relief.

Estimated Benefit to Airports

Eliminating the AMT on airport bonds would provide significant savings. While these debt service savings could provide financial relief to airports, they also translate into greater capacity to fund important safety and security projects and create jobs, by allowing the savings to support new bonds. It is essential to recognize the public good provided by an efficient air transportation system, and bonds issued in furtherance of this goal should be treated accordingly. There is no reason why these projects, most of which are eligible for some form of public financing (either AIP, PFCs or both) should not be recognized as public projects, eligible for fully tax-exempt status.

Estimated Budget Cost

While PABs under this proposal would no longer be subject to AMT, a strong argument can be made that there would be little or no loss to the U.S. Treasury from this change. The reason is that PABs are not generally held by investors subject to AMT in the first place, which is a conclusion based on interviews with bond dealers and is empirically supported by market data on the yield premium for AMT bonds. If the interest on such bonds were actually taxable to bondholders, the bonds--as fully taxable investments--would be expected to command a significantly greater taxable interest rate in order to truly offset the tax liability.

Rather, the observed differential in interest rates between governmental purpose bonds and PABs is attributable to technical supply/demand factors (more limited universe of buyers for AMT bonds for precisely this reason), not any realized tax liability to the investor. Most AMT tax liability arises from loss of deductibility of state and local taxes and personal exemptions, according to recent studies of the Joint Committee on Taxation.² Therefore, the Treasury would not actually be foregoing any meaningful volume of tax receipts by converting PABs to non-AMT status, eliminating the assignment of any related budget score.

Please contact Annie Russo (202-293-4544; arusso@aci-na.org) or Debby McElroy (202-861-8090; dmcelroy@aci-na.org).

² *Present Law and Background Relating to The Individual Alternative Minimum Tax*, Joint Committee on Taxation, May 20, 2005, JCX-37-05, p. 14.