



Tax Treatment of Airport Bonds

Airports play a vital role in the U.S. economy, providing for the efficient movement of people and goods to domestic and international markets.

In order to keep pace with anticipated growth in traffic levels, U.S. airports have invested an average of \$12 billion per year in capital improvements since 2000. Federal Airport Improvement Program (AIP) grants have contributed only about one-fifth of this \$12 billion. Because of this, airports rely heavily on the issuance of debt to provide the funds necessary to expand capacity.

As Congress continues to debate Federal Aviation Administration (FAA) reauthorization legislation, Airports Council International-North America (ACI-NA) advocates that the treatment of airport bonds be changed to governmental purpose bonds to reflect the fact that they are funding projects at public use facilities. Currently, many airport bonds are classified as private activity bonds (PABs) resulting in higher costs for airports.

Private Activity Bonds

Bonds are a significant part of airport funding. Airports rely on four primary sources of funding for the development of infrastructure: Airport bonds (58 percent); federal AIP grants (21 percent); local PFCs used on a pay-as-you-go basis (11 percent); and locally generated revenues (10 percent). More than 60 percent of airport-issued bonds are required to be sold as PABs rather than governmental purpose bonds.

While, in general, U.S. airports are operated by state, regional or local governments, many airport bonds are deemed PABs because private parties, such as commercial service airlines, are significant users of airport facilities. In addition, directly or indirectly, these airlines provide a significant share of the revenues used to repay those bonds. However, projects built with these bonds, while used by private entities, increase capacity and reduce congestion in the national airspace system. Increased capacity facilitates efficient trade and transportation, benefiting even those who do not directly access the system.

Impacts

While generally considered tax-exempt, interest paid to investors on PABs is actually subject to the Alternative Minimum Tax (AMT). This results in investors demanding an interest rate premium of 10 to 30 basis points. ACI-NA estimates that without the AMT liability on airport bonds airports can save \$748 million over the next ten years.

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 keep pace with the ever increasing demand for air travel. The inability to advance refund airport bonds prohibits airports from efficiently managing their debt and will cost an estimated \$320 to \$490

million over the next 10 years. The combined effect will result in \$1 to \$1.2 billion in added costs to airports and foregone capacity projects.

Solutions

The higher interest rates demanded of PABs and the inability to restructure debt results in an unduly high cost of capital for airports. ACI-NA proposes several administrative and legislative strategies for alleviating this problem including:

- Amending regulations so that any project that is AIP or PFC eligible would qualify for governmental bond financing.
- Amending the Internal Revenue Code to allow qualifying facilities to be financed with governmental bonds.
- Modify IRS rules so that the structure of short-term agreement with airlines is not a factor in determining the tax status of airport bonds.

ACI-NA estimates that eliminating the AMT penalty and allowing advance refunding would result in benefits to airports that are 1.9 to 3.3 times the cost to the federal budget in foregone tax receipts. 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.