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Ballard Spahr: New Rules Encourage Use of P3s.

The recently released Internal Revenue Service (IRS) rules in the final allocation and accounting regulations encourage the use of public-private partnerships (P3s). Under these rules, a private party can form a partnership with a public party and use both tax-exempt bonds and equity to finance a facility. Previously the tax rules did not permit these types of partnership structures.

What do the final regulations do?

In general, allocation and accounting rules play a role in determining whether tax-exempt bonds, including tax-exempt bonds issued to pay a portion of the capital costs of a P3, are categorized as governmental bonds or private activity bonds (PABs) under the Internal Revenue Code. Governmental bonds are bonds where the proceeds are primarily used to finance governmental functions or which are repaid with governmental funds. PABs are bonds in which the state or local government serves as a conduit, providing financing to private businesses or individuals. Regulations already exist for measuring the extent of use by a party other than a state of local government (private business use) in a bond financed facility. The existing regulations provide that if a facility is financed exclusively with tax-exempt bonds, up to 10 percent private business use generally is permitted.

Mixed-use facilities. The accounting rules are relevant when a facility being financed with tax-exempt bonds is used by both governmental users and private users (referred to as a mixed-use facility). The final regulations provide guidance on when more than 10 percent private business use of a facility can be permitted in circumstances where there is less than 100 percent tax-exempt bond financing. The final regulations provide a method to identify the portion of a mixed-use project that is governmentally used. Mixed-use financing is permitted where the financing reflects the proportionate benefit derived by the users.

P3s and the partnership piece of the final rules

In a major step forward, the final regulations permit partnerships between private and governmental partners without jeopardizing the tax-exempt status of bond-financed facilities and provide rules for measuring the use of bond-financed property by a private partner. In doing so, the IRS and U.S. Treasury Department specifically indicated that the change was made to accommodate pP3s and remove barriers to tax-exempt financing of the government's (or 501(c)(3) organization's) portion of the benefit of property used in joint ventures.

Measuring private business use. The final regulations set forth a method for measuring the private business use of a tax-exempt bond-financed property resulting from the use of the property by a partnership that includes a partner that is a nongovernmental person. The amount of the use by the private partner will be based on that partner's greatest share of the partnership items (income, gain, loss, deduction or credit) in any one-year period.

The final partnership rule is a great step forward for private parties seeking to enter into arrangements with public entities because it permits flexibility in structuring arrangements that will not jeopardize the tax-exempt status of the bonds. The need for this type of rule is evidenced both by the increased interest and the discussions regarding flexibility in structuring P3s for infrastructure projects. Moreover, the implementation of the Affordable Care Act has highlighted the need for recognition of the proportionate benefit to a governmental person or 501(c)(3) organization participating in a joint venture with private partners.

When can these regulations be applied?

The final regulations generally apply to bonds sold, and deliberate actions that occur, on or after January 25, 2016. Issuers also may elect to apply the partnership provisions and the allocation and accounting rules in whole but not in part to any bonds to which the current regulations apply.

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Attorneys in Ballard Spahr's Public Finance Group have participated in every kind of tax-exempt bond financing and have extensive experience with the rules and regulations set by the IRS and U.S. Treasury. Working closely with attorneys in Ballard Spahr's P3/Infrastructure Group, they routinely monitor and report on new developments that impact federal and state infrastructure programs related to transportation and other types of projects.