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Nossaman: Top Public Finance Attorneys Urge Regulatory Changes to Foster More P3's.

We all know how hard it is to change federal statutes these days—you need an Act of Congress and the President to sign the bill. Last week, a group of the top public finance lawyers in the US offered an approach relating to the use of tax exempt bonds that wouldn't require a change in tax statutes but instead could be accomplished through a change in the regulations relating to the so-called "private use" test. As the group pointed out in its letter to high ranking US Treasury officials, Congress itself has made it clear that Treasury had the authority to adopt other, more flexible rules.

The US is unique in the world in its use of tax exempt financing to finance a variety of infrastructure. To benefit from this source of debt capital, a project must not have private use nor can debt service be repaid from private business revenues. The issue for P3's arises because of the long-term operation and maintenance responsibilities that are a feature of many P3 contracts. Current IRS rules limit the length and method of compensation payable to a private party in a way that makes it almost impossible to effectively transfer long-term life cycle risk to the private sector. There are notable exceptions to these rules for specific types of infrastructure, such as qualified transportation facilities, airports and ports and water/wastewater facilities but in many cases there are so many requirements applicable to issuing these "private activity bonds" tax exempt financing is not available.

The question for P3's is when do long-term operation and management services and payment for these services create "private use" for purposes of the tax exempt bond rules? In the past the IRS has published somewhat prescriptive revenue procedures that describe "safe harbor" provisions for management contracts relating to the term of the contract and the manner of compensation. The problem is these "safe harbor" provisions predate the development and growth of the P3 delivery model. Over the last several years, through published notices and private letter rulings, the IRS has indicated that strict adherence to the "safe harbor" provisions may not preclude the use of tax exempt financing. Furthermore, the IRS recently published regulations relating to the allocation and accounting of revenues from a bond financed facility that recognize merely sharing these revenues with a private entity will not adversely impact the tax exempt financing for the project. And recent private letter rulings for water/wastewater facilities, solid waste disposal facilities and electrical transmission and distribution systems recognize the need for flexibility in this area. The Treasury Department released a 2014 white paper on "Expanding our Nation's Infrastructure through Innovating Financing" describing in detail the use of an availability payment contract where the public owner makes service fee payments to a private manager subject to compliance with specific performance standards and provided the facility is available for general public use.

In addition to several specific "fixes" to the "safe harbor" provisions on the term of the contract and how compensation is paid, the attorney group is proposing a general framework that focuses on the primary purpose of the project—is the arrangement designed to transfer the benefit of the lower cost of tax exempt financing to a private party or are there sufficient controls on the activities of the private party exercised by the public owner to achieve the primarily public purpose of the project.

This simple fix to the current “safe harbor” rules relating to private management contracts could go a long way to increasing the use of the P3 delivery approach for much needed public infrastructure.

Nossaman LLP – Barney A. Allison

USA December 14 2015

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