
Financing Infrastructure Through Tax Policy: Tug-Of-War With A Frayed Rope.

In Short :

The Situation: Private activity bonds are issued by or on behalf of states and local governments to finance certain private (or partially private) projects that benefit the public. Usually, interest income from bonds issued by states and local governments to finance government projects is exempt from federal income taxes.

The Development: The U.S. House tax reform bill proposes to eliminate the tax exemption for newly issued private activity bonds, while the Senate's tax bill would allow the exemption to remain.

Looking Ahead: It remains to be seen how the final tax reform measures will treat interest from government project bonds.

Recent bills on U.S. tax reform before the House and Senate have taken competing positions with respect to the tax exemption for private activity bonds ("PABs"). While the House bill would eliminate the tax exemption for newly issued PABs, the Senate proposal would retain their tax-exempt status. The ultimate outcome could have major implications for infrastructure projects, including those funded by public-private partnerships.

Public-private partnerships are a type of funding model for infrastructure projects, whereby the public partner is represented by the local, state, or national government and the private partner is typically a privately-owned business, often with an expertise that can add value and complement the overall goals of the project. There are several potential benefits of this type of partnership, such as quicker completion of projects and minimizing the debt that local governments need to take on.

Overview of Private Activity Bonds

PABs are bonds issued by or on behalf of states and local governments that finance certain private (or partially private) projects that benefit the public. Generally, the income interest from bonds issued by states and local governments to finance government projects is exempt from federal income taxes, while the income from bonds issued for the benefit of private actors and mixed public-private businesses is subject to federal income taxes. However, there is an exception for bonds issued to finance qualified private activities, such as the construction of airports, docks and wharves, high-speed intercity rail facilities, waste facilities, and mass transit. In those specific cases, states and local governments can issue bonds to finance projects owned by private or mixed private-public businesses, and the income from those bonds is currently exempt from federal income tax.

In the United States, PABs are a major source of funding used for infrastructure projects. While the Trump administration has expressed the benefits of stimulating infrastructure investment through public and private capital and made it clear that this is a key agenda item, the need for investment and upgrades in the United States is something that is widely accepted by both political parties.

Recent transportation projects such as the I-77 hot lanes in North Carolina and I-95 managed lanes in Virginia benefitted from the issuance of PABs. The competing House and Senate bills are now creating uncertainty with respect to this important financing mechanism.

Competing House and Senate Tax Proposals on Private Activity Bonds

The tax reform bill recently passed by the House would eliminate the tax exemption for PABs. The House's projected increase in revenue for eliminating this exemption is approximately $39 billion. However, this change would also essentially eliminate an important financing method used for public-private partnerships since, if enacted, interest rates for financing infrastructure projects would likely increase and the incentive for private investment in public projects would likely decrease.

The Senate tax reform bill would maintain the tax-exempt status of PABs and, therefore, preserve the incentives that private entities currently have to invest in public work projects. This aspect of the Senate plan is consistent with President Trump's pledge to attract private capital to rehabilitate America's infrastructure. The elimination of PABs will likely make it much more difficult to meet the President's goal of $1 trillion of infrastructure spending, including increased investment from the private sector.

Final Provisions on Project Activity Bonds Not Yet Settled

It is unclear whether the tax-exempt status of PABs will be retained in the final version of any U.S. tax reform. We will continue to monitor developments, and provide updates as events progress.

TWO KEY TAKEAWAYS

1. PABs are a significant source of funding used for infrastructure projects.

2. The Senate tax reform bill would maintain the tax-exempt status of PABs, preserving the incentives that private entities currently have to invest in public work projects.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Last Updated: November 24 2017

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