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# Consideration of Tax Issues in Developing and Evaluating P3 Concessions for Transportation

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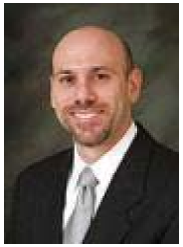

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# Presentation Outline

- **Part 1**: Key Public and Private Sector Considerations
- **Part 2**: Taxes in the Context of P3 Project Delivery Evaluation

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# Part 1: Key Public and Private Sector Considerations

# Overview

**Public Sector – Key Considerations**

- Understanding indirect vs. direct taxes generated by the project
- Types of direct taxes generated by the P3
- Incremental economic impact of P3s

**Private Sector – Key Considerations**

- Entities usable by a P3 investment structure
- Investor-specific tax considerations
- Non-federal taxes relevant to P3 transactions
- Tax-exempt and foreign entity tax considerations

**Toll and Availability Payment Concessions**

- General observations for these two common P3 delivery models
- Underlying reasons for the differences in tax treatment

# Public Sector Sponsors: Key Considerations

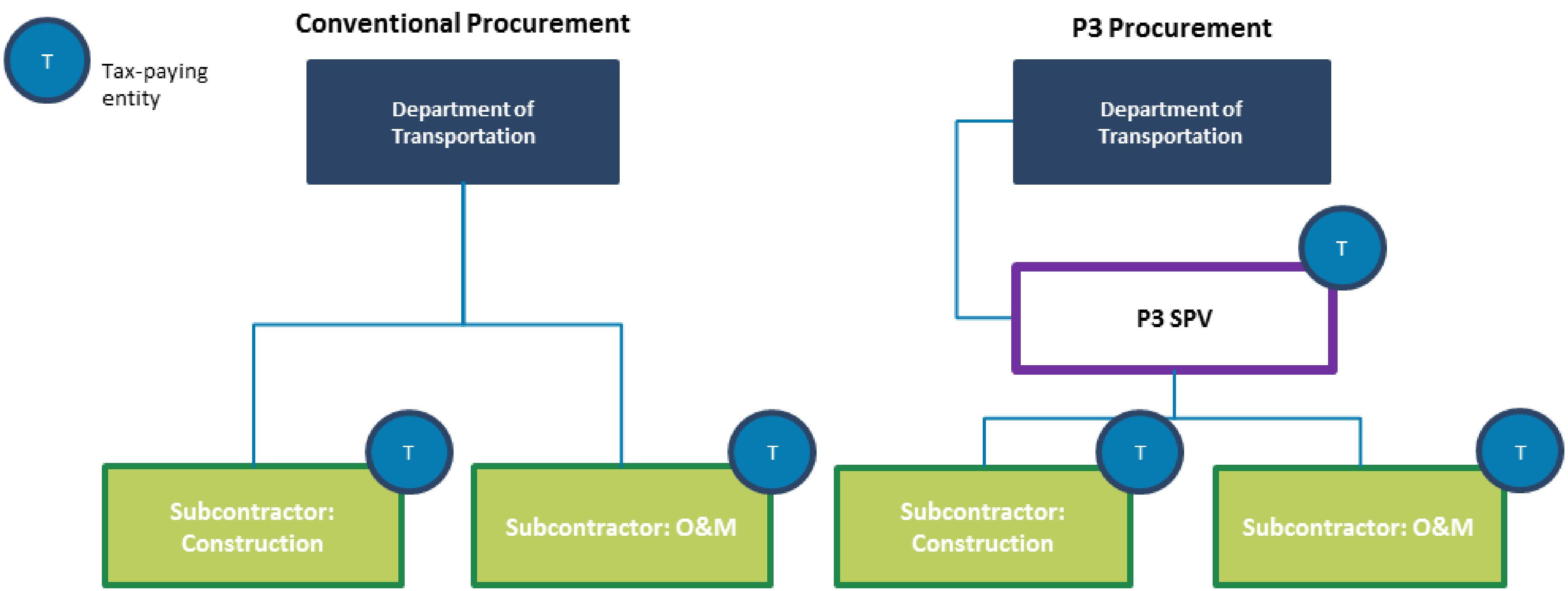
Tax considerations involve evaluating overall economic impact of project, as well as parsing direct and indirect taxes generated

| | |
|---|---|
| Direct vs. Indirect taxes | • Direct taxes: Local, State, Federal taxes paid by Concessionaire<br>• Indirect taxes: based on increased economic activity |
| Direct taxes | • Income, Sales, Property |
| Incremental Economic Impact | • P3 lifecycle costs reduction<br>• P3 accelerated delivery |

# Incrementality of P3 Taxes

**Incrementality**

- P3s can create an additional tax-paying entity relative to traditional procurement
- Some exemptions given to "level the playing field"



# Heterogeneity of P3 Taxes

**Heterogeneity of tax treatment**

- Variety of tax rules
- Bespoke tax strategies and corporate structures

# Private Sector – Key Considerations for Investment Structure

Private Sector Investors will typically structure the Special Purpose Vehicle (SPV) as a "pass-through" entity

| | |
|---|---|
| P3 Legal Entity | • Minimize tax burden<br>• Increase flexibility<br>• SPV impacts on cash distributions |
| Income tax for SPV | • Limited Liability Company (LLC): pass-through to members<br>• C Corporation: double taxation |
| Tax attributes | • Treatment of Net Operating Losses (NOLs)<br>• Exit considerations |

# Private Sector Investors: Key Considerations

Each P3 will be unique based on the taxes levied and the tax status of the equity investors

**State & Local taxation**

- Treatment of Partnerships
- Non-residency
- Franchise tax
- Tax relief

**Tax-exempt investor**

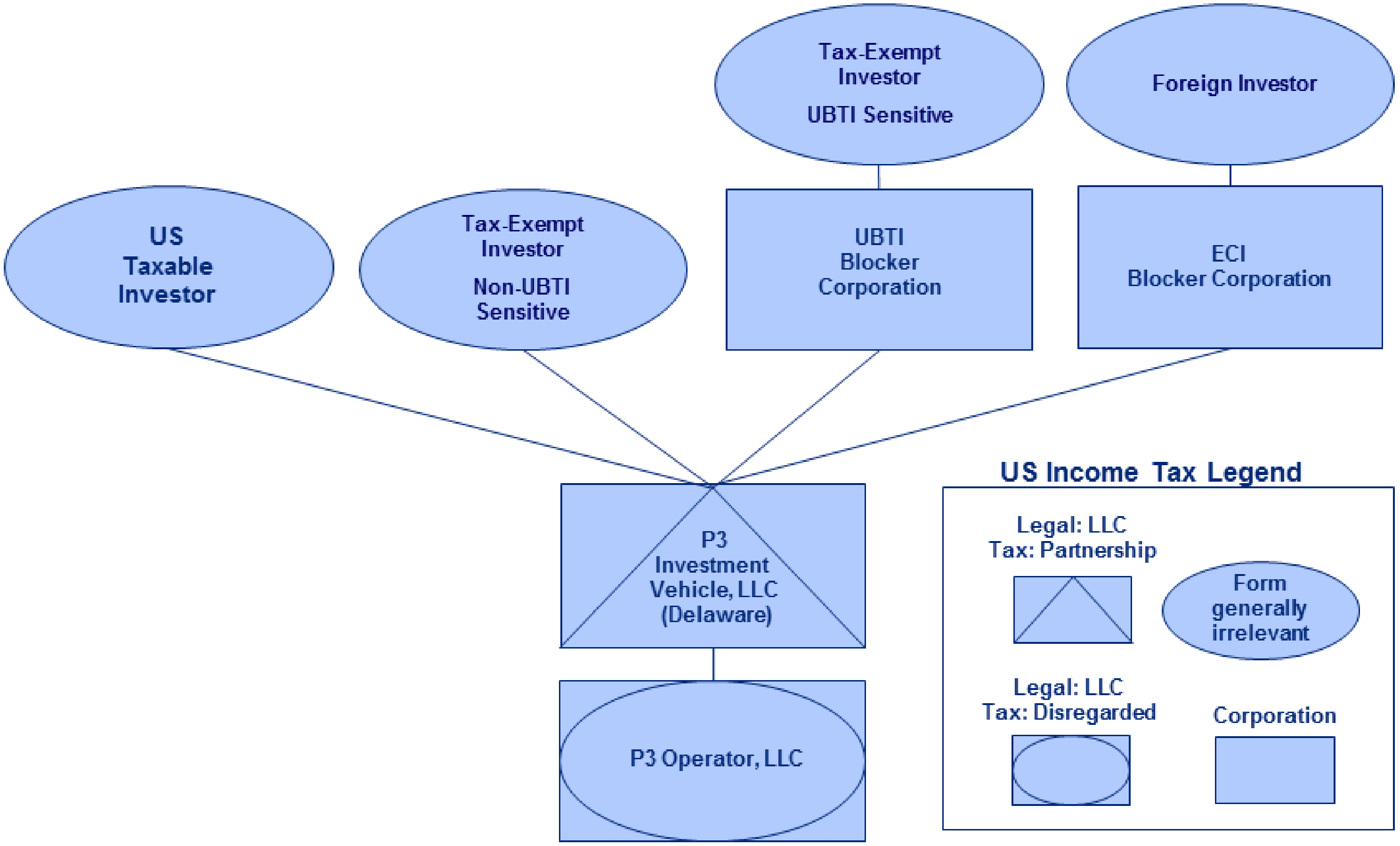
- Unrelated Business Taxable Income
- Corporate Blocker (pays taxes)

**Foreign investor**

- U.S. taxation
- Corporate blocker (pays taxes)

# Illustrative Legal Entity Structure

A pass-through LLC with multiple owners, each having unique tax characteristics



# Implications of Different P3 Structures

Two common P3 concession structures are “toll concession” and “availability payment”, each having unique tax characteristics

**Commonalities**

- Use of partnership by SPV for income tax purposes

**Toll Concession**

- Tax Losses in initial years
- Depreciation of real assets and intangible rights

**Availability Payments**

- Percentage Completion Method (PCM) impact on taxes
- Allocation of concession into Operating and Capital

# Questions?

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# Part 2: Taxes in the Context of P3 Delivery Evaluation

# Overview

Taxes in the Context of P3 Evaluation

- Benefit Cost Analysis (BCA) overview
- Value for Money (VfM) analysis overview and application

Methods for Tax Revenue Analysis

- Competitive Neutrality Adjustment (CNA) analysis overview and application
- Trade-offs between levied taxes and overall project value
- Perspectives and methods on performing VfM and CNA

# P3 Evaluation

Valuing potential tax revenues typically depends on a robust evaluation of the project's impact and the delivery method

**Benefit Cost Analysis**

- Benefits and costs of a project over a no-build scenario
- Indirect taxes
- Early stage analysis for "go / no-go" decision

**Project delivery method**

- Value for Money analysis
- Public Sector Comparator vs. Shadow Bid

**Competitive Neutrality Adjustment**

- Adjusts for distortions to the VfM
- Taxes and risk allocation

# VfM in Practice – U.S. Trends

VfM analysis focuses on understanding trade-offs between options

**Public Sector Comparator**

- Increased focus on increasing the quality of PSC
- PSC used as “auction reserve price”

**Shadow Bid vs. Actual Bid**

- Disconnect between shadow bids and actuals
- Revenue estimates
- Discount rates

**Decision Tool**

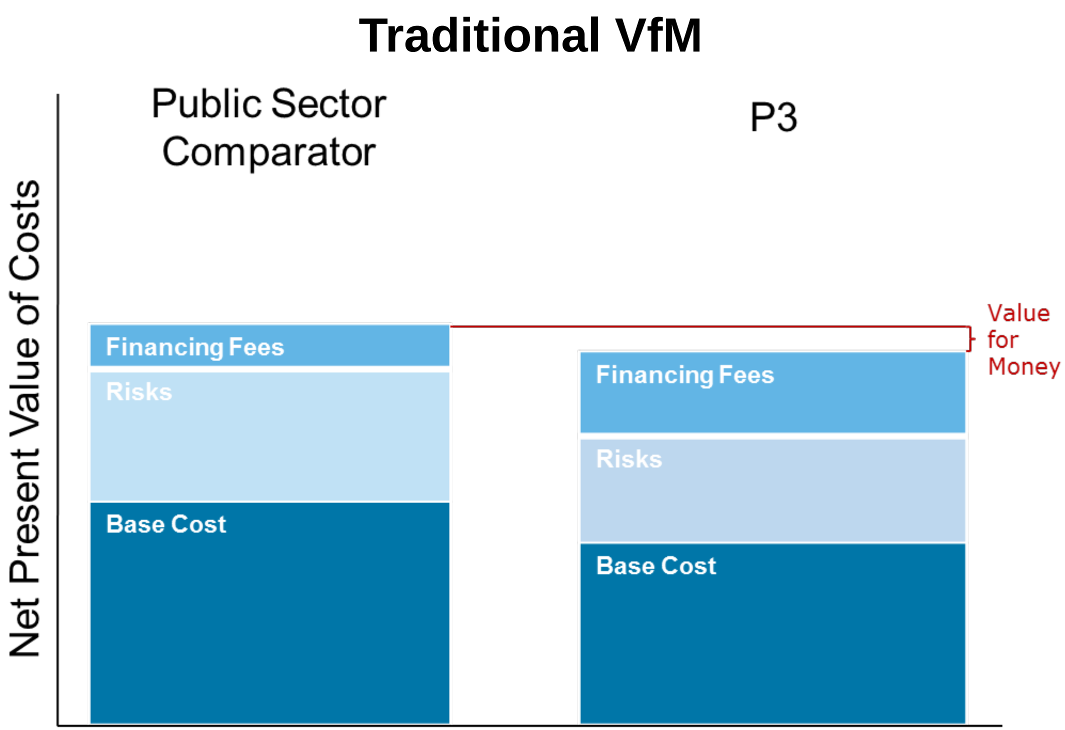
- Adapting to assist public entities in making the multi-factor decisions associated with procurement
- Trade-off analysis between procurement strategies
- Quantitative and Qualitative factors

# VfM in Practice – U.S. Trends, contd.

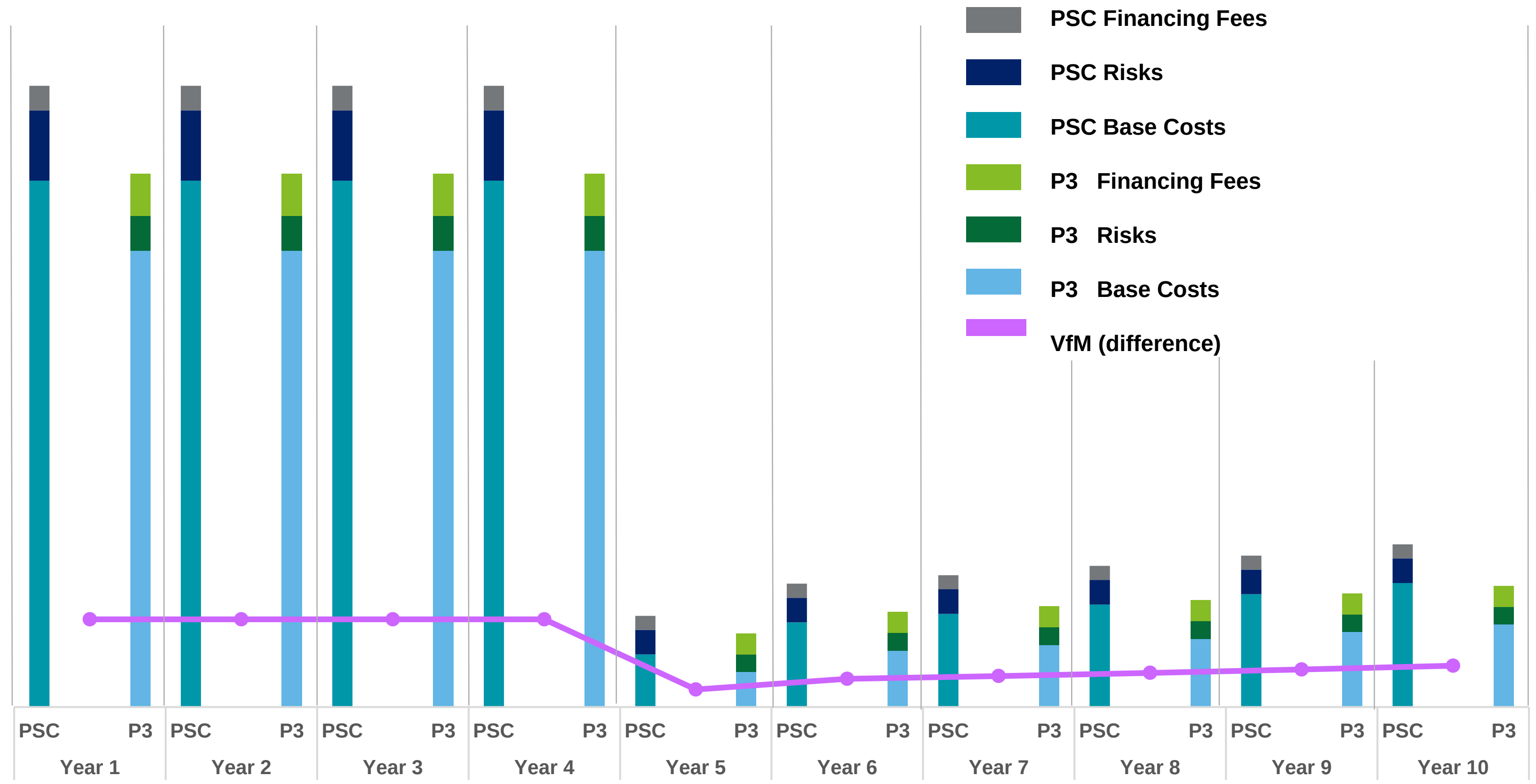
Quantitative assessments of VfM have looked beyond the traditional net present value comparison to adding a “flow” analysis

**Evolution of VfM**

- Annual VfM comparison provides additional insight
- Conventional present value analysis may “penalize” early project delivery



# Annual VfM


PSC Financing Fees
PSC Risks
PSC Base Costs
P3 Financing Fees
P3 Risks
P3 Base Costs
VfM (difference)
PSC P3
Year 1
Year 2
Year 3
Year 4
Year 5
Year 6
Year 7
Year 8
Year 9
Year 10

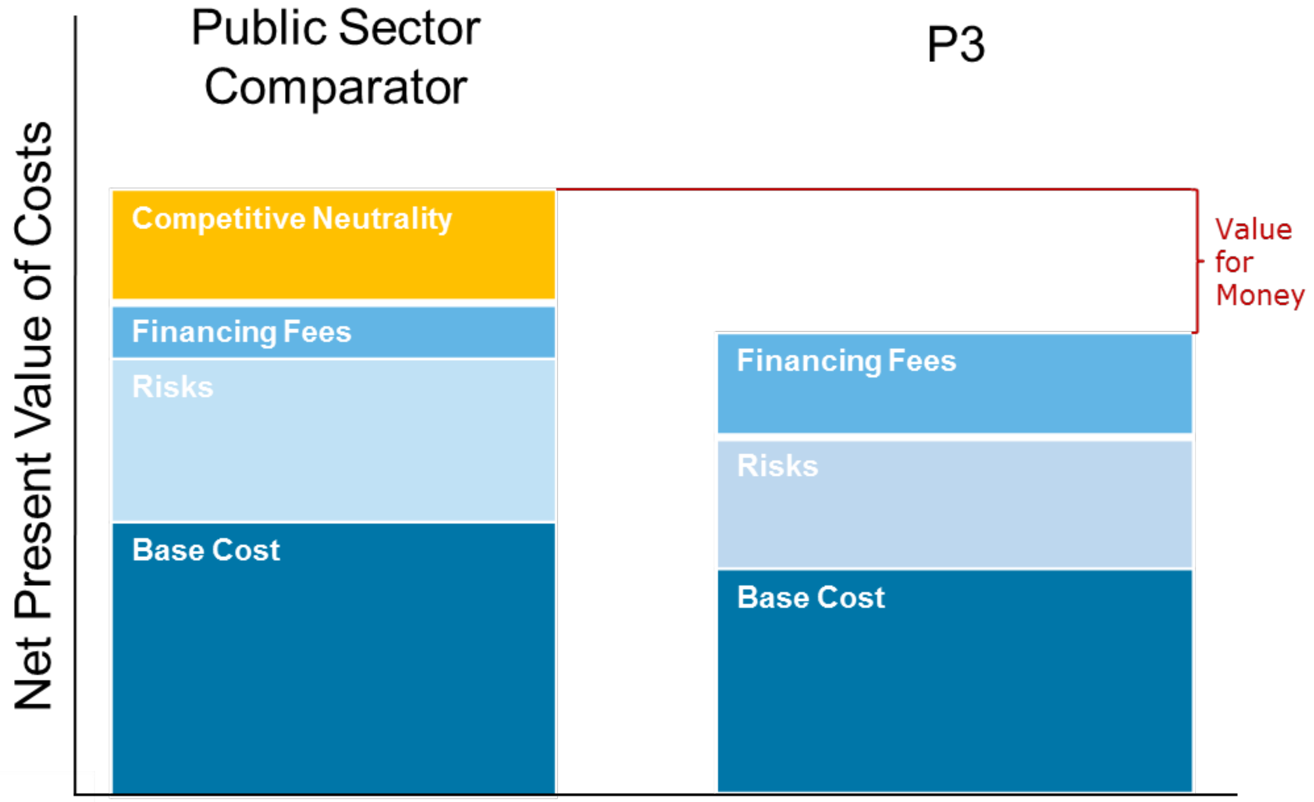
# Tax Revenue Valuation for Competitive Neutrality Adjustment (CNA)

CNAs attempt to quantitatively “level the playing field” between conventional and P3 procurement

| | |
|---|---|
| CNA for tax revenue valuation | • Opportunity cost of foregone taxes added to PSC |
| Taxes included in the CNA | • Dependent on project sponsor<br>• Typically, includes taxes levied at sponsor’s level<br>• Assumption-driven |
| Taxable debt | • Additional tax stream for Local, State, and Federal<br>• P3 debt usually tax-exempt |

# Value for Money with Competitive Neutrality Adjustment

A common method for incorporating taxes into CNA is to add the opportunity cost of foregone taxes paid directly by the P3 owners to the costs of the Public Sector Comparator



# Tax Revenue Valuation: P3 Tradeoffs and Incentives

There is an inherent trade-off between the amount of taxes paid directly by a P3 and the cost of the P3 to the public broadly

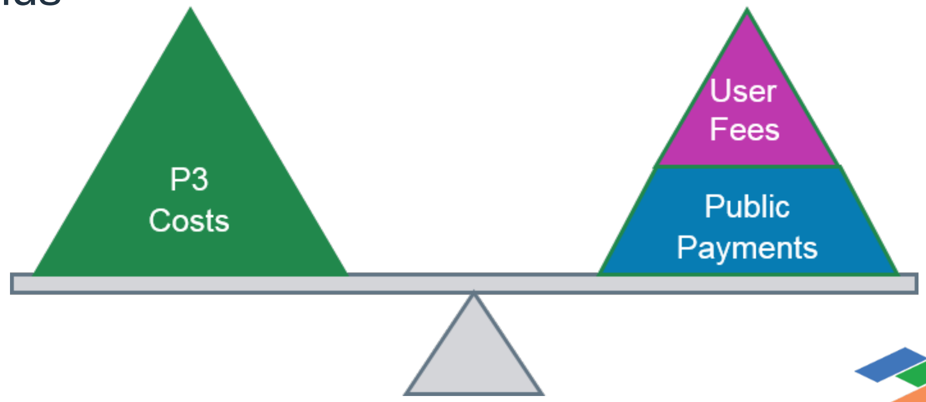
**P3 impact on taxes**

- Indirect taxes not linked to procurement
- Direct taxes only relevant if collected by public sponsor

**Tax particulars**

- Balancing tradeoffs between value and taxes for public sponsor
- Taxes accounted as cost in private investors' bids

Like all P3 costs, taxes paid by P3s come from user fees or public payments



# Tax Revenue Valuation – Modeling Tax Revenue Streams

**Modeling direct taxes**

- Scenario analysis to assess tax impacts
- Demand (toll) and performance (availability) analysis over time
- Assumptions made for P3 tax structure and impact

**Modeling indirect taxes**

- Assumptions on impact of project on tax base
- Calculations of incremental tax revenues

**Eye of the beholder**

- Analysis focus dependent on interest of entity performing the analysis
- Assumption-driven
- VfM and CNA as tools inform the decision

# Questions?

# Contact Information

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https://www.fhwa.dot.gov/ipd/p3/

FHWA

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U.S. Department of Transportation

Consideration of Tax Issues in Developing and Evaluating Public-Private Partnership Concessions for Transportation: A Discussion Paper

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