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

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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
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
- **Indirect taxes**: based on increased economic activity

**Direct taxes**

- Income, Sales, Property

**Incremental Economic Impact**

- P3 lifecycle costs reduction
- P3 accelerated delivery
Incrementality of P3 Taxes

- 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.

- Minimize tax burden
- Increase flexibility
- SPV impacts on cash distributions

- Limited Liability Company (LLC): pass-through to members
- C Corporation: double taxation

- Treatment of Net Operating Losses (NOLs)
- 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?
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

**Traditional VfM**

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<tr>
<th>Net Present Value of Costs</th>
<th>Public Sector Comparator</th>
<th>P3</th>
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<td>Financing Fees</td>
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Annual VfM

[Diagram showing comparison of PSC, P3 financing fees, risks, and base costs over years 1 to 10, with VfM (difference) indicated by a line graph.]
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
• Typically, includes taxes levied at sponsor’s level
• Assumption-driven

Taxable debt

• Additional tax stream for Local, State, and Federal
• 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.

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

- 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

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

Modeling direct taxes

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

Modeling indirect taxes

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

Eye of the beholder
Questions?
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