

Tax Incentives

Nonprofit Corporations and South Carolina's Southern Connector

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Within certain bounds, current tax law permits public-private partnerships to use tax-exempt debt when financing specific kinds of infrastructure. However, if a private entity develops and owns a highway or bridge project, issuance of tax-exempt bonds is prohibited. Moreover, project sponsors (including public agencies) cannot access tax-exempt debt when their plans include long-term performance-based management contracts with private operators.

In response to these constraints, both public and private project sponsors occasionally establish a financing conduit in the form of a nonprofit corporation. By virtue of its nonprofit status, the corporation is eligible to issue tax-exempt debt, and its position as an intermediary between private developer and public agency also permits entry into agreements for private development and operation of the project. The South Carolina Department of Transportation is employing this approach on a 16-mile tolled beltway segment, the Southern Connector. By means of a nonprofit corporation, SCDOT will realize the cost savings of a tax-exempt debt issue while deriving the benefits of private development and operation of this \$200 million project.

Most experts agree that this so-called "63-20" nonprofit financing conduit is currently the best means of preserving projects' eligibility for tax-exempt financing while enabling public agencies to enjoy the efficiencies of sharing risks and responsibilities with private-sector partners. The 63-20 designation refers to the relevant Internal Revenue Service ruling that authorizes this financial arrangement.

Notwithstanding the benefits of a 63-20 arrangement, insertion of a nonprofit intermediary into the middle of an arrangement complicates the flow of funds and may have other



South Carolina Department of Transportation Chair H. B. "Buck" Limehouse calls bulldozer operator to initiate construction of Southern Connector. *Right*, SCDOT Executive Director Elizabeth S. Mabry; *left*, Interwest Company President Bob Farris.

disadvantages as well. Karen Hedlund of the law firm of Nosaman, Guthner, Knox & Elliott, LLP, argues that while the 63-20 model works well for some projects, the nonprofit structure can suffer from three potential shortcomings. First, private developers are prohibited from making equity contributions to the project, and thus have no long-standing economic stake in the project. Second, payments to private operators may not be linked to net revenues generated by the project, a prohibition that rules out many kinds of performance-based incentives. And third, the need for public agencies to distance themselves from their private partners can potentially cause the private partners and even the nonprofit corporations to lack political accountability.

Greater flexibility in laws regarding private-activity bonds could offer project sponsors a wider array of choices in deciding how to couple public-private partnerships with tax-exempt debt. The Highway Infrastructure Privatization Act (HIPA), proposed by the Senate as part of its Intermodal Surface Transportation Efficiency Act reauthorization package, would have permitted 15 highway and bridge projects to move onto a level playing field with other types of infrastructure (including airports, docks, and energy facilities) by allowing them to be financed with tax-exempt debt as qualified private-activity bonds. However, HIPA did not win a place in the Transportation Equity Act for the 21st Century. Unless or until HIPA wins legislative approval, project sponsors may wish to pursue the 63-20 option if the savings offered by tax-exempt debt compare favorably with the efficiency gains associated with private-equity partnerships and long-term incentive-based contracts.



Financing construction of Southern Connector in Greenville, South Carolina, was facilitated by creation of a "63-20" nonprofit corporation.