The Road to Ruin: Can We Afford the Anti-Tax Movement?

Monday, 12 May 2014 10:00

By Ellen Dannin, Truthout | News Analysis

(Photo: Richard Masoner / Cyclelicious)

Experience has shown that the anti-tax movement is a luxury we cannot afford. Its clout and legislators' fear of that clout means that taxes cannot be raised - even to keep pace with inflation. The result is crumbling infrastructure and no way to build new or repair what exists.

As a result, we are left without money to maintain, repair and build our roads, bridges and other transportation infrastructure - not to mention other needs that we are unable to meet.

We are told that the private sector can fill these needs, but, as it turns out, privatized infrastructure depends on public money - and a lot of it.

How much public versus private money is invested in infrastructure privatization? At the March 5, 2014, congressional hearing called Overview of Public-Private Partnerships in Highway and Transit Projects, witnesses who are fans of privatization testified that the private "partners" in PPPs invest as little as 3 percent to 20 percent - leaving the public to fill the 80-97 percent gap in funding.

The written testimony of Congressional Budget Office (CBO) economist Joseph Kile, one of the witnesses at the March 5 hearing, warned that "revenues from the users of roads and from taxpayers are the ultimate source of money for highways, regardless of the financing mechanism chosen." The significance of Kile's statement can be seen in the fact that one partner - the private sector - has almost no financial skin in the game. Meanwhile, the public partner - that is, the taxpayers - carries nearly the full financial burden.

Unfortunately, word of that reality has not gotten out. In fact, some governors have suppressed information about their privatization of state bridges and other infrastructure and have tried to silence critics of privatization. Other public officials are unaware of, or in denial about, how our public infrastructure is paid for.

In other words, those who think that partnerships mean equal sharing of a burden will see that grossly unequal responsibility is the norm. How and why that is the case is discussed below.

Understanding the Magic of the Market

Until recently, our public transportation system has been built and maintained through taxes, such as the fuel tax, tax-free government bonds, and government appropriations. The fuel tax has not kept pace with inflation and has not been raised since 1994. In addition, higher mileage vehicles and hybrid and electric cars pay much less or no fuel tax.

The loss of so much tax revenue means not enough money to build, repair and maintain our roads, but we clearly need those roads. That shortfall has pushed desperate local, state and federal governments to find creative ways to drum up money, including strategies that amount to robbing Peter to pay Paul.

For example, government bonds pay low interest rates, but are attractive to investors because they are low-risk investments, and interest earned is tax free. However, these sources of revenue cannot be used to finance private infrastructure. As a result, Congress has created ways to finance privatized roads. The two most important are the Transportation Infrastructure Finance and Innovation Act (TIFIA) loans and tax-exempt Private Activity Bonds (PABs).

During the Congressional hearing - Phillip A. Washington, the head of the Denver Regional Transportation District, called on Congress to expand financing for PPPs. Meanwhile, during the hearing, Congresswoman Eleanor Holmes Norton (D-DC) presented a breakdown of public versus private funding of the Denver Union Station Project, using Mr. Washington's written testimony.

The figures show that only $54.3 million, less than 3 percent of the funding for the $2.04 billion project, was private money. The rest of the funding - 97 percent - was public. The two most important sources – private activity bonds and Transportation Infrastructure Finance and Innovation Act (TIFIA) loans - are discussed below – and links can be followed for additional information.

This money is your tax dollars at work, that is, after a detour through the private finance sector.

Public Sources of Financing

- U.S. Department of Transportation, Federal Transit Administration New Starts Full Funding Grant - $1.03 billion

• Private Activity Bonds - $396.1 million

• Transportation Infrastructure Finance and Innovation Act (TIFIA) loan - $280.0 million

• Other federal grants - $57 million

• Regional Transportation District (RTD) sales tax revenue - $128.1 million

• Revenue bond proceeds - $56.8 million

• Local/Colorado Department of Transportation (CDOT)/other contributions - $40.3 million

Private Sources of Financing

• Private Equity - $54.3 million

Nothing was wrong or illegal about this funding. Federal, state and local governments regularly provide financial support for infrastructure projects, and Mr. Washington's job includes finding funding for this project. However, his call for more federal funding suggests that he did not appreciate just how tiny the private investment in that project was and just who had skin in the game.

The oral testimony of the other witnesses also had lopsided public versus private financing, with private funding in the range of 10 to 20 percent. In other words, what makes infrastructure privatization attractive to investors is public subsidies.

SILOs and LILOs - Tax Breaks Gone Wild

Many have wondered why infrastructure privatization contracts have lease terms as long as 75 to 99 years. Surely, long before those contracts end, that infrastructure will be obsolete.

The answer is tax breaks, in particular, Sale-in / Lease-out (SILOs) and Lease-in / Lease-out (LILOs). To receive the tax breaks required, first, "selling" or "leasing" a long-term asset, such as a road, and then immediately leasing it back.

These tax breaks caused concern for many years, because they seem fraudulent. In 2008, the IRS Commissioner Doug Shulman gave notice that it would prosecute those who used LILOs and SILOs:

> LILOs and SILOs involved complex and convoluted purported leasing arrangements in which some of the nation's largest corporations supposedly leased or purchased large assets, such as foreign rail systems or sewer systems, and immediately leased them back to their original owners. Under the arrangement, these corporations, which include companies in the Fortune 500, buoyed their balance sheets by gaining billions of dollars of tax deferrals. Using LILOs and SILOs, these companies, including many of the nation's top banks, put off the recognition of current income for tax purposes for many years. . . .
>
> The nation's leading commercial enterprises have the legal and accounting resources to take full advantage of favorable provisions of tax law. But they are not entitled to use their extensive resources to twist provisions of tax law to the point that they no longer reflect the Congress' intent. As a basic matter of fairness to all taxpayers, the IRS cannot allow LILO and SILO deals to stand. The time has come for these shelter participants to put these cases behind them. The best way for them to do so is to act on the settlement offer they will now receive.

To understand just how troubling SILOs and LILOs are, consider that Senator Chuck Grassley (R-Iowa) called them "nothing more than good, old-fashioned tax fraud," and former Senator Max Baucus (D-Mont.) called SILOs "shell games" and "three-card-monty," transactions that "siphon cash" from taxpayers. Whatever they are called, it is fair to say that investing in infrastructure privatization has been attractive to investors largely because of various sorts of tax breaks that have siphoned money from investment in important projects.

Robert W. Wood and Steven E. Hollingworth's, Tax Notes Special Report, "SILOs and LILOs Demystified," provides a number of examples of how these two schemes operated. The basic problem with these quasi-fraudulent deals was that they had no purpose other than creating tax benefits for the investors, while causing the loss of tax revenue that should have provided for public needs.

Eventually, Commissioner Shulman disallowed these tax gimmicks. According to the commissioner:

> The public has a right to expect that large corporations be good corporate citizens and meet their compliance obligations. The nation's leading commercial enterprises have the legal and accounting resources to take full advantage of favorable provisions of tax law. But they are not entitled to use their extensive resources to twist provisions of tax law to the point that they no longer reflect the Congress' intent.

More About Tax Breaks Gone Wild - Private Activity Bonds and TIFIA

Private Activity Bonds and Transportation Infrastructure Finance and Innovation Act (TIFIA) loans are two types of subsidies used to support the construction of private infrastructure.

Tax-exempt Private Activity Bonds and public tax-free bonds are attractive to private investors for similar reasons. They are secure investments backed by the government, and interest on the bonds is not taxed. However, tax-free bonds mean a loss of tax revenue that otherwise would be used for public needs.

The three private sector witnesses argued strenuously in support of making more PABs available. Mr. Washington testified that he would like to see the amount of PABs doubled because PABs were a huge tool. Witness Richard Fierce, senior vice president of Fluor Enterprises, called PABs the life blood for transport and said he would like the cap on the amount of PABs to be lifted. Witness James Bass, interim executive director and chief financial officer, Texas Department of Transportation, said that, without TIFIA loans for Texas infrastructure, few projects would happen.

However, by calling for more public funding of private infrastructure projects beyond the 80-97 percent private investors had already received, these knowledgeable people are telling us that private investors have little to no interest in these deals unless the federal, state and local governments provide almost all of the PPPs' funding.

During the hearing, Representative Capuano (D-Mass.) took issue with the use of PABs and giving $23 billion in taxpayer money to private investors. Capuana challenged the witnesses to explain why it wouldn't be better to fund infrastructure through traditional means such as using highway trust fund money. Of course, before highway trust fund money can be used to provide modern infrastructure, the gas tax must be tweaked so it can generate sufficient money to meet those needs.

Programs such as PABs and TIFIA are subsidized by public money, but, rather than paying cash, the subsidies are provided through more complex routes. Private Activity Bonds mimic public bonds by making interest paid to bondholders tax free. However, bonds that are tax free mean less money in the government treasuries that issue those bonds.

It is important to keep in mind that we are using PABs and TIFIAs to fund privatized infrastructure, rather than directly using taxes to build and maintain roads and other infrastructure, because the anti-tax movement has made taxes toxic. If there is any magic in the market, it seems to be magic from the dark side.

For those who want more on infrastructure privatization and finance, Chicago Law Professor Julie Roin has two articles on the subject that can be found here and here.