Statement for the Record

Hearing on Long-Term Financing of the Highway Trust Fund

Committee on Ways and Means
U.S. House of Representatives

June 17, 2015

As the House Committee on Ways and Means meets to consider the feasibility of various ideas to provide a sustainable, long-term solution to the shortfall in the Highway Trust Fund, the undersigned organizations urge the Committee to consider a simple, cost-effective proposal that would galvanize billions in new private capital for investment in U.S. transportation and infrastructure. Specifically, any long-term highway bill should include reforms to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), such as those proposed in H.R. 2128, legislation introduced by Ways and Means Members Kevin Brady (R-TX) and Joseph Crowley (D-NY).

FIRPTA is a major obstacle to mobilizing private sector capital for infrastructure projects. The punitive FIRPTA law subjects foreign investment in U.S. real estate or infrastructure to a much higher tax burden than applies to a foreign investor purchasing a U.S. stock or bond, or an investment in any other asset class. FIRPTA imposes U.S. tax on gain realized by a foreign investor on the disposition of an "interest" in U.S. real property, which includes infrastructure assets. In some cases, FIRPTA can generate a tax burden as high as 54.5 percent. The FIRPTA regime is an anti-competitive outlier that deters and deflects capital to other markets. FIRPTA reform would serve as a strong, market-driven catalyst for the financing of much-needed infrastructure improvements, including upgrades to our transportation system.

Meeting our infrastructure needs will require a combination of public and private investment, and passive foreign investors could play a significant role in financing public-private partnerships involving: ports, bridges, airports, tunnels, toll roads, light rail, freight rail, and other income-producing infrastructure assets. Pooled and syndicated capital is already being deployed in infrastructure projects through infrastructure funds organized as partnerships. REITs are another model that has been used with some success for infrastructure investment.[1] Nonetheless, the United States is far behind other regions of the world in harnessing private investment for infrastructure development.[2]

[1] Deloitte, *REITs and Infrastructure Projects* (2010), *available at*: http://www2.deloitte.com/content/dam/Deloitte/mx/Documents/bienes-raices/REITs_infrastructure_proyects.pdf

[2] OECD, *Pension Funds Investment in Infrastructure: A Survey* (2011), *available at*: http://www.oecd.org/sti/futures/infrastructureto2030/48634596.pdf.

Foreign institutional investors—pension funds, life insurance companies, etc.—are ideal partners for U.S. infrastructure projects because they have the capital needed for large-scale projects and the time horizon necessary for the long-term returns associated with the upfront investment. Infrastructure investments are attractive to foreign institutional investors because they offer: stable and predictable income streams that exceed fixed income markets, diversification benefits, and a hedge against inflation. Because the public-private infrastructure model is more developed in other countries, foreign institutional investors are often more comfortable and experienced investing in infrastructure assets than are their U.S. counterparts.

FIRPTA is a major hurdle for the foreign investor seeking to invest in US infrastructure projects. Under current law, FIRPTA applies when at least 50 percent of a company's balance sheet is attributable to the value of real property. In 2008, the IRS issued an announcement in which it indicated that many of the governmental licenses and permits being issued in connection with the leasing of transportation assets, such as toll bridges, should be treated as inseparable from the underlying real property, and thus as US real property interests subject to FIRPTA.[3] In 2014, the IRS issued proposed regulations in the REIT area confirming that, among other things, certain inherently permanent structures such as microwave transmission, cell, broadcast, and electrical transmission towers; bridges; tunnels; roadbeds; and railroad tracks are real property for REIT purposes.[4]

The fear of triggering FIRPTA liability is blocking inbound infrastructure investment. In a 2013 report, one of the big four accounting firms noted how FIRPTA obstructs infrastructure investment in the United States:

> The FIRPTA rules may be of significant relevance to non-US persons investing in infrastructure projects because such investments often provide investors various rights in the underlying infrastructure asset. As a result of these interests or rights in the asset, a further issue is raised as to whether the investor has obtained beneficial ownership of real property rights to which the FIRPTA rules could apply.[5]

The Joint Committee on Taxation has also acknowledged the effect of FIRPTA on foreign investors in U.S. infrastructure, "the special U.S. tax rules applicable to foreign investment in U.S. real estate . . . may affect the U.S. tax treatment of foreign [infrastructure] investors. Some advisors have taken the position that the intangible franchise right is an interest in real property for purposes of section 897."[6]

Large private investors in transportation infrastructure cite FIRPTA as a principal obstacle to attracting greater foreign capital for infrastructure projects. According to Christopher Lee, founder and managing partner of Highstar Capital, an infrastructure investment firm ,"[t]here are many billions of dollars in overseas capital sitting on the sidelines because those investors are wary of the burden

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[3] Internal Revenue Service, Announcement 2008-115 (Dec. 1, 2008), *available at:* http://www.irs.gov/irb/2008-48_IRB/ar18.html.

[4] Treas. Prop. Reg. §§ 1.856-3; 1.856-10. The proposed rules were published in the Federal Register on May 14, 2014 and are available at: http://www.gpo.gov/fdsys/pkg/FR-2014-05-14/pdf/2014-11115.pdf.

[5] PWC, *Infrastructure Investing: Global Trends and Tax Considerations, Part 2* (2013), *available at:* http://www.pwc.com/us/en/capital-projects-infrastructure/publications/assets/infrastructure-investing-part2.pdf.

[6] Joint Committee on Taxation, *Overview of Selected Tax Provisions Relating to the Financing of Surface Transportation Infrastructure*, JCX-49-14 (May 5, 2014).

FIRPTA will have on their investments.[7] Highstar Capital has invested more than $7.8 billion in infrastructure since its inception.

Because of the close connection between FIRPTA and infrastructure investment, the Administration has included a FIRPTA reform proposal in its *Rebuild America* infrastructure initiative and its last three budget submissions.

Moreover, transportation improvements, infrastructure build-outs, and thousands of new jobs would flow from the commercial real estate investment generated by FIRPTA reform. Real estate development and infrastructure upgrades are inextricably linked. For example, in just the last month, a prominent property owner in the Northeast agreed to invest $220 million in improvements to Grand Central Station, one of the country's most important transit hubs, as part of a larger commercial real estate project in New York.[8] Similar examples, on a smaller scale, can be found throughout the country.

Last year, the Urban Land Institute (ULI) released its annual report on infrastructure trends and issues.[9] According to ULI's survey of 250 public sector leaders in local/regional government and over 200 senior-level private developers, the most promising source of infrastructure funding over the next decade will be joint development or cooperation between local governments and developers. Also high on the list was "negotiated exactions," which refers to tying development rights to infrastructure improvements. The report concluded that "contributions from real estate are often essential components of the funding package for infrastructure projects."[10]

The infrastructure build-outs that accompany new development are a major component of real estate investment. Real estate projects finance transportation and other improvements through mandatory state and local impact fees. A 2012 study found that nationally, for a typical multi-family development, impact fees in excess of 6.7 percent of the project's value will be paid to the local government to finance the community's surrounding infrastructure.[11] The same study found that the average developer of a 100,000 square foot retail shopping center in the United States will pay a local government $568,500 to improve nearby roads, $244,000 to improve the water and sewer system, and $83,700 to build up surrounding parks.

The Real Estate Investment and Jobs Act of 2015 (H.R. 2128), introduced by Representatives Brady and Crowley, includes two critical provisions to mobilize foreign capital for real estate and infrastructure investment in the United States. First, it would increase the ownership stake that a foreign investor can take in a publicly traded U.S. real estate investment trust without triggering FIRPTA liability and extend the provision to certain collective investment vehicles. Second, it would remove the

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[7] *See* Christopher Lee, *Let's* at Least Have a Sensible Tax Structure When It Comes to Infrastructure, The Huffington Post, *available at*: http://www.huffingtonpost.com/christopher-h-lee/lets-at-least-have-a-sens_b_3112325.html.

[8] Associated Press, NYC approves skyscraper in exchange for transit hub work (May 27, 2015), *available at*: http://finance.yahoo.com/news/nyc-approves-skyscraper-exchange-transit-201204047.html.

[9] Urban Land Institute, *Infrastructure 2014: Shaping the Competitive City* (2014), *available at*: http://uli.org/wp-content/uploads/ULI-Documents/Infrastructure-2014.pdf.

[10] *Id.* at 4.

[11] Duncan Associates, *2012 National Impact Fee Survey* (2012), *available at:* http://www.impactfees.com/publications%20pdf/2012_survey.pdf.

tax penalty that FIRPTA imposes on foreign pension funds that invest in U.S. real estate and infrastructure. Together, these two bipartisan and noncontroversial changes would unlock billions of foreign capital for job-creating investment here at home.

In less than two months, H.R. 2128 has already attracted the co-sponsorship of 31 of the 39 members of the Ways and Means Committee. In February, the Senate Finance Committee unanimously passed a version of the Real Estate Investment and Jobs Act (S. 915). The full House passed a similar bill in 2010 by a vote of 402-11.

Over the long run, by mobilizing capital and increasing investment, FIRPTA reform will have a positive impact on the economy, job growth, and tax revenue. However, any short-term effect on the federal budget, as estimated by the Joint Committee on Taxation, can be fully offset with noncontroversial, related revenue provisions. At the time of mark-up, S. 915 was financed with provisions aimed at improving tax compliance.

Congress should reform outdated tax regimes such as FIRPTA and pave the way for market-based, privately financed infrastructure investment. Thank you for the Committee's consideration of our submission. If Ways and Means Committee staff would like to discuss this issue in greater detail, please contact Ryan McCormick, Vice President and Counsel of The Real Estate Roundtable, at (202) 639-8400 or rmccormick@rer.org.

We look forward to working with the Committee to advance meaningful FIRPTA reform.

Alternative & Direct Investment Securities Association
American Hotel & Lodging Association
American Resort Development Association
American Society of Interior Designers
Building Owners and Managers Association International
CCIM Institute
Institute of Real Estate Management
International Council of Shopping Centers
International Union of Painters and Allied Trades
Investment Program Association
NAIOP, Commercial Real Estate Development Association
National Apartment Association
National Association of REALTORS®
National Association of Real Estate Investment Trusts
National Multifamily Housing Council
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