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BROWNFIELDS

TAX CREDITS

Many states offer valuable incentives or tax credits that encourage the remediation of contaminated lands. As states have extended and amended their brownfields tax credit programs, some changes in eligibility, timing and requirements to apply for the tax credits have been enacted, as well as efforts to provide additional clarity, transferability, expansion, or, in some cases, restrictions. The author of this article says that while these tax credit programs may seem daunting, they should not discourage potential developers from considering currently contaminated properties as sites for redevelopment. Highlighting the success of the Massachusetts brownfields tax credits program, the author says that states continue to issue these credits, and a vibrant resale market for these credits exists, allowing for the continued strategy of using tax credits to recoup funds spent on remediation expenses.

The Greenery of Brownfields

BY WARREN KIRSHENBAUM

As the inventory of available land continues to be developed, it stands to reason that proposed sites will, in increased numbers, tend to be former mills, abandoned buildings and other industrial properties that will need to be repurposed for current use. However, many of these sites have latent environmental issues, and while the term brownfields is over-inclusive, the subsurface contamination in these prop-

erties may prove to be a discouragement for potential developers. There are programs—on the state level—that provide financial incentives as well as indemnification for remediating contaminated property. Currently, no national tax incentive program exists for brownfields renewal (the national program expired in 2011). Many states, in fact, still offer valuable incentives or tax credits that encourage the remediation of contaminated lands and by doing so offer a slew of additional related

and tangible benefits. Massachusetts, for example, has a brownfields tax credit program that is the envy of the nation.

The Evolution of Brownfields Redevelopment

For decades much attention has been paid to reversing the damage done to the environment; referencing a site as a brownfield site is often a term of art rather than a realistic description. The origin of the term “brownfield” dates back to the early 1990s, when a U.S. congressional field hearing held by the Northeast Midwest Congressional Coalition June 28, 1992, first coined the term.

The federal brownfields program dates back to 1995, when the U.S. Environmental Protection Agency initiated the program. Given the EPA’s definition of a brownfield as a “property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant;” land labeled with this term could include anything from former industrial sites and abandoned gas stations or coal mines to dumps or junkyards and manufacturing facilities. According to the EPA, the program is “designed to empower states, communities, and other stakeholders in economic redevelopment to work together in a timely manner to prevent, assess, safely clean up, and sustainably reuse brownfields.” Note that when analyzing the incentives available on a state level, one should pay less attention to the terms used by the EPA, as they are far more restrictive than the state definitions. By way of example, in Massachusetts, the definition of an “eligible person” for tax credit purposes and the federal definition of “eligible person” (which determines responsible party status) are very different.

Federal Tax Incentive. The 1997 federal brownfields tax incentive stemmed from the above-mentioned brownfields program, and was initiated to further encourage the remediation of brownfield sites by allowing environmental cleanup costs to be fully deducted in the same tax year, instead of capitalized and spread out over time. This expedited deduction allowance could result in a reduction of taxes due on a federal tax return and could possibly even generate a refund. The law was enhanced in 2006, when it was expanded to include petroleum cleanups. This change offered even more properties the ability to be developed and reused, as now former gas stations and other sites that housed underground storage tanks could be considered. Unfortunately, the federal statute was not originally written as a long-term law, and was passed over for extension when Congress passed the American Taxpayer Relief Act of 2012. Accordingly, the federal incentive expired in December 2011. As it was, the brownfields tax incentive as a federal benefit did not gain wide understanding and utility, and those who did comprehend the potential benefit were weary of investing too much into the program due to the continued uncertainty of whether it would be extended in the years between 1997 and 2011.

Still, the incentive’s legacy is seen in many states that have gone on to adopt their own brownfields incentive or tax credit programs. Most of these programs are similar to the original federal program, varying only slightly by adding flexibility to the rules and eligibility requirements for environmental remediation efforts so

that the programs are more fully utilized. Given the massive costs inherent in some cleanups, cost can be a significant deterrent, and without state incentives or tax credits some contaminated property would remain toxic indefinitely.

Development Perspective. From a development perspective, many questions, issues, and concerns arise when considering a contaminated site. Most prevalent will inevitably be whether liability will extend to the new owner; whether and to what extent the contamination will impede, add expense to, or derail financing alternatives; and the actual financial cost of the remediation, and its effect on the project’s pro-forma and total development costs. Tackling these questions requires a solid understanding of the brownfields universe, as well as the current legislative environment and history of the state approach to brownfields redevelopment. Changes to the state’s laws on brownfields redevelopment, the definition of a permanent solution, and any future restriction on property use will be key determinants to the development plan for the property. Being aware of both the environmental and the economic advantages of remediating property and achieving a permanent solution is critical. Finally, knowing what brownfields redevelopment assistance is available, and how the process works (including who is involved in the process), will help to determine whether the undertaking is viable.

Some of the relevant federal laws that states have relied upon to develop their own interpretations of brownfields redevelopment include the Resource Conservation and Recovery (which focuses on “cradle to grave” oversight of waste); the Toxic Substances Control Act (which specifically regulates polychlorinated biphenyls (PCBs)); the Comprehensive Environmental Response, Compensation, and Liability Act (commonly known as “superfund”) and related amendments, including the Hazardous and Solid Waste Amendments of 1984 (which focused on incinerators and landfills); the Superfund Amendments and Reauthorization Act of 1986 (which focused on underground storage tanks); and the Small Business Liability Relief and Brownfields Revitalization Act of 2002.

Developers who are interested in repositioning a site that may be contaminated should review the eligibility requirements of programs in their specific state. Brownfields insurance, grants, low-interest loans, or tax credits (BTCs), when available, can provide access to additional financing avenues or collateralization sources on sites that may not seem to be feasible upon initial analysis (whether due to their current level of contamination, or the cost involved in remediating the property). These financial incentives help to reform blighted property into usable and useful land, and can serve to ease the skittishness of financial institutions that are notoriously wary of environmental issues. From a political perspective, the financial benefits allocated to environmental cleanups provide a valuable social function, in that they encourage the cleanup of toxins that negatively affect the environment, and its human and animal inhabitants.

Economic and Community Value. In addition to the contaminated site, these affected properties when exposed to the vagaries of nature can contaminate abutting properties, widening the contaminated area and exacerbating its effects. Remediating current contamination, and curtailing downgradient causation has an additive

effect that positively impacts the greater community, not only by creating land that can be developed, but by enhancing the surrounding neighborhood and driving up property values and community pride. In addition, research found that a BTC or incentive program can actually be a boon to a state's fiscal health. In Massachusetts, for example, studies have shown that its BTC program generates \$7 to the commonwealth for each \$1 of tax credit claimed. In addition, these contaminated and forlorn sites that otherwise might be left to decay are instead being restored and redeveloped into income-producing, taxpaying sites, decreasing the supply of previously undesirable and abandoned lots in the process.

In fact, without the BTC program, Massachusetts would have a much larger inventory of contaminated land and less construction and environmentally generated employment, resulting in lower payroll and withholding tax revenue, and overall lower property values for neighboring lots.

Case Study

There are various real-life examples that we have encountered in which tax credits played a real and calculable role in making a contaminated site a viable redevelopment project. One example was a site owned by a trust that discovered contamination after the purchase of the land, and unfortunately due to downgradient runoff, had contaminated two abutting properties. Today, after a multiyear remediation process and extensive use of tax credits, there are three redeveloped properties, including a public ice skating rink. Separately, we were involved in a project where an owner was in the process of remediating a site, and was faced with a situation where the remediation costs exceeded his available budget. This caused the remediation of the property to come to a standstill. Development was halted due to the financial hardships, and the owner would have been subject to fines and other enforcement measures from the DEP. Utilizing tax credits, we were able to offer financing to the owner, collateralized against the tax credits. This allowed the remediation to be completed and the property was successfully developed.

Again using Massachusetts as an example, its tax credit program operates on a two-tier basis. There is a 50 percent tax credit awarded to eligible sites where either a permanent solution is achieved (documented by the filing of a Response Action Outcome (RAO) Statement with the state's DEP), or where a Remedy Operation Status (ROS) has been achieved on the property; a 25 percent tax credit is available to taxpayers that have achieved an RAO with an activity and use limitation (AUL). An AUL is a legal document that is recorded with the Registry of Deeds, and details restrictions placed on the remediated land, or conditions that must be maintained for the property to remain of "no significant risk" to those on/around the property.

In practice, AULs often are used by landowners who are required by law to remediate their property, but who do not wish to incur the costs incumbent in achieving a permanent solution without any limitations. An example of a cleanup that contains an AUL is one where the contaminated soil is not removed but is contained under an asphalt surface, such as for a parking lot. A cleanup that achieves an RAO with no restrictions

is generally required for residential uses, which allows any use, including those where children could be present. On the other hand, a cleanup to industrial use standards, which limits the use of the property to commercial and industrial enterprises, and not multifamily housing, day care, or such uses, is restrictive and would necessitate an AUL. In Massachusetts (and other states), government has recognized that achieving a status in which the soil is safe for some use, even with limitations and maintenance requirements, is better than leaving contaminated land undeveloped.

Massachusetts Contingency Plan. Massachusetts has enacted the Massachusetts Contingency Plan (MCP), which guides reporting, assessment, and remediation of soil, sediments and groundwater that have been impacted by the release of oil or hazardous materials. The MCP is a risk-based regulation that helps assess whether a disposal poses a significant risk to human health and the environment. The MCP also provides specific timelines for reporting releases of oil and hazardous materials. The program is semi-privatized and utilizes Licensed Site Professionals (LSPs) to administer the cleanups, thereby saving the state the need for a larger workforce.

Since its inception, the MCP has added additional requirements, such as knowledge-based management, which reviews scientific research and then raises or lowers contaminant concentrations accordingly. Other amendments have streamlined and simplified the site classification process to allow no tier permits, and have offered permanent solutions for vapor intrusion and some petroleum sites.

The development and remediation of a brownfield property entails several phases. An initial site assessment defines the area through the use of maps, records search, and process knowledge. Thereafter, a comprehensive site assessment pairs further site assessment with testing. Mapping out a remedial alternatives plan and instituting the remedial implementation plan is the next phase of the renewal process. The following phase focuses on the operation, maintenance, and monitoring of the site, which may include an RAO Statement, an activity and use limitation determination, or the implementation of Remedy Operation Status.

Massachusetts Brownfields Advisory Group. To effectively run the BTC program, Massachusetts has established the Brownfields Advisory Group. This organization has solidified partnerships between MassDevelopment, the Department of Environmental Protection, the Executive Office of Housing and Economic Development, the Business Development Corporation, the Department of Revenue, and the Attorney General's Office. The Brownfields Advisory Group has subsidized an environmental insurance program, carved out a program for Solar Renewable Energy Credits (SREC II), and developed a program of Brownfields redevelopment assistance.

BTCs in Massachusetts and elsewhere offer the added ability to carry over, recapture, and transfer the credit. Any portion of a credit that has been earned but not allowed based on previously cited limitations can be used in a subsequent tax year. The tax credit can be carried over for five years. That said, no tax credit can be carried over to a year when the taxpayer has ceased to maintain the Remedy Operation Status or permanent solution.

Recapture of an issued tax credit is a possibility when a taxpayer ceases to maintain the Remedy Operation Status or permanent solution prior to the sale of the property or the termination of the lease. In this case, the difference between the tax credit taken and the tax credit allowed for maintaining the remedy is added back as additional taxes due in the year in which the failure occurs. The sale of the property or the termination of the lease, in and of itself, will not result in recapture.

Recent additional provisions provide for the transfer, sale or assignment of a tax credit to another taxpayer or to a nonprofit organization. A taxpayer or nonprofit intending to transfer, sell or assign a tax credit must submit the appropriate form and provide appropriate information so that the brownfields tax credit can be properly allocated.

Typically an LSP will also be involved in the process to help secure any deserved tax credits. An LSP is an engineer or scientist authorized to oversee the assessment and cleanup of contamination releases, and is governed by the Board of Registration of Hazardous Waste Site Cleanup Professionals. The LSP program in Massachusetts has augmented the privatization of the cleanup of hazardous waste sites and dramatically increased the number of sites considered, thus making it a highly successful state-private enterprise endeavor.

Contamination usually consists of soil and/or groundwater contamination that exceeds the state's recommended quantity/concentration. In addition, brownfield sites with additional contamination such as asbestos, lead, coal ash, etc. may in some circumstances be added to a remediation plan. Eligible cleanup costs for contamination typically must not have been caused by the owner, but rather were either newly discovered after the property's purchase, or was known of with the intent to remediate and renovate.

The value of brownfields tax credits cannot be understated. In Massachusetts, for example, tax credits are equal to 25 percent or 50 percent of allowed cleanup costs (depending on the circumstances; this is similar for most states that offer brownfields tax credits). As an

example, \$1 million spent on cleanup is worth either \$500,000 in tax credits or \$250,000 in tax credits. The tax credits can be used as a dollar-for-dollar offset against state taxes owed, transferred as a commodity, or sold in the secondary marketplace for cash.

Typically, allowable brownfields tax credit remedial costs include state reporting and filing costs, remedial third-party labor, permitting, wetland restoration, risk assessors, legal counsel review, deed filings, in-kind services with receipts, equipment, drilling, disposal, groundwater treatment, laboratory testing costs, land value assessment, and land surveys. Costs that are usually disallowed include site development costs, real estate acquisition, interest and financing, intercompany personnel costs, and other legal costs not related to the environmental remediation.

Conclusion

As states have extended and amended their BTC programs, some changes in eligibility, timing, and requirements to apply for the tax credits have been enacted, as well as efforts to provide additional clarity, transferability, expansion, or, in some cases, restrictions. These tax credit programs may seem daunting, yet they should not discourage potential developers from considering currently contaminated properties as sites for redevelopment. BTCs in Massachusetts and elsewhere continue to be issued, and a vibrant resale market for BTCs exists, allowing for the continued strategy of using tax credits to recoup funds spent on remediation expenses.

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