CDFA Tax Credit Finance Course:
Brownfield Tax Expensing Program

Presented by
Charlie Bartsch
Vice President, ICF International
January 24, 2008

Passion. Expertise. Results.

www.icfi.com

What this session will cover…

- Overview of “brownfields” and the federal brownfield expensing tax incentive
- Role of the incentive in project finance
- Using the incentive – steps in the process
- Misconceptions and frequently asked questions
- Current status and future prospects
- Case study examples

Brownfield Cleanup Expensing Incentive – the Best Kept Secret in Government…

- Value of the incentive
  - *Enhances project cash flow*
  - *Offsets cleanup costs*
  - *Lowers taxable income*
  - *Tax advantages of remedies integrated into design*
  - *Encourages developers to pursue brownfield/ infill/smart growth/vacant property strategies*
- Activity only a fraction of level projected at enactment

Brownfield Cleanup Expensing Incentive – the Best Kept Secret in Government…

Incentive value, in any given project, depends on:

- Total cost of the project
- Total cost of the cleanup
- How long developer holds the property
- Developer’s tax situation

Legislative history and current status of brownfield expensing tax incentive

- Originally signed into law in August, 1997, as part of the **Taxpayer Relief Act**; sunset on 12/31/2003
- **Consolidated Appropriations Act** of 2001 repealed geographic restrictions
- Extended to 12/3/2005 as part of the **Working Families Tax Relief Act**
- Expanded to petroleum sites, extended to 12/31/2007 as part of the **Tax Relief and Health Care Act**

Legislative history and current status of brownfield expensing tax incentive

- H.R. 1753, to extend it permanently, eliminate recapture penalties, introduced in House 3/29/2007
- No Senate action yet; Finance Committee interest
- Currently – incentive in limbo
  - ***1 year extension (minus recapture) in House tax extenders package***
  - ***part of HR 3996 (AMT relief); dropped in final passage***
  - ***searching for a vehicle in 2008***
  - ***overall, authority seamless since 1997 enactment***

What Are Brownfields?

- The Brownfield Revitalization Act of 2002 defined brownfield sites as ***"real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance pollutant or contaminant.***"

- Practical real estate development impact of this definition – **they are found in both large cities and small towns everywhere!!**

The Face of Brownfields…1 million sites

Bloomington, IN

West Chester, PA

Milwaukee, WI

San Francisco, CA

The New Face of Brownfields…60,000+ Successes and Counting

Bloomington, IN

West Chester, PA

Milwaukee, WI

San Francisco, CA

Expensing Incentive Overview

What is the brownfield expensing tax incentive?

- Deduction pegged to cleanup costs, which allows new owners to recover cleanup costs in the year incurred
- Only federal brownfield incentive targeted to private site owners.

Expensing Incentive Overview

What is the background behind the brownfield expensing tax incentive?

- Effort by Congress to attract new owners to brownfield sites

- Aims to level the economic playing field between greenfield and brownfield sites through favorable tax treatment of cleanup costs

Expensing Incentive Overview

What's the level of recent activity?

From 2004-2007….

- 175 applications submitted, in 29 states *****
  - 170 applications approved
- $295 million in cleanup costs expensed

* ***Treasury estimate pre-enactment -- 10,000 properties annually would expense cleanup costs***

Expensing Incentive Overview

Why has it gotten so little use?

- Uncertainties/ambiguities/lack of guidance
- Expired, on again/off again authority makes planning difficult
- Lack of information, bad information among development, accounting, and legal communities
- Impact of recapture
- Not structured as/perceived as deal maker

Expensing Incentive Overview

Where has it been used – 2004-2007?

- Wisconsin – 19 applications
- Massachusetts – 16 applications
- Rhode Island – 15 applications
- Maryland, Texas – 12 applications
- Pennsylvania – 10 applications

Expensing Incentive Overview

Where has it been ignored – 2004-2007?

- ***19 states***

  Alabama, Alaska, Arizona, Arkansas, Hawaii, Idaho, Iowa, Kansas, Maine, Mississippi, Montana, Nebraska, Nevada, North Dakota, Oklahoma, South Carolina, South Dakota, Utah, Wyoming

Brownfield Expensing Incentive – What it Does

- Allows deduction of **“qualified environmental cleanup costs”** in the year incurred or tax paid
- Can deduct instead of adding the cost to the basis of the property
- Generally available for costs paid or incurred after August 5, 1997, through December 31, 2007

Brownfield Expensing Incentive – “Qualified Environmental Cleanup Costs”

- Costs paid to abate or control a hazardous substance at a **“qualified contaminated site”**
- Can include:
  - *Site assessment, cleanup, monitoring costs*
  - *Costs necessary to install an institutional or engineering control*
  - *State VCP fees and associated costs*
  - *Removal of demolition debris*

Brownfield Expensing Incentive – "Qualified Contaminated Site"

- **Qualified site** must meet 2 requirements:
  - Be held for use in a trade or business, for production of income, or as inventory
  - Has had release, threat of release or disposal of a hazardous substance at or on the site

Brownfield Expensing Incentive – "Qualified Contaminated Site"

- **Qualified site** considerations:
  - State environmental agency must provide a statement that site meets latter requirement (release/threat of release – brownfield qualification)
  - Sites on EPA National Priorities List (Superfund), or proposed for listing, are ineligible

Brownfield Expensing Incentive – Limitations

Recapture Penalties

- Deduction may be recaptured as ordinary income when property is sold or otherwise disposed of --
  - *Taxed as ordinary income rather than at capital gains rate, if taxpayer would have received an addition to basis if this deduction had not been elected*

Brownfield Expensing Incentive – Limitations

Petroleum Contamination

- Petroleum contaminated sites only eligible since January 1, 2006
  - *Inconsistency in statutory “brownfield definition corrected*
  - *Consideration if filing amended return to claim incentive*

Brownfield Expensing Incentive – What are the Steps in the Process?

***Step 1* – determine whether you meet the taxpayer requirements**

***Step 2* – determine which costs can be deducted**

***Step 3* – ask your state to declare you eligible for the tax incentive**

***Step 4* – note additional criteria for qualifying expenditures between August 5, 1997 and December 21, 2000**

***Step 5* – file and claim**

Brownfield Expensing Incentive – Step-by-step Process

Step 1 – determine whether you meet the taxpayer requirements

- Property must be “held by the taxpayer”
- Taxpayer must hold the property for business or income generation purposes

Brownfield Expensing Incentive – Step-by-step Process

Step 2 – determine which costs can be deducted…those that --

- Address a release or threat of release
- Meet the definition of "hazardous substance"
- Fit the list of "typical eligible expensing expenses"

Brownfield Expensing Incentive – Step-by-step Process

Step 2 (cont.) – determine which costs can be deducted

- "Typical eligible expensing expenses" include:
  - *Site assessment, investigation, and cleanup*
  - *Monitoring costs*
  - *Costs necessary to install an institutional or engineering control*
  - *State VCP fees and associated costs*
  - *Removal of demolition debris*

Brownfield Expensing Incentive – Step-by-step Process

Step 3 – ask your state to declare you eligible for the tax incentive

- Check with state contact for eligibility determination
  - Typically, state environmental agency/VCP
  - ***Designated state agency contacts available at:*** **www.epa.gov/swerosps/bf/stxcntct.htm**
- Rapid process in virtually all states

Brownfield Expensing Incentive – Step-by-step Process

Step 3 (cont.) – time frame for state tax incentive eligibility declaration

States that move the fastest to certify eligibility…

- Texas – 1 day
- New Jersey – 2 days
- Massachusetts – 5-10 days
- Virginia, California, Missouri, North Carolina – 1 week

Longest reported review time: Ohio – 30 days

Brownfield Expensing Incentive – Step-by-step Process

Step 3 – state declaration of tax incentive eligibility… the caveats emptors

- Note that information may be used against you by cleanup or enforcement authorities
- ***Surprise!!*** Some state contacts may not know that they are, what this incentive is
- ***More surprise!!*** Ditto local IRS agents

Brownfield Expensing Incentive – Step-by-step Process

Step 4 – note additional criteria for qualifying expenditures between August 5, 1997 and December 21, 2000

- Original geographic eligibility targeting criteria must be followed if filing an amended return to apply incentive to costs incurred prior to 12/21/00
- Expenditures after 12/21/00 <u>do not</u> have to meet them

Brownfield Expensing Incentive – Step-by-step Process

Step 4 (cont.) – additional criteria for qualifying expenditures between August 5, 1997 and December 21, 2000

Projects must be in either:

- Census tracts with poverty rates of 20% or more
- Certain low population, distressed census tracts
- Federally designated EZs or ECs
- EPA pilot sites announced before 2/1/97

Brownfield Expensing Incentive – Step-by-step Process

Step 5 – file and claim

Simple incentive paperwork --

- Small businesses -- *2-page form, Section 198 expensing*
- Companies/partnerships with $10 M+ in assets – *longer Schedule M-3*
- Individuals – *"Other expenses" line on Form 1040, Schedules C, E, or F*

Brownfield Expensing Incentive – Step-by-step Process

Step 5 (cont.) – file and claim

- Filing an amended return?
  - *Use the appropriate criteria, depending on the date of cleanup expenditures*
  - *Eligible within 3 years of filing original return*
  - *Eligible within 2 years if seeking a refund*

Case Studies of the Brownfield Expensing Incentive

Where has the incentive been used?

- T.R. Thickston – *Bloomington, IN*
- Lawrence Gateway – *Lawrence, MA*
- Goodwill Fire Department – *West Chester, PA*
- MLK Drive Restoration – *Milwaukee, WI*
- SBC Park – *San Francisco, CA*

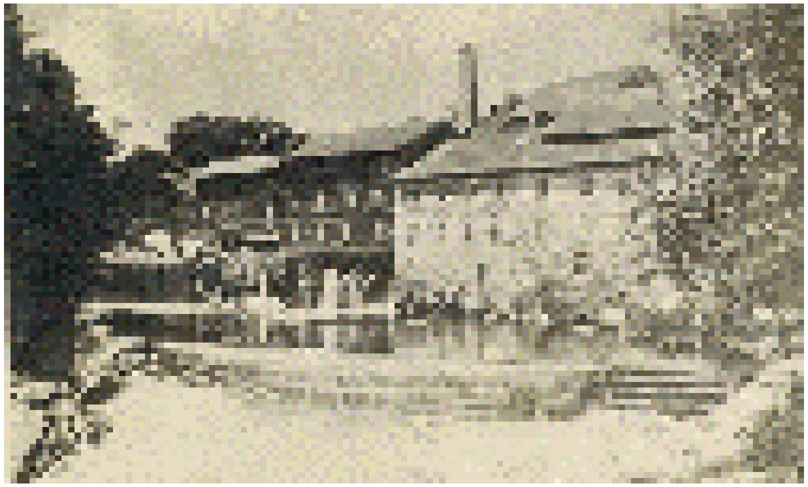
T.R. Thickston Glass Company, Bloomington, IN

- Former recycling center with foundry waste
- Project spearheaded by environmental consulting firm familiar with tax incentive
- Property purchased at county tax sale
- Cleanup included removal of 60 loads of contaminated soil, import of 80 loads of new soil and clay

T.R. Thickston Glass Company, Bloomington, IN

- Indiana certification process requires affidavit, Phase I and II reports
- Incentive saved about $80,000 in tax liability, used to support cash flow until redevelopment began
- Site leased to commercial glass operation; created 3 jobs
- Developer has done 2 more projects – former plating facility, former junkyard

Lawrence Gateway – Lawrence, MA



- 8.6 acre former plastics manufacturing facility with 100-year history, acquired by GenCorp in the 1950s, closed in the 1980s
- Soil, groundwater contamination – PCBs, solvents, oils, metals
- $80 million total cleanup costs since 1987

Lawrence Gateway – Lawrence, MA

- Converted into a medical complex and supportive amenities (parking, open space)
- In 1998 alone, Gen Corps attributes $2.4 million in returned cash flow to brownfield expensing incentive
- Additional benefits in subsequent years

Alliance Environmental/Goodwill Fire Department – West Chester, PA

- 8.5 acre former brick quarry, pharmaceutical property and dump site in economically distressed area
- groundwater contamination
- Property acquired in 1998 by Alliance Environmental
- Cleaned and redeveloped as part of Alliances's corporate expansion plan
- Linked to PA brownfield incentives

Alliance Environmental/Goodwill Fire Department – West Chester, PA

- Now, location of Good Will Business Park: 100,000 sq. ft. of retail, public service facilities including fire department, Alliance HQ
- Incentive provided Alliance with nearly $800,000 in tax relief, received needed cash injection as tax refund
- Alliance has used incentive on a second project, a former concrete plant

MLK Drive Restoration – Milwaukee, WI

- 1-acre abandoned site
- PCB contamination
- Project spearheaded by development consultant
- Site capped, part of cap used as parking lot

MLK Drive Restoration – Milwaukee, WI

- Now, site redeveloped as mixed use – dentist office and 2 apartments
- Contractor/owner expensed more than $100,000 in cleanup costs, including expenditures on parking lot cap

SBC Park – San Francisco, CA

- 13-acre former landfill and industrial warehousing site
- Area characterized by cargo storage yards, abandoned buildings, crumbling piers
- Contamination included waste from former coal gasification plant
- Land leased from Port of San Francisco
- First privately financed ballpark in 30 years

SBC Park – San Francisco, CA

- Tax incentive worth several million in $300 million project
- Considerable benefits to city: $10 million in annual rent/concessions; considerable economic spin-off around the stadium
- Catalyst in $1 billion in waterfront redevelopment investment

Frequently Asked Questions

- ***Meeting the contamination criteria***
- ***Determining eligible expenses***
- ***Meeting the ownership criteria***
- ***Securing state eligibility certification***
- ***Doing the paperwork***

Frequently Asked Questions

Meeting the contamination criteria

- What exactly is a “hazardous substance” as defined?
  - *Based on Superfund definition, and includes most substances that are ignitable, corrosive, reactive, or toxic*
- Does “hazardous substance” as defined include oil or mixtures with oil?
  - *In December 2006, Congress amended the incentive to make petroleum products eligible – crude oil, oil condensates, and gasoline*

Frequently Asked Questions

Meeting the contamination criteria

- What exactly is a “release or threat of release”?
  - *Releases include “spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment”*
- What release documentation is required by states?
  - *Varies state by state*

Frequently Asked Questions

Determining eligible expenses

- **Is there any tax difference between “incurring” and “paying for” a cleanup cost?**
  - *Is these activities take place in different years, the year chosen for the deduction will depend on the taxpayer’s accounting method*
- **Are costs of asbestos or lead removal eligible?**
  - *Generally not -- CERCLA does not govern remedial actions to address products that are part of a building’s structure and result in exposure within buildings*
  - *Eligible if able to show threat of release into outside environment*

Frequently Asked Questions

Determining eligible expenses

- Could construction of an access road or operations and maintenance costs be expensed under this provision?
  - *Yes – if these activities are part of the abatement or control strategy*
- Are preliminary site assessment/investigation/ remedial planning activities eligible?
  - *Yes -- as the first step in abating or controlling hazardous substances*

Frequently Asked Questions

Determining eligible expenses

- Could the incentives apply if contamination was capped with a parking lot?
  - *Yes – if these activities are part of the abatement or control strategy*
- Can parks or open space qualify for the incentive?
  - *No – property being cleaned up must be used in a trade or business, or income producing*

Frequently Asked Questions

Determining eligible expenses

- Is there a time limit for deducting qualifying expenditures?
  - *Costs as far back as August 5, 1997 may qualify; limits on filing amended returns (i.e., within 3 years of original filing) apply*
- When will the IRS issue regulations or a list of costs that qualify?
  - *The IRS has no plans to do this*

Frequently Asked Questions

Meeting ownership criteria

- Does an environmental assessment paid by a prospective purchaser qualify?
  - *No -- property must be "held by the taxpayer"*
- Can investment properties held for future sale qualify?
  - *Yes – any property used for non-personal purposes or for the production of income qualifies; this includes properties held by a developer for future sale*

Frequently Asked Questions

Meeting ownership criteria

- What happens if a business later sells the property?
  - *Incentive benefits may be subject to recapture*
- Can publicly owned properties, or leased properties, ever take advantage of the incentive?
  - *Possibly, if the property is considered "held by the taxpayer" – paying cleanup costs a property covered by a long-term lease could qualify*

Frequently Asked Questions

Securing state eligibility statements

- How does the taxpayer verify that a property is eligible?
  - *Taxpayers must receive a statement that a release or threat of release has taken place; documentation varies by state*
- How do the states verify property eligibility?
  - *Methods vary by state*
- How long are these statements valid?
  - *As long as the incentive is in place*

Frequently Asked Questions

Securing state eligibility statements

- Can properties be declared eligible before any work begins?
  - *Yes – states certify that a brownfield exists; they do not determine whether any work has taken place*
- What happens if something "turns up" during the eligibility determination process?
  - *Such information may trigger enforcement actions* ☹

Frequently Asked Questions

The paperwork…

- What forms must a business file for this incentive?
  - *Small businesses -- 2-page form, Section 198 expensing*
  - *Companies/partnerships with $10 M+ in assets – longer Schedule M-3*
  - *Individuals – "Other expenses" line on Form 1040, Schedules C, E, or F*
- How complicated are they?
  - *Only your accountant knows for sure….*

For additional information…

From IRS –

- ***Publication 954, "Tax Incentives for Empowerment zones and Other Distressed Communities, at:***

  www.irs.gov/pub/irs-pdf/p954f.pdf
- ***Rev. Proc. 98-47: "procedures to make the election under Section 198…"***

From EPA

- ***Designated state agency contacts available at:*** **www.epa.gov/swerosps/bf/stxcntct.htm**

ICF CONSULTING

Thank you!

If you have questions…

If you need additional information….

If you'd like to be notified of any legislative updates affecting the brownfield expensing incentive…

Charlie Bartsch

cbartsch@icfi.com

(202) 862-1134