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Brownfields Tax Incentive Guidelines

Background

The U.S. Environmental Protection Agency (EPA) is committed to helping revitalize former industrial or commercial areas that were abandoned due to concerns about environmental contamination. EPA and its federal partners believe that, with the right incentives, these former engines of industrial growth can once again generate value for both the private and public sectors.

These areas are "brownfields," which EPA defines as "abandoned, idled, or under-used industrial and commercial facilities where expansion or redevelopment is complicated by real or perceived contamination." These properties may be large or small; urban or rural; former factories or warehouses. They have all been left idle due to concerns about cleanup costs and legal liabilities.

On the public sector side, economic development officials recognize that redevelopment can lead to a wide variety of public benefits, including reduced blight, new jobs, lower crime rates and higher tax revenues. Private sector companies have also seen the advantages of brownfields redevelopment. Many of these sites are located in areas with strong infrastructure, transportation and urban markets.

To encourage this new interest in brownfields, EPA, the Department of the Treasury, and its other Federal partners have created incentives for potential developers. One of these is the Brownfields Tax Incentive, signed into law by President Clinton as part of the Taxpayer Relief Act on August 5, 1997. Under the tax incentive, certain environmental cleanup costs at targeted sites may be fully deducted by eligible taxpayers in the year in which they are incurred. The Treasury Department estimates that the $0.3 billion incentive will leverage $3.4 billion in private investments and return some 8,000 brownfields to productive use.

This tax incentive is one of many federal initiatives to encourage business development and commercial economic revitalization Programs exist that address a multitude of issues, including expanding access to capital, small business technical assistance, and workforce training and hiring incentives, and business owners should review the full range of initiatives that can turn a brownfields into an attractive business location.

An Introduction to Tax Incentives

The Brownfields Tax Incentive is not a tax credit, but reduces your tax burden indirectly by lowering your taxable income. The incentive does this by allowing you to claim many eligible cleanup costs as a current *expense*, rather than *capitalizing* them as long-term assets. Companies prefer deductions, because this substantially reduces their current income, allowing them to capture the tax savings now rather than later.

In the past, environmental cleanup costs had to be capitalized in some circumstances but not in others. In response to this problem, the Brownfields National Partnership worked together to "level the playing field." Under the Brownfields Tax Incentive, companies conducting a cleanup in certain areas may now deduct some expenses. Additionally, companies operating at a loss in the first years of business may use the tax incentive to establish a "net operating loss' that may be applied in future taxable years.

What's in These Guidelines

The next few pages of this guide will help you determine whether your property may be eligible to take advantage of the Brownfields Tax Incentive. This step-by-step guide covers:

- A fictional case study to show you the potential benefits of the incentive
- A description of the types of taxpayers that may use the tax incentive
- Suggestions for how to find out whether your property is in a targeted area
- Guidelines on the types of eligible cleanup deductions you may take
- Instructions on how to seek state verification of property and contamination eligibility

The Brownfields Tax Incentive: A Fictional Case Study

The following fictional example is designed to show you how the Brownfields Tax Incentive could create value for your company. In the short run, eligible companies that use the incentive can gain a large cash infusion up front, which can be used to finance the cleanup or generate higher long-term returns because they have opted to reinvest some of their savings into other projects. Companies can also realize long-term benefits from the tax incentive. By changing the timing of their tax payments, companies that use the incentive can reduce their total tax burden in real terms.

Both the scenarios and the assumptions used in the following fictional case have been simplified to provide readers with an easy analysis of the types of returns that could be achieved through use of the incentive. Your project will have different levels of savings, depending on your circumstances.

> **Acme Company**
>
> The fictional Acme Company wants to locate its new factory on a plot of land in an inner city neighborhood. The Company hopes to employ local workers at the facility, generating both new jobs and income for the community. While the plot is large enough for the new factory, it is contaminated with PCBs. If one assumes that the Company will clean up its property at a particular cost, and that this cost may be "expensed" in the year in which it is incurred, then the Company will save dollars commensurate with its corporate tax rate.

Scenario 1 – Up-front Cash Infusion

Expensing cleanup costs in the year incurred will reduce the net income on which tax is paid. In this way, a smaller portion of Acme's profit will go to pay taxes. The savings incurred can then be used to defray the costs of the new factory and/or additional investment in company infrastructure and productivity.

From an economist's perspective, the value of Acme's redevelopment project is increased by the first year savings and earnings on this savings as measured by the time value of money. Even if the savings could be realized over time, today's dollars are worth more than future dollars

Additionally, a new company with large up-front costs or an ongoing concern contemplating a significant investment may use the tax incentive to create a net operating loss. The net operating loss can be deducted by carrying the loss back 2 years when the business had profits or forward 20 years and deducted from future profits.

Scenario 2 – Lower Real Tax Burden

Another way to view Acme Company's savings is by realizing that the actual value of the taxes paid is affected by when the payments are made. Thus, by realizing tax savings in the first year, Acme savings will be impacted over the usable life of the improved property by inflation. Due to inflation, dollars saved in the present year are worth more than would be the dollars saved in the future years if the costs were amortized rather than expensed. Thus, Acme's tax burden, in real terms, is lower if it uses the incentive.

Step 1: Determine whether you meet the taxpayer requirements.

- **The property must be "held by the taxpayer."** This definition includes outright ownership. However, some types of long-term lease arrangements may qualify. If there is a question, taxpayers should consult with their tax counsel to determine whether their circumstances qualify.

- **The taxpayer must hold the property for business or income generation purposes.** This may include trade or business property, investment property, or property held as inventory. This does not include personal use property.

Step 2: Find out whether your property is located in one of the targeted areas.

The Brownfields Tax Incentive is designed to create economic growth in disadvantaged areas by encouraging the redevelopment of brownfields. The incentive primarily targets regions with low household income levels, as well as areas with a historical commitment to brownfields redevelopment. Sites on the National Priorities List are ineligible.

Eligible property must fall into **at least one** of the four categories designated below:

- Census tracts with a **poverty rate of 20% or more**.

- Census tracts with **populations of less than 2,000 people. More than 75% of the tract must be zoned for commercial or industrial use, and** the tract must **be located next to other census tracts with poverty rates of 20% or more**.

- All **Federally designated Empowerment Zones** or **Enterprise Communities**.

- **EPA Brownfields Pilot** sites designated prior to February 1997.

When determining eligibility based on census data criteria, you must use 1990 census data. Data from other more recent census samples is not permitted under the Brownfields Tax Incentive, which requires the use of the data from the last decennial, or ten-year, census.

If your property lies only partially in one of the four areas, you may qualify for a partial tax incentive. Taxpayers may receive a partial deduction covering those eligible costs incurred in cleaning up those parts of the property that fall in a qualifying area.

Additional information about each of these programs is included in Table 1.1, "Property Eligibility Requirements," on the following page. This table also includes instructions on how to use various free on-line resources to determine whether a given property qualifies. If you do not have World Wide Web access, please call (202) 260-4039 to get further assistance from the staff at EPA's Brownfields Office. In addition, you may also call HUD's Community Connections Service at (800) 998-9999.

Table 1.1

Property Eligibility Requirements

Qualifying area	How to tell if your property qualifies
Census tracts with a poverty rate of 20% or higher	**Step 1: Determine in which census tract the property is located.** The Federal Financial Institutions Examination Council web site allows you to look up census tracts given a street address or zip code for free. **http://www.ffiec.gov/geocode/** **Step 2: Determine the poverty rates within that census tract.** The Census Bureau web site provides state-by-state lists of census tracts with poverty rates of 20% or more. The information is at: **http://www.census.gov/ftp/pub/housing/tracts/**. HUD's Community Connections can also help you with this at (800) 998-9999.
Census tracts with populations of less than 2,000 people; more than 75% of the tract zoned for industrial use; and located next to census tracts with poverty rates of 20% or more.	**Step 1: Determine in which census tract the property is located.** Follow the instructions on Step 1 above to look up the census tract. **Step 2: Find out whether the population level in the tract is less than 2,000 people.** The Census Bureau web site posts lists of the population in each census tract, organized by state at **http://www.census.gov/geo/www/ezstate/poverty.html**. HUD's Community Connections can provide you with this list at (800) 998-9999. **Step 3: Contact your local planning office.** Your local planning office can tell you about how the tract has been zoned, as well as what other tracts border your census tract. Once you identify those tracts, you can use Step 2 above to determine whether they meet the poverty levels.
U.S. EPA Brownfields National Demonstration Pilots[1]	**Step 1: Identify whether your city, county, or state is one of the 75 eligible Brownfields Pilots.** The EPA lists these at **http://www.epa.gov/brownfields/html-doc/list_st.htm**. You can also call HUD's Community Connections at (800) 998-9999 to receive a copy of the list. **Step 2: Determine whether the property falls in the boundaries of the pilot area.** Contact the manager of the pilot project to discuss whether the property is eligible. Pilot managers are listed on the EPA web site at: **http://www.epa.gov/brownfields/contacts.htm**
Federally designated Empowerment Zone or Enterprise Community[2]	**Step 1: Determine whether the property falls in a federal EZ or EC area.** The Department of Housing and Urban Development provides a free search engine that allows you to check whether an address is within the boundaries of a federal Empowerment Zone or Enterprise Community at **http://www.hud.gov/ezec/locator/**. You can also obtain this information by calling HUD's Community Connections service at (800) 998-9999.

[1] The Brownfields National Demonstration Pilot Program was created by U.S. EPA in 1995 to help cities spur brownfields redevelopment. Cities, states and Indian Tribes *have received $200,000 in funding to identify and assess sites and carry out other activities to facilitate brownfields redevelopment. Under the program, pilot managers* designate certain areas within the city or state that are considered to be official parts of the project. Properties must fall within these to be eligible for the tax incentive. In addition, the properties must have been designated as part of the project in the city's initial agreement with the EPA.

[2] The EZ/EC Program is run by the Department of Housing and Urban Development and the Department of Agriculture. The program uses a wide variety of tax incentives and performance grants to create jobs and business opportunities in economically distressed areas across the country. More information on the program is available at **http://www.hud/gov/ezeclist.html** or **www.ezec.gov**.

Step 3: Find out which cleanup costs may be deducted.

In general, a property is eligible for the tax incentive if it is an area at or on which there has been:

- A release or threat of release of a hazardous substance, or
- Disposal of a hazardous substance

However, the property must not be listed or proposed for listing on EPA's Superfund National Priorities List. The expenses associated with the cleanup must occur after August 4, 1997 and before January 1, 2001.

What constitutes a release or a threat of release?

A release under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) includes spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping or disposing of hazardous substances into the environment. The "environment" under CERCLA includes surface water, ground water, ambient air, and land, but does not include indoor areas. Therefore, for a release or a threat of release to exist, it must involve or threaten the outdoor environment.

What is a hazardous substance?

The Brownfields Tax Incentive defines "hazardous substance" as any substance that is defined under CERCLA. The list of CERCLA hazardous substances can be found at 40 CFR §302.4, Table 302.4. However, the Brownfields Tax Incentive excludes products that are part of the structure of a building and result in exposure within that building (e.g. interior lead-based paint or asbestos that results in indoor exposure) from its definition of a "hazardous substance," even if that substance is listed on Table 302.4. In addition, petroleum is not a "hazardous substance."

To determine whether a particular substance is a "hazardous substance," you should consult an environmental attorney. U.S EPA Regional offices may be a source of information on defining a hazardous substance.

What expenses are eligible?

Generally, taxpayers may deduct those expenses that are paid or incurred in connection with the abatement or control of hazardous substances. For example, the costs of building an access road could be eligible if they were paid or incurred in connection with the abatement or control of hazardous substances, but not if it would just speed construction of a new building. If a taxpayer acquires otherwise depreciable property in connection with such an activity, the property's cost will not be immediately deductible, but may be expensed over the life of the property. Absent the Brownfields Tax Incentive, such depreciation would not be allowed.

Types of eligible expenses include:

- Site assessment and investigation
- Site monitoring
- Cleanup costs
- Operations and maintenance costs
- State voluntary cleanup program oversight fees
- Removal of demolition debris

Step 4: Ask your state for a statement that you are eligible for the tax incentive.

Before the IRS will accept the deduction, a designated state agency must provide you with a statement that the property meets the geographic and contamination criteria described above. You can find your state's designated agency by consulting Table 1.2 on the following page. If you need further assistance, you can visit the EPA's web site at **http://www/epa/gov/brownfields/contacts.htm**, or call EPA's Brownfields Office at (202) 260-4039. HUD's Community Connections service may also be able to help you at (800) 998-9999.

Each state agency will have a different application process and documentation requirements. For example, the state may require one or more of the following:

- a letter from the appropriate municipality certifying that the property meets the industrial zoning criteria
- reports or photographs from Phase I or Phase II environmental site assessments
- an affidavit detailing a release or a threat of a release of a hazardous substance at an eligible property

Once the statement is issued, the IRS will consider it valid for the life of the tax incentive. You need not attach a copy of the statement to your tax return to claim the deduction. In addition, the IRS does not require you to fill out a separate special form to claim the deduction. You need simply write "Section 198 Election" on your income tax return next to the line where the remediation expense is claimed as a deduction.

Taxpayers should be aware that states are not precluded from using information provided by a taxpayer to take action at a property under state cleanup or enforcement authorities.

Please note that the designated state agencies do not determine whether a given expenditure is eligible. Taxpayers should work with their tax counsel on the matter of eligible expenses.

Other Resources

These guidelines were prepared in partnership with Department of Treasury, Department of Commerce's Economic Development Administration, Department of Housing and Urban Development, and the Small Business Administration. Taxpayers should also consider the following resources for information on the Brownfields Tax Incentive.

- **Internal Revenue Service publications.** Further information is available in IRS publication 954, "Tax Incentives for Empowerment Zones and Other Distressed Communities" at **http://www.irs.ustreas.gov/forms_pubs/pubs/p954toc.htm** or the "Environmental Cleanup Cost Deduction" at **http://www.irs.ustreas.gov/forms_pubs/pubs/p95405.htm**. To confirm whether property or expenses are eligible for deduction under the tax incentive, taxpayers should consult with tax counsel or environmental attorney. In addition, the identified state contacts listed on the next page may provide needed technical assistance on using the tax incentive.
- **U.S. Environmental Protection Agency**. Additional fact sheets on the Brownfields Tax Incentive are available at **www.epa.gov/brownfields/** or by calling (202) 260-4039.
- **HUD's Community Connections Service**. You can receive technical assistance and printed materials on the Brownfields Tax Incentive by calling (800) 998-9999.

Table 1.2 Contact List for States and Territories

List available on the internet at www.epa.gov/brownfields/stxcntct.htm

State/Territory	Contact	Phone Number
Alabama	William Hardy, Alabama Dept. of Environmental Management	(334) 271-7974
Alaska	Alaska Department of Environmental Conservation	(907) 465-5010
Arizona	Amanda Carr, Arizona Dept. of Environmental Quality	(602) 207-4109
Arkansas	Jean Koeninger, Arkansas Dept. of Pollution Control and Ecology	(501) 682-0854
California	Sandy Karinen, California Dept. of Toxic Substances Control	(916) 255-3745
Colorado	Dan Scheppers, Colorado Dept. of Public Health and Environment	(303) 692-3398
Connecticut	Thomas Botti, Connecticut Dept. of Environmental Protection	(860) 424-3794
Delaware	Delaware Dept. of Natural Resources and Environmental Control	(302) 739-4403
Florida	Mary Blakeslee, Florida Office of Tourism	(850) 922-8743
Georgia	Darren Meadows, Georgia Department of Natural Resources	(404) 657-8600
Hawaii	Bryce Hataoka, Hawaii Dept. of Health	(808) 586-4248
Idaho	Idaho Bureau of Hazardous Materials	(208) 334-3263
Illinois	Shirley Baer, Illinois Environmental Protection Agency	(217) 785-8728
Indiana	Indiana Dept. of Environmental Management	(317) 232-8611
Iowa	Lavoy Haage, Iowa Dept. of Natural Resources	(515) 281-4968
Kansas	Kansas Dept. of Health and Environment	(785) 296-1535
Kentucky	Herb Petitjean, Kentucky Division of Waste Management	(502) 564-6716
Louisiana	Louisiana Dept. of Environmental Quality	(504) 765-0261
Maine	Nicholas Hodgkins, Maine Dept. of Environmental Protection	(207) 287-2651
Maryland	Jim Metz, Maryland Department of the Environment	(410) 631-3437
Massachusetts	Nicholas Zavolas, MA Dept. of Environmental Protection	(617) 556-1125
Michigan	James Linton, Michigan Department of Environmental Quality	(517) 373-8450
Minnesota	Gerald Stahnke, Minnesota Pollution Control Agency	(612) 297-1459
Mississippi	Jerry Banks, Mississippi Dept. of Environmental Quality	(601) 961-5221
Missouri	Jim Belcher, Missouri Dept. of Natural Resources	(573) 526-8913
Montana	Carol Fox, Montana Dept. of Environmental Quality	(406) 444-0478
Nebraska	Jeff Kelley, Nebraska Dept. of Environmental Quality	(402) 471-3387
Nevada	Eugene Klara, Nevada Division of Environmental Protection	(702) 687-4670
New Hampshire	New Hampshire Dept. of Environmental Services	(603) 271-6778
New Jersey	Terri Smith, New Jersey Dept. of Environmental Protection	(609) 984-3122
New Mexico	Stacy Sabol, New Mexico Environment Department	(505) 827-2754
New York	New York State Dept. of Environmental Conservation	(518) 457-3446
North Carolina	Jack Butler, NC Dept. of Environment and Natural Resources	(919) 733-2801
North Dakota	Fritz Schwindt, North Dakota Dept. of Health	(701) 328-5150
Ohio	Amy Yersavich, Ohio Environmental Protection Agency	(614) 644-2285
Oklahoma	Rita Kottke, Oklahoma Dept. of Environmental Quality	(405) 702-5127
Oregon	Kevin Dana, Oregon Dept. of Environmental Quality	(503) 229-6629
Pennsylvania	Thomas Fidler, Pennsylvania Dept. of Environmental Protection	(717) 783-7816
Puerto Rico	Miguel Maldonado	(787) 767-8181
Rhode Island	Angela Shulman, RI Dept. of Environmental Management	(401) 222-2797
South Carolina	Keith Lindler, SC Dept. of Health and Environmental Control	(803) 896-4052
South Dakota	South Dakota Dept. of Environment and Natural Resources	(605) 773-5559
Tennessee	Andy Shivas, Tennessee Dept. of Environment and Conservation	(615) 532-0912
Texas	Chuck Epperson, TX Natural Resources Conservation Commission	(512) 239-2498
Utah	Utah Department of Environmental Quality	(801) 536-4404
Vermont	George Desch, Vermont Agency of Natural Resources	(802) 241-3491
Virginia	Chris Sitaram, Virginia Dept. of Environmental Quality	(804) 698-4403
Washington	Harold Bucholz, Washington Dept. of Ecology	(360) 407-7185
West Virginia	Ken Ellison, West Virginia Division of Environmental Protection	(304) 558-5929
Wisconsin	Michael Prager, Wisconsin Dept. of Natural Resources	(608) 261-4927
Wyoming	Wyoming Dept. of Environmental Quality	(307) 777-7758

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