



Environmental Practice BRIEFING

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Following are recent developments in environmental law and policy that may be of interest to our colleagues, clients and friends:

Developers to Benefit from New York Brownfield Redevelopment Tax Incentives

On October 7, 2003, New York State Governor George E. Pataki signed into law a series of programs that together are called the New York Brownfield Cleanup Program (BCP). The BCP was designed to stimulate brownfield cleanup and reuse by replacing the 10-year-old New York Voluntary Cleanup Program (NYVCP) with a program that is more focused on eliminating developers' fears of investing in contaminated real estate in New York. The new program attempts to stimulate brownfield cleanup and reuse in many ways, including by providing for the substantial tax incentives that are described in this Briefing. As the scope and structure of the benefits have become understood, it has become clear that these tax incentives may well transform some real estate redevelopment deals that previously were deemed economically unviable into viable, and even lucrative, transactions.

I. BCP BACKGROUND

Brownfield sites are parcels of underproductive property where redevelopment is made more difficult and less attractive by the actual or suspected presence of environmental contamination. Due in large part to concerns about environmental liabilities associated with the property, brownfields frequently are vacant, abandoned or mothballed. According to some estimates, there are thousands of brownfield sites in New York.

It may seem surprising that it is difficult to nurture private sector interest in developing brownfield sites. As they were often the site of historical commercial enterprises, these properties tend to be located near or in developed neighborhoods, within close proximity to a substantial labor force and modes of transportation and are readily served by utilities. This contrasts sharply with building

on previously undeveloped land, which requires new infrastructure and exacerbates land-use concerns centered on ever-decreasing open and/or untrammelled space. Unfortunately, the perceived costs and uncertainty associated with taking on an environmental investigation or remediation often tip the balance away from making brownfield redevelopment an attractive option.

In the past, developers who considered taking on brownfield redevelopment projects faced perceived legal, administrative and financial burdens. The federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA, also known as the "Superfund" law) and its state-level counterparts created concerns for developers who purchased contaminated sites for redevelopment purposes, primarily because these laws provide that even owners who are not responsible for polluting the site can, in certain circumstances, be held liable for the entire cost of cleaning up the contamination on such sites. Moreover, a developer's response to environmental contamination is governed by regulations enforced by a governmental agency which, in New York, is the New York Department of Environmental Conservation (NYDEC). Such agencies are generally not known for efficiency, flexibility, clarity or sensitivity to developers' needs. Developers thus had reason to be concerned that their ability to benefit from (or even close) a brownfield redevelopment project was subject to a governmental agency's administrative processes and timetable. These types of legal and administrative burdens decreased the likelihood and probable magnitude of a positive return from the developer's investment. Moreover, the lack of clear cleanup standards meant that the cost of a cleanup was uncertain, which further undermined the financial viability of a brownfield redevelopment project.

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Over the past several years, the federal government and most states have sought to reform their contaminated site cleanup laws to facilitate the investigation and remediation of those sites. New York was late in coming to the party, in part due to protracted battles amongst various stakeholders over the BCP and what form it should take. While many of the regulations implementing the new law have yet to be promulgated, it appears that New York's efforts to do better than the current statutory program and the NYVCP may well pay off. The BCP reforms the state's liability scheme to more closely parallel the newly amended (and more user-friendly) CERCLA. The BCP sets forth reasonably clear and comprehensive cleanup guidelines—called “Tracks”—that are correlated to intended future use (for example, a cleanup to the strict Track 1 standards will permit future residential uses; cleanups to the less strict Track 2, 3 or 4 standards will permit future commercial uses). The BCP also promises quicker administrative turnaround times and a less ambiguous release from liability when the project is successfully completed than that offered by the NYVCP.

The New York legislature apparently recognized that diminishing the negative aspects of brownfield projects would not in itself be sufficient to draw developers to these sites. Therefore, New York has also increased the size of the carrot by offering targeted tax relief via the BCP.

II. BCP TAX INCENTIVES

Under the BCP, three credits are available to offset New York corporate, utility, bank and insurance franchise taxes, as well as to offset personal income taxes (collectively, “Qualifying Taxes”). The tax credits are: (1) the Brownfield Redevelopment Tax Credit, (2) the Property Tax Credit for Remediated Brownfields and (3) the Environmental Remediation Insurance Credit.

To initiate the BCP process, a New York taxpayer must enter into a Brownfield Site Agreement (BSA) with the NYDEC. In the BSA, the developer agrees to appropriately investigate and/or remediate a site it owns or is developing and to pay the NYDEC's oversight costs. When the developer receives a Certificate of Completion by the NYDEC, indicating the successful completion of cleanup activities under the BCP, the developer who executed the BSA becomes eligible for the tax credits. A developer eligible for the tax credits is referred to as a Qualified Developer and a site for which a Certificate of Completion has been issued is referred to as a Qualified Site.

The tax credits become available to Qualified Developers for tax years beginning on or after April 1, 2005, and will remain available to Qualified Developers who receive a Certificate of

Completion on or before March 31, 2015. According to tax advisory opinion TSB-A-04(1) I (April 1, 2004), the costs incurred in the cleanup and redevelopment of a Qualified Site incurred after the BSA has been executed but before the first taxable year beginning on or after April 1, 2005 are included in determining the tax credits. Individuals can use the tax credits to reduce their tax liability to zero. If there are more credits available than tax liability in a single tax year, the Qualified Developer may choose either to apply the excess credits to the next taxable year or to be paid the cash value of the excess credits without interest. Finally, if the taxpayer is eligible for tax credits pursuant to other specified programs, it may have to choose which credits to receive.

A. BROWNFIELD REDEVELOPMENT TAX CREDIT

The Brownfield Redevelopment Tax Credit (BRTC) is comprised of three tax-credit components: (1) the site preparation component, (2) the tangible property component and (3) the on-site groundwater remediation component. The amount of each credit component is equal to a specified percentage (the Applicable Percentage), which is 12 percent for certain legal entities and 10 percent for individuals and other designated legal entities, of certain costs (Qualifying Costs) associated with remediating and developing a Qualified Site. The Applicable Percentage may be increased by: (1) 8 percent, if at least 50 percent of the Qualified Site is located in a so-called Environmental Zone (as designated by the NYDEC based on poverty and unemployment rates in the area) and (2) 2 percent, if the Certificate of Completion indicates that the soil has been remediated to the Track 1 level. As a result, Qualified Developers that are legal entities may be able to claim a maximum credit of 22 percent of Qualifying Costs, while Qualified Developers that are individuals may be able to claim a maximum credit of 20 percent of Qualifying Costs. For large projects, these tax credits may be very valuable.

1. Site Preparation Credit Component

The Qualifying Costs associated with the site preparation component are those capital expenditures incurred in connection with qualifying for and obtaining a Certificate of Completion and with preparing a site for the construction of a building that will have an industrial, commercial, recreational or conservation purpose (a Qualifying Use). For example, site preparation costs include the cost of staging and completing necessary environmental remediation activities, as well as the cost of excavation, temporary wiring, scaffolding, demolition and security fencing. Site preparation costs do not include the cost of acquiring the property. For Qualifying Costs incurred prior to the issuance of a Certificate of Completion, the site preparation component of the BRTC is first available in the

year the Certificate of Completion is issued. Otherwise, the credit is first available in the year the improvement to which the Qualifying Costs apply is put into service. However, the credit must be applied for before the end of the fifth tax year after the issuance of the Certificate of Completion.

2. Tangible Property Component

The Qualifying Costs associated with the tangible property component are the cost basis of Qualified Tangible Property. Qualified Tangible Property is comprised of physical assets, such as building components and equipment, which: (1) are depreciable pursuant to section 167 of the Internal Revenue Code (the Code), (2) have a useful life of four years or more, (3) have been acquired by purchase as defined in section 179(d) of the Code, (4) are located at a Qualified Site, (5) are principally used by the taxpayer for a Qualified Use and (6) are placed in service within a designated period following the issuance of a Certificate of Completion for the Qualified Site. The tangible property component of the BRTC is available to a Qualified Developer for a Qualified Site that is leased to a tenant only if the tenant did not cause the environmental contamination at the site that required remediation. The tangible property component of the BRTC is first available for the taxable year in which the Qualified Tangible Property is placed in service on the Qualified Site, but must be applied for before the end of the tenth tax year following thereafter.

3. On-site Groundwater Credit Component

The Qualifying Costs associated with the on-site groundwater credit component are the on-site groundwater remediation costs paid by the Qualified Developer with respect to the Qualified Site, but only to the extent that such costs are required as part of an approved remedial work plan and are not included in the costs of either of the other two components of the BRTC. For Qualifying Costs incurred prior to the issuance of a Certificate of Completion, the on-site groundwater credit component of the BRTC is first available in the year the Certificate of Completion is issued. Otherwise the credit is first available in the year the Qualifying Costs are incurred. The credit, however, must be applied for before the end of the fifth tax year after the issuance of the Certificate of Completion.

B. PROPERTY TAX CREDIT FOR REMEDIATED BROWNFIELDS

Under the BCP, a Qualified Developer may be granted the Property Tax Credit for Remediated Brownfields, referred to here as the Property Tax Credit, against Qualifying Taxes based on the amount of real estate taxes assessed and the number of workers employed at the Qualified Site. For purposes of this provision of the BCP, a Qualified Developer is a taxpayer who either has been issued a Certificate of Completion with respect

to the Qualified Site or has acquired all or part of a Qualified Site from an unaffiliated taxpayer who was issued a Certificate of Completion for the Qualified Site less than seven years before the transfer.

The Property Tax Credit is equal to 25 percent of the product of the Employment Number Factor and the “eligible real property taxes” paid or incurred by the Qualified Developer during the taxable year in which the credit is being claimed (or 100 percent of such product if the Qualified Site is located in an Environmental Zone, but not in excess of \$10,000 for each full-time employee). The Employment Number Factor used to determine the Property Tax Credit ranges from 0.25 to 1.00 based on the number of full-time employees at the site (by either the Qualified Developer or a lessee) with a minimum of 25 full-time employees required for the Property Tax Credit to be available. Eligible real property taxes include only those taxes or other impositions that are liens on the Qualified Site.

C. ENVIRONMENTAL REMEDIATION INSURANCE CREDIT

The Environmental Remediation Insurance Credit, referred to here as the Insurance Credit, is tied directly to the cost of qualifying environmental remediation insurance premiums incurred by the Qualified Developer. The Insurance Credit is equal to the lesser of \$30,000 or 50 percent of the premium paid for environmental remediation insurance obtained to protect the Qualified Site. The Insurance Credit is only available if the premium was paid after the execution of the relevant BSA and must be taken against Qualified Taxes in the year that the Certificate of Completion is issued. The credit is only available once with respect to a particular Certificate of Completion.

III. USING THE TAX BENEFITS

While the general parameters of the BCP tax incentives are now known, there is some uncertainty surrounding certain ambiguous provisions of the tax credit program. One such concern relates to the transferability of the tax credits. Unlike the Property Tax Credit (for which transferability is specifically provided by law) and the Insurance Credit (which, by its terms, can only be claimed once), it is unclear whether BRTC are transferable. Because the availability of these credits is tied to the issuance of a Certificate of Completion, the entity that executes the BSA, and therefore is issued the Certificate of Completion, is presumably the only party that can benefit from the tax credits. But if the BSA signatory is not the developer entity who makes the significant project-wide capital expenditures or if the BSA signatory is the developer but wants or needs to transfer the site prior to the completion of initial redevelopment, the entity that ultimately seeks all or part of the tax credits may not be the holder of the Certificate of Completion. While some

governmental officials have indicated their support for clarifying that BRTC are transferable, no official pronouncement has been made. On the other hand, it has been determined, pursuant to advisory opinion TSB-A-04(1) I (Apr. 1, 2004), that the BRTC components can be allocated to the partners of a partnership or the members of a limited liability company that elects to be treated as a partnership for New York tax purposes. At least until this transferability issue is resolved, the developer's legal structure is an important consideration.

Another potential issue relates to the Property Tax Credit. Presently, there is no indicated limit on the number of years for which the credit may be claimed. However, a memorandum released in November 2003 by the Director of the Environmental and Regulatory Programs of the Business Council of New York State cites this as a major legislative oversight and states that the legislature had intended a 10- to 15-year duration following the issuance of a Certificate of Completion. It is unknown if this or any other deadline will be imposed.

In addition, it is unclear whether the cleanup of all New York brownfield sites (regardless of the nature or extent of contamination) will be eligible for the tax credits.

The NYDEC recently issued a controversial guidance document that appears to broaden the circumstances under which it can deny eligibility for the BCP due to the nature and extent of the site contamination in question. This move towards narrowing of the eligibility criteria has significant policy implications. The impact of this policy change, however, may only be to reduce the number of sites eligible for the tax credits. There does not appear to be a movement to limit the magnitude or applicability of the credits.

Although interpretative regulations have not yet been issued with respect to these ambiguities, commentators have requested that either such regulations be promulgated or be made clear that no such clarifying regulations will be promulgated in the near future.

IV. CONCLUSION

By enacting the BCP, New York has created true and potentially significant economic incentives to redevelop New York brownfield sites. The New York environment, New Yorkers and developers who structure their entities and transactions carefully should all benefit from these incentives.

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