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CRS Report for Congress

Brownfields Tax Incentive Extension

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Summary

The brownfields tax incentive expires on December 31, 2007. Enacted in 1997, the provision allowed a taxpayer to fully deduct the costs of environmental cleanup in the year the costs were incurred (called "expensing"), rather than spreading the costs over a period of years ("capitalizing"). The provision was adopted to stimulate the cleanup and development of less seriously contaminated sites by providing a benefit to taxpaying developers of brownfield properties. In each of its budget proposals since FY2003, the administration has suggested that Congress make the tax incentive permanent. The 109th Congress renewed the provision through 2007 (P.L. 109-432) and made it effective retroactively to December 31, 2005, when the previous extension expired. The law also made sites contaminated by petroleum products eligible for the tax incentive. The 110th Congress may wish to consider another extension, or making the incentive permanent, as well as considering repeal of the recapture requirement.

Information on the extent of use of the brownfields tax incentive cannot be determined from federal income tax returns. However, to take advantage of the tax break, a developer has to obtain a certification from the state environmental agency that the site qualifies as a brownfield. CRS surveyed the agencies of all states in 2003 to ask how many applications they had received and approved. Twenty-seven states reported that they had received brownfield tax incentive applications, for a total of 161 applications, of which 147 were approved. The other 23 states reported that they received no requests for certification.

The brownfields[1] tax incentive expires on December 31, 2007. First enacted as part of the Taxpayer Relief Act of 1997 (P.L. 105-34), the incentive allows a taxpayer to fully deduct the costs of environmental cleanups in the year the costs were incurred (called "expensing"), rather than spreading the costs over a period of years ("capitalizing"). Its purpose is to encourage developers to rehabilitate sites where environmental

[1] For purposes of the tax incentive, a brownfield site ("qualified contaminated site") is a property held for use in a trade or business, for the production of income, or as inventory where there has been a release, or threat of release, or disposal of a hazardous substance. Sites on the Superfund National Priorities List are excluded (26 U.S.C. 198(c)).

contamination stands in the way of bringing unproductive properties back into use. (The provision has no application for public sector entities, such as municipalities, that develop brownfields and do not pay income taxes.)

To take advantage of the brownfields tax incentive, the developer of a property has to obtain a statement from the state environmental agency that the parcel is a "qualified contaminated site" as defined in the 1997 law. Because the brownfields tax deduction does not have its own separate line on either individual or corporate federal income tax returns, the only sources of information on the extent of use of the incentive are the state agencies that certify that the properties are indeed brownfields. CRS surveyed the appropriate agencies in each state in 2003 to determine the number of brownfield certifications they had issued. Twenty-seven states reported that they had received requests for certification, for a total of 161 requests, of which 147 were approved. Twenty-three states reported receiving no formal requests. The state-by-state responses are presented in the table at the end of this report.

Background. Federal tax law generally requires that the cost of *improvements* to a property must be deducted over a period of years, whereas other expenses, such as repairs, may be deducted in the same year they are incurred. Being able to deduct the costs when incurred is a financial benefit to the taxpayer. A 1994 ruling by the Internal Revenue Service[2] (IRS) held that the costs of cleaning up contaminated land and groundwater are deductible in the current year, but *only for the person who contaminated* the land. In addition, the cleanup would have to be done without any anticipation of putting the land to a new use. Further, any monitoring equipment with a useful life beyond the year it was acquired would have to be capitalized. On the other hand, a person who acquired previously contaminated land, such as a brownfield site, would have to capitalize the costs of cleanup, spreading them out over a number of years.

Cleanup costs are a major barrier to redevelopment of contaminated land. The Taxpayer Relief Act of 1997, which included the brownfields tax incentive, thus had the effect of expanding benefits and allowing developers who had not caused the contamination to deduct cleanup costs from their taxable income in the current year, rather than having to capitalize them.

As initially enacted, the brownfields tax incentive was available only to a property that was located in a "targeted area." The law defined a targeted area as a census tract with greater than 20% poverty, an adjacent commercial or industrial census tract, an Empowerment Zone or Enterprise Community, or one of the 76 brownfields to which the Environmental Protection Agency (EPA) had awarded a brownfield grant at that time. The Consolidated Appropriations Act, 2001 (P.L. 106-170) repealed the targeted area geographic restrictions and extended the tax break to all brownfields ("qualified contaminated sites").

A significant drawback of the tax incentive is that it is subject to "recapture." This means that the gain realized from the value of the property when it is later sold must be taxed as ordinary income (rather than at the generally lower capital gains rate) to the extent of the expensing allowance previously claimed. This dilutes the benefit of the tax

[2] Revenue Ruling 94-38.

break and has the effect of simply postponing a certain amount of the developer's tax liability until the property is resold. As a stimulus to development, the overall value of the brownfields tax break is dependent on a number of factors, including the total cost of the project, the cost of cleanup, how long the developer intends to hold the property before selling it, and the developer's individual tax situation. Repeal of the recapture provision has been favored by the Real Estate Roundtable and its partner associations representing various aspects of the real estate industry (architects, building owners and managers, mortgage bankers, general contractors, and others).

Since FY2003, the Administration's budget proposals have proposed making the tax incentive permanent. It has been in effect continuously since its enactment in 1997 and has been extended four times, most recently in the Tax Relief and Health Care Act of 2006, P.L. 109-432 (Division A, title I, § 109).[3] This extension through 2007, which was enacted on December 20, 2006, was made retroactive to December 31, 2005, when the previous extension expired. The EPA supports the permanent extension, as does the Real Estate Roundtable and its partners noted above.

This enactment also broadened the definition of hazardous substances, for purposes of the tax incentive, to include petroleum products (including crude oil, crude oil condensates, and natural gasoline).

The brownfields provision is one of a number of tax credits, deductions, and taxpayer benefits that were considered together. For more information, see CRS Report RL32367, *Temporary Tax Provisions ("Extenders") Expired in 2005*, by Pamela Jackson.

Survey Findings. The CRS survey, conducted between April and June 2003, found that a total of 161 brownfield tax incentive applications were made in 27 states. Of those, 147 were approved and 14 were denied. Seven states had 10 or more applications: Wisconsin had 20; Massachusetts, 17; Delaware, 16; New York, 14; Virginia, 11; and Michigan and Pennsylvania, 10 each. Thirteen states had one to three applications.

Twenty-three states reported that they had received no applications for certification. Many in that group said they had received inquiries but no formal applications, and some of those states added that they had made efforts to publicize the availability of the tax incentive through their websites and at in-person presentations at various meetings.

Table 1, below, presents the results of the survey in detail. The 23 states that reported receiving no applications were:

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[3] The other renewals were in the Ticket to Work and Work Incentives Improvement Act of 1999, P.L. 106-170 (title V, §511); in the Consolidated Appropriations Act, 2001, P.L. 106-554 (Appendix G, title I, §162); and in the Working Families Tax Relief Act of 2004, P.L. 108-311 (title III, §308(a)).

Alabama	Kansas	North Dakota
Alaska	Maine	Oklahoma
Arizona	Mississippi	South Carolina
Arkansas	Montana	South Dakota
Colorado	Nebraska	Utah
Hawaii	Nevada	West Virginia
Idaho	New Hampshire	Wyoming
Iowa	New Mexico	

Table 1. Applications for Certification for the Brownfields Tax Incentive

State	Number of Applications			Reasons for Denial	Average Estimated Time for Decision
	Received	Granted	Denied		
California	7	6	1	Site was not in a targeted area	12 days
Connecticut	1	1	0	n.a.	Not available
Delaware	16	14	2	One property was not a brownfield; at the other, the owner did not qualify	Not available
Florida	2	2	0	n.a.	Less than 30 days
Georgia	1	1	0	n.a.	3 days
Illinois	3	3	0	n.a.	About 1 week
Indiana	4	4	0	n.a.	30 days
Kentucky	1	1	0	n.a.	About 3 weeks
Louisiana	1	1	0	n.a.	1 or 2 days
Maryland	2	2	0	n.a.	About 2 weeks
Massachusetts	17	16	1	Site did not contain a hazardous substance	5-10 days

State	Number of Applications			Reasons for Denial	Average Estimated Time for Decision
	Received	Granted	Denied		
Michigan	10	9	1	Lead contaminant level did not exceed state's background level criteria	14 calendar days
Minnesota	3	2	1	Site was not in a targeted area	1 week
Missouri	6	6	0	n.a.	Within 30 days
New Jersey	2	2	0	n.a.	About 1 week
New York	14	10	4	Sites did not meet the definition of "qualified contaminated site"	19 days
North Carolina	2	2	0	n.a.	Within 2 weeks
Ohio	5	5	0	n.a.	60 days
Oregon	4	4	0	n.a.	About 3 days
Pennsylvania	10	10	0	n.a.	5-8 business days
Rhode Island	3	0	3	Two sites were not in a targeted area; the other did not meet the definition of "qualified contaminated site"	Within 2 weeks
Tennessee	2	2	0	n.a.	7 working days
Texas	8	8	0	n.a.	About 2 weeks
Vermont	1	1	0	n.a.	1 or 2 days
Virginia	11	10	1	Site was not in a targeted area	Less than 2 weeks
Washington	5	5	0	n.a.	Same day
Wisconsin	20	20	0	n.a.	About 2 weeks

Note: n.a. = Not applicable.