OUTSIDE COUNSEL

BY HOWARD B. EPSTEIN AND LAWRENCE P. SCHNAPF

Brownfield Law: A Question of Interpretation

Next month, New York's Brownfield Cleanup Law will be a year old. This article discusses some of the emerging issues involving eligibility, liability relief, and the tax credits that have surfaced during the implementation process of the act.

The statutory definition of a brownfield is "any real property where redevelopment or reuse may be complicated by the presence or potential presence of hazardous waste, petroleum or other contaminant."[1] Recently, a controversial Brownfield Cleanup Program (BCP) application filed by Forest City Ratner Companies for the New York Times Tower project that could generate nearly $170 million in brownfield tax credits has focused attention on when site reuse or redevelopment is "complicated" by contamination. Some brownfield advocates argue that such projects are not truly brownfields. Perhaps in response to the controversy or mindful of the potential costs of the BCP tax credits, the state Department of Environmental Conservation (DEC) has begun asking some BCP applicants to explain how the contamination is affecting the site redevelopment or reuse.

Howard B. Epstein

Lawrence P. Schnapf

Neither the brownfield act nor the draft BCP guidance issued by the DEC (BCP guide) provide any insight on this question. For example, will it be enough to show that the contamination has made redevelopment more expensive or harder to attract investors? Will a developer be required to show that the projected cleanup costs exceed a certain percentage of the development costs or that it could not obtain financing without obtaining a certificate of completion (COC)? If the applicant has obtained environmental insurance or a fixed price remediation contract, does the contamination no longer "complicate" reuse or redevelopment?

It is unclear how much contamination must be present for a site to be a brownfield.

It is also unclear how much contamination must be present for a site to be a brownfield. Does any concentration of hazardous waste or petroleum qualify or must there be some minimum threshold amount of contamination? Also, must the contamination be from a discharge or can it simply be associated with fill material imported to the site?

The act contains five categories of sites that are ineligible for the BCP.[2] The DEC has broadly interpreted the exclusion for enforcement actions or cleanup orders to apply to notices of violations and stipulation agreements issued under the Navigation Law or the Control of Bulk Storage of Petroleum Act.[3] This interpretation could disqualify many sites that should otherwise be eligible for the BCP.

Howard B. Epstein *is a partner at Schulte Roth & Zabel.* **Lawrence P. Schnapf** *is an attorney at the firm.*

Eligible Applicants

The DEC can reject a BCP application if the applicant has a "substantial interest" ineligible for the BCP. Because "substantial interest" is undefined, it is unclear if this term refers to holding a controlling or lesser interest in the entity.

Are volunteer obligations really limited to the site? Under the act, a "volunteer" is only required to investigate and clean up contamination at the site. The only off-site obligation of the volunteer is to perform a "qualitative exposure assessment" to evaluate the risk posed to public health and the environment.

Unfortunately, the BCP guide states that a volunteer must "characterize" contamination and evaluate "fate and transport" mechanisms. These are terms of art under the existing DEC remediation programs and could be construed to require volunteers to fully investigate off-site contamination. This would be inconsistent with the goals and obligations of volunteers set forth in the act.

Another question concerns what is covered under liability limitation and reopeners.[4]

After issuance of a COC, the applicant will receive a liability limitation protecting it and its successors/assigns from liability to the state under statutory or common law for contamination addressed by the BCP. Volunteers will also be released from liability to New York for natural resource damages under the Comprehensive Environmental Response, Compensation, and Liability Act.

However, it is unclear if the release will apply to other federal agencies that may have concurrent jurisdiction over the same natural resources (e.g., waterfront property).

To become effective, the COC must be recorded within 30 days of issuance or within 30 days of the applicant acquiring title. It is unclear if the COC will become void if the applicant fails to record it or files it beyond the 30-day period.

The DEC may modify or revoke a COC for "good cause." Because of the ramifications for revoking a COC (e.g., forfeiture of tax credits), the DEC needs to add a definition of "good cause" and establish administrative mechanisms for appealing such determinations.

Upon issuance of the COC, the applicant will also receive contribution protection for matters addressed by the COC. However, the liability limitation does not release applicants from their own acts or omissions causing personal injury or wrongful death. It is unclear

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if a volunteer may be protected from third-party property damage claims or injunctive relief where the volunteer takes title after completing an on-site cleanup and was not required to remediate contamination that migrated from the site prior to the act.

Tax Credits

There are two key categories where tax credits are available.

Perhaps the most valuable tax credit is the Brownfield Redevelopment Tax Credit (BRTC).[5] Similar to the state Investment Tax Credit, the BRTC applies to three types of costs: site preparation costs, tangible property costs, and on-site groundwater remediation.

The "site preparation" credit applies to costs that can be chargeable to a "capital account" and includes costs of soil and groundwater remediation, site clearance and demolition, excavation, security and other costs to make the site usable for commercial, industrial, residential, recreational and environmental conservation purposes. However, site acquisition costs are not eligible. Applicants may claim credits for site preparation costs for up to five years after the COC.

The Qualified Tangible Property Credit (QTPC) cost component is available for costs of buildings and improvements that are placed into service within three years of the COC. The QTPC may be claimed for up to 10 years after the property is placed into service. An applicant does not have to own the property to claim the QTPC. Thus, a tenant can claim the credit for the cost of leased improvements provided the tenant is not responsible for disposal or discharge of hazardous wastes or petroleum.

The BRTC can be "recaptured" or added back to the taxpayer's taxable income for the year that a "recapture" event occurs. One recapture event is revocation of a COC. Another recapture event is when the property is sold within 12 years of the COC. As drafted, this credit substantially reduces the attractiveness of the BCP for residential projects since a developer that sells a condominium, townhouse or single family residence on the brownfield site within 12 years of the COC could lose most if not all of the credit. It is less clear if a recapture event would be triggered by the sale of co-op units since this involves transfer of stock and not transfer of title in land. Rental units do not appear to be subject to the recapture provision.

The "on-site groundwater remediation" cost component refers to costs incurred after the COC and may be claimed for up to five years after the COC. The five-year limit may discourage the use of long-term operation and maintenance programs in favor of more aggressive treatment technologies that could result in greater upfront costs.

The amount of the BRTC varies. The base tax credit is 12 percent for a corporate taxpayer and 10 percent for a non-corporate taxpayer. The credit increases by 8 percent if at least 50 percent of a site is located in an "environmental zone." The taxpayer can add another 2 percent for unrestricted (residential) cleanup. Thus, the maximum BRTC is 22 percent for a corporate taxpayer and 20 percent for a non-corporate taxpayer.

The BRTC is a refundable tax credit but may not be used to reduce a taxpayer's liability below its applicable alternative minimum tax. Any unused BRTCs will be treated as an overpayment of income tax for that taxable year, entitling the taxpayer to a tax refund. The credit may be claimed by individual partners in a partnership, members of limited liability companies and shareholders of New York "S" corporations.

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Applicants may accrue costs for the BRTC after execution of the act but pre-act costs are ineligible. The tax credit may not be claimed until after the COC. The BRTC is available in the taxable year in which the COC is issued beginning in April 1, 2005. Less clear is whether applicants may claim the BRTC for COCs issued before April 1, 2005.

Real Property Taxes

The other significant brownfield tax credit is the Brownfield Remediation Tax Credit for Real Property Taxes (brownfield RPTC). This tax credit is modeled after the Empire Zone RPT Program. The brownfield RPTC is based on the number of jobs at a brownfield site, including employees of tenants. While the brownfield RPTC may stimulate construction of shopping malls and office buildings, it does not provide much incentive for residential development.

The brownfield RPTC includes credits for eligible real property taxes as well as payments in lieu of taxes. The brownfield RPTC may be claimed against income taxes by individual partners in a partnership, members in a limited liability company, or shareholder in an "S" corporation that received a COC.[6] The brownfield RPTC is limited to owners of the contaminated property who obtained a COC.

There is a complicated formula for calculating the brownfield RPTC tax. First, the amount of the eligible real property taxes is multiplied by either 25 percent (or 100 percent if at least one-half of the property is located in an environmental zone). This product is then multiplied by an "employment number factor," which is based on the average number of full-time employees at the site during the taxable year.[7] Thus, for a site not located within an environmental zone that has $2 million in eligible real property taxes and 50 employees, the brownfield RPTC would be calculated as follows: 25 percent x $2 million = $500,000 x 50 percent (employment number factor) = $250,000.

The brownfield RPTC has a maximum cap of $10,000 times the average number of employees for the taxable year. Thus, using our prior illustration, the developer of the site would be limited to claiming $50,000 per year.

Another unanswered question is what effect does the exercise of a reopener have on the ability of the applicant to obtain the brownfield tax credits? Will previous tax credits get recaptured?

Transferring the BRTC

The BRTC is available to a taxpayer that has received a COC. Since a subsequent site owner would not have been issued the COC, it is unclear if the BRTC can be transferred with site ownership. However, where the applicant is an LLC, partnership or corporate entity, the benefits of the BRTC should be available by transferring an ownership interest in the entity that received the COC. The Department of Treasury and Finance is currently reviewing requests for advisory opinions on this issue. In contrast, the brownfield RPTC is expressly transferable to subsequent purchasers of the site who take title within seven years of issuance of the COC.

There are also some timing issues that need to be resolved. For example, if a site is transferred after an act is executed but prior to issuance of a COC, can a successor who completes the work claim the costs incurred by the seller? Similarly, can a purchaser acquiring the property after a COC but before the certificate of occupancy claim the BRTC for the costs of the improvements constructed by the seller?

The Brownfield Cleanup Law has already generated significant interest in redeveloping contaminated properties, particularly in the downstate area. This article has highlighted only some of the important challenges facing the DEC and the legislature as the BCP is implemented. How these questions are resolved will largely determine the success of this long-awaited law.

1. ECL §27-1405.1.
2. ECL §27-1405(2).
3. ECL §17-0101.
4. ECL §27-1421(2)(a).
5. N.Y. TAX LAW §21.
6. N.Y. Tax Law §22.
7. The employment number factor is calculated by applying a multiplier against the average number of full-time employees at the site. For sites with less than 50 employees, the multiplier is 25 percent; for sites with 50 but less than 75 employees, the employment number factor is 50 percent; for sites with 75 but less than 100 employees, the employment number factor is 75 percent; and for sites with 100 or more employees or sites located in an environmental zone, the employment number factor is 100 percent.