BROWNFIELDS ARE INDEED OPPORTUNITY ZONES

Hodgson Russ Environmental, Brownfield and Tax Alert
January 22, 2020

The Tax Cuts and Jobs Act created a new incentive program to spur development in distressed communities that qualify as "Opportunity Zones." Opportunity Zones are designed to encourage economic growth and investment in certain population census tracts designated by state and local governments. The primary benefits of the program are:

1. A deferral of tax on an item of capital gain that is reinvested in an Opportunity Zone Fund – the tax on the original capital gain can be deferred until 2026;
2. A basis step-up of up to 15% on the original capital gain; and
3. The ability to avoid paying any tax on capital gains from the sale or exchange of any Opportunity Zone investments held for 10 years or more.

Our attorneys have helped several businesses and investors navigate the program and we've noted a few subtle and perhaps unintended benefits that can arise, especially for New York residents who are looking to move out of the state in search of a more favorable tax situation.

But now another group of investors, specifically brownfield developers, stand to benefit as a result of the recently issued final set of Opportunity Zone regulations. In order to obtain the benefits under the program, the law requires either that:

(1) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund, or

(2) the qualified opportunity fund substantially improves the property. *See* IRC § 1400Z2-2(d)(2)(D)(i)(II).

Many questions persisted regarding the operation of the "original use" and "substantial improvement" tests when the initial regulations were promulgated. One such question was recently answered to the delight of developers and related investors. The regulations confirm that "all real property composing a brownfield site, including land and structures located thereon," will be treated by the IRS as satisfying the "original use" test. The Treasury Department specifically noted that "[c]leaning up and reinvesting in these properties increases local tax bases, facilitates job growth, utilizes existing infrastructure, takes development pressures off of undeveloped, open land, and both improves and protects the environment." This

Attorneys

Joseph Endres
Michael Hecker
Charles Malcomb
Paul Meosky
Daniel Spitzer
Jeffrey Stravino
Henry Zomerfeld

Practices & Industries

Brownfield Redevelopment
Environmental
State & Local Tax

confirmation provides investors with the certainty they have been looking for when looking at potentially marrying Opportunity Zone investments with State-based brownfield programs. Sounds like a win, win, win, win, win, win situation!

Finally, regarding the "substantial improvement" test, the final rule confirms that the costs of brownfield site assessment and remediation are eligible as costs for purposes of determining "substantial improvement" if the costs "add to the basis of the subject property." Thus, it seems likely that the costs of brownfield site assessment and remediation will typically be included in the calculation of the "substantial improvement" test. This is an important distinction for investors, as it might have deterred them from sites where significant remedial action was expected that might otherwise not be captured, at a minimum, through the Opportunity Zone benefits.

But it is important to remember that not all interactions between federal law and state brownfield developments have such happy endings. For example, in order to receive refundable state tax credits for developing a remediated site pursuant to New York's current Brownfield Cleanup Program, costs for tangible property must have "a depreciable life for federal income tax purposes of fifteen years or more." Tax Law § 21(a)(3)(iv). The NYS Tax Department has held on audit that if a taxpayer takes advantage of accelerated depreciation and depreciates such tangible property for a period of less than 15 years, even if the property could have been depreciated over 15 years or more, the costs for such property will not give rise to the refundable tax credits. It seems that according to the NYS Tax Department's interpretation, taxpayers must make a choice between a federal accelerated depreciation benefit and the refundable state tax credits. This is a pretty draconian application of the law, the legality of which has yet to be tested. We'll be following this closely, and providing any updates as they develop.

If you received this alert from a third party or from visiting our website, and would like to be added to our Brownfield Redevelopment mailing list or any other of our mailing lists, please visit us at: https://forms.hodgsonruss.net/sign-up-for-email-and-other-communications..html.