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Brownfield Redevelopment in Opportunity Zones: Taking Advantage of OZ Tax Benefits

Determining Substantial Costs, Vacancy, and Environmental Remediation

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Brownfield Redevelopment in Opportunity Zones: Taking Advantage of OZ Tax Benefits

PRESENTED BY

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Overview of the Brownfield Program

- A brownfield is a property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.
- Estimated 400,000 to 600,000 brownfield sites in the US
- Numerous laws designed to facilitate the redevelopment of the underutilized sites. This program focuses on the financial incentives.

Overview of the Brownfield Program

- How did we get here? The Evolution of the Brownfield Program.
- 1980 Congress enacted Comprehensive Environmental Response and Compensation Liability Act (CERCLA), which creates EPA's Superfund Program.
  - Most properties don't score high enough to become Superfund sites. Properties that are or may be environmentally contaminated (a/k/a brownfield properties) are in neighborhoods and communities across the country.

Overview of the Brownfield Program

- How did we get here?
- In 1995
  - after years of working with municipalities and State governments to address contaminated properties, EPA develops agreements with states to address the 'double jeopardy' liability from state and federal Superfund statutes. The Superfund Memoranda of Agreement (SMOAs) recognize (with qualifications) that sites cleaned through state VCPs are not of interest to Superfund.
  - EPA expand the Brownfield Assessment Grant Program. Nationwide, EPA awards 22 new grants in 1995 and 36 in 1996.

Overview of the Brownfield Program

- How did we get here?
- In 1997
  - The federal brownfields tax incentive is part of the Taxpayer Relief Act (Public Law 105-34). This tax incentive allows environmental cleanup costs to be fully deducted in the year incurred, rather than spread over time - thereby encouraging brownfield cleanup and reuse. In December 2000, the federal brownfield tax Incentive is amended (as part of Public Law 106-554) to provide a tax break to developers and investors whose funds address site contamination issues. The federal brownfields tax incentive ends December 31, 2011.

Overview of the Brownfield Program

- How did we get here?
- In 1997
  - EPA's Brownfield Cleanup Revolving Loan Fund (RLF) Grant Program launched in response to requests for cleanup funds. In the first year, EPA awards 24 grants; recipients include 2 states, 1 county and 21 cities and local communities. Grant amount range from $300,000 to $1,000,000. The recipients create loan funds which make low-interest loans for brownfield cleanup. Following cleanup, communities access other federal, state, tribal, local and private sources for redevelopment funds.

Overview of the Brownfield Program

- How did we get here?
- In 1997
  - Congress appropriates $10 million in Superfund Core funds so EPA can support development of state voluntary cleanup programs (VCPs) and risk-based cleanup approaches. Memoranda of agreements (MOAs) negotiated between states and EPA are part of early brownfield VCP operations. These MOAs clarify EPA and state roles, providing comfort for contaminated sites enrolled in state VCPs. EPA funding to states allows them to conduct brownfield assessments.

Overview of the Brownfield Program

- How did we get here?
- In 1998
  - The Brownfields National Partnership of over 15 federal agencies, designate 16 Brownfields Showcase Communities in 1998 and 12 in 2000. Each Showcase Community receives funds and direct staff support to coordinate and demonstrate the benefits of brownfields activities at the local level.

Overview of the Brownfield Program

- How did we get here?
- In 1998
  - EPA pilots a job training grant program in August 1998 to provide training in innovative and alternative treatment technologies to unemployed and underemployed residents in brownfield communities. Grants to 11 government, academic, education, workforce and community organizations help examine local hiring and promote educational opportunities, partnerships and training programs related to brownfields cleanup and redevelopment.

Overview of the Brownfield Program

- How did we get here?
- In 2002
  - Congress passes the Small Business Liability Relief & Brownfields Revitalization Act which is signed into law in 2002. The Act defines a “brownfield" and authorizes funding for assessment, cleanup and RLF grants (with more flexibility than grants piloted under Superfund grant authority), targeted brownfields assessments (TBAs), State and Tribal Response Programs, and research, training and technical assistance grants (including brownfields job training grants). The Act also clarifies CERCLA liability by providing liability protections for innocent landowners, contiguous property owners, bona fide prospective purchasers.

Overview of the Brownfield Program

- How did we get here?
- In 2002
  - EPA receives annually appropriated funds from Congress to support brownfields assessment, cleanup and job training. The Brownfields Program distributes those funds through national grant competitions.

Overview of the Brownfield Program

- How did we get here?
- In 2002
  - EPA now funds a wide range of technical assistance (TA) providers to further support brownfield site assessment and cleanup activities. TA providers are available to help communities across the country by providing free assistance on how to tackle brownfield challenges.

Overview of the Brownfield Program

- How did we get here?
- In 2002
  - States are able to enter into a memorandum of agreement (MOA) with EPA to define and clarify roles and responsibilities for contaminated sites addressed under state response programs. States with MOAs are automatically eligible for EPA response program funding. By 2019, 25 states have MOAs.

Overview of the Brownfield Program

- How did we get here?
- In 2002
  - EPA begins receiving funds annually from Congress to support State and Tribal Response Programs. Funds are allocated to eligible states, DC, territories and tribes to implement four Response Program elements: 1) survey and inventory brownfield sites; 2) oversight and enforcement to ensure responses protect human health and the environment according to federal and state law; 3) mechanisms and resources that provide opportunity for public participation, include public access to documents, prior notice and an opportunity to comment and a mechanism that a person affected by a release may request a site assessment; and 4) a mechanism for cleanup plan approval.

Overview of the Brownfield Program

- How did we get here?
- In 2006
  - The 2002 CERCLA amendments require purchasers of property to conduct an 'all appropriate inquiry' (AAI) to investigate past site activities, prior to acquiring a brownfield, if they want to assert the new Bona Fide Prospective Purchaser defense to CERCLA liability. EPA works with brownfields stakeholders nationwide to establish AAI standards and procedures. The AAI Final Rule (November 1, 2006) provides that ASTM International Standards E1527 and E2247 satisfy the statutory requirements for conducting AAI.

Overview of the Brownfield Program

- How did we get here?
- In 2010
  - Initiated in 2010 as a pilot grant program, EPA creates the Brownfields Area-Wide Planning grants program to help communities prepare for site cleanup and reuse. Brownfield Area-Wide Planning grant recipients research which brownfield properties could be catalysts for neighborhood revitalization. They determine feasible site reuses through community engagement, market and infrastructure analyses. The resulting area-wide plan includes specific implementation actions, such as sites to assess (and cleanup if needed); site and other area improvements needed; near-term v. long-term activities; partners needed to lead each effort; and amount of investment needed.

Overview of the Brownfield Program

- How did we get here?
- In 2018
  - Based on feedback and input from brownfield stakeholders, Congress passes the Brownfields Utilization, Investment and Local Development (BUILD) Act of 2018. The BUILD Act updates and strengthens EPA's Brownfields Program.
  - The BUILD Act expands liability protection for local governments by amending CERCLA's definition of "owner or operator" to exempt local governments that acquire ownership or control over contaminated properties through law enforcement activities, eminent domain by purchase or condemnation, or "through other circumstances in which the unit of State or local government acquires title by virtue of its function as a sovereign."
  - Not an affirmative defense (like BFPP).
  - Local government generally will not be liable under CERCLA for the contaminated properties they own, unless the local government actually "caused or contributed to the release c

Overview of the Brownfield Program

- How did we get here?
- In 2019
  - Using the new grant authorities of the 2018 BUILD Act, the Program awards 11 Multipurpose pilot grants in June 2019. Multipurpose grants allow recipients to conduct brownfields planning, assessment and cleanup activities. The new multipurpose authority expands the resources and activities beyond the approach that was piloted in nine communities in 2012.

Overview of the Brownfield Program

In 2020, where is the Federal Brownfield Program?

- On average, $17.45 is leveraged for each Federal brownfield dollar spent and 9 jobs are leveraged per $100,000 of Federal brownfield grant funds spent on assessment, cleanup, and revolving loan fund cooperative agreements.
- EPA 2020 Assessment, Cleanup and RLF grantees
  - Approx. $65M awarded in 2020
  - 15 states received no funding
  - Approx. 30% of the applications are funded

Overview of the Brownfield Program

- The BUILD Act expands liability protection for local governments by amending CERCLA's definition of "owner or operator" to exempt local governments that acquire ownership or control over contaminated properties through law enforcement activities, eminent domain by purchase or condemnation, or "through other circumstances in which the unit of State or local government acquires title by virtue of its function as a sovereign."
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the release or threatened release of a hazardous su

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Tax Incentives In Federal Opportunity Zones

Bob Collings
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Opportunity Zone Tax Incentives

- Established under the "TAX CUTS AND JOBS ACT" (TCAJA): P.L. 115-97 § 13823, 131 Stat. 2183-8 (Dec. 22, 2017).
  - govinfo.com/content/pkg/PLAW-115publ97/pdf/PLAW115-publ97.pdf
- TCAJA adds "Subchapter Z. Opportunity Zones" to the end of chapter 1 of the Internal Revenue Code 26 U.S.C. §§ 1-1400Z-2.

Opportunity Zone Tax Incentives

- Subchapter Z has 2 parts (6 pages of text).
  - 1400Z-1 creates the process for designating certain census tracts as "opportunity zones."
  - For background on census tracts, a PowerPoint is offered:
    - www2.census.gov/geo/pdfs/education/CensusTracts.pdf
  - Online maps of 8,766 census tracts designated Qualified Opportunity Zones by U.S. Dept. of Treasury: cdifund.gov/Pages/Opportunity-Zones.aspx

Opportunity Zone Tax Incentives

- Lists: IRS Notice 2018-48,
  - irs.gov/pub/irs-drop/n-18-48.pdf
  - 2 in Puerto Rico added IRS Notice 2019-42

QOZ Designations

- The designation period under 1400Z-1(c)(2) has ended. There is no provision for new designations.
- States nominated up to 25% of "low income community" census tracts as defined by 26 U.S.C. § 45D(e):
  - Poverty rate > 20%
  - Rural tract median family income < 80% State avg.
  - Metropolitan tract median family income < 80% of State avg. or metropolitan avg.

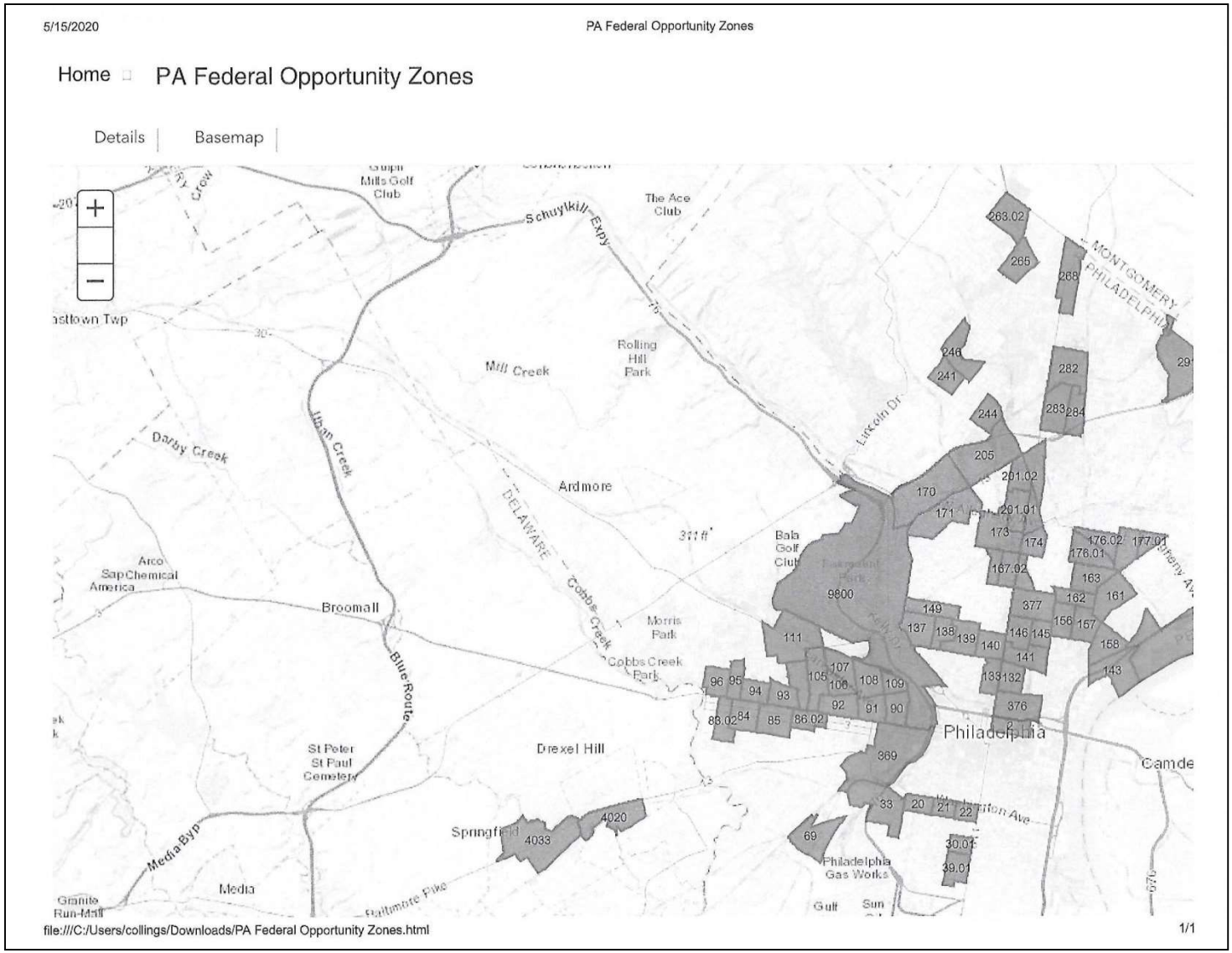
QOZ Designations

- Minimum State designation of 25 sites.
- Contiguous Tract rules

Designated QOZ Characteristics

- Average Poverty Rate 32% in QOZs, vs. 17% for average census tract
- Median family income in QOZs 39% below area/state medians
- Unemployment 1.6 x average U.S. census tract

Map of Philadelphia - QOZs



1400 Z-2 Tax Incentives

- "Qualified" is a well-known flag in IRS programs.
  - Qualified opportunity zone property invested in Qualified Opportunity Funds investing in Qualified Opportunity Zone Business in Qualified Opportunity Zones receive the following benefits:

1. Deferral of capital gains realization up to 2026 or end of the qualified investment

1400 Z-2 Tax Incentives

2. Step up in basis of qualified investments by 10% of deferred gain if held 5 years or more
3. Step up in basis of qualified investments by 15% of deferred gain if held 7 years or more
4. Avoidance of capital gains if held more than 10 years (Basis raised to Fair Market Value (FMV)

Look at the "Qualifieds"

- See 1400Z-2 text at 26 U.S.C.
- See rules: 85 Fed. Reg. 1866-2001 (Jan. 13, 2020)
- QOZs are defined clearly
- Types of investments/vehicles broadly stated:
  - Stock ownerships or partnership interest in a QOF qualified business property invested in a QOF
- Includes Qualified REITs, S corporations, Regulated Investment Companies and others

QOF Prior Appraisal Process

- None, other than being a partnership or corporation that files a tax return.
- QOFs may self-certify (Form 8996), but
- Failure to satisfy all rules applicable to assets, investments and business activity, including location in a QOZ, may result in penalties or loss of incentives.

More Restrictions

- Gross Income 50% Test
- Location of 70% tangible assets in QOZ
- At least 90% of fund assets invested in QOZ property
- Original Use Rules and Significant Improvement: Discussed in next session of Principal Brownfield Issues

Terms You Will Consider

- Internal Rate of Return (IRR) discount rate that reduces net present value to zero.
- Net Present Value: Total cost of project.
- Indirect Investment.
- Property classes.
- Safe Harbors.

Qualified Opportunity Zones

- Federal tax legislation to encourage investment in businesses and projects located in qualified low income communities designated as Opportunity Zones through the creation of qualified opportunity funds and the granting of tax incentives to investors
- Final IRS Regulations effective March 13, 2020

Tax Incentives to Investors

- **Delay** paying tax on capital gains
- **Reduce** the amount of tax on original capital gain if hold for at least 5 years (10% reduction) or 7 years (additional 5% reduction)
- **Avoid** tax on any appreciation of the qualified opportunity fund investment if held for 10 years

Qualified Opportunity Funds

- Investment vehicle organized as a corporation or partnership for the purpose of investing at least 90% of its assets in "Qualified Opportunity Zone Property”
- Self-certification (no IRS approval)

Eligible QOF Investments

Qualified Opportunity Zone (OZ) Property:

- Qualified OZ Stock in a Qualified OZ business
- Qualified OZ Partnership Interest in a Qualified OZ business
- Qualified OZ Business Property used in a Qualified OZ business

Qualified OZ Business Property

- Tangible property
- Used in trade or business
- Acquired after December 31, 2017
- Original use commences with the Qualified OZ business or the business substantially improves the property
- Substantially all (70%) of use in Qualified OZ

Original Use

- Generally date first placed in service
- Vacant structures – at least 5 years prior to purchase by Qualified OZ business
- Tenant improvements to leased property count
- Not applicable to land

Leased Property

- Lease entered into after December 31, 2017
- All lease terms are market rate terms
- Substantially all (70%) of the use in a Qualified OZ during substantially all of the period for which the business leases the property
- No original use or substantial improvement required

Land

- Must be used in a trade or business of the Qualified OZ business
- Holding for investment is not a trade or business
- Anti-abuse rules apply

Qualified OZ Business

- A trade or business that satisfies 5 tests:
- “Substantially all” test–70% of use
- In tangible property test
- The "serious business" test
- Working capital test
- Gross in come test

Gross Income Test

- At least 50% of the Qualified OZ business's total gross income is derived from the active conduct of such business within a Qualified OZ
- Safe Harbors

The New Opportunity Zone Regulations

- The final IRS Regulation (85 FR 1866) – Effective 3/13/2020
- To obtain the benefits under the Opportunity Zone 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).

The New Opportunity Zone Regulations

- The new 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 New Opportunity Zone Regulations

- Now brownfield sites no longer need to meet the strict time constraints of the IRS "substantial improvement" test.
  - What is a substantial improvement?
    - doubling the basis of property over a 30-month period.
- How does a brownfield site qualify as an "original use"?

The New Opportunity Zone Regulations

- How does a brownfield site qualify as original use?
  - Meet basic safety standards for health and the environment

The New Opportunity Zone Regulations

- Purchaser of property from local government who held the property as a results of an involuntary transfer (including through abandonment, bankruptcy, foreclosure, or receivership) may treat all the real property (including the land and structures thereon) as satisfying the "original use" requirement.

The New Opportunity Zone Regulations

Sites within Opportunity Zones purchased after Dec 2017 *Table dapted from USEPA Guidance on IRS Regulations for Opportunity Zones	Satisfies "Original Use" requirement	Must "substantially improve" property
Site is bare land	Yes	
Brownfields Site	Yes	
Site vacant prior to OZ designation and vacant for at least 1 year prior to purchase	Yes	
Site not vacant at time of OZ designation but became vacant and remained vacant for 3 years	Yes	
Non-brownfield Site that does not meet vacancy requirements		Yes

The New Opportunity Zone Regulations

- What qualifies as an eligible cost to demonstrate "substantial improvement" at an OZ Site?
  - Expenses for site assessment and remediation (85 FR 1913-14)

The New Opportunity Zone Regulations

- Permitting delays:
  - Delays caused by governmental approvals that cause QOF to fail to meet IRS requirements to deploy capital within 31 months is tolled for duration of permitting delay
    - Includes delays for brownfield regulatory approvals if awaiting these approvals precludes any further action to complete the project (85 FR 1925-26)

The New Opportunity Zone Regulations

- Permitting delays:
  - Clear guidance?
    - Therefore, with regard to instances in which governmental delay does not pose a substantial obstacle for improving such tangible property, a tolling of the 31-month period would not be appropriate.
    - However…

The New Opportunity Zone Regulations

- Permitting delays:
- The Treasury Department and the IRS have determined that the 31-month working capital safe harbor should be tolled in certain instances, i.e.
  - the final regulations make clear that, if a governmental permitting delay has caused the delay of a project covered by the 31-month working capital safe harbor, and no other action could be taken to improve the tangible property or complete the project during the permitting process, then the 31-month working capital safe harbor *will be tolled for a duration equal to the permitting delay*.

The New Opportunity Zone Regulations

- Permitting delays:
  - Examples of timeline for governmental approvals for brownfields projects.
    - Vetting, due diligence
    - Pre-application
    - Application
    - Approvals and Agreements
    - Investigation, Remediation, Closure Approvals

The New Opportunity Zone Regulations

- Permitting delays:
- Federally Declared Disaster Areas?? Covid-19??
  - if a project is located within a QOZ designated as a part of a Federally declared disaster area (as defined in section 165(i)(5)(A)), the qualified opportunity zone business may receive up to an additional 24 months to consume its working capital assets, provided the project is delayed due to that disaster.
  - A disaster loss is a loss occurring in a disaster area and attributable to a federally declared disaster (Treas. Reg. Section 1.165-11(b)(1)) as any disaster subsequently determined by the president to warrant assistance by the federal government under the Disaster Relief and Emergency Assistance Act. On March 13, 2020, President Trump made this declaration in connection with the COVID-19 pandemic, paving the way for these early disaster loss claims.

The New Opportunity Zone Regulations

- Covid-19
  - The IRS has issued Notice 2020-23 which includes relief with respect to specified time-sensitive actions including the 180-day investment period of capital gains into Qualified Opportunity Zone Funds (QOF). The notice indicates if the deadline to invest the gain dollars into a QOF was on or after April 1, 2020 and before July 15, 2020, then the Taxpayer's deadline is automatically extended to July 15, 2020.

The New Opportunity Zone Regulations

- Covid-19
- The Working Capital Safe Harbor
  - Qualified opportunity fund (QOF) investments have a 31-month working capital safe harbor, which allows a qualified opportunity zone business (QOZB) 31 months to utilize working capital held as cash and cash equivalents.
  - If a qualified opportunity zone (QOZ) is located in a federally declared disaster area, the QOZB may receive up to an additional 24 months (on top of that 31-month working capital safe harbor) to consume its working capital assets — provided, of course, the project is delayed due to that federally declared disaster.
  - It's no doubt that many QOZBs are greatly impacted by COVID-19, which has temporarily closed businesses across the country under shelter in place orders or caused significant economic distress due to consumers' efforts to social distance. As many QOZBs have just been getting started over the past year, they likely will be looking for some relief from the various testing requirements and would greatly appreciate having the extra 24 months added to their working capital safe harbor.

The New Opportunity Zone Regulations

- Covid-19
- The 12-month reinvestment rule
  - Under the reinvestment rule, a QOF has 12 months to reinvest proceeds from the sale of QOZ assets into other QOZ assets.
  - But both the Department of the Treasury and the IRS agree that this reinvestment period should be expanded if delays are caused by a federally declared disaster. Although they had natural disasters like tornados, floods and forest fires in mind when they modified the reinvestment period rules to allow an expansion, COVID-19 has been declared a federal disaster in many states, and we hope the IRS will clarify this still will be applied.
  - It's important to note that a QOF must invest proceeds as originally planned before the disaster. For example, if the QOF completed its application and was waiting on a response, but now it is unable to invest in a certain QOZB property because the property is located in a federally declared disaster area, the QOF must invest the proceeds in similar property located in that QOZ.

The New Opportunity Zone Regulations

- 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 suggests a compliment between Opportunity Zone investments with State-based brownfield programs.

The New Opportunity Zone Regulations

- 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, the costs of brownfield site assessment and remediation will typically be included in the calculation of the "substantial improvement" test.
  - Investors now benefit. Previously, investors may have balked at sites where significant remedial action was expected because the investment might not be captured. Now, these investments may county toward Opportunity Zone benefits.

Where We Go From Here

- Is there still a strong incentive for taxpayers to make OZ investments in 2020??
  - Goal is to reinvest capital gains – are there any to invest??
- In a post Covid-19 world, will they??

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Best Practices

- Do a business plan adapted for 1400Z-2.
- Look at location of assets/properties within designated zones or qualified contiguous areas.
- Make sure real property is a brownfield, not an excluded site.
- Determine incentive outcomes depending on property and gains, treatment of gains under various time horizons.

Best Practices (continued)

- Consider benefits/risks of notice and involvement of environmental agencies.
- Make sure you know the goals of your likely targeted investors, and their time horizons.
- Check plan “fit” with existing grant programs or other incentives you are using.
- Managing cleanup to avoid significantly increased remedy costs, or loss of tax incentives or both.

Best Practices (continued)

- Check documentation for safe harbor and compliance.
- Competent professional staff for remediation.
- Impact of remediation on time horizons.
- Special permits or government approval/oversight of remediation part of development.
- Land Use Covenants/Environmental Covenants/Deed Restrictions/Institutional Controls.

Best Practices (continued)

Legal Issues for Brownfield sites