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Tax implications of buying, using, and selling Mass. Brownfields Tax Credits

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The tax implications of buying, using, and selling Mass. Brownfields Tax Credits, which historically have not been well-understood, have become clearer following the release of an IRS chief counsel advice memorandum late last year. The following summary has been prepared by Cooperstown Environmental based on its reading of the IRS guidance. ¹

Massachusetts Brownfields Tax Credit Program

The Mass. Brownfields Tax Credit program, created in 1998 to help spur the cleanup and redevelopment of contaminated commercial and industrial properties throughout the state, has been an exceptionally successful program. Hundreds of property owners who are "Eligible Persons" - which the law defines as parties who did not cause or contribute to the contamination nor who owned or operated the property at the time of the contamination - have benefited from the ability to recover up to half of their response costs once they have reached a permanent solution in accordance with the DEP's cleanup standards. Owners of these properties - all of which are located in economically distressed areas - are located in every congressional district across Mass.

2006 Reforms

Two key provisions were added in 2006 that expanded the Brownfields Tax Credit program to more entities and made the program even more valuable. At that time, not-for-profit organizations became eligible for the tax credits; previously only individuals, partnerships, LLCs, trusts, sole proprietors, and corporations were able to receive credits. Many non-profits perform cleanups: community development corporations (CDCs), colleges and universities, charities, and others. Prior to the reforms, such organizations did not qualify for the tax credits and therefore could not benefit from the program. The other change instituted in 2006 made the tax credits transferable; by allowing the credits to be sold, this provision enables both non-profits and other entities to produce cash. A robust market now exists for the purchase and sale of these credits, adding liquidity and spreading the benefits to allow more redevelopment and spurring more site cleanups.

Tax Implications of Sale and Use of Credits

Following the move to allow the sale of brownfields credits, many were unclear as to the tax consequences of the purchase, sale, and use of the credits. Little or no formal guidance existed from the IRS or the Mass. Department of Revenue (DOR) and sellers often received conflicting advice from accountants, tax professionals, and even from the DOR itself regarding the proper treatment of credit sales.

A recently-published advice memorandum from the Office of the Chief Counsel has helped to clarify this situation. Buyers, sellers, and users of credits should be aware of these procedures and properly report all transactions to minimize audit risk. The IRS and the MassDOR are coordinating their efforts and have begun to contact parties who did not in past years act in conformance with the

recent guidance. Since all credit transfers must be made through the MassDOR, a complete database exists of who owns and uses each credit. Failure to declare income generated from the sale and use of these credits may subject parties to audit risk.

IRS Guidance

The IRS Memorandum released in November 2011 (ILM 201147024) clarified the tax treatment of Mass. Brownfields Tax Credits as well as other transferable state credits including the film tax credit, the historic rehabilitation credit, the low income housing tax credit (LIHTC), and the medical device tax credit. In summary, the memorandum described the following principles:

Â§ These credits generally are considered capital assets to the original recipient, with no cost basis

Â§ The sale of the tax credit is a taxable event

Â§ A discounted purchase of a tax credit generates a capital gain when the tax credit is used

These conclusions have varying ramifications to recipients, sellers, and buyers of credits as discussed below.

Tax Credit Recipients

To a taxpayer or non-profit entity that qualifies, applies for, and is granted a tax credit (the original recipient), the award of the credit itself does not constitute income. Rather, it is simply treated as a reduction in taxes owed, and no gain is produced for federal tax purposes.

However, if the credits are sold to another taxpayer, a capital gain would be recognized. Since the original recipient has no "cost basis" in the credit, the proceeds received from the sale would be considered a capital gain in the year payment is received. The gain would be short-term or long-term depending on the holding period between receipt and sale.

For example, suppose a cleanup generated a credit of \$50,000 and the recipient used \$10,000 against its own taxes and sold the remaining \$40,000 at \$0.75 per dollar of credit, resulting in a cash receipt of \$30,000. The \$10,000 applied against its own tax liability would have no income implications but the sale would generate a \$30,000 capital gain, taxable to the seller.

For original recipients the use of credits in satisfaction of their own Mass. income taxes does not result in the realization of gross income but only a reduction in the otherwise allowable state tax deduction.

Tax Credit Resellers

Resellers of credits - those who buy credits and resell them to users - would recognize a gain on the difference between the purchase and sale price.

Tax Credit Buyers

A buyer of credits who then uses the credits to reduce its taxes is considered to have a gain equal to the difference between the discounted purchase price and the amount of taxes offset (i.e., the face value of the credit used). The gain is recognized in the year the credits are used. For example, assume a buyer purchases a \$100,000 credit for \$80,000, then uses \$20,000 of credit against his taxes each year for five years (the credits have a "shelf life" of six years and can be carried forward, but not back). This would generate an annual taxable gain of \$4,000 (\$20,000 of credits used each year, which had a basis of \$16,000).

A key clarification in the recent advice memorandum for a purchaser of Brownfield Tax Credits who applies the credits against its tax liability is that the federal deduction for state taxes paid is not lost. Extending the example above, suppose the buyer had a tax liability to the Commonwealth of Mass. of \$40,000 per year. Each year the buyer paid \$20,000 in cash towards its tax liability, utilizing the credits to satisfy the other \$20,000 of liability. The buyer can still deduct \$40,000 (the \$20,000 paid

in cash and the fair market value of the credits) on its federal return as state taxes paid. Preserving the itemized deduction may be an added benefit for many credit purchasers .

The Bottom Line

The bottom line is that anyone who is eligible for a Mass. Brownfields Tax Credit should investigate the program and apply for an award if they meet the basic criteria. If you performed a cleanup at any time since 1998 and you were not responsible for the contamination (it was pre-existing or caused by someone else); your project is located in an Economically Distressed Area (EDA), which includes most cities and towns in the state; you have completed the cleanup or are currently in Remedy Operating Status; and the site is used for commercial purposes - then you may be eligible for a credit.

Once received, the most tax-advantaged option is to apply the credits received against one's own taxes. If the credit exceeds the available tax appetite, a sale of all or a portion of the credits can generate cash. The proceeds, however, must be declared as taxable income. Buyers of credits can benefit from the discount to face value at which the credits are purchased, although the savings from the discount itself is considered a taxable gain and must be recognized when the credits are used.

Make sure that the procurement, sale, and use of these tax credits are done properly in order to maximize your benefits and minimize your audit risks. As with many aspects of life, it often pays to seek expert advice when dealing with arcane procedures and government programs.

1 Note: This is not intended to be nor should it be construed as tax advice; the summary provided herein has not been reviewed or approved by the IRS; reference is made to the original IRS publications for a complete description of the Agency's guidelines; Any use or reliance on this information, descriptions, or conclusions herein shall be done without recourse to Cooperstown Environmental LLC. Anyone contemplating a transaction involving tax credits should seek the advice of a tax professional.

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