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110 WEST FAYETTE STREET · ONE LINCOLN CENTER · SUITE 900 · SYRACUSE NEW YORK 13202 · P 315 422 1391 · F 315 422 3549
194 WASHINGTON AVENUE · SUITE 315 · ALBANY NEW YORK 12210 · P 518 689 3570 · F 518 689 3571

BROWNFIELD CLEANUP PROGRAM TAX CREDIT UPDATE
DTF ADDRESSES BROWNFIELD CREDIT ALLOCATION

By Philip S. Bousquet

New York's Brownfield Cleanup Program (BCP) legislation offers significant state tax credits for the cleanup and redevelopment of brownfields – sites where redevelopment is hindered by the presence of pollutants. A taxpayer that successfully cleans up a brownfield site and receives a "certificate of completion" from the New York State Department of Environmental Conservation can claim BCP tax credits. One of these credits, known as the "tangible property credit component," is a percentage (10% to 22%) of the federal tax "basis" (capitalized costs) of qualified tangible property placed in service on a brownfield site. Qualified tangible property includes residential condominiums and most depreciable property, including buildings.

On November 30, 2006, the New York State Department of Taxation and Finance ("DTF") issued an advisory opinion addressing the allocation among partners in a partnership of this credit component where a partner's ownership percentage changes after the qualified tangible property is placed in service.

In the opinion, DTF advised a taxpayer whose 99.1% interest in a partnership was reduced to 0.9% that the taxpayer could claim 99.1% of the tangible property credit component for qualified property (in this case, residential rental property) placed in service before the taxpayer's ownership percentage in the partnership was reduced.

DTF considered two scenarios. Under both scenarios, DTF assumed that a certificate of completion had been issued to the taxpayer for the brownfield site before the rental property was placed in service, and that the partnership and its partners were calendar year taxpayers.

Scenario One. In the first scenario, DTF determined that where the property was placed in service on December 30, 2006, and the partnership interest was reduced on January 3, 2007, the partner would receive its full allocable share of the credit (99.1%) in 2006. The 2007 reduction in the partner's ownership interest was irrelevant to the allocation of the credit.

DTF's analysis of the first scenario will make sense to most taxpayers -- changes in ownership in a later tax year should not affect allocations of income, loss, or credit items in a prior year, even if the change takes place a few days after the close of the year.

Scenario Two. In the second scenario, the property was placed in service in the same year that the taxpayer's partnership percentage was reduced, but prior to the reduction. The tax department also determined that the partner whose interest was reduced would be entitled to claim the BCP credit based on the partner's ownership percentage (99.1%) at the time the property was placed in service. DTF



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reasoned that because under federal tax rules an ownership change cannot be used to shift tax losses from one partner to another, a similar rule would apply to the BCP credits.¹

DTF's opinion does not consider whether the result would be different if the partnership agreement had contained a provision specifying an allocation method, applicable where the partners' ownership percentages shift during a taxable year, that would have created a different result than that reached by DTF. As a result, it is not clear whether DTF would permit the allocation of all or a portion of the BCP tangible property credit component to newly-admitted partners or to partners who increase their ownership percentages, even if required by the terms of a partnership agreement (or LLC operating agreement).

The BCP credits can be significant – well into the millions of dollars on large brownfield redevelopment projects. The enhanced return on investment generated by the BCP credits provides a critical incentive for investment in brownfield redevelopment in New York. Additional investment (and a corresponding change in ownership) often occurs when construction is complete and project facilities are placed in service, triggering both the BCP credit *and* the allocation provisions of the partnership or operating agreement in the same tax year.

Brownfield project developers and their investors need to know whether BCP credit allocations under their agreements will be respected by DTF, particularly in those critical tax years when ownership of the entity changes hands and BCP credits are earned. Unfortunately, further clarification from DTF is required before those critically important questions can be answered.

For further information about this important topic, please contact Phil Bousquet at 315.701.6309 / phil@gslaw.com or Lowell Seifter at 315.701.6307 / lseifter@gslaw.com.

¹ DTF did not explain why the BCP credit allocation should follow the partnership's treatment of tax *losses*, although because the BCP tangible property credit component arises from the partnership's capital investment (tax basis), it might make sense for the credit to be allocated in the same manner that gain or loss on disposition of the asset would be allocated.