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## Doing Business with Brownfields

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### Money Matters: Tax Incentives and Transaction Strategies

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## Discussion Topics

- Tax Incentives
- Coordination Tips
- Using Tax Credits in Project Finance
  - Attracting Investment Capital
    - BCP Credit example
    - Entity structure
- State tax credits and debt financing

## Available Tax Incentives

- NYS Tax Credits
  - Brownfield Cleanup Program (BCP)
  - Empire Zone Credits (EZ)
  - Green Building Credits
  - Qualified Emerging Technology Company Credits
- Federal credits (project dependent)
  - Historic Rehabilitation tax credit
  - Low Income Housing tax credit
  - Empowerment Zone wage tax credit
- Federal Brownfields Tax Incentive (Code sec. 198)
  - Allows deduction of "qualified" cleanup expenses

## Available Tax Incentives

- IDA Transactions
  - PILOT Agreements (property tax financing)
  - Issue Bonds
  - Mortgage tax exemption
  - Sales tax exemption (construction)
- Tax-Exempt Financing
  - Public use
  - Qualified Private Activity bonds
  - Tax Increment Financing (TIF)

## Coordination Tips

- **New York Tax Credit Coordination & Overlap**
  - Brownfield Projects in an Empire Zone
    - QEZE Tax Reduction Credit – OK (no overlap)
    - QEZE Credit for Real Property Taxes – overlaps with BCP credit based on property taxes
      - PILOT payments count for both
      - Credit calculated differently; PILOT limits are also different for newer projects
    - EZ Wage Tax credit – OK
    - Investment Tax Credit – overlaps with BCP  
Redevelopment credit for property that is eligible for both

## Coordination Tips

- **Federal and NYS Tax Credits**
  - Calculate impact on federal tax liability of NYS tax credits
    - NYS credits will reduce the federal deduction for state taxes;
    - Refundable credits probably taxable in year refund received
  - If federal credit reduces basis (like the Rehabilitation Tax Credit), this will impact any state credit or credit limitation linked to federal tax basis (e.g., BCP Redevelopment credit; BCP and EZ credits for property taxes)

## Tax Credits in Project Finance

- NYS Tax Credits – Refresher of key points
  - With tax "flow-through" entities (LLCs, S corps, partnerships), credits are claimed by owners
    - Understand WHO will claim the credits
  - Dollar for dollar reduction of income tax (vs. a "deduction" which reduces taxable income)
  - BCP Credits and some Empire Zone credits are "refundable"
    - Refunds probably subject to federal tax

## Tax Credits in Project Finance

- Tax Credits attract investment capital
  - Enhance Return on Investment
  - Attract "tax credit investors" for specialized projects
    - Federal credit syndications
    - NYS credit syndications
- Entity Structure & Timing of Formation
  - Can impact tax credits
    - EZ credits require analysis of date of creation of entity, employment history, date of certification

## Example – Redevelopment Credit

### Assumptions

Site Preparation Costs (incl. cleanup)	\$1,000,000
Qualified Tang. Prop. (Bldgs., equip.)	\$20,000,000
Annual Property Taxes	\$500,000
Employees on-site	80
Property in En-Zone	<b>Yes</b>
Clean up to Track 1	No
Taxpayer Type	Individuals (LLC)

# BCP Redevelopment Credit

## Calculate "Applicable Percentage"

Rate for Individuals (LLC Owners)	10.00%
Bonus for En-Zone	8.00%
Bonus for Track 1	<u>-0-</u>
<b>TOTAL:</b>	<b>18.00%</b>

## Example – Redevelopment Credit

	<u>Cost</u>	<u>App. %</u>	<u>Credit</u>
Site Preparation	\$1,000,000	18.00%	\$180,000
Qualified Tangible Property	\$20,000,000	18.00%	\$3,600,000
On-Site GWR	<u>-0-</u>	18.00%	<u>-0-</u>
TOTAL:	\$21,000,000	18.00%	<b><u>\$3,780,000</u></b>

## Example – Redevelopment Credit

### BCP Credits as return on investment

- \$3.78M pre-tax cash return to project owners
- Assume our \$21M project is financed 70% debt, 30% equity
  - Investors initially contributed \$6.3M (30% of \$21M)
  - Construction financing for \$14,700,000
- \$3.78M vs. \$6.3M invested → pre-tax ***cash on cash*** return of **60.0%** -- not including project return or return from other credits
  - Net of 35% federal tax –return is **39.0%**
- Capital remaining at risk (after tax) is \$3,843,000
  - $\$6,300,000 - (\$3,780,000 * [1 - 35\%]) = \$3,843,000$

## Example - Credit for Property Taxes

Annual Taxes	\$500,000
Multiplier (25%, or 100% in En-Zone)	× 100.00%
Employment Number Factor (75% for 80 ftes)	<u>× 75.00%</u>
Annual Credit Amount:	<b>\$375,000</b>
Credit Period (Years)	<u>× 10</u>
<b>Gross Value of Credit:</b>	<b>\$3,750,000</b>
Discount Rate (for "present value")	5.00%
<b>Value in today's dollars:</b>	<b><u>\$2,895,650</u></b>

## Example – Credit for Property Taxes

BCP Credit for property taxes as return on investment

- Pre-tax cash return to owners of \$375,000 for 10 years
- Assume \$21M project → 70% debt, 30% equity (\$6.3M)
- $\$375,000 / \$6.3M = \underline{5.95\%}$  *annual* cash on cash return (does not include project return)
- Return on capital still at risk:  $\$375,000 / \$3,843,000 = \underline{9.76\%}$ 
  - After taxes (35%) → return on capital at risk is 6.34%

## Attracting Investors with Tax Credits

- Key point – with pass-through entities (LLCs, partnerships) owners get tax credits – immediate return on investment
- Rules for allocating tax credits among owners
  - Cannot allocate just tax credits to investors because of partnership tax rules
  - Operating agreement can be structured to reward investors and developer
    - Shifting allocation structures
    - Tax credit "syndications"
- Investor Concern: Tax credit recapture (how do you protect against risk of recapture?)

## Attracting Investors with Tax Credits

- Example – allocation "flip"
  - Allocate income, loss and credits to the investors until they get their capital back (can include a return on capital)
  - After the investors get their capital back, profits, losses and credits are allocated in some percentage between the developer and the investors (i.e. 50/50)
- Investor Perspective: Flip structure allows credits to go to investors, which provides an early return and reduces their risk in the deal
- Developer Perspective: Credits can get developer to the "flip" sooner

## Tax Credits in Debt Financing

- Deal economics
- NYS credits flow through to owners/investors – the entity is the borrower, but does not get the credits
- Lenders typically won't lend using tax credits as security
- Very difficult to realize on collateral – NYS will typically not issue a refund check to anyone other than the taxpayer
- Timing – financing commitments in place prior to filing of returns claiming credits
- Re-contributed credits can create more favorable financial ratios
- Lenders may require investors to use the credits to fund reserves.

## Summary

- Understand array of tax incentives for brownfield projects
- Incentives affect other incentives and need to be coordinated to create optimal package
- BCP credits are a better incentive for investors than lenders



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