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# Incentives for Brownfield Development

**Discussion Paper prepared for the  
National Round Table on the Environment and the Economy**

**Economic Instruments to Encourage Sustainability on  
Private Lands Workshop**

**October 22, 1997**

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## **1. Introduction**

The purpose of this report is to identify incentives for brownfield development. These will be considered by the National Round Table on the Environment and the Economy (NRTEE) at its Workshop on Greening the Federal Budget, in October 1997. Stakeholders at the workshop will discuss incentives for brownfield development to be included in the federal government's 1998 budget. After the workshop, the NRTEE will make specific recommendations to the federal finance minister.

## **2. Background**

Brownfield sites are abandoned or under-used properties with real or suspected environmental contamination. Unlike other lands that may be contaminated by environmental discharges, brownfield sites still have potential uses and can provide investment opportunities along transportation corridors or in established urban areas with municipal services. However, many barriers stand in the way of brownfield development.

Over the past year, a NRTEE Task Force established its Financial Services Program, with the following objectives to examine:

- the barriers to brownfield development and to find ways to overcome these barriers; and
- the state of information on environmental conditions of land and to make recommendations for further research.

The NRTEE held five stakeholder meetings, from October 1996 through to March 1997, with about 200 participants. These meetings addressed the fundamental question "What can be done to create an atmosphere that will encourage people to invest in the redevelopment of brownfields?"

The draft report of the NRTEE Task Force identified the need to ensure the following:

- readily available inventories of brownfield sites;
- availability of site-specific information to investors;

- clear and comprehensible regulatory requirements for clean-up;
- availability of insurance instruments to spread risks; and
- ways to reduce or limit liabilities for previous site contamination.<sup>1</sup>

Governments may take many approaches to encouraging brownfield development. Incentives are clearly only one piece of a complex puzzle, but they would have little effect on many of the issues identified in the NRTEE Task Force draft report. The capital appreciation and net income from brownfield development might be attractive if liabilities are managed. Limited but timely incentives might take the form of cost-effective policies to stimulate investments in brownfields rather than greenfields development, which generally require additional investment in public infrastructure, such as roads, water, sewer, public transit, and many other public investments, and lead to urban sprawl and development of rural lands near urban areas. So the redevelopment of brownfield sites (often resulting in higher property values for the surrounding neighbourhoods) can open win-win-win opportunities for all levels of government, the private sector, and surrounding communities.

## **3. Environmental Liability**

Statutory environmental liability is a significant concern in land transactions. If a property is contaminated, the costs of clean-up and restoration may far exceed the value of the land. For example, fines for offences under Ontario's *Environmental Protection Act* can amount to \$200,000 a day for a first offence and up to \$400,000 a day for a second offence. In Quebec, fines can be up to \$250,000 for a first offence and up to \$1 million for a second offence. Saskatchewan specifies imprisonment for up to three years and fines of up to \$1 million. This form of liability understandably inhibits investments in brownfield sites, as they may already have a history of contamination.

In Canada, environmental liability is not based on causation of, or direct responsibility for, the

contamination. There is generally no time limit for such liability; it can apply to past and future contamination of land by any parties, not just those currently operating a business on the property. Administrative orders can be issued on a stop-and-desist, clean-up, or preventive basis to current or previous owners of the property, or to anyone who has been in charge of or had management control of the source of contamination, regardless of fault or causation. This includes major lenders, who are often regarded as the "deep pockets," in the event that some responsible parties go out of business or are unable to share the financial responsibilities for clean-up. In Canada, however, governments unwilling to be saddled with "orphan shares" are unlikely to revise this doctrine of "joint and several liability," which enables governments to recover the costs of clean-up from any solvent responsible party, regardless of the degree of its responsibility.

In various ways, private sector parties can limit their risk of liability, through due diligence, careful environmental assessments, and agreements between the parties. These may include warranties, covenants on who is responsible for past or future contamination, and indemnification of one party by another. Governments can ease the way for these kinds of agreements.

#### **4. Types of Incentives**

This report describes several possible incentives for private sector investments in brownfields development with recommendations made in each subsection:

- income tax treatment of clean-up expenses;
- income tax treatment of financial assurance and restoration trusts;
- public-private property transactions;
- municipal property tax assessment; and
- incentives to prevent future contamination.

These incentives alone cannot overcome the many barriers to brownfield development. Governments and the private sector both need to address these barriers

directly, not just through these incentives. A discussion of the barriers is beyond the scope of this report, but the Canada Mortgage and Housing Corporation (CMHC) has recently published two reports, *Removing Barriers to the Redevelopment of Contaminated Sites for Housing*<sup>2</sup> and *The Financial Services Sector and Brownfield Redevelopment*.<sup>3</sup> These reports group the barriers into six categories:

- regulatory;
- technical and scientific;
- legal and liability;
- financial;
- urban planning; and
- communications.

Some of the barriers identified by CMHC are the slow pace of regulatory reviews, generic and overly conservative clean-up criteria, governments' reluctance to sign off on remediation plans, lack of widespread acceptance of risk assessment-risk management approaches, uncapped liabilities, uncertain financing, lack of insurance instruments for contaminated lands, and public misconceptions and fears.

The Canadian Home Builders' Association (CHBA) circulated its *Position Paper on Government Policies, Procedures and Criteria for the Cleanup of Contaminated Sites*,<sup>4</sup> which also outlines a number of obstacles to redevelopment. The CHBA's main concerns were liability issues, reasonable standards and criteria for clean-up, and government leadership and involvement.

Direct program grants or subsidies, whether universally available or made available on a site-specific basis, are matters of policy not addressed in this report, but they would give evidence of direct government involvement. Recent US experience in direct programs is worth keeping in mind. The Brownfields Initiative of the US Environmental Protection Agency (EPA) tries to encourage voluntary state programs, tries to develop clean-up guidance, and tries to remove sites from the Superfund tracking list. In addition, the EPA is funding more than 70 pilot projects, at up to US\$200,000 each.<sup>5</sup>

## **4A. Clean-up Expenses**

In addition to the issue of joint-and-several liability for costs of clean-up and future contamination, another question concerns Revenue Canada's treatment of the actual funds expended for clean-up of historic contamination: Are such expenses deductible against income or are they capital outlays? Clearly, deductibility against income would be more likely to attract investors. The reason for considering environmental restoration costs as capital outlays is the generally accepted accounting practice for matching the costs of a capital asset (including its improvements) to the income it produces over its lifetime.

In general, Revenue Canada has permitted deductions against income of environmental restoration costs in the year they are incurred, rather than requiring that restoration costs be capitalized. Important administrative conditions are that "the business activity that caused the environmental damage was carried out by the same party that incurred the clean-up costs" and that "clean-up costs incurred to preserve or protect an asset are considered to be capital."<sup>6</sup> The latter implies, for example, that costs for clean-up activities that go beyond restoration, to improve the condition of the property beyond its original status, are nondeductible against income and must be treated as capital outlays. If, for example, a gasoline service station is redeveloped to serve other commercial purposes, what costs are deductible expenses?

Even if restoration costs for brownfield sites are deductible against income, investors may have too little income for the deductions to be meaningful. For example, a single-site owner might depend on revenues from the lease or sale of the cleaned-up property at a future date, after site restoration, with no revenues in the meantime. In the oil and gas industry, corporations with insufficient revenue streams to benefit from the deductibility of certain expenses can make use of flow-through shares. Shareholders can deduct exploration and some development charges as expenses against their own incomes if the corporation renounces those expenses through flow-through shares. Similar treatment of brownfield restoration expenses incurred by a corporate property owner could potentially attract new investors and establish new businesses on the brownfield site.

For restoration costs deemed to be capital outlays, favourable income tax treatment might also attract investments to raise the value of brownfield sites for commercial or residential uses. Examples of such treatment may include rapid write-down of the capital outlays and refundable tax credits for specified kinds of expenditures.

### **Recommendations for NRTEE Discussion**

1. Develop clear-cut guidelines on the conditions for brownfield restoration costs to be deemed deductible expenses rather than capital outlays.
2. Develop options for sensible terms and conditions for eligibility of brownfield restoration costs for flow-through shares, such as dollar limits, time limitations, and nature of the business interests of eligible shareholders.
3. Develop options for favourable tax treatment of capital outlays for brownfield restoration, including short write-down periods and refundable tax credits, such as dollar limits, rates of write-down, terms and conditions for qualifying investments, and incentives for public-private partnerships.

## **4B. Financial Assurance and Restoration Trusts**

*Financial assurance* refers to instruments that give varying degrees of assurance of a company's ability to fund future restoration, such as cash, bonds, letters of credit, performance bonds, insurance, deposits to provincially managed accounts, and site-specific trusts.

Funds set aside by a corporation for future restoration purposes are generally not deductible against income. The *Income Tax Act* permits no expenses for "a reserve, a contingent liability or amount of a sinking fund" to be deducted against income.<sup>7</sup> However, Revenue Canada permits such set-aside funds to be deductible against income if they are required to be paid to a provincial government and if they were irrevocable payments that fully discharge the payer's restoration responsibilities.

Recent federal budgets provide for favourable tax treatment of mining environmental trusts, which set aside funds for future reclamation subject to provincial requirements. Funds paid into these site-specific trusts are deductible against income in the year that the funds are set aside. These funds are tax exempt when they are withdrawn from the trust if they are used for specified reclamation purposes. The income earned on the funds while in the trust, before being used for reclamation, is taxable. In the past year, environmental trusts have been permitted for aggregates and waste-disposal sites. Thus, environmental restoration trusts have the distinct benefit of being deductible against income, whereas reserves or provisions for contingent liabilities are not deductible.

The precise costs of future restoration of brownfield sites are essentially impossible to define. The issues of "How clean is clean?" and how to establish legitimate benchmarks for the cost-efficiency of restoration activities are irresolvable. Still, permitting environmental trusts for restoration of brownfield sites, up to specified limits, might be an incentive for such restoration and for higher-value commercial uses of brownfield sites.

#### ***Recommendation for NRTEE Discussion***

4. Develop terms and conditions for environmental trusts for brownfield restoration, including funding limits, eligibility of payers, time periods, and conditions for withdrawals.

### **4C. Public-Private Property Transactions**

Part of the attraction of brownfield sites is their proximity to urban areas with high levels of commercial or even residential development. The market value of a brownfield site, after clean-up, can far exceed its former value.

In general, the federal government treats appreciation of commercial land value as a capital gain. As discussed earlier, Revenue Canada regards costs incurred to preserve or improve the market value of property as capital outlays, not deductible expenses. Although a key

expectation of investors in a brownfield site may be a significant increase in market value of the property (after restoration), generally a substantial tax liability is incurred at the time of transfer or sale of the property. Since the tax payable can be expected to coincide with a large stream of revenues, this would not be a barrier to investment. But additional incentives may be needed.

However, site restoration and public communications about the new, increased value of the site are complex. Some of the risks to be weighed against the prospect of increased market value of a property are uncertainty of scientific and technical information on the extent of prior contamination, the uncertainty concerning the relative responsibilities of different parties because of joint-and-several liability, vagueness of some standards for clean-up, uncertain performance of technologies, and the usual uncertainties about future regulatory requirements.

The involvement of governments in firming up or controlling the upfront risks may be worth a reduction in investors' ultimate level of capital gains. This is especially true from the perspective of governments and the surrounding community, as the benefits of brownfield development can be more than just the increase in market value of capital assets. Other benefits, economic in the broad sense, include preservation of jobs on the site; restoration of the diversified tax base of urban areas; reduced potential of the effects of previous contamination on human health; reduced levels of crime; and improved appearance of downtown areas, which may attract investment and tourism.

The reduced or limited upfront risks may be a trade-off investors make against potential "windfall" capital gains on redeveloped brownfield sites. This kind of trade-off requires the active involvement of governments and the private sector. Whether these are called public-private partnerships, or alliances, or cooperative associations, the objective is to create agreements among governments, investors, and financiers to allocate and limit risks.

The NRTEE Financial Services Program draft report cites as an example of this approach, the closure of an

old refinery in Montreal in 1991. The owners became insolvent, but the creditors assumed no ownership of the assets because of the potential environmental liabilities. The Government of Quebec took out a receiving order. A trust was established, which purchased the site for one dollar. A new company leased the land on a renewable 40-year lease, purchased the refinery assets at very low cost, and established a fund for decontamination costs of up to US\$1 million a year. Quebec assumed liability for all costs related to past contamination; the Quebec government, the trust and the company agreed to clean up past contamination and set a schedule for doing so. But the appreciation of land value will accrue to the Government of Quebec.<sup>8</sup>

Another approach would be for governments to establish caps on liabilities for previous contamination and permit market forces and robust regulation of future environmental impacts to determine future land values. The caps would depend on due diligence, use of best available scientific and technical knowledge at the time of the contamination, and use of clean-up technology options, as well as market valuations of surrounding land used for similar purposes. Such an approach would be site-specific.

#### **Recommendations for NRTEE Discussion**

5. Develop terms, conditions, and draft protocols for public-private agreements on sharing risks of liability for past contamination and benefits of future revenue streams and capital gains.
6. Develop criteria and accreditation processes for setting caps on liabilities for past contamination, reflecting best knowledge at the time of contamination.

#### **4D. Municipal Property Tax Assessment**

If brownfield sites lie abandoned or unused, they produce little in the way of property tax revenues for the municipality. On the other hand, if the municipality takes ownership of the site in lieu of back taxes, it carries the risk of also assuming the costs of

clean-up. Once cleaned up or restored, the former brownfield site can become a source of significant annual tax revenues; these taxes increase the hurdles to be overcome by potential investors in the restoration of brownfield sites.

It is better for a municipality to induce and ensure some level of tax revenues than to leave brownfield sites unused. But it would be better still for municipalities to provide limited tax holidays or property tax assessments ramped-up over time to reduce the initial tax burdens of brownfield redevelopers and investors. Higher levels of government can assist this kind of effort by sharing the cost of the foregone tax revenues with the municipality. Programs for sharing the costs of infrastructure are also possible.

#### **Recommendation for NRTEE Discussion**

7. Develop options to enable time-limited abatements of property tax assessments on redeveloped brownfield sites.

#### **4E. Incentives to Prevent Future Contamination**

Regulatory frameworks change all the time as they attempt to protect human health and the natural environment. Bioaccumulative and persistent toxic contaminants are prohibited. But many substances in widespread use can be toxic contaminants, although they are neither persistent nor bioaccumulative, such as gasoline and perchlorethylene (used in drycleaning). Governments prefer pollution prevention, rather than cleaning up after contamination or spills. They can structure incentives to make pollution prevention feasible for the business operator on a brownfield site.

For example, beginning January 1998, the Quebec government will impose a fee of \$2.50 for each litre of perchlorethylene used for drycleaning. Users must register, and they become eligible for refundable tax credits when purchasing new equipment that uses far less or no perchlorethylene. This is an example of tax treatment that provides incentives to reduce a specific form of contamination. Quebec makes these fees and

tax credits essentially revenue neutral for the government. Revenues from the fees are not earmarked exclusively for general spending on the environment, but they also do not contribute to the government's deficit position.

The ways environmentally damaged lands are assessed may also become a significant issue. A perverse incentive may exist to pollute as much as possible, while meeting regulatory obligations, to drive down the market value of a piece of land.<sup>9</sup>

#### **Recommendation for NRTEE Discussion**

8. Develop options for tax treatments that create credits or incentives to phase out specified polluting activities and that minimize perverse incentives.

## **5. Conclusion**

This report reviewed a range of incentives for brownfield development, mainly looking at approaches linked to the federal budget. The actual design of specific incentives would require in-depth assessment of fiscal impacts and of practical, administrative needs. Planners must also have, at an early stage, the views of diverse and informed stakeholder groups on rankings of priorities, prospects for take-up, hidden pitfalls of implementation, and possible unintended consequences. Getting something started is more important, at the present, than developing finely tuned instruments.

### **5A. Summary of Recommendations for NRTEE Discussion**

1. Develop clear-cut guidelines on the conditions for brownfield restoration costs to be deemed deductible expenses rather than capital outlays.
2. Develop options for sensible terms and conditions for eligibility of brownfield restoration costs for flow-through shares, such as dollar limits, time limitations, and nature of the business interests of eligible shareholders.

3. Develop options for favourable tax treatment of capital outlays for brownfield restoration, including short write-down periods and refundable tax credits, such as dollar limits, rates of write-down, terms and conditions for qualifying investments, and incentives for public-private partnerships.
4. Develop terms and conditions for environmental trusts for brownfield restoration, including funding limits, eligibility of payers, time periods, and conditions for withdrawals.
5. Develop terms, conditions, and draft protocols for public-private agreements on sharing risks of liability for past contamination and benefits of future revenue streams and capital gains.
6. Develop criteria and accreditation processes for setting caps on liabilities for past contamination, reflecting best knowledge at the time of contamination.
7. Develop options to enable time-limited abatements of property tax assessments on redeveloped brownfield sites.
8. Develop options for tax treatments that create credits or incentives to phase out specified polluting activities and that minimize perverse incentives.

## **6. Notes**

1. National Round Table on the Environment and the Economy, *Report of the Financial Services Program* (draft). Fall, 1997.
2. Canada Mortgage and Housing Corporation, *Removing Barriers to the Redevelopment of Contaminated Sites for Housing*, 1996.
3. Canada Mortgage and Housing Corporation, *The Financial Services Sector and Brownfield Redevelopment*, 1996.
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5. W. Duvel, "The Brownfields Initiative," *Soil and Groundwater Cleanup*, August–September, 1997.
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