

**STATEMENT OF TIMOTHY BRAZELL
ON BEHALF OF**

**American Institute of Architects
Building Owners and Managers Association International
International Council of Shopping Centers
Mortgage Bankers Association of America
National Association of Industrial and Office Properties
National Association of Real Estate Investment Trusts
National Association of Realtors
National Apartment Association
National Multi Housing Council
The Associated General Contractors of America
The Real Estate Roundtable**

TO

THE SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

REGARDING

Tax Incentives

For

Land Use, Conservation, and Preservation

**Timothy Brazell
Member, The Real Estate Roundtable**

April 30, 2002

Introduction

Mr. Chairman and members of the Subcommittee, my name is Timothy Brazell. I am Tax Manager of Lowe Enterprises, Inc. a Los Angeles based real estate company with offices across the country and in Europe.

I am here today on behalf of The Real Estate Roundtable. The Real Estate Roundtable is the vehicle through which the leaders of the real estate industry come together to identify, analyze and advocate policy positions on capital, finance, environmental, investment and tax issues. Roundtable members are the Chairmen, Presidents or Chief Executive Officers of the nation's 100 leading commercial, retail and multifamily real estate companies and the managing directors of major financial institutions.

The Roundtable also includes the elected leaders of Washington's major real estate trade organizations. Collectively, Roundtable members hold portfolios containing over 2.5 billion square feet of developed property valued at more than \$250 billion. The industry represents over one million people involved in virtually every aspect of the real estate business.

Joining The Real Estate Roundtable in these comments are: American Institute of Architects; Building Owners and Managers Association International; International Council of Shopping Centers; Mortgage Bankers Association of America; National Association of Industrial and Office Properties; National Association of Real Estate Investment Trusts; National Association of Realtors; National Apartment Association; National Multi Housing Council; The Associated General Contractors of America.

Over the past 30 years, Lowe has developed, acquired or managed more than \$6 billion of real estate assets. Lowe currently employs over 7,000 people, with a management team of approximately 250 men and women.

The firm operates through three wholly owned divisions:

Lowe Enterprises Investment Group directs the company's capital and investment activities, including more than \$3 billion of fiduciary investments on behalf of nine public and private pension plans;

Lowe Enterprises Real Estate Group oversees the development and property management of the firm's commercial and residential projects throughout the U.S., including over 13 million square feet of commercial assets currently under management and more than 4 million square feet of commercial space currently being developed, and;

Lowe Hospitality Group is responsible for its hotel and resort development and management activities.

Lowe Commercial Development Company ("LCDC") is a joint venture between Lowe Enterprises and Teachers Insurance Annuity Association, which was formed in August 1999 to

pursue new commercial development opportunities. LCDC targets 100,000 to 500,000 square-foot office and industrial development opportunities in suburban and urban locations.

Mr. Chairman, I am here to day to testify in strong support of H.R. 2264, a bill to extend and expand the expensing of environmental remediation costs. This bill is sponsored by Mr. Weller of this Subcommittee and is cosponsored by Ways and Means Committee Members Nancy Johnson and Bill Coyne. S. 1082 is the companion bill sponsored by Senator Torricelli.

H.R. 2264 would do three things:

1. Make permanent Internal Revenue Code Section 198, which allows the expensing of brownfield clean up costs, but is currently scheduled to sunset January 1, 2004.
2. Broaden the definition of “hazardous substances” in Section 198 so it covers petroleum, pesticides, lead paint and asbestos contaminants,
3. Repeal the provision in the law requiring the recapture of the Section 198 deduction when the property is sold.

Making Section 198 Permanent

Redevelopment of existing sites and properties is an important component of any community’s development plans. The U.S. Conference of Mayors estimates that there are over 400,000 brownfields sites across the country. Development of these sites would help restore many blighted areas, create jobs where unemployment is high and ease pressure to develop beyond the fringes of communities. Small, urban centered businesses often benefit most directly by this redevelopment. Many brownfields properties are located in inner cities -- precisely where many businesses want to be. The economics are often right. Critical infrastructure, including transportation, is already in place and the workforce is in close proximity.

In 2000, the above listed real estate organizations backed the provision in the Community Renewal and Reinvestment Act of 2000 that removed the geographic targeting requirements of Internal Revenue Code Section 198. This allowed developers of “brownfields” to expense the clean up costs of brownfields wherever they are located. Prior to this change, these clean up costs had to be added to the purchase price of the land (“capitalized”) unless the contaminated site was located in an empowerment zone or other designated low-income area.

Capitalization means there is no deduction for these expenses until the building is sold. Since this could be several years, this increases the overall tax burden of the redevelopment project. This higher tax burden hinders redevelopment efforts — particularly in areas that need them most.

We are pleased that in 2000 Congress determined that these clean up costs should be deductible in the year they are incurred and do not have to be capitalized. However, for revenue reasons, Congress scheduled the expensing provision to expire in 2004. We strongly believe

clean up cost expensing for all brownfields should be extended permanently. H.R. 2264 would do this and we urge its immediate enactment.

Broadening the Definition of “Hazardous Substance”

Petroleum and Pesticides

In addition to extending Section 198 permanently, we also believe Section 198 should be amended to work more as intended by Congress. One such amendment would be to broaden the types of hazardous substances that are eligible for expensing treatment if cleaned up to include petroleum, lead paint asbestos and pesticides.

The current version of IRC Section 198 relies on the term “hazardous substance” used in the Comprehensive Environmental Response Compensation and Liability Act (“CERCLA”) to identify which contaminated sites would be eligible for tax relief: Section 98(c)(1)(A)(iii) defines a “qualified contaminated site” as one “at or which there has been a release (or threat of release) or disposal of hazardous substance.” The term “hazardous substance” is defined in Section 198(d)(1) to have the same meaning as in sections 101(14) and 102 of CERCLA. Section 198(d)(2) further states that the term “hazardous substance” shall not include any substance for which a removal or remedial action is not permitted under section 104(a)(3) of CERCLA.

At first blush, it appears logical for the drafters of Section 198 to simply borrow the term “hazardous substance” as used in CERCLA, the principal federal statute concerning environmental remediation, rather than coming up with a new term or a new definition. But, the problem created by this approach is that it assumes that the CERCLA definition of the term is broad enough to encompass all types of toxic materials that might be found at a brownfield site. That is not the case.

When CERCLA was adopted in 1980, Congress made the decision that it did not want the federal Superfund used to clean up certain types substances – such as petroleum and certain pesticides – or to be spent cleaning up the interiors of buildings. While the decision not to authorize the spending of federal funds on these types of cleanups had significance for the administration of the Superfund program, the same rationale does not apply to a statute intended to provide a tax incentive to private parties cleaning up brownfield properties.

When CERCLA was adopted in 1980, the term “hazardous substances” was expressly defined not to include “petroleum.” Also, although the term “hazardous substance” was defined to include a variety of substances considered toxic under various other environmental laws, it did not include most pesticide products and a variety of other toxic materials.

There were various reasons for the decision to exclude from the definition of “hazardous substance,” these materials which are nonetheless considered toxic. In the case of petroleum contamination, for example, Congress made a decision to rely on other statutory mechanisms to effectuate cleanups. In 1984, Congress adopted subtitle I of the Resource Conservation and Recovery Act (“RCRA”), 42 U.S.C. section 6991 et seq., which addressed the cleanup of

releases from underground storage tanks, many of which contain gasoline, fuel oil, or other petroleum products. In 1990, Congress adopted the Oil Pollution Act, 33 U.S.C. Section 2701 et seq., to address oil pollution into navigable waters. Thus, the exclusion of “petroleum” from the CERCLA definition of “hazardous substances” was not an indication that Congress believed that petroleum pollution did not need to be cleaned up. Petroleum simply was covered in other statutes.

Petroleum and pesticide pollution are common at brownfield sites. Petroleum products in the forms of fuel oil, heating oil or gasoline, were often used at these sites. Indeed, these materials were often stored in above ground or underground tanks. Also, some of these sites have been contaminated by migrating gasoline spills from nearby service stations.

Pesticide residues are also frequently found at brownfield sites. Pesticides were often used to control weeds or insects at these sites when they were operating industrial plants. Moreover, some of these sites may be contaminated by pesticides run-off from other properties. While it may make sense not to authorize the use of federal funds under the Superfund program to clean up petroleum and pesticides, these substances often have to be cleaned up at brownfield sites before those properties can be returned to beneficial use. There is no reason not to extend the same type of tax incentive to a private party who is cleaning up petroleum waste or pesticide residues on a brownfield site as to one who is cleaning up other types of contaminants.

Asbestos and Lead Paint

Also, Congress in adopting CERCLA in 1980 did not want EPA to spend Superfund dollars cleaning up the interior of buildings. Accordingly, Congress adopted section 104(a)(3)(B) of CERCLA which prohibited EPA from cleaning up the interior of structures. Congress did not adopt this limitation because it believed that contaminated interiors did not require cleanups. Rather, Congress believed that the use of the limited funds set aside for Superfund cleanups should be prioritized to deal with contamination that had escaped into the general environment. Once again, Congress used other federal programs to address interior contamination, such as the asbestos regulations under the Clean Air Act.

IRC Section 198, as currently drafted, states that the term “hazardous substance” does not include a substance that EPA would not be permitted to cleanup under section 104(a)(3) of CERCLA. Because of the applicability of the limitation in subsection 104(a)(3)(B), no expensing is allowed for the removal of asbestos, lead paint or other hazardous materials inside the buildings that are located at otherwise qualified sites. But brownfield restoration often involves the cleanup of existing buildings on the property. Expensing of costs to clean up buildings would give developers more reason to invest in brownfield properties. Thus, the expensing treatment IRC section 198 should be expanded to cover the removal of hazardous substances from buildings.

Also, as a point of clarification, the definition of lead-based paint and lead-based paint hazards is more accurately described and defined in "Identification of Dangerous Levels of Lead; Final Rule 66 Fed. Reg. 1206. We would urge that S. 2264 be amended so that Section 1 (b) (2) (D) reads: any asbestos (whether friable or non-friable), oil (as defined in section 1001(23) of the

Oil Pollution Act of 1990), pesticide (as defined in section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act), radon, lead-based paint and lead-based paint hazards as defined in Lead: Identification of Dangerous Levels of Lead; Final Rule 66 Fed. Reg. 1206.

Recapture

Finally, another amendment that H.R. 2264 would make to Section 198 is to repeal the recapture requirement of Section 198(e). Currently, any qualified environmental remediation expenditure expensed under Section 198 is subject to recapture as ordinary income when the property that was contaminated is sold or otherwise disposed of.

In effect, the amount expensed as a cleanup cost is treated as depreciation on IRC Section 1245 property. Thus, when the property is sold, gain to the extent of the cleanup cost deduction is treated as ordinary income.

Example

In 2001, Owner purchased an acre of land that was contaminated with a hazardous substance. The land cost \$10,000 and Owner spent \$5,000 in remediation expenses. Currently, he is allowed to claim a current deduction for the \$5,000 instead of adding it to his basis in the land. If he sells the land for \$16,000, he would be required to treat \$5,000 of his \$6,000 gain (\$16,000 sale proceeds less \$10,000 cost) as ordinary income taxable at 39.6%. The remaining \$1,000 gain would be taxed at 20%.

When Does Recapture Matter?

In the example above, if Owner sold the land the year after he cleaned it up, he would receive little or no benefit from having deducted the clean up costs. This immediate repayment to the government leaves Owner with little tax incentive to clean up the property.

We believe that a more appropriate result would be to treat any gain in excess of Owner's original investment/acquisition cost in the property (\$5000 in this case) as capital gain by repealing the recapture requirement. This provides an incentive for Owner to clean up the property without having the deduction effectively rescinded after the improvement is made.

If the clean up expenditure were recaptured as a capital gain, rather than as ordinary income, each party is in a stronger position. It would allow the government to recover a portion of its tax incentive from the developer, the developer retains a significant incentive for bearing the expense and associated risks of the clean up activity, and the community receives an improved property with the prospect of job creation.

This treatment would be particularly helpful for developers who acquire brownfield properties with the intent of reclaiming them and then selling the improved property shortly thereafter. If a developer were to acquire a brownfield, clean it up and restore it to a viable market use, but then immediately lose the benefit of the clean up deduction at the time of sale,

the developer is left with little, if any, incentive effect. If the recapture provision were repealed, Section 198 would become far more of a redevelopment incentive than it is now.

Conclusion

In conclusion, we urge Congress and this committee specifically to enact H.R. 2264. The result will be the injection of new capital into rehabilitation projects. Many small, urban centered businesses will benefit resulting in substantial job creation and economic revitalization. Also, the viability of existing space will improve and ease the pressure to develop “greenfields” allowing for the preservation of more open space.