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The Section 198 Brownfields Tax Incentive: 2007 CRS Survey

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Summary

What was regarded as a key brownfields tax incentive in the Internal Revenue Code expires on December 31, 2007. Originally enacted in the Taxpayer Relief Act of 1997 (P.L. 105-34), the provision allows a taxpayer to fully deduct the costs of environmental cleanup in the year the costs were incurred (called "expensing"), rather than spreading the costs over a period of years ("capitalizing"). The provision was adopted to stimulate the cleanup and development of less seriously contaminated sites by providing a benefit to taxpaying developers of brownfield properties. It also contains a "recapture" provision, which diminishes its benefits. In each of its budget proposals since FY2003, the administration has proposed that Congress make the incentive permanent. The 109th Congress renewed the provision (for the fourth time) through 2007 (P.L. 109-432) and made it effective retroactively to December 31, 2005, when the previous extension expired. The law also made sites contaminated by petroleum products eligible for the tax incentive. The 110th Congress may consider a variety of options, including granting another extension, making the incentive permanent, allowing it to expire, or repealing the recapture requirement.

Until recently, information on the extent of use of the brownfields tax incentive could not be determined from federal income tax returns. Use of a new tax form, Schedule M-3, for corporations and partnerships with assets over $10 million began being phased in with tax year 2004. The first of those data, covering the 2004 tax year, became available in February 2007. They showed that section 198 environmental remediation costs of $295 million were reported by 110 corporations, out of a population of 5,557,965 corporate returns. This information is understated because it excluded more than half of all corporations, and all partnerships.

To take advantage of the tax break, a developer has to obtain a certification from the state environmental agency that the site qualifies as a brownfield. CRS surveyed the agencies of all states in 2003, and again in 2007, to ask how many certification applications they had received and approved. In 2003, 27 states reported that they had received a total of 161 applications since enactment in 1997, of which 147 were approved. In 2007, 29 states reported that they had received 175 applications over the previous four years, of which 170 were approved. The results were somewhat surprising; before enactment in 1997 the Treasury Department and the Environmental Protection Agency had expected it to be used as many as 10,000 times per year.

Accordingly, CRS also asked the state agencies, four private developers, and the editor of a trade publication for their views on why the tax incentive was so little used. There was divided opinion on the utility of the tax incentive, and criticism of its stop-and-go nature due to its expiration and renewal every one or two years. The Schedule M-3 data for firms with more than $10 million in assets confirm the CRS survey findings of modest use of the section 198 brownfields tax incentive. The tax form was fully phased in with tax year 2006, and full information will be available in February 2009. However, as discussed in this report, it appears that the section 198 tax break is a useful tool in some brownfield situations.

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The Section 198 Brownfields Tax Incentive: 2007 CRS Survey

The brownfields tax incentive in section 198 of the Internal Revenue Code expires on December 31, 2007. It was first enacted in the Taxpayer Relief Act of 1997 (P.L. 105-34), and has been extended four times, most recently in 2006. The provision is intended as a stimulus to the development of brownfields by allowing developers to recoup some of their cleanup costs.

There is now more information available to the Congress as it considers the future of section 198 than was available when previous extensions were enacted. The 110th Congress may consider another short-term (or long-term) extension, making the tax extension permanent, or allowing it to expire. Another possibility is to repeal the recapture provision.

The Brownfields Problem

A brownfield is a commercial or industrial site that is abandoned or underutilized, and where redevelopment has not occurred because of the presence, or perception of the presence, of hazardous substances, and the fear of the accompanying liability for the costs of environmental cleanup. These are not traditional Superfund sites, which are the nation's worst hazardous waste locations. Generally (though not always), they are not highly contaminated and therefore present lower risks to health, and cost comparatively less to clean up than Superfund sites.

In a 2004 report, the Environmental Protection Agency (EPA) estimated that there are between 500,000 and 1 million brownfield sites, though how many would require cleanup to make them safe for reuse is unknown. Based on information from EPA's brownfield assistance programs, 70% of them (350,000 — 700,000) might require some degree of cleanup expenditure.[1]

Using rough estimates, EPA also calculated that total expenditures at state sites, excluding those on the Superfund National Priorities List, by both public and private entities have been about $1 billion annually in recent years. During this same period cleanup has been accomplished at about 5,000 state and private party sites per year.

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[1] U.S. EPA. *Cleaning Up the Nation's Waste Sites: Markets and Technology Trends, 2004 Edition*. EPA 542-R-04-015, September 2004, pp. 9-6, 9-18. Available at [http://www.epa.gov/superfund/news/30years.htm].

At this rate, 150,000 sites would be cleaned up, at a cost of $30 billion over the next 30 years, which was the time horizon of the EPA report.[2]

To help address this problem, Congress enacted EPA's brownfields program of grants and technical assistance,[3] and also relaxed certain Superfund liability provisions, established a "brightfields" demonstration program (for brownfield sites redeveloped using solar energy technologies), authorized tax-exempt facility bonds for qualified green building and sustainable design projects, and provided two brownfield tax incentives.[4] (See **Table 1**.) This report examines the extent to which one of these, the federal section 198 tax incentive, has been used.[5]

Description of the Tax Incentive

The section 198 brownfields[6] tax incentive expires on December 31, 2007. First enacted as part of the Taxpayer Relief Act of 1997 (P.L. 105-34), the incentive allows a taxpayer to fully deduct the costs of environmental cleanups in the year the costs were incurred (called "expensing"), rather than spreading the costs over a period of years ("capitalizing"). Its purpose is to encourage developers to rehabilitate sites where environmental contamination stands in the way of bringing unproductive properties back into use. (The provision has no direct application for public sector entities, such as municipalities, that develop brownfields and do not pay income taxes.)

To take advantage of the brownfields tax incentive, the developer of a property has to obtain a statement from the state environmental agency that the parcel is a "qualified contaminated site" as defined in the law.

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[2] *Ibid.*, pp. 9-18, 9-19.

[3] For more information, see CRS Report RS22575, *Brownfield Issues in the 110th Congress*, by Mark Reisch.

[4] Most states also provide some combination of liability relief, grants, loans, tax incentives, and technical assistance.

[5] The other brownfields tax incentive is in 26 U.S.C. § 512(b)(19). Enacted in 2004 in P.L. 108-357, it allows a tax-exempt investor (such as a pension fund, foundation, or university) to invest in brownfields and not treat the gains as taxable unrelated business income, provided it incurs cleanup costs of at least $550,000 or at least 12% of the property's fair market value, whichever is greater, and also meets other requirements. This paper does not address that provision.

[6] For purposes of the tax incentive, a brownfield site ("qualified contaminated site") is a property held for use in a trade or business, for the production of income, or as inventory where there has been a release, or threat of release, or disposal of a hazardous substance. Sites on the Superfund National Priorities List are excluded (26 U.S.C. §198(c)).

Table 1. Brownfield Enactments

Year	Act
1997	Taxpayer Relief Act of 1997, P.L. 105-34. § 941 adds new 26 U.S.C. §198, the brownfields tax incentive (expensing of environmental remediation costs).[7]
2002	Small Business Liability Relief and Brownfields Revitalization Act, P.L. 107-118. Title I, and Title II, Subtitle B, limit certain Superfund liability provisions. Title II, Subtitle A enacts EPA's brownfields program. Title II, Subtitle C authorizes grants for state and tribal response programs (brownfield and related programs).
2004	Economic Development Administration Reauthorization Act of 2004, P.L. 108-373. § 213 adds new 42 U.S.C. § 3154(d), brightfields demonstration program (brownfield site redeveloped using solar energy technologies).
2004	American Jobs Creation Act of 2004, P.L. 108-357. § 701 adds 26 U.S.C. § 142(l), making green building and sustainable design projects that include a brownfield site eligible for tax-exempt bonds. § 702 adds 26 U.S.C. § 512(b)(19), allowing tax-exempt entities to invest in brownfields without incurring unrelated business income tax.

A significant factor concerning the tax incentive is that it is subject to "recapture." This means that the gain realized from the value of the property when it is later sold must be taxed as ordinary income (rather than at the generally lower capital gains rate) to the extent of the expensing allowance previously claimed. This dilutes the benefit of the tax break and has the effect of simply postponing a certain amount of the developer's tax liability until the property is resold. As a stimulus to development, the overall value of the brownfields tax break is dependent on a number of factors, including the total cost of the project, the cost of cleanup, how long the developer intends to hold the property before selling it, and the developer's individual tax situation. Repeal of the recapture provision has been favored by the Real Estate Roundtable and its partner associations representing various aspects of the real estate industry (architects, building owners and managers, mortgage bankers general contractors, and others).

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[7] The tax incentive has been extended four times: in the Ticket to Work and Work Incentives Improvement Act of 1999, P.L. 106-170 (title V, § 511); in the Consolidated Appropriations Act, 2001, P.L. 106-554 (Appendix G, title I, § 162); in the Working Families Tax Relief Act of 2004, P.L. 108-311 (title III, § 308(a)); and in the Tax Relief and Health Care Act of 2006, P.L. 109-432 (Division A, title I, § 109).

Background of the Incentive

Federal tax law generally requires that the cost of *improvements* to a property must be deducted over a period of years, whereas other expenses, such as repairs, may be deducted in the same year they are incurred. Being able to deduct the costs in the year when they are incurred is a financial benefit to the taxpayer. A 1994 ruling by the Internal Revenue Service[8] (IRS) held that the costs of cleaning up contaminated land and groundwater are deductible in the current year, but *only for the person who contaminated the land*. In addition, the cleanup would have to be done without any anticipation of putting the land to a new use. Further, any monitoring equipment with a useful life beyond the year it was acquired would have to be capitalized. On the other hand, a person who acquired previously contaminated land, such as a brownfield site, would have to capitalize the costs of cleanup, spreading them out over a number of years. Some have noted that this is a somewhat perverse situation that works against one who would want to buy and clean up a contaminated property, and put it to use.[9]

Cleanup costs are a major barrier to redevelopment of contaminated land. The Taxpayer Relief Act of 1997, which included the brownfields tax incentive, thus had the effect of expanding benefits and allowing developers who had not caused the contamination to deduct cleanup costs from their taxable income in the current year, rather than having to capitalize them.

As initially enacted, the brownfields tax incentive was available only to a property that was located in a "targeted area." The law defined a targeted area as a census tract with greater than 20% poverty, an adjacent commercial or industrial census tract, an Empowerment Zone or Enterprise Community, or one of the 76 brownfields to which EPA had awarded a brownfield grant at that time. Congress repealed the targeted area geographic restrictions and extended the tax break to all brownfields ("qualified contaminated sites") in the Consolidated Appropriations Act, 2001 (P.L. 106-170).

Since FY2003, the Administration's budget proposals have proposed making the tax incentive permanent. It has been in effect continuously since its enactment in 1997 and has been extended four times,[10] most recently in the Tax Relief and Health Care Act of 2006, P.L. 109-432 (Division A, title I, § 109). This extension through 2007, which was enacted on December 20, 2006, was made retroactive to December 31, 2005, when the previous extension expired. EPA supports the permanent extension, as does the Real Estate Roundtable and its partners noted above.

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[8] Revenue Ruling 94-38.

[9] See, e.g., John W. Lee and W. Eugene Seage, "Policy Entrepreneurship, Public Choice, and Symbolic Reform Analysis of Section 198, the Brownfields Tax incentive: Carrot or Stick or Just Never Mind?," *William and Mary Environmental Law and Policy Review*, spring 2002, pp. 616-618; and Bruce Keyes, "Brownfield Transactions," *Urban Land*, June 2005, p. 36.

[10] See footnote 7.

This 2006 enactment also broadened the definition of hazardous substances to include petroleum products (including crude oil, crude oil condensates, and natural gasoline) for purposes of the tax incentive (but not for any other part of the Superfund Act).

Sources of Information

Until recently, there was no official information available at the federal level on the extent of use of the § 198 provision. It did not have its own separate line on either individual or corporate federal income tax forms (which is why CRS was first asked to perform the state survey in 2003). In 2004 the IRS introduced a new form, Schedule M-3, which provides information, for the first time, on the use of the section 198 brownfields tax incentive.

Schedule M-3

Only large and midsize businesses (corporations and partnerships with total assets of $10 million or more) are required to file the new Schedule M-3 with their returns. Use of the schedule was phased in, and in the first year of use, tax year 2004 (for returns submitted in 2005), only some corporations and no partnerships were required to file it. Those corporations that did use it were not required to complete the whole form, and part of the information on the brownfields tax incentive was in the optional part of Schedule M-3. A number of corporations completed it anyway. The results for 2004 only recently became available, and show section 198 remediation costs of $294,970,000, reported by 110 corporations out of a population of 5,557,965 corporate returns.

This information is obviously limited, since the response for 2004 excluded more than half the corporations and all the partnerships, response on the brownfields tax incentive was at the corporations' discretion, and it was limited to those companies with assets of $10 million or more. Also, the data show how much the 110 corporations spent on cleanup costs, but do not reveal at how many brownfields the money was spent. The compilation of data from tax year 2005 (when reporting was mandatory for all corporations) is ongoing, and will be available to the public in February 2008. Partnerships with assets over $10 million were required to use Schedule M-3 beginning with tax year 2006, and those results will be available in February 2009. Even when fully phased in, though, the form will not be applied to entities with assets under $10 million. For more information on Schedule M-3, see **Appendix A**.

CRS Survey Findings

CRS surveyed the appropriate environmental agency in each state in 2003, and again in 2007, to determine the number of brownfield certifications they had issued. In 2003, 27 states reported that since the enactment of the provision in August 1997 until the time of the survey in April-June 2003 they had received a total of 161 requests for certification, of which 147 were approved, and 14 were denied. Twenty-three states reported receiving no formal requests.

In the 2007 survey, there was a modest increase. Twenty-nine states reported receiving 175 requests from 2003 until the second survey in February-April 2007, of which 170 were granted. Twenty-one states received no requests. There were four additional states that received and approved requests in 2003-2007 (New Mexico, Colorado, West Virginia, and New Hampshire), and two that had received requests in the 2003 survey, but none in the 2007 survey (Georgia and Kentucky).

The 175 requests are equivalent to just under 44 per year for 2003-2007. In the earlier period August 1997 to spring 2003) the average was about 28 per year. The state-by-state responses are presented in **Table 2**.

While this is a significant increase on a percentage basis, about 57%, the numbers are far below what was anticipated prior to the original enactment of the tax break in 1997. According to hearing testimony, EPA and the Treasury Department expected the incentive to "be used at 30,000 sites over the 3-year life of the incentive" (10,000 sites per year), but as of summer 1999 it had been used at "only a couple dozen sites."[11] The conference report accompanying the 1997 bill estimated the budget effect of the provision as costing the Treasury $417 million over 5 years ($83.4 million per year).[12]

In 1999, as Congress was considering making the tax incentive permanent, Treasury estimated it would be used to clean up 18,000 brownfields over the next 10 years (1,800 per year); the department anticipated that the loss in revenue resulting from the tax incentive would be $600 million for 5 years ($120 million per year), and that it would induce an additional $7 billion in private investment.[13] The conference report in that year estimated a revenue loss of $114 million over 5 years ($22.8 million per year).[14]

Comments of State Agencies and Developers

Because of this discrepancy between expectations and the apparent results, CRS asked the state agency representatives who responded to the survey for their opinions as to why so few brownfield developers were taking advantage of the tax incentive. CRS also contacted four private developers and the editor of a brownfields trade

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[11] Testimony of Charles Bartsch, Senior Policy Analyst, Northeast-Midwest Institute, in U.S. House. Committee on Ways and Means. Subcommittee on Oversight. *Impact of Tax Law on Land Use, Conservation, and Preservation*. Hearing, 106th Congress, September 30, 1999, Serial 106-76, p. 68 (hereinafter, *Impact of Tax Law on Land Use* hearing).

[12] U.S. House. Committee of Conference. *Taxpayer Relief Act of 1997, Conference Report to Accompany H.R. 2014.* H.Rept. 105-220, 105th Congress, July 30, 1997, p. 787.

[13] Testimony of Leonard Burman, Deputy Assistant Secretary for Tax Analysis, Department of the Treasury, in *Impact of Tax Law on Land Use* hearing, p. 39.

[14] U.S. House. Committee of Conference. *Ticket to Work and Work Incentive Improvement Act of 1999, Conference Report to Accompany H.R. 1180.* H.Rept. 106-478, 106th Congress, November 17, 1999, p. 183.

publication to solicit their viewpoints on the subject, as well.[15] A summary of their comments follows.

- Land development is a large and diverse industry. There is only a very limited number of developers who specialize in brownfields.

- The size of brownfield projects ranges from one acre to about a thousand acres; 25 to 50 acres is typical. They take longer to complete — probably double the time of non-brownfield development — because environmental cleanup can be unpredictable.

- Several respondents felt that the incentive doesn't offer that much financial benefit, especially when one considers the recapture provision, and particularly if the property is sold in the short term. It is not a driving factor that will tip the decision toward cleanup. Also, a number of states offer tax breaks and other incentives that are more generous than the federal incentive, which by comparison may not seem worth the effort.

- On the other hand, one developer observed that it was necessary to have the right circumstances to successfully use the section 198 incentive. Depending on the project, and the tax status of the different investors, he indicated it might be more advantageous to employ other tax strategies. Another agreed that the benefit was meaningful, especially when used at a larger site. It is another way to make a deal incrementally successful.

- The provision has been extended only for periods of a year or two at a time, and twice the extensions were partially retroactive, since it had expired before the extension was passed. This on-again, off-again history creates uncertainty regarding its future availability, and makes it difficult for developers to plan, particularly for large-scale, multi-year projects. Even smaller projects can encounter unforseen delays, pushing them past the provision's end date, and causing forfeiture of anticipated benefits. For an economically marginal project, this uncertainty could be enough to decide against going forward. One state official mentioned that at times he was unsure of the incentive's status, which made him reluctant to recommend it.

- Lack of information about the incentive's availability was also blamed for the level of use. Sometimes this was accompanied by criticism of EPA for insufficient leadership, although it was also

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[15] Charles Bartsch, Vice President, ICF International, Washington, DC; Todd Davis, CEO, Hemisphere Development, Cleveland, Ohio; Bruce Keyes, Partner, Foley & Lardner, Milwaukee, Wisconsin; Jonathan Philips, Senior Director, Cherokee Investment Partners, Raleigh, North Carolina; and John Spizzirri, Managing Editor, *Brownfield News*, Chicago, Illinois.

acknowledged that the agency had improved in recent years. Some states also recognized their own shortcomings in promoting the incentive. A few mentioned that the new eligibility of petroleum-contaminated sites might increase its use. One developer observed that publicity, or an outreach program aimed at accountants might be what was needed. Another commented that even after 10 years, the provision remained somewhat "esoteric," and even tax advisors were not all aware of it.

- A corollary of the previous point is that it is possible that many developers, especially smaller ones, are unaware of both the 1994 IRS ruling and the existence of the section 198 brownfields tax incentive. These persons would simply claim their environmental cleanup costs on their tax returns in the same way they claimed other development costs. The IRS authority on section 198 said that she found this plausible, and while there is no direct information on how much it is used, an indirect indicator is that she has received no inquiries from IRS auditors about taxpayers who use the incentive.[16]

- One state thought it was possible that developers used the agency's "milestone letters" (certifying that the developer has reached a certain point in the cleanup process) for other purposes, including supporting their income tax returns.

- A few states mentioned that LLCs (limited liability companies) are sometimes created for brownfield projects. In the first few years, when the environmental cleanup would be carried out, they would have no income tax, so the incentive would be useless.

Congressional Action

In the 110th Congress, one bill has been introduced that addresses section 198. H.R. 1753 makes the brownfields tax incentive permanent and repeals the recapture provision. Introduced by Representatives Jerry Weller and Xavier Becerra on March 29, 2007, the bill was referred to the Ways and Means Committee. There has been no further action.

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[16] Merrill Feldstein, Senior Counsel for Income Tax and Accounting, Internal Revenue Service, telephone conversation, July 24, 2007.

Conclusion

CRS conducted the interviews before learning of the existence of Schedule M-3. None of the interviewees knew of the form either, judging by the conversations. The early information from the new IRS form shows that the brownfields tax incentive is indeed being used by large and midsize businesses, and somewhat more than the survey indicated. The number of corporations reporting its use are likely to rise from 110 as other corporations and partnerships begin filing the M-3. There will also continue to be an unknown number of smaller businesses with total assets of less than $10 million that will take advantage of section 198.

The survey showed an average of about 44 brownfield certifications per year in 2003-2007, and the IRS form revealed that 110 corporations reported deductions for cleanup costs of $295 million in 2004, an average of $2.68 million per company. One would expect, but there is no way to know, that the companies worked on more than one site each.

The Schedule M-3 data confirm the survey findings that the provision is not used as much as was expected when section 198 first became law. Nevertheless, these first results show that $295 million was reported as a deduction item on Schedule M-3 for tax purposes by the private sector for cleaning up brownfields in 2004, and that was the goal of the provision: to provide an incentive to bring contaminated lands back into productive use. The $295 million figure is from *voluntary* reporting by only a portion of the pertinent taxpayer universe, and it is very likely to increase now that the use of Schedule M-3 is mandatory for all corporations and partnerships.

There is probably no way to measure whether the tax incentive has proven to be the reason why any certain number of brownfields have been cleaned up. Nor are we likely to know if repeal of the recapture provision would lead to more cleanups at economically marginal sites.

The best observation may be what the interviewed developers said: that it can be a useful tool in some circumstances in putting a brownfield remediation/land development deal together. In that sense, brownfield supporters note that it has been a help in cleaning up the half million or more brownfield sites around the United States. It should be remembered that there is a certain unknown number of cleanups being accomplished by firms with assets under $10 million. From the survey, it does not seem that there are a great many of them, but it is also plausible that a fair number are also being done by individuals with no knowledge of IRS's 1994 revenue ruling or the section 198 tax incentive, and are simply treating their cleanup costs as normal development expenses.

A factor that has sometimes affected the passage of the brownfields tax incentive is that it is one of a number of tax credits, deductions, and taxpayer benefits that have all been considered together in recent years. This group changes from year to year. For more information, see CRS Report RL32367, *Temporary Tax Provisions ("Extenders") Expired in 2005*, by Pamela Jackson and Jennifer Teefy.

The Survey, State by State

Table 2 presents the results of the survey in detail. Nineteen states reported in both the 2003 and 2007 surveys that they had received no applications for certification. Many in that group said they had received inquiries but no formal applications, and some of those states added that they had made efforts to publicize the availability of the incentive through their websites and at in-person presentations at various meetings. The 19 states that reported receiving no applications were:

Alabama	Kansas	North Dakota
Alaska	Maine	Oklahoma
Arizona	Mississippi	South Carolina
Arkansas	Montana	South Dakota
Hawaii	Nebraska	Utah
Idaho	Nevada	Wyoming
Iowa		

Four states reported receiving no requests in 2003, but did receive and approve requests in the 2003-2007 period. These are New Mexico, Colorado, West Virginia, and New Hampshire. Two states that received requests for certification in the first survey period reported receiving none in the 2003-2007 period: Georgia and Kentucky.

In 2003, seven states had 10 or more applications: Wisconsin had 20; Massachusetts, 17; Delaware, 16; New York, 14; Virginia 11; and Michigan and Pennsylvania, 10 each. In 2007, six states had at least 10 applications: Wisconsin had 19; Massachusetts, 16; Rhode Island, 15; Maryland and Texas, 12 each; and Pennsylvania, 10.

Table 2. Applications for Certification for the Brownfields Tax Incentive: Compilation of 2003 and 2007 CRS Survey Results

State	Number of Applications						Reasons for Denial	Average Estimated Time for Decision
	Received		Granted		Denied			
	2007	2003	2007	2003	2007	2003		
California	8	7	5	6	3	1	2003: Site was not in a targeted area 2007: Two sites were contaminated with petroleum; at the other the applicant provided incomplete information	2003: 12 days 2007: 1 week
Colorado	1	0	1	0	0	0	n.a.	2007: 3 weeks
Connecticut	4	1	4	1	0	0	n.a.	2003: Not available 2007: Within 2 weeks
Delaware	1	16	1	14	0	2	2003: One property was not a brownfield; at the other the owner did not qualify	2003: Not available 2007: 2-5 days
Florida	1	2	1	2	0	0	n.a.	2003: Less than 30 days 2007: 1 week

State	Number of Applications						Reasons for Denial	Average Estimated Time for Decision
	Received		Granted		Denied			
	2007	2003	2007	2003	2007	2003		
Georgia	0	1	0	1	0	0	n.a.	2003: 3 days 2007: n.a.
Illinois	3	3	3	3	0	0	n.a.	2003: About 1 week 2007: 10 days
Indiana	3	4	3	4	0	0	n.a.	2003: 30 days 2007: About 2 weeks
Kentucky	0	1	0	1	0	0	n.a.	2003: About 3 weeks 2007: n.a.
Louisiana	7	1	7	1	0	0	n.a.	2003: 1 or 2 days 2007: Less than 1 week
Maryland	12	2	12	2	0	0	n.a.	2003: About 2 weeks 2007: Not available

State	Number of Applications						Reasons for Denial	Average Estimated Time for Decision
	Received		Granted		Denied			
	2007	2003	2007	2003	2007	2003		
Massachusetts	16	17	15	16	1	1	2003: Site did not contain a hazardous substance 2007: Site was contaminated by petroleum	2003: 5-10 days 2007: 5-10 days
Michigan	7	10	7	9	0	1	2003: Lead contaminant level did not exceed state's background level criteria	2003: 14 calendar days 2007: 2 weeks
Minnesota	5	3	5	2	0	1	2003: Site was not in a targeted area	2003: 1 week 2007: 2 weeks
Missouri	7	6	7	6	0	0	n.a.	2003: Within 30 days 2007: 1 week
New Hampshire	5	0	5	0	0	0	n.a.	2007: Less than 1 week
New Jersey	9	2	9	2	0	0	n.a.	2003: About 1 week 2007: 2 days
New Mexico	2	0	2	0	0	0	n.a.	2007: 2 weeks

State	Number of Applications						Reasons for Denial	Average Estimated Time for Decision
	Received		Granted		Denied			
	2007	2003	2007	2003	2007	2003		
New York	9	14	9	10	0	4	2003: Sites did not meet the definition of "qualified contaminated site"	2003: 19 days 2007: 2-3 weeks
North Carolina	3	2	3	2	0	0	n.a.	2003: Within 2 weeks 2007: 1 week
Ohio	4	5	4	5	0	0	n.a.	2003: 60 days 2007: 30 days
Oregon	5	4	4	4	1	0	2007: Application was for asbestos floor tiles and lead paint in the interior of the building	2003: About 3 days 2007: 1 week
Pennsylvania	10	10	10	10	0	0	n.a.	2003: 5-8 business days 2007: About 1 week
Rhode Island	15	3	15	0	0	3	2003: Two sites were not in a targeted area; the other did not meet the definition of "qualified contaminated site"	2003: Within 2 weeks 2007: Not available

State	Number of Applications						Reasons for Denial	Average Estimated Time for Decision
	Received		Granted		Denied			
	2007	2003	2007	2003	2007	2003		
Tennessee	2	2	2	2	0	0	n.a.	2003: 7 working days 2007: Not available
Texas	12	8	12	8	0	0	n.a.	2003: About 2 weeks 2007: 1 day
Vermont	1	1	1	1	0	0	n.a.	2003: 1 or 2 days 2007: 3 weeks
Virginia	1	11	1	10	0	1	2003: Site was not in a targeted area	2003: Less than 2 weeks 2007: 1 week
Washington	2	5	2	5	0	0	n.a.	2003: Same day 2007: 3 weeks
West Virginia	1	0	1	0	0	0	n.a.	2007: 1 week
Wisconsin	19	20	19	20	0	0	n.a.	2003: About 2 weeks 2007: 2-3 days
TOTALS	**175**	**161**	**170**	**147**	**5**	**14**		

Note: n.a. = Not applicable.

Appendix. A Brief Description of Schedule M-3[17]

In addition to their income tax returns, corporate and partnership taxpayers are required to file financial statements (also called "balance sheets" or "books") which provide an overview of a business's profitability and financial condition, and permit comparisons both with the entity's financial statements of previous periods, and with other taxpayers. Ideally, a business's income tax return and its financial statement will agree with, and be consistent with each other. For a variety of reasons, "adjustments must be made to reconcile the differences between financial accounting based books and records[,] and the presentation required for federal income tax return purposes.... Schedule M-1, *Reconciliation of Income (Loss) per Books with Income per Return* fulfilled this role for corporate tax returns of all sizes for over forty years."[18]

Schedule M-1 is very short, only 10 lines long.[19] As the national and international business environment evolved, and tax and financial issues became more complex over the last four decades, M-1 proved less and less useful. The major purpose of the form is to flag which returns should be examined further, and possibly audited. But as more and more information was aggregated into M-1's 10 lines, its strength as an analytical tool declined.

Consequently, Schedule M-3 was developed for use by large and midsize businesses (those with total assets of $10 million or more). Compared to the 10 items of information collected on the M-1, the new M-3 collects about 300 data points on more than 75 lines.[20] The additional information enables the IRS to more easily identify returns that may be using questionable means ("aggressive transactions," as they are sometimes referred to) to reduce their tax burden. It also increases efficiency by allowing prompt identification of returns that do not require further review. The increased transparency should have a deterrent effect, as well.[21]

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[17] Derived largely from personal communications from Ellen Legel, Senior Staff Economist, Statistics of Income Division, Internal Revenue Service, August 20, and September 12, 2007; and from Charles Boynton, Portia DeFilippes, and Ellen Legel, "A First Look at 2004 Schedule M-3 Reporting by Large Corporations," *Tax Notes*, v. 112, no. 11 (September 11, 2006), pp. 943-981. Hereinafter cited as Boynton, DeFilippes, and Legel. Available at [http://www.irs.gov/pub/irs-utl/schedulem32004firstlookboynton_defilippeslegeltax_notes091506.pdf].

[18] Charles Boynton and William Wilson. "A Review of Schedule M-3: The Internal Revenue Service's New Book-Tax Reconciliation Tool," *Petroleum Accounting and Financial Management Journal*, v. 25, no. 1 (Spring 2006), p. 2. Available at [http://www.irs.gov/businesses/corporations/article/0,,id=163246,00.html].

[19] Schedule M-1 can be seen on page 4 of Schedule 1060, "U.S. Corporation Income Tax Return," at [http://www.irs.gov/pub/irs-pdf/f1120.pdf].

[20] Schedule M-3 can be viewed at [http://www.irs.gov/pub/irs-pdf/f1120sm3.pdf].

[21] Assistant Secretary for Tax Policy Pam Olson, Department of the Treasury, in "Treasury and IRS Propose New Tax Form for Corporate Tax Returns," press release, January 28, 2004.

On a broader level, the new M-3 provides a wealth of information for research and can bring to light trends that IRS may wish to investigate further.

Another feature of the M-3 that IRS views as particularly significant is the form's distinction between temporary and permanent differences. It has been explained as follows:

> Temporary (timing) differences occur because tax laws require the recognition of some items of income and expense in different periods than are required for book purposes. Temporary differences originate in one period and reverse or terminate in one or more subsequent periods....
>
> By their very nature, [they] involve issues regarding the correct year for the item's inclusion in income or deduction as an expense. From a tax administration standpoint, they concern the time value of money.... Purely temporary differences are generally low risk for tax administration — and important in terms of the magnitude of the difference and the time before the temporary difference turns — because of the time value of money.
>
> In contrast to temporary differences, permanent differences are adjustments that arise as a result of fundamental permanent differences in financial and tax accounting rules. Those differences result from transactions that will not reverse in subsequent periods.... [P]ermanent differences have the potential to substantially influence reported earnings per share computations, and, in the case of public companies, stock prices. Accordingly, permanent differences of a comparable size generally have a greater audit risk than temporary differences.[22]

Schedule M-3 was phased in for tax year 2004 for firms reporting total assets greater than $10 million filing the regular Form 1120 corporation income tax return. The M-3 is optional for firms with total assets less than $10 million. Some of these firms did report an M-3. It was not used for the following return types: 1120S for S corporations, 1120-L for life insurance companies, 1120-PC for property and casualty insurance companies, 1120-F for foreign corporations, 1120-RIC for regulated investment companies, 1120-REIT for real estate investment trusts, and 1120-A for small firms. Those using M-3 for 2004 were not required to complete the whole form; certain parts were optional, but the whole M-3 was required for 2005 (if the taxpayer's total assets exceeded $10 million). For three of the other Form 1120 return types[23] (1120S, 1120-L, and 1120-PC), 2005 was the phase-in year, and 2006 was the full compliance year. Form 1120-F had phase-in in 2007, and the whole form will be required for 2008. Tax year 2005 information will be available in February 2008.

There were 5,557,965 corporate taxpayers for 2004, of whom 35,929 filed the accompanying Schedule M-3.

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[22] Boynton, DeFilippes, and Legel, p. 945.

[23] Except Forms 1120-RIC and 1120-REIT, which will never use Schedule M-3.

Partnerships (which use Form 1065) were required to use Schedule M-3 beginning with tax year 2006 (phase-in). That information will be available in February 2009. For tax year 2004, there were 2,546,877 partnership filers.

Schedule M-1 is still being used by corporations with total assets under $10 million. It contains no information on the section 198 brownfields tax incentive.