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Pollution Control Tax—State and Local Credits & Incentives

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Manufacturers, utilities, technology companies, extractive businesses, indeed industries of all stripes may have day-to-day processes and activities that may cause pollution of differing types and magnitudes. In this regard, many industries are required by federal, state, or local regulations to reduce or eliminate certain pollutants from their business activities. This regulatory push towards becoming greener and cleaner is augmented by state programs providing tax credits and incentives that seek to offset the costs of implementing pollution control activities.

What is pollution?

The term "pollution" is defined as the "contamination of air, water, or soil by substances that are harmful to living organisms."[1] The prevention of pollution often involves practices that increase efficiency in the use of energy, water, or other natural resources, and protect resources through conservation.

The federal Pollution Prevention Act ("P2") defines "pollution prevention" as "reducing or eliminating waste at the source by modifying production processes, promoting the use of nontoxic or less toxic substances, implementing conservation techniques, and reusing materials rather than putting them into the waste stream."[2] P2 has focused industry on pollution source reduction through equipment and technology modifications, process or procedure modifications, reformulation or redesign of products, and improvements in training.[3] Likewise, state and local governments have enacted their own statutes seeking to influence corporate behavior towards increased pollution prevention.

While industry in the United States has become increasingly accepting of the need to become more environmentally conscious and sustainable, upfront investment costs remain a barrier. To help decrease these costs, federal, state and local governments have employed tax and financial incentives to encourage investments in pollution control equipment and mitigation activity.

What is pollution control equipment?

Pollution control equipment and property can encompass a wide variety of items used by businesses to mitigate odors, vapors, water contamination, or other emissions. Likewise certain systems such as air filtration systems, double-walled tanks, and leak retaining walls may be considered pollution control equipment even though they may be characterized as "real" (versus "personal") property. Even investments in low-emission or zero-emission vehicles, and the infrastructure to support battery-electric vehicles, plug-in hybrid-electric vehicles, and hydrogen fuel-cell-electric vehicles, are now generally considered to be pollution control "equipment."

Because the definition of pollution as well as what is considered an eligible pollution control investment typically varies from one state to the next, careful analysis is required to differentiate those various state rules and requirements.

State-level pollution control tax credits and incentives

Many states offer qualifying businesses one or more types of incentives to invest in pollution control equipment and mitigation activity. The format of the incentive may differ depending on the state and the focus of its tax code. The incentives may include corporate income tax credits (e.g., investment tax credits), sales and use tax exemptions, property tax exemptions, and, in some cases, cash grants. Qualification for these incentives is typically based on the type of business activity and/or industry within the state.

For example, if a business in Arizona purchases certain real or personal property that is used in Arizona to control or prevent pollution, the business can receive an income tax credit equal to 10% of the purchase price, up to a maximum credit of $500,000 per year.[4] Income tax credits or investment tax credits ("ITC") generally provide a direct reduction of tax. Additionally in some cases, there may be a higher credit percentage available when the equipment reduces pollution at a facility.

In Arizona, property that may qualify for this credit includes "a portion of a structure, building, installation, excavation, machine, equipment or device and any attachment or addition to or reconstruction, replacement or improvement of that property that is directly used, constructed, or installed in this state for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, monitor, control or reduce air, water, or land pollution that results from direct operating activities in conducting business" in Arizona.[5]

In Georgia, a company engaged in either manufacturing or telecommunications support that purchases pollution control equipment (and has operated in Georgia for at least three years) is eligible to earn an investment tax credits between 1%–8% (depending on location) of qualified capital investments of $50,000 or more.[6] "Pollution Control or Prevention Machinery or Equipment" is defined for purposes of this Georgia credit as all tangible personal property, used in whole or in part, to reduce or eliminate air and water pollution by removing, altering, disposing, or storing pollutants, contaminants, waste or heat.[7] This credit can be used to offset up to 50% of a company's Georgia corporate income tax liability. If the earned credit exceeds that limit, then the unused credit can be carried forward for up to 10 years and applied to future years' tax liability.[8]

Several states offer sales and use tax exemptions for investments in pollution control equipment and mitigation activity. Such exemptions eliminate (or partially eliminate) state and local sales and use tax due when a business purchases eligible equipment. For example, Tennessee offers a full (100%) sales and use exemption for the purchase of pollution control equipment with respect to "any system, method, improvement, structure, device or appliance that is required and primarily used to bring the purchaser into compliance with pollution control laws or regulations."[9] Purchasers may apply to the Tennessee Commissioner of Revenue for a refund of taxes paid or for the authority to have the purchases exempted from tax. The Tennessee exemption may also apply to machinery and equipment used to produce electricity in a certified green energy production facility.[10]

In New York, a sales and use tax exemption applies to machinery and equipment used for disposing of industrial waste as a part of a process for preventing water or air pollution, but only if the machinery or equipment was purchased by a manufacturer and used predominantly to actually treat, bury, or store waste materials from a production process, and if over 50% of the waste treated, buried or stored results from the production process.[11]

In Pennsylvania, a sales and use tax exemption is available for the purchase of "equipment, machinery and supplies designed and used to control, abate or prevent air, water or noise pollution" by a manufacturing or mining business.[12]

In Mississippi, a sales and use tax exemption applies to investments in pollution control equipment used for industrial purposes by manufacturers or custom processors.[13] Pollution control equipment means "equipment, devices, machinery or systems used or acquired to prevent, control, monitor or reduce air, water or groundwater pollution, or solid or hazardous waste as required by federal or state law or regulation."[14] It should be noted that a taxpayer must provide a certification from a professional engineer that the purchases meet the Mississippi exemption requirements.

Likewise, several states offer property tax exemptions as a way to incentivize investment in pollution control equipment and mitigation activity. Typically, the local ad valorem tax due for tangible personal property is abated, thus reducing the costs of pollution control equipment placed in service in a business's facility.

For example, in Nevada, all property, both real and personal, is exempt from property tax to the extent that the property is used as a facility, device or method for the control of air or water pollution. Nevada defines the term "facility, device or method for the control of air or water pollution" to mean "any land, structure, building, installation, excavation, machinery, equipment or device or any addition to, reconstruction, replacement, or improvement of land or an existing structure, building, installation, excavation, machinery, equipment or device used, constructed, acquired or installed after January 1, 1965, if the primary purpose of the use, construction, acquisition or installation is compliance with law or standards required by any environmental protection agency, authorized by and acting under the authority of the United States or the State of Nevada or any of its political subdivisions, for the prevention, control or reduction of air or water pollution."[15] Nevada requires the business to file an affidavit declaring that the property for which the exemption is being sought meets the requirements of the statute and the affidavit must be filed with the property exemption request.[16]

Finally, some states offer a combination of incentives for the purchase of pollution control or mitigation equipment. For example, in Alabama, the state offers both a sales and use tax exemption and a property tax exemption for the purchase of pollution control equipment. For sales tax purposes, equipment or materials purchased primarily for the control, reduction, or elimination of air or water pollution are exempt from sales and use tax.[17] For property tax purchases, all equipment, facilities, or materials constructed or acquired primarily for the control, reduction, or elimination of air or water pollution are statutorily exempt from property taxation.[18]

Conclusion

These are just a few examples of state programs that seek to affect affirmative pollution control in the course of a business's regular activities. These examples serve to illustrate that for both cost savings reasons and broader perceptions of "good corporate citizenship," businesses should analyze and determine if they have taken actions (or anticipate capital expenditures) that may result in reducing or controlling pollution. Many states offer tax credits and incentives to correspondingly reduce the cost of required investments. Businesses should consider speaking with a tax professional regarding how to capitalize on the benefits of these programs.

[1] *The American Heritage Science Dictionary*, Houghton Mifflin Company (1st ed. 1995).

[2] Pollution Prevention Act of 1990, Pub. L. No. 107-508, 104 Stat. 1388-321 et seq.; 42 U.S.C. § 13101 (1990).

[3] 42 U.S.C. § 13101 *et seq.*

[4] Ariz. Rev. Stat. Ann. § 43-1081(A).

[5] Ariz. Rev. Stat. Ann. § 43-1081(B).

[6] Ga. Code Ann. §§ 48-7-40.2, 48-7-40.3, 48-7-40.4.

[7] Ga. Comp. R. & Regs. 560-7-8-.37(i).

[8] Ga. Code Ann. §§ 48-7-40.2, 48-7-40.3, 48-7-40.4.

[9] Tenn. Code Ann. § 67-6-346.

[10] Tenn. Code Ann. § 67-6-346.

[11] N.Y. Tax Law § 1115(a)(40).

[12] 61 Pa. Code § 32.32; 61 Pa. Code § 32.35.

[13] Miss. Code Ann. § 27-65-101.

[14] Miss. Code Ann, § 27-65-101.

[15] Nev. Rev. Stat. Ann. § 361.077(1) and (2).

[16] Nev. Rev. Stat. Ann. § 361.077(4).

[17] Ala. Code § 40-23-4(a)(16) – (18).

[18] Ala. Code § 40-9-1(20).