HB 2144 Disconnect from Opportunity Zone/Opportunity Fund Provisions

Testimony for House Revenue – John Calhoun and Jody Wiser – 3.11.2019

In January Bloomberg Businessweek selected Oregon as the most egregious example in the country for selecting districts for incentive tax breaks that did not need them.

This happened because there was little to no discussion about this provision of the new tax law. It was submitted at the last moment without Congressional hearings or national debate. Oregon was given only 90 days to lock in the eligible districts. The Oregon legislature had no chance to debate this and there were no public hearings on the site selection. Instead the legislature was rightfully focused on the debate about disconnecting from the Tax Cuts and Jobs Act (TCJA) pass-through provisions that would have had an immediate and sizable impact on State revenues.

Oregon selected nearly the entire downtown of its largest city to be eligible for the law's suite of benefits, as well as neighborhoods such as the Inner East Side and the Pearl District. More than 40 percent of the Portland commercial real estate investments during the past three years fell within areas now zoned for the tax breaks, a far higher percentage than in any other major U.S. city, according to a recent analysis by Real Capital Analytics Inc.

As the Oregonian's follow up story pointed out, the Metro area is not much better. It includes the Airport district which has had considerable investment; Beaverton, including the Nike campus, which though it isn't a part of Beaverton, already is in a Beaverton Enterprise Zone; Hillsboro, the heart of our booming high-tech industrial growth; Tigard surrounding Washington Square and Tualatin including Bridgeport Mall, areas that have seen strong investment; and Oregon City, the next hot spot for investment in the region.

The rest of Oregon seems equally random. Why is Hood River included, but John Day is not? Why is downtown Salem included, but Keizer is not?

What are some of those who are looking at this and selling the idea saying?

"Opportunity Zones could be the single biggest tax break in decades"
Gaurav Agarwal in Accounting Today 8.18.18

"This is the biggest initiative of this type by the federal government with the least debate, the least staff support, the least research and still the least clarity,"
Eric Garcetti, the mayor of Los Angeles

"The deferral in capital gains tax on an investment rolled into an Opportunity Fund could be roughly equivalent 'to cutting that tax bill in half,' while the tax savings on the new investment 'was like getting 33 percent more profit," Because Oregon law conforms with federal tax law, Brown added, "you save on Oregon taxes as well as federal."
David Brown, Partner Obsidian Opportunity Fund, Portland Business Journal, 6.25.2018

Although the initial revenue drain on the State budget will be modest, it should explode in 10 years when the projects begin being sold with no capital gains tax due. Most of the tax benefits will go to projects already planned or that would happen anyway without a revenue loss. It is just an unneeded gift to the investor class. It will result in overbuilding in Portland and underbuilding in other zones like Klamath Falls and Umatilla, let alone poor districts like John Day that are not on the gravy train.

The zones set arbitrary boundaries that create instant wealth to owners inside the zone while leaving similar properties on the opposite side of the street at a disadvantage.

We should disconnect entirely. The federal incentives will make most of the investments happen anyway and they do not need the Oregon tax break to use this program. Oregon would not design an incentive program like this, and we shouldn't let the Federal Government set our tax policy. If you cannot agree to a total disconnect, limiting the Oregon tax break to the zones that are below the median on the investment scale and above the 20% poverty rate will add incentives where they are really needed and not give handouts to investors that are going to invest anyway.

Many new buildings, businesses and re-investments were completed in these zones in the years just before the law passed; they'll not get the Opportunity Zone/Opportunity Fund tax breaks. Others are far luckier, but they won't necessarily be providing any better benefits to Oregon than what was built in 2015, 2016 and 2017. Simply because of timing, those whose projects were still in the planning stages when the TCJA passed and other future projects will be eligible for the Opportunity Fund tax breaks.

For example, an investor group had already purchased the old Shleifer Furniture Store on SE Grand in Portland with plans to convert it back into a hotel well before the December 2017 TCJA. Now, with a little change in ownership structure, they will make their planned improvements and harvest the three capital gains tax advantages. Likewise, the Goodman family announced well before the TCJA that they intend to develop their twelve surface parking lots in Portland; 11 of the 12 fall within identified Opportunity Zones.

The Federal program has given them and other property owners instant extra value, because their property happens to be inside a boundary. It's like a farmer having property inside vs outside the Urban Growth Boundary, where land can jump from $20,000 an acre as farm land to $600,000 an acre as residential development property.

We are confident that the Oregon legislature would never design this program. It's not that we don't spend money on economic development. The Tax Expenditure Report projects $1.9 billion in tax code economic development subsidies, while the co-chairs' budget has another $261 million in lottery and GF funding for the upcoming biennium. But this Opportunity Zone/Fund scheme was not Oregon's idea.

The Tax Expenditure Report anticipates the cost of the benefit for Opportunity Fund investors at $10.5 million this biennium and $15.9 million next. This is $26.4 million you do not have to part with now. If you disconnect now, it is hard to estimate what you will save ten, twenty, thirty years from now. Our guess is that the cost could be in the range of $200 million per biennium by 2031-33 based on our 1031 Exchange lost revenue experience.

These capital gains tax breaks are outside of Oregon's values. We've never had capital gains tax breaks, and we shouldn't now. Investors, whether from California, Japan, Russia or Oregon will benefit. Despite its "low income census district focus" the law was designed for investors, not to positively affect the lives of regular Oregonians. We are certain you would never, ever, design this program yourselves.

Please, pass HB 2144 to untie Oregon's tax policy from this federal "Opportunity" program. Our first choice is that you disconnect completely, as proposed with HB 2144. Alternatively, you could limit Oregon's connection to investments in the 16 opportunity zones that currently are actually experiencing high poverty and stagnant growth.

Additional exhibits:

2019-21 Tax Expenditure Report
Economic Development Tax Expenditures

TE Number	Tax Expenditure Name	Type	TOTAL $M
Income Tax			
1.013	Regional Economic Development Incentives	Exclusion	< $0.1
1.014	Income of Controlled Foreign Corporations	Exclusion	$0.0
1.015	Capital Gain Invested in Opportunity Zone	Exclusion	$15.9
1.016	Exclusion of Gain from Certain Small Business Stock	Exclusion	$15.6
1.206	Accelerated Depreciation of Buildings	Deduction	$3.1
1.207	Accelerated Depreciation of Equipment	Deduction	$421.8
1.208	Research and Development Costs	Deduction	$10.5
1.209	Section 179 Expensing Allowances	Deduction	$70.4
1.210	Amortization of Business Start-Up Costs	Deduction	$1.8
1.211	Foreign-Derived Intangible Income	Deduction	$163.5
1.220	Development Costs for Nonfuel Minerals	Deduction	< $0.1
1.310	Oregon Investment Advantage	Subtraction	$15.9
1.311	Dividend Received from an IC-DISC	Subtraction	$12.2
1.317	Depletion Costs for Metal Mines	Subtraction	< $0.1
1.414	Renewable Resource Equipment Manufacturing Facilities	Credit	< $0.1
1.415	Qualified Low Income Community Investments	Credit	$26.6
1.416	Qualified Research Activities	Credit	$9.3
1.417	Qualified Research Activities (Alternative)	Credit	$1.1
1.418	Long Term Rural Enterprise Zone Facilities (Income Tax)	Credit	NA
1.419	Reservation Enterprise Zone (Income Tax)	Credit	< $0.1
1.420	Electronic Commerce Enterprise Zone (Income Tax)	Credit	$5.7
1.501	Public Warehouse Sales Throwback Exemption	Other	< $0.1
1.502	Tax Rates for Certain Pass Through Income	Other	$302.0
		Subtotal:	$1,075.4
Property Tax			
2.011	Commercial Buildings Under Construction	Full Exemption	$21.5
2.012	Construction in Process in an Enterprise Zone	Full Exemption	Incl. in 2.011
2.013	Enterprise Zone Businesses	Full Exemption	$122.3
2.014	Long Term Rural Enterprise Zone (Property Tax)	Full Exemption	$94.6
2.015	Certain Property Owned by a Port	Full Exemption	$0.6
2.016	Brownfield Development	Full Exemption	< $0.1
2.017	New Industrial Property in Rural Areas	Full Exemption	NA
2.028	Cargo Containers	Full Exemption	< $0.1
2.097	Gigabit Internet	Partial Exemption	NA
2.098	Certain Communication Related Property	Partial Exemption	$34.8
2.099	Strategic Investment Program	Partial Exemption	$550.6
2.100	Cap on Central Assessment for Certain Companies	Partial Exemption	$2.5
		Subtotal:	$826.9
Other Taxes			
17.001	Certain Vehicle Modifications (Vehicle Use Tax)	Exclusion	NA
18.001	Certain Vehicle Modifications (Vehicle Privilege Tax)	Exclusion	NA
		Total:	$1,902.3

LRO 1.28.2019

In July 2017, the Oregonian wrote:

24-story tower with swimming pool planned for downtown Portland's West End

Twelve West – the downtown Portland tower crowned with windmills – is getting a sister.
At 24 stories, Eleven West will be slightly taller, and bronze instead of silver, but both towers will share an architect and developer.

In the past several years, the Goodman family's Downtown Development Group has capitalized on the city's influx of new workers and residents by starting to develop the many parking lots it owns. In Portland's West End, the half-block along Washington Street between 11th and 12th avenues, is one of the last remaining empty lots in the trendy neighborhood.

Over the next three years, the Eleven West site – now half parking lot, half grass and dirt – will be transformed into a 225-unit apartment tower with 110,000 square feet of office space, ground-floor retail and four levels of underground parking

In August 2018, Gaurav Agarwal in Accounting Today For CPA's wrote:

Opportunity zones could be the single biggest tax break in decades, but the topic is not yet well known to many CPAs, and that lack of knowledge could end up costing your clients millions….

To see exactly how much more an investor can save, compare a $100,000 capital gain rolled into a traditional stock portfolio versus an opportunity fund both earning a 7 percent annual return.

*After ten years, net of taxes, the total return on the stock portfolio would be **32** percent. Meanwhile, the net, after-tax return on the opportunity fund investment would be **73** percent.*

On an after-tax basis, opportunity funds could mean a two times higher return on investment as compared to a traditional stock portfolio.

As you can imagine, such potential return premiums are attracting interest throughout the investor community.

We read the bills and follow the money