House Committee on Revenue
Testimony Opposed to HB 4010: Disconnection from IRC §1400Z-2

Chair Nathanson, Vice Chairs Marsh and Reschke and members of the Committee.

My name is Jonathan McGuire and I lead the Qualified Opportunity Zone practice apart of Aldrich CPA's and Advisors. Our Firm's mission is to help our clients achieve their goals, both internally and externally, while also leaving a lasting legacy on our community.

Many of my colleagues, clients, and fellow citizens are alarmed at the potential disconnect from the Federal Opportunity Zone legislation as the many reasons to support the bill appear to be short-sighted towards the overall tax revenue, economic development needed in the state, and lasting social improvement to the lives of citizens in these communities.

The Opportunity Zone program was initially created during the Obama administration and received bipartisan support lead by the efforts of both Senators Cory Booker and Tim Scott. This is not a "Trump tax cut" in substance, but merely by form as the Senate attached this provision to the Tax Cuts and Jobs Act passed in December of 2017. The TCJA acted as the catalyst to put the legislation on the books.

The number 1 issue we see towards those concerned with loosing tax revenue, is a lack of understanding of the dollars being deployed to these opportunity zone investments. Historically, taxpayers have relied on two primary wealth preservation tools to avoid the recognition of tax. These are the Basis step-up at the date of death and the §1031 or "Like-Kind" exchange. Those investing in traditional equities, such as stock and bonds, aren't able to utilize the 1031 exchange as this is limited to real estate. Unless the cash is needed from these investments, the Taxpayers will hold the investments never recognizing their capital gains while just paying the estate tax with the investments. The heirs then sell the stock and have tax-free capital gains. Currently there is an estimate of 6-7 Trillion Dollars of these gains pent up in the market. With or without the Qualified Opportunity zone program, Real Estate investors will still have access to the 1031 exchange. They will be able to trade and upgrade their real estate holdings without owing a dollar of tax until they decide to outright sell the real estate or again wait until death for the basis step up to pass the wealth to heirs.

The Opportunity Zone program is an attempt to unlock a portion of these gains, typically invested in large national and multi-national corporations that do not necessarily take a vested interest in the small, local communities. The Opportunity Zone program requires that you sell a capital or business asset at a gain to make a qualifying investment. The initial gain is deferred until the end of 2026. A sizable portion of the tax that will be realized from these deferrals are from sales of stock. This is the same stock that would not have been sold and held until death. It never would be taxed until the taxpayer dies. In addition with Oregon's unlimited gifting allowance, Taxpayers can transfer wealth to avoid estate taxes in Oregon altogether. By creating an avenue to release these capital gains into the economy, Oregon is going to realize revenue that it otherwise would not collect.

With the direct investment, there will be new economic activity contributing to Oregon's revenue. The operations of the funds will be taxed as ordinary income. The counties and cities will realize additional revenue through Real and Personal Property Taxes from the increased value of previously under or non-performing locales. If Real Estate, the construction/improvement to these areas will create another layer of economic activity as contractors will realize additional income, their employees will continue to have jobs thus earning a taxable W-2 wage, and they too will contribute to the economy through shopping at the local grocery store, which will pay tax, paying rents or a mortgage from the purchase of a home, of which the landlord or mortgage company will pay tax from revenue, etc. The ripple that this economic activity creates an expanded tax base for the state and for the counties and the local community. This improves the overall well-being of all located in the community. This one dollar spent will move through the economy and be taxed multiple times as taxpayers transact with each other.

Long term though, A QOZ investment or a non-QOZ investment regardless of valuation, with be subject to estate tax upon taxpayer death.

Paraphrasing from a recent article by Alan Greenblatt of governing.com, According to the Economic Innovation Group (EIG), since the recession, around half of net new business creation in the US has taken place in just 20 counties. In addition, more than three quarter of total venture capital now flows to just three states, California, Massachusetts, and New York. While the economy in the Bay Area, Boston and Seattle is booming, most places are losing workers. More than a third of the jobs in America's most innovative industries — technology, computer manufacturing, biotech, telecommunications and the like — are located in just 16 counties, according to a recent report from the Brookings Institution. More than half of those jobs are in 41 counties. All told, just 31 counties — out of more than 3,000 nationwide — account for a third of the nation's GDP.

Oregon is not an economic center of choice for the major capital in the US. By stripping away the Opportunity Zone program it inherently makes Oregon less competitive at a national level and more likely than not will see investment dollars move over the river to Vancouver and up into Washington State, or across the border to places such as the Boise and Reno metro areas. Boise is one of the fastest growing cities in the nation, and Reno and surrounding areas are getting economic booms from companies such as Tesla locating large manufacturing facilities in the areas.

Although the program was designed at a Federal level, each state had the power in the governor's office to select zones that they wished to have be part of the program. If you are worried about inequality of investment, look at current proposed US Senate bills by Ron Wyden and Tim Scott with potential changes to zones so the state and local government can drive investment to the desired areas. If you want to criticize zone location, go ask the governor why these zones were selected.

Some arguments that may be presented are that California and Washington do not conform to this tax incentive, so why then should Oregon? California's tax system does not connect to any federal tax law changes without a vote from the legislature. This creates a multitude of compliance headaches for taxpayers to keep track of business books for federal purposes and another set for California tax purposes. The cost of compliance with California taxpayers can easily add $1,000 per tax return to deal with all the California versus Federal disconnects. California, led by an effort by their governor, attempted to connect to the federal program. Much to the dismay of the governor, the state legislature voted it down. The argument that Washington doesn't comply is untrue and misleading. Washington DOES NOT have an Income Tax. Therefore Washington has no reason to consider compliance/noncompliance with the federal program! Washington Taxpayers and Washington investors do not have to worry about any income tax burden.

Oregon residents, despite investing in other states, are taxed on all income inside and outside of Oregon. There may be tax credits assessed for taxes paid to other states, but Oregon residents may already freely invest in other states resulting in similar Oregon tax revenue. Therefore Oregon investors going outside the state to make investment would still result in some revenue regardless. Oregon has one of the higher income tax rates amongst the 50 states which despite credits for taxes paid to other states still results in revenues to Oregon.

The Pearl is a unique census tract in the US. Despite the revival, there is still need for workforce housing in the metro area. With rent control, inclusionary zoning, the Portland/Multnomah county income taxes, etc., an incentive is needed to attract the type of projects the area and city planners are in dire need of. In addition, economies of scale matter. Disproportionate investment will take place between urban and rural areas. $1,000,000 of investment in rural Oregon is going to go much further than the same dollar amount in downtown Portland. Investment will naturally flow towards these areas due to the capital required to make projects work.

There is worry of gentrification, but through additional revenue through the expansion of the tax base through property tax, income tax, payroll taxes, commercial activity tax, this could actually increase resources at the state and local level to help provide and fully fund required services/assistance. The economic stimulus in the zones would be expected to impact the rest of the community to create wage growth, greater access to resources, etc. that currently are not available.

I would like to highlight some Opportunity Zone deals taking place in Oregon and around the country, as well as look at what other states are doing. With permission to share from a small developer client of mine, he is redeveloping a building in downtown Salem that used to be a Chinese Restaurant. In the redevelopment, he has taken the top floor and converted it to 5 units of workforce housing that is desperately needed in the downtown Salem. The Ground floor he has created a food hall with shared kitchen space to allow 6-7 new micro restaurants to sprout up and employ a chef and their kitchen staff. In addition, a bar servicing the food hall will employ multiple full time employs as well as wait staff for maintaining the eating areas. In the basement, will be entertainment activities for purchase that will employ 2 full time employees and a 6-8 part time employees.

From a public policy perspective, the state of Illinois has actually created additional state level incentive to further the impact of opportunity zones. They introduced a $45 billion capital program by the Dept. of Commerce and Economic Opportunity. Of this, $12 billion is reserved for the state's opportunity zones. This is on top of connecting fully with the Federal Opportunity Zone legislation. I invite representatives to review what another state is doing and show that incentivizing business and economic development with further the success and viability of the economy overall. The Illinois program as a grant requires an application process for Taxpayers to compete for these grants to do projects. As the state controls these, they can help direct the investment they want to see done.

Around the nation the following projects are underway:

- <u>Wilmington, Delaware</u> will see the construction of an innovative vertical farm that will work to employ formerly incarcerated individuals. This will provide these individuals a path forward in society to improve their lives and leave a past life of crime behind.
- <u>In Louisiana</u>: Launch Pad, could be the best operating business example to deliver on the promise of the Opportunity Zone legislation and might just be the critical conduit by which Opportunity Zones renew American entrepreneurship and cities. Started in New Orleans, Launch Pad has opened 3 new cities in 2018, all in Opportunity Zones, with plans for at least 20 by 2020. Launch Pad serves entrepreneurs as a coworking space,

convening place, and community center, with a focus on ecosystem collaboration and support of local organizations. It can act as the gravitational point of an entrepreneurial ecosystem. Entrepreneurs working together creates innovation and new ideas to constantly improve our technology, infrastructure, and so on.

- In Iowa: Denison Mayor Jared Beymer announced recently 45 housing units will be built to address the community's housing shortage.

- In Arizona: Virtua Partners have fully-funded three of its Opportunity Zone projects in Arizona and have paved the way for Opportunity Zone investing. Recently they held their groundbreaking in Tempe, Arizona for their first residential project through the OZ program – providing 90 units of affordable housing, creating an estimated 200 construction jobs alone.

- In Utah: Housing and Urban Development Secretary Ben Carson took a trip to Salt Lake City, Utah recently to tour a 200,000-square-foot mixed-use real estate development known as the HUB of Opportunity and located within an opportunity zone. Once it opens next spring, the development will include 156 apartments, space for a specialized employment training center for young adults with autism and a commercial space to attract small businesses.

- In Vermont, following the closure of three small Vermont colleges in 2019, a new plan is emerging to transform the former College of St. Joseph's campus, located in an Opportunity Zone, into an innovation hub. The proposed center would have co-working space, non-degree education and workforce development programs, and mentorship opportunities for startups.

Some have said that Opportunity Zone tax incentives are morally corrupt. What is "morally corrupt" (borrowing their term) is not creating a business environment that could lift people out of poverty, increase the livability for all, and improve the socioeconomics of the community. Yes, investors are getting tax breaks, but they are taking on a higher risk profile in these areas by exiting traditional safe equities. With incentives, you can drive more money to these areas by leveling the playing field for investor return. These investors are going to make money regardless, and targeting the investment to underserved areas can spur and have a greater impact on economic growth statewide. A typical investor is worried about a profit and a return, and many in Oregon look to a triple bottom line investment strategy focusing on economic, social, and environmental profit. As a result, they are invested in the community to ensure the success and profitability of their investment rather than relying on the performance of corporate earnings from their stock portfolios. Invest in the small businesses that build the community, that give people the dignity of work, and help eliminate the housing crisis, opioid crisis by getting people off the street, and unlock our full economic potential.

Sincerely,

Jonathan McGuire, CPA MT