“Opportunity Zones could be the single biggest tax break in decades.”
---GauravAgarwal, Accounting Today, 8/18/18

Hidden in the new federal tax law rushed through in December 2017 is a scheme that allows investors to totally escape capital gains taxes while claiming, often falsely, that they are helping low income communities. There has been very little public discussion of this provision in the mass media, but the investment community is rushing to create funds for wealthy investors to take advantage of the new law.

In addition to adding to the federal deficit while accelerating the accumulation of wealth amongst the already rich, the law will ultimately be costly to Oregon because we are connected to the federal tax provision unless we disconnect as we did the pass-through tax loophole.

Opportunity Fund contributions have four imbedded tax breaks according to Virtue Partners:

1. Investors may reinvest capital gains from any existing investments into an Opportunity Fund and both defer and reduce those capital gains taxes
2. After the investment is held for 5 years, the tax basis in the original investment is increased by 10%, and after 7 years, the tax basis is increased by 15%
3. After 10 years, investors permanently avoid any capital gains tax on the post-acquisition gains
4. These tax benefits include increased expensing and depreciation.

All four tax breaks will be applied to both federal and state taxes if we don’t disconnect from the federal law.

David Brown, partner in the Obsidian Opportunity Fund, said 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,” at today’s tax rates.

Even spread out over a long horizon, “those kinds of advantages are considered not insignificant in the investment community,” he said. Because Oregon law conforms with federal tax law, Brown added, “you save on Oregon taxes as well as federal.”

Portland Business Journal, June 25, 2018

The justification for these tax breaks is to incentivize investments in low income neighborhoods. However, in Oregon and elsewhere the designated zones are not all low income areas by any means. In fact, in Portland, the central business district from SW 12th to the river, and the fast-gentrifying tracts of the Pearl, the South Waterfront, inner NE Portland, and inner SE Portland were deemed opportunity zones despite having booming capital investments in recent years with more already planned. Downtown Beaverton and the Nike Campus are included as are downtown Hillsboro, Tigard, and Tualatin; all areas that are already experiencing rapid growth. Meanwhile, Hood River is included, but not Pendleton. Facebook’s Prineville data center complex, which the company already aims to expand, is in an Opportunity Zone, but Apple’s — just on the other side of Oregon Route 126 — is not, David Brown pointed out to the Portland Business Journal.

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The result of the zones that are included and those that are not is that investment will indeed flow to the targeted areas and away from those not so designated. The state legislators from Pendleton should be unhappy. However, because so many of the identified Opportunity Zones are very desirable investment targets, they will get the bulk of the investments and those zones that truly need investment, but are riskier, will likely not benefit. Almost inevitably, this scheme will result in tax giveaways for investment that would have occurred anyway in booming areas while not helping areas that need it.

**While there is nothing we can do now to close the federal gift to the investor class or to change the identified zones over the next 10 years, we can and must disconnect Oregon from this provision. It is imperative that this be done in the 2019 session before these investments get locked in. While the cost to state revenue will be modest initially, it will grow over time and be substantial in ten years when the first projects start to be re-sold and the zero tax rate applies.**

“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,” said Eric Garcetti, the mayor of Los Angeles. “

“One of the concerns we have is that opportunity zone capital will most naturally flow to projects that have the highest return with the least amount of risk,” said Kimberlee Cornett, a managing director at the Kresge Foundation. “Investments most needed by these communities don’t necessarily have those characteristics.”

Virtua Partners, a Phoenix-based private-equity firm, is raising $200 million for an opportunity zone fund including three Phoenix-area projects: a 130-room Marriott hotel with furnishings by West Elm; 81 single-family townhomes with a swimming pool and clubhouse; and a 90-unit apartment complex near Arizona State University’s campus in Tempe. All three projects would have been completed even without the tax break, said Virtua executive Derek Uldricks.

There is no limit on the potential tax benefits for investors and, unless the Trump administration decides otherwise, no requirement for measuring the program’s effectiveness, such as examining which investments in each area use the new incentive.

The tax break is an easier fit for investing in real estate rather than in companies, some venture capitalists say. The legislation “was written by and for real-estate investors,” said Ross Baird, president of Village Capital Group, a Washington, D.C.-based venture capital firm exploring other ways to use the program.

Many Pacific Northwest investors are watching the program with interest. For one thing, the program allows investors to use traditional public bond funds to invest in opportunity zones.

**Useful links**

http://www.oregon4biz.com/Opportunity-Zones/

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