House Committee on Revenue
Testimony Opposed to HB 3039: Disconnection from IRC §1400Z-2

Chair Nathanson, Vice Chairs Walters 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. 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.

Revenue Impacts

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. There was 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 certain business assets 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. 2026 will be an tax windfall for the state, and the catalyst of the development projects will provide an increase in annual income tax revenue from additional rents, business income, and wages paid in the community.

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 is the business of choice, 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 which is the great equalizer in our tax system.

Economic Impacts

The Economic Innovation Group released a report on March 22, 2023 highlighting the great effects the Opportunity Zone program has had across the nation. Their key findings are as follows:

- OZ investment reached approximately 3,800 communities from mid-2018 through 2020, representing nearly half (48 percent) of the total number of designated OZ communities nationwide. For comparison, it took 18 years for New Markets Tax Credit (NMTC) investments to reach an equivalent number of communities.
- OZ investment is going to communities that are substantially more economically distressed than the rest of the country. Ranked from lowest to highest levels of need, they average in the 87th percentile for poverty, 81st for median household income, and 80th for unemployment.
- Total OZ equity investment was at least $48 billion by the end of 2020. This capital was raised from roughly 21,000 individual and 4,000 corporate OZ investors and deployed into 7,800 Qualified Opportunity Funds.
- OZ designation caused a "large and immediate" increase in new commercial and residential development activity such that the likelihood of investment in a given month jumped by over 20 percent in designated tracts across 47 studied cities.
- Rather than crowding out local activity, OZ designations carried positive economic spillovers into neighboring communities and boosted development at a city-wide scale.
- In addition to boosting the supply of housing, OZ designations improved local home values by 3.4 percent from 2017 to 2020 with no observed increase in rents.

Oregon has not been 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. As seen in the key findings above, there has been a bona fide economic increase in activity which should further grow and establish a greater tax base. The economic innovation group has noted that 76% of all designated zones in Oregon have received some level of investment through Opportunity Zones. This is the HIGHEST IN THE NATION!! It shows how useful the program is for investments outside of major markets. We encourage you to read this report and consider the findings. The macro-economic impact is showing and the facts clearly point to the programs success.

Inclusion, Fairness, ESG

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, Cory Booker 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, please inquire with the previous governor's administration of whom was given the sole authority which census tracts to designate. We should support federal legislation to change zones to better target areas we wish for economic development to take place.

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 over $1,000 per tax return to deal with all the California/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. Complicating our Oregon tax system is not equitable.

Opponents to this tax incentive have said that Opportunity Zones 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. These investors are going to make money regardless, and targeting the investment to underserved areas can spur a greater impact on economic growth statewide. A typical investor is worried about a profit and a return, but many in Oregon look to a triple bottom line investment strategy focusing on ESG 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. Lets invest in the small businesses that build the community, that give people the dignity of work, and help eliminate the housing crisis, and unlock our full economic potential.

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.

Oregon projects in Opportunity Zones

I would like to highlight some Opportunity Zone deals taking place in Oregon. These economic activities all would not have happened without Opportunity Zones. The projects are diverse in nature, ranging from large to small.

There are two projects specifically I want to highlight that are walking distance from the Capitol Building in Salem.

- The first is by a local developer named Charles Weathers. He has redeveloped 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. You would know this place as the Fork Forty Food Hall of State St.. In the basement, will be entertainment activities for purchase that will employ multiple individuals and provide for entrepreneurs to start a business. Charles has also taken ownership of another building in downtown Salem that is primed for redevelopment and renovation. Because of the opportunity zone program, he was able to attract another investor and lessen his debt load with rising interest rates. Without the investor, he wouldn't have been able to get this additional project started.

- A larger project in Salem that would not have been developed is the Holman Riverfront Park Hotel. Led by Vanessa Sturgeon, a Portland area developer, has recently completed a brand-new hotel offering desperately needed in Salem's downtown core. By giving another hotel location downtown, it will further spur economic activity at the local shops, restaurants while giving additional space to host events and provide a restaurant of its own in the coming months. The Hotel should create XX jobs that otherwise would not exist. To put into perspective, the building that previously existed was an old auto repair shop and parking structure that had been vacant for years. It was an unproductive property and utter eye-sore at one of the busiest intersections in Salem. Just in Real Estate and personal property taxes alone, the redevelopment of this site is adding tax revenue. The fact this is a hotel should provide immediate tax impact to Oregon through the CAT revenue that also would not have previously existed.

There are a number of other projects that could be highlighted, all of which have happened, are in progress, or in pre-development stage where Oregon is focus of attention because of our zones. There is development in the Metro area to add housing in urban areas to help provide affordable housing. There is a development project to create a planned community in Burns to revitalize and create new economic activity in a beautiful part of rural eastern Oregon. We are seeing an increase in affordable housing being built in the Tigard triangle as the future reach of mass transit options increase to that area. All of these would not happen at the speed development is taking place without Opportunity Zones.

In conclusion, we formally oppose this legislation. We recommend this not be advanced to the house in its current form. Should this bill move forward, we ask that amendments to the bill be requested and considered to level the playing field for those previously invested in Opportunity Zones. In 2020, HB 4010 had multiple amendments that were agreed to by this committee that at a minimum should be reintroduced to the current bill HB 3039.

Sincerely,

Jonathan McGuire, CPA
Aldrich CPA's and Advisors

Leah Anderson, CPA
Aldrich CPA's and Advisors