HB 3039: Tax Opportunity Zone profits like any other income

House Committee on Revenue – Jody Wiser – 5.23.2023

Co-Chair Nathanson and Meek, members of the committee, my name is Jody Wiser, with Tax Fairness Oregon. We're a network of volunteers who advocate tax code that is rational and equitable.

The federal Opportunity Zones provision is neither. Oregon should disconnect from it. In plain English, the legislature should require Oregonians to pay state taxes on their O Zone profits, just as they would any on other capital gains realizations. We oppose the -2 amendment. It guts the bill and allows millionaire investors, trusts and corporations to get tax breaks on investments since the birth of the program in late 2017.

Here are some examples of investors—if they are Oregon taxpayers—who would get tax breaks that should not blessed with the -2 tax break:

Three Portland buildings that took advantage of O Zone financing long after their launch: the Ritz-Carlton, where condos sell for $8 million; 11West, a retail-office-condo; and the Grand Stark Hotel, a former furniture store on the East Side. TFO documented transfers in ownership after all three projects had begun, allowing them to use O Zone financing. The tax breaks were gravy.

David Wessel, formerly of *The Wall Street Journal*, traveled the country talking to funders and developers. His chapter titled "Portland: Tax Breaklandia," details a fourth project.

Wessel found that 250 SW Taylor broke ground in 2016 and signed Northwest Natural as its 20-year tenant two months before O Zones became law. A year after that, a New York firm bought the nearly finished building using O Funds. Those investors, at little risk, must hold still for 10 years. Actually, they can transfer their money to another O Zone project.

And these investors took advantage of the rules changing in the middle of their game.

We all understand that the legislature is entitled to change tax laws at any time, particularly a law it had no role in creating. Every O Fund prospectus we've read warns investors that tax benefits may be eliminated just as they were created and none mentions state taxes. We also believe that investments in Oregon projects represent a tiny share of Oregonians' O Fund holdings and therefore present little risk to the General Fund.

In Gresham, Wessel found no OZ investments. He did find an urban renewal project. It includes offices, a job training entity, Montessori school, restaurant, non-profit food hall, and a five-story apartment building, under construction, with 20% affordable units. **Exactly the kind of project OZ advocates hyped.** But it had no O Zone funding. Developer Roy Kim wrote Wessel (p. 191):

Rockwood is in a truly distressed community. Rents are low, so returns are low. Investors in O Zones are looking for higher returns, which are not available at Rockwood. For O Zones to provide capital to rural and distressed communities, the structure as designed does not work—unless you have an investor in need of tax deferral that is also a philanthropist willing to take a very small return.

These organizations agree:

- Oregon Education Association
- Oregon School Employees Association/AFT
- Oregon Center for Public Policy
- League of Women Voters
- American Association of University Women of Oregon
- Human Services Coalition of Oregon
- Ecumenical Ministries of Oregon
- Oregon Unitarian Universalist Voices for Justice
- Main Street Alliance for Oregon
- Oregon Coalition of Christian Voices
- Onward Oregon

Opportunity Zones are the latest in a three-decade line of provisions that give tax breaks on capital gains invested in land occupied by poor people. If the breaks are generous enough, the theory goes, investment will lift them out of poverty.

Despite ever greater largess, the record is unchanged. Place-based tax incentives do not work. As the Heritage Foundation concluded in 2019:

Academic and government studies consistently show place-based development programs fail to increase employment, raise wages, or advance general economic opportunity for targeted residents because they have not addressed the main causes of poverty.

From the Cato Institute:

O Zones have balkanized American cities into winner and loser zones. They are supposed to alleviate poverty, but the main beneficiaries are the landlords who own development sites within the politically chosen zones.

Said Brett Theodos of the Urban Institute: The O Zone provision "is referenced against operating businesses, smaller and rural projects, and the mission-aligned projects that could deliver maximum community benefit."

These supply-side think tanks see that this tax-code giveaway can't be justified by evidence. We make three points based on the evidence.

First: Only the rich can play. Which is the title of David Wessel's book on O Zones. A person generally will invest in O Zones only if he has unrealized capital gains he can sell and put into an O Zone project. Most funds are limited to SEC-accredited investors.* Generally the price of entry is

$100,000 or more. Some funds have lower requirements. To take full advantage, an investor must park the money for a decade.

Second: O Zone investors target projects with the greatest potential return. Out of 8,764 zones, 1% received 42% of investment. 5% received 78%, according to a study of early investments. 63%, receive zero O Zone capital.

Why is that? Because if you're an investor, you want the highest return. With 8700 zones to choose from, a rational investor will not put money in low-income neighborhoods, but in high-end projects. That's as true in Oregon as anywhere else.

We asked local officials to discuss their O Zone experience.

Hillsboro Mayor Steve Callaway expressed skepticism about the potential and said projects in his two O Zones haven't received its financing.

Washington County Chair Kathryn Harrington was unaware of any and said the county has no position on this bill.

Oregon City has no O Zone projects.

Beaverton Mayor Lacey Beaty has declined to respond to calls and emails since we met with her in 2021. She did file a letter for the March 21 House Revenue hearing claiming that Opportunity Zones were a "critical tool" for redevelopment, but she didn't cite any projects.

Redmond has a hotel built by a California investor. **Ken Kruse** sent a letter to House Revenue in 2020 in which he said the project "would not have been feasible absent the OZ incentives." But Kruze proves our point: Kruse could take advantage of the federal benefits, but California never provided them. Kruze pays California taxes on his profits. He received no benefit from Oregon.

This brings us to the cost. From old and current Tax Expenditure Reports, we share these.

1.015 CAPITAL GAIN INVESTED IN OPPORTUNITY ZONE

Internal Revenue Code Section: 1400Z-2
Oregon Statute: 316.048 and 317.013 (Connections to federal personal and corporation taxable income)
Federal Law Sunset Date: 12-31-2026
Year Enacted in Federal Law: 2017

	Corporation	Personal	Total
2017-19 Revenue Impact:	$7,000,000	$3,500,000	$10,500,000
2019-21 Revenue Impact:	$10,800,000	$5,100,000	$15,900,000

	Corporation	Personal	Total
2019-21 Revenue Impact:	$9,600,000	$22,100,000	$31,700,000
2021-23 Revenue Impact:	$6,800,000	$16,000,000	$22,800,000

	Corporation	Personal	Total
2021-23 Revenue Impact:	$4,000,000	$28,000,000	$32,000,000
2023-25 Revenue Impact:	$3,000,000	$20,000,000	$23,000,000

DOR’s estimate began at $10 million a biennium. Two years later, it tripled, to $32 million. Our connection to a provision not of Oregon’s making has cost us tens of millions of dollars in revenue, and disconnecting would return revenue foregone, now and in the future.

Last December, the Joint Committee on Taxation, the congressional equivalent of LRO, revised its estimate of the federal cost from two years earlier. The revenue foregone from individuals rose by a factor of 11—$400 million to $4.4 billion compared to late 2020. The chart below shows the two estimates.

Joint Committee on Taxation

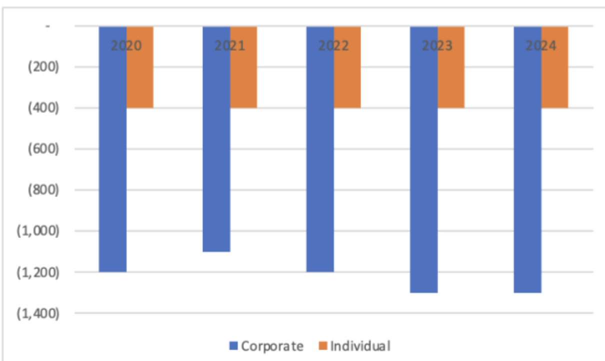
Federal expenditure estimates ($ millions)

November 2020

	2020	2021	2022	2023	2024
Corporate	(1,200)	(1,100)	(1,200)	(1,300)	(1,300)
Individual	(400)	(400)	(400)	(400)	(400)
	(1,600)	(1,500)	(1,600)	(1,700)	(1,700)

December 2022

	2022	2023	2024	2025	2026
Corporate	(1,000)	(1,000)	(1,000)	(1,000)	4,200
Individual	(4,400)	(4,600)	(4,700)	(4,700)	19,500
	(5,400)	(5,600)	(5,700)	(5,700)	23,700



Sources: JCX-23-20, JCX-22-22

Would passage of the bill as introduced harm Oregon O Zone projects?

Let’s be clear about what the bill would do: require Oregonian individuals and corporations to pay tax on O Zone profits just like any other profits.

- Would that affect developments in Oregon? Not any more than developments elsewhere. Oregon investors are like others: most are motivated by R-O-I. 99 of 100 projects are out of state.
- Would state’s taxation discourage investment in Oregon? No, because the investment pools are mostly national, and nonresidents don’t pay Oregon taxes.
- Nine states don’t have an income tax and so don’t offer breaks. Several states disconnected. California was never connected, but it has seven of the top 50 investment targets; its high tax rates are irrelevant. What is relevant is the return.
- For those investing in Beaverton or Prineville, they will do so because they are committed to their communities, like Roy Kim, or they expect the project will have a robust R-O-I. If they want R-O-I, and they don’t expect good returns, they will look elsewhere.
- Will Oregon investors sit out because they only get the federal 23.8% break, not 33.7%? I don’t know. But I do know this: **Only the rich will play.**

Here are arguments from people who submitted testimony in 2020, and our response.

Mike Stober, OBI: "The legislation may actually encourage Oregon investors to invest in opportunity zones in other states." *Oregon taxpayers are liable for tax on capital gains no matter where they are realized.*

Scott Hibbs, Standard Insurance Company: "I believe that the disconnect will hinder the flow of capital to the small and rural opportunity zones." *Virtually no capital has flowed to rural O Zones, in Oregon or elsewhere.*

Rep. David Brock Smith: "In my district, the major project is a $65 million golf course . . . and the jobs that are associated with these Opportunity Zone projects bring resources to these impoverished communities." *Golf courses, and certain other businesses, are not eligible for O Zone tax benefits (26 USC 144(c)(6)(B)).*

Kim Heddinger, Golden Realty, Eugene: "We need every tool in our tool chest in this current environment where we have a severe lack of housing, affordable housing and a homeless problem." *Little O Zone financing has not gone to affordable housing.*

Frank Bubenik, Mayor, Tualatin: "Recently, the Opportunity Zone Program has provided national marketing appeal for Tualatin that has led to the creation of 100 jobs with an average salary of $70,000, and investments of nearly $10 million dollars." *The bill wouldn't affect national investors who invest through a national fund.*

Ken Kruse, SCP Redmond Hotel: "I am proud to say that our project in Redmond—which would not have been feasible absent the OZ incentives—resulted in the investment of nearly $12 million into reopening a vintage 49-room hotel." *Mr. Kruse, a Californian, will receive no state tax benefits from the federal provision in California or Oregon.*

This year **Scott Bruun, OBI** (House Revenue, March 21): "For most Oregon investors, [the bill] would add an additional 9.9% marginal tax for opportunity zone investments. While this may not totally kill opportunity zone investments in Oregon, it will most certainly curtail them." *Logically, most Oregonians invest out of state, and most investors in Oregon projects, like Ken Kruse, are non-residents.*

And Senate Finance Chair, Ron Wyden*,* wrote in letters sent last year to several investment firms: "Currently, there are no safeguards or transparency measures in place to ensure taxpayers are not simply subsidizing high-end real estate investments by billionaires without demonstrating the benefit they are providing to low income-communities they claim to help."

**Accredited Investors, according to the IRS, must have:*

- Net worth over $1 million, excluding primary residence (individually or with spouse or partner)
- Income over $200,000 (individually) or $300,000 (with spouse or partner) in each of the prior two years, and reasonably expects the same for the current year
- And financial acumen as well, also defined.

We read the bills and follow the money