The Real Estate Roundtable
Opportunity Zones
Tax Policy

Summary

Created in 2017, Opportunity Zones (OZs) are designated, low-income census tracts where qualifying investments are eligible for reduced capital gains taxes. By channeling investment where it is needed, OZs help stimulate jobs, generate economic opportunity, and improve the built environment in low-income communities. The decentralized design of OZs allows more investors and stakeholders to participate in the market and invest in these projects.

This year, the renewal and reform of the OZ tax incentives is expected to be a **major topic of discussion** as Congress considers the **extension** of the Tax Cuts and Jobs Act of 2017. RER has advocated for a long-term extension of the OZ incentives, as well as additional reforms to scale their impact and improve their effectiveness.

Tax legislation passed by the House Ways and Means Committee in May would extend OZ incentives through 2033, create new benefits for rural OZs, call for a new round of OZ census tract designations, and make other reforms to the provisions.

Key Takeaways

- In their short tenure, OZs have created jobs and spurred billions of dollars of new investment in economically struggling communities across the country.
- Opportunity Funds finance affordable, workforce, and senior housing; grocery-anchored retail centers; and commercial buildings that create spaces for new businesses and jobs.
- In 2020, the White House Council of Economic Advisers estimated that the Opportunity Funds had raised **$75 billion** in private capital in the first two years following the incentives' enactment, including **$52 billion** that otherwise would not have been raised. The council projected this capital could lift one million people out of poverty in OZs by 11 percent.
- Despite major hurdles such as COVID-19 and high interest rates, more recent estimates suggest OZs have attracted over **$120 billion** in capital.
- Today, **72 percent** of U.S. counties contain at least one OZ, and **32 million** people live in the 8,764 OZ-designated census tracts.

Background

Tax Cuts and Jobs Act of 2017 (TCJA)

- First introduced by Senator Tim Scott (R-SC) and supported on a bipartisan basis, OZs were created under section **1400Z of the Internal Revenue Code** as part of TCJA. The three main OZ tax benefits were a **deferral of prior capital gain** rolled into an OZ fund, an increase (partial "step-up") in the basis of the prior investment after a five or seven-year holding period, and the **exclusion of gain** on the OZ investment after 10 years.
- The final OZ regulations were issued four months before the COVID-19 lockdown. The tax benefits are **gradually phasing down**, with the deferral of prior gain ending in **2026**. The partial basis step-up has expired for new OZ fund contributions.
- In the last Congress, bipartisan House legislation (Reps. Mike Kelly, R-PA and Dan Kildee, D-MI; H.R. 5761) would extend OZ deadlines for two years, allow helpful "fund of funds" OZ tax structures, sunset certain high-income OZ census tracts, and create new OZ information reporting and transparency rules.

Recommendations

Provide a Long-Term Extension of OZ Deadlines: Congress should ensure that OZs continue to act as a catalyst for economic development in struggling communities by passing legislation that extends OZ deadlines.

- In the case of new investments, two of the three OZ tax incentives have either expired altogether or phased down. The third and **most important benefit**, the exclusion of gain on OZ investments held at least 10 years, expires for new investments made after December 31, 2026.
- A long-term extension will avoid disruption to the growing ecosystem of opportunity funds and the network of OZ investors that are mobilizing private capital for low-income communities and creating new jobs, housing, and economic opportunities for their residents.

Supplement the Extension of OZs with Well-Designed Reforms: Congress should also continue working on improvements to the OZ tax incentives to boost their scale and impact. RER encourages Congress to enact the following reforms:

- Remove limitations on the type of capital eligible for investment in Opportunity Funds.
- Add a new OZ tax benefit for the conversion of older, obsolete commercial buildings to housing.
- Establish a rolling deferral period and reinstate a basis step-up for new OZ investments.
- Codify, lengthen, and improve the OZ working capital safe harbor.
- Increase flexibility of Opportunity Fund ownership, investment, restructuring, and leasing arrangements.
- Modify the substantial improvement threshold to cover a broad range of real estate rehabilitation and development projects.
- Promote greater foreign investment.
- Establish information reporting and transparency requirements.