

## **HELP HARD-HIT COMMUNITIES BY REFORMING AND ENHANCING OPPORTUNITY ZONES**

May 14, 2020

Dear Senator:

In the coming weeks, as state and federal authorities determine it is safe to resume normal activities, bold policies will be needed to restore and create jobs for the tens of millions of individuals who lost employment due to the COVID-19 pandemic. Similarly, policies will be needed to help preserve the local tax base that finances critical services such as schools and law enforcement in low-income communities. Opportunity Zones have demonstrated the ability to promote capital formation and job growth, and they could be an effective policy tool to help hard-hit localities recover. As one element of economic stimulus legislation, we urge you to consider three key enhancements to the Opportunity Zone tax incentives.

First, Congress should allow opportunity funds to raise capital from all sources, not just gain rolled over from a recently disposed investment. The existing rule severely constrains the amount of capital that flows into struggling communities. Under current law, only an investor who has capital gain to roll over from an existing investment can participate in the Opportunity Zone tax incentives. As a result, rather than spurring new capital formation for business investment, Opportunity Zones largely encourage a transfer from one investment to another. This limitation prevents many individuals from participating in funds, including residents of the communities where the Opportunity Zone activities occur. The rule also means that the incentive is weakest when it is most needed because it is dependent on the profitability of existing investments to create the pool of capital available for Opportunity Zone investment. If the economic downturn deepens and asset markets further tighten, the amount of existing gain available for investment in opportunity funds will decline as well. Expanding the sources of capital available to opportunity funds would help avoid a backslide in Opportunity Zone investment and job growth in low-income communities during this period of severe economic stress. In addition, by removing the roll-over requirement, Congress would encourage the productive investment of capital that is currently on the sidelines and underutilized.

Second, Congress should spur productive real estate investment in low-income communities by providing that a 50 percent increase in the basis of a building constitutes a substantial improvement of the property. The current requirement to increase basis by 100 percent is a significant hurdle for real estate projects, notwithstanding the capital-intensive nature of rehabilitating and renovating real estate. The 100 percent rule is a much higher standard than the substantial improvement requirement that applies for other purposes, such as private activity bonds and the low-income housing tax credit (LIHTC). A modified test could greatly expand the impact of Opportunity Zones in communities hard hit by the COVID-19 pandemic. A standard that is closer to the tests for the LIHTC or private activity bonds would cover a larger universe of buildings and spur greater economic development and job creation.

Third, Congress should provide certainty to potential Opportunity Zone investors by codifying the tax rate on deferred gain and extending current deadlines for the basis increase and recognition of deferred gain. Under current law, gain rolled into an opportunity fund is deferred and taxed at the end of 2026 at the then-current capital gains rate. The uncertainty regarding potential tax rates at the end of 2026 has caused many prospective Opportunity Zone investors to question the after-tax economics of potential opportunity fund investments. Investors fear that a future increase in the tax rate could

severely reduce the after-tax return from an opportunity fund project or business. Congress could reduce investor uncertainty, without any change in current tax rates, by independently codifying the marginal tax rates applicable to Opportunity Zone deferred gain at the levels that currently apply to individual long-term capital gain. In so doing, a future increase in the general capital gains rate structure would not apply to Opportunity Zone deferred gain unless Congress expressly modified the Opportunity Zone deferred gain rates.

Closely related, Congress should preserve the economic incentives of the original Opportunity Zone provisions by extending for two years the recognition date for deferred gain, and consequently, the deadlines that must be met in order to qualify for the increase in basis for gain rolled into an opportunity fund. Taxpayers that hold an opportunity fund investment for five years qualify for a 10 percent increase in their basis in the investment. Taxpayers that hold the investment for seven years qualify for an additional 5 percent increase. Prior gain that is rolled into an opportunity fund and deferred is recognized and taxed no later than December 31, 2026. The passage of time since enactment of the Tax Cuts and Jobs Act has eroded the economic incentives associated with the basis increase and tax deferral. The 5 percent increase for the seven-year holding period is no longer available and the 10 percent increase expires at the end of 2021. Moreover, the present value benefit of the tax deferral is declining as the time period between the qualifying investment and the recognition of deferred gain in 2026 narrows. In order to avoid a retrenchment in Opportunity Zone investment, Congress should restore the economic incentives associated with these provisions by extending the date for the recognition of deferred gain by two years, until December 31, 2028. In addition to extending the deferral period, this would allow taxpayers to get the full, combined 15 percent increase in their basis if a qualifying opportunity fund investment is made by the end of 2021.

New, bold ideas are needed to help bring jobs and investment back to communities struggling from the impact of the COVID-19 pandemic. Improvements to the Opportunity Zone tax incentives are one area where there should be a strong, bipartisan consensus. Thank you for your consideration of these proposals.

Sincerely,

The Real Estate Roundtable  
American Hotel & Lodging Association  
American Resort Development Association  
Asian American Hotel Owners Association  
CCIM Institute  
Institute of Real Estate Management  
NAIOP, Commercial Real Estate Development Association  
National Apartment Association  
National Association of REALTORS®  
National Multifamily Housing Council  
REALTORS® Land Institute