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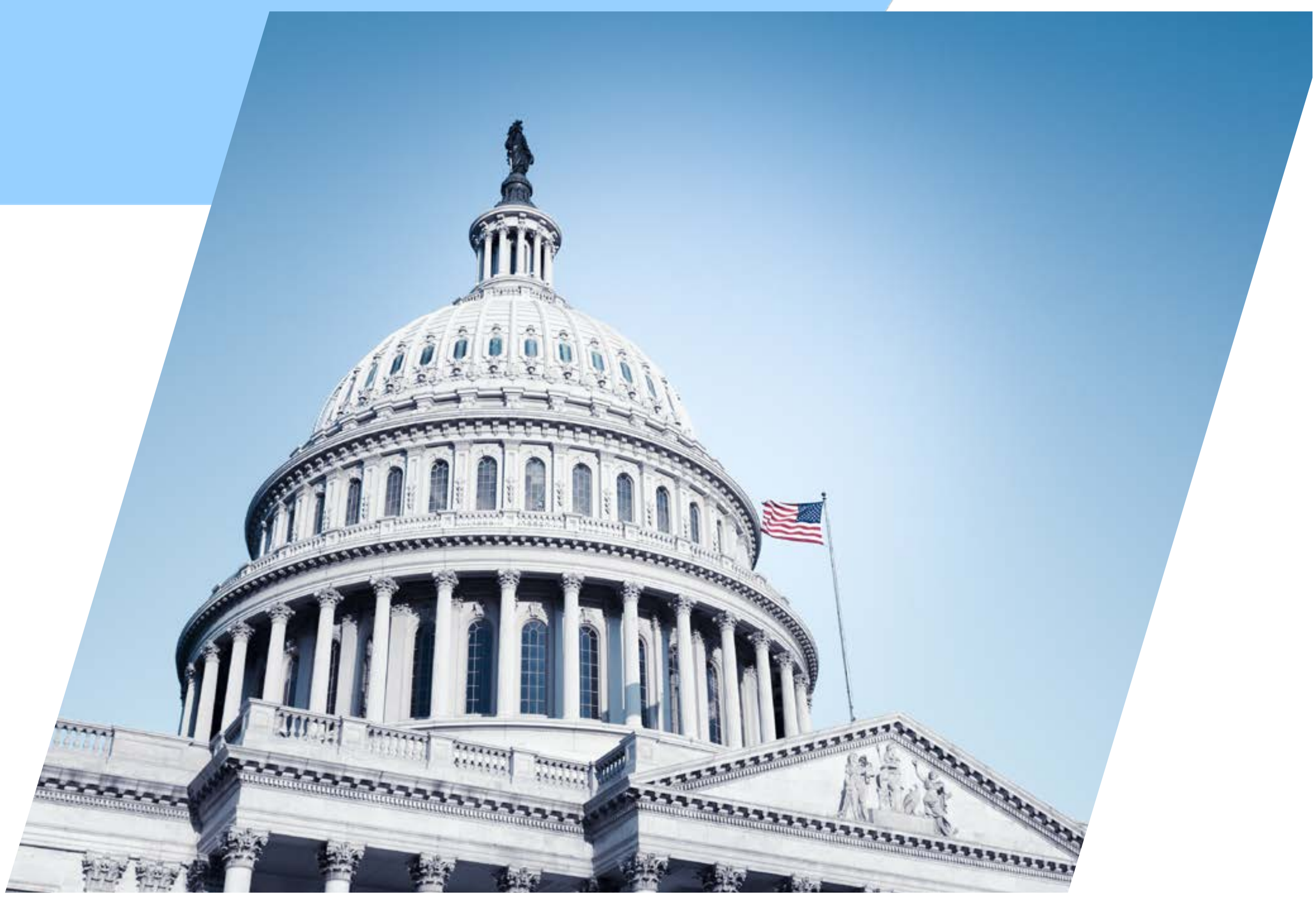
New Legislative Proposals for the Opportunity Zone Program



D&S Opportunity Zone Practice Group
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New Legislative Proposals for the Opportunity Zone Program

The Opportunity Zone program (the "OZ Program") has been receiving some (perhaps unwelcome) attention over the past few weeks as several legislative proposals have been released in Congress. The legislation is most certainly in response to the unfavorable press, in the New York Times and elsewhere, which paints a picture of the OZ Program as a tax shelter for the wealthy that is not achieving its goal of funneling investments to low-income communities.

Politics aside, here is what you need to know about the proposed legislation and how it may, or may not, impact the OZ Program.

1- What is in the proposed legislation?

There were four separate bills introduced in Congress which would each modify certain features of the OZ Program,[1] and there was a fifth bill which would repeal the OZ Program entirely[2]. Putting aside this fifth bill for a moment, there are many overlapping features among the other four bills. Rather than parse each separately, below is a list of the most critical provisions.

Keep in mind as you read this that the legislation is still only in *proposed* form. Any final legislation will need to be approved in both the House and the Senate (more on that below), so if any of these proposals move forward, various provisions could be added or deleted or the bills could be merged together anyway.

- **Zone Redesignation –** The big headline grabber is likely to be the potential redesignation of certain Opportunity Zones. In the original designation process, each state was permitted to nominate some "adjacent" census tracts that were themselves not low income, as long as they were adjacent to low income census tracts. All of the adjacent tracts would be disqualified, as well as any census tracts that do not currently meet the statutory requirements to be low income (the median family income must not exceed 120% of U.S. median family income, and other metrics are weighed). States would be able to designate replacement zones, but any existing investments in the disqualified zones are only grandfathered in as qualifying property if the property was placed in service before November 6, 2019 (to meet the original use test), or if the

[1] The Opportunity Zone Accountability and Transparency Act (no bill number) was introduced in the House, the Opportunity Zone Fairness and Inclusion Act (HR 4999) was introduced in the House, the Opportunity Zone Reform Act (HR 5042) was introduced in the House, and the Opportunity Zone Reporting and Reform Act (S 2787) was introduced in the Senate.

[2] This fifth bill was introduced in the House (no bill number).

basis of qualifying property acquired before November 6, 2019 is doubled within 30 months from the date of acquisition (to meet the substantial improvement test).

- **Stricter Interpretations of Certain Requirements –** In response to Treasury's taxpayer-friendly interpretation of certain requirements in the Internal Revenue Code, the proposed legislation would statutorily enact stricter requirements.
  - Leases between related persons would not constitute qualifying property. (In the proposed regulations, leases between related parties are okay subject to a few additional guardrails.)
  - The "double your basis" requirement for the substantial improvement test would apply to land, as well as existing improvements. (In the proposed regulations, only the basis of existing improvements must be doubled to meet the substantial improvement test. The basis allocated to land is ignored.)
  - The meaning of "substantially all" would be fixed at 90%. (In the proposed regulations, "substantially all" is defined to be 70% in certain places, such as the percentage of tangible property at the QOZB level that must be qualified opportunity zone business property.)

- **New Sin Businesses –** The list of "sin businesses" would be expanded to include skating facilities, skyboxes, luxury boxes, and investments in private planes. In addition, self-storage facilities, parking structures, sports stadiums and certain luxury residential developments (those without at least 50% of the units being occupied by residents whose income is 50% or less of area median income) would be specifically carved out and excluded from the definition of qualified opportunity zone business property.

- **Other Proposals –** Additional provisions include a requirement that QOFs form an investment advisory board comprised of members of the community in which the QOF is investing, a requirement that a percentage of a QOF's investment be made in smaller-scale projects and minority and women-owned businesses, and affordable housing requirements.

- **Reporting –** Most of the bills call for a slew of reporting requirements by QOFs, and by investors too. The reportable information would include basic information about the QOF and any QOZBs in which the QOF is invested in, as well more granular information about the underlying investments and other impact-driven metrics such as the number of employees employed by the QOF or QOZB, and the percentage of low income rental units in a residential development. The proposals would also require reports by the QOF on the QOF investors themselves, and the QOF investors would have a separate requirement to report their QOF investments and dispositions. Some of the reports would be publicly available, subject to privacy concerns.

The effective dates of the new requirements vary, which is the element that will certainly be attacked on fairness grounds. Some of the provisions would be slated to take effect as of the date the legislation is enacted, some would take effect retroactively to November 6, 2019 (the date that two of the bills were released) and some would take effect retroactively to December 22, 2017 (when the OZ Program was enacted with tax reform).

The fifth bill, which would repeal the OZ Program entirely, is particularly harsh because there would be no grandfathering at all, so any eligible gain invested to date would have to be included in income and investors would not be able to claim any future tax benefits.

2- <u>What is the likelihood of changes to the OZ Program?</u>

Before you cast the OZ Program into the dustbin, remember first that all of these proposals are just that – *proposals*. In order for any of these changes to become law, the bills need to work their way through the legislative process, which includes committees, debates, amendments, conferences, etc. A bill must be approved in both the Senate and the House, and then it must be signed by the President (or overcome a veto).

Given the current make-up of Congress, as well as the current President, we do not expect any imminent movement on the proposed legislation. There has been bipartisan support for reporting requirements, but even that would require the full legislative process. With an election less than a year away and the impeachment inquiry, it may be difficult to get momentum on anything less than critical in Washington DC.

Of course the 2020 election could tip the balance of power in Congress and in the White House, in which case the proposed legislation may have a better chance of moving ahead. Even if that does happen, a more realistic scenario is a prospective enactment of any new provisions, rather than a retroactive disqualification of investments that were made in compliance with the law in effect at that time. Such a reversal would likely erode public faith in the tax incentives space and in the tax regulatory process.

For a bit of possibly comforting historical context, it is extremely rare for Congress to retroactively change the tax laws to disqualify existing investments. Of course the terms of any final legislation that amends the OZ Program, even solely on a prospective basis, would have to be carefully parsed to determine whether any in-process projects would still qualify, or whether only completed projects are grandfathered.

Bottom line takeaway: This is proposed legislation that has a long way to go before possibly becoming law. This flurry of proposals is likely just political posturing at the moment, especially given the harsh effect that the current version of the proposals would have (both on the OZ Program and on reliance on the tax laws more broadly). Without a crystal ball, we cannot say for sure what any future legislation may look like, but hopefully there will be some measurable data at that point to illustrate the impact of the OZ Program, which would go a long way in helping to ensure its survival.

The D&S Opportunity Zone Practice Group brings together a 50-person team, including lawyers, paralegals, and our business professionals providing a unique value add for clients. The OZ team is led by:

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