Opportunity Zone program attracts Congressional proposals, regulatory action

December 2, 2019

In brief

The Qualified Opportunity Zone (QOZ) program, enacted in the 2017 tax reform legislation (the Act), has triggered developments in Congress and the Administration. Several bills have been introduced that are intended to strengthen reporting requirements, while bills by Senate Finance Committee Ranking Member Ron Wyden (D-OR) and others call for substantive changes to the Act's provisions.

Meanwhile, the IRS has proposed new changes to Form 8997, Initial and Annual Statement of Qualified Opportunity Fund Investments requiring information on the value of QOZ investments. Announcing the form, Treasury officials reportedly indicated that they would work with Congress to develop additional requirements. Separately, Treasury hopes to issue final OZ regulations -- expected to exceed 500 pages -- by year-end.

Observation: In light of the short time left for legislative action, and the crowded Congressional agenda, it will be exceedingly difficult for Congress to consider by year-end a broad range of QOZ proposals. If an opportunity for action arises, the reporting proposals have the broadest bipartisan interest at present.

In detail

Background

The QOZ Program is intended to promote investments in economically distressed communities across the country. Through the program, investors can inject capital into low-income communities and promote long-term economic growth through a variety of special-purpose investment vehicles.

To encourage investment in the QOZ Program, taxpayers may be eligible for significant tax benefits that can include tax deferral for capital gain invested in a qualified opportunity fund (QOF), elimination of up to 15% of the tax on the capital gain invested in a QOF, and full elimination of tax when exiting a QOF investment.

For additional background information on the QOZ program, see the PwC Tax Insights and webcasts listed at the end of this Insight.

Reporting requirements

Bipartisan Senate bill

In May 2019, Senator Cory Booker (D-NJ), Tim Scott (R-SC), Todd Young (R-IN), and Margaret Hassan (D-NH) introduced S. 1344, which would require reporting requirements for QOFs, similar to information reporting requirements included in the original QOZ bill that were removed when they were included in the 2017 tax reform legislation (the Act). The reporting requirements were eliminated from final the Act due to the 'Byrd Rule', a feature of the budget reconciliation process that was used during tax reform so only a majority vote was needed for Senate approval; the Byrd Rule prohibits reporting requirement type provisions that do not have a direct budgetary impact.

Wyden bill

S. 2787, introduced by Ranking Member Wyden includes mandatory reporting requirements for QOFs and investors and a requirement to make such information public on the QOF's website for three years, with the exception of the investor information. The required information includes disclosing the value of all property held, directly or indirectly, by the QOF or by QOZ businesses conducted by the QOF, as well as additional detailed information with respect to qualified business property; average monthly number of employees of QOZ businesses conducted by the QOF; details on corporations and partnerships in which the QOF holds an interest, including the identity of each entity; and disclosure of investors and the amount of their investments in the fund. QOF investors would have to provide an annual statement containing the information required above. QOFs that do not file this information each tax year would be subject to penalties. These provisions would apply for tax years beginning after the date of enactment.

Bipartisan House bill

House Ways and Means Committee Members Reps. Ron Kind (D-WI), Mike Kelly (R-PA), and Terri Sewell (D-AL) on November 8 introduced HR 5011, the *Opportunity Zone Accountability and Transparency Act.* This bill requires information reporting by QOFs outlined above.

This bill also would require Treasury to collect and compile statistical information with respect to each QOZ, including the number of QOFs that have made an investment in each QOZ, the aggregate amount of investment in each zone by QOFs, and other metrics concerning job creation, poverty reduction, and community and economic development. The information would be made available to the public annually.

Substantive proposals

Ranking Member Wyden bill

Zone re-designation

In addition to the reporting requirements, the Wyden bill would disqualify a census tract from being designated as a QOZ to the extent the tract has median family income (MFI) that exceeds 120% of the national MFI, with exceptions for tracts that have a poverty rate of 20% or higher and a student population of less than 10%. In addition, census tracts contiguous with a low-income community no longer would be treated as QOZs.

The bill would allow states to replace the disqualified zones with zones in low-income communities. States would have 90 days to re-designate the same number of zones that were sunsetting under the high-income provision, and replacement zones would be designated for 10 years from enactment of this legislation. The bill further specifies that for any current investments in the replacement zones, the original use of such property must have occurred before November 6, 2019 (date of introduction), and for property acquired before such date, the property is substantially improved before the close of the 30-month period beginning the month of acquisition.

Maintenance of boundaries

S. 2787 would add a provision in regard to the maintenance of boundaries of QOZs and provide that the designation of a QOZ applies to the geographic area as it is drawn at the time of designation and will remain the same throughout the entire designation period.

Modification to prohibited investments

The bill would expand the list of prohibited QOZ businesses to include golf courses, massage parlors, suntan facilities, health club facilities, liquor stores, gambling establishments, country clubs, tennis/racquet clubs, hot tub facilities, racetracks, skating facilities, airplane use, and luxury boxes. In addition, the bill requires a QOF to hold trades or businesses that are QOZ businesses, amending the provision that currently allows the above-listed businesses to operate if operated directly by the Fund.

Clarification of QOZ rules

The Wyden bill would change the proposed regulatory guidance, replacing "substantially all" with "not less than 90 percent" across the statute. This change impacts QOF holding periods, use, and the amount of tangible property held by QOZ businesses that must be in a zone.

The bill would add three new property types which would not be treated as qualifying as QOZ business property – self-storage property, stadium property, and disqualified residential rental property – and provides definitions for each of the excluded properties. Self-storage property is any property that rents or leases individual storage space for the purpose of storing personal property. Stadium property means any property which, during at least five days of the year, is used as a stadium or arena for professional sports, exhibitions, games, or training. Disqualified residential property is defined as any residential property unless 50% or more of the residential units are both rent-restricted (following the lower income housing credit rules and definitions) and occupied by individuals whose income is 50% or less of area median income.

In regard to leased property, the bill would disallow related-party leases from being treated as QOZ business property and would require leased property to meet the substantial improvement or original use tests.

S. 2787 provides a technical correction on original use, removing language that would require the original use of property to be in the QOZ and confirms that original use relates to use by the QOF.

The Wyden bill changes the substantial improvements test to now include land, also overriding regulatory guidance that land can be taken out of the calculation of the basis for the purposes of the substantial improvement test.

The bill would require Treasury to maintain a public list of QOFs and the name, address, and website of each Fund.

Report by Government Accountability Office (GAO)

The Wyden bill would require GAO to report to Congress on the effectiveness of QOZs, including distribution of investments across QOZs and industries or investment purposes; impact of designation on the area in terms of employment, new business start-ups, poverty reduction, housing costs, and income distribution among residents of the zone; economic benefits compared to the costs of the designation; and the impact on non-designated low-income communities. The GAO reports would be issued five years and 10 years after the enactment of this legislation.

Other bills

Clyburn bill

Rep. Jim Clyburn (D-SC) on November 12 introduced HR 5042, the *Opportunity Zone Reform Act*. This bill largely incorporates the substantive proposals of Sen. Wyden's bill as outlined above, including zone re-designation (including changes to the definition of low-income communities and contiguous census tracts, as well as redesignation of replacement tracts), maintenance of boundaries, modification to prohibited investments, and other clarifying rules. In addition, the Clyburn bill would add parking property to the list of property types that are excluded from QOZ business property. This bill also requires a GAO report to Congress on the effectiveness of QOZs.

Johnson bill

Rep. Hank Johnson (D-GA) on November 8 introduced HR 4999. This bill would require (1) QOFs to have advisory and investment boards consisting of members of the target communities, (2) diversity in investment advisors, and (3) a mixture of investments ensuring some money goes to smaller-scale projects with low capitalization requirements, as well as to minority businesses and individuals residing in the target communities. These provisions would be effective as of the date of enactment.

The takeaway

The bills described above would add additional reporting requirements for QOFs, including detailed information about the assets and businesses a QOF holds. Also, the Wyden and other bills would make major changes to the QOZ incentive and the program as a whole. Congressional action on some of these proposals remains uncertain.

Background information

PwC Insights

New Opportunity Zone Guidance - Questions and Answers, May 9, 2019

Qualified opportunity funds provide tax incentives for investors, March 21, 2018

Opportunity Zones proposed Treasury regulations clarify uncertainties, October 19, 2018

Tax reform readiness: Opportunity Zones - realizing benefits and avoiding pitfalls, November 1, 2018

Federal opportunity zones offer state tax opportunities, complexities, January 8, 2019

PwC Webcasts

Tax Readiness: Understanding the new Opportunity Zone guidance and how it applies to businesses and investors, April 30, 2019

Tax Reform readiness: Opportunity Zones proposed regulations - Optimizing benefits and avoiding pitfalls, October 30, 2018

Let's talk

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