MALIA M. COHEN
CHAIR
STATE BOARD OF EQUALIZATION

April 24, 2019

TO: Members of the Board of Equalization

FROM: Malia M. Cohen, Chairperson

RE: Board of Equalization Board Meeting, April 30, 2019
Item L.4. Opportunity Zones

On April 17, 2019, the Internal Revenue Service (IRS), through the United States Department of Treasury, released its proposed regulation regarding Opportunity Zones investments (Internal Revenue Service 26 CFR Part I [REG-120186-18] RIN 1545-BP04 Investing in Qualified Opportunity Funds).[1] Within a few months, the IRS, through the Treasury Department, is expected to issue administrative rules regarding this regulation.

Opportunity Zones were created through The Tax Cuts and Jobs Act of 2017. The statute was introduced with bi-partisan sponsors, led by Senators Cory Booker (D-NJ) and Tim Scott (R-SC), was designed to spur growth in low-income communities by encouraging reinvestment of capital gains into certified Opportunity Funds. Under the statute, opportunity zones can be established in designated census tracts as area where investments can be made by individuals through special funds (Qualified Opportunity Fund) which will allow taxpayers to reduce or defer federal capital gains taxes.

The incentives for investors regarding the treatment of capital gains rolled into a Qualified Opportunity Fund (QOF) include: no up-front taxes on federal capital gains; 10% increase in rolled-over federal basis for QOF investments held five years; 15% increase in rolled-over federal basis for QOF investments held seven years; investor's original tax bill can be deferred to December 31, 2026, or until they sell their QOF Investment; Investments held QOFs for at least ten years are not taxed for federal capital gains.

There are few limitations on the kind of investments which qualify for Opportunity Fund investments. However, there is consensus that Opportunity Zones will likely spur investments in real estate as a way of reducing capital gains taxes.

[1] Proposed IRS Opportunity Zones investment regulation, linked at: http://src.bna.com/Hra

There will be around 8,700 Opportunity Zones nationwide. The Department of Treasury has certified 879 census tracts in California as Qualified Opportunity Zones.[2]

According to the State of California Opportunity Zone portal, the 879 Opportunity Zone census tracts were selected based upon the following criteria: Opportunity Zones with a median income in the census tracts below $100,000; Opportunity Zones which substantially overlap other census tracts already targeted for disadvantaged communities for Cap and Trade purposes; and distribution of Opportunity Zones among the counties.

California Government Operations has developed an interactive tool kit to locate Opportunity Zones. Go to: https://opzones.ca.gov/oz-map/

The State has created a multi-agency team to implement the Opportunity Zones program. This group is in the process of reaching out to investors and communities to determine if co-investment possibilities exist to leverage development and investment which can benefit communities in Opportunity Zones.

This multi-agency team includes:

- Office of the Governor
- California Department of Finance
- California Department of Housing and Community Development
- California Department of Food and Agriculture
- California Workforce Development Board
- California Housing Finance Agency
- California State Transportation Agency
- California High Speed Rail Authority
- California Operations Agency
- California Department of Transportation
- Governor's Office of Business Development
- California Energy Commission
- California Air Resources Board
- Labor & Workforce Development Agency
- Strategic Growth Council

Opportunity Zones: Impact on Property Tax Rules and Regulations

Given the potential for significant investments throughout California which could impact property tax values, it is appropriate for the Board to receive information and recommendations, and develop advice regarding property valuation, exclusions and exemptions, and issues posed by Opportunity Zones.

[2] See Opportunity Zones FAQ, linked at https://opzones.ca.gov/faqs/

One issue affecting property valuation in Opportunity Zones is the impact of Opportunity Zones on accelerating the development of affordable housing, and whether such acceleration could result in impacts on property valuation, particularly related to new construction. Recent press reports indicate there are approximately 1,000 projects already proposed for Opportunity Zones, with 59% being multi-unit developments.

Another possible issue affecting property valuation is whether certain properties, or portions of properties developed or rehabilitated in Opportunity Zones could qualify for the Welfare Exemption. This may be an issue for properties used exclusively for certain rental housing and if households in these properties met the criteria required for residents who are elderly or disabled, or who meet the low-income requirements, relative to our low-income housing rules.

Since investment decisions are being made daily concerning Opportunity Zones, it may be appropriate for the Board of Equalization to consider whether Letters to Assessors (LTA) are appropriate to clarify the tax treatment of property upgraded because of investments in Opportunity Zones. In addition, some properties are being transferred into Opportunity Zones, raising reassessment issues and/or possible change in ownership exclusions.

It may also be appropriate to determine if any clarifications (LTA) are necessary for property tax rules regarding the application of the Welfare Exemption to properties in Opportunity Zones.

One approach could be to request a presentation from the Property Tax Department on Opportunity Zones, which could address of these property valuation issues, and others which may arise during their review.

Therefore, this item is being placed on the agenda for the Board to consider the following actions:

- Direct the Executive Director to review and report on Opportunity Zones and associated property tax implications; and/or
- Host an informational hearing on Opportunity Zones and associated property tax implications.