United States Government Accountability Office

Testimony

Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

# OPPORTUNITY ZONES

# Data on Investment Activity and IRS Challenges Ensuring Taxpayer Compliance

Accessible Version

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Chairman Pascrell, Republican Leader Kelly, and Members of the Subcommittee:

Thank you for the chance to discuss our work on the Opportunity Zones tax incentive. As you know, Congress created this tax incentive in December 2017 to spur investments in economically distressed communities.[1] Opportunity Zones are designated census tracts where certain qualified investments are eligible for federal tax benefits. According to our analysis, the nearly 9,000 designated tracts are home to more than 10 percent of the nation's population and have lower income, higher poverty, and greater non-white population than other eligible but non-designated tracts.

Taxpayers who invest in Qualified Opportunity Funds—that then invest in qualified property or businesses—could receive significant tax-related benefits. Funds and their investors generally must invest in Opportunity Zones for a minimum number of years and report information annually to receive tax benefits and avoid penalties. The Internal Revenue Service (IRS) administers and ensures compliance with these rules.

My remarks today are based on our October 2021 report on Opportunity Zones, which was publicly released last week.[2] Today I will focus on two aspects of this report—available taxpayer data on Opportunity Zone investments and IRS's plans to ensure taxpayers comply with the rules governing the Opportunity Zones tax incentive.

To conduct this work, we analyzed IRS data and interviewed U.S. Department of the Treasury and IRS officials. We also analyzed IRS regulations and compliance planning documentation. We evaluated IRS's Opportunity Zones compliance plan using criteria from Standards for Internal Control in the Federal Government and IRS's current strategic

[1]*See* Pub. L. No. 115-97, § 13823, 131 Stat. 2054, 2183-88 (2017) (codified as amended at 26 U.S.C. §§ 1400Z-1 – Z-2).

[2]GAO, *Opportunity Zones: Census Tract Designations, Investment Activities, and IRS Challenges Ensuring Taxpayer Compliance,* GAO-22-104019 (Washington, D.C.: Oct. 7, 2021).

plan.[3] More detailed information on our objectives, scope, and methodology can be found in the issued report. Our work was performed in accordance with generally accepted government auditing standards.

## Limited Data Indicate about $29 Billion Invested in Opportunity Zones

A comprehensive picture of investment activity in Opportunity Zones based on tax data is currently unavailable due in part to decisions around transcription of paper-filed returns. For example, some of IRS's preliminary summary data on investors and funds is based only on information captured from forms submitted to IRS electronically. Other information from forms that were mailed to IRS, or emailed to IRS in a PDF format, was not fully transcribed from paper or PDF forms into IRS information systems. As a result, comprehensive aggregated reporting and analysis would be time- and labor-intensive for IRS to produce.

Tax filing extensions and IRS processing delays due to Coronavirus Disease 2019 (COVID-19) have also limited the availability of data for analysis. For example, data on investors and funds have also been delayed because IRS extended tax return filing deadlines—as well as other deadlines specific to the Opportunity Zones tax incentive—due to COVID-19. Disruptions in IRS operations during the COVID-19 pandemic have also delayed the processing of some returns.

However, IRS has collected limited information on Qualified Opportunity Funds and investors for tax compliance purposes and was able to analyze electronically filed returns and selectively transcribed paper filings. According to preliminary IRS data for tax year 2019, more than 6,000 Qualified Opportunity Funds reported holding about $29 billion in qualified property, as shown in table 1. IRS data also indicate nearly

[3]GAO, *Standards for Internal Control in the Federal Government,* GAO-14-704G (Washington, D.C.: Sept. 10, 2014). Internal Revenue Service, *FY2018-2022 Strategic Plan*, Publication 3744 (Rev. 4-2018).

18,000 taxpayers reported being invested in those funds during tax year 2019.[4]

[4]Some data for tax year 2018 are available, however Treasury and IRS issued final regulations and certain tax filing forms for the Opportunity Zones tax incentive after tax year 2018. Because investors and funds are required to report information annually on their cumulative investments, data from tax year 2019 provides a more complete picture of investment activity.

**Table 1: Available Data on Qualified Opportunity Funds and Investors, Tax Year 2019**

| Category | Subcategory | 2019 |
|---|---|---|
| **Qualified Opportunity Funds** | Number of Forms 8996 filed[a] | 6,845 |
| **Qualified Opportunity Funds** | Dollar amount of qualified property held (in millions) | 28,910 |
| **Investors** | Number of Forms 8997 filed[b] | 17,891 |

Source: Internal Revenue Service data. | GAO-22-105526

Note: Data are incomplete due to return processing delays, missing information from amended returns and some returns filed on paper, and limited information transcribed from taxpayer forms.

[a]Funds file Form 8996 annually to self-certify that they are a qualified fund and to report total qualified property held at the middle and end of the tax year. The number of Forms 8996 filed may not equal the number of Qualified Opportunity Funds as some taxpayers filed Form 8996 without expressing intent to become a Qualified Opportunity Fund.

[b]Investors file Form 8997 annually to report information about their investments in Qualified Opportunity Funds.

Taxpayer data on Opportunity Zone investment activity are also limited in other ways. Specifically, in October 2020, we reported that as a result of unclear statutory authority, there are insufficient data available to evaluate the performance of the Opportunity Zones tax incentive.[5] IRS generally collects data explicitly for tax administration and compliance purposes; some of these data, such as investment amounts, can be used to evaluate outcomes. However, only limited reporting on performance is possible. Also, because additional data collection and reporting on the incentive are necessary to evaluate outcomes, we asked Congress to consider requiring more reporting for the incentive, and specified in our October 2020 report that Treasury is best suited to collect that information. As of November 2021, no legislation has been introduced in the current Congress to address these issues.[6]

[5]GAO, *Opportunity Zones: Improved Oversight Needed to Evaluate Tax Expenditure Performance*, GAO-21-30 (Washington, D.C.: Oct. 8, 2020).

[6]In October 2020, we identified at least five bills introduced in the 116th Congress that would have specified types of data to be collected about Qualified Opportunity Funds, and investments those funds made in businesses and properties. These bills addressed several categories of data not currently being collected that could help answer key questions related to the performance of Opportunity Zones, such as the type of business and number of employees, and the square footage of real property and number (if any) of residential units. See GAO-21-30.

# IRS Can Better Address Risks Posed by Limited Data and Complex Investments

IRS developed a compliance plan to ensure Qualified Opportunity Funds and investors are complying with the tax incentive's requirements, but IRS faces challenges in implementing the plan because it depends on data that are not readily available for analysis. Further, IRS' compliance plan does not include researching the potential compliance risks posed by high-wealth individuals and large partnerships that are involved in Opportunity Zone investments.

According to the September 2020 plan, IRS intends to mitigate some compliance risks through automated matching of information reported by investors and funds with information from third parties and other sources. However, based on IRS's form-transcription decisions, the agency will be unable to conduct some of these mitigation activities.

IRS has historically limited using data elements from electronically-filed returns for compliance purposes when these data are not also transcribed from paper-filed returns. This decision is to ensure that paper-filed returns are treated similarly to electronic returns. IRS's ability to easily and accurately report data on the tax incentive is thus constrained by how much information is captured from taxpayer forms.

We recommended IRS assess the risks that data limitations pose to its Opportunity Zones tax incentive compliance plan and take steps to mitigate those risks. IRS agreed with our recommendation. IRS officials said that they would review previously-identified risks considering data limitations and then identify potential alternative mitigation actions and revise the compliance plan, as appropriate. Assessing and mitigating the risks from the lack of expected data will help IRS better identify and address taxpayer noncompliance.

IRS assigned primary responsibility for implementing the Opportunity Zones tax incentive to its Small Business/Self-Employed division, but IRS data and our case studies indicate that a significant number of Qualified Opportunity Funds and their investors are taxpayers who typically fall under the purview of IRS's Large Business and International (LB&I)

division.[7] Available tax return data indicate that many investors who deferred capital gains by investing in Qualified Opportunity Funds are likely high-income or high-wealth individuals. Audits of high-income and high-wealth individuals with especially complex returns are led by a special group of LB&I examiners.

Similarly, IRS analysis of data from tax year 2018 indicates that about 86 percent of Qualified Opportunity Funds were organized as partnerships. Some of the funds we reviewed through our case studies were partnerships with hundreds of partners and total assets of $100 million or greater. We also found that nearly all funds are investing in real estate developments, many of which are complex, multiyear projects such as hotels and multifamily housing projects

IRS has previously identified high-wealth and high-income individuals, and pass-through entities like partnerships as posing high compliance risks. However, IRS has not researched potential compliance risks these groups pose for the Opportunity Zones tax incentive. As a result, IRS may be unable to effectively plan and target its compliance efforts.

We recommended that IRS's Small Business and Self-Employed and Large Business and International divisions research compliance risks posed by high-wealth individuals and large partnerships that are using the Opportunity Zones tax incentive and take appropriate steps to address the risks identified. IRS partially agreed with this recommendation. Specifically, IRS agreed to conduct the recommended research but stated that the agency cannot agree to take related mitigating actions because it needed to consider available resources and competing priorities of work based on the highest risk for noncompliance. Our recommendation asked that IRS take appropriate steps to address the risks identified. We think it is reasonable that IRS would take a number of considerations into account when determining those steps.

In conclusion, IRS faces challenges implementing its plan to ensure compliance with the Opportunity Zones tax incentive because the plan relies on data that are not readily available for analysis. IRS has also not

[7]We selected 18 Qualified Opportunity Funds for case studies using a purposeful, stratified random sampling methodology to ensure that we examined a range of characteristics, including a variety of investment approaches and projects. We found that the Opportunity Zones tax incentive attracted investment in housing, renewable energy businesses, and other projects. The case studies are not generalizable to the entire population of funds.

researched the potential compliance risks posed by certain taxpayer groups generally considered to be high risk for noncompliance.

Chairman Pascrell, Republican Leader Kelly, and Members of the Subcommittee, this concludes my prepared remarks. I look forward to answering any questions that you may have.

## GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact me at (202) 512- 6806 or LucasJudyJ@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

GAO staff who made key contributions to this testimony and the report on which it is based are Brian James (Assistant Director), Dawn Bidne, Jacqueline Chapin, Mark Kehoe, Daniel Mahoney, and Peter Verchinski. Other staff who made key contributions to the reports cited in the testimony are identified in the source products.

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