American Indian Law Journal

Volume 9 | Issue 2 Article 3

5-24-2021

Unqualified? Investing In Qualified Opportunity Zones On Reservations

Ben Gibson

UNQUALIFIED? INVESTING IN QUALIFIED OPPORTUNITY ZONES ON RESERVATIONS

By Ben Gibson

I. INTRODUCTION

As part of the Tax Cuts and Jobs Act (TCJA) of 2017, Congress included yet another place-based incentive program in the tax code. These programs are aimed at encouraging individuals and businesses to invest in low-income communities. Congress has previously created various "zones"—enterprise zones, empowerment zones, and promise zones—to attract investment to such areas, each branded with evermore uplifting names. Section 1400Z of the tax code details the latest place-based program: qualified opportunity zones (QOZs). Through this program, Congress provides tax benefits to investors in certain low-income communities. The QOZs have been hailed as significant for the taxpayers using the program, the impoverished communities that qualified for the program, and the industries predicted to take off in these communities.[1] But the program was structured to incentivize long-term investments, so the most significant incentives for taxpayers to invest in the program already begin to expire this year. Yet many of the communities intended to benefit from this provision have not experienced any meaningful investment.[2]

Through this paper, I will focus on the lack of investment in one type of community targeted by the program: Indian reservations.[3] Indian reservations continue to lag behind other communities selected as QOZs in most economic measures. For instance, the poverty and unemployment rates far exceed the national average.[4] In many ways, reservations appear to be the ideal candidates for the benefits that flow from opportunity zone status: incentives to invest, increased business, and higher levels of employment. And yet the investments on reservations pale in comparison to other QOZs.

Since the TCJA was passed, articles have detailed the method and purpose of the QOZs.[5] And now, after several years of implementation, there are attempts to analyze the effectiveness of

[1] *See, e.g.*, Peter Grant & Gregory Zuckman, *Big Stock Windfall? New Rule Defers Taxes with Real Estate Investment*, WALL ST. J. (Oct. 2, 2018, 11:43 AM), https://www.wsj.com/articles/real-estate-developers-rush-to-capitalize-on-tax-incentive-1538229600 [https://perma.cc/XY64-MW6G] (quoting one law firm as saying that opportunity zone investments could be "the biggest thing to hit the real-estate world in perhaps the past 30 years or even more"); *see also* Kevin Hassett, *Background Press Call on the Impact of the Tax Cuts and Jobs Act*, WHITE HOUSE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS (Apr. 12, 2019) (suggesting that property value in opportunity zones had increased 20 percent since the TCJA was passed).

[2] *See* Ruth Simon & Peter Grant, *Opportunity-Zone Funds Are Off to a Slow Start, Lagging Behind Heady Expectations*, WALL ST. J. (Oct. 22, 2019, 7:00 AM), https://www.wsj.com/articles/opportunity-zone-funds-are-off-to-a-slow-start-lagging-behind-heady-expectations-11571742002 [https://perma.cc/3ESM-XPPF]. As described below, under the statute all re-invested capital gains will have to be realized for tax purposes by the 2026 tax year. Taxpayers must hold the investments in QOFs for at least five years for the amount of capital gains realized to decrease, so any investments made after 2021 will not receive one of the largest benefits of Section 1400Z. *See* 26 U.S.C. § 1400Z-2(b)(2)(B)(iii) (2017).

[3] I use the term "Indian" throughout, as it is a term of art frequently used throughout the relevant statutes.

[4] *See* JOINT COMM. ON TAXATION, 116TH CONG., OVERVIEW OF FEDERAL TAXATION PROVISIONS AND ANALYSIS OF SELECTED ISSUES RELATING TO NATIVE AMERICAN TRIBES AND THEIR MEMBERS, 29 (Comm. Print 2020) [hereinafter OVERVIEW].

[5] *See generally* Reid Vardell, Note, *The Land of Opportunity Zones: Deferring Taxable Capital Gains Through Investments in Low Income Communities*, 84 MO. L. REV. 915 (2019); *see also* Riley Coy, *Good Enough: How Minimal IRS Guidance is Sufficient to Navigate § 1400Z Opportunity Zones*, 3 BUS. ENTREPRENEURSHIP & TAX L. REV. 1 (2019).

the scheme.[6] By focusing specifically on the current status of QOZs on reservations, this paper contributes to scholarly work that has described and analyzed qualified opportunity zones. Over 200 reservations and Alaskan villages include at least one opportunity zone.[7] And yet, at present, investments in QOZs on reservations are rare. Based on a survey that I performed of over one hundred funds investing in QOZs, I was able to identify only two funds presently operating on reservations or actively pursuing opportunities on reservations. I will argue that the lack of investment on reservations is primarily a product of complexities and costs particular to Indian country not fully grappled with in Section 1400Z or its regulations. Below, I will describe how qualified opportunity zones are intended to work, the difficulties of implementation on reservations, and opportunities going forward for tribes to encourage investment.

II. SECTION 1400Z IN PRACTICE

Before evaluating the potential challenges of using Section 1400Z on reservations, I will describe the basic mechanics of how the program is intended to operate. To understand the obstacles to the QOZ program succeeding on reservations, it is necessary to understand the method by which it encourages investment in low-income communities in general.

A. How does the program benefit taxpayers?

Through the program, taxpayers can reinvest a particular category of earnings—capital gains—in qualified opportunity funds (QOFs). The QOFs provide three main benefits to taxpayers. First, they allow the taxpayer to defer a capital gain. If a taxpayer realizes a capital gain—for example, by selling stocks or other property—she can reinvest that money into a QOF within 180 days without having the gain recognized for tax purposes.[8] She will only have to recognize the gain once she then sells her investment in the QOF or in 2026 if the investment is held that long.[9] Second, if the taxpayer keeps her investment in the QOF for at least five years, her basis in the

[6] Some critical analysis has focused on QOFs that technically qualified under the criteria, but that need capital investments less. *See, e.g.*, Tony Mecia, *Opportunity Zones Knock Where They're Needed Least*, WALL ST. J. (Sep. 13, 2019, 6:10 PM), https://www.wsj.com/articles/opportunity-zones-knock-where-theyre-needed-least-11568412633 [https://perma.cc/YTL4-5C8Z] (flagging that some well-off areas surrounding universities are receiving investments as QOFs because students bring down the average income of the area). Another critique has focused on the types of properties that are growing in value. *See* Alan Sage, Mike Langen, & Alex Van de Minne, Where Is the Opportunity in Opportunity Zones? Early Indicators of the Opportunity Zone Program's Impact on Commercial Property Prices, (Jun. 1, 2019) (unpublished article) (arguing that Section 1400Z has only increased the value of certain types of property—vacant lots and redevelopments—in opportunity zones) *available at* https://ssrn.com/abstract=3385502 [https://perma.cc/Q4Z8-ZE7S].
[7] *See List of Tribal Designated Opportunity Zones*, NATIVE AMERICAN FINANCE OFFICERS ASSOCIATION, https://res.cloudinary.com/nafoa/image/upload/v1542737810/20181120_OZ_in_IC.pdf [https://perma.cc/B2RU-8H7R] (last visited Mar. 25, 2020).
[8] *See* 26 U.S.C. § 1400Z-2(a)(1).
[9] *See id.* at § 1400Z-2(b)(1).

investment will increase to ten percent of the original investment.[10] With an increased basis, she will only pay taxes on a portion of the original investment. Third, if the taxpayer keeps her investment in the QOF for at least ten years, any appreciation beyond the original capital gain will not be taxable.[11]

A brief example can illustrate how QOFs work in practice. For this example, I will assume that the taxpayer has experienced a long-term capital gain that will be taxed at fifteen percent.[12] In 2020, a capital asset the taxpayer originally acquired for $30,000 is now worth $130,000. If she sold the capital asset, she would realize the $100,000 gain for that tax year and pay a federal capital gains tax of $15,000. Alternatively, under Section 1400Z, she could reinvest the $100,000 in a QOF within six months of her realization event to defer paying taxes on the gain.[13] When she sells her investment in the QOF, or if she holds onto the investment through 2026, she will then have to realize the original $100,000 gain for tax purposes. If she keeps the $100,000 invested at least five years, through 2025, she would be given a basis of ten percent of the original investment: $10,000. With a ten percent basis, she will only be taxed on ninety percent of her original investment. So, only $90,000 would be taxed in 2025, rather than the $100,000 that would have been taxed in 2020. Applying a fifteen percent capital gains tax, she would owe $18,000 in taxes. She would save $2,000 in taxes just by investing in the QOF. In addition, if she keeps her investment for at least ten years, she would not be taxed on any appreciation on top of her original $100,000 investment.

Many taxpayers looking to take advantage of the QOZ program have millions in unrealized capital gains. This scheme of deferral and decreased tax burden represents a significant windfall for them. By some estimates, there are up to $6 trillion in unrealized capital gains in the United States.[14] If only a portion of this $6 trillion is reinvested in QOFs while the provision is in effect, this still will represent significant tax savings for investors. In fact, the Joint Committee on Taxation estimates that taxpayers will save $1.6 billion between 2018-2027 through investments in QOFs.[15]

---

[10] The longer the capital gain is kept in the QPF, the less gain the taxpayer will need to pay taxes on when she ends her investment with the QOF. If kept in the QOF for five years, the taxpayer is given a basis in the fund equaling ten percent of their investment. *See id.* at § 1400Z-2(b)(2)(B)(iii). That basis increases to fifteen percent if kept in the fund for seven years, though the deadline for this has already passed. *Id.* at § 1400Z-2(b)(2)(B)(iv).

[11] *See id.* at § 1400Z-2(c).

[12] This is the present rate for taxpayers with an income between $38,600 and $425,000. *See* 26 U.S.C. § 1(j)(5)(B)(ii). Also, Section 1400Z does not discriminate between long-term (held for longer than one year) and short-term (held for less than a year) capital gains. *See* 26 C.F.R. § 1.1400Z2(a)-1(b)(11) (2020). The benefits apply to both.

[13] In general, the fact that she defers the gain does not mean she has to defer capital losses. *See id.* She could realize any losses in the current tax year while deferring her gains, which would decrease her taxable income.

[14] *See Opportunity Zones: Tapping into a $6 Trillion Market*, ECONOMIC INNOVATION GROUP (Mar. 21, 2018), https://eig.org/news/opportunity-zones-tapping-6-trillion-market [https://perma.cc/FR6R-8CWW].

[15] *See* Scott Eastman & Nicole Kaeding, *Opportunity Zones: What We Know and What We Don't*, TAX FOUNDATION (Jan. 8, 2019), https://taxfoundation.org/opportunity-zones-what-we-know-and-what-we-dont/#_ftn2 [https://perma.cc/7YN3-E7DN].

B. What counts as a QOF?

Just because a business invests in low-income communities, the business is not automatically regarded as a QOF for tax purposes. A QOF must be certified by the Internal Revenue Service. To receive certification, a QOF must be a partnership or corporation that invests at least ninety percent of its assets in qualified opportunity business property.[16] This ninety percent threshold can be reached in one of two ways: directly or indirectly.

First, a QOF can directly invest in qualified opportunity business property. To be considered a "qualified opportunity business property," the property must meet three requirements. First, it must have been acquired after the TCJA went into effect on December 31, 2017.[17] Second, the original use of the property must commence with the QOF, or the fund must substantially improve the property within 30 months.[18] Third, while the fund holds the property, "substantially all" the property's use must have occurred in a QOZ.[19]

A QOF can also meet the ninety percent requirement by investing indirectly in a qualified opportunity business. Stocks and partnership interests held in a qualified opportunity business are treated as qualified opportunity business property.[20] To be a qualified opportunity business, "substantially all" of the tangible property the business owns or leases must be qualified opportunity business property.[21] Also, at least fifty percent of the business's total gross income must be derived from the active conduct of the business.[22] Finally, certain types of "vice" businesses cannot be qualified opportunity businesses.[23] If a business meets these criteria, QOFs can count investments in the business toward the ninety percent asset requirement.

C. Where are the QOZs?

Congress aimed to encourage investment in particular low-income areas through these funds, giving a booster to a variety of geographic regions experiencing market failure. Only funds

---

[16] *See* 26 U.S.C. § 1400Z-2(d)(1)-(2). If a certified QOF does not maintain the ninety percent standard, it can be penalized for each month it is below ninety percent. *See id.* at § 1400Z-2(f)(1)(A).
[17] *See id.* at § 1400Z-2(d)(2)(D)(i)(I).
[18] *See id.* at § 1400Z-2(d)(2)(D)(i)(II). For property to be "substantially improved," the QOF must make additions to the basis exceeding the adjusted basis of the property at the time of acquisition. *See id.* at § 1400Z-2(d)(2)(D)(ii).
[19] *Id.* at § 1400Z-2(d)(2)(D)(i)(III).
[20] That stock or partnership interest must not have been acquired until after the TCJA went into effect. *See id.* at § 1400Z-2(d)(2)(B)-(C).
[21] *Id.* at § 1400Z-2(d)(3)(A)(i). The regulations indicate that the "substantially all" requirement is met if at least seventy percent of the tangible property owned or leased by the business is qualified opportunity business property. 26 C.F.R. § 1.1400Z2(d)-1(d)(2) (2020).
[22] *See* 26 U.S.C. § 1400Z-2(d)(3)(A)(ii) (citing 26 U.S.C. § 1397C(b) (2018)). The regulations have defined this provision expansively to help businesses that do a significant amount of their business with customers off the reservation. *See* 26 C.F.R. § 1.1400Z2(d)-1(d)(3) (2020).
[23] 26 U.S.C. § 1400Z-2(d)(3)(A)(iii) (2020) (citing 26 U.S.C. § 144(c)(6)(B) (2009)) (including a "private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises").

that invest in a QOZ generate the aforementioned benefits for taxpayers. These zones are census tracts that met several criteria set by Congress to determine which low-income areas could qualify.[24] Based on these criteria, over 42,000 census tracts were deemed eligible to be designated as QOZs.[25] From this list, each state executive was allowed to nominate up to twenty-five percent of the qualifying census tracts within their state.[26] This resulted in a final list of almost 9,000 zones from all 50 states, Puerto Rico, and other United States territories.[27]

D. How Section 1400Z benefits low-income communities

For low-income communities, the QOZ program represents a potential influx of capital into areas where the market has failed. These QOZs have been identified as communities that struggle to attract private businesses for a variety of reasons, such as remoteness, lack of a skilled workforce, and higher crime rates.[28] As a result, the poverty and unemployment rates in these communities are higher than the national average.[29] It often takes a financial nudge from Congress to compensate for the higher costs of doing business in these areas. The QOZ program stands as the latest iteration in a long line of other place-based incentive programs that Congress has used to encourage investment in these communities.[30]

But is the opportunity zone program the most effective way to help these communities? At first blush, it appears that Section 1400Z represents an intentional decision by Congress to forego significant amounts of tax revenue. Capital gains that would otherwise be taxed at the full rate when realized will be taxed at a lower rate if invested in a QOF for at least five years. Why would Congress give up this tax revenue that it could use to help these same low-income communities through direct assistance?

The program is actually attempting to correct for a pre-existing distortion in the tax code: the lock-in effect for capital gains. The gain from the sale of a capital asset—such as stocks, real property, and other property—is realized for tax purposes only at the time of sale.[31] To take the example from earlier, if an asset is bought for $30,000 and appreciates to a value of $130,000, the asset is worth $100,000 more. But that $100,000 is not realized for tax purposes until the asset is

---

[24] Section 1400Z borrows its definition of low-income communities from the New Markets Tax Credit Program. The requirements include at least a twenty percent poverty rate and median family income cannot exceed eighty percent of the state's, or if in a metropolitan area, 80 percent of the metropolitan's, median family income. *See id.* at § 1400Z-1(c)(1) (citing 26 U.S.C. § 45D(e)(1) (2020)).
[25] *See Opportunity Zones: How Communities Were Selected for Participation*, MISSION INVESTORS EXCHANGE, https://missioninvestors.org/resources/opportunity-zones-how-communities-were-selected-participation [https://perma.cc/G942-S8DX] (last visited Mar. 26, 2020).
[26] *See* 26 U.S.C. § 1400Z-1(d)(1) (2020).
[27] *See* Richard Rubin, *New 'Opportunity Zone' Tax-Break Rules Offer Flexibility to Developers*, WALL ST. J. (Oct. 19, 2018, 4:52 PM), https://www.wsj.com/articles/new-opportunity-zone-tax-break-rules-offer-flexibility-to-developers-1539948600 [https://perma.cc/QS9W-J56R].
[28] *See Opportunity Zones: Facts & Figures*, ECONOMIC INNOVATION GROUP, https://eig.org/opportunityzones/facts-and-figures [https://perma.cc/XX2U-R53R] (last visited Mar. 24, 2020).
[29] *See id.*
[30] *See* Eastman & Kaeding, *supra* note 16.
[31] *See* 26 U.S.C. §§ 1221-1222 (2019).

sold. Individuals and businesses often wish to defer the sale of property and realization of capital assets for tax purposes. This results in deadweight loss: taxpayers make decisions about their assets based upon the tax code rather than upon their actual consumption preferences. And it also results in a lock-in effect: there is an enormous amount of capital that is not liquid. As previously indicated, there is over $6 trillion of unrealized capital gains in the United States.

The QOZ program represents a calculated bet by Congress. In theory, creating a mechanism that decreases the tax burden on capital gains will encourage more taxpayers to realize capital gains.[32] And at the same time, Section 1400Z will channel previously locked-in capital into low-income communities most in need of private investments. Hundreds of millions of dollars of capital gains have flowed into QOFs since the TCJA was enacted. Though revenues might be lower in the short-term, by 2026, the year by which the re-invested capital gains must be realized, the government should see some increase in tax revenues. And numerous local communities have seen property values increase in response to the investments.[33] In many ways, the bet has paid off. But not all QOZs have experienced this payoff.

III. QOFs on Reservations

A. What is happening on reservations?

In principle, reservations are ideal beneficiaries of Section 1400Z. Many QOZs overlap with reservation land. Reservations are among some of the most economically deprived areas in the country and most in need of infusions of capital. For Native Americans, unemployment rates and poverty rates are double the national average.[34] On some reservations, those rates are much higher.[35] These areas need the increased opportunities that often come with capital. The Bureau of Indian Affairs has touted the significant benefits of QOFs for reservations. It has said that QOZs are "an important new tool with which to attract investments in a wide range of projects to improve the economic conditions on tribal lands" and that "there are potentially millions of dollars that could be attracted to areas throughout Indian Country."[36]

But very few QOFs are investing in reservations. To determine the extent to which reservations have been passed over for investments, I began by looking at several large databases that compiled information about currently operating QOFs.[37] These databases provided

[32] The Joint Committee on Taxation currently estimates that Section 1400Z will result in an overall decrease of tax revenue. *See* Eastman and Kaeding, *supra* note 16.
[33] *See* Hassett, *supra* note 1 (indicating a twenty percent increase in property values in QOFs).
[34] *See* OVERVIEW, *supra* note 5, at 29.
[35] *See generally* Katherine Peralta, *Native Americans Left Behind in Economic Recovery*, U.S. NEWS & WORLD REPORT (Nov. 27. 2014) https://www.usnews.com/news/articles/2014/11/27/native-americans-left-behind-in-the-economic-recovery (describing poverty and unemployment statistics on reservations).
[36] BUREAU OF INDIAN AFFAIRS, TRIBAL ECON. DEVELOPMENT AT-A-GLANCE SERIES: OPPORTUNITY ZONES IN INDIAN COUNTRY 8 (2020).
[37] There is no full compilation of QOFs available at present. Novogradac claims to be tracking 513 funds, but it only has contact information listed for 167 funds on its website. *See Opportunity Funds List*, NOVOGRADAC

geographic, investment, and contact information. From an initial list of 210 QOFs from these databases, I identified 106 funds that were operating in states that contained QOZs on Indian Reservations. Of these 106 QOFs, 46 indicated on their websites the specific tracts they were investing in, which did not include reservations. I sent a brief survey to the remaining sixty funds, asking them whether they were presently operating on reservations or intended to pursue opportunities on reservations going forward. I received responses from fifteen of the QOFs I reached out to. Through these responses, I identified one fund that is presently investing in projects on a reservation and a second that is actively planning to pursue such investments.[38] Given that the most recent Treasury Regulations were finalized in 2020, these numbers do not necessarily reflect the full investment that might happen on reservations. Regardless, this number is incredibly low.

It should not come as a surprise that QOFs have invested little on reservations. The funds operate as a free market. Taxpayers do not have to invest in QOFs in the first place, and they are not compelled to invest in particular funds in particular areas. Section 1400Z represents a calculated bet for taxpayers. They will change their behavior and realize capital gains only if they believe a reinvestment opportunity in a QOF will be a safe place to defer their capital gains for at least five years in order to decrease the amount they will have to realize. They are also incentivized to reinvest their gains in opportunities that will potentially result in further tax-free appreciation after ten years.[39] With almost 9000 QOZs, taxpayers can weigh the various opportunities against one another and choose the QOFs that will best serve their purposes. In turn, the various zones can pitch themselves to investors and offer tax breaks, exemptions from regulation, or otherwise adjust local laws to further incentivize investment.

Compared to other locations, reservations represent unique challenges when it comes to investment. Below, I describe two key legal issues that may help explain why QOFs are not investing on reservations. First, some of the most likely investors—tribes and tribal corporations—are not subject to federal income tax, so they have less incentive to invest in funds. Second, the regulatory regimes on reservations are often complicated and overlapping, raising the cost for funds looking to invest on reservations.

---

https://www.novoco.com/resource-centers/opportunity-zone-resource-center/opportunity-funds-listing [https://perma.cc/GW57-QZL5] (last visited Mar. 24, 2020). The list of 210 funds that I used was compiled by the National Council of State Housing Agencies. *See Opportunity Zone Fund Directory*, NATIONAL COUNCIL OF STATE HOUSING AGENCIES (Jan. 27, 2021), https://www.ncsha.org/resource/opportunity-zone-fund-directory/ [https://perma.cc/X4NH-TLF7]. This list only includes multi-project funds. As such, the numbers I provide are probative of the lack of QOFs operating on reservations but are not final. Further research, beyond the scope of this project, is needed on the number of QOFs currently operating.

[38] Two other projects advertise that they are operating on tribal lands, but, when contacted, did not confirm whether they were investing on tribal land.

[39] Some commentators have suggested that most investments in QOFs were going toward projects that would have happened regardless of the tax break, such as luxury hotels. *See* Jesse Drucker and Eric Lipton, *How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich*, N.Y. TIMES (Aug. 31, 2019), https://www.nytimes.com/2019/08/31/business/tax-opportunity-zones.html [https://perma.cc/AKX5-34E8].

B. Obstacle: Finding investors

To get off the ground, QOFs need investors. Individuals or companies are incentivized to invest in a QOF for several reasons. As previously discussed, investors may use QOFs as a way to defer realizing capital gains or to experience appreciation that will be exempt from taxation. For many investors, QOFs might also be a way to do something good for their communities. In the context of reservations, tribes and tribal corporations often have the most resources and the greatest moral incentive to invest in their local community. But the incentives created by Section 1400Z are ineffective in nudging these actors to invest in QOFs.[40]

Many tribal entities are already exempt from federal income tax. Individual tribal members are still subject to the federal income tax. But federally recognized Indian tribes are exempt. And this exemption extends to federally chartered tribal corporations, such as those chartered under Section 17 of the Indian Reorganization Act.[41] While it is presently unclear whether the exemption extends to tribally chartered corporations, tribal corporations that are considered an "integral part" of the tribe are likely to be exempted.[42] Finally, an increasing number of tribes are opting to incorporate as limited liability companies. By doing so, the owners of these entities gain the limited liability benefit of a corporation while also still maintaining their tax-exempt status.[43]

By wisely choosing how to form and how to affiliate with the tribe, many corporations on reservations already have a way of avoiding federal taxes on the sale of property. Thus, they have less financial incentive to use QOFs. Deferred taxes and stepped-up basis mean little to entities who face no federal tax burden in the first place.

Still, tribes have expressed a desire to be able to form and invest in QOFs, even if they cannot reap the federal tax benefits.[44] The first round of proposed regulations said a QOF must be an entity organized in one of the fifty states, the District of Columbia, or a United States possession.[45] It did not mention tribes at all. The most recent regulations make clear that a QOF can be organized under the laws of a federally recognized Indian tribe.[46] But these regulations also make clear that all QOFs, regardless of where they are organized, are subject to the federal income tax, in particular, the penalties for failure to comply with the 90% investment standard for QOFs.[47] The regulations, though, do not address the fact that tribes and tribal corporations lack the same

[40] It is also worth noting, however, that the tax-exempt status of tribes and some tribal corporations also can work to the advantage of investors. Because these parties are tax exempt, they are able to pass along the benefit of those exemptions in transactions with other parties. *See* Erik Jensen, *Taxation and Doing Business in Indian Country*, 60 ME. L. REV. 1, 8 (2008).
[41] *See id.* at 42.
[42] COHEN'S HANDBOOK OF FEDERAL INDIAN LAW § 8.02(2)(a) (Nell Jessup Newton ed., 2017) [hereinafter COHEN'S HANDBOOK].
[43] *See id.*
[44] *See, e.g.*, *Tribes Shut Out of 'Opportunity Zone' Deals*, NONDOC (Mar. 26, 2019), https://nondoc.com/2019/03/26/tribes-shut-out-of-opportunity-zone-deals/ [https://perma.cc/LS8R-3AC3].
[45] *See* Investing in Qualified Opportunity Funds, 85 Fed. Reg. 1866, 1951-52, (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1).
[46] *See* 26 C.F.R. § 1.1400Z2(d)-1(a)(1)(ii) (2020).
[47] *See id.*

tax incentives to invest in QOFs. While tribes can, and many want to, set up QOFs and invest money to attract other investors, they would do so without the tax incentives motivating other investors.

C. Obstacle: Regulatory complexity on reservations

QOFs looking to invest on reservations must navigate the same regulatory hurdles that any business faces when investing on a reservation. The land on reservations carries various legal tenure statuses, meaning that it can be difficult for businesses to transact for land use on reservations. Also, because tribal governments are another sovereign, entities operating within reservation boundaries may be subject to three different regulatory regimes: federal, state, and tribal. These complex and overlapping regulatory regimes can create higher transaction costs for businesses on reservations, deterring investment.

1. Land Status in Indian Country

From its enactment, experts have viewed Section 1400Z as a tool that favors real estate investment.[48] Other businesses have struggled to keep up. For the first several years that QOFs operated, investors were concerned about the ambiguity surrounding certain types of businesses. In particular, investors were concerned that businesses that transacted with customers outside of the opportunity zone might not qualify as qualified opportunity businesses. It was only through the most recent regulations that the Treasury Department took actions that made clear that other businesses could qualify. But these businesses still must meet exacting criteria to qualify for QOF treatment.[49]

By contrast, from its inception, Section 1400Z clearly identified tangible property as one of the assets in which a QOF can invest.[50] Investors acted quickly with this certainty, and QOFs focused on real estate development have proliferated.[51] Real estate, by comparison, was simple. All transactions remained internal to the opportunity zone and, as long as property values increased, investors received the benefits of Section 1400Z without facing any significant risk. Because real estate investments are comparatively safe and likely to experience appreciation over the long-term, real estate businesses fit into the QOZ program like a hand in a glove.

---

[48] *See* Ruth Simon & Richard Rubin, *New Hotel or Affordable Housing? Race is on to Define 'Opportunity Zones'*, WALL ST. J. (July 13, 2018, 5:30 AM), https://www.wsj.com/articles/new-hotel-or-affordable-housing-race-is-on-to-define-opportunity-zones-1531474200 [https://perma.cc/GH4X-BRJP].

[49] *See* 26 C.F.R. § 1.1400Z2(d)-1(d) (requiring the business to maintain 70 percent of its tangible property as qualified opportunity zone business property and requiring at least 50 percent of the business's gross income to be derived from the activity of the trade or business in the opportunity zone).

[50] *See* 26 U.S.C. § 1400Z-2(d)(2)(D) (2017).

[51] *See* Drucker & Lipton, *supra* note 40.

But real estate investments are particularly complicated on tribal land.[52] Land on reservations can carry various legal tenure statuses. Most land on reservations is trust land: land is held in trust by the federal government for the tribes or individual tribal members.[53] Given this unique trust relationship, the federal government places rigid restrictions on the alienation of this land.[54] This means that third parties looking to use trust land for business will often lease the land from tribes or tribal members. But even when leasing, most uses of trust land are subject to approval by the Bureau of Indian Affairs or the Secretary of the Department of the Interior.[55] Making matters more difficult, trust land is often fractionated. This means that the land's ownership is divided among various owners.[56] The information costs of transacting for such jointly owned trust property can be prohibitive.

The Department of Treasury has taken steps to make it more feasible for QOFs to invest on trust land. The Treasury has finalized regulations that make clear that leased land can count as qualified opportunity business property.[57] It has also eased other requirements for leased land. Unlike tangible property that is purchased, the "original use" and "substantial improvement" requirement does not apply to leased land.[58] This is because that leased property cannot be placed in service for depreciation or amortization purposes.[59] In addition, tribes leasing land to a related person do not need to show that the lease is at the market rate, a requirement for other land leased by qualified opportunity businesses.[60]

Despite these clarifications and exemptions, there remain major hurdles for QOFs looking to invest on reservations. For those QOFs focused on real estate development, the opportunities on reservations are much more limited. The opportunities that do exist may involve determining what steps must be taken to lease or purchase the type of land in question, increasing the transaction costs. These regulatory difficulties are compounded by the practical reality that tribal land frequently appears to be less attractive for investment because of how remote it is. Tribes face an uphill climb when convincing investors that QOFs focused on tribal investing will see meaningful growth.

---

[52] *See* Jessica Shoemaker, COMPLEXITY'S SHADOW: AMERICAN INDIAN PROPERTY, SOVEREIGNTY, AND THE FUTURE, 115 MICH. L. REV. 487, 489 (2017) ("Two tracts situated immediately adjacent to each other--or even two co-owners joined in shared ownership of the same physical resource--may be subject to entirely different rules set by different sovereigns and may have incongruent property rights.").

[53] *See* COHEN'S HANDBOOK § 15.03.

[54] *See id.* at § 15.06(1).

[55] *See id.* at § 21.02(3); *see also* 25 U.S.C. § 415 (2018); 25 C.F.R. §§ 162.1- .201 (2013). Courts have also held that Secretarial approval of a lease also triggers review under the National Environmental Policy Act. *See, e.g.*, Davis v. Morton, 469 F.2d 593 (10th Cir. 1972).

[56] *See* Shoemaker, *supra* note 53, at 490-91 (explaining that negotiation around property becomes much more complicated when there are not clear property entitlements).

[57] *See* 26 C.F.R. § 1.1400Z2(d)-(c).

[58] *Id.* at § 1.1400Z2(c)-(e).

[59] *See* BUREAU OF INDIAN AFFAIRS, *supra* note 37, at 7.

[60] *See* 26 C.F.R. § 1.1400Z2(d)(c)(2)(iii).

2. Regulation of Business in Indian Country

American Indian nations predate the United States. Although tribes are subject to the federal government's plenary powers, they continue to possess attributes of sovereignty. While this sovereignty is not complete, it includes at least several powers significant enough to give investors pause: the power to tax and otherwise regulate much of the conduct that takes place in Indian Country.[61]

Given this state of affairs, businesses on tribal lands are often subject to regulations imposed by up to three sovereigns: federal, state, and tribal governments. Businesses are often deterred from operating on reservations because of the concerns about the potential costs of coming into compliance with three sets of laws. While the law is not as complicated as is often suggested, businesses on reservations must be aware of the status of the land on which they operate and the status of the customers they transact with. Below, I will describe how the reality of overlapping jurisdiction plays out in one particular issue: state and tribal taxation.[62]

Outside of reservations, businesses can typically expect to be taxed by the state in which they operate. But the rules change when states attempt to impose taxes on land or activities on reservations. States cannot tax trust land.[63] And, in general, they cannot tax the personal property or the activities of Indians on that land.[64] But, states can tax property on reservations that Congress has made alienable.[65] And states can usually impose excise taxes on the sale of goods made on reservations as long as the legal incidence of the tax falls on a non-Indian.[66] In limited instances, states cannot regulate activity on reservations that the federal government has preempted through a comprehensive regulatory scheme. To determine whether the state tax is preempted, courts apply a balancing test to weigh the competing interests of the federal government, tribe, and the state.[67]

But unlike businesses located elsewhere, those located on reservations might also be subject to taxation by the tribe. Like other sovereigns, tribes can usually regulate the activity of

[61] *See* Washington v. Confederated Tribes of Colville Indian Reservation, 447 U.S. 134, 152 (1980) ("The power to tax transactions occurring on trust lands and significantly involving a tribe or its members is a fundamental attribute of sovereignty which the tribe retains unless divested of it by federal law or necessary implication of their dependent status.").

[62] Similar rules will often, but not always, govern other issues of civil law on a reservation. For instance, the *Montana* test discussed below will still be used to determine whether or not a defendant can be hailed into tribal court. *See* Strate v. A-1 Contractors, 520 U.S. 438, 453 (1997). But some areas of regulation are expressly addressed by federal law. For example, the Clean Water Act gives tribes civil jurisdiction for the sake of implementing the act, regardless of land tenure and whether the regulated party is an Indian. *See* 33 U.S.C. § 1377(e) (2014).

[63] *See* COHEN'S HANDBOOK § 8.03(1)(e).

[64] *See id.*

[65] *See* Cass County v. Leech Lake Band of Chippewa Indians, 524 U.S. 103, 113 (1998).

[66] *See* Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 458-59 (1995).

[67] *See* White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980). Recently, lower courts have seldom limited the state's power to tax under this balancing analysis. *See, e.g.*, Agua Caliente Band of Cahuilla Indians v. Riverside Cnty., No. ED CV 14-0007-DMG (DTBx), 2017 WL 4533698, at *11-18 (C.D. Cal. June 16, 2017), *aff'd*, 749 F. App'x 650 (9th Cir. 2019) (allowing state taxes on non-Indians for leasing trust property on reservation because of general services states provided to the lessees). In practice, all businesses selling goods and services to non-Indians should be prepared to face taxation by the state.

their own members within the reservation.[68] Tribes can also impose sales and excise taxes on any business handled on trust land.[69] But tribes can only tax activity on non-trust land within a reservation if the taxed party has entered a consensual relationship with the tribe or if the activity threatens or has some direct effect on the political integrity, economic security, or the health or welfare of the tribe.[70] All the while, tribes are caught between a rock and a hard place: do they exercise their sovereign authority to tax or forego potential revenue for the tribe to avoid imposing double or triple taxation on businesses?

Given this backdrop, it can feel daunting for a business to choose to locate on a reservation. The above analysis concerned taxation. The same analysis could be done for any number of other areas subject to regulation: employment law, environmental law, etc. It is easier to predict liabilities and costs on non-reservation land. Businesses operating on reservations do have to perform extra work to determine what types of liabilities and costs they face. The extra work and increased uncertainty associated with operating on a reservation can often seem prohibitive to a business deciding where to locate.

IV. INCENTIVIZING INVESTMENT ON RESERVATIONS

A. Actions Tribes Can Take

Even though Congress failed to adequately consider tribes through the QOZ program and ensuing regulations have come up short in correcting for that oversight, tribes should not give up on QOFs. Tribes have particular legal advantages, both inside and outside the tax code, which can compensate for the added regulatory costs on reservations. Section 1400Z stands as one in a long line of attempts by Congress to change behavior in a way that benefits businesses operating on reservations. These advantages create a deadweight loss in the tax code that operates to the benefit of tribes, changing taxpayer behavior in a way that can create more business on reservations. By highlighting these various advantages and layering them on top of one another, tribes can still make the best of a bad situation.[71]

---

[68] *See* COHEN'S HANDBOOK §8.04(2)(a).
[69] *See* Confederated Tribes of the Colville Indian Reservation, 447 U.S. at 152-53. As a practical matter, tribes may often choose not to impose taxes for fear of double-taxing activity already taxed by the state.
[70] *See* Montana v. United States, 450 U.S. 544, 565-66 (1981); *see generally* Jensen, *supra* note 41, at 86-89. Most qualified opportunity businesses operating on reservations would either be operating on trust land or would have entered a consensual relationship with the tribe or a member and would thus be subject to taxation by the tribe.
[71] Several of these provisions in the tax code were set to expire at the end of 2020 but were extended for another year. One, which I do not discuss below, is the New Market Tax Credit (NMTC) Program. Most reservations met the criteria for the NMTC Program, which incentivized investment in community development entities by providing tax credit to investors. *See* 26 U.S.C. § 45D. These community development entities then function as financial institutions in low-income communities. *Id.* at § 45D(c). Tribal entities, though, received only 0.30 percent of NMTC investments from 2003 to 2014. Stephen Cooper, *Tribal Governments Seek Parity with States on Tax Incentives*, LAW360 (Mar. 4, 2020, 7:25 PM), https://www.law360.com/articles/1249671/tribal-governments-seek-parity-with-states-on-tax-incentives [https://perma.cc/CPS8-EF6S].

There are a handful of provisions in the federal tax code specifically targeted at encouraging investment on reservations.[72] For instance, non-tribal employers operating businesses on reservations may be able to receive an Indian employment credit.[73] Section 45A of the tax code provides non-tribal employers a tax credit against income tax liability for the first $20,000 in wages and qualified health insurance costs paid with respect to specific employees.[74] The credit is equal to 20% of the excess of eligible employee wages and qualified health insurance costs for the current year, less the amount of such wages and costs incurred by the employee in 1993.[75] In addition, section 168(j) of the tax code permits accelerated depreciation of business property on reservations.[76] With accelerated depreciation, businesses will initially have a lower taxable income by claiming larger deductions for depreciation up front.[77]

Congress has also created particular incentives for investing in energy development on reservations. The Tribal Energy Loan Guarantee Program provides grants to tribes and tribal energy development organizations to build the capacity for energy projects on reservations.[78] It also ensures that borrowers can access capital for energy development through low-interest loans.[79] Moreover, tribes that invest in renewable energy technology can benefit from this provision and encourage further investment through the Investment Tax Credit (ITC). In 2020, the ITC provided investors in certain types of renewable energy with a 26% tax credit for investments made in qualifying projects.[80] Though a tribe would not usually be able to claim that credit for itself, the IRS issued a private ruling letter in 2013 that indicated that tribes could pass through the credit to a lessee.[81] While tribes may be disadvantaged in regards to real estate investments, energy development projects represent a unique opportunity for tribes to attract QOFs going forward.[82]

B. Actions Congress Can Take

Although tribes can take actions to incentivize investment, Congress is best situated to make reservations more attractive to private investors. Congress has plenary power over

---

[72] Some states also offer particular advantages on state income tax for working on reservations. *See, e.g.*, OREGON REV. STAT. §§ 285C.300-.320 (2017) (giving tax credits to those investing on the reservations of federally recognized tribes in Oregon).
[73] *See* 26 U.S.C. § 45A (2020).
[74] *See id.* The employees must be Indians or the spouse of an Indian and cannot make over $30,000 (adjusted for inflation, $50,000). *See* OVERVIEW, *supra* note 5, at 21.
[75] *See* 26 U.S.C. § 45A(a) (2020).
[76] *See* 26 U.S.C. § 168(j) (2020).
[77] It should be noted, however, that this particular incentive is no longer unique to tribes and can be accessed by any taxpayer regardless of where her business is located. *See* 26 U.S.C. § 179(a) (2018).
[78] *See* 25 U.S.C. § 3502(a)(1) (2020).
[79] *See* 25 U.S.C. § 3502(a)(2)(C) (2020).
[80] *See* 26 U.S.C. § 48(a)(6)(A)(1)-(c)(2)(A)(ii) (2021).
[81] *See* I.R.S. Priv. Ltr. Rule. 201310001 (Mar. 8, 2013), at 4.
[82] *But see* Michael Maruca, *From Exploitation to Equity: Building Native-Owned Renewable Energy Generation in Indian Country*, 43 WM. & MARY ENV'T. L. & POL. REV. 391, 442-45 (2019) (noting that the federal tax incentives often used to encourage renewable energy cannot help already tax-exempt tribes looking to control renewable energy project).

reservations and so can create incentives that can drive investment on reservations and potentially loosen some of the regulations that may dampen investment.

First, Congress should continue tax incentive programs that uniquely benefit businesses on reservations. Provisions like the Indian employment credit help to lower the costs of conducting business on reservations. Congress should also consider creating particular carveouts from current regulations for businesses looking to invest in QOZ reservations. For instance, Congress could establish an expedited review by the BIA for approval of QOF use of leased trust land. Rather than requiring a process that can take years, creating an expedited review for QOFs would help incentivize investment during the timeframe when individuals stand to benefit the most from an investment before the statute lapses.

Second, Congress should be careful about creating redundancies in the tax code that make investments on reservations less attractive. For example, businesses on reservations can accelerate the rate of depreciation on business property.[83] But under the TCJA, all businesses, regardless of whether they are on a reservation or not, can fully accelerate the depreciation on $1 million of business property.[84] On an even larger scale, the Coronavirus Aid, Relief, and Economic Security (CARES) Act took away some of the incentive to use QOFs to decrease capital gains tax. The CARES Act allows the owners of pass-through businesses to use their excess business losses to offset any non-business personal income, including capital gains, that they have in a year.[85] While such a provision may be necessary to help buoy businesses during the current recession, it effectively nullifies many of the incentives of business owners to use QOFs to save on capital gains tax going forward.

V. CONCLUSION

The distinctive legal issues on reservations have made it difficult for tribes to benefit from the tax incentives for businesses to invest in low-income communities. As I have indicated above, the legal complexity on reservations limits Section 1400Z's effectiveness on reservations. For now, tribes must make extra efforts to attract QOF investments on tribal lands by highlighting the legal advantages for businesses on reservations. Congress has built distortions in favor of tribes in the tax code that may be able to offset some of the other disadvantages tribes face. Going forward, though, Congress should not attempt to spur economic development on tribal lands through a one-size-fits-all solution. Section 1400Z is the most recent reminder that the types of incentives that have worked in other low-income communities may not translate easily onto reservations. Congress must be willing to confront the complexity of using the tax code to spur economic development on tribes and write statutes that work in the particular legal context of Indian Country.

---

[83] *See* 26 U.S.C. § 168(j).
[84] *See* 26 U.S.C. § 179(b)(1).
[85] *See, e.g.*, Steven Rosenthal, *Heads I Win, Tails I Win Too: Winners from the Tax Relief for Losses in the CARES Act*, FORBES (Apr. 21, 2020, 10:46 AM), https://www.forbes.com/sites/stevenrosenthal/2020/04/21/heads-i-win-tails-i-win-too-winners-from-the-tax-relief-for-losses-in-the-cares-act/#5228a20a68b2 [https://perma.cc/6TN2-8S7Z].