Opportunity Zones

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Administering Agency: U.S. Department of the Treasury

Year Enacted: 2017

Number of Persons/Households Served: There are 8,700 Qualified Opportunity Zones nationwide, encompassing 35 million people.

Population Targeted: Low-income census tracts with an individual poverty rate of at least 20% and median family income no greater than 80% of the area median income (AMI). Each state, territory, and Washington, D.C. was eligible to nominate up to 25% of its total eligible census tracts. Up to 5% of that 25% could be comprised of contiguous census tracts that are adjacent to a low-income community as long as the adjacent census tracts had a median family income that did not exceed 125% of the median family income of the adjacent low-income community.

The Opportunity Zones tax benefit is designed to drive long-term equity capital in a diverse range of activities in designated low-income census tracts.

HISTORY

The Opportunity Zones tax benefit was originally conceptualized in the "Investing in Opportunity Act." This bipartisan, bicameral legislation was sponsored by Senators Tim Scott (R-SC) and Cory Booker (D-NJ) and Representatives Pat Tiberi (R-OH) and Ron Kind (D-WI) in the 115th Congress. The law was enacted as part of the "Tax Cuts and Jobs Act" in December 2017.

PROGRAM SUMMARY

Qualified Opportunity Zones are low-income communities and adjacent census tracts that are now eligible to receive private investment through Opportunity Funds. The Opportunity Zones Program provides an incentive for individual and business investors to reinvest unrealized capital gains into Opportunity Funds in exchange for a temporary tax deferral and other benefits tied to long-term holdings. There are two main tax incentives to encourage investment:

1. Investors may gain temporary deferral of inclusion of gross income for capital gains that are reinvested into Opportunity Funds.
    a. Investors can roll existing capital gains into Opportunity Funds with no up-front tax bill.
    b. If investors may hold their Opportunity Fund investments for five years, the basis of their original investment is increased by 10% (meaning they will only owe taxes on 90% of the rolled-over capital gains). If investors hold for seven years, the basis increases by an additional 5%.
    c. Investors may defer their original tax bill until December 31, 2026 at the latest, or until they sell their Opportunity Fund investments, if earlier.
2. Investors may exclude capital gains on Opportunity Fund investments held for at least ten years from taxable income. In other words, after settling their original tax bill, patient investors in Opportunity Funds will not have capital gains taxes on their Opportunity Fund investments.

Qualified Opportunity Funds are a new class of investment vehicle set up as a partnership or corporation to aggregate and deploy private investment in Qualified Opportunity Zones.

The three categories of eligible investment types are collectively called Opportunity Zone Property. They include:

- Stock in a domestic corporation.
- Capital or profits interest in a domestic partnership.
- Tangible property used in a trade of business of the Opportunity Fund that substantially improves the property.

Certain activities, known as “sin businesses,” are not eligible for Opportunity Fund investments. These include operating a country club, golf course, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility, or liquor store. Other than these prohibited items, eligible investments opportunities are broad and flexible.

FUNDING

The Opportunity Zones tax benefit is not funded through federal appropriations; it is a tax expenditure, meaning that the federal government forgoes tax revenue in order to incent an activity. Recent estimates suggest that upwards of $6 trillion in unrealized capital gains currently sit on the books of U.S. taxpayers. While it is yet to be seen how many investors will ultimately move their capital into Opportunity Funds, the scope of potential investment suggests a promising opportunity for community investments.

FORECAST FOR 2019

The Department of the Treasury and Internal Revenue Service (IRS) released a first proposed rule in October, 2018 offering initial guidance for stakeholders seeking to structure Opportunity Funds and deploy capital. The IRS stated that a second round of proposed rules would be released in the near future.

President Trump signed an Executive Order on December 12, 2018 establishing the White House Opportunity and Revitalization Council, to be chaired by HUD Secretary Ben Carson. The primary purpose of the Council will be to target existing federal programs to Opportunity Zones. The Council will assess actions each federal agency can take under existing authorities to focus federal programs in Opportunity Zones. It will also assess actions each agency can take to minimize regulatory and administrative costs. The Council will regularly consult state, local, and tribal officials, as well as individuals in the private sector.

Successful implementation of Opportunity Zones should include many of the same best practices that the affordable housing and community development industry has developed over the past several decades. The Low-Income Housing Tax Credit and New Markets Tax Credit, two proven and effective tools that use a tax credit to encourage activity that otherwise would not occur, provide a model for successful public-private partnerships that benefit low-income residents.

There are no provisions in the statute specifying that investments must benefit low-income people, build affordable housing, employ low-income residents, or provide affordable capital for local small businesses or minority-owned or women-owned businesses. Nor are there protections to prevent the displacement of low-income people or local small businesses as a result of new investments in distressed communities.

WHAT TO SAY TO LEGISLATORS

The success of Opportunity Zones depends on its structure and implementation. If implemented with local needs and priorities in mind, Opportunity Zones have the potential to catalyze investments that revitalize distressed communities and connect local residents to opportunity. If implemented without a commitment to direct and sustained community benefits to existing low-income residents and businesses, there is a danger that local residents and businesses could be displaced if Opportunity Zone investments cause property values and costs of living to rise.

Due to the foregone revenue associated with the Opportunity Zones tax benefit, Opportunity Funds should be required to report on their investment activity to ensure accountability of federal resources. Congress provided clear guidance in the Conference Report that accompanied the “Tax Cuts and Jobs Act” by requesting that the Treasury report to Congress on Fund activities and community impacts. However, it is not clear that the implementation process will require Opportunity Funds to report this information.

By definition, Opportunity Zones target some of our nation's most distressed communities. When fostering economic activity in areas that would not otherwise receive this type of investment, it is critical that benefits accrue to all members of a community and not just a few. Federal guidelines should explicitly require Opportunity Fund investment to provide benefits to low-income residents and business and also prevent Opportunity Fund investments that would harm low-income residents and local businesses. For example, the elimination of affordable housing could be defined as a form of "abuse" because housing affordability is vital to achieve the intent that Congress laid out when implementing this new tax incentive.

The Treasury should follow Congress's guidance and collect this data from Opportunity Funds. Without this important transaction-level information, it will be virtually impossible to evaluate the efficacy of Opportunity Zones as an investment tool or the impact that these investments have on communities.

FOR MORE INFORMATION

Enterprise Community Partners, 202-649-3410, www.opportunityzonesinfo.org.

The IRS Opportunity Zone webpage, https://bit.ly/2Etzdce.