



# OPPORTUNITY ZONES: BASICS AND OUTLOOK

Ferox Strategies, Washington DC

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# WHAT ARE OPPORTUNITY ZONES?



**Opportunity Zones (OZs) allow investors to avoid capital gains taxes by re-investing their gains in economically underserved areas**

- Real estate or other assets in OZs provide the basis for Opportunity Funds where investors may re-invest their capital gains in place-based investments to defer and eventually avoid capital gains taxes
  - Investors in OZs may **defer paying capital gains taxes to 2026**
  - Investors who hold investments in OZs longer can **exclude increasing amounts of their profits from capital gains taxes** (reaching 15% after 7 years)
  - Investors who hold investments in OZs for 10 years or more **zero out their capital gains tax**
  - Investors must spend at least as much to **improve** property as they paid to acquire it
- Ticking clock: to qualify for most tax benefits, investors and developers must finalize OZ investments by **December 31, 2019**

# WHAT ARE OPPORTUNITY ZONES?



## Vehicle for investing in OZs: Opportunity Funds

- Opportunity Funds must be a corporation or a partnership (including LLCs) formed to invest in OZ property
- At least 90% of an Opportunity Fund's assets must be in tangible qualified OZ property
- Important caveats:
  - Opportunity Fund operators may self-certify with the IRS, with no pre-review
  - Value of the Fund may rise or fall, which could impact ultimate deferral – the IRS is likely to have more guidance in coming months

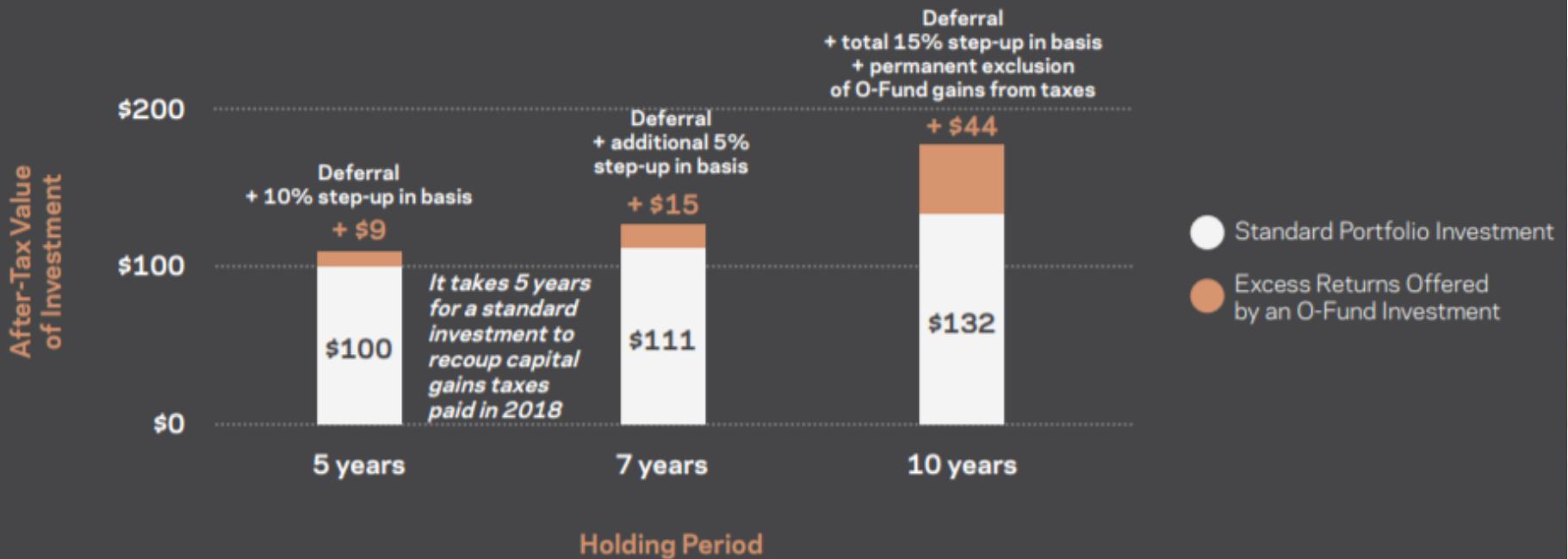


LEFT: OZ advocate Sen. Tim Scott (R-SC) testifies at Joint Economic Committee Hearing, "The Promise of Opportunity Zones" May 16, 2018

# WHAT ARE OPPORTUNITY ZONES?



How does a capital gain of \$100 reinvested in 2018 perform over time?



\* Note: Assumes long-term federal capital gains tax rate of 23.8%, no state income tax, and annual appreciation of 7% for both the O-Fund and alternative investment.

Source: Economic Innovation Group, [Opportunity Zones Fact Sheet](#)

# WHAT ARE OPPORTUNITY ZONES?



**State governors designated OZs in spring 2018 based on eligibility criteria laid out by Congress and the Treasury Department as well as their own local knowledge of growth-ready areas**

- OZs retain their status for 10 years
- About 8,700 (12%) Census tracts nationwide, home to 32 million people, are OZs
- OZs' average poverty rate 31%; average median family income 59% of area median\*

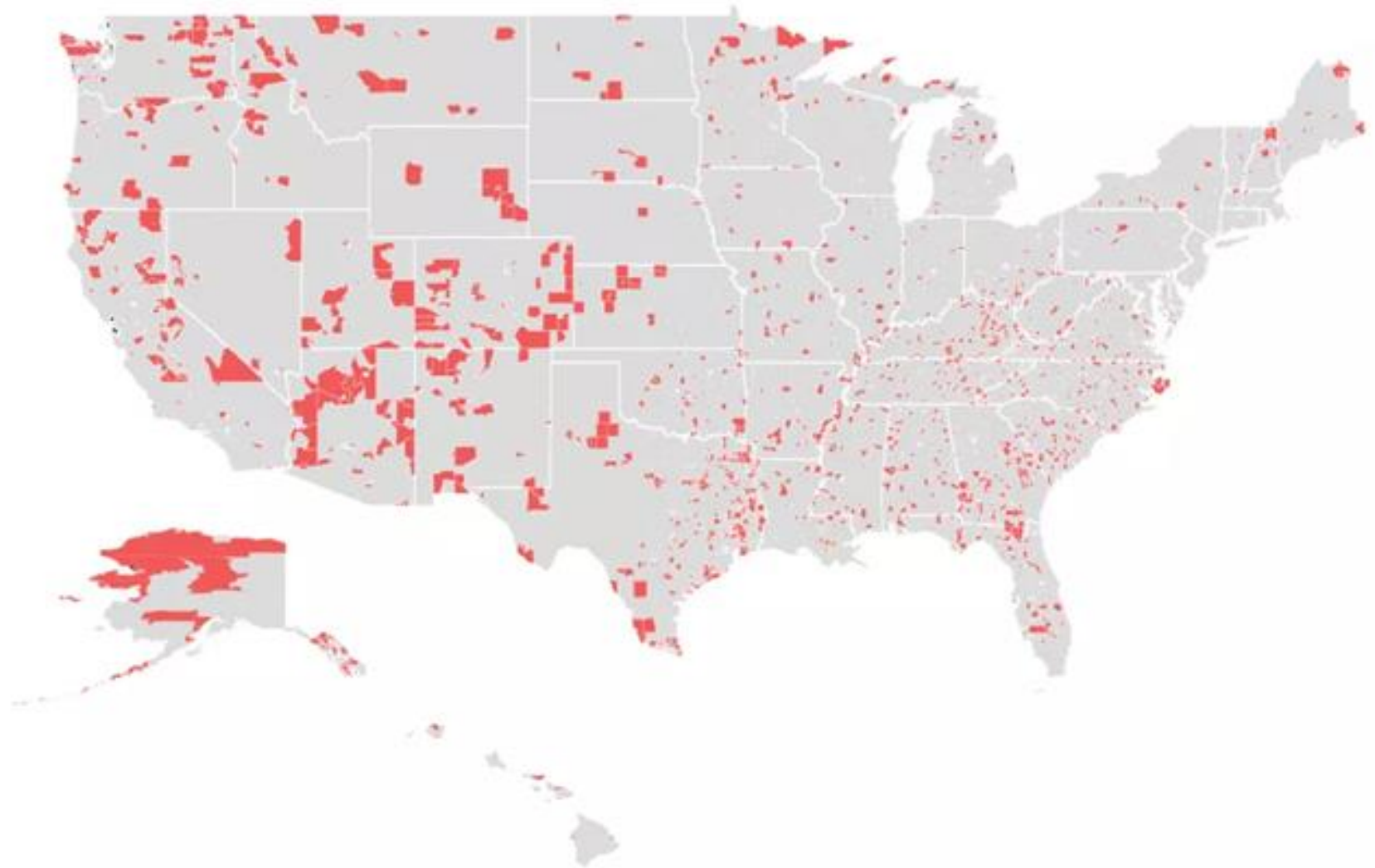
**What makes OZs different from other programs like Enterprise Zones or Renewal Communities?**

- Investors may invest ONLY their capital gains, where other programs required investment of all proceeds (asset sales, like-kind exchanges, etc.)
- Syndicators may organize and market Opportunity Funds investing in OZs, meaning much broader investment potential
- Much larger group of eligible OZs (8,700 Census tracts) than other federal programs

\*Source: Economic Innovation Group, "[Opportunity Zones: The Map Comes Into Focus](#)" June 15, 2018.

# Land of Opportunity

Designated Opportunity Zone Census Tracts



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Source: Fund for Our Economic Future's analysis of Qualified Opportunity Zone tracts, as designated by the U.S. CDFI Fund.

# WHAT ARE OPPORTUNITY ZONES?



**OZs as a concept originated at the Economic Innovation Group (EIG), a non-partisan think tank that remains a top resource on OZs**

**Bipartisan congressional champions for OZs:** Sen. Tim Scott (R-SC), Sen. Cory Booker (D-NJ), Rep. Pat Tiberi (R-OH), Rep. Ron Kind (D-WI) led introduction of the “Investing in Opportunity Act” in early 2017. The Investing in Opportunity Act was folded into the Tax Cuts and Jobs Act and passed into law December 22, 2017.



Sen. Tim Scott (R-SC)



Sen. Cory Booker (D-NJ)



Rep. Ron Kind (D-WI)



Rep. Pat Tiberi (R-OH)\*

\*Rep. Pat Tiberi has since retired from Congress

# IRS IMPLEMENTING REGULATIONS



## **IRS's 1st regulations issued October 2018 – OZ investments must:**

- Bring new business to area with at least 70% of “tangible property” in OZ
- Expand existing businesses in OZ
- Increase and improve OZ’s residential and commercial real estate

## **IRS guidance very favorable to investors:**

- “Almost all” capital gains– gains from real estate, private equity, businesses, public securities, even home sales – can be invested in OZs
- Clarifies how partnerships and pass-through entities can invest
- Investors must acquire OZ assets after December 31, 2017 (can’t “grandfather” older investments)
- Eligible investors may claim tax benefits from the program until 2048, even though OZ designations expire in 2027
- If an OZ investment is a building, the IRS looks at building value, not underlying land value when evaluating improvement, expanding options for investors
- Investors may take up to 31 months to improve OZ properties, but they start the clock on their tax deferrals right away

SOURCE: Internal Revenue Service, “[Treasury, IRS issue proposed regulations on new Opportunity Zone tax incentive](#)” October 19, 2018



# CRITICS RAISE CONCERNS



OZs gained new attention in November 2018, when Amazon announced a new “HQ2” facility in an OZ in New York City, raising concerns that large multinationals can enjoy OZs as tax shelters without accountability for potential negative results.

HOWEVER, it's unclear if Amazon will qualify for OZ tax deferrals, due to the IRS's rule that at least 70% of a business' assets needs to be located in an OZ – the IRS still needs to clarify.\*

The New York Times

*Amazon's New York Home Qualifies as 'Distressed' Under Federal Tax Law*

**Bloomberg  
Tax**

November 9, 2018

**Amazon NY Could Win Big Under Tax Break Meant for Distressed Zones (Corrected)**

\*Source: Economic Innovation Group, "[HQ2 and Opportunity Zones: The Big Picture](#)" November 16, 2018

# CRITICS RAISE CONCERNS



Amazon-related concerns add to those already raised by critics since the birth of the OZ program. **Typical concerns include:**

- Some governors may have chosen OZs that are already developing, not necessarily the neediest areas
- So far, none of the OZ program rules attempt to ensure that OZ investments benefit local residents already living in OZs
- The OZ program so far has few metrics for measuring success, accountability, or transparency to the public
- Because the program is new, no experienced investors/syndicators

Further reading:

- Urban Institute, "[Did States Maximize Their Opportunity Zone Selections?](#)" May 21, 2018
- Tax Policy Center (the Urban Institute and Brookings Institution), "[The IRS Proposes Generous Rules For Opportunity Zone Investors But What Will They Mean For Communities?](#)" October 23, 2018
- Brookings Institution, "[Learning from Opportunity Zones: How to Improve Place-Based Policies](#)" October 2018
- Center for American Progress, "[OPINION: How Amazon \(and Trump\) can get rich off a tax break that's supposed to help poor people](#)" November 16, 2018



The IRS is [accepting comments on its 1<sup>st</sup> regulations through December 28](#)

**2<sup>nd</sup> round of IRS rules for OZs is due in January 2019** The IRS may address:

- How to report performance information like WHO is investing in OZs, HOW MUCH is being invested, HOW investments are used
- Clarify the IRS's 70% percent "tangible assets" rule for businesses in OZs:
  - Businesses may be headquartered in an OZ but do significant business outside the zone, such as a delivery-based business or technology company. Does the IRS view them as sticking to the 70% rule?
  - This is the core of the Amazon HQ2 debate – does HQ2 fall under Amazon's corporate umbrella, or does the HQ2 qualify as a separate entity meeting the 70% rule?
- The IRS must further define qualifying "improvements" OZ investors must make.
- Will the IRS add protections for local residents of OZs, such as adding local hiring, minority contracting, or affordable housing requirements?

# NEXT STEPS FOR CONGRESS



## OZs will remain a subject of great interest on Capitol Hill into 2019

- Congressional champions remain invested in the OZ program's success, so they will continue to closely follow implementation and may intervene if they perceive the program is straying from their intent
- Amazon HQ2 could bring new scrutiny from progressive members of Congress worried about gentrification, accountability



**Alexandria Ocasio-Cortez** ✓  
@Ocasio2018

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Amazon is a billion-dollar company. The idea that it will receive hundreds of millions of dollars in tax breaks at a time when our subway is crumbling and our communities need MORE investment, not less, is extremely concerning to residents here.

8:44 PM - 12 Nov 2018

8,530 Retweets 38,351 Likes



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Displacement is not community development. Investing in luxury condos is not the same thing as investing in people and families.

Shuffling working class people out of a community does not improve their quality of life.

9:03 PM - 12 Nov 2018

2,657 Retweets 12,771 Likes



# NEXT STEPS FOR CONGRESS



## Politics could influence debate

- Concerns of progressive Democrats could push progressive OZ advocates with presidential ambitions, such as Sen. Booker (D-NJ) and Sen. Kirsten Gillibrand (D-NY), to seek to place more protections for locals, transparency
- OZs' creation in TCJA could brand it a "Trump" program or a giveaway to big companies, risking public and progressive backlash



**Rachel McCleery**

@R\_McCleery

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This is insane. [#GOPTaxScam](#)



**Jim Tankersley** @jimtankersley

Pictured: The "Opportunity Zone" — median income \$138,000 — that is set to be Amazon's new NYC home:  
[nytimes.com/2018/11/14/us/...](https://www.nytimes.com/2018/11/14/us/)

Show this thread

12:23 PM - 14 Nov 2018

Left: Tweet from Senate Finance Committee's Democratic spokesperson for tax and oversight

## Committees of jurisdiction:

- Individual members of Congress may introduce legislation, write to agencies, or publicly comment on OZ implementation
- Best chance of meaningful action comes from primary committees of jurisdiction over tax policy, and therefore OZ implementation: the House Ways and Means Committee, and the Senate Finance Committee



House Ways and  
Means Chairman  
Rich Neal (D-MA)



House Ways and Means  
Ranking Member Kevin  
Brady (R-TX)



Senate Finance  
Chairman Chuck  
Grassley (R-IA)



Senate Finance Ranking  
Member Ron Wyden (D-OR)



**What changes could Congress make to the OZ program?** Congress will likely wait for the next round of IRS regulations to come out in January before acting, or perhaps even later to judge the progress of investments. However, potential actions Congress could take include:

- If OZs are believed to be successful in driving private investment to underserved areas, Congress could seek to **extend or expand** it, such as providing for renewal of OZ designations or another round of designations
- If Congress believes the IRS does not provide appropriate **transparency and accountability rules**, they may try to do so in legislation
- Similarly, Congress could seek to insert **protections for local communities** against the negative impacts of gentrification
- Public opinion and media coverage can push Congress to act – for example, depending on the IRS’s decision on Amazon’s HQ2, Congress may react by overruling the IRS’s underlying implementing rules for OZs
- Lobbying groups are also active on the Hill: city and state governments, fair housing advocates, and powerful financial services firms are all pressing for action favoring members’ interest

# WHAT ARE OZ INVESTORS LOOKING FOR?



Investors will always look for as close to a “sure thing” as possible, but there is no magic formula for an investment yielding a return

Local factors that could attract investors include:

- **Development already underway:** indicators of shifting economic fortunes, such as ongoing construction, rising local average incomes or housing prices can signal to investors an area already in the early stages of revitalization
- **Infrastructure:** Proximity and reliability of major surface transportation and public transit, broadband internet and mobile infrastructure, water infrastructure
- **Workforce and education:** A steady supply of educated and trained workers ready to work at and patronize new businesses in the area
- **Relationships:** support from local government and community leaders
- **Stackable incentives:** In addition to federal advantages from OZs, investors will seek out areas offering further state and local tax incentives as well as further federal incentives such as EPA Brownfield sites



# CONCLUSION



The Opportunity Zone program is a unique new tax incentive program estimated to unlock between \$100 billion (per Secretary of Treasury Steve Mnuchin) and \$6 trillion (per EIG) in private investments in underserved areas

- OZs enjoy bipartisan support in the Trump Administration and in Congress
- Investors, from individuals to large financial institutions, are extremely interested in investing in OZs ahead of the December 2019 deadline
- However, implementation of OZs is critical to its future:
  - Community leaders have raised concerns about the program's protections for residents of underserved areas
  - Investors need further clarity from the IRS before diving in
  - Confusion over Amazon HQ2 in NYC is an early test of public and policymakers' understanding and reaction to the program

## **Next steps:**

- IRS will issue 2<sup>nd</sup> round of implementing regulations around January 2019
- Congress is likely to hold hearings on OZ implementations in 2019
- Investors will likely race to make investments in 2019 before deadline

## ABOUT THE AUTHOR



**Lucia Alonzo** ([LinkedIn](#)) serves as Chief of Staff at Ferox Strategies, where she leads the firm’s research, analysis, and writing while maintaining a busy schedule advocating for our clients on Capitol Hill. Lucia excels in several sectors including transportation and infrastructure, tax, appropriations, immigration and border security, defense and homeland security, and education and workforce issues.

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