Opportunity Zones

Krista D'Alessandro, Policy Analyst,
Enterprise Community Partners

Administering Agency: U.S. Department of the Treasury (Treasury)

Year Enacted: 2017

Number of Persons/Households Served: There are 8,766 certified Opportunity Zones across all 50 states, six territories, and Washington, D.C., 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 incentive 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 incentive 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

The Opportunity Zones tool is technically not a program, but a tax incentive. The Treasury has certified 8,766 Opportunity Zones; these are low-income communities and adjacent census tracts that are now eligible to receive private investment through Opportunity Funds.

Opportunity Funds are a new private sector investment vehicle that must invest at least 90% of its assets in qualifying Opportunity Zones businesses and/or business property. There are three tiers of tax incentives to encourage taxpayers to invest capital gains into a Qualified Opportunity Fund:

- A temporary tax deferral for capital gains reinvested in an Opportunity Fund. The deferred gain must be recognized on the earlier of the date on which the Opportunity Zones investment is sold or December 31, 2026.
- A step-up in basis for capital gains reinvested in an Opportunity Fund. The basis of the original investment is increased by 10% if the investment in the qualified Opportunity Zones fund is held by the taxpayer for at least five years, and by an additional 5% if held for at least seven years, excluding up to 15% of the original gain from taxation.
- A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in a qualified Opportunity Zones Fund, if the investment is held for at least ten years. (Note: this exclusion applies to the gains accrued from an investment in an Opportunity Fund, not the original gains).

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. The Joint Committee on Taxation estimates that Opportunity Zones tax expenditures will total $8.2 billion over the course of 2020 through 2024. Estimates suggest that upwards of $6 trillion in unrealized capital gains currently sit on the books of U.S. taxpayers.

FORECAST FOR 2021

The Treasury and Internal Revenue Service (IRS) released the final regulations for Opportunity Zones in December of 2019. The regulations combined and updated the prior two tranches of proposed regulations (previously released in October 2018 and April 2019). The final regulations became effective on March 13, 2020 and provide technical clarification for stakeholders interested in making Opportunity Zones investments and/or managing a Qualified Opportunity Fund.

However, the final regulations do not directly address the broader concerns from low-income community advocates about the potential consequences of these private investments. There are no provisions in the statute nor final regulations 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. Also not included in the final regulations are data collection and reporting requirements that would allow Opportunity Zones stakeholders to assess the outcomes of the new tax incentive.

The Opportunity Zones legislation requires investments to be made by December 31, 2019 to be eligible for the maximum 15% reduction in capital gains for holding investments seven years. While there is currently no single, comprehensive log of Opportunity Funds and investment activity, several third-parties have created resources to collect volunteered investment information. As of December 2020, the National Council of State Housing Agencies' (NCSHA's) Opportunity Zones Fund Directory listed 222 funds representing nearly $46.9 billion in anticipated investments. NCSHA's directory estimates that 62 % of the funds plan to invest at least some portion of their capital in affordable or workforce housing or community revitalization. The Novogradac Opportunity Funds Listing is tracking 811 funds, with $12.05 billion raised as of August 2020. Opportunity Zones investments will continue in 2021.

There were numerous bills introduced in the 116th Congress that would add to or revise the statue that created Opportunity Zones. Many of these bills would have implemented some form of reporting requirements and increased oversight of the tax incentive to ensure that benefits reach the intended low-income communities. This includes S.1344, which would strengthen Opportunity Zones reporting requirements and specifically require the Treasury to collect data on Opportunity Funds and their impact on low-income communities, as well as S. 2787, which would establish reporting requirements and prohibit Opportunity Zones investments in certain luxury assets. H.R. 5042, would revise the requirements for designating certain census tracts as qualified Opportunity Zones based on median family income, and H.R. 4999 would require qualified Opportunity Funds to have an investment advisory board and meet certain investment diversity and affordable housing requirements.

Other bills introduced would have expanded how the tax incentive could be used. For example, H.R. 6529 would designate small businesses affected by Covid-19 as qualified Opportunity Zones businesses, and H.R. 7262 would encourage Opportunity Funds to invest in Community Development Financial Institutions.

There were also bills introduced that would expand the geographic targeting of Opportunity

Zones. H.R. 7492 would designate all of Puerto Rico as an Opportunity Zone, whereas S.4780 would designate certain low-income community areas affected by Hurricane Laura as Opportunity Zones. Another bill, H.R. 5252, would repeal the provision in the Internal Revenue Code authorizing Opportunity Zones altogether. Ultimately, no bills modifying the Opportunity Zones provision were passed in the 116th Congress.

Meanwhile, the Trump Administration continued to prioritize Opportunity Zones through federal policies and programs in its final year. The White House Opportunity and Revitalization Council (Council), formed by Executive Order in December 2018 and headed by HUD Secretary Ben Carson, comprised of 17 federal agencies and federal-state partnerships and aimed to better coordinate federal resources across Opportunity Zones. In 2020, the Council released two reports: a report on Opportunity Zones best practices in May and a report providing an initial assessment of Opportunity Zones impact in August. Also in August, President Trump issued an Executive Order giving preference to Opportunity Zones when federal agencies consider where to locate offices and facilities.

The transition from the Trump to the Biden Administration raises important questions about the future of Opportunity Zones. The Biden Administration has proposed to retain, though reform, Opportunity Zones and has released its initial recommendations for the program. These include that Opportunity Funds partner with non-profit and community-oriented organizations and jointly produce a community-benefit plan for each investment, that Treasury review Opportunity Zones tax benefits to ensure that they are only allowed where there are clear economic, social, and environmental benefits to a community, and that the tax incentive increase transparency by requiring detailed reporting and public disclosure requirements for tax beneficiaries. The Biden Administration's proposed tax plans also have important implications for investment in Opportunity Funds, particularly its proposal to raise capital gains taxes.

WHAT TO SAY TO LEGISLATORS

Opportunity Funds should be required to report on their investment activity to ensure accountability of federal resources. The "Investing in Opportunity Act" included language requiring Treasury to report on the impacts and outcomes of Opportunity Fund investments; however, when the tax incentive was ultimately enacted as part of the "Tax Cuts and Jobs Act of 2017," reporting requirements were not included.

The U.S. Government Accountability Office (GAO), the federal agency charged with providing oversight on federal programs for Congress, released a report in November of 2020 that makes two key findings: 1) that Congress should consider providing Treasury the authority to collect and report data on Opportunity Zones performance, since they have yet to designate this responsibility to any specific agency and; 2) that Congress should consider identifying questions that it would like Treasury to address to help guide data collection and reporting, as there is currently insufficient data available to assess Opportunity Zones program outcomes.

Since the Opportunity Zones tax incentive was enacted, Enterprise has been urging Congress and the Administration to commit to reporting public data on investments in Opportunity Zones. Enterprise believes that the Opportunity Zones tax incentive should be used to advance equitable and inclusive growth, and that an important part of assessing this new tax incentive is transparency and accountability through data and reporting requirements. Enterprise believes that the federal government must require public data collection and reporting on Opportunity Fund investments and outcomes, allowing Congress and the public to evaluate whether this new tax incentive is driving equitable investments.

Advocates should urge members of Congress to enact meaningful reporting requirements on Opportunity Zones investments, similar to those outlined in the previously introduced S.1344, legislation that would require Trea-

sury to collect data and issue a report on program outcomes.

The Opportunity Zones tax incentive has the potential to play a key role in the economic recovery following Covid-19. Any future opportunities to reform or modify Opportunity Zones should consider the impact on the designated low-income communities above all. 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 Zones investments cause property values and costs of living to rise.

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.

A statutory requirement to collect and publicly report meaningful data on Opportunity Zones investments is the first critical step necessary toward strengthening the accountability and transparency of this new tax incentive.

FOR MORE INFORMATION

Enterprise Community Partners, www.opportunityzonesinfo.org.

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