

Innovation and Responsiveness: Opportunity Zones

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Disclaimer

The views and opinions expressed in this presentation are solely those of the speakers and do not necessarily represent those of the Federal Reserve Bank of Richmond or the Federal Reserve System.

Recognition

Special thanks to my colleague Jeanne Milliken Bonds of the Richmond Fed who first compiled this information for a presentation to the Municipal Association of South Carolina.

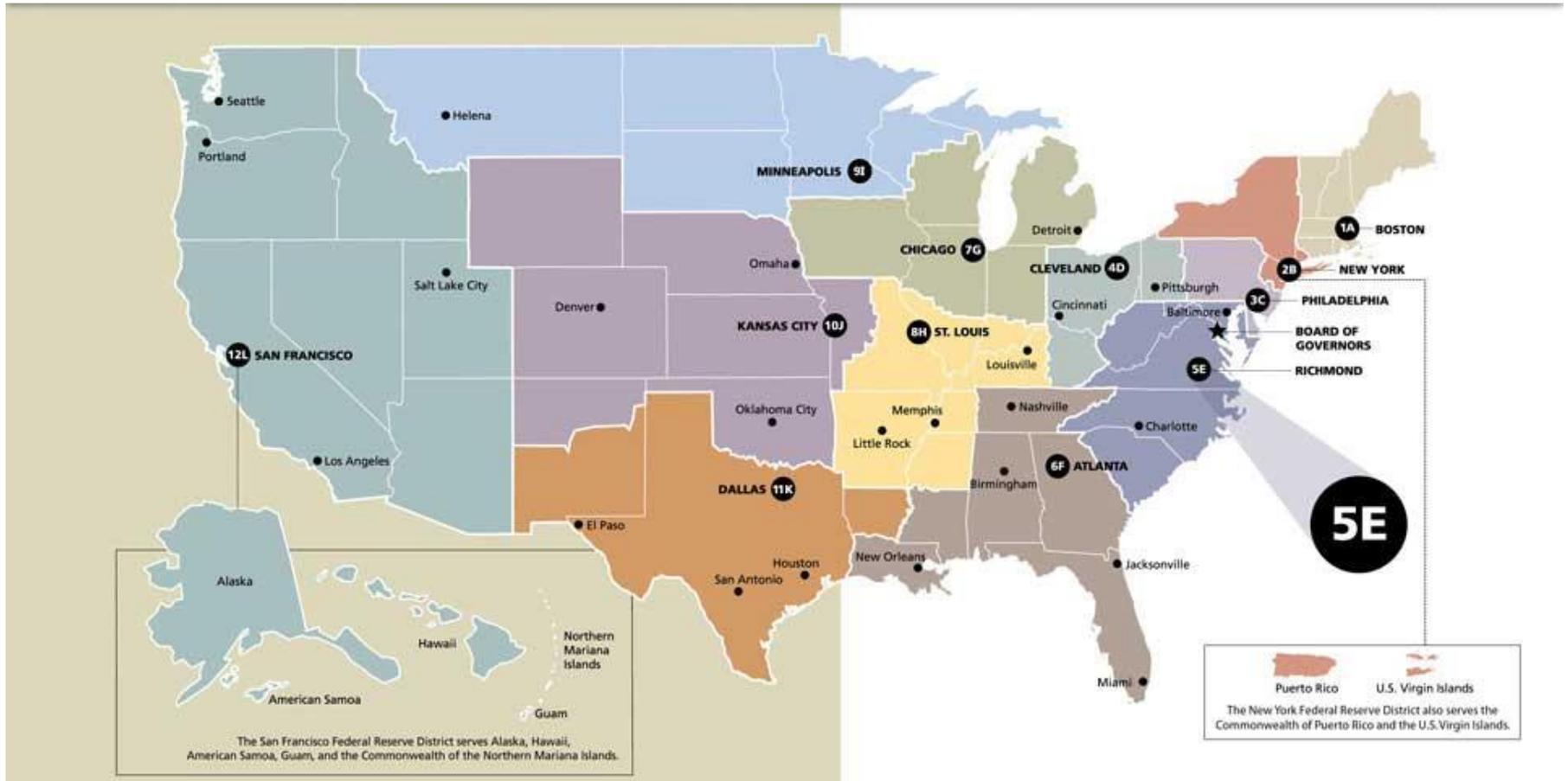
Opportunity Zones

- Created as part of the Tax Cuts and Jobs Act of 2017
- Opportunity Zones are low-income census tracts that offer tax incentives to invest and hold capital gains in Zone assets or property
- States designated up to 25% of low income census tracts as “Opportunity Zones”

Community Development @ Federal Reserve

- Actively engaged in economic growth for low and moderate income communities.
- We leverage our knowledge of communities and CRA to support investment and economic revitalization in communities.

The Federal Reserve System's 12 Regional



The Opportunity Zone Tax Incentive

- The goal of the Opportunity Zone tax incentive is to drive long-term equity capital to distressed communities with tax benefits on investments in Opportunity Funds.
- The law authorizes U.S. Treasury to *define and certify* Opportunity Funds to deploy equity investment capital in Opportunity Zones for eligible purposes - investment in real estate and businesses.
- U.S. investors receive a temporary tax deferral and other tax benefits when they reinvest unrealized capital gains into Opportunity Funds for a *minimum* of five years.
- Governors in every state, U.S. territory, and the Mayor of Washington, D.C. designated Opportunity Zones.
- U.S. Treasury certified the Opportunity Zones the chief executives designated.
- The majority of certified Opportunity Zones are low-income census tracts.

Investor Incentives

- A temporary deferral of inclusion for capital gains reinvested into an Opportunity Fund with the deferred gain recognized on the date on which the opportunity zone investment is disposed of or December 31, 2026.
- A step-up in basis for capital gains reinvested in an Opportunity Fund.
 - The basis of the original investment increases by 10% if the investment is held by the taxpayer for at least 5 years.
 - An additional 5% is accrued if held for at least 7 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 an Opportunity Fund, if the investment is held for at least 10 years.
- Deferral grows into capital gains tax relief the longer the investment is held.
 - An investor who retains an investment for seven years will pay only 85% of the capital gains taxes that would have been due on the original investment.
 - If the investment is held beyond 10 years, the investor permanently avoids capital gains taxes on any proceeds from the Opportunity Fund investment.

Opportunity Zone Designations

- Uses the same definition for a “low-income community” used by U.S. Treasury CDFI Fund’s New Markets Tax Credit (NMTC) program.
- Every state/territory/D.C. could designate up to 25% of its census tracts that met the requirements. Up to 5 % could be non-low-income contiguous census tracts.
- Opportunity Zone designations (post certification) remain in place for a period of 10 years.
- Nineteen states (Including South Carolina) met the March 21, 2018 deadline to submit Opportunity Zone designations.
- U.S. Treasury has now certified zone designations in all states and territories. [CDFI Fund](#) (map and list)

Opportunity Funds

- Opportunity Funds are Treasury-certified investment vehicles that deploy capital into Opportunity Zones.
- Required to hold at least 90% of assets in an Opportunity Zone.
- Investors create Opportunity Funds for new, expanded businesses, real estate development.
- Investors minimize their tax burden through preferential treatment of capital gains and deferral of federal taxes.

Rules and Regulations

- U.S. Treasury uses revenue procedures and Frequently Asked Questions (FAQs) to interpret and implement.
- There will not be formal rule-making or a set of regulations
- The IRS will not release regulations on the tax incentive.
- Possibly Community Reinvestment Act (CRA) and Public Welfare Investments (PWI) considerations for banks as investors in Opportunity Funds.

FAQs

- On April 24, 2018, the IRS released an Opportunity Zone FAQ:

Q. How does a taxpayer become certified as a Qualified Opportunity Fund?

A. To become a Qualified Opportunity Fund, an eligible taxpayer self certifies. (Thus, no approval or action by the IRS is required.) To self-certify, a taxpayer merely completes a form (which will be released in the summer of 2018) and attaches that form to the taxpayer's federal income tax return for the taxable year. (The return must be filed timely, taking extensions into account.)

Community Reinvestment Act and Public Welfare Investments

- Banks could choose to create OZ Funds - individual investor capital, unrealized capital gains.
- OZ Funds must make equity investments.
- “Areas targeted for redevelopment by federal, state, local, or tribal government?”
- Hot spots
- Deserts
- Local intent?
- Permissible PWIs are “designed to primarily promote the public welfare.”

Benefits and Concerns

- New or increased capital in communities vs incentive without a lot of guardrails
- Gentrification – new or increased
- Concentration in high-cost cities vs underserved remain underserved
- Unwelcome or harmful investments in communities or decisions without community participation – S.C. “do no harm” guidelines
- Displacement of existing Community Development investments like NMTC, LIHTC
- Lack of reporting requirements

OZ Strategies in Local Communities

- Create partnerships to raise and deploy funds
- Institutional sponsorship of OZ Funds: universities, developers, government, foundation, CDFIs, CDCs
- OZ Funds paired with other impact investing, CD and related tax credits like HTC, LIHTC, NMTC
- City/County zoning, ordinances, planning

Resources

- [CDFI Fund \(U.S. Treasury\)](#)
- [Enterprise](#)
- [Urban Institute](#)
- [Local Initiatives Support Coalition \(LISC\)](#)
- [Bloomberg Tax](#)
- [Council of Development Finance Agencies](#)
- [Novogradac](#)
- [Holland & Knight](#)
- [South Carolina Opportunity Zones](#)
- [www.FedCommunities.org](#)
- [Connecting Communities Webinar](#) July 26, 2018 3:00 pm (EST)