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How Governments Can Help Put the "Opportunity" in Opportunity Zones

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First introduced by the tax reform legislation signed into law in late 2017, Opportunity Zones present a new opportunity for taxpayers to defer and/or eliminate tax liability and, at the same time, spur much needed economic development in underserved communities. With opportunity knocking at the door, ***the key question that the leaders of governmental units (including cities, counties, special districts, states, and territories such as Puerto Rico) that include one or more Opportunity Zones must now ask themselves is: What steps can be taken by the public sector to induce investment in MY Opportunity Zone?*** As was the case with communities that sought to attract Amazon's HQ2, coordinating policies, programs and creative approaches to deploy public sector resources, including economic development tools, could make all the difference.

Brief Summary of the Tax Incentive

In general, taxpayers who sell appreciated capital assets are required to pay the resulting capital gains tax in the year of the sale. Opportunity Zones provide a way to change this result by giving many taxpayers the ability to elect to defer, and potentially reduce, the required tax payment if all or a portion of the capital gain is reinvested in an "Opportunity Fund" within 180 days from the date of the sale. The Opportunity Fund, in turn, must hold at least 90% of its assets in Qualified Opportunity Zone Property, which generally consists of investments (direct or indirect) in one or more Qualified Opportunity Zone Businesses (i.e., an active trade or business in which substantially all of its property is used in the Opportunity Zone). Except for golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, gambling facilities, or liquor stores, almost any type of business could qualify as a Qualified Opportunity Zone Business. For example, qualifying businesses would include grocery stores, multi-family housing, and manufacturing or other industries that could produce significant tax revenues and employment opportunities with the Opportunity Zone.

States with high populations, such as Texas, have as many as 628 census tracts designated by a state's governor and certified by the Treasury Department as Opportunity Zones (a list of the tracts designated by the Treasury Department is available ***here***). Although the Opportunity Zone provisions have been effective all year, the opportunity remained mostly untapped while Treasury drafted much needed regulations to clarify certain aspects of the new law. Fortunately, that wait is now over, as the IRS issued proposed regulations (which can be relied upon) on October 19, 2018, as well as a Revenue Ruling that provides additional guidance.

(Click ***here*** for a technical summary of Opportunity Zone provisions under the Internal Revenue Code and the recently released proposed Treasury Regulations).

How Can Governments Encourage Local Investment

Governmental units that have one or more Opportunity Zones located in their jurisdiction should consider what role they can play in attracting a portion of the predicted $100 billion of investments resulting from the new tax law, which likely will include the development of a strategy that leverages the efforts of a cross-disciplinary team of economic development, banking, finance and legal experts, and ultimately produces clear and unambiguous policies that the private sector may rely upon in determining investment opportunities in an Opportunity Zone.

For example, a successful strategy might include an inventory of key infrastructure elements, including streets, drainage, parks, schools, transportation and other existing attributes of the area that would be relevant to an investor and provide a detailed plan of enhancements that are planned in that area. Those enhancements could also be accelerated to the extent that investments are planned by the private sector. Additionally, this inventory would chronicle other data such as the existence of nearby educational institutions that produce an available workforce, a dependable public transportation system, favorable climate, affordable housing options and access to health care, and/or a strong economy in the area surrounding the Opportunity Zone. If any of these or other attributes are present, the governmental unit could advertise the benefits through an effective public relations campaign that utilizes multimodal avenues of communication, including reaching out directly to fund managers, advertising on local and national media outlets, and hosting discussions with business leaders. Further, the governmental unit could work in tandem with civic-minded local and regional business leaders to promote the investment in the Opportunity Zone.

In addition to considering the attractive features of the Opportunity Zones, investors will also be looking for other economic incentives that will make a project more likely to succeed financially. Thus, governmental units also should consider leveraging other incentives that make an investment in a particular Opportunity Fund more attractive to potential investors and businesses. For example, the governmental unit (or a related governmental entity, such as a management district or a tax increment reinvestment zone) could issue bonds to finance capital improvements to provide needed infrastructure such a utilities and roads to support a project in an Opportunity Zone. Likewise, governmental investment in public transportation would demonstrate the governmental unit's commitment to supporting investments in the Opportunity Zones. Similarly, the governmental unit could consider whether property tax abatement programs could be offered as an incentive to entice businesses to expand or locate in the Opportunity Zone. Finally, multiple governmental units (e.g., a city, a county, and a transit authority) could work together to package incentives to promote and attract investment in their coterminous jurisdictional area. However accomplished, ***a key concept is identifying ways that the private sector can work to improve the chances that businesses investing in these areas will be successful.***

Last Words

Opportunity Zones present a new platform for a public-private partnership between governmental units, investors, and businesses. Governmental units with Opportunity Zones need to develop their “story” regarding what sets them apart and why Opportunity Funds and Qualified Opportunity Zone Businesses should invest in their community. However that story is best told, now is the time for governmental units to act – given the national interest that this new tax incentive has garnered, there is sure to be fierce competition among governmental units to attract investors.

For more information or if you have specific questions regarding any of the above, please contact ***Brian Teaff***, ***Victoria Ozimek***, or ***Barron Wallace***.