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Novogradac Conference Speakers Expect Opportunity Zones Will Continue to be a Game-Changer for Low-Income Communities

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Legislators, policymakers and stakeholders at the Novogradac 2020 Opportunity Zones Virtual Conference in July discussed opportunity zones (OZ) legislation, reporting requirements, guidance and the evolving marketplace–all in the context of how the OZ incentive can play a role in strengthening communities and the economy.

"Opportunity zones changed the conversation," said Daniel Kowalski, Counselor to the Secretary of Treasury, during the Novogradac conference. "Most economic incentive programs are grants or debt and the opportunity zone is an equity play. ... It's important we have this new tool that focuses on equity and changes the conversation about what you need to do in order to build up a low-income community."

Bipartisan Support in Washington

Conference speakers shared their outlook on OZ legislation, generally agreeing that the two most likely vehicles for OZ legislation this year are a COVID-19 relief bill or an end-of-year tax package. In particular, proposals for an extension of the OZ incentive and for an expansion of reporting requirements have gained traction in Congress.

"The COVID-19 pandemic has made it clear that legislation around a two-year time extension is now more important and more necessary than ever before," said Sen. Tim Scott, R-S.C., author of the original OZ legislation and a member of the tax-writing Senate Finance Committee, during his conference keynote address. "This will allow those

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using the OZ incentive to weather the storm and give our communities more time to plan and harness the potential of opportunity zones."

Sen. Scott said he would continue working to get his bipartisan Improving and Reinstating the Monitoring, Prevention, Accountability, Certification and Transparency Provisions of Opportunity Zones (IMPACT) Act passed into law so that decision makers can better track and understand the impact of OZs. The IMPACT Act would institute reporting requirements that were included but later stripped from the 2017 tax reform package that enacted OZs.

"We really need to work to get the IMPACT Act passed," said Emily Lavery, legislative assistant to Sen. Scott. "It's extremely robust … and includes the largest scope of minute-level data on actual community impact, which is really what we're trying to understand."

Chad Maisel, economic policy advisor for Sen. Cory Booker, D-N.J., said that there is support from both sides of the aisle and from both chambers of Congress for OZs to succeed.

"I think the basis of any legislative package to move forward is likely to revolve around reporting and increased transparency," said Maisel. "It's something that Sen. Booker has talked a lot about and Sen. Scott has talked a lot about." Maisel added that Sen. Booker is also interested in phasing out the small percentage of higher-income [contiguous] census tracts designated by governors as OZs, but that might not need a federal tax incentive as much as other areas.

In addition to having support in Congress, the OZ incentive is also a priority for the White House Opportunity and Revitalization Council. The council is made up of 17 federal agencies and federal-state partnerships working together to focus resources into OZs and other economically distressed communities.

Alfonso Costa Jr., former deputy chief of staff for the U.S. Department of Housing and Urban Development, outlined the White House Opportunity and Revitalization Council's report on OZ best practices and said that additional actions will be made public in the near future.

"The White House Opportunity and Revitalization Council is intently focused on making sure that OZs are places where existing residents are the ultimate beneficiaries of the funds being invested through qualified opportunity funds, and that will never change," said Costa.

Reporting and Data Collection

On the topic of reporting and data collection, Kowalski said the Internal Revenue Service (IRS) Form 8996 for qualified opportunity funds (QOFs) will provide two key pieces of information to help evaluate the OZ incentive: the amount of investment being made and the location of those investments.

Kowalski estimates that it will take about 18 months for Treasury to compile and process OZ information reported through Form 8996, so a complete set of data for 2019 OZ investments might not be available until mid-2021.

Kowalski said that once Treasury processes the Form 8996 information, the department should be able to create a heat map to illustrate where OZ investments are being made. Different gradations of color can show the depth of investment in a particular tract on a dollar basis.

Certain economic indicators are not tracked through Form 8996, such as income, poverty levels and job

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creation and destruction–information that will be available through the American Community Survey (ACS). The challenge is comparing ACS data, which is averaged over five years, with single-year data for OZ investments reported through Form 8996. Kowalski said Treasury will need to work through the time difference between the two data sets.

IRS Guidance

Notice 2020-39

As a response to the COVID-19 pandemic, the IRS in June provided OZ deadline relief through Notice 2020-39. Among several provisions, the guidance provided extensions for taxpayers to invest their capital gains in a QOF.

Panelists said the deadline extensions in Notice 2020-39 provided welcome relief, especially for transactions negotiated pre-COVID-19 that may need re-examination. "In some cases, you are seeing [developments] looking for capital and not necessarily meeting investor expectations that have changed post-COVID," said Julia Shin, vice president and managing director of impact investing for Enterprise Community Investment Inc. "The additional time that has been granted [through Notice 2020-39] has been helpful in working through some of these questions and I think will still be very helpful moving forward."

Implementing the Final Rule

Novogradac partner and conference chairman John Sciarretti led a discussion with representatives from the IRS on the final OZ regulations released in December 2019. The panel covered several aspects of the final rule, including the investment standard test, which requires that a QOF hold at least 90 percent of its assets in OZ property at the end of a six-month period. Under the final rule, the option to disregard recently contributed property for up to six months before a testing date does not address any earnings on that property nor does it address any capitalized organizational or startup costs that funds might have during the process.

Sciarretti suggested that Treasury allow funds to exclude earnings on the temporary contribution and to ignore any capitalized costs related to organization and startup. Panelist Alfred Bae, general attorney for the IRS, responded that it is reasonable for funds to disregard the earnings on contributions that were otherwise being disregarded under the Treasury regulations. Bae said that taxpayers should also be allowed to ignore organization and startup costs. QOFs having no assets in either the numerator or the denominator due to these disregarded assets can report as 100 percent on Form 8996, according to Bae.

Another discussion topic was how the IRS would treat a change in the use of working capital plan as a result of COVID-19. Sciarretti gave examples of how some entities have found it necessary to adjust their plans because of COVID-19, including difficulty raising financing or needing to change plans for a full-service hotel to office or residential space. Julie Hanlon Bolton, deputy associate chief counsel for the IRS, said the IRS is considering stakeholder requests that entities that modify or change their business plans because of COVID-19 are not considered to fail the working capital safe harbor requirement to use working capital assets in a manner "substantially consistent" with their written plan and schedule.

Other topics covered by the IRS panel included the treatment of related-party additions to basis, the infusion of working capital assets, triple-net leases and measuring the working capital safe-harbor COVID-19 extension.

Future Regulations

Since final regulations were issued in December 2019, followed by technical corrections in April, Kowalski

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said he considers the status of OZ regulations complete for now. One area in which Treasury may consider issuing guidance is the redrawing of census lines after the latest census update.

OZ Marketplace

Another topic discussed was the effects of the COVID-19 pandemic and an observed slowdown or pause in some OZ activity. Factors stemming from COVID-19, such as economic uncertainty, construction delays and underwriting challenges have contributed to some OZ participants taking a pause. Panelists said that those planning OZ developments in commercial retail and hospitality, in particular, may be rethinking their strategies.

The pandemic has also prompted businesses to think about evolving patterns of commerce, such as a greater focus on online shopping, which makes warehousing and delivery services even more important. There may also be a push to produce more goods domestically to avoid supply chain disruptions, especially in the pharmaceutical industry. Panelists said business can consider OZ investments as an opportunity to meet these evolving market demands while benefiting OZ communities.

Speakers discussed a final rule published by federal regulatory agencies June 25 to modify the Volcker Rule's prohibition on banking entities sponsoring or investing in covered funds—a ruling that allows banks to participate in the OZ incentive. Panelists said this rule change makes them optimistic that more dollars will flow into the OZ space.

The conference also included discussion of OZ investment in operating businesses. "It's been well documented that the overwhelming majority of OZ investments to date have been in real estate," said Michael Kressig, a Novogradac partner and panel moderator. "The original sponsors of the incentive certainly envisioned a place for real estate investments, but they also believed that in order for this incentive to have its intended economic, catalytic impact on these distressed communities that it was really important that operating businesses and the job creation that they generate have a big place in the market."

"I think that the recent regulation changes are very helpful to the operating business environment," said Terry Jester, CEO of Solpad and the Impact OZ Fund. "There is a challenge of getting the message out about whatever these operating businesses' needs are and applicability for distressed communities or distressed areas."

Outlook

Despite challenges, including the COVID-19 pandemic, speakers expressed optimism that the OZ incentive will continue to drive capital into neighborhoods in need.

"The time to reinvest in our most distressed communities is right now," said Sen. Scott. "The IRS has worked hard to create flexibility that will allow folks investing in 2020 to have the time they need to make smart, impactful investments. I also want to encourage those creating powerful change through opportunity zones to be vocal–I mean be loud, be seen, be heard. We need to hear your stories because the more information is in the public forum about the success of the opportunity zones, the more traction the zones will have across the country."

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