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Opportunity Zones Must Work for Working Businesses.

In the first quarter of 2018, we and our colleagues worked with our governors to designate our states' Opportunity Zones. No economic development program is perfect. But this new federal tax tool, which was introduced by over 100 bipartisan congressional co-sponsors, has great potential. We take our responsibility to utilize this new tool to strengthen the economic vitality of our communities and enhance the well-being of our citizens seriously. We selected zones based on the intent of Congress that this new federal capital gains tax incentive attract scarce equity capital to underinvested communities for two purposes: the development of brick and mortar projects and the growth of operating businesses. This program was not designed simply for investments in real estate. It was also created to foster entrepreneurial ventures, to strengthen manufacturers, to draw capital to businesses small and large, and to result in the production of jobs in these designated communities. As key stakeholders in the success of our states' Opportunity Zones, we want to ensure that the regulations the IRS delivers in the coming weeks reflect this same two-part intent.

The scale of need is vast. As recently as 2016, more than three-quarters of all U.S. counties still contained fewer places of business than before the recession, according to the Economic Innovation Group. If current trends continue, some of the country's most distressed census tracts may never recover the jobs they lost to the Great Recession. The status quo would have investors continue to pour capital into the places already doing well. Opportunity Zones have the potential to change investor behavior by providing an incentive to take off blinders and consider investing in spaces and businesses that can bring new vitality and opportunity to places that have been left behind.

We and our peers – a dozen top state economic development officials – have written two letters to Treasury, the IRS, and the regulatory authorities summarizing our suggestions to ensure this new tax incentive delivers what both Congress and our governors have promised their constituents. We make four main recommendations.

First, Opportunity Zone investors should be able to invest in high-impact operating businesses that can generate jobs and wealth at scale by drawing revenue from outside of the community into it. Investors should be able to inject equity into manufacturers and e-commerce companies in addition to the restaurants and storefronts that also make up a community. For example, this means that the 50 percent gross income requirement should be interpreted to require that qualifying entities be active businesses as opposed to holding companies or patent boxes. But it should not require that income be majority derived from a single point of sale in an Opportunity Zone, which would disqualify most e-commerce companies, manufacturers, and other businesses with the potential to create significant numbers of new jobs and wealth for their communities. (The current set of proposed regulations seemingly require such predominantly localized sales.) We agree with proposals that allow businesses the necessary operational flexibility to qualify for these investments, such as the straightforward requirements that 70 percent of a qualifying business's tangible property be in an Opportunity Zone.

Second, the IRS and Treasury must demonstrate a basic understanding of what motivates investors to provide equity to operating businesses by writing rules and regulations that allow Opportunity Funds–the required vehicles for investment under this program–to create diverse investment portfolios. Successful Opportunity Fund managers will naturally seek to spread out their risk by investing in several businesses in case any of them fail. Diversification is particularly important in struggling communities where investors already view projects as riskier and returns are seen as less certain. Because sound funds will make multiple business investments, they will need flexibility in the time allowed to meet the law's twice annual "90 percent asset test" to ensure that the Fund managers can put together a strong portfolio of qualifying business investments that will attract and keep investors interested in zone communities.

Third, Opportunity Funds should be able to buy and sell assets without triggering tax liabilities for their partners that would undermine the 10-year tax benefit. Specifically, the rules should allow funds to reinvest interim gains in a timely manner without incurring a penalty or triggering a taxable event. Successful investing requires a degree of nimbleness to react to new developments. Investors will be reluctant to commit to holding a stake in a single company for 10 years given all the forces that could intervene during that period. Investors should be able to divest from less-than-successful companies if they keep their capital at work in Opportunity Zones. The IRS could consider establishing a minimum hold period for any individual investment in a zone, but requiring an investor to hold each individual business investment for 10 years (rather than simply committing to remain invested in the Fund for 10 years) will significantly undermine the ability to invest in operating businesses.

Finally, we encourage Treasury to adopt simple, unobtrusive reporting requirements to collect data on Funds and their investments. Such reporting will illuminate where the incentive has been successful and will help identify areas for improvement and modification in the future. These data will help us understand whether this program is incentivizing the investments intended by Congress.

We recognize that finalizing new regulations is never as simple as it seems, but by working together, we are confident we can unleash the true potential of Opportunity Zones in these key communities.

THE HILL

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