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## **Multi-Asset Funds, Aggregating, Gentrification And Abuse: IRS Still Has A Lot On Its OZ Regs Plate.**

The second and likely final public hearing for the opportunity zone program showed that the program's staunchest advocates are still hoping the federal government makes some changes to the rules before they are finalized.

The program allows investors to place [capital gains](#) into a [qualified opportunity fund](#) — referred to during Tuesday's hearing as QOFs and pronounced like "quaffs" — and avoid paying taxes on that money if it is invested into a property or business in an opportunity zone.

Across the country there are more than 8,000 [opportunity zones](#), census tracts encompassing or adjacent to distressed communities, chosen by each state's governor and Washington, D.C.'s mayor.

While the regulations were written as part of the Tax Cuts and Jobs Act of 2017 to incentivize investors to pour their money into developments and businesses in underprivileged areas, speakers at the hearing outlined ways the current language has helped keep investors on the sidelines.

The most recent draft was [released in April](#), after a [previous public hearing](#) in February. This week's hearing, held in the New Carrollton Federal Building in Lanham, Maryland, featured 19 speakers, none of whom represented any state or local government entity, a change from the last hearing.

Instead, the group was made up largely of attorneys, accountants and developers who are trying to make use of the program. Many of them testified that some of the language in the last set of regulations is slowing them down.

"Investors are extremely reluctant to commit dollars today without having certainty of the rules that apply at the end of their investment," Javelin 19 President Jill Homan said at the hearing.

Homan has already raised and deployed money from a QOF.

One of the main issues still at hand is the exit strategy for a QOF that has invested in multiple assets. One of the hiccups, speakers said, is the regulations state that the only way to achieve the full tax benefit is if the entire QOF is sold after the 10-year investment timeline. If property owned by a QOF is sold, but the QOF doesn't trade — in other words, if there is a typical real estate deal — it has a smaller tax benefit.

What's more, most QOFs — as is typical in a real estate transaction — establish LLCs that operate as Qualified Opportunity Zone Businesses. If that LLC sells after 10 years, it is treated with a third type of tax benefit.

"This incredibly important point is lost on many investors," Homan told *Bisnow* after the hearing. "The consensus in the industry is you don't get the OZ tax benefits if you just sell the real estate. If you sell the property LLC, you get some but not all of the tax benefits."

"We need to synthesize these three different outcomes," Homan added. "Most investors think this is a great tax incentive and want to take advantage of it, and this nuance is completely lost on them."

Most sections of the most recent [IRS guidance](#) told investors that they could use the regulations to make investment decisions with confidence that the rules wouldn't change. When it came to exits from multi-asset funds, Develop LLC founder Steve Glickman said, the IRS stipulated that investors shouldn't consider the language final.

"What I've been told in private conversations with the IRS is the reason they did that is to give themselves flexibility to create a better framework, if they wanted to, around those exits because the exits wouldn't happen for years," Glickman told *Bisnow* after the hearing.

"Any type of funds, investors and fund managers ask right now, 'How are we going to exit out of these vehicles?' ... That's holding up some of the market, more of the risk-averse network of investors and wealth managers who want to see that become final."

If that piece of the regulation is not changed, it could significantly depress the overall impact of the program, Glickman said. [Billions of dollars in multi-asset opportunity funds](#) have already been raised, but those funds would have to be restructured or sold all at once.

"The status quo concern was the only way to exit from a multi-asset fund is you have to sell the whole portfolio. That depresses the price because it's harder to find someone to buy it," Glickman said. "It's also going to depress these communities, because it's going to decrease the value of the asset appreciating. It makes it less likely for people to invest because of those reasons."

Another issue that was repeatedly raised was the language in the regulations implying that property had to be substantially improved to realize the tax benefits of an opportunity zone. The issue potential investors have with the current regulations — it is unclear when they will be finalized — is that each improvement appears measured on an asset-by-asset basis.

"The whole industry of opportunity zones has been evolving. And we've been learning together," Homan said. "A lot of that learning comes through fact patterns. It's through all these fact patterns that you realize, 'Whoa, now what do we do?' Is the expenditure for the substantial improvement, can you aggregate it or do you have to substantially improve every asset?"

Essentially, if a developer improves an apartment building, builds amenities and adds some shops, rather than measuring the overall benefit to the entire property of the apartment building, each asset would have its benefit assessed differently, and not all would qualify for the tax break, Homan said.

"That's called aggregating, and that's not considered a substantial improvement," Homan said. "I have to only substantially improve the residential and I get no credit for the other stuff."

The panel that listened and asked questions of the speakers was led by Treasury Associate Tax Legislative Counsel Michael Novey and IRS Special Counsel Julie Hanlon Bolton. While Congress passed the bill with the opportunity zone program, their teams are the ones receiving input and tweaking the regulations to implement the law as intended.

Novey was receptive to the comments on the aggregation and multi-asset exit issues, and pressed most of the speakers to propose fixes, rather than just point out the problems.

More than one speaker stated concern over the program's [potential to be an accelerant for gentrification](#) in neighborhoods that are already seeing displacement and active development.

"We're concerned about the negative externalities that a program like this will impose on black and brown people," said William Cunningham, the first speaker of the day.

Cunningham is an economist, the founder of Creative Investment Research and an adjunct professor at Georgetown University.

Novey said later in the hearing that he is conscious of the fact that more money will be going into the more affluent opportunity zones.

"A lot of people have criticized designations by governors of census tracts that are already gentrified," Novey said.

While it is not definite that Tuesday's hearing was the last the IRS and Treasury will hold on the topic, the only next steps being publicly discussed are the final changes that will be made to the regulations after the hearing and thousands of pages of testimony submitted online or by mail.

"It may or may not be the last hearing on opportunity zones, it depends on whether the IRS wants to do a third round," said Glickman, who was an architect of the program and has worked with the agencies in crafting the regulations. "Some people have suggested they might do that around abuse prevention and penalties and safe harbors and other aspects of the compliance and enforcement side. They've indicated publicly that they expect this to be their last round."

The U.S. Impact Investing Alliance Executive Director Fran Seegull asked the panel to more clearly state penalties for abuse, as well as ways to track data to measure the program's impact. Novey pushed back on whether the IRS or Treasury could collect the data based on the law, but seemed intrigued by the abuse issue.

"It would help for you to give us some examples of abuses you think we ought to write into the regs and what the consequences of those abuses should be for the investors," Novey told Seegull. "We need some help."

**Bisnow**

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