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Latest Opportunity Zones Guidelines Offer More Clarity For Business Investments.

“This reg removes a lot of the most obvious impediments that have kept capital on the sidelines,” says one expert.

A new round of proposed Opportunity Zones regulations the U.S. Treasury Department rolled out Wednesday could help get more capital flowing to low-income areas under the program, particularly to start-up companies and other non-real estate business ventures.

The economic development initiative has been in a lengthy ramp-up phase since it was created as part of the 2017 federal tax overhaul. Treasury released an initial set of draft rules last fall that were seen as a big step forward, but left significant issues unaddressed.

“There’s sort of been this promise of Opportunity Zone capital, which a lot of places haven’t seen yet and I think far more places are going to see it now,” said Steve Glickman, founder and CEO of Develop LLC, an advisory firm for opportunity funds.

“Really up until this point you saw Opportunity Zone capital, because of the amount of regulatory uncertainty, going into deals that would have happened anyhow,” he added.

The Trump administration on Wednesday held an event in Washington, D.C. focused on the program, which state, local and tribal leaders attended. “Our goal is to rebuild homes, schools, businesses, and communities that need it the most,” President Trump said.

“We want to see loving homes, safe neighborhoods, and a gleaming Main Street,” he added during his remarks.

Mayor George Flaggs, Jr., of Vicksburg, Mississippi, said at the event that “as a mayor of a city and former legislator for 25 years, I’ve never seen any piece of legislation that allows more collaboration between federal, state, and local government.”

Opportunity Zones offer people and companies substantial tax breaks on capital gains they funnel into “qualified opportunity funds.” The funds are then supposed to invest the money into economically distressed census tracts that have been designated as zones.

The program is designed to reward those who keep their money in the zones longer, with tiered tax breaks unlocked at the five, seven and 10 year marks.

Some people tracking the initiative have raised concerns that it could mainly lead to money getting pumped into relatively safe real estate investments, while providing a pathway for wealthy investors to get off the hook for federal capital gains tax obligations.

That’s not the outcome that many state and local leaders would like to see. For them and others, a key part of the program’s success will be ensuring that capital also flows to “operating businesses” that will help generate new jobs and local wealth.

John Lettieri, president and CEO of the Economic Innovation Group, a think-tank that has played a role in shaping the program, said the latest regulations are positive step on this front.

"This reg removes a lot of the most obvious impediments that have kept capital on the sidelines to date, particularly on the operating business side," he said. "I think it's going to free up a lot of capital."

A detailed summary of the regulations published by Michael Novogradac, managing partner of Novogradac, a firm that provides accounting and consulting services, echoes that view. It says one of the biggest takeaways is that the guidance "addresses gating issues" that were limiting investment in operating businesses.

"The second tranche of guidance provides answers to many questions and includes information that will help guide investors, fund managers and others," Novogradac adds.

Glickman and Lettieri described broadly some of the ways the 169-page draft regulations promise to lay new groundwork for business investment in the zones.

For one, the rules provide additional flexibility and clarity about the timeframe for funds to make investments and how they can go about reinvesting gains generated from within the zones.

Glickman explained that one of the reasons the reinvestment guidelines are important is that, compared to a real estate deal, investors tend to have less control over the timing of when they will exit out of an investment in an operating business.

For example, they may have limited sway over the business' decisions, or when a company goes public or gets acquired.

Treasury has set requirements for how much of a fund's assets must be invested in zones. The new guidance makes clear that the proceeds from the sale of an Opportunity Zone investment would not run afoul of this requirement so long as the money is reinvested within a year.

Likewise, investors would be shielded from losing their capital gains tax breaks under these circumstances.

"That allows investors and funds to deal with reality that there may be exits from their business investments before 10 years that won't blow up the tax incentive," Glickman said.

Another concern with the initial set of rules had to do with a mandate that at least 50 percent of the gross income of a business that is eligible for investment must come from commercial activity in a zone.

Treasury in its latest guidance provides several "safe harbor" options to comply with this guideline.

For instance, one of these safe harbors allows a business to qualify if at least half of the work performed by its employees, based on hours, occurs in a zone—even if it's selling goods or services outside the area.

Lettieri also flagged a part of the regulations that deals with buildings that have been vacant for at least five years, and said it should create more of a "glide path" for redeveloping this type of property.

Other notable parts of the draft guidance have to do with how opportunity funds would be wound down as they near their end, and how a 31-month time window for recipients of capital to put the funds to use would apply to operating businesses.

Glickman predicted that by the end of June far more money will have flowed into the Opportunity Zones marketplace.

“I think you’ll start seeing the changes on the ground,” he said. “More capital going to more places, across a bigger set of assets. And this really starts to be the true test of the market.”

Route Fifty

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