



Attracting Investment & Growing your Business through Opportunity Zones

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How we got here - *Investing in the Opportunity Act*



Unlikely pair = Senator **Tim Scott** (R-SC) + Billionaire **Sean Parker** (co-founder of *Facebook*)

US Senate asked billionaires to invest in government programs for distressed communities.

Billionaires said “no, but we’ll invest directly.”

Result = 2017 Tax Cuts & Jobs Act allows direct investment of ***\$6.1 trillion*** in gains (paper profits).

Governors had one chance to select ***up to 25%*** of low-income areas in their State (8,700+ in U.S.)

Opportunity Zones (**OZ**): What they **are** vs. **are not**

ARE

1. \$6.1 trillion potential = ~\$696 million per OZ
2. Intended to create permanent jobs
3. Intended to keep profits in Zone = sustainability
4. Regulated by feds = U.S. Treasury & HUD
5. Great for social impact investors = 7-20 year exit

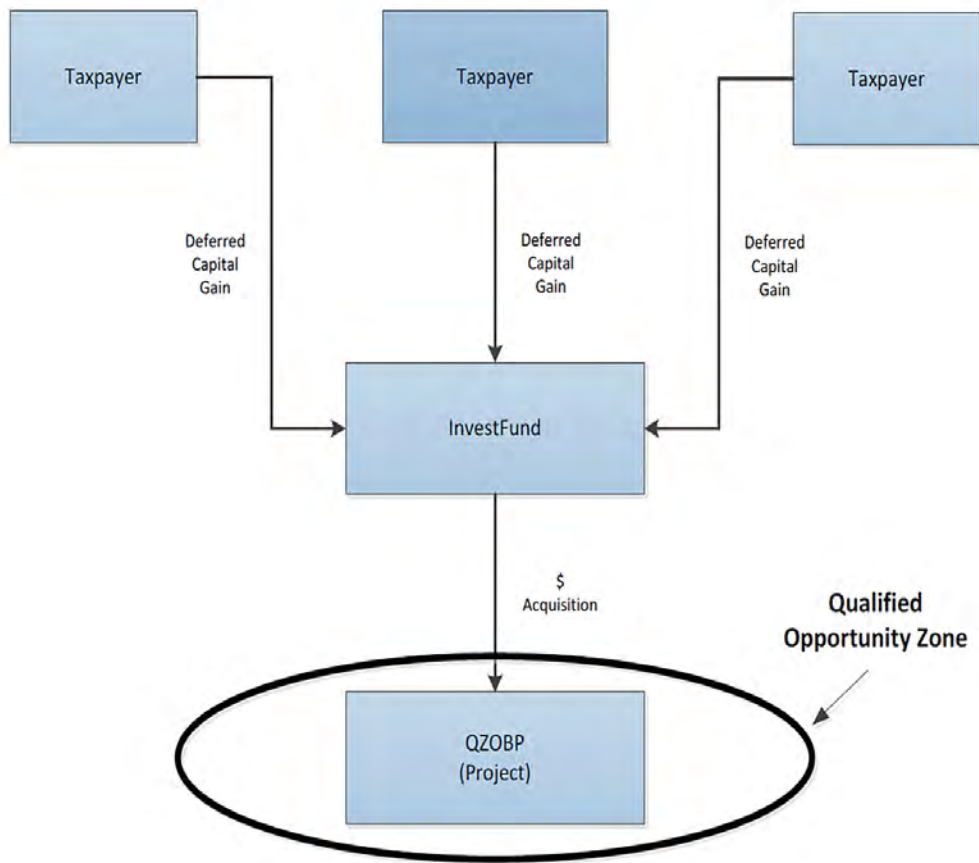
NOT

1. Entitlement programs = **\$0 from gov't**
2. Intended for **residential** (market rate) **housing**
3. Intended to **export rental \$\$** out of OZ
4. Regulated by **States** (can't be changed)
5. For real estate investors = **no quick profits**

Qualified Opportunity Zone Funds (QOF)

(QOZ = \emptyset , without a “special purpose fund”)

Special Purpose Fund = not “traditional” venture capital fund; meets specific US Dept. of Treasury criteria to track taxes, investments, debt, transfers, and ideally, tax credits.



1. QOF = privately managed investment fund.
2. 90%+ of assets in QOZ property:
 - a. QOZ stock (original bought w/cash)
 - b. QOZ partnership interest (same)
 - c. QOZ business property (tangible property bought after 12/31/17)
3. Invest any capital gains from 2017-26 within 180 days of original asset sale.

Why Invest through a QOF?

Investors receive five (5) key benefits on *unrealized* capital gains reinvested:

1. Roll over existing capital gains with **\$0** up-front tax bill.
2. Defer original tax until 12/31/26, or until QOF investment is sold.
3. Tax basis is stepped-up (increased) by 10% at 5 years
4. Tax basis is stepped-up (increased) by additional 5% (15% total) at 7 years
5. **\$0** capital gains **after 10 years** = permanent exclusion of tax (Yeah!)

Why did Lincoln establish a Fund *before* any city in the U.S.?

1. Generates revenue for town
2. Prioritizes regional projects & permitting
3. Produces 200+% returns on investment
4. Can support neighboring towns
5. Protects the vulnerable from scam artists
6. ACM2 supports with NMTC/CRA - priority
7. EMDC supports regional CEDS integration
8. OZF provides workforce development partners
9. OZF provides SBA business incubator
10. OZF provides \$ for Housing & Broadband

ACM vs. Other OZ Funds

Acadia Capital Management Funds

Other OZ Funds

- | | |
|--|---|
| 1. Priority = Permanent job creation = offsets poverty | 1. Priority = Mixed-use housing = rich > richer |
| 2. Federal Partners = SBA + HUD + EDA | 2. Federal Partners = None |
| 3. Bank Partners = People's United Bank + The First | 3. Bank Partners = None |
| 4. Bonus Incentives = New Markets Tax Credits (39% ROI) | 4. Bonus Incentives = None |
| 5. Entrepreneurial Support = Regional Business Incubator | 5. Entrepreneurial Support = None |
| 6. K-12/Workforce Support = Apple & Husson are partners | 6. K-12/Workforce Support = None |
| 7. Municipal Funding = Yes, credit line from Fund | 7. Municipal Funding = None |
| 8. Collateral Services = Energy partners & Project management | 8. Collateral Services = None |
| 9. Multiple Project Sourcing = Yes, ACM has pipeline of 60+ projects | 9. Multiple Project Sourcing = No |
| 10. Liability Protection = Yes, ACM indemnifies municipality 100% | 10. Liability Protection = No |

Why Acadia Capital Management's Model Works

1. Direct access to New Markets Tax Credits - <https://www.mainebiz.biz/article/brien-walton-named-ceo-of-acadia-capital-management-cde-consortium>
2. Only OZ Fund manager with HUD & SBA validation - <https://twitter.com/EMDCMaine/status/1152329198016630784>
3. Manages the most U.S. OZ Funds - <https://www.mainebiz.biz/article/lincoln-calais-baileyville-jumping-on-opportunity-zones-to-ignite-development>
4. National expert on OZ strategy & structure - <https://www.mainebiz.biz/article/navigate-the-new-rules-for-opportunity-zones>
5. Proven ability to attract investment & jobs - <https://www.mainebiz.biz/article/clt-firm-lignaterra-will-anchor-lincoln-forest-innovation-park>

For more detailed guidance from a peer-reviewed business law journal on the OZ program and how to maximize their potential, please see - [Walton, B. C. \(2019\). Federal Opportunity Zone Rules Remain Unclear for Municipal Governments: Where Do We Go from Here? Business Law Review \(15337421\), 52, 43.](#)



Questions?

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2010 Census Tract Number	Town	County Name
23001010500	Auburn	Androscoggin
23001020300	Lewiston	Androscoggin
23003951000	Washburn	Aroostook
23003951600	Limestone	Aroostook
23003950300	Madawaska	Aroostook
23003950100	Caswell, Stockholm, Connor	Aroostook
23005000300	Portland (Port area)	Cumberland
23005002800	Westbrook	Cumberland
23005003000	S. Portland	Cumberland
23005011100	Brunswick	Cumberland
23009965503	Ellsworth	Hancock
23011010300	Augusta	Kennebec
23011024102	Waterville	Kennebec
23017965500	Rumford	Oxford
23017965600	Rumford	Oxford
23017966200	Paris	Oxford
23019000300	Bangor	Penobscot
23019004100	Brewer	Penobscot
23019007100	Old Town	Penobscot
23019027000	Lincoln	Penobscot
23019028000	Enfield	Penobscot
23019030000	Millinocket	Penobscot
23019031000	E. Millinocket	Penobscot
23021960301	Greenville	Piscataquis
23023970600	Bath	Sagadahoc
23025965900	Hartland	Somerset
23025966500	Madison	Somerset
23027043000	Belfast	Waldo
23029955500	Calais	Washington
23031005200	Saco	York
23029955400	Baileyville, Whiting, Dennysville,	Washington
23029955900	Pembroke, Baring, Meddybumps	Washington

Basics of the Opportunity Zone (QOZ) Fund Program

1. WHAT ARE OPPORTUNITY ZONES (QOZ)?

Under §1400Z of the Internal Revenue Code (IRC), an Opportunity Zone (QOZ) is a [census tract](#) that has been designated as eligible to receive private investments through an Opportunity Zone Fund (QOF).

2. WHAT ARE OPPORTUNITY ZONE FUNDS (QOF)?

Under IRC §1400Z-2(d), a QOF is a privately managed investment vehicle organized as a corporation or a partnership to help direct resources to low-income communities, and the vehicle must hold at least 90% of its assets in QOZ property (please see description under #4 below). Typical examples of a QOF include:

- \$100 MM national private equity fund providing growth capital to mid-market businesses in QOZ.
- \$50 MM disaster fund that develops/leases new affordable housing for those displaced by disasters.
- \$20 MM local fund providing equity for a \$100 MM conversion of a shopping mall into a mixed-use development that includes new retail stores and workforce housing.

3. WHY INVEST IN A QOF?

Through QOZ, investors can receive five (5) key tax benefits on capital gains reinvested in QOFs:

- i. Can [roll over](#) existing capital gains into QOFs, with zero (\$0) up-front tax bill.
- ii. Can [temporarily defer](#) their original tax bill until 12/31/26, or until the QOF investment is sold.
- iii. Can receive [step-up in basis](#) for capital gains reinvested in QOF. Specifically, the basis is increased by 10% if QOF investment is held for at least 5 years. This means the investor will only owe taxes on 90% of the rolled-over capital gains, and by an additional 5% (15% total) if held for at least 7 years.
- iv. Can receive a [permanent exclusion](#) from taxable income of capital gains from the sale or exchange of QOF investment (including gains from the QOF), *if* the investment is held for at least 10 years.
- v. There is [no cap](#) on how much can be invested in QOFs, and you owe \$0 capital gains after 10 years.

4. HOW DO QOZ WORK?

QOFs invest in corporations, partnerships, and tangible property that substantially improve a business.

The example below shows how an investor's available after-tax funds compare under different scenarios, assuming various holding periods, annual investment appreciation of 7%, and a long-term capital gains tax rate of 23.8% percent (federal capital gains tax of 20% and net investment income tax of 3.8%).

The table below also provides additional information on the tax liabilities and differences in after-tax annual rates of return. As is clear, the incentives built into the QOZ program are designed to reward long-term investments in distressed communities the most by ensuring job creating-businesses stay in the community.

Example: A Capital Gain of \$1,000,000 is Reinvested in 2018 and held for 10 years

Holding Period	Appreciation Rate	Investment in a Stock Portfolio		Investment in a QOF		Difference in After-Tax Annual Rate of Return
		Total Tax Liability	After-Tax Funds Available	Total Tax Liability	After-tax Funds Available	
5 years	7%	\$310,000	\$1,000,000	\$310,000	\$1,090,000	1.9%
7 years	7%	\$350,000	\$1,110,000	\$350,000	\$1,260,000	1.8%
10 years	7%	\$410,000	\$1,320,000	\$200,000	\$1,760,000	3.0%

Jane has \$1,000,000 of unrealized capital gains in her stock portfolio. She decides in 2018 to reinvest those gains into a QOF that invests in distressed areas of her home state, and she holds that investment for 10 years. Jane is able to defer the tax she owes on her original \$1,000,000 of capital gains until 2026. Further, the basis is increased by 15% (effectively reducing her \$1,000,000 of taxable capital gains to \$850,000). Thus, she will owe \$200,000 (23.8% of \$850,000) of tax on her original capital gains when the bill finally comes due. In addition, since she holds her QOF investment for at least 10 years, she owes no capital gains tax on its appreciation. Assuming that her QOF investment grows 7% annually, the after-tax value of her original \$1,000,000 investment in 2028 is \$1,760,000. Jane has enjoyed a 5.8% effective annual return, compared to the 2.8% an equivalent non-QOF investment would have delivered.

- Total tax bill in 2028: \$200,000
- After-tax value of investment in 2028: \$1,760,000
- Effective after-tax annual return on \$1,000,00 capital gain in 2018: 5.8%

After ten years, net of taxes, the total return on the stock portfolio would be 32 percent. Meanwhile, the net, after-tax return on the QOF investment would be 73 percent. **On an after-tax basis, QOF could mean two times (2x) higher return on investments vs. a traditional stock portfolio.**

5. WHERE CAN PEOPLE INVEST IN QOZ?

There are more than 8,700 QOZ in the U.S. and \$6.1 trillion in unrealized capital gains, which means each QOZ could receive **\$700 million** if distributed proportionately. Maine has 32 Zones, and cities that establish their own Fund, present less risk to investors and an easier process for developers, which gives ACM partners a clear financial advantage.

6. WHEN CAN PEOPLE START INVESTING IN QOZ?

Authorized by the "Tax Cuts and Jobs Act," passed by Congress in the final days of 2017, the QOZ program has the specific goal of promoting investment of the estimated \$6.1 trillion in unrealized gains held privately in the U.S. into the development of low-income communities across the country, in exchange for federal tax advantages only available through the QOZ legislation. Investors with \$1+ million can contact Dr. Walton at brien@ac8ia.com for information on subscribing to an existing QOF, or ACM can register a new, private QOF for you. Once the QOF is registered (*takes 3-4 weeks and costs ~\$50,000, depending upon complexity*), investors can sell their capital assets, e.g., stocks, mutual funds, etc., at their convenience. Once the capital asset is sold, however, investors have 180 days to roll the capital gain into a QOF.

7. WHO HELPS INVESTORS PARTICIPATE IN QOFS?

Acadia Capital Management II, Inc. (18NMC201357) is a "community development entity" or "CDE" affiliated with Eastern Maine Development Corporation (EMDC), which is a certified Community Development Financial Institution (CDFI), Economic Development District, MicroEnterprise Development Organization, and a certified SBA Lender, that operates Maine's \$1.1 billion Procurement Technical Assistance Centers and is ranked #1 in Maine and #12 in the U.S. for SBA 7a programs. The CDE only provides federal NMTC. Acadia Capital Management LLC is separate from the CDE, but is the CDE's exclusive partner, providing all aspects of support for OZ Fund creation and management.

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FEDERAL OPPORTUNITY ZONE RULES REMAIN UNCLEAR FOR MUNICIPAL GOVERNMENTS: WHERE DO WE GO FROM HERE?

by Brien C. Walton, J.D., LL.M., A.L.M., MS.Ed., Ed.D.*

I. INTRODUCTION

If someone asked you “who could better invest in the most economically distressed communities in your state – a resident billionaire or the federal government?” who would you choose? This is similar to the question, and challenge, that was presented to political leaders on Capitol Hill in early 2016, by Silicon Valley billionaires, who believed their business acumen and ties to local and regional communities gave them unique insights as to the best ways to grow businesses in their communities.¹ In April 2016, with bipartisan support at the end of the Obama administration, Senators Tim Scott (R-South Carolina) and Cory Booker (D-New Jersey) introduced a bill on the Senate floor while Congressmen Pat Tiberi (R-Ohio) and Ron Kind (D-Wisconsin) introduced the bill in the House, that became the “Tax Cuts and Jobs Act” and promised to pump a massive amount of cash into America’s most impoverished communities by offering wealthy investors and corporations a chance to erase their tax obligations.² The rationale behind the law is persuasive – there is an

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¹ Steven Bertoni, *An Unlikely Group of Billionaires and Politicians Has Created the Most Unbelievable Tax Break Ever*, Forbes, July 17, 2018, www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/.

² *Id.*

astounding \$6.1 trillion in paper profits (capital gains) currently held by taxpayers that, theoretically, could be directly invested into revitalizing economically distressed communities throughout the United States, called “Qualified Opportunity Zones,” hereinafter “Opportunity Zones.”³

On December 22, 2017, the *Tax Cuts and Jobs Act* created a new section of the Internal Revenue Code (26 U.S. Code § 1400Z) that provides tax incentives for investments in targeted areas in the United States through investment vehicles called “Qualified Opportunity Zone Funds,” hereinafter “Opportunity Zone Funds.”⁴ The purpose of an Opportunity Zone Fund is to promote economic development in Opportunity Zones by offering investors substantial federal tax advantages that are only available through the new program. There are currently more than 8,700 such Opportunity Zones throughout the United States, which means that each Opportunity Zone, assuming a proportionate distribution across all Opportunity Zones, could receive at least \$701 million in capital to support scalable businesses and expedite economic growth.⁵ The key to the success of this plan for revitalizing communities is recognizing the power of “capital assets” that are generally defined under §1221(a) of the Internal Revenue Code (“IRC”), as property held by the taxpayer (whether or not connected with his trade or business) for 12 months or more.⁶

Specifically, the goal is to encourage wealthy individuals and entities that have held appreciated assets for 12 months or more, to sell that asset. Prior to this new law, upon the sale of a capital asset, taxpayers were required to immediately send 20% of the net proceeds (capital gain⁷) to the Internal Revenue Service (“IRS”) as a tax. Today, however, these Opportunity Zones allow the taxpayer to directly invest that 20% of net proceeds into economically-distressed communities. Essentially, the U.S. Senate recognized that navigating a bureaucratic infrastructure may not be the best way to support low-income communities, so they removed the “middleman.” This has created an incentive for those with the capital to decide exactly where that capital goes and for what purpose - as long as the “where” is a federally-recognized low-income census tract and the “purpose” is to help

³ *Id.*

⁴ 26 U.S. Code § 1400Z-1 - Designation. (Westlaw through P.L. 115- 97).

⁵ 26 U.S. Code § 1400Z-1 - Designation. (Westlaw through P.L. 115- 97). A complete list of designated qualified opportunity zones is found in Notice 2018-48, 2018-28 I.R.B. 9.

⁶ 26 U.S. Code § 1221 - Capital asset defined. (Westlaw through P.L. 115- 97).

⁷ 26 U.S. Code § 1222 - Other terms relating to capital gains and losses. (Westlaw through P.L. 115- 97).

stimulate economic growth in that community. Unfortunately, the law was enacted with guidance only on how the Opportunity Zones would be chosen in the respective states, but little to no guidance on what qualifies as “tangible business property,” the structural requirements in forming Opportunity Zone Funds, or how taxpayers can ensure their investments and development projects supported by the Opportunity Zone Fund will meet regulatory compliance standards, such as monitoring and tracking protocols that can be more art than science.

This article explains the key provisions under the Opportunity Zones’ statute, reviews the key ways to maximize Opportunity Zone benefits in use throughout the nation, and explores an innovative approach that enables the creation of Mega-Opportunity Zone Funds to leverage multiple investors and multiple developers under single fund, which has the potential to transform economic development and business resiliency in disaster-stricken and severely distressed communities.

II. THE NEW STATUTE: 26 U.S. CODE § 1400Z

Under §1400Z-1(a) of the Internal Revenue Code (IRC), an Opportunity Zone is simply a population census tract that is a low-income community designated as a “qualified opportunity zone.”⁸ From that simple definition, however, the low-income communities so designated have incredible leverage that enables them to receive private investments through an Opportunity Zone Fund. Under the original drafting of the statute, an Opportunity Zone Fund was generally defined under IRC §1400Z-2(d)(1) as *any* investment vehicle organized as a corporation or partnership for the purpose of investing and holding at least 90% of its assets in qualified opportunity zone property (e.g., capital assets held for 12 months or more by the taxpayer).⁹

IRC §1400Z-2(d)(2) further distinguishes qualified opportunity zone property as consisting of either stock, partnership interests, or tangible property used in a trade or business.¹⁰ It may be readily apparent to business-minded taxpayers what corporate stock or partnership interests are, which generally reflect any documents that represent a taxpayer’s ownership interest in a business entity engaged in activities designed to earn a profit. It is much less apparent, however, what constitutes “tangible business property” for the purposes of Op-

⁸ 26 U.S. Code § 1400Z-1 - Designation. (Westlaw through P.L. 115- 97).

⁹ 26 U.S. Code § 1400Z-2 - Special rules for capital gains invested in opportunity zones. (Westlaw through P.L. 115- 97).

¹⁰ 26 U.S. Code § 1400Z-2 - Special rules for capital gains invested in opportunity zones. (Westlaw through P.L. 115- 97).

portunity Zone investment, e.g., does residential real estate qualify, or does commercial real estate, or a startup business, or an existing business, etc.? The distinction of what constitutes business property is critically important because investors are required to leave their capital in the Fund for at least five years in order to receive minimal benefits of tax deferral - at least 10 years for the full benefit of 100% elimination of capital gains tax.

Typical Examples of an Opportunity Zone Fund

Under IRC §1400Z-2(d), an Opportunity Zone Fund is a privately managed investment vehicle organized to help direct resources to low-income communities, and Opportunity Zone Funds invest in U.S. company stock and partnership interests; and tangible property used to substantially improve business operations. The incentives built into the Opportunity Zone program appear to be specifically designed to reward long-term investments in distressed communities, and on an after-tax basis could mean a two times (2x) higher return on investments vs. a traditional stock portfolio because the investor is able to use the 20% of “found money” to not only invest initially, but any appreciation in asset value can also be deferred.

For example, if Ms. Taxpayer, sells her real estate investment in California for a \$1 million profit and the investment was held for more than one year, then the capital gains tax at 20% would be \$200,000. Ms. Taxpayer, instead of sending the \$200,000 to the Internal Revenue Service, can then invest that \$200,000 into a promising startup manufacturer in a New England Opportunity Zone. Ms. Taxpayer is already ahead because she has full use of an additional \$200,000 that was not available otherwise, but if that \$200,000 investment grows to \$2 million during the 10-year holding period in the Opportunity Zone Fund, then upon sale of the \$2 million asset in Year 11, there is still zero tax due to the Internal Revenue Service. Instead of paying \$200,000, Ms. Taxpayer earns \$2 million, which is a powerful incentive.

Typical examples of an Opportunity Zone Fund include:

- \$100 MM national private equity fund providing capital to growth-stage manufacturing companies.
- \$50 MM regional, disaster relief fund that develops and leases new, affordable housing for people displaced by the 2018 natural disasters.
- \$20 MM local fund providing equity for a \$100 MM conversion of a shopping mall into a mixed-use development that includes new retail stores and workforce housing.

Opportunity Zone Benefits for Investors

Through Opportunity Zones, investors receive five (5) key tax benefits on unrealized capital gains reinvested in Opportunity Zone Funds. Under IRC §1400Z-2(b)(2)(B), which details the determination of the basis for taxpayers that invest in an Opportunity Zone Fund, the following benefits are illustrated:

- Investors can roll over existing capital gains into Opportunity Zone Funds, with \$0 up-front tax bill.¹¹
- Investors can temporarily defer their original tax bill until ten (10) years after initial investment into the Fund, or when the Opportunity Zone Fund investment is sold.¹²
- A step-up in basis for capital gains reinvested in an Opportunity Zone Fund. Specifically, the basis is increased by 10% if the Opportunity Zone Fund investment is held by the taxpayer for at least five (5) years. This means the investor will only owe taxes on 90% of the rolled-over capital gains, and by an additional 5% (15% total) if held for at least seven (7) years.¹³
- A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Zone Fund, if the investment is held for at least 10 years. In other words, capital gains = \$0 after 10 years.¹⁴
- There is no upper limit on how much can be invested in Opportunity Zone Funds, but at least 90% Opportunity Zone Fund assets must be invested in Opportunity Zones.¹⁵

These benefits are unique to this program and will likely evolve as legislators review feedback from municipalities, investors, and developers, but being able to save 20% as a foundational principle makes this program a viable incentive for any project that requires equity because it can be obtained relatively inexpensively compared to other equity sources. For example, if an investor must divert cash from their savings to make an investment, the opportunity cost (or risk of loss) will be higher than if the same investor can use cash that they would normally not think twice about missing - the capital gains tax. For lenders and investors concerned with risk mitigation, this program will facilitate those objectives.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

III. THE RULES HAVE SLOWLY EVOLVED: TWO ROUNDS OF GUIDANCE

Round 1: October 19, 2018

Subsequent to the enactment of the *Tax Cuts and Jobs Act* on December 22, 2017, there have been two rounds of additional guidance provided that attempted to clarify and expand upon the original rules regarding the deferral of capital gains associated with investments in Opportunity Zones. On October 19, 2018, the U.S. Treasury Department (hereinafter, “Treasury”) published Revenue Ruling 2018-29,¹⁶ (hereinafter, “Revenue Ruling”) and issued Proposed Regulations § 1.1400Z-2 (2018) under IRC § 1400Z-2.¹⁷

The proposed regulations clarified a key distinction in the type of gains that can be deferred under the program, which is exclusively capital gains and not ordinary gains.¹⁸ The proposed regulations also significantly expanded the number of eligible properties that can be invested in by taxpayers by excluding the value of land from a property’s adjusted basis for the purpose of meeting the “30% Substantial Improvement” test,¹⁹ a provision that essentially requires an investment in Opportunity Zone property to add at least 30% to the original value of the Opportunity Zone property, after acquisition or investment. The proposed regulations also provided guidance on the timing of investments into an Opportunity Zone Fund after the sale of an original capital asset (e.g., taxpayers have six months from the sale of a capital asset to place the proceeds into an Opportunity Zone Fund), and rules for self-certification of an Opportunity Zone Fund.²⁰ The “self-certification” of an Opportunity Zone Fund is what has created much of the concern and confusion amongst legal and tax professionals, and has slowed adoption of the program.

Because the context in the proposed regulations is “self-certification,” without any guidance aside from stating that taxpayers will need to make deferral elections on Form 8949, which is to be submitted with the taxpayer’s federal income tax returns for the taxable year in which the gain would have been recognized, if it had not been deferred,²¹ the result has been confusion on many important issues required to encourage investment. For example, there was no guidance as to the type of fund structure, e.g., what fund structure is

¹⁶ Rev. Rul. 2018-29, 2018-45 I.R.B. 765.

¹⁷ Prop. Treas. Reg. 1.1400Z-2 (2018).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

most appropriate (corporation vs. limited partnership vs. limited liability company), does the Opportunity Zone Fund have track each investor separately or can they grouped under a single filing, or even *how* the Opportunity Zone Fund should track investors and other participants in the capital stock of a project, e.g., appropriate methods of monitoring and tracking of investment impact and job growth. When you consider that much of the publicity around Opportunity Zones have been focused at real estate developers, without distinguishing between residential versus commercial development, the potential problem becomes clear.

Specifically, if a residential real estate developer believes they are helping a community by building apartments and condos, creates an Opportunity Zone Fund to support the development, but the final rules stipulate that because the mission of the program is to ensure investment capital circulates *within* a low-income community for at least five years, then unless the residential real estate developer lives in that low-income community, the investment is being exported out of the Opportunity Zone to the developer's own community, which likely is in contravention of the program's mission. Similarly, if a commercial developer builds retail space, it is unclear whether they also must invest in the business that occupies the commercial space to receive the benefit, because simply building a structure does not generate and circulate investment throughout the community if the building remains vacant, etc. To further exacerbate the problem – there is still the outstanding issue of what happens when there is an investor for the construction of the building that is different from the investor in the business that will occupy the building, e.g., do both, mutually exclusive investors receive the tax deferral benefits or does one...and which one?

Although the guidance was helpful in clarifying some issues, additional issues resulted that have further stymied adoption of the program for taxpayers without extensive experience in both venture capital and real estate taxation, which makes the Opportunity Zone regulations some of the most complex in the economic development industry. To address the complexity, however, Treasury issued Proposed Regulations § 1.1400Z-2 (2019) under IRC § 1400Z-2,²² that presented additional guidance while repealing and clarifying portions of the “2018 Proposed Regulations.”

²² Prop. Treas. Reg. 1.1400Z-2 (NPRM, 2019).

Round 2: April 17, 2019

The second round of Opportunity Zone rules issued on April 17, 2019, by the U.S. Treasury Department does make the tax incentive program aimed at increasing development in underserved areas more accessible for investors and communities that want to set up Opportunity Zone Funds, but there are still critical gaps that have caused some economic development projects to stop altogether, until further guidance is released. Proposed Regulations § 1.1400Z-2 (2019) is a two-part document and many real estate professionals have focused solely on the 169-page, core document entitled, “Investing in Qualified Opportunity Funds,” which is a “Notice of Proposed Rulemaking” (hereinafter, “NPRM”). This is an important distinction because, under Treasury’s Internal Revenue Manual, an NPRM simply announces to the public that Treasury is considering modifying published regulations or is issuing rules on matters not addressed in the existing regulations.²³

The second part of the document release, however, was a “Notice and Request for Information” (hereinafter, “RIF”) that seeks public input regarding exactly what type of public information is required to track investments in an Opportunity Zone Fund, and exactly how that monitoring and tracking process should be implemented and regulated. Specifically, the RIF is entitled “Request for Information on Data Collection and Tracking for Qualified Opportunity Zones,” and it is this document that has legal and tax professionals scrambling to restructure existing Opportunity Zone Funds to ensure taxpayers avoid the wrath of the Internal Revenue Service.²⁴

“Notice of Proposed Rulemaking” (NPRM):

Proposed revisions in the 169-page NPRM are numerous and have relative importance that will vary greatly, depending upon the specific needs and objectives of the taxpayer, so for the purposes of this article, the broad categories are addressed and a few key provisions are highlighted that provide critical clarity for an innovative approach to leveraging Opportunity Zone Funds that directly supports city managers, town managers and economic development directors, who rarely have the time, resources, or in-house expertise to proactively create, market, and manage an Opportunity Zone Fund.

Three broad categories of guidance in the NPRM pertain to the classification and treatment of various forms of Real Estate, treatment of Operating Business income, and Opportunity Fund Management.

²³ IRM 32.1.1.2.2 refers to Notice of Proposed Rulemaking.

²⁴ Prop. Treas. Reg. 1.1400Z-2 (RIF, 2019).

Regarding real estate, amongst other details, under § II of the NPRM, application of IRC § 1400Z-2(d)(2)(D)(i) is clarified regarding how Opportunity Zone property is no longer required to be purchased to meet the 70% (substantially all) test to qualify, e.g., the proposed regulations will permit leased properties to also qualify under certain circumstances.²⁵ Regarding business income, amongst other details, under § III(B) of the NPRM, application of IRC § 1397C(b)(2) is clarified regarding how an Opportunity Zone business must have at least 50 percent of its total gross income “from the active conduct of such business,” and provides details on *how* taxpayers can ensure that they meet the requirement.²⁶ Before this clarification, it was unclear whether the 50% was based upon time expended, revenue generated, or the physical location of the resources used in the businesses, etc. There is also guidance on the type and aggregation of assets to qualify for tax deferral.

Two (2) impactful changes for economically-distressed communities under the NPRM, however, that those communities can immediately benefit from, I would note the following:

1. Under § III(A) of the NPRM, the application of IRC § 1397C(b)(2) is clarified under the section entitled, “Real Property Straddling a Qualified Opportunity Zone,” where the Treasury Department and IRS will now permit real property straddling the boundaries of an Opportunity Zone, e.g., 49% outside of the Opportunity Zone, but 51% in the Opportunity Zone, to qualify for the Opportunity Zone's tax deferral benefits.²⁷

This provision should be welcome news to any business whose land is on the census-tract line that defines the Opportunity Zone and it provides a great opportunity for real estate investors. Essentially, owners of those parcels should be able to enjoy an increase in value because businesses no longer have to be 100% within an Opportunity Zone, e.g., 51% is sufficient. A potential strategy for investors and developers might be to partner with a landowner on the Opportunity Zone line to launch your business using the 20% in capital gains saved under the Opportunity Zone rules. In other words, there are very few Opportunity Zones relative to the number of communities that can benefit from them, so this provision enables savvy taxpayers and their financial professionals to look for opportunities that are immediately adjacent to the increasingly valuable Opportunity Zones, to effectually have many more economic development projects qualify that would not have been possible under the original rules. This could mean tens,

²⁵ Prop. Treas. Reg. 1.1400Z-2 (NPRM, 2019).

²⁶ *Id.*

²⁷ *Id.*

or even hundreds of millions of dollars, in additional regional economic impact.

The second provision that town managers and economic development directors should find particularly useful in the NPRM is illustrated in Proposed Regulations §1.1400Z-2(c)(4)(i)(B)(6), which pertains to “Original use of leased tangible property.”²⁸ Several town managers have anecdotally told me would be very beneficial to their communities if they had the ability to demolish or rehabilitate abandoned, dilapidated, or obsolete buildings, that effectively deter growth around them. For example, it would not be too difficult to find a once beautiful historic building on an Opportunity Zone’s Main Street, that has been abandoned for more than five years and is now an eyesore on the verge of collapse due to its state of disrepair. If no taxes on the property have been paid in years, the town might actually own the building after a foreclosure or tax lien default, but economically distressed towns are unlikely to have the resources to rehabilitate every building they had to reclaim from absentee or delinquent owners.

As previously mentioned, the guidance provided on October 19, 2018, left serious gaps in defining exactly what qualified Opportunity Zone business property comprises, and no distinction was drawn between the purchase and ownership of business property in contrast to the leasing of tangible business property. This distinction is important because a significant percentage of land in an economically-distressed community may be owned by absentee owners, which may explain a potential reason for the lack of development, e.g., if the owner lives in a different state, they may not be actively pursuing development in a distant community that might be cost prohibitive, or they may not be closely tied to the community. Similarly, there may be dilapidated commercial properties, owned by private individuals or held by the municipality, that have remained unleased for years or even decades as the community declined, and the owners in possession were unable to identify an incentive to bring the properties up to code. These potentially leasable properties can provide the impetus for growth by creating the “flagship” rehabilitation project.

For purposes of Proposed Regulations §1.1400Z-2(d)(2)(i)(B)(6), “if property has been unused or vacant for an uninterrupted period of at least 5 years, original use in the qualified opportunity zone commences on the date after that period when any person first uses or places the property in service in the qualified opportunity zone [...and used tangible property satisfies the original use requirement if the property

²⁸ *Id.*

has not been previously so used or placed in service in the qualified opportunity zone].”²⁹

A town manager with entire blocks of vacant buildings may want to pursue rehabilitating those vacant buildings to jump-start the local economy, but they struggle to find banks or developers willing to take the chance. Because the Opportunity Zone's primary purpose is to support scalable businesses and keep investment dollars circulating in the community for at least ten years, the Treasury Department has relaxed the rules that govern the holding period of Opportunity Zone investments. Specifically, property that has been unused or vacant for at least 5 years prior to being used in the Opportunity Zone, can now have a “start date” of the first day any person first uses or places the property in service in the Opportunity Zone. As a result, this provision should make it much easier for towns to attract investment in their most devastated neighborhoods, e.g., investors can use capital gains they would not otherwise miss. Next, we will review the notice and request for information that has focused on operational requirements for Opportunity Zone Funds, that were not previously addressed in the original law or the October 2018 guidance.

“Notice and Request for Information” (RIF):

The RIF is only a seven-page document, but two sentences on the first page have resulted in dozens of usually stoic real estate and tax attorneys scrambling for guidance because the original rules did not appear, from their perspective, to so clearly reflect the program’s purpose of encouraging investment in active, scalable businesses (for permanent job creation), as opposed to any type real estate investment, e.g., the building of apartments, condos, commercial office space, etc., which do not usually create permanent jobs and may only indirectly support the creation of jobs for the businesses that may occupy their buildings. Specifically, the RIF states “Sections 1400Z-1 and 1400Z-2 seek to encourage economic growth and investment in designated distressed communities (qualified opportunity zones) by providing Federal income tax benefits to taxpayers who invest in businesses located within these zones through a QOF. The purpose of information collection and tracking is to measure the effectiveness of the policy in achieving its stated goals, and ensure that this investment opportunity remains an attractive option for investors to use.”³⁰

There are several issues covered in the RIF, but the key item fueling uncertainty pertains to the question presented in the document that

²⁹ *Id.*

³⁰ Prop. Treas. Reg. 1.1400Z-2 (RIF, 2019).

asks, "What data would be useful for tracking the effectiveness of providing tax incentives for investment in qualified opportunity zones to bring economic development and job creation to distressed communities?"³¹ The expectation of Treasury is that they will receive input regarding:

1. Measures that would signal improved economic development in local target markets as well as spillover to neighboring areas;
2. Measures of job creation specific to the distressed community;
3. Who would collect the data;
4. Frequency of data to be collected; and
5. Sources from which to collect data.³²

The second item in the list – tracking job creation specific to the distressed community – is where real estate developers should be concerned if they are only constructing a building (e.g., temporary jobs), but not investing directly into an actual business that can create permanent, full-time jobs that can sustain a community into the next generation. The mission of the Opportunity Zone program appears to be the creation of permit full-time jobs to raise the standard of living in economically distressed communities, so that ideally, in 10 years when the next batch of zones is identified, current Opportunity Zones will no longer qualify because of sustained economic growth. Since the rules were first announced, there has been rampant “groupthink” that has led many reporters, legal, financial, and real estate professionals, to not carefully read IRC §1400 to understand how the related provisions emphasize the intent of Congress to keep cash generated in Opportunity Zones circulating in that community for several years, instead of exporting the cash out of the community to a developer’s non-Opportunity Zone community.³³ For attorneys and financial professionals with regional economic growth as a primary goal, there are opportunities, some direct and some indirect, in the Opportunity Zone guidance that can greatly support all investors and developers in a distressed community, with a Treasury-compliant Fund that provides a cost-effective pathway to economic growth that can be safely launched today, under the existing rules, without the need to delay months or years for the final rules.

³¹ *Id.*

³² *Id.*

³³ *Id.*

IV. WHERE DO WE GO FROM HERE?

The Birth of “Mega” Opportunity Zone Funds

To their credit, the U.S. Treasury Department has sought strategic advice from a few corporate real estate tax attorneys with venture-capital experience, who have been working very closely with the Treasury Department since the Opportunity Zone rules were first announced, and have continued to work with other federal agencies, such as the U.S. Small Business Administration, U.S. Department of Agriculture’s Rural Development division, and U.S. Department of Homeland Security’s Federal Emergency Management Agency, with a “mandate” to proactively identify, create, and validate, innovate ways to maximize Opportunity Zone Fund benefits and directly support town managers and economic development directors in the most severely distressed communities, and economic development professionals have been actively supporting those federal initiatives for the past year throughout New England, and in disaster areas in the Midwest and on the West Coast.³⁴

The State of Maine, however, is unique among the 50 states, and not just because it is the only state in the U.S. whose name has one syllable. As of the Summer of 2019, Maine is the only state in the U.S., where forward-thinking, business-friendly towns have taken the initiative to create their own Opportunity Zone Funds to attract investors to the *entire* town – not just a single project. Maine has three such funds, in Lincoln, Calais, and Baileyville, and their respective economic development directors were some of the few that were almost giddy over the new Opportunity Zone rules released on April 17, 2019.³⁵

The proposed rules comprise 169-pages full of acronyms and legalese that could easily overwhelm public administrators without legal training or experience in complex structured finance, but the impact of the guidance in those pages is something any conscientious public administrator should find exciting. Specifically, the April 17, rules allow an Opportunity Zone Fund to invest in multiple businesses or development projects, provided the Fund has established “appropriate” monitoring and tracking protocols, as determined by the IRS. A potential strategy for a town manager or economic development director is to take the initiative to create their own Opportunity Zone

³⁴ Brien Walton, *Navigate the new rules for Opportunity Zones*, Mainebiz, May 13, 2019, www.mainebiz.biz/article/navigate-the-new-rules-for-opportunity-zones.

³⁵ Maureen Milliken, *Lincoln, Calais, Baileyville Jumping on Opportunity Zones to Ignite Development*, Mainebiz, May 22, 2019, www.mainebiz.biz/article/lincoln-calais-baileyville-jumping-on-opportunity-zones-to-ignite-development.

Fund to support the entire community, not just a single parcel, e.g., multiple projects aggregated under one Fund has substantial economies of scale. To date, three towns in Maine correctly predicted how the rules would evolve, so it is reasonable to expect other Opportunity Zones to soon maximize this innovative approach as well.³⁶

It is also important to note that the Opportunity Zone program is governed, in part, by the Treasury Department's Community Development Financial Institution Fund (CDFI Fund), which has established appropriate tracking protocols routinely used by Community Development Entities (CDEs) in the federal New Markets Tax Credit program.³⁷ This means that financial professionals experienced with the CDFI Fund may have more insights into the Opportunity Zone program than most professionals, but because the rules are constantly evolving, reliance upon the way the CDFI Fund may have operated in the past is no guarantee of how the new, Opportunity Zone program will be managed. In fact, the CDFI Fund specifically states that they are "supporting the IRS with the Opportunity Zone nomination and designation process under IRC §1400Z-1 only," which excludes the Opportunity Zone Fund operation guidelines under IRC §1400Z-2.³⁸ As a result, attorneys should not assume the rules for federal New Markets Tax Credits will be transferred verbatim into the Opportunity Zone rules.

In fact, real estate vision and creativity are woefully insufficient in understanding how different venture capital fund structures can adversely impact certain real estate investment vehicle structures, both operationally and from a tax perspective, so receiving guidance from experts in all three fields (corporate taxation, real estate, and venture capital, is prudent). The first town in the U.S. to receive that guidance and take the initiative to launch their own Opportunity Zone Fund for the use and benefit of every investor and developer considering Central Maine for business, was Lincoln, Maine.³⁹

³⁶ *Id.*

³⁷ *Opportunity Zones Resources*, Community Development Financial Institutions Fund, U.S. Department of the Treasury, www.cdfifund.gov/Pages/Opportunity-Zones.aspx (last visited June 8, 2019).

³⁸ *Id.*

³⁹ Charles Eichacker, *To Lure Business, Lincoln Moves Quickly to Take Advantage of New Federal Tax Break Program*, Bangor Daily News, December 5, 2018, bangordailynews.com/2018/12/05/news/penobscot/to-lure-business-lincoln-moves-quickly-to-take-advantage-of-new-federal-tax-break-program/.

1st “Mega” Opportunity Zone Fund: Lincoln Lakes Opportunity Zone Innovation Fund

An Opportunity Zone designation is nothing more than a census-tract, providing as much clarity as a zip code. The designation itself does not provide particular benefits to either investors or businesses unless there is an attendant Opportunity Zone Fund created to be the conduit for equity investment capital, produced from the sale of a capital asset. It is the Fund, operating according to Treasury Department guidelines and providing the necessary oversight and reporting that will ensure that all of the investments and activities carried out within the Opportunity Zone will meet the rigorous requirements of the federal government and other federal and state regulatory agencies. Without a properly established and managed Opportunity Zone Fund, however, the tax benefits which will drive this new investment cannot be tracked and monitored appropriately to ensure compliance with the IRS regulations. It is safe to say that all taxpayers want to stay on the good side of the IRS, so adopting appropriate tracking and monitoring protocols for each investor, each developer, each project, and each related financial incentive used by the stakeholders involved in the project is critical to achieving permanent tax deferral.

In December 2018, the town of Lincoln, Maine, established the “Lincoln Lakes Opportunity Zone Innovation Fund” – the first such fund in Maine and the first fund in the nation that has been established by a municipality in order to promote investments within a rural community. Lincoln’s Economic Development Director, Jay Hardy, who was a co-author of Maine’s Tax Increment Financing legislation and veteran public administrator, extensively vetted the potential strengths, weaknesses, opportunities, and threats of the Opportunity Zone program, and after interviewing dozens of attorneys, accountants and real estate brokers, received unanimous approval from Lincoln’s town council to create the Lincoln Lakes Opportunity Zone Innovation Fund, in partnership with an external fund manager. Because Lincoln is a relatively small town, a key purpose of the Fund to facilitate and aggregate smaller projects, thus spreading the risk and encouraging projects that are a better match, in terms of scale, with typical economic expansion in a smaller rural Maine community. The town of Lincoln’s approach is directly aligned with the mission and objectives of the U.S. Treasury Department, which makes them an excellent “flagship” for the Opportunity Zone program’s allowance of larger Funds that create a single community pipeline for multiple investors and multiple projects, to facilitate a comprehensive economic

development strategy for the entire region around the Opportunity Zone.⁴⁰

V. CONCLUSION

There are more than 8,700 Opportunity Zones in the U.S. that provide an excellent opportunity to expedite a community-based approach to economic development designed to leverage options both in and outside of the designated Opportunity Zones. Most projects are "one-off" real estate developments, although some may be taking a huge risk by assuming residential real estate is consistent with Opportunity Zone program incentives. The rules on IRC § 1400 clearly explain that the mission is to directly promote business growth, and while residential homes might be an obvious inconsistency with the rules, the rules are unclear about "workforce housing" that can, theoretically, directly promote business growth, using a broad interpretation. It is these vagaries in the language that make the full intention of the Opportunity Zone guidelines unclear.

The lack of clarity is understandable because it does take time to gauge impact, adjust accordingly, then re-issue guidance, but until the final rules are published, many attorneys, accountants, and real estate professionals may sit on the sidelines to wait in safety. Economic development is not for the faint of heart, however, and some risk is inherent in this industry, no matter how much guidance is provided. The primary premise IRC § 1400Z-2 is to facilitate and expedite attracting capital to areas where capital is scarce, then committing to keeping that capital in that community to circulate for at least 10 years. To maximize that benefit, it makes more sense to have a "Mega" Opportunity Zone Fund that can leverage more regional resources in collaborative, public-private partnerships, instead of chasing "one-off" developments. This is not to discourage small developments, but in terms of maximizing impact - economically-distressed communities can usually do more when they have more capital behind them to encourage others to move forward.

Towns, such as, Lincoln, Calais, and Baileyville have already launched their "Mega" Opportunity Zone Funds that, respectively, are not focused on a single project, but aggregate all development projects in the municipality. When you consider that the U.S. Treasury Department estimates there is \$6.1 trillion available to fund the 8,700+ Opportunity Zones, which equates to \$701 million per Opportunity Zone, if distributed proportionately, and a small state, such as Maine, has 32 Opportunity Zones, the potential is more than \$22 billion for

⁴⁰ *Id.*

state of only 1.3 million people (~\$17 million per person).⁴¹ Of course, the \$6.1 trillion will not be distributed proportionately across each Opportunity Zone, e.g., some Zones may never create a Fund, while other Zones in crowded areas may receive several billion dollars. One thing is fairly certain, however, and that is Opportunity Zone Funds that have figured out what the U.S. Treasury wants first, and proactively took steps to leverage collateral benefits for potential investors and developers, e.g., community banking partners, local political support, state/local tax abatement, etc. - those Opportunity Zones will be getting the most attention, and likely, more of the available investment capital.

⁴¹ Steven Bertoni, An Unlikely Group of Billionaires and Politicians Has Created the Most Unbelievable Tax Break Ever, Forbes, July 17, 2018, www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/.