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Unwrapping the Banking Possibilities in Opportunity Zones

I. INTRODUCTION

In 2017, the passage of the Tax Cuts and Jobs Act (“TCJA”) provided bankers with a brand new investment program in which certain economically distressed communities in the United States could be labelled “Opportunity Zones.”¹ Opportunity Zones allow taxpayers to invest capital gains into investment vehicles called Qualified Opportunity Funds (“QOFs”), which then inject the capital into their Opportunity Zone property in hopes of improving property for the benefit of the community.² These investment projects should bring new capital into low- and moderate-income communities that banks can take advantage of in a multitude of different ways, assuming they are aware of how to circumvent some of the issues facing Opportunity Zone participation.³

The Internal Revenue Service (“IRS”) issued multiple rounds of proposed regulations on Opportunity Zones and QOFs that help answer some of the pressing questions relating to QOF creation, with the final regulations being published on January 13, 2020.⁴ Businesses—including banks—can now utilize these regulations to determine the most

1. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z (2018); *Opportunity Zones Frequently Asked Questions*, IRS, <https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions> [<https://perma.cc/2AP5-BVGP>] (last visited Jan. 4, 2020) (“[Opportunity Zones] are designed to spur economic development and job creation in distressed communities throughout the country and U.S. possessions by providing tax benefits to investors who invest eligible capital into these communities.”).

2. TCJA § 13823, 26 U.S.C. § 1400Z-2(d); *see also* David Levy, Nickolas Gianou & Diana Lopo, *Opportunity Zones Abound but Investors, Tread Carefully*, SKADDEN, ARPS, MEAGHER, & FLOM LLP AND AFFILIATES (Aug. 7, 2018), <https://www.skadden.com/insights/publications/2018/08/opportunity-zones-abound-but-investors> [<https://perma.cc/4YAL-LCAG>] (explaining that QOFs inject the cash investments into one or more Opportunity Zone businesses).

3. *See* Monica C. Meinert, *Lands of Opportunity*, ABA BANKING J. (Mar. 19, 2019), <https://bankingjournal.aba.com/2019/03/lands-of-opportunity/> [<https://perma.cc/A7A7-JLMU>] (explaining that Opportunity Zones are more attractive to investors because of their tax benefits).

4. Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18652 (proposed May 1, 2019) (to be codified at 26 C.F.R. pt. 1); Investing in Qualified Opportunity Funds, 83 Fed. Reg. 54279 (proposed Oct. 29, 2018) (to be codified at 26 C.F.R. pt. 1); Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1).

appropriate way to participate in Opportunity Zones.⁵ While larger banks have more tools at their disposal to participate, smaller banks may have a more difficult time finding these investments to be fruitful for a host of reasons.⁶

There are a multitude of reasons why bankers should be aware of the Opportunity Zone program. Due to capital income restraints, banks are likely unable to invest directly into Opportunity Zones in the way most taxpayers can.⁷ However, banks are able to get involved primarily by providing loans to QOFs or creating their own QOFs arranged as bank subsidiaries.⁸ Because taxpayers looking for investment opportunities will likely be drawn to QOFs due to the tax benefits provided by the Opportunity Zone program, banks will have more opportunities to lend to quality investors with significant capital.⁹ These investment opportunities largely appear to be commercial real estate deals,¹⁰ as real estate developers have taken a keen interest in Opportunity Zones.¹¹ Bankers should especially be aware that Opportunity Zone investments may help their institutions achieve Community Reinvestment Act (“CRA”) compliance since the program’s goals are aligned with those of the CRA.¹²

5. See Andy Peters, *Banks Explore Ways to Capitalize on Tax Law’s ‘Opportunity Zones’*, AM. BANKER (Mar. 26, 2019), <https://www.americanbanker.com/news/banks-explore-ways-to-capitalize-on-tax-laws-opportunity-zones> [https://perma.cc/YSZ6-LQJP] (explaining that bank executives are excited about the prospect of Opportunity Zones, and banks are expected to be involved in making loans to Opportunity Zone developers).

6. See *id.* (“Many small banks are still studying how they can get involved, or if participation is even feasible. There are challenges . . .”).

7. *Opportunity Zones: Can Your Bank Benefit?*, ELLIOT DAVIS (June 20, 2019), <https://www.elliottdavis.com/opportunity-zones-can-bank-benefit/> [https://perma.cc/28VW-MNDW].

8. Peters, *supra* note 5 (explaining that banks are expected to provide large amounts of loans or establish their own investment funds that inject equity into Opportunity Zone projects).

9. See Meinert, *supra* note 3 (explaining that investors will be searching for fruitful investment opportunities).

10. See *infra* Part V.B–V.C; see generally Andy Peters, *Will This be CRE Lenders’ New Best Friend?*, AM. BANKER (Oct. 29, 2018), <https://www.americanbanker.com/news/will-this-be-cre-lenders-new-best-friend> [https://perma.cc/5XJ3-TRDW] (explaining that commercial real estate loans could be beneficial for banks in Opportunity Zone investment).

11. See Mary Burke Baker, *Opportunity Zones Aren’t Just for Real Estate Development*, DEV. MAG. (Spring 2019), naiop.org/Research-and-Publications/Magazine/2019/Spring-2019/Business-Trends/Opportunity-Zones-Arent-Just-for-Real-Estate-Development [https://perma.cc/SVY2-U6JB] (explaining that when Opportunity Zones were created, real estate developers were extremely interested in the program).

12. Community Reinvestment Act of 1977 (“CRA”) § 802, 12 U.S.C. § 2901 (2018); Press Release, Tim Scott, U.S. Senator, Reform to Include Scott’s Investing in Opportunity

This Note discusses Opportunity Zones, the new regulations around them, and how banks of all sizes can get involved in the Opportunity Zones. This Note proceeds in six parts. Part II addresses the concept of Opportunity Zones.¹³ Part III discusses the regulations that the IRS has proposed and finalized.¹⁴ Part IV explains the issues that still exist and are likely to limit banks' participation in Opportunity Zones.¹⁵ Part V analyzes the possible options that all banks have in investing in Opportunity Zones.¹⁶ Part VI concludes the note by summarizing the best options for large and small banks.¹⁷

II. OPPORTUNITY ZONES

A. Background

On December 22, 2017, the TCJA¹⁸ was enacted in an attempt to reallocate capital gains to low-income communities in exchange for tax benefits.¹⁹ The TCJA gives the governor of each state power to designate certain tracts of land as Opportunity Zones based on the level of income within those communities.²⁰ The TCJA provides tax benefits to those who invest in Opportunity Zones by allowing investors to defer taxes on gains that are invested into a QOF, with the possibility to eliminate taxes on all gains following the initial investment.²¹

Act (Nov. 15, 2017), <https://www.scott.senate.gov/media-center/press-releases/senate-tax-reform-to-include-scotts-investing-in-opportunity-act> [<https://perma.cc/GMK2-EM3A>].

13. See *infra* Part II.

14. See *infra* Part III.

15. See *infra* Part IV.

16. See *infra* Part V.

17. See *infra* Part VI.

18. Tax Cuts and Jobs Act ("TCJA") § 13823, 26 U.S.C. § 1400Z (2018).

19. Scott, *supra* note 12 ("The HIOA changes the way capital gains are taxed when those gains are reinvested long-term in distressed communities."); Michael March & Brandon Mourges, *Opportunity Zones: The Good, the Bad, and the Yet to be Defined*, ROSENBERG MARTIN GREENBERG (Jan. 17, 2019), <https://www.rosenbergmartintax.com/news/opportunity-zones-the-good-the-bad-and-the-yet-to-be-defined/> [<https://perma.cc/SP38-4YDP>] ("From this, we infer that the Federal government's intention was to shift capital from appreciated assets to areas in which capital contributions would act as a catalyst for economic growth.").

20. TCJA § 13823, 26 U.S.C. § 1400Z-1(b)(1)(A).

21. *Id.* § 13823, 26 U.S.C. § 1400Z-2; see also Jonathan Talansky, John K. Sweet, Robert A. Beard, & Nikolai Karetnyi, *IRS and Treasury Release Second Round of Qualified Opportunity Zone Guidance*, KING & SPALDING (Apr. 19, 2019), <https://www.kslaw.com/news-and-insights/irs-and-treasury-release-second-round-of-qualified-opportunity-zone-guidance> [<https://perma.cc/V89R-6JTT>] ("The potential tax benefits . . . include deferral of tax (until 2026) on eligible gains invested in a QOF, partial

South Carolina Senator Tim Scott explained that the Opportunity Zone legislation was meant to bring long-term investments into low-income and distressed communities in order to “help create jobs, spur entrepreneurship and small business, and restore hope where it has been fading for far too long.”²² The legislation uses tax benefits to increase investments into low-income communities by reallocating capital from non-Opportunity Zone transactions into Opportunity Zones property,²³ investments that may have not otherwise been possible.²⁴

B. Opportunity Zone Designation

An Opportunity Zone is a “population census tract that is a low-income community” which the governor of the state has nominated for the purposes of the TCJA.²⁵ Following its nomination, the Treasury Secretary must approve the tract as an Opportunity Zone in order to finalize the designation process.²⁶ A tract of land can qualify as a low-income community in one of three ways: first, the federal poverty rate of those residing in the tract is at least 20%;²⁷ second, the tract is outside of a metropolitan area and its median family income does not exceed 80% of the statewide value;²⁸ third, the tract is within a metropolitan area and its median family income does not exceed 80% of either the metropolitan area median family income or the statewide value.²⁹

The TCJA also provides an exception for tracts that do not otherwise qualify as Opportunity Zones, provided they meet two requirements.³⁰ First, the tract of land must be contiguous with other

exclusion of such gains if certain holding periods are achieved, and the elimination of all post investment gain . . .”).

22. Scott, *supra* note 12.

23. Levy, Gianou & Lopo, *supra* note 2 (“[I]ts goal is to reallocate capital to these investments from appreciated investments outside the zone.”).

24. See Press Release, PNC, PNC Provides \$15 Million To Finance American Life Redevelopment In Birmingham Opportunity Zone (July 30, 2019), <http://pnc.mediaroom.com/2019-07-30-PNC-Provides-15-Million-To-Finance-American-Life-Redevelopment-In-Birmingham-Opportunity-Zone> [https://perma.cc/7T6R-NCLM] (“This project is only possible because of PNC Bank, Opportunity Zone funding, historic tax credits . . .”).

25. TCJA § 13823, 26 U.S.C. § 1400Z-1(b)(1)(A)(i).

26. *Id.* § 1400Z-1(b)(1)(B).

27. *Id.* § 1400Z-1(c)(1).

28. The TCJA leaves “metropolitan area” undefined. *Id.*

29. *Id.*

30. *Id.* § 1400Z-1(e)(1).

Opportunity Zones.³¹ Second, the tract's median family income cannot exceed 125% of the median family income of the contiguous Opportunity Zone.³²

As of July 9, 2019, the U.S. Department of the Treasury certified over 8,700 tracts to be Opportunity Zones.³³ These tracts currently represent over 24 million jobs and include 1.6 million businesses.³⁴ Moreover, as of March 2019, experts estimated there could be up to \$6 trillion of investment opportunities within Opportunity Zones nationwide.³⁵ Over 250 Opportunity Zones lie within North Carolina, with less than 5% of the Opportunity Zones utilizing the contiguous tract exception for non-low-income communities.³⁶ North Carolina Opportunity Zones are home to over 1.1 million people, with more than 50,000 places of business.³⁷ North Carolina aimed to have a minimum of one Opportunity Zone per county.³⁸ Consequently, Opportunity Zones are distributed relatively evenly throughout the state.³⁹ Furthermore, North Carolina gave priority for Opportunity Zone designation to industrial sites, presumably because they are more likely to yield economic results.⁴⁰ Similarly, South Carolina prioritized tracts that had seen little economic fruition, yet were susceptible to population and economic growth with proper investment.⁴¹ Of the 135 Opportunity

31. *Id.*

32. *Id.*

33. Amanda E. Agati, *Evaluating the Opportunity in Opportunity Zones*, PNC (Jan. 24, 2019), <https://www.pnc.com/insights/wealth-management/markets-economy/evaluating-the-opportunity-in-opportunity-zones.html> [<https://perma.cc/N8MR-ZSJ5>]; see TCJA § 13823, 26 U.S.C. § 1400Z-1(a) (explaining that tracts are based on the population census).

34. Peters, *supra* note 5.

35. *Id.*

36. See N.C. DEP'T OF COMMERCE, NORTH CAROLINA DESIGNATED QUALIFIED OPPORTUNITY ZONES (2018), <https://public.nccommerce.com/oz/NorthCarolinaDesignatedQOZs.xlsx> [<https://perma.cc/2DAG-37NA>] (listing the 252 designated Opportunity Zones in North Carolina with eleven designated due to the contiguous tract exception non-low-income community, making up 4.4% of the total).

37. N.C. Dep't of Commerce, *North Carolina Opportunity Zones Program*, NC OPPORTUNITY ZONES, <https://public.nccommerce.com/oz/#section-resources> [<https://perma.cc/27EB-86S6>] (last visited Oct. 20, 2019).

38. *Id.*

39. See *id.* ("Opportunity for all: Aim for at least one Opportunity Zone in every county.").

40. *Id.*

41. S.C. Governor's Office, *South Carolina Opportunity Zones*, SCOPPORTUNITYZONE.COM, <http://www.scopportunityzone.com> [<https://perma.cc/U67M-54YQ>] (last visited Oct. 20, 2019).

Zones in South Carolina, seven tracts were identified by the contiguous tract exception.⁴²

C. *Qualified Opportunity Fund Structure*

Once tracts are deemed Opportunity Zones, taxpayers and investors may invest properly realized capital gains—called the “qualified gain amount”⁴³—into QOFs no more than 180 days after the realization occurs in return for an interest in the QOF.⁴⁴ Businesses can create QOFs the same way the supermarket chain Kroger⁴⁵ and banks like PNC have.⁴⁶ Moreover, other entities such as Community Development Financial Institutions (“CDFIs”) can create new funds and partnerships for the purposes of self-certifying as a QOF.⁴⁷ However, CDFIs currently cannot restructure themselves into QOFs.⁴⁸ One important limitation is that the tax exemption which investors receive from their Opportunity Zone investment is limited to the qualified gain amount, therefore not inclusive of extraneous cash investments.⁴⁹ Moreover, the provision also

42. *Id.*

43. Levy, Gianou & Lopo, *supra* note 2; *see also* Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. 1400Z-2(a)(1) (2018) (explaining that the qualified gain amount is the “gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer. . .”).

44. TCJA § 13823, 26 U.S.C. § 1400Z-2(a)(1)(A).

45. Kroger created its own QOF called Kroger Opportunity Fund I to take advantage of the tax incentives the TCJA provide. The Kroger Opportunity Fund I has received \$8 million through private investment alone. Mark Heschmeyer, *Kroger Doubles Up on Federal Real Estate Incentives for New Development*, COSTAR (Dec. 19, 2018), https://product.costar.com/home/news/shared/907226719?utm_source=costar&utm_medium=email&utm_campaign=costar-national-newsletter&utm_content=p2 [<https://perma.cc/6795-C72E>] (providing an explanation on how Kroger has created its own QOF).

46. *See* Peters, *supra* note 5 (explaining that QOFs likely will be made by companies that have a large foot in real estate, like Kroger).

47. “[CDFIs] share a common goal of expanding economic opportunity in low-income communities by providing access to financial products and services for local residents and businesses.” *What Are CDFIs?*, CDFI FUND, https://www.cdfifund.gov/Documents/CDFI_infographic_v08A.pdf [<https://perma.cc/T9CB-FMJS>] (last visited Feb. 7, 2020); CHARLES TANSEY & MICHAEL SWACK, THE POTENTIAL ROLE FOR CDFIS IN OPPORTUNITY ZONES 14–16 (The Carsey Sch. Of Pub. Policy 2019), <https://scholars.unh.edu/cgi/viewcontent.cgi?article=1362&context=carsey> [<https://perma.cc/NKG6-SQSM>].

48. TANSEY & SWACK, *supra* note 47, at 10.

49. Levy, Gianou & Lopo, *supra* note 2; *see also* TCJA § 13823, 26 U.S.C. § 1400Z-2(a)(1) (explaining what the appropriate form of gains are for Opportunity Zone investment).

disincentivizes taxpayers to invest noncash property into QOFs because the investment will not qualify for an Opportunity Zone tax exemption.⁵⁰

QOFs are required to hold at least 90% of their assets in Opportunity Zone property in order to maintain their status.⁵¹ Opportunity Zone property consists of stock, partnership interest, or business property.⁵² In order for tangible property to be Opportunity Zone business property, it must meet three criteria: (1) The property must be acquired via purchase after 2017; (2) either the original use of the property in the Opportunity Zone begins with the QOF, or the QOF substantially improves the tangible property; and (3) “during substantially all of the [QOF’s] holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.”⁵³ Real estate projects, such as investments in obsolete buildings, are viable options for Opportunity Zone business property because they both require substantial improvements and will never be used outside of the Opportunity Zone.⁵⁴ For example, PNC Bank is involved in an Opportunity Zone investment in which an obsolete dry storage and maintenance building will be renovated into a residential building.⁵⁵ Through this plan, the building will certainly be improved while remaining inside the Opportunity Zone.⁵⁶

Furthermore, Opportunity Zone stocks and partnership interests follow identical sets of requirements in order to be utilized by QOFs:⁵⁷ (1) The QOF “must acquire its equity interest” in the given property “for

50. Marc Schulz, *An In-Depth Guide to the Latest Opportunity Zone Regs: Part 1*, SNELL & WILMER (June 14, 2019), https://information.swlaw.com/REACTION/2019/Articles/An_In-Depth_Guide_To_the_Second_Tranche_of_Opportunity_Zone_Regs_%20Part1-Law360.pdf [<https://perma.cc/9JDB-39W9>] (“[T]he portion of the eligible interest in the QOF that represents appreciation from the contribution of noncash property that is contributed on a tax-free basis to the QOF partnership cannot be a qualifying investment.”); *see also* TCJA § 13823, 26 U.S.C. § 1400Z-2 (explaining that special tax rules only apply to capital gains investments).

51. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(1).

52. *Id.* § 1400Z-2(d)(2)(A).

53. *Id.* § 1400Z-2(d)(2)(D)(i).

54. *It Took an Opportunity to Give New Life to an Old Building*, PNC, <https://www.pnc.com/en/about-pnc/topics/pnc-pov/community/opportunity-zone.html> [<https://perma.cc/4YGU-6LYX>] (last visited Oct. 7, 2019).

55. *Id.*

56. *See id.* (providing an obsolete building as an example of Opportunity Zone property that should be improved).

57. Levy, Gianou, & Lopo, *supra* note 2 (explaining the requirements for both Opportunity Zone stocks and partnership interests as the same requirements).

cash at original issuance after 2017”;⁵⁸ (2) the stocks and interests must be held in a qualified opportunity zone business;⁵⁹ and (3) during substantially all of the QOF’s holding period of an entity’s stock or interest, the entity must be an Opportunity Zone business.⁶⁰

D. *Benefits of the QOF Structure*

While the TCJA leaves many details to be determined by the regulations, the current structure of QOFs provides several benefits for those interested in taking advantage of Opportunity Zones.⁶¹ First, because there is neither a requirement that a QOF come into existence after the creation of the TCJA, nor a requirement that a QOF must have been established within an Opportunity Zone,⁶² a QOF can be a pre-existing entity originating from outside the Opportunity Zone, as long as it satisfies the remaining QOF holding requirements.⁶³ This is a major benefit since launching a new entity in a low-income community comes with its own set of issues.⁶⁴ Simply put, there is no need to go through the process of creating an entire new entity in order to create a QOF because any existing entity meeting the QOF holding requirements can become a QOF.⁶⁵

Additionally, QOFs can use both personal and real property to meet the Opportunity Zone business property requirement, thus providing more options for entities aiming to certify as QOFs.⁶⁶ Therefore, QOFs

58. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(B)–(C); Levy, Gianou & Lopo, *supra* note 2.

59. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(B)–(C); Levy, Gianou & Lopo, *supra* note 2.

60. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(B)–(C); Levy, Gianou & Lopo, *supra* note 2.

61. *See generally* March & Mourges, *supra* note 19 (detailing the positive characteristics the QOF structure provides).

62. *See id.* (“To date, there is no legal prohibition for a preexisting entity self-certifying as a QOF. Once the QOF is formed, it must acquire OZP after December 31, 2017 by purchase in an arms-length transaction.”).

63. *Id.*; *see also* Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866, 1898 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule) (“[P]reexisting entities are not barred from qualifying as QOFs or qualified opportunity zone businesses.”).

64. March & Mourges, *supra* note 19 (explaining that a pre-existing entity can self-certify as a QOF).

65. *See id.* (“To date, there is no legal prohibition for a preexisting entity self-certifying as a QOF. Once the QOF is formed, it must acquire OZP after December 31, 2017 by purchase in an arms-length transaction.”).

66. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. 1400Z-2(b)(2)(D) (2018); Tucker Thoni, *4 Working Capital Safe Harbors for QOZ Startups*, GRAY ROBINSON (Aug. 14,

can help finance not just commercial and real estate projects, but infrastructure and business projects as well.⁶⁷ Congress provides those seeking to classify as QOFs with options to hold tangible and personal assets that can be used—in very limited ways—outside the Opportunity Zone.⁶⁸ This benefit provides QOFs with greater freedom to acquire property that is not limited to use only within an Opportunity Zone, unlike the physical restrictions on real property.⁶⁹

E. Tax Exemptions

For investors, the most significant feature of the Opportunity Zone legislation is its three-part tax benefit.⁷⁰ First, taxpayers can invest accumulated capital gains into QOFs, which will not be taxed “until the end of 2026 or when the asset is disposed of.”⁷¹ This allows investors to delay potentially heavy taxes on the capital gains until as late as 2026.⁷² Second, “[f]or capital gains placed in [QOFs] for at least 5 years, investors’ basis on the original investment increases by 10 percent. If invested for at least 7 years, investors’ basis on the original investment increases by 15 percent.”⁷³ Third, once the investment is held for at least

2019), <http://www.gray-robinson.com/docs/4-working-capital-safe-harbors.pdf> [https://perma.cc/AD96-Q8NT].

67. *What Are Opportunity Zones and How Do They Work?*, TAX POL’Y CTR., <https://www.taxpolicycenter.org/briefing-book/what-are-opportunity-zones-and-how-do-they-work> [https://perma.cc/MG64-MNDH] (last visited Sept. 14, 2019) (explaining that QOFs can help finance “commercial and industrial real estate, housing, infrastructure, and existing or start-up businesses.”).

68. TCJA § 13823, 26 U.S.C. 1400Z-2(d)(2)(D)(i); *see also* Marc Schulz, *An In-Depth Guide to the Latest Opportunity Zone Regs: Part 2*, SNELL & WILMER (June 17, 2019), https://information.swlaw.com/REACTION/2019/Articles/An_In-Depth_Guide_To_the_Second_Tranche_of_Opportunity_Zone_Regs_Part2-Law360.pdf [https://perma.cc/T2TD-UQBX] (explaining that property can be moved in and out of the property for use outside of an opportunity zone).

69. TCJA § 13823, 26 U.S.C. 1400Z-2(d)(2)(D)(i); *see generally* Thoni, *supra* note 66 (explaining that tangible property can be acquired as Opportunity Zone business property so long as it is substantially improved or has its original use in the Opportunity Zone).

70. *What Are Opportunity Zones and How Do They Work?*, *supra* note 67.

71. *Id.*; *see also* TCJA § 13823, 26 U.S.C. § 1400Z-2(b)(1) (providing the statutory basis for the first tax incentive).

72. TCJA § 13823, 26 U.S.C. § 1400Z-2(b)(1).

73. *Id.* § 1400Z-2(b)(2)(B)(iii–iv); *What Are Opportunity Zones and How Do They Work*, *supra* note 67 (explaining the concept of basis increase for a held investment over five and seven years).

ten years, investors pay no taxes on the capital gains produced through their investment in the QOF.⁷⁴

The five-, seven-, and ten-year requirements for tax benefits are specifically tailored to ensure that the investments stay in the Opportunity Zones long-term.⁷⁵ If the time requirements were significantly shorter than five years, investors could take advantage of short-term tax benefits without bringing tangible improvements to the Opportunity Zone communities.⁷⁶ Moreover, the five-year tax benefit allows investors with less financial stability to take advantage of Opportunity Zones by making less lengthy investments that can bear fruit without waiting for ten years.⁷⁷

F. *Why Banks Should be Interested*

Banks should be aware of the financial impact Opportunity Zones will have on their communities.⁷⁸ One of the primary reasons for banks to take notice of Opportunity Zones around them is the high likelihood that the program will bring an influx of capital into areas where it is typically scarce.⁷⁹ The capital influx into low-income areas could provide banks with more opportunities to lend to projects that would not have existed without the Opportunity Zone program.⁸⁰ These investment opportunities largely appear to be real estate ventures in which banks can lend to real estate development projects and help arrange QOFs for these

74. TCJA § 13823, 26 U.S.C. § 1400Z-2(b)(2)(C); *What Are Opportunity Zones and How Do They Work*, *supra* note 67.

75. See Meinert, *supra* note 3 (explaining that the tax investment is best for long term investments); Peters, *supra* note 5 (explaining that the Opportunity Zone rules require investors to hold their investments for a lengthy amount of time in order to get the most benefits).

76. See Peters, *supra* note 5 (“Opportunity Zone rules require equity investors to keep their money in the project for at least 10 years to receive the tax benefit. A lengthy minimum requirement should discourage private investors that are looking to make a quick buck and get out of town . . .”).

77. See Agati, *supra* note 33 (explaining that ten-year investments may appear less attractive due to the timely constraints they require).

78. See Meinert, *supra* note 3 (explaining that Opportunity Zones will bring larger amounts of capital into low-income areas).

79. *Id.* (“That said, for bankers that have an Opportunity Zone in their market, the program could mean a greater influx of capital into these areas that could be particularly beneficial in rural areas where low land values have made lending a challenge.”).

80. *Id.*

development projects.⁸¹ However, it is unclear whether other loan types, such as commercial or industrial loans, are available for Opportunity Zone benefits because the finalized regulations do not appear address them.⁸² Regardless, through Opportunity Zones and QOF creation, banks could have many new opportunities to lend to their communities.⁸³ Indeed, Opportunity Zones were created with the belief that banks would act as financial intermediaries in Opportunity Zone investments.⁸⁴ Involving banks as intermediaries is a concept unique to Opportunity Zones since previous programs lacked such an incentive.⁸⁵

The CRA is another important facet of the relationship between Opportunity Zones and banks.⁸⁶ Similar to Opportunity Zones, one of the primary goals of the CRA is to expand economic opportunities for inhabitants of low- and moderate-income communities.⁸⁷ CRA regulations explain that banking investments benefiting low- to moderate-income communities and inhabitants qualify as public welfare investments.⁸⁸ It is possible that Opportunity Zone investments will provide CRA credit, although the investments will not automatically provide this.⁸⁹ Investments in QOFs will receive CRA credit if the

81. See, e.g., *It Took an Opportunity to Give New Life to an Old Building*, *supra* note 54 (discussing how PNC participated in the development of an apartment building by financing the project through its bank along with investing through its own QOF).

82. Peters, *supra* note 5; see generally Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule) (providing the regulatory background that lacks a discussion on commercial and industrial loans).

83. See Meinert, *supra* note 3 (explaining that bankers are beginning to reach out to local developers regarding lending during QOF creation).

84. See Jessie Romero, *Opportunity Zones: More Money, More Problems?*, 24 ECON FOCUS, First Quarter 2019, at 10, 13, https://www.richmondfed.org/publications/research/econ_focus/2019/q1/feature1 [<https://perma.cc/SDB9-DTQS>] (describing how previous tax-based policies did not facilitate financial intermediation of banks in their programs).

85. See *id.* (describing how previous tax-based policies did not facilitate financial intermediation of banks in their programs).

86. See Bob Ibanez, *Opportunity Zones – Giving CRA Credit Where Credit is Due*, NOVOGRADAC (Nov. 13, 2018), <https://www.novoco.com/notes-from-novogradac/opportunity-zones-giving-cra-credit-where-credit-due> [<https://perma.cc/FQS3-JHLY>] (explaining that CRA credit qualifying requirements are consistent with the goals of Opportunity Zones).

87. Community Reinvestment Act of 1977 (“CRA”) § 802, 12 U.S.C. § 2901 (2018).

88. Examples of Qualifying Public Welfare Investments, 12 C.F.R. § 24.6 (2019).

89. “The Community Reinvestment Act (CRA), enacted in 1977, requires the Federal Reserve and other federal banking regulators to encourage financial institutions to help meet the credit needs of the communities in which they do business, including low- and moderate-income (LMI) neighborhoods.” *Community Reinvestment Act (CRA)*, FED. RES. https://www.federalreserve.gov/consumerscommunities/cra_about.htm [<https://perma.cc/554A-3Z84>] (last updated Dec. 7, 2018); FDIC, OPPORTUNITY ZONES:

individual activities being invested in are considered “community development” under the CRA and occur within the CRA assessment areas for that particular bank.⁹⁰ Some banks currently expect that Opportunity Zone investments will yield CRA credits.⁹¹ For example, PNC, an active participant in Opportunity Zones,⁹² expects to receive CRA credit for the more than \$75 million it has already allocated to Opportunity Zones.⁹³

III. IRS AND TREASURY PROPOSED REGULATIONS

The IRS released two rounds of Notices of Proposed Rulemaking (“NPR”) as well as a finalized round of regulations in response to extensive comments on the TCJA Opportunity Zone legislation.⁹⁴ The second proposal both supplements and revises the first because the first did not entirely address the requirements relating to QOF investment.⁹⁵ The finalized regulations address several additional comments that were not denoted on the initial two proposals.⁹⁶ The following section analyzes pertinent portions of the proposals as well as the impact of the finalized regulations.⁹⁷

COMMUNITY BANKS, MINORITY DEPOSIT INSTITUTIONS, AND CDFI BANKS (2019), (Draft of forthcoming FDIC report) <https://www.fdic.gov/communitybanking/2019/2019-10-10-opzones-mdi.pdf> [<https://perma.cc/WC6C-NANR>] (“Investments in Qualified Opportunity Funds do not automatically receive CRA consideration. The investments made by the Qualified Opportunity Fund will be assessed according to the activity being evaluated”); *see also* Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866, 1941 (Jan. 13, 2020) (finalized rule) (explaining that the prospect of CRA credit is beyond the scope of the finalized regulations).

90. FDIC, *supra* note 89.

91. *See* Peters, *supra* note 5 (explaining that PNC expects to receive CRA credit for investments).

92. *Id.*

93. *Id.*

94. *See* Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18652 (May 1, 2019) (to be codified at 26 C.F.R. pt. 1) (notice); Investing in Qualified Opportunity Funds, 83 Fed. Reg. 54279 (Oct. 29, 2018) (to be codified at 26 C.F.R. pt. 1) (notice); Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866, 1898 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule); Office of the Federal Register, *A Guide to the Rulemaking Process*, https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf [<https://perma.cc/5RY5-U4HG>] (last visited Oct. 17, 2019) (“The proposed rule, or Notice of Proposed Rulemaking (NPRM), is the official document that announces and explains the agency’s plan to address a problem or accomplish a goal.”).

95. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18652 (May 1, 2019) (notice) (“The proposed regulations contained in this notice of proposed rulemaking describe and clarify requirements relating to investing in QOFs not addressed in 83 FR 54279 (October 29, 2018).”).

96. Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866 (Jan. 13, 2020) (finalized rule).

97. *See infra* Part III.A.

A. *Original Use*

The “original use” provision found in the TCJA was a major issue for NPR commenters.⁹⁸ In order for property to qualify as Opportunity Zone business property, the QOF must either include the property’s original use or substantially improve the property.⁹⁹ The second set of proposed regulations state that the tangible property’s original use commences in one of two ways: (a) the property owner puts the property to use in the Opportunity Zone “for purposes of depreciation or amortization,” or (b) the property owner puts the property to use in an Opportunity Zone “in a manner that would allow depreciation or amortization” of the property.¹⁰⁰ However, the proposals emphasize that the tangible property must have been put into such use by a taxpayer, regardless of whether that particular taxpayer is the current owner of the property.¹⁰¹

The final regulations adopted this test for original use, appropriately rejecting the notion that the prior use of property may have an impact on whether or not the property has its original use in the Opportunity Zone.¹⁰² The finalized rule allows tangible property that has not previously been put to use in an Opportunity Zone to satisfy the TCJA original use provision.¹⁰³ Therefore, those looking to take advantage of Opportunity Zones by acquiring the unused property must only satisfy the remaining Opportunity Zone business property requirements.¹⁰⁴

Moreover, the IRS also provides an exception to original use rule that allows vacant or abandoned property to satisfy the original use requirement.¹⁰⁵ The initial proposals regarding this exception allowed that property vacant or abandoned for five years could inherently satisfy

98. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(d)(2)(D)(i)(II) (2018); Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18654 (May 1, 2019) (notice).

99. 26 U.S.C. § 1400Z-2(d)(2)(D)(i)–(ii).

100. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1908 (Jan. 13, 2020) (finalized rule).

101. *Id.*

102. *See id.* at 1909 (explaining that allowing property previously used in the Opportunity Zone would not encourage new investments into Zones because the property in of itself is not new).

103. *Id.* at 1908.

104. *See generally id.* at 1908–10 (providing the details of how unused and vacant property can satisfy the original use provision).

105. *See id.* at 1910 (explaining that the prior proposed regulations have addressed comments regarding vacant and unused property).

the original use requirement.¹⁰⁶ However, the final regulations modified this rule substantially in order to better achieve Opportunity Zone goals by implementing a more specific test.¹⁰⁷ The finalized rules allow vacant and unused property to satisfy the original use provision in one of two ways.¹⁰⁸ First, there is only a one-year vacancy requirement for property that *was vacant* at the time notice of the Opportunity Zone’s designation was published and remained vacant until the property was purchased by a QOF.¹⁰⁹ Second, if the property *was not vacant* at the time notice of designation was published, the property must be vacant for three years before a QOF can claim its original use.¹¹⁰

This modification is far more beneficial for all parties than the original five-year provision.¹¹¹ The new one-year provision is appropriate because Opportunity Zone participants will not be able to purchase a property simply to then leave it vacant only for one year, thereby only abusing the property.¹¹² Additionally, the three-year provision helps taxpayers invest into Opportunity Zones quicker than the five year provision while still preventing the abuse that a one-year provision could provide.¹¹³

B. *Substantially All*

The phrase “substantially all” is used multiple times in the TCJA in differing contexts regarding Opportunity Zone property.¹¹⁴ The “substantially all” test is used to determine the usage requirements and holding period requirements for Opportunity Zone stocks, interests, and business property.¹¹⁵ The secondary proposals explained that in order to

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *See id.* (explaining the reasoning behind the modification of the original provisions).

112. *Id.* (explaining that participants cannot purchase something and then make it vacant as the one-year provision only applies to property already vacant).

113. *Id.*

114. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(d)(2)(B)–(D) (2018).

115. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(D)(i)(III) (“[D]uring substantially all of the qualified opportunity fund’s holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.”); TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(B)(i)(III) (“[D]uring substantially all of the qualified opportunity fund’s holding period for such stock, such corporation qualified as a qualified opportunity business.”); TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(C)(iii) (2018) (“[D]uring substantially all of the qualified

be declared eligible Opportunity Zone property, the stock, interest, or business property must be used in an Opportunity Zone 70% of the time.¹¹⁶ Also, substantially all of a holding period was considered to be 90% of the QOF's entire holding period.¹¹⁷ The finalized regulations adopted these percentage-based proposals, a decision beneficial for all parties.¹¹⁸

The final regulations make the benefits of these specific requirements clear.¹¹⁹ For these provisions, a threshold too low would prevent Opportunity Zones from maximizing the benefits from the investments, while a high threshold would disincentivize investors and likely decrease the creation of QOFs.¹²⁰ The QOF holding and usage requirements properly ensure that the goals of the Opportunity Zones legislation are met while still providing an incentive for investors.¹²¹ Specifically, the 90% holding requirement is appropriate because taxpayers holding Opportunity Zone property are more easily able to control and determine their holding period.¹²² Additionally, the 70% property usage requirement addresses concerns that business property may not be utilized enough within Opportunity Zones while simultaneously providing business property owners with some leeway in using their property.¹²³

opportunity fund's holding period for such interest, such partnership qualified as a qualified opportunity zone business.”).

116. TCJA § 13823, 26 U.S.C. § 1400Z-2(d)(2)(D)(III); Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1905 (Jan. 13, 2020) (finalized rule) (applying mostly just to business property since stocks and interests are not exactly capable of being physically used in this sense).

117. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1905 (Jan. 13, 2020) (finalized rule).

118. *Id.* at 1905–1906.

119. *See id.* at 1905 (explaining the benefits of using a 90% holding requirement test and a 70% usage requirement test).

120. *See id.* (explaining that the 70% standard allows for a “diverse spectrum of businesses” while the 90% standard encourages the long-term investments).

121. *See id.* (noting that the enforced higher standards promote long-term investments while the lower standards enforced promote diversity in the investments).

122. *See id.* (explaining that a standard over 70% for holding requirements is better since the taxpayers have more control for how long the property is held).

123. *See generally id.* at 1906 (“The Treasury department and the IRS . . . have determined that a 70% standard achieves an appropriate balance between providing proper flexibility to potential investors in QOZs and limiting the potential for abuse.”).

C. *In Consideration of Land*

In order to be eligible as Opportunity Zone business property, the TCJA requires that most forms of property are either substantially improved or maintain its original use in the Opportunity Zone.¹²⁴ However, the second proposal explained that land can be used for the purposes of Opportunity Zone businesses without being subject to the original use or substantial improvement provisions.¹²⁵ Commenters were concerned that this would lead to purchasers taking advantage of Opportunity Zones by not making improvements to the land.¹²⁶ In response, the second proposal also required that “land can be treated as qualified opportunity zone business property for purposes of section 1400Z-2 only if it is used in a trade or business of a QOF or qualified opportunity zone business.”¹²⁷ The final regulations maintain these rules, allowing land to act as Opportunity Zone property without being subject to the original use and substantial improvement provisions.¹²⁸

Requiring that land only be used in a trade or business of a QOF or Opportunity Zone business serves as a compromise between those who prefer requiring substantial land improvement and those who prefer less overall regulation on Opportunity Zones.¹²⁹ While the original use provision does not apply to land, the final regulations also explain that it is not the place of the IRS or Treasury to determine whether there has been substantial improvement because land can be used in a variety of ways.¹³⁰ Moreover, the earlier regulations clearly stated that “[i]n many cases, regulations that imposed a requirement on all types of trades or businesses to substantially improve . . . land that is used by them may encourage noneconomic, tax-motivated business decisions, or . . .

124. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(d)(2)(D)(i) (2018).

125. Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18652, 18654 (May 1, 2019) (to be codified at 26 C.F.R. pt. 1) (notice).

126. *Id.*

127. *Id.*

128. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1914–15 (Jan. 13, 2020) (finalized rule).

129. *See generally* Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18654–55 (proposed May 1, 2019) (notice) (detailing how the IRS responded to comments on the lack of regulation surrounding the improvement of land portions); Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1914–15 (Jan. 13, 2020) (finalized rule) (explaining that the proposals are made to give landowners some leeway while still requiring landowners to meet some standards).

130. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1915 (Jan. 13, 2020) (finalized rule).

prevent many businesses from benefitting”¹³¹ Additionally, the second proposals included anti-abuse rules that prohibit use of the land as Opportunity Zone property if the land is clearly purchased for “inappropriate tax purposes.”¹³² The final regulations adopt these anti-abuse rules, thus adding more protection against those who may attempt to purchase land with fraudulent or inappropriate reasons.¹³³

D. *Transactions Triggering Inclusion*

The TCJA explains that the invested gains will be included as income on December 31, 2026, or the date the investment is “sold or exchanged,” whichever occurs first.¹³⁴ Some comments to the IRS expressed concern that this provision does not address non-sale or exchange transactions that still involve some form of possessory transfer, such as gifting or abandonment.¹³⁵ In response to these comments, the proposed regulations provided that, “an inclusion event results from a transfer of a qualifying investment in a transaction to the extent the transfer reduces the taxpayer’s equity interest in the qualifying investment for Federal income tax purposes.”¹³⁶ The finalized regulations retain this rule and further clarify that “transactions described as inclusion events result in a reduction or termination of a qualifying investment’s status as a qualifying investment to the extent of the reduction or termination, except as otherwise provided in § 1.1400Z2(b)–1(c) or other provisions of the section 1400Z–2 regulations.”¹³⁷ Maintaining this rule is a wise decision because it prohibits investors from transferring their investments without including the gain in their

131. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18655 (proposed May 1, 2019) (notice).

132. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1933 (Jan. 13, 2020) (finalized rule).

133. *See id.* at 1991 (explaining that the anti-abuse rules are used to prevent transactions in which a significant purpose of the transaction is inconsistent with the purposes of the TCJA).

134. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(b)(1) (2018).

135. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 18661 (proposed May 1, 2019) (notice) (“By using the terms ‘sold or exchanged,’ section 1400Z-2(b)(1) does not directly address non-sale or exchange dispositions, such as gifts, bequests, devises, charitable contributions, and abandonments of qualifying investments.”).

136. *Id.*

137. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1877 (Jan. 13, 2020) (finalized rule).

income.¹³⁸ The final regulations do not actually hinder attempts to properly invest in Opportunity Zones.¹³⁹ Instead, the regulations prohibit the unethical exploitation of different tax loopholes in the TCJA.¹⁴⁰

IV. ISSUES FACING BANKS

Even with the finalized regulations providing guidance, banks still face some uncertainties in Opportunity Zone participation.¹⁴¹ Banks will not be able to participate in Opportunity Zones if they fail to properly structure projects and follow rules.¹⁴² The requirements for QOFs,¹⁴³ lack of transparency from large banks,¹⁴⁴ large scale investment requirements,¹⁴⁵ and limited amount of time all could serve as issues for banks, both large and small.¹⁴⁶

A. QOF Requirement Limitations

QOFs are a key tool when investing in Opportunity Zones, but the amount of statutory and regulatory QOF requirements may make it difficult for many banks—specifically small banks—to even find a QOF

138. *See id.* (explaining generally that a cashing out of an investment will trigger inclusion).

139. *Id.*; *see generally* *New Opportunity Zone Rules Answer Pressing Questions*, GRANT THORNTON (Apr. 18, 2019), <https://www.granthornton.com/library/alerts/tax/2019/Flash/new-opportunity-zone-rules-answer-questions.aspx> [<https://perma.cc/U6P3-58XC>] (describing how there is a nonexclusive list of events that will result in inclusion so that investors cannot cash out against the purposes of Opportunity Zones).

140. Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1877 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1); *see generally* *New Opportunity Zone Rules Answer Pressing Questions*, *supra* note 139 (explaining that the rules prevent taxpayers from cashing out without triggering gain).

141. Kelsey Lemaster & Karen Turk, *Proposed QOZ Regulations Offer Greater Clarity—But Significant Questions Remain*, GOODWIN LAW (May 9, 2019), https://www.goodwinlaw.com/publications/2019/05/05_09-proposed-qualified-opportunity-fund [<https://perma.cc/C8T3-5982>] (“The proposed regulations clarify several significant point but leave open many questions.”); *New Opportunity Zone Rules Answer Pressing Questions*, *supra* note 139 (“Areas of uncertainty remain, however, and the rules are complex and require projects to be structured in specific ways.”).

142. *New Opportunity Zone Rules Answer Pressing Questions*, *supra* note 139 (“Areas of uncertainty remain, however, and the rules are complex and require projects to be structured in specific ways.”).

143. *See infra* Part IV.A.

144. *See infra* Part IV.B.

145. *See infra* Part IV.C.

146. *See infra* Part IV.D.

in the first place.¹⁴⁷ This is an issue for anyone attempting to invest because QOF creation is such a complex process that the opportunity to find a reputable QOF with flourishing property to invest into may be difficult.¹⁴⁸ However, these requirements will certainly prove more burdensome for small banks that have neither the financial nor human capital to invest at a rate that large banks, such as PNC, can and already have.¹⁴⁹

Some of these limitations have already been mentioned, such as the original use and substantially all provisions, as well as the many percentage-based requirements for Opportunity Zone businesses.¹⁵⁰ However, there are additional requirements for QOFs that could limit the amount of QOFs found in Opportunity Zones, thus having a negative impact on banks' ability to find vehicles for investment.¹⁵¹ For example, the original use provision is accompanied by a substantial improvement provision requiring that tangible property which does not have its original use within the Opportunity Zone must be substantially improved.¹⁵² Therefore, if entities hoping to self-certify as QOFs cannot take advantage of a property's original use, then the entities must substantially improve whatever property they may be able to find.¹⁵³

B. *Lack of Transparency*

Another issue specifically facing small banks is the lack of transparency required from larger banks on their Opportunity Zone

147. See Levy, Gianou & Lopo, *supra* note 2 (“[T]he details of structuring an OZ Fund can be complicated by certain statutory requirements.”); see generally Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18652 (proposed May 1, 2019) (to be codified at 26 C.F.R. pt. 1) (notice) (detailing all of the QOF regulatory requirements in the second round of proposals); Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18666 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule) (detailing all of the QOF regulatory requirements in the final rules).

148. See Levy, Gianou & Lopo, *supra* note 2 (“[T]he details of structuring an OZ Fund can be complicated by certain statutory requirements.”).

149. See Peters, *supra* note 5 (explaining generally that large banks have more resources to utilize for investments than small banks).

150. See *supra* Part II.C; see *supra* Part III.A–B.

151. See generally Levy, Gianou & Lopo, *supra* note 2 (discussing the difficulties of exiting QOFs, tests for Opportunity Zone business stock and partnership interests, and the dangers of a penalty tax).

152. Investing in Qualified Opportunity Funds, 84 Fed. Reg. 18666 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule).

153. *Id.*

investments.¹⁵⁴ There are currently no statutory or regulatory requirements for an Opportunity Zone investor to disclose anything regarding their method of investment.¹⁵⁵ Because of this, small banks may find it rather difficult to find reasonable models for Opportunity Zone participation that suit their business preferences.¹⁵⁶ Large banks, by virtue of having more capital, hold an advantage over small banks in their ability to determine how to invest in Opportunity Zones.¹⁵⁷ Small banks, while still technically having the same statutory and regulatory opportunities as large banks, do not have the same access to the investment tools that large banks have. This is mainly due to the capability of large banks to pay for the human capital that promotes intelligent business investments.¹⁵⁸

C. *Scale of Investment*

The long-term investment requirement is easily one of the biggest hurdles for banks in terms of Opportunity Zone participation.¹⁵⁹ The minimum amount of time to receive any tax benefits at all from an Opportunity Zone investment is five years, with a ten-year requirement for the maximum benefit.¹⁶⁰ Indeed, Opportunity Zones require investors to hold their investments for longer than most typical investments.¹⁶¹

154. Peters, *supra* note 5 (explaining that banking officials are hoping that regulations will be passed forcing large banks to disclose their records on Opportunity Zone investments).

155. *Id.* (“As of now, it is impossible to know what is happening with Opportunity Zone projects, which makes it difficult for small banks to find models for how to participate”); see Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z (2018) (providing the statutory background for Opportunity Zones where there is no requirement to disclose information of investment methods); Investing in Qualified Opportunity Funds, 84 Fed. Reg. at 1866 (Jan. 13, 2020) (finalized rule) (providing the regulatory background for Opportunity Zones where there is no requirement to disclose information of investment methods).

156. Peters, *supra* note 5.

157. See *generally id.* (discussing how large banks have been investing in Opportunity Zones and could serve as models for small banks if given the chance).

158. *Id.*

159. See Molly Oelerich, *The Real Opportunity in Opportunity Zones*, FIFTH THIRD BANK, <https://www.53.com/content/fifth-third/en/commercial-banking/resource-center/acting-on-your-industry/real-opportunities-opportunity-zones.html> [<https://perma.cc/8SFW-6694>] (last visited Sept. 21, 2019) (“The tax benefits require a longer holding period than many commercial real estate investors are used to. That may necessitate looking at deals a bit differently to ensure enough capital is reserved to fund operations and management-related expenses.”).

160. Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(b)(2)(B)(iii), 1400Z-2(c) (2018).

161. See Oelerich, *supra* note 159 (explaining that commercial real estate investors are not accustomed to holding periods as long as those seen in Opportunity Zones).

With some banks predicting a possible economic downturn on the horizon,¹⁶² a long-term investment into geographic regions specifically determined to be low-income communities may not be financially feasible for banks that do not have the financial capital or security that more established banks have.¹⁶³ This is an issue most pertinent to smaller banks that have limited financial resources in comparison to larger banks, who may be more capable of withstanding a long-term investment.¹⁶⁴ Furthermore, if small banks choose to make investments through capital gains, they must also ensure that after investing, they have enough stored capital from previous transactions to continue standard operations and cover other expenses.¹⁶⁵

However, while banks should tread carefully before making future long-term investments, they should by no means consider Opportunity Zone investment to be a futile effort as there are examples of banks, both large and small, investing in Opportunity Zones.¹⁶⁶ For instance, Optus Bank, a three-location bank in South Carolina, is currently considering a \$6.5 million construction loan for an expansion of a charter school building in Columbia.¹⁶⁷ Additionally, Washington D.C.'s City First Bank—a single-location,¹⁶⁸ \$366 million asset bank—plans to participate in Opportunity Zones by uniting investors and lenders, regardless of the ten-year requirement for maximum tax

162. See DAVID KELLY & JORDAN JACKSON, J.P. MORGAN ASSET MGMT., BEING PREPARED FOR THE NEXT MARKET DOWNTURN 2 (2019), <https://am.jpmorgan.com/us/institutional/library/preparing-dc-plan-participants-for-the-next-market-downturn> [<https://perma.cc/W36V-HCGQ>] (“[T]he economy should grow more slowly and slow growth combined with some exogenous shock could trigger a recession, with the risk rising in late 2019 and 2020.”).

163. See generally Peters, *supra* note 5 (giving background information on small banks not having the same financial standing as large banks).

164. See generally *id.* (explaining that small banks face challenges in participating in Opportunity Zones).

165. Oelerich, *supra* note 159.

166. See generally Peters, *supra* note 5 (providing examples of a small South Carolina bank investing in Opportunity Zones as well as a large bank in PNC investing in Opportunity Zones).

167. *Id.*

168. CITY FIRST BANK, <https://www.cityfirstbank.com/node/267> [<https://perma.cc/42BK-L682>] (last visited Oct. 7, 2019).

benefits.¹⁶⁹ As for larger banks, PNC has clearly established that large banks have the financial capabilities to invest in opportunity zones.¹⁷⁰

D. Limited Amount of Time

As mentioned above, Opportunity Zone investors will not be taxed until the earlier of the date in which the asset is disposed of or the end of 2026.¹⁷¹ Therefore, there is a limited amount of time for investors to invest and take advantage of the tax benefits.¹⁷² Taxpayers who have not already invested in Opportunity Zones are no longer capable of reaching the seven-year tax benefit because only investments made prior to the end of 2019 can reach the latest taxable date at the end of 2026.¹⁷³ However, taxpayers can only take advantage of the five-year tax benefit if they invest prior to the end of 2021.¹⁷⁴ While this is certainly a limitation to Opportunity Zone investment, losing the seven-year benefit should not serve as a complete disincentive because the five- and ten-year tax benefits are still extensive.¹⁷⁵

V. OPTIONS FOR BANKS TO INVEST

While banks should be mindful of the issues facing Opportunity Zone investment, there are still options for banks of all sizes to get involved with the program.¹⁷⁶ Banks can utilize capital gains,¹⁷⁷ provide loans,¹⁷⁸ create investment funds,¹⁷⁹ and even profit in a more indirect

169. See Peters, *supra* note 5 (providing an example of a small bank CEO who acknowledges the ten-year requirement yet still believes participation is possible through as an intermediary between investors and developers).

170. See Matthew Rothstein, *PNC Backs Local Developer's Opportunity Zone Project in Kensington*, BISNOW (Feb. 20, 2019), <https://www.bisnow.com/philadelphia/news/opportunity-zones/pnc-opportunity-zone-kensington-development-civetta-property-group-97615> [https://perma.cc/V7QU-RPAD] (providing an example of how PNC has invested in a Kensington Opportunity Zone).

171. See *supra* Part II.E.

172. *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7.

173. *Id.*

174. *Id.*

175. See *id.* (explaining that missing the seven-year tax benefit does not preclude investors from receiving the five-year benefit).

176. See *generally id.* (explaining that there are some benefits for community banks, such as creating equity funds and providing loans).

177. See *infra* Part V.A.

178. See *infra* Part V.B.

179. See *infra* Part V.C.

way from the business resources Opportunity Zones will bring into low-income communities.¹⁸⁰

A. *Capital Gains Investments*

Technically, the first way banks can participate in Opportunity Zones is the same way most taxpayers would participate in Opportunity Zones—reallocating realized capital gains by investing them into QOFs for tax benefits.¹⁸¹ However, it is unlikely that many banks, especially smaller institutions, will take on this form of direct investment.¹⁸² Moreover, this would require banks to have some form of realized capital gain to invest in the first place, something which many banks do not have due to special tax rules.¹⁸³ Regardless of this limitation, if banks do somehow come into possession of properly realized capital, it would behoove them to be aware that direct investment is always an option.¹⁸⁴

B. *Loans*

Loans are the simplest way any bank can participate in Opportunity Zones.¹⁸⁵ As a primary function of banks, even the smallest banks can take advantage of new business ventures requiring loans.¹⁸⁶ Opportunity Zones will bring business opportunities to low-income communities all over the country where local banks can provide loans to developers who may have to substantially improve property for the sake of qualifying as a QOF under the new regulations.¹⁸⁷ Moreover, in order

180. See *infra* Part V.D.

181. See *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7 (explaining that it is unlikely many community banks will directly invest into Opportunity Zones).

182. *Id.*

183. Meinert, *supra* note 3 (“Due to special tax rules, many banks do not have capital gain income and may have limited opportunity to invest themselves.”); *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7 (explaining that most banks will not directly invest in Opportunity Zones).

184. See *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7 (explaining that it is unlikely many community banks will directly invest into Opportunity Zones).

185. See Peters, *supra* note 5 (explaining that banks are expected to get involved by providing developers with loans).

186. E. Gerald Corrigan, *Are Banks Special?*, FED. RES. BANK OF MINNEAPOLIS (Jan. 1, 1983), <https://www.minneapolisfed.org/article/1983/are-banks-special> [<https://perma.cc/MS4N-PKXE>] (explaining that one of the three characteristics that makes banks unique is how they serve as a backup source of liquidity).

187. See Peters, *supra* note 5 (explaining that banks are expected to get involved by providing developers with loans).

to satisfy regulatory requirements,¹⁸⁸ developers will likely require loans to develop property so that it may be used in the trade or business of an Opportunity Zone business.¹⁸⁹

The loan possibilities brought in by the new legislation will bring banks many opportunities to create loans that may not have been financially feasible without the Opportunity Zone tax benefits.¹⁹⁰ This is particularly true for commercial real estate loans.¹⁹¹ For example, in what turned out to be a \$15 million investment, PNC bank provided a \$4.2 million loan to a Birmingham, Alabama housing development project, with a majority of the rest provided through PNC's QOF equity investment.¹⁹² QOFs generally require funding in order to satisfy their requirements, and as the general vehicle for Opportunity Zone investment, QOFs will always be around for banks to provide loans for.¹⁹³

C. *Creating Investment Funds*

Another way banks can participate in Opportunity Zones is by creating investment funds.¹⁹⁴ Instead of directly investing capital gains into other QOFs, banks can utilize their own properly-created QOFs to inject equity into Opportunity Zone Projects, as PNC and other large entities have done.¹⁹⁵ These investment funds essentially work as wholly-owned QOFs established by the banks for the purposes of facilitating investment.¹⁹⁶ Additionally, this is where CDFIs may become useful, as banks can look for CDFIs to assist in providing debt for their

188. *See generally* Investing in Qualified Opportunity Funds, 84 Fed. Reg. 1866, 1898 (Jan. 13, 2020) (to be codified at 26 C.F.R. pt. 1) (finalized rule) (providing the regulatory requirements for the use of property in a trade or business of an Opportunity Zone business).

189. *See* Peters, *supra* note 5 (“Banks expect to be involved primarily by making loans to developers backed by investors.”).

190. *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7.

191. *See* Andy Peters, *Will This Be CRE Lenders' New Best Friend?*, AM. BANKER (Oct. 29, 2018, 2:35 PM), <https://www.americanbanker.com/news/will-this-be-cre-lenders-new-best-friend> [<https://perma.cc/5XJ3-TRDW>] (explaining that commercial real estate loans could be beneficial for banks in Opportunity Zone investment).

192. PNC, *supra* note 24.

193. *See* Meinert, *supra* note 3 (“[T]he bank has already begun doing outreach to local developers to ensure that if they establish qualified opportunity funds, the bank is in a position to make the loan.”); *see generally* Tax Cuts and Jobs Act (“TCJA”) § 13823, 26 U.S.C. § 1400Z-2(d)(1) (2018) (providing the statutory definition for QOFs to show that QOFs are the investment vehicles for Opportunity Zones).

194. Peters, *supra* note 5.

195. *Id.*

196. PNC, *supra* note 24.

investment projects run through their wholly owned QOFs.¹⁹⁷ However, because banks have limited powers,¹⁹⁸ the appropriate location for QOFs within the banking system is either as a subsidiary corporation of the bank or as a subsidiary under the holding company structure.¹⁹⁹ Additionally, banks should be aware that the limitations of the Volker Rule may apply to institutions subject to its rules when creating QOFs for their own accounts and purposes.²⁰⁰

In 2018, PNC created the PNC OPZONE Community Development Fund, Inc., a QOF funded entirely by the bank to invest in Opportunity Zone projects that the bank is involved in.²⁰¹ PNC bank utilized the PNC OPZONE Community Development Fund with the \$15 million housing project investment mentioned above.²⁰² PNC bank also employed its own QOF when it invested \$8 million, also backed by a \$2.5 million loan, into an Opportunity Zone project in Kensington, a Philadelphia neighborhood.²⁰³ That Opportunity Zone project included a five-story, fifty-six unit apartment building²⁰⁴ in one of the most impoverished and drug-riddled neighborhoods on the east coast.²⁰⁵ Indeed, banks capable of creating their own investment funds in the form

197. See Seth Julyan, *Learn How PNC is Starting an Opportunity Zone Fund*, OPPORTUNITY FIN. NETWORK (July 30, 2018) <https://ofn.org/articles/learn-how-pnc-starting-opportunity-zone-fund> [<https://perma.cc/M9W4-JG4L>] (explaining that PNC is looking for CDFIs to help assist in providing debt for their Opportunity Zone projects).

198. National Bank Act (“NBA”) § 1, 12 U.S.C. § 24(Seventh) (2018).

199. See FDIC, *OPPORTUNITY ZONES: COMMUNITY BANKS, MINORITY DEPOSIT INSTITUTIONS, AND CDFI BANKS* (2019) (Draft of forthcoming FDIC report) <https://www.fdic.gov/communitybanking/2019/2019-10-10-opzones-mdi.pdf> [<https://perma.cc/WC6C-NANR>] (describing generally how QOFs can be established as bank subsidiaries but also will be subject to limitations of the Bank Holding Company Act).

200. The Volker Rule implements some restrictions on banks’ ability to engage in proprietary trading and have relationships with certain financial entities such as hedge funds and private equity funds. However, there is an exception for “banks with total assets of \$10 billion or less and trading assets and liabilities of 5 percent or less of total consolidated assets.” *Id.*

201. PNC, *supra* note 24.

202. *Id.*

203. Rothstein, *supra* note 170.

204. Jacob Adelman, *Philly Developers Start Cashing in on Trump Tax Breaks, as ‘Opportunity Zone’- Funded Projects Advance*, THE PHILA. INQUIRER (Apr. 5, 2019), <https://www.inquirer.com/real-estate/commercial/opportunity-zones-philadelphia-brewerytown-kensington-germantown-sage-pnc-20190405.html> [<https://perma.cc/8LJC-QD7A>].

205. See generally Jennifer Percy, *Trapped by the ‘Walmart of Heroin’*, N.Y. TIMES (Oct. 10, 2018), <https://www.nytimes.com/2018/10/10/magazine/kensington-heroin-opioid-philadelphia.html> [<https://perma.cc/4AVC-NLK5>] (providing background on the drug and poverty issue in Kensington).

of QOFs could certainly benefit from following PNC's model.²⁰⁶ Although, it is important to note, that while small banks should certainly consider this as a possible option, it is probably reserved for larger banks as well as other nonbank entities that have the financial resources and regulatory capacity to make such subsidiaries.²⁰⁷

D. *Indirect Methods of Participation*

Some banks simply may not be in the position to participate heavily in Opportunity Zones, most specifically smaller banks with less resources.²⁰⁸ In such a case, small banks located in and around Opportunity Zones can still flourish from the Opportunity Zone program.²⁰⁹ Because the goal of the program is to bring capital and jobs into low-income communities, Opportunity Zones will provide bankers with more opportunities to lend to other projects and possibly more residents to open new accounts.²¹⁰ In simpler terms, banks that have chosen not to directly partake in Opportunity Zone loans and investments for themselves should still be aware of their chances to take advantage of the general increase of human and financial capital that Opportunity Zones can bring to their areas.²¹¹

One way banks can grow from the Opportunity Zone presence is by allowing their bankers to act as partners with the city to generally oversee Opportunity Zone investment.²¹² Local governments are incentivized to partner with qualified community representatives to

206. See Peters, *supra* note 5 (“Banks can also establish investment funds to inject equity into these projects . . .”).

207. See *id.* (explaining that investment funds have primarily been made by private equity groups and companies); *Opportunity Zones: Can Your Bank Benefit?*, *supra* note 7 (“Its unlikely that many banks will invest directly in opportunity zone projects . . .”).

208. See generally Peters, *supra* note 5 (explaining generally that for small banks, participation in Opportunity Zones may not be feasible).

209. Meinert, *supra* note 3.

210. See generally *id.* (noting generally how Opportunity Zones increase economic activity with banks in low-income areas); Scott, *supra* note 12 (expressing that the goal of Opportunity Zones is to bring in jobs and economic investment into low-income areas).

211. See generally Meinert, *supra* note 3 (mentioning that Opportunity Zones increase financial activity with banks in low-income areas).

212. See Local Initiatives Support Corporation, *Initiatives and Guardrails in the Opportunity Zones*, LISC OPPORTUNITY ZONES, <https://www.lisc.org/opportunity-zones/community-partners-playbook/step-three/> [<https://perma.cc/Z96J-5YAR>] (last visited Oct. 21, 2019) (explaining that bankers are reasonable options to serve as partners to cities in Opportunity Zone oversight).

ensure that no negative effects, such as gentrification,²¹³ are brought to the community by larger investors.²¹⁴ Experienced local bankers could be the perfect people for the job.²¹⁵ In partnering with cities to oversee Opportunity Zones, bankers may not be directly involved with Opportunity Zone investment through their own loans and investments, but they will be helping to ensure that their communities flourish.²¹⁶ By encouraging their bankers to partner with cities to oversee Opportunity Zones, banks can both cultivate a friendly presence in the community and gain experience with Opportunity Zones in case the bank does choose to participate in the future.²¹⁷ While this would not be participation to the extent of investment or loans, it would still allow smaller banks incapable of or uncomfortable with more intensive participation to benefit from Opportunity Zones.²¹⁸

VI. CONCLUSION

The Opportunity Zone legislation and regulations are still new, but the chances for investors, banks, and Opportunity Zone residents are tremendous.²¹⁹ Banks particularly should be cautious in their participation in Opportunity Zones, but possibilities for engagement will be plentiful.²²⁰ Larger banks should be aware of the abundance of options they have in participating in Opportunity Zones, most notably through

213. See generally Angela Peoples, *Opportunity Zones Are Just an Opportunity for the Rich to Gentrify Poor Neighborhoods*, MARKETWATCH (Oct. 29, 2019, 6:04 AM), <https://www.marketwatch.com/story/opportunity-zones-are-just-an-opportunity-for-the-rich-to-gentrify-poor-neighborhoods-2019-10-29> [<https://perma.cc/V6L2-GG6Z>] (providing an example of the fears of gentrification in Opportunity Zones).

214. See *id.* (explaining that local governments should put guardrails in place to prevent Opportunity Zone developments from negatively impacting their communities).

215. See Local Initiatives, *supra* note 212 (explaining that bankers are reasonable options to serve as partners to cities in Opportunity Zone oversight).

216. See generally *id.* (explaining that partners with the city would be helping to ensure that investments have no negative effects and support the existing population).

217. See *id.* (detailing how community driven bankers can be good options for cities to partner with).

218. See *id.* (explaining that bankers can gain experience with Opportunity Zones by partnering with cities).

219. See generally UBS, *Making an Opportunity of Opportunity Zones*, (Jan. 31, 2019), <https://www.ubs.com/microsites/wma/insights/en/investing/2019/opportunity-zones.html> [<https://perma.cc/QR65-3SS9>] (discussing Opportunity Zone plans involving both Amazon and the football team, the Oakland Raiders).

220. See generally Oelerich, *supra* note 159 (“U.S. investors are estimated to be holding \$6.1 trillion in unrealized gains that would qualify for investment in the program.”).

providing loans to real estate projects²²¹ and by creating their own QOFs to inject equity into Opportunity Zone projects.²²² Even though these could be options for all banks, smaller banks would be better suited to focus only on providing loans²²³ and by taking advantage of the more indirect community building resources that Opportunity Zones provide.²²⁴ Overall, while investments and resources will flow from the Opportunity Zones, a bank's best option for participating in Opportunity Zones is the issuance of loans for QOFs and QOF developers.²²⁵

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221. *See supra* Part V.B.

222. *See supra* Part V.C.

223. *See supra* Part V.B.

224. *See supra* Part V.D.

225. *See* Peters, *supra* note 5 (explaining that banks are expected to get involved by providing developers with loans).

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