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QUALIFIED OPPORTUNITY FUNDS: PRIVATE EQUITY EXEMPTIONS FROM PUBLIC RESPONSIBILITY

ABSTRACT

The historic Tax Cuts and Jobs Act (TCJA), passed and signed into law in 2017, included a pilot program of a new kind of tax advantage: the Qualified Opportunity Zone. The obscure provision has since spawned novel investment vehicles, called Qualified Opportunity Funds, through which qualified individuals and entities participate in what are often significant tax advantages, including deferral of capital gains for up to ten years. Because Qualified Opportunity Funds have come into existence so recently, regulation has been slow to catch up to the ways in which this tax program is rapidly attracting capital from private equity, investment banks, and even real estate crowdfunding platforms. While the program purports to improve underdeveloped areas of the United States, in practice the dearth of guidelines directing these investments perpetuates a black hole of information surrounding the risk and reporting of the investments, and also invokes securities laws as merely a minimum threshold, rather than meaningfully regulating how and with whom the funds can invest. This Note suggests that greater mandated disclosure requirements, and an extension of the tax incentives to investments only in particular kinds of projects—those that actually advance the goals envisioned by the TCJA provision—would improve the program's efficacy and protect investors across the spectrum.

INTRODUCTION

A think tank cofounded by Sean Parker,[1] lobbied for a novel kind of tax incentive:[2] invest in "high-poverty" communities and reap outsized returns.[3] This idea initially garnered the support of Democrats and Republicans.[4] In December 2017, Congress passed and President Trump signed into law the Tax Cuts and Jobs Act (TCJA),[5] a "landmark overhaul"[6] of the tax code that

1. Lydia DePillis, *A "Mind-Boggling" Tax Break Was Meant to Help the Poor. But Trendy Areas Are Winning Too*, CNN (June 14, 2019), https://www.cnn.com/2019/06/14/economy/opportunity-zones-investing-los-angeles/index.html. Sean Park is most notably known for cofounding Napster in 1999 and serving as Facebook's first president in 2004. *Sean Parker*, ENCYCLOPEDIA BRITANNICA (Oct. 12, 2019), https://www.britannica.com/biography/Sean-Parker.

2. Jesse Drucker & Eric Lipton, *How a Trump Tax Break to Help Poor Communities Became a Windfall for the Rich*, N.Y. TIMES (Sept. 27, 2020), https://www.nytimes.com/2019/08/31/business/tax-opportunity-zones.html.

3. DePillis, *supra* note 1.

4. Drucker, *supra* note 2.

5. Matthew R. Joyce, *In the (O)Zone: New Tax Program Guides Investor Capital to Areas of Need*, 68 R.I. BAR J. 9, 9 (2019).

6. *Id.*

included a new incentive for "private equity investment in lower income areas."[7] The new law created a provision allowing the deferral of capital gains taxes from real estate and business investments made in struggling areas called opportunity zones[8] with few regulatory restrictions on how those investments can be made.[9] It is no surprise that "more than 200 [opportunity zone] funds have been established" by banks and real estate companies with the objective of raising up to $57 billion for investment into new projects.[10] Not even the COVID-19 pandemic has dissuaded developers from "pump[ing] billions of dollars into the [opportunity] zones nationwide."[11]

In October 2018, the Internal Revenue Service (IRS) issued proposed regulations outlining the basic structure of section 1400Z-2, which outlined the type and timing of gain deferral.[12] In May 2019, section 1400Z-2 was further clarified with proposed regulations regarding the use and eligibility of types of property.[13] Most recently, on January 13, 2020, the IRS published final regulations on section 1400Z-2, concretizing the tax rules that allow Qualified Opportunity Zones (QOZs) the attractive incentives to the funds that invest in them.[14]

The funds are special investment vehicles, called Qualified Opportunity Funds (QOFs),[15] wherein investors can defer capital gains taxes on their invested capital if assets are held up to ten years.[16] This enables the investment of large sums in the present that can "potentially gener[ate] more profits over time."[17] The legislative purpose of QOFs is to direct capital into underdeveloped communities where it is most needed.[18] Due to the expansive definition of what kind of investments are qualified,[19] massive amounts of capital (seemingly necessary to take advantage of the tax benefits) has flown into QOFs.[20] For example, the single largest known QOF is managed by CIM

7. Kelly L. Frey, *Opportunity Zones: The Good, The Bad And The Ugly*, LAW 360 (Jan. 29, 2019), https://www.law360.com/articles/1122587/opportunity-zones-the-good-the-bad-and-the-ugly; *Opportunity Zones Frequently Asked Questions*, INTERNAL REVENUE SERV. (Dec. 15, 2020), https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions.

8. Drucker, *supra* note 2.

9. *Id.*

10. *Id.*

11. Joe Gose, *Despite Challenges, Opportunity Zones Provide Much-Needed Capital*, N.Y. TIMES (Nov. 24, 2020), https://www.nytimes.com/2020/11/24/business/opportunity-zones-funding-development.html?referringSource=articleShare.

12. *See* Federal Register 26 CFR Part 1, Investing in Qualified Opportunity Funds (Jan. 13, 2020).

13. *Id.*

14. *Id.*

15. DePillis, *supra* note 1.

16. *Id.*; *See* Federal Register 26 CFR Part 1, Investing in Qualified Opportunity Funds (Jan. 13, 2020).

17. Drucker, *supra* note 2.

18. DePillis, *supra* note 1.

19. Special Rules for Capital Gains Invested in Opportunity Zones 26 U.S.C.S. § 1400Z-2 2(D)(i)-(I-III) (LexisNexis 2019).

20. Drucker, *supra* note 2.

Group and looks to raise $5 billion for opportunity zone projects.[21] QOFs investing in America's underdeveloped communities are poised to necessarily produce large consequences for those communities.[22]

The nature of private markets is such that private funds (including QOFs) generally do not have to provide information about their holdings, performance, or fees to potential investors or the public, including the community in which it invests capital.[23] Although the underlying assets in a QOF would typically be considered a security under securities regulations,[24] there are major exemptions available to QOFs in certain circumstances. If the QOF does not solicit its investment offerings to the public, and if a QOF's ownership remains limited to a certain number and type of investor, that fund may not have to disclose any information about itself.[25]

When the recent TCJA created the QOZ program, the federal government incentivized the rebuilding of communities to private individuals with enough capital to benefit from the tax treatment of the venture.[26] While new economic growth is generally a laudable achievement, it stands to reason that both potential investors and the public are still entitled to information about the funds derived from the tax benefits of QOFs that purport to deliver high returns,[27] and which tangibly alter neighborhoods.[28] Disclosure seems especially important because QOFs have a government mandate to improve areas of the country,[29] in addition to enabling an avenue to achieve a high return on investment.[30]

As part of the Trump administration's successful effort to deliver historic tax reform,[31] a new investment vehicle, the QOF, was sanctioned as a tool for certain types of investors to invest in distressed communities while benefiting from tax incentives on capital gains. The purpose of the funds is to carry out

21. DePillis, *supra* note 1.

22. *Id.*

23. *Id.*; *Private Equity's Other Transparency Problem*, INSTITUTIONAL INV. (July 8, 2017), https://www.institutionalinvestor.com/article/b1505pghn17t4s/private-equitys-other-transparency-problem.

24. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, SEC. AND EXCH. COMM'N (July 31, 2019), https://www.sec.gov/page/staff-statement-opportunity-zones-federal-and-state-securities-laws-considerations.

25. *Id.*

26. Drucker, *supra* note 2.

27. Ryan Ermey, *Opportunity Zone Investing: Is It for You?*, KIPLINGER (June 5, 2019), https://www.kiplinger.com/article/investing/T041-C000-S002-opportunity-zone-investing-is-it-for-you.html.

28. DePillis, *supra* note 1.

29. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.

30. Ermey, *supra* note 27.

31. *President Trump Proposed a Massive Tax Cut. Here's What You Need to Know*, WHITE HOUSE (Apr. 26, 2017), https://www.whitehouse.gov/articles/president-trump-proposed-massive-tax-cut-heres-need-know/.

investments in these communities to ideally spur greater business activity.[32] The tax incentives associated with QOFs are really only accessible to wealthy investors who roll over their capital gains from a previous project and do not sell the QOF asset for seven to ten years.[33] This inaccessibility, combined with the fact that QOFs can be structured to exempt themselves out of the usual public disclosure required for securities, creates an opaque system where money that is ostensibly improving communities is shrouded in unnecessary darkness. While the lack of government oversight and regulation of these funds may be a boon to investors by allowing them flexibility in choosing projects to pursue,[34] it provides little to no insight into projects that are ultimately achieving the public purpose of redevelopment.[35]

If QOFs prove themselves to be a successful method for improving areas of the nation, they may be a model for future legislation. For both the present iteration of the law and for any similar future tax incentive, this Note proposes two solutions to improve access to information about QOFs in spite of disclosure exemptions: (1) enact stronger disclosure regulations for governmentally incentivized projects regardless of whether the funding is public or private equity—such as QOFs—so that the public, investors or not, can apprise themselves of the investments and changes to their communities; and (2) amend the QOZ tax provision to only grant incentives for investing when money is invested in particular ways.

Government should not abdicate its own role in public development to unfettered private capital in QOFs to spur economic growth in depressed areas without *also* requiring: (1) disclosure about the funds to other investors and the public; and (2) investment in productive economic activity, rather than investment that chases the highest rate of return (and with preferential tax treatment no less). Modest reform of the QOF can ensure that this type of investment vehicle carries out its legislative purpose of delivering real growth where it is desperately needed.

Part I of this Note defines the QOF, its origin, structure, and purpose, and how these factors allow for ambiguity when interpreting the regulations. Next, Part II provides a brief introduction to securities laws and an examination of how they offer little guidance for QOFs and also enable a lack

32. Samantha Jacoby, *Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection*, CTR. ON BUDGET AND POL'Y PRIORITIES (May 1, 2019), https://www.cbpp.org/blog/opportunity-zone-regulations-favor-investor-flexibility-over-community-protection.

33. Samantha Jacoby, *Potential Flaws of Opportunity Zones Loom, As Do Risks of Large-Scale Tax Avoidance*, CTR. ON BUDGET AND POL'Y PRIORITIES (Jan. 11, 2019), https://www.cbpp.org/research/federal-tax/potential-flaws-of-opportunity-zones-loom-as-do-risks-of-large-scale-tax.

34. *Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection*, *supra* note 32.

35. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.

of accountability. Part III proposes reform of QOFs through examples of possible models of disclosure requirements and amendment of the tax incentive to promote actual economic activity.

I. TAX REFORM AND OPPORTUNITY ZONES

As part of the 2017 TCJA, opportunity zones were included as a robust incentive for investors to deploy capital "with limited government oversight."[36] In this way, Congress sought to encourage investment where revitalization was most needed in "low-income communities." [37] State governors nominated locations within their respective states to be included in these zones.[38] The Secretary of the Treasury approved nominations and certified the zones.[39] Later, the IRS published a map of all census tracts considered a QOZ after the passage of the new legislation.[40] The map provides investors with approximately 8,700 tracts[41] across all U.S. states and some territories[42] that qualify for investments. Investments in QOZs are subject to generous tax benefits, which include tax deferral on capital gains, tax exclusion of capital gains, and the ten-year benefit.

First, with respect to tax deferral, "an eligible taxpayer may elect to defer recognition [of gains] to a date that is no later than [December] 31, 2026," provided that the taxpayer invest in a QOF "within the 180-day period [after a sale of an asset that would incur capital gains]."[43] In other words, the taxpayer must reinvest his untaxed gains in a QOF.[44] The taxpayer is also required to elect to defer the eligible gain.[45] Both long-term and short-term capital gains are eligible for deferral.[46] Second, with respect to tax exclusion of gains, as long as the taxpayer has held an investment in a QOF at least five

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36. Joyce, *supra* note 5, at 9.

37. Text of Amendments, 163 Cong Rec S 7721, 7727, 115th Cong. (Dec. 1, 2017).

38. *Id.*

39. Matthew Bender & Company, Inc., 2019 *Emerging Issues 8734, Qualified Opportunity Zones: Prop. Regs.*, LEXIS (May 8, 2019).

40. *Opportunity Zones Resources*, U.S. DEP'T. TREASURY COMMUNITY DEV. FIN. INSTITUTIONS FUND (Oct. 12, 2019), https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx; *See also Designated Qualified Opportunity Zones Under Internal Revenue Code § 1400Z-2: IRS Notice 2018-48, 2018–28 Internal Revenue Bulletin 9, July 9, 2018, IRS Notice 2019-42, 2019–29 Internal Revenue Bulletin, July 15, 2019*, INTERNAL REVENUE SERV. (Oct. 12, 2019), https://www.irs.gov/pub/irs-drop/n-18-48.pdf (listing all population census tracts designated as QOZs for purposes of Internal Revenue Code §§ 1400Z-1 and 1400Z-2).

41. Bender, *supra* note 39.

42. Joyce, *supra* note 5.

43. Marc Schultz, *An In-Depth Guide to Latest Opportunity Zone Regs: Part 1*, LAW 360 (June 14, 2019), https://www.law360.com/articles/1169157/an-in-depth-guide-to-latest-opportunity-zone-regs-part-1.

44. Ronald P. Cima and Brett R. Cotler, *Recent Developments Relating to Investments in Qualified Opportunity Zone Funds*, 36 J. TAX'N INV. 11 (2019).

45. *Id.*

46. *Id.*

to seven years before recognizing a capital gain,[47] an investor can "exclude from tax up to 15 percent of the gain on the sale or exchange of capital assets, and to defer the remainder until no later than 2026, if one or more investments are made in a qualified opportunity fund…within 180 days."[48] Third, the ten-year benefit to investors allows taxpayers to defer any capital gains taxes on the money they invest in opportunity zones "for up to seven years…and not owe any taxes on the profits" after ten years.[49] More specifically, the taxpayer in this situation can elect to "increase the income tax basis of his or her investment (which is zero at the time such investment is made) in the QOF to the investment's fair market value on the date of sale…thereby eliminating any taxable gain."[50]

Taken together, the generous, but time-barred tax incentives present an unparalleled opportunity for potential return on investment. Unlike IRS Code 1031, which allows an unlimited timeframe on tax deferral of capital gains on like kind property exchanges, the QOF tax benefit expires in December 2028.[51] Further, it "applies to almost any type of project, requires no bureaucratic approval or monitoring[,] and has no cap."[52] This gives potential investors a limited window in which to take advantage of the opportunity to defer their QOF capital gains on virtually any qualified business or property investment subject to fund formation requirements.

A. QOF STRUCTURE

To qualify for the tax benefits outlined in the TCJA, a QOF must be established as an entity investing specifically in an opportunity zone. Qualified entity types include either a "corporation or a partnership,"[53] although a "taxpayer," such as an "individual, a trust, [or] estate" can qualify as well.[54] Additionally, a QOF can be an LLC, REIT or S corporation and must "use IRS Form 8996 to self-certify as to its status as a QOF."[55]

In any QOF, 90% of assets in a QOF must be "qualified opportunity zone property"[56] (Zone Property), defined as "(1) qualified opportunity zone stock, (2) qualified opportunity zone partnership interest, or (3) qualified

47. Schultz, *supra* note 43.
48. Cima, *supra* note 44.
49. Drucker, *supra* note 2.
50. Schultz, *supra* note 43; IRS Investing in Qualified Opportunity Funds, 26 C.F.R. pt. 1, 1870 (2020).
51. Cima, *supra* note 44.
52. DePillis, *supra* note 1.
53. Cima, *supra* note 44.
54. Bender, *supra* note 39; IRS Investing in Qualified Opportunity Funds, 26 C.F.R. pt. 1, 1870 (2020).
55. *Id.*
56. Marc Schultz, *An In-Depth Guide to Latest Opportunity Zone Regs: Part 2*, LAW 360 (June 17, 2019), https://www.law360.com/articles/1169875/an-in-depth-guide-to-latest-opportunity-zone-regs-part-2.

opportunity zone business property."[57] Both zone stock and partnership interests are interests that are "issued to the QOF after December 31, 2017"[58] and, at the time of issue, must be from a corporation or partnership that is a qualified opportunity zone business.[59] QOZ businesses and QOFs hold "tangible property used in a trade or business"[60] of that fund. This property is qualified when it is acquired after December 31, 2017 by the fund, its original use begins with the fund, or the fund substantially improves the property.[61]

B. WHO BENEFITS FROM QOFS

Although the tax bill is intended to bring investment to poor communities,[62] in an economic market, capital flows straight to the lowest-risk, highest return environment before low-income residents directly benefit.[63] While investors are eligible to invest in businesses or real estate in the opportunity zones,[64] since the TCJA's enactment, most of that money is flowing into opportunity zones via investments in real property.[65] While tangible property is also eligible for investment,[66] real estate is an "ideal"[67] asset in a QOF because buildings "substantially improved through construction, renovation, or rehabilitation,"[68] as well as new developments of land qualify as Zone Property subject to the tax benefits.[69] This has incentivized "billions of untaxed investment profits" to be deployed in recent projects such as "high-end apartment buildings and hotels, storage facilities that employ only a handful of workers, and student housing in bustling college towns."[70]

Community members in areas slated for opportunity zone development are understandably wary, as gentrification and high-end projects are already displacing the longtime population.[71] Since the investment opportunity in these zones is still in its infancy, it is difficult to say who has benefited, or

57. Special Rules for Capital Gains Invested in Opportunity Zones 26 U.S.C.S. § 1400Z-2 2(A)(i-iii) (LexisNexis 2019).
58. Schultz, *supra* note 56.
59. Special Rules for Capital Gains Invested in Opportunity Zones 26 U.S.C.S. § 1400Z-2 2(B)-(C) (LexisNexis 2019).
60. Special Rules for Capital Gains Invested in Opportunity Zones 26 U.S.C.S. § 1400Z-2 2(D)(i) (LexisNexis 2019).
61. Special Rules for Capital Gains Invested in Opportunity Zones 26 U.S.C.S. § 1400Z-2 2(D)(i)-(I-III) (LexisNexis 2019).
62. Drucker, *supra* note 2.
63. *Id.*
64. DePillis, *supra* note 1.
65. Drucker, *supra* note 2.
66. Schultz, *supra* note 56.
67. Joyce, *supra* note 5, at 12.
68. *Id.* at 12-13.
69. *Id.* at 13.
70. Drucker, *supra* note 2.
71. DePillis, *supra* note 1.

will benefit, the least. Without government investment in public infrastructure that tends to "[prime] the ground" for private investment, it is yet to be seen how private investors will choose to invest money once the "low-hanging fruit" of low-risk, high-reward projects are completed.[72] In any case, whether investors are pursuing high-end or affordable development, the projects will have an impact on the area for better or worse. Arguably, these investors take on not just a promising return on investment, but also an implicit public duty. If the government is going to incentivize investors to substantially alter communities, it should also subject those investments to regulation that facilitates the public purpose of economic development.

C. THE ISSUE OF FEW REGULATIONS

In addition to the QOZs, the TCJA created new Treasury Regulations, provisions 1400Z-1 and 1400Z-2.[73] The latter provision "allows a taxpayer to elect to defer certain gains," while regulations proposed after the passage of the TCJA "require deferral elections" to be filed in IRS Form 8949 with a taxpayer's or QOF's tax return.[74] The gap between TCJA legislation and tax implications requiring further regulation is present in other aspects of QOZs as well. Further guidance was proposed in 2019 and, as of 2020, finalized regarding issues such as "[t]ax treatment of the sale of [Zone Property]" and "[c]larity on the definition of qualified opportunity zone business property."[75] Evidently, leaving these large, important aspects unclear presents an opportunity for investors to take advantage of the tax legislation.

Only recently has the Securities and Exchange Commission (SEC) publicized its guidance on QOFs and the applicability of securities and investment laws.[76] The tax reform legislation itself "does not require public disclosure of who … tak[es] advantage of the [opportunity zones] or how they are deploying their funds."[77] In this way, investors can structure their QOF in a way that is most advantageous to its return on investment objective as opposed to being held to account for benefits (or lack thereof) conferred to the public. This may be an acceptable outcome for typical venture capital or private equity funds that are not investing as directly in community change.[78] But for a QOF, whose purpose is to tangibly impact an area, the public should have a right to know how their communities are being

72. *Id.*
73. Bender, *supra* note 39.
74. *Id.*
75. *Id.*; *see generally* IRS Investing in Qualified Opportunity Funds, 26 C.F.R. pt. 1 (2020).
76. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
77. Drucker, *supra* note 2.
78. Stephanie C. Thomas & Zeeshan Ahmedani, *California Law Requires Enhanced Fee Disclosure for Public Pension and Retirement Systems Investing in Private Funds*, MORRISON & FOERSTER (Apr. 10, 2017), https://www.mofo.com/resources/insights/170410-ca-fee-disclosure-pension-systems.html.

developed through private investments and who is directing such investments.

II. SECURITIES LAWS AND QOFS

As new investment vehicles created by the 2017 tax reform, QOFs function as tax incentives for those who can raise enough capital to invest in order to benefit from them.[79] The Congressional Joint Committee on Taxation, for example, "estimates that investors of QOFs will receive in the aggregate approximately $1.6 billion in tax benefits per year from 2018 through 2027."[80] This is by no means a fringe benefit to be overlooked but rather one in which the government is giving up an estimated $1.6 billion in tax revenue to incentivize economic development.[81]

The IRS and SEC have issued guidelines for investors to follow to ensure that regulations are adhered to even though the TCJA itself says very little about limitations.[82] These guidelines spurred a "'gold rush' mentality among money managers, accounting and consulting companies, and law firms."[83] While there are uncertainties about QOFs as sound investments given the lack of "primary source-law,"[84] the SEC and IRS guidelines can be instructive. The SEC guidelines suggest that QOFs will typically be considered a security,[85] and the IRS states that any corporation or partnership organized as a QOF needs only to fill out IRS Form 8996 with its tax return.[86] The regulatory treatment of QOFs, however limited, can only do so much to properly "incentivize capital investment … in depressed areas"[87] of the country. For a number of reasons, securities laws do not go far enough in regulating the disclosure of information about QOFs and their underlying investments.

A. The SEC and Regulation of Securities

The SEC was created by the Securities Exchange Act of 1934 to restore investor confidence in markets after the stock market crash that precipitated the Great Depression.[88] The SEC enforces securities laws to protect investors

79. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.

80. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.

81. *Opportunity Zones Frequently Asked Questions*, *supra* note 7; *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.

82. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.

83. Frey, *supra* note 7.

84. *Id.*

85. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.

86. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.

87. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.

88. *What We Do*, SEC. AND EXCH. COMM'N (Dec. 18, 2020), https://www.sec.gov/Article/whatwedo.html.

by requiring publicly-traded companies to disclose information about their businesses and securities, and requiring those who sell and trade securities to deal fairly with investors.[89] Passed in tandem with the creation of the SEC was the Securities Act of 1933 that requires financial and other significant information about public securities to be disclosed, and prohibits fraud and misrepresentation in these sales.[90] Under the Securities Act of 1933, not all sales of investment offerings must be registered; limited, private offerings, in-state, and municipal, state, or federal securities can be exempted.[91] Congress later passed the Investment Company Act of 1940 (the 1940 Act), which regulates investment companies in all their complexities of organization.[92] Under the 1940 Act, companies are required to disclose to the public information about "the fund, its investment objectives, as well as on investment company structure and operations."[93] However, there are also important exemptions to the 1940 Act, such as for private funds owned by a limited number of people.[94] Both the Securities Act of 1933 and the 1940 Act have exemptions that now sweep the newly created QOFs into their purview but with differing consequences.

Among the most recent guidelines issued by the SEC, many QOFs will have to register for offers and sales of securities, but exemptions such as SEC Rules 506(b) and 506(c) of Regulation D provide exemptions for private offerings to a small number of investors, and public offerings made to purchasers who are verified, accredited investors.[95] Similarly, QOFs with investments held in at least 90% of qualified property may also implicate registration as an investment company.[96] However, Private Fund Exclusions Sections 3(c)(1) and 3(c)(7) of the 1940 Act can provide registration exemptions for issuing interests to a small number of investors who are "qualified purchasers."[97] Taken together, it is easy to see how QOFs structured as private pools of capital can bypass public disclosure requirements that might shed light on where the funds invested in QOZs originate.

89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
95. *Id.*
96. *Id.*
97. *Id.*

B. WHAT MAKES A QOF SUBJECT TO SECURITIES LAWS AND EXEMPTIONS

Securities are statutorily defined in the Securities Act of 1933[98] as "any note, stock, treasury stock…or, in general, any interest or instrument commonly known as a 'security'"[99] including "limited partnership interests, membership interests in an LLC, notes, bonds, and investment contracts."[100] Likewise, QOFs have a statutory definition set out in the TCJA as "any investment vehicle which is organized as a corporation or partnership for the purpose of investing in qualified opportunity zone property."[101] QOFs are typically offered to investors as "interests"[102] in the fund, which can be structured as a corporation, limited liability company, or partnership.[103] Because QOF investing opportunities have flexible entity formations, QOF interests are likely to appear to qualify as securities on their face.[104] The SEC advises, nevertheless, that a QOF will likely constitute a security except in "limited circumstances."[105]

The Securities Act of 1933 has a significant component of regulation that requires businesses to register their securities offerings with the SEC, or seek an exemption.[106] An offer of a security "shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."[107] Regarding QOFs, the SEC has advised that "advertising a business opportunity could be considered an offer … [so] efforts to attract investors to a QOF are offers of a security and subject to federal and state securities laws."[108] It follows that an offering of a QOF interest seems to qualify as something that is regulated by the SEC and requires disclosure.

Section 4(a)(2) of the Securities Act of 1933 exempts registration of 'private placement' transactions, where 'sophisticated investors' have "access to the type of information normally provided in a prospectus for a registered securities offering and agree not to resell or distribute the securities

98. Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa).
99. 15 U.S.C §77b(a)(1);
100. *See* 15 U.S.C §77b(1); *see also* Staff *Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
101. Staff *Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
102. *Id.*
103. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
104. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.
105. *Id.*
106. *Id.*
107. *Securities Act of 1933*, *supra* note 99.
108. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.

to the public."[109] Regarding QOFs, the SEC similarly advises that "the QOF issuer is not permitted to use general solicitation," but differs from Section 4(a)(2) insofar as "offers and sales are limited to [both] 'accredited investors' and up to 35 sophisticated, non-accredited investors."[110] Both require information "as provided in registered offerings."[111]

An accredited investor is defined in SEC Rule 501 as someone who is a director or officer of the company that is issuing securities, or a person whose net worth is greater than $1,000,000 excluding limitations on indebtedness such as the value of one's primary home.[112] Recently, the SEC expanded accredited investor status to also include individuals with certain professional certifications.[113] By contrast, and for an exempt offering in particular, a sophisticated investor is someone who is "able to evaluate the risks and merits of the investment, or be able to bear the investment's economic risk."[114] Some have noted that in recent decades the ranks of accredited investors have risen "through inflation alone…but are [likely] neither financially sophisticated enough nor wealthy enough to be exposed to the risk of exempt offerings."[115] It would seem that the only kind of investor in a QOF, then, would be someone with significant capital to both deploy and reap the tax benefits from, meeting the standard of an accredited or sophisticated investor, both of which by definition require a capacity to evaluate and absorb risk but are subject to different requirements for different types of offerings.[116]

Notably, the SEC provides certain exemptions that "may be available to QOF issuers."[117] These include SEC Rules 506(b) and Rule 506(c) of Regulation D.[118] Rule 506(b) is a "'safe harbor'" provision under Section 4(a)(2).[119] This exemption, as stated above, provides the standards a company must meet.[120] These include "no general solicitation or advertising" of the securities, and limits the securities sold to a maximum of 35 non-accredited

109. *Private Placements – Rule 506(b)*, SEC. & EXCH. COMM'N (Mar. 12, 2020), https://www.sec.gov/smallbusiness/exemptofferings/rule506b.

110. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.

111. *Id.*

112. Securities Act of 1933 § 230.501 Definitions and terms used in Regulation D, 17 CFR 230.501 (Dec. 2020).

113. *See generally*, SEC Order Designating Professional Licenses as Natural Persons for Accredited Investor Status, 17 C.F.R. pt. 230 (2020)

114. *Private Placements – Rule 506(b)*, *supra* note 109.

115. SEC Order Designating Professional Licenses as Natural Persons for Accredited Investor Status, 17 C.F.R. pt. 230, 64273 (2020).

116. Securities Act of 1933 § 230.501 Definitions and terms used in Regulation D, 17 CFR 230.501 (Dec. 2020).

117. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.

118. *Id.*

119. *Private Placements – Rule 506(b)*, *supra* note 109.

120. *Id.*

investors.[121] Non-accredited investors are entitled to financial and company disclosures that would suffice for a registered offering.[122] With regard to QOFs, then, the SEC advises that a QOF issuer can be exempt when these same requirements are met.[123] Additionally, another pertinent exemption is Rule 506(c) which generally allows broad solicitation and advertisement provided that "all purchasers in the offering are accredited investors" and "the issuer takes reasonable steps to verify the purchasers' accredited investor status."[124] With regard to QOFs, the SEC advises that an exempt offering under this rule will be an offering to accredited investors who are verified subject to a "principles-based method of verification."[125]

This examination of the SEC rules and guidelines reveals that a QOF generally will be subject to securities regulations that implicate registration and disclosure requirements. However, if the fund is organized in such a way that it does not solicit its QOF interests in compliance with Rule 506(b) and limits those interests to the right kind of investors in compliance with Rule 506(c), it seems that QOFs can escape public disclosure of their securities.

C. How a QOF Can Qualify as a Private Fund

In comparison, the 1940 Act also has relevant exemptions for non-public funds like QOFs. The 1940 Act and the Investment Advisors Act of 1940 both were passed to regulate "conflicts of interest" within companies, and investment advisors' conduct, respectively.[126] The SEC recently issued advice for QOFs stating that "QOFs typically are pooled investment vehicles through which investors contribute funds to invest in [QOZs]" and will likely be subject to the disclosure requirements of the 1940 Act.[127] However, the SEC proposed the Private Fund Exclusions, Sections 3(c)(1) and 3(c)(7) of the 1940 Act as possible exemptions.[128]

The 1940 Act defines investment companies generally as an issuer who "holds itself out as being engaged … in the business of investing, reinvesting, or trading in securities," and "whose own securities are offered to the investing public."[129] Since, QOFs are "engaged in the business of investing" they may have to register under the 1940 Act.[130] But, the Private Fund

121. *Id.*
122. *Id.*
123. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
124. *Exempt Offerings, General Solicitation – Rule 506(c)*, SEC. & EXCH. COMM'N (Mar. 12, 2020), https://www.sec.gov/smallbusiness/exemptofferings/rule506c.
125. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
126. *What We Do*, *supra* note 88.
127. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.
128. *Id.*
129. *Id.*
130. *Id.*

Exclusions may also "apply."[131] Section 3(c)(1) of the Private Fund Exclusions holds that an issuer is "not an investment company if its outstanding securities are beneficially owned by not more than 100 persons."[132] Section 3(c)(7) states that "an issuer will not be an investment company if its outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are 'qualified purchasers' … and does not at that time propose to make a public offering of its securities."[133] Here, a qualified purchaser means any natural person or company who owns at least $5,000,000 in investments, as defined in Section 2(51)(a).[134] This is certainly a much higher standard than an accredited or sophisticated investor as required under the Securities Act of 1933. If a QOF can be structured so as to be owned privately with at least $5,000,000 in investments,[135] and with no plans or conduct indicating public offerings of securities,[136] then the QOF could likely exempt itself from investment disclosure.

As laid out here, one can see that a QOF is by default likely to be subject to standard federal securities laws regarding disclosure because the fund will necessarily need to find investors and capital.[137] However, QOFs can find ways around the default rules by meeting the requirements of exemptions—from not soliciting securities to the public[138] and only allowing access to accredited investors[139] to keeping fund ownership limited and raising a certain threshold amount of capital.[140] The ultimate effect of a QOF exempting itself from these basic SEC and 1940 Act securities regulations is ultimately a lack of disclosure about the funds, which deprives potential and current investors of the information necessary to "make informed judgments about whether to purchase a company's securities."[141] In this case, if a QOF need not register its offerings at all, it is unclear how potential investors are to know what they are buying into. Given the high standards one must meet to qualify as an investor in a QOF, that is, as an accredited or sophisticated investor or a qualified purchaser, QOF investors are likely to be only high-net-worth individuals who don't need the protection of securities laws in the same way that the general investing public does. Although the SEC's securities laws protect "investors, not the government,"[142] the TCJA created

131. *Id.*
132. *Id.*
133. *Id.*
134. Investment Company Act of 1940, Securities and Exchange Commission 91 P.L. 547, 84 Stat. 1413, 91 P.L. 547, 84 Stat. 1413.
135. *Id.*
136. *Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations*, *supra* note 24.
137. *Id.*
138. *Id.*
139. *Id.*
140. *Investment Company Act of 1940*, *supra* note 134.
141. *What We Do*, *supra* note 88.
142. *Id.*

the possibility of QOFs to accomplish a particular community investment goal,[143] ostensibly a public objective. And as the government intends to incentivize growth in economically underprivileged areas[144] via QOFs, the QOFs that are already building and changing communities are completely opaque.[145] Securities laws are not enough to ensure that the QOZ tax break is used efficiently and for the purpose of creating positive economic change in underserved places since QOFs can work around securities laws that would require disclosure of their business activities and underlying investment offerings to the public.[146]

III. REFORM OF THE TCJA QOZ PROVISION

As discussed above, there are significant transparency issues regarding the private capital that funds QOFs. There is also the fact that the TCJA's lack of guidelines or requirements enables perverse incentives, such as millions of dollars being poured into luxury projects that arguably benefit the investors more than the local population.[147] To remedy the loophole left by the TCJA's ambiguity, this Note proposes a two-fold solution: (1) enact regulations imposing stronger disclosure requirements for governmentally sanctioned projects regardless of whether the funding is private or public equity; and (2) amend the TCJA QOZ provision to only grant incentives when money is invested in particular ways.

A. DISCLOSURE REQUIREMENTS

First and foremost, the purpose of disclosure as regulated by the SEC is to protect investors.[148] This disclosure consists of information that relays its financial standing, largest shareholders, and how the business operates now and in the future.[149] Disclosure of this kind is typical and required of public companies. However, private equity's opacity with regard to disclosure prevents outsiders from being able to evaluate the health and returns of the company.[150] Notably, the California Public Employees' Retirement System (CalPERS) "adopted fee reporting templates like the one released by the Institutional Limited Partners Association in early 2016."[151] This meant that CalPERS began reporting its fees, returns, and expenses to the chagrin of the public who quickly criticized the amount the fund pays in those private equity

143. DePillis, *supra* note 1.
144. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
145. Drucker, *supra* note 2.
146. *Staff Statement on Opportunity Zones: Federal and State Securities Laws* Considerations, *supra* note 24.
147. DePillis, *supra* note 1.
148. Mary Jo White, *The Path Forward on Disclosure*, SEC. AND EXCH. COMM'N (Oct. 15, 2013), https://www.sec.gov/news/speech/spch101513mjw.
149. *Id.*
150. *Private Equity's Other Transparency Problem*, *supra* note 23.
151. *Id.*

fees and expenses.[152] While CalPERS maintains that this public scrutiny has been an unnecessary distraction to its mission, the California State Teachers' Retirement System has stated that it "understands the need for transparency with a state-supported entity" like itself.[153] The new disclosure requirements foisted upon these large public funds was a result of California Assembly Bill 2833 (AB 2833) which went into effect on January 1, 2017.[154] The bill was enacted to increase public knowledge of the fees public pension and retirement funds paid to private equity firms. This bill is particularly salient because the new disclosure requirements include unearthing what private funds have typically considered their "trade secrets"—that is, their investment returns and management fees.[155] At inception, some believed the bill would dampen private equity's interest in partnering with California public pension systems[156] while others believe that this same proprietary information "could only improve investment partnerships between [limited partners] and [general partners]."[157] Just as the California state legislature deemed this information to be important enough to warrant mandatory disclosure, investors in QOFs, too, could greatly benefit from knowing what to expect from the fund.

Because only accredited investors are able to take advantage of QOFs, and to be eligible for the capital gains deferral one must use proceeds from a prior investment,[158] it might seem unnecessary to want greater disclosure to protect already wealthy investors. However, the very nature of "distressed real estate deals"[159] ought to warrant greater disclosure and insight into what the fund invests in and how. QOFs have "little track record, inexperienced managers, high fees and a high hurdle to entry" which means they are investments suited to experienced and wealthy investors rather than the mass affluent saving for retirement.[160] Even so, it is likely that even wealthy investors would want to know how the QOF operates and what condition it is in given the high-risk nature of its underlying assets. Particularly, this would be the case because QOFs are still unsettled as the investment and operational rules of QOFs continue to evolve.[161] If the investor does not comply with these ambiguous rules, they may have to pay a penalty, or worse, the fund's investor would not be eligible for the capital gains tax breaks.[162]

152. *Id.*
153. *Id.*
154. Kenneth W. Muller et al., *California Law Requires Enhanced Fee Disclosure for Public Pension and Retirement Systems Investing in Private Funds*, LEXOLOGY, https://www.lexology.com/library/detail.aspx?g=caf10898-3460-4f42-9ae3-b4e0cb5f9752.
155. *Id.*
156. *Id.*
157. *Private Equity's Other Transparency Problem*, *supra* note 23.
158. Ermey, *supra* note 27.
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.*

Although some investors and companies have already rushed in to begin their typically high-end projects,[163] later investors may want to appraise for themselves the cost-benefit of a QOF's quality and potential return on investment given these risks. It has been reported that QOF fees, for example, "mimic those of hedge funds and private-equity investments."[164] However, it is too early to predict what types of gains these funds will deliver or if they are even valuable.[165]

Given the purpose of QOFs to inspire investment in low-income areas,[166] naturally the kind of money needed to revitalize an area is massive even if the land or business value is currently below market. As such, it is not surprising that QOFs and their tax benefits target wealthy investors who can actually take advantage of them. But, because the government is allowing private money to flow in under the tax law provision for QOFs, unimpeded by the weak constraints of securities laws, the SEC should impose greater regulations on this money. Like California's AB 2833 proposing greater transparency into public funds' investments, there should also be legislation or regulations requiring greater transparency into the fee structure, operation, and information about underlying assets in QOFs.

QOFs seem to straddle a fine line between public and private investments. They are a vehicle sanctioned and created by the government for the use of private funds to invest in forgotten areas.[167] This essential function ought to necessitate disclosure to the public of the kind of fees and structure of the investments that are changing neighborhoods because, like with CalPERS and the California State Teachers' Retirement System, QOFs are government supported vehicles[168] with the intent to return maximum value to the economically depressed areas of the nation. The government's abdication of responsibility for these "depressed" areas[169] punts the heavy lifting of investment in risky projects to private investors who may or may not be able to shoulder losses better.[170]

QOFs are not stated to exist for the purpose of returning maximum benefits to the investors[171] although the tax benefits create potentially higher returns and serve as useful incentives for enticing investors to bring money to the venture. Despite the possibility of public criticism of the investments made through QOFs, like the kind of backlash that CalPERS experienced after adopting more transparent disclosures,[172] the public and especially the

163. DePillis, *supra* note 1.
164. Ermey, *supra* note 27.
165. *Id*.
166. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
167. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
168. *Private Equity's Other Transparency Problem*, *supra* note 23.
169. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
170. *What We Do*, *supra* note 88.
171. *Opportunity Zones Frequently Asked Questions*, *supra* note 7.
172. *Private Equity's Other Transparency Problem*, *supra* note 23.

people who live in the neighborhoods that are changing due to QOFs deserve to know who is changing their neighborhoods and how. Although these residents will most likely not be accredited investors themselves, just as anyone can look up SEC filings of public companies regardless of whether one intends to purchase shares of a company, so too should QOFs offer a public disclosure system in which anyone can access relevant information. If QOFs become a widespread and effective vehicle for change in this country, greater public disclosure will be necessary not only to the general public but also to future investors, firms, and perhaps public pensions' private equity investments.

Interestingly, one of the newest investment platforms, Fundrise, allows investors to invest their money in real estate, including in QOFs, (albeit with the requirement of accreditation)[173] by "crowdfund[ing]" the money for the platform's investments.[174] This pooled private money is then used to invest in real estate assets directly,[175] with individual investors needing a low minimum to get started and no accreditation in most cases.[176] The money investors put into the platform has a lock-up period of 3-7 years and projects a 12.3% average annual rate of return.[177] Aside from the risk of using a platform like Fundrise that has only existed since 2012,[178] this platform enables investors access to what is typically only accessible to high-net-worth individuals, including QOFs. The mere fact that QOFs can be accessed directly by the even the smallest of accredited investors absolutely necessitates greater regulatory scrutiny and transparency into what exactly people are investing in.

Just as other industries have become highly regulated, such as oil and gas and banking,[179] greater regulation and public disclosure promotes accountability to the government and investors, and indirectly to the people impacted by these companies and investments. Government mandated investment vehicles should not be a complete gamble for investors if QOFs are to accomplish their intended purpose; if QOFs are to become a sustainable way of incentivizing private capital to revitalize areas of the country, disclosure requirements will promote the transparency and accountability needed to inform potential investors of the risks and rewards and provide the general public with knowledge of who is changing their community.

173. *Fundrise Opportunity Fund*, FUNDRISE (Jan. 10, 2020), https://fundrise.com/offerings/opportunity-fund/view.
174. Chris Muller, *Real Estate Crowdfunding with Fundrise*, DOUGHROLLER (June 3, 2020) https://www.doughroller.net/real-estate-investing/fundrise-review/.
175. *The Service, Investing with Fundrise*, FUNDRISE (Nov. 24, 2019), https://fundrise.com/investing-with-fundrise.
176. C. Muller, *supra* note 174.
177. *The Service, Investing with Fundrise*, *supra* note 175.
178. *About Us*, FUNDRISE (Nov. 24, 2019), https://fundrise.com/about.
179. White, *supra* note 148.

B. AMENDMENT OF TAX INCENTIVE

The second part of this Note's proposed solution concerns the reform of QOFs in the QOZ tax provision itself. Disclosure alone does not solve the issue of incentivizing money to be invested for the greatest benefit to the community. While disclosure can inform the public and other investors of what the fund is already doing, it cannot direct money to a more proper use per se. But the tax code can.

What is interesting about QOFs is that several tax credit programs were implemented before it.[180] Two tax credit programs that had the purpose of spurring greater investment in low-income areas include the New Markets Tax Credit Program (NMTCP) and Low Income Housing Tax Credit (LIHTC).[181] Enacted in 2000, the NMTCP allows investors to "provide capital to community development entities…and in exchange [were] awarded credits against their federal tax obligations."[182] Similar to QOFs, the NMTCP supports projects in government designated areas.[183] Meanwhile, the LIHTC is even older; enacted in 1986 as part of the 1986 Tax Reform Act, LIHTC "issues tax credits to state and territorial governments…who then award the credits to private developers of affordable rental housing projects."[184] Both of these tax credit programs operate by and through greater governmental regulation and housing agencies.[185] Because they are tax credit programs, they are subject to "annual Congressional approval and/or tax credit allocation authority."[186] The tax credits are limited by the amount that is allowed to be issued, which means that "there's an intrinsic limit on the number of investors who can participate, and the total amount of dollars that can be invested into the development of a community under these programs."[187]

In contrast, QOFs are not limited by any tax credit system and instead use tax breaks to incentivize investment through the fund vehicle.[188] QOFs can "self-certify without prior approval from a government agency" which means that "[QOFs] are managed entirely in the private market with the administration of the funds falling solely on the shoulders of private fund managers rather than government agencies or investors."[189] On its face, the lack of government oversight would seem to be a boon for spurring the

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180. *Fundrise Opportunity Fund*, *supra* note 173.
181. *Id.*
182. *What is the new markets tax credit and how does it work?*, TAX POL'Y CTR. (May 2020), https://www.taxpolicycenter.org/briefing-book/what-new-markets-tax-credit-and-how-does-it-work.
183. *Id.*
184. *Id.*
185. *Fundrise Opportunity Fund*, *supra* note 173.
186. *Id.*
187. *Id.*
188. *Id.*
189. *Id.*

amount of investment capital necessary to revitalize forgotten communities. But without the teeth of Congressional and agency approval in programs like tax credits, overly generous tax benefits may invite investors looking to primarily shelter money in QOZs that otherwise can already attract capital rather than invest to better a community.[190] The tax break "includes no requirements to ensure that local residents benefit from investments receiving the tax break,"[191] although it's reported that some local governments, like Baltimore, are trying to track QOZ investments and their impact themselves.[192]

The "potential loopholes…could enable investors to secure the tax benefits while generating little real economic activity in the opportunity zones."[193] Accordingly, investors are able to take advantage of the requirement that the QOF invest and produce "real economic activity"[194] in several ways: (1) using the QOF to buy undeveloped land as part of a business without improving the land; (2) using the QOF to buy a building that has been vacant for five years, not improving it and instead use it to operate a 'low-investment business'; and (3) using the QOF to invest in a business that leases property.[195] Unsurprisingly, the Urban Institute claims that the majority of QOZ investments to date "have been in real estate versus business."[196] Some experts say "the ability to bring permanent jobs through operating businesses to low-income areas could have a greater positive community impact than a new apartment tower."[197] But, the reality is that QOZs "are needed to attract real estate funding to underserved areas."[198] Thus, while the QOZ tax incentive invites potential investors, even "a new pool of investors that historically hasn't been engaged in these communities," it also enables possible exploitation of the responsibility in taking on a QOF investment to generate "real economic activity."[199]

The IRS issued final regulations adding "one rule that gives the IRS limited authority to combat abuse."[200] This rule is called the anti-abuse rule and stipulates that "the IRS may challenge any investment that it finds isn't intended to increase investment or business activity in [a QOZ]."[201]

190. *Potential Flaws of Opportunity Zones Loom*, *supra* note 33; Gose, *supra* note 11.
191. *Id.*
192. Gose, *supra* note 11.
193. *Id.*
194. *Potential Flaws of Opportunity Zones Loom*, *supra* note 33.
195. *Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection*, *supra* note 32.
196. Gose, *supra* note 11.
197. Gose, *supra* note 11.
198. *Id*.
199. *Potential Flaws of Opportunity Zones Loom*, *supra* note 33; Gose, *supra* note 11.
200. *Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection*, *supra* note 32; *See* IRS Investing in Qualified Opportunity Funds, 26 C.F.R. pt. 1 (Jan. 13, 2020).
201. *Opportunity Zone Regulations Favor Investor Flexibility Over Community Protection*, *supra* note 32

While this is a step in the right direction to greater oversight of such an unregulated investment vehicle, this is still not enough. New IRS regulations, then, could propose harsher requirements or limit or prohibit certain uses of money stronger than a mere anti-abuse rule. The IRS could propose that the tax incentives will only accrue to those investors who buy and *improve* property or existing businesses or generate entirely *new* business activity. This would impose a higher standard of entrepreneurial investment and may eliminate investors who otherwise sought a relatively low investment capital gains tax shelter.

Taken together, disclosure and stricter guidelines governing funds can make QOFs a successful program for community investment. Unlike its closest comparison, the Enterprise Zones, enacted in the 1970s,[202] QOFs are not burdened by cumbersome government intrusion or regulation.[203] Enterprise Zones continue to exist today and provide tax credits, not incentives, for business investment and they are often beholden to city and state governments for approval. But Enterprise Zones seek to incentivize "improvements to public infrastructure and services, venture capital funding, and income tax credits."[204] As many of these time-limited areas expire, QOFs can fill a gap in much-needed funding for communities if deployed properly. It is an interesting experiment to forsake governmental agency approval in trying to attract wealthy investors to QOFs, unlike previously enacted programs that combine tax credits with the requirement of some sort of approval and oversight. Using tax incentives instead of credits opens up the field of potential investors but also presents opportunities for abuse. QOFs will be able to take advantage of tax benefits until 2027,[205] so it behooves the government to strike a balance between allowing investors flexibility and disavowing tax sheltering and outsized potential loss of tax revenue, estimated at $1.6 billion per year.[206]

CONCLUSION

The twin problem of QOF opacity and the lack of regulation can be improved, if not solved, by two major reforms: one that requires the SEC to mandate disclosure and another that requires the IRS to define QOF uses more narrowly and encourage the development of highly productive rather than rent-seeking business and investment activity. With the advent of investing platforms such as Fundrise that allow the general and accredited investing public access to previously unattainable markets like private equity

202. Mark Crawford, *The Attraction of Enterprise Zones: Tax Benefits and Incentives for Businesses*, AREA DEV. (Nov. 8, 2020), https://www.areadevelopment.com/siteSelection/nov08/enterprise-zones-cost-effective.shtml.
203. *Id.*
204. *Id.*
205. *Fundrise Opportunity Fund*, *supra* note 173.
206. *Potential Flaws of Opportunity Zones Loom*, *supra* note 33.

and QOFs, there is an even greater need to require fund disclosures. Additionally, because QOFs are inherently risky investments, disclosure would also benefit potential high-net-worth individuals evaluating the risk and return of one of these projects. Overall, the ability for all to see and understand how their community is changing is a small favor to ask in exchange for the investments that ideally revitalize that same community. Greater transparency into investment funds like QOFs will benefit the public as well as the government in its regulation of those who seek tax advantages. If private equity is the best way to direct capital to areas that need the most investment and can do so better than government can, the suggestions above should be small consolations for the greater ability to use the power of private capital to improve society.

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