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The Opportunity Zone Program Presents Opportunity for Renewable Energy Development

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The federal Tax Cuts and Jobs Act of 2017 created a tax incentive program (the "Opportunity Zone Program") that has the potential to provide a significant amount of funding for the development of renewable energy projects. The program incentivizes investors to pour money into 8,700 census tracts, known as Opportunity Zones, by offering significant tax benefits with respect to current and future capital gains. Investors can defer (and potentially exclude a portion of) capital gains from the sale of any assets by investing amounts equal to such capital gains into Qualified Opportunity Funds (QOFs) within 180 days from such sale. By investing in QOFs, investors can defer taxes on their current capital gains until the earlier of December 31, 2026 or the disposition of the QOF investment. If the QOF investment is held for five years, 10 percent of the deferred capital gain is permanently excluded, and if such investment is held for seven years, 15 percent of such deferred capital gain is permanently excluded (to take advantage of the 15 percent gain exclusion, QOF investments must be made no later than December 31, 2019). As an additional incentive, if an investor holds a QOF investment for 10 years, all capital gains on future appreciation related to that QOF investment (not the deferred gain on the previously sold property) are excluded from tax.

The Economic Innovation Group (EIG), an advocacy group founded by Sean Parker, spearheaded the program with the goal of helping these "economically distressed" zones receive capital investments usually seen in more economically advantaged areas. In order to ensure that the designated zones receive benefits from the program, the QOF must hold at least 90 percent of its assets in qualified opportunity zone property. These assets must be newly constructed, or substantially improved and derive 50 percent of gross income from active conduct of business in an opportunity zone. On October 19, 2018, the Treasury Department issued much anticipated guidance on the implementation of the Opportunity Zone Program. Our colleagues, Abraham (Avi) Reshtick and David Salamon provided a more detailed overview of the applicable rules in a related article. Additional guidance was expected to be provided by Treasury in January but that timing may need to be adjusted given the current Government shutdown.

While the Opportunity Zone Program provides attractive incentives for renewable energy development, few QOFs have focused their investments on renewables so far. A majority of the investments have focused on other industries such as real estate. However, the lack of investment in renewable energy does not mean that renewable energy projects will not receive investments through the Opportunity Zone Program. There is no cap on the amount of money that can be invested through the program, and EIG estimated that there was $6.1 trillion in unrealized capital gains in the United States in 2017. This capital is deployable through QOFs and can provide attractive financing options for renewable energy developers.

The Opportunity Zone Program provides a unique opportunity for funding renewable energy projects. Funds like the Obsidian Opportunity Fund have already begun to capitalize on the program and others will likely follow. The nature of renewable energy projects means that they will likely meet the 90 Percent Asset Test, provide substantial improvement to the property and derive income directly from business in the Opportunity Zone. QOFs are an underutilized funding source for renewable energy projects and have the potential to bring significant funding to the industry. With the government issuing its first package of guidance in mid-October 2018, additional implementing guidance expected in the very near future and with the opportunity to permanently exclude 15 percent of deferred gain available only for QOF investments made through December 31, 2019 (thereafter, that opportunity will be limited to 10 percent), we expect a significant uptick in overall Opportunity Zone investments in 2019.