

## The Confluence of Solar Energy, Capital Gains, and Opportunity Zones

by Ronald D Berkebile

In 2017, Congress passed the *Tax Cut and Jobs Act*. Embedded in the Act were two new IRS sections known as 1400Z-1 and 1400Z-2. Commonly referred to as the Opportunity Zone legislation, 1400Z-2 introduced a unique capital gain tax incentive. Specifically, it offered a tax reduction, deferral of taxes, and tax exemptions.

Understanding the Opportunity Zone federal legislation requires intermediate to advanced tax code knowledge and a similar amount of accounting. For some, this can be daunting, but it shouldn't be a deterrent for maximizing capital gain potential. To fill the knowledge gap, nationally, there are accountants, tax experts, and legal teams with the required expertise.

Similar to other investors, Ruth McElroy Amundsen endured a learning curve and followed a self-prescribed qualification process. It began with a discovery period and was followed by an evaluative stage, an exploratory phase, and engagement.

Ruth believes, "Climate change is the most serious issue facing global communities. It requires substantial effort and urgent actions." As an engineer with children and caring for elderly relatives, Ruth's time is limited. While her schedule inhibits innovative environmental experimentation and implementation potential, she found an alternative source for fulfilling her lifelong objectives. In 2018, a confluence of environmental sustainability, social returns, legislative incentives, and a financial windfall enabled Ruth to actively engage her financial resources to achieve those goals. Her objective was to increase global renewable energy usage.

While Ruth's goal is longstanding, her recent experience with a private school was a catalyst for her opportunity zone venture. After taking the lead in a \$1.0 million solar panel installation project for a local private school, she said, "I had an amazing feeling of really doing something tangible and meaningful." Upon completion of the project, she was asked to speak to several groups about financial strategies for installing solar power. At one meeting, an attendee asked, "Why weren't Opportunity Zones an option in your presentation?" Without prior knowledge of the program, Ruth researched the federal capital gain incentive and incorporated the knowledge into her financial strategies. Soon afterward, she unexpectedly received capital gains, and the Opportunity Zone legislation became personally relevant. Along with the legislative research, she sourced articles about solar power investors establishing Opportunity Zone Funds. Armed with this new found knowledge and the assistance of a professional team, Ruth created an Opportunity Zone Fund for installing solar panels on businesses and non-profits in Opportunity Zones.

Through Ruth's self-motivated research, her Opportunity Zone findings connected her with another important personal issue. Each zone had been identified as a census tract largely comprised of low-income families and were identified as high potential areas for making positive social impacts. The investment infusion would be a source of funding to establish businesses,

transform aging infrastructure, and bring meaningful employment to the zones. If the right jobs were brought to the zone, unskilled workers would have a chance to develop new skills and gain meaningful wages. According to Ruth, “The gap between the rich and poor is growing, and the income disparity is magnifying racial and social inequities.” If approached in a planned and thoughtful way, Opportunity Zone investments could have a positive effect upon unemployed workers and low-wage income earners.

While the solar and social inequities seem to be very separate issues, Ruth’s activity with *Mothers Out Front* aided in the linkage of the two. Through her work with this organization, climate and social justice for low-income families were clearly concerning issues. Low-income families struggle to meet energy costs. With a desire to make a difference, disadvantaged neighborhood workshops were conducted by the organization to help reduce resident utility bills. According to Ruth, “These meetings, as well as research about energy injustice, made the disproportionate energy burden on low-income residents very evident.” Thinking innovatively, perhaps, solar energy could be a solution. Discovering Virginia restrictions inhibited residential solar panel installations, Ruth’s attention turned to existing businesses, new start-ups, and non-profit organizations. Not only could solar energy help businesses, but when solar panels were installed, the project would need a workforce, and this could lead to employment potential within Opportunity Zones. The contract Norfolk Solar made with the solar installation company includes a requirement to hire and train solar panel installers from within Opportunity Zones. “Hopefully,” Ruth said, “this will help interested resident/workers gain new skills and experience.”

As demonstrated by Ruth’s experience, establishing a Qualified Opportunity Zone Fund requires legislative and tax research; moreover, dependent upon an investor’s knowledge, fund establishment may require some tax, accounting and/or legal assistance. The Opportunity Zone legislation is new, and rules are still evolving (a second tranche is pending). In Ruth’s case, she asked attorneys and accountants to help with establishing the Fund and structuring the business. Initially, she wanted a very simple structure with one LLC and one bank account; however, based upon legal and accounting advice, three LLCs and three separate bank accounts were established. Because an Opportunity Zone Fund is restricted to capital gains received after December 31, 2017, and Ruth wanted to invest other non-qualifying funds, an investment fund was created and was designed to coexist with the Opportunity Zone Fund. Both funds are invested into Ruth’s Opportunity Zone Business - Norfolk Solar Qualified Opportunity Zone Fund. The Funds financially enable Norfolk Solar to purchase the solar systems and pay the operating expenditures.

Ruth’s business model is unique and was designed to accommodate her lifelong objectives. Typically, Opportunity Zone Funds are large and have more than one investor. According to Ruth, “I really wanted this Fund to consist only of our family and not involve other investors. This strategy would add a flexible dimension enabling quick future changes. I didn’t want the business influenced by larger investors who could force a deviation from my objectives.” Ruth needed a small fund, and it needed to be established quickly. By doing so, Norfolk Solar could demonstrate feasibility, and it could catalyze other environmentally sustainable investors to follow her example. Timeliness was essential, because Opportunity Zone incentives have deadlines. For instance, unless future modifications in the second tranche are made to the tax code, an investor

desiring to maximize incentives has to establish a Qualified Opportunity Zone Fund by December 31, 2019.

Early investment into a Fund is beneficial. If an investment is made into a fund by December 31, 2019 and remains in the fund for seven years, the federal tax on the original investment is based upon 85% of the capital gain invested (i.e. \$1.0 million is taxed at \$850,000). In addition, the tax is not due until the end of the seven-year period; consequently, the time value of money has a valuation benefit for the taxpayer. If an investment is made after December 31, 2019 but before December 31, 2021 and is held for five years, the original capital gain investment is taxed at 90% (i.e. \$1.0 million is taxed at \$900,000). Lastly, if a ten-year capital gain investment is made prior to December 31, 2026, and the investment is divested after ten-years, the subsequent capital gain is tax-free (i.e. \$1.0 million is invested and divested for \$1.5 million, the \$500,000 gain is not taxed). The ten-year exemption can also coexist with the deferrals/reductions.

While capital gains are incentivized, Ruth's business also benefits from other incentives and operating profits. To market and manage Norfolk Solar, Ruth employed Alden Cleanthes. Alden is well known in the metropolitan area for her environmental and sustainability expertise. The business contractually benefits from other tax incentives, depreciation credits, and the sale of solar energy. The business receives a 30% investment tax credit and 100% depreciation in the first year. The first-year net recovery is roughly 60% of the investment. While the tax incentives are a welcome financial benefit, the accounting practice for depreciation and taxation was challenging. Pragmatically, Ruth sought professional assistance with these matters. Taylor Brown, from Charlottesville, Virginia's Suntribe Solar and Jerry Breed, from the law firm Miles & Stockbridge, gave advice for establishing an Opportunity Zone Fund.

Expectedly, most Opportunity Zone investors are trying to maximize gains, and financial professionals are the conduit for this objective. Ruth's investment differs. Maximization for Norfolk Solar can be defined as a confluence of environmental sustainability, social change, and a modest return. As valuable as large gains, Norfolk Solar's model is designed to lower the region's carbon emissions, mitigate climate change, stem sea level rise, encourage investment in renewables, invest in low-income neighborhoods, and employ a workforce needing new skills and meaningful wages.



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