Staff Statement on Opportunity Zones:

Federal and State Securities Laws Considerations

The adoption of the Tax Cuts and Jobs Act[1] in December 2017 established the "opportunity zone" program to provide tax incentives for long-term investing in designated economically distressed communities. The program allows taxpayers to defer and reduce taxes on capital gains by reinvesting gains in "qualified opportunity funds" that are required to have at least 90 percent of their assets in designated low-income zones.

The staffs of the Securities and Exchange Commission (SEC) and the North American Securities Administrators Association (NASAA) are providing this summary of the opportunity zone program that briefly discusses the program and describes the compliance implications for opportunity funds under federal and state securities laws.[2]

Specifically, this summary discusses:

1. What are qualified opportunity zones (QOZs);
2. When interests in qualified opportunity funds (QOFs) would be "securities" under federal and state securities laws;
3. Registration of securities offerings with the SEC and/or state securities regulators and potential exemptions from securities registration for investments in a QOF (particularly through Rule 506 of federal Regulation D);
4. Broker-dealer registration requirements for persons selling interests in QOFs; and
5. Registration and exemptions from registration for QOFs that are "investment companies" and considerations for advisers to a QOF.

This summary is intended to help participants in the opportunity zone program understand securities laws considerations. It is not intended to be a comprehensive description of all federal and state securities laws and rules that might apply to transactions conducted in connection with the opportunity zone program

Whether certain activities require registration of the offering of securities, broker-dealer registration, investment company registration, or investment adviser registration is a fact-specific analysis that must be conducted on a case-by-case basis. You may want to consult with an attorney with experience in federal and state securities laws when considering the matters discussed in this summary.

1. WHAT ARE QUALIFIED OPPORTUNITY ZONES?

The Tax Cuts and Jobs Act directed the Treasury Department, with input from the states, to designate low-income census tracts as QOZs. Nationwide, the Treasury Department has designated more than 8,700 QOZs, which in general have a poverty rate of at least 20 percent and a median income no more than 80 percent of the statewide or metropolitan average.[3]

These tax incentives are meant to incentivize capital investment and economic development in the designated economically depressed areas.[4] By reinvesting qualifying capital gains in a QOF—whether through a corporation, limited liability company (LLC), or partnership organized to invest in QOZ property—investors may realize federal income tax benefits.

What are the Tax Benefits of Investing in Opportunity Zones?

Qualifying investments in QOFs are eligible for temporary tax deferrals for reinvested capital gains; a 10% tax basis increase for any investment held at least five years and a 15% tax basis increase for investments held at least seven years; and exclusion of capital gains taxes from the sale or exchange of an investment in a QOF held for at least 10 years.[5] The Congressional Joint Committee on Taxation estimates that investors in QOFs will receive in the aggregate approximately $1.6 billion in tax benefits per year from 2018 through 2027.[6]

1 Pub. L. No. 115-97, 131 Stat. 2054 (2017).

2 This summary represents the views of the SEC's and NASAA's staff and are not rules, regulations or statements of the SEC, NASAA or of any state securities regulator. The SEC has neither approved nor disapproved its content. Further, this summary does not alter or amend applicable law and has no legal force or effect. This summary creates no new or additional obligations for any person. Special thanks to the state and federal regulators who collaborated on this guidance, including Sebastian Arduengo (VT), Faith Anderson (WA), Lisa Hopkins (WV), Andrea Seidt (OH), Leslie Van Buskirk (WI) and the staff of the Office of Small Business Policy in the SEC's Division of Corporation Finance.

3 *See* 26 I.R.C. § 45D(e); IRS Rev. Proc. 2018-16. A current list of QOZs is maintained at https://www.cdfifund.gov/Documents/Designated%20QOZs.12.14.18.xlsx.

4 *See* Internal Revenue Service, *Opportunity Zones Frequently Asked Questions*, at https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions;. see also Economic Innovation Group, *Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas*, April 2015, at https://eig.org/wp-content/uploads/2015/04/Unlocking-Private-Capital-to-Facilitate-Growth.pdf.

5 *Id. See also* Press Release, *Treasury, IRS Announce First Round Of Opportunity Zones Designations For 18 States*, U.S. Department of the Treasury (April 9, 2018), *available at* https://home.treasury.gov/news/press-releases/sm0341, and Press Release, *Treasury Issues Second Set of Highly Anticipated Opportunity Zones Guidance*, U.S. Department of the Treasury (April 17, 2019), *available at* https://home.treasury.gov/news/press-releases/sm660.

6 Joint Committee on Taxation, *Estimated Revenue Effects of the "Tax Cuts and Jobs Act," As Passed By the Senate On December 2, 2017*, JCX-63-17, December 6, 2017, p. 6, at https://www.jct.gov/publications.html?func=startdown&id=5047.

2. ARE INTERESTS IN QUALIFIED OPPORTUNITY FUNDS "SECURITIES"?

QOFs are statutorily defined as "any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property." Under federal and state laws, securities are defined broadly to include shares of stock, limited partnership interests, membership interests in an LLC, notes, bonds, and investment contracts. **Interests in a QOF offered and sold to investors will typically constitute securities within the meaning of federal and state laws except in limited circumstances (such as a QOF established and operated as a general partnership where each partner has a substantial role in its management).**

As a result, QOFs must comply with all applicable regulations of the SEC and the securities regulators in the states where they are doing business, in addition to other applicable regulations, such as those of the Internal Revenue Service (IRS) and Treasury Department. This includes being aware of, and complying with, applicable provisions such as the registration and anti-fraud provisions of federal and state securities laws.

3. ARE QOF OFFERINGS REQUIRED TO BE REGISTERED WITH THE SEC AND THE STATES OR ARE EXEMPTIONS FROM REGISTRATION AVAILABLE?

Under the federal Securities Act of 1933 (Securities Act), all offers and sales of securities must be either (1) registered with the SEC or (2) conducted in compliance with an exemption from registration. State securities laws also require registration or an exemption from registration before securities may be offered or sold in the state. Even if an exemption from registration applies, the offer and sale of the securities are subject to the anti-fraud provisions of the federal and state securities laws enforced by the SEC and state securities regulators (private investors also may have standing to bring claims).

Securities regulators interpret broadly the meaning of the term "offer." For example, advertising a business opportunity could be considered an offer; therefore, it is prudent to assume that efforts to attract investors to a QOF are offers of a security and subject to federal and state securities laws.

Offerings of QOF interests may not need to be registered with the SEC or state securities regulators if an exemption from registration is available. Federal and state securities laws contain several exemptions from registration.[7] For example, some frequently used exemptions from registration that may be available to QOF issuers include:

- Rule 506(b) of Regulation D, which provides an exemption from registration for a private offering to accredited investors and up to 35 sophisticated investors; and
- Rule 506(c) of Regulation D, which provides an exemption from registration for an offering that may be conducted publicly so long as the QOF issuer takes reasonable steps to verify the accredited investor status of each purchaser.

When is a QOF Issuer Eligible to Use the Exemptions under Rule 506?

Rule 506 is a commonly used exemption from registration under federal securities laws that allows any issuer to raise an unlimited amount of money and to sell securities to an unlimited number of accredited investors.[8] Rule 506 includes certain additional requirements, including "bad actor" disqualification provisions and certain restrictions on transfers of the securities. In addition, the issuer is required to file a notice with the SEC on Form D within 15 days after the first sale of securities in the offering. The principal exemptions in Rule 506 are in subparagraphs (b) and (c).

Rule 506(b)

In an offering under Rule 506(b), the QOF issuer is not permitted to use general solicitation or advertising to offer the securities, and offers and sales are limited to "accredited investors" and up to 35 sophisticated, non-accredited investors.[9] If non-accredited investors are participating in the offering, the issuer must give any non-accredited investors a disclosure document that generally contains the same type of information as provided in registered offerings. The issuer must also give any non-accredited investors financial statement information and should be available to answer questions from prospective purchasers who are non-accredited investors. (Additional information about Rule 506(b) is available here.)

7 Whether seeking to register your QOF offering with the SEC or state securities regulators or seeking to qualify for an exemption under federal or state securities laws, you should consult experienced securities counsel before initiating any offering.

8 The term "accredited investor" is defined in Rule 501 of Regulation D. For a natural person, it includes anyone who earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, or has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence).

9 Sophisticated investors are investors who have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment.See Rule 506(b)(2)(ii).

Rule 506(c)

In an offering under Rule 506(c), the QOF issuer is permitted to use general solicitation or advertising but all the investors must be accredited investors and the issuer must take reasonable steps to verify the accredited investor status of all purchasers. Rule 506(c) sets forth a principles-based method of verification which requires an objective determination by the issuer (or those acting on its behalf) as to whether the steps taken are "reasonable" in the context of the particular facts and circumstances of each purchaser and transaction. In addition to this flexible method of verification, Rule 506(c) includes as an alternative a non-exclusive list of verification methods that issuers may use to satisfy the verification requirement with respect to natural person purchasers. (Additional information about Rule 506(c) is available here.)

Are There Any Restrictions Under State Law Applicable to Rule 506 Offerings?

Although federal law preempts state registration and qualification under Rule 506, the states have authority to require notice filings and collect state fees. In almost every state, an issuer making a Rule 506(b) or Rule 506(c) offering is required to submit a notice to state regulators within 15 days of the first sale to an in-state investor. Issuers should contact state securities regulators in the states in which they intend to offer or sell securities for further information on state requirements.

Are Any Other Exemptions Available?

Other exemptions from registration may be available for a QOF offering, including Rule 504 of Regulation D, the intrastate offering exemption in Rules 147 and 147A, Regulation A or Regulation Crowdfunding, if the QOF issuer meets the eligibility and other requirements of the relevant exemption. However, these exemptions are generally not available to an issuer that is an investment company as defined in the Investment Company Act of 1940 (Investment Company Act), as described below.

When is a QOF Issuer Eligible to use the Exemption under Rule 504?

In a Rule 504 offering, the QOF issuer may offer and sell up to $5,000,000 of securities in a 12-month period, except for:

- QOFs that are subject to public reporting under sections
- 13 or 15(d) of the Securities Exchange Act of 1934 (Exchange Act);
- QOFs that are investment companies as defined in the Investment Company Act;
- QOFs that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies; and
- QOFs that are disqualified under "bad actor" disqualification provisions.

Under Rule 504, QOF issuers are required to file a notice with the SEC on Form D within 15 days after the first sale of securities in the offering. An offering conducted under Rule 504 must either be registered or exempt in each state where the offering will be conducted. Issuers should contact state securities regulators in the states in which they intend to offer or sell securities for further information on state requirements. (Additional information about Rule 504 is also available here.)

When is a QOF Issuer Eligible to Use the Intrastate Offering Exemption in Rules 147 and 147A?

Under Rule 147A, QOF issuers must meet certain requirements in order to qualify for the intrastate offering exemption:

- The issuer's principal place of business—the place where the issuer's officers, partners, or managers primarily direct, control and coordinate its activities—must be in the state in which it is making the offering;
- The issuer is not registered or required to be registered under the Investment Company Act;
- The issuer must be doing business in the state in which it is making the offering;
- The issuer may conduct offerings via the Internet or other means of interstate advertising, but must limit sales to in-state residents or persons the issuer reasonably believes are in-state residents; and
- The issuer must obtain a written representation as to each purchaser's residency.

Rule 147 is substantially similar to Rule 147A except that offers also are limited to in-state residents or persons the issuer believes are in-state residents, and the issuer must be incorporated or organized in the state in which it is making the offering. QOF issuers registered or required to be registered under the Investment Company Act are not eligible to conduct offerings pursuant to the intrastate offering exemptions.

Under these exemptions, QOF issuers must prominently disclose in advertisements and all offering materials that sales will only be made to residents of the issuer's state. QOF issuers also must comply with state securities laws and regulations in the state where the securities are offered and sold, which may require registration or a notice filing.

Many states have exemptions in their securities laws for private offerings to accredited investors and for *de minimis* offerings to a limited number of unaccredited investors. Intrastate QOFs may also take advantage of state "crowdfunding" exemptions that allow issuers to solicit capital from a large number of unaccredited individuals who each invest a small amount of money.

When is a QOF Issuer "Doing Business" in a Particular State under Rules 147 or 147A?

In order to be "doing business" in a state within the meaning of Rules 147 and 147A, QOF issuers must satisfy at least one of the following requirements:

- It must derive at least 80% of its consolidated gross revenues, whether from the operation of a business, real property, or the rendering of services, within the state;
- It must have at least 80% of its consolidated assets located within the state;
- It must intend to use and actually use at least
- 80% of its net proceeds from the offering towards
- the operation of a business, the operation or purchase of real property, or the rendering of services within
- the state; or
- A majority of its employees must be based in-state.

For an issuer that changes its state of incorporation or organization, Rules 147 and 147A limit the ability of those issuers from making intrastate offerings for at least six months from the date of last sale of securities in its prior state of residence. (Additional information about Rules 147 and 147A is also available here.)

4. ARE THERE ANY BROKER REGISTRATION REQUIREMENTS FOR THOSE SELLING INTERESTS IN QOFS?

A person who solicits or refers potential investors to an offering of securities by a QOF or assists in structuring a QOF issuer should consider carefully the broker registration requirements under the federal and state securities laws.

A "broker" is a person engaged in the business of effecting securities transactions for the account of others.[10] Generally, it is unlawful for an unregistered broker (or dealer) to effect any transactions in, or to induce or attempt to induce the purchase or sale of, a security.[11] As a result, absent an available exception or exemption, a person engaged in the business of effecting transactions in securities for the account of others would be required to register with the SEC as a broker. Similarly, state securities laws require registration with the state securities regulator when transacting business as a broker-dealer or agent in a given state, absent the availability of applicable exemptions.[12]

The question of whether a person is a broker turns on the facts and circumstances of the transaction. Over the years, the courts and the Commission have identified certain activities as indicators of broker status. These include, among other things:

- Marketing securities to investors;
- Soliciting investors to purchase or sell a security;
- Assisting an issuer to identify potential purchasers
- of securities;
- Screening potential purchasers of securities;
- Negotiating between the issuer and the investor;
- Handling customer funds and securities; and
- Making valuations as to the merits of an investment
- or giving investment advice.

In evaluating whether a person has acted as a broker, no one factor is determinative; all facts and circumstances must be considered, and not all factors need to be present to establish that a person has acted as a broker.

The significance of these activities is heightened where there also is compensation that depends on the outcome or size of the securities transaction — in other words, transaction-based compensation. Securities regulators have long viewed receipt of transaction-based compensation as a strong indication that someone is engaged "in the business" of being a broker. Thus, a person receiving transaction-based compensation for engaging in these activities should consider whether it needs to register as a broker, absent an exception or an exemption.

The sponsor of a QOF may employ persons to market and solicit the QOF to potential investors. While Exchange Act Rule 3a4-1 provides a non-exclusive safe harbor from broker registration for certain associated persons of an issuer, this exemption is contingent, among other things, on the person having substantial duties "otherwise than in connection with transactions in securities," participating in no more than one offering every twelve months, and not receiving compensation that is based either directly or indirectly on transactions in securities.[13] If, however, a fund sponsor were to choose to market the fund interests through its employees, paying them a sales commission, then in those situations, the employees, as well as potentially the employer, may be acting as brokers.

10 *See* Section 3(a)(4)(A) of the Exchange Act .

11 The Exchange Act separately defines a "dealer" as a person that is engaged in the business of buying or selling a security for its own account. *See* Exchange Act Section 3(a)(5). Businesses that act both as brokers and as dealers are commonly termed "broker-dealers."

12 *See*, *e.g.*, Uniform Securities Act of 2002, §§ 401 and 402.

13 *See* Exchange Act Rule 3a4-1(a)(4)(ii). Rule 3a4-1 also includes exceptions, subject to certain conditions, for associated persons of an issuer who offer and sell securities to various financial institutions and intermediaries, such as registered broker-dealers (Rule 3a4-1(a)(4)(i)), or who conduct only "passive" sales activities, such as preparing written sales materials (Rule 3a4-1(a)(4)(iii)).

Similarly, a sponsor of a QOF may wish to work with an intermediary that refers potential investors to the fund. An intermediary that is paid compensation for making such referrals or performing the activities indicative of broker status, as discussed above, may be required to register as a broker. As a result, broker registration requirements can apply to a wide range of persons including, among others, solicitors, consultants, finders, promoters, or service professionals (e.g., lawyers, accountants, and others who place investors into a QOF investment in return for a fee dependent on the completion of a successful securities transaction).

5. IS THE QOF REQUIRED TO REGISTER AS AN "INVESTMENT COMPANY"?

QOFs can also implicate the registration provisions of the Investment Company Act of 1940 (Investment Company Act) and, potentially, the Investment Advisers Act of 1940 (Advisers Act) or related provisions of state securities laws.

The Investment Company Act generally defines an "investment company" as an issuer which:

- Is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities;
- Is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or,
- Is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire "investment securities" having a value exceeding 40 percent of the value of its total assets (exclusive of government securities and cash items) on an unconsolidated basis.

Absent an exclusion from this definition or an exemption from requirements to register, entities meeting this definition are generally subject to the registration provisions of the Investment Company Act. As noted above, QOFs typically are pooled investment vehicles through which investors contribute funds to invest in qualified opportunity zones. Depending on the facts and circumstances, these investment vehicles may have to register as investment companies under the Investment Company Act.

Are there Exclusions from the Definition of an Investment Company that Might Apply?

Below are some high-level summaries of exclusions from the definition of "investment company" under the Investment Company Act that might apply:

Private Fund Exclusions - Section 3(c)(1) and Section 3(c)(7)

Section 3(c)(1) of the Investment Company Act states, in part, that an issuer is not an investment company if its outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons or, in the case of a qualifying venture capital fund, 250 persons, and which is not making and does not presently propose to make a public offering of its securities.[14] Section 3(c)(7) of the Investment Company Act states, in part, 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 it is not making and does not at that time propose to make a public offering of its securities. For purposes of this provision, the term "qualified purchaser" is defined by Section 2(a)(51) of the Investment Company Act.

Mortgage-Related Pools Exclusion - Section 3(c)(5)(C)

Under Section 3(c)(5)(C), an issuer generally will not be considered an investment company if it is not engaged in the business of issuing redeemable securities and if, in part, it is primarily engaged in purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. QOFs that primarily invest in qualifying investments may be eligible for the exemption under Section 3(c)(5)(C). However, with some exceptions, the Commission has taken the position that an issuer that is primarily engaged in the business of holding interests in a pooled investment vehicle that invests in real estate generally may not rely on Section 3(c)(5)(C).[15]

6. IS THE ADVISER TO A QOF SUBJECT TO THE ADVISERS ACT OR COMPARABLE REGULATION UNDER THE STATE SECURITIES LAWS?

The Advisers Act defines an investment adviser, in part, as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability

14 Private investment companies (also commonly referred to as "private funds") may engage in a general solicitation pursuant to Rule 506(c) of Regulation D while continuing to rely on the exclusions available in Sections 3(c)(1) and 3(c)(7), notwithstanding the language on public offerings set forth in those exclusions. *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (July 10, 2013) ("[P]rivate funds generally rely on one of two exclusions from the definition of 'investment company' under the Investment Company Act – Section 3(c)(1) and Section 3(c)(7) – which enables them to be excluded from substantially all of the regulatory provisions of that Act. . . . As we stated in the Proposing Release and reaffirm here, the effect of Section 201(b) is to permit private funds to engage in general solicitation in compliance with new Rule 506(c) without losing either of the exclusions under the Investment Company Act." (footnotes omitted)).

15 *See, e.g., Real Estate Investment Trusts*, Investment Company Act Release No. 3140 (Nov. 18, 1960); *Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments*, Investment Company Act Release No. 29778 (Aug, 11, 2011)

of investing in, purchasing, or selling securities . . .".[16] State securities laws generally follow this definition. Absent an exclusion from this definition or an exemption from the requirement to register, entities meeting this definition that have a certain level of assets under management, or who advise a registered investment company, are subject to Commission registration under the Advisers Act. Generally, the level of assets under management triggering Commission registration is $100 million, although in some cases, those advisers with between $25 million and $100 million in assets under management are subject to Commission registration. Otherwise, advisers falling below the $100 million threshold generally are required to register with the appropriate state securities regulator.

Depending on the facts and circumstances, to the extent that an entity involved in opportunity zone investments engages in the activities enumerated in the definition of "investment adviser," it may have to register as such with the SEC under the Advisers Act, or in some cases, the appropriate state securities authorities. Persons and entities that might need to register include (but are not limited to) general and managing partners of partnerships, managing members of limited liability companies, or individuals or entities performing functions of an investment advisory nature.

Common Exclusions from "Investment Adviser" Definition and Exemptions from Registration

Below is a non-exhaustive list of commonly relied upon exclusions from the Advisers Act definition of "investment adviser" and exemptions from registration:

- **Professional Exclusion.** Section 202(a)(11)(B) excludes from the term "investment adviser" any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of their profession.
- **Broker Exclusion.** Section 202(a)(11)(C) excludes from the term "investment adviser" any broker or dealer whose performance of such services is solely incidental to the conduct of their business as a broker or dealer and who also receives no special compensation for such services.[17]
- **Private Fund Adviser Registration Exemption.** In summary, Advisers Act Rule 203(m)-1 provides that an investment adviser that serves as an adviser solely to private funds and has assets under management of less than $150 million is exempt from registering as such with the SEC. However, an investment adviser relying on this exemption must still comply with certain SEC reporting requirements.

Federal and State Securities Regulators Welcome Your Questions

For questions about exemptions from registration under the federal securities laws, please contact the Office of Small Business Policy in the SEC's Division of Corporation Finance. You may submit a request for interpretive advice using their online form.

For questions about state securities laws, please contact the state securities regulator in the state in which you intend to offer or sell securities. You may also obtain useful information on state securities laws registration requirements and exemptions to registration requirements by visiting the website of the North American Securities Administrators Association (NASAA) at www.nasaa.org.

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16 *See* Advisers Act Section 202(a)(11).

17 *See Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, Investment Adviser Act Release No. 5249 (June 5, 2019).