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Top 10 Things Every Tax Professional Should Understand About Opportunity Zones (Part 1)

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By: Sean Byrne

In this two-part series, we'll cover the top 10 key points for tax professionals to understand about Opportunity Zones (OZs). OZs were established by Congress in the Tax Cuts and Jobs Act of 2017 to provide an incentive to encourage long-term investments in low-income communities throughout the United States.

#1: ONLY capital gains are eligible for Opportunity Zone benefits. All capital gains qualify, not just gains from real estate. An investor can re-invest capital gains from separate transactions. But ONLY capital gains are eligible for the OZ incentive when invested in a Qualified Opportunity Fund (QOF).

#2: Capital gains must be invested in a QOF within 180 days of recognition. The 180 day clock begins when deferred gain is recognized for federal tax purposes. If a partnership recognizes gain, the partnership can invest in a QOF (the 180 day window begins the day the partnership recognized the gain). If the partnership does not invest the capital gain in a QOF, then the partners can invest their share of gain. The regulations provide that the partners' 180 day window begins the last day of the partnership taxable year. Please note that 180 days is not six months (be sure to count the days).

#3: QOFs can include non-capital gains. Because most QOFs are project specific, many QOFs may have both capital gains and other investments. Investment that is not from capital gains does not receive federal OZ tax benefits. For example, non-profit organizations have taken interests in QOFs, including the Kresge Foundation, which committed $22MM to support impact investment by providing guarantee funds in exchange for transparency, reporting, community involvement and impact.

#4: The primary motivation for most OZ investors is the lack of capital gains tax on the QOF investment. The lack of a large direct subsidy ensures the OZ program will not make bad projects successful. The ten-year holding period requirement advances public policy goals and will fit long-term investors who anticipate avoiding capital gains tax on appreciation over years (investments can be held through the end of 2047). The long holding period is similar to tax credit supported programs, such as Low Income Housing Tax Credits, New Markets Tax Credits and Historic Tax Credits. When thinking about the lengthy holding period, also consider other incentives that may be available, such as state specific OZ incentives, property tax abatements, TIFs and other PILOT financed structures.

#5: A host of "substantially all" requirements apply to the use of QOF property so that the use is primarily in OZs. Real estate investments can be relatively straightforward, but investments in operating businesses can be very complex. When the "substantially all" provisions are compounded, the result is, for a QOF holding a qualified opportunity zone business, 90% of QOF assets must hold investments of which 70% of the assets are qualified opportunity zone business property – resulting in 63% being "substantially all."

Look for final five key points in the upcoming edition of *Development Incentives Quarterly.*