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New Opportunities with Opportunity Zone Tax Incentives.

The 2017 tax reform legislation includes a new tax incentive to spur investments in distressed areas throughout the United States and its possessions. The Opportunity Zone Tax Incentive, set forth in Internal Revenue Code Sections 1400Z-1 and 1400Z-2, allows taxpayers to defer gain from the sale of property, in some cases permanently where certain requirements are met. Even if a taxpayer does not have gain on which it seeks to defer tax, the Opportunity Zone Tax Incentive provides a permanent deferral opportunity for any appreciation in a relevant investment, provided that investment is held for at least ten years. To qualify for these incentives, taxpayers must invest in a "qualified opportunity fund," which means an investment vehicle organized as a corporation or a partnership that invests in a business in a low-income area that has been specifically designated as a "qualified opportunity zone." A list of currently designated areas is available here.

Under the Opportunity Zone Tax Incentive program, taxpayers with gain from the sale or exchange of property (any type of property) can elect to exclude that gain from gross income to the extent of the amount of cash invested by such taxpayer in a qualified opportunity fund within 180 days of the sale or exchange. This deferral opportunity applies to sales or exchanges occurring before December 31, 2026, and unlike Internal Revenue Code Section 1031 exchanges, is not limited to gain from specific types of property. In addition, the IRS has clarified that gain arising in 2017 may be eligible for the Opportunity Zone Tax Incentive, even if the taxpayer has already filed its tax returns for the 2017 taxable year, so long as the 180 day requirement (among the other relevant requirements) is met and the taxpayer amends its 2017 tax returns to reflect this election.

The incentive permits gain deferral until December 31, 2026, or, if earlier, the date the qualified opportunity fund investment is sold or exchanged. The taxpayer's basis in the qualified opportunity fund investment is initially zero, but is increased over time depending on the taxpayer's holding period for such investment. If the qualified opportunity fund investment is held for at least five years, the taxpayer will be entitled to permanent deferral on 10 percent of its deferred gain and can increase its basis by such amount. If the investment is held for at least 7 years, the taxpayer is entitled to permanent deferral on an additional 5 percent of its deferred gain and can increase its basis by this amount.

Permanent deferral potential is available for post-investment appreciation if the taxpayer holds its qualified opportunity fund investment for at least 10 years and makes an election under Section 1400Z-2 to step up its basis to fair market value on the date it is sold or exchanged.

Qualified opportunity funds must hold at least 90 percent of their assets in qualified opportunity zone property, which includes qualified opportunity zone business property, stock or partnership interests. "Qualified opportunity zone business property" means tangible property used in a trade or business of the qualified opportunity fund and located in a qualified opportunity zone if: (i) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or, (ii) if the property is used, the qualified opportunity fund, during any 30 month period beginning after the date of the acquisition of such property, incurs costs with respect to such property that exceed the fund's basis at the start of the 30 month period. As an example, if used property is acquired by the qualified opportunity fund for $1 million and such fund incurs, within the

30 month period, $1.1 million in costs to improve this property, the fund should be deemed to have met the above requirement for used property. Qualified opportunity zone stock or partnerships interest include interests in corporations or partnerships with respect to which substantially all of the tangible property owned or leased by such entity is qualified opportunity zone business property.

The Internal Revenue Service has indicated that, to become a qualified opportunity fund, a fund can self-certify its status as such. Certification will be performed by attaching a form to the fund's tax return. The form is expected to be available this summer.

While there are still many unanswered questions as taxpayers await further guidance, the Opportunity Zone Tax Incentive presents an attractive opportunity for deferral of gain, including potential permanent deferral on portions of the gain. In addition, it appears that there could be opportunities to pair this deferral with tax credits, such as the new market tax credit, low-income housing credit, rehabilitation credit and investment tax credit. The Opportunity Zone Tax Incentive seems to be an interesting tax incentive for a wide array of investors, and we will provide updates as guidance on this program is issued.

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