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NUTTER NOTES

# Navigating Opportunity Zones – Will Investors Be Enticed?

## More Guidance Needed from Federal Officials as Questions Remain

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SPECIAL TO BANKER & TRADESMAN

When the Tax Cuts and Jobs Act was enacted in December 2017, some predicted that an unknown provision creating so-called "Opportunity Zones" could be one of the most popular aspects of tax reform.

More than a year later, Opportunity Zones are generating a high degree of interest among investors, developers, government officials and community development organizations. But, although preliminary guidance has been issued to fill gaps in the legislation, more is needed to provide investors with clear parameters on this new tax benefit. To navigate this exciting opportunity, investors and developers need to know three key things: the basic requirements, the timing and the unknowns.

Opportunity Zones are low-income census tracts nominated by governors and designated by the U.S. Treasury Department. The U.S. Treasury approved Gov. Charlie Baker's application to designate 138 tracts in 79 Massachusetts communities as Opportunity Zones on May 18, 2018.

The purpose of this legislation was to create incentives to attract new capital to areas of the country in need of economic development that would not otherwise attract sufficient development dollars. The legislation offers three types of tax benefits: capital gain deferral up to Dec. 31, 2026 on gain that is properly invested in Opportunity Zones; up to a 15 percent reduction in the gain that is recognized on Dec. 31, 2026 or earlier, if the investment is sold prior to that date; and a complete elimination of capital gain realized on the qualified Opportunity Zone investment, if the investment is held by the taxpayer for at least 10 years.

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## The Basics

A Qualified Opportunity Fund is the investment vehicle that offers the preferential tax benefits. The fund must be organized as a corporation, limited liability company or a partnership for the purpose of holding at least 90 percent of its assets in Qualified Opportunity Zone Property, which includes:

- **Business Property:** Tangible property used in a trade or business of the Qualified Opportunity Fund if three criteria are met: the property must be purchased after Dec. 31, 2017; the property's original use either commences with the Qualified Opportunity Fund or the Qualified Opportunity Fund substantially improves the property and substantially all of the property's use is in a Qualified Opportunity Zone during substantially all of the Qualified Opportunity Fund's holding period.
- **Stock:** Stock in a domestic corporation that was obtained by the fund after Dec. 31, 2017.
- **Partnership/LLC Interests:** Capital or profits interest in a domestic partnership or limited liability company if such interest is acquired after Dec. 31, 2017.

For stock and partnership/LLC interests, the entity must be a Qualified Opportunity Zone Business at the time of purchase and must maintain its designation as a Qualified Opportunity Zone Business for a substantial duration of the fund's holding period.

## Timing

There are several timing requirements, which can affect the value of the tax benefit to the investor-taxpayer. First, the gain to be protected from tax must be reinvested, or rolled over, within 180 days of the sale or exchange to an unrelated party that produced the capital gain (although there is some additional flexibility for investments through partnerships). This 180-day requirement has spurred many comparisons with the like-

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kind exchange tax deferral rules, but they are two separate tax benefits.

Another important timing consideration for Opportunity Zones is the amount of time that an Opportunity Zone Fund has to deploy the cash it receives from investors into qualifying investments. Funds have up to 30 months to invest in qualified opportunity zone property. Even with this flexibility, developers are finding it more feasible to invest in property that has certain development potential.

## Unknowns

Investors and developers are looking for more favorable guidance in order to maximize their investments. For example, the Treasury Department needs to weigh in on whether the 10-year exclusion applies when a fund sells the underlying assets in the fund or if it is limited to the sale of the fund interest – the answer affects the way investments are structured. Guidance is also needed on how these rules apply to leased property, direct investments in a trade or business and subsidiary entities operating in one or more zones.

Legislators and government officials are hopeful that Opportunity Zones will provide communities in need of economic development a powerful tool to attract investors. Some stakeholders are cautious as to whether or not this benefit alone would drive an investor's behavior. But, taken with other incentives, it could serve to direct development funds to areas that would not otherwise attract attention. While projects are getting started and funds are being formed, offering statements are providing no assurances with respect to qualification of the funds being formed. It looks like it will not be an investment for the faint-hearted for a little while longer. ◀

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