INSIGHTS

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Will Developers Swipe Right on Opportunity Zones?

Q: WHY DID THE TAX CUTS AND JOBS ACT OF 2017 CREATE THE "OPPORTUNITY ZONES" PROVISION?

A: Qualified Opportunity Zones are low income census tracts nominated by governors and designated by the U.S. Treasury Department. The purpose of this legislation is to create incentives to attract new capital to areas of the country in need of economic development that would not necessarily attract sufficient development dollars absent such incentives. The legislation offers three types of tax benefits: (1) capital gain deferral up to Dec. 31, 2026 on gain that is properly invested in Opportunity Zones, (2) up to a 15% reduction in the gain that is recognized on Dec. 31, 2026 (or earlier, if the investment is sold prior to that date), and (3) 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.

Q: HOW DO QUALIFIED OPPORTUNITY ZONES OPERATE?

A: 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% 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: (1) the property must be purchased after Dec. 31, 2017; (2) the property's original use either commences with the Qualified Opportunity Fund or the Qualified Opportunity Fund substantially improves the property; and (3) 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.

Q: COULD YOU DESCRIBE THE TIMING REQUIREMENTS?

A: Investors must adhere to 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 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-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. The proposed regulations issued in Oct. 2018 provided helpful guidance in that regard, allowing up to 30 months for the capital gain proceeds to be invested in qualified opportunity zone property. Even with this flexibility, developers are finding it more feasible to invest in property that has certain development potential, as the permitting process can easily consume much of that 30-month grace period.

Q: HOW CAN INVESTORS AND DEVELOPERS MAXIMIZE THEIR INVESTMENT?

A: Investors and developers are looking for more favorable guidance in order to navigate the unknowns. For example, clarity is needed on the interaction of these rules with the partnership taxation rules. Treasury needs to weigh in on whether the 10 year exclusion applies when a fund sells the underlying assets in the fund or if it really is just limited to the sale of the fund interest – the answer affects the way investments are structured. And, clarity is needed whether these benefits extend to leased property as well as whether there are limitations on the extent to which these investments can be leveraged.

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