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Investment in Opportunity Zones Can Yield Significant Tax Benefits (Part 1 - Introduction)

REAL ESTATE, TAX, TAX REFORM
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The Tax Cuts and Jobs Act (the “Act”) signed into law back in December contains a number of tax beneficial provisions. One that should catch the eye of investors with significant capital gains includes an economic development program that encourages investment in designated low-income communities. Generally the program allows individual and corporate taxpayers to defer paying taxes on gains recognized from the sale of stock, business assets or any other type of property – regardless of where the property sold is located – for as long as until December 31, 2026. To qualify, the investor reinvests the disposition proceeds into a new type of investment vehicle called a “Qualified Opportunity Fund” (or “QOF”). Even better, in addition to deferring current taxes, partial exclusion on the deferred gain **plus** partial to full exclusion from income of future appreciation on the new assets is possible. These benefits become available when the QOF uses the funds it receives to invest in businesses operating in certain low-income locations described under the statute as a Qualified Opportunity Zone (“QOZ”).

In Notice 2018-48 (published June 20, 2018), the IRS, working in conjunction with officials from each of the 50 states, the District of Columbia and U.S. territories, provides an official list of qualifying QOZs. With this information, investors can now investigate in depth whether they are interested in potentially enhancing future after-tax investment returns by investing in assets and/or businesses located in these areas.

The executive summary of the program is that an investor realizing capital gain from the sale of property to an unrelated party must, within 180 days from the disposition of the gain generating asset disposition, invest the gain proceeds in a QOF to gain access to the benefits the provision offers. The QOF, which can be a partnership or corporation formed by the taxpayer/investor, then must invest in a qualified opportunity zone business (excluding certain businesses including golf courses, racetracks or massage parlors) or business property. Assuming necessary operating conditions and requirements are met, a taxpayer electing to take advantage of this new statutory tax incentive could:

i. defer until December 31, 2026 paying tax on capital gain resulting from the original sale of assets;

i. permanently exclude up to 15% of his or her gain from the original sale of assets; and

i. permanently exclude appreciation earned on the investment in the opportunity fund.

As with many aspects of the Act, there are interpretive issues that still need to be addressed by the IRS. Further, specific compliance and operating requirements must also be met, which will be discussed in a future article. The opportunity is worth exploring, however, when taking into consideration your overall tax planning and investing goals.

If you are interested in learning more about this tax opportunity, please do not hesitate to contact us.

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