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Client Alert: New Federal Qualified Opportunity Zone Program

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CLIENT ALERT | 2.8.2018

Deadline Imminent for Input on Communities to be Selected as “Qualified Opportunity Zones”

By: Joseph B. Mann and Kelly B. Bissinger

As part of federal tax reform, Congress created a new “Qualified Opportunity Zone” program to encourage investment in businesses that are located in low-income communities. Under this program, a taxpayer who recognizes gain on the sale of property (including, for example, investment assets such as stock or other security interests, and business assets) can defer and partially eliminate such gain, as well as additional future gain, by investing the sale proceeds in a “Qualified Opportunity Fund.” A Qualified Opportunity Fund is a partnership or corporation certified by the U.S. Treasury Department and formed for the purpose of making investments in businesses located in low-income communities designated as “Qualified Opportunity Zones.”

This program creates a new potential source of capital for businesses and real estate developments located in Qualified Opportunity Zones, while at the same time creating a new tax benefit for investors seeking to reduce their tax burden on taxable asset dispositions.

In order to obtain the benefits of this program, an investor must invest proceeds from a sale or exchange of assets to an unrelated party into a Qualified Opportunity Fund within 180 days from the date of such sale or exchange. Such an investor may choose to reinvest only a portion of the proceeds from the original sale or exchange, in which case only a portion of the gain would be deferred. A Qualified Opportunity Fund is required to invest at least 90% of its assets in businesses (other than certain “sin” businesses) where (i) substantially all of the tangible assets of each such business are used in a Qualified Opportunity Zone, and (ii) at least 50% of the gross income earned from each such business is from the active conduct of business in a Qualified Opportunity Zone.

Because this program is brand new, there are not yet any communities designated as Qualified Opportunity Zones. **However, the process for designating census tracts as Qualified Opportunity Zones is a short one, and is already underway.** The governor of each state (and the mayor of D.C.) has until March 21, 2018 (with a possible 30-day extension) to nominate particular qualifying census tracts within the state (or D.C.) to be certified as Qualified Opportunity Zones. The Treasury Department then has 30 days (with a possible 30-day extension) to decide which nominated census tracts to certify as Qualified Opportunity Zones. Census tracts designated as Qualified Opportunity Zones under this process will remain so designated through December 31, 2028. Each state (and D.C.) may nominate at least 25 census tracts, and up to 25% of the number of census tracts in such state (or D.C.) treated as “low-income communities.” Generally speaking, a census tract will be eligible for designation as a Qualified Opportunity Zone if it has a poverty rate of at least 20% or a median income that does not exceed 80% of the metropolitan median income or the statewide median income. Certain census tracts that are contiguous to tracts meeting those income requirements are also eligible for Qualified Opportunity Zone designation.

The investment of sale proceeds by a taxpayer in an Opportunity Zone Fund will result in a deferral of gain from the sale until the earlier of (i) the disposition by the taxpayer of its investment in the Qualified Opportunity Fund, and (ii) December 31, 2026 (unless such time period is otherwise extended by Congress).

In addition, 10% of the deferred gain is eliminated for investments in Qualified Opportunity Funds held for at least five years, and an additional 5% of the deferred gain is eliminated for Qualified Opportunity Fund investments held for at least seven years. Furthermore, for investments in Qualified Opportunity Funds held for at least 10 years, the investor will not recognize taxable gain on any appreciation in value of the investment in the Qualified Opportunity Fund occurring after the date of the investment.

At this point, there are many questions about how the Qualified Opportunity Zone rules will be applied. Additional guidance is expected and will be necessary in order to fully implement this program. Vorys will continue to monitor the Qualified Opportunity Zone program and report on future developments.

Given the short time frame in which the Qualified Opportunity Zones must be nominated, taxpayers, businesses, developers and others with an interest in having particular census tracts designated as Qualified Opportunity Zones should promptly contact their Vorys attorney to discuss a strategy to provide input on the designation process.

If you have any questions about the Qualified Opportunity Zone program or the Qualified Opportunity Zone designation process, please contact your Vorys attorney.