

Opportunity Zones: Tax Incentives to Drive Economic Growth in Low-Income Communities

The Tax Cuts and Jobs Act passed by Congress at the end of December 2017 established the Opportunity Zones program, a tax incentive program to encourage investments in low-income communities nationwide. The Program creates potential for “Opportunity Zones” – designated census tracts where the poverty rate is 20 percent or higher. The provision is designed to drive long-term capital to these Opportunity Zones. Under the provision, businesses and individuals who invest in Opportunity Zones may defer and reduce otherwise taxable capital gains.

Arizona is one of the first states in the nation to have its zones officially designated. Under the provision, each state’s governor may nominate up to 25 percent of the qualifying low-income census tracts as Opportunity Zones. Last month, Governor Doug Ducey designated 168 tracts to be designated Opportunity Zones, the maximum allowable under the provision. On April 9, 2018, the U.S. Department of the Treasury and the IRS certified Ducey’s selections. Following the completion of the Treasury Department’s certification process throughout the nation, approximately 8,700 population census tracts in the United States will have the Opportunity Zone designation.

The new law creates a temporary deferral of inclusion in taxable income for capital gains that are reinvested into a “Qualified Opportunity Fund.” In order to be qualified, an opportunity fund must be certified by the U.S. Treasury Department, must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone Property, and must hold at least 90% of its assets in the Qualified Opportunity Zone Property. The Opportunity Funds will act as private investment vehicles connecting investors to the Opportunity Zones.

Taxpayers may defer capital gains tax due upon a sale or disposition of property if the capital gain portion of the sale or disposition is reinvested within 180 days in a Qualified Opportunity Fund. The program integrates a step-up basis for capital gains reinvested. The basis is increased by 10 percent if the investment in the Opportunity Fund is held by the taxpayer for at least 5 years, and by an additional 5 percent if held for at least 7 years, thereby excluding up to 15 percent of the original gain from taxation. For an investment maintained longer than 10 years and upon a sale or disposition of the investment, the new provision also allows the taxpayer to elect the basis in the investment to be equal to the fair market value of the investment.

The Opportunity Zone program provides 3 primary tax incentives to Opportunity Fund investors: (1) the ability to defer federal income taxes on the gain arising from the sale or exchange of an asset, (2) the potential to reduce a portion of such gain by increasing the investor’s tax basis in the investment made in an Opportunity Fund, and (3) the potential to eliminate the federal income taxes on all future appreciation of the Opportunity Fund investment.

The idea behind the Opportunity Zoning program was championed by a wide-ranging coalition of investors, entrepreneurs, community developers, economists, and other stakeholders. The aim of the program is to address persistent poverty and uneven recovery in American communities. U.S. Investors currently hold \$2.3 trillion in unrealized capitals gains, representing a significant untapped resource for economic development.

The new law envisions the creation of Opportunity Funds whose managers would look for eligible projects in Opportunity Zones. Sophisticated fund managers should move towards complex structures and entity planning to optimize return for investors and maximize subsidy for low-income business and property investment. Whether it's new and expanding businesses, affordable housing, infrastructure, energy, commercial developments, or another platform that creates productive economic activity, the Opportunity Zones program is flexible enough to support the diversity of needs and opportunities in urban, suburban, and rural zones across the country.

If you are interested in assistance with Opportunity Zone Fund formation, please contact Thrasher Law Offices at:

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