

Treasury and IRS Announce Designation of Opportunity Zones for 18 States

Prepared by:

Craig W. Hammond and Peter J. Kulick

Dickinson Wright LLP



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Summary

The Tax Cut and Jobs Act of 2017 (TCJA) established a new economic development incentive, known as an “Opportunity Zone”. An Opportunity Zone is designed to incentivize long-term capital investments in designated low-income communities by providing investors with a deferral from recognizing federal capital gains tax and, in some circumstances, entirely exempting the gain derived from an investment in designated Opportunity Zones.

Each state was allowed to nominate up to 25% of its low-income, high poverty census tracts to the U.S. Department of the Treasury for designation as a Qualified Opportunity Zone. The deadline for each state to make such submissions was March 21, 2018, unless a state requested a 30-day extension.

On April 9, 2018, the U.S. Department of the Treasury and the IRS designated Qualified Opportunity Zones in each state which submitted its nominations by the March 21st deadline. Those jurisdictions include American Samoa; Arizona; California; Colorado; Georgia; Idaho; Kentucky; Michigan; Mississippi;

Nebraska; New Jersey; Oklahoma; Puerto Rico; South Carolina; South Dakota; Vermont; Virgin Islands; and Wisconsin.

For a map and listing of all designated Qualified Opportunity Zones, see the Opportunity Zones Resources page established by the U.S. Department of Treasury Community Development Financial Institutions Fund at the following link (which will be updated as designations of Opportunity Zones are made in the remaining states): <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>

Opportunity Zone Incentives

The Opportunity Zone tax incentive established by the TCJA is the first new community development tax incentive enacted since the Clinton Administration. The program is designed to drive long-term capital investment to designated low-income communities and uses tax incentives to encourage private investment in impact funds. Investors are eligible to receive certain tax benefits on unrealized capital gains reinvested in Opportunity Zones through pooled Opportunity Funds.

The program uses low-income census tracts as determined under Section 45D(e) of the Internal Revenue Code of 1986, as amended, as the basis for determining census tracts eligible for an Opportunity Zone designation. This census tract eligibility criteria mirrors the low-income tract criteria for the federal New Market Tax Credit program with an important exception. Unlike the New Market Tax Credit Program, where all low-income

census tracts were universally eligible, each state governor is allowed to nominate up to 25% of its eligible census tracts. For example, in the State of Michigan, there are 1,152 eligible census tracts. Therefore, the maximum of 25%, or 288, of these census tracts were allowed to be designated as a Qualified Opportunity Zone. The Qualified Opportunity Zone designation is for 10 years.

Section 1400Z-2 of the Internal Revenue Code allows the temporary deferral of inclusion in gross income for certain gains realized to the extent that corresponding amounts are timely invested in a Qualified Opportunity Fund. These tax incentives include:

- Investors can defer tax on all prior capital gains reinvested in a Qualified Opportunity Fund until the earlier of the date on which the Opportunity Zone investment is disposed or December 31, 2026.
- For capital gains reinvested in an Opportunity Fund, the basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least five years and by an additional 5% if held for at least seven years, thereby excluding up to 15% of the original gain from taxation.
- If the investor holds the investment in the Qualified Opportunity Fund for at least ten years, the investor would be eligible for an increase in its basis equal to the fair market value of the investment on the date that it is sold. This means

investors who hold up to 10 years would face no capital gains on their Opportunity Zone investments.

The Opportunity Zone incentive may be combined with other federal economic development incentives such as New Market Tax Credits, Low Income Housing Tax Credits, and historic rehabilitation tax credits.

Opportunity Funds

A Qualified Opportunity Fund is a new class of investment vehicle organized as a corporation or partnership that specializes in aggregating private capital and investing at least 90% of the fund assets in Qualified Opportunity Zone Property. Qualified Opportunity Zone Property includes any qualified opportunity zone stock, any qualified opportunity zone partnership interest and any qualified opportunity zone business property.

Treasury and the IRS plan to issue further guidance on Qualified Opportunity Funds but it is expected that an Opportunity Fund will be available to be used as a primary investment in a wide range of commercial or residential development in Qualified Opportunity Zones.

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