The Actual
Opportunity in
Opportunity Zones

Overview

One of the newest and least recognized benefits of the Trump tax cuts passed in December 2017 is the new tax code creating Opportunity Zones. These Zones are comprised of select Census tracts, which were finalized on June 21, 2018. Termed "Qualified Opportunity Zones" (QOZs), these areas are intended to be a win-win for both low-income communities in dire need of investment capital and investors looking to defer, minimize, or eliminate, capital gains.

The Opportunity Zones are more impactful than any legislation geared toward tax deductions or deferrals in the past 50 years. Not only do QOZs benefit real estate investors, but also those who want to eliminate capital gains made in the stock market or the sale of any asset – including generational gains.

Investment Benefit # 1: In order to qualify for tax deferral, appreciated assets have to be "re-invested" into a Qualified Opportunity Fund (QOF) which invests in properties/businesses in an Opportunity Zone within 180 days of realizing gains on assets in order to get a capital gains deferment. Several recent articles by the **Forbes** and the **Economic Innovation Group** indicate that there are over $6 trillion in unrealized capital gains still invested in the stock market. The Opportunity Zones were intended to encourage this ~$6 trillion to be invested in QOZ areas.

Investment Benefit # 2: The largest advantage of investments in QOZ properties is the ability for tax free gains on the appreciation of QOZ properties (including improvements made on this property) if the properties are held in a QOF at least 10 years.

QOZs allow an investor to forgo and or skip paying capital gains at two different points in time, and in two different sets of circumstances.

These Zones will be of great benefit to the municipalities that have these federally selected Census tracts in them. Additionally, if an investor already has indications that a location is a good investment without these Zones, then being in a new QOZ provides an added advantage, making the site potentially superior.

Currently, LKG Realty Advisors are in the process of closing four different transactions that will benefit participate and benefit from this new legislation. In addition, we have many parcels/ projects in opportunity zones that are currently in the pipeline. Contact our office, for more information.

Flexible Gain Rollover / Deferment

The most inspiring tax advantage is that these Opportunity Funds are more flexible than 1031 Exchanges (that force you to purchase a substitute property of equal or higher value with the requirement of a similar “exchange”).

The QOZ rules allow investors to transfer into real estate from capital gains made in other economic sectors, such as stock gains or business sales, which are not eligible for 1031 Exchange tax deferment.

Plus, QOZs allow investors for the first time the ability to exit the investment (in ten years) and retain 100 % of the gains made – i.e., with no tax consequences on the appreciation.

How the QOZ Works

- Tax benefits are only available to those to who re-invest their gains in a QOF within 180 days of recognizing that gain.
- Opportunity Zone Funds may receive other funds, but these other funds will not be able to benefit later in bypassing taxes on capital gains.
- The investor must purchase real estate, stock and or partnership interest in a QOZ.
- IRS has stated that Opportunity Zones will be self-certified via an individual’s personal Federal Income Tax Return.
- To qualify as an Opportunity Fund, at least 90% of the assets of the Partnership have to be within the Qualified Opportunity Zones.

Tax Advantages and Disadvantages:

- Example: Capital gains of your initial investment in a QOF are deferred until the end of 2026. That is, funds initially invested within 180 days of some previous sale will be required to pay the initial capital gains (owed in 2019) in 8 years (so you do pay those initial capital gains from Benefit #1 mentioned earlier, but you were able to use the funds to purchase in a QOF, and make yield on them tax free for 7-8 years).

- Appreciation in the new investment property and the improvements made therein can be a 100% tax-free investment – regardless of the appreciation – if the funds are held in a QOF are held for ten years.

- Requirement for QOZ tax benefits: the taxpayer must invest the capital gain funds created from the sale or disposition of real estate, stock or other assets

Example of Optimum Location: Bryan-College Station, TX

Like many other college towns – B/CS has been one of the highest growing metro areas in the region over the past several decades. This small metro area is positioned within the 'Texas Triangle' formed Houston, Austin, and Dallas-Fort Worth – a triangle where ~79% of the State's population growth occurs.

Bryan-College Station has always been defined as low income, based on Census data, because of the high proportion of Texas A&M University students who make up the overall employment base. These students tend to be either unemployed or work part-time, and are normally minimum wage earners.

This metro area offers a great opportunity for investments, particularly if the parcels selected are already potentially good investments. These local locations include Bryan's downtown, University Drive and the "Eastgate" of the University.

<u>Example of Specific Tax Consequences for One Investment</u>: Trey sells an existing investment in August 2018 and realizes a capital gain of $2,000 of which Trey reinvests in a Qualified Opportunity Fund by October 2018. Since Trey reinvested his gains within the 6-month window, he pays no tax on the Gain of $2,000 in 2018 – but rather pays this gain 7.5 years later, after investing in a QOZ.

In sum, if Trey still holds his Opportunity Zone investments until mid-2026, then the deferred gain will be triggered. He will pay the full taxes on the $2,000 gain. But he had reinvested that $2,000 gains in 2018, and we will assume that it ultimately becomes worth $6,000 ten-year forward in 2028. At that ten-year time frame, Trey pays no capital gains on the substantial increase (4,000) he earned in his real estate investment of the parcel, or on the improvements.

Questions Asked by Investors

Q: Do you have to invest all your capital gains?

A: No, you can invest a portion.

Q: Can I invest without using funds gleaned from previous capital gains and still be allowed the same ten-year tax treatment?

A: No, not at this time.

Q: If I buy ten properties and do improvements worth only 20% of the parcels' costs, does this apply to 20% investment across all ten tracts, or can it be 100% of just one property?

A: It's best to have improvements worth 100% or more of the parcel's investment.

Q: Can we use regular funds from savings and invest and get the 10 year treatment from a step up in basis?

A: This is not an IRS -accepted approach at this time.

Q: The code says purchase OR substantial improvement to get desired tax treatment - can we just buy in a Zone and not do much of anything?

A: At this time, we believe the IRS will require substantial improvements (equaling at least 100% of the property purchase price)

Q: If I already own property in the OZ, and if I did substantial improvement of at least 100% -- would this be allowed by IRS to be considered my Opportunity Zone investment?

A: If this improvement was done in 2018, there is a possibility this could be allowed, but you should seek council from your CPA for clarity

Questions and answers below are shown on the IRS website

Q: What is an Opportunity Zone?

A: An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation authority to the Internal Revenue Service.

Q: Who created Opportunity Zones?

A: Opportunity Zones were added to the tax code by the Tax Cuts and Jobs Act on December 22, 2017.

Q: Have Opportunity Zones been around a long time?

A: No, they are new. The first set of Opportunity Zones, covering parts of 18 states, were designated on April 9, 2018.

Q: What is the purpose of Opportunity Zones?

A: Opportunity Zones are an economic development tool—that is, they are designed to spur economic development and job creation in distressed communities.

Q: How do Opportunity Zones spur economic development?

A: Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains until the earlier of the date on which an investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a Qualified Opportunity Fund. Second, if the investor holds the investment in the Opportunity Fund for at least ten years, the investor would be eligible for an increase in basis equal to the fair market value of the investment on the date that the investment is sold or exchanged.

Q: What is a Qualified Opportunity Fund

A: Qualified Opportunity Fund is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in an Opportunity Zone and that utilizes the investor's gains from a prior investment for funding the Opportunity Fund.

Q: I am interested in investing in an Opportunity Zone. Is there a list of Opportunity Zones available?

A: Yes. The current list of approved Opportunity Zones can be found at [Opportunity Zones Resources](). This list will continue to be updated as more Opportunity Zones are approved. A complete list of approved Opportunity Zones will be published later this spring after all Opportunity Zones have been nominated, certified and designated

Q: How does a taxpayer become certified as a Qualified Opportunity Fund?

A: To become a Qualified Opportunity Fund, an eligible taxpayer self certifies. (Thus, no approval or action by the IRS is required.) To self-certify, a taxpayer merely completes a form (which will be released in the summer of 2018) and attaches that form to the taxpayer's federal income tax return for the taxable year. (The return must be filed timely, taking extensions into account.)

Q: I sold some stock for a gain in 2018, and, during the 180-day period beginning on the date of the sale, I invested the amount of the gain in a Qualified Opportunity Fund. Can I defer paying tax on that gain?

A: Yes, under § 1400Z-2(a)(1) of the Internal Revenue Code, you may elect to defer the tax on some or all of that gain. If, during the 180-day period, you had invested in one or more Qualified Opportunity Funds only an amount that was less than your entire gain, you may still elect to defer paying tax on part of the gain, up to the amount that you invested in that way.

Q: How do I elect to defer my gain on the sale of the stock?

A: You may make an election to defer the gain, in whole or in part, when filing your 2018 Federal Income Tax return in 2019 (that is, you may make *the election on the return on which the tax on that gain would be due if you do not defer it).*

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26 USC 1400Z-2: Special rules for capital gains invested in opportunity zones Text contains those laws in effect on October 3, 2018

From Title 26-INTERNAL REVENUE CODE Subtitle A-Income TaxesCHAPTER 1-NORMAL TAXES AND SURTAXESSubchapter Z-Opportunity Zones

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§1400Z–2. Special rules for capital gains invested in opportunity zones

(a) In general

(1) Treatment of gains

In the case of gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer-

(A) gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of such sale or exchange,

(B) the amount of gain excluded by subparagraph (A) shall be included in gross income as provided by subsection (b), and

(C) subsection (c) shall apply.

(2) Election

No election may be made under paragraph (1)-

(A) with respect to a sale or exchange if an election previously made with respect to such sale or exchange is in effect, or

(B) with respect to any sale or exchange after December 31, 2026.

(b) Deferral of gain invested in opportunity zone property

(1) Year of inclusion

Gain to which subsection (a)(1)(B) applies shall be included in income in the taxable year which includes the earlier of-

(A) the date on which such investment is sold or exchanged, or

(B) December 31, 2026.

(2) Amount includible

(A) In general

The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of-

(i) the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

(ii) the taxpayer's basis in the investment.

(B) Determination of basis

(i) In general

Except as otherwise provided in this clause or subsection (c), the taxpayer's basis in the investment shall be zero.

(ii) Increase for gain recognized under subsection (a)(1)(B)

The basis in the investment shall be increased by the amount of gain recognized by reason of subsection (a)(1)(B) with respect to such property.

(iii) Investments held for 5 years

In the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

(iv) Investments held for 7 years

In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii), the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

(c) Special rule for investments held for at least 10 years

In the case of any investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under this clause, the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged.

(d) Qualified opportunity fund

For purposes of this section-

(1) In general

The term "qualified opportunity fund" means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured-

(A) on the last day of the first 6-month period of the taxable year of the fund, and

(B) on the last day of the taxable year of the fund.

(2) Qualified opportunity zone property

(A) In general

The term "qualified opportunity zone property" means property which is-

(i) qualified opportunity zone stock,

(ii) qualified opportunity zone partnership interest, or

(iii) qualified opportunity zone business property.

(B) Qualified opportunity zone stock

(i) In general

Except as provided in clause (ii), the term "qualified opportunity zone stock" means any stock in a domestic corporation if-

(I) such stock is acquired by the qualified opportunity fund after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

(II) as of the time such stock was issued, such corporation was a qualified opportunity zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a qualified opportunity zone business), and

(III) during substantially all of the qualified opportunity fund's holding period for such stock, such corporation qualified as a qualified opportunity zone business.

(ii) Redemptions

A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

(C) Qualified opportunity zone partnership interest

The term "qualified opportunity zone partnership interest" means any capital or profits interest in a domestic partnership if-

(i) such interest is acquired by the qualified opportunity fund after December 31, 2017, from the partnership solely in exchange for cash,

(ii) as of the time such interest was acquired, such partnership was a qualified opportunity zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a qualified opportunity zone business), and

(iii) during substantially all of the qualified opportunity fund's holding period for such interest, such partnership qualified as a qualified opportunity zone business.

(D) Qualified opportunity zone business property

(i) In general

The term "qualified opportunity zone business property" means tangible property used in a trade or business of the qualified opportunity fund if-

(I) such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017,

(II) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property, and

(III) during substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

(ii) Substantial improvement

For purposes of subparagraph (A)(ii), property shall be treated as substantially improved by the qualified opportunity fund only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.

(iii) Related party

For purposes of subparagraph (A)(i), the related person rule of section 179(d)(2) shall be applied pursuant to paragraph (8) of this subsection [1] in lieu of the application of such rule in section 179(d)(2)(A).

(3) Qualified opportunity zone business

(A) In general

The term "qualified opportunity zone business" means a trade or business-

(i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting "qualified opportunity zone business" for "qualified opportunity fund" each place it appears in paragraph (2)(D)),

(ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b), and

(iii) which is not described in section 144(c)(6)(B).

(B) Special rule

For purposes of subparagraph (A), tangible property that ceases to be a qualified opportunity zone business property shall continue to be treated as a qualified opportunity zone business property for the lesser of-

(i) 5 years after the date on which such tangible property ceases to be so qualified, or

(ii) the date on which such tangible property is no longer held by the qualified opportunity zone business.

(e) Applicable rules

(1) Treatment of investments with mixed funds

In the case of any investment in a qualified opportunity fund only a portion of which consists of investments of gain to which an election under subsection (a) is in effect-

(A) such investment shall be treated as 2 separate investments, consisting of-

(i) one investment that only includes amounts to which the election under subsection (a) applies, and

(ii) a separate investment consisting of other amounts, and

(B) subsections (a), (b), and (c) shall only apply to the investment described in subparagraph (A)(i).

(2) Related persons

For purposes of this section, persons are related to each other if such persons are described in section 267(b) or 707(b)(1), determined by substituting "20 percent" for "50 percent" each place it occurs in such sections.

(3) Decedents

In the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.

(4) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including-

(A) rules for the certification of qualified opportunity funds for the purposes of this section,

(B) rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property, and

(C) rules to prevent abuse.

(f) Failure of qualified opportunity fund to maintain investment standard

(1) In general

If a qualified opportunity fund fails to meet the 90-percent requirement of subsection (c)(1),[2] the qualified opportunity fund shall pay a penalty for each month it fails to meet the requirement in an amount equal to the product of-

(A) the excess of-

(i) the amount equal to 90 percent of its aggregate assets, over

(ii) the aggregate amount of qualified opportunity zone property held by the fund, multiplied by

(B) the underpayment rate established under section 6621(a)(2) for such month.

(2) Special rule for partnerships

In the case that the qualified opportunity fund is a partnership, the penalty imposed by paragraph (1) shall be taken into account proportionately as part of the distributive share of each partner of the partnership.

(3) Reasonable cause exception

No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause.

(Added Pub. L. 115–97, title I, §13823(a), Dec. 22, 2017, 131 Stat. 2184 .)

Effective Date

Section effective on Dec. 22, 2017, see section 13823(d) of Pub. L. 115–97, set out as an Effective Date of 2017 Amendment note under section 1016 of this title.

For More Information

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