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Opportunity Zone Proposed Regulations Issued: What Was Answered

The Economic Opportunity Zones program was created by the Tax Cuts and Jobs Act (TCJA) in December of 2017 to incentivize the private sector to invest long term in qualified low-income communities throughout the United States in order to spur economic development and job creation. Taxpayers can roll their gains into these new Qualified Opportunity Funds in exchange for potentially significant tax benefits. Investors in Qualified Opportunity Funds can defer the tax on the gains from the sale of assets rolled into the funds and, depending on how long they maintain the investments in such funds, they may receive an increase to their basis and tax free treatment on additional gains earned from funds invested in the fund.

On October 19, 2018, the Treasury released proposed regulations relating to the Opportunity Zones. These regulations may be relied upon by taxpayers until final regulations are published.

The proposed regulations help clarify some of the ambiguities/questions that were inherent in the TCJA with respect to Opportunity Zones. Taxpayers now have guidance to rely on to help start investing in Opportunity Zones.

Below are answers to some of the most anticipated questions surrounding Opportunity Zones.

What gains are eligible for deferral?

The proposed regulations provide that a gain is eligible for deferral if it is treated as a capital gain for Federal Income tax purposes. These gains generally include capital gain from an actual, or deemed sale or exchange, or any other gain that is required to be included in a taxpayer's computation of capital gain.

Who can elect to defer a gain under the Opportunity Zones?

The proposed regulations clarify that individuals, corporations, regulated investment companies, REITs, partnerships and other pass through entities can make an election to defer capital gains. The regulations also clarified that a partner in a partnership can elect to defer a capital gain if the partnership did not make an election to defer.

Does a debt investment qualify as an investment in a Qualified Opportunity Fund (QOF)?

The proposed regulations clarify that a debt investment cannot be an eligible investment in a Qualified Opportunity Fund. The regulations do allow a taxpayer to collateralize a loan with an investment in a QOF.

When does the 180 day period start that a taxpayer must invest in a QOF?

The proposed regulations provide that a taxpayer has 180 days from the trade date for an exchange that would require that taxpayer to include the gain in the computation of capital gains for federal income tax purposes. If a taxpayer receives a capital gain dividend the taxpayer has 180 days from the date the dividend is paid to make an election to defer the gain.

Can a gain on the sale of a QOF be deferred?
The regulations allow a taxpayer to defer the gain on a sale of a QOF into another QOF. The taxpayer has 180 days from the date the taxpayer disposed of his or her entire interest in the QOF.

If I elect to defer my short term capital gain into a QOF and hold for a year and a day, is my gain now long term Capital gain?
The proposed regulation clarify that any capital gain that is deferred by an investment into a QOF retains its attributes. Thus when a short term capital gain that was deferred is required to be included in taxable income it will be reported as short term gain. The regulations also clarify that the deferred gain relating to collectibles will be taxed at 28%, unrecaptured Section 1250 gain taxed at 25% and a deferred gain of a Section 1256 Contract will be 40% short term capital gain and 60% long term capital gain.

If a partnership did not make an election to defer gain, when does the 180 day period start for the partner?
If the partnership did not make an election, the partner's 180 day period generally starts on the last day of the partnership year. Similar rules also apply for an S-corporation shareholder and beneficiary of an estate.

Is there a maximum amount of time I can hold my interest in a QOF before losing the automatic step up in basis immediately before sale?
The proposed regulations provide that an investment in a QOF will receive a step up in basis immediately before disposition as long as the QOF is sold no later than December 31, 2047.

In order to meet the substantial improvement test does a QOF need to increase the value of the building by 100% of the total purchase price including land?
The proposed regulations clarify that a QOF need to only substantially improve the building without regard to the land.

Will a taxpayer fail the 90% test because they did not spend the cash contributed to the QOF within the required time period?
The proposed regulations allow a working capital safe harbor, which allows businesses to adopt a written plan that identifies the financial property as property held for acquisition, construction or substantial improvement of tangible personal property as long as the business substantially complies with the plan.

While these proposed regulations provide answers to many taxpayer questions there are still many unanswered questions. Treasury has already announced that an additional set of regulations will be forthcoming. Anchin has a dedicated team of tax professionals who continue to analyze these regulations and the effect on our clients. If you have questions please contact Paul Gevertzman, Jeff Bowden, or your Anchin Relationship Partner.

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