LEGISLATIVE UPDATE

OPPORTUNITY ZONES PROGRAM PRESENTS POTENTIAL OPPORTUNITIES FOR COMMERCIAL REAL ESTATE

By Erin Stackley

The Tax Cuts and Jobs Act of 2017 created a new program, the "Qualified Opportunity Zones" (QOZ), intended to encourage economic growth and development in under-served communities by offering tax benefits to investors. This program holds enormous potential for commercial real estate investment and development in the designated zones. However, neither the Treasury Department nor the Internal Revenue Service (IRS) have released the proposed rules for it, so the full impact of the program is still unknown.

Under the QOZ program, the states, territories, and Washington, D.C. are all nominated areas (by census tract) to be "Opportunity Zones." In the spring of 2018 the IRS reviewed and determined which to certify, finalizing the designations. The Zones are in under-served communities, and since census tracts can be small, some are sandwiched between neighborhoods that have already seen significant development and growth (especially in urban areas).

In order to qualify for the tax benefits (explained below), investors must create "Opportunity Funds" to invest in the Zones. Anyone is able to create an Opportunity Fund, but it must be made using capital gains from a previous sale, rolled into the fund within 180 days. Additionally, the statute specifies that Opportunity Funds:

- May be a partnership or corporation organized for the purpose of investing in QOZ property;
- Must hold at least 90 percent of its assets in QOZ property, which can be stock, partnership interests, and/or other tangible property used in a trade or business (e.g. real estate) within a QOZ; and
- Must be certified according to forthcoming IRS and Treasury regulations.

So, what are the tax benefits of investing in a QOZ? First, for gains reinvested into a fund, the capital gains tax is deferred as long as they are kept there, up to nine years. On top of that, the tax ultimately paid on them is reduced by 10 percent after five years and an additional 5 percent (for a total of 15 percent) after seven years. This is done via an adjustment in basis.

There are also significant tax benefits for gains accrued while in an Opportunity Fund: for investments held in an Opportunity Fund for ten years or more, all gains accrued while there are excluded from tax.

Though QOZs are a federal program, the states may have a role to play as well. States that are interested in making their Zones more attractive to investors could, for example, conform their state tax laws to the federal laws by relieving investors from paying state capital gains rates on income earned from QOZ investments. The states will likely be reviewing their tax codes in response to the federal changes, though not all will choose to make such changes.

The QOZ program officially kicked off with the designation of the Zones themselves, but the IRS and the Treasury are still promulgating the rules for its implementation. The agencies need to address important questions, including: how to certify an Opportunity Fund (the Treasury has indicated they will allow self-certification); specifically outlining the timing requirements for investing; possible guardrails against fraud and abuse within the program; and how the program will interact with or impact other tax incentives meant to encourage investment in low-income areas. These proposed rules were initially expected to

"This program holds enormous potential for commercial real estate investment and development.."

be released in the summer of 2018, but have been delayed by the agencies.

NAR is closely monitoring this issue and will provide feedback on the proposed regulations to the Treasury and the IRS to ensure that the program is successful. In the meantime, please check out the "Opportunity Zones" page on nar.realtor[1] for more information on the program, including links to the IRS "FAQ" page and a list or map of all the designated QOZs. ∇

[1]www.nar.realtor/taxes/qualified-opportunity-zones