

CROSS-BORDER FINANCE ALERT



Opportunity Zone Tax Incentives 101

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The 2017 Tax Act received a great deal of attention on both sides of the border in 2018. Businesses (and tax professionals) across the globe scrambled to analyze the revised Code to see how it impacted them. But one area that didn't get much initial attention was the provisions introducing the concept of the "Opportunity Zone". That is starting to change, and Opportunity Zones are becoming hot topics in the business world.

The Basics

An "opportunity zone" is a population census tract that meets the definition of a "low-income community" and has been specifically designated as a Qualified Opportunity Zone ("QOZ") under section 1400Z-1 of the Code. The IRS has designated over 8,700 certified QOZs in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands. An official list is contained IRS Notice 2018-48. The QOZ designation remains in effect until December 31, 2028. Policy-wise, the designation of these low-income communities as QOZs is intended to incentivize the movement of capital into QOZs to develop property and create and expand businesses in an effort to reduce poverty and increase employment. How do they do that? In typical US fashion ... by creating tax incentives!

What Tax Incentives Are Available?

As an initial matter, to be entitled to any tax QOZ benefits, US taxpayers must invest in QOZs through specific investment vehicles referred to as Qualified Opportunity Funds ("QOF"). A taxpayer must invest all or a portion of a realized gain on property into a QOF within 180 days of a realization event. The incentives they are eligible for will depend on how long they hold the QOF investment.

Gain Deferral - The taxpayer may be able to defer the invested gain until the earlier of (a) the date that the taxpayer sells or exchanges the investment in the QOF, or (b) December 31, 2026, at which point the taxpayer recognizes gain equal to the lesser of (a) the fair market value of the investment over basis, or (b) the deferred gain over basis. Thus, the latest that the deferred gain is required to be recognized is December 31, 2026.

Basis Increase - The taxpayer's initial basis in the investment in the QOF is zero. But if the taxpayer holds the investment in the QOF for at least 5 years, the taxpayer's basis in the investment is increased by an amount equal to 10% of the gain that the taxpayer originally elected to invest and defer (which means that 10% of the deferred gain is permanently excluded). And if the taxpayer holds the investment in the QOF for at least 7 years, the taxpayer's basis in the investment is further increased by an amount equal to 5% of the gain that the taxpayer originally elected to invest and defer (which means that 15% of the deferred gain is permanently excluded).

Exclusion of Gain - If the taxpayer holds the investment in the QOF for at least 10 years, the taxpayer can elect to have basis equal the fair market value on the date the investment is sold or exchanged (which means that post-acquisition gain is permanently excluded).



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Conclusion

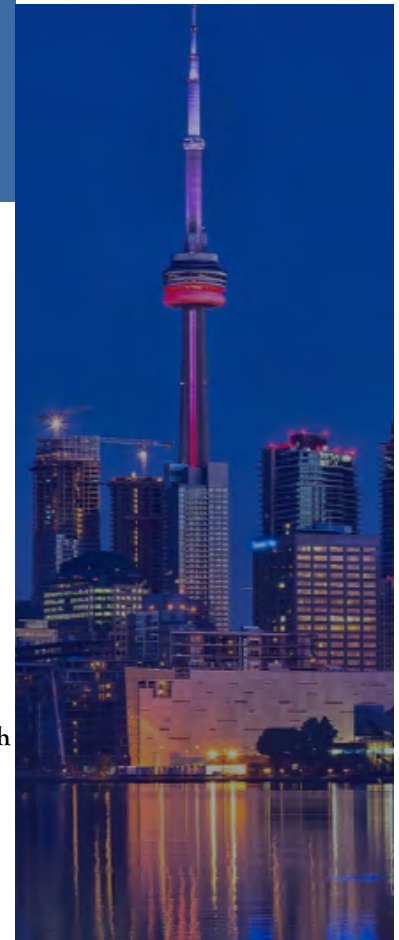
To date, the activity in this space has been somewhat limited primarily due to the lack of detailed guidance coupled with significant statutory penalties. Treasury and the IRS issued proposed regulations last October and we expect these regulations to be finalized by the end of March. If the additional guidance addresses a sufficient amount of the unanswered questions, we expect to see significant increase in activity in this space. Please feel free to contact us to discuss these issues in greater depth and evaluate whether an investment in a QOF is right for you.

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