MAYNARDNEXSEN

Opportunity Zones Can Affect Your North Carolina Real Estate Investments

Related Professionals

George T. Smith III
919.653.7836
gtsmith@maynardnexsen.com

Practices

Government & Regulatory Affairs

Tax Law

01.02.2019

On Friday, October 19, 2018, the Treasury Department issued its proposed regulations on the Opportunity Zones program. The proposed regulations provide some clarity and answers to many uncertainties surrounding the program.

On Friday, October 19, 2018, the Treasury Department issued its proposed regulations on the Opportunity Zones program. The proposed regulations provide some clarity and answers to many uncertainties surrounding the program. Investors across the country have speculated about the actual benefits Opportunity Zones provide, weary to commit without more concrete, proven results. However, large companies have increasingly begun to invest in Opportunity Zones, such as Amazon's new site on Long Island City in Queens. But what exactly are Opportunity Zones, and how do the new proposed regulations affect my real estate investment?

What are Opportunity Zones?

Opportunity Zones are a new community development **program** established by Congress in the Tax Cuts and Jobs Act of 2017 to encourage long-term investments in low-income urban and rural communities. The Opportunity Zones program provides a tax-incentive for investors to re-invest their unrealized capital gains into Opportunity Funds dedicated to investing into Opportunity Zones labeled by chief executives of every US state. There are roughly 9,000 zones in the US, with North Carolina offering 252 zones across the state.

The program is designed to incentivize patient capital investments in low-income communities nationwide. All underlying incentives relate to the tax treatment of capital gains, and all are tied to the longevity of an investor's stake in a Qualified Opportunity Fund, providing the most

upside to those who hold their investment for 10 years or more. Opportunity Funds are dedicated to investing in the identified Opportunity Zones. North Carolina's 252 zones were certified by the United States Treasury on May 18, 2018. The list of North Carolina Opportunity Zones can be downloaded **here**.

The major draw of this program on the investor side is the federal tax incentive it offers. The law provides tax incentives to invest unrealized capital gains—assets that have accrued value but haven't yet been sold—in what's called a Qualified Opportunity Fund. The fund must then put at least 90 percent of its assets into Opportunity Zone properties. Investors can avoid paying taxes for up to nine years on gains invested in Opportunity Funds and may also pay lower taxes on those gains or see some gains permanently excluded from their taxable income if their investment is held in a fund for at least 10 years. The program also offers the following opportunities for investors:

→ *Temporary Deferral* for capital gains invested into an Opportunity Fund.

→ *Step-Up in Basis* for capital gains reinvested into an Opportunity Fund. The basis of the original investment is increased by 10% if the Qualified Zone Fund is held for at least five years by the taxpayer, and is increased by 5% for at least seven years, and can exclude up to 15% of the original gain from taxation.

→ *Permanent Exclusion from taxable income of capital gains* from a sale or exchange of an investment in a Qualified Opportunity Zone held for at least 10 years.

Unlike other programs such as the Low-Income Housing Tax Credit or the New Markets Tax Credit, there is no authorized cap on the amount of capital accessed through the Opportunity Funds and respective Opportunity Zone investments. The main source for these investments is the approximately $2.2 trillion of capital gains unrealized by individuals and corporations. These funds are essentially channels to pooled equity that will be used for equity investments into small business and real estate throughout distressed communities.

Proposed Regulations for Opportunity Zones

The tax bill says the Treasury Secretary will prescribe "rules to prevent abuse" of funds but gives no further details, and it doesn't explicitly empower local or state governments to control how investments are made. On October 19, 2018, the Treasury Department and the IRS issued proposed **regulations** for the new Opportunity Zone program. These proposed regulations clear up some uncertainty for the program, yet many questions remain unanswered and seek additional input from stake-holders. Some of the biggest concerns addressed in the proposed regulations provide more flexibility to the many ambiguities in the law.

→

Any person that recognizes capital gain for federal income tax purposes (including a "C" corporation, a RIC, a REIT, an S Corp., or a trust or estate) is eligible to defer all or a portion of such gain by investing in an Opportunity Fund.

→

Any gain not treated as capital gain is not eligible to be deferred. Likewise, any gain realized but not recognized for federal income tax purposes, such as a gain in corporate reorganizations, certain partnership transactions and Section 1031 like-kind exchanges, is not eligible to be deferred.

→

A taxpayer is allowed to split the gain derived from a single transaction into multiple Opportunity Fund investments.

→

Opportunity Fund is required to have 90% of its assets in qualified Opportunity Zone property, and the Opportunity Zone business must have substantially all (defined as 70% of assets) of its tangible property within an Opportunity Zone.

→

Deferral of capital gains by a partnership and/or its partners – where a partnership recognizes a capital gain and invests the gain into an Opportunity Fund, the deferred partnership-level gain will not be taxed at the partner level in the year of deferral. When the gain is recognized, the partnership's partners will be taxed on the recognized gain.

→

How do you defer the qualifying capital gain? Taxpayers will defer the gain by making a deferral election on Form 8949, which will need to be attached to a Federal Income Tax Return for the taxable year the gain would have been recognized but for the deferral.

→

Any entity classified as a domestic corporation or a domestic partnership for federal income tax purposes is eligible to be an Opportunity Fund, which can be organized as REITs and S corporations. An eligible interest in an Opportunity Fund includes preferred stock and a partnership interest with special allocations, but not a debt interest. The eligible interest can be used as collateral for a loan.

→ Qualified Opportunity Funds were determined by the Community Development Institutions Fund of the Treasury Department. In other words, community development type organizations are not the only type of entity that qualify under the law.

__George Smith__ is an Associate with Nexsen Pruet's __Public Policy & Regulatory__ practice. He regularly represents companies and individuals before the North Carolina Property Tax Commission, administrative and regulatory boards and commissions, Superior Court and the North Carolina Court of Appeals.