New Guidance Clarifies Opportunity Zone Tax Incentive

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The U.S. Treasury Department and IRS have issued proposed regulations (REG-115420-18) further clarifying the Opportunity Zone tax incentive created by the Tax Cuts and Jobs Act (TCJA). The now 8,761 Opportunity Zones were nominated by their respective states and are defined at the census tract level. There are Opportunity Zones in all 50 states, Washington, DC and several U.S. territories, including Guam, Puerto Rico, St. Croix and St. Thomas. These zones are predominantly in low-income areas, and the tax incentive was designed to promote economic growth.

Under the proposed regulations to IRC Section 1400Z-2, investors may defer tax on almost any capital gain up to December 31, 2026 by investing in an Opportunity Zone. In general, to qualify for a deferral, the capital gain amount deferred must be invested in a Qualified Opportunity Fund (QOF). These funds are entities treated as partnerships or corporations for federal income tax purposes, organized in one of the Opportunity Zone states/U.S. territories (or Washington, DC) and used for the purpose of investing in qualified Opportunity Zone property.

To be a QOF, at least 90 percent of assets must be invested in qualified Opportunity Zone property. Furthermore, certain entities do not qualify as Opportunity Zone businesses for investment, such as private or commercial golf courses, country clubs, or gambling facilities (like racetracks).

REG-115420-18 also clarifies what entities can defer capital gains through this program. If a partnership has capital gains, either the partnership itself or its partners can elect deferral; similarly, if pass-through entities like S-corporations or trusts incur capital gains, their shareholders or the trust's beneficiaries can defer. Additionally, taxpayers that hold QOF investments for at least 10 years can increase the basis of their investment to its fair market value on the date the investment is sold or exchanged.

Other guidance in REG-115420-18 and Rev. Rul. 2018-29:

- Clarification on requirement that buildings purchased in Opportunity Zones must be "substantially improved:" This applies to the building itself, not the land. This aims to facilitate repurposing vacant buildings in low-income areas.
- Further guidance on the "original use" requirement for land purchased in Opportunity Zones after 2017.
- Taxpayers may use a new Form 8996 to self-certify as a QOF and report annually that they comply with the "90 Percent Asset Test."
- When 180-day period begins for pass through entities and the partners or shareholders.
- Opportunity funds can be either new or existing partnerships or corporations.
- Defines the term "substantially all" to mean 70 percent or more.

DHG will continue to monitor updates to the Opportunity Zone tax incentive and other tax reform measures.

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