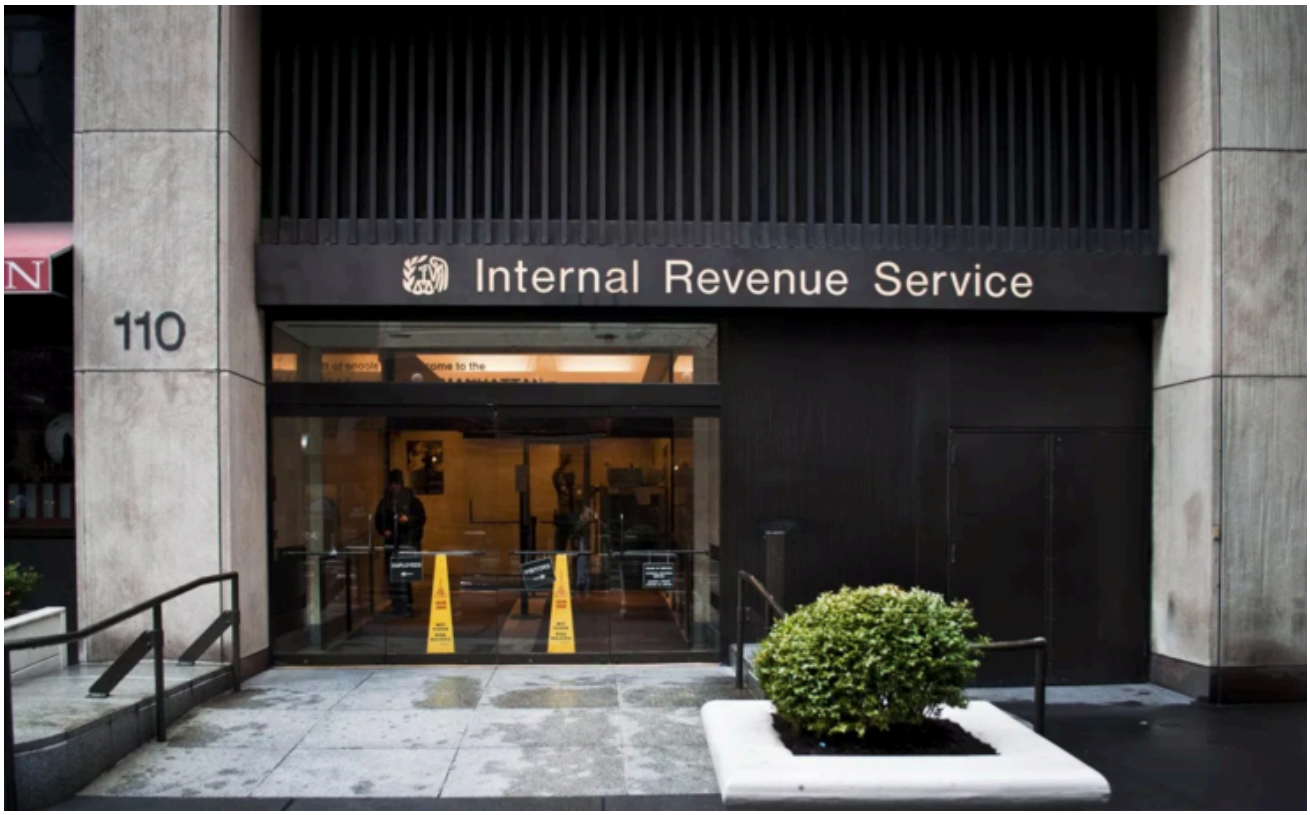
ACCOUNTING TODAY. Proposed Regulations on Qualified Opportunity Zones

GRASSI & CO. (November 01, 2018)



On October 19, 2018 the Treasury and IRS issued proposed regulations on the new Opportunity Zone Tax incentive created by the Tax Cuts and Jobs Act (TCJA) encouraging economic growth and development through private investment in specific low-income or rural communities and disaster areas.

A Taxpayer may exclude from gross income, gain on the sale or exchange of any property to an unrelated party in the tax year of the sale, or exchange if the gain is reinvested in a qualified opportunity fund within 180 days of the sale or exchange.

The Proposed regulations outline the requirements that investors must satisfy to defer the taxation of capital gains invested in a qualified opportunity fund (QOF).
Some highlights of the Proposed Regulations include:

Only Capital Gains Qualify

The Proposed Regs made clear that only capital gains qualify.

- An example of income that does not qualify is if the investor is categorized by the IRS as a "dealer", the profits from most property flips will be taxed at their ordinary income tax rate not capital gain rates.

- Pass-Through Entities: For any pass through entity (multi member partnership or S Corp) the deferral could be elected by either the entity or separately by each individual owner if they choose to.

We had sent a communication to our clients regarding the original announcement made in June:

The Tax Cuts and Jobs Act of 2017 created code section 1400Z, which is designed to encourage economic growth and development through private investment in specific low-income or rural communities and disaster areas. A taxpayer may elect to exclude from gross income, gain on the sale or exchange of any property to an unrelated party in the tax year of the sale, or exchange if the gain is reinvested in a qualified opportunity fund within 180 days of the sale or exchange. These designated communities may receive funding from Opportunity Funds, which allow a wide array of investors to pool their resources together to rebuild distressed neighborhoods. The deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of, or December 31, 2026.

Each state is encouraged to notify the Federal government as to what low-income population communities should qualify for this tax incentive. Each state shall have no more than 25% of its low-income populations designated as qualified opportunity zones. If a state has less than 100 low-income population zones, then 25 zones shall be designated for this tax incentive.

The qualified opportunity zone provisions create a tax incentive for investors through the following means:

A temporary tax deferral of capital gain recognition on transactions completed before December 31, 2026

A potential step-up in tax basis of the taxpayer's investment if the holding period is at least 5 years or more; if sold before a 5 year holding period the tax basis in the investment is deemed zero.

A potential for no capital gain recognition if the investment is held for at least 10 years; taxpayer will treat their basis in the investment as the fair market value on that date of sale

A qualified opportunity fund can be organized as either a corporation or a partnership and must invest in “qualified opportunity zone property”, which is tangible property owned and leased by the taxpayer in a qualified opportunity zone. In order for a business to qualify as being in a qualified opportunity zone, at least 50% of the gross income of the business must be derived from the conduct of business in the zone. Also the businesses cannot be related to golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, gambling or any business involved in the sale of alcoholic beverages for consumption off premises. The qualified opportunity fund must hold at least 90% of its assets in qualified opportunity zone property.

The Treasury plans to issue further guidance on qualified opportunity funds, but it is anticipated that this provision will be a significant way to encourage investment in qualified opportunity zones across the country.

While the deferral or exclusion of gain will flow through to New York State, it is not yet clear on whether the state will follow the Federal treatment regarding the deferral of the gain. We were told NYS will follow the Federal treatment, but formal written guidance is not yet available.

If you anticipate a large capital gain within the next 8 years and would like to explore investment in a qualified opportunity zone fund as a way to temporarily or permanently defer these gains, please contact Jeffery Cohen, Partner and Tax Services Leader of Grassi & Co., at JCohen@grassicpas.com [2] or Joseph Molloy, Principal and Tax Construction Leader, at JMolloy@grassicpas.com [3].

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