



QUALIFYING FOR OPPORTUNITIES IN OPPORTUNITY ZONES

Opportunity Zones can offer benefits to investors, particularly in the form of deferred or eliminated capital gains taxes, but qualifying for these opportunities comes with its own set of complexities.

By Matthew J. Ertman and Michael C. Pruter

The Tax Cuts and Jobs Act, signed into law in December 2017, offers a new opportunity for investors by creating what are known as Opportunity Zones in low-income areas. This tax incentive program was created in an attempt to bring new economic opportunities to areas with poverty rates of at least 20 percent or median family incomes of no more than 80 percent of statewide or metropolitan-area family income. The program encourages investors to make long-term financial investments in Qualified Opportunity Zones (QOZs). In exchange, the investor receives a number of benefits related to the deferral or elimination of capital gains taxes.

Investors wishing to take advantage of these tax benefits must, within 180 days of a sale or exchange resulting in capital gains, invest the gain into a Qualified Opportunity Fund, which is an investment vehicle organized as a corporation or a partnership that utilizes the gains from a prior investment to capitalize the fund. This short timeline may prove challenging for investors, who will have to figure out the best way to acquire or repurpose their properties and assets within this window.

At least 90 percent of the fund's assets must be invested in qualified properties located in a QOZ, or a pen-

alty is paid for failing to meet this requirement. An exception to this rule can be made if it is shown that failure to maintain the 90 percent requirement is due to reasonable cause. The fund also requires a business plan which shows that it has a QOZ Property identified, and that it will invest in this property within the next fiscal year.

There are three main incentives and benefits to invest in Qualified Opportunity Funds:

1. To defer recognition of capital gains
2. To eliminate recognition of up to 15 percent of these capital gains
3. To potentially eliminate recognition of all capital gains upon the sale or exchange of a fund investment.

These Qualified Opportunity Funds are very different than traditional funds, and investors will have to be creative to structure them correctly to comply with the current tax requirements.

Once a Fund is established, its assets can then be invested in business properties located in QOZs. Potential investors can use a mapping tool made publicly available through the U.S. Treasury Department to determine if a piece of property is within an area designated as a QOZ.

The types of properties that qualify as QOZ properties include:

- *Qualified Opportunity Zone Stock* — stock in a U.S. corporation that is a QOZ Business
- *Qualified Opportunity Zone Partnership Interest* — any capital or profits interest in a U.S. partnership that is a QOZ business
- *Qualified Opportunity Zone Business Property* — tangible property used in a trade or business of a Qualified Opportunity Fund

All three types must be acquired solely for cash, must have been a QOZ Business when acquired and must qualify as a QOZ Business during substantially all of the fund's holding period.

Qualifications as a QOZ

For a trade or business to be defined as a QOZ Business, it must meet a number of qualifications. The business property must be leased or purchased after Dec. 31, 2017; the business must be the first to use the property, or it must substantially improve the property; the property must be used in the QOZ during substantially all of the QOZ Business's holding period; at least 50 percent of the total gross income of the QOZ Business must be derived from the active conduct of business in the QOZ; and notably, the QOZ Business must not be a country club, massage parlor, hot tub facility,



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racetrack, health club, or store whose principal business is the sale of alcoholic beverages for consumption off premises.

Qualifying QOZ Businesses may include apartment buildings, hotels, mixed-use properties, retail strip malls and fast food chains.

Under the current rules and regulations, it appears difficult for established businesses in QOZs to earn QOZ Business status, as it would be unlikely that the property owned by the business would have been purchased or leased after Dec. 31, 2017, or that the business is the first to use the QOZ property. As a result of these restrictions, it appears that the program will currently benefit new businesses being created in QOZs.

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