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The New Tax Act provides potential avenue for investing in industrial and commercial facilities in economically distressed communities

By Bruce Baker, Dana Stanton and Cody Rogers

Part of the recently enacted Tax Law, known as the Tax Cuts and Jobs Act, Public Law 115-97 (the "Tax Act") was established to provide significant financial incentives to developers and investors who invest in designated, qualified economically distressed communities. Investors and developers will need to move quickly to reach out to the governors of the states that are home to many of these properties since deadlines are fast approaching for designating locations.

Qualified opportunity zones

The Tax Act adopted provisions of a bill previously known as the "Investing in Opportunity Act," which is designed to draw long-term investments to low-income communities across the nation by allowing investors to defer capital gains taxes. A principal sponsor of this legislation was Sen. Tim Scott, a South Carolina Republican, who worked with the Economic Innovation Group, a Washington, D.C., think tank identified with tech mogul Sean Parker.

The Investment in Opportunity Act requires the designation by state governors of "Qualified Opportunity Zones" ("QOZs") within low-income communities. Investors can then create "Qualified Opportunity Funds" ("QOFs")—private sector investment vehicles to fund development and redevelopment projects in QOZs. Investors can achieve a tax deferral, and possible exclusion, for capital gains that are reinvested into a QOF. If a taxpayer generates capital gains and invests that amount into a QOF within 180 days, the tax may be deferred until the fund investment is sold or exchanged. If the taxpayer holds the investment for five years, the taxpayer will pay tax on only 90% of the original gain. If the investment is held for seven years, only 85% of the original capital gain will be taxable. If the investment is held for ten years, the increase in the value of the fund investment is excluded from taxation. The Tax Law also contains a provision for the payment of taxes by December 31, 2026. More information on the Investing in Opportunity Act can be found here.

The process for designating qualified opportunity zones

Potential QOZs must be proposed by the governor of each state from among the state's low-income community ("LIC") census tracts. QOZ eligibility is based on the 2011–2015 American Community

Survey ("ACS") five-year data from the Census Bureau. The CDFI Fund has identified over 41,000 population census tracts that are eligible for designation as a QOZ, including (1) 31,680 population census tracts that contain LICs eligible for designation as QOZs, and (2) 9,453 non-LIC population census tracts that are eligible for designation if a particular LIC contiguous to the non-LIC tract is designated as a QOZ. Contiguous tracts must be at or below 125% of the area median income.

However, governors need to move quickly because proposed designations are due by March 21, 2018, although, governors may request a thirty-day extension of this deadline. Nominations are to be submitted to the U.S. Treasury Secretary, who will then make the QOZ designations. Designations remain in effect for ten years and once the QOZs are set, it is unclear how they might be changed once set.

The Internal Revenue Service ("IRS") just released Rev. Proc. 2018-16 for governors for nominating QOZs. In addition, the IRS has developed a Nomination Tool, which can be accessed online by governors to make their QOZ nominations. The IRS guidance can be found here.

Pursuant to the legislative history, particular consideration should be afforded to areas that have recently experienced significant layoffs due to business closures or relocations. Thus, communities with closed (or closing) industrial plants, shopping malls and similar facilities within their borders are particularly well-suited for consideration.

Investors, developers and property owners should reach out to their governors and highlight the advantages of nominating census tracts that contain closed power plants as QOZs in order to take advantage of this very useful provision of the Tax Act.

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