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“Investing in Opportunity Act” a new community development resource

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As part of the recent tax overhaul passed by Congress and signed into law by President Trump, a little publicized provision was added to the Internal Revenue Code (the “Code”) with the goal of revitalizing economically distressed communities. This provision, known as the Investing in Opportunity Act (the “Act”), creates a new vehicle for investors to defer capital gain taxes.

The Act was effective upon signing on December 22, 2017, and allows for the creation of Qualified Opportunity Zones (“QOZ”) within “low-income communities” as defined in Section 45D(e) of the Code, but as outlined below, not all “low-income communities” will be QOZs. Qualified Opportunity Funds (“QOF”) may be used to defer capital gains taxes until either the initial investment in the QOZ is sold, or December 31, 2026 (whichever comes first). The QOF is an investment vehicle for investing in QOZ property (other than another QOF) that holds at least 90 percent of its assets in QOZ property (or less with reasonable cause), or otherwise pay a penalty equal to 90% of assets over QOZ property (which is QOF stock, partnership interest, business property), similar to New Market Tax Credits.

The Governor of each state may submit nominations for a limited number of QOZs to the Treasury Secretary for certification and designation within 90 days of enactment. If the number of “low-income communities” in a state is less than 100, the governor may designate up to 25 tracts, otherwise the governor may designate tracts not exceeding 25% of the number of “low-income communities” in the state. The designation remains in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after the date of designation. The QOZ may include areas adjacent to the QOZ up to 125% of the median income of the adjacent low-income community/QOZ. No more than 5% of total QOZ within a particular state/dependency may be designated under these criteria.

Investments in QOZs may become eligible for deferment only after a 5 year period (after which the investment in the fund must be increased to equal 10% of the gains deferred, and the investment in the fund is subject to a 5% increase after 7 years and will equal “fair market value” after 10 years. The Act allows for a deferral of capital gains from sale of assets in designated communities/census tracts—temporary deferral of inclusion in gross income for capital gains reinvested in a QOF and the permanent exclusion of capital gains from the sale or exchange of an investment in the QOF.

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The Act allows for a temporary deferral of inclusion in gross income for capital gains that are reinvested in a QOF, up to the amount invested within 180 days after sale of the subject asset.

The deferred gain is recognized on the earlier of the date on which the QOZ investment is disposed of or December 31, 2026. Only taxpayers who roll over capital gains of non-zone assets before December 31, 2026, will be able to take advantage of the special treatment of capital gains for non-zone and zone realizations under the provision.

In the case of the sale or exchange of an investment in a QOZ fund held for more than 10 years, at the election of the taxpayer, the basis of such investment in the hands of the taxpayer shall be the fair market value of the investment at the date of such sale or exchange.

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