Select Communities to Become Eligible for New Federal Tax Incentive for Private Investment

Local governments and other interested parties may now provide input on the designation of census tracts as "Opportunity Zones" eligible for a new federal tax incentive that seeks to promote private investment in low-income communities. The Opportunity Zone program, which was first proposed by a bipartisan group of lawmakers, was established by Congress in December 2017 as part of H.R. 1 (commonly known as the Tax Cuts and Jobs Act). This information sheet describes the developing process for designating a community as an Opportunity Zone, provides an overview of the key requirements of a qualified opportunity fund, and explains the tax incentives created by the program.

Designation of Opportunity Zones. Each state governor may nominate Opportunity Zones from all census tracts that are "low-income communities" for purposes of the New Markets Tax Credit program (map). The number of nominations is limited to 25 percent of the number of "low-income communities" in a state (or, in states with fewer than 100 "low-income communities," up to 25 eligible areas). A governor may also nominate a census tract that is not a "low-income community," if it is adjacent to another designated "low-income community" and the median family income of the census tract does not exceed 125 percent of the median family income of the adjacent "low-income community," but these nominations may not exceed 5 percent of a governor's total nominations (1.25 percent of the total number of "low-income communities" in the state). The IRS estimates that over 41,000 census tracts are eligible to be nominated. The deadline for nominations is March 21, 2018, but governors may request a 30-day extension. The Secretary of the Treasury generally has 30 days to certify a governor's nominations and to designate census tracts as Opportunity Zones.

In Washington, the State Department of Commerce is developing a process for nominating census tracts and has requested public input on the selection of particular communities. Although final criteria have not yet been adopted, the Department announced that it may use such criteria as economic impact, social equity, the potential for eligible private projects (such as housing, manufacturing, or business expansion) to benefit in the next five years, the availability of other sources of equity to available projects, the ability of Opportunity Zones to complement communities' existing strategic plans, and support for designation from partners such as local governments and economic development organizations. According to the Department, 25 percent of Washington's low-income areas amounts to 139 census tracts eligible for nomination. Interested persons with comments or questions for the Department can email opportunityzones@commerce.wa.gov.

Opportunity Funds. An opportunity fund is an investment vehicle that is organized for the purpose of investment in qualified opportunity zone property and that holds at least 90 percent of its assets in qualified opportunity zone property. Qualified opportunity zone property must be acquired after December 31, 2017 and can take the form of stock or a partnership interest in a qualified opportunity zone business, or tangible business property used in a qualified opportunity zone business. A qualified opportunity zone business must meet several requirements, including (but not limited to) a requirement that substantially all of its tangible property must be used within an Opportunity Zone and that its property must be either originally used or substantially improved by the business. Additional conditions, including with respect to the business type, income sources and use of intangible property, must also be satisfied.

Tax Incentives. The Opportunity Zone program offers three tax benefits to investors who invest long-term capital gains in an opportunity fund. First, investors may defer recognition of the capital gains as taxable income until they sell or exchange the opportunity fund investment or until December 31, 2026, whichever is earlier. Second, investors receive a 10-percent step-up in the basis of the capital gains after holding the opportunity fund investment for at least 5 years, plus an additional 5-percent step-up after holding it for at least 7 years. Third, investors may permanently exclude from their taxable income any additional gains on investments in an opportunity fund that are held for at least 10 years.

Opportunity funds may be used in combination with other federal, state or local programs to provide equity for private business or development.

If you have any questions about this article or pertaining to state and municipal law and finance generally, please contact any of our public finance attorneys.

Alison Benge	Alison.Benge@pacificalawgroup.com	206.602.1210
Deanna Gregory	Deanna.Gregory@pacificalawgroup.com	206.245.1716
Faith Li Pettis	Faith.Pettis@pacificalawgroup.com	206.245.1715
Stacey Lewis	Stacey.Lewis@pacificalawgroup.com	206.245.1714
Jon Jurich	Jon.Jurich@pacificalawgroup.com	206.245.1717
Will Singer	Will.Singer@pacificalawgroup.com	206.602.1216

This information sheet is for informational purposes only, is not legal, tax or investment advice, and does not purport to be a complete description of the requirements related to the Opportunity Zone program. Such requirements are set forth in 26 U.S.C. §§ 1400Z-1 and 1400Z-2 and Rev. Proc. 2018-16, and may be further defined by future regulations or statutes.

Dated: February, 20, 2018

PACIFICA
LAW GROUP