Investing in Qualified Opportunity Funds

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The Tax Cuts and Jobs Act signed on Dec. 22, 2017, amended the tax code to encourage economic growth and investment in designated distressed communities, called qualified opportunity zones, by providing federal income tax benefits to taxpayers who invest in businesses, known as Qualified Opportunity Funds, located within these opportunity zones. The amendments to the tax code allow each state to designate investment areas as "Qualified Opportunity Zones." Earlier this year, the N.C. Department of Commerce designated 252 census tracts covering a wide geographic area of urban and rural areas across the state as Qualified Opportunity Zones. In the Triad, many of these opportunity zones are adjacent or near ongoing redevelopment projects in Greensboro along East Wendover Avenue, East Market Street and East Gate City Boulevard and in Winston Salem along University Parkway.

The initial amendment to the tax code left several questions unanswered. Recently, the IRS published its long-awaited rules to answer these open questions. The proposed rules will allow deferral of taxation on certain gains to the extent corresponding amounts of such gains are timely invested in a partnership or a corporation organized for the purpose of investing in property located in a Qualified Opportunity Zone.

The three main benefits of investing in a Qualified Opportunity Fund are, first, a deferral on inclusion in gross income for certain gains reinvested in a Qualified Opportunity Fund until Dec. 31, 2026, if the investment is made within 180 days after the initial sale. Further there is an ability to exclude tax on up to 15 percent of the gains reinvested if the Qualified Opportunity Fund investment is held for five to seven years. Lastly, the Opportunity Zone Program allows for exclusion from gross income of the post-acquisition gains on investments in a fund so long as the investment is held for at least 10 years. Notably, the structure of the tax benefits creates a strong incentive to close on Qualified Opportunity Zone investments by Dec. 31, 2019.

The IRS's recent publication of its guidance answers many questions left open by the initial tax code amendment. As a result of the proposed rules, there will be greater taxpayer certainty as to the type and timing of transactions that qualify for capital gains deferral and therefor greater use of the Opportunity Zone Program.

Because deferral of capital gains can be an important tax planning tool for many business owners and real estate investors that have recently sold these assets, you should consult with your tax professional prior to the end of the year to see how an investment in an opportunity zone may be beneficial to your particular financial situation. Given the wide reach of the Opportunity Zone Program, if you have recently sold a business or real estate interest and are contemplating re-investing the gain, then your next investment may qualify for deferral of taxes owed on the gain.

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