



## **Opportunity Zones**

*Tax incentives for investing in low-income communities*



Accountants and Advisors

# Opportunity Zones

The Opportunity Zones program, established through the Tax Cuts and Jobs Act, aims to spur long-term private sector investments in low-income communities nationwide. Investors in Opportunity Funds established within the designated Qualified Opportunity Zones can take advantage of federal tax benefits in exchange for their contribution to economic growth and investment in distressed communities. Project sponsors can also benefit from lower-cost capital generated by the program.

## How it works

The Opportunity Zones program offers federal tax incentives for investing unrealized gains in Qualified Opportunity Funds, which are investment vehicles created specifically for these purposes. The amount of benefit ultimately recognized depends on the holding period of the investment.



### 1. Deferral

Investors receive a temporary deferral of tax on gains reinvested into Qualified Opportunity Funds. The reinvestment must be made within 180 days of the sale creating the gain. The period of deferral ends upon the earlier date of the sale of the reinvestment in the Qualified Opportunity Fund or Dec. 31, 2026.



### 2. Reduction

The reduction benefit provides investors a step-up in basis, the amount of which is contingent on the length of time they maintain the investment in the qualifying fund. If the investment is held for five years, 10 percent of the original gain is eliminated. If it is held for seven years, an additional 5 percent is eliminated. In total, the reduction benefit allows investors to potentially exclude up to 15 percent of the original gain from taxation.



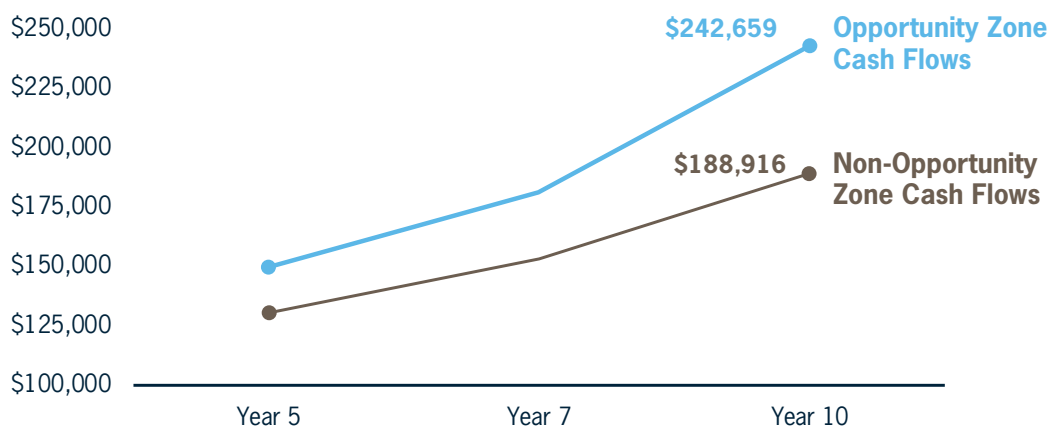
### 3. Exclusion

If the investment is held for at least 10 years, the appreciation on the investment is permanently excluded from taxation. Based on a plain reading of the new law, it appears this only applies to additional appreciation after the investment in the Opportunity Fund is made. As additionally noted below, further guidance is needed from the IRS or Treasury Department to clarify uncertainties within the provisions.

## Investment example

### Cash flows in Opportunity Zones over a 5-, 7-, and 10-year horizon

For \$100,000 of invested capital



This model assumes a 23.80% federal tax rate, 5.00% growth rate and 10.00% annual investment return. This model is for illustration purposes only, and contains certain financial assumptions as to the possible future results that are inherently uncertain and subjective. We make no representation or warranty as to the attainability of those assumptions or whether future results will occur as illustrated.

## Benefits dependent on number of years the investment is held

< 5 yrs

Deferred payment of existing gains until the investment is sold or exchanged

5-7 yrs

Benefits listed above plus 10% of tax on existing gain is cancelled

7-10 yrs

Deferred payment of existing gains until 12/31/26 or the date that the investment is sold or exchanged (whichever comes first) **plus** 15% of tax on existing gain is cancelled

> 10 yrs

Benefits of 7-10 year investment plus investors pay no gains tax on the investment (investments are exempt from any gains beyond those which were previously deferred)

## How to establish a certified Qualified Opportunity Fund

Eligible taxpayers may self-certify to become a Qualified Opportunity Fund by attaching to its tax return a form expected to be released later in the summer of 2018. No approval or action by the IRS is required.

## Where are the Opportunity Zones?

To establish the qualifying zones, states, U.S. possessions and Washington D.C. nominated various low-income communities. The governor of each state could select 25 percent of the state's qualifying areas for the program. The qualifying areas were designated by census tract data and had to meet the definition of low-income as defined under the New Markets Tax Credit program.

The states could designate up to five percent of their Qualifying Opportunity Zones in areas that are not classified as low-income but are contiguous to qualifying areas. They were also required to consider the following when identifying their zones:

- > Areas that are currently the focus of economic development initiatives to attract investment and foster business activity
- > Demonstrated success in target areas from other programs such as Promise Zones, Renewal Areas, Enterprise Zones and New Markets Tax Credits
- > Areas that have recently suffered significant job loss due to business closure or relocation

Now certified by the U.S. Department of Treasury, the Opportunity Zones will remain fixed from the date of designation through the close of the tenth calendar year.

Use our interactive map to search the complete list of Qualified Opportunity Zones that have been nominated, certified and designated.

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## What's next?

There are a number of open issues surrounding the Opportunity Zones that require guidance from the U.S. Treasury Department or Internal Revenue Service. These include clarity on how the funds will be established, types of gains that qualify for the deferral, types of reinvestments that will be allowed, and what gain is specifically eligible for the 10-year exclusion. We will provide regular updates as the program continues to take shape and investment criteria and timing is outlined.

Baker Tilly has extensive knowledge of comprehensive capital structures, including tax credits and incentives, traditional lending programs and nontraditional capital sources. If you are looking to invest gains in or leverage the Opportunity Zones program for a business or project benefitting low-income communities, **connect with us today.**

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Fiscal year 2017 total firm revenue of **\$546 million**



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