ENVIRONMENTAL, LAND USE AND ZONING
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NEW IRS RULES MEAN NEW OPPORTUNITIES FOR DEVELOPMENT

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On October 19, 2018, the Treasury Department released [proposed regulations on Opportunity Zones] that are expected to have a big impact on community development.

Created as part of the 2017 Tax Cuts and Jobs Act, Opportunity Zones are low-income census tracts designated by the governor of each state. Qualified investments in Opportunity Zones are eligible for significant tax benefits and are expected to drive large-scale development in distressed communities. 8,761 census tracts have been designated as Opportunity Zones to date, spanning all fifty states, the District of Columbia, and five U.S. territories, including over 500 Opportunity Zones across New York State.

Taxpayers that invest in Opportunity Zones can significantly defer, reduce, or even eliminate federal capital gains tax liability. The Tax Cuts and Jobs Act established the following key parameters for taxpayers to realize these benefits:

- The investment must be in a corporation or partnership with a sufficient amount of its assets located in an Opportunity Zone. The asset can be qualified real estate, personal property, original issue stock, or partnership interests.
- In order to incentivize new development, the investment vehicle, known as a "Qualified Opportunity Fund" or "QOF," must have purchased the asset after December 31, 2017.
- Longer-term investments will reap more benefits. Investing capital gains in a QOF defers capital gains tax until the earlier of: (1) when the taxpayer sells the investment; or (2) December 31, 2026. Keeping capital gains invested for at least five or seven years eliminates 10% or 15%, respectively, of capital gains tax. If an investor keeps the investment in the QOF for at least ten years, the investor will pay no capital gains tax when he or she sells the investment.
- Of particular importance to developers, QOFs used in real estate must "substantially improve" the real property by at least doubling its value through new construction or significant rehabilitation.

If the Treasury Department adopts the regulations, real estate developers and communities in Opportunity Zones could enjoy significant benefits. The regulations provide the following clarifications, which generally make the program more attractive for investors:

- Only capital gains will be eligible for deferral.
- A QOF that invests in real property located in Opportunity Zones only needs to substantially improve the value of buildings and not land value. This means real estate investors can take advantage of Opportunity Zones in markets where land values are too high to double, such as

New York City. Real estate investors are also incentivized to rehabilitate distressed properties and invest in communities where land values are limited by market conditions.

- Taxpayers must invest in a QOF no more than 180 days from when the gain would be recognized for federal income tax purposes. Because this leaves little time to find qualified real estate, negotiate a contract, complete due diligence, and obtain land use approvals, taxpayers will either need to identify a qualified project before realizing a gain, identify a project post-gain that requires few approvals or offers an expedited approvals process, or obtain approvals post-closing. Addressing any environmental impacts within this timeframe adds additional complexities to a transaction.
- To qualify as "Opportunity Zone business property," at least 70% of the tangible property owned or leased by the trade or business must be in an Opportunity Zone.
- Individuals, C corporations (including regulated investment companies (RICs) and real estate investment trusts (REITs)), partnerships, S corporations, trusts, and estates will be eligible to elect deferral.
- Taxpayers must invest in a QOF prior to June 2027 to take full advantage of the ten-year benefits and eliminate capital gains tax liability.
- Pre-existing entities that otherwise satisfy the requirements for QOF may be used as a QOF.

Although final regulations will most likely not be released until early 2019, the Treasury Department stated that an eligible taxpayer may rely upon the proposed regulations before final adoption if the taxpayer applies the rules in their entirety and in a consistent manner. The Treasury Department also expects to release additional regulations and guidance in the near future.

If you would like more information regarding the Treasury Department regulations, please contact a member of Environmental, Land Use and Zoning, Tax, or Real Estate practice groups at 585.232-6500 or visit www.hselaw.com.

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