

## Stakeholders Must Act Now To Nominate Opportunity Zones

By **Aileen Thomas and Jonathan Katz** (February 23, 2018, 6:16 PM EST)

The Tax Cuts and Jobs Act, P.L. 115-97, created a new community development program that encourages private investment in qualified opportunity zones. The program allows taxpayers to defer and reduce capital gain if the taxpayer reinvests capital gain proceeds in a qualified opportunity fund.

In order for states to participate in this program, they must act quickly. The deadline for states to submit their qualified opportunity zone nominations — or request a 30-day extension — is March 21, 2018.

### Designation Process

Under TCJA, the chief executive officer of a state may nominate a limited number of census tracts to be designated as qualified opportunity zones. In this context, a "state" includes "any State, any possession of the United States, and the District of Columbia." [1]

Nominations must be submitted in writing by the state CEO to the secretary of the treasury by March 21, 2018. The secretary then has 30 days to consider and designate the qualified opportunity zones for such state. The state CEO may request an extension of the determination period and/or the consideration period from the secretary for an additional 30 days. An online nomination tool has been developed for state CEOs to submit their nominations.

The designation of qualified opportunity zones remains in place for 10 years.

A census tract is eligible for designation if it is a low income community, or LIC, meaning it has an individual poverty rate of at least 20 percent and median family income up to 80 percent of the area median. The maximum number of census tracts a state CEO may designate may not exceed 25 percent of the total number of LICs in the state. In calculating the maximum number of LICs each state may nominate, any fraction will be rounded up to the next whole number. If a state has fewer than 100 LICs, then a total of 25 tracts may be designated.

A state may also substitute up to 5 percent of the tracts designated with non-LIC tracts if the non-LIC tract is contiguous to a LIC and the median family income of such tract does not exceed 125 percent of



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the median family income of the contiguous LIC.

The Community Development Financial Institutions Fund has created an online resource — the Opportunity Zones Information Resource — that identifies all census tracts eligible for designation as qualified opportunity zones based on the U.S. Census Bureau's American Community Survey 2011-2015 ACS 5-year Estimates data. The OZIR can be found at <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>.

The OZIR has identified over 41,000 census tracts that are eligible to be designated as opportunity zones.

States may rely on the OZIR to identify eligible census tracts. The OZIR is a “safe harbor,” meaning any census tract that is identified as being either a LIC or an eligible non-LIC contiguous tract on the OZIR will not fail to be certified if it is no longer eligible based on more recent census data.

### **Criteria for Designation**

TCJA does not provide any specific criteria that state CEOs must use when deciding what eligible census tracts to nominate. Accordingly, each state has the flexibility to apply whatever criteria make the most sense for the state. Legislative history suggests, although in a nonbinding manner, that states consider areas that:

- Are currently the focus of mutually reinforcing state, local, or private economic development initiatives to attract investment and foster startup activity
- Have demonstrated success in geographically targeted development programs, such as promise zones, new market tax credits, empowerment zones, and renewal communities
- Have recently experienced significant layoffs due to business closures or relocations

### **Stakeholder Input**

In determining what census tracts to nominate as opportunity zones, states are seeking input from interested stakeholders, including local government officials, economic development groups, businesses and potential investors, in various ways. Several states have launched portals allowing stakeholders to propose census tracts for inclusion in their nomination:

- **Colorado:** Interested stakeholders can provide input to the Colorado Office of Economic Development and International Trade at <https://choosecolorado.com/oz/> or directly to the appointed enterprise zone administrator for their geographic area of interest. The deadline for providing input is Feb. 28, 2018.
- **Idaho:** Any city, county or tribe can submit an online application to the Idaho Department of Commerce at <https://commerce.idaho.gov/communities/opportunity-zones/>. The deadline for submitting an application is 4:00 p.m. MST on March 2, 2018.

- **Kansas:** Communities can submit a proposal to the Kansas Department of Commerce. Details about the submission process can be found at <http://www.kansascommerce.gov/1067/Opportunity-Zones>. A letter of interest on official local government or economic development organization letterhead must be included. The deadline for submitting a proposal is March 1, 2018.
- **Kentucky:** Cities and counties can submit proposals to the Kentucky Cabinet for Economic Development. More information about the submission process can be found at [http://kydlgweb.ky.gov/Articles/16\\_articleView.cfm?NewsID=496](http://kydlgweb.ky.gov/Articles/16_articleView.cfm?NewsID=496). Submissions must be on local government letterhead signed by the chief elected official and sent via email on or before Feb. 26, 2018.
- **Missouri:** Any city or county can submit an application to the Missouri Department of Economic Development. The application can be found at <https://ded.mo.gov/content/opportunity-zones> but must be submitted either via mail or scanned and emailed. Each submission must be on the local government letterhead signed by the chief elected official or their official representative and must be scanned and emailed or postmarked no later than March 2, 2018.
- **Mississippi:** Any city or county elected official, or economic development official can submit an online application to the Mississippi Development Authority at <https://www.mississippi.org/opportunityzone/>. Review of applications will begin on March 5, 2018.
- **Nebraska:** Any city or county may submit a proposal to the Nebraska Department of Economic Development. A proposal submission form can be found at <https://opportunity.nebraska.gov/wp-content/uploads/2018/02/OZ-Proposal-Guidelines-2-15-2018.pdf>. Proposals must be submitted on local government letterhead signed by the chief executive official. Applications must be emailed or mailed by March 9, 2018.
- **North Carolina:** Interested stakeholders may submit feedback to the North Carolina Department of Commerce online at <http://public.nccommerce.com/oz/#section-overview>. Comments must be submitted by March 8, 2018.
- **Ohio:** Members of the public can submit recommendations to the Ohio Development Services Agency online at <https://odsa.secure.force.com/ozf/>. The deadline for submitting recommendations is 4:00 p.m. on March 2, 2018.
- **South Carolina:** Counties, cities, or municipalities can submit nominations to the South Carolina Department of Commerce. More information about the submission process can be found at <http://www.sccounties.org/sc-department-of-commerce-accepting-census-tract-nominations-for-opportunity-zones>. The deadline to make a submission is 5:00 p.m. on Feb. 28, 2018.
- **Tennessee:** County Mayors (or their designees) may submit nominations to the Tennessee Department of Economic & Community Development online at <https://www.tn.gov/ecd/opportunity-zones.html>. All submissions must be made by 5:00 p.m. CST on March 7, 2018.

- **Virginia:** Interested stakeholders may submit input to the Virginia Department of Housing and Community Development online at <http://www.dhcd.virginia.gov/index.php/component/content/article/346.html>. The deadline for submissions is 11:59 p.m. on March 2, 2018.
- **West Virginia:** Applications can be submitted to the West Virginia Department of Commerce online at <http://westvirginia.gov/opportunity-zones.html>. All applications must have a letter of support on official county or city letterhead. The application deadline is March 7, 2018.

### **Tax Benefits of the Program**

The three primary benefits to a taxpayer that reinvests capital gain proceeds in a qualified opportunity fund are:

- **Temporary Deferral:** A taxpayer that invests capital gain proceeds in a qualified opportunity fund will not have to pay capital gain tax on such proceeds until the earlier of the date the taxpayer sells its interest in the qualified opportunity fund or Dec. 31, 2026.
- **Capital Gain Reduction:** If the taxpayer holds its interest in the qualified opportunity fund for at least five years, 10 percent of the original capital gain will be eliminated. If the taxpayer holds its interest in the fund for at least seven years, an additional 5 percent — for a total of 15 percent — of the original capital gain will be eliminated.
- **Appreciation Exclusion:** If the taxpayer holds its interest in the qualified opportunity fund for at least 10 years, the taxpayer will not be taxed on the appreciation in the qualified opportunity fund.

In order to take advantage of the tax benefits of the program, a taxpayer must reinvest capital gain proceeds in a qualified opportunity fund within 180 days from the date of the sale or exchange of a capital asset.

A qualified opportunity fund must hold at least 90 percent of the fund's assets in qualified opportunity zone property. Equity investments in qualifying businesses primarily operating in qualified opportunity zones and tangible property used in a trade or business within qualified opportunity zones each qualify as qualified opportunity zone property.

In the end, the program is intended to direct investment to low-income communities that have been designated as qualified opportunity zones, which is ultimately accomplished through a qualified opportunity fund's investment, directly or indirectly, in a trade or business operating in a qualified opportunity zone.

### **Example**

Assume a taxpayer owns stock with a basis of \$20,000 and sells the stock in 2018 for \$120,000. Ordinarily, the taxpayer would recognize \$100,000 of capital gain in 2018. However, under the qualified opportunity zone program, the taxpayer may defer this gain and eliminate tax on future appreciation by investing the \$100,000 capital gain in a qualified opportunity fund within 180 days of the sale. The

following chart summarizes the taxpayer's capital gain recognition assuming it sells its interest in the fund for \$150,000 after two, five, seven and 10 years:

<b>Holding Period of Fund</b>	<b>Gain from Original Capital Asset</b>	<b>Gain from Fund Appreciation</b>
2 Years	\$100,000*	\$50,000
5 Years	\$90,000	\$50,000
7 Years	\$85,000	\$50,000
10 Years	\$85,000	\$0

\* No capital gain is eliminated, but the capital gain is deferred for two years.

### Takeaways

- The program should provide a number of tax benefits to investors and direct much needed capital to low income communities.
- The deadline for states to nominate qualified opportunity zones is approaching soon, so states need to act quickly.
- TCJA authorizes the treasury secretary to prescribe regulations necessary or appropriate to carry out the purposes of the program. Additional guidance will be necessary before qualified opportunity funds can be formed and investments made under the program.

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[1] Rev. Proc. 2018-16, § 2.04 (I.R.S. Feb. 8, 2018)