WHAT INVESTORS AND DEVELOPERS SHOULD KNOW ABOUT OPPORTUNITY FUNDS

Opportunity Zone ("OZ") investments were sanctioned by changes to the Internal Revenue Code included in the Tax Cuts and Jobs Act of 2017 (See IRC section 1400Z-2). The purpose was to encourage investment in economically depressed areas by providing investors with tax incentives for certain investments in certified "opportunity zones" designated by the various states and approved by the Internal Revenue Service. Reportedly, there are now over 8,000 designated OZs throughout the United States, including several in Florida, Massachusetts and Rhode Island.

Tax Incentives

Investing in OZs, directly or through a fund, offers a number of tax incentives, all of which relate to federal capital gains tax on the investment. First, an investor can defer capital gains tax on existing investments (including stock and other capital assets) if they are sold and the proceeds are invested in an OZ or an OZ Fund (described below). In order to take advantage of this deferral, the investor must reinvest the proceeds in an OZ or Opportunity Fund within 180 days of the sale of the existing investment. This permits the investor to defer tax on the capital gain until the earlier of (i) the date the OZ investment is sold or (ii) December 31, 2026.

The other tax benefits are dependent upon how long an investor holds his or her investment in an Opportunity Fund. If the investment is held for at least 5 years, the investor is only taxed on 90% of the gain recognized on the sale. An investor who holds the investment for 7 years will only be taxed on 85% of the gain recognized on sale.

If an investor holds his or her investment for 10 years or more, the capital gain on sale is free from any federal capital gains tax provided that the OZ investment was funded with capital gain from a prior investment.

Opportunity Funds

In order to facilitate investments by high net worth investors, many real estate developers and money management companies have set up Opportunity Funds. These funds essentially pool money received from investors and invest in businesses or real estate projects in certified OZs. In order to qualify, a fund must have 90% of its assets invested in real estate or approved businesses, such as businesses that use OZ property as part of the business, within a certified OZ and otherwise comply with IRS Regulations. Because investments in these funds involve a high degree of risk, most funds are limited to so-called accredited investor (that is, investors with a net worth of $1 million, excluding their primary residence, or income of at least $200,000 (or $300,000 with the investor's spouse).

Some Practical Advice

However attractive the tax incentives may be, potential investors need to do their due diligence simply because every investment made by the fund must be in an economically distressed area. The tax benefits only arise if the investment is sold for a profit. Things to consider include trends in the area (is there other urban renewal in progress), the experience of the fund sponsor, general contractor and the property management, etc. It may also be worth considering a fund investing in an area close enough to visit occasionally, so the investor can monitor progress.

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