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New Program Allows Deferral and Possible Forgiveness of Capital Gains Invested in Low-Income Community Businesses

Bloomberg

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A new Opportunity Zone program to encourage investment in low-income community businesses was included in the 2017 tax act,¹ signed into law by the President on December 22, 2017.

New Code §1400Z-1 and §1400Z-2² allow individual and corporate taxpayers to defer capital gains on the sale of stock, business assets, or any other property (whether or not the asset sold was located in or related to a low-income community) by investing the proceeds in an Opportunity Fund, which in turn must invest at least 90% of its assets, directly or indirectly, in businesses located in certain low-income communities designated as Opportunity Zones. Partial forgiveness of deferred capital gains and gains from future appreciation is possible for Opportunity Fund investments held for five, seven, and ten years.

OVERVIEW

Deferral and Possible Forgiveness of Capital Gains

Any taxpayer can defer capital gains in an unlimited amount from the sale or exchange of any property to an unrelated person by investing part or all of the proceeds from such sale or exchange in an Opportunity Fund. The property sold can be stock, business assets, personal assets, or any other property. The property sold need not be located in or connected in any way with a low-income community.

To defer a gain, a taxpayer must invest proceeds from the sale in an Opportunity Fund within 180 days, beginning on the date of the sale or exchange, in an amount equal to the gain to be deferred. For example, if an individual sells stock with a tax basis of \$200,000 for \$1 million, the entire capital gain of \$800,000 could be deferred if at least \$800,000 of proceeds were timely invested in an Opportunity Fund. If the taxpayer instead invested only \$500,000 of the proceeds in an Opportunity Fund, then that amount of gain could be deferred and the other \$300,000 of gain would be taxable in the year of sale. If the taxpayer invested the entire \$1 million of proceeds in an Opportunity Fund, the investment would be treated as two investments of \$800,000 and \$200,000, with only the first investment eligible for the program.

The deferred gains are taxable when the investment in the Opportunity Fund is sold or, if earlier, on December 31, 2026.

Ten percent of the deferred gain is forgiven for Opportunity Fund investments held for five years, and 15% is forgiven if the investment is held for seven years. It is not clear how the five- and seven- year provisions would apply where those periods straddle December 31, 2026, the date on which deferred gains are triggered into income whether or not the Opportunity Fund investment has been sold.

For an Opportunity Fund investment held for 10 years, the tax basis of the new investment is deemed to be its fair market value on sale. Because a 10-year holding period will necessarily straddle December 31,

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¹ Pub. L. No. 115-97.

² Added by §13823 of the 2017 Tax Act, effective beginning on December 22, 2017.

2026, the result of this rule is that further appreciation on the investment (but not the deferred gain) is eliminated permanently.

Definition of 'Opportunity Zone'

The governor of each state (and the mayor of the District of Columbia) has until March 21, 2018, (with a possible 30-day extension) to nominate up to 25% of the qualified census tracts in their state as Opportunity Zones. If the state has less than 100 qualified census tracts, the governor can nominate up to 25 of such tracts. A small number of census tracts contiguous to a qualified census tract can also be nominated, subject to certain limitations. The Secretary of the Treasury has 30 days to certify a governor's nominations and designate the tracts as an Opportunity Zone, with a possible extension of another 30 days.

If a governor fails to nominate Opportunity Zones by the deadline, the opportunity may be lost forever, thus depriving the state of potential beneficial investments.

The definition of "qualified census tract" for this purpose is generally any census tract that has a poverty rate of at least 20% or that has a median income that does not exceed the higher of 80% of the median income of the metropolitan area or of the statewide median income.

The designation of a qualified census tract as an Opportunity Zone will be effective until December 31, 2028.

Definition of 'Opportunity Fund'

An Opportunity Fund is any corporation or partnership that invests at least 90% of its assets in Opportunity Zone businesses, either directly or through qualifying corporations or partnerships. The Opportunity Fund must be "certified" under rules to be promulgated by the Treasury Secretary. The statute does not provide requirements for certification, but legislative history references the New Markets Tax Credit program for this purpose, so it is likely that the certification process will be similar to certification of a "community development entity" (CDE) under that program.

The statute does not specify who may sponsor or manage an Opportunity Fund; persons who now manage a CDE or a "community development financial institution" (CDFI), as well as bank and investment bank participants in the New Markets Tax Credit program, are likely to be participants in the Opportunity Fund program.

Definition of 'Opportunity Zone Business'

An Opportunity Fund may hold interests in an Opportunity Zone Business directly or through a subsidiary partnership or corporation. In all cases, to qualify

as an Opportunity Zone Business, substantially all of the tangible assets of the business must be used in an Opportunity Zone, at least 50% of the gross income earned by the business must be from the active conduct of a business in the Opportunity Zone, and the business can hold only a limited amount of investment assets. With the exception of a limited number of "sin businesses," almost any type of business will qualify. Many of the requirements to qualify as an Opportunity Zone Business are similar to rules applicable to an "enterprise zone business" and to "qualified Gulf Opportunity Zone property." Some requirements are also similar to those for a "qualified active low-income community business" in the New Markets Tax Credit program. Hopefully taxpayers will be permitted to rely on existing guidance in those areas in determining whether a business qualifies as an Opportunity Zone Business.

ANALYSIS

Deferral of Capital Gains

Any individual, corporation, or trust, whether foreign or domestic, can elect to defer an unlimited amount of capital gain from the sale or exchange of any property to an unrelated person by investing part or all of the proceeds from such sale or exchange in a "qualified opportunity fund," as defined below (Opportunity Fund or O Fund) during the 180-day period beginning on the date of the sale or exchange.³ The property sold can be stock, business assets, personal assets, or any other property. The property sold need not be located in, or connected in any way with, a qualified census tract (as defined below). Only capital gains realized in sales or exchanges on or before December 31, 2026, can be deferred under this program.⁴

A taxpayer may elect to defer all or only a portion of the gain from a particular sale or exchange.⁵ For example, if an individual sells stock with a tax basis of \$200,000 for \$1 million , the entire capital gain of \$800,000 could be deferred if at least \$800,000 of proceeds were timely invested in an Opportunity Fund. If the taxpayer instead invested only \$500,000

 $^{^{3}}$ §1400Z-2(a)(1)(A) . Unless otherwise indicated, all section references herein refer to sections of the Code, as amended by the2017 Tax Act. In a taxable exchange, the "proceeds" would be other property, and not cash. It is unclear whether the taxpayer could contribute the property received to an Opportunity Fund (or whether the Opportunity Fund would accept such contribution), or if instead the taxpayer would need to contribute cash equal to the value of the property received.

⁴ §1400Z-2(a)(2)(B).

⁵ §1400Z-2(a)(1)(A).

in an Opportunity Fund, then that amount of gain could be deferred and the other \$300,000 of gain would be taxable in the year of sale. If the taxpayer invested the entire \$1 million of proceeds in an Opportunity Fund, the investment would be treated as two investments of \$800,000 and \$200,000, with only the first investment eligible for the program.⁶

The deferred gains are taxable when the investment in the Opportunity Fund is sold or, if earlier, on December 31, 2026.⁷ The requirement that all deferred gains be included in income on December 31, 2026, whether or not the investment in the O Fund has been sold, would create a "phantom income" issue, and may negate all or some of the benefits of holding the Opportunity Fund investment long enough to satisfy the five-, seven-, or 10-year holding periods, as discussed below.

The amount of the deferred gain subject to tax is generally the entire amount of such gain, except that if the O Fund investment is sold at a loss, only the actual gain realized is taxable. This is accomplished by taxing the following amount: (i) the lesser of the amount of the deferred gain or the fair market value of the taxpayer's investment in the O Fund on the date of gain recognition *minus* (ii) the taxpayer's basis in the O Fund.⁸ For this purpose, the taxpayer's basis in the O Fund is deemed to be zero,⁹ except as adjusted as discussed below. Presumably the gain would be taxed in the same manner as it would have been taxed in the year of the sale or exchange, e.g., as capital gain from the sale of a business asset, capital gain that constitutes "net investment income" pursuant to \$1411, "unrecaptured \$1250 gain," etc. The deferred gain would be taxed at the rate in effect for the year of gain recognition (i.e., either the year the taxpayer's interest in the O Fund is sold, or 2026).

The taxpayer's basis in the O Fund is increased by the amount of deferred gain included in income,¹⁰ so that if the gain is recognized in 2026,¹¹ but the taxpayer continues to hold the property, such gain will not be taxed again when the taxpayer sells its interest in the O Fund.

Partial Forgiveness of Gain for O Fund Investment Held for Five Years or Seven Years

If a taxpayer holds an investment in an O Fund for at least five years, the taxpayer's basis in the O Fund is increased (over zero) by 10% of the amount of the deferred gain,¹² so that on sale of the O Fund investment, 10% of the deferred gain is permanently forgiven. A similar provision increases the basis by an additional 5% for an O Fund investment held for at least seven years.¹³ It is unclear whether an investor would receive the benefit of these provisions if the five- or seven-year holding period straddles December 31, 2026. Because all of the deferred gain would be taxable on that date, the 10% or 15% basis increase could not offset deferred gain. However, it appears that it would nonetheless step up the basis in the O Fund, and thus could offset gain from appreciation (if any) on sale of the O Fund interest.

For example, if on July 1, 2018, a taxpayer sold stock having a tax basis of \$200,000 for \$1 million, timely invested the \$800,000 of proceeds in an Opportunity Fund, and then sold his O Fund investment on August 15, 2023, then only \$720,000 (i.e., \$800,000 - [10% of \$800,000]) of the \$800,000 deferred gain would be subject to tax. If the sale of the O Fund investment were instead on August 15, 2025, only \$680,000 (i.e., \$800,000 - [15% of \$800,000]) of deferred gain would be subject to tax. However, if the stock were sold and the O Fund investment were made on July 1, 2022, neither the five-year nor the seven-year holding period would be met by December 31, 2026, and so on that date the taxpayer would have to include the entire \$800,000 of gain in income for the 2026 taxable year. The taxpayer's basis in the O Fund would be increased from zero to \$800,000. If the taxpayer continued to hold the investment until August 15, 2027, and then sold his or her interest for \$1.5 million, it appears that his or her basis would be further increased by \$80,000 (10% of the original deferred gain), and thus the gain on the sale would be \$620,000 (\$1,500,000 - \$880,000).

Forgiveness of Gains for O Fund Investment Held for 10 Years

Another potentially very valuable provision for an investor is contained in §1400Z-2(c).¹⁴ This provision provides that the basis in an O Fund investment held for at least 10 years is the fair market value of the investment on the date on which such investment is sold. Because the 10-year period will necessarily straddle December 31, 2026 (when the deferred gain is required to be taken into income), it appears that the

⁶ §1400Z-2(e)(1).

 $^{^{7}}$ §1400Z-2(a)(1)(B) and §1400Z-2(b)(1).

⁸ §1400Z-2(b)(2)(A).

⁹ §1400Z-2(b)(2)(B)(i).

¹⁰ §1400Z-2(b)(2)(B)(ii).

¹¹ I.e., under §1400Z-2(a)(2)(B).

^{12 §1400}Z-2(b)(2)(B)(iii).

^{13 §1400}Z-2(b)(2)(B)(iv).

¹⁴ A taxpayer must elect for this provision to apply, in addition to the initial election to defer gains. Presumably the only reason that a taxpayer would not make an election is if that would eliminate a loss.

effect of this provision is to forgive gain on appreciation of the O Fund interest. Therefore, a taxpayer presumably would retain his or her investment in the O Fund beyond December 31, 2026 and pay a tax on the phantom income triggered on such date, if he or she expected the appreciation in the O Fund interest to be significant.

Continuing the above example where the taxpayer sold his stock and made an O Fund investment on July 1, 2018, but held such investment until August 15, 2028,¹⁵ when he sold it for \$1.5 million , his basis would be stepped up from \$800,000 to \$1.5 million,¹⁶ and he would recognize no gain on the sale. He previously included \$680,000 in income on December 31, 2026 (because he met the 7-year holding period at that time), so the effect of the 10-year provision is to entirely exclude tax on appreciation.

If the December 31, 2026 "phantom income" date were extended by Congress, it is possible that an O Fund investor that held its interest for at least 10 years could have all gains — deferred and resulting from future appreciation—forgiven, which would be a very strong incentive for taxpayers to invest in an Opportunity Fund and would likely drive large amounts of capital to deserving low-income communities.

A "qualified opportunity zone" (Opportunity Zone or O Zone) is any population census tract that is a "low-income community" (qualified census tract) that is timely nominated as an Opportunity Zone by the governor of a state¹⁷ (or the mayor of the District of Columbia) and certified and designated as an Opportunity Zone by the Secretary of the Treasury (Secretary).¹⁸

A "low-income community" has the same definition as in §45D(e) for purposes of the New Markets Tax Credit.¹⁹ Generally, this is any census tract that has a poverty rate of at least 20% or that has a median income that does not exceed 80% of the higher of the median family income of the metropolitan area or the statewide median family income.²⁰

Up to 25% of the qualified census tracts in a state may be nominated as an Opportunity Zone. If the state has less than 100 qualified census tracts, up to 25 of such tracts may be nominated.²¹ A governor may include in his or her nomination census tracts that are not qualified census tracts if they are contiguous to a qualified census tract that is also nominated as an Opportunity Zone and the median family income of such tract does not exceed 125% of the median family income of the contiguous tract.²² Not more than 5% of the population census tracts designated can include tracts designated under this provision.²³ This permits a governor to create more uniform districts, and also can allow more prosperous areas to be designated, which in turn permits businesses located in those areas to participate in the program.

The deadline for a governor to nominate one or more Opportunity Zones and notify the Secretary of such nomination is March 21, 2018 (the last day of a 90-day period beginning on the date of enactment of the statute);²⁴ a governor may request one 30-day extension from the Secretary.²⁵ The statute does not permit additional extensions; thus, if a governor does not nominate one or more Opportunity Zones (and notify the Secretary) by the initial or extended deadline, the opportunity may be lost forever.²⁶

The Secretary must certify the nomination and designate the nominated tracts as Opportunity Zones within 30 days of receipt of a governor's nomination, which period can be extended by 30 days if the gov-

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¹⁵ It is not clear how the provision would be applied if the 10year period extended beyond December 31, 2028, when designations of Opportunity Zones expire.

¹⁶ §1400Z-2(c) provides that the basis is stepped up to fair market value, but a sale to an unrelated party would be strong evidence that the sales price was fair market value.

¹⁷ For this purpose, §1400Z-1(c)(3) defines "state" to include any possession of the United States. For purposes of the New Markets Tax Credit program, a possession of the United States includes only American Samoa, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, and the U.S. Virgin Islands. *See* H.R. Conf. Rep. No. 106-1033, 106th Cong., 2d Sess. 990 (2000). Section 7701(a)(10) also provides that the term "state" shall be construct to include the District of Columbia, where such construction is necessary to carry out the provisions of Title 26 of the U.S. Code.

 $^{^{18}}$ §1400Z-1(a) and §1400Z-1(b).

¹⁹ §1400Z-1(c)(1).

²⁰ §45D(e)(1).

²¹ §1400Z-1(d). The Senate Amendment, but not the Conference Agreement, provided that governors are "required to provide particular consideration to areas that: (1) are currently the focus of mutually reinforcing state, local, or private economic development initiatives to attract investment and foster startup activity; (2) have demonstrated success in geographically targeted development programs such as promise zones, the new markets tax credit, empowerment zones, and renewal communities; and (3) have recently experienced significant layoffs due to business closures or relocations." H.R. Conf. Rep. No. 115-466, 115th Cong., 1st Sess. 399 (2017). The statute does not contain any of these requirements, although such requirements were included in H.R. 828 (discussed in n. 26).

²² §1400Z-1(e)(1).

²³ §1400Z-1(e)(2).

²⁴ §1400Z-1(b), §1400Z-1(c)(2)(B).

²⁵ §1400Z-1(b)(2).

²⁶ The direct antecedent of the Opportunity Zone provisions was the Investing in Opportunity Act, H.R. 828, 115th Cong. (2017). (A substantially identical bill was also introduced in the Senate.) H.R. 828 allowed the Secretary to designate Opportunity Zones in a state if the governor failed to take timely action, but that provision was not included in the statute. It is unclear if the Secretary would have that authority nonetheless or would choose to exercise it.

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ernor requests such extension. Curiously, it appears that the Secretary is the party who may grant himself an extension. The statute does not address what happens if the Secretary fails to certify the nomination within the prescribed period.²⁷

Determining which qualified census tracts to nominate as Opportunity Zones will create challenging policy considerations. In addition to choosing tracts that would benefit from the investment, it will be important to designate locations that will attract Opportunity Zone businesses that are able to project financial success.

The designation of a qualified census tract as an Opportunity Zone will be effective until December 31, 2028.²⁸

'Qualified Opportunity Fund'

A "qualified opportunity fund" (Opportunity Fund or O Fund) is any corporation or partnership organized for the purpose of investing in qualified opportunity zone property (as defined below) and that holds at least 90% of its assets in such property.²⁹ It appears that an O Fund cannot invest in another O Fund, even if that would otherwise meet the definition of qualified opportunity zone property.³⁰ The 90% requirement is determined by the average of the percentage of qualified opportunity zone property held by the O Fund as measured (a) on the last day of the first sixmonth period of the taxable year of the O Fund, and (b) on the last day of the taxable year.³¹ For a calendar year taxpayer, these dates would be June 30 and December 31 on a going-forward basis, but may be a different date for the first taxable year if it is a short year. The statute does not specify whether the percentage is to be determined by reference to the adjusted tax basis or fair market value of the qualified opportunity zone property held by the O Fund, or on some other basis.³²

If the O Fund fails the 90% test in any year, it is not disqualified as such, but is required to pay a penalty for each month in which it fails to meet the requirement in an amount equal to (a) the excess of (i) 90% of its aggregate assets, over (ii) the aggregate amount of qualified opportunity zone property held by the O Fund, multiplied by (b) the underpayment rate under $(6621(a)(2))^{33}$ If the O Fund is a partnership, it appears that each partner must pay his or her proportionate share of the penalty.³⁴ No penalty is imposed if the O Fund can demonstrate that its failure to meet the 90% test was due to reasonable cause.³⁵ The statute does not specify how assets are to be measured for this purpose (i.e., by adjusted tax basis, fair market value, or some other method), and does not provide how a penalty can be determined and applied on a monthly basis when the 90% test is determined on an annual basis.

The Secretary is required to promulgate regulations providing rules for certifying an Opportunity Fund.³⁶ The statute does not provide any requirements for certification, but the legislative history references the New Markets Tax Credit program,³⁷ so it seems likely that the certification process will be similar to certification of a "community development entity" (CDE) under that program, and may be managed by the Community Development Financial Institutions Fund, the agency within the U.S. Department of the Treasury that administers the New Markets Tax Credit program and other community development programs. The certifying agency should limit the certification process to determining compliance with the

²⁷ H.R. 828 deemed a governor's nominations to be designated (if they were eligible) if the Secretary failed to act.

²⁸ Section1400Z-1(f) states that "[a] designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation." All qualified opportunity zone designations must be made by March 21, 2018 (with a possible 30-day extension). 1400Z-1(c)(2)(B). Thus, because all designations must be made in 2018, the designations will be effective until December 31, 2028, i.e., the close of the 10th calendar year beginning on or after the date of such designation. It is unclear whether investments made on or before December 31, 2028, will continue to qualify once the Opportunity Zone designations expire.

²⁹ §1400Z-2(d)(1).

 $^{^{30}}$ §1400Z-2(d)(1).

³¹ §1400Z-2(d)(1)(A), §1400Z-2(d)(1)(B).

³² From a policy perspective, using fair market value would seem to be the better approach, but that would require periodic valuations. Thus, as a practical matter, using adjusted tax basis may be the most acceptable approach.

 $^{^{33}}$ §1400Z-2(f)(1). The underpayment rate in §6621(a)(2) is the federal short-term rate determined under §1274(d) plus three percentage points. The underpayment rate for January 1 through March 31, 2018, is 4%.

³⁴ §1400Z-2(f)(2).

³⁵ §1400Z-2(f)(3).

 $^{^{36}}$ §1400Z-2(e)(4)(A). The Secretary is also tasked with prescribing regulations concerning reinvestments by an Opportunity Fund and to prevent abuse. §1400Z-2(e)(4)(B) and §1400Z-2(e)(4)(C).

³⁷ The Conference Committee Report provides that the O Fund "provision intends that the certification process for a qualified opportunity fund will be done in a manner similar to the process for allocating the new markets tax credit." H.R. Conf. Rep. No. 115-466, 115th Cong., 1st Sess. 399 (2017). As discussed in the sentence containing footnote 38, the reference to "allocating" the New Markets Tax Credit is an apparent misstatement, and the intent was to reference the certification process under the New Markets Tax Credit program instead.

statute, and should not seek to impose substantive requirements limiting sponsorship of an O Fund or concerning the qualified opportunity zone property in which an Opportunity Fund may invest, as is now imposed on CDE's under the allocation process (and not the certification process) under the New Markets Tax Credit program.³⁸

The statute does not specify who may sponsor or manage an O Fund, and thus any person may organize, manage, and promote an Opportunity Fund, although it is possible that the certifying agency will impose some restrictions in this regard. Persons who now manage a CDE or a "community development financial institution," as well as bank and investment bank participants in the New Markets Tax Credit program, are likely to be participants in the Opportunity Fund program.

Definition of "Qualified Opportunity Zone Property"

"Qualified opportunity zone property" is property that is (i) qualified opportunity zone stock, (ii) qualified opportunity zone partnership interests, or (iii) qualified opportunity zone business property (all as defined below).³⁹

"Qualified opportunity zone stock" (O Zone Stock) is stock of any domestic corporation (i) acquired by the O Fund after December 31, 2017, at original issuance solely in exchange for cash, and (ii) which, at the time such stock is issued and during substantially all of the O Fund's holding period, is a qualified opportunity zone business (as defined below).⁴⁰ If the corporation is newly formed, it does not need to constitute a qualified opportunity zone business on the date the stock is issued, but the corporation must be organized for purposes of being a qualified opportunity zone business.⁴¹ Stock does not qualify as O Zone Stock if the issuing corporation redeemed a significant amount of its stock within the two-year period beginning one year before the issuance to the O Fund, or

redeemed any stock from the O Fund or a party related to the O Fund within a four-year period beginning two years before the issuance to the O Fund.⁴²

A "qualified opportunity zone business" (Opportunity Zone Business or O Zone Business) is a trade or business (i) in which substantially all of the tangible property owned or leased by the entity is Opportunity Zone Business Property (as defined below), and (ii) which (a) derives at least 50% of its gross income from the active conduct of a trade or business, (b) uses a substantial portion of any intangible property in such trade or business, and (c) has less than 5% of its assets invested in nonqualified financial property.⁴³ Notwithstanding the preceding, a trade or business will not qualify as an O Zone Business if it is engaged in owning or operating any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.44

"Qualified opportunity zone business property" (Opportunity Zone Business Property or O Zone Business Property) is tangible property used in a trade or business: (i) that is acquired by purchase (within the meaning of $\$179(d)(2)^{45}$) after December 31, 2017; (ii) the original use of which in the O Zone commences with the O Zone Business, or the O Zone Business substantially improves the property; and (iii) substantially all of the use of which is in the O Zone.⁴⁶ Property is substantially improved for this purpose if during any 30-month period following ac-

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³⁸ Although there are many similarities between the Opportunity Zone program and the New Markets Tax Credit program, a crucial difference will be in underwriting the potential financial success of the low-income community businesses in which an Opportunity Fund invests. Under the New Markets Tax Credit program, the ultimate financial success of a qualified active lowincome community business is not critical for an investor to be able to claim the tax credit available under that program. On the contrary, an investor in an Opportunity Fund may require safety and economic growth potential in the businesses owned by the Opportunity Fund, just as in any other economic investment the investor may consider.

³⁹ §1400Z-2(d)(2).

⁴⁰ §1400Z-2(d)(2)(B).

^{41 §1400}Z-2(d)(2)(B)(i)(II).

 $^{^{42}}$ 1400Z-2(d)(2)(B)(ii). The rules of <math display="inline">1202(e)(3) are used for this purpose.

⁴³ §1400Z-2(d)(3)(A)(i) and §1400Z-2(d)(3)(A)(ii), in part by reference to §1397C(b)(2), §1397C(b)(4) and §1397C(b)(8). "Nonqualified financial property" is defined in §1397C(e) as: debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities and other similar property. This would include bank accounts, checking accounts, and other time and demand deposits. Although not specifically listed in the statute, it would seem that cash should also be treated as nonqualified financial property. Nonqualified financial property does not include reasonable amounts of working capital held in cash or cash items or in debt instruments with a term of 18 months or less, or debt instruments described in §1221(a)(4). See Mount, 585 T.M., New Markets Tax Credit, for a full discussion of nonqualified financial property and the challenges presented by this limitation in the New Markets Tax Credit area.

⁴⁴ §1400Z-2(d)(3)(A)(iii), by reference to §144(c)(6)(B).

 $^{^{45}}$ Section 1400Z-2(e)(2) modifies the related party test in 179(d)(2) by substituting "20%" for "50%" each place it appears in 267(b) and 707(b)(1).

⁴⁶ §1400Z-2(d)(2)(D)(i). A similar "substantially all" requirement in §1400N (relating to Gulf Opportunity Zone Property, also referred to as "GO Zone Property") was interpreted to mean 80%. Notice 2006-77, at §3.

quisition of such property there are additions to basis that equal the adjusted basis as of the beginning of such 30-month period.⁴⁷

Many of the requirements applicable to Opportunity Zone Business Property and an O Zone Business are similar to rules applicable to an "enterprise zone business" pursuant to §1397C and to "qualified Gulf Opportunity Zone property" pursuant to §1400N. Some requirements are also similar to those for a "qualified active low-income community business" in §45D.⁴⁸ Hopefully taxpayers will be permitted to rely on existing guidance in those areas in determining whether a business qualifies as an Opportunity Zone Business.

Qualified opportunity zone property also includes certain interests in a partnership, with requirements substantially identical to those applicable to O Zone Stock,⁴⁹ but which would apply when the business is organized as a partnership rather than a corporation. Last, qualified opportunity zone property also includes O Zone Business Property held directly by an

⁴⁹ §1400Z-2(d)(2)(C).

O Fund⁵⁰; it seems very unlikely that an O Fund would hold and operate business assets directly, except perhaps in a single-investor fund.

A special favorable rule applies in determining whether an O Zone Business qualifies (and continues to qualify) as an O Zone Business: If any tangible property owned or leased by an O Zone Business fails to qualify as O Zone Business Property, it shall continue to be treated as O Zone Business Property for the lesser of (i) five years after the date on which it ceased to qualify, or (ii) the date on which such property is no longer owned by the O Zone Business.⁵¹ One example of when this rule could apply is if tangible property initially used by an O Zone Business in an O Zone is moved outside the O Zone but continues to be used by the O Zone Business.

CONCLUSION

The 2017 Tax Act has potentially created a valuable program to drive capital to and benefit low-income communities. Its ultimate success will depend on how quickly the certifying agency can organize the program and begin certifying O Funds, the limitations that the certifying agency may impose on O Funds and its permissible investments, and most importantly, whether Congress extends the current date of December 31, 2026, on which all deferred gains are automatically taxable.

⁴⁷ §1400Z-2(d)(2)(D)(ii).

⁴⁸ See Maule, 597 T.M., *Tax Incentives for Economically Distressed Areas*, for an overview of the provisions concerning an enterprise zone business and qualified Gulf Opportunity Zone property. *See* Mount, 585 T.M., *New Markets Tax Credit*, for a general discussion of the qualified active low-income community business requirements.

^{50 §1400}Z-2(d)(2)(D).

^{51 §1400}Z-2(d)(3)(B).