

Opportunity Zones

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Issue

Explain the new federal Opportunity Zone program and the tax advantages available to those investing in the zones. Where are Connecticut's opportunity zones located? What role does the state play in their development?

Summary

The new federal Opportunity Zone program, created as part of the 2017 federal Tax Cuts and Jobs Act ([P.L. 115-97](#)), is designed to spur economic development and job creation in distressed communities by providing special tax benefits for private investments in the zones. The program has two major components. The first requires state chief executive officers to designate eligible low-income areas as qualified opportunity zones (QO zones). The second qualifies investors for tax benefits if they make certain investments in qualified funds that are created to invest in eligible businesses and property in the zones.

The tax benefits are structured as a tax deferral on gains earned from prior investments that are subsequently invested in a QO fund. (Generally, gains are generated when investors sell assets that have appreciated in value.) Taxpayers may also receive additional tax benefits based on how long they hold their QO fund investment. If investors hold their investment for five years, 10% of the amount invested is excluded from federal income tax. If they hold it for seven years, an additional 5% is excluded from tax. In addition, if investors hold their investments for at least 10 years, they may elect to exclude any gain from the QO fund investment from tax.

Connecticut has 72 opportunity zones in 27 municipalities; the zones were nominated by Governor Malloy and approved by the U.S. Treasury Department earlier this year. A 2018 law requires the Department of Economic and Community Development commissioner to conduct a study identifying best practices for marketing the zones' benefits to increase investment in them and, by January 1, 2019, report her findings to the Commerce Committee ([PA 18-49](#), § 21). Although there are no other state economic development programs specifically tied to the federal QO zones, the state has a number of direct financing programs (e.g., Small Business Express) and tax credit programs (e.g., urban and industrial site reinvestment credits) that could be used separately or in conjunction with the QO fund investments in the zones.

Designated Opportunity Zones

Under the opportunity zone law, state chief executive officers (generally governors) had until March 22, 2018, to nominate eligible low-income census tracts ("low-income communities") as QO zones. The qualifying tracts are those where at least 20% of the residents are below the poverty level or earn no more than 80% of the area's median income, the same as those under the federal New Markets Tax Credit (NMTC) program ([26 U.S.C. § 45D\(e\)](#)). (The NMTC program, which uses federal income tax credits to attract private capital to low-income areas, expires at the end of the 2019 calendar year.) Governors could also designate tracts contiguous to these qualifying low-income tracts if (1) their median family income was no more than 125% of the contiguous low-income tract and (2) the total number of contiguous tracts designated did not exceed 5% of the state's total qualified zones.

The law caps the total number of QO zones in each state at 25% of the state's low-income communities, but it allows up to 25 zones in states with fewer than 100 qualifying low-income communities. The U.S. Treasury secretary must certify the QO zones within 30 days of receiving the nominations. (A list of all designated zones is available [here](#).) The zone designations remain in effect for 10 years ([26 U.S.C. § 1400Z-1](#)).

QO Funds

To access the tax benefits under the program, investors must direct their investments in the zones through a QO fund that invests in zone businesses. A QO fund is an investment vehicle organized as a corporation or partnership specifically for investing in the stocks, partnership interests, or tangible personal property of a business located in an opportunity zone (i.e., a QO zone business). It must hold at least 90% of its assets in these investments.

A QO zone business is a trade or business in which substantially all of its tangible property is (1) purchased by the QO fund after December 31, 2017; (2) originally used or substantially improved by the QO fund; and (3) used in a QO zone (i.e., QO zone property)([26 U.S.C. § 1400Z-2\(d\)\(3\)\(A\)](#)).

Excluded Businesses

A QO zone business excludes private and commercial golf courses, country clubs, massage parlors, hot tub or suntan facilities, racetracks or other gambling facilities, and liquor stores (26 U.S.C. § 1400Z-2(d)(3)(A)(iii)).

To become certified as a QO fund, the taxpayer must certify to the Internal Revenue Services (IRS) that the fund meets the eligibility requirements by completing a form and attaching it to the entity's federal tax return for the tax year. No additional IRS approval or action is required (IRS, "[Opportunity Zones Frequently Asked Questions](#)," last updated June 7, 2018).

Tax Benefits for Investing in QO Funds

The program's tax benefits are available to investors that reinvest gains earned on prior investments in a QO fund. Specifically, the law allows a taxpayer to elect to defer the tax payment on a gain realized in the current year if the gain is invested in a QO fund within 180 days of the sale or exchange that created the gain. The taxes on this gain can be deferred until the taxpayer sells or exchanges the QO fund investment or December 31, 2026, whichever comes first.

Investors may receive additional tax benefits if they hold their QO fund investments for at least five, seven, or 10 years. After five years, 10% of the gain deferred from investing in the QO fund is added to the basis of the QO fund investment, thereby permanently excluding that portion of the gain from tax. (The basis of an investment is its original value used to calculate gain or loss for tax purposes.) After seven years, an additional 5% of the gain is excluded. After 10 years, taxpayers may elect to exclude from tax any gains realized from the sale or exchange of their QO fund interests.

The following example illustrates how these tax benefits work. Suppose a taxpayer sells an asset in January 2018 and has a resulting gain of \$1 million. The taxpayer then reinvests the \$1 million gain in a QO fund within 180 days of the property's sale and pays no tax on the gain in 2018. The additional benefits may be available depending on the taxpayer's subsequent decisions.

- If the taxpayer sells its investment in the QO fund three years later for \$1.2 million, it must pay taxes on the deferred gain of \$1 million and the \$200,000 in appreciation.

- If the taxpayer sells its investment six years later for \$1.4 million, then 10% of the \$1 million gain (\$100,000) would be added to the taxpayer's basis in the QO fund, reducing the deferred gain subject to tax to \$900,000. The taxpayer must pay taxes on the deferred gain of \$900,000 and the \$400,000 in appreciation.
- If the taxpayer sells the investment eight years later for \$1.6 million, then an additional 5% of the \$1 million gain (\$50,000) would be added to the basis. The taxpayer must pay taxes on the deferred gain of \$850,000 and the \$600,000 in appreciation.
- If the taxpayer holds the investment for 10 years and then sells it for \$1.8 million, the taxpayer may elect to exclude the \$800,000 in appreciation from tax. In this case, the taxpayer must only pay taxes on the deferred gain of \$850,000.
- If the taxpayer holds the investment for 10 years and then sells it for \$800,000, the taxpayer may elect to recognize the \$200,000 loss.

Connecticut's QO Zones

Table 1 lists the 27 Connecticut municipalities with QO zones and the number of zones in each one. As it shows, Hartford has the greatest number of zones (10), followed by Bridgeport and New Haven (7) and East Hartford and Stamford (5). A map of the zones can be found [here](#).

Table 1: Connecticut's QO Zones

Municipality	Number of Zones	Municipality	Number of Zones
Ansonia	1	New Haven	7
Bridgeport	7	New London	3
Bristol	1	Norwalk	3
Danbury	1	Norwich	3
East Hartford	5	Putnam	1
Groton	1	Stamford	5
Hamden	1	Stratford	1
Hartford	10	Torrington	1
Manchester	2	Waterbury	4
Mansfield	1	West Hartford	1
Meriden	3	West Haven	2
Middletown	2	Windham	1
Naugatuck	1	Windsor	1
New Britain	3	Total	72

Source: [Gov. Malloy Announces Federal Approval of Connecticut's Opportunity Zone Nominations](#). (May 18, 2018).

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