IRS Makes QOZs Compelling But You Have To Mine The Regulations

By David S. Neufeld, Esq.

With the enactment of the 2017 tax law, the country was introduced to Qualified Opportunity Zones, a sweeping program that can yield massive tax benefits to investors and provide economic revitalization to areas that have long been on the losing end of the economy. While Congress provided broad brush principals, the Treasury Department has been filling in the gaps with extensive regulations.

Fundamental QOZ Framework

An individual or entity with capital gains realized after 2017 and before 2027 from any source (e.g. the sale of stock, not just from real estate) can defer paying tax on that capital gain to the extent the gain amount is invested in a Qualified Opportunity Fund (QOF) within 180 days of realization.

That gain can be deferred until as late as the end of 2026 as long as the funds remain invested in the QOF. Depending on the length of that investment period, 10% (for a five year investment) or 15% (for a seven year investment) of the deferred gain can, in fact, be abated completely. Under current law, to achieve the 15% abatement the investment must be made by December 31, 2019, and to achieve the 10% abatement the investment must be made by December 31, 2021. In addition, any tax on the gain from the new investment in the QOF can be entirely abated if the new investment in the QOF is held at least ten years.

To be a QOF, 90% of the fund's assets must be invested in tangible property (real or personal) ("Qualified Opportunity Zone Business Property") or business("Qualified Opportunity Zone Business"), located within certain specified zones, called Qualified Opportunity Zones ("QOZ"). These QOZs are economically disadvantaged census tracts designated by the governors of each state and, with some limitations, in contiguous census tracts. There are 169 zones in New Jersey.

Surprises in the Proposed Regulations

Here are a few of the most interesting and surprising results of regulations proposed by Treasury:

Qualified Opportunity Zone Business Property

While in many cases when a QOF buys an existing structure in the QOZ it must expend an amount on improvements at least equal to the amount it spent to acquire the property.Vacant buildings within the QOZ may present an exception. As long as it has been vacant and has not been depreciated by the seller for at least five years a QOF can acquire it and is not required to invest an additional amount that equals or exceeds its basis in the vacant building.

In a couple of instances Treasury, with a tip of the hat to reality, acknowledges that government inaction (zoning boards, for instance) can delay projects, and loosens the time required to permit projects to achieve the tax benefits.

QOZ Business Property can be either owned or leased. There are several rules concerning leased property, including one rule that provides that if QOZ Business Property is leased from a related person the lessee must also acquire other QOZ Business Property with a value that equals or exceeds the value of the leased property (using a present value calculation) within no more than 30-months from the date the lessee takes possession of the leased property.

Qualified Opportunity Zone Business

A QOZ Business is a trade or business in which 70% of the tangible property owned or leased by it is QOZ Business Property (among other rules) and is not the type of business contained in a list of prohibited ventures.

The prohibited businesses are golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, gambling establishments, and stores that sell alcohol for off premises consumption. Nothing more, nothing less. With states now coming on line with both medical and recreational marijuana it appears from this list that a marijuana facility of any type would not be prohibited by this list. It is important to note that this list is not a creature of regulation but instead derived by statute; it would therefore take an act of Congress to change it. The IRS cannot do so on its own. For Congress to add cannabis to this list it would have to acknowledge that, notwithstanding the federal stance on marijuana, it is a legal substance under the laws of several states.

How Congress deals with this existential question will be very interesting to watch. Furthermore, an argument can be made that any legal marijuana facilities set up under the current formulation

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A Message From President Wescoe

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will add 300ft. Riparian Zone buffers to both the 749 river miles and their tributaries.

While these protections are likely justified in many instances, certain designations appeared to be based on poorly documented data and sampling that threw into question the validity of the expanded protections. Accordingly, NJBA asked DEP to restart the rulemaking with a new, more encompassing and thorough stakeholders' process. NJBA will keep members apprised of any new information as DEP evaluates public comments.

Our association will be busy over the next year as we continue to build a more affordable, sustainable and vibrant housing and retail and industrial market in New Jersey. With the support of our members, we will be able to accomplish much for New Jersey residents and the homebuilding community.

I want to thank each of you for the opportunity to represent you as NJBA President. I am proud to be at the helm of an association that is working to help all New Jersey's residents obtain the American Dream of homeownership. I look forward to seeing you all on August 19 at the NJBA Annual Golf Outing at the Cherry Valley Country Club in Skillman.

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of the law will have to be grandfathered if the law were to change.

Notable Rules Governing the Investment in the QOF

Not only is the federal government reducing the amount of deferred gain recognized by up to 15% it is also indemnifying a portion of this investment by effectively stating that a taxpayer with a bad investment might avoid paying the tax on some or all of the 85% remaining amount deferred. When the final reckoning comes on the deferred gain the gain will be recognized on the earlier of the date the QOZ investment is disposed of or by December 31, 2026. Furthermore, if the deemed sale date is December 31, 2026. Furthermore, if the deemed sale date is December 31, 2026, the amount of gain will be computed by subtracting the taxpayer's basis in the QOZ investment on that date from the lesser of the remaining deferred gain or the fair market value of the QOZ interest on that date. This is a gift! If the investment in the QOF is doing well the deferred gain ultimately recognized is capped at the amount deferred. If the investment is doing poorly it is possible the recognized gain can be lower than the amount deferred.

In addition an investment can be made in-kind and qualify for deferral. However, services to a QOF -- carried interests -- are not considered an investment resulting in an interest in a QOF that will qualify for tax benefits.

The Real Impact, Liability and Cost of NJDEP's New Groundwater Mounding Requirements

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values which would otherwise produce overly conservative results. While these additional engineering services will undoubtedly increase the design cost, the potential for savings during construction makes it an investment well made.

Groundwater mounding is an important factor to be assessed in any good stormwater management design. To ensure that a design is effective but not overly taxing on the budget, it is important to engage initially with a skilled engineering team who understands these intricacies and can recommend an appropriate scope of engineering and testing to provide a comprehensive design protective of both the neighbor's "perpetually dry basement" as well as the developers bank account.

Controlled Insurance Programs On Construction Projects

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subjected to background checks. On the other hand, they will typically be entitled to refunds on their regular policies for the time and effort spent on CIP projects. At the end of the day, whether a CIP project is good for you or not is open to debate, but CIPs are becoming much more commonly used in construction, and contractors, developers, and owners should know about them.

Newly Proposed Opportunity Zone Regulations Further Encourage Redevelopment, New Business Growth and Leasing Opportunities

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This article merely highlights several of the many amendments and supplemental provisions provided in the April 2019 proposed regulations. The Treasury is scheduled to conduct a public hearing in July 2019 concerning the OZ Program, and additional regulations will likely be released later this summer. Notwithstanding that the OZ Program is a "work in progress," developers, landlords and entrepreneurs should be conscious of the OZ Program's many real estate benefits as well as the December 31, 2019 deadline to maximize the OZ Program's tax incentives. Those seeking to participate under the OZ Program should promptly speak with their attorneys and accountants to discuss how they can best take advantage of the OZ Program.