New Program Provides Tax Benefits by Investing in Texas Opportunity Zones

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The Opportunity Zone program was created by the 2017 Tax Cuts and Jobs Act to encourage investment in low-income communities. Under this program (Sections 1400Z-1 and 1400Z-2 of the Internal Revenue Code, the "Statute"), an individual or corporate taxpayer can defer an unlimited amount of tax (and if additional requirements are satisfied, avoid a portion of the tax altogether) on capital gain from the sale of stock, business assets, or any other property (business or personal) if the gain is reinvested in a qualified low-income community designated as an "Opportunity Zone."

Last week Governor Abbott submitted 628 census tracts in 145 counties to the U.S. Treasury Department for certification as Texas Opportunity Zones.   A list of the submitted census tracts is available here. The Treasury Secretary has 30 days from the receipt of the Governor's submission to certify the census tracts as Opportunity Zones, which period can be extended by another 30 days at the Governor's request.

In order to take advantage of the Opportunity Zone program's tax benefits, the capital gain must be reinvested in an "Opportunity Zone Fund" within 180 days of the sale of the property generating the otherwise taxable gain.   An "Opportunity Zone Fund" is a business entity that invests at least 90% of its assets in an "Opportunity Zone Business" and is certified under rules to be promulgated by the U.S. Treasury Secretary.   An "Opportunity Zone Business" is a business that has substantially all of its assets located in an Opportunity Zone and that derives at least 50% of its gross income from the active conduct of a business within the Opportunity Zone.   The Statute does not define the "active conduct of a trade or business", but given the similarities to the New Markets Tax Credit program, we can look to that program's definition of "qualified active low-income community business" for guidance. With that perspective we can expect most activities that constitute a trade or business for federal income tax purposes to be considered the active conduct of a business, with the exception of residential rental real property. The Statute also specifically excludes golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, gambling facilities, and package stores.

The tax benefits to investing in an Opportunity Zone are:

- A tax deferral on the amount reinvested until the earlier of December 1, 2026 or the investment in the Opportunity Zone Fund is sold.
- Partial avoidance of the tax on capital gains is available by way of a "step-up" in the basis for Opportunity Zone investments held for at least five years.The basis in the is increased by 10% if the Opportunity Zone investmentis held for five years, and 15% if it is held for seven years.
- The appreciation of the Opportunity Zone investment (but not the original investment) can avoid tax altogether if the investment is held for 10 years or more.

Although key elements of the Opportunity Zone program remain to be developed (namely the Opportunity Zone Fund certification process by the Treasury Secretary), the 2017 Tax Cuts and Jobs Act has created a tax-advantaged incentive to investing in low-income communities.

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