

17. Opportunity zones (sec. 13823 of the Senate amendment and new secs. 1400Z-1 and 1400Z-2 of the Code)

Present Law

The Code occasionally has provided several incentives aimed at encouraging economic growth and investment in distressed communities by providing Federal tax benefits to businesses located within designated boundaries.¹¹⁹¹

One of these incentives is a federal income tax credit that is allowed in the aggregate amount of 39 percent of a taxpayer investment in a qualified community development entity (CDE).¹¹⁹² In general, the credit is allowed to a taxpayer who makes a “qualified equity investment” in a CDE which further invests in a “qualified active low-income community business.” CDEs are required to make investments in low income communities (generally communities with 20 percent or greater poverty rate or median family income less than 80 percent of statewide median). The credit is allowed over seven years, five percent in each of the first three years and six percent in each of the next four years. The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed. The Department of Treasury’s Community Development Financial Institutions Fund (“CDFI”) allocates the new markets tax credits.

The maximum annual amount of qualified equity investments is \$3.5 billion for calendar years 2010 through 2019. The new markets tax credit is set to expire on December 31, 2019. No amount of unused allocation limitation may be carried to any calendar year after 2024.

House Bill

No provision.

Senate Amendment

The provision provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains

¹¹⁹¹ Such designated areas were referred to as empowerment zones, the District of Columbia Enterprise (“DC”) Zone, and the Gulf Opportunity (“GO”) Zone, and each of these designations and attendant tax incentives have expired. The designations and tax incentives for the DC Zone, and the GO Zone generally expired after December 31, 2011. 1400(f), 1400N(h), 1400N(c)(5), 1400N(a)(2)(D), 1400N(a)(7)(C), 1400N(d). The empowerment zones program and attendant tax incentives expired as of December 31, 2016. Secs. 1391(d)(1), There are also areas that were designated as renewal communities under section 1400E which received tax benefits that all expired as of December 31, 2009, except that a zero-percent capital gains rate applies with respect to gain from the sale through December 31, 2014 of a qualified community asset acquired after December 31, 2001, and before January 1, 2010 and held for more than five years. For more information on these programs and attendant tax incentives, see Joint Committee on Taxation, *Incentives for Distressed Communities: Empowerment Zones and Renewal Communities* (JCX-38-09), October 5, 2009.

¹¹⁹² Sec. 45D.

from the sale or exchange of an investment in the qualified opportunity fund.

The provision allows for the designation of certain low-income community population census tracts as qualified opportunity zones, where low-income communities are defined in Section 45D(e). The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation.

Governors may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. If the number of low-income communities in a State is less than 100, the Governor may designate up to 25 tracts, otherwise the Governor may designate tracts not exceeding 25 percent of the number of low-income communities in the State. 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.

The provision provides two main tax incentives to encourage investment in qualified opportunity zones. First, it allows for the temporary deferral of inclusion in gross income for capital gains that are reinvested in a qualified opportunity fund. A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property. The 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. The provision provides the Secretary authority to carry out the process.

If a qualified opportunity fund fails to meet the 90 percent requirement and unless the fund establishes reasonable cause, the fund is required to pay a monthly penalty of the excess of the amount equal to 90 percent of its aggregate assets, over the aggregate amount of qualified opportunity zone property held by the fund multiplied by the underpayment rate in the Code. If the fund is a partnership, the penalty is taken into account proportionately as part of each partner's distributive share.

Qualified opportunity zone property includes: any qualified opportunity zone stock, any qualified opportunity zone partnership interest, and any qualified opportunity zone business property.

The maximum amount of the deferred gain is equal to the amount invested in a qualified opportunity fund by the taxpayer during the 180-day period beginning on the date of sale of the asset to which the deferral pertains. For amounts of the capital gains that exceed the maximum deferral amount, the capital gains must be recognized and included in gross income as under present law.

If the investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, the basis on the original gain is increased by 10 percent of the original gain. If the opportunity zone asset or investment is held by the taxpayer for at least seven years, the basis on the original gain is increased by an additional 5 percent of the original gain. The deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2026. Only taxpayers who rollover capital gains of non-zone assets before December 31, 2026, will be able to take advantage of the special treatment of capital gains for non-zone and zone realizations under the provision.

The basis of an investment in a qualified opportunity zone fund immediately after its acquisition is zero. If the investment is held by the taxpayer for at least five years, the basis on the investment is increased by 10 percent of the deferred gain. If the investment is held by the taxpayer for at least seven years, the basis on the investment is increased by an additional five percent of the deferred gain. If the investment is held by the taxpayer until at least December 31, 2026, the basis in the investment increases by the remaining 85 percent of the deferred gain.

The second main tax incentive in the bill excludes from gross income the post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years. Specifically, in the case of the sale or exchange of an investment in a qualified opportunity zone fund held for more than 10 years, at the election of the taxpayer the basis of such investment in the hands of the taxpayer shall be the fair market value of the investment at the date of such sale or exchange. Taxpayers can continue to recognize losses associated with investments in qualified opportunity zone funds as under current law.

The Secretary or the Secretary's delegate is required to report annually to Congress on the opportunity zone incentives beginning 5 years after the date of enactment. The report is to include an assessment of investments held by the qualified opportunity fund nationally and at the State level. To the extent the information is available, the report is to include the number of qualified opportunity funds, the amount of assets held in qualified opportunity funds, the composition of qualified opportunity fund investments by asset class, and the percentage of qualified opportunity zone census tracts designated under the provision that have received qualified opportunity fund investments. The report is also to include an assessment of the impacts and outcomes of the investments in those areas on economic indicators including job creation, poverty reduction and new business starts, and other metrics as determined by the Secretary.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement generally follows the Senate amendment with the following modifications. First, the provision provides that each population census tract in each U.S. possession that is a low-income community is deemed certified and designated as a qualified opportunity zone effective on the date of enactment. Second, the provision clarifies that chief executive officer of the State (which includes the District of Columbia) may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. This change clarifies that the mayor of the District of Columbia may also submit nominations. Third,

the provision clarifies that there is no gain deferral available with respect to any sale or exchange made after December 31, 2026, and there is no exclusion available for investments in qualified opportunity zones made after December 31, 2026. The agreement also makes some technical changes to the Senate amendment to make it clear which taxpayer may claim the tax benefits.

18. Provisions relating to the low-income housing credit (secs. 13411 and 13412 of the Senate amendment and sec. 42 of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year period for the cost of building rental housing a sufficient portion of which is rent restricted and occupied by tenants having incomes below specified levels.¹¹⁹³ Qualified basis is the low-income portion of the building times the eligible basis. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The applicable percentage for new buildings that are not Federally subsidized, is computed to yield a present value of 70 percent of the qualified basis over a 10-year period. For other buildings the applicable percentage is calculated to yield 30 percent. Rehabilitation expenses are treated as a separate new building.

Increase in credit for certain high cost areas

In the case of a building located in a qualified census tract or difficult development area, the eligible basis of a building is 130 percent of eligible basis. This “basis boost also applies to rehabilitation expenditures that are treated as a separate new building.

A “difficult development area” is an area designated by the Secretary of Housing and Urban Development (“HUD”) as having high construction, land, and utility costs relative to the area’s median income. The portions of metropolitan statistical areas that may be designated for this purpose cannot exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule applies to nonmetropolitan areas.

A “qualified census tract” means any census tract which is designated by HUD in which either: (1) 50 percent or more of the households have an income which is less than 60 percent of the area median income for the year; or (2) the poverty rate in that tract is 25 percent. The portion of a metropolitan statistical area that may be designated for this purpose cannot exceed an area having 20 percent of the population of such metropolitan statistical area. Each metropolitan statistical area is treated as a separate area and all nonmetropolitan areas in a State are treated as one area.

In addition, a building which is designated by a State housing credit agency as requiring an increase in credit to be financially feasible is treated as located in a HUD-designated difficult

¹¹⁹³ Sec. 42.