DOW JONES, A NEWS CORP COMPANY

DJIA 25499.84 0.47% ▲ S&P 500 2777.53 0.32% ▲ Nasdaq 7479.65 -0.07% ▼ U.S. 10 Yr -5/32 Yield 3.198% ▼ Crude Oil 69.31 0.96% ▲ Euro 1.1514 0.53% ▲

THE WALL STREET JOURNAL.



ECONOMY

# New ‘Opportunity Zone’ Tax-Break Rules Offer Flexibility to Developers

U.S. Treasury releases guidelines designed to spur projects in low-income areas

The Treasury Department’s program, with bipartisan roots, was a small piece of last year’s tax law and has been attracting intense attention from real-estate developers and fund managers **PHOTO:** MANDEL NGAN/AGENCE FRANCE-PRESSE/GETTY IMAGES

*By Richard Rubin*

Updated Oct. 19, 2018 12:35 p.m. ET

WASHINGTON—The Trump administration proposed guidelines Friday that will help investors use a new tax incentive that encourages development in low-income areas.

The Treasury Department designed the rules for the Opportunity Zone program to give businesses enough flexibility and certainty to start making major investments, said senior department officials.

The program, with bipartisan roots, was a small piece of last year’s tax law and has been attracting intense attention from real-estate developers and fund managers who have been soliciting investors and anxiously awaiting the rules.

Earlier this year, after getting recommendations from governors, Treasury designated nearly 9,000 census tracts as opportunity zones, spread across urban and rural areas and including almost all of Puerto Rico. Nearly 35 million Americans live in the zones, which have higher poverty and unemployment rates than the rest of the country, according to Treasury.

Investors in the zones get two benefits. First, they can roll capital gains from an unrelated investment into a zone and defer those capital-gains taxes until the end of 2026. Those taxes can be reduced by as much as 15% if investors hold on to their zone investments long enough.

RELATED

- New Rule Defers Taxes With Real Estate Investment (Oct. 2)
- Race Is On to Define ‘Opportunity Zones’ (July 13)
- As States Pick ‘Opportunity Zones’ for Tax Breaks, a Debate Over Who Benefits (March 20)
- U.S. Treasury Department: Opportunity Zones Resources

Second, taxes on capital gains from investments in zones can be avoided if the investments are held for at least 10 years. All told, the program is projected to reduce federal revenue by $9.4 billion between 2018 and 2022, according to the Joint Committee on Taxation, though the long-run cost could be smaller as deferred taxes are paid. Treasury Secretary Steven Mnuchin has said the zones could attract $100 billion in investment.

The senior Treasury officials said Friday’s first set of rules reflects several decisions to assist investors and spur projects.

The Treasury created a 70-30 rule that measures whether a given business counts as having “substantially all” of its assets in an opportunity zone. Under that rule, as long as 70% of a business’s tangible property is in a zone, the business doesn’t lose its ability to qualify for the tax break.

For example, a restaurant chain with four locations inside zones and one outside could get the break. A senior Treasury official described that rule as a “pretty favorable standard.”

Because 10% of an opportunity fund’s assets can already be invested outside a zone, according to the tax law, applying a 70-30 rule to the remaining 90% means that as little as 63% of a fund could be invested inside a zone, according to the regulations. Treasury considered and rejected a 90-10 rule instead of the 70-30 rule.

In the regulations, Treasury asks for input on a series of technical questions, such as what happens if a business abandons property in an opportunity zone and how to treat movable property, such as vehicles, that may spend part of their time outside the zone. Taxpayers can rely on the regulations while the IRS solicits comments and considers changes in the final version.

Of particular concern to real-estate developers is the law’s requirement that capital gains generally must be reinvested into the zones within six months after the prior investment is sold.

Because many residential and retail construction projects require a longer time frame, developers worried that they would be penalized if they accumulated cash while starting their investments.



The Treasury‘s proposed rules give businesses an additional 30 months to hold that working capital, as long as they have a plan for a qualifying project in a zone, the Treasury officials said. Those plans don’t have to be filed with the government but must be available for an Internal Revenue Service audit, the officials said.

Congress deliberately created an open-ended program with few restrictions, with the idea of relying on market forces and the new tax incentive to guide development. It’s easily used for real estate, but operating businesses can also take advantage.

That openness is also a potential pitfall. The law doesn’t require any hiring of the areas’ low-income residents or sharply limit what types of projects qualify.

The Treasury isn’t making investors and project sponsors track the wages or hiring of zone residents.

Mayors in cities like Louisville, Ky., and Newark, N.J., and foundations across the country have been trying to use incentives and local regulations to shape projects to ensure that residents of the zones benefit, as money flows into their neighborhoods.

**Write to** Richard Rubin at richard.rubin@wsj.com