OPPORTUNITY ZONES SERIES

Gains Eligible for OZ Tax Incentives Expand: Section 1231 Property

This alert is part of the OZ Series that highlights topics in the Opportunity Zones final regulations published in the Federal Register on January 13, 2020. One of the changes in the final regulations makes it easier for taxpayers with capital gains from the sale of business property to receive tax benefits under the Opportunity Zones program. The final regulations treat the gross amount of the gain recognized from each disposition of business property subject to Section 1231 of the Internal Revenue Code (Section 1231) as eligible capital gain that may be invested in a Qualified Opportunity Fund.

<u>Section 1231 Business Property Generally</u>

Section 1231 generally governs the character of a taxpayer's gains or losses with respect to depreciable or real property that is used in the taxpayer's trade or business and held for more than one year, subject to certain exceptions (e.g., inventory, property held primarily for sale to customers in the ordinary course of business and certain intellectual property rights). Under Section 1231(a), if a taxpayer's aggregate gain from the sales of Section 1231 property exceeds the aggregate loss from sales of Section 1231 property (net gain/loss) during a taxable year, such gains and losses are treated as long-term capital gains and losses. However, if the aggregate loss exceeds the aggregate gain, then such gains and losses are treated as ordinary income and loss.

Section 1231 property includes real and depreciable property used in a trade or business that a taxpayer owns directly or through a partnership or corporation. For example, a limited partnership (LP) with 3 partners has owned and leased to tenants a commercial building since 2010. The LP sells the building in 2020. The building is treated as Section 1231 property for the LP and each partner. Conversely, property held for investment is not subject to Section 1231. For example, in 2018, one of the partners of the LP sold his limited partnership interest to a third party. The limited partnership interest is property held for investment and is not subject to Section 1231.

<u>Determining Eligible Capital Gain on Gross Basis</u>

The final regulations change the May 2019 proposed regulations which required eligible capital gain for Section 1231 property to be determined at year-end by netting of gains and losses from dispositions of Section 1231 property. Under the final regulations, generally capital gain from Section 1231 property eligible for tax benefits under the Opportunity Zone program is determined on the date of the sale, exchange, or disposition of the Section 1231 property and is equal to the gross amount of the gain recognized from such disposition.

A taxpayer no longer must wait until the end of a taxable year to determine the amount of Section 1231 gain that is eligible to be deferred and reinvested into a Qualified Opportunity Fund because Section 1231 losses no longer must off-set the amount of eligible gain.

As a result of the change to the gross approach, the status as an eligible gain and the amount of the eligible gain are known at the time of a sale or exchange. Therefore, the 180-day period for an eligible taxpayer to invest an amount with respect to an eligible gain on Section 1231 property begins on the date of the sale or exchange giving rise to the gain.

<u>More Eligible Capital Gains Available to Invest in Qualified Opportunity Funds</u>

The gross approach eliminates unnecessary barriers to potential Qualified Opportunity Fund investments both in terms of the timing of the investment and the amount to be invested. By allowing the 180-day period to begin on the date of the sale or exchange that gives rise to the eligible Section 1231 gain, taxpayers will accelerate capital infusion into Qualified Opportunity Funds because they can invest eligible gain from dispositions of Section 1231 property within 180-days of the sale or exchange of such property. The gross approach generally expands the pool of eligible capital gains by removing the requirement to net Section 1231 capital gains against Section 1231 losses for a taxable year.

Opportunity Zones Team

BOUSQUET HOLSTEIN PLLC

Linking tax policy and economic development, the federal Opportunity Zones program offers federal income tax deferral and reduction to encourage equity investment of capital gains in designated low income census tracts to facilitate increased business activity and economic revitalization. Bousquet Holstein has a long history advising investors, developers, entrepreneurs and local governments on maximizing federal and state income tax credits and incentives; on developing, implementing and taking advantage of federal, state and local economic development programs; and on forming, raising capital for, lending to, operating and selling business organizations. We have assembled a team of professionals with diverse experience to work with our clients to understand the rewards and risks of the OZ program and help them structure OZ investment and OZ businesses to preserve OZ tax benefits and leverage OZ investments to maximize their impact on neighborhoods and communities.

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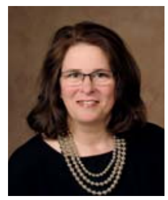

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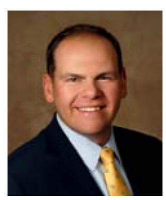

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Links to OZ Resources:

- **BH Legal Alert:** Opportunity Zones Series: Final Regulations Enhance Tax Incentive Program
- Listing of Opportunity Zones in New York State
- U.S. Treasury Department Opportunity Zones Final Regulations
- Opportunity Zones Frequently Asked Questions