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Opportunity Zone Funds: A New Structure for Private Equity

January 17, 2019 – In December 2017, the Tax Cuts and Jobs Act (the “Act”) created a new type of investment vehicle, an opportunity zone fund (“OZ fund”), through which investors can defer or eliminate federal taxes for investments in certain “opportunity zones.” After a lengthy review process, the U.S. Treasury Department has designated 8,764 census tracts, with over 500 in New York State alone, as opportunity zones.

Investors can obtain significant tax benefits by investing in these OZ funds, which in turn must invest at least 90 percent of their assets in “qualified opportunity zone business property” (“QOZBP”), which generally includes (i) certain tangible property acquired and placed into service in an opportunity zone after 2017 and (i) stock or partnership interests of certain qualified OZ portfolio companies that the OZ fund acquired at its original issuance.

Investors in OZ funds can obtain three principal tax benefits. In particular:

1. Investors with taxable capital gains from the sale of certain property before January 1, 2027 can roll over gains on a tax deferred basis within 180 days. Tax is deferred until the earlier of the sale of the investment in the fund or Dec. 31, 2026.
2. At the end of the deferral period, if the investment in the fund was held for five years, taxpayers receive a partial basis step-up enabling to escape tax on 10% of the deferred gain. This benefit increases to 15% if the investment in the fund was held for 7 years. Because the deferral period ends on Dec. 31, 2026, investors can fully benefit from this provision only for investments made by December 31, 2019.
3. If the investor holds the interest in the OZ fund for at least 10 years, the investor will be able to sell its interest in the OZ fund without recognizing any taxable capital gains on the post-acquisition appreciation. As this benefit is generally only available for sales of the investor’s interest in the OZ fund, rather than the fund’s sale of the underlying property, careful tax planning is needed to ensure that investors receive the most advantageous tax treatment.

The process for creating OZ funds, rolling taxable gains into such funds and ensuring that investors receive the optimal tax treatment for their investment in the funds is quite complex and requires careful planning. The Treasury Department has provided further details in recent proposed regulations, however many issues remain unclear and require further regulatory guidance.

Investors should analyze their prospective investments to determine whether they may be able to obtain the significant tax benefits that are available through OZ fund investments.

If you require any additional information concerning the new opportunity zones and OZ funds, or any other tax issues, please contact:

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