Long Island Business News

https://libn.com/2018/12/03/getting-in-the-zone/

Getting in the zone

By: Bernadette Starzee December 3, 2018

The Tax Cuts and Jobs Act of 2017 has had a major impact on accounting firms and their clients this year and it's only getting started. New guidance is still coming out every day as tax professionals and the companies and individuals they serve investigate the opportunities created by the most sweeping tax reform in decades.

One major aspect of the act is a tax incentive to reinvest capital gains in so-called "qualified opportunity zones."

"It was the last part of the tax law – it kind of sneaked in, and it's ground-breaking," said Jeff Cohen, a partner and leader of tax services at Grassi & Co. CPAs, which is based in Jericho. "Its goal is to change the economic outlook of low-income areas. It's similar to economic development programs that have been done on the state level, but it's a national project rather than a local project, and it's going to be far-reaching."

Cohen pointed to the success of economic development programs in New York City that incentivized investment in previously low-income areas like East Williamsburg in Brooklyn and Hunts Point and Port Morris in the Bronx.

"Every single area in New York City that was written off as permanently lost: now you can't buy commercial real estate there because there's nothing available – it's like Tuscany in Seinfeld," Cohen said. "That's what happens when you offer tax incentives and a group of businesses comes into the area."

While allowing individuals and businesses to defer taxes on capital gains, the provision encourages capital investment in certain low-income communities in all 50 states and the District of Columbia, which have been approved to qualify for opportunity zone investments. On Long Island, there are several opportunity zones in Nassau and Suffolk, including areas in Hempstead, Riverhead, Central Islip, Glen Cove, Wyandanch, Huntington Station, Long Beach and North Bellport, according to Marc Fogel, a partner at Berdon Accountants and Advisors, which has offices in Jericho. Fogel expects the measure will encourage private investment from "both big and smaller-level organizations" in those areas in the coming year and beyond.

"That's the hope," said Fogel, who has received many inquiries from his clients, especially among real estate developers. "A couple of my clients, who happen to own undeveloped properties in areas designated as opportunity zones, are looking to set up opportunity funds, with the hope they can attract other investors to invest with them," he added.

A taxpayer may defer up to 100 percent of realized capital gain if the capital gain is reinvested into a qualified opportunity fund within 180 days from the date of the sale of the asset, according to the "2018 Year-End Tax Guide," which accounting firm Marcum, which has offices in Melville, sent to its clients.

Opportunity funds allow multiple investors to pool their resources to rebuild blighted neighborhoods. Besides investing in an opportunity fund, there are two additional ways to invest in an opportunity zone in order to defer and/or eliminate capital gains, according to the Marcum report: investors can invest directly in a qualified opportunity zone business or a qualified opportunity zone property.

In the case of a fund, it can be set up as a corporation or a partnership and must hold at least 90 percent of its assets in qualified opportunity zones, according to Marcum. In order for a business to qualify as being in an opportunity zone, at least 50 percent of the gross income of the business must be derived from the conduct of business in the zone. Also, certain categories of businesses are excluded.

The capital gain can come from the sale of just about any asset – such as real estate, stocks or artwork – and only the gain needs to be invested to get the tax incentive, Fogel said.

“Let’s say you held Amazon stock with a cost basis to you of $1 million and you sell it for $2 million,” Fogel said. “To qualify for the deferral of the gain, you just have to reinvest the $1 million appreciated value of the stock into the zone; you don’t have to invest the full $2 million proceeds.”

Besides deferring taxes from capital gains, the investor realizes additional benefits.

“If taxpayers keep their investment in a qualified opportunity fund for five years, when they sell it, they would only have to pay tax on 90 percent of the gain that was originally deferred,” Fogel said. “If taxpayers keep their investment in a qualified opportunity fund through 2026, they would only have to pay tax on 85 percent of the gain they originally deferred.”

And, perhaps most significantly, no capital gain tax will have to be paid on any appreciation on the qualified opportunity fund property, as long as it is held for 10 years, Fogel said.

“So if I invested $1 million next year and I sold the property for $2 million 10 years after I invested in the fund, that $1 million of gain would not be taxed,” Fogel said.

This incentive, coupled with the federal government’s program to incentivize companies to repatriate dollars that were invested overseas back into the U.S., will have a “major impact on these areas,” Cohen said.

But it’s not enough to just invest in an opportunity fund.

“For every dollar that you invest in a zone, you have to put in another dollar” in improvements, Cohen said. “They don’t want someone to buy up all of, say, Trenton, N.J. and sit on it and wait for someone else to come in. They’re looking for people who are going to develop the property and create jobs.”