Year-End Considerations for Investors to Take Advantage of Federal, Ohio Opportunity Zone Tax Credits for 2019 Investments

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What is the Ohio opportunity zone tax credit?
Included within Ohio's 2020-2021 state budget bill (passed earlier this year) is a provision allowing taxpayers investing in Ohio qualified opportunity zones (OQOZs) through an "Ohio qualified opportunity fund" (OQOF) to apply for a credit against their Ohio tax equal to 10% of the taxpayer's investment to the extent the OQOF invests in one or more OQOZs. The legislation is intended to compliment the investment incentives offered by the federal opportunity zone program, birthed by the 2017 Tax Cuts and Jobs Act.

Piggyback to the federal opportunity zone program
The *federal* opportunity zone program does not issue tax credits. Rather, it incentivizes opportunity zone investment by permitting taxpayers to defer payment of tax on their capital gain, reducing the amount of capital gain taxed and, provided the investment in the qualified opportunity fund (QOF) is held long enough, elimination of tax on the appreciated value of the investment in the QOF.

The Ohio program, on the other hand, issues taxpayers a tax credit in qualifying Ohio opportunity zone investments. Significantly, the program does not limit investment in OQOFs to capital gain. For these and other reasons, Ohio's incentive provides additional, and immediate, benefits to Ohio opportunity zone investors.

How does it work?
Make sure you are invested in an "Ohio qualified opportunity fund"
An OQOF is a fund that: (1) meets the federal definition of a qualified opportunity funds, and (2) holds **all of its invested assets** in qualified opportunity zone property situated in an OQOZ. The fund does not need to invest all its assets, but those that are invested must be invested in qualified opportunity zone property situated in an OQOZ.

File your application with the Ohio Development Services Agency
Unlike the federal program (which does not require application to the IRS to take advantage of its incentives), those seeking the Ohio tax credit must submit an application to receive the credit. While application forms have not yet been published, our inquiries of the Ohio Development Services Agency (ODSA) indicate that an online application form will be available in the next one to two weeks.

Tax credits are limited, so file your application early

If you have invested in an OQOF in 2019 (assuming a calendar-year taxpayer), act quickly, because credits are limited. The total credit allowed to any one applicant is $1,000,000 (i.e., 10% of a $10 million investment) per fiscal biennium (i.e., a 2-year period). Applications are reviewed in the order they are received and **as soon as the state has issued $50,000,000 of tax credit certificates, awards will be closed until the succeeding biennium**. So, if you have invested in an OQOF in 2019 (applications are for investments made in the immediately preceding year), make sure to file your application sooner, rather than later, to avoid being left out. **Applications are accepted between January 1 and February 1 of each year.** ODSA is required to issue certificates to taxpayers within 60 days after it has received a complete application.

> *Tax credit example (from ODSA FAQs for 2020 Application Round):*
> *A Taxpayer contributes $1 million to an OQOF. The OQOF then invests $750,000 of that contribution in qualified opportunity zone property situated in an OQOZ in 2019. In January 2020, the Taxpayer can apply for a 10% tax credit on the $750,000 invested. The tax credit in this scenario calculates to $75,000 (10% of the $750,000).*

The credit may be claimed for the taxpayer's qualifying taxable year, or the next ensuing taxable year

The credit is nonrefundable and may be claimed for the taxpayer's qualifying taxable year or the next ensuing taxable year, and any unused amount may be carried forward for the following 5 taxable years. If the certificate is issued to a pass-through entity (e.g., an S-corporation, partnership or limited liability company) for an investment by the entity, any taxpayer that is a direct or indirect investor in the entity on the last day of the entity's qualifying taxable year may claim the taxpayer's proportionate or distributive share of the credit against the taxpayer's aggregate amount of Ohio tax levied. Any taxpayer claiming a credit under the program must submit a copy of the certificate with the taxpayer's return or report.

Tax credit certificates are transferable

Tax credit certificates are transferable, one time only, to another taxpayer.

Federal

Time is running out to capture the full 15% "discount" offered by the federal opportunity zone program. Investments must be made in a QOF on or before December 31, 2019. (The following is an excerpt from this full alert, released in July.)

For an investor to realize the full 15% discount on deferred capital gain invested in a QOF, the investment must be made no later than December 31, 2019. Why? Because the full discount is applied in two phases. The first discount amounts to 10% of the deferred capital gain, and is applied for investments held for at least five years. The remaining 5% discount tacks-on if the investment is held for at least seven years. Therefore, because the deferred federal tax on the invested capital gain must be paid, at the latest, on December 31, 2026, if an investor desires to take advantage of the entire 15% discount, it must make its investment in a QOF on or before December 31, 2019 (i.e., at least seven years prior).

Similarly, unless capital gain is invested in a QOF on or before December 31, 2021, the second (i.e., 5%) discount will be lost to the investor.

Finally, QOZ designations remain in effect until December 31, 2028. Therefore, unless Congress extends the deadline, if an investor desires to exclude recognition of federal capital gain tax on the appreciation of its investment in a QOF, it must make its investment no later than December 31, 2028; provided, however, the QOF investment must be sold no later than December 31, 2047.

The bottom line is that to maximize the tax benefits of the federal opportunity zone program, the earlier the investment, the greater the reward.

(For an overview of the basics on the federal opportunity zone program, see our prior articles **here** and **here**.)

For more information, please contact the author or any member of McGlinchey Stafford's Real Estate Team.

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