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# Opportunity Zone Tax Rules May Lock Out Startups

By Siri Bulusu Posted Dec. 4, 2018, 6:24 PM

- Incentive favors real estate sector, according to investors
- Startups need flexibility for quick entry and exit from opportunity funds

Economically distressed areas may not benefit from a new tax perk aimed at driving in investor capital unless the IRS clarifies how the rules will apply to startups.

The first set of rules on opportunity zones (REG-115420-18) favor long-term real estate projects and don't ensure flexibility for startup investments—the sector that will drive the job growth and economic development intended by the incentive, practitioners said. That lack of certainty could keep the tax incentive from attracting a full range of investments.

"If you're going to revitalize an area you need to bring in jobs, not just refresh buildings," Mark Ruckman, founder of Halagard, Inc., a Dallas-based company currently seeking to raise a $2 million opportunity fund.

The proposed rules promise potentially massive tax breaks on capital gains that are recycled into development projects and businesses in previously overlooked areas. The incentive, part of last year's tax overhaul (Pub. L. No. 115-97), has drawn a lot of attention from investors and could tap into an estimated $6 trillion in idle capital gains.

Investors have been raising concerns with the Internal Revenue Service. Comments on the proposed rules are due Dec. 28.

**Uncertainty Hurts**

Real estate projects are often considered attractive investments because they are usually single-site and single-use and therefore easy for investors to enter and exit. The current confusion lies in investments in business ventures, which can vary from manufacturing operations to child care and sometimes require changes in location. Both categories of investments can qualify for the tax break, though they must satisfy different requirements.

Confused investors may be deterred from taking on non-real estate projects in opportunity zones, because the rules don't lay out how an investor can exit one opportunity zone investment and redeploy the funds into another.

"Unlike most single-site real estate developments, many startup businesses expand or pivot from their original business plan," said Girard Miller, an angel investor and retired chartered financial analyst based in Orange County, Calif.

Investors in diversified angel and venture capital funds don't know in advance the percentage of investment going into an opportunity fund because they are usually spread among 10 to 15 different companies in different jurisdictions, Miller said. That can make it hard to raise and deploy capital that creates new businesses.

"The idea that there would be a single-purpose opportunity zone fund for startup businesses is going to be a non-starter. At this stage of the regulations, this sector is going to be frozen all the way out of the opportunity zones program," he said.

**Pressure on Real Estate**

Real estate investors may also be feeling anxious about the proposed opportunity zone rules, said Erik Loomis, a partner at Cox, Castle & Nicholson LLP. His firm is based in Los Angeles.

"The term substantially improves means that taxpayers must double their adjusted basis in the property after purchase and during any 30-month period that they hold their qualified opportunity zone property," Loomis said.

The requirement as applied to land may force non-economic investments like warehouses, factories, or other business operations that could make real property businesses in opportunity zones economically nonviable, practitioners said.

"You can build all the buildings, but we need businesses to occupy all that new real estate," Miller said.

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