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OPPORTUNITY ZONES: HOW HEALTH PROVIDERS CAN BENEFIT FROM THE TRUMP TAX CUT PROGRAM

While much focus was given to the individual and corporate tax reductions provided in the Tax Cuts and Jobs Act of 2017 ("TCJA"), the TCJA also stirred up a great deal of interest among investors with the designation of qualified opportunity zones ("Opportunity Zones"). The Opportunity Zone additions to the Internal Revenue Code allow investors to defer and reduce taxes on capital gains if those gains are invested in qualified opportunity funds ("Opportunity Funds") that invest in economically distressed communities. Although for-profit health care providers stand to benefit directly from Opportunity Zone investment, tax-exempt providers partnering with for-profit developers or other investors can potentially realize lower costs of capital for real estate and construction projects as the for-profit partner is able to achieve tax savings through the Opportunity Zone program. In order to take full advantage of these benefits, hospitals and their investor partners should make qualifying investments in Opportunity Funds no later than December 31, 2019.

ALL IN THE TIMING: WHAT ARE OPPORTUNITY ZONES AND HOW DO THEY WORK?

As authorized by the TCJA, state governors designated and the IRS approved over 8,700 Opportunity Zones in order to spur investment in economically distressed areas. There are Opportunity Zones in all 50 states, the District of Columbia and five U.S. territories, the locations of which are indicated on this map. A large number of hospitals and health systems are located in or near Opportunity Zones, meaning that numerous health providers may be able to realize the tax benefits offered by this program.

In order to tap into the tax advantages of Opportunity Zone investment, a taxpayer must start with capital gain from a prior investment and must reinvest that gain into an Opportunity Fund within 180 days of realization of the initial gain. An Opportunity Fund is a partnership, multi-member LLC taxed as a partnership or a corporation that invests at least 90 percent of its holdings in one or more Opportunity Zones.

Investing in an Opportunity Fund provides three potential tax benefits for investors:

1. **Tax Deferral on Previously Earned Capital Gains –** Taxpayers who reinvest their accumulated capital gains (recognized on the sale or exchange of property to an unrelated party) into Opportunity Funds will not be taxed on those gains until the earlier of: (a) the date on which the qualifying investment is sold or exchanged; or (b) December 31, 2026.

2. **Basis Step-Up for Previously Earned Capital Gains –** Taxpayers who reinvest their accumulated capital gains into Opportunity Funds and hold that investment for at least five years may exclude 10 percent of the original deferred gain. Taxpayers who hold their Opportunity Fund investment for at least seven years may exclude an additional five percent of the original deferred gain for a total exclusion of 15 percent of the original deferred gain.

3. **Permanent Exclusion of Taxable Income on New Gains –** Taxpayers who invest in an Opportunity Fund and hold that investment for at least 10 years will pay no taxes on capital gains produced through that investment (although the deferred gain that was initially reinvested in the Opportunity Fund would have been taxed on or before December 31, 2026 as described above).

To qualify as Opportunity Zone property, property must meet the following three criteria: (1) it must be depreciable property or an equity investment in a qualified Opportunity Zone business, which is acquired by a trade or business by purchase on or after January 1, 2018; (2) the original use (or a substantial improvement) of such property must commence with the Opportunity Fund investment; and (3) during substantially all of the holding period of the property, substantially all of the use of the property must be in an Opportunity Zone. IRS guidance also permits tenant improvements in leased property to qualify as Opportunity Zone business property under certain circumstances.

It is important to note that in order to obtain the full 15 percent stepped-up basis available on reinvested capital gains, taxpayers must hold the Opportunity Fund investment for at least seven years. Therefore, to take full advantage of the available tax benefits, taxpayers must make their initial investment on or before December 31, 2019 since gains can only be deferred until December 31, 2026.

HOW CAN HOSPITALS AND HEALTH SYSTEMS BENEFIT?

- Many hospitals and health systems are located in or near Opportunity Zones or are desiring to enter new markets in Opportunity Zones. This program attracts potential capital and development partners who are able to take advantage of deferred and reduced gains even where the hospital cannot.
- An Opportunity Fund could be directed by one hospital forming a corporation for Opportunity Zone investment or by multiple entities forming a joint venture partnership or LLC that might be held by a hospital and its foundation, a hospital and a developer, multiple health providers or some other combination.
- As hospitals and health systems focus their investments on social determinants of health, the Opportunity Zone program allows providers to leverage their investment strategies to help improve health outcomes, not just for inpatient and outpatient care but also for population health and wellness initiatives. Because qualified Opportunity Zone property includes equity investments in businesses, substantially rehabilitated real estate and business assets located in the Opportunity Zone, health providers can pursue a holistic approach in their Opportunity Zone investment portfolios to include non-traditional health care investments such as affordable housing or grocery stores.
- Tax-exempt health providers can magnify their impact by deploying grants strategically to foster investment by others. Beyond the social determinants impact, health providers can take steps to promote their own geographic area for general development purposes. This might involve direct financial investment in the community or it might instead take the form of master planning of a hospital's community through starting or investing in a qualified Opportunity Zone business.

In order to fully avail themselves of the Opportunity Zone program, health providers will need to understand the full pipeline for these kinds of deals, as well as market forces, both locally and nationally (such as vacancy rates and investment trends). Forming a cross-disciplinary team dealing with finance/investments, community/population health, plan management, government relations, facilities and more will be vital to success.

This blog post is Part I in a multi-part series: This post provides background on the Opportunity Zone program and offers ideas for how hospitals can make real estate investments that qualify for tax benefits under the Code. Part II of the series explores specific applications of the Opportunity Zone program for health providers.

Hall Render can help. If you have any questions or would like more information, please contact:

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