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## DEVELOPMENT SERVICES AGENCY

### Opportunity zones and business investment credits

- Authorizes a nonrefundable tax credit equal to 10% of a taxpayer's investment in an Ohio Opportunity Zone fund.
- Limits individual credits to \$1 million per fiscal biennium and total credits to \$50 million per biennium.
- Reduces the total biennial cap on the existing small business investment credit from \$100 million to \$50 million and otherwise modifies that credit.

### Opportunity zone investment credit

(R.C. 107.036, 122.84, 122.86, 5747.82, and 5747.98)

The bill authorizes nonrefundable income tax credits for individuals who invest in an investment fund that, in turn, invests principally in Ohio opportunity zones. The credits enhance existing federal and Ohio tax benefits for investments in such zones.

### Opportunity zone background

Beginning in 2018, federal law allows states to designate economically distressed areas that meet certain criteria as "opportunity zones."<sup>15</sup> Once the zone is certified by the Secretary of the Treasury, certain investments made to benefit the zone are eligible for preferential federal tax treatment. Specifically, when a taxpayer reinvests capital gains (i.e., income from the sale of stock or other asset) in an "opportunity zone fund" – an investment fund that holds at least 90% of its assets in property, stock, or ownership interests that benefit opportunity zones – the tax on those capital gains is deferred until the investment is sold or exchanged from the fund.<sup>16</sup>

Moreover, if the investment is held in the opportunity zone fund for five years, the investment's basis is increased by 10% of such deferred gain (effectively a 10% decrease in tax on the original gain). If held for at least seven years, the basis is increased by 15%. If held for ten years, not only is the basis increased by 15%, but any capital gains accrued while the investment was held in the opportunity zone fund is exempt from tax.

Because Ohio law uses federal adjusted gross income as a starting point for Ohio income tax liability, the federal deferral and reduction in capital gain taxes also defers or reduces a taxpayer's Ohio income tax. These federal and Ohio tax benefits are available regardless of where the zone is located.

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<sup>15</sup> 26 U.S.C. 1400Z-1. The Opportunity Zone law was enacted in December of 2017 by the federal "Tax Cut and Jobs Act." A map of opportunity zones designated in Ohio is available at [http://development.ohio.gov/bs/bs\\_censustracts.htm](http://development.ohio.gov/bs/bs_censustracts.htm).

<sup>16</sup> 26 U.S.C. 1400Z-2. To qualify, the capital gains must be reinvested in the fund within 180 days after the gain is realized.

## **Ohio income tax credit**

The bill adds to these existing incentives a new Ohio income tax credit for investments that benefit Ohio-designated zones. To qualify for the credit, a taxpayer must invest in an opportunity zone fund that in turn invests at least 90% of its invested assets in opportunity zones in Ohio (referred to in the bill as an “Ohio qualified opportunity fund”). Unlike the federal tax incentives, the bill’s credit is available even for investors that do not have capital gains to reinvest.

Each individual’s credit equals 10% of the investment, is nonrefundable, and is limited to \$1 million per state fiscal biennium. The total amount of credits available for all taxpayers is limited to \$50 million per biennium. Because of this limit, investors must apply for the credit.

The taxpayer must apply to the Development Services Agency (DSA) between January 1 and February 1 following the taxpayer’s taxable year when an investment is made. The taxpayer must include in the application (1) the total investment the taxpayer made in Ohio qualified opportunity funds and (2) a statement from an officer of each fund certifying the amount the taxpayer invested in that fund and the date of the investment. DSA must consider applications in the order in which they are received.

If the taxpayer qualifies for the credit, DSA will issue the taxpayer a credit certificate that lists the amount of the credit. The taxpayer must file a copy of the certificate with the taxpayer’s return.

### **Qualifying Ohio opportunity zones**

The bill provides details for determining whether an opportunity zone fund’s assets are invested in an Ohio-designated zone for the purposes of the credit. In the case of assets in the form of tangible property, “substantially all” of the property must be used in the zone during “substantially all” of the fund’s holding period of the property. In the case of assets in the form of stock or partnership interests in a business, “substantially all” of the business’ tangible property must be used exclusively in the Ohio zone during “substantially all” of the fund’s holding period of the stock or interest. (Under proposed Treasury regulations, “substantially all,” when used in reference to the percentage of a business’ tangible property it uses in an opportunity zone, may be as little as 70%.)

### **Biennial forecast of forgone revenue**

(R.C. 107.036)

Continuing law requires that every main biennial budget bill include detailed estimates of the state revenue that will be forgone due to “business incentive” tax credits in the current biennium and future biennia. The bill adds the new opportunity zone investment credit to the list of tax credits that are to be included in these estimates.

### **Small business investment credit**

(R.C. 122.86)

The bill modifies an existing income tax credit for investments in smaller businesses, principally by reducing the total biennial limit on the credit allotment. Currently, the amount of

the credits awarded each fiscal biennium is limited to \$100 million; the bill reduces the limit to \$50 million.

The bill also modifies qualifications a business must satisfy in order for a taxpayer's investment to qualify for the credit. Whereas current law requires a business to employ at least 50 full-time equivalent employees, the bill specifies that this requirement is to be satisfied throughout the two-year period leading up to a taxpayer's investment.

Current law also requires the business to incur costs for payroll or for one or more of four different categories of assets in an amount equal to, or more than, the taxpayer's investment amount for which the credit is granted, and to do so within six months of the taxpayer's investment. The categories include real property, tangible personal property, vehicles used primarily in the business, and intangible property (e.g., royalties, trademarks, licenses).

The bill modifies these qualifications as follows:

- Eliminates the requirement that the business' costs equal the amount of the investment for which the credit is claimed, requiring only that some such costs be incurred.
- Modifies the payroll qualification by permitting increased pay for owners, officers, or managers to count toward payroll, and by disallowing pay for retained employees to count toward payroll. Only the pay of employees hired after the investment would count. (Under current law, the payroll qualification refers to the pay of "new employees," but expressly allows pay for retained employees to count as pay for new employees. The bill removes reference to retained employees' pay.)
- Allows the business to count installation costs toward the cost of tangible personal property.
- Replaces the cost of intangible property with the cost of leasehold improvements or construction.

The bill also modifies the administration of the credit. As under current law, taxpayers must apply to DSA to qualify for the credit, or the business may apply on a taxpayer's behalf. The bill specifies that, in either case, the application must be made within 60 days after the investment is made and within the same fiscal biennium in which the investment is made. And, whereas under current law the right to claim a credit is represented by a "certificate," which may be used to claim the tax credit once the investment's required two-year holding period concludes, the bill refers to this right as an "allocation," which may be converted to a certification once the holding period is over, allowing the credit to be claimed thereafter. Credit allocations are made only once an applicant provides DSA with all documentation needed to demonstrate that a business satisfies the qualifications.

Under both current law and the bill, the credit is available for investments in businesses having assets of \$50 million or less, or annual sales of \$10 million or less, and employing no more than 50 full-time-equivalent employees or employing more than 50% of their U.S. employees in Ohio.

The bill's changes apply to investments made on or after July 1, 2019.