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Opportunity Zones in Texas: What You Need to Know

Texas, the second largest state in the U.S., has 628 designated Opportunity Zones, making it one of the most promising areas for Opportunity Fund investing in the entire country. Texas has O-Zones located in or near all its major urban areas, including Austin, Houston, Dallas, and San Antonio. The median household income of Texas's Opportunity Zones is $36,268, compared to the median income of $57,547 for all census tracts in the state. In addition, 70.22% of Texas's Opportunity Zones are in a metro area, compared to 85.58% of all census tracts statewide.

What are the Opportunity Fund Tax Benefits in Texas?

Just like in other states, the Opportunity Zones program offers investors a way to defer their federal capital gains taxes by investing in Opportunity Funds specialized investment vehicles which must place at least 90% of their assets in eligible businesses or real estate inside a Qualified Opportunity Zone (QOZ). To be eligible for investment, a company must do at least 50% of its business inside a QOZ. And, for a property to be eligible, an Opportunity Fund must be engaging in new construction, or must be investing more into rehabilitating the property than it invested to purchase the property in the first place.

Opportunity fund investors who invest within 180 days of selling an asset can defer paying capital gains taxes until April 2027. If they keep their investment for at least 10 years, they can enjoy a 15% discount on their capital gains tax liability, as well as paying zero capital gains taxes on any appreciation their investment has made since entering the Opportunity Fund.

Opportunity Fund Investments Can Be Paired With Texas Historic Tax Credits

Much like the Federal Historic Tax Credits (HTC) program, Texas has its own historic tax credit program, which was signed into law by Governor Rick Perry in 2013. The program

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allows investors a credit of up to 25% of eligible costs incurred when rehabilitating a historic building. This credit can be used against state franchise taxes, and can be used, saved, and/or spread out over up to five future state franchise tax bills, giving it unprecedented flexibility. In theory, this historic tax credit could be used with federal historic tax credits to maximum investment yields when rehabilitating property owned by an Opportunity Fund.

Other tax credit programs that can be paired with Opportunity Fund projects include the Low Income Housing Tax Credit (LIHTC), designed for affordable housing properties, and the New Markets Tax Credit (NMTC), designed for commercial property in specifically distressed census tracts (most of which overlap Opportunity Zones).

The Texas Enterprise Zone Program May Also Be Leveraged With The Opportunity Zone Program

The Texas Enterprise Zone Program (ZEP) is a tax refund program intended to increase job creation and economic activity in lower-income areas of the state. While Opportunity Funds purely investing in commercial and multifamily real estate typically would not be eligible, if an Opportunity Fund were also to invest in job-creating local businesses, the company would be able to take sales tax refund, which could positively impact its profitability. To qualify, a business does not necessarily need to be in an Enterprise Zone, (though it does make it easier). Fortunately, however, many Enterprise Zones overlap Opportunity Zones.

What are the benefits of investing in Opportunity Zones in Texas?

Investing in Opportunity Zones in Texas can provide investors with three main tax benefits. First, investors may defer capital gains taxes until they sell their investment or by December 31, 2026, whichever occurs first. In addition, investors who keep their money in an Opportunity Fund for at least 5 years will receive a 10% reduction of their capital gains tax liability, while those who keep their investment in the fund for at least 7 years will receive an additional 5% discount, for a total 15% capital gains tax discount. Lastly, investors who keep their money in an Opportunity Fund for at least 10 years will not have to pay any capital gains taxes on any additional appreciation their investment has experienced since it was placed in the fund.

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What types of investments qualify for Opportunity Zone incentives in Texas?

In Texas, investments in commercial and multifamily real estate qualify for Opportunity Zone incentives. To qualify, the property must either be new construction, or if it is a rehabilitation project, the Opportunity Fund must invest equal or greater funds into property improvements than it did to initially purchase the property. In addition, all construction or rehabilitation projects must be completed within 30 months. For an Opportunity Fund to invest in a business, the business must not be in a prohibited category, such as liquor stores, massage parlors, gambling-related businesses, golf courses, tanning salons, and several other types of "sin" businesses. The business must also do at least 70% of its business inside the Opportunity Zone to qualify.

What are the tax advantages of investing in Opportunity Zones in Texas?

Investors in Texas who invest in Opportunity Zones can benefit from three main tax advantages. First, investors may defer capital gains taxes until they sell their investment or by December 31, 2026, whichever occurs first. This means they will not have to pay the taxes until April 2027. Second, investors who keep their money in an Opportunity Fund for at least 5 years will receive a 10% reduction of their capital gains tax liability, while those who keep their investment in the fund for at least 7 years will receive an additional 5% discount, for a total 15% capital gains tax discount. Finally, investors who keep their money in an Opportunity Fund for at least 10 years will not have to pay any capital gains taxes on any additional appreciation their investment has experienced since it was placed in the fund.

What are the eligibility requirements for investing in Opportunity Zones in Texas?

To invest in Opportunity Zones in Texas, investors must invest through an Opportunity Fund. An Opportunity Fund is a partnership or corporation which plans to invest a minimum of 90% of its assets in Opportunity Zones. To be eligible, a property must either be new construction, or if it is a rehabilitation project, the Opportunity Fund must invest equal or greater funds into property improvements than it did to initially purchase the property. However, a recent regulatory ruling posits that this only applies

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to the cost of the building, not the cost of the land. For instance, if an Opportunity Fund invested $1 million into an outdated apartment building, and it was found that the building was worth $600,000, while the land was worth $400,000, the Opportunity Fund would only need to invest $600,000 into property improvements, not the full $1 million. In addition, all construction or rehabilitation projects must be completed within 30 months. For an Opportunity Fund to invest in a business, the business must not be in a prohibited category. Prohibited business categories include liquor stores, massage parlors, gambling-related businesses, golf courses, tanning salons, and several other types of "sin" businesses. Despite this, an Opportunity Fund can generally own property that is being leased to these businesses, they just cannot own shares in these types of businesses themselves. Plus, the business must do at least 70% of its business inside the Opportunity Zone to qualify.

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