Federal Opportunity Zones

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Introduction

- The Tax Cuts and Jobs Act includes a new tax incentive oriented towards directing private capital investment into certain low-income census tracts
- There is believed to be several billions of dollars in unrealized capital gains held by U.S. taxpayers
- The new Opportunity Zone program has the chance to be a transformative program in urban redevelopment
- A "Super" 1031 Like-Kind Exchange Provision with an added benefit and applicable to the sale of any property
- Projects must be in the eligible zones

Tax Benefits

- Deferral of capital gains until 2026
  - Substantial benefit for short-term gains which become long-term gains and taxed at preferential rates
- Reduction of capital gains invested in the Qualified Opportunity Fund by 10 percent if Opportunity Fund investment held for 5 years
  - 15 percent reduction if held for 7 years
- No gain on the sale or exchange of the interest in the Qualified Opportunity Fund if held for 10 years
  - Basis step-up equal to fair market value

Mechanics of Program

- Taxpayers can invest gains from the sale or exchange of any property (with an unrelated person – 20% ownership) in **Qualified Opportunity Funds**
  - Sale or exchange must take place by Dec. 31, 2026
  - Proceeds must be reinvested in Qualified Opportunity Fund within 180 days of sale or exchange
- A Qualified Opportunity Fund can be any corporation or partnership organized for the purpose of investing in **Qualified Opportunity Zone Property**
  - <u>Stock or partnership interest</u> in a business based in the zone and acquired after Dec. 31, 2017; or
  - <u>Tangible property used in a trade or business</u> of the QOF if acquired after Dec. 31, 2017, the original use of the property is in the zone or it has been substantially improved
  - <u>Substantial improvement</u> – if during any 30-month period following acquisition the additions to basis equal the adjusted basis of property at the beginning of the 30-month period

Mechanics of Program

- Qualified Opportunity Fund must have assets of which 90 percent constitute qualified opportunity zone property—determined after first 6 month period and last day of the fund's taxable year
  - Penalties for non-compliance based on underpayment rate
- Tax benefits only available for gains invested; other funds must be segregated in Qualified Opportunity Fund
- Qualified Opportunity Fund expected to self-certify with the IRS via form available this summer
- Future regulations anticipated which would afford a Qualified Opportunity Fund the ability to sell or transfer Qualified Opportunity Zone Property if the proceeds are reinvested in other Qualified Opportunity Zone Property without triggering a taxable event
- Projects in zones cannot be a: golf course, country club, massage, hot tub or suntan facility, or a gambling facility

Opportunity Fund Example 1

Scenario 1:
Taxpayer holds the Opportunity Fund investment for 5 years and then sells or disposes of the investment in 2024 for $20 mill.

- Original $10 Mill. gain reduced by 10 percent and recognized in 2024.
- Basis in Opportunity Fund investment increased to $9 Mill.
- Gain of $11 Mill. also recognized for disposition of Opportunity Fund investment in 2024.

Taxpayer

$10 Mill. Gain

1. In 2019, Taxpayer sells appreciated property to a third party – building, land, stock, bonds, partnership/LLC interest etc.

2. Taxpayer invests proceeds from sale of property within 180 days of sale into Opportunity Fund (also in 2019)

Opportunity Fund

3. Opportunity Fund uses investment proceeds to invest in Qualified Opportunity Zone Businesses and/or Qualified Opportunity Zone Property

QOZB Stock | **QOZB Ptshp. Interest** | **Residential or Mixed-Use Building**

Opportunity Fund Example 2

<u>Scenario 2:</u>
Taxpayer holds the Opportunity Fund investment for 7 years and then sells or disposes of the investment in 2026 for $20 mill.

- Original $10 Mill. gain reduced by 15 percent and recognized in 2026.
- Basis in Opportunity Fund investment increased to $8.5 Mill.
- Gain of $11.5 Mill. also recognized for disposition of Opportunity Fund investment in 2026

Taxpayer

$10 Mill. Gain

1. In 2019, Taxpayer sells appreciated property to a third party – building, land, stock, bonds, partnership/LLC interest etc.

2. Taxpayer invests proceeds from sale of property within 180 days of sale into Opportunity Fund (also in 2019)

Opportunity Fund

3. Opportunity Fund uses investment proceeds to invest in Qualified Opportunity Zone Businesses and/or Qualified Opportunity Zone Property

QOZB Stock

QOZB Ptshp. Interest

Residential or Mixed-Use Building

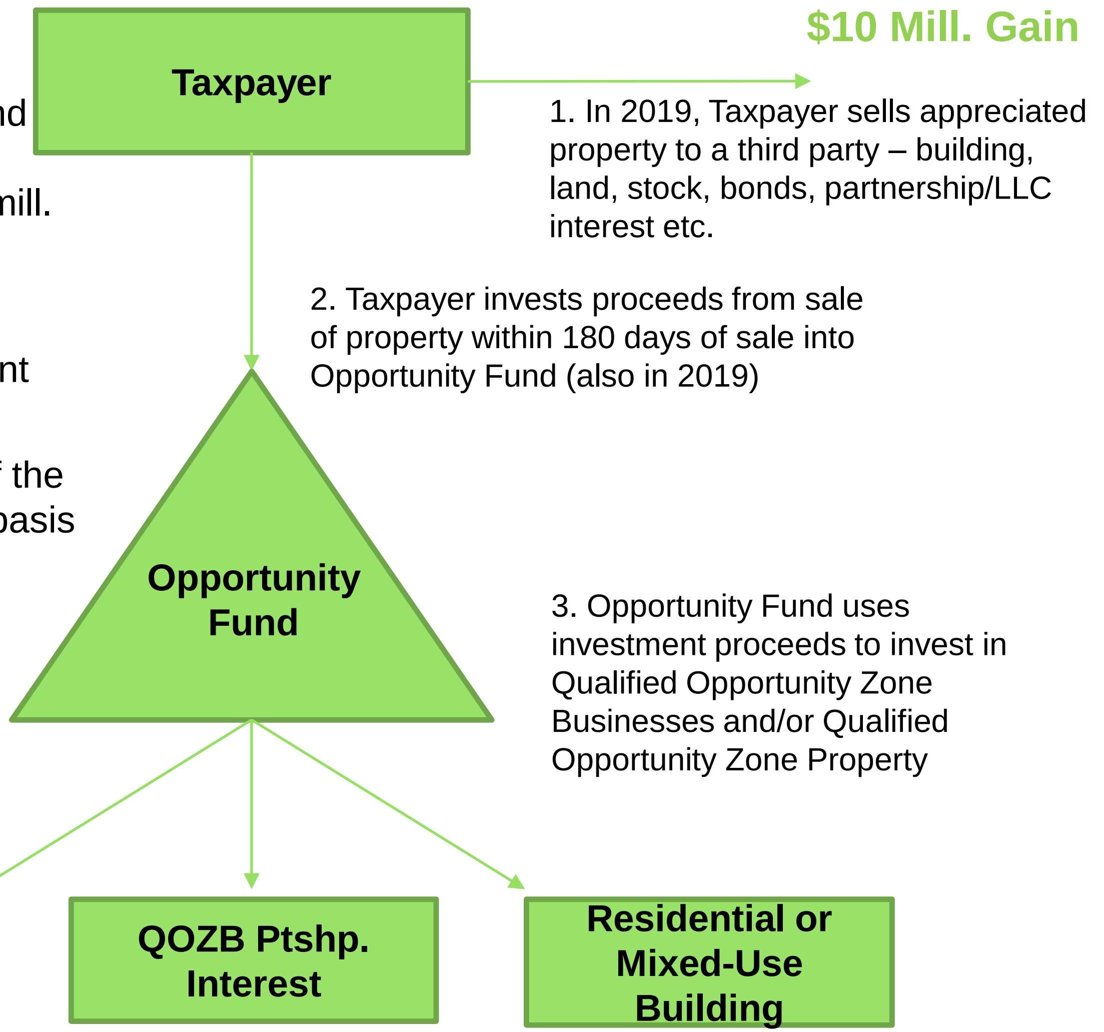
Opportunity Fund Example 3

<u>Scenario 3:</u>
Taxpayer holds the Opportunity Fund investment for 10 years (or longer) and then sells or disposes of the investment in 2029 (or later) for $20 mill.

• Original $10 Mill. gain reduced by 15 percent and recognized in 2026.

• Basis in Opportunity Fund investment increased to $8.5 Mill.

• No gain on the sale or disposition of the Opportunity Fund investment due to basis increase to FMV.



Summary of Tax Benefits

Holding Period of Opportunity Fund Investment	Tax Benefits
Less Than 5 Years	Deferral of Original Gain Until Earlier of: 12/31/26 or Date of Disposition of Qualified Opportunity Fund Investment
5 Years	Benefit Above + Reduction of Original Deferred Gain by 10 Percent When Recognized
7 Years	Original Deferral above + Reduction of Original Deferred Gain by 15 Percent When Recognized
10 Years	Benefits above + No Tax on Disposition of Qualified Opportunity Fund Investment