QUALIFIED OPPORTUNITY ZONE SUMMARY

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A. Background

1. The Opportunity Zone (OZ) Program was established as part of the 2017 Tax Act

2. Provides tax benefits to anyone with "appreciated assets" of any kind – appreciated assets do not have to be real estate but can be the sale of stocks, bonds, or pretty much any other assets that have large capital gains. There is no "like kind" requirement here as there is with a 1031 exchange. Partial guidance was made available by Proposed Regulations issued on October 19, 2018

   https://www.gpo.gov/fdsys/pkg/FR-2018-10-29/pdf/2018-23382.pdf

B. Tax Advantages

1. The portion of your investment attributable to the gain from the appreciated asset is eligible for future appreciation in the fund. Deferred gains become taxable when the OZ investment is sold or on December 31, 2026 when the benefit ends.

2. Gain deferral- 10% of gain is forgiven on property held for five (5) years and an additional 5% for property held for seven (7) years

3. Forgiveness of gain on appreciation if the OZ investment is held for ten (10) years or more.

C. Must invest in a Qualified Opportunity Fund (QOF)

1. Can be an LLC, corporation or partnership for the purpose of investing in a Qualified Opportunity Zone Property (QOZP). The investment must be an equity interest. The QOF must be certified, although the fund self-certifies without IRS approval. The certification is done on Form 8996 https://www.irs.gov/pub/irs-drop/rr- 1 8-29 .pdf

2. A QOF can choose the first month in its taxable year in which it will be treated as a QOF. If a month is not chosen, the first month will default to the first month of the taxable year.

3. A QOF must hold 90% of its assets in QOZ property.

4. Timing You get to defer gain as long you reinvest the gains in a QOF within 180 days of realizing those gains. The first day of the 180-day period is the date on which the gain would be recognized for Federal income tax purposes.

5. Partnerships: If the partnership doesn't elect to defer the gain, a partner may elect its own deferral with respect to the partner's share of the distribution. The partner's 180-day period begins on the last day of the partnership's taxable year which can extend the time to invest the gain. The partner may also choose to begin its own 180-day period on the same date as the start of the partnership's 180-day period.

D. Qualified Opportunity Zone Business (QOZB)

1. A trade or business in which *substantially all* of the tangible property owned or leased by the business is qualified opportunity zone business property (QOZBP)

    a. The property must have been acquired by purchase after December 31, 2017

    b. “Substantially all": at least 70 percent of the tangible property owned or leased by a trade or business is qualified opportunity zone business property, the trade or business.

2. Investments cannot include "sin businesses" such as : commercial golf course or country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility for gambling, or off-sale liquor store.

3. Working Capital Safe Harbor: applies to QOZB that acquire, construct or rehabilitate business property used in a business operating in a OZ. The safe harbor allows QOZB to treat all working capital (cash and debt instruments) as reasonable for a period of 31 months as long as there's a plan that says it's being held for the acquisition, construction or substantial improvement of property in an opportunity zone and promises it will be used before those months are up.

E. Qualified Opportunity Zone Business Property (QOZBP)

1. Property purchased from an unrelated party (20% test) after December 31, 2017.

2. Original use of the property must commence with the QOF, or the QOF must substantially improve the property.

    a. Must be a new use in the QOZ (original use of the property must commence with the QOF or subsidiary), or

    b. Substantial improvement

        (i) During any 30-month period beginning after the date of acquisition...additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis at the beginning of such 30-month period

(ii) Land cost is not included in determining the amount that must be expended during the 30-month period.

F. Single Versus Two Tiered Structured Investments

1. An QOF may invest directly in projects (single tiered structure) where a QOF uses eligible cash proceeds to acquire and hold a QOZ business property or it may invest indirectly through a two tiered structure with a corporate or partnership subsidiary

2. <u>Direct Investment</u>: Under a direct investment structure 90% of all of the QOF's assets must be QOZB Property and the QOZB property must be used in the QOF's trade or business. Intangible property is not QOZB property for the 90 percent asset test. 10% of the QOF's assets may be held in cash or liquid investments

    a. No reasonable working capital safe harbor available under the direct investment scenario.

3. <u>Indirect Investment</u>: The two-tier structure allows for the working capital safe harbor. It also allows for a lower 70 percent asset test at the corporate or partnership subsidiary level (as opposed to a 90 percent asset test for the QOF). 5% plus "reasonable working capital" of the QOF assets may be invested in cash or liquid investments. For an indirect investment, there is no limit on what might be intangible property, but the intangible property must be used in the active conduct of a trade or business (50% test)

G. Existing Buildings- The program only applies to buildings that were acquired after December 31, 2017.

H. Non-Compliance Penalty- For every month a QOF fails to meet the 90% test, there is a monthly penalty. The penalty is equal to the excess of (i) the amount equal to 90% of the aggregate assets less (ii) the aggregate amount of QOZ property held by the QOF multiplied by the underpayment penalty in § 6621(a)(2).