Opportunity Zone Program

August 21, 2018

Program Overview

Tax Cuts and Jobs Act of 2017 created a new community development program that encourages private investment in **qualified opportunity zones**. The program allows taxpayers to defer and reduce gain from the sale or exchange of property if the taxpayer reinvests the gain proceeds in a **qualified opportunity fund**.

Tax Benefits of the Opportunity Zone Program

Allows any taxpayer to **defer** an unlimited amount of gain from the sale or exchange of property (from just about any source) and potentially **eliminate** a portion of the gain and all future appreciation

- Deferral allowed through December 31, 2026
- 5 year holding period = 10% gain elimination
- 7 year holding period = 5% more gain elimination (15% total)
- 10 year holding period = Appreciation (in excess of gain) eliminated

Example

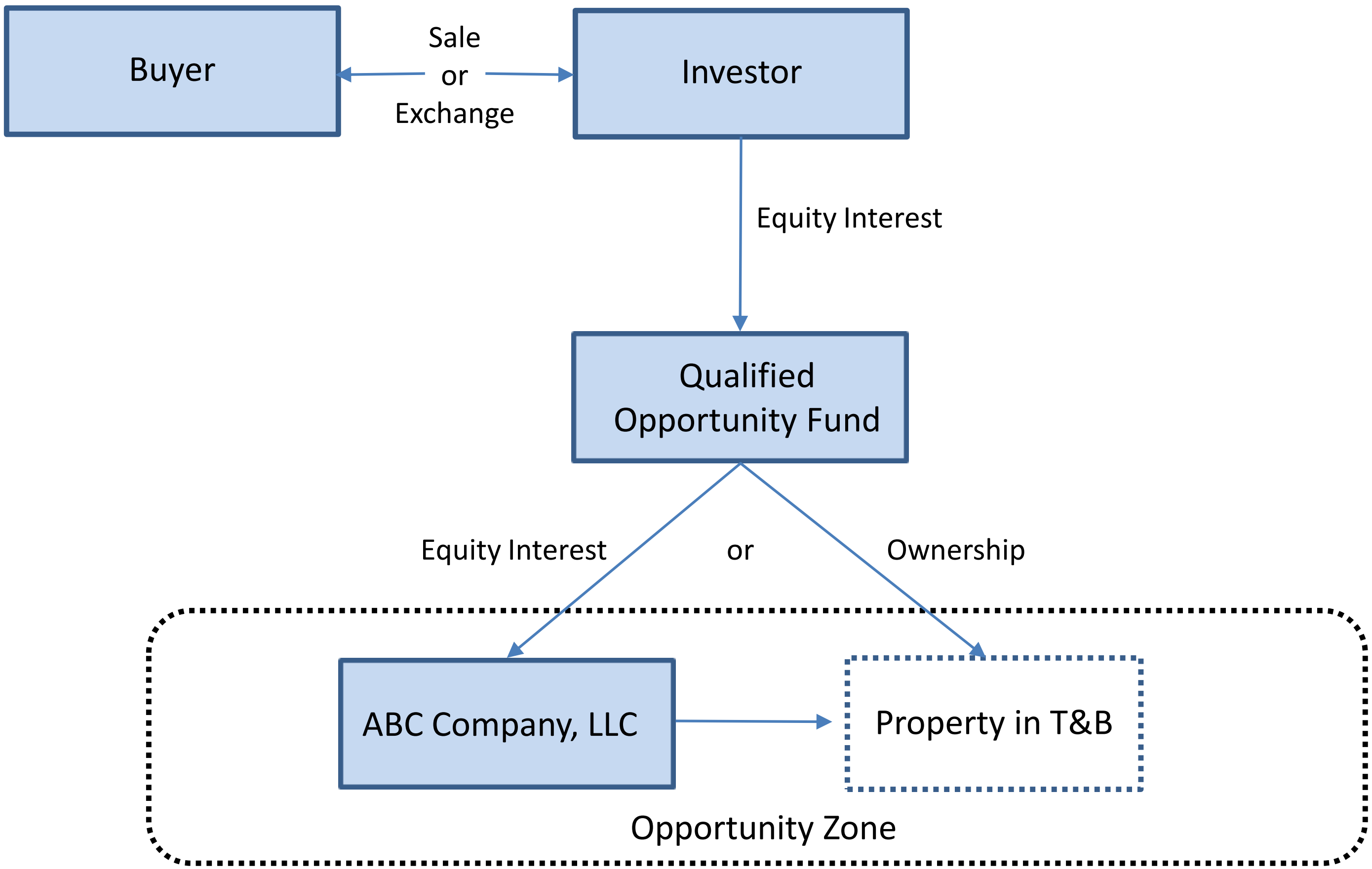
Taxpayer owns stock with a basis of $20,000 and sells the stock in 2018 for $120,000

- Ordinarily, the taxpayer would recognize $100,000 of gain in 2018
- However, under the new program, the taxpayer may defer this gain and eliminate tax on future appreciation by investing the $100,000 gain in a qualified opportunity fund within 180 days of the sale
- Assume further that investment appreciates to $150,000

Holding Period of Fund	Gain from Original Capital Asset	Gain from Fund Appreciation	Total Gain
2 years	$100,000*	$50,000	$150,000
5 years	$90,000	$50,000	$140,000
7 years	$85,000	$50,000	$135,000
10 years	$85,000	$0	$85,000

*No gain is eliminated, but the gain is deferred for 2 years.

Sample Structure



Opportunity Zone Program

- Taxpayer must invest all or a portion of its proceeds equal to the gain in a **qualified opportunity fund**
  - 180 days
  - Only amount equal to gain must be invested
  - Gain cannot result from sale or exchange with related party
- A qualified opportunity fund must hold at least 90% of the fund's assets in certain qualifying businesses or property located in a **qualified opportunity zone**

Definitions

Qualified Opportunity Fund

- Corporation or Partnership
- Certified by U.S. Treasury (Self certification via IRS Form)
- Must invest 90% of its assets in opportunity zone businesses (i.e., stock or partnership interest) or business property

Opportunity Zone Business

- Substantially all of tangible assets of business must be qualified opportunity zone business property (see next page)
- 50% of the gross income earned in the active conduct of a trade or business
- A substantial portion of intangible property must be used in the active conduct of a business
- Other rules similar to NMTCs (i.e., NQFP, sin businesses, etc.)

Definitions

Opportunity Zone Business Property

- Tangible property used in a trade or business
- Acquired by purchase (179(d)(2)) from unrelated party after 12/31/17
- Original use in the zone commences with OZ business or fund or the opportunity zone business substantially improves the property
- Substantially all used in the qualified opportunity zone

Qualified Opportunity Zone (See below)

- Up to 25% of State's Low-Income Communities (LIC) may be designated
- Up to 5% may be Eligible Non-LIC Contiguous Tracts
- March 21, 2018 deadline for Governors to nominate (or request 30-day extension)
- Treasury Secretary must designate within 30 days thereafter (unless extended for 30 days)
- The qualified opportunity zone designation will remain in place for 10 years

Program Uses & Structures

- **Captive Investments**
- **Private Equity**
- **Tax Credit Twinning**
  - HTCs
  - LIHTCs
  - NMTCs
- **Leveraged Structures**
  - At all levels
  - Repayment of debt with Fund investment

Unanswered Questions

- Taxation upon downstream sale
  - If Fund sells its underlying investment, is Fund taxed (or does gain pass through to investor) on gain or can it be deferred if reinvested?
  - What happens if complete liquidation after 2026
- "Active Conduct" – Timing safe harbor
- "Trade or Business" – Narrow or broad
- Established vs. new QOZ business
- Investment timing by Fund (90% requirement)
- 5 and 7 year holding periods straddle 2026
- Extension of 2026 deadline
- Plenty of others

Key Takeaways

- Significant gain deferral and elimination
- Only gain (and not full sale proceeds) must be reinvested
- 180 days to invest gain proceeds
- Phantom income event in 2026
- Waiting on Treasury
  - Opportunity fund certification (IRS Form)
  - General tax guidance

IRS Guidance

The IRS is currently working on guidance for the Opportunity Zone Program. Comments may be sent to:

Internal Revenue Service
Attn: Scott Dinwiddie, Associate Chief Counsel
(Income Tax and Accounting)
Room 4500
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

For More Information

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