



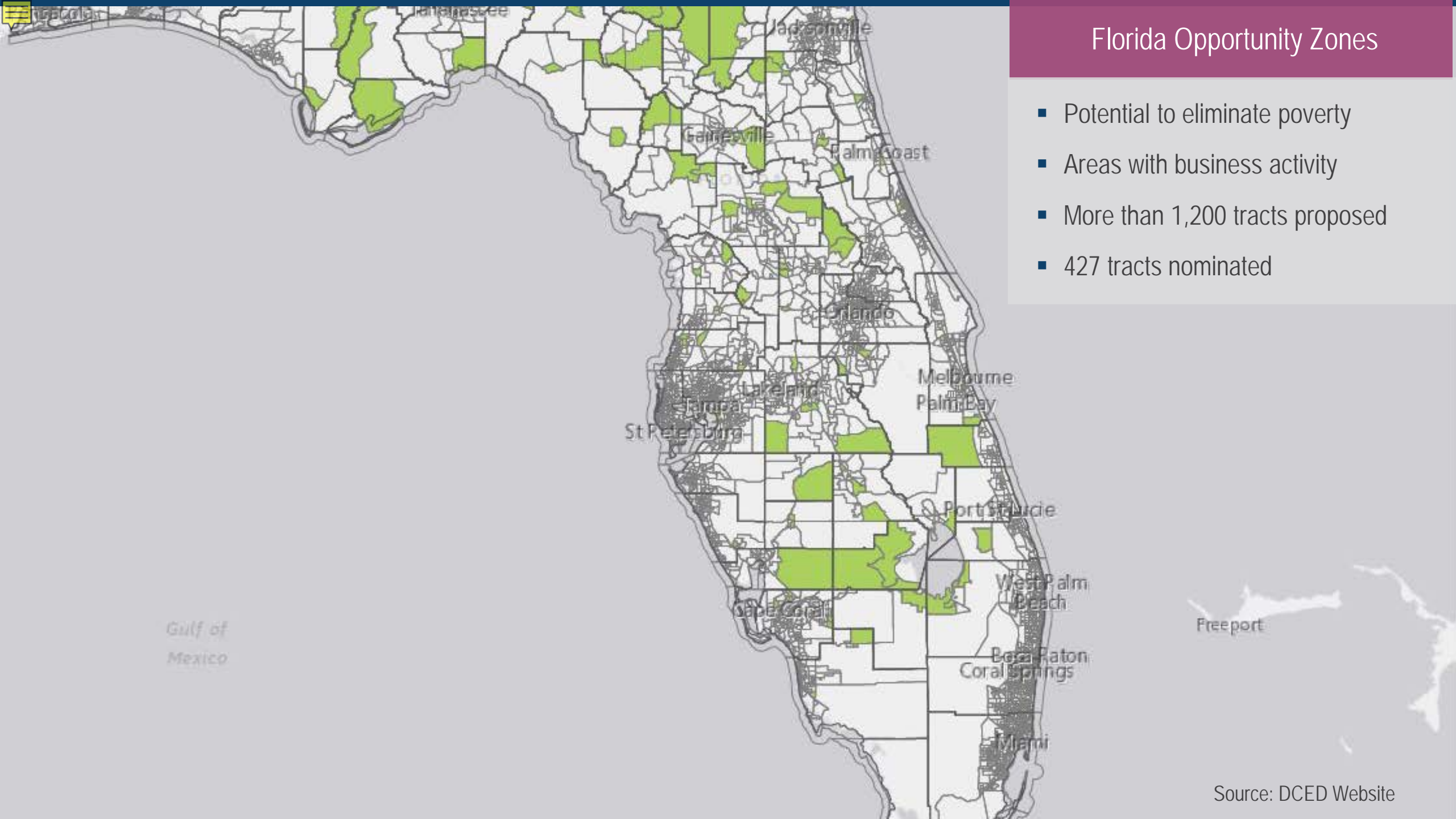
**Buchanan
Ingersoll &
Rooney PC**

Taking Advantage of Opportunity Zones: A Panel Discussion

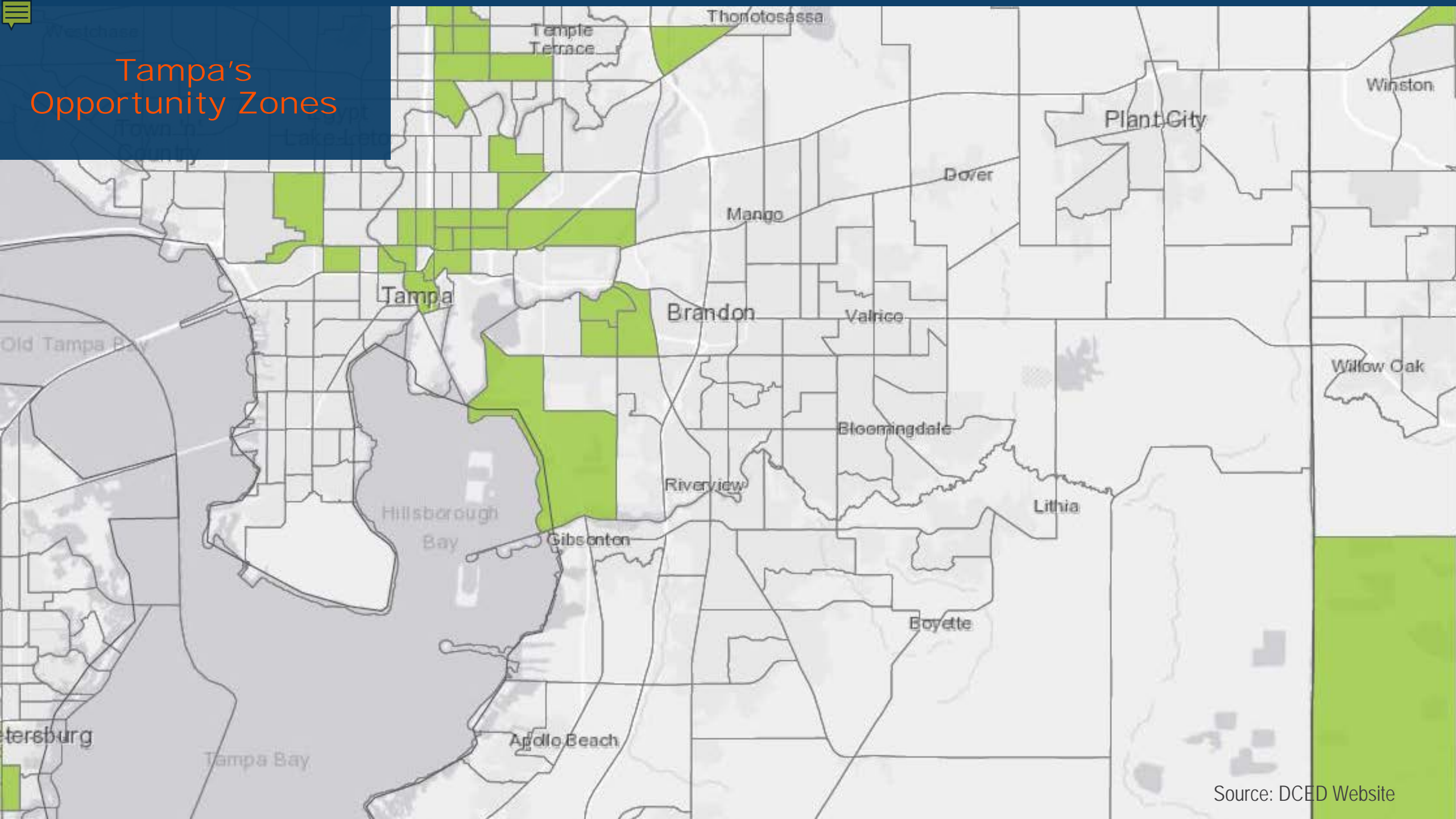
Presented by Buchanan Ingersoll & Rooney
Tampa – October 2018

Florida Opportunity Zones

- Potential to eliminate poverty
- Areas with business activity
- More than 1,200 tracts proposed
- 427 tracts nominated



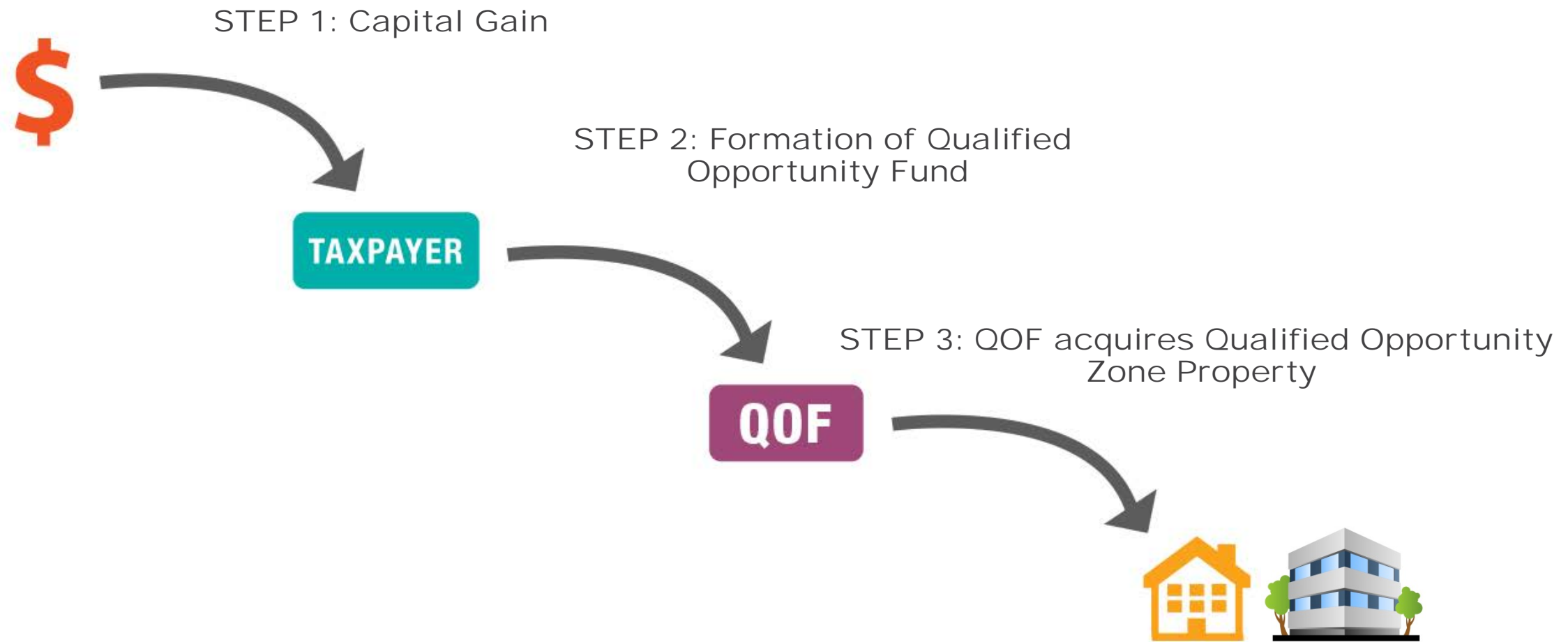
Tampa's Opportunity Zones



How were Qualified Opportunity Zones Designated?

- A Qualified Opportunity Zone (QOZ) is a population census tract that meets the definition of a “low-income community” (as that term is defined under §45D(e) in the context of the New Markets Tax Credit)
- Had to be specifically designated as a QOZ under §1400Z-1
- Governors were allowed to designate up to 25% of census tracts as QOZs.
- Required Treasury approval but that approval was essentially automatic
- IRS Notice 2018-48, (July 9, 2018) includes an official list of all population census tracts designated as QOZs. There are QOZs in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands.

Formation of an Opportunity Zone Fund



EXAMPLE:

- August 1, 2018 - Taxpayer realizes a \$100 million dollar capital gain on the sale of an asset. For purposes of this example, assume that the entire \$100 million is eligible to be invested in a QOF.
- September 1, 2018 - Taxpayer invests the \$100 million in a QOF and affirmatively elects to defer the gain. Taxpayer's initial basis in the QOF investment is zero. Taxpayer continues to hold the investment.
- September 1, 2023 - Taxpayer's basis in the QOF increases to \$10 million (10% of the deferred gain). Taxpayer continues to hold the investment.
- September 1, 2025 - Taxpayer's basis in the QOF increases to \$15 million (15% of the deferred gain). Taxpayer continues to hold the investment.

EXAMPLE, CONT.

- December 31, 2026 - In spite of the fact that Taxpayer has not yet sold the investment in the QOF, Taxpayer is required to recognize the lesser of (a) the FMV of the investment over basis or (b) the deferred gain over basis. Assume that on December 31, 2026, the FMV of the QOF interest has appreciated to \$140 million. Thus, Taxpayer recognizes \$85 million (\$100 million deferred gain minus \$15 million basis) of capital gain on December 31, 2026. Taxpayer's basis in the investment is increased by the \$85 million gain recognized to \$100 million.
- September 1, 2028 - Taxpayer sells the QOF investment for its FMV, which is then \$150 million. Because Taxpayer has held the investment for 10 years, Taxpayer is able to elect to have basis equal FMV and recognizes no gain on the sale.

First Set of Regulations – October 19, 2018

- Address issues that are fundamental to the initial investment in and creation of a qualified opportunity fund (QOF)
- Also address issues related to the original use and substantial improvement tests, the definition of a qualified opportunity zone business, including reasonable working capital rules, and how debt is treated in a QOF taxed as a partnership
- IRS contemporaneously issued Rev. Rul. 2018-29 that addresses the application of the original use and substantial improvement test to the purchase of land with an existing building in an opportunity zone as well as a draft QOF self-certification form (Form 8996) and accompanying instructions.
- There will be at least one more round of proposed regulations; OIRA's new unified agenda now lists a second project on OZs that must be completed by the end of the year

Taxpayer Elects to Defer and Re-invest “Gain” (1)

What type of realized gain is eligible for deferral?

- Statute refers only to “gain,” prior versions of this provision as well as the relevant Committee Report refer to “capital gain” (as does the title of the section)
- Proposed regulations (Oct. 19) – only “capital gain” is eligible
- Section 1231 gain from the sale of real estate used in a trade or business and unrecaptured §1250 gain are eligible
- Section 1245 Gain (“recapture”) and depreciation recaptured under §1250) are not eligible

Taxpayer Elects to Defer and Re-invest “Gain” (2)

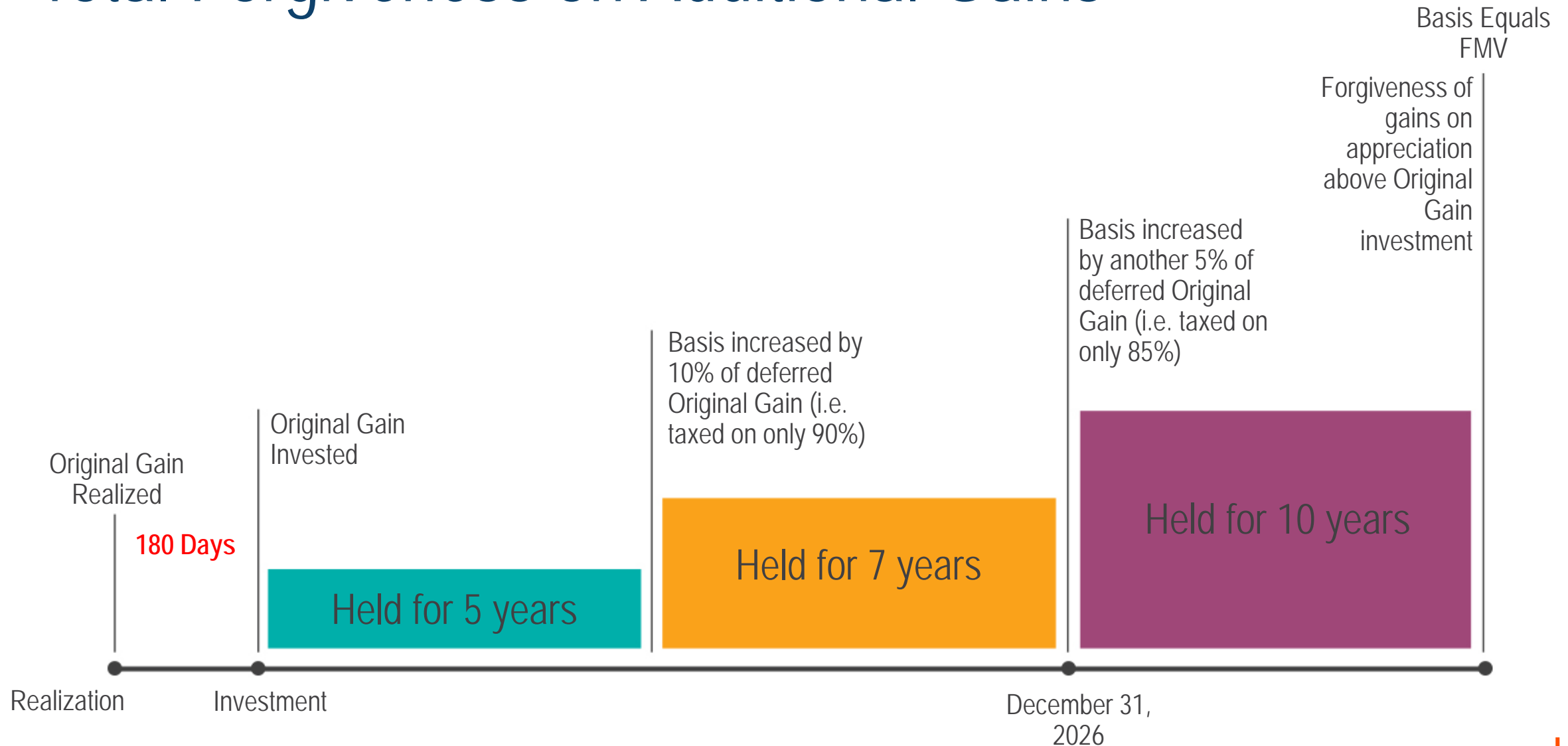
Who is the taxpayer that makes the election and defers the gain?

- any taxpayer that recognizes capital gain for Federal income tax purposes is a taxpayer eligible to elect deferral under the opportunity zone rules. Thus, individuals, C corporations (including a RIC or REIT), partnerships, S corporations, and trusts or estates are all eligible to defer gain through investment in a QOF
- Gain from pass-through entities – the partnership can elect to defer or a partner to whom the gain is allocated can make the election

How much time does the taxpayer have to re-invest the realized gain?

= 180 DAYS from date of realization

Partial Forgiveness of Original Gain & Total Forgiveness on Additional Gains



Timing Issues

- Under the proposed regulations the latest date on which an investor could make an investment of deferred gain to which the basis step-up election, applicable after a 10-year hold, would apply is *June 29, 2027*. If a taxpayer has capital gain that would otherwise be recognized on December 31, 2026 and elects to defer that gain (which it would have to do by June 29, 2027), that investment would qualify for the gain exclusion benefit as long as the taxpayer held the investment until at least June 29, 2037.
- The proposed regulations allow a taxpayer to make the basis step-up (to fmv) election for dispositions of qualifying investments (investments purchased with eligible gain subject to a deferral election) occurring after the 10-year hold and before January 1, 2048.

Taxpayer Must Invest Gain into a Qualified Opportunity Fund (QOF)

- There is nothing special about the fact that the investment vehicle is called a “fund”- does not need to be some multi-member public fund to qualify – could be a 2-person partnership!
- Investment vehicle classified as a partnership or corporation for the purpose of investing in qualified opportunity zone property (QOZP) (cannot invest in another QOF); a QOF can be an LLC taxed as a partnership or corporation;
- A pre-existing entity can certify as a QOF (but it must be able to meet the requirements within the testing periods)
- A QOF has to hold at least 90% of its assets in QOZP

How is a QOF certified?

- A QOF is able to self-certify; no required approval or action by the IRS;
- IRS released Draft Form 8996 (and instructions); expected that a QOF will attach this form to its Federal tax return for all relevant tax years and will use this form to self-certify and also to annually report compliance with the 90/10 test.
- The proposed regulations provide flexibility to funds by allowing an eligible entity to identify the first month in the initial taxable year in which the entity wants to be a QOF, which does not have to be the date the fund was created. So, a fund can be created and can begin certain processes (such as permitting, etc...) and then choose a later month on its self-certification, right before the first investment of deferred gain is made

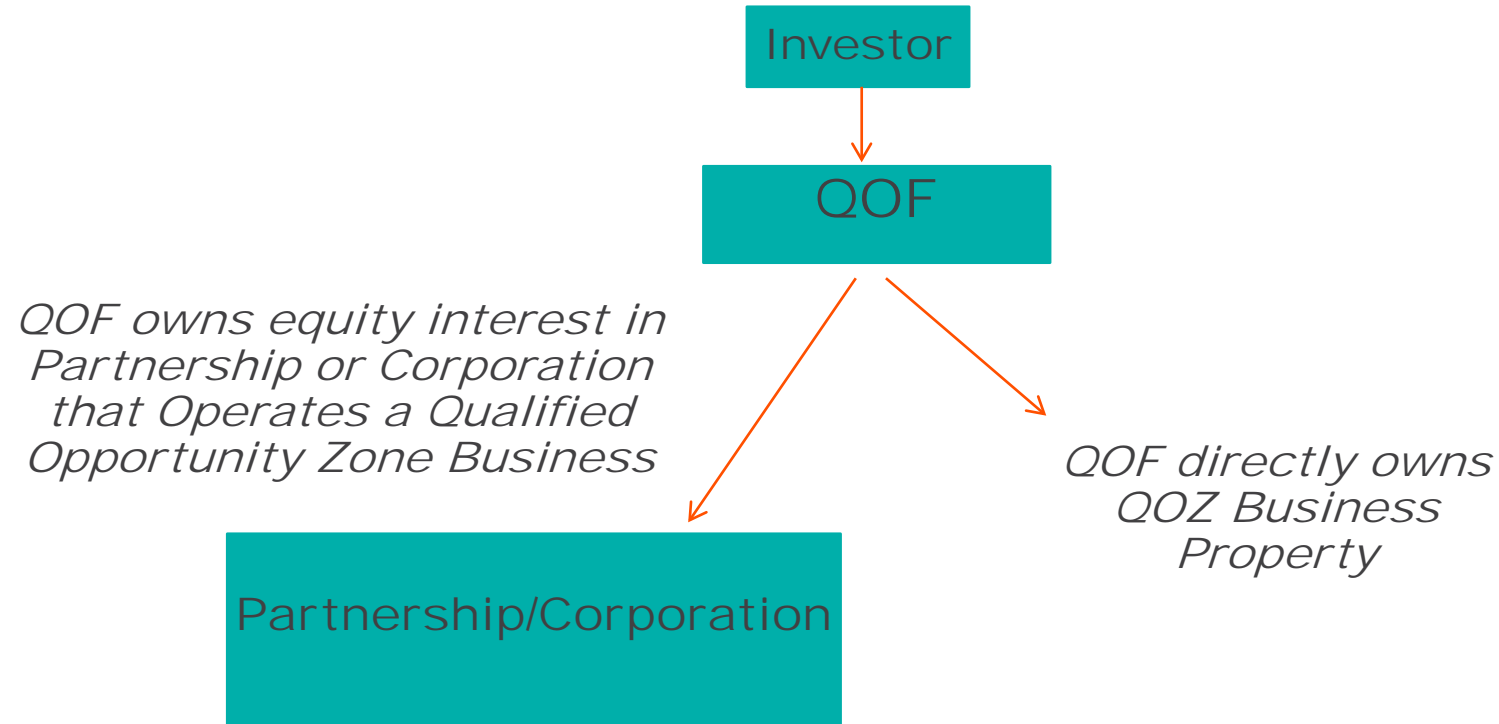
QOF – What Type of Property Must a QOF invest in?

90% of the Funds asset must be QUALIFIED OPPORTUNITY ZONE PROPERTY (QOZP)

QOZP includes (1) qualified opportunity zone stock (QOZ stock); (2) qualified opportunity zone partnership interests (QOZ partnership interests), and (3) qualified opportunity zone business property (QOZBP).

SO ... QOF may invest DIRECTLY IN QOZBP or INDIRECTLY through an equity interest in ANOTHER ENTITY

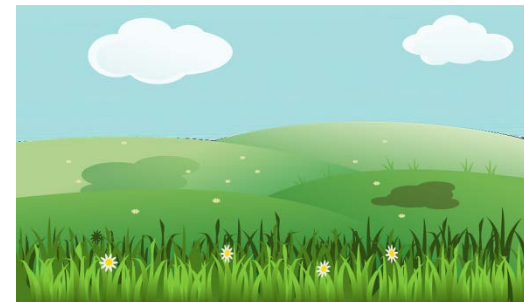
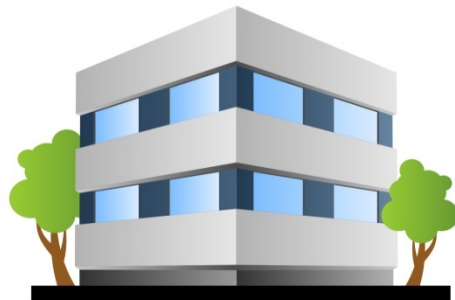
QOF's Direct or Indirect Ownership in OZ



New QOZ Business

Expansion of existing business into QOZ

Improvement of existing business already located in QOZ



Construction of new asset

Substantial improvement of existing asset

What is Qualified Opportunity Zone Business Property?

The definition of qualified opportunity zone business property (QOZBP) is **pivotal** regardless of whether a QOF invests in that property directly or does so through a qualified opportunity zone partnership interest (or qualified opportunity zone stock).

QOZBP is defined as **tangible property used in a trade or business** that meets the following **THREE** requirements:

1. **“Purchase” requirement:** acquired by purchase after December 31, 2017;
2. **“Use” requirement:** EITHER (a) the original use of the property in the zone commences with the QOF (or the QOZB) or (b) the QOF (or QOZB) substantially improves the property; AND
3. **“Substantially all of the use” requirement:** during substantially all of the holding period for the property, substantially all of the use of the property is in the zone.

What is a Qualified OZ Partnership Interest & Qualified Opportunity Zone Stock ?

QOZ Partnership Interest:

- Capital or profits interest in domestic partnership
- Acquired by QOF after Dec. 31, 2017 solely in exchange for cash
- As of date of acquisition, partnership was a QOZB (or, if a new partnership, it is being formed for purposes of being QOZB)
- During substantially all of the QOF's holding period for the interest, the partnership is a QOZB

QOZ Stock:

- Stock in domestic corporation
- Acquired by QOF after Dec. 31, 2017 at its original issue solely for cash
- As of date of issue, corporation was a QOZB (or, if a new corporation, it is being formed for purposes of being QOZB)
- During substantially all of the QOF's holding period for the stock, the stock is a QOZB
- Rule similar to 1202(c)(3) applies

Qualified Opportunity Zone Business ... (1)

A **QOZB** is a trade or business that meets all of the following requirements:

- (1) **substantially all** of the tangible property owned or leased by the partnership is QOZBP (proposed regs have defined “substantially all” in this context as 70%)
- (2) at least 50% of the partnership’s total gross income is derived from the **active conduct** of the business;
- (3) a **substantial portion** of the intangible property is used in the active conduct of the business;

Qualified Opportunity Zone Business ... (2)

Requirements, cont.

(4) less than 5% of the average of the aggregate unadjusted bases of property is attributable to nonqualified financial property *[NOTE HERE that “nonqualified financial property” includes debt, stock or partnership interests but does not include reasonable amounts of working capital]*; and

(5) the business does not include operation of a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, gambling establishment or a store if the principal business is the sale of alcohol for consumption off premises.

QOZB – Working Capital Safe Harbor

Proposed regulations:

- Working capital safe harbor that applies to QOF investments in QOZBs that acquire, construct or rehabilitate tangible business property (which includes both real property and other tangible property used in a business operating in an opportunity zone)
- As long as a QOZB has a written plan that identifies cash being held for a project and there is a written schedule for deployment of the cash that the business substantially complies with, the committed cash will be considered reasonable working capital for up to 31 months.
- To the extent that the working capital safe harbor applies to a QOZB, the tangible property referred to in the written plan, which is expected to be QOZBP once completed, is not treated as failing to satisfy the QOZBP requirements solely because the work on the property is not completed.

Application of the 90/10 Test

The 90% test is applied by determining the average of the percentage of QOZP held in the fund as measured on the last day of the first 6-month period of the taxable year of the fund, and the last day of the taxable year of the fund. If a QOF fails to meet the 90% requirement and does not establish reasonable cause, the QOF is required to pay a monthly penalty of the excess of the amount equal to 90% of its aggregate assets, over the aggregate amount of QOZP held by the QOF multiplied by the underpayment rate in the Code.

Application of the 90/10 Test, cont.

- *How are a QOF's assets measured for purposes of the 90/10 test?*

The proposed regulations (and the draft instructions to Form 8996) provide that if a QOF files a financial statement with the SEC or another federal agency other than the IRS or if the QOF has an audited financial statement prepared in accordance with U.S. GAAP, the QOF will use the asset values as reported on its financial statement as the relevant value for the 90% test. If the QOF does not have a financial statement that meets these requirements, value will be based on the QOF's cost.

Reinvestment on Sales of Assets/Exit Strategies

- *What happens with interim gains realized by QOF when QOF sells an asset before the 10-year mark ?? Can gain be avoided if funds from sale are reinvested in other QOZBP within a reasonable time (12 months) (borrowing from NMTC)? Treated as a continuous investment?*
- Statute is very specific – in the case of any “investment” held by the t/p for at least 10 years, if the t/p makes an election, the the basis of such property will equal the FMV of such investment **on the date the investment is sold or exchanged. So, need a sale or exchange of the interest in the QOF to exclude gain.**
- *If, after 10 years, a QOF taxed as a partnership sells its assets/terminates and distributes proceeds to investors, this is technically not a “sale or exchange” of the investors’ interests so does the OZ gain exclusion rule apply?*

Thank you

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