



LAI Minnesota Luncheon

September 18, 1018

Deloitte Tax LLP

Presenters:

Gary Hecimovich

Boake Munsch

Time: 11:30 – 1:00pm ET

Date: September 18, 2018

Agenda

Topic

Opportunity Zones: Overview and Benefits

Definitions and How to Qualify for Section 1400Z-2 Treatment

Considerations, Legislative History, and Anticipated Guidance

Resources, Contacts, and Questions

Opportunity Zones: Overview and Benefits

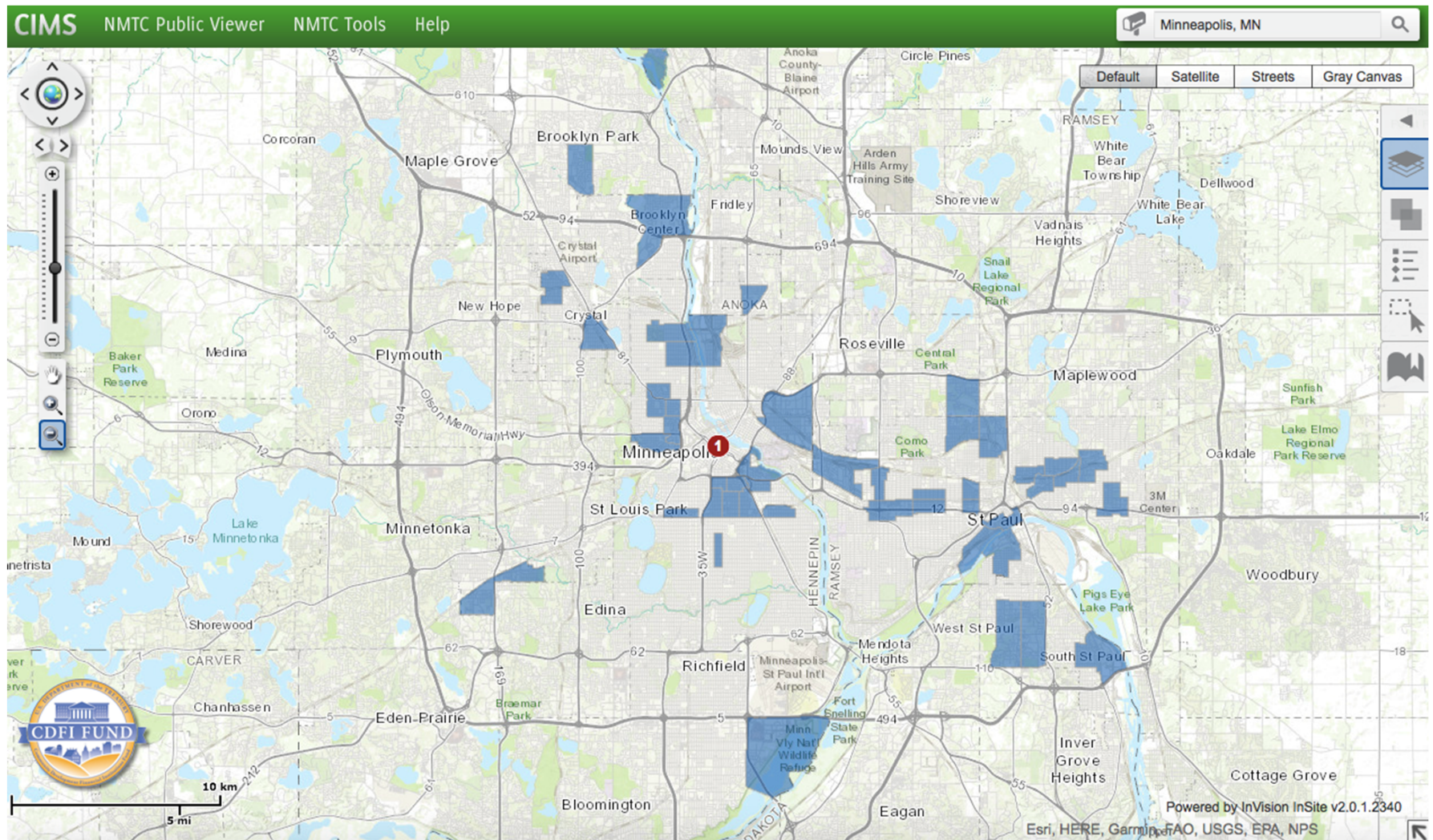
Opportunity Zones Overview

The 2017 Tax Act (P.L. 115-97) added new **sections 1400Z-1** and **1400Z-2**, providing for special treatment of capital gains invested in certain low-income communities.

- **Section 1400Z-1** provides for the designation of certain low-income communities as qualified opportunity zones (QOZs).
 - **QOZ** means a population census tract that is low-income community and has been designated by the Governor (or other Chief Executive Officer) as a QOZ.
 - The designation remains in effect for 10 years beginning on the date of the designation.
 - The number of census tracts that have been designated cannot exceed 25% of the total low-income communities in a state. Low population states were allowed to nominate a disproportionate number of qualifying census tracts (at least 25). US possessions also qualify (almost the entire island of Puerto Rico is designated as a QOZ).
 - **QOZ Designation/Map:**
https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml
 - **Low-income community** has the same meaning as when used under section 45D(e), the New Markets Tax Credit program, which includes any population census tract if the poverty rate is at least 20%; or if the median family income is less than 80% of the statewide/metropolitan area median family income.
- **Section 1400Z-2** allows taxpayers to defer short- or long-term capital gains on sales to, or exchanges with, an unrelated person of property if the capital gain portion is reinvested in a QOZ.

Opportunity Zones

Map of Minneapolis, MN



Opportunity Zones Overview (cont.)

- A **qualified opportunity fund (QOF)** is any investment vehicle which is organized as a corporation or partnership for the purpose of investing in QOZ property and holds at least 90% of its assets in QOZ property.
- **QOF property** includes QOZ stock, QOZ partnership interests, or QOZ business property.
 - QOZ business property can be new or substantially improved tangible property acquired from an unrelated party after 12/31/17 (including commercial buildings), equipment, and residential rental or nonresidential rental property located in a QOZ.
 - QOZ stock and QOZ partnership interests may be acquired by a QOF after 12/31/17 with respect to a startup or an existing trade or business, however, such trade or business must also satisfy the definition of a **QOZ business**.

Opportunity Zones: Three Potential Benefits

1

Deferral of gain from a sale or exchange of prior investments

Taxpayers may elect to temporarily defer from inclusion in gross income certain gains from the sale or exchange of an asset to the extent of the aggregate amount invested in a QOF during the 180-day period beginning on the date of the sale or exchange. The deferral lasts until the earlier of the sale or exchange of the QOF investment or December 31, 2026.

2

Reduction of deferred gain from the sale or exchange of prior investments

After holding investments in QOFs for a specified period of time, taxpayers may receive a permanent reduction of the deferred gain originally realized equal to 10% (if QOF is held at least 5 years) or 15% (if QOF is held at least 7 years) through a partial basis step-up (see examples below).

3

Exclusion of gain from the sale or exchange of investments in QOFs

After holding investments in QOFs for a period of at least 10 years, taxpayers may elect to receive a permanent exclusion of the appreciation of the QOF investment through a full basis step-up to the fair market value (FMV) of the QOF investment on the date such investment is sold or exchanged.

Opportunity Zone Benefit Examples

	Investor re-invests \$10,000 of <u>gain proceeds</u> into a QOF in 2018 within 180 days of disposition. The investor keeps capital gains proceeds invested in the QOF for:		
	5 years (sell in 2023)	7 years (sell in 2025)	10 years (sell in 2028)
QOF sales price	\$15,000	\$17,000	\$20,000
QOF basis increase as % of the deferred gain	10%	15%	15%
QOF basis increase	\$1,000	\$1,500	\$1,500
	Gain recognition summary:		
Deferred gain (\$10,000 less partial basis step-up) and date of recognition	\$9,000 (net of \$1,000 partial basis step-up) 12/31/2023	\$8,500 (net of \$1,500 partial basis step-up) 12/31/2025	\$8,500 (net of \$1,500 partial basis step-up) 12/31/2026
Gain on appreciation of QOF investment	\$5,000	\$7,000	\$0*
Total gain recognized:	\$14,000	\$15,500	\$8,500

* When a QOF investment is sold/exchanged after 10 years of being invested in the QOF, the taxpayer may elect to step up the basis of the QOF investment to the FMV of such investment on the date that the investment is sold or exchanged. Thus, any appreciation on the QOF investment will NOT be included in taxable income.

Definitions and How to Qualify for Section 1400Z-2 Treatment

Opportunity Zone: Additional Definitions

- A **qualified opportunity fund (QOF)** is any investment vehicle which is organized as a corporation or partnership for the purpose of investing in QOZ property and holds at least 90% of its assets in QOZ property.
 - Although guidelines are not yet released, it is expected that the corporation or partnership may self-certify as a QOF by merely filing an IRS form with its income tax return.
- **QOZ property** includes QOZ stock, QOZ partnership interests, or QOZ business property.
 - QOZ business property can be new or substantially improved tangible property acquired from an unrelated party after 12/31/17 (including commercial buildings), equipment, and residential rental or nonresidential rental property located in a QOZ.
 - QOZ stock and QOZ partnership interests may be acquired by a QOF after 12/31/17 with respect to a startup or an existing trade or business, however, such trade or business must also satisfy the definition of a **QOZ business**.

QOZ Property: QOZ Stock

- **Any stock** in a domestic corporation, if:
 - Such stock is **acquired** by QOF **after December 31, 2017**, at its **original issue** (directly or through an underwriter) from the corporation **solely in exchange for cash**;
 - As of the time such stock was issued, such **corporation was a QOZ business** or, in the case of a new corporation, such corporation was being organized for the purposes of being a QOZ business; and
 - During **substantially all** of the QOF's holding period for such stock, such **corporation qualified as a QOZ business**.

QOZ Property: QOZ Partnership Interest

- **Any capital or profits interest** in a domestic partnership, if:
 - Such interest is **acquired** by QOF **after December 31, 2017** from the partnership **solely in exchange for cash**,
 - As of the time such interest was acquired, such **partnership was a QOZ business** or, in the case of a new partnership, such partnership was being organized for the purposes of being a QOZ business, and
 - During **substantially all** of the QOF's holding period for such interest, such **partnership qualified as a QOZ business**.
- **QOZ business determination**: When a QOF acquires a partnership interest (any capital or profits interest in a partnership) rather than directly engaging in a trade or business, the 90% asset holding test essentially shifts from measuring the assets held by the QOF to the assets held by the partnership to determine whether the partnership interest will be respected as QOZ property.
 - The partnership must be determined to satisfy the definition of a QOZ business at the time the partnership interest is acquired (or at the time organized for the purpose of being a QOZ business), and for substantially all the QOF holding period of such interest.

QOZ Property: QOZ Business

A trade or business in which **substantially all of the tangible property owned or leased** by the taxpayer (partnership or corporation) is QOZ business property, meaning each of the following requirements are satisfied:

- **At least 50% of the total gross income** of such entity is **derived from the active conduct** of any such business in the QOZ,
- A **substantial portion of the intangible property** of such entity is **used in the active conduct** of any such business in the QOZ,
- **Less than 5%** of the average of the aggregate unadjusted bases of the property held by such entity is attributable to **nonqualified financial property**, and
- The trade or business is **NOT engaged in certain “sin” businesses**, including:
 - Golf courses,
 - Country clubs,
 - Massage parlors,
 - Hot tub facilities,
 - Suntan facilities,
 - A Racetracks or other facilities used for gambling, or
 - Any store that primarily sells alcohol for consumption off premises.

QOZ Property: Tangible Property

Tangible property

used in a trade or business of the QOF, if:

- Such property was **acquired by purchase** (as defined in section 179(d)(2)) **after 12/31/2017**;
- The **original use** of such property in the QOZ commences with the QOF or the QOF **substantially improves** the property; and
- During substantially all of the QOF's holding period for such property, **substantially all of the use** of such property was in a qualified opportunity zone.

Acquired from Unrelated Person. To be considered tangible property acquired by the QOF by purchase after 12/31/2017, such property must be acquired from a seller that is unrelated to the QOF at the time of acquisition. The seller will be treated as unrelated provided the seller owns directly or indirectly a 20% or less capital or profits interest (or value/control 20% or less interest) in the QOF. See sections 707(b)(1) and 267(b).

Original Use. First use to which the property is put in the QOZ. See special rule under section 1394 regarding property that has been vacant for the preceding 12 months.

Substantially Improved. Property shall be treated as substantially improved by the QOF only if, during any 30 month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the QOF exceed the amount equal to the adjusted basis of such property at the beginning of such 30 month period.

Substantially All Use in QOZ During Holding Period. Substantially all is not defined. This term is defined as being at least 85% in the NMTC regulations and could be interpreted to mean 90% or more in order to be consistent with the 90% asset test.

How to Qualify for Section 1400Z-2 Treatment

- **Step 1 – Identify or form a QOF**

- An investment vehicle taxed as a C corporation, partnership, or S corporation.
- Organized for the purpose of investing in QOF property.
- The corporation or partnership may self-certify as a QOF by merely filing an IRS form with its income tax return.

- **Step 2 – Invest amounts “matched” to gains from recent sales or exchanges of property and elect under section 1400Z-2(a)(1) to:**

- Temporarily defer gain from the sale or exchange of an asset from inclusion in gross income to the extent of the aggregate amount invested in a QOF during the 180-day period beginning on the date of the sale or exchange.
- Capital gains realized from one or more sales or exchanges of property within 180 days from the date of investment in the QOF qualifies for tax-favored treatment:
 - Gain deferral / up to 15% exclusion (election must be made by the taxpayer making the QOF investment), and
 - Basis step-up upon sale or exchange of QOF investment (election must be made by the taxpayer selling or exchanging QOF investment).
- NOTE: Additional non-tax-favored contributions may be made to QOF but those investments are treated as a separate investment and not eligible for basis step-up election upon sale or exchange of QOF investment.

How to Qualify for Section 1400Z-2 Treatment (cont.)

- **Step 3 – QOF uses proceeds to acquire QOZ property**
 - QOZ stock, QOZ partnership interests, QOZ business property
- **Step 4 – QOF must pass semi-annual 90% asset test performed on measuring dates**
 - QOF must hold at least 90% of its assets in QOZ property as determined by the average of the percentage of QOZ property 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.
- **Step 5 – QOZ partnership interests and/or QOZ stock held by a QOF must also satisfy definition of QOZ business on measuring dates**
 - To satisfy this requirement, a semi-annual determination must be made (on applicable testing dates) based on the tax balance sheet of the partnership and/or corporation to determine whether the entity satisfies the definition of a QOZ business.

Considerations, Legislative History, and Anticipated Guidance

Opportunity Zone Considerations

- **Important Dates:**

- **December 31, 2017** – must acquire QOZ stock, QOZ partnership interest, or QOZ business property after this date
 - This is probably the biggest restriction when determining whether property “counts” as QOZ property
- **December 31, 2019** – latest date to invest for 7-year, 15% gain exclusion
- **December 31, 2021** – latest date to invest for 5-year, 10% gain exclusion
- **December 31, 2026** – required recognition of capital gains on original investment

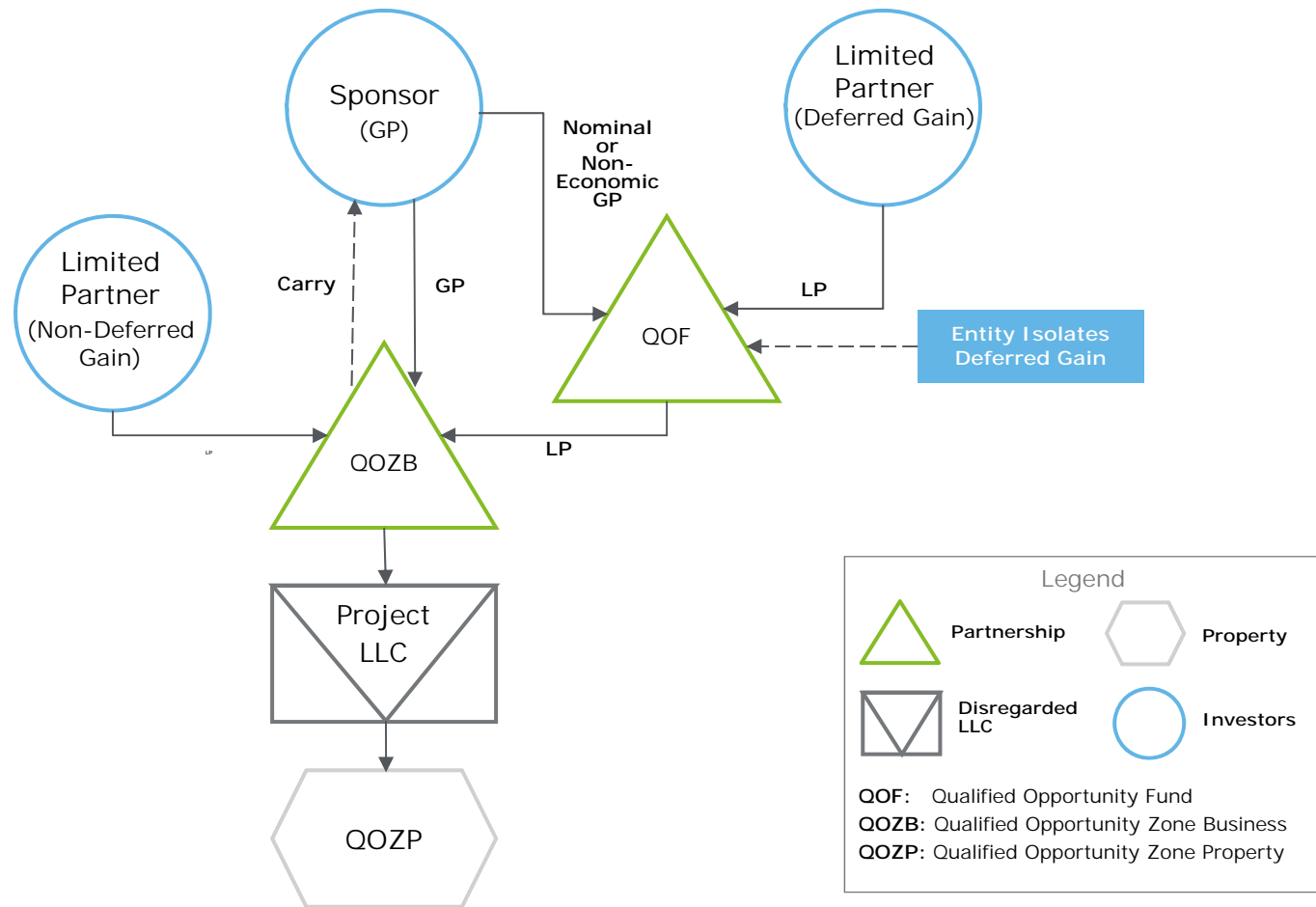
- **Penalties:**

- If a QOF fails to meet the requirement to hold 90% QOZ property, the QOF must pay a penalty for each month it fails this requirement, unless the taxpayer can show reasonable cause.

- **Additional considerations:**

- Related party rules will need to be analyzed with investments in qualifying businesses.
- Only cash may be used to purchase QOZ stock or QOZ partnership interests.
- If the original use of property in the QOZ does not commence with the QOF, the requirement to double basis/improvements in first 2.5 years can be a significant burden.
- Consider the potential for loss on QOF investments and overall investment strategy and returns. The statute requires no particular outcome by the QOF.
- It is anticipated the opportunity zone benefits will be able to pair with the Low-Income Housing Credit, New Markets Tax Credit, Investment Tax Credit, Production Tax Credit, and other incentive opportunities for both federal and state.

QOZ Fund Potential Structure



Opportunity Zone Considerations (cont.)

Deloitte services

Fund services

- Guidance on eligible investments
- Opportunity fund certification
- Opportunity Fund investment tracking, reporting and compliance;
- Tax exit planning

Investor services

- Tax basis calculations and planning including gain deferral, basis step-up and mandatory recognition date planning
- Related-party restriction guidance
- Fund due diligence

Opportunity zone business

- Calculation of benefits for businesses in opportunity zones
- Tax consulting on investment structures and exit planning
- Guidance on eligible investments
- Identification of state credits and incentives.

Legislative History and Anticipated Guidance

- [IRS Opportunity Zone FAQs](#) (last updated June 7, 2018)
 - Not included in Internal Revenue Bulletin (IRB); cannot be relied upon as legal authority.
- [Notice 2018-48](#) (July 9, 2018, published in IRB)
 - Lists the population census tracts designated as QOZs.
- Regulatory authority is provided in section 1400Z-2(e)(4) to carry out the purposes of this section, including rules:
 - For the certification of qualified opportunity funds (QOFs) for the purposes of this section,
 - To ensure a QOF has a reasonable period of time to reinvest the return of capital from investments in QOZ stock and QOZ partnership interests, and to reinvest proceeds received from the sale or disposition of QOZ property, and
 - To prevent abuse.
- Temporary and proposed regulations expected to first address how to make the exclusion election under section 1400Z-2(a)(2).

Legislative History and Anticipated Guidance (cont.)

- Amongst items requiring clarification:
 - Certain aspects regarding the application of the 180-day rule (*i.e.*, election may be made on amended 2017 tax return),
 - The extent of the exclusion regarding its application against all gains or only those gains characterized as capital gain for federal income tax purposes, and
 - Whether the same taxpayer that triggers the gain is required to make the election to defer gain or whether this can be determined at the individual investor level on a taxpayer by taxpayer basis.

Resources, Contacts, and Questions

Resources

Resource

[Tax Reform Resource Page](#)

[Qualified Opportunity Zone Incentives Placemat](#)

Access webcast materials & replays @ Tax Xchange > Calls & Webcasts > National Competency Calls

Contacts

Name	Phone
Gary Hecimovich	+1 202 879 4936
Boake Munsch	+1 612 749 7086



As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

This document is for internal distribution and use only among personnel of Deloitte Tax LLP. Deloitte Tax LLP shall not be responsible for any loss whatsoever sustained by any person who relies on this document.

Copyright © 2018 Deloitte Development LLC. All rights reserved.