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QUALIFIED OPPORTUNITY ZONE INCENTIVES

Taxpayers may **defer and partially reduce capital gains tax due*** on the disposition of property where gains are reinvested in an Opportunity Zone through a Qualified Opportunity Fund.

- **Qualified Opportunity Zone ("QOZ")**: A population census tract that is low-income and has been designated by the Governor (or other Chief Executive Officer) as a qualified opportunity zone.
- **Qualified Opportunity Fund ("QOF"):** A self-certified entity taxed as a partnership or corporation that holds at least 90% of its assets in Qualified Opportunity Zone Property ("QOZ Property").

**Introduced by The Tax Cuts and Jobs Act. See I.R.C. Section 1400Z-1 and corresponding Section 1400Z-2. Although the legislative history and title to Section 1400Z-2 refers to capital gain, the operative provisions of the law do not limit the type of gain to which the provisions apply.*

Three Types of Potential Benefits for Program Participants

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.

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 percent (if QOF is held at least five years) or 15 percent (if QOF is held at least seven years) through a partial basis step-up (see examples below).

Exclusion of Gain from the Sale or Exchange of Investments in QOFs: After holding investments in QOFs for a period of at least ten 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 of the QOF investment on the date such investment is sold or exchanged.

Examples

Investor keeps capital gains proceeds invested in the Qualified Opportunity Fund for 5 Years

- Investor re-invests $10,000 of gain proceeds into a QOF in 2018 within 180 days of disposition.
- QOF investment is held for 5 years, and sold in 2023 for $15,000.
- Basis in the QOF will be increased by an amount equal to **10%** of the deferred gain, or $1,000.
- Upon disposition in 2023, Investor recognizes both:
    - $9,000 of deferred gain net of $1,000 partial basis step-up, and
    - 5,000 of gain determined with respect to the appreciation of the QOF investment.
    - $14,000 Total Gain

Investor keeps capital gains proceeds invested in the Qualified Opportunity Fund for 7 Years

- Same as above except QOF investment is held for 7 years, and sold in 2025 for $17,000.
- Basis in the QOF will be increased by an amount equal to **15%** of the deferred gain, or $1,500.
- Upon disposition in 2025, Investor recognizes both:
    - $8,500 of deferred gain net of $1,500 partial basis step-up, and
    - 7,000 of gain determined with respect to the appreciation of the QOF investment.
    - $15,500 Total Gain

Investor keeps capital gains proceeds invested in the Qualified Opportunity Fund for 10 Years

- Same as above except QOF investment is held for 10 years, and sold in 2028 for $20,000.
- Basis of the QOF will be increased by an amount equal to **15%** of the deferred gain, or $1,500.
- Investor recognizes:
    - $8,500 of deferred gain net of $1,500 partial basis step-up on December 31, 2026, and
    - -0- gain excluded from taxation with respect to appreciation of the QOF investment.
    - $8,500 Total Gain

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What Can Qualified Opportunity Funds Own?

QOZ Property: Includes QOZ stock, QOZ partnership interests, or QOZ business property. Investments must be made in QOZs , and can comprise new or substantially improved tangible property (including commercial buildings), equipment, and multi-family complexes.

- QOZ stock must be held in a domestic corporation, acquired at original issue after December 31, 2017 solely in exchange for cash, issued by a QOZ business. During substantially all of the fund's holding period, the corporation must be a QOZ business. The rules are similar for QOZ partnership interests except the partnership does not need to be newly formed (i.e., no original issue requirement).
- QOZ business property must be purchased after December 31, 2017, and is subject to modified related party rules of IRC section 179(d)(2). The property must be new or substantially improved by the fund, and substantially all of the use of the property must remain in a QOZ during substantially all of the QOZ's holding period.

QOZ Business: Trade or business in which substantially all of the tangible property owned or leased is QOZ business property. In addition, a qualifying business is required to:

1. Derive 50% or more of total gross income from the active conduct of the trade or business in the QOZ;
2. Utilize a substantial portion of the intangible property in the active conduct of the trade or business in the QOZ;
3. Less than 5% of the average of the aggregate unadjusted bases of the property held by the business can be attributed to nonqualified financial property; and
4. Cannot be engaged in certain "sin" business including a golf course, country club, massage parlor, hot tub facility, suntan facility, a facility used for gambling, or any store that the principal business of which is the sale of alcoholic beverages for consumption off premises.

QOZ Designation Process

- Designation: A census tract that is a low-income community is designated as a QOZ if the chief executive officer of the State nominates the tract and notifies the Secretary of the Treasury in writing of the nomination, and the Secretary certifies the nomination.
- Timing: States had to submit a list of nominated low-income census tracts by either March 21, 2018 or April 20, 2018 (assuming automatic 30 day extension).
- Number of Designations: The number of census tracts that may be designated generally cannot exceed 25 percent of the total low-income communities in the State. Certain census tracts that are contiguous to a low-income community may also be designated as QOZs. Treasury formally published the list of all population census tracts (over 8,700) designated a QOZ on July 9, 2018 (Notice 2018-48).
- Map of Designated Zones: A searchable map can be accessed at https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx).

Considerations for Qualified Opportunity Funds

Certification Process: QOFs must be certified. However, the Internal Revenue Service ("IRS") recently issued Frequently Asked Question ("FAQ") News Release (last updated June 7, 2018), indicating that an eligible taxpayer may self-certify as a QOF by completing a form (to be released in summer 2018) and attaching the form to the taxpayer's federal income tax return for the taxable year.

Compliance and Penalties: If a qualified opportunity fund fails to meet the requirement to hold 90% QOZ Property, the QOF must pay a penalty for each month it fails to meet the requirement. The penalty is determined by multiplying the applicable month's underpayment rate (as set forth in Section 6621 (a)(2)) by the excess of 90 percent of the Opportunity Fund's aggregate total assets over the aggregate amount of QOZ property held. The rules do allow for a exception to this penalty for reasonable cause.

Related Party Restrictions

The Opportunity Zone rules contain related party restrictions. QOFs cannot purchase QOZ property from a related party for purposes of satisfying the after December 31, 2017 purchase date requirement. In addition, gains from the sale or exchange of property with a related party are also not eligible for deferral or a step-up in basis even if proceeds from the disposition are re-invested into a QOF in a timely manner. The related party rules for these purposes look to persons treated as related under Section 267(b) or Section 707(b)(1), but apply a more restrictive 20% test rather than 50%.

Deloitte Services

- **Fund Services**: (1) Guidance on Eligible Investments and Structuring; (2) Opportunity Fund Certification; (3) Opportunity Fund Investment Tracking, Reporting and Compliance; (4) Exit Tax Planning.
- **Investor Services**: (1) Tax Basis Calculations and Planning including Gain Deferral, Basis Step-Up and Mandatory Recognition Date Planning; (2) Related-Party Restriction Guidance; (3) Fund Due Diligence.
- **Opportunity Zone Services**: (1) Calculation of Exclusions or Deferral of Gains for Businesses with qualifying dispositions and reinvestments in Opportunity Zones; (2) Tax Consulting on Investment Structures and Exit Tax Planning; (3) Guidance on Eligible Investments; (4) Tax Opinions; and (5) Identification of state credits & incentives.