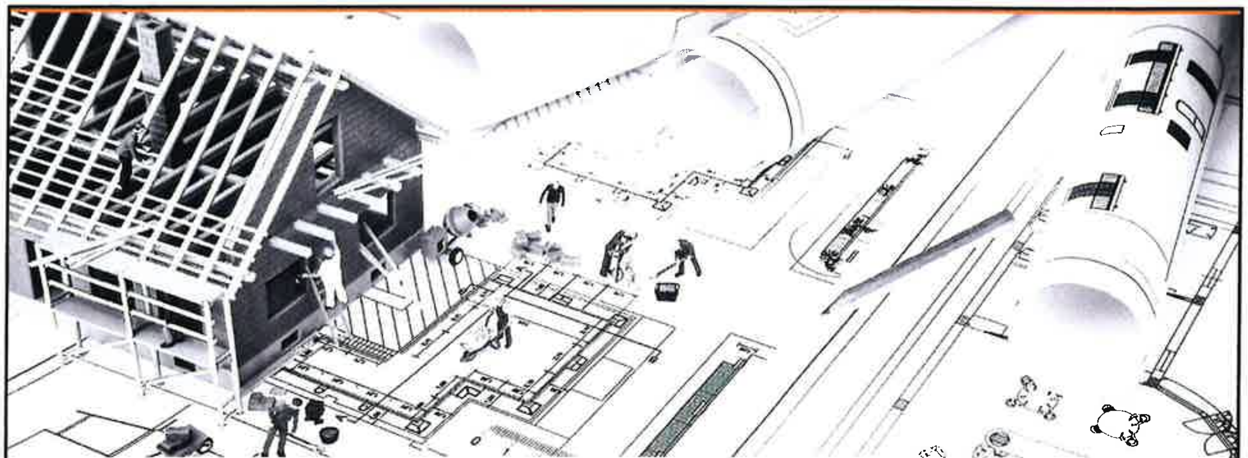


Buchanan Ingersoll & Rooney PC

Taking Advantage of Opportunity Zones

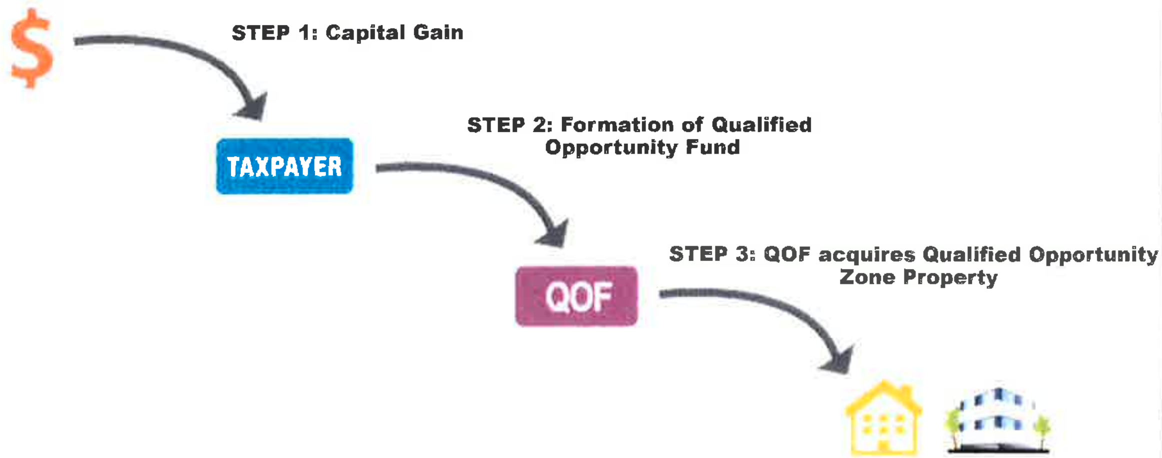
The Federal opportunity zone program is a very generous tax incentive aimed at driving private capital into distressed communities

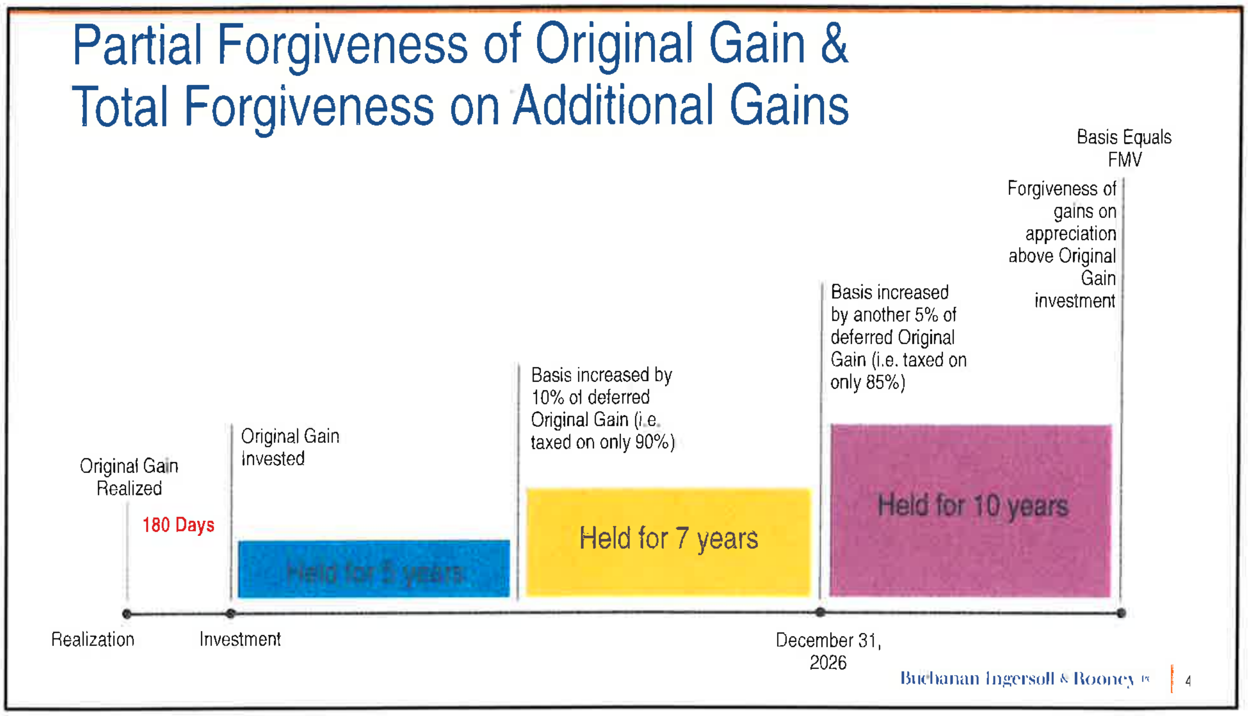
It is one of the only aspects of tax reform that had bipartisan support – it was originally introduced by Senators Corey Booker and Tim Scott

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. There are interactive maps of all 50 states online.

Formation of a Qualified Opportunity Fund (QOF)





Example:

- On April 1, 2019, Taxpayer sells stock and realizes a $1,000,000 capital gain.
- On May 1, 2019, Taxpayer invests that $1,000,000 of capital gain into a Qualified Opportunity Fund (QOF)(within the 180 day window)
- Taxpayer's initial basis in his QOF interest is zero
- On May 1, 2024, Taxpayer has held the QOF investment for 5 years and gets a $100,000 (10%) increase in basis – basis in QOF interest is now $100,000 (ignoring any other transactions that might have affected basis)
- On May 1, 2026, Taxpayer has held the QOF investment for 7 years and gets an additional $50,000 (15%) increase in basis – basis in QOF interest is now $150,000 (again, ignoring any other transactions that might have affected basis)
- On December 31, 2026, Taxpayer is treated as recognizing the deferred gain that was invested into the QOF; so, in this example, Taxpayer would put $850,000 of capital gain on Taxpayer's return for the 2026 tax year and pay tax on that amount of gain; this is true regardless of whether Taxpayer sells or retains the interest in the QOF
- Assume taxpayer continues to hold the QOF interest; if Taxpayers sells or exchanges the interest in the QOF any time after May 1, 2029 (the 10-year mark) and before January 1, 2048 (under the proposed regulations), Taxpayer is able to step up the basis in the interest to fair market value which eliminates post-acquisition gain

Taxpayer Elects to Defer and Re-invest "Gain"

What type of realized gain is eligible for deferral?

- Capital Gain

Who is the taxpayer that makes the election and moves 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 make the election 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 with special rules for pass-through gain

A QOF – What is it?

- 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)
- No "special" characteristics
- Cannot be a disregarded entity
- Is able to self-certify

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

To avoid penalties, on each "testing date," 90% of the Fund's assets 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).

- Even though a QOF is allowed to hold QOZBP directly, because of the guidance in the proposed regulations, all QOFs at this point are investing in OZ projects and OZ property through qualified opportunity zone stock or a qualified opportunity zone partnership interest (that is, through ownership of an interest in a subsidiary (which is referred to as a "qualified opportunity zone business" (QOZB) in the statute))
- A QOF's "testing dates" are generally June 30 and December; however, in a QOF's first taxable year, the initial testing date is based on the month that the QOF first certifies as such; as an example, if the first month of certification for a QOF is April, the Fund's first testing date is September 30 and the second testing date for that year is December 31

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 (double the basis in 30 months); 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.

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 regulations 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 a trade or business in the zone;

(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 cash, 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 (referred to as "sin businesses").

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 from date of contribution.
- 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.

Still have unanswered questions….

- Second set of regulations expected within 30 days (sent to OMB last week)
- Issues re: cash at both QOF and QOZB level
- Issues re: substantial improvement test (vacant land, etc.)
- Issues re: pre-existing ownership in a zone
- Issues re: leases
- Partnership-specific basis issues, debt-financed distribution issue & depreciation recapture
- Issues re: interim sales of assets/re-investment of capital proceeds
- Issues re: exit from a pass-through QOF
- ETC….

- Investors/fund managers/developers are moving on this now; funds are being created and capital is being invested; there are some who are waiting on the sidelines for additional regulatory certainty (especially those interested in investing in operating businesses where there is less clarity in the rules) but we should have that very soon;
- Important to note that unlike the low-income housing tax credit and New Markets, this is NOT a top-down program; that is, the government does not have a defined role and is not involved statutorily with what projects the benefits will be allocated to; this program is driven by taxpayers who are making decisions regarding where they want to invest their private capital;
- Cities and municipalities need to be thinking about how to attract capital to the areas of greatest need and how to encourage the type of development that is most critical to those areas;
- Need to layer state and local incentives to encourage investment in riskier projects; there are clearly some OZs that are more attractive than others from an economic perspective and in order to encourage development in all of the zones, concessionary capital will be vital to the success of the program;
- I believe that we will see creative P3 models being utilized across the nation to build and re-vitalize our low-income communities;

- There is tremendous potential in this program to attract significant amounts of patient capital to distressed communities across this state and across our nation and it is certainly the hope that we will see impactful and lasting change in the economics of those communities as a result

Thank you

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