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Opportunity Zones Second Round of Proposed Regulations

June 12, 2019

Gary Gruner, CPA & Laura Berry, CPA



Agenda

- What are the tax benefits to an investor?
- How do Qualified Opportunity Funds (QOF) work?
- What is Qualified Opportunity Zone Business Property (QOZBP)?



History of Opportunity Zones?

Sean Parker was the primary architect behind Opportunity Zones. He is a philanthropist and entrepreneur with a record of launching genre-defining companies including Facebook, Napster and Plaxo. He is the Founder and Executive Chairman of the Economic Innovation Group.



What is a Qualified Opportunity Zone?

“Qualified Opportunity Zones are a new community development program established by Congress in the Tax Cuts and Jobs Act of 2017 to encourage long-term investments in low-income rural & urban communities nationwide.

The Opportunity Zones program provides a tax incentive for investors to re-invest their unrealized capital gains into Opportunity Funds that are dedicated to investing into Opportunity Zones designated by the chief executives of every U.S. state and territory.”

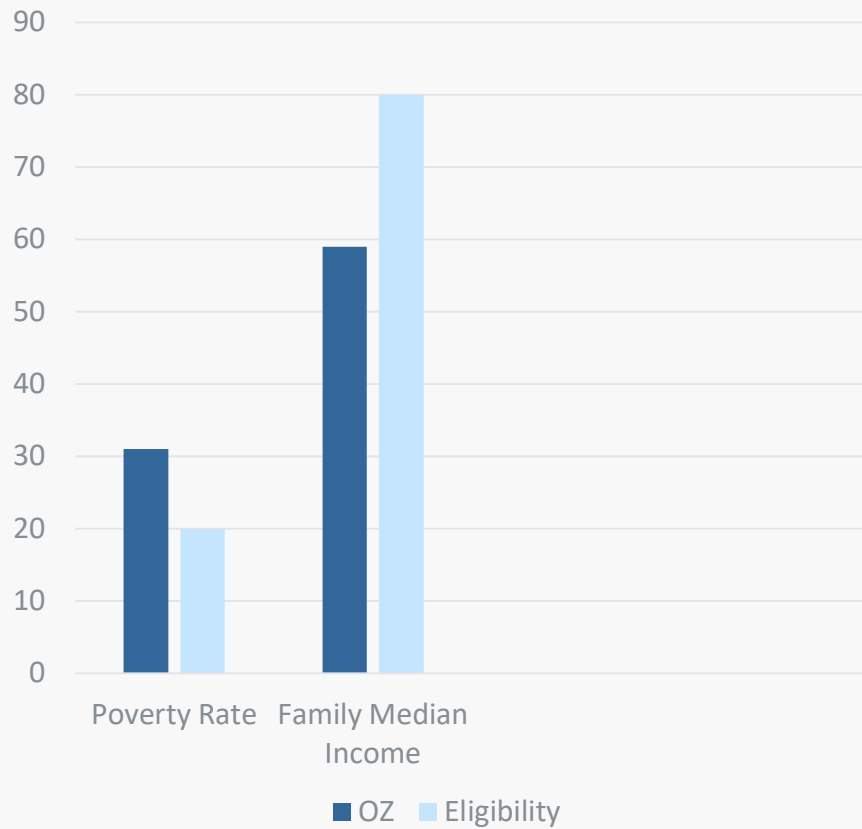
Economic Innovation Group, (EIG)

What is a Qualified Opportunity Zone?

- These new Federal Opportunity Zones are intended to facilitate investment in areas where poverty rates are greater than 20 percent.
- The governor of each state nominated communities as Qualified Opportunity Zones and submitted the nomination to the Secretary of the Treasury no later than April 20, 2018.
- Areas can be nominated as Qualified Opportunity Zones if the areas are low income communities as defined in Code Section 45D(e). The Secretary of the Treasury has 30 days to certify an area as a Qualified Opportunity Zone from the date it receives the nomination.



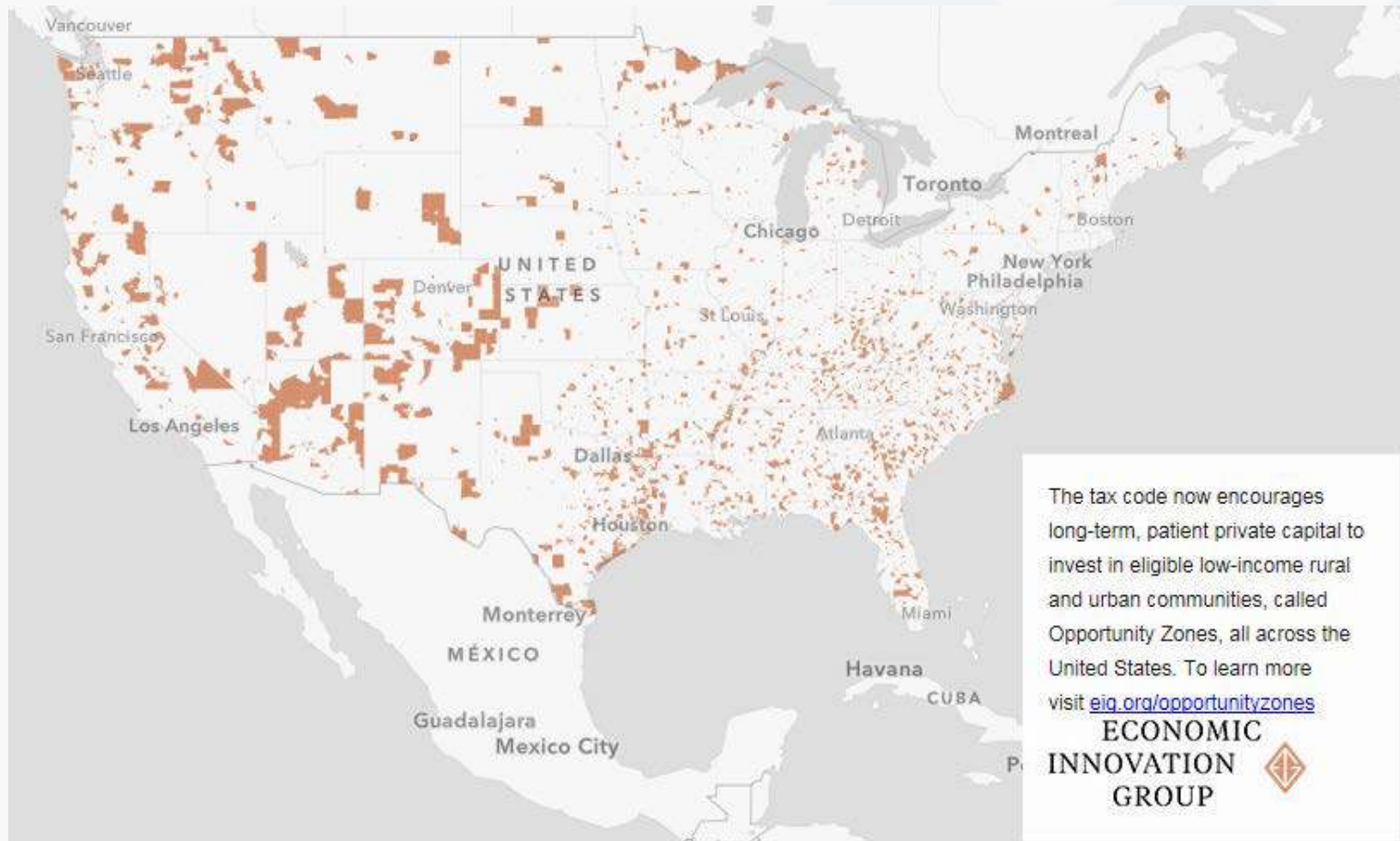
OZ Demographics



Per a study done by EIG (based in DC):

- Average poverty rate of all OZ is ~31% (exceeds 20% eligibility)
- On average family median income of OZ is ~59% of area's median (below 80% eligibility)
- 96% of the areas included in OZ have not experienced significant socioeconomic change in recent year
 - Lowers chances for significant gentrification and displacement of existing communities

Opportunity Zones in USA



- <https://eig.org/opportunityzones>
- https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml

GA Opportunity Zones

- “Georgia submitted 260 nominations from 83 counties, comprising 60 percent rural communities and 40 percent urban communities, ahead of the March 21 deadline and all were approved by the Department of the Treasury. The program will be administered by the Georgia Department of Community Affairs (DCA)”

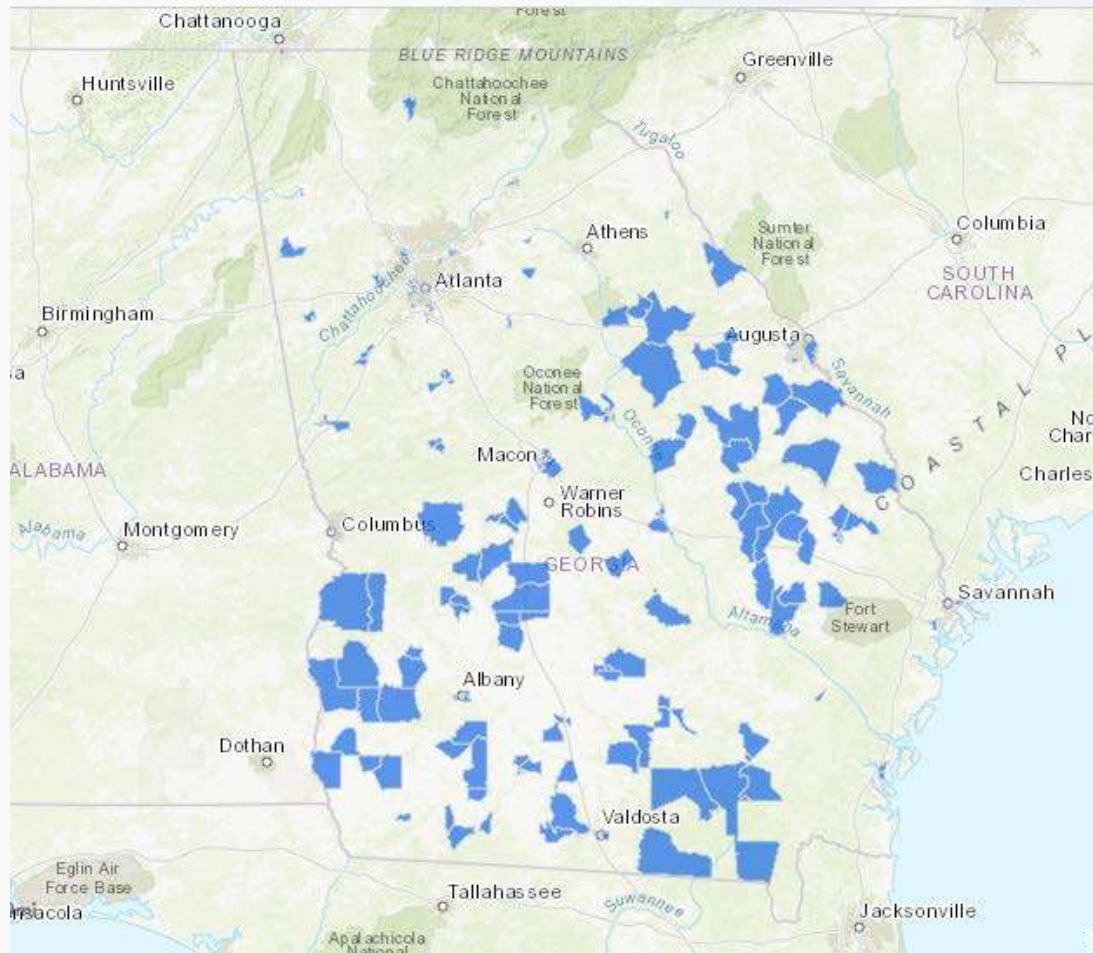
GA Opportunity Zones

- Gov. Deal states “...both rural and urban communities that experienced a slower economic recovery in the last few years, these tax incentives represent another step forward in their economic revitalization.”
- DCA Commissioner **Christopher Nunn**
“This designation will enable some of our state’s struggling communities to attract much-needed private sector investment, by giving an economic ‘shot in the arm’ to these communities, our goal is to boost investment where it’s most urgently needed.”

– georgia.gov – ‘Deal: Department of the Treasury designated Qualified Opportunity Zones in Georgia’

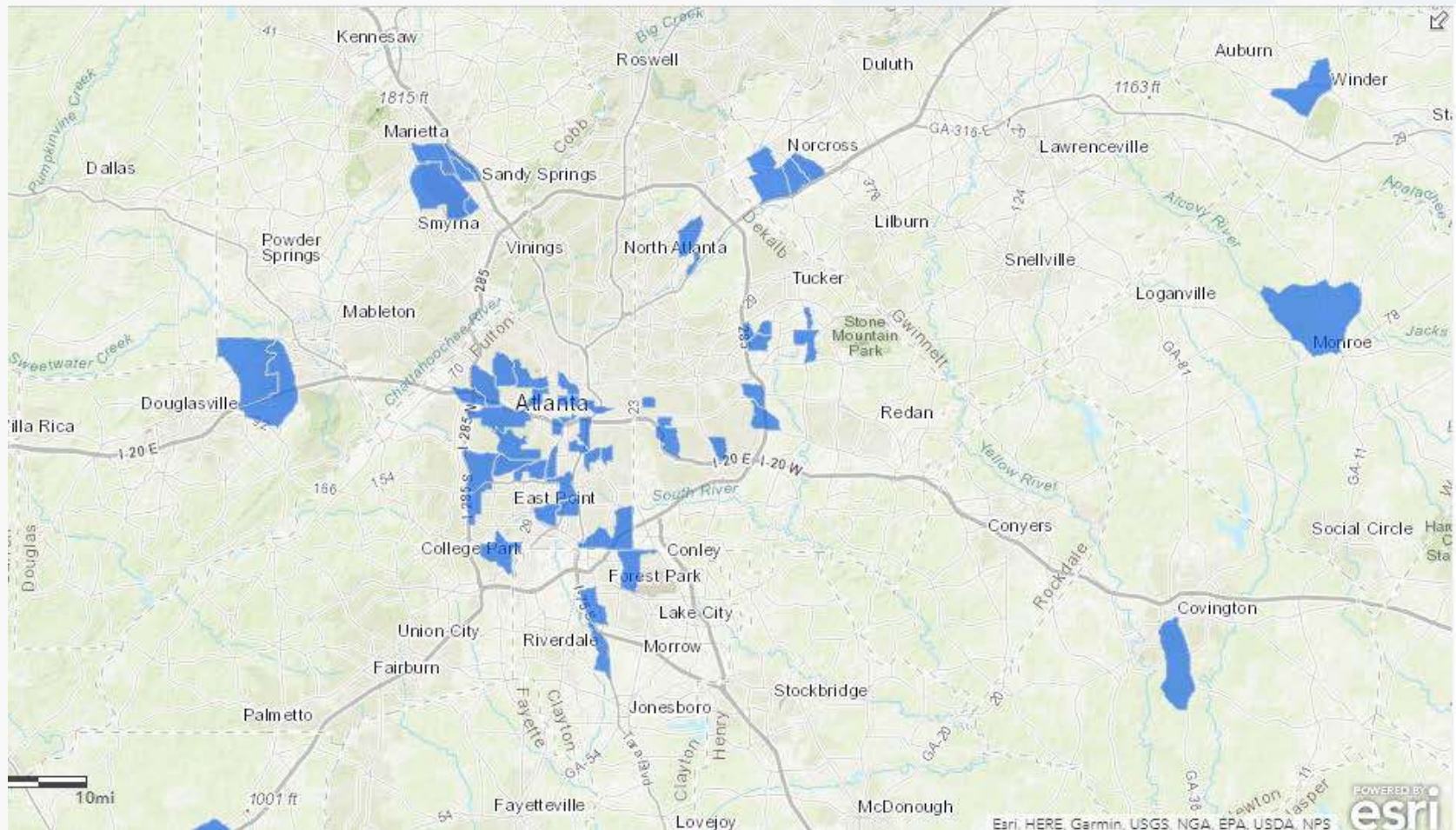


Opportunity Zones in GA



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Opportunity Zones in Atlanta



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Investor Benefits

What Am I Investing In?

“Don’t let the tax tail wag the dog!”



3 Main Incentives

Temporary
deferral of
current
capital
gains (up to
8 years)

Step up in
basis –
reduction of
capital gain
(up to 15%)

Permanent
exclusion
on
opportunity
zone
investment
gains

What Can Be Invested

- Code Sec. 1400Z-2(a)(1)
 - “gain from sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer.”
 - Amount of gain invested will not be included in income for the tax year
 - Gain must be reinvested within 180 days of sale
 - Sale must take place before 12/31/2026
- There is no maximum amount that can be invested in a Qualified Opportunity Fund (QOF)

Treasury Guidance Update

Proposed Regulations

What is Gain?

- Capital Gains: The proposed regulations state that a gain is eligible for deferral if it is treated as a capital gain for federal income tax purposes
- Gains from Pass-Through
 - Partnership or partner can elect to defer gain
 - Partners 180 days starts at the partnerships year end
 - Partner can also use the partnership's sale date if it is a capital gain
- Attributes of the deferred gain are preserved

1231 Gains

- The amount of 1231 gain eligible for the benefits of a QOF are **net** 1231 gain for the year
- The 180 day reinvestment period starts on the last day of the tax year
- Extended tax returns can be an issue

Treasury Guidance Update

Proposed Regulations (October 2018)

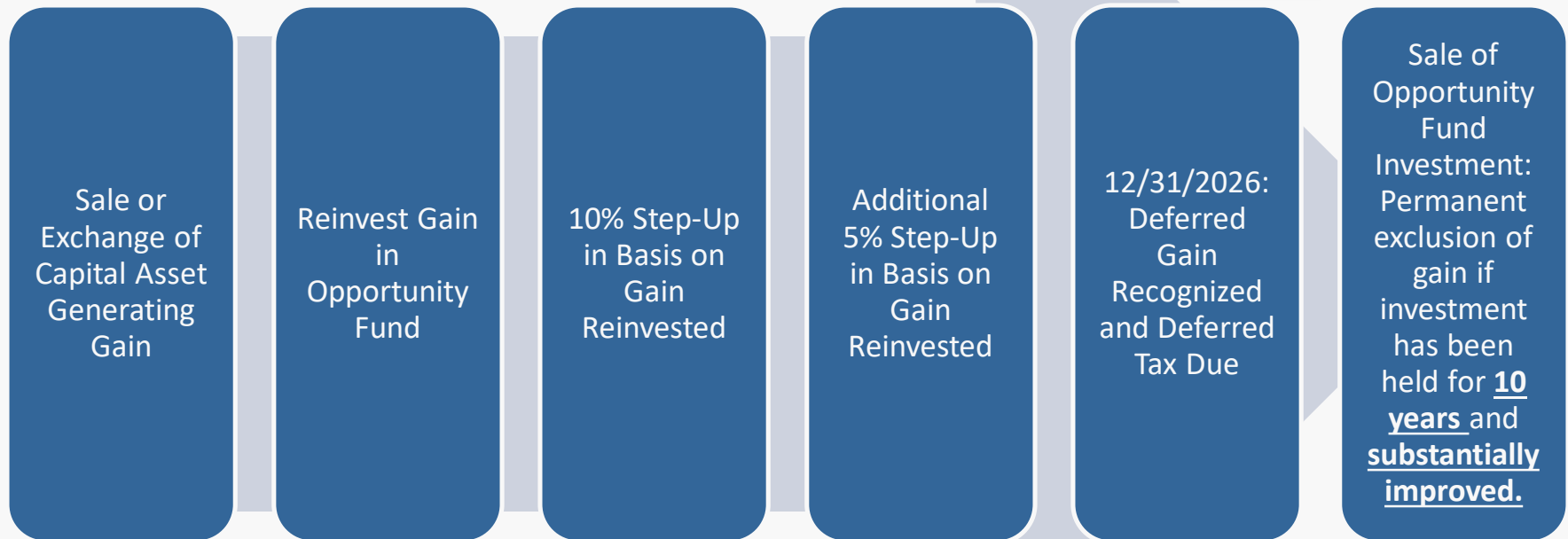
Eligible Taxpayers

- Individuals
- Corporations (including RICs and REITs)
- Partnerships
- Common trust funds under Section 584
- Qualified settlement funds
- Disputed ownership funds
- Other entities taxable under Section 1.468B

“Mixed-Funds”

- Taxpayers may also invest mixed funds.
- Treated as two separate investments
 - Re-invested gains
 - Additional capital contributed
- Only re-invested gains will receive the tax benefits found in investing in an QOF

Timeline of Recognition



180 days

5 years

7 years

*Gain must be recognized on 12/31/2026 – no additional Step-Up following this date

Investment Comparison

TRADITIONAL PORTFOLIO INVESTMENT	QOF INVESTMENT
<p>Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation</p>	

Investment Comparison

TRADITIONAL PORTFOLIO INVESTMENT	QOF INVESTMENT
Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation	
Original gain \$200,000	
Tax on gain in year of sale 20%	
<u>Tax paid on original gain (40,000)</u>	
Amount Reinvested \$160,000	

Investment Comparison

TRADITIONAL PORTFOLIO INVESTMENT	QOF INVESTMENT
Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation	
Original gain	\$200,000
Tax on gain in year of sale	20%
<u>Tax paid on original gain</u>	<u>(40,000)</u>
Amount Reinvested	\$160,000
Value after 10 years	\$415,000
<u>Less tax on appreciation</u>	<u>(51,000)</u>
Net Return	\$364,000
ROI – 82%	

Investment Comparison

TRADITIONAL PORTFOLIO INVESTMENT		QOF INVESTMENT	
Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation		Original Gain \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation	
Original gain	\$200,000	Original gain	\$200,000
Tax on gain in year of sale	20%	Tax on gain in year of sale	0%
Tax paid on original gain	(40,000)	Amount Reinvested	\$200,000
Amount Reinvested	\$160,000		
Value after 10 years	\$415,000		
Less tax on appreciation	(51,000)		
Net Return	\$364,000		
ROI – 82%			

Investment Comparison

TRADITIONAL PORTFOLIO INVESTMENT		QOF INVESTMENT	
Original Gain: \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation		Original Gain \$200,000 LTCG Tax Rate of 20% 10% Annual Appreciation	
Original gain	\$200,000	Original gain	\$200,000
Tax on gain in year of sale	20%	Tax on gain in year of sale	0%
Tax paid on original gain	(40,000)	Amount Reinvested	\$200,000
Amount Reinvested	\$160,000	Value after 10 years	\$518,750
Value after 10 years	\$415,000	Less tax on deferred gain*	(34,000)
Less tax on appreciation	(51,000)	Less tax on appreciation	0
Net Return	\$364,000	Net Return	\$484,750
		<i>*After 15% Step-Up in Basis not adjusted for TMV of \$.</i>	
ROI – 82%		ROI – 142%	

Treatment of Losses

- Despite being sold at a loss, there is still potential benefit if the investment is sold after a 5-7 year period (Step-Up in basis has occurred.)
 - (See example on next slide)

Loss Benefit Example

Original gain of \$1 million
invested in Opportunity Fund

Opportunity Fund
investment is sold for
\$700,000 before 2026

Held for 5 Years:

$\$700,000 - (\$1,000,000 * 10\%) =$
\$600,000 Gain Recognized

Held for 7 Years:

$\$700,000 - (\$1,000,000 * 15\%) =$
\$550,000 Gain Recognized

1031 Exchange vs. Opportunity Zone

	Section 1031	OZ Fund
Property Type	real property	any property
Investment Timing	Within 180 days	Within 180 days
Step-Up in Basis	Only upon death do heirs get a step-up to market value	-10% step-up on re-invested gain after 5 years -additional 5% step-up after 7 years
Gain Recognition	Deferred Gain – fully taxable upon sale	-Reduction in original gain (due to step-up in basis depending on holding period) -0 capital gain recognized on gain from OZ fund, if held for 10 years
Intermediary Required	Yes	No

What is a Qualified Opportunity Fund?

What is a Qualified Opportunity Fund?

Although funds can accommodate a wide variety of businesses, an opportunity fund is well suited for certain types of real estate development projects, infrastructure, and energy projects.



What is a Qualified Opportunity Fund?

- An investment vehicle (partnership / corporation) in which 90% of its assets are invested in Qualified OZ property.
- Measured at six and twelve month intervals on the tax year.
- QOZ Property can be **Stock, Partnership Interest** or **Business Property**.
- The QOF testing is self administrated

What is Qualified OZ Property?

Opportunity Zone Property

OZ Stock

- Stock in domestic corp. acquired after 12/31/17
- Corp is a QOZ Business at time of stock issuance
- During Funds holding period, stock remained qualified as a QOZ Business

OZ Partnership Interest

- Capital or profits in interest after 12/31/17
- Partnership is or being organized as a OZ Business.
- During Funds holding period, partnership remained qualified as a QOZ Business

OZ Business Property

- Tangible property used in trade or business purchased by fund after 12/31/17
- Originates or is substantially improved by the QOF
- During Funds holding period the use of the property remains in the OZ.

QOZ Business Property

- Owned by QOF or QOZB
- Tangible property acquired (from unrelated Party) after 2017 and used in a trade of business
- Originates with the QOF / QOZB or is substantially improved (100%) and
- During substantially all (90%) of the QOF's holding period, substantially all (70%) of the use of the property was in a qualified opportunity zone

Substantially Improved Property

- Code Sec. 1400Z-2(d)(2)(D)(ii)

“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 qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period.”

- **Update**

- If an acquired property (land and building) have been vacant for 5 years, when placed back in service it is considered original use and the basis is not needed to be increased.
- **Determined on an asset by asset basis**



Real Property Straddling A Zone

- Empowerment Zone Rules
- If Contiguous, based on square footage, the amount of real property in the zone is substantial compared to the real property outside the zone

Treasury Guidance Update (October 2018)

Revenue Ruling 2018-29

Land and Building Substantial Improvement

Clarifies that the substantial improvement to the purchase of an existing building is measured by the additions to the adjusted basis of the building excluding the land.

Leased Property

- The QOF or QOZB can lease property from a **related party**
- Not required to be the original owner or substantially improve
- Must be market rate (arms-length transaction)
- Prepaid rent cannot be more than 12 months

QOZ Business

- Trade or Business
- Substantially all (70%) of its owned / leased property is **QOZBP** and:
 1. Business generates 50% of gross income from the active conduct of a qualifying trade or business. (Safe Harbors apply)
 2. Business uses a substantial (40%) part of its intangible property in active conduct of the business

QOZ Business

3. Less than 5% of the unadjusted basis of the property is nonqualified financial property.
 - debt, stock, partnership interests
4. Business is not a nonqualified business

What Doesn't Qualify

- A trade or business will not qualify as an QOZ business if it is engaged in owning or operating any:
 - Private or commercial golf course, country club,
 - massage parlor, hot tub facility, suntan facility,
 - racetrack or other facility used for gambling, or
 - any store the principal business of which is the sale of alcoholic beverages for consumption off premises (i.e., liquor store).
 - **Triple Net Leases**



Trade or Business Safe Harbor

50% of gross income safe harbor, one of the following:

1. 50% of services performed by employees or independent contractors (based on hours) are in QOZ
2. 50% of the compensation paid to employees or independent contractors are in a QOZ
3. 50% of income generated from tangible property **and** management operations are within the QOZ

31 Month Working Capital Safe Harbor

- Written plan for the acquisition, construction or substantial improvement
- Written schedule of when the capital will be deployed
- Extended if deployment of capital is held up due to government delays
- Overlapping is permitted

Substantially All

- QOF
 - 90% of assets invested in a QOZ Property
- QOZ Business
 - 70% of the tangible property is owned or leased by a trade or business is QOZ business property.
- QOZ Business Property
 - 70% in use within a qualified opportunity zone
- QOF Holding Period
 - During 90% of the Fund holding period the QOZ Business remains qualified.

Form 8996

Form **8996**

(December 2018)
Department of the Treasury
Internal Revenue Service

Qualified Opportunity Fund

► Go to www.irs.gov/Form8996 for the latest information.
► Attach to your tax return. See instructions.

OMB No. 1545-0123

Attachment
Sequence No. **996**

Name

Employer identification number

Part I General Information and Certification

- 1 Type of taxpayer: Corporation Partnership
- 2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)?
 No. STOP. Do not file this form with your tax return.
 Yes. Go to line 3.
- 3 Is this the first period the taxpayer is a Qualified Opportunity Fund?
 Yes. By checking this box, you certify that by the end of the taxpayer's first qualified opportunity year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and the description of the qualified opportunity zone business. See instructions.
 No. Go to Part II.
- 4 If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund.

Part II Investment Standard Calculation

5 Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	5		
6 Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	6		
7 Divide line 5 by line 6.	7		
8 Total qualified opportunity zone property held by the taxpayer on the last day of the taxpayer's tax year	8		
9 Total assets held by the taxpayer on the last day of the taxpayer's tax year	9		
10 Divide line 8 by line 9.	10		

Part III Qualified Opportunity Fund Average and Penalty

11 Add lines 7 and 10	11		
12 Divide line 11 by 2.0. See instructions if Part I, line 3 is "Yes"	12		
13 Is line 12 equal to or more than .90? <input type="checkbox"/> Yes. Enter -0- on this line and file this form with your tax return. <input type="checkbox"/> No. The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return	13		

Cat. No. 37820G

Form **8996** (12-2018)

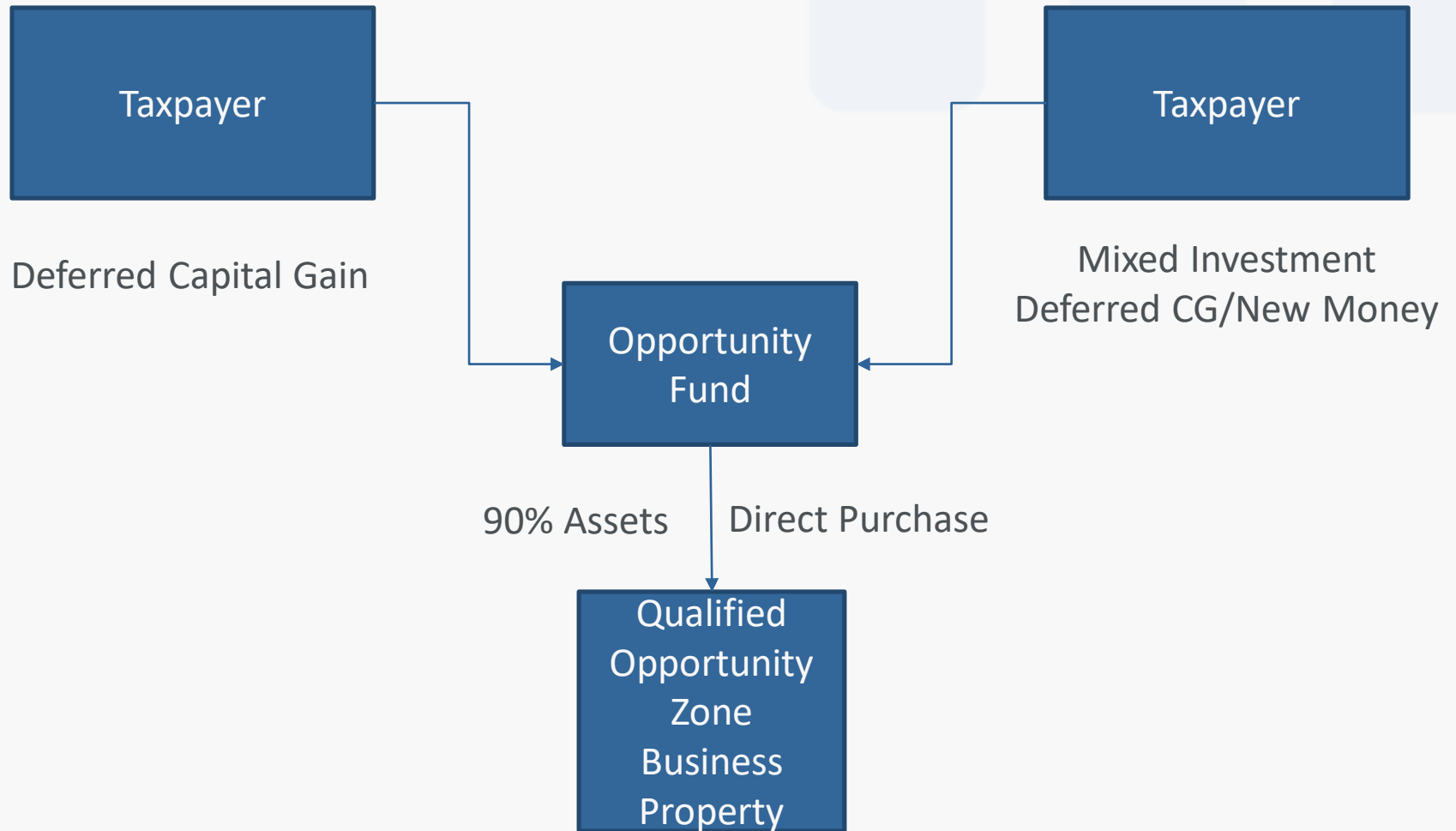
Qualified Opportunity Fund 90% Test –

- Every six months (June 30 and December 31)
- First test is the earlier of: six months after the start of the fund or December 31

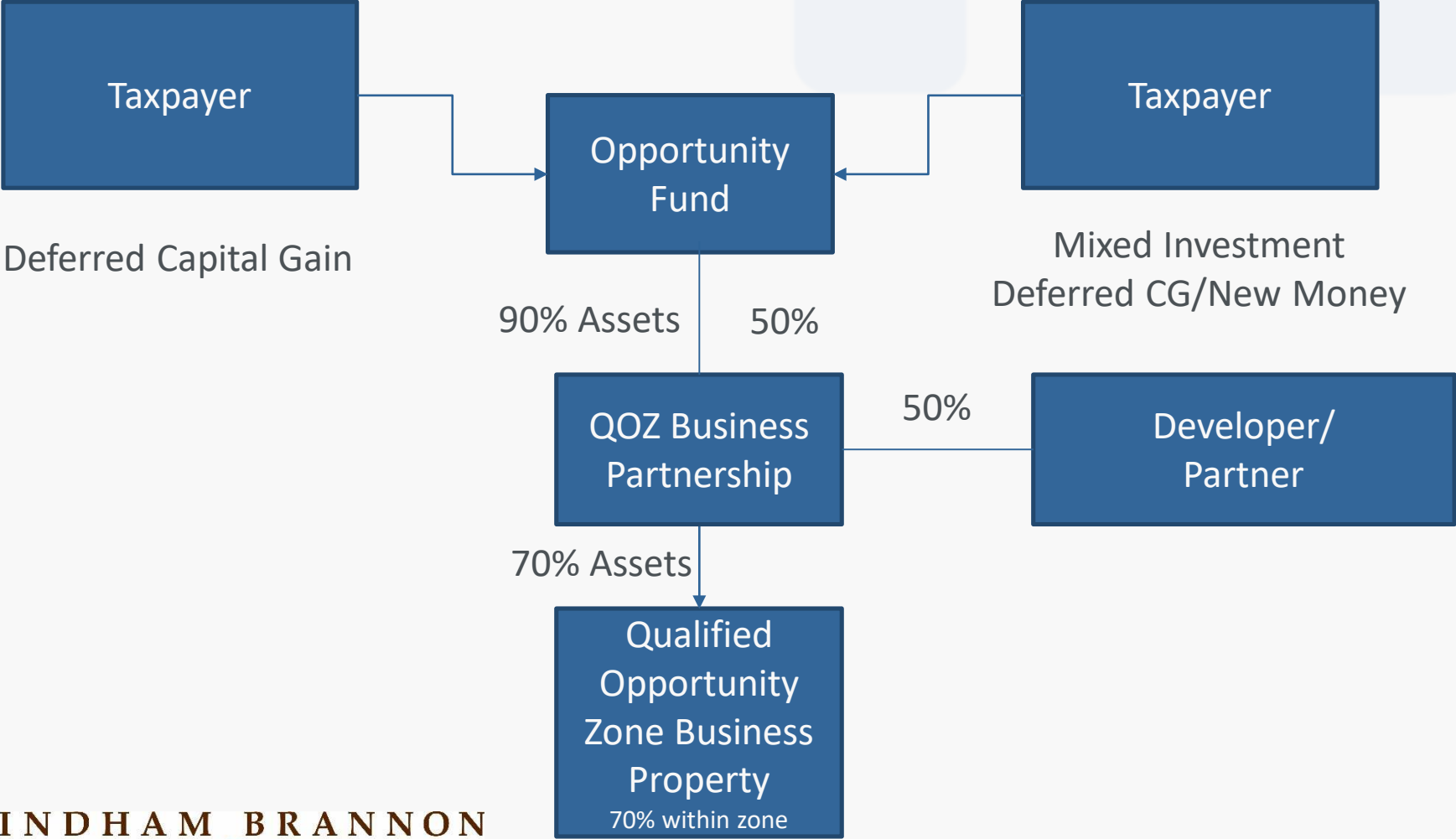
Safe Harbor

- Does not need to include cash contributed within the last six months.

Opportunity Zone Structures



Opportunity Zone Structures



Qualified Opportunity Fund Reinvestment

- Cash is not included in the 90% test if reinvested within 12 months
- If the QOF sells QOZP before the 10 year period all normal tax consequences apply.
- This only applies to the QOF sale of QOF property (not a QOZB sale of property)

Distributions

- The Fund can distribute money back to the investors before the 10 year period
- Cash-out refinance
- Debt basis
- Disguised sale rules (2 years)

Inclusion (recognition) Events

A taxpayer will recognize its deferred gain upon the sale or change of its Opportunity Fund interest before December 31, 2026. Examples of this include

- A gift of an QOF, including to a charity
- Certain direct or indirect transfer of interests in an QOF partnership
- A sale or other taxable disposition of an interest in an QOF partnership or QOF corporation

Non-inclusion Events

- Transfer of an QOF interest to a grantor trust or other disregarded entity.
- Death of an owner of an QOF interest, the estate/beneficiaries step into the shoes of the decedent.
- Generally tax free mergers and spinoff involving two QOF corporations.

Contact Windham Brannon if you are . . .

- Needing advise on how to save tax on large capital gains by diversifying into specific Opportunity Zone Funds.
- Planning to setup and need assistance with establishing a private Opportunity Zone Fund.
- Planning to establish a business in an Opportunity Zone.

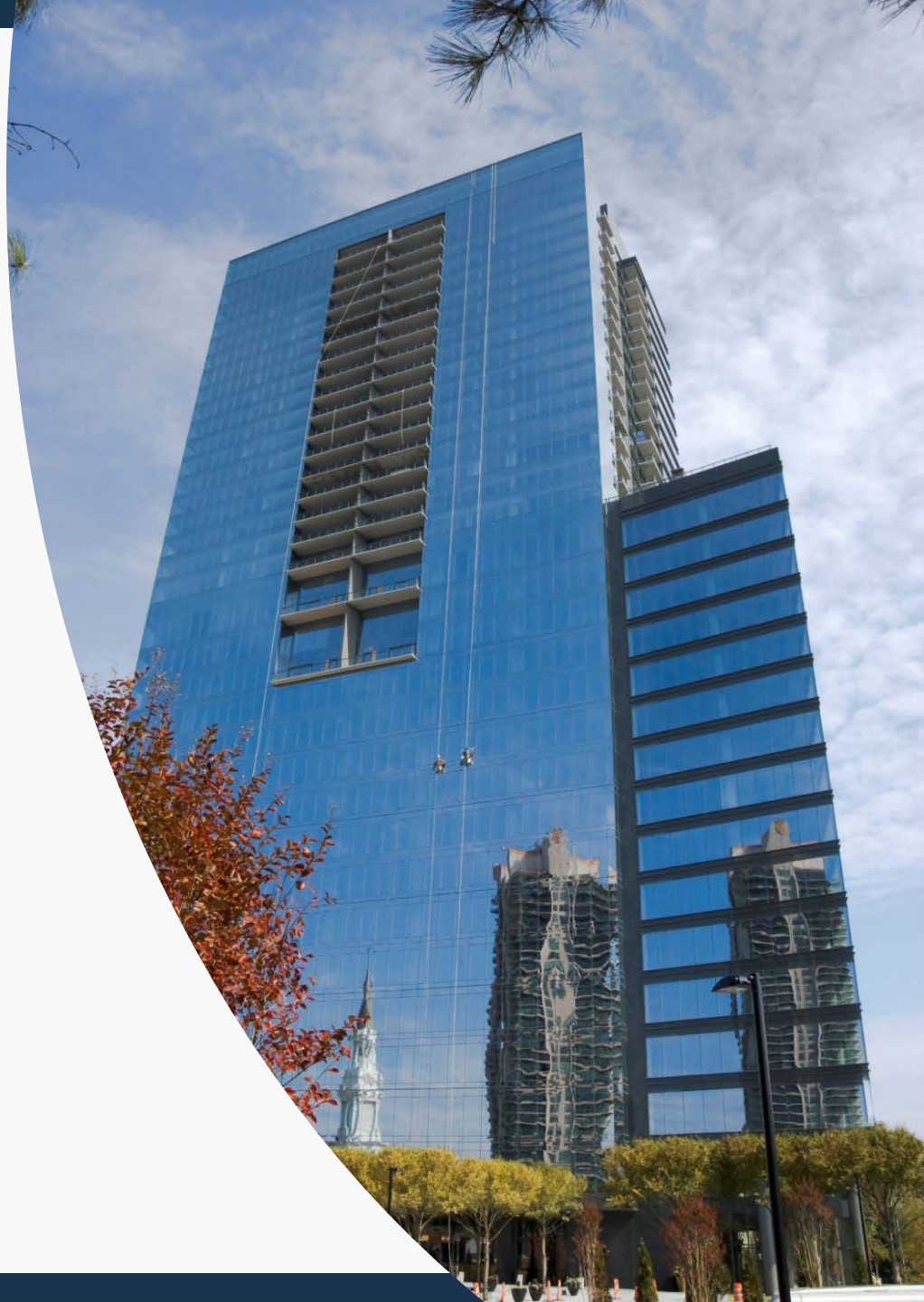
Firm Overview



About the firm

- Founded in 1957 and headquartered in Atlanta, Windham Brannon is a leading audit, tax, accounting and advisory firm
- Our client base represents a wide range of industries
- We offer a comprehensive suite of services to provide clients with effective business solutions
- Our goal is to provide the most valuable insights and resources to help our clients succeed

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Contact Us!



Laura Berry, CPA

678-510-2790

lberry@windhambrannon.com



Gary Gruner, CPA

678-510-2887

ggruner@windhambrannon.com