

# Taking Advantage of Opportunity Zone Investing

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# Your Presenters

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# Wipfli LLP

- Firm founded in 1930
- Headquartered in Milwaukee
- 250+ partners
- 2,200+ associates
- 47 offices across the U.S. and 2 India

- Private Equity Services
- Fund, Transaction Advisory and Portfolio Company Services
    - Manufacturing and Distribution
    - Construction and Real Estate
    - Health Care
    - Technology
- ACG Growth Champion
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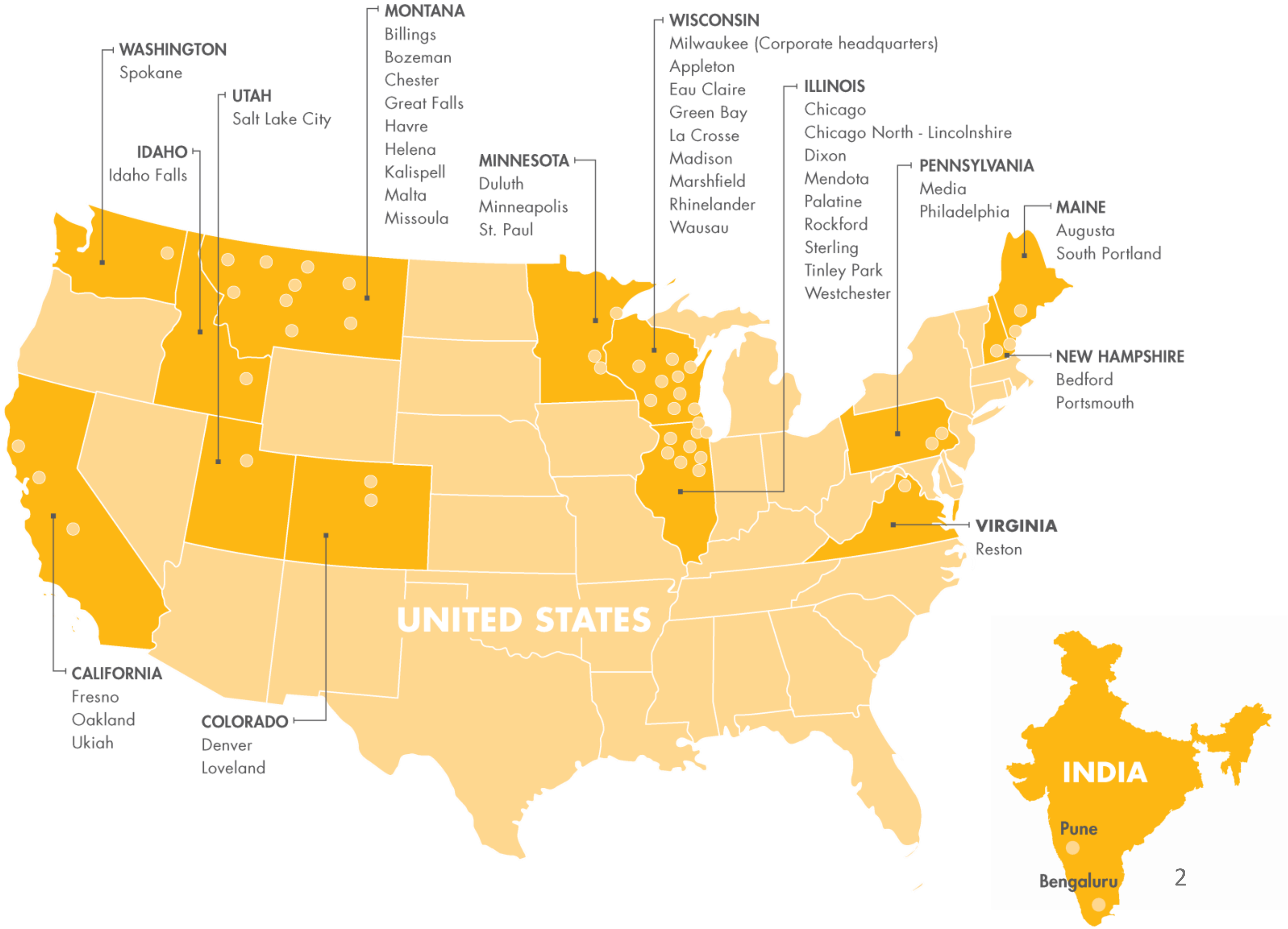


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# Polling Question #1

# Qualified Opportunity Zone Investment

# What Are Opportunity Zones?

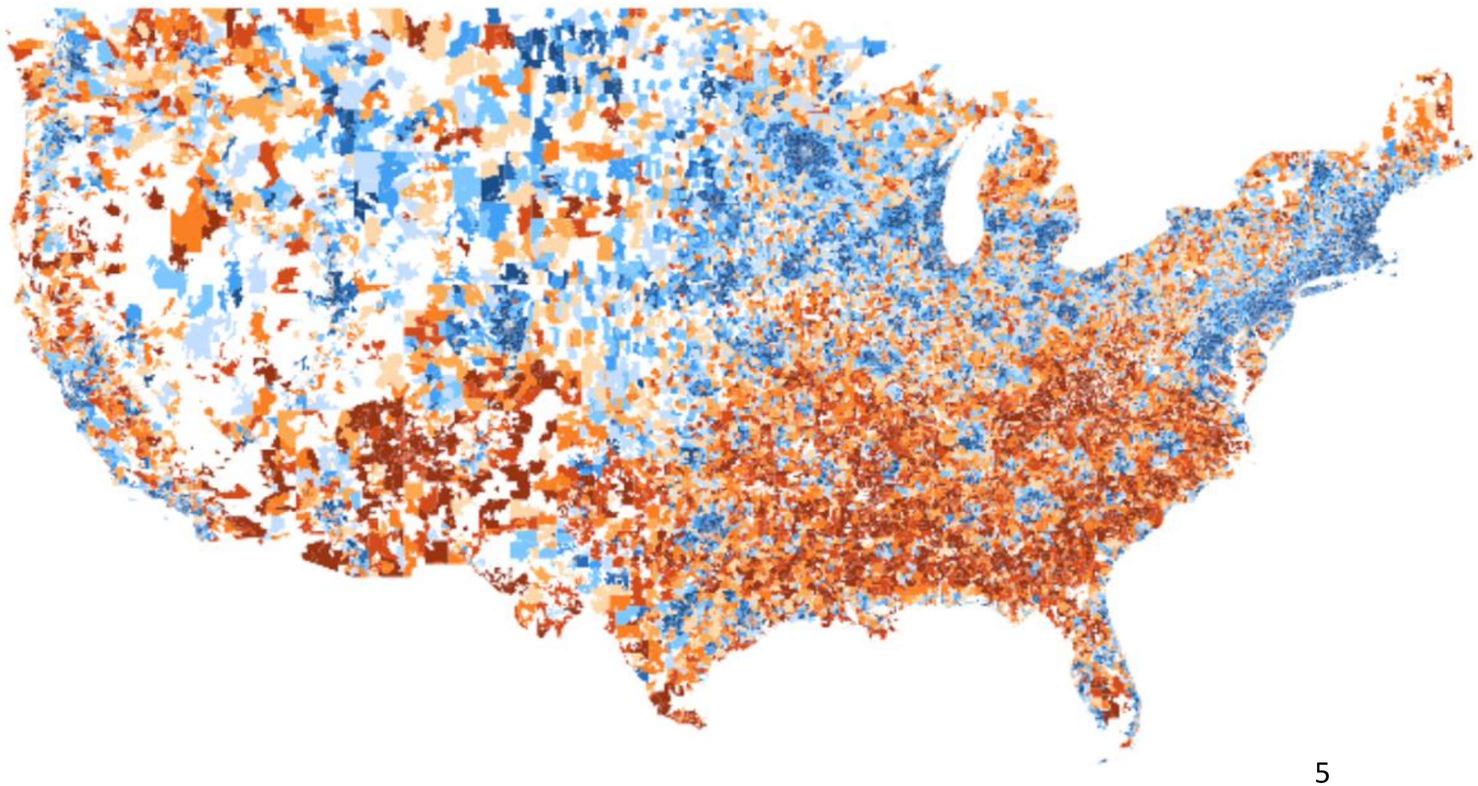

- Generally, low-income census tracts, both urban and rural
  - Some are not low-income census tracts themselves but are contiguous to a low-income census tract
  - Every major city has at least one zone; most have several
- Nominated by governor or CEO of each U.S. state, district or territory by March 21, 2018 (30-day extensions granted)
- Certified by Treasury
  - There are a total of 8,700 certified zones, covering 12% of the U.S. land mass, including all of Puerto Rico
  - Certification of these zones is effective through December 31, 2027 (10 years)


Opportunity Zones

# Why Opportunity Zones and Why Now?


- 52 million Americans (one in six) live in economically distressed communities
- Source:  EIG's "Distressed Communities Index"

Prosperous Distressed

https://eig.org/opportunityzones

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# How Do Opportunity Zones Address This Discrepancy?


- Opportunity zones aim to connect low-income communities with much-needed capital.
- It was estimated that U.S. households and corporations were sitting on an estimated $6.1 trillion of unrealized capital gains at the end of 2017.
- Opportunity zones offer a way for investors to take their realized capital gains and reinvest them into businesses in distressed communities all across the country.  In exchange, investors would receive a graduated series of federal tax incentives tied to long-term investment in those distressed communities.

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# Investor – Who and What?


- Individuals, C or S corporations, partnerships, LLCs, trusts and estates, common trust funds, qualified settlement funds or disputed ownership funds
- Taxpayer has “capital gain” from an actual or deemed sale or exchange of property or any other gain included in the calculation of capital gain for federal income tax purposes
  - The sale or exchange of property must be with an unrelated third party (20% standard applies rather than normal 50%)
  - Gain can be from personal, business, or investment property
- Taxpayer reinvests that capital gain into a Qualified Opportunity Fund (QOF) within 180 days of the transaction triggering the gain

# Investor – Why?


Federal tax benefits for investor:

- Investors can make an election for their reinvested capital gain to be deferred until *earlier* of:
    - When they sell their QOF investment
    - December 31, 2026
- In addition to the deferral of capital gain for up to eight years (assuming they make their QOF investment in 2018 and hold it until at least 2026), if investors hold their QOF investment for at least:
    - Five years, their *original deferred capital gain* is reduced by 10%
    - Seven years, their *original deferred capital gain* is reduced by another 5%
- Ten years = If taxpayers elect, no taxable gain is recognized on the sale of their *QOF investment* (their tax basis in the QOF investment is deemed to be equal to its FMV as of the date of sale), but a taxable loss can still be recognized
    - This 10-year hold benefit is not impaired solely because the designation of opportunity zones ceases to be in effect on December 31, 2027
    - The taxpayer remains eligible for the 10-year hold benefit until December 31, 2047

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# Sample Fund Investment – Investor Tax Benefits


2018 | 2019 | 2020

- January 2, 2018:
  Taxpayer realizes a $1M capital gain

- June 30, 2018:
  Within 180 days, the taxpayer invests that $1M of capital gain into a fund

  Taxpayer is deemed to have a $0 beginning basis in the fund investment

  Fund Invests the $1 M in Qualified Opportunity Zone Property

# Sample Fund Investment – Investor Tax Benefits


2023

2024

2025

- June 30, 2023:
  After five years, taxpayer's basis in fund investment increases from $0 to $100K, which is 10% of $1M original investment

- June 30, 2025:
  After seven years, taxpayer's basis in fund investment increases from $100K to $150K, which is 15% of $1M original investment

# Sample Fund Investment – Investor Tax Benefits


| 2026 | 2027 | 2028 |
|---|---|---|
| • December 31, 2026: Remaining $850K of the original $1M of deferred capital gain is taxed.<br><br>Taxpayer's basis in fund investment increases from $150K to $1M.<br><br>Always confirm that the current FMV of the taxpayer's investment in the fund is not less than original amount of cash invested (in this case, $1M). If it is, the amount of deferred gain subject to tax would actually be less than $850K. | | • June 30, 2028:<br>After 10 years, taxpayer sells fund investment for $3M. Taxpayer elects for basis to be deemed equal to FMV; therefore, taxpayer has $0 gain on sale of fund. |

# Qualified Opportunity Fund


- A fund can be a:
  - Corporation (C or S),
  - Partnership, or
  - LLC that is taxed as either a corporation or partnership
- The fund entity must hold at least 90% of its assets in Qualified Opportunity Zone Property
  - Average % measured semiannually, at the end of the fund’s first six months and again at year-end
    - If the first tax year of the fund is less than six months, the average % is measured only at year-end.
  - The 90% test is based on:
    - Amounts shown on the fund’s Applicable Financial Statements (AFS), or
    - Cost if the QOF does not have AFS
  - A penalty, equal to 5% of the shortfall under 90%, applies if this 90% test not satisfied

# Qualified Opportunity Zone Property – Stock or Partnership Interest


- Equity interest must be in a new or existing:
  - Domestic corporation
  - Domestic partnership, or
  - Domestic LLC taxed as a corporation or partnership
- Equity interest must be acquired by fund after December 31, 2017
- Equity interest must be acquired for cash
- Stock or partnership interest must be original issue, not acquired from another investor in the corporation, partnership or LLC


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# Qualified Opportunity Zone Business Defined


- Substantially all of the trade or business's tangible property, owned or leased, is QOZB Property
  - For purposes of this requirement only, *substantially all* is defined as at least 70%
  - For all other requirements included in the statute and proposed regulations that include the phrase *substantially all*, the phrase has not yet been defined
  - No guidance is yet issued as to how to measure operating leases for the purpose of this 70% test
- A substantial portion of its intangible property is used in the active conduct of the trade or business
- A least 50% of its total gross income is derived from the active conduct of its trade or business *in the qualified opportunity zone*

# Qualified Opportunity Zone Business Defined


- Less than 5% of the average of the aggregate unadjusted basis of its property is attributable to nonqualified financial property
  - Nonqualified financial property includes cash and cash equivalents, stocks, debt, partnership interests, options, futures and forward contracts, warrants, notional principal contracts and annuities
  - Working capital exception
    - An exception is made for reasonable amounts of working capital held as cash, cash equivalents or debt for 18 months or less
  - Safe harbor
    - The working capital exception can also be applied to property held by the QOZB for a period of up to 31 months if:
      - There is a written plan for the property to be used for the acquisition, construction or substantial improvement of tangible property in the QOZ
      - There is a written schedule that the property will be used within 31 months
      - The business substantially complies with that schedule
      - The written plan and schedule are retained in the taxpayer's records

# Qualified Opportunity Zone Business Defined


- The trade or business cannot be what is considered a “sin business”:
  - Private or commercial golf course or country club
  - Massage parlor, hot tub or suntan facility
  - Racetrack or other facility used for gambling
  - Any store with the principal business of selling alcohol for off-premise consumption

# Qualified Opportunity Zone Business Property


- Tangible property that is used in the trade or business of the QOF or QOZ business
- The property must be acquired by purchase from an unrelated party (20% standard applies rather than normal 50%)
- Property must be acquired after December 31, 2017

# Qualified Opportunity Zone Business Property



- To meet the definition of QOZ Business Property:
  - The “original use” of the property within the QOZ must commence with the QOF or QOZ business

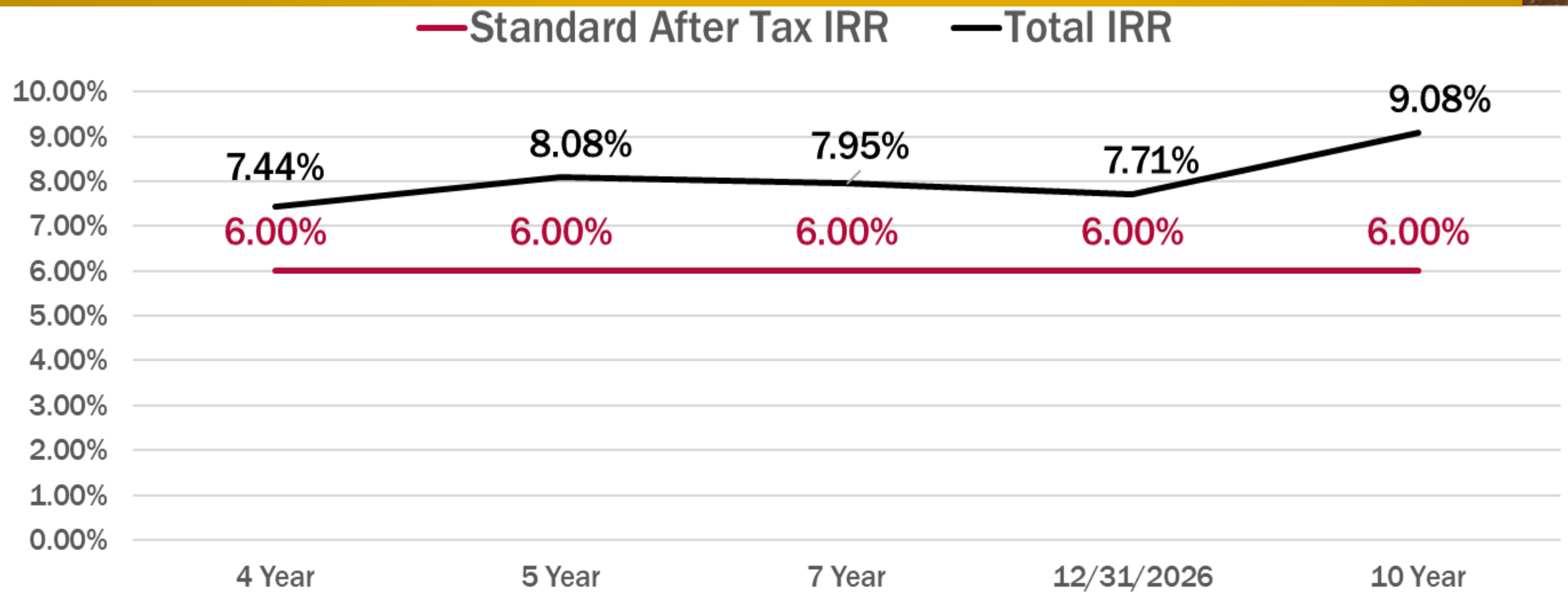
    **-OR-**

  - “Substantial” improvements must be made to the property
- Original use
  - “Original use” means the property is either newly built in the QOZ or is new or used property brought into the QOZ by the QOF or QOZ business
  - In the case of the purchase of vacant land within a QOZ, this original use rule does not apply – an exception that should encourage the repurposing of vacant or otherwise underutilized land in distressed areas

# Qualified Opportunity Zone Business Property


- Substantial improvements
  - For improvements to be considered “substantial,” the cost basis of the property must be more than doubled during any 30-month period beginning after the date of the property’s acquisition
  - In the case of a purchase of existing land and building within the QOZ, this substantial improvement test is based on the taxpayer’s cost basis in the building only, not the land (Rev. Rule 2018-29)
    - Therefore, it is not necessary that the taxpayer’s cost basis in the land also be doubled during the 30-month period
    - This bifurcation should encourage the repurposing of vacant buildings in distressed areas

# Incremental Benefit of Opportunity Zone Investment




| 23.8% Tax Rate | 4 Year | 5 Year | 7 Year | 12/31/2026 | 10 Year |
|---|---|---|---|---|---|
| Standard After Tax IRR | 6.00% | 6.00% | 6.00% | 6.00% | 6.00% |
| Incremental OZ Benefit | 1.44% | 2.08% | 1.95% | 1.71% | 3.08% |
| OZ Investment IRR | 7.44% | 8.08% | 7.95% | 7.71% | 9.08% |
| Percentage Increase | 24% | 35% | 32% | 29% | 51% |

*Table Source-Novogradac & Company (www.novoco.com/resource-centers/opportunity-zones-resource-center)

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# Key Terms and Requirements


**TCJA's New Opportunity Zone Program - Key Terms and Requirements**

Investor with Capital Gains

↓

Qualified Opportunity Fund (Fund)

↓

Qualified Opportunity Zone (Zone)

↓

Qualified Opportunity Zone Property (Zone Property)

| Opportunity Zone Stock | Oportunity Zone Partnership Interest | Opportunity Zone Business Property (Business Property) |
|---|---|---|

↓ ↓ ↓

Qualified Opportunity Zone Business (Zone Business)

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# What Guidance Are We Still Waiting On?


- Treatment of interim gains by the QOF
- The definition of a *reasonable period* for a QOF to reinvest proceeds from the sale of qualifying assets without paying a penalty
- Time period for QOF to invest cash received from an investor
- The definition of other uses of *substantially all*
- Conduct leading to decertification
- Tax treatment of debt-financed returns of capital
- State conformity


# Polling Question #2

# Investing in a Qualified Opportunity Fund

# Questions

## How can we help?

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# Have More Questions?


**Contact us:**

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