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QUALIFIED OPPORTUNITY ZONES AND QUALIFIED OPPORTUNITY FUNDS

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DISCLAIMER

This presentation does not constitute tax, legal or other advice, and is intended solely to highlight certain basic rules and concepts with respect to the topic being discussed.

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QUALIFIED OPPORTUNITY FUNDS

- The 2017 Tax Cuts and Jobs Act includes a new tax incentive provision that is intended to promote investment in economically distressed communities, referred to as "Opportunity Zones." Through this program, investors can achieve the following three significant tax benefits:
  - Deferral of gain on the disposition of property to an unrelated person until the earlier of the date on which the subsequent investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a "Qualified Opportunity Fund" within 180 days of the property's disposition;
  - Elimination of up to 15% of the gain that has been reinvested in a "Qualified Opportunity Fund" provided that certain holding period requirements are met; and
  - Potential elimination of tax on gains associated with the appreciation in the value of a Qualified Opportunity Fund, provided that the investment in the Qualified Opportunity Fund is held for at least ten years.

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QUALIFIED OPPORTUNITY FUNDS

- An Opportunity Zone is an economically distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment.
- Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the IRS.
- All Opportunity Zones are available on the U.S. Department of Treasury website

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QUALIFIED OPPORTUNITY FUNDS

- A Qualified Opportunity Fund "QOF," in turn, is an investment vehicle that is established as either a domestic partnership or a domestic corporation for the purpose of investing in eligible property that is located in an Opportunity Zone and uses investor gains from prior investments as a funding mechanism.

- The investor can get the tax benefits of Opportunity Zones even if the investor doesn't live, work or maintain a business in an Opportunity Zone, the investor just needs to invest in a QOF.

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QUALIFIED OPPORTUNITY FUNDS

- To become a QOF, the entity self-certifies.

- The entity must meet certain requirements, in particular a general requirement that at least 90% of its assets be “qualified opportunity zone property” used within an Opportunity Zone (as further discussed below), but no approval or action by the IRS is required.

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GENERAL REQUIREMENTS

- Recognition of qualified “gain”
- Eligible reinvestment/disposition
  - Timing
  - Holding periods
- Qualification as a QOF
  - QOZ business/assets requirement
- Proposed Regulations – issued by Treasury on October 19, 2018 to provide additional guidance

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QUALIFIED "GAIN"

- Only capital gain eligible. **Excludes**:
  - Ordinary income from sale of inventory, "dealer" income and certain depreciation recapture
  - Gain on sale to certain "related" persons
- **Includes**:
  - Gross amount of capital gains
  - Long-term or short-term capital gains
  - Capital gain recognized by a taxpayer either directly or through partnerships (subject to special rules)
  - Certain gains from regulated futures contracts (IRC Section 1256)
  - Although not specified, presumably gross amount of gain recognized on the sale of trade or business assets (IRC Section 1231), provided taxpayer has a net IRC Section 1231 gain

ELIGIBLE REINVESTMENT/DISPOSITION

- Rollover must occur during the 180-day period following the date of sale
  - Special rules apply to gains from partnerships, REITs, RICs, etc.
- Only gain amount must be rolled over; not entire sale proceeds
- Taxpayer can specify all or portion of the gain as a rollover amount
- Rollover gain may be combined with non-rollover contributions made by the same or other investors.
- Taxpayer must dispose of interests in the QOF after relevant holding periods satisfied.

QUALIFICATION AS QOZ FUND

- Must be treated as partnership or corporation for tax purposes
- At least 90% of the entity's assets must consist of a QOZ property, tested bi-annually
- Working capital exception – permits retention of working capital over a 31-month period pursuant to a working capital plan
- QOZ property includes taxable business property held directly or through a qualified QOZ business
  - QOZ business requires only that 70% of its assets consist of QOZ property
- No "sin" businesses

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TAX BENEFITS

- Deferral of rollover gain until 2026 (or when investment sold)
  - Consider tax rate changes
  - Harvesting losses
- Tax basis increased by 10% after 5 years *(note: requires investment before 2022)*
- Tax basis increased by an additional 5% after 7 years *(note: requires investment before 2020)*
- Tax basis step-up to fair market value after 10 years excludes post-rollover appreciation from tax
- Note: benefits may not extend to state or local tax base

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EXAMPLE

Facts

- A sells assets with 100x tax basis for 200x on January 1, 2019, i.e. 100x capital gain
- The 100x gain is invested in a QOF before June 30, 2019
- A holds the QOF investment until 2046 and sells it for 300x

Consequences

- A recognizes no gain from the sale in 2019
- A's tax basis in the QOF is 0 on January 1, 2019
- A's tax basis increases to 10x in 2024
- A's tax basis increases to 15x in 2026
- A reports capital gain of 85x on December 31, 2026
  - Note: Capital gain will be treated as long-term if the assets were held for more than one year at the time of the sale on January 1, 2019; otherwise treated as short-term
- A recognizes 0 gain on the sale of the QOF interest in 2046

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ABOUT US

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Jeffrey Uffner, chair of Stroock’s Tax Practice and a core member of its Private Funds Group, represents prominent securities, real estate, distressed debt and infrastructure fund sponsors and global, national and regional private funds, in all aspects of domestic, foreign and cross-border tax planning.

Jeffrey has extensive experience in a wide range of transactional and commercial tax matters, having structured highly complex, tax-efficient investment platforms for taxable and tax-exempt institutions, high net worth individuals and non-U.S. investors.

For more than 140 years we have partnered with our clients to ensure their continued success. We are firmly committed to helping our clients achieve their business goals. We work together as a team of lawyers delivering practical, results-driven guidance to find the most creative and effective solutions.

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ABOUT US

Mayer Greenberg

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Mayer Greenberg is a partner at Stroock and advises domestic and foreign investors on the tax implications of joint ventures, mergers, reorganizations and restructurings.

Mayer has particular experience in transactions involving real estate and energy assets. He advises REITs and clients with tax-exempt or other special status regarding the tax consequences of their investment strategies and other activities, often including non-U.S. investors with tax sensitivities in multiple jurisdictions.

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ABOUT US

Eric Requenez

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Eric Requenez is a partner at Stroock and represents fund sponsors and investors in the formation, structuring and capitalization of investment funds as well as other securities offerings, regulatory and compliance matters, transactions and other corporate matters.

He advises fund sponsors and placement agents in the structuring, negotiation and capitalization of U.S. and non-U.S. private funds, including private equity funds, real estate funds, credit funds, energy and infrastructure funds, hedge funds, hybrid funds, fund-of-funds, and venture capital funds. Eric also advises clients on the formation of related advisory and management entities.

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Kevin Matz, partner at Stroock, concentrates on domestic and international estate and tax planning, estate administration and related litigation. His practice primarily involves advising high net worth individuals in wealth transfer planning; drafting wills and trusts; gift, estate, income and generation-skipping transfer tax planning and tax return preparation; charitable gift planning; probate proceedings and estate administration; and associated litigation as well as corporate counseling.

Kevin has advised clients on entity and succession planning, including use of family limited partnerships, use of grantor retained annuity trusts, transfers to irrevocable trusts involving complex valuations, qualified personal residence trusts, irrevocable life insurance trusts, and the use of charitable remainder trusts, charitable lead trusts and private foundations to further family planning and philanthropic objectives.

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