

Opportunity Zones

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WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Create Opportunities

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Opportunity Zone Program

Created by the Tax Cuts and Jobs Act of 2017

Formed to generate economic activity and job creation in low-income communities

Encourages investment of unrealized capital gain into these low-income community projects/businesses

Opportunity Zones

Benefits

- Capital Gain Deferral
 - Deferred until investment is sold, or Dec. 31, 2026 whichever comes earlier
 - If investment is not sold before Dec. 31, 2026 any remaining deferred gain is recognized at that time

Opportunity Zones

Benefits

- Permanent Reduction of Deferred Gain
 - Investments held less than 5 years result in 100% deferred gain recognition
 - Investments held > 5 years, < than 7 years result in recognition of 90% of deferred gain
 - Investments held 7 years or more years results in 85% deferred gain recognition

Opportunity Zones

Benefits

- Permanent exclusion for investments held for at least 10 years
- At sale of investment, election made to step up basis in investment to FMV
- Election results in a permanent exclusion from income of any post-acquisition capital gain
- Results in permanent benefit for depreciation deductions
- Taxpayers can recognize losses by not making the permanent exclusion election

Types of Gains and Taxpayers

Types of gains allowed

- Capital gains – Short Term and Long Term
- §1231 Gains
- Some issues with §1256 contracts and straddles
- Gain cannot be generated via a related party sale

Types of taxpayers

- Trusts
- Individuals
- Partnerships
- Corporations

Passthrough Gains

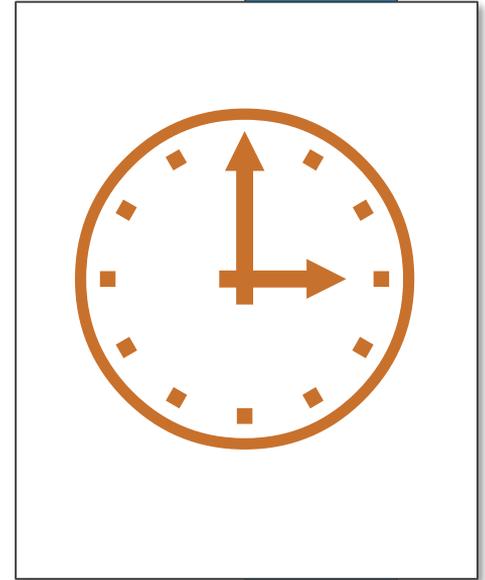
Partnership or S Corp can make election to invest in QOF

If fail to make election

- Gain flows out to partners
- Can make election to use same asset sale date as passthrough, or
- Can elect to use last date of taxable year for passthrough

Opportunity Zones – Timing of Investment

- From date asset sold – 180 days to put into a QOZ Fund
- Funds do not need to go to a qualified intermediary
- The date the money is transferred to fund will be the start of the 10 year hold window



Opportunity Zone Timeline



Opportunity Zone Example

	<u>Traditional</u>	<u>QOF</u>
2019 Gain on sale	\$ 15,000,000	\$ 15,000,000
Taxes due (@ est rate of 26%)	<u>(3,900,000)</u>	<u>-</u>
Net available to invest	11,100,000	15,000,000
 2026 Pay tax on deferred gain		
Gross Gain	n/a	15,000,000
Less: step-up in basis		<u>(2,250,000)</u>
		12,750,000
Taxes due (@ est rate of 26%)		<u>(3,315,000)</u>
 2029 Exit transaction		
Value of investment (based on 7% annualized return)	23,363,857	31,572,779
Basis in investment	<u>(11,100,000)</u>	<u>(15,000,000)</u>
Gain on investment	12,263,857	16,572,779
Taxes due (@ est rate of 26%)	(3,188,603)	n/a
 Summary of Cash Flow		
Ending Value Net of Taxes Paid	20,175,254	28,257,779
 Benefit of Investing in QOF		\$ 8,082,525



Comparison to §1031

Opportunity Zones

- Does not have to be like-kind property
- Real or personal property
- Substantially all must be located in an OZ
- No identification of replacement property requirement
- Close on replacement within 180 days of sale
- Only need to invest gain from sale
- Can invest in partnership interests and stock
- Gain recognized – earlier of sale or 12/31/26
- 10% basis step up for 5 year hold, 15% for 7 year hold
- Permanent exclusion on appreciation if held longer than 10 years

§1031

- Must be like-kind property
- Real property, no personal property
- No location requirement
- Replacement property must be identified within 45 days
- Close on replacement within 180 days of sale
- Must invest entire proceeds from sale
- Cannot invest in partnership int. or stock
- Gain rec. – upon sale of replacement prop.
- No step up in basis
- No gain exclusion on appreciation

Qualified Opportunity Zone (QOZ)

Low-income community population census tract, AND

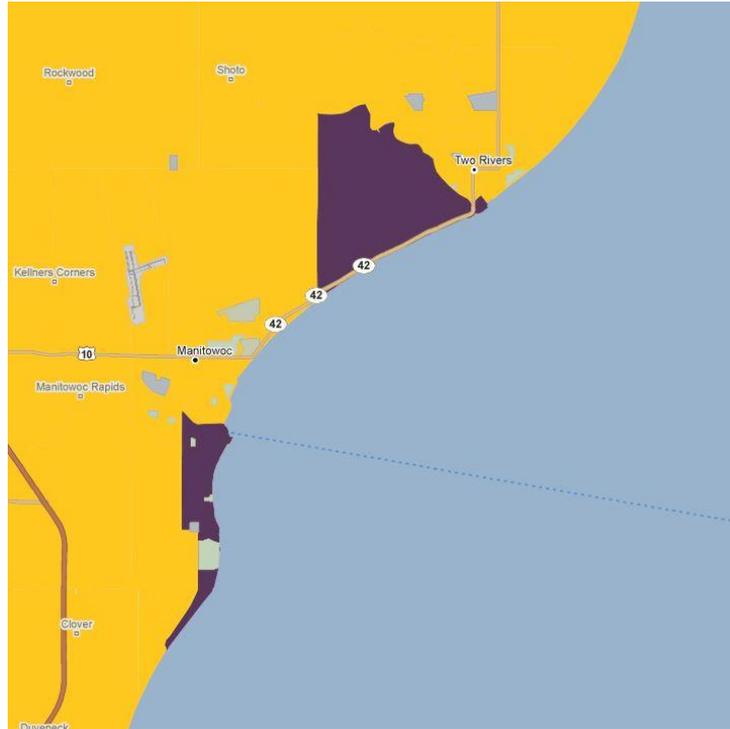
- Nominated by the chief executive officer of the state
- Number of zones:
 - Limited to 25% of low-income communities in a state
 - If state has less than 100 low-income communities can choose 25 QOZ's
- Contiguous Tracts
 - Contiguous tracts not in a low-income community may be designated QOZ's if:
 - ◇ Contiguous with a low-income community designated as a QOZ, and
 - ◇ Median family income of the tract does not exceed 125% of the contiguous low-income community
 - Contiguous tracts cannot make up more than 5% of census tracts designated in the state as QOZ's

Wisconsin Opportunity Zones

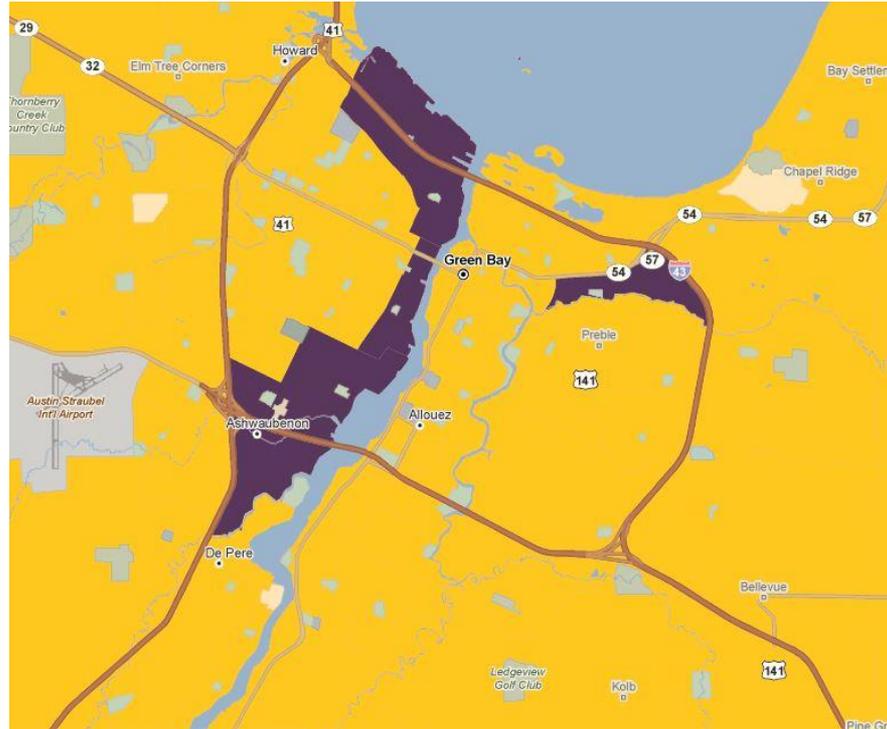
- Wisconsin Housing and Economic Development Authority
 - <https://www.wheda.com/Opportunity-Zones/>
- CLA Opp. Zone Website and Mapping Tool
 - <https://www.claconnect.com/services/tax/opportunity-zones>



Manitowoc Area Opportunity Zones



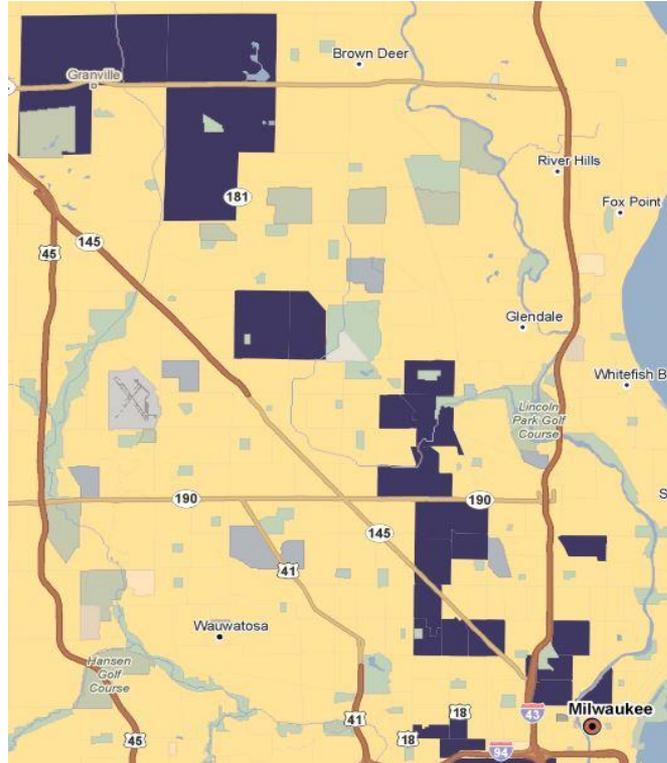
Green Bay Area Opportunity Zones



Fox Valley Area Opportunity Zones



Milwaukee-North Opportunity Zones



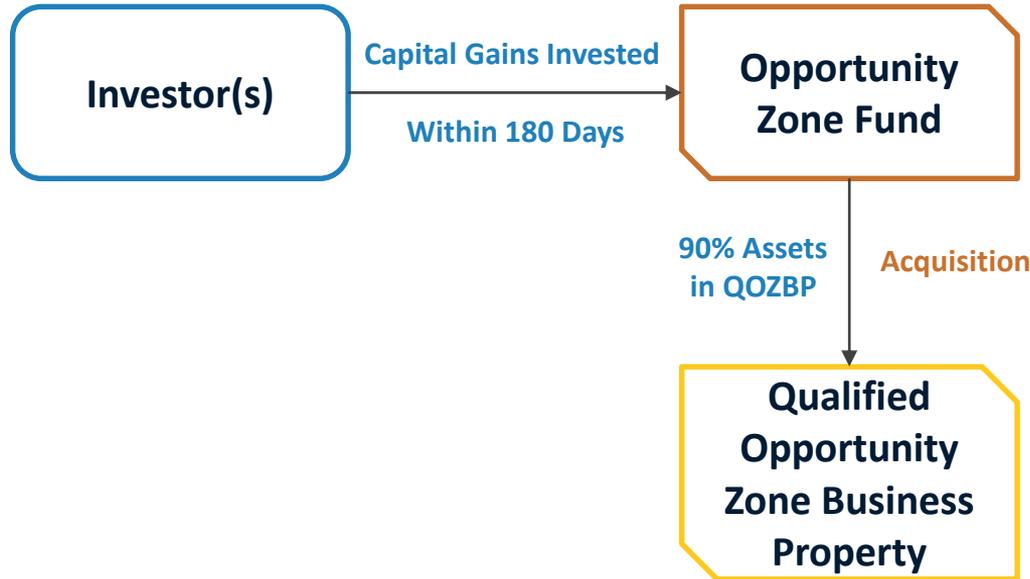
Qualified Opportunity Zone Fund

- Fund can be any partnership or corporation that holds at least 90% of its assets in QOZ property

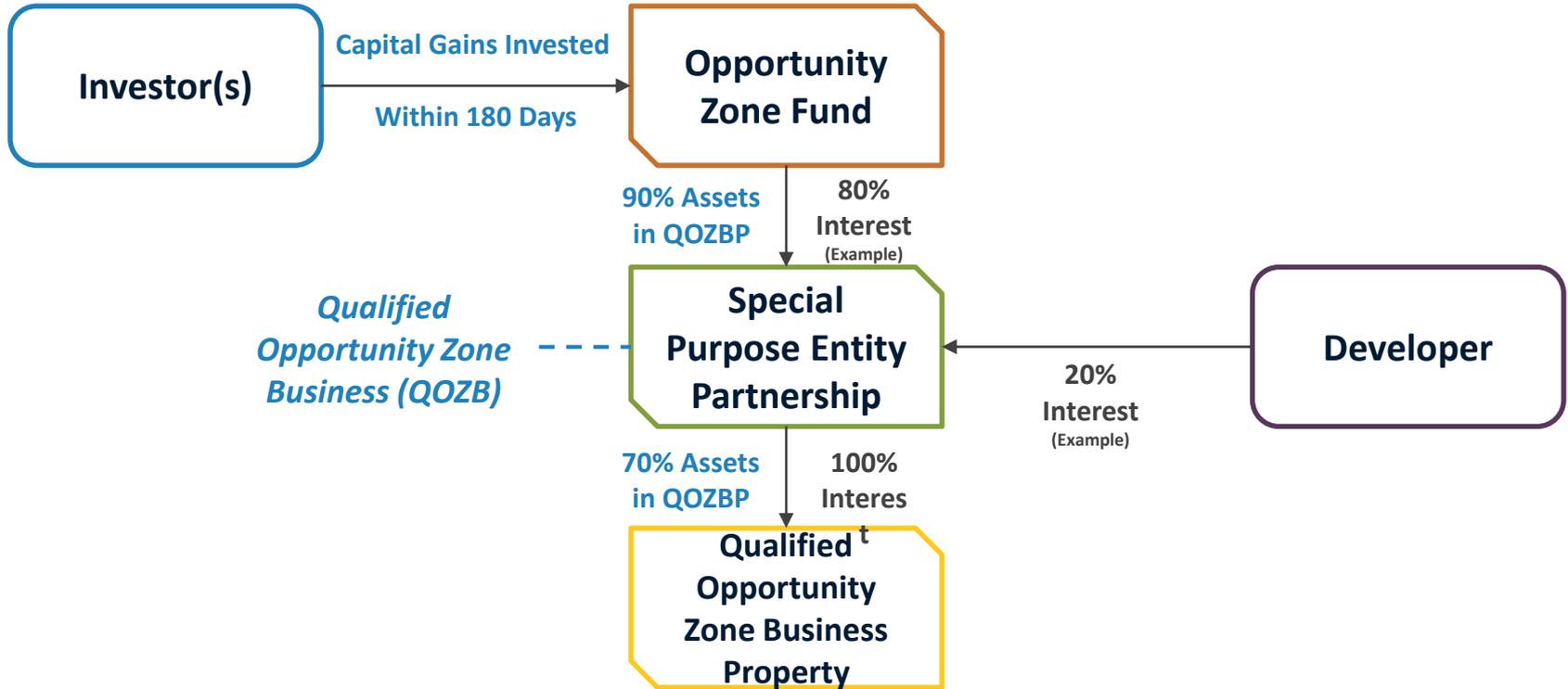
- Must follow guidelines outlined by statute and the Treasury

- Requires self certification, no approval required by IRS
- Complete a form and submit with Federal income tax return

Investment Structure – Direct Investment



Investment Structure – Indirect Investment



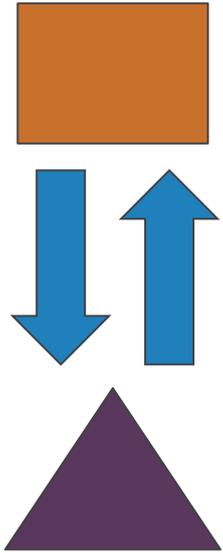
What Can Opportunity Zones Invest In?

- Real Property
 - Original use must be with fund or must be substantially improved
 - Substantially Improved = At least 100% of adjusted basis in property
- Operating Businesses
 - Equity investments or stock purchase
 - Subject to “Substantially All” 70% test
- Equipment

**What Can
Opportunity
Zones Funds
Not Invest In?**

- Private or Commercial Golf Courses
- Country Clubs
- Massage Parlors
- Hot Tub Facility
- Suntan Facility
- Racetrack or other Facility used for Gambling
- Any Store where Principal Business is the Sale of Alcoholic Beverages for Consumption off Premises

Related Party Issues



- Gains generated from a related party sale are not eligible for opportunity zone benefits
- Property purchased from a related party is an ineligible opportunity zone asset
- The definition of a related party is tied to its definition in §267(b) or §707(b)(1)
 - However, must substitute **20%** for 50% each place it occurs in each section

Rev Ruling 2018-29

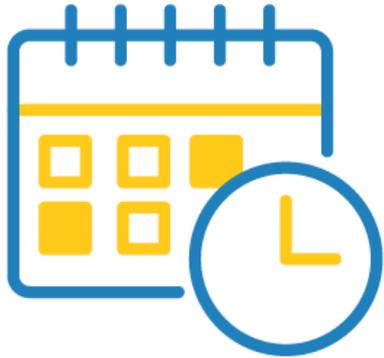
Eases substantial improvement test

Land can be backed out of calculation

Example:

- Purchase property for \$100,000
- Land appraised at \$50,000
- Substantial improvement requirement of \$50,001

10 Year Investment Matters



Clarified the investment does not need to be held 10 years

If investment is sold prior, proceeds can be reinvested into new QOF within 180 days

10-year window is restarted

Working Capital Safe Harbor

- Available at the QOZB Level
- Allows for 31 months to deploy cash at QOZB level
- Alleviates some testing requirements on indirect structure

NEW!

Working Capital Safe Harbor (Continued)

- Now includes:
 - Development of a Trade or Business in QOZ as well as acquisition, construction and/or substantial improvement of tangible property
- QOZB can have multiple overlapping or sequential applications

QOF Timing Flexibility

NEW!

Non-recognition allowance of any investments received in the prior six months for purposes of meeting the 90% asset test on a testing date

12-month redeployment allowance for assets sold during 10-year hold period (interim gains)

- Assets treated as QOZ property during redeployment period

NEW!

Gross Income Test

Requires that 50% of income be from active trade or business within a zone or meets one of the following safe harbors



50% or greater of the services performed by employees or independent contractors (based on hours are performed in the QOZ)



50% or greater of the amount paid for services are for services performed by employees or independent contractors in the QOZ



The tangible property and management and operational functions needed to produce 50% gross income are located in the QOZ

NEW!

Interim Gains

12-month allowance for QOF to reinvest proceeds from asset sale during 10-year hold period.

Investor's holding period is not impacted by QOF's sale of assets (and redeployment).

Investors in QOF partnerships will recognize interim gains under ordinary tax principles.

Valuation Methods

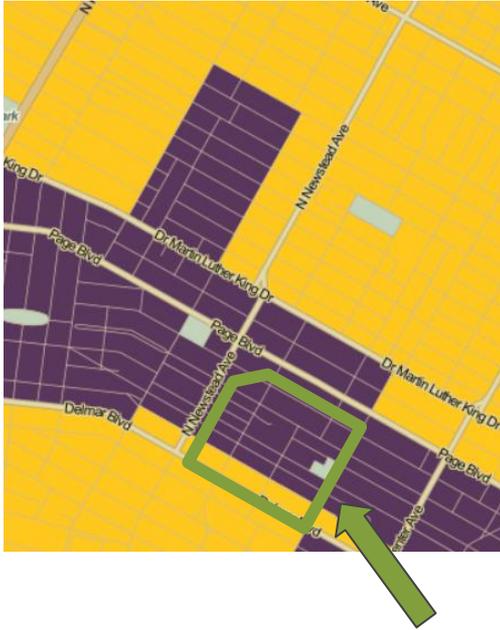
- For 90% asset test of QOFs or 70% Tangible Property Test of QOZB, asset values are determined using either:
 - Values reported on an applicable financial statement
 - Or the cost of the assets

NEW!

Proposed Regs. allow taxpayers to use the adjusted cost basis of property and NPV of lease payments for leased property.

NEW!

Real Property Straddling a QOZ



- If contiguous, property outside of QOZ would be deemed QOZ property if:
 - Amount of real property based on sq. ft. located within a QOZ is substantial (over 50%) as compared to real property outside of the QOZ

NEW!

Greenfield Development



- Land can qualify as QOZBP if used in trade or business of QOF or QOZP
- No original use or substantial improvement requirement
- Subject to anti-abuse rules

NEW!

Original Use – Vacant Property



- Proposed Regulations deem property to be original use if vacant for an uninterrupted period of at least five years
- No substantial improvement required

NEW!

Leased Property



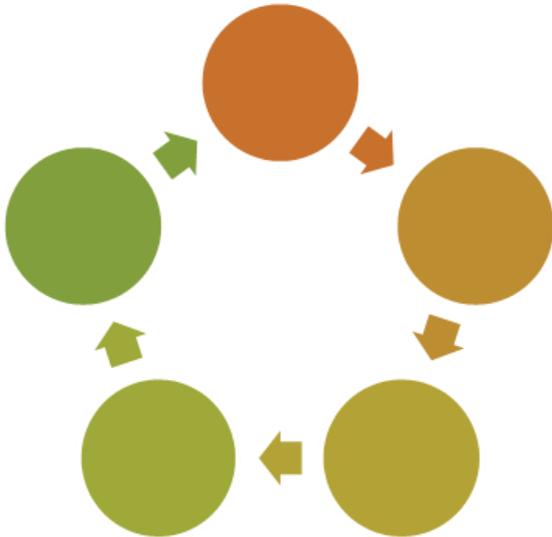
- Leased tangible property can be QOZBP
- No original use requirement
- Must be leased after 12/31/17
- Must be in QOZ during substantially all of the period leased by QOF or QOZB

NEW!

Related Party Leases

Related party leases allowed as long as:

- No prepayment of rent exceeding one year
- Must be “market rate lease” based on common arm’s-length transactions in the locale of QOZ
- Personal property must be acquired by lessee at the earlier of end of lease term or 30 months from start of lease
- Anti-abuse rule to prevent use of leases to avoid substantial improvement requirement for real property



Debt Refinancing and Distributions

Debt financed distributions are allowed, but care should be taken

- Must make sure opportunity zone investors have basis to take distributions
- Distributions cannot be a return of capital
- If return of capital, would trigger a partial disposition of QOF investment
- Can refinance and distribute to the extent of appreciation in property



Further clarification on these rules is needed.

NEW!

Inclusion Events

- Specific (not all-inclusive) list of transactions that trigger deferred gain
- Examples
 - Gifts of interest, including charitable donation
 - Distribution in excess of partner's basis

Additional Items Outlined in

NEW!

Regulations

Inventory in transit does not fail to be QOZBP

Trade or business defined in reference to §162

Ownership and operation of real property included in trade or business income (except for triple-net leases)

“Substantial Portion” as it relates to intangible property used in the active conduct of a trade or business defined as 40%

QOF interests retain tax benefits upon investor’s death

Qualifying QOF investments can be made with property other than cash

Carried interests do not qualify for OZ benefits

Partner’s basis deemed to be zero

Anti-abuse rule: Investments that would otherwise qualify can be re-characterized as non-qualified if the transaction is deemed to achieve a result inconsistent with the purposes of the OZ statute

Issues Created by

NEW!

Regulations

§1231 gains reinvested into QOFs are deemed to have occurred on last day of taxable year

Cannot sell land to unrelated fund and defer gain into same fund

Substantial improvement is on an asset-by-asset basis

- Treasury has requested comment on this

Questions Outstanding (Waiting Further Guidance)

- How are penalties applied
- Additional reporting requirements
 - Changes to Form 8996
 - Request for comments on additional information to gauge success of OZ program
- Requested additional comments on property that is not purchased but is substantially improved
- Its clear we can amend 2017 returns to defer gain into a QOF; however, can we file amended returns for 2018 or later years to take advantage of QOZ election?

Whatever road
leads you to
Opportunity Zones,
CLA is right there
with you.

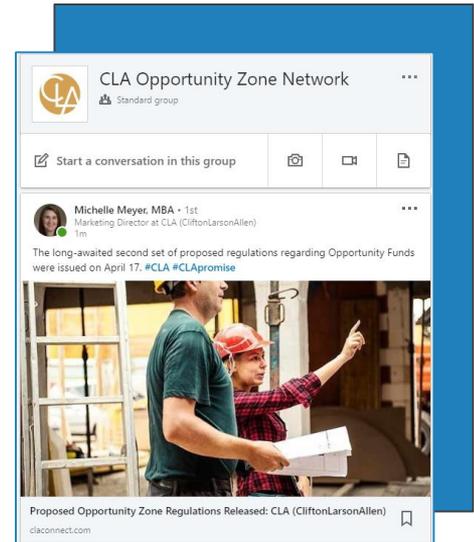


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Questions?

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