QUALIFIED OPPORTUNITY ZONE INVESTMENTS

A Visit to OZ

By

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A. Overview

1. The Opportunity Zone (OZ) Program was established as part of the 2017 Tax Act

2. Some predict that the OZ Program has the potential to be the largest economic development program in the United States

3. The Program has been somewhat stalled due to lack of guidance from the IRS, but partial guidance was made available by Proposed Regulations issued on October 19, 2018

   https://www.gpo.gov/fdsys/pkg/FR-2018-10-29/pdf/2018-23382.pdf

4. By Executive Order, the President established the White House Opportunity and Revitalization Council

   a. The Council is chaired by the Secretary of Housing and Urban Development with the Assistant to the President for Domestic Policy serving as the Vice-Chair

   b. The seventeen (17) other members include the Secretary of the Treasury, the Attorney General, the Secretary of Agriculture, the Secretary of Commerce and the Secretary of Energy

   c. The mission of the Council is to work across agencies to coordinate activities to maximum impact on economically distressed areas, including qualified opportunity zones

      (i) The Council is to recommend policies that would reduce regulatory and administrative burdens; and

      (ii) The Council is to evaluate whether and how agencies can prioritize assistance to qualified opportunity zones

B. Benefits of Opportunity Zone Tax Incentives – There must be gain deferral to get any benefits

1. Gain deferral

   a. Gain is deferred until December 31, 2026 or earlier sale

   b. When recognized, the deferred gain includes the same attributes in the year of inclusion that it would have had if tax on the gain had not been deferred

(i) This would include characterization of capital gain as long-term or short-term

(ii) Attribute of gain probably does not include the tax rate at the time of deferral, but this is not entirely clear

2. Partial forgiveness – 10% of gain is forgiven on property held for five (5) years and an additional 5% for property held for seven (7) years

3. Forgiveness of gain on appreciation if the OZ investment is held for ten (10) years or more

    a. There is total forgiveness of any appreciation

    b. There is an increase in basis of the investment equal to its fair market value on the date the investment is sold or exchanged

    c. The Proposed Regulations provide that a taxpayer can sell a qualified opportunity zone investment by December 31, 2047, after holding it for at least 10 years and still make the election to pay no tax on the gain recognized on such a qualified opportunity zone investment

    d. This is true even though the designation of the area as a qualified opportunity zone expired on December 31, 2028

C. Example

1. June 1, 2018 – Taxpayer sells property that results in $1 million gain

2. November 15, 2018 (within 180 days) – Taxpayer invests $1 million in Qualified Opportunity Fund (QOF)

    a. Taxpayer has $0 basis in the investment in the QOF

    b. QOF invests the taxpayer's funds in Qualified Opportunity Zone Property

3. November 15, 2023 (5 years) – Taxpayer's basis in investment is $100,000 ($100,000 gain forgiven)

4. November 15, 2025 (7 years) – Taxpayer's basis in investment is $150,000 (an additional $50,000 gain is forgiven)

5. December 31, 2026 ("First Recognition Date") – Taxpayer pays tax on $850,000 deferred gain (less if the fair market value of property has declined)

6. November 15, 2038 (20 years) ("Second Recognition Date") – Taxpayer sells investment for $2,000,000 and there is no tax on the $1,000,000 appreciation

D. Principles of Program

1. OZ investment must be equity, not a loan

2. OZ investment must be long-term

3. OZ investment must result in improvement in OZ

E. What is a Qualified Opportunity Zone (QOZ)?

1. A qualified opportunity zone is a census tract that is a low-income community designated as a QOZ

2. The definition of low-income community refers to the New Markets Tax Credit (Code Section 45D(e))

    a. The poverty rate is at least 20%

    b. The median family income for the census tract does not exceed 80% of the statewide median family income or the metropolitan area median family income, as applicable

3. QOZ remain in effect through December 31, 2028, although recent guidance indicates that taxpayer may hold assets until December 31, 2047

4. Over 8,700 census tracts located in the United States have been designated (approximately 11% of the country by census tract) – 100% of Puerto Rico is a QOZ

5. The governors of each state submitted proposals for opportunity zones, but could designate no more than 25% of the eligible tracts

6. OZ must meet basic low-income criteria, but contiguous census tracts could be designated

7. OZ are fixed and will not change

F. What is a Qualified Opportunity Fund (QOF)?

1. A QOF is an investment fund organized as a corporation or partnership for the purpose of investing in a Qualified Opportunity Zone Property (QOZP)

    a. The investment in a QOF must be an equity interest in the QOF

        (i) Investors in the QOF can negotiate different business arrangements (preferred stock and partnership interests with special allocations are permitted)

(ii) Some investors might want cash earlier while others may prefer to wait

b. The interest can be used as collateral for a loan

c. The QOF must be certified, although the fund self-certifies without IRS approval

(i) The certification is done on Form 8996

https://www.irs.gov/pub/irs-drop/rr-18-29.pdf

(ii) The form must identify the first taxable year of being a QOF

(iii) QOFs may choose the month that the certification is effective

(iv) Investments made prior to the first effective month will not qualify for QOF benefits

2. There is no limit on the number of funds or the amount of gain

3. Note that only the gain from the prior investment, and not the full amount of the corpus of the prior investment, must be reinvested

4. When does a QOF begin?

a. A QOF will choose the first month in its taxable year in which it will be treated as a QOF. If a month is not chosen, the first month will default to the first month of the taxable year

b. The "first 6-month period of the taxable year of the fund" means the first 6-month period composed entirely of months which are within the taxable year and during which the entity is a QOF

5. A QOF must hold 90% of its assets in QOZ property

a. Tested six months after QOF status is effective

b. Tested at end of first tax year

c. Carefully pick first year – bad example

(i) QOF selects October 1, 2019 as first month

(ii) QOF only has 90 days to invest to meet 90% test

(iii) Investments before October 1, 2019 would not qualify

d. Carefully pick first year – good example

(i) QOF picks June 2019 as first month

(ii) First 90% test would be November 30, 2019

(iii) Second 90% test on December 31, 2019

e. Cash may cause a QOF to fail the 90% test, subject to an exception for maintenance of cash as "reasonable working capital" – See Section O(3) below

f. The Proposed Regulations somewhat clarified the valuation method for applying the 90% asset test

g. For applying the 90% asset test, the QOF uses the asset values that are reported on the QOF's applicable financial statement for the taxable year (as defined in § 1.475(a)-4

(i) There are issues with the definition of financial statements used in the regulation because most QOFs do not technically have the type of financial statements described in (typically applies to dealers in securities)

(ii) IRS has informally indicated that it will not follow technical requirements for financial statements, but there is no formal guidance

h. If a QOF has no applicable financial statement, the QOF uses the cost of its assets

6. Three types of business property are eligible for investment

a. Original-issue stock of a QOZ corporation

b. Interest in a QOZ partnership

c. Tangible property in QOZ that is substantially improved which is:

(i) New construction

(ii) Very substantial rehabilitation – rehabilitation must equal or exceed acquisition cost

(iii) Use of financial statements could be an issue for the 90% test because the asset will depreciate

(iv) Special attention needs to be given to operating leases because of changing GAAP rules

7. Can a QOF be organized as an LLC?

   a. The Tax Act refers to "any investment vehicle <u>organized</u> as a corporation or partnership" (Section 1400Z-2(d))

   b. The Proposed Regulations clarified that a QOF must be classified as a corporation or partnership for Federal income tax purposes, which includes an LLC

8. Where can the QOF be organized?

   a. The QOF must be created or organized in a U.S. state or the District of Columbia

   b. One exception is that a QOF organized to invest in property in a U.S. territory may be organized in that territory

   c. A pre-existing entity can qualify if it meets the statutory requirements

G. What is a Qualified Opportunity Zone Business (QOZB)?

1. A QOZB is a trade or business in which substantially all of the tangible property owned or leased by the business is qualified opportunity zone business property (QOZBP)

   a. The property must have been acquired by purchase after December 31, 2017

   b. Guidance is needed as to whether substantial improvements to property that was acquired before December 31, 2017 can be considered separate QOZBP

   c. The meaning of "substantially all" must constitute zone business property

      (i) If at least 70 percent of the tangible property owned or leased by a trade or business is qualified opportunity zone business property, the trade or business is treated as satisfying the <u>substantially all</u> requirement

      (ii) The business uses the asset values that are reported on its financial statement for the taxable year (as defined in § 1.475(a)-4(h) or cost basis (see discussion above)

      (iii) Since the QOF must meet the 90% asset test and a QOZB needs to meet a 70% safe harbor, it appears that, in combination, the QOF and QOZB may need to only hold 63% of their assets in QOZ property

(iv) Substantially all is also used in several other sections of the statute and is to be addressed in the additional proposed regulation to be published in the "near future"

2. Investments cannot include "sin businesses" which include:

   a. Commercial golf course or country club

   b. Massage parlor

   c. Hot tub facility

   d. Suntan facility

   e. Racetrack or other facility for gambling

   f. Off-sale liquor store

3. At least 50% of the income is derived from the "active conduct" of the businesses

   (i) For purposes of IRC 1400Z-2, in order for an entity in which a QOF invests to be a QOZB, 50% of the total gross income of such entity must be derived from the active conduct of such business

   (ii) One suggestion is to adopt the NMTC interpretation so the QOF must reasonably expect that the entity will generate revenues within three years after the date of the investment

   (iii) This Section is labeled as "Reserved" in the Proposed Regulations. Apparently, this will be addressed in the next regulations.

4. A substantial portion of the intangible property is used in the active conduct of the business

   (i) Guidance is required as to what constitutes "active conduct"

   (ii) See Section O(6) below

5. Less than 5% of the average of the aggregate unadjusted bases of the entity's property can be attributable to "nonqualified financial property," such as debt, stock, partnership interests, options, future contracts, forward contracts, swaps, annuities, and similar property (excluding reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less, or ordinary course trade or business notes receivable)

6. What is reasonable working capital for an QOZB?

   a. The Proposed Regulations provide a safe harbor for 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

b. For projects that are being constructed, the Proposed Regulations provide that "working capital" includes cash (as well as cash equivalents and debt instruments with a term of 18 months or less) maintained by the QOF for up to 31 months after acquiring the qualified opportunity zone property for the purpose of acquiring, constructing or rehabilitating the property if:

(i) There is a written plan that identifies such cash as being held for this purpose,

(ii) There is a written schedule consistent with the ordinary business operations of the business that the property will be used within 31 months, and

(iii) The business substantially complies with the schedule

c. Additional guidance is required to allow QOFs to hold reasonable cash reserves

(i) Time is needed to invest funds after received

(ii) IRS should issue guidance to allow 12 months to invest, similar to NMTC Program

H. Qualified Opportunity Zone Business Property (QOZBP)

1. Tangible property used in a trade or business

2. Acquired by purchase from an unrelated party (20% test) after December 31, 2017

3. During substantially all of the holding period, substantially all of the use is in the QOZ

4. New use or substantial improvement

a. Original use in the QOZ, or

b. Substantial improvement

(i) During any 30-month period beginning after the date of acquisition…additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis at the beginning of such 30-month period

(ii) "During substantially all of the QOF's holding period for such stock/interest, such corporation/partnership qualified as a QOZB

(iii) If entity acquires property with a plan to construct or rehabilitate, is the property a QOZB while it is waiting for construction or when it is being constructed/rehabilitated?

(iv) Land cost is not included in determining the amount that must be expended during the 30-month period where the land is under an existing building

(v) There is some question as to whether vacant land (in contrast to land under existing building) must be included in determining the amount that must be expended

5. A QOZB that ceases to be a QOZ business property shall continue to be treated as such for five years or until no longer held (if earlier)

I. Details Regarding Investments in QOFs

1. Who must make the investment?

a. The Proposed Regulations clarify that taxpayers eligible to elect deferral include individuals, C corporations (including regulated investment companies (RICs) and real estate investment trusts (REITs)), partnerships, and certain other pass-through entities, including common trust funds described in section 584, as well as, qualified settlement funds, disputed ownership funds, and other entities taxable under § 1.468B of the Income Tax Regulations

b. The Proposed Regulations include special rules for partnerships and other pass-through entities, and for taxpayers to whom these entities pass through income and other tax items

c. Can a QOF investor that does not make a substantial cash contribution to the QOF receive QOF appreciation benefits (interest in exchange for services)?

2. How are gains of partnerships treated?

a. Under the Proposed Regulations, a partnership may elect to defer all (or part) of a capital gain. If an election is made, the elected deferred gain is not included in the distributive shares of the partners

b. If the partnership doesn't elect to defer the gain, a partner may elect its own deferral with respect to the partner's share of the distribution. The partner's 180-day period begins on the last day of the partnership's taxable year

(i) Note this can effectively extend the time to invest the gain

(ii) Could be up to 544 days from date of gain (364 days plus 180 days)

c. The partner may also choose to begin its own 180-day period on the same date as the start of the partnership's 180-day period

d. You may want to revise existing partnership agreement to:

(i) Inform partners about sales so that they can choose start of 180 period

(ii) Provide process for the GP to get consent prior to making election to defer gain at partnership level

e. Note the Proposed Regulations do not address whether, when a partnership itself elects to defer gain and invest in a QOF, the bases of partners interests in the electing partnership also step up

f. Similar rules apply for RICs and REITs

g. The rules do not address how capital gains generated by a member of a consolidated return group should be treated

h. You may want to move investments to partnerships to extend time Partnership incurs gain on January 1, 2018 – Partners may have until June 28, 2019 to invest – 180 days after December 31, 2018 – end on Partnership tax year (544 days), although IRS has been asked to issue guidance confirming that there can be two separate 180 day periods

3. When must taxpayer make the investment?

a. The Proposed Regulations provide that, except as specifically provided in the Proposed Regulations, the first day of the 180-day period is the date on which the gain would be recognized for Federal income tax purposes, without regard to the deferral available under section 1400Z-2

b. The Proposed Regulations include examples that illustrate the general rule by applying it to capital gains in a variety of situations (including, for example, gains from the sale of exchange-traded stock and capital gain dividend distributions)

c. A taxpayer can elect to defer and invest only a portion of the gain and invest balance in the same or different QOF within 180 days of the gain event

d. Be careful about timing of capital contributions and the "substantially all" test

(i) QOF plans to invest $6,000,000 in LLC on February 1, 2019 and $6,000,000 on February 1, 2020

(ii) The LLC has $4,000,000 of property that is owned prior to January 1, 2018 (not QOZB because acquired before January 1, 2018)

(iii) The LLC has taken the steps to have the $6,000,000 meet the reasonable working capital requirements

(iv) The LLC fails the substantially all test because the $6,000,000 working capital is only 60% of the LLC's $10,000,000 of assets

(v) The QOF investment in the LLC would not qualify as eligible QOZ property, so the QOF fails the 90% test

(vi) The solution is for the QOF to invest all $12,000,000 up front so that 75% of asset would qualify ($12,000,000 ÷ 16,000,000 = 75%)

4. What gains are eligible for tax deferral?

a. The title to Section 1400Z-2 refers to capital gains, but the statute refers to gains

b. The Proposed Regulations clarified that only capital gains are eligible for deferral

c. Eligible gains do not include gains from:

(i) Sale of inventory

(ii) Assets held for sale to customers in the ordinary course of business

(iii) Depreciation recapture

(iv) Section 291 gain

(v) Straddles

d. The gain to be deferred must be gain that would be recognized, if deferral under Section 1400Z-2(a)(1) were not permitted, not later than December 31, 2026

e. The gain must not arise from a sale or exchange with a related person as defined in Section 1400Z-2(e)(2). Section 1400Z-2(e)(2) incorporates the related person definition in Sections 267(b) and 707(b)(1) but substitutes "20 percent" in place of "50 percent" each place it occurs

f. Exit tax liability from a LIHTC or HTC transactions should qualify to the extent the sale is not to a related party to the extent the gain is not ordinary income due to depreciation

(i) If general partner with more than 20% interest in limited partnership buys project, neither the partnership or partners would benefit from investing in QOF because it is a related party sale

(ii) By contrast, if the general partner buys the partnership interests of the other partners, they would have unrelated gain and could invest in a QOF

5. What happens when a taxpayer purchases multiple interests in QOFs and disposes of interests?

a. Where a taxpayer purchases multiple interests in a QOF with identical rights and later sells a portion of the interests, FIFO (first in, first out) will be used

b. Identical rights would be equivalent shares of corporate stock in a corporation or partnership interests with identical rights

c. A pro-rata method is used where multiple identical interests in a QOF were purchased on the same day

d. A taxpayer had a short-term capital gain in December 2018 that was invested for 100 shares in a QOF in March 2019 and then a long-term capital gain in April 2019 that was invested for another 100 identical shares in the QOF in June 2018

e. In 2020, the taxpayer sold 100 shares of the QOF

f. That sale would trigger the short-term capital gain that occurred in December 2018

g. It is unclear what happens if QOF reinvests gain received during 10 years – See Section 0.4

J. Direct Versus Indirect Investment

1. An QOF may invest directly in projects or may invest indirectly through a corporate or partnership subsidiary

2. Property must be acquired from an unrelated person (20% standard) by the QOF after December 31, 2017 and

a. The original use of the property must commence with the QOF or subsidiary, or

b. The QOF or the subsidiary must substantially improve the property

3. 90% of the funds must:

a. For a direct investment, be invested in QOZ business, or

b. For an indirect investment, be invested in qualified stock or partnership interests of the subsidiary

4. Cash or Liquid Investments

a. For a direct investment, 10% of the QOF's assets may be held in cash or liquid investments

b. For an indirect investment, 5% plus "reasonable working capital" of the QOF assets may be invested in cash or liquid investments

5. Type of Property

a. For a direct investment, only 10% of the assets may be intangible property and 90% must be invested in tangible property

b. For an indirect investment, there is no limit, but the intangible property must be used in the active conduct of a trade or business (50% test)

6. Indirect investments require that 50% of the gross income must be derived from OZ. This leads to a number of questions for an operating business:

a. Where is the business located?

b. Where are the components manufactured?

c. Where are the components assembled?

d. Where is the product sold – distribution facility?

e. Where can the product be purchased?

K. Can a QOF Dispose of and Reinvest in Assets?

1. How will intermittent gain be treated?

a. Can the QOF invest in and dispose of assets during the seven-year period and still qualify for the 15% increase in basis?

b. That seems to be consistent with the stated policy of the program, but the Proposed Regulations did not directly address the issue

2. How long does QOF have to reinvest the return of capital from investments?

   a. The Statute provided that Regulations are to authorize that a QOF has a reasonable period of time to reinvest the return of capital

   b. Issue if QOF sells QOF property shortly before a testing date

   c. This is to be addressed in "soon-to-be-released" regulations

L. Can QOZ Be Used For An Existing Building?

1. The program really does not apply to a building owned before December 31, 2017.

2. The program may increase the sales price that someone is willing to pay for land/building in QOZ

3. There may be options to develop a project with LIHTC or HTC where owner sells property to LLC or limited partnership and is not a related party

M. Non-Compliance Penalty

1. For every month it fails to meet 90% test, there is a monthly penalty

   a. The penalty is equal to the excess of (i) the amount equal to 90% of the aggregate assets less (ii) the aggregate amount of QOZ property held by the QOFmultiplied by the underpayment penalty in § 6621(a)(2)

   b. Example – Taxpayer has 10,000,000 assets, 80% of which is QOZP. Assuming a 5% penalty rate, the penalty would be $50,000 ($9,000,000 (10,000,000 x 90%) x 5%

2. There is a reasonable cause exception to the penalty

3. It is unclear as to time that penalty will be charged (per month or per year)

4. How are the assets valued for the test?

N. Potential to Combine with Other Programs

1. New Markets Tax Credits

   a. The seven-year NMTC investment term is compatible with the OZ seven-year period for 15% basis increase

   b. If the NMTC investor is also the investor seeking to defer gain through the OZ program, the total investment must be treated as equity

c. The OZ requirement that the investment be equity rather than loans is not compatible with the typical NMTC structure

d. NMTC zones and OZ are not identical

e. QALICBs and QOZ businesses are similar

f. CDES may need to have their applications amended to permit equity investments

g. CDEs would have to become a QOF

h. Investors may not be interested in equity investments

i. Deferral election may be limited as NMTC investors will need basis to take required NMTC basis deduction

2. Historic Credits

a. Any qualified historic property in an OZ could qualify for OZ benefits and historic credits

b. Five-year HTC holding period is shorter than 10-year OZ holding period

c. For pass-through structures – the master tenant needs to be the QOF to avoid non-qualified financial property issues in landlord

3. Low-Income Housing Tax Credits

a. The 15-year compliance period is compatible with the 10-year OZ period

(i) Investors will have to plan for tax payment on December 31, 2026

(ii) The lack of appreciation in LIHTC projects may be a deterrent

b. Substantial rehab rules under OZ are much greater

(i) $6,000+/unit for LIHTC

(ii) Must equal beginning basis for OZ

c. Timing of substantial rehab differs

(i) 24 months for LIHTC

(ii) 30 months for OZ

d. Addressing Exit Tax Liability

(i) When gain is determined in December 2026, it will be based on the fair market of the partnership interest which will be less because there will be very few remaining tax credits

(ii) Limited partner will be able to avoid recognition of gain on negative capital account because that is gain from disposition of interest in QOF

e. Be careful when structuring exit from existing LIHTC partnership because a transfer of property from the partnership to the general partner would be a related party transfer if the general partner has more than 20% interest in the limited partnership

(i) Proceeds from related party transfers do not qualify for QOZ

(ii) Instead have general partner acquire the limited partner interests

4. Renewable Energy – These programs are potentially less compatible because of lack of appreciation

O. 1031 Versus Opportunity Zone

1. When is gain realized?

a. For 1031, when property disposition occurs

b. For OZ, earlier of property disposition or December 31, 2026

2. Time for investing gain:

a. For 1031, gain must be invested within six months

b. For OZ, gain must be invested in QOF within six months and QOF has additional six months to invest in property

3. 1031 only applies to gain from real property

4. Amount of investment:

a. For 1031, the full corpus of the current investment must be reinvested. Proceeds from the current investment must be held by a qualified intermediary

b. For OZ, only gain on current investment must be reinvested and there is no requirement that the proceeds be held by a qualified intermediary

P. Major Outstanding Issues

1. What happens if capital is invested in installments?

a. Typically, investors make equity investment in installments depending on satisfaction of conditions

b. Unfortunately, the grace period that the safe harbor establishes for businesses to qualify only applies to businesses with working capital. Businesses serially drawing capital from investors and/or lenders and therefore not holding working capital reserves are not eligible for the safe harbors and therefore do not have time to qualify.

2. Treatment of Leases

a. Can a business that consists of leasing residential rental property qualify as an opportunity zone business?

(i) Residential rental property is not listed in IRC § 1400Z2

(ii) Rev. Rul. 2018-29 describes a residential rental project so seems to indicate that direct ownership of a residential rental property by a QOF qualifies

(iii) The revenue ruling does not expressly address ownership of residential rental property owned indirectly through a QOZB

(iv) Section 1397C (b) may require that a corporation or partnership be considered a "qualified business entity"

(v) Under Section 1397C(d), a qualified business is prohibited from leasing residential rental property

(vi) Since Treasury has specifically mentioned the use of OZ with LIHTC, this should be clarified

b. How is a lease of tangible property treated under the OZ Program?

(i) OZ business property means property acquired by purchase and does not appear to include a lease (Code Section 179(d)(2))

(ii) Only finance leases should be required to be QOZB property and the operating leases should be exempt from the requirement

3. Timing of investment of funds received by QOF is still an issue

a. A QOF needs some reasonable period of time to invest funds received

b. While the working capital exception provides some relief, QOFs may be unable to accept funds from taxpayers within the 180-day requirement if QOF investments are not identified and ready to close

c. A QOF should have at least 12 months to invest funds

4. Can gains realized by QOF be deferred if reinvestment in replacement eligible property?

a. IRC § 1400Z-2 provides that "the second main tax incentive in the bill excludes from gross income the post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years

b. The statute refers to the investment in the QOF rather than individual assets

c. Treasury has been requested to issue guidance permitting the QOF to defer recognition of gains if the proceeds from the sale of an asset are reinvested in eligible property within 12 months

5. Does a return of a portion of the partner's cash (not to exceed the partner's basis in its QOF interest) as a result of a refinancing of the asset owned by the QOF constitute a sale or exchange that triggers the end of the tax deferral period

6. What constitutes the active conduct of a trade or business in the opportunity zone?

a. The NMTC guidelines should be adopted to determine active conduct

b. The NMTC rules treat an entity as engaged in the active conduct of a trade or business if at the time the investment is made, the investor reasonably expects that the entity will generate revenues within three years

c. Guidelines also need to be adopted for determining where a business's gross income is derived, perhaps tied to the percentage of where the business's tangible property is used

Q. State Tax Implications

1. State tax laws will impact benefits

a. The New York State Department of Taxation and Finance said that deferral or exclusion of gains will flow through to New York taxpayers (with a caveat that New York could consider decoupling from the federal provision)

b. The California Franchise Tax Board, on the other hand, stated that California will not conform to the deferral and exclusion of capital gains reinvested or invested in QOFs

2. OZ benefits increase if state conforms to federal law

3. Some states are adopting specific legislation to address OZ

4. Several states could be involved in determining tax liability based on where gain occurred and where the OZ fund is

    a. State where original gain was realized

    b. State where QOF is organized

    c. State of residency of the taxpayer

R. Example – Rev. Rul. 2018-29 – Rehabilitation

1. In September 2018, QOF buys a factory located in a QOZ

2. The purchase price is $800,000, $480,000 is for land and $320,000 for building

3. Within 24 months, QOF invests $400,000 to rehab building

4. How does this qualify?

    a. Purchased after December 31, 2017

    b. The use of the property is in the QOZ

    c. Property is substantially improved doing 30-month period because the additions to basis with respect to tangible property in hands of QOF exceed the adjusted basis of the tangible property at the beginning of the 30 month period

5. Is land included? No

    a. QOF spent $400,000 – not more than total purchase price, but more than $320,000 building

    b. QOF doesn’t have to substantially improve land

6. What this doesn’t answer? Timing

EXHIBIT A

OZ Timeline

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November 15, 2018

Qualified Opportunity Zones
Three Tax Benefits

1. Deferral of Tax on the Current Gain
2. Partial Reduction in Tax on the Current Gain
3. Complete Avoidance of Tax on Gain from Investment in QOF

(1) Current Gain	(2) Current Gain	(3) QOF
Deferral	Reduction	Avoidance
2018		
2019		
2020	Y1	Y1
2021	Y2	Y2
2022	Y3	Y3
2023	Y4	Y4
2024	Y5 (10%)	Y5
2025	Y6	Y6
2026	Y7 (5%)	Y7
2027		Y8
2028		Y9
2029		Y10
2030		Y11
2031		Y12
2032		Y13
2033		Y14
2034		Y15

EXHIBIT B

OZ v. Traditional Comparison 7%

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November 15, 2018

Illustrative Scenario - After-Tax Potential Net Returns
$100,000 Investment over 10-year hold (assuming 7% annual appreciation)

Traditional Stock Portfolio

	Gain	23.8% Less Taxes	Net Investment	7% Appreciation	Appreciated Value
Y1	100,000	(23,800)	76,200	5,334	81,534
Y2				5,707	87,241
Y3				6,107	93,348
Y4				6,534	99,883
Y5				6,992	106,874
Y6				7,481	114,356
Y7				8,005	122,361
Y8				8,565	130,926
Y9				9,165	140,091
Y10	-	(17,540)	-	9,806	132,357
	100,000	(41,340)	76,200	73,697	

Original investment	100,000
Appreciation	73,697
Taxes	(41,340)
Net after-tax value after 10 years	132,357
Original investment	100,000
ROI	32,357
IRR	3.2%

Opportunity Fund

	Gain	23.8% Less Taxes	Net Investment	7.00% Appreciation	Appreciated Value
Y1	100,000		100,000	7,000	107,000
Y2				7,490	114,490
Y3				8,014	122,504
Y4				8,575	131,080
Y5				9,176	140,255
Y6				9,818	150,073
Y7				10,505	160,578
Y8		(20,230)		11,240	151,589
Y9				10,611	162,200
Y10	-	-	-	11,354	173,554
	100,000	(20,230)	100,000	93,784	

Original investment	100,000
Appreciation	93,784
Taxes	(20,230)
Net after-tax value after 10 years	173,554
Original investment	100,000
ROI	73,554
IRR	6.3%

EXHIBIT C

Comparison 5%

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November 15, 2018

Illustrative Scenario - After-Tax Potential Net Returns
$100,000 Investment over 10-year hold (assuming 5% annual appreciation in OZ)

Traditional Stock Portfolio

	Gain	23.8% Less Taxes	Net Investment	7% Appreciation	Appreciated Value
Y1	100,000	(23,800)	76,200	5,334	81,534
Y2				5,707	87,241
Y3				6,107	93,348
Y4				6,534	99,883
Y5				6,992	106,874
Y6				7,481	114,356
Y7				8,005	122,361
Y8				8,565	130,926
Y9				9,165	140,091
Y10	-	(17,540)	-	9,806	132,357
	100,000	(41,340)	76,200	73,697	

Original investment	100,000
Appreciation	73,697
Taxes	(41,340)
Net after-tax value after 10 years	132,357
Original investment	100,000
ROI	32,357
IRR	3.2%

Opportunity Fund

	Gain	23.8% Less Taxes	Net Investment	5% Appreciation	Appreciated Value
Y1	100,000		100,000	5,000	105,000
Y2				5,250	110,250
Y3				5,513	115,763
Y4				5,788	121,551
Y5				6,078	127,628
Y6				6,381	134,010
Y7				6,700	140,710
Y8		(20,230)		7,036	127,516
Y9				6,376	133,891
Y10	-	-	-	6,695	140,586
	100,000	(20,230)	100,000	60,816	

Original investment	100,000
Appreciation	60,816
Taxes	(20,230)
Net after-tax value after 10 years	140,586
Original investment	100,000
ROI	40,586
IRR	3.9%

EXHIBIT D

Comparison Breakeven

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November 15, 2018

Illustrative Scenario - After-Tax Potential Net Returns
$100,000 Investment over 10-year hold (assuming 4.4% annual appreciation in OZ)

Traditional Stock Portfolio

	Gain	23.8% Less Taxes	Net Investment	7% Appreciation	Appreciated Value
Y1	100,000	(23,800)	76,200	5,334	81,534
Y2				5,707	87,241
Y3				6,107	93,348
Y4				6,534	99,883
Y5				6,992	106,874
Y6				7,481	114,356
Y7				8,005	122,361
Y8				8,565	130,926
Y9				9,165	140,091
Y10	-	(17,540)	-	9,806	132,357
	100,000	(41,340)	76,200	73,697	

Original investment	100,000
Appreciation	73,697
Taxes	(41,340)
Net after-tax value after 10 years	132,357
Original investment	100,000
ROI	32,357
IRR	3.2%

Opportunity Fund

	Gain	23.8% Less Taxes	Net Investment	4.44% Appreciation	Appreciated Value
Y1	100,000		100,000	4,441	104,441
Y2				4,638	109,079
Y3				4,844	113,924
Y4				5,059	118,983
Y5				5,284	124,267
Y6				5,519	129,786
Y7				5,764	135,550
Y8		(20,230)		6,020	121,340
Y9				5,389	126,729
Y10	-	-	-	5,628	132,357
	100,000	(20,230)	100,000	52,587	

Original investment	100,000
Appreciation	52,587
Taxes	(20,230)
Net after-tax value after 10 years	132,357
Original investment	100,000
ROI	32,357
IRR	3.2%

EXHIBIT E

GRAPH

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November 15, 2018

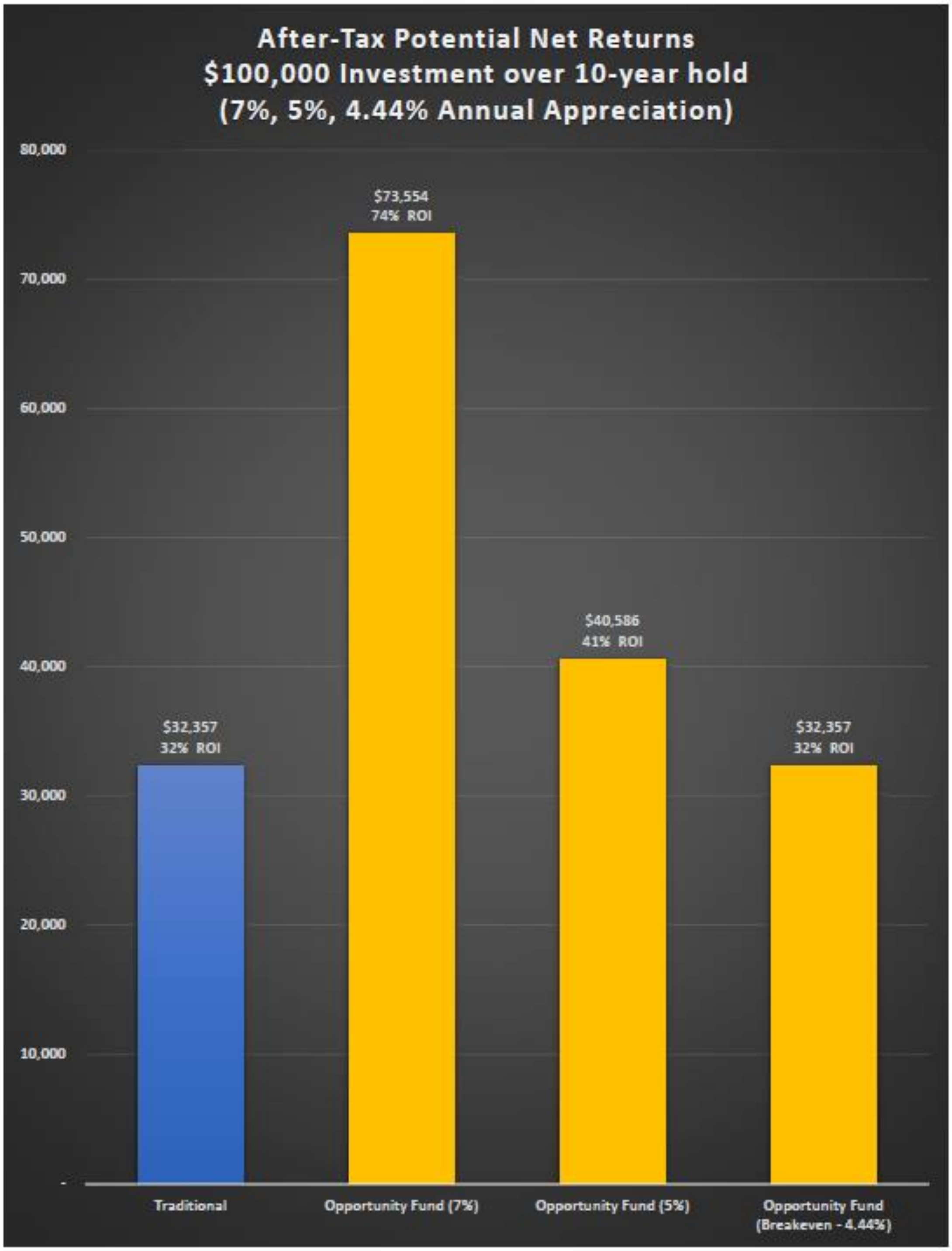

EXHIBIT F

LIHTC IRR / Pricing Comparison

Mahoney Ulbrich Christiansen Russ P.A.
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November 15, 2018

HYPOTHETICAL - FOR ILLUSTRATION PURPOSES ONLY.

Opportunity Zones
Hypothetical $35 m TDC, 4% bond deal

Schedule of Investor's Hypothetical Internal Rate of Return - Income Tax Basis
December 31, 2018 through 2034

	Cash Investment	Taxable Income (Loss)	Tax Rates	Tax Benefits (Costs)	Cash Distributions	Housing Tax Credits	Projected Tax Benefit (Cost) upon Disposition	Net (Investment) Benefit	Cumulative
2018	$ 1,860,000	$ -	21.00%	$ -	$ -	$ -	$ -	$ (1,860,000)	$ (1,860,000)
2019	-	(1,312,868)	21.00%	275,702	-	-	-	275,702	(1,584,298)
2020	7,440,000	(862,920)	21.00%	181,213	-	500,000	-	(6,758,787)	(8,343,084)
2021	-	(863,258)	21.00%	181,284	-	1,000,000	-	1,181,284	(7,161,800)
2022	-	(844,250)	21.00%	177,292	-	1,000,000	-	1,177,292	(5,984,508)
2023	-	(824,946)	21.00%	173,239	-	1,000,000	-	1,173,239	(4,811,269)
2024	-	(805,338)	21.00%	169,121	-	1,000,000	-	1,169,121	(3,642,148)
2025	-	(785,915)	21.00%	165,042	-	1,000,000	-	1,165,042	(2,477,106)
2026	-	(765,668)	21.00%	160,790	-	1,000,000	-	1,160,790	(1,316,316)
2027	-	(745,086)	21.00%	156,468	-	1,000,000	-	1,156,468	(159,848)
2028	-	(724,157)	21.00%	152,073	-	1,000,000	-	1,152,073	992,225
2029	-	(702,868)	21.00%	147,602	-	1,000,000	-	1,147,602	2,139,828
2030	-	(681,757)	21.00%	143,169	-	500,000	-	643,169	2,782,997
2031	-	(766,396)	21.00%	160,943	-	-	-	160,943	2,943,940
2032	-	(754,998)	21.00%	158,550	-	-	-	158,550	3,102,489
2033	-	(743,043)	21.00%	156,039	-	-	-	156,039	3,258,528
2034	-	(912,632)	21.00%	191,653	-	-	(797,181)	(605,528)	2,653,000
	$ 9,300,000	$ (13,096,101)		$ 2,750,181	$ -	$ 10,000,000	$ (797,181)	$ 2,653,000	

Internal Rate of Return (IRR)	5.3%
Price	0.93

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November 15, 2018

HYPOTHETICAL - FOR ILLUSTRATION PURPOSES ONLY.

Opportunity Zones
No exit tax

Schedule of Investor's Hypothetical Internal Rate of Return - Income Tax Basis
December 31, 2018 through 2034

	Cash Investment	Taxable Income (Loss)	Tax Rates	Tax Benefits (Costs)	Cash Distributions	Housing Tax Credits	Projected Tax Benefit (Cost) upon Disposition	Net (Investment) Benefit	Cumulative
2018	$ 1,860,000	$ -	21.00%	$ -	$ -	$ -	$ -	$ (1,860,000)	$ (1,860,000)
2019	-	(1,312,868)	21.00%	275,702	-	-	-	275,702	(1,584,298)
2020	7,440,000	(862,920)	21.00%	181,213	-	500,000	-	(6,758,787)	(8,343,084)
2021	-	(863,258)	21.00%	181,284	-	1,000,000	-	1,181,284	(7,161,800)
2022	-	(844,250)	21.00%	177,292	-	1,000,000	-	1,177,292	(5,984,508)
2023	-	(824,946)	21.00%	173,239	-	1,000,000	-	1,173,239	(4,811,269)
2024	-	(805,338)	21.00%	169,121	-	1,000,000	-	1,169,121	(3,642,148)
2025	-	(785,915)	21.00%	165,042	-	1,000,000	-	1,165,042	(2,477,106)
2026	-	(765,668)	21.00%	160,790	-	1,000,000	-	1,160,790	(1,316,316)
2027	-	(745,086)	21.00%	156,468	-	1,000,000	-	1,156,468	(159,848)
2028	-	(724,157)	21.00%	152,073	-	1,000,000	-	1,152,073	992,225
2029	-	(702,868)	21.00%	147,602	-	1,000,000	-	1,147,602	2,139,828
2030	-	(681,757)	21.00%	143,169	-	500,000	-	643,169	2,782,997
2031	-	(766,396)	21.00%	160,943	-	-	-	160,943	2,943,940
2032	-	(754,998)	21.00%	158,550	-	-	-	158,550	3,102,489
2033	-	(743,043)	21.00%	156,039	-	-	-	156,039	3,258,528
2034	-	(912,632)	21.00%	191,653	-	-	-	191,653	3,450,181
	$ 9,300,000	$ (13,096,101)		$ 2,750,181	$ -	$ 10,000,000	$ -	$ 3,450,181	

Internal Rate of Return (IRR)	6.1%
Price	0.93

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November 15, 2018

HYPOTHETICAL - FOR ILLUSTRATION PURPOSES ONLY.

Opportunity Zones
No exit tax, increase price

Schedule of Investor's Hypothetical Internal Rate of Return - Income Tax Basis
December 31, 2018 through 2034

	Cash Investment	Taxable Income (Loss)	Tax Rates	Tax Benefits (Costs)	Cash Distributions	Housing Tax Credits	Projected Tax Benefit (Cost) upon Disposition	Net (Investment) Benefit	Cumulative
2018	$ 1,936,000	$ -	21.00%	$ -	$ -	$ -	$ -	$ (1,936,000)	$ (1,936,000)
2019	-	(1,312,868)	21.00%	275,702	-	-	-	275,702	(1,660,298)
2020	7,744,000	(862,920)	21.00%	181,213	-	500,000	-	(7,062,787)	(8,723,084)
2021	-	(863,258)	21.00%	181,284	-	1,000,000	-	1,181,284	(7,541,800)
2022	-	(844,250)	21.00%	177,292	-	1,000,000	-	1,177,292	(6,364,508)
2023	-	(824,946)	21.00%	173,239	-	1,000,000	-	1,173,239	(5,191,269)
2024	-	(805,338)	21.00%	169,121	-	1,000,000	-	1,169,121	(4,022,148)
2025	-	(785,915)	21.00%	165,042	-	1,000,000	-	1,165,042	(2,857,106)
2026	-	(765,668)	21.00%	160,790	-	1,000,000	-	1,160,790	(1,696,316)
2027	-	(745,086)	21.00%	156,468	-	1,000,000	-	1,156,468	(539,848)
2028	-	(724,157)	21.00%	152,073	-	1,000,000	-	1,152,073	612,225
2029	-	(702,868)	21.00%	147,602	-	1,000,000	-	1,147,602	1,759,828
2030	-	(681,757)	21.00%	143,169	-	500,000	-	643,169	2,402,997
2031	-	(766,396)	21.00%	160,943	-	-	-	160,943	2,563,940
2032	-	(754,998)	21.00%	158,550	-	-	-	158,550	2,722,489
2033	-	(743,043)	21.00%	156,039	-	-	-	156,039	2,878,528
2034	-	(912,632)	21.00%	191,653	-	-	-	191,653	3,070,181
	$ 9,680,000	$ (13,096,101)		$ 2,750,181	$ -	$ 10,000,000	$ -	$ 3,070,181	

Internal Rate of Return (IRR)	5.3%
Price	0.968
Price increase	0.038

$ 380,000 Equity increase

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HYPOTHETICAL - FOR ILLUSTRATION PURPOSES ONLY.

Opportunity Zones
No exit tax, increase price for lower cost of capital

Schedule of Investor's Hypothetical Internal Rate of Return - Income Tax Basis
December 31, 2018 through 2034

	Cash Investment	Taxable Income (Loss)	Tax Rates	Tax Benefits (Costs)	Cash Distributions	Housing Tax Credits	Projected Tax Benefit (Cost) upon Disposition	Net (Investment) Benefit	Cumulative
2018	$ 1,961,000	$ -	21.00%	$ -	$ -	$ -	$ -	$ (1,961,000)	$ (1,961,000)
2019	-	(1,312,868)	21.00%	275,702	-	-	-	275,702	(1,685,298)
2020	7,844,000	(862,920)	21.00%	181,213	-	500,000	-	(7,162,787)	(8,848,084)
2021	-	(863,258)	21.00%	181,284	-	1,000,000	-	1,181,284	(7,666,800)
2022	-	(844,250)	21.00%	177,292	-	1,000,000	-	1,177,292	(6,489,508)
2023	-	(824,946)	21.00%	173,239	-	1,000,000	-	1,173,239	(5,316,269)
2024	-	(805,338)	21.00%	169,121	-	1,000,000	-	1,169,121	(4,147,148)
2025	-	(785,915)	21.00%	165,042	-	1,000,000	-	1,165,042	(2,982,106)
2026	-	(765,668)	21.00%	160,790	-	1,000,000	-	1,160,790	(1,821,316)
2027	-	(745,086)	21.00%	156,468	-	1,000,000	-	1,156,468	(664,848)
2028	-	(724,157)	21.00%	152,073	-	1,000,000	-	1,152,073	487,225
2029	-	(702,868)	21.00%	147,602	-	1,000,000	-	1,147,602	1,634,828
2030	-	(681,757)	21.00%	143,169	-	500,000	-	643,169	2,277,997
2031	-	(766,396)	21.00%	160,943	-	-	-	160,943	2,438,940
2032	-	(754,998)	21.00%	158,550	-	-	-	158,550	2,597,489
2033	-	(743,043)	21.00%	156,039	-	-	-	156,039	2,753,528
2034	-	(912,632)	21.00%	191,653	-	-	-	191,653	2,945,181
	$ 9,805,000	$ (13,096,101)		$ 2,750,181	$ -	$ 10,000,000	$ -	$ 2,945,181	

Internal Rate of Return (IRR)	5.0%
Lower cost of capital	95.00%
Equivalent IRR	5.3%
Price	0.981
Price increase	0.051

$ 505,000 Equity increase