



Understanding the benefits and challenges of Opportunity Zones

Tuesday, Nov. 27, 2018
2:00-3:00 pm ET

We will be starting soon



Please disable pop-up blocking software before viewing this webcast

Speakers



Dustin Stamper

Managing Director
Washington National Tax Office
dustin.stamper@us.gt.com



David Auclair

National Managing Principal
Washington National Tax Office
david.auclair@us.gt.com



Steve Carter

Managing Director
State and Local Taxes
steve.carter@us.gt.com

Learning objectives

1

Define key characteristics of the expanded opportunity zones

2

Identify potential tax benefits

3

Recognize the qualifications necessary for investment

Agenda

1

Opportunity Zone investment benefits

2

Requirements, planning implications,
and unresolved issues

Opportunity zones benefits

Rewarding investments in specific geographic areas

- One of most generous tax incentives ever created by Congress to spur investment in specific geographic areas
- Potential triple tax benefit:
 - Defer capital gain equal to amount invested in an OZ fund:
 - Gain not recognized until investment sold or exchanged or by Dec. 31, 2026
 - Original gain partially forgiven when recognized:
 - Basis bump of 10% if held 5 years
 - 15% if held 7 years
 - If QOF investment held 10 years, no additional gain besides the 85% of deferred gain recognized in 2026

Illustration of potential tax benefit

	QOF	Outside investment
Investment of \$1 million in gain on Dec. 31, 2018		
Gain	\$1 million	\$1 million
Tax on gain	\$0	\$238,000 (20% + 3.8%)
Amount invested	\$1 million	\$762,000
Mandatory recognition event Dec. 31, 2026		
Gain recognized	\$850,000 (15% basis increase)	\$0
Tax	\$202,300 (20% + 3.8%)	
Sale of investment after 10 years on Dec. 31, 2028		
Value at 5% growth	\$1,628,895	\$1,241,218
Tax cost of 2026 gain	\$223,036 (\$202,300 at 5%)	\$0
Tax on sale	\$0	\$114,054 (\$479,218 gain)
After tax proceeds	\$1,405,859	\$1,127,164

- Assumes 5% return inside and outside fund and held for 10 years
- Under this scenario, our model shows investor would need to 7.7% rate of return outside fund to match after tax proceeds

Opportunity zones benefits

Modeling the benefit

- Benefit depends on how long the investment is held
 - Tax benefit can still make it worthwhile if held 7 years, 5 years, or even shorter
- Tax benefit can make it worthwhile even if rate of return is worse than other investments
 - Can model after tax proceeds based on separate rates of return
 - Can model rate of return needed outside fund to match OZ fund benefits

Comparison with like-kind exchange

Section 1031 v. Opportunity zones

Section 1031



Must reinvest all proceeds of sale to avoid capital gains



Now limited to real estate but real estate in unlimited geographic area



No capital gain forgiveness but gain can be deferred indefinitely if held or if future disposition are like-kind (or step-up at death)

Opportunity Zone



Only required to invest amount of actual gain



Almost any capital gain eligible but investment must be made in OZ



Permanent Capital gain forgiveness on top of deferral but mandatory recognition event in 2026

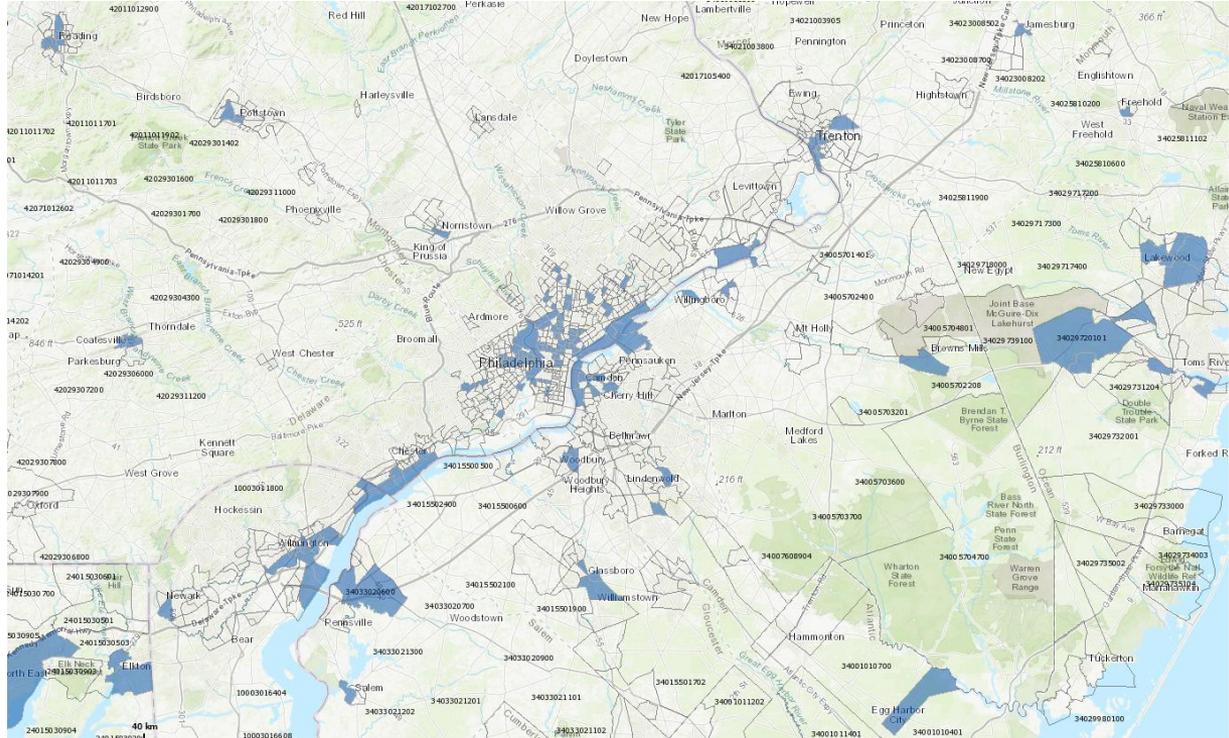
Where are the Opportunity Zones?

How broadly available is the benefit?

- More than 8,700 census tracts qualifying across 50 states, DC, and Puerto Rico
- Generally targeted to underdeveloped or low-income areas, but these do not line up perfectly with census tracts
- Many OZ comprise areas ripe for investment development
- Every major U.S. city has multiple qualifying areas
- Map available: <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>

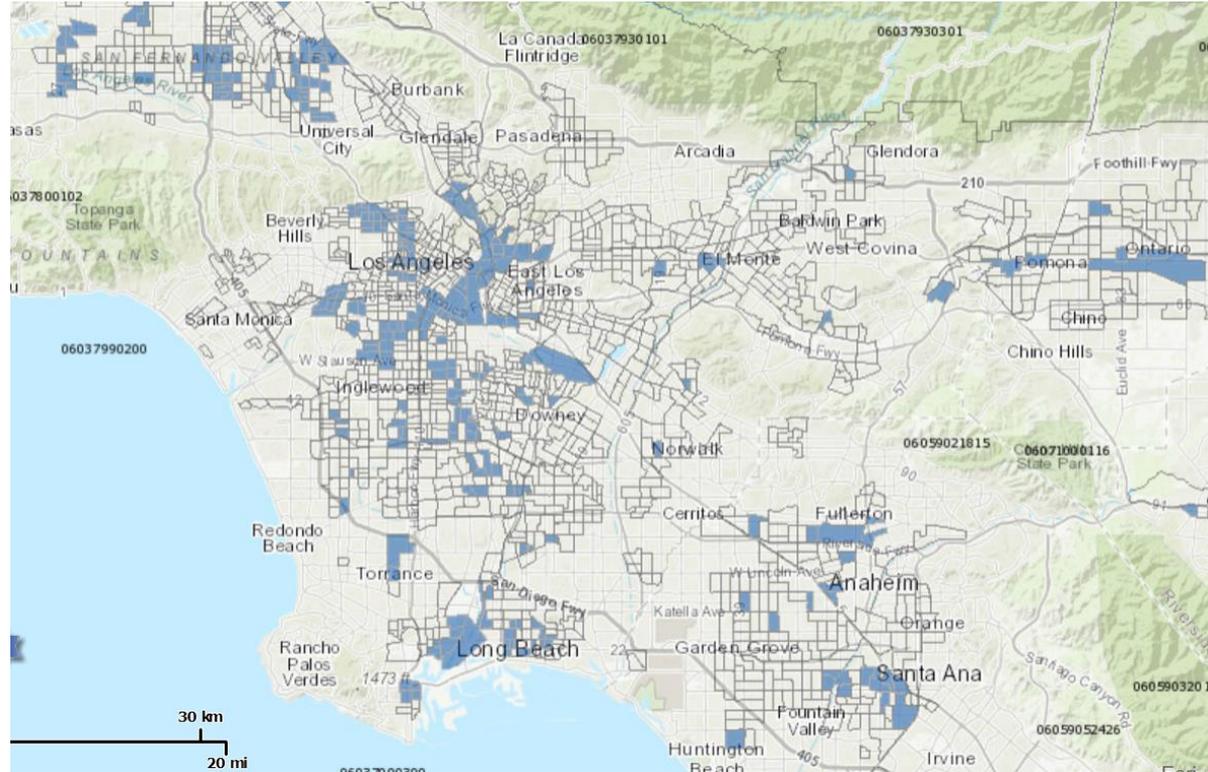
Where are the Opportunity Zones?

Example: Philadelphia



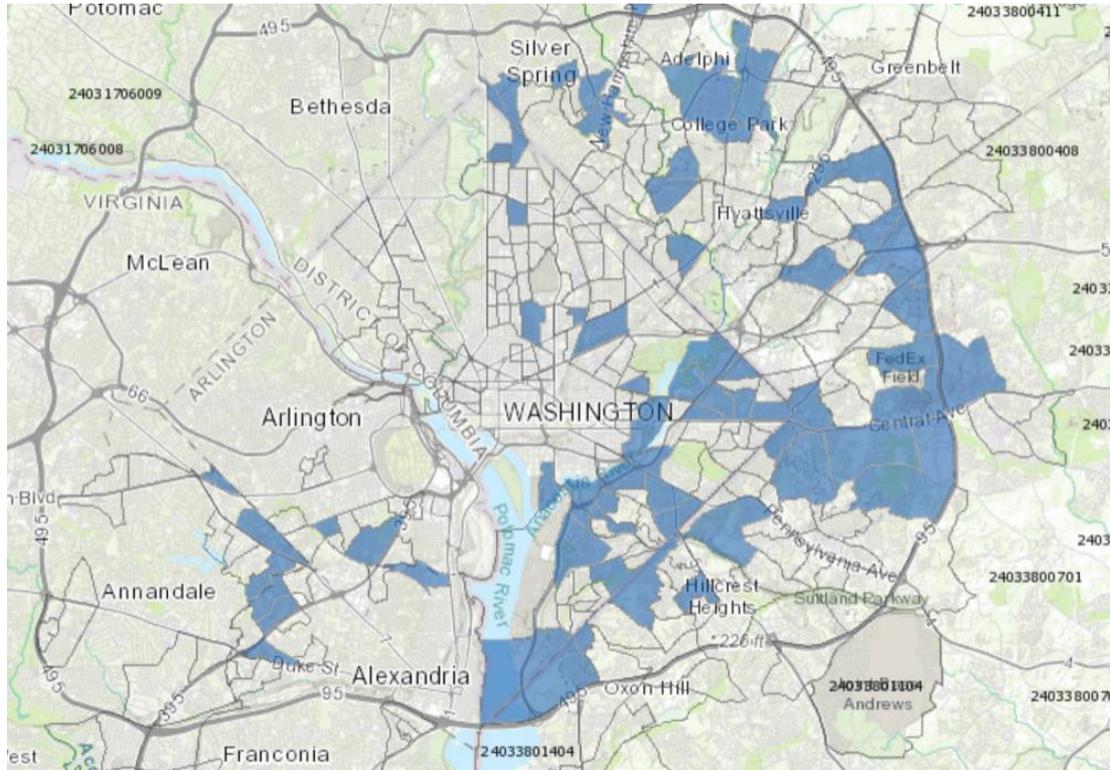
Where are the Opportunity Zones?

Example: Los Angeles



Where are the Opportunity Zones?

Example: Washington, DC



How hard is it to qualify?

What is a QOF?

- Do not have to be a big sophisticated “fund” to benefit: Any partnership or corporation can be a “fund” by self-certifying on a 1-page form, including real estate developers and operating businesses

BUT...

- Numerous requirements and complex rules so investments and activities have to be structured in specific ways to qualify
- **Proposed regulations answer many questions, but several key issues left for second round of proposed regulations coming soon**

Agenda

1

Opportunity Zone investment benefits

2

Requirements, planning implications,
and unresolved issues

What gain qualifies?

And who can defer?

- Deferral available for gain “treated as capital gain for Federal income tax purposes” if investment made within 180 days after sale or exchange that creates gain
 - Special rules for §1256 contract
 - Gain from straddles does not qualify
- Individuals, corporations, partnerships, REITs, RICs, trusts and estates can defer gain
 - Individuals deferring gain from pass-through can start the 180 day period at the end of the entity’s year or the day of the sale of exchange creating the gain if known
- Election made on Form 8949 attached to the income tax return

Selling the asset

Getting the benefit on sale

- Sale must occur by Dec. 31, 2047 (20.5 years after last investment allowed)
- Gain retains character when recognized (short-term v. long-term, etc.)
 - *Grant Thornton Insight: The mandatory recognition date of 12-31-26 for original gain means investment in gain must be made before the end of 2019 to get 7-year basis bump*
- Must have original gain to defer when making investment in order to elect basis increase and gain-free sale after 10-year holding period
 - *Grant Thornton Insight: This means there is little benefit for investing amounts not used to defer gain*
- Unresolved issue: How do you unwind the fund? Gain forgiveness is for sale of fund, not its assets – More on this later. . .

Qualifying investment

What is a qualified opportunity zone fund?

- Any partnership or corporation for Federal tax purposes (including LLCs) that self-certifies as a QOF on new Form 8996 with income tax return
 - Can designate month it begins as QOF
 - Existing entities can qualify, but will be difficult because property must be acquired after Dec. 31, 2017 and any investments in the fund before it self-certifies are not QOF investments
- Must have 90% of its assets in **qualified opportunity zone property**
 - Use book value if “applicable financial statement,” otherwise use “cost”
 - Working capital held in cash qualifies for up to 31 months if qualifies for safe harbor requirements
 - Semi-annual testing for 90% test

Qualified opportunity zone property

What qualifies for the 90% asset test?

- Qualified opportunity zone partnership interest
- Qualified opportunity zone stock
- Qualified opportunity zone business property

Qualified OZ stock and partnership interest

- Qualified OZ partnership interests and stock:
 - Original issue stock or partnership interest
 - Acquired solely in exchange for cash after 12-31-17
 - Entity is a qualified **OZ business** for “substantially all” of the holding period (**no definition of “substantially all” in proposed regs**)

Qualified opportunity zone business

- Qualified OZ business:
 - Substantially all of property is qualified opportunity zone business property (**proposed regs define this substantially all as 70%**)
 - 50% of income derived in active conduct of business in OZ (**no definition of active conduct**)
 - Substantial portion of intangible property is used in OZ (**no definition of “substantial portion” in proposed regs**)
 - Less than 5% of property is non-qualified financial property
 - No golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks, casinos, or liquor stores

Qualified OZ business property

What qualifies?

- Tangible property acquired after Dec. 31, 2017 not from a related party
 - Big hurdle for existing investments
 - When is self-constructed property acquired?
- “**Original use**” in OZ must commence with QOF or OZ business or the property must be “**substantially improved**” (double the basis in 30 months)
 - Land does not have to meet this requirement (Rev. Rul. 2018-29)
 - IRS appears willing to provide some leeway on “original use”
- “**Substantially all**” of the use of the property must be in the OZ during “**substantially all**” of the holding period
 - Proposed regs provide no definition of substantially in these cases

Qualified OZ business property

How much does my fund need?

- *Grant Thornton Insight: A QOF can reduce the amount of qualifying property it holds to 63% by holding the property through a qualified opportunity zone business*
- QOF holding property directly: 90%
- QOF holding business interest: 90% in business interest x 70% (substantially all) of the business's assets

Other significant unresolved issues

What else don't we know yet?

- IRS indicates it is willing to expand **original use** to cover abandonment, vacant, or under-utilized in next round of proposed regulations
 - How far can we really take this? Need to see rules
- What happens when the fund sells assets?
 - How long do you have to reinvest for 90% asset test?
 - Does the fund recognize gain? Not if it's reinvested? What about when the fund unwinds?
- What will “**substantially all**” mean in all these other uses?

Next steps

What can I do now?

- Can generally rely on proposed regulations now if you rely on them in their entirety
- Take OZs into consideration now for gains this year and for planned investments in zones because timing is critical:
 - Only have 180-days to make investment
 - Cannot get QOF treatment for investments before the date the fund designates as becoming QOF (and subject to 90% test) and property generally does not qualify unless QOF gets original issue entity interest or purchases property directly from an unrelated party
- Careful: Proposed regs provide clarity in many areas, but there is significant risk from unresolved issues

Any final questions?



Speakers



Dustin Stamper

Managing Director
Washington National Tax Office
dustin.stamper@us.gt.com



David Auclair

National Managing Principal
Washington National Tax Office
david.auclair@us.gt.com



Steve Carter

Managing Director
State and Local Taxes
steve.carter@us.gt.com

Disclaimer

This Grant Thornton LLP presentation is not a comprehensive analysis of the subject matters covered and may include proposed guidance that is subject to change before it is issued in final form. All relevant facts and circumstances, including the pertinent authoritative literature, need to be considered to arrive at conclusions that comply with matters addressed in this presentation. The views and interpretations expressed in the presentation are those of the presenters and the presentation is not intended to provide accounting or other advice or guidance with respect to the matters covered.

For additional information on matters covered in this presentation, contact your Grant Thornton LLP adviser.

Disclaimer

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this PowerPoint is not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties under the U.S. Internal Revenue Code or (b) promoting, marketing or recommending to another party any transaction or matter addressed herein.

The foregoing slides and any materials accompanying them are educational materials prepared by Grant Thornton LLP and are not intended as advice directed at any particular party or to a client-specific fact pattern. The information contained in this presentation provides background information about certain legal and accounting issues and should not be regarded as rendering legal or accounting advice to any person or entity. As such, the information is not privileged and does not create an attorney-client relationship or accountant-client relationship with you. You should not act, or refrain from acting, based upon any information so provided. In addition, the information contained in this presentation is not specific to any particular case or situation and may not reflect the most current legal developments, verdicts or settlements.

You may contact us or an independent tax advisor to discuss the potential application of these issues to your particular situation. In the event that you have questions about and want to seek legal or professional advice concerning your particular situation in light of the matters discussed in the presentation, please contact us so that we can discuss the necessary steps to form a professional-client relationship if that is warranted. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein.

© 2018 Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd. All rights reserved. Printed in the U.S. This material is the work of Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd.

Thank you for attending

To retrieve your CPE certificate

- Respond to the online evaluation form. Please note, you may need to disable pop-up blocking software to complete this evaluation.
- Print your CPE certificate and retain for your records. Participants are responsible to maintain CPE completion records.
- Those receiving CPE will also receive the certificate at the email address used to register for the webcast.
- We are unable to grant CPE credit in cases where technical difficulties preclude eligibility. CPE program sponsorship guidelines prohibit us from issuing credit to those not verified by the technology to have satisfied the minimum requirements in monitoring response and viewing time.

If you experience any technical difficulties, please contact 877.398.9939 or email GTWebcast@centurylink.com

Thank you for attending



www.grantthornton.com



twitter.com/GrantThorntonUS



linkd.in/GrantThorntonUS

Visit us online.
For questions regarding your CPE certificate, contact
CPEEvents@us.gt.com