INVESTING CAPITAL GAINS IN OPPORTUNITY ZONES

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Opportunity Zone Investment Considerations

1. OZF must be corporation or partnership taxed as such; no single member LLCs.
2. Choice between corporation or partnership; tax on corporate distribution of real estate.
3. Wherewithal to pay tax when it is due, particularly with partnership election to defer gain.
4. Time frame to put the money to work in the qualifying use; clear plan with contingencies.
5. Trade or business test if a triple net lease.
6. Possible disposition and reinvestment in opportunity zone.
7. Regulations limit to Capital Gains.
8. Must make election to defer, take 10 or 15 percent discount and exempt gain (after 10 years).
9. Tax rate uncertainty.
10. An alternative to a 1031 exchange.
11. Whether 50% of income comes from the Opportunity Zone or beyond.
12. Whether to invest directly in Opportunity Zone business.

Open Issues

1. Internal Revenue Code uses term "gain" and proposed regulations substitute "capital gain" limiting the benefit.
2. Determinations of original use of property within the Opportunity Zone.
3. Ground rules for disposition and reinvestment.
4. Undefined term "substantially all" used in the Internal Revenue Code.
5. Exceptions from penalty if Fund fails 90% test.
6. Permissible distributions from OZ Fund, e.g., from refinancing proceeds.
7. Measuring income from within the Opportunity Zone.

Other Considerations

1. Securities law implications.
2. Terms of the Partnership Agreement or LLC Operating Agreement.
3. Success of Opportunity Zone business and need to relocate.
4. Success of Opportunity Zone business and meeting test for income from within the Zone.
5. Determining, annually, a valuation of assets of business or use of cost.
6. The five percent limit on nonqualified financial property and reserve requirements.
7. The likelihood of different objectives of the partners, particularly if investment is held ten years, at which time partner(s) may want to realize tax free gain but other partner(s) do not wish to realize gain.

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Example

Small and Mighty Sold for $11,000,000, creating $10,000,000 in Long Term Capital Gain (CG)
Federal Tax on CG = $2,000,000

Qualified Opportunity (QO) Zone

Invest $10,000,000 CG in QO Fund
Defer Tax on CG until earlier of withdrawal of investment from QO Fund or December 31, 2026
Basis in QO Fund = Zero Dollars ($0.00)

When deferral ends, $2,000,000 Tax is paid unless

- Investment in QO Fund is held five (5) years
  - 10% reduction in CG   Tax savings of $200,000
- Investment in QO Fund is held an additional two (2) years
  - 5% additional reduction in CG   Tax Savings of $100,000
- Possible reduction in CG Tax to $1,700,000

Once CG is taxed, investment in QO Fund receives step up in basis.
Investment held for ten years: Any gain on $10,000,000 investment is tax exempt.

Withdrawal from QO Fund in year Six receiving $12,000,000
- CG Tax on $9,000,000 = $1,800,000
- CG Tax on $2,000,000 = $ 400,000

Withdrawal from QO Fund in year Eleven receiving $12,000,000
- CG Tax on $9,000,000 = $1,700,000 (paid in 2027)
- CG Tax on $2,000,000 = $ 0.00