

Investing in Opportunity Act

“IOA” 2017 Tax Cuts & Jobs Act



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THE SHERBERT GROUP
INTEGRATED TAX CREDIT SOLUTIONS



MOXIE INVESTMENT FUNDS



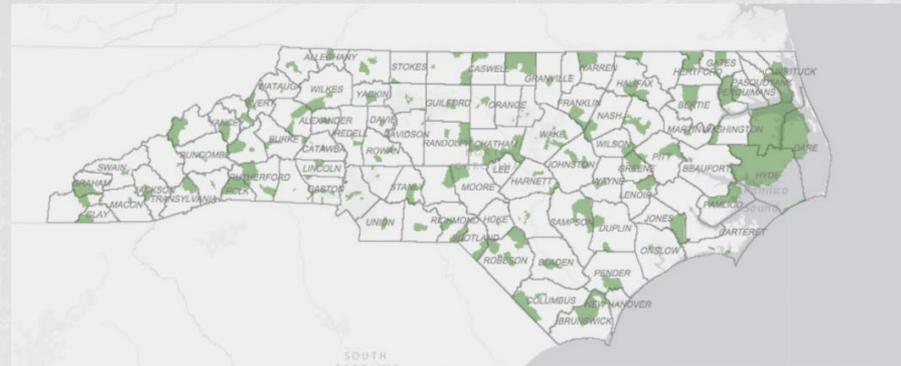
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Introduction

- Qualified Opportunity Zones were added to the Internal Revenue Code by the 2017 Tax Cuts and Jobs Act (The “2017 Tax Act”) by Code sections:
 - 1400Z-1 discusses designation of Opportunity Zones.



- 1400Z-2 discusses how to invest **capital gains** into opportunity zones and receive significant tax benefits





Who Can Benefit?

- Literally any US taxpayer with capital gains can potentially benefit from this new tax incentive. This Includes:
 - Individuals or corporations looking to reinvest gains from sales of property in order to defer and reduce taxes;
 - Real estate developers and start-up companies located in an Opportunity Zone who are looking for equity investment; and
 - Real estate sponsors, syndicators and/or private equity funds looking to create Opportunity Funds and then make investments in Qualified Opportunity Zone Property, including investments in corporations, partnerships or direct investments in property.





3 Major Buckets of “Opportunity”

- A taxpayer who timely reinvests gain from a sale of property into a “Qualified Opportunity Fund” (“Fund”) can enjoy the following tax benefits:
 - Bucket 1 - Deferral: Gain on a property sale that is invested in a Fund is deferred until the earlier of the date that the taxpayer sells its interest in the Fund or December 31, 2026.
 - Bucket 2 - Capital Gain Reduction: If the taxpayer invests in the Fund for at least 5 years, 10% of the original gain is excluded; if the investment lasts for at least 7 years, an additional 5% (for a total of 15%) of the original gain is excluded.
 - Bucket 3 - Appreciation Exclusion: If the taxpayer invests in the Qualified Opportunity Fund for at least 10 years, all appreciation in the new investment will be tax-free.





Bucket 1 – Deferral of Capital Gain

- Investor Sells an Investment or Property for a Capital Gain of **\$100**
 - Reinvests the Capital Gain in a Qualified Opportunity Fund
- **Capital Gain of \$100 is deferred** until the earlier of:
 - Date on when NEW investment is SOLD or Exchanged, or
 - December 31, 2026
- How much Gain is Recognized?
 - **Lesser** of the amount of **gain excluded originally or the sales proceeds**
- What does this mean?
 - **Original Gain \$100**
 - **Reinvestment \$100**
 - **Sale in 2020 for \$90**
 - In 2020 your deferred gain of \$100 is recognized as **\$90 gain**





Bucket 2 – Reduction of Gain

- If New Investment is held for 5 years, the basis in the Investment is increased by 10%
- If New Investment is held for 7 years, your basis in the Investment is increased by 15%

This can result in the **reduction of the original deferred gain**

Examples:

1. Original reinvested gain **\$100** (12/31/2018)
Sell in 2022 for **\$90**
Gain recognized **\$90** (no reduction of gain since not held for 5 or 7 years)
2. Original reinvested gain of **\$100** (12/31/2018)

Sell on 1/1/2024 for **\$90** (5 years plus 1 day)

Basis = \$0

Increase in Basis $10\% \times \$100 = \10

Sales Proceeds \$90 (A)

Adjusted Basis = \$10 (B)

Resulting Gain $\$80$ (A) – (B)





Bucket 3 – Permanent Exclusion of New Investment Acquisition Appreciation

- For Investments held by taxpayer for at least 10 years, the basis of such property = FMV at the time the investment is sold or exchanged for Qualifying Investments made between Now & December 31, 2028
- Example – Investment in Fund is Held for 10 Years and Sold in 2028



Example – Investment in Fund is Held for 10 Years and Sold in 2028

<u>Opportunity Zone Investment Held for at least 10 Years</u>		<u>Ordinary Investment</u>		<u>Benefit</u>
		<u>Bucket 2 - Reduction of Gain</u>		
Deferred Gain (taxed in 2026)	\$100.00	Gain (taxed in 2018)	\$100.00	
Basis Step-up	15.00	Basis Step-up	0.00	
Taxable Gain	85.00	Taxable Gain	100.00	
Tax (at 23.8%)	\$20.23	Tax (at 23.8%)	\$23.80	\$3.57
<u>Bucket 1 - Present Value of Deferral of Gain (assumed sale on 12/31/2018)</u>				
Present value of tax @ 10% discount rate	\$9.44		\$20.23	\$10.79
<u>Bucket 3 - Permanent Exclusion of New Investment Appreciation</u>				
Gain on Disposition of Investment in Fund	\$100.00	Gain on Investment	\$100.00	
Basis Step-Up	100.00	Basis Step-Up	0.00	
Taxable Gain on Disposition	0.00	Taxable Gain on Disposition	100.00	
Tax (at 23.8%)	\$0.00	Tax (at 23.8%)	\$23.80	\$23.80
TOTAL BENEFITS				\$38.16
BENEFITS AS A PERCENT OF ORIGINAL GAIN				38.16%



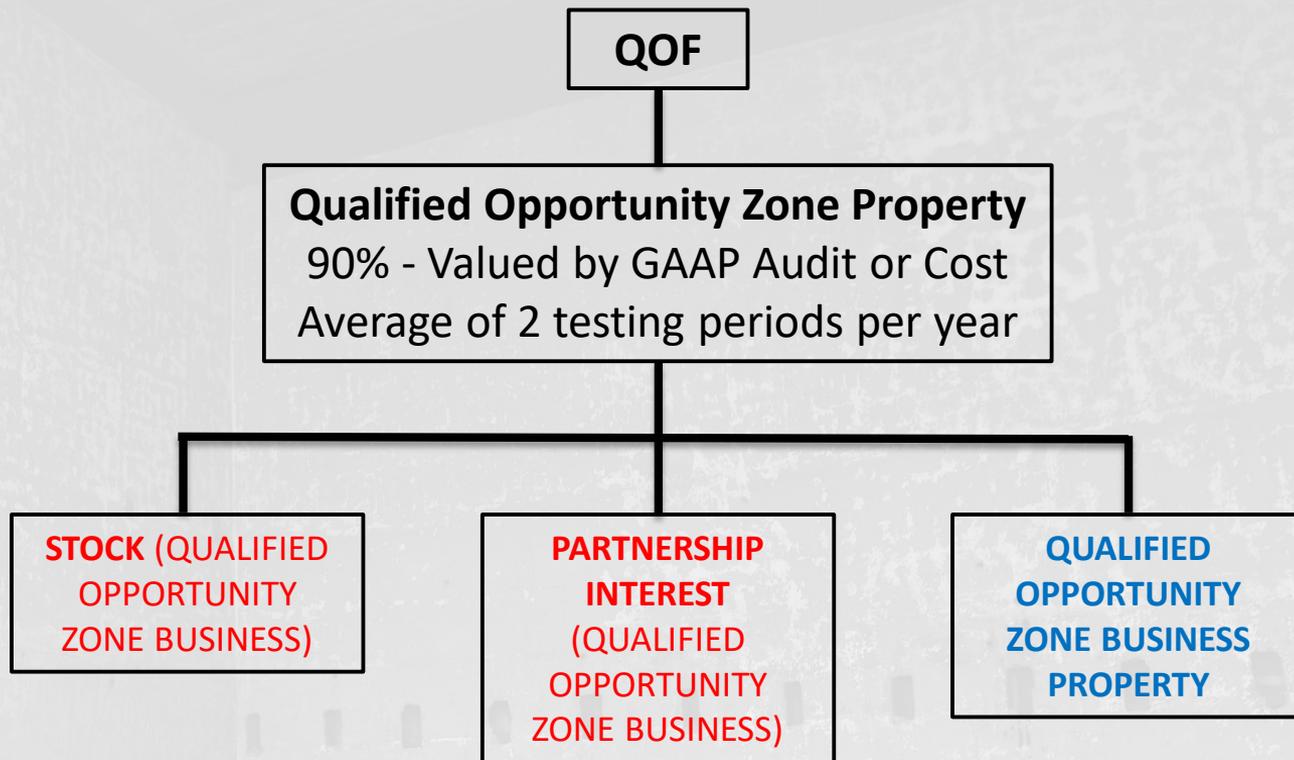


What is a Qualified Opportunity Fund?

- A **Corporation or Partnership** organized for the purpose of investing in “Qualified Opportunity Zone Property” that holds at least 90% of its assets in QOZP
 - 90% determination is made at 6 month and year end measurement periods
 - If a Opportunity Zone does not have at least 90% of its assets in QOZP, then fund assets (not invested in QOZP) are penalized at the same interest rate for underpayments of Federal Taxes under IRC Section 6621 – 6% starting in January – no penalty if failure is due to “reasonable cause”, which has not been well defined.
 - Calculation = Shortfall amount x underpayment rate divided by 12
 - This is reported on Form 8996



Qualified Opportunity Fund





Qualified Opportunity Zone Business (Stock or Partnership Interest)

- Purchased **after December 31, 2017**
 1. Substantially all (70%) tangible property **owned or leased** is a **QOZBP**
 2. 50% gross income is derived from active conduct of the business in the QOZ
 3. “Substantial portion” of intangible property is used in active conduct of the trade or business in the OZ (ex. Franchise Fee)
 4. < 5% of the average of the aggregate unadjusted basis is attributable to Nonqualified Financial Property (“NQFP”) – Debt, Stock, Non –Qualifying Partnership Interest, LESS reasonable Working Capital, ordinary accounts receivable.
 5. No Sin Businesses – Golf Course, Country Club, Massage, Hot Tub/Suntan Facility, Race Track/Gambling, off premises alcohol seller.
- Working Capital safe harbor – 3 requirements:
 1. **Designated in writing** for acquisition, construction and/or substantial improvement of tangible property.
 2. A **written schedule** for the expenditure of working capital assets to be spent within 31 months.
 3. Actual use of the working capital that is consistent with 1 and 2.



QOZB Structure Diagram



Investment



Investment



QOF must hold at least 90% of its assets in QOZP (i.e. QOZ stock, QOZ partnership interest or QOZBP)

Substantially all (at least 70%, per proposed regulations) of the tangible property owned or leased by the QOZB must be QOZBP.





Qualified Opportunity Zone Business Property

- Tangible property used in business
 1. Property acquired by QOF via non-related party purchase after December 31, 2017,
 2. Original use of such property in the QOZ commences with the QOF or the QOF Substantial Improves the property AND,
 3. During “substantially all” of the QOF’s holding period for such property, “substantially all” of the use of such property is in a QOZ.





Compare QOZB with QOZBP

QOF owns an equity interest in a corporation or partnership operating a QOZB:

70/30 test relevant to QOZBP

Working Capital Safe Harbor applies to allow unlimited amount of cash as long as entity substantially complies with a written plan of deployment for acquisition, construction and/or rehabilitation within 31 months

50% gross income from active conduct of trade or business (deemed to be met during construction/rehabilitation under working capital safe harbor)

QOF directly own QOZBP and operates business:

90/10 test (if QOF does not hold interests in subsidiaries, 90% of its assets must be QOZBP)

No working capital safe harbor; absent further guidance, all cash would be counted toward the 10% of assets that can be non-QOZBP

No gross income requirement from active conduct standard



Compare QOZB with QOZBP (continued)

QOF owns an equity interest in a corporation or partnership operating a QOZB:	QOF directly own QOZBP and operates business:
Can own an unlimited amount of Intangible Property as long as a “substantial portion” is used in the active conduct of a trade or business (deemed to be met during construction/rehabilitation under working capital safe harbor)	All Intangible Property counts toward the 10% of assets that can be non-QOZBP (QOZBP only calls for tangible property)
No sin businesses allowed	No prohibition on sin businesses
A QOZB is able to lease property and the statute contemplates that this property could qualify as QOZBP, but it is not clear how the QOZBP requirements are applied to leased property	No specific reference to the lease of property directly by a QOF
Statute provides a 5-year grace period for characterization of property held by a QOZB as QOZBP	As currently written, this 5-year grace period does not apply to QOZBP held directly by a QOF



Proposed Regulations Issued October 19, 2018

- Provide a safe harbor that allows an O Zone Business to hold funds for up to 31 months for the acquisition, construction, or improvement of real and other tangible property
- Calculate the substantial improvement test by reference to the basis of the building, excluding the basis of the land
- Require that an O Zone Business have only 70% of its assets invested in O Zone Business Property
- Allow gains recognized by a partnership to be invested in an O Fund by either the partnership or its partners
- Allow all of the benefits of the program to be claimed by taxpayers through December 31, 2047, despite the earlier expiration of the O Zone **designations**
- Allow an O Fund to specify the first year and month in which it will be classified as an O Fund
- Limit the eligible gains that can be deferred under the program to capital gains, arguably contrary to the statute

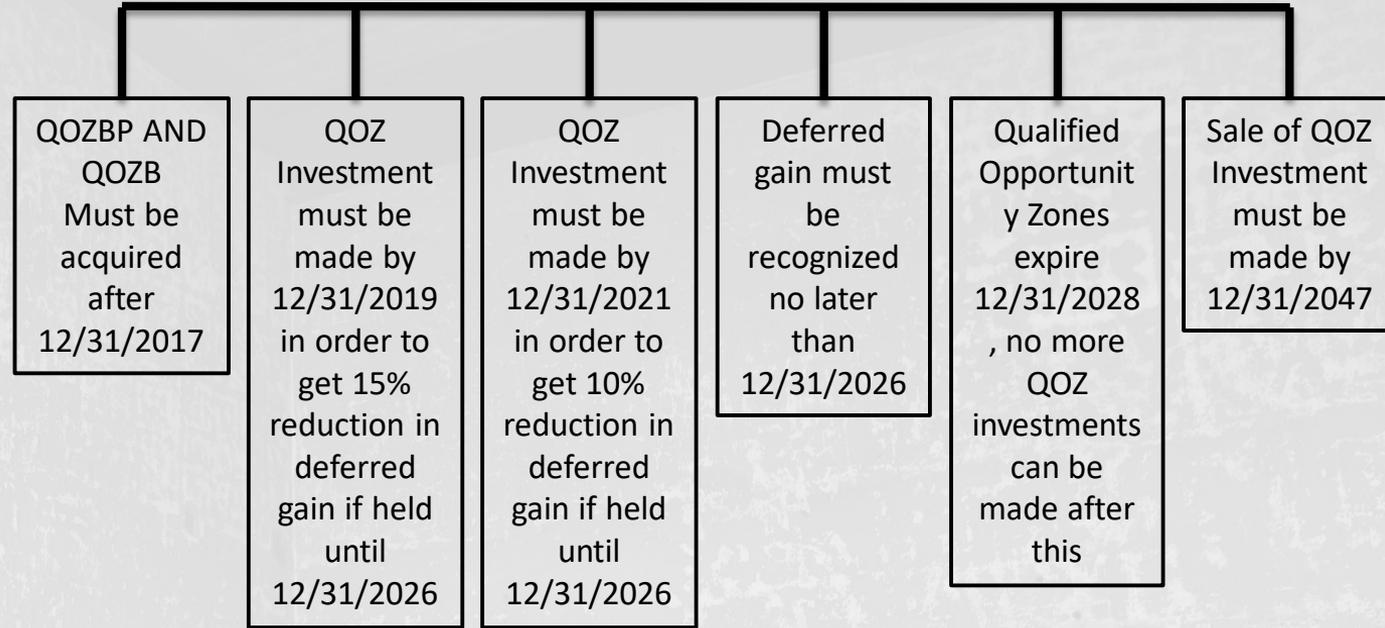


Guidance Still Needed

- What are some of the biggest open questions that need timely guidance by the Treasury?
 - Rules describing permissible distributions from an O Fund, including those funded by refinancing distributions
 - Rules on re-investment of disposition proceeds and return of capital
 - The meaning of “substantially all” for the uses not addressed in the proposed regulations
 - Information reporting requirements
 - How do QOZB requirements apply to leased property?
 - Can syndicated funds be used to invest in QOF (the statute contemplating direct investment in a fund)?
 - Reasonable cause exception to the 90% test



OZ Critical Dates





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