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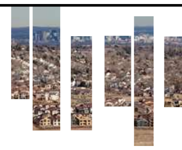


Qualified Opportunity Funds

June 21, 2019

Simple Concept

- Fund invests in qualified property, corporations, or partnerships
- Reinvest capital gain in Fund (equity interest in Fund only)
- Receive tax benefits
  - Defer tax on reinvested gain
  - Permanently exclude part of reinvested gain
  - Permanently exclude post-investment gain

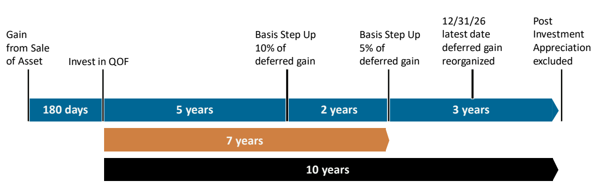
Possible Tax Benefits

- Temporary deferral of capital gain recognition from a prior investment
  - Recognition not later than December 31, 2026
  - Already some discussion about extending this
- Permanent exclusion of up to 15% of the deferred gain
  - 10% if held for 5 years
  - 15% if held for 7 years
- Permanent exclusion of future gains if held 10 years

Example

- Prior to December 31, 2019 taxpayer sells stock for $500. Basis $300. Capital Gain $200
- Investment of $200 in QOF within 180 days, elects to defer gain
- Year 5 - 10% ($20) basis step up
- Year 7 - 5% ($10) basis step up
- December 31, 2026 gain of $170 recognized
- All post-investment appreciation tax free after 10 years
  - Must sell no later than December 31, 2047

Timeline for Investment



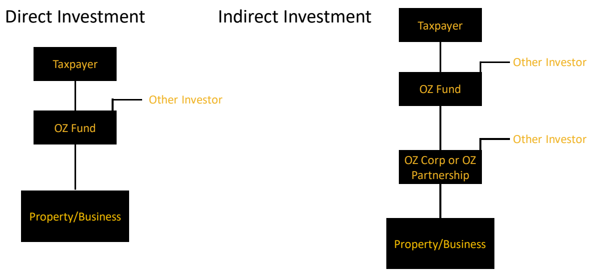
If investment made after 2019, not eligible for last 5% gain exclusion on deferred gain

If investment made after 2021, not eligible for gain exclusion on deferred gain

Fundamental Limitation

- Benefits apply only to capital gain invested into QOF within 180 days of realization of gain
  - 180-day period begins on day gain would be recognized but for its reinvestment in a QOF
- Can acquire interest in QOF either directly from the QOF for cash or contribution of property (not services), or by purchase from a 3rd party
- Capital invested in excess of the gain is not eligible for the OZ tax benefits
  - Treated as a traditional investment, but does not free OZ from investment restrictions

OZ Fund Structures



Qualified Opportunity Funds (QOF)

- Investment vehicles organized as a corporation or partnership
- Organized for purpose of investing in qualified opportunity zone property
- 90% of assets of fund must be held in qualified opportunity zone property
  - Tested twice per year
  - Value based on QOF's applicable financial statement or cost basis (owned property) and present value (leased property)
- QOF self certifies (Form 8996)

Permissible Fund Investments

Qualified Opportunity Zone Property

- Qualified Opportunity Zone Business Property (direct investment)
- Qualified Opportunity Zone Stock (indirect investment)
- Qualified Opportunity Zone Partnership Interest (indirect investment)

Permissible Fund Investments

1. Qualified Opportunity Zone Business Property (QOZBP)

- Tangible property used in a trade or business
- Acquired by purchase or lease after 2017
- Original use in the zone commences with the fund or the fund substantially improves the property
- Substantially all (70%) of the use of such property is in the zone for substantially all (90%) of the fund's holding period

First use or substantial improvement requirement

- If not original use property must meet substantial improvement criteria.
  - "original use":
    - means property has not previously been placed in service for depreciation/amortization in the zone
    - also includes property that has been vacant for 5+ years
- For substantial improvement: during a 30-month period after the date of acquisition of property, additions to basis exceed the QOF's adjusted basis at the beginning of the 30-month period.
- if acquire land + improvements, measured by basis of improvements only

Permissible Fund Investments

2/3. Qualified Opportunity Zone Stock; Qualified Opportunity Zone Partnership Interest

- Domestic corporation or partnership acquired after 2017 as original issue
- Solely in exchange for cash
- During substantially all of the holding period, the corporation or partnership is a qualified opportunity zone business

Qualified Opportunity Zone Business (QOZB)

- This is what the portfolio, corporation, partnership, or business must be:
  - Trade or business
  - Substantially all (70%) of the tangible property owned or leased is qualified opportunity zone business property (QOZBP)
  - Substantial portion of intangible assets (40%) used in active conduct of business in the zone
  - 50% of gross income derives from active conduct of trade or business in the zone
    - 3 safe harbor tests: employee hours; payments for services; conjunctive (assets + operations/management)
  - Not a listed "sin" business
    - e.g., casino, golf course, liquor store, suntan facility, racetrack, massage parlor, racquet sport and skating facilities
  - Less than 5% of assets attributable to non-qualified financing property
  - Reasonable working capital allowed

Good Rules for Leases

- Leased tangible property may be treated as qualified opportunity business property for 90/10 test and 70/30 test if:
  - lease entered into after 2017
  - substantially all of the leased property is used in the QOZ during substantially all of the lease term
  - lease must be market rate and no prepayments of more than 12 months allowed
- Leased property not subject to original use requirement
- Leased property not subject to substantial improvement requirement
- Leased property not subject to related party rules
  - if a lease of personal property, lessee must also acquire equal value of tangible personal property during shorter of lease term or 30 months

Cash

- **Fund Level (investment entity)**
- 90% of QOF assets must be QOZP
- Cash is not QOZP
  - cash invested in QOF in 6 months prior to test date is ignored
  - cash obtained upon sale of QOZP is treated as QOZP if reinvested in new QOZP within 12 months
- **QOZB Level (lower-tier entity)**
- QOZB can hold reasonable working capital reserves
  - Under regs, working capital is reasonable if:
    - there is a written plan for the development of a business, or the acquisition, construction or substantial improvement of tangible property in an OZ;
    - there is a reasonable written capital deployment schedule for expenditure of the working capital, which schedule shows the working capital being deployed within 31 months (extended if government causes delay) ; and
    - working capital is used in a manner consistent with the written schedule

Exit Strategies

- Statute requires sale of interest in QOF for 10-year exclusion
- Sale of assets by QOFs and QOZBs are taxable to QOF or QOZB (gain passed thru to owners if partnership/S corp)
  - exception: regulations provide that owners of QOFs that are partnership/S corps can elect to exclude their allocable share of capital gain on their K-1 from the sale of property by the QOF if they've held their QOF investment for 10 years

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Thank you

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