

Opportunity Zones: Debriefing the Final Regulations

February 25, 2020

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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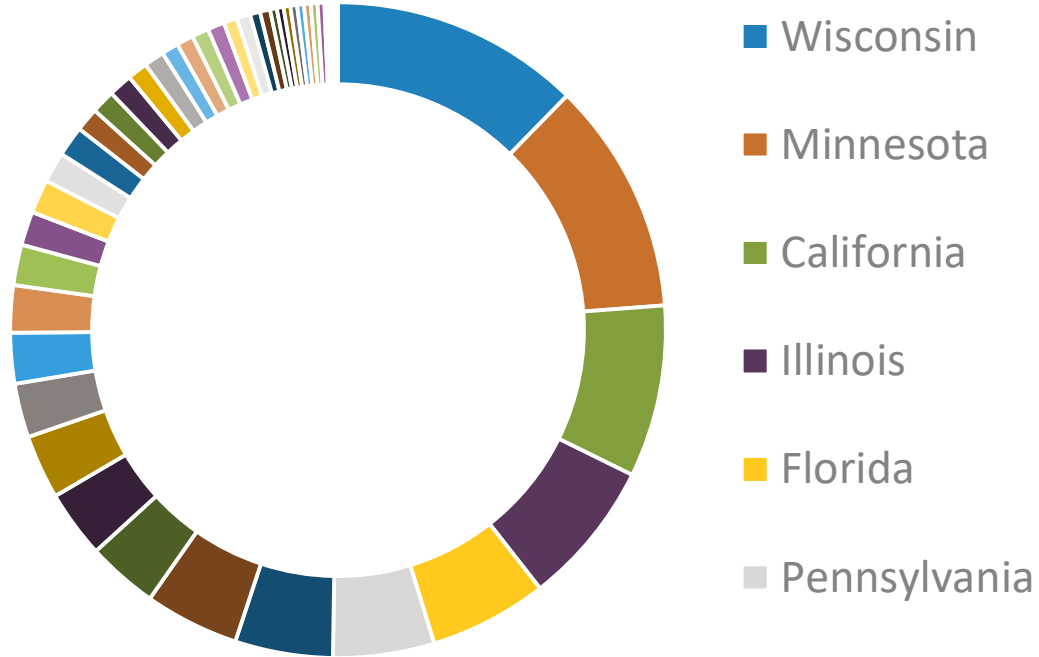


Learning Objectives

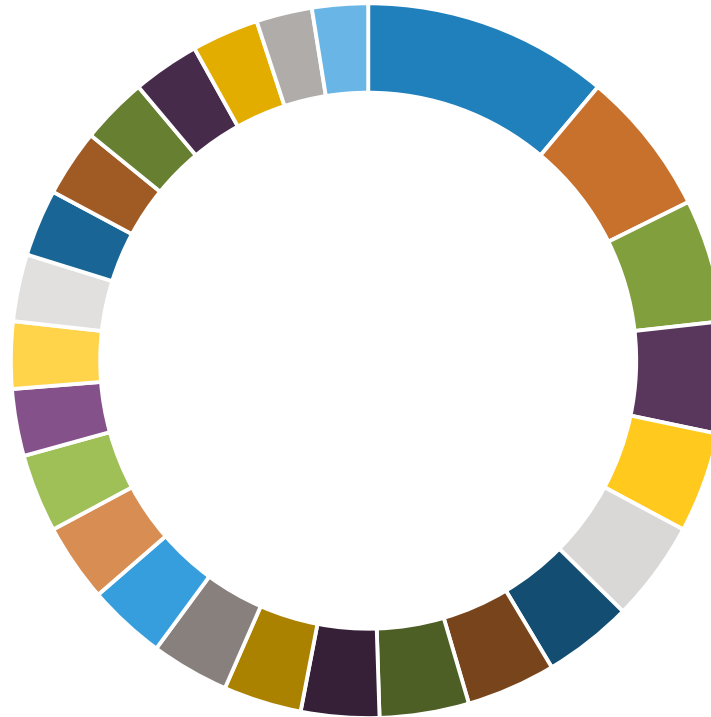
- Identify key takeaways from Final Opportunity Zone Regulations
- Identify major changes to investment timelines
- Identify pitfalls brought about by final Regulations



Attendees By State

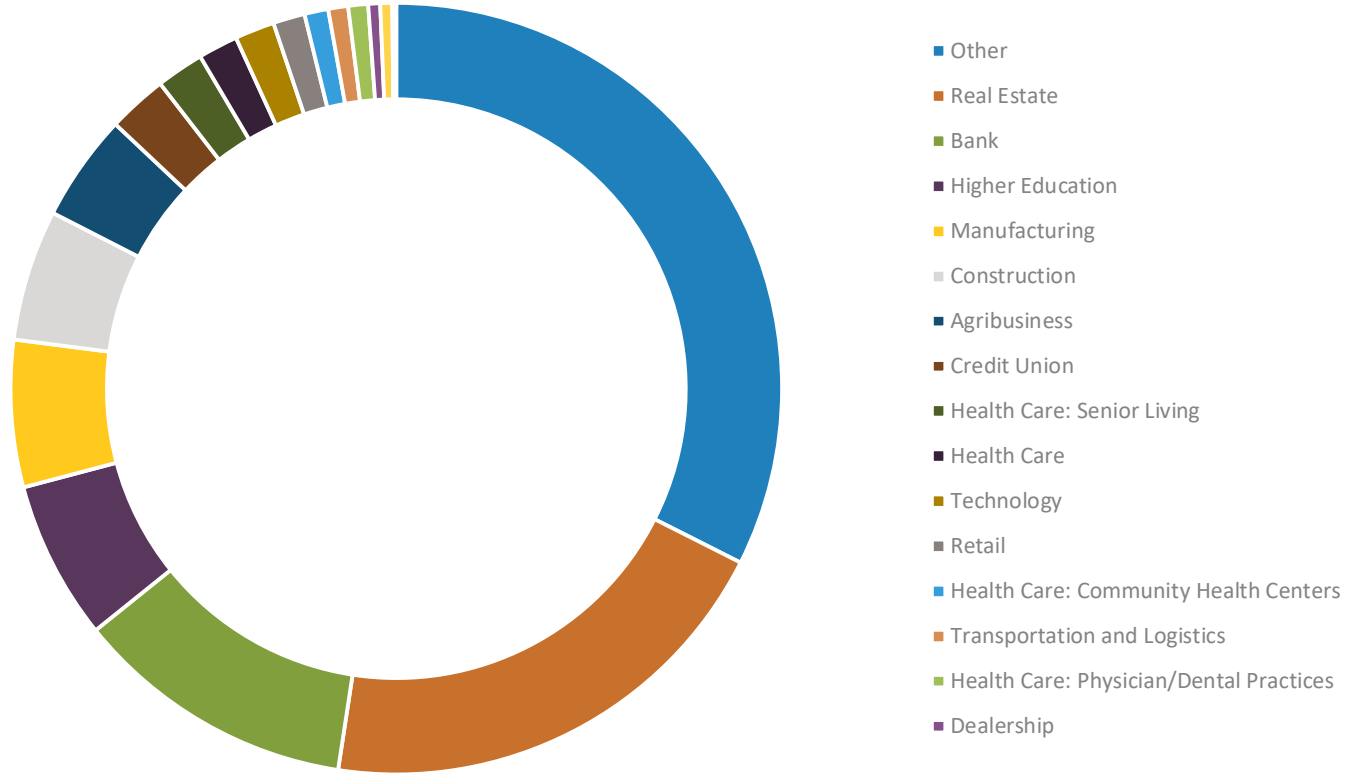


Attendees by City



- Minneapolis
- Phoenix
- Appleton
- PITTSBURGH
- Green Bay
- Tampa
- St. Louis
- Sacramento
- Chicago
- Seattle
- Peoria
- boston
- Albuquerque
- Milwaukee
- Morris
- Indianapolis
- Saint Louis
- Roseville
- Los Angeles
- Scottsdale
- Charlotte

Attendees by Industry



Opportunity Zone Program

Created by Tax Cuts
and Jobs Act of 2017

Formed to generate
economic activity
and job creation in
low-income
communities

Encourages
investment of
unrealized capital
gain into these low-
income community
projects/businesses

Benefits

Deferral of capital gains

Reduction of deferred gain over time

Permanent gain exclusion on appreciation of investment

Capital Gain Deferral Period

- Deferred until investment is sold, or Dec. 31, 2026, whichever comes earlier
- If investment is not sold before Dec. 31, 2026, any remaining deferred gain is recognized at that time and taxed at the current income tax rates enacted at the time.

Permanent Reduction of Deferred Gain

- Investments held less than 5 years result in 100% deferred gain recognition
- Investments held > 5 years, < than 7 years result in recognition of 90% of deferred gain (**investment must be made on or before December 31, 2021**)
- Investments held > 7 years result in 85% deferred gain recognition (**pre-2020 investments only**)

Permanent exclusion for investments held for at least 10 years

- At sale of investment, election made to step up basis in investment to FMV
- Election results in a permanent exclusion from income of any post-acquisition capital gain
- Results in permanent benefit for depreciation deductions
- Taxpayers can recognize losses by not making the permanent exclusion election

Timing of Investment



- From Deemed Recognition Date – 180 days to put into a QOZ Fund
- Funds do not need to go to a qualified intermediary
- The date the money is transferred to fund will be the start of the 10 year hold window

Timeline



Comparison to Non-OZ



Assumptions for Bob and Sherrie

Capital Gain from Sale of Asset	\$15,000,000
Long-Term Capital Gains Rate (Federal and State)	26.0%
Traditional Portfolio Annualized Return	7%
QOF Portfolio Annualized Return	7%

Traditional Portfolio

2020	
	Pay Taxes Now
Gain	\$15,000,000
Taxes due	(\$3,900,000)
After-tax gain	\$11,100,000
Amount invested in traditional portfolio:	
\$11,100,000	

2026
Investment is now worth:
\$19,071,867

2030
Investment is now worth:
\$23,363,857
Sell Investment
\$ 23,363,857.00
Taxes due \$ (3,188,603.00)
\$ 20,175,254.00

(\$7,088,603.00)
Total taxes paid since 2020
\$20,175,254
Ending value net of all taxes paid

Qualified Opportunity Zone Fund (QOF)

2020	
	Defer Taxes
\$ 15,000,000	Gain
\$ -	Taxes due
\$ 15,000,000	After-tax gain
Amount invested in QOF:	
\$15,000,000	

2026	
Investment is now worth:	
\$25,772,793	
Pay taxes on deferred gain	
*Basis is increased by 10% reducing tax bill	
\$	13,500,000
	Deferred gain x 0.90
\$	(3,510,000) Taxes due

2030	
Investment is now worth:	
\$31,572,779	
QOF tax-free appreciation	
Sell Investment	
\$	31,572,779
\$	- Taxes due
\$	31,572,779

(\$3,510,000.00)
Total taxes paid since 2020
\$28,062,779
Ending value net of all taxes paid

Savings of \$7,887,525



What Can Opportunity Zones Invest In?

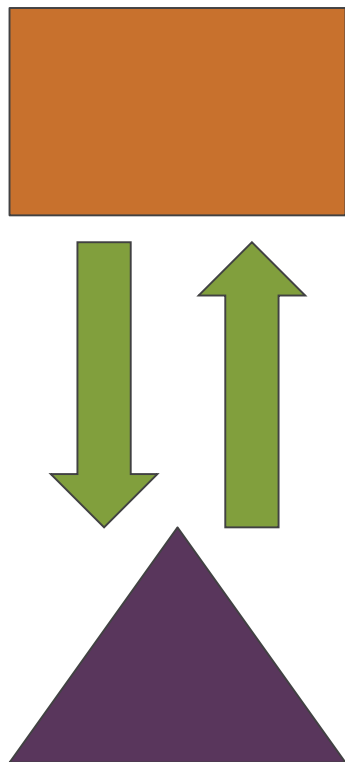
- Real Property
 - Original use must be with fund or must be substantially improved
 - Substantially improved = at least 100% of adjusted basis in property
- Operating Businesses
 - Equity investments or stock purchase
- Equipment



What Can Opportunity Zone Businesses Not Invest In?

- Private or commercial golf courses
- Country clubs
- Massage parlors
- Hot tub facility
- Suntan facility
- Racetrack or other facility used for gambling
- Any store where principal business is the sale of alcoholic beverages for consumption off premises
- Same prohibition is not in place for assets owned directly by QOF

Related Party Issues



- Gains generated from a related party sale are not eligible for Opportunity Zone benefits
- Property purchased from a related party is an ineligible Opportunity Zone asset
- The definition of a related party is tied to its definition in §267(b) or §707(b)(1)
 - However, must substitute **20%** for 50% each place it occurs in each section

“Related Party” Sales of Property to QOF/QOZB

- Preamble to final regulations disallows sale of property to QOF/QOZB with subsequent investment of that gain into QOF
- Treated as a contribution of property
- No gain to defer as a result
- Does not matter if seller retains 20% or less
- Looking for clarification if this was Treasury’s intent

Types of Gains and Taxpayers

Types of gains allowed

- Capital gains – short term and long term
- Gross §1231 gains
- Some issues with §1256 contracts and straddles
- Gain cannot be generated via a related party sale

Types of taxpayers

- Trusts
- Individuals
- Partnerships
- Corporations

Pass-through Gains

Partnership or S Corp can make election to invest in QOF

If fail to make election

- Gain flows out to partners
- Partners 180 day reinvestment window can begin on one of three possible dates
 - Can make election to use same asset sale date as passthrough, or
 - Can elect to use last date of taxable year for passthrough, or
 - Can elect to use the passthrough entity's tax return due date without extensions

Installment Sales

- Clarifies and expands installment sale gain recognition & QOF investment rules
- Two options for start of 180 day reinvestment period
 - Date an installment sale payment is received
 - Last day of tax year for all installment sale gains received in a tax year
- Applies to gains realized before 2018



Working Capital Safe Harbor

- Available at the QOZB level
- Allows for 31 months to deploy cash at QOZB level
 - Cash may not be a “good” asset
- Potential for additional 31 month window for “startups” for a total of 62 months
 - Need for both a master funding plan and working capital plans for each funding
- Alleviates some testing requirements on indirect structure
- Now includes:
 - Development of a Trade or Business in QOZ as well as acquisition, construction and/or substantial improvement of tangible property
- QOZB can have multiple overlapping or sequential applications but cannot exceed 62 months



Substantial Improvement

- Final Regulations allow for an aggregate application of the substantial rehabilitation test vs. asset by asset approach
- This includes purchase of new property used in same trade or business
- Must be used in same trade or business



Disposition of Investment



Multiple asset funds now
easier to wind-down

Regulations fixed issue by allowing asset sales at QOF level. Investor must have held investment for at least 10 years. Final Regs. expand treatment to QOZBs.

Step Up of Assets to FMV

- Clarified that “hot assets” are stepped up to FMV (no depreciation recapture) even for ordinary recapture
- Clarity that debt is included in total value computation



Original Use – Vacant Property & Brownfield Sites



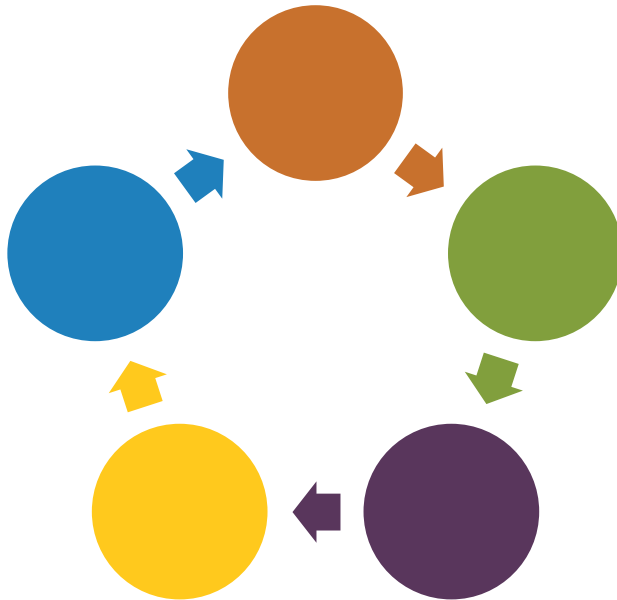
- Final Regulations deem property to be original use if vacant for an uninterrupted period of at least three years
- Reduced to one year if vacant at the time QOZ was designated
- Vacant defined as 80% unoccupied
- Brownfield Sites are deemed original use if made to be “safe”
- No substantial improvement required

Leased Property



- Leased tangible property can be QOZBP
- No original use requirement
- Must be leased after 12/31/17
- Must be in QOZ during substantially all of the period leased by QOF or QOZB

Related Party Leases



- Related party leases allowed as long as:
 - No prepayment of rent exceeding one year
 - Must be “market rate lease” based on common arm’s-length transactions in the locale of QOZ
 - Personal property must be acquired by lessee at the earlier of end of lease term or 30 months from start of lease
 - Anti-abuse rule to prevent use of leases to avoid substantial improvement requirement for real property


Additional Items Outlined in Regulations

- Inventory in transit does not fail to be QOZBP
- Trade or business defined in reference to §162
- Ownership and operation of real property included in trade or business income (except for triple-net leases)
- “Substantial Portion” as it relates to intangible property used in the active conduct of a trade or business defined as 40%
- QOF interests retain tax benefits upon investor’s death
- Qualifying QOF investments can be made with property other than cash
- Carried interests do not qualify for OZ benefits
- Partner’s basis deemed to be zero
- Anti-abuse rule: Investments that would otherwise qualify can be re-characterized as non-qualified if the transaction is deemed to achieve a result inconsistent with the purposes of the OZ statute



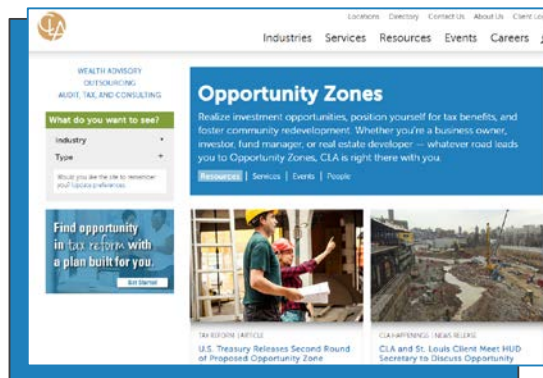
Questions Outstanding (Waiting Further Guidance)

- How broad are anti-abuse provisions?
- Is there a limit to how many times a QOF can fail the test and pay penalty?
- How do we apply use of proposed vs. final regulations?
- What happens to assets held but not sold at the end of 2047?
- Is cannabis deemed a “sin” business in states with legal marijuana laws?

A man with grey hair, wearing a light blue button-down shirt and dark trousers, is standing on a paved surface next to a black bicycle. He is leaning on the handlebars and looking towards the right. In the background, there is a large construction site with a tall yellow crane and a building under construction. The scene is set against a clear blue sky. A large green arrow graphic points from the left towards the man and the construction site.

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leads you to
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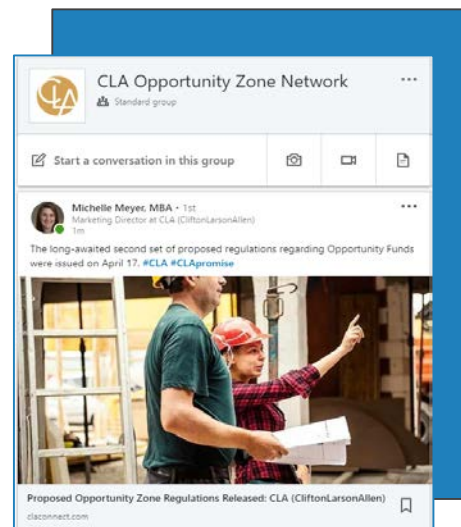


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Contacts

Matt Drinen

Director, Tax Credit Services

matt.drinen@CLAAconnect.com

314-925-4381

Luke Pope, CPA

Principal

luke.pope@CLAAconnect.com

314-925-4353

Michael LaBelle

Manager

michael.labelle@CLAAconnect.com

314-925-4495





Questions?

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