

Anchin Alert

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More on the New Qualified Opportunity Zones – Formation and Operation of a Fund

This is the third in a series of alerts by the Anchin Tax Credits and Incentives Team on the new Economic Opportunity Zones program created by the Tax Cuts and Jobs Act (TCJA) in December of 2017 to encourage and incentivize long term investments in qualified low-income communities nationwide. The program provides a tax incentive for investors to roll their capital gains into a Qualified Opportunity Fund (QOF), that in turn invests in certain economically distressed communities.

Taxpayers can take realized capital gains and re-invest cash representing the gains into these new funds during the 180-day period beginning on the date of such sale or exchange, in return for potentially significant tax benefits. Investors in QOF's can defer the income tax on the gains rolled into the funds and, depending on how long they maintain the investments in such funds, they may receive an increase to their basis and tax free treatment on additional gains earned from the cash invested in the fund.

If an investor holds the gain rolled over in a QOF for at least 5 years, then the basis of such investment will be increased by 10% of the amount of the gain deferred. If that investment is held by the taxpayer for at least 7 years, the basis is increased by an additional 5% of the amount of the deferred gain. If the investor is still holding the investment in the QOF on 12/31/26 the original gain deferred (reduced for any increase in basis related to holding periods above) would then need to be recognized for tax purposes. If that investment is held for a period of at least 10 years, the basis of the investment in the QOF can be stepped-up to the fair market value on the date of disposal thus making all of the appreciation on the investment in the QOF tax-free!

Structure

In order to qualify as a QOF, an investment vehicle:

- Must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone Property (QOZ), and
- 90% of its assets must be QOZ property determined by the average of the percentage of QOZ property held in the fund as measured on the last day of the first six-month period of the taxable year of the fund and on the last day of the taxable year of the fund.
- While there was initial uncertainty as to how certification as a QOF would be established, the IRS has issued guidance that eligibility will be established through self-certification. The fund will attach a form (expected to be released by the IRS this summer) to its timely filed federal tax return, including extensions.

QOZ Property

QOZ property is defined as property which is: (1) QOZ stock, (2) a QOZ partnership interest or (3) QOZ business property.

QOZ stock is stock in a domestic corporation that is acquired by the QOF after December 31, 2017 in exchange solely for cash. The corporation must be in a QOZ business at the time the stock was acquired if not a newly formed corporation with the intent on being a QOZ business and during substantially all of the stock's holding period the corporation qualified as a QOZ business.

A QOZ partnership interest is a capital or profits interest in a domestic partnership acquired by the QOF after December 31, 2017 from the partnership solely in exchange for cash. The partnership must be in a QOZ business at the time the partnership was acquired if not a newly formed partnership with the intent on being a QOZ business and during substantially all of the partnership's holding period the partnership qualified as a QOZ business.

QOZ business property is tangible personal property used in a trade or business acquired by the QOF by purchase after December 31, 2017. The original use of the property must start with the QOF or the QOF must substantially improve the property. Property is substantially improved by the QOF if the additions to the basis during any 30-month period beginning after the date of acquisition by the QOF exceed the adjusted basis of the property at the beginning of that 30-month period. As an example, a property acquired within a QOZ for \$1 million would need to be improved by an amount in excess of \$1 million within a 30-month period to be considered substantially improved.

Both the QOZ stock and QOZ partnership interest require that the acquired or newly created entity be a QOZ business. A QOZ business is one in which substantially all of the tangible property owned or leased by the taxpayer is QOZ business property; at least 50% of the gross income is derived from the active conduct of the trade or business; a substantial portion of any intangible property is used in the active conduct of the trade or business; less than 5% of the average of the aggregate unadjusted bases of the property is attributable to nonqualified financial property; and business is not a specifically excluded "sin" business (i.e., golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facilities used for gambling, or any store where the principal business is the sale of alcoholic beverages for consumption off premises).

If a QOF fails to meet the 90% asset test it will be subject to a penalty for each month that it fails to meet the test. There is no penalty imposed where the QOF's failure to meet the 90% asset test requirement can be shown to be due to reasonable cause.

Although much depends on the regulations and guidance still to be issued by the government, we are already seeing tremendous interest in the new Economic Opportunity Zone program among both investors and fund sponsors. Our Anchin Tax Credits and Incentives Team is monitoring and evaluating the program as it develops. We will continue to provide updates as information becomes available.

To learn more about the Qualified Opportunity Zones program and how it might benefit you or your company, contact Anchin Partner & Tax Credits & Incentives Leader, Paul Gevertzman at 212.840.3456 or via email at paul.gevertzman@anchin.com.

For a map of all designated QOZs go to:

https://www.cims.cdfifund.gov/preparation/?config=config_nmtc.xml

To view all designated QOZs on the map, click on the "Layers" tab on the menu on the right hand side of the screen. Select "Opportunity Zone Tract" and unselect "2011-2015 LIC Census Tract," You can then zoom in to a specific area on the map. Designated QOZs will appear in **blue**.

For maps of all NYS designated QOZs by region go to:

<https://esd.ny.gov/opportunity-zones>



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