Proposed Opportunity Zone Rule Summary

Rules public hearing date: January 10, 2019 at 10:00 am in the Internal Revenue Building Auditorium, 1111 Constitution Ave, NW, Washington, DC

Gains eligible for deferral: The US Treasury and IRS interpret the act to be exclusively for capital gains and excludes ordinary gains.

> **Capital gains**: The sale or exchange of a capital asset required to be reported by a taxpayer
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> **Ordinary gains**: Income from wages, tips, bonuses, self-employment, partnerships, sole proprietorships, and LLCs

Taxpayer types eligible to elect gain deferral: Taxpayers include individuals, C corporations, S corporations, shareholders, regulated investment companies (RICs), real estate investment trusts (REITs), partnerships, partners, some pass-through entities, common trust funds, qualified settlement funds, disputed ownership funds, domestic settlement funds, decedent estates, beneficiaries, and trusts.

Qualified Opportunity Fund investments: An investment must be an equity interest. This includes preferred stock and partnership interests with special allocations.

Qualified Opportunity Fund debt instrument investments: Debt instruments are not an eligible investment.

Qualified Opportunity Zone collateral interest: The taxpayer can use the Opportunity Zone investment as collateral for a loan without impairing the qualification.

Partnership money contributions: Money contributions to a partnership do not constitute an opportunity zone investment.

180-day deferment investment rule: To be eligible, a capital gain must be invested within 180 days of the sale or exchange. The first day of the 180-day period is the date the gain would be recognized for Federal income tax purposes.

Sale of interest within 180 days and reinvestment into another Opportunity Zone deferral: If an investor acquires an interest in an opportunity zone and sells or exchanges the interest within 180 days, the seller may elect to reinvest in another opportunity zone but must reinvest the original deferral amount, and the 180-day investment period requirement remains the original start date.

Sale of interest accountability methods: The gain from the sale of a portion of an interest must be accounted for at sale using the FIFO method. When FIFO is not appropriate for explaining varying attributes, a prorate method is to be used

Multiple elections: Multiple elections of an eligible gain is not legal.

> **Eligible gain**: The capital gain designated in an opportunity zone plus non-designated gains.

1256 contract deferrals: The IRS allows 1256 contract deferrals, but they must be reported as a net change for all contracts. Some taxpayers report on an individual contract basis. Deferrals are not allowed using this method. The IRS is willing to consider comments pertaining to a per contract reporting process. The IRS is seeking comments pertaining to this stipulation.

> **1256 contracts**: Regulated futures contracts, foreign currency contracts, nonequity options, dealer equity options, dealer securities futures contracts

Deferred offsetting position transactions and straddles: Unless offsetting position transactions are exclusively section 1256 contracts, offsetting position transactions and net straddle gains are not eligible for the deferral program.

> **Straddles**: An investment strategy whereupon call and put options are purchased on the same future at the same price and expire on the same date. If the future value increases, the option is called. If the future value decreases below the strike price, the option is put.

> **Offsetting position transactions**: A transaction whereupon a taxpayer diminishes risk loss by holding more than one personal property position.

> **Personal property**: Stock holdings and other futures

Deferred gains in partnerships: A partnership may defer all or part of a gain. When a partnership invests in an opportunity zone and has elected to defer, the deferral gain is not required to be included as a distributive share amongst partners.

Deferred partner elections: If a partner's distributive share satisfies all the opportunity zone requirements, the partner may elect to defer regardless of other partners' non-election. The 180-day period is the same as if the partnership were to invest.

Deferral reporting: Treasury is considering the use of Form 8949 as a document for reporting deferrals and will be attached to the Federal income tax forms. The form will identify deferred gains as if the gains were not deferred. Confirmation of the form usage will be announced soon.

Mixed fund opportunity zone investment basis point step-up: Treasury is considering the limitation of basis point step-up benefits for exclusively qualified opportunity fund investments. Mixed funds would not benefit.

> **Basis point step-up**: After the ten-year deferral, the investor has the option for identifying the sale or exchange of personal property at the fair market value.

> **Mixed fund**: An investment with deferred and non-deferred funding sources.

Basis point step-up election and opportunity zone designation termination: On December 31, 2028, opportunity zone designations will expire, but for some 10-year investments, the anniversary will occur after the opportunity zone designation expires. Despite the expiration, the basis step-up election will remain in effect until December 31, 2047.

The latest month in which a ten-year exemption period can begin: The latest date an election can occur is December 31, 2026. Because the fund has 180 days to invest, the latest month for beginning the ten-year period is June 2027.

Program expiration and exit strategies: To allow late investors an opportunity to maximize tax exemption gains at exit, an additional ten years was added to the proposed termination date of the program.

Initial self-certification and annual 90% asset tests: The IRS is proposing the use of Form 8996 as the document for reporting self-certification and annual 90% asset tests. The form would accompany the Federal income tax returns. The form should be released soon.

Deferral and opportunity fund process: An opportunity fund must precede a deferral election.

90% asset testing periods: An opportunity fund has to perform the 90% asset test within 6 months of becoming a qualified opportunity fund, and it must perform a subsequent test at the end of the year. If a qualified opportunity fund begins after June, it must test at the end of the year. Additional rules are forthcoming for qualified opportunity funds established in December. The 90% asset test is required semiannually thereafter.

Qualified opportunity fund decertification: Treasury and IRS are developing decertification regulations.

Reinvestment period: Treasury and IRS are seeking input for determining a reasonable period of time to reinvest assets sold and reinvested and tax treatment of any gains.

Pre-existing entities and qualified opportunity funds: As long as a pre-existing entity meets the qualified opportunity fund requirements, there is no prohibition from establishing itself as a qualified opportunity fund or a subsidiary.

Asset valuation: Asset valuation is based upon the qualified opportunity fund’s financial statement for the taxable year. When a financial statement does not exist, the cost of the asset is used.

Cash and the 90% asset rule: Treasury and IRS are proposing a 31 month safe harbor for holding cash with the intent of acquiring, constructing, or rehabilitating tangible real and business operating property in an opportunity zone. To qualify for safe harbors, a written plan and schedule would be necessary, and the business would have to substantially comply with the schedule. The plan would have to be retained.

Working capital and assets: Treasury and IRS are accepting comments whether to add a 30-month safe harbor to business operations.

Qualified opportunity zone businesses and tangible property: To meet the requirement as a qualified opportunity zone business, substantially all of a business’ tangible property has to be owned or leased by the business. Treasury and IRS have proposed the substantially all threshold at 70%.