BARTON

Qualified Opportunity Zones – New Opportunities in Real Estate

Pursuant to the newly enacted Tax Cuts and Jobs Act, investors are able to utilize a new and powerful mechanism to achieve tremendous savings and deferral of Federal capital gains taxes through the reinvestment in designated geographic areas of the United States known as qualified opportunity zones (“QOZ”) through qualified opportunity zone funds (“QOZF”).

What Savings are Available to the Taxpayer?

1. Tax Deferral on the Initial Capital Gain
    - Normally one would have to pay capital gains tax when they file their annual tax return. By investing in a QOZF, no capital gain tax is due with that year’s tax filing.
    - The capital gain tax is due to be paid with the tax filing on the earlier of when (1) the taxpayer sells their investment in the QOZF or (2) December 31, 2026.
2. Potential Step-up in Basis of the Invested Initial Capital Gain
    - If at the time the tax is due the taxpayer has held the investment for the requisite time period they are entitled to a step-up in basis to further reduce their capital gains tax liability. If by December 31, 2026 the investment is held for 7 years, the taxpayer effectively reduces their tax liability by 15%, or they receive a 10% reduction if held for only 5 years.
3. Elimination of any Tax Due on the Appreciation of the Investment in the QOZF.
    - If the QOZF is held for at least 10 years, then there would be ZERO capital gains tax due on the appreciation of the fund after the initial investment. However, the taxpayer can remain in the QOZF until January 1, 2048.

EXAMPLE: A taxpayer sells artwork worth $1.5 million in 2018 that they originally purchased in 2012 for $500k.The taxpayer would then retain the $500k from the sale and within 180 days invest $1 million in the QOZF. Provided they keep the monies in the QOZF for the requisite time period, then the taxpayer would pay capital gains tax on a gain of $850k (not $1 million) in 2026. If the property appreciates from $1 million to $3 million and the taxpayer sells out of the investment after 10 years, the taxpayer pays ZERO tax on the $2 million gain.

Critical Mechanics:

1. Investment in the QOZF must be made within 180 days following the day that the otherwise taxable event occurs and Form 8949 must be filed for the deferral election.
2. The amount that needs to be reinvested for complete deferral is the full amount of recognized gain only, and not the full amount realized from the sale.
3. Unlike Section 1031 like-kind exchanges, appreciated assets such as artwork or stocks, in addition to real estate, can be invested in the QOZF.
4. The Proposed Regulations provide that the deferred gain's tax attributes will be preserved and taken into account when the gain is taxable. Thus, deferred long-term capital gain will be recognized as taxable long-term or short-term gain depending on the character of the gain that is deferred.

QOZF Compliance:

1. Investment must be made in the designated QOZ.
2. Investment can be made to develop raw land or an existing developed property.
3. QOZF must "substantially improve" the property:
   a. Invest sufficient capital to double the investment based on the improvement on the property only, exclusive of the land value.
   b. The QOZF may not merely hold cash and must make the necessary investment within 31 months to qualify for "safe harbor" treatment.
   c. Asset Test:
      i. The QOZF must invest 90% of the cash held with the intent of investing in QOZ property when the QOZF invests directly.
      ii. If a lower tier entity (aka subsidiary) invests in QOZ property, then if it invests merely 70% of cash held by said lower tier entity, then for purposes of compliance with the 90% rule, 100% of the funds in the lower tier entity will qualify.
4. The new tax rule is a Federal rule, and not a NYS or NYC rule, so that there is no requirement for affordable housing or other restrictions as seen in the 421-a or similar

NY programs; however, golf courses, country clubs, massage parlors, hot tub and suntan facilities, racetracks, gambling facility or liquor stores do not qualify as permissible investments for a QOZF. Intellectual Property may be permissible and can be an incentive for technology startups.

5. Taxpayers may invest in multiple QOZF.
6. There is no minimum or maximum when it comes to the number of properties or amount of funds or number of investors in a QOZF per the new law.
7. Be careful for related party transactions and a reduced threshold of 20% that applies.

In conclusion, the new QOZF program is a win-win for investors and opportunity zones by providing unprecedented tax savings for investing in businesses and community development and redevelopment. When properly followed, it provides a tremendous opportunity for taxpayers to switch asset classes and investment opportunities without incurring capital gains tax liability.

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