FEDERAL INCOME TAX BENEFITS FOR INVESTMENTS IN A QUALIFIED OPPORTUNIY FUND (QOF)

THE QOZ TAX BENEFITS

- Defer tax on capital gain until 2026 taxable year
- 10% of tax eliminated if investment in QOF held for at least 5 years
- An additional 5% of tax eliminated after 7-year holding period
- No tax imposed on sale of interest in QOF that has been held at least 10 years

QUALIFYING FOR QOZ TAX BENEFITS

- All taxpayers realizing capital gain qualify for QOZ Tax Benefits
- Must invest amount of gain in a QOF within 180 days of when gain would otherwise be recognized
- LTCG and STCG are eligible
- Gain from sale to a related party not eligible
- No need to invest all of gain (designate deferred gain on IRS Form 8949)
- No need to "trace" sale proceeds into QOF investment
- Taxpayer realizing capital gain must make the QOF investment

NUANCES

- Special rules for capital gain recognized by tax partnerships (either partnerships or partners may invest in QOF)
- 2026 tax rates will apply to deferred capital gain
- Acceleration of deferred gain upon early disposition of membership interest in QOF
- Special rules for "mixed investments" (interest in QOF consists partially of deferred gain and partially regular cash)
- 10-year exclusion unclear unless interest in QOF is sold (as opposed to sale of QOF investments)

QUALIFIED OPPORTUNITY FUNDS (QOFs)

- Any corporation or tax partnership (includes LLCs) that is organized for the purpose of investing in qualified opportunity zone property – must include statement of purpose in organizational documents by end of 1st QOF tax year

- QOZ Tax Benefits available only for equity investments in QOFs (loans to QOFs don't work)

- Qualified opportunity zone property generally includes: (i) property used in a qualified opportunity zone business operated by the QOF; (ii) qualified opportunity zone stock; and (iii) qualified opportunity zone partnership interests

- A QOF "self-certifies" by filing IRS Form 8996 with its federal income tax return for its first QOF taxable year

- A QOF must hold at least 90% of its assets in qualified opportunity zone property: 90% test applied as average of assets held at end of 1st six-month period in tax year and at end of tax year; assets measured for 90% test with reference to original cost or by "applicable financial statement"

- A QOF will have trouble satisfying 90% test if it raises capital before the capital is needed to purchase qualified opportunity zone property; as a result, under current regulations, most QOFs will invest in partnerships or corporations that will conduct qualified businesses instead of directly purchasing and operating a qualified business

- Penalty for failure to satisfy 90% test is product of tax underpayment interest rate and dollar amount by which qualified assets are less than 90%, imposed on monthly basis (reasonable cause exception)

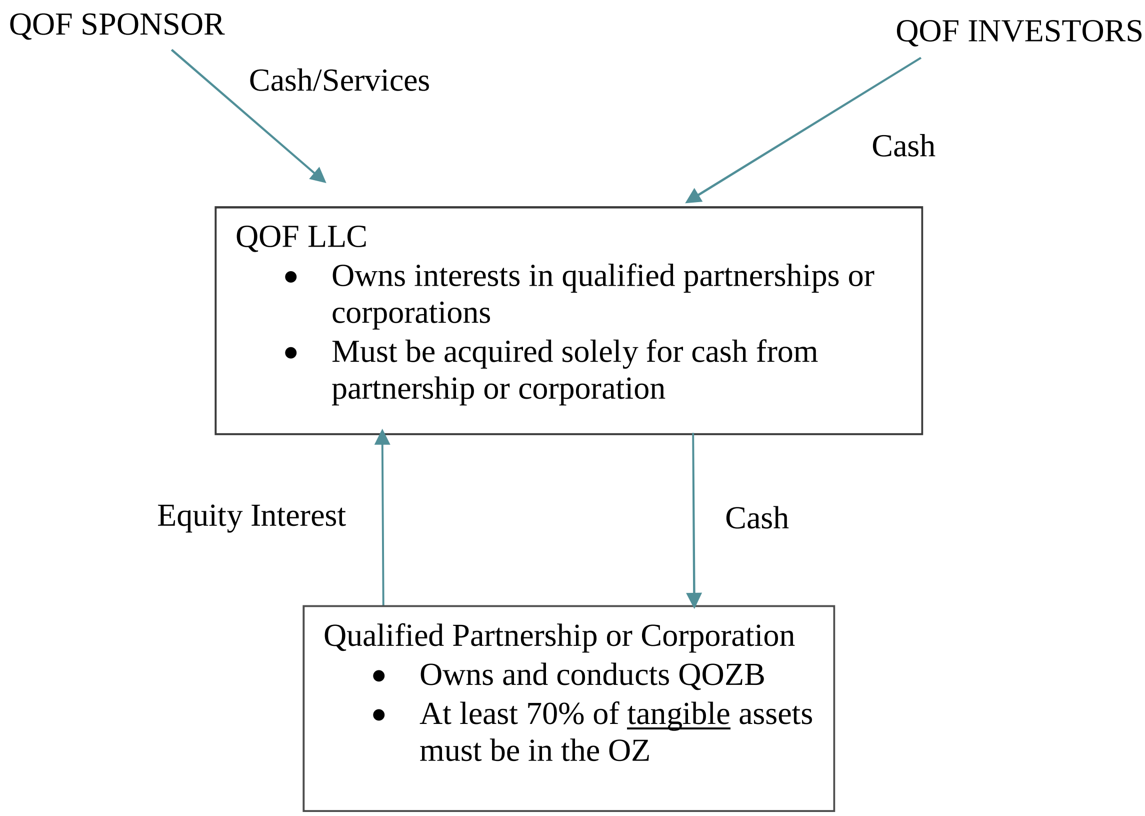
- A QOF's failure of 90% test does not disqualify the QOF or result in disallowance of QOZ Tax Benefits (future guidance may address this)

- QOFs have been created and sponsored by developers, government agencies and by multi-property investment fund sponsors

- A QOF could be a multi-asset fund or a single property/business fund – single property funds are simpler and less risky

- Except for availability of QOZ Tax Benefits with respect to equity investments in QOF, a QOF is just like any other investment vehicle

QUALIFIED OPPORTUNITY ZONE BUSINESSES (QOZB)



- Any trade or business can be a QOZB except a "sin business" (golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, gambling or liquor store)

- Assets acquired from related parties are "bad assets" for 70% test

- Assets acquired before 2018 are "bad assets" for 70% test

- QOZB must hold less than 5% of total cost basis of assets as cash or investment assets

- QOZB must realize at least 50% of annual gross income from active conduct of trade or business within QOZ

- Assets used in QOZB need to be new <u>or</u>, if used, the corporation or partnership must make improvements costing as much as acquisition price over a 30-month period

- Tangible property under construction will be treated as used in an active business for at least 31 months, and cash held for future construction use is a "good asset" if there is a working capital plan to expend it within 31 months

- 70% test and 31-month rule to not apply to QOFs that directly own and operate the QOZB