Title: Rules for Qualified Opportunity Funds Facilitate New Investment Opportunities
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The Lane Report

Readers of The Lane Report may recall the new Qualified Opportunity Zones program (discussed in the June 2018 Lane Report), which was established under the Tax Cuts and Jobs Act of 2017. Under this program, investors can defer paying capital gains tax by re-investing their capital gain in "qualified opportunity funds" within 180 days of realizing the gain. Qualified opportunity funds are created to invest in "qualified opportunity zones," which are low-income communities which have been designated by state governors and approved by the Secretary of the Treasury.

A qualified opportunity fund must be a corporation or partnership which holds at least 90% of its assets in stock or partnership interests in businesses which have substantially all of their tangible property located in a qualified opportunity zone, or business property which is used by the fund itself in a trade or business located in a qualified opportunity zone.

The Internal Revenue Service has since issued proposed rules regarding qualified opportunity funds; these rules should guide both funds and their investors in taking advantage of the new program. The IRS plans to hold a public hearing on the rules on January 10, 2019; the final rules will be issued at a later date. Although the rules will only become effective when the final rules are published in the Federal Register, a taxpayer may rely on the proposed rules with regard to capital gains that would be recognized before that date, as long as the taxpayer applies the rules in their entirety and consistently.

These are some of the highlights of the proposed rules:

1. Any taxpayer which is subject to capital gains tax may defer the tax by re-investing its gains in a qualified opportunity fund. If a partnership realizes a capital gain, normally that gain would be passed through to its partners who would pay the capital gains tax thereon. However, the proposed rules allow the partnership to reinvest its capital gain in a qualified opportunity fund and thus defer recognition of the gain -- meaning that the partners will not be taxed on their share of the gain in the year in which it was realized. Furthermore, if the partnership does not choose to reinvest its gain, each partner will have the opportunity to reinvest its share of the gain in a qualified opportunity fund and thus defer recognition of the gain. In that case, the partner will have 180 days from the end of the partnership's tax

year to reinvest its share of the gain in a qualified opportunity fund. Analogous rules will be applied to S corporations and their shareholders, as well as to trusts and estates and their beneficiaries.

2. Eligible investments in qualified opportunity funds must be equity investments -- which include preferred stock, but not debt instruments. However, an investor is allowed to use its investment in a qualified opportunity fund as collateral for a loan.
3. Qualified opportunity funds are required to self-certify as such. A fund will self-certify by completing and filing IRS Form 8996 (Qualified Opportunity Fund) with its tax return. The IRS has released a draft version of this form; the form is not yet available for filing.
4. A qualified opportunity fund may elect the first month in which it chooses to be a qualified opportunity fund. This option will be helpful to funds as they start up, because a qualified opportunity fund must meet the criterion of having at least 90% of its assets in qualified opportunity zone property, on average, at the end of the first 6 months of its tax year and at the end of its tax year. A fund which is starting up and takes several months to reach the 90% asset threshold can thus delay the start of its qualification period to ensure that it won't miss the requirement.
5. A pre-existing corporation or partnership may become a qualified opportunity fund, as long as it satisfies all the requirements that apply to qualified opportunity funds. In particular, the entity must have acquired its qualified opportunity zone property after December 31, 2017. A pre-existing entity can't become a qualified opportunity fund by virtue of having owned stock, partnership interests, or business property before that date, even if the property later came to be located in a qualified opportunity zone.
6. For purposes of testing whether a fund has met the 90% asset threshold, the fund must use the asset values reported on its applicable financial statement prepared in accordance with generally accepted accounting principles -- which often will be the financial statement required to be filed with the Securities and Exchange Commission. Otherwise, such a financial statement may be one filed with a Federal government agency other than the SEC or IRS, or a financial statement prepared for significant business use. If there is no financial statement that meets any of those criteria, the fund must value its assets based on their cost.
7. For purposes of determining whether a business has "substantially all" of its property as qualified opportunity zone business property, at least 70 percent of the business's tangible property owned or leased by the business must be used within a qualified opportunity zone. Nevertheless, although the term "substantially all" is used multiple times within the statute, that should not be interpreted to allow a cumulation that would violate the law's intent. That is, a sentence such as "During substantially all of the entity's holding period for the tangible property, substantially all of the use of the tangible property was in a qualified opportunity zone" would likely not be interpreted to accept a situation in which for only 70% of the entity's holding period, 70% of the use of the tangible property was in a qualified opportunity zone; 70% of 70% is 49%, which is far from "substantially all."

If you have realized a capital gain on which you would like to defer the capital gains tax, you may wish to take advantage of this opportunity. Or you may wish to offer others that opportunity. If you're interested in pursuing such an investment or organizing a Qualified Opportunity Fund of your own, please contact Marc J. Lane in confidence via email at mlane@MarcJLane.com or phone at (312) 372-1040/ (800) 372-1040.

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