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OPPORTUNITY ZONES

A SHIPMAN & GOODWIN® ALERT

December 27, 2018

Qualified Opportunity Zones

The federal Tax Cuts and Jobs Act of 2017 introduced a new community redevelopment program intended to encourage investment in certain low-income communities across the country by sparking economic development and job growth within these communities. In certain circumstances, a taxpayer may invest capital gains from a sale or exchange into a qualified opportunity fund (QOF), which QOF has, in turn, invested in property such as stock, partnership interests or business property (including real property), located within a qualified opportunity zone (QOZ), after December 31, 2017, allowing the taxpayer to potentially exclude from income up to 15% of the capital gains and defer the recognition of the capital gains income to December 31, 2026. In addition, there is the potential of excluding all gains from the QOF investment if such investment is held for at least ten years. This is a powerful new tool that, when coupled with other investment incentives such as Low-Income Housing Tax Credits, EB-5 visa investment projects and other state-based programs, or as replacement property in a Section 1031 like-kind exchange, could result in significant tax savings to investors.

Investing in QOFs can permit the deferral of taxation on the capital gains that are rolled over into the QOF until the earlier of the date on which the property in which the QOF has invested is sold or exchanged, or December 31, 2026. If the taxpayer remains invested in the QOF for more than five years, the taxpayer is entitled to a 10% exclusion of the deferred capital gain. If the taxpayer remains invested in the QOF for more than seven years, the taxpayer is entitled to an additional 5% exclusion of the deferred capital gain, resulting in an overall 15% exclusion of the deferred gain. The deferred capital gains will need to be recognized no later than December 31, 2026. If, however, the taxpayer remains invested in the QOF for more than ten years, the taxpayer is eligible to increase its basis in its post-investment gains in the QOF to an amount equal to the fair market value of the property on the date of its sale or exchange, *which may result in the taxpayer not paying any tax on the returns on the investment that have been made while such funds were invested in the QOF*. If the taxpayer has invested other money into the QOF in addition to the deferred capital gains, these investments may be bifurcated and, while the taxpayer may be able to defer or avoid paying tax on a portion of the invested capital gains, the taxpayer may be subject to paying capital gains on any other money invested into the QOF. Investors should be cautioned that, as a result of the requirement that the investment in the QOF be held for the requisite ten-year period to take advantage of the capital gain exclusion, the requirement that the deferred capital gain be recognized by December 31, 2026 can create liquidity concerns as funds from the sale or exchange of the property will not be available to fund such tax payment.

To take advantage of investing in a QOF, the taxpayer must invest its capital gains in the QOF within 180 days of the sale or exchange of the capital asset resulting in capital gains. As

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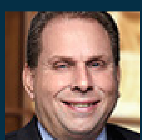

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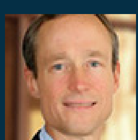

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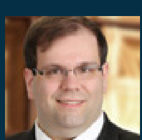

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opposed to a Section 1031 like-kind exchange, the asset being sold or exchanged resulting in capital gains may be nearly anything, including unrelated stocks or shares in a corporation, membership interests in limited liability companies, partnership interests, a business or real property, and only the gains from such sales or exchanges must be reinvested into the QOF. The QOF must hold at least 90% of its assets in the QOZ stock, partnership interests or business property. QOZ business property is tangible property (including real property) purchased after December 31, 2017, located within a QOZ and used in the trade or business of the QOF, the original use of which commences with the investment in the QOF or the QOF substantially improves the property.

The recently released Revenue Ruling 2018-29 holds that if a QOF purchases an existing building located on land that is wholly within a QOZ, the requirement that the original use of the property be in the QOZ *is not applicable to the land on which the building is located*. If the building is substantially improved in order to qualify it as QOF property, the measure of such substantial improvement is the QOF's additions to its adjusted basis *in the building only*. Because of the permanence of land, the land is separated from the building and is not required to be substantially improved because its original use can never be in the QOZ. A building located on land within a QOZ is treated as substantially improved if, during any 30-month period beginning after the date of acquisition of the building, additions to the taxpayer's basis in the building exceed an amount equal to the taxpayer's adjusted basis of the building at the beginning of the 30-month period. For example, if the taxpayer purchases a building and land for $100,000 with the intent to convert the building into residential rental property, and (a) $60,000 was attributable to the value of the land; and (b) $40,000 was attributable to the value of the building, so long as the value of the taxpayer's improvements to the building (which operate as additions to its basis in the building) exceed the $40,000 value attributable to the building, the property *will be considered substantially improved*.

In Connecticut, QOZs are located in each major city and in some rural areas. A map of designated QOZs in Connecticut may be found at http://ctmaps.maps.arcgis.com/apps/View/index.html?appid=5e0c6a70e75744b0b0bcd3b4d5280571&extent=-74.0893,41.0406,-71.4526,42.0163. Because QOZs are designated by census tract, QOZs may be located within designated State of Connecticut Enterprise Zones, which may exempt a seller of real property from the payment of real estate conveyances taxes due to the State of Connecticut upon such sale (though municipal real estate conveyances taxes may still be due to the municipality). This may further encourage investment within QOZs as sellers take advantage of the value added to their properties located within QOZs. We note that given that most of the properties in QOZs may be environmentally impaired or "brownfields", planning for environmental risk management will be prudent.

Recent proposed draft regulations clarify that a pre-existing entity may qualify as a QOF so long as its otherwise meets the requirements to be a QOF, and that cash may be an appropriate QOF property so long as it is held with the intent of investing in QOZ property because developing a new business or the construction or rehabilitation of real estate may take longer than six months. As such, a working capital safe harbor has been proposed for businesses located within QOZs that acquire, construct or rehabilitate both real property and other tangible property used in operating such a business for a period of up to 31 months so long as, among other things, there is a written plan identifying the financial property as

being held for the acquisition, construction or substantial improvements of tangible property in the QOZ, there is a written schedule consistent with the ordinary business operations of the business that the property will be used within 31 months and the business substantially complies with this schedule.

Under the current law, taxpayers have until December 31, 2028, to invest in QOFs as the QOZs are set to expire as of that date; however the recently issued proposed regulations indicate that the ten year hold period can be met so long as the QOF investment is sold no later than December 31, 2047. Further, taxpayers have until December 31, 2019, to rollover their capital gains in QOFs to be eligible for the 15% increase in basis of their invested capital gains and until December 31, 2021, to rollover their capital gains in QOFs to be eligible for the 10% increase in basis of their invested capital gains. . A draft version of the self-certification form required to be filed with the IRS may be found at https://www.irs.gov/pub/irs-dft/f8996--dft.pdf, and instructions for such form are found at https://www.irs.gov/pub/irs-dft/i8996--dft.pdf.

Shipman & Goodwin LLP recently held a webinar on Qualified Opportunity Zones and Qualified Opportunity Funds. If you are interested in listening to the webinar on demand at any time, you may do so by visiting https://bit.ly/2zgPHQL.

Questions or Assistance:

For more information on Qualified Opportunity Zones and Qualified Opportunity Funds, please contact Lou Schatz at lschatz@goodwin.com (tax), Bruce Chudwick at bchudwick@goodwin.com (business) or Greg Muccilli at gmuccilli@goodwin.com (real estate).

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