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What an OZ Investment Looks Like on Your Tax Return



Presenter



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Greg is a senior tax manager in Plante Moran's real estate and construction group. He has more than 11 years of public accounting experience, all of which has been spent within the real estate and construction industries specializing in partnership taxation, including tax structuring and planning related to real estate transactions. Greg has been very involved in the Opportunity Zones incentive program since its inception in 2017.

Plante Moran is one of the nation's largest certified public accounting firms, providing clients with audit, accounting, tax, and business advisory consulting services. Within our firm, we have a team focused on Opportunity Zones and staying current on relevant information.



Overview

- How the Opportunity Zone program works
- Tax Return Reporting
- Extension of Tax Deadlines
- COVID-19 - Impact and Mitigation
- Q & A Session



How the Opportunity Zone program works



How the Opportunity Zone program works

Benefits to Investors:

- Deferral of capital gain until 12/31/26
 - To the extent gain is invested in Qualified Opportunity Fund (QOF) in 180 days.
 - Phantom income recognized on 12/31/26 if QOF not yet sold
- Exclusion of part of deferred capital gain – No tax on up to 15% of the deferred gain depending upon holding period of investment in QOF prior to 12/31/26
 - 10% permanent exclusion with 5+ year holding period (N/A for QOF investments after 12/31/21)
 - 15% permanent exclusion with 7+ year holding period (N/A for QOF investments after 12/31/19)
- Permanent exclusion of gain from sale of investment in QOF
 - **Permanent** exclusion (through a basis step-up) of gains derived from the later sale of the QOF investment if held 10+ years
 - Only available to the extent the investment in QOF was funded with deferred gain



How the Opportunity Zone program works

How Benefits Work in Tax Law:

- Deferral of capital gain until 12/31/26
 - Deferral allows the taxpayer to recognize gain at a later date, thereby allowing for a deferral on the required tax payments.
- Exclusion of part of deferred capital gain
 - Taxpayer will NEVER pay tax on the excluded portion of gain
 - Taxpayer has zero basis in the investment, meaning the future sale would lead to gain on the entire investment.
 - However, this benefit allows a “step-up” in basis of 10% of the investment. This leads to the gain being reduced to 90% of its original amount = 90% of the tax due.
- Exclusion of gain from sale of investment in QOF
 - Building on the above, this allows exclusion of the gain when eventually selling the investment in the QOF
 - The taxpayer’s basis is stepped up from the partial deferred capital gain and then steps up to the full investment amount when the tax is paid in 2026. Then upon sale (after 10 years), the basis is stepped up to FMV immediately before the sale = no gain on sale.



How the Opportunity Zone program works

Example:

Capital gain sale

- » Sale price = \$1,500,000
- » Basis = \$500,000
- » Capital gain = \$1,000,000
- » Sale date = August 2, 2020

Reinvestment

- » Deferred gain = Amount invested up to \$1,000,000
- » Reinvestment date = Nov 30, 2020 (within 180 days)

QOF sale

- » Sale date = Nov 30, 2030 (> 10 year holding period)
- » Sale price = \$2,000,000
- » Basis = \$2,000,000

\$900,000 phantom income recognized 12/31/26

+ \$100,000 step up after 5 years

+ \$1,000,000 election to step up to fair market value

- » **Gain = \$0 on 11/30/2030**

\$2,000,000 sale price

- \$2,000,000 basis



Tax Return Reporting



Tax Return Reporting - QOFs

Tax Reporting – Qualified Opportunity Funds

- Is the entity attaching Form 8996 to certify as a QOF?
 - Partnerships (Form 1065, Schedule B, Line 26)
 - S Corporations (Form 1120S, Sch B, Line 15)
 - Corporations (Form 1120, Sch K, Line 25)

26	Is the partnership attaching Form 8996 to certify as a Qualified Opportunity Fund?	
	If "Yes," enter the amount from Form 8996, line 14	▶ \$ <input type="text"/>

- Form 8996
 - Form is used to self-certify as a Qualified Opportunity Fund
 - Required to be filed with entity tax return



Tax Return Reporting – Form 8996

Form 8996 (Rev. January 2020) Department of the Treasury Internal Revenue Service	Qualified Opportunity Fund ▶ Go to www.irs.gov/Form8996 for the latest information. ▶ Attach to your tax return. See instructions.	OMB No. 1545-0123
		Attachment Sequence No. 996
Name	Employer identification number	
Part I General Information and Certification		
1 Type of taxpayer: <input type="checkbox"/> Corporation <input checked="" type="checkbox"/> Partnership		
2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)? No. STOP. Do not file this form with your tax return. <input checked="" type="checkbox"/> Yes. Go to line 3.		
3 Is this the first period the taxpayer is a Qualified Opportunity Fund? <input checked="" type="checkbox"/> Yes. By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and a description of the trade or business(es) that the QOF is engaged in either directly or through a qualified opportunity zone business. See instructions. No.		
4 If you checked "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund ▶ <u>DECEMBER</u>		
5 Did any investor dispose of, in part or in whole, their equity interest in the fund? Yes. Attach a statement with each investor's name, the date of disposal, and the interest that they transferred during the QOF's tax year. <input checked="" type="checkbox"/> No.		



Tax Return Reporting – Form 8996

Part II Investment Standard Calculation

6 Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3, is "Yes"	6	0.
7 Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3, is "Yes"	7	0.
8 Divide line 6 by line 7	8	0
9 Total qualified opportunity zone property held by the taxpayer on the last day of the taxpayer's tax year	9	1,500,000.
10 Total assets held by the taxpayer on the last day of the taxpayer's tax year	10	1,500,000.
11 Divide line 9 by line 10	11	1.000

Part III Qualified Opportunity Fund Average and Penalty

12 Add lines 8 and 11	12	1.0000
13 Divide line 12 by 2.0. See instructions if Part I, line 3, is "Yes"	13	1.000
14 Is line 13 equal to or more than 0.90? <input checked="" type="checkbox"/> Yes. Enter -0- on this line and file this form with your tax return. No. The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return	14	0.

For Paperwork Reduction Act Notice, see your tax return instructions.

Form 8996 (Rev. 1-2020)



Tax Return Reporting – Form 8996

Page 2 (Part VI – Line 14 Penalty)

- Detailed calculation for any potential penalty
- Only applicable if under less than 90% of total assets are qualified opportunity zone property
- Penalty calculated as of the last day of each month

Pages 3-4 (Part V, Part VI)

- Part V - QOZ Business Property (direct investment)
- Part VI - QOZ Stock or Partnership Interests (indirect investment)
- Required information = QOZ Tract No., EIN of QOZB, Investment Value, Owned/Leased Property Value at end of 1st 6-month period and last day of tax year
- Type of Accounting Method used – AFS vs. Alternative



Tax Return Reporting - Individuals

Tax Reporting – Individuals (finalized in February 2020)

- Form 8997 - Initial and Annual Statement of QOF Investments
 - Required to be filed for any taxpayer who holds a QOF investment during the tax year – includes four sections:
 - Part I – QOF investments at beginning of tax year
 - Part II – capital gains realized, but deferred by QOF investment
 - Part III – QOF investment dispositions during tax year
 - Part IV – QOF investments at end of tax year
 - Information Required
 - QOF's EIN
 - Date the QOF interest was acquired
 - Description of QOF investment (shares, percentage interest, etc.)
 - Amount of short-term/long-term gain taxpayer deferred/disposed



Tax Return Reporting - Form 8997

Form 8997 Department of the Treasury Internal Revenue Service	Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments ▶ Go to www.irs.gov/Form8997 for instructions and the latest information.	OMB No. 1545-0123 2019 Attachment Sequence No. 997		
Name		Tax identification number (see instructions)		
Part I Total QOF investment holdings at beginning of tax year If different from last year's ending QOF investment holdings, attach explanation.				
(a) Qualified Opportunity Fund (QOF) EIN	(b) Date QOF investment acquired (MM/DD/YYYY)	(c) Description of QOF investment (For example, 100 shares or 25% interest)	Deferred gain held in QOF	
			(d) Amount of short-term deferred gain remaining in QOF	(e) Amount of long-term deferred gain remaining in QOF
Enter the totals, if any, from continuation sheet ▶				
Enter the totals from columns (d) and (e) ▶				



Tax Return Reporting - Individuals

Tax Reporting – Individuals (finalized in February 2020)

- Form 8949 and Schedule D
 - Form 8949
 - Report initial decision to defer capital gain by investing in QOF
 - Any disposition of an interest in a QOF
 - Therefore, only filed in first and last year of OZ investment
 - Requires detailed information about each QOF deferral and disposition
 - Schedule D
 - Taxpayers check a box on Schedule D if they disposed of a QOF investment
 - Also, carry over relevant information from Forms 8997 and 8949 to Schedule D
 - Also used to report any capital gain that they are deferring when making QOF investment



Tax Return Reporting - Individuals

Tax Reporting – Form 8949

- Reporting the deferral election - Each QOF investment of IRC section 1231 gains will use two separate rows in Part I (short-term transactions) or Part II (long-term transactions), as applicable, of Form 8949.
 - For the first row, in column (a), write “QOF INVESTMENT FROM FORM 4797.” Leave columns (b) through (g) blank. In column (h), report the amount of the QOF investment from Form 4797 as a positive number. For example, if (\$75,000) was reported in column (g) of Form 4797, report \$75,000 in column (h) of Form 8949.
 - For the second row, in column (a), enter only the EIN of the QOF investment. In column (b), enter the date of the QOF investment. Leave columns (c), (d), and (e) blank. Enter code “Z” in column (f) and the amount of the deferred gain as a negative number (in parentheses) in column (g).



Tax Return Reporting – Form 8949

Part II Long-Term. Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You must check Box D, E, or F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- (D) Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- (E) Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- (F) Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (e) in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
						(f) Code(s) from Instructions	(g) Amount of adjustment	
	QOF INVESTMENT FROM FORM 4797							100,000
	EIN OF QOF	6/15/2020				Z	(100,000)	(100,000)



Extension of Tax Deadlines



Extension of Tax Deadlines

Tax Due Dates

- All federal deadlines extended until 7/15
- Most states followed suit and extended to 7/15, OH included
- Q1 and Q2 estimates extended until 7/15 (both due)
- Extended due dates have not moved (still 9/15 for partnerships, 10/15 for C Corps and individuals)
- Going to be a busy summer for some of us!

OZ Extensions

- The investment window was extended to July 15, 2020 for any 180-day deadline that otherwise would have ended between April 1 and July 15.
- Could be further extended with future relief



COVID-19 - Impact and Mitigation



COVID-19 - Impact and Mitigation

Market Impact

- The COVID-19 pandemic has impacted all facets of the economy – and opportunity zones are no exception.
- The uncertainty impacts:
 - QOFs – how to raise capital
 - QOZBs – how to keep projects moving along and staying compliant
 - **Investors** – how to feel confident in investments and meeting tax requirements



COVID-19 - Impact and Mitigation

Investment Timelines

- Notice 2020-23 extended the investment window to July 15, 2020 for any 180-day deadline that otherwise would have ended between April 1 and July 15.
- Using this extension, QOFs can effectively grant themselves an extra 6 months to invest in QOZP by delaying receipt of contributions into July 2020.
 - Due to timing of testing, a QOF receiving investment in June will be required to invest funds in QOZP by December 31, 2020.
 - If QOF is able to delay into July 2020, it will have until June 30, 2021 to invest such funds in QOZP
- Influx of investments in late summer/early fall due to stock sales in reaction to COVID-19 pandemic



COVID-19 - Impact and Mitigation

QOZB Relief: 31-month Working Capital Safe Harbor

- A QOZB generally has 31-months to expend working capital funds following a written plan
- The shelter in place requirements could lead to not meeting this deadline
- The final OZ regulations provide an automatic 24-month extension of the 31-month period if a QOZB is located in a federally declared disaster area
- All 50 states have been declared federal disaster areas.
- Document, document, document!



COVID-19 - Impact and Mitigation

QOF Relief - 12-Month Reinvestment Period

- A QOF has 12 months to reinvest proceeds from the sale of property or a return of capital without impacting the 90% investment standard.
- The regulations allow an additional 12 months if the reinvestment is delayed due to a federally declared disaster

QOF Penalty Relief – “Reasonable cause exception”

- QOFs unable to complete due diligence due to shelter in place restrictions.
- QOFs invested in QOZBs that fail the 70% tangible property standard because of construction delays.
- QOFs invested in QOZBs that fail the 50% gross income test or 40% intangible property test because shelter in place restrictions significantly reduce work inside OZs and/or cause employees to work remotely outside of OZs.
- Document, document, document!



COVID-19 - Impact and Mitigation

Qualified Improvement Property (QIP) Correction

- The CARES Act corrected depreciable life of QIP from 39 years to 15 years, thereby making this bonus eligible.
- QIP acquired and placed in service between September 27, 2017 and December 31, 2022 is eligible for 100% bonus depreciation. Thereafter, bonus depreciation is gradually phased out through 2026.
- This can significantly increase the after-tax rate of return for QOF investments
 - Potential ways to make the correction
 - Form 3115
 - Amending 2018 tax return
 - Superseding 2019 tax return
 - Leads to a permanent tax benefit for investors in commercial and mixed-use buildings in OZs



COVID-19 - Impact and Mitigation

Possible Future OZ Relief

- Although there is no guarantee, there is potential for the following relief items to be addressed.
- Requests have been supported by EIG Coalition and Senator Tim Scott
 - Extend the 30-month substantial improvement period.
 - Automatically apply the reasonable cause exception to QOF penalties under certain pre-determined circumstances.
 - Broaden the 180-day investment period extension.
 - Provide relief from the 50% gross income safe harbor and the 40% intangible property test for QOZB's with employees teleworking or furloughed due to COVID-19.
 - Increase the number and/or length of regulatory 6-month cure periods



Questions



References

- **Opportunity Zone resources available at:**
 - <https://www.plantemoran.com/opportunityzones>
 - [COVID-19_Resource_Center](#)
- **Opportunity Fund information available at:**
 - <https://www.cbuzofunds.com/>
- **Links to mapping sites to determine eligibility by address**
 - <https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>
 - Ohio - https://development.ohio.gov/bs/bs_censustracts.htm
- **IRS Opportunity Zone FAQs**
 - <https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>



Thank you for attending

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