

Tax reform: Legislation Creates a New Tool for Economic Development

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Vermont Opportunity Zone Summit



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Today's presenters



Stephen P. Trenholm, CPA, MST Tax Director

- Member of American Institute of Certified Public Accountants and the Vermont Society of Certified Public Accountants.
- Steve provides tax consulting in areas of complex mergers, business formations, and tax credit studies.

Where are the Vermont Opportunity Zones Located?

25 low income census tracts in Barre City, Bennington, Brattleboro, Burlington, Johnson, Lyndon, Newport City, Randolph, Rockingham, Royalton, Rutland City, St. Albans City, St. Johnsbury, South Burlington, Springfield, Vergennes, and Winooski as Opportunity Zones

So What are the Tax Benefits 30,000 foot view?

- New IRC Section 1400Z-2 contains special rules for capital gains invested in Opportunity Zones.
 - Allows deferral of gain on sale to an unrelated person of any property provided the “gain” is invested in Qualified Opportunity Zone assets within 180 days.
 - Taxpayer must make an election for this gain deferral.
 - The gain cannot be deferred past December 31, 2026
 - Any appreciation in the Opportunity Zone property itself can be permanently excluded provided the investment is held for 10 years

What is Qualified Opportunity Zone Property

- QO Zone property is property which is: [\(Code Sec. 1400Z-2\(d\)\(2\)\(A\)\)](#)
- . . . QO Zone stock [\(Code Sec. 1400Z-2\(d\)\(2\)\(A\)\(i\)\)](#)
- . . . QO Zone partnership interest or [\(Code Sec. 1400Z-2\(d\)\(2\)\(A\)\(ii\)\)](#)
- . . . QO Zone business property [\(Code Sec. 1400Z-2\(d\)\(2\)\(A\)\(iii\)\)](#)

What is Qualified Opportunity Zone Stock

- the stock is acquired by the QO Fund after Dec. 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash, [\(Code Sec. 1400Z-2\(d\)\(2\)\(B\)\(i\)\(I\)\)](#)
- . . . as of the time the stock was issued, the corporation was a QO Zone business (defined below) (or, in the case of a new corporation, the corporation was being organized for purposes of being a QO Zone business), and [\(Code Sec. 1400Z-2\(d\)\(2\)\(B\)\(i\)\(II\)\)](#)
- . . . during substantially all of the QO Fund's holding period for the stock, the corporation qualified as a QO Zone business. [\(Code Sec. 1400Z-2\(d\)\(2\)\(B\)\(i\)\(III\)\)](#)

What is Qualified Opportunity Zone Partnership Interest

- A QO Zone partnership interest is any capital or profits interest in a domestic partnership if: [\(Code Sec. 1400Z-2\(d\)\(2\)\(C\)\)](#)
- . . . the interest is acquired by the QO Fund after Dec. 31, 2017, from the partnership solely in exchange for cash, [\(Code Sec. 1400Z-2\(d\)\(2\)\(C\)\(i\)\)](#)
- . . . as of the time the interest was acquired, the partnership was a QO Zone business (defined below) (or, in the case of a new partnership, the partnership was being organized for purposes of being a QO Zone business), and [\(Code Sec. 1400Z-2\(d\)\(2\)\(C\)\(ii\)\)](#)
- . . . during substantially all of the QO Fund's holding period for the interest, the partnership qualified as a QO Zone business. [\(Code Sec. 1400Z-2\(d\)\(2\)\(C\)\(iii\)\)](#)

What is Qualified Opportunity Zone Business Property

- A QO Zone business property is tangible property used in a trade or business of the taxpayer if these three requirements are satisfied: [\(Code Sec. 1400Z-2\(d\)\(2\)\(D\)\(i\)\)](#)
- (i) the property was acquired by the QO Zone by purchase (as defined in [Code Sec. 179\(d\)\(2\)](#)) after Dec. 31, 2017. [\(Code Sec. 1400Z-2\(d\)\(2\)\(D\)\(i\)\(I\)\)](#)
- (ii) the original use of the property in the QO Zone commences with the QO Fund or the QO Fund substantially improves the property. [\(Code Sec. 1400Z-2\(d\)\(2\)\(D\)\(i\)\(II\)\)](#) For this purpose, property is treated as substantially improved by the taxpayer only if, during any 30-month period beginning after the date of acquisition of the property, additions to basis with respect to the property in the QO Fund's hands exceed an amount equal to the adjusted basis of the property at the beginning of the 30-month period in the taxpayer's hands. [\(Code Sec. 1400Z-2\(d\)\(2\)\(D\)\(ii\)\)](#)
- (iii) during substantially all of the QO Fund's holding period for the property, substantially all of the use of the property was in a QO Zone. [\(Code Sec. 1400Z-2\(d\)\(2\)\(D\)\(i\)\(III\)\)](#)

What is a Qualified Opportunity Zone Fund?

- The term “qualified opportunity fund” means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—
 - (A) on the last day of the first 6-month period of the taxable year of the fund, and
 - (B) on the last day of the taxable year of the fund.

How is the Election to Defer Gain Made?

- You may make an election to defer the gain, in whole or in part, when filing your 2018 Federal Income Tax return in 2019 (that is, you may make the election on the return on which the tax on that gain would be due if you do not defer it).

How Does a Taxpayer become a Qualified Opportunity Fund?

- To become a Qualified Opportunity Fund, an eligible taxpayer self certifies. (Thus, no approval or action by the IRS is required.) To self-certify, a taxpayer merely completes a form (which will be released in the summer of 2018) and attaches that form to the taxpayer's federal income tax return for the taxable year. (The return must be filed timely, taking extensions into account.)

What is a Qualified Opportunity Zone Business?

- A QO Zone business is a trade or business: [\(Code Sec. 1400Z-2\(d\)\(3\)\(A\)\)](#)
- . . . in which substantially all of the tangible property owned or leased by the taxpayer is QO Zone business property (determined by substituting “QO Zone business” for “QO Fund” each place it appears in [Code Sec. 1400Z-2\(d\)\(2\)\(D\)](#), see above),
- . . . which satisfies the requirements of [Code Sec. 1397C\(b\)\(2\)](#) (rule relating to the definition of an enterprise zone business that requires at least 50% of a qualified business entity's total gross income be derived from the active conduct of a qualified business, see [FTC 2d/Fin ¶L-9955](#) ; [USTR ¶13,97A4](#)), [Code Sec. 1397C\(b\)\(4\)](#) (requirement under the definition of a qualified business entity requiring that a substantial portion of the entity's intangible property is used in the active conduct of the business, see [FTC 2d/Fin ¶L-9955](#) ; [USTR ¶13,97A4](#)), and [Code Sec. 1397C\(b\)\(8\)](#) (rule providing that less than 5% of the average unadjusted basis of qualified business entity's property is attributable to nonqualified financial property, see [FTC 2d/Fin ¶L-9955](#) ; [USTR ¶13,97A4](#)). ([Code Sec. 1400Z-2\(d\)\(3\)\(A\)\(ii\)](#)) and
- . . . which is not described in [Code Sec. 144\(c\)\(6\)\(B\)](#) (i.e., property other than any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises, see [FTC 2d/Fin ¶J-3299](#) ; [USTR ¶1444.02](#)). ([Code Sec. 1400Z-2\(d\)\(3\)\(A\)\(iii\)](#))

Recognition of deferred gain at the end of the deferral period.

- Gain to which [Code Sec. 1400Z-2\(a\)\(1\)\(B\)](#) applies (i.e., gain excluded under the temporary deferral election) is included in income in the tax year which includes the earlier of: [\(Code Sec. 1400Z-2\(b\)\(1\)\)](#)
- (a) the date on which the investment is sold or exchanged, or [\(Code Sec. 1400Z-2\(b\)\(1\)\(A\)\)](#)
- (b) Dec. 31, 2026. [\(Code Sec. 1400Z-2\(b\)\(1\)\(B\)\)](#)

Amount of Deferred Gain Included in Gross Income.

- The amount of gain included in gross income under [Code Sec. 1400Z-2\(a\)\(1\)\(A\)](#) (see observation below) is the excess of: [\(Code Sec. 1400Z-2\(b\)\(2\)\(A\)\)](#)
- (a) the lesser of the amount of gain excluded under [Code Sec. 1400Z-2\(b\)\(1\)](#) (see observation below) or the fair market value (FMV) of the investment as determined as of the date described in [Code Sec. 1400Z-2\(b\)\(1\)](#) (i.e., the end of the deferral period), over [\(Code Sec. 1400Z-2\(b\)\(2\)\(A\)\(i\)\)](#)
- (b) the taxpayer's basis in the investment (defined immediately below). [\(Code Sec. 1400Z-2\(b\)\(2\)\(A\)\(ii\)\)](#)

Basis in the Qualified Opportunity Zone Property.

- Except for the increases to basis discussed below or in [Code Sec. 1400Z-2\(c\)](#) (discussed below), the taxpayer's basis in the investment is zero. ([Code Sec. 1400Z-2\(b\)\(2\)\(B\)\(i\)](#))
- Basis increases.
- In the case of any investment held for at least five years, the basis of the investment is increased by an amount equal to 10% of the amount of gain temporarily deferred under [Code Sec. 1400Z-2\(a\)\(1\)\(A\)](#) (discussed above). ([Code Sec. 1400Z-2\(b\)\(2\)\(B\)\(iii\)](#))
- In the case of any investment held by the taxpayer for at least seven years, in addition to any basis adjustment made under [Code Sec. 1400Z-2\(b\)\(2\)\(B\)\(iii\)](#) for an investment held more than five years (discussed immediately above), the basis of the property is increased by an amount equal to 5% of the amount of gain deferred by reason of [Code Sec. 1400Z-2\(a\)\(1\)](#). ([Code Sec. 1400Z-2\(b\)\(2\)\(B\)\(iv\)](#))

Basis in the Qualified Opportunity Zone Property, Continued.

- The basis in the investment is increased by the amount of gain recognized when the temporary deferral period ends under [Code Sec. 1400Z-2\(a\)\(1\)\(B\)](#) with respect to the property. [\(Code Sec. 1400Z-2\(b\)\(2\)\(B\)\(ii\)\)](#)
Thus, if the investment is held by the taxpayer until at least Dec. 31, 2026, the basis in the investment increases by the remaining 85% of the deferred gain
- In the case of a sale or exchange of the investment before Dec. 31, 2026 (that causes the deferral period to end and gain to be recognized), the inclusion of any gain recognized in the basis in the investment would result in a circular computation. Under that computation, the basis in the investment is used to calculate the amount of gain recognized at the end of the deferral period (see item (b) above) and the amount of any gain recognized would be needed to compute the basis in the investment

Penalty for failure of a QO Fund to maintain the 90% investment standard

- If a QO Fund fails to meet the 90% requirement of Code Sec. 1400Z-2(c)(1) (see observation below), the QO Fund has to pay a penalty for each month it fails to meet the requirement in an amount equal to the product of: [\(Code Sec. 1400Z-2\(f\)\(1\)\)](#)
- the excess of: [\(Code Sec. 1400Z-2\(f\)\(1\)\(A\)\)](#)
 - . . . the amount equal to 90% of its aggregate assets, over [\(Code Sec. 1400Z-2\(f\)\(1\)\(A\)\(i\)\)](#)
 - . . . the aggregate amount of QO Zone property held by the fund, multiplied by [\(Code Sec. 1400Z-2\(f\)\(1\)\(A\)\(ii\)\)](#)
- the underpayment rate established under [Code Sec. 6621\(a\)\(2\)](#) (see [FTC 2d/Fin ¶V-1101](#) ; [USTR ¶66,214](#)) for the month. [\(Code Sec. 1400Z-2\(f\)\(1\)\(B\)\)](#)
- Partnerships.
- If the QO Fund is a partnership, the penalty is taken into account proportionately as part of the distributive share of each partner of the partnership. [\(Code Sec. 1400Z-2\(f\)\(2\)\)](#)

Questions and Answers on Gain Deferral

- **Q. I sold some stock for a gain in 2018, and, during the 180-day period beginning on the date of the sale, I invested the amount of the gain in a Qualified Opportunity Fund. Can I defer paying tax on that gain?**
- A. Yes, under § 1400Z-2(a)(1) of the Internal Revenue Code, you may elect to defer the tax on some or all of that gain. If, during the 180-day period, you had invested in one or more Qualified Opportunity Funds only an amount that was less than your entire gain, you may still elect to defer paying tax on part of the gain, up to the amount that you invested in that way.
- **Q. I sold some stock on December 15, 2017, and, during the required 180-day period, I invested the amount of the gain in a Qualified Opportunity Fund. Can I elect to defer tax on that gain?**
- A. Yes, as long as it was invested in the 180-day period, under § 1400Z-2(a)(1) of the Internal Revenue Code, you may elect to defer the tax on that gain. A deferral election may be made on your 2017 Federal Income Tax return. Information about the sale of your stock is required to be included in that return using IRS Form 8949. Precise instructions on how to use that form to elect deferral of the gain for your 2017 return will be forthcoming shortly.
- **Q. Can I still elect to defer tax on that gain if I have already filed my 2017 tax return?**
- A. Yes. You may elect to defer the gain, but you will need to file an amended 2017 return. As part of that amended return, you will follow the election procedure described in the answer to the preceding question.

Thank you



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Thank you for your time!

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