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Key considerations about opportunity zone fund investments

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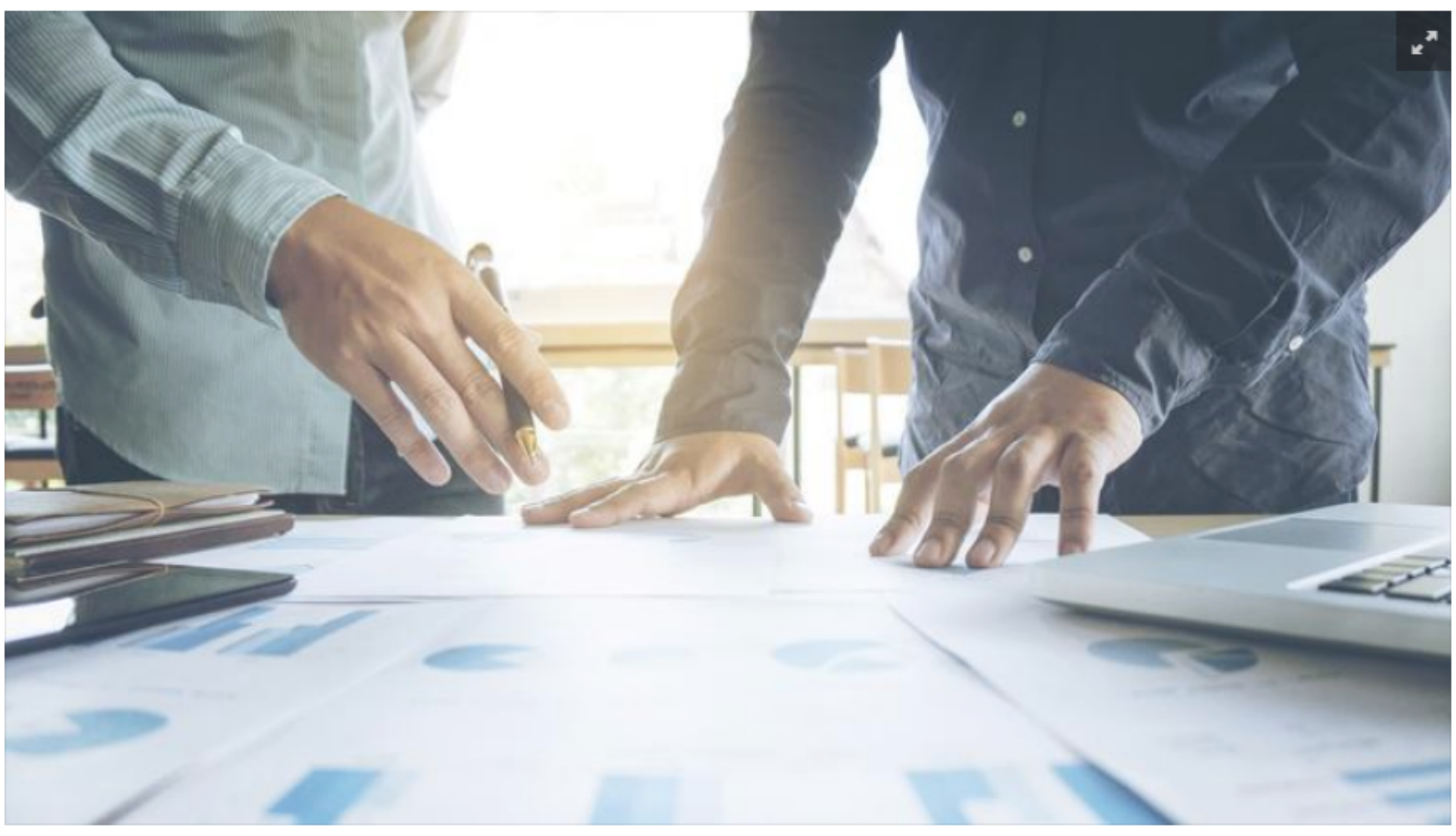

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In order to be able to reap the potential tax benefits associated with opportunity zones, a taxpayer must invest in a qualified opportunity fund (QOF). The QOF may take the form of a corporation (S corporations included), a partnership or a multi-member LLC (single-member LLCs do not qualify) formed for the purpose of making investments in opportunity zones.

Pre-existing entities

QOFs need not be newly established entities; a pre-existing entity can elect to be a QOF. However, only assets acquired by a pre-existing entity after 2017 count towards the requirement that 90% of a QOF's assets constitute eligible property or investments.

Self-certification

A QOF must self-certify that it holds 90% of its assets in qualified opportunity zone property. The 90% investment standard is determined by the average of the percentage of qualified opportunity zone property held in the QOF as measured on: (1) the last day of the first six-month period of the tax year of the QOF, and (2) the last day of the tax year of the QOF. The proposed regulations issued in April 2019 provided some helpful guidance on the timing and requirements of this process.

Requirements

QOFs must invest in qualified opportunity zone property which can be either (1) a direct investment in opportunity zone business property (QOZBP) or (2) an investment in the stock or partnership interests of entities which are engaged in a qualified opportunity zone business (a QOZ subsidiary).

Qualified opportunity zone business property (QOZBP) means tangible property used in a trade or business conducted within an opportunity zone, provided that:

- The property is acquired by the QOF from an unrelated person.
- Either the "original use" of the property in the QOZ commences with the QOF or the QOF "substantially improves" property by doubling the basis of the property over a 30 month period.
- "Substantially all" of the use of the property in within an opportunity zone.

Leased property, under proposed regulations issued in April 2019, is considered QOZBP so long as the lease is entered into after Dec. 31, 2017 and the terms of the lease are at market rate. In addition, the proposed regulations issued in April 2019 provided some meaningful and generally helpful guidance on these requirements.

If a QOF invests in a QOZ subsidiary, the QOZ subsidiary must be engaged in a qualified opportunity zone business. A qualified opportunity zone business (QOZB) is a trade or business in which substantially all of the tangible property owned or leased by the business is QOZBP. A QOZB may not operate a "sin" businesses: golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, casino and sale of alcohol to be consumed away from the premises.

Comparison of holding an opportunity zone property versus investing in an opportunity zone business:

- If a QOF has $10 million in assets and wants to hold only $6.3 million on QOZBP, it can do so by investing $9 million in a partnership and having the partnership invest $6.3 million (i.e., 70% of its assets) on QOZBP.
- The operating partnership could hold the remaining $2.7 million in cash of $450,000 (i.e., 5 % of its assets) and $2.25 million in non-qualifying tangible assets.
- The QOF could hold its remaining $1 million (i.e., $10 million less the $9 million invested in the partnership subsidiary in cash, bonds, the S&P 500, etc.
- In contrast, if the QOF opted to purchase the qualified opportunity zone business property itself, it would have to buy $9 million of QOZBP, all of which would have to constitute tangible assets, and could then hold the remaining $1 million in cash, stocks, the S&P 500, non-qualifying real estate, etc.

Securities considerations

In addition to ensuring that the requirements above are satisfied, anyone considering forming a QOF with the intent to raise funds from others must also consider securities law implications and other applicable laws.

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