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West Palm Beach***TO:** Michael Simon**FROM:** Telsula C. Morgan, Esquire**DATE:** December 13, 2018**SUBJECT:** Interplay between Boynton Beach CRA and Opportunity Zone Funding

Issue:

Determine whether the Boynton Beach Community Redevelopment Agency (Boynton Beach “CRA”) can contribute to Qualified Opportunity Zone Funds and research the benefits associated with the same.

Background:

In December 2017, the Tax Cuts and Jobs Act (the “Act”) was signed into law by President Donald Trump. The Qualified Opportunity Zone Program (“the Program”), codified under 26 U.S. Code 1400Z-2, was established as part of the Act to spur economic development and job creation in distressed communities by making it more appealing to investors to invest in such places. In turn, investors will receive a tax incentive for their private, long-term investment in these economically distressed communities known as qualified opportunity zones. The Program essentially allows investors to defer and potentially reduce taxes on the disposition of *any property* by investing the capital gain in a “qualified opportunity zone fund” (“QOF”) within 180 days of the sale of the property.

A QOF is an investment vehicle that is set up as either a partnership or corporation for the purpose of investing in qualified opportunity zone property. Qualified opportunity zone property is either qualified opportunity zone stock, a qualified opportunity zone partnership interest, or qualified opportunity zone business property acquired after December 31, 2017, that is used in a trade or business conducted in a qualified opportunity zone, or ownership interest in an entity operating

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with such tangible property. A QOF that simply acquires property already used in the qualified opportunity zone will not qualify without substantial improvement. Substantial improvement requires improvements equal to the QOF's initial investment into the existing property over a 30-month period.

In order to become eligible as a QOF, no approval or action by the IRS is required. A corporation or partnership is simply required to complete a self-certification form and attach it to its federal income tax return for the taxable year. The QOF must hold at least 90% of its assets in qualified opportunity zone property. A qualified opportunity fund that fails to meet the 90% requirement will be subject to penalties.

By investing in a QOF, investors are allowed to temporarily defer the taxes on their capital gains until the end of 2026. There is no dollar amount on the amount of capital gain that can be deferred under the temporary deferral election; however once an election is made to defer some or all of the gain from a sale or exchange, another election cannot be made with respect to the same transaction giving rise to the deferred gain. The gain will continue to remain deferred until the earlier of when the QOF is sold or exchanged, or December 31, 2026.

If an investor holds an interest in a qualified opportunity fund for five (5) years, the taxes on the deferred taxable gain would be reduced by 10%. However, if the investor holds an interest in a qualified opportunity fund for seven (7) years, the deferred taxable gain would be reduced by 15%. To achieve the full 15% gain reduction, an investor must invest gain in a qualified opportunity fund by December 31, 2019. As an additional incentive, under the Act, investors are allowed to avoid tax on the appreciation in a qualified opportunity fund if an investment is held for at least ten (10) years prior to a sale of an interest in a qualified opportunity fund.

Analysis:

Although all the risks and benefits of the Program are not known, the Program appears to be a way for the CRA to encourage developers to invest in areas that have been designated as a qualified opportunity zone, such as the Heart of Boynton MLK corridor. There does not appear to be any benefit to the CRA investing in a QOF, as only taxpayers that recognize capital gain for federal income tax purposes are eligible to elect deferral under the Program. These taxpayers include individuals, C corporations (including regulated investment companies and real estate investment trusts), partnerships, and certain pass-through entities, including common trust funds described in Section 584, as well as qualified settlement funds, disputed ownership funds, and other entities under §1.468(B) of the Income Tax Regulations.

Further, given the new nature of this investment vehicle, it is difficult to assess the level of risk associated with this type of investment fund. Significant uncertainty remains regarding the tax consequences arising from investments in qualified opportunity funds, such as the applicable tax

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rate on the deferred gain. Additionally, there are some questions regarding how deferral benefits will work if a qualified opportunity fund organized as a partnership sells property before a qualified opportunity fund investor sells its investment in the qualified opportunity fund. Most sources recommend that investors consult with a tax advisor before pursuing such an investment.