Qualified Business Deduction & Opportunity Zones

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Qualified Business Income Deduction

Qualified business income is the net amount of items of income, gain, deduction, and loss relating to any domestic qualified trade or business of the taxpayer.

Capital gains and losses, dividends, and investment interest are excluded. Wages or guaranteed payments paid by the trade or business to the taxpayer are also excluded.

Deduction of 20% of domestic qualified business income from partnerships, S corporations, or sole proprietorships is available. The deduction is factored into taxable income after adjusted gross income.

Qualified Business Income Deduction

The deduction starts to be phased out for specified service businesses (accountants, health care professionals, lawyers, financial planners, consultants, etc.) for individuals with taxable income exceeding $157,500 ($315,000 in the case of a joint return).

Any trade of business where the principal asset is the reputation or skill of one or more of its employees or owners mystery solved with issuance of proposed regulations.

Qualified Business Income Deduction

The following additional limitation is phased in for individuals with taxable income exceeding $157,500 ($315,000 in the case of a joint return). The deduction would be limited to the greater of

a) 50% of the taxpayer's share of wages relating to the qualified trade or business or

b) the sum of 25% of the W-2 wages relating to the qualified trade or business and **2.5% percent of the unadjusted basis immediately after acquisition of all qualified property.**

Qualified Business Income Deduction

For this purpose, qualified property means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation

a) which is held by, and available for use in, the qualified trade or business at the close of the taxable year,

b) which is used at any point during the taxable year in the production of qualified business income, and

c) the depreciable period for which has not ended before the close of the taxable year.

Three Benefits of Opportunity Zone Investments:

1. Gain Deferral
2. Partial Forgiveness (after 5 and 7 years)
3. Forgiveness of additional gains (after 10 years)

Benefit #1: Gain Deferral

The period of capital gain tax deferral ends upon the earlier of:

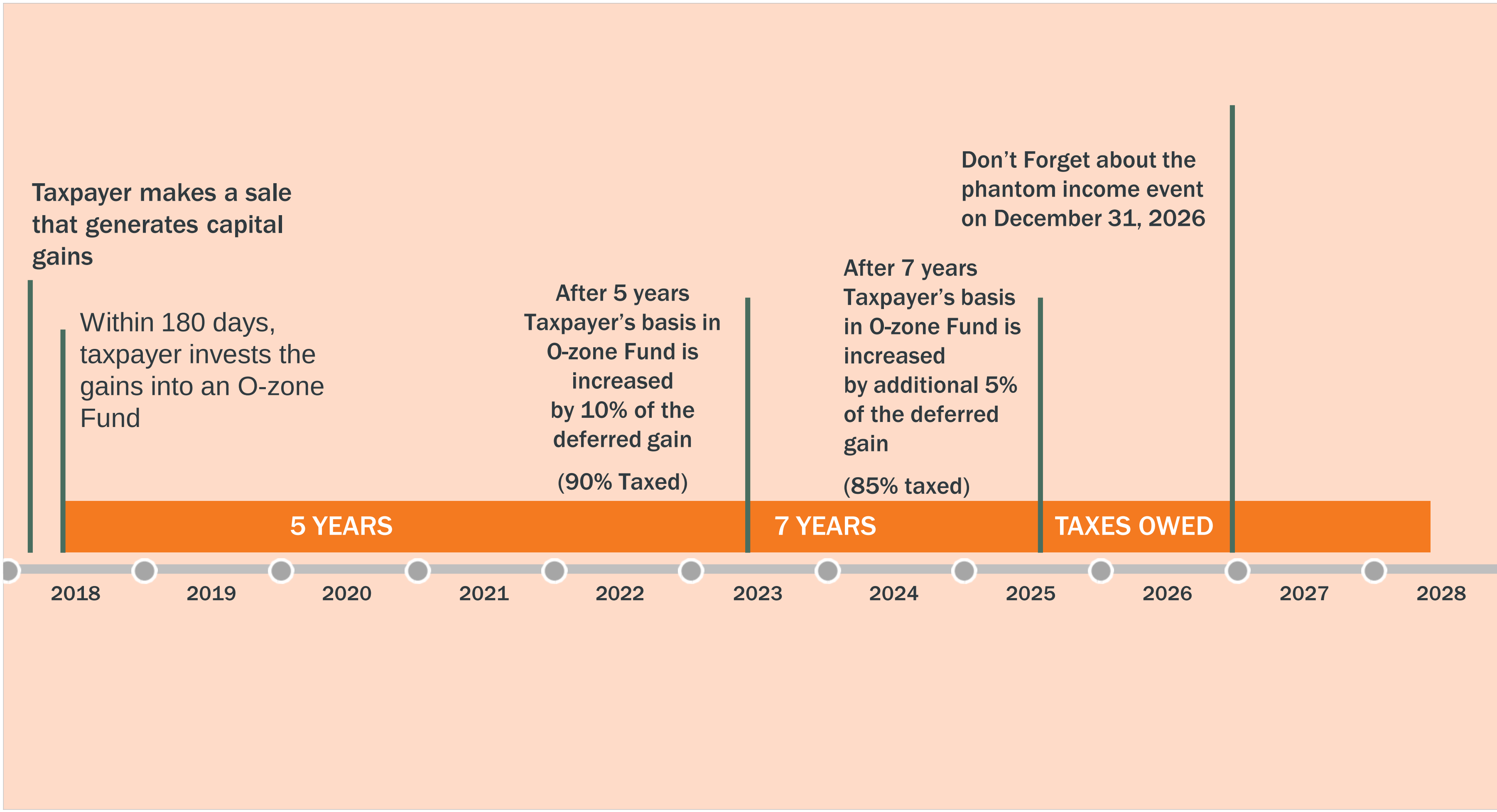
1) The date on which the investment is sold or exchanged;

OR

2) December 31, 2026 (phantom income event)

*Note: Initial tax basis in the O-zone Fund investment is $0

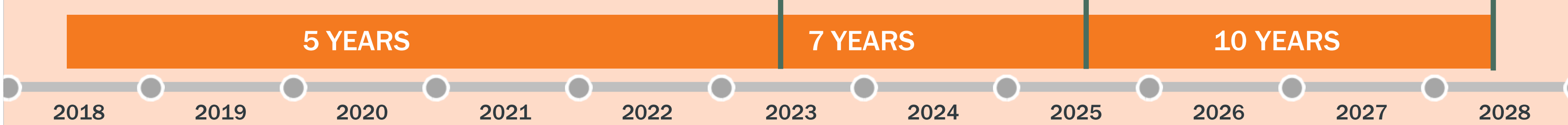
Benefit #2: Partial Forgiveness



Benefit #3: Forgiveness of Appreciation of Investment

<u>At election of taxpayer</u>, upon the sale or exchange of the investment, basis in O-zone Fund is equal to Fair Market Value.

*Remember, this does not exempt the taxpayer from phantom income event on initial deferred gains; only applies to the appreciation.



Opportunity Zones

Opportunity Funds Must Invest in Qualified Opportunity Zone Property:

- Qualified Opportunity Zone Stock
- Qualified Opportunity Zone Partnership Interest
- Qualified Opportunity Zone Business Property

Note: Funds must maintain 90 percent of their assets in Qualified Opportunity Zone Property to continue to qualify as a Qualified Opportunity Fund.

Opportunity Zones

Qualified Opportunity Zone Stock or Partnership Interest

- Qualified Opportunity Zone Stock must be stock in a domestic corporation.
- Qualified Opportunity Zone Partnership Interest must be a capital or profits interest in a domestic partnership.
- Qualified Opportunity Zone Stock or Partnership Interest must be acquired **from the corporation or partnership** by the Opportunity Fund after December 31, 2017 solely in exchange for **cash**.
- Must be stock or a partnership interest in a Qualified Opportunity Zone Business **or** a business that is being organized for the purpose of being a Qualified Opportunity Zone Business.
- During **substantially all** of the holding period of the Qualified Opportunity Stock or Stock or Partnership Interest, the corporation or partnership must continue to qualify as a Qualified Opportunity Zone Business.

Opportunity Zones

Qualified Opportunity Zone Business:

A trade or business.

Substantially all of its tangible property (whether owned or leased) is **Qualified Opportunity Zone Business Property**

and

- At least 50 percent of its gross income must be from the **active** conduct of a trade or business in an Opportunity Zone.
- A substantial portion of its intangible property must be used in the **active** conduct of its business in an Opportunity Zone.
- No more than 5 percent of the average unadjusted basis of its assets may consist of “non-qualified financial property.”
- Cannot be a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off-premises.

Qualified Opportunity Zone Business Property is tangible property used in a trade of business if:

- It is acquired by purchase (as defined in Section 179(d)(2) related party rules, but using a 20% related party test instead of 50%) after December 31, 2017;
- The original use in the Qualified Opportunity Zone commences with the Qualified Opportunity Zone Business

or

- The Qualified Opportunity Zone Business **substantially improves** the property; and
- During **substantially all** of the holding period for such property, **substantially all** of the use of such property is in an Opportunity Zone.

Substantial Improvement Test:

Property is treated as “substantially improved” if, during any 30-month period beginning after the acquisition of the property, additions to basis of the property exceed an amount equal to the adjusted basis of the property at the beginning of such period. In other words, doubling the acquisition price.

Preliminary Steps in Formation of Opportunity Zone Fund

1. Formation of Opportunity Zone Fund (OZF) as a corporation or a partnership for purposes of investing in Qualified Opportunity Zone Property ("QOZF") :

2. Formation of the operating entity limited liability company.

3. Terms of the Investment Management Agreement.

4. Self-certification of OZF based upon IRS Frequently Asked Questions. To self-certify, a taxpayer completes a form (to be released by end of 2018), which is attached to taxpayer's federal income tax return.

5. Preparation of OZF Business Plan (reviewed by counsel), including land and building acquisition, timing.

The Unknowns

1. OZF application
2. Various compliance deadlines in first year
3. General mechanics if an OZF sells a property interest
4. Tax Basis and the ability to claim depreciation
5. Gains after 10 years tied to land appreciation
6. Depreciation recapture after 10 years
7. How long a OZF can hold cash from disposition of asset before reinvesting