Opportunity Zones

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December 3, 2018 – Kennewick, WA

Opportunity Zones

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Mr. Moody has a master's degree in Accountancy and graduated with magna cum laude honors. Mr. Moody worked for Grant Thornton at their headquarters in Chicago, IL for seven years, including two years with their UK affiliate in Birmingham, England. Mr. Moody has audited and consulted many non-profit organizations including universities, museums, Boy Scout councils and for-profit companies in many industries. Mr. Moody has extensive experience in financial accounting for large groups and consolidations, international organizations, investment and financial services organizations, and utilities. Mr. Moody is currently an audit manager at Blodgett, Mickelsen & Adamson, P.S.

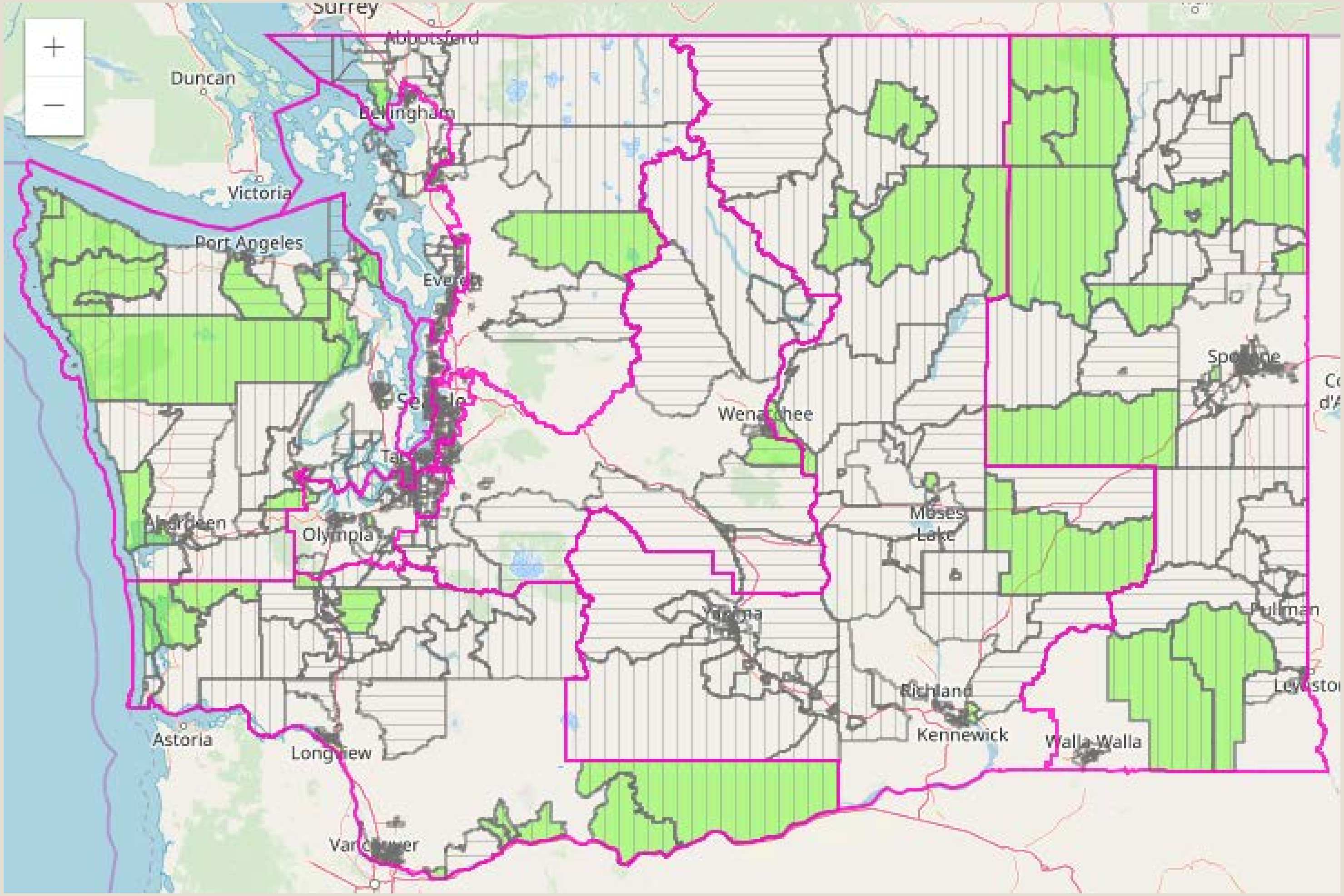
Travis Adamson, CPA, MAcc

Mr. Adamson began his career with the international accounting firm Ernst & Young, LLP in their Seattle, Washington office. While there, Mr. Adamson gained experience in tax issues regarding private equity partnerships and large corporate clients. Mr. Adamson also participated in ASC 740 implementation projects, tax provision audits and tax basis studies and was recently selected by the Washington Attorney General's office to provide expert witness testimony on tax matters. Mr. Adamson is currently a tax and audit partner at Blodgett, Mickelsen & Adamson, P.S.

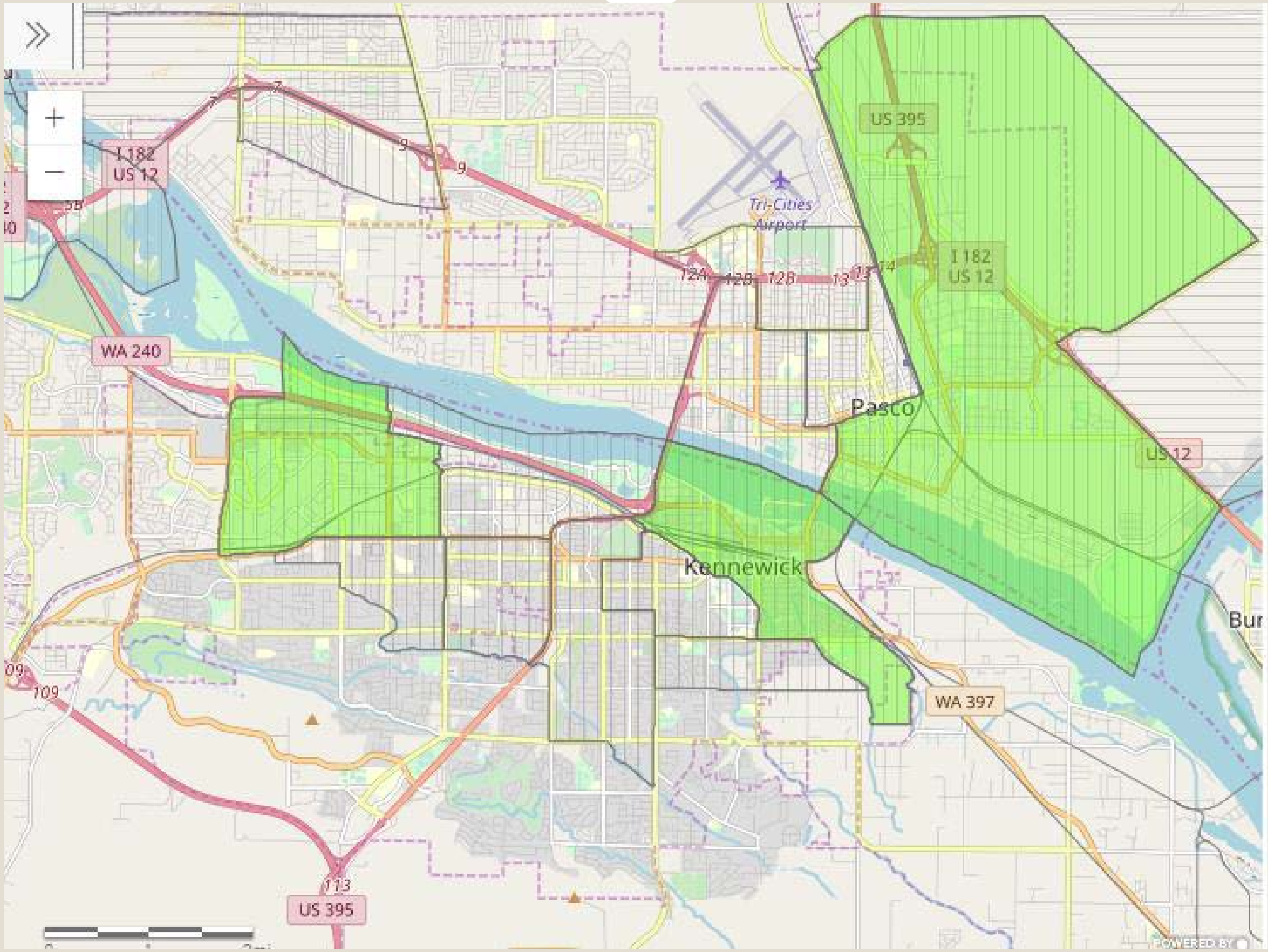
What are Opportunity Zones?

- An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment.
- Up to 25 percent of qualifying census tracts could be designated by each Governor to be Opportunity Zones
- 139 Zones created in Washington
- More than 8,700 Zones created nationwide

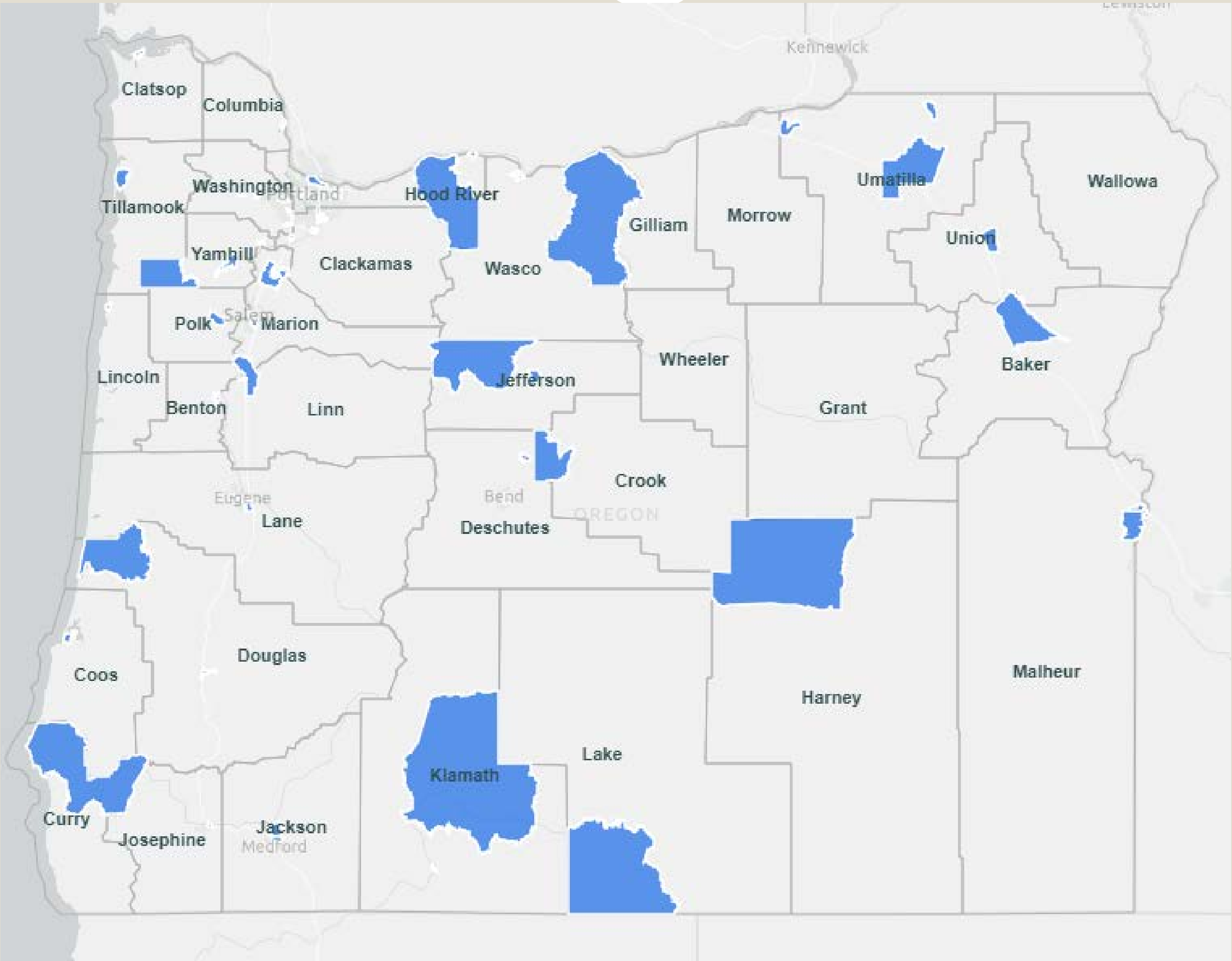
Opportunity Zones in Washington



Opportunity Zones in the Tri-Cities



Opportunity Zones in Oregon



What are the benefits?

- Investors can defer paying tax on capital gains until 2026
- Investors who own investments in Qualified Opportunity Zones Funds for 5 and 7 years get a 10% and 5% (15% total) step-up in basis meaning you could potentially pay tax on just 85% of your original gain
- Investments held for 10 years can grow tax-free through 2047

Why all the buzz?

- In most cases, investing in a Qualified Opportunity Fund (QOF) will be a better option than a 1031 exchange.
- Investors holding appreciated land/property, stock or other assets can get cash out of their assets and avoid paying tax for a few years.
- Business owners looking to retire or relocate their office can greatly benefit from investing in QOFs.

How QOFs work

- Investors can self-certify that they have formed a QOF beginning on their 2018 tax return using Form 8996.
  - QOFs must be a partnership or corporation formed for the purpose of investing in eligible property that is located in an opportunity zone.
  - You do not need to live in an opportunity zone to benefit from them.
- QOFs can be organized and funded anytime within 180 days of when the capital gain is generated.

Qualifying property

- Investments can be made in any of the following:
  - Tangible property – land, buildings, structures, equipment, vehicles, etc.
  - Stock or partnership interest of a QOF.
  - Assets must be located within an opportunity zone or substantially used in one.
  - Assets must be acquired after December 31, 2017.
  - Assets must be used for the first time within the opportunity zone or substantially improved for use in the opportunity zone.
    - Substantially improved means the asset's cost must be doubled.
      - Example – a $500,000 building would need improvements of an additional $500,000 to qualify

Qualifying property

- Investments could also be a business acquisition so long as substantially all of the business property is located within opportunity zones and 50% or more of gross income is derived from business within the zone.
- Investments in liquor stores, country clubs, golf courses, massage parlors, tanning salons, hot tub facilities, racetracks or gambling operations <u>are NOT allowed.</u>

Example 1

- Retiring dentist with $250,000 of basis in her practice and $500,000 of basis in the land and building.
  - Practice is sold on July 1, 2018 for $1,500,000 and the land and building sell for $1,000,000 for a total sale of $2,500,000.
  - Capital gains of $1,250,000 and $500,000 are generated for a total of $1,750,000.
  - Potentially $350,000 of tax is owed (20% rate)

Example 1 (Cont.)

- Using a 1031 exchange the dentist could potentially defer the $500,000 land and building gain by investing the full $1,000,000 into a similar property.
  - Only cash available upon retiring is from the sale of the practice.

- Using a Qualified Opportunity Zone Fund she could defer the gain for up to eight years and possibly only pay tax on 85% of her gain, or $1,487,500.
  - $262,500 of capital gains never gets taxed!

Example 1 (Cont.)

- Additionally, the dentist is only required to invest the capital gains of $1,750,000. She could take $750,000 tax-free as a return of basis.
- December 1, 2018 the dentist creates an LLC and invests $1,500,000 to be used to buy a lot and build a small commercial office building in downtown Kennewick.
- On 2018 tax return the dentist pays tax on $250,000 gain not invested and self-certifies that her LLC is a QOF and she will defer the $1,500,000 gain.

Example 1 (Cont.)

- Dentist purchases land in early 2019 and begins construction. Building completed early 2020 and two tenants begin paying rent to the dentist.
- Dentist files 2019 tax return and continues to defer gain on $1,500,000.
- Dentist holds the property through 2026.
- In 2023 she gets a 10% step-up in basis to $150,000.
- In 2025 she gets an additional 5% basis step-up to $225,000.

Example 1 (Cont.)

- On her 2026 tax return, with a basis of $225,000 and an original deferred gain of $1,500,000, the dentist recognizes $1,275,000 of taxable capital gain and pays the tax in 2026 at the 2026 capital gain rates.
- Her property is sold for $4,000,000 in 2042 at a gain of $2,500,000.
  - No taxes are owed on this gain.

Example 2

- Same initial scenario as Example 1 except:
  - Dentist sells the property on December 10, 2023 for $2,000,000.
  - QOF investment was for 5 years and she gets a 10% basis step-up to $150,000.
  - Total capital gain of $1,850,000 is taxed in 2023 ($1,500,000 original deferred gain less 10% step-up plus $500,000 appreciation on the property between 2018 and 2023).

Example 3

- Same initial scenario as Example 1 except:
  - Dentist sells the property on December 10, 2021.
  - QOF investment was for 3 years and she gets no basis step-up.
  - Total gain of $1,500,000 is taxed in 2021 and the only tax benefit received was a 3-year deferral.

Example 4

- Same initial scenario as Example 1 except:
  - Dentist sells the property for $1,500,000 on December 10, 2021 because she can’t find any tenants.
  - The proceeds are invested 5 months later in a dry cleaning business across the street that is a qualified opportunity zone business.
  - On her 2021 taxes the dentist can continue to defer the $1,500,000 capital gain because a new QOF investment was made within six months.

Questions/Comments

- Questions?