

Bond Case Briefs

Municipal Finance Law Since 1971

Structuring Opportunity Zone Funds.

The Opportunity Zones Program created by the U.S. Tax Cut and Jobs Act of 2017 (the “OZone Program”) and the first wave of proposed regulations issued by the Treasury Department on October 19, 2018 (the “Regulations”) have been designed to generate economic activity in low-income urban and rural communities. Sullivan & Worcester’s Opportunity Zones Practice Group has analyzed the OZone Program and Regulations and has successfully structured multiple Qualified Opportunity Funds (“QOFs”) with an anticipated aggregate capital raise of nearly \$600 million.

As we and our clients continue to develop innovative QOF structures, we will provide a series of advisories that highlight specific structuring elements that are consistent with the OZone Program and the Regulations.

Additional Time to Invest Capital Gains (October 26, 2018)

Under §1400Z-2(a)(1)(A), to be able to elect to defer capital gains, a taxpayer must generally invest in a QOF during the 180-day period beginning on the date of the sale or exchange giving rise to the capital gain. The Regulations, however, allow for flexible tax planning and provide the opportunity to make strategic decisions about the commencement and expiration of the 180-day investment period.

According to the Regulations, a partnership may elect to defer all or part of a capital gain to the extent it makes an eligible investment in a QOF. If the partnership itself makes an eligible investment in a QOF within the 180-day period following the transaction giving rise to the capital gain, the capital gain that is invested by the partnership in the QOF is not included in the net capital gain allocated to the partners under Code Sections 702 and 706.

If, however, the partnership chooses to not reinvest the gain in a QOF, then the capital gain will be included in the gain distributed on the partnership K-1 to its partners.

In turn, a separate 180-day investment period for the partners begins on the last day of the partnership’s taxable year, which is the date when the partnership-level gain is treated as distributed to the partners under Code Section 706.

The Regulations then go one step further and add a feature that gives flexibility to the partners. If a partner knows that the partnership has recognized eligible gain on a sale or exchange to an unrelated party, and that the partnership has chosen to not make an eligible investment in a QOF, then the partner may treat his/her own 180-day period as being the same as the partnership’s 180-day period.

Example:

Assume a partnership sells stock held for investment and recognizes capital gain on March 1, 2019. The partnership would have 180 days (i.e., until August 27, 2019) to invest the gain in a QOF. If the partnership elects to invest this gain in a QOF, the invested gain will not be included in capital gain distributed to its partners for the tax year. If the partnership chooses not to invest this gain in a

QOF, then the individual partners are permitted to invest their distributive share of the partnership gain in a QOF. Under these circumstances, the 180-day period would commence on December 31, 2019 (assuming the partnership is a calendar year taxpayer), and partners would have 180 days (i.e., until June 28, 2020) to make an eligible QOF investment.

If, however, a partner is aware that the partnership recognized the gain on March 1, 2019 and has made the decision not to invest in a QOF, such partner can decide whether to invest his/her distributive share of the partnership gain during the partnership's 180 day period (i.e., until August 27, 2019) or during the second 180-day period beginning on December 31, 2019 (i.e. until June 28, 2020).

Although it seems anomalous, it appears that the individual partner cannot make a qualifying investment related to the partnership gain during the period after August 27, 2019 and before December 31, 2019.

However, these rules provide exceptional flexibility in managing the 180-day investment period, especially when there is good communication between the partnership and its partners. At the extreme, gain recognized by a calendar-year partnership on January 1, 2019 could potentially be invested by an individual partner as late as June 28, 2020.

The Regulations state that rules analogous to the rules provided for partnerships and partners apply to other pass-through entities (including S corporations, decedents' estates, and trusts) and to their shareholders and beneficiaries. Comments are requested regarding whether taxpayers need additional details regarding analogous treatment for pass-through entities that are not partnerships.

Sullivan & Worcester

by Daniel Ryan

October 29, 2018