Qualified Opportunity Zone Funds

Spencer Erickson – Vice President, Tax Managing Director, Alternative Investments

The Opportunity Zones program is a new economic development tool, designed to encourage economic investment and job creation in distressed areas of communities, by allowing an incentive to taxpayers who re-invest capital gains in designated Opportunity Zones. In addition to other tax reforms, Qualified Opportunity Zones were added to the tax code by the Tax Cuts and Jobs Act in 2017. Such Opportunity Zones were proposed by each state and certified by the IRS.

Participation in the Opportunity Zones program requires that capital is invested through a Qualified Opportunity (QOZ) fund. There are three primary tax incentives in the Opportunity Zone program. The first is realized by a taxpayer when capital gain proceeds are re-invested into a QOZ fund within 180 days of disposition. Additional incentives are realized as additional requirements are met. The chart below lists the tax incentive and the corresponding basic requirements:

Tax Incentive	Requirements
Deferral of capital gain recognition to 12/31/2026 or date of disposition	Re-investing capital gain proceeds into a QOZ fund within 180 days of disposition. Hold investment in the QOZ fund until 12/31/2026.
Up to 15% tax basis step-up	Receive a 10% step-up in tax basis by holding the investment in the QOZ fund five years. Receive an additional 5% step-up by holding the investment an additional two years.
Tax free capital appreciation	Receive a step-up of tax basis to market value by holding the investment in the QOZ fund for ten years.

QOZ Funds operate similarly to many existing private fund structures:

- They can be a corporation, LLC, partnership, etc.
- They can have a single investor, or multiple investors.
- They can invest in a single project, or multiple projects.
- They can focus on real estate, private equity, or venture capital.

Only two additional requirements separate a QOZ fund from any other private fund:

- They elect QOZ fund status on their tax return.
- They invest at least 90% of their capital in Qualified Opportunity Zone Property.

Investment in Qualified Opportunity Zone Property includes either a new equity investment in Qualified Opportunity Zone Businesses, or direct investment in Qualified Opportunity Zone Business Property as outlined below.

Property Type	Definition/Requirements
Qualified Opportunity Zone Business	The investment must be new (not purchased on the secondary market), equity (not debt) in a domestic corporation, or partnership. Substantially all of the business' tangible property (owned or leased) must be Qualified Opportunity Zone Business Property (defined below). The business must generate at least 50% of its total gross income from — and deploy a substantial portion of its intangible property in — the active business conduct. Some industries are excluded: financial services, golf courses, country clubs, massage parlors, hot tub or suntan facilities, race tracks, gambling, sale of alcoholic beverages, among others.
Qualified Opportunity Zone Business Property	A Qualified Opportunity Zone Business Property must be tangible, used in a Qualified Opportunity Zone trade or business, in a Qualified Opportunity Zone. Use of the property must originate with the fund, or the fund must substantially improve the property (double the basis of the property over 30 months). Land in an Opportunity Zone can qualify by being used in a trade or business without meeting the original use requirement, but the substantial improvement requirement applies to buildings.

In summary, to receive the tax benefits from the Opportunity Zones Program, a taxpayer must invest in a QOZ fund, the fund must invest in businesses or property, and the businesses or property must be in an Opportunity Zone.

We recognize there may be an opportunity for fund managers and investors to take advantage of this new program and we expect to see significant product development and investment activity around Opportunity Zones in the near term. Our expert tax and accounting teams are here to support fund managers as they navigate the Opportunity Zone program as well as other impacts of recent tax reforms.

Spencer Erickson
Vice President
Tax Managing Director
Alternative Investments

Spencer.Erickson@umb.com

Spencer serves as UMB's alternative investments tax managing director, where he oversees all aspects of tax reporting for the firm's many private fund tax clients. Spencer is a leading expert in the hedge fund and private equity tax industry. He advises fund clients on entity/fee structuring, allocation methodology, and investment/operations for tax efficiency.