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# OZ Rules and Considerations

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# Presentation Roadmap

**Investor Considerations:** Tax Incentives and Eligibility

**QOF Considerations:** Structuring and Other

**Practical Considerations:** Our Experiences and Approach



# Investor Considerations:

Tax Incentives and Eligibility

# Tax Incentives - Overview

Three Major FEDERAL Tax Incentives (*CA doesn't Conform*)



**TEMPORARY  
DEFERRAL**



**STEP-UP IN  
BASIS**



**PERMANENT  
EXCLUSION**

# Tax Incentives – Temporary Deferral



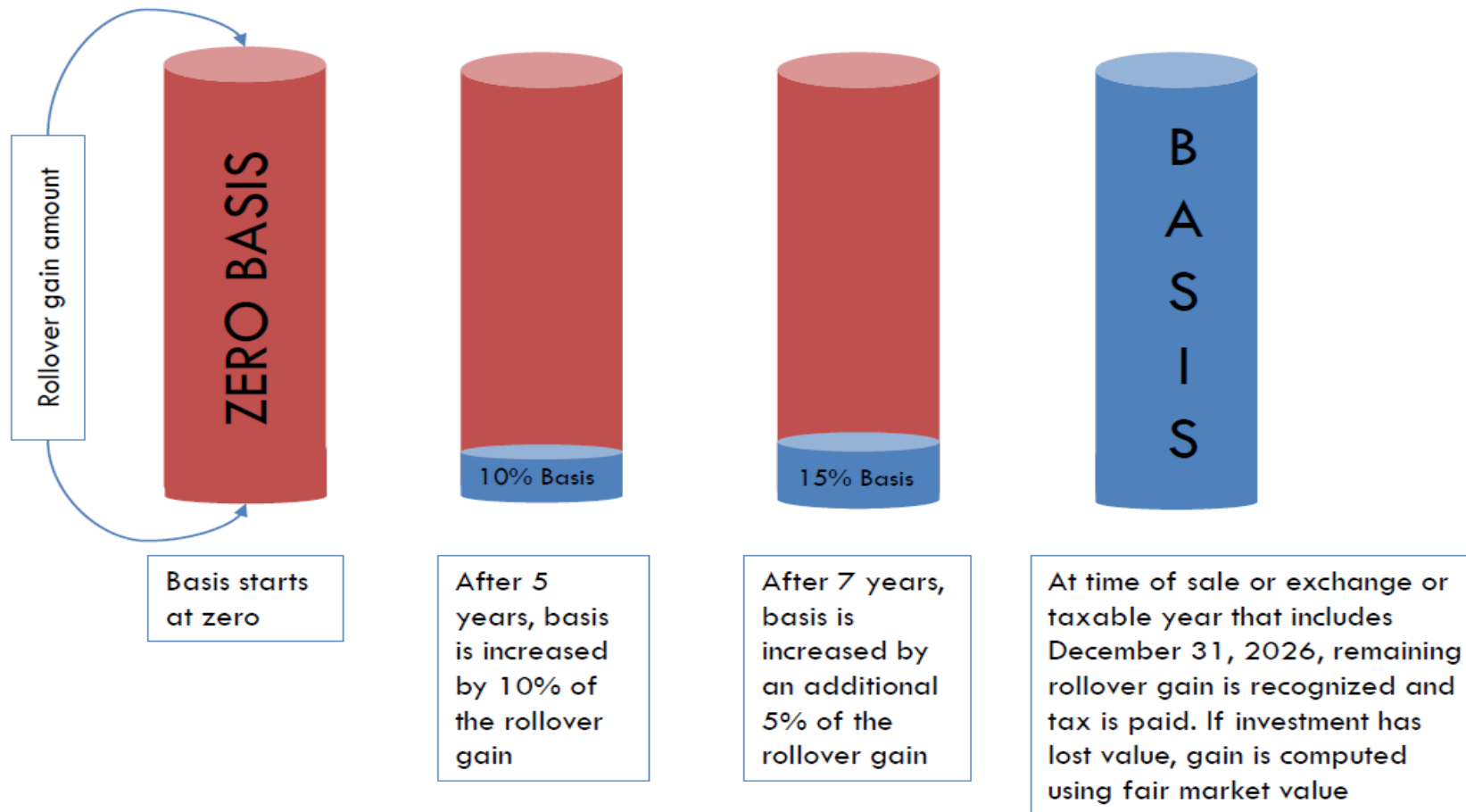
TEMPORARY  
DEFERRAL

Capital gains reinvested in QOFs within 180 days are not recognized until the earlier of when the investment is sold or exchanged, or December 31, 2026.

## Takeaways:

- **Know the gain amount** (beware of 1231 gains)
- **Know the 180-day start date** (varies by type of gain and type of investment)
- **Know important dates**
  - December 31<sup>st</sup> is first day of eligibility for 1231 gains
  - June 30<sup>th</sup> (approx.) is the deadline for reinvestment of passthrough gains

# Tax Incentives – Step-Up in Basis



## Takeaways:

- 12/31/19 is last day to get the full 15% reduction
- 12/31/21 is the last day to a the 10% reduction
- Debt allocation important to create basis for losses and distributions.

# Tax Incentives – Permanent Exclusion



IF the QOF investment is held for 10 years, then investors don't have to pay capital gains for appreciation on the QOF investment itself.

# Eligibility

## Eligible Gains

- Any capital gain NOT from a related party sale
- Includes short term capital gains
- Excludes gains taxed at ordinary rates
- For 1231 property – net gains and losses



## Eligible Taxpayers

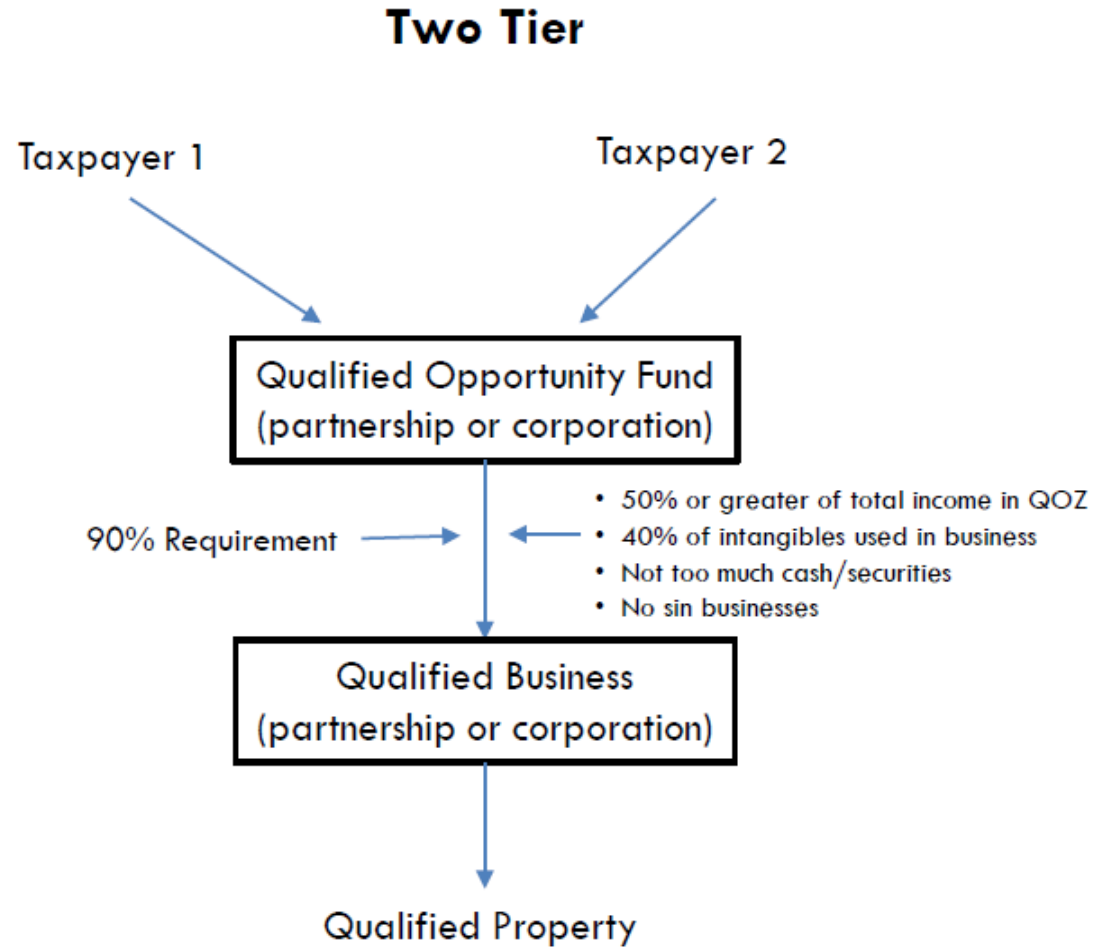
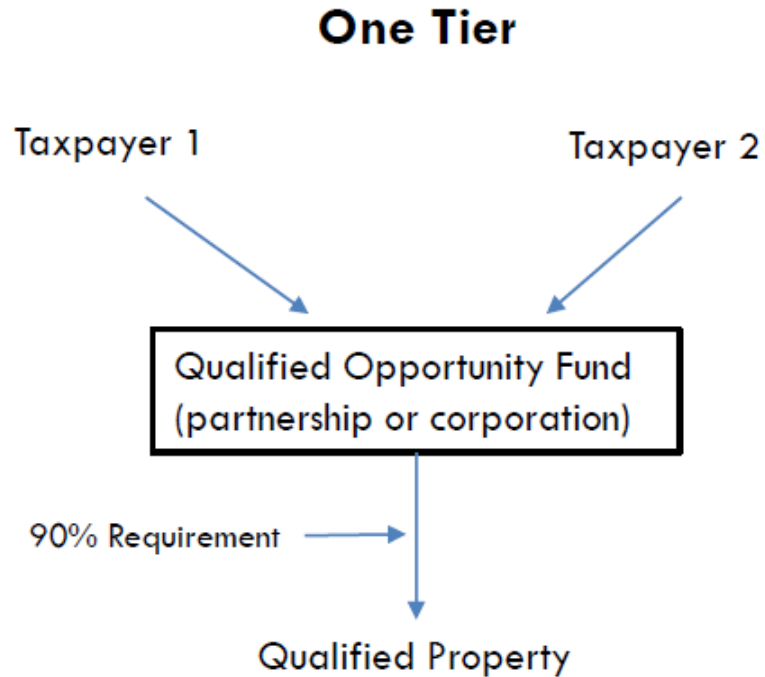
- Any taxpayer with eligible gain (includes C and S corporations, partnerships, and trusts and estates)
- Note on Passthroughs – deferral can at the entity level or individual level



# QOF Considerations:

## Structural and Other

# QOF Requirements and Structures



# Qualified Property



## **Acquisition Test**

- Acquired by purchase from unrelated party, or leased at market rate, after 12/31/17

## **Original Use or Substantial Improvement Test**

- Must be original use in OZ or Substantially Improved
  - Substantial Improvement = Double basis in each asset within 30 months of acquisition
  - Nuanced rules for leased property

## **Substantially All Test**

- During substantially all of the holding period (90%), substantially all (70%) of the property's use must be in an OZ

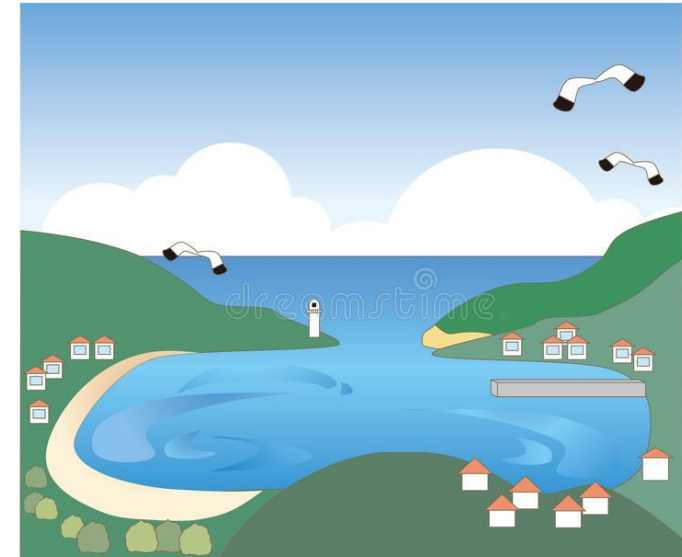
# Safe Harbors (and the like)

## Cash Contributions (QOF)

- QOF has six months to deploy capital contributions (before counted in the asset test)

## Working Capital Safe Harbor (QOZB only)

- QOZ Businesses get a 31 month Working Capital Safe Harbor do deploy working capital in accordance with a written plan



# Practical Considerations

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## Organization and Structuring

- QOFs highly incentivized to operate through subsidiaries (70% rule and working capital safe harbor)
- Only partnerships and corps allowed, no disregarded entities
- Agreements should reflect invest in OZ properties, allow for sufficient admin fees, etc.

## Operations

- Property acquisition – make sure property is Qualified and is acquired by the correct entity
- Understand investor tax incentives and timelines
- Balance desire to bring in capital early vs. tight timelines for improving property and deploying cash
- Know tax impact of QOF investors having zero basis (debt structuring)
- Determine whether to plan for April 2027 tax bill (plan distributions?)
- Compliance and Recordkeeping crucial

## Exit

- Do you plan to sell in 10 years or hold? Do investors know?
- Allow flexibility to sell earlier in business cycle demands it

# What We're Doing

## Individual investors

- Discussing OZs as an option to defer gains, keeping in mind that a QOF is still an investment that carries risk

## Businesses

- Advising on topics covered in the previous slide
- Developing templates for compliance tracking and reporting
- Some financial projections, layering in tax savings

**Thank You!**