

THE ADVANTAGES OF INVESTING IN THE B.A.F.E GROUP, LLC.

Tax Advantages for Investors:

Overview

Congress enacted section 1400Z-2, in conjunction with section 1400Z-1, as a temporary provision to encourage private sector investment in certain lower-income communities designated as qualified opportunity zones (see Senate Committee on Finance, Explanation of the Bill, at 313 (November 22, 2017)). Taxpayers may elect to defer the recognition of capital gain to the extent of amounts invested in a QOF (Qualified Opportunity Fund), provided that the corresponding amounts are invested during the 180-day period beginning on the date such capital gain would have been recognized by the taxpayer. Inclusion of the deferred capital gain in income occurs on the date the investment in the QOF is sold or exchanged, or on December 31, 2026, whichever comes first. For investments in a QOF held longer than five years, taxpayers may exclude 10 percent of the deferred gain from inclusion in income, and for investment held longer than seven years, taxpayers may exclude a total of 15 percent of the deferred gain from inclusion in income. In addition, for investments held longer than 10 years, the post-acquisition gain on the qualifying investment in the QOF may also be excluded from income. In turn, a QOF must hold at least 90 percent of its assets in qualified opportunity zone property, as measured by the average percentage held at the last day of the first 6-month period of the taxable year of the fund and the last day of the taxable year. The statute requires a QOF that fails this 90 percent test to pay a penalty for each month it fails to maintain the 90-percent asset requirement.

General Information:

- 1400Z-2 of the Internal Revenue Code (Code) relating to gains that may be deferred as a result of a taxpayer's investment in a qualified opportunity fund (QOF).
- It allows for the deferral of inclusion in gross income for certain gains to the extent that corresponding amounts are reinvested in a QOF.
- It excludes from gross income the post acquisition gains on investments in QOFs that are held for at least 10 years.
- The proposed regulations provide rules permitting a corporation or partnership to self-certify as a QOF.
- Taxpayers will use Form 8996, Qualified Opportunity Fund, both for initial self-certification and for annual reporting of compliance with the 90-Percent Asset Test in section 1400Z-2(d)(1).
- In setting forth the gains that are subject to deferral, the text of section 1400Z-2(a)(1) specifies "gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer," to the extent that such gain does not exceed the aggregate amount invested by the taxpayer in a QOF during the 180-day period beginning on the date of the sale or exchange.
- The Treasury Department and the IRS believe, based on the legislative history as well as the text and structure of the statute, that section 1400Z-2 is best interpreted as making deferral available only for capital gains.

- Eligible gains, therefore, generally include capital gain from an actual, or deemed, sale or exchange, or any other gain that is required to be included in a taxpayer's computation of capital gain.

- The gain to be deferred must be gain that would be recognized, if deferral under section 1400Z-2(a)(1) were not permitted, not later than December 31, 2026, the final date under section 1400Z-2(a)(2)(B) for the deferral of gain.

- The gain must not arise from a sale or exchange with a related person as defined in section 1400Z-2(e)(2).

•Under these rules, the entities and taxpayers can invest in a QOF and thus defer recognition of eligible gain.

- Taxpayers will make deferral elections on Form 8949, which will be attached to their Federal income tax returns for the taxable year in which the gain would have been recognized if it had not been deferred.

•A taxpayer that holds a QOF investment for at least ten years may elect to increase the basis of the investment to the fair market value of the investment on the date that the investment is sold or exchanged.

- The proposed regulations clarifies that as long as the investment in the QOF was made with funds subject to a proper deferral election under section 1400Z-2(a), which requires the investment to be made prior to June 29, 2027, then the 10-year gain exclusion election is allowed as long as the disposition of the investment occurs before January 1, 2048.

- At least 70 percent of the tangible property owned or leased by a trade or business is qualified opportunity zone business property, then the trade or business is treated as satisfying the substantially all requirement of section 1400Z-2(d)(3)(A)(i).*

- However, the 70 percent requirement for a trade or business will give QOFs an incentive to invest in a qualified opportunity zone business rather than owning qualified opportunity zone business property directly. For example, consider a QOF with \$10 million in assets that plans to invest 100 percent of its assets in real property. If it held the real property directly, then at least \$9 million (90 percent) of the property must be located within an opportunity zone to satisfy the 90 percent asset test for the QOF. If instead, it invests in a subsidiary that then holds real property, then only \$7 million (70 percent) of the property must be located within an opportunity zone. In addition, if the QOF only invested \$9 million into the subsidiary, which then held 70 percent of its property within an opportunity zone, the investors in the QOF could receive the statutory tax benefits while investing only \$6.3 million (63 percent) of its assets within a qualified opportunity zone.

- Although there is a lack of available data regarding the extent to which small entities invest in QOFs, this certification is based on the belief of the Treasury Department and the IRS that these funds will generally involve investments made by larger entities and investments are entirely voluntary.