Real Estate Connection

PERKINS & CO

Let's get there

O-Zones & Year-End Tax Update

PERKINS & CO

REAL ESTATE
NOVEMBER 13, 2018

O-Zones

POTENTIAL TAX BENEFITS

- Deferral of capital gains until 12/31/2026
  - Section 1231 and unrecaptured Section 1250 gains included
- Permanent exclusion of portion of deferred gain if:
  - Held > 5 years, 10%
  - Held > 7 years, additional 5% (15% total)
- Permanent exclusion of any appreciation from investment in "Qualified Opportunity Fund" (QOF) disposed after 10+ years

TAXPAYER REQUIREMENTS

- Invest (cash only) in QOF within 180 days of when gain realized
- Elect to defer the capital gain via Form 8949
  - Not “all or nothing”, any portion can be deferred
  - Note you can retain your “basis”
- Can be done at either partnership/S corp or individual partner/shareholder level

TAXPAYER REQUIREMENTS (CONTINUED)

- Gain can't result from sale to related party (20% test)
- Must pay deferred tax no later than 12/31/2026
  - Deferred gain retains its original character (i.e., short-term, long-term, etc.)
  - Rates in effect in 2026 apply

QOF REQUIREMENTS

- Organized as either a corporation or partnership
  - Multi-member LLCs allowed
- Formed for the express purpose of investing in qualified opportunity zone property (semi-annual 90% asset test)
  - Qualified opportunity zone stock
  - Qualified opportunity zone partnership interest
  - Qualified opportunity zone business property
    - Use originates with QOF or is "substantially improved" by QOF
    - "Substantially all" of the use of the property is in a qualified opportunity zone
    - Loans don't qualify

QOF REQUIREMENTS (CONTINUED)

- "Substantially improved" within 30 months beginning after date of acquisition
  - Additions to basis > QOF basis in property prior to improvement
  - Excludes land basis
- "Reasonable working capital" can be held and used by a QOF so long as:
  - Its qualifying use is designated in writing
  - A reasonable written schedule for its spending exists
  - It will be completely consumed within 31 months of receipt by QOF
  - AND, actual spending is substantially consistent with above requirements

QOF REQUIREMENTS (CONTINUED)

- Mixed fund investments are allowed
  - Debt does not create a mixed-fund investment
- Vice businesses not allowed
  - Golf courses & country clubs, massage parlors, hot tub facilities, suntan facilities, gambling facilities or liquor stores
- Self-certify using IRS Form 8996
  - File annually with tax return

FORM 8996

Form **8996** (December 2018) Department of the Treasury Internal Revenue Service

Qualified Opportunity Fund
► Go to *www.irs.gov/Form8996* for the latest information.
► Attach to your tax return. See instructions.

OMB No. 1545-0123
Attachment Sequence No. **996**

Name | Employer identification number

Part I General Information and Certification

1 Type of taxpayer: ☐ Corporation ☐ Partnership

2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)?
☐ **No. STOP.** Do not file this form with your tax return.
☐ **Yes.** Go to line 3.

3 Is this the first period the taxpayer is a Qualified Opportunity Fund?
☐ **Yes.** By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and the description of the qualified opportunity zone business. See instructions.
☐ **No.** Go to Part II.

4 If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund.

Part II Investment Standard Calculation

5	Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	5	
6	Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	6	
7	Divide line 5 by line 6	7	
8	Total qualified opportunity zone property held by the taxpayer on the last day of the taxpaye's tax year	8	
9	Total assets held by the taxpayer on the last day of the taxpayer's tax year	9	
10	Divide line 8 by line 9	10	

Part III Qualified Opportunity Fund Average and Penalty

11	Add lines 7 and 10	11	
12	Divide line 11 by 2.0. See instructions if Part I, line 3 is "Yes"	12	
13	Is line 12 equal to or more than .90? ☐ **Yes.** Enter -0- on this line and file this form with your tax return. ☐ **No.** The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return	13	

Cat. No. 37820G — Form **8996** (12-2018)

Page **2**

…enalty

…art III, line 13 complete Part IV to figure the penalty. Enter the number from line 8 below on Part III, line 13. See instructions if Part I, line 3 is "Yes."

	(a) Month 1	(b) Month 2	(c) Month 3	(d) Month 4	(e) Month 5
…e last day of the month					
…90					
…pportunity Zone Property on …e month					
…om line 2. If less than zero,					
…te					
…line 5					
…2.0. Round up to two decimal …ctions if Part I, line 3 is "Yes"					

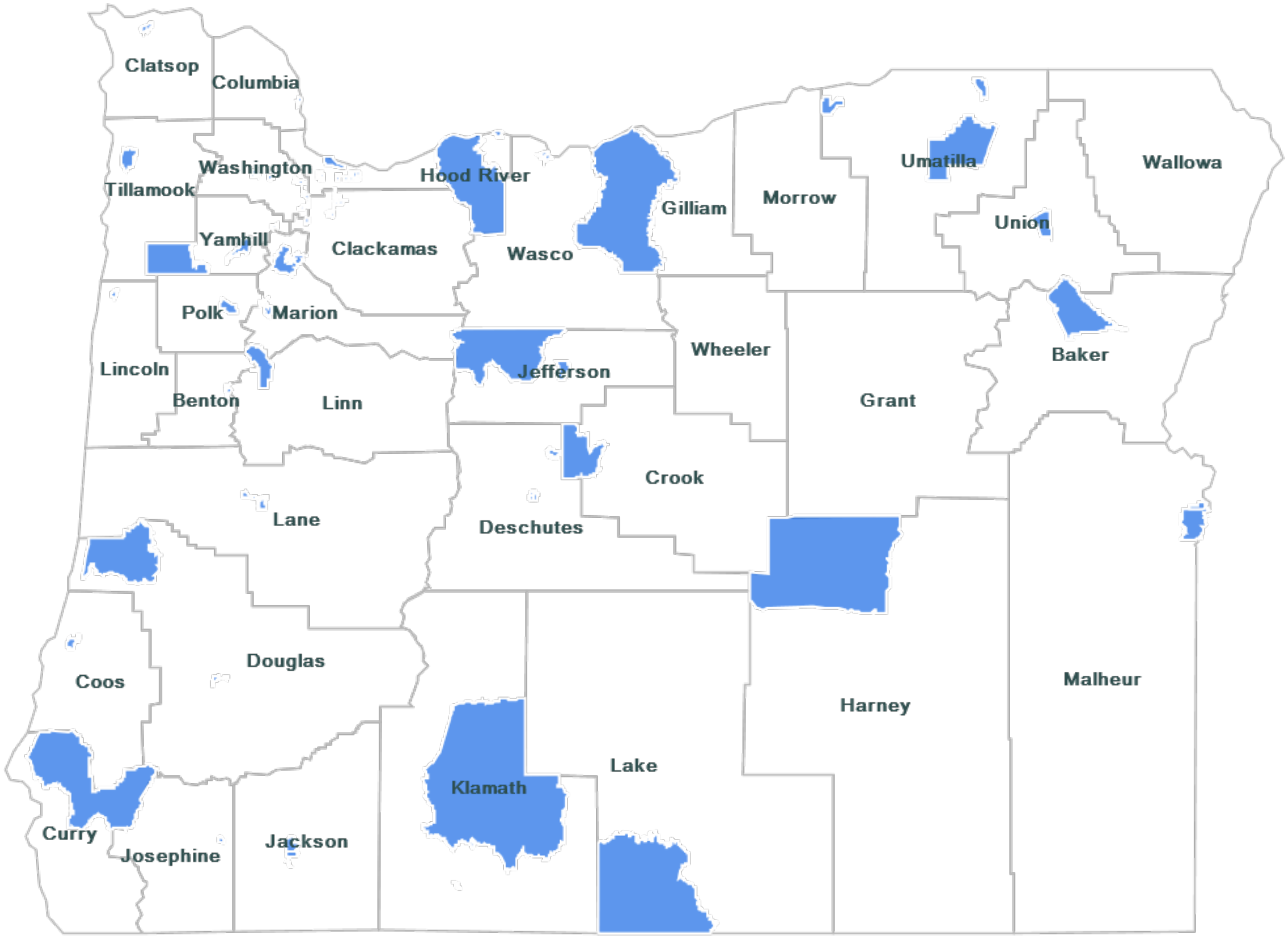
	(g) Month 7	(h) Month 8	(i) Month 9	(j) Month 10	(k) Month 11	(l) Month 12

…mns (a) through (l) of line 7. Enter the total here and on Part III, line 13 . . . $

Form 8996 (12-2018)

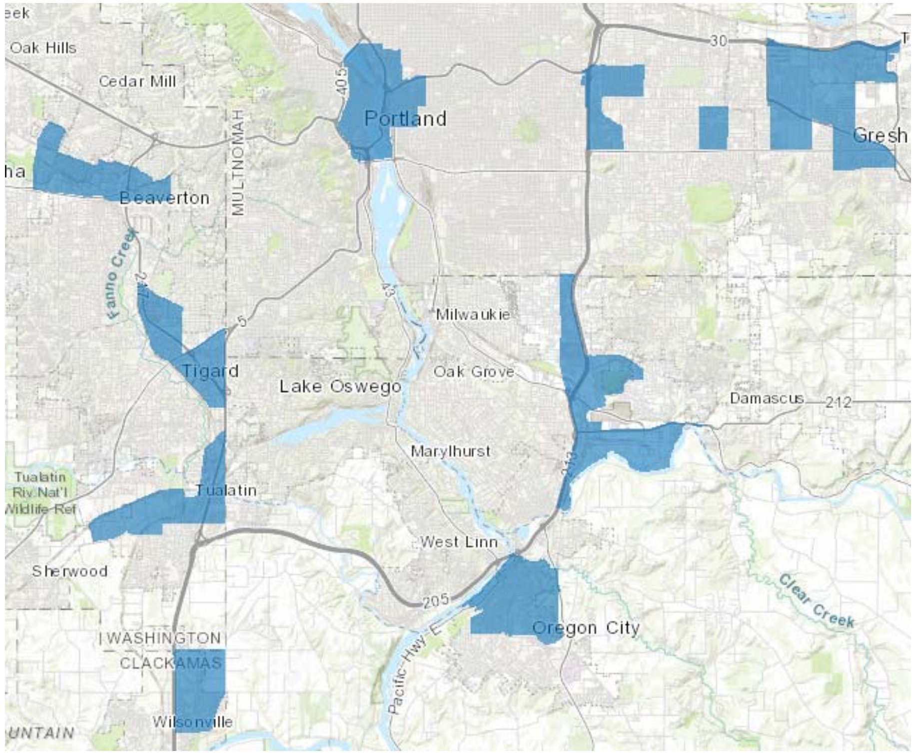
O-ZONES
OF INTEREST

STATE OF OREGON

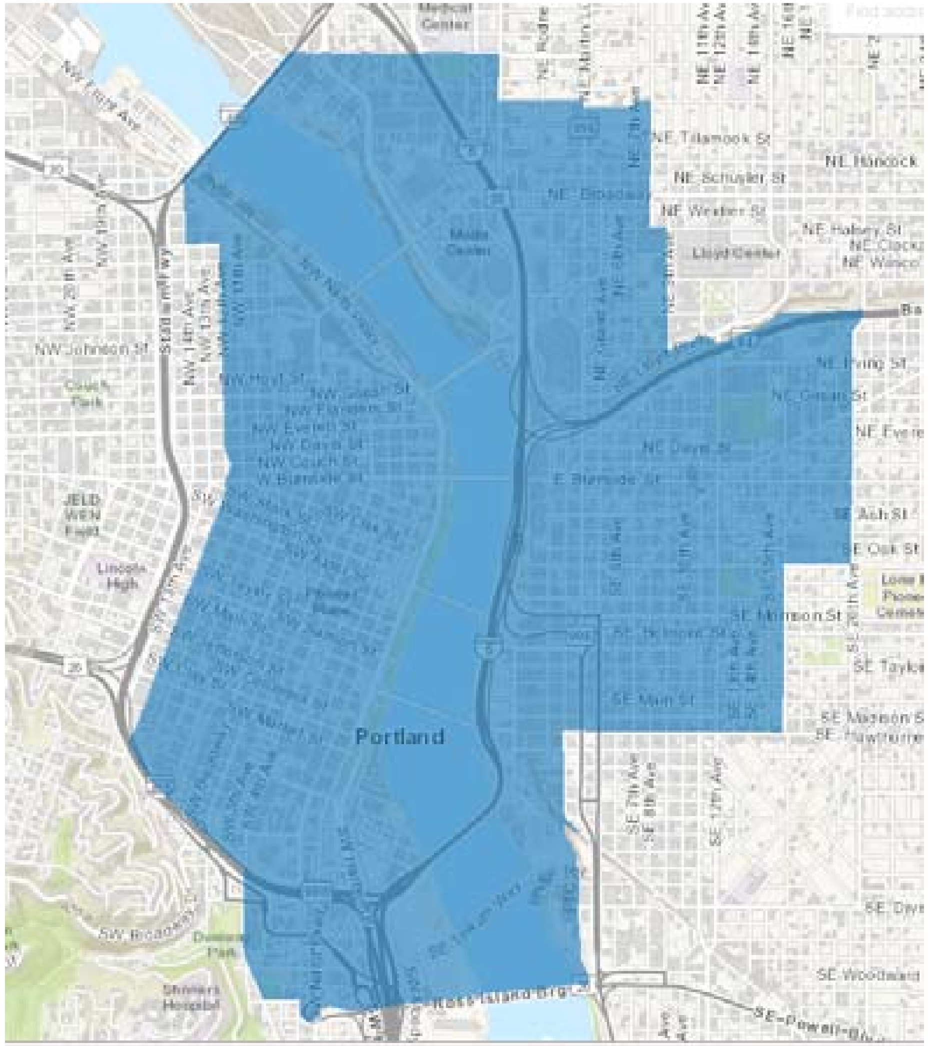


O-ZONES
OF INTEREST

PORTLAND METRO

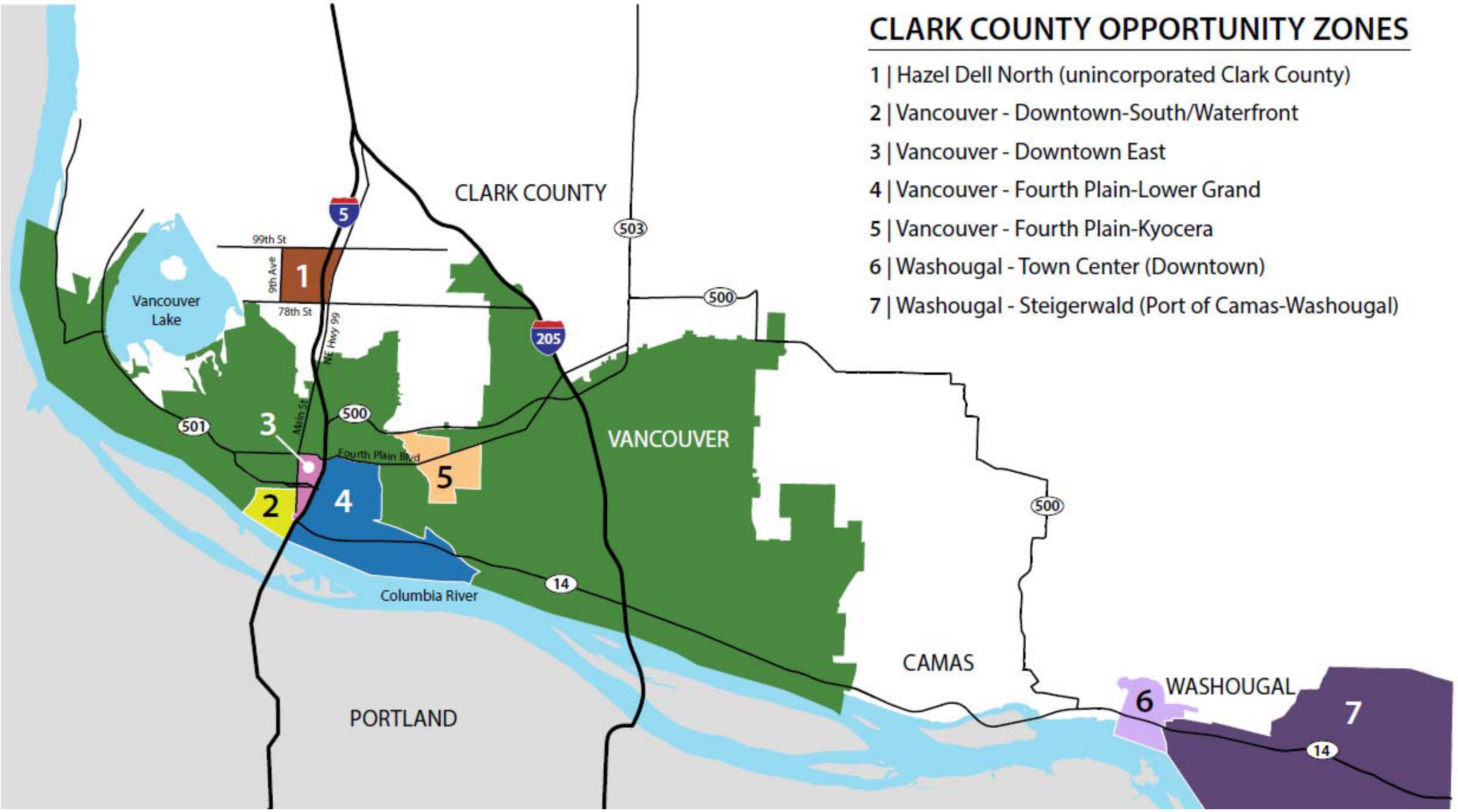


PORTLAND - PEARL, SOUTH WATERFRONT, DOWNTOWN AND INNER EASTSIDE



O-ZONES
OF INTEREST

CLARK COUNTY



YEAR-END TAX UPDATE

20% QBI DEDUCTION (AKA 199A DEDUCTION)

- Development, property management, construction, brokerage and agents all qualify
- Investment management and other SSTBs don't qualify
- W2 wages and "Unadjusted Basis in assets" (UBIA) are key
- All pass-through entities will be required to report QBI information to their owners for <u>EACH</u> trade or business
  - W2 wages
  - UBIA
  - QBI
- Oregon disconnect

DEPRECIATION

100% Bonus Depreciation

- Assets with <= 15 year MACRS lives
- “New to you” property qualifies (i.e., used)
- Qualified improvement property still needs technical correction to qualify
  - Currently 39 year MACRS life
  - Intended to be 15 year MACRS life
- Phases out 20% each year starting in 2023
- Watch contract date vs in-service date

OTHER BUSINESS CONSIDERATIONS

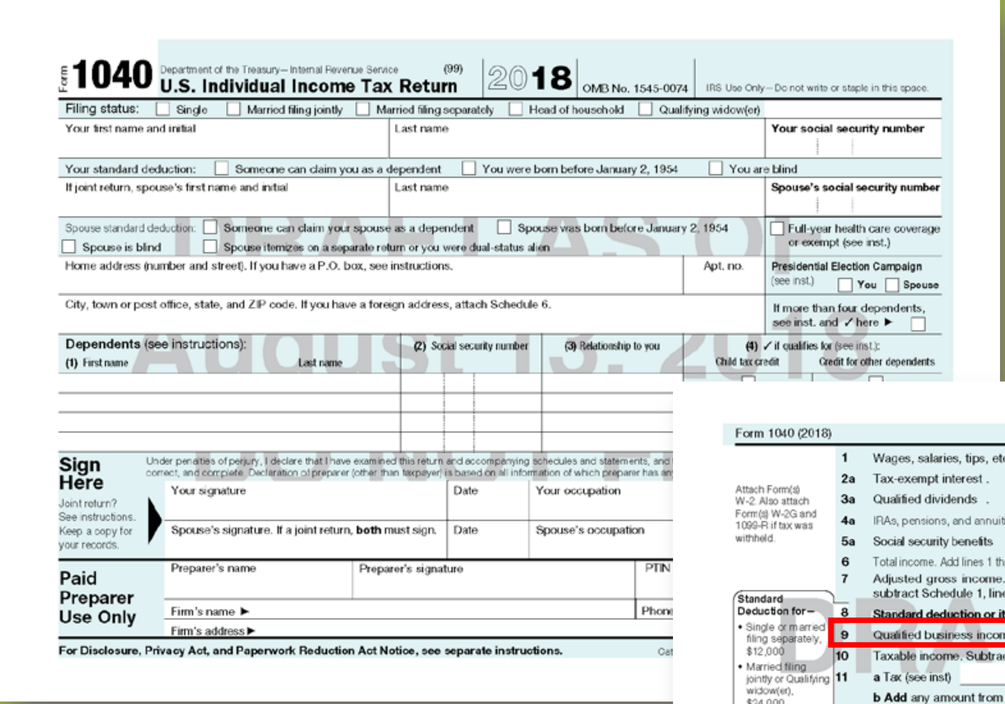
- Business interest expense limitation
- Net operating losses
- Excess business losses
- Carried interest
- 1031 exchanges/cost segregation
- Entertainment/meals expense & qualified transportation fringes for employees

- Oregon apportionment based upon "economic nexus" vs "cost of performance"
  - Change doesn't apply to City of Portland/Multnomah County
- City of Portland 0.4% rate increase to 2.6%
- New partnership audit rules effective for 2018

OTHER PERSONAL CONSIDERATIONS

- State and local taxes limited to $10,000 max
- Revised mortgage interest limitations
  - $750,000 vs $1.1 million
  - HELOCs limited to actual primary home improvements
- No miscellaneous itemized deductions (tax prep fees, investment management fees, employee business expenses, etc.)

FORM 1040



Form 1040 Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return 2018 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing status: Single Married filing jointly Married filing separately Head of household Qualifying widow(er)

Your first name and initial | Last name | Your social security number

Your standard deduction: Someone can claim you as a dependent | You were born before January 2, 1954 | You are blind

If joint return, spouse's first name and initial | Last name | Spouse's social security number

Spouse standard deduction: Someone can claim your spouse as a dependent | Spouse was born before January 2, 1954 | Full-year health care coverage or exempt (see inst.)
Spouse is blind | Spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | Presidential Election Campaign (see inst.) You Spouse

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6. | If more than four dependents, see inst. and ✓ here ▶

Dependents (see instructions): (1) First name Last name | (2) Social security number | (3) Relationship to you | (4) ✓ if qualifies for (see inst.): Child tax credit | Credit for other dependents

Sign Here Joint return? See instructions. Keep a copy for your records.
Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and ... correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any ...
Your signature | Date | Your occupation
Spouse's signature. If a joint return, **both** must sign. | Date | Spouse's occupation

Paid Preparer Use Only
Preparer's name | Preparer's signature | PTIN
Firm's name ▶ | Phone
Firm's address ▶

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat

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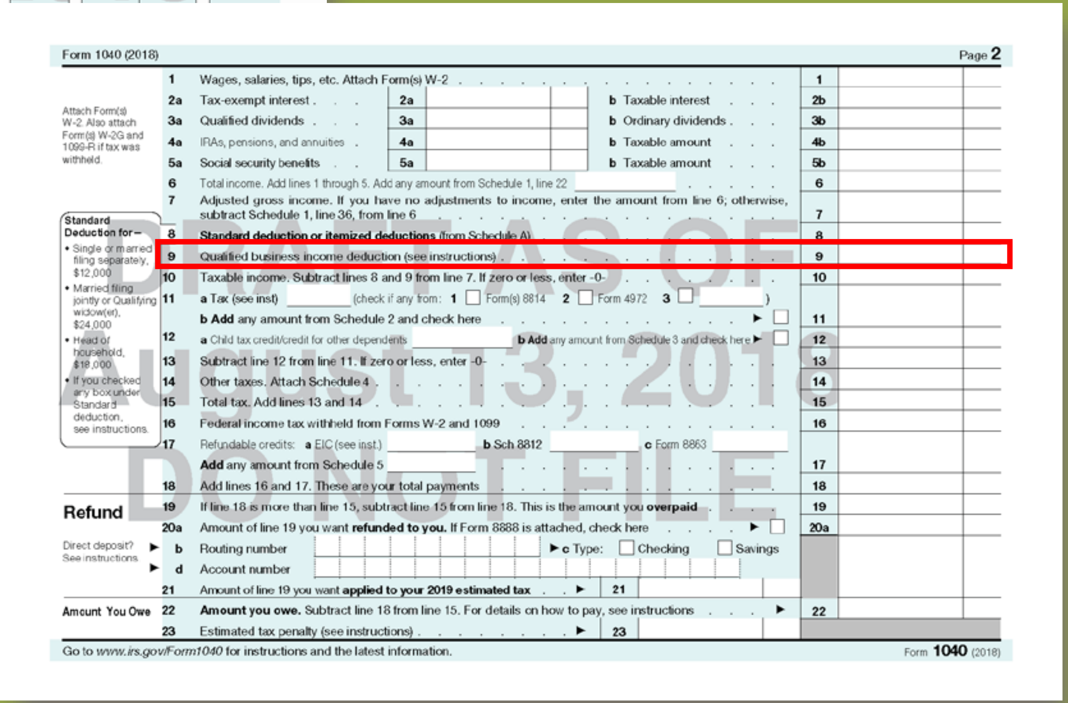

Form 1040 (2018) Page **2**

Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.	1	Wages, salaries, tips, etc. Attach Form(s) W-2					1	
	2a	Tax-exempt interest	2a		b	Taxable interest	2b	
	3a	Qualified dividends	3a		b	Ordinary dividends	3b	
	4a	IRAs, pensions, and annuities	4a		b	Taxable amount	4b	
	5a	Social security benefits	5a		b	Taxable amount	5b	
	6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22					6	
	7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6					7	
Standard Deduction for— • Single or married filing separately, $12,000 • Married filing jointly or Qualifying widow(er), $24,000 • Head of household, $18,000 • If you checked any box under Standard deduction, see instructions.	8	**Standard deduction or itemized deductions (from Schedule A)**					8	
	9	Qualified business income deduction (see instructions)					9	
	10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-					10	
	11	a Tax (see inst) (check if any from: 1 Form(s) 8814 2 Form 4972 3) b **Add** any amount from Schedule 2 and check here ▶					11	
	12	a Child tax credit/credit for other dependents b **Add** any amount from Schedule 3 and check here ▶					12	
	13	Subtract line 12 from line 11. If zero or less, enter -0-					13	
	14	Other taxes. Attach Schedule 4					14	
	15	Total tax. Add lines 13 and 14					15	
	16	Federal income tax withheld from Forms W-2 and 1099					16	
	17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863 **Add** any amount from Schedule 5					17	
	18	Add lines 16 and 17. These are your total payments					18	
Refund	19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you **overpaid**					19	
	20a	Amount of line 19 you want **refunded to you.** If Form 8888 is attached, check here ▶					20a	
Direct deposit? See instructions. ▶	b	Routing number ▶ c Type: Checking Savings						
▶	d	Account number						
	21	Amount of line 19 you want **applied to your 2019 estimated tax** ▶ 21						
Amount You Owe	22	**Amount you owe.** Subtract line 18 from line 15. For details on how to pay, see instructions ▶					22	
	23	Estimated tax penalty (see instructions) ▶ 23						

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2018)

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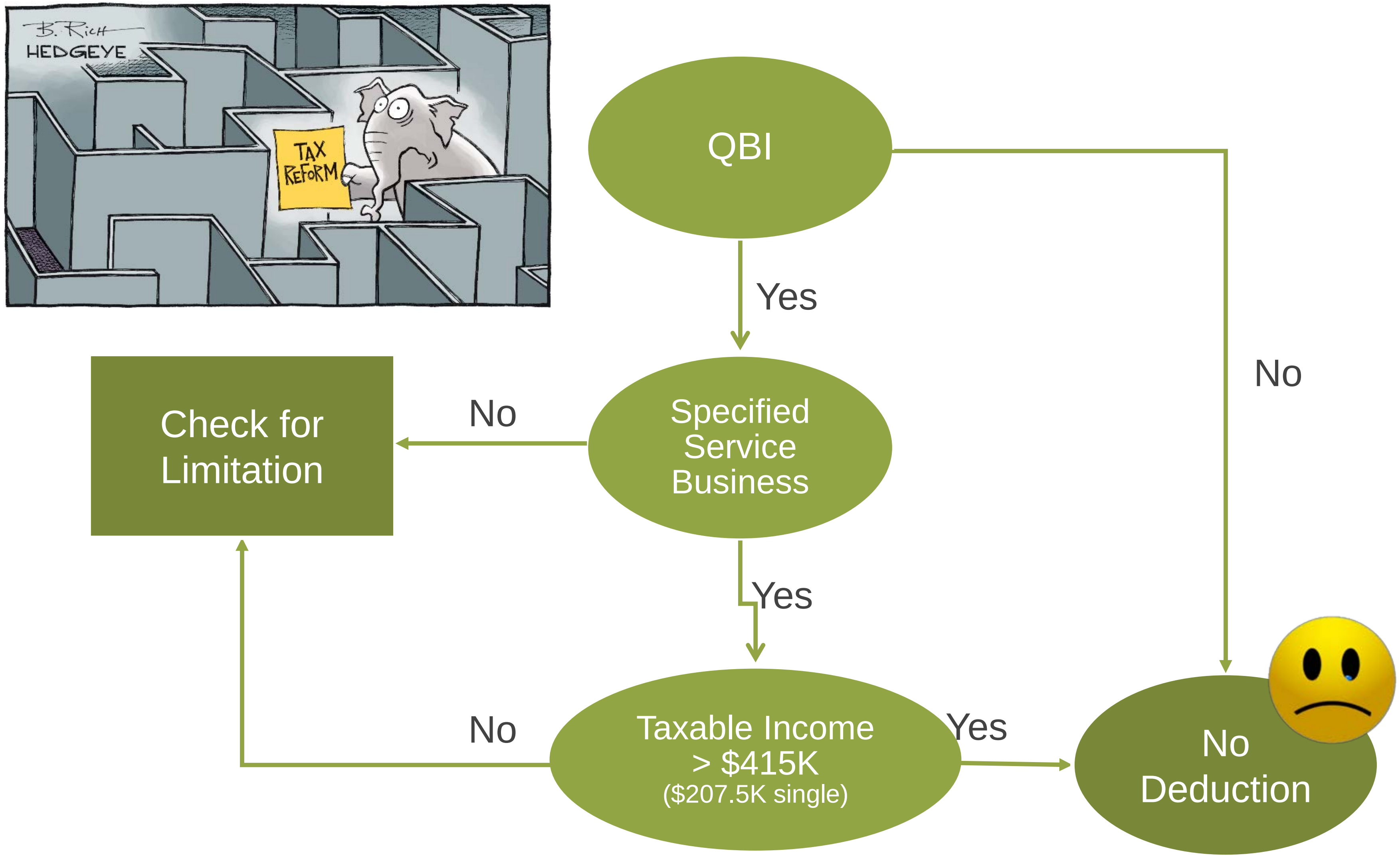
APPENDIX

ADDITIONAL DETAILS

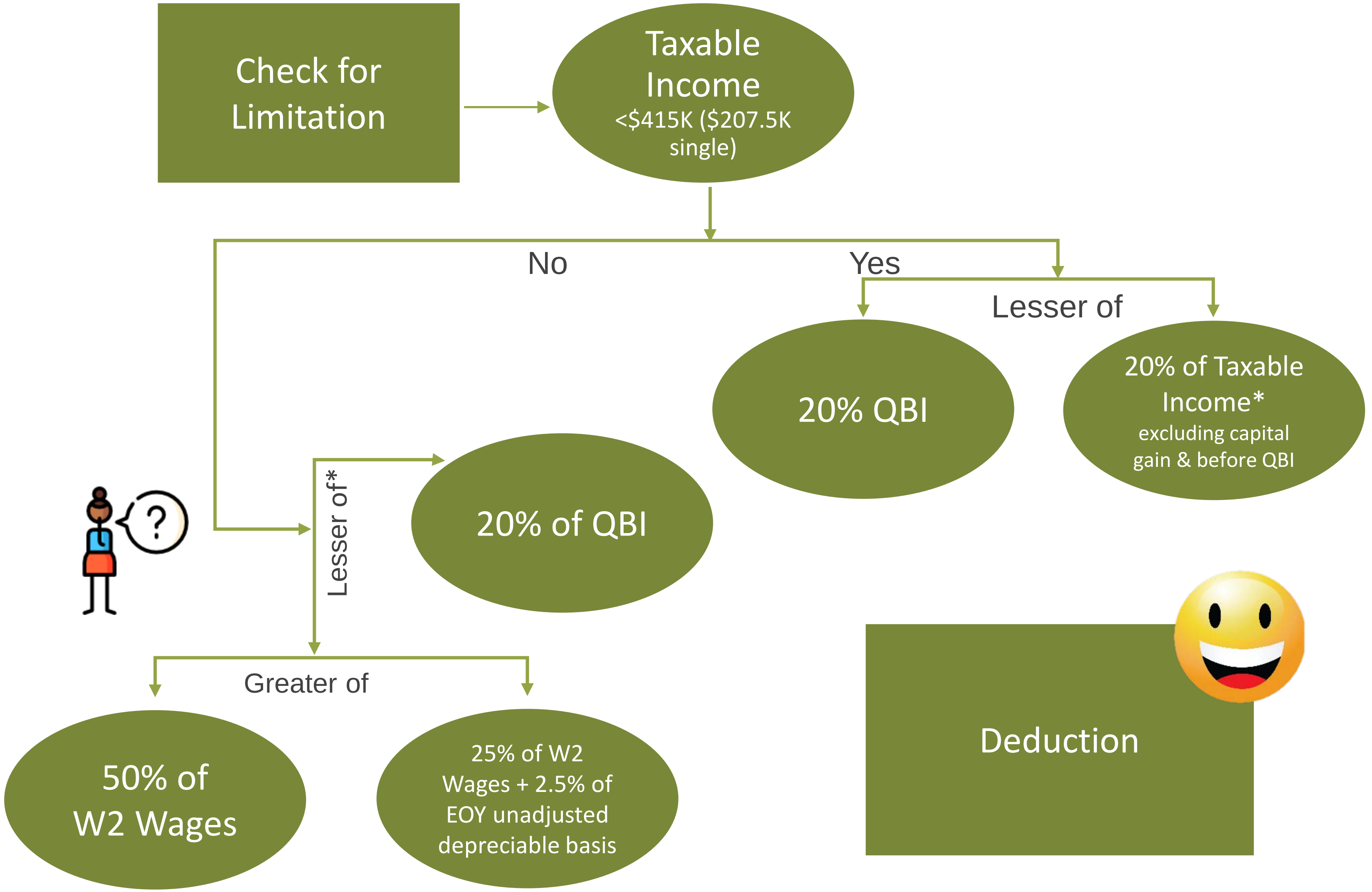
O-Zone Resources

- IRS Opportunity Zones Frequently Asked Questions
- IRS Notice 2018-48 Listing of Qualified Opportunity Zone Census Tracts
- Business Oregon Opportunity Zones Website
- Economic Innovation Group US Opportunity Zones Map Website
- WA Department of Commerce Opportunity Zones Website

20% DEDUCTION — QUALIFIED BUSINESS INCOME (QBI)



20% DEDUCTION — QUALIFIED BUSINESS INCOME (QBI)



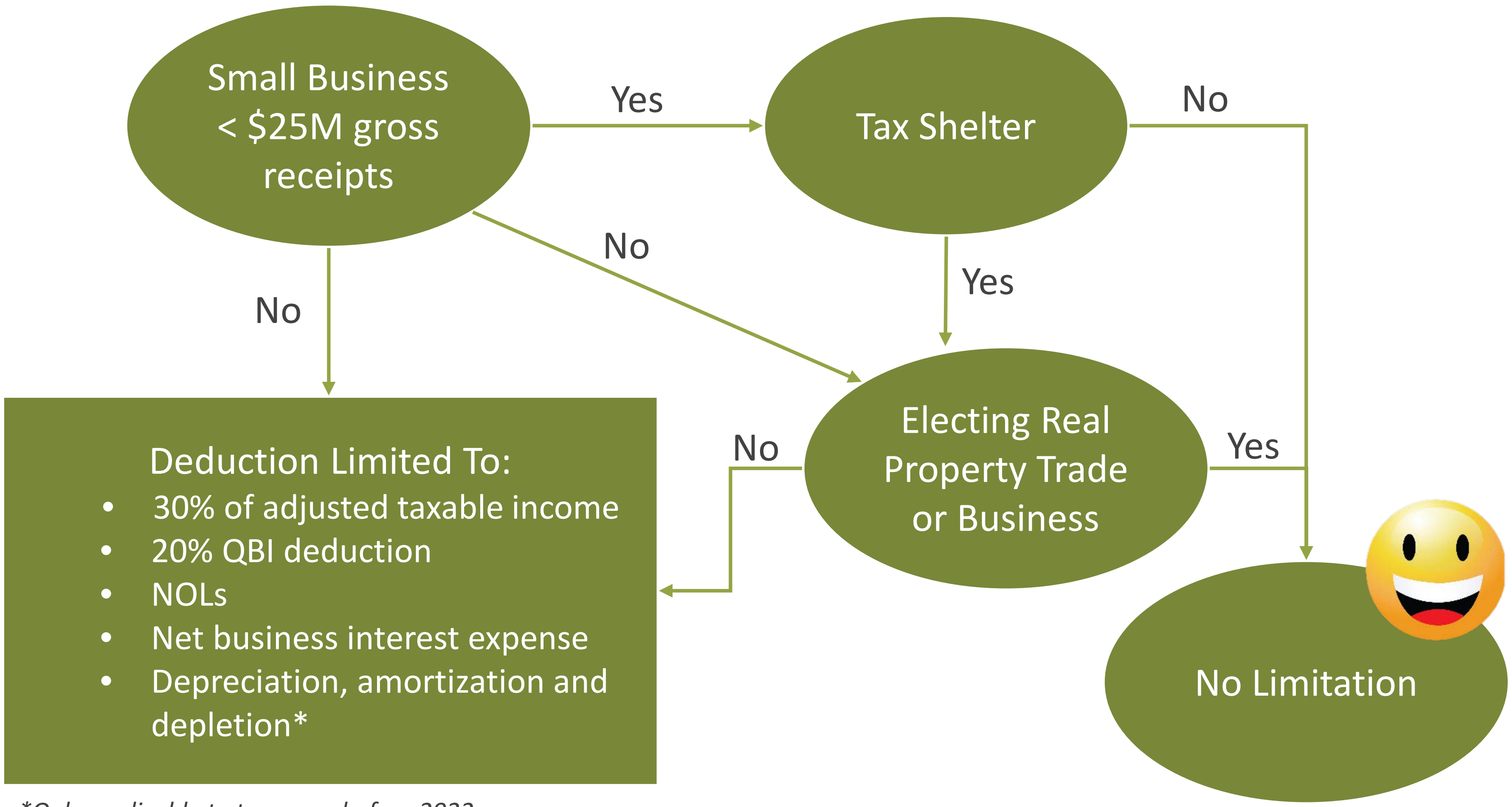
*Deduction still limited to 20% of taxable income

20% DEDUCTION – QBI CASE STUDY

SINGLE LLC BUSINESS OWNER

Federal	2017	2018	Difference
LLC Income	$750,000	$750,000	$0
SE Tax Deduction	($17,930)	($18,000)	($70)
Standard Deductions	($6,350)	($12,000)	($5,650)
QBI Deduction	($0)	($150,000)	($150,000)
Taxable Income	$725,720	$570,000	($155,720)
Tax Due (rounded)	$283,500	$217,000	($66,500)

BUSINESS INTEREST EXPENSE LIMITATION



**Only applicable to tax years before 2022*

BUSINESS INTEREST EXPENSE CASE STUDY

BUSINESS INTEREST EXPENSE LIMITATION

Income & Expense Items	2017	2018	2022
Gross Income	$500,000	$500,000	$500,000
Operating Expenses	($150,000)	($150,000)	($150,000)
Depreciation	($75,000)	($75,000)	($75,000)
Amortization	($10,000)	($10,000)	($10,000)
Interest Expense	($125,000)	($125,000)	($125,000)
30% Limitation Adjustment	$0	$20,000	$45,500
Taxable Income	$140,000	$160,000	$185,500
Adjusted Taxable Income	N/A	$350,000	$265,000
30% Limitation	N/A	$105,000	$79,500

NET OPERATING LOSSES

- Limited to 80% of taxable income
  - Formerly 100% for regular tax and 90% for AMT
- Unused NOLs carried forward indefinitely and not allowed to be carried back
  - Formerly 2 year carryback, then 20 year carryforward (unless carryforward only election made)

NET OPERATING LOSSES CASE STUDY

Income Source	2017	2019
W2 Wages	$100,000	$100,000
Interest & Dividends	$5,000	$5,000
Rental Income	$45,000	$45,000
Prior Year NOL	($150,000)	($120,000)
Total Income	$0	$30,000

- For 2017, prior year $250,000 NOL carried forward from 2016
- For 2019, prior year $250,000 NOL carried forward from 2018

EXCESS BUSINESS LOSSES

- Losses limited to $500K MFJ ($250K Single)
- Excess losses added to (NOL) carryforward
  - Limited to 90% of taxable income
- Pass-through entity loss limitations applied at partner/shareholder level

EXCESS BUSINESS LOSSES CASE STUDY

Income Source	2017	2018
W2 Wages	$400,000	$400,000
Interest & Dividends	$25,000	$25,000
ST Capital Gains	$175,000	$175,000
Sch E Nonpassive Loss	($600,000)	($500,000)
Total Income	$0	$100,000

Married taxpayer with nonpassive losses of $600,000

CARRIED INTEREST

- New 3 year holding period requirement
  - Partnership interest must meet three year holding period
  - Assets within the partnership must meet three year holding period
- Treated as short-term capital gain otherwise

1031 Exchanges/Cost Segregation

- 1031 exchanges
  - Real property unchanged
  - Personal property eliminated
- Cost segregation
  - 100% bonus depreciation
    - New and used property ("new to you")
    - Applies to assets acquired and placed in service between 9/28/2017 and 12/31/2022
    - Not eligible if elect out of business interest expense limitation and required to use ADS lives/methods
- Timing considerations and overlap of year-end

Entertainment/Meals & Transportation Fringes

- Entertainment expenses are no longer deductible
  - Includes professional and college sporting event tickets
- Most business and employee meals limited to 50%
  - De minimis fringe benefit exception (meals for convenience of employer) now subject to 50% limitation
  - Still some meals that qualify for 100% deduction
- Qualified transportation fringe benefits (parking, mass transit passes, etc.)
  - Deductible by employer if included in employee’s taxable wages
  - Not deductible by employer if excluded from employee’s taxable wages

CHOICE OF ENTITY

- Sole Proprietor/Single-Member LLC
- Partnerships/LLCs
- S Corporation
- C Corporation

C CORP VS S CORP CASE STUDY

	C Corp	S Corp	Difference
Taxable Income	$1,000,000	$1,000,000	$0
Corporate Tax Rate	21%	0%	21%
Tax Paid at Corp Level	$210,000	$0	$0
Cash Available to Distribute to Owners	$790,000	$1,000,000	$210,000
Distributions to Owners	$790,000	$1,000,000	$210,000
QBI Deduction	$0	($200,000)	($200,000)
Taxable Income	$790,000	$800,000	$10,000
Individual Tax Rate	20%	37%	
Net Investment Income Tax	3.8%	0%	
Tax Paid at Individual Level	$188,020	$296,000	$107,980
Total Tax Paid on Income	$398,020	$296,000	($102,020)
Cash Available after Tax	$601,980	$704,000	$102,020
Effective Tax Rate	39.8%	29.6%	(10.2%)

OTHER CONSIDERATIONS

- Gift and estate exemption increase (temporary?)
  - How about states?
- Unrelated business taxable income (UBTI)
  - IRA investors beware

New Partnership Audit Rules

- “Partnership representative” replaces “tax matters partner”
  - Only person who can represent the partnership before the IRS
  - Granted broad authority unless otherwise limited in partnership/operating agreement
  - Not required to be a partner/member
- Partnerships can now be liable for tax underpayments
  - Tax is assessed at highest marginal rate (corporate or individual)
  - Certain qualifying partnerships can elect out, but limited application
  - Audit adjustments can be “pushed out”, but 2% increased interest rate cost for election
- State conformity lagging

THANK YOU

PERKINS & CO

#PERKINSPRESENTS

REAL ESTATE CONNECTION

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