

KIRKLAND ALERT

August 6, 2018

Opportunity Zones: Key Takeaways from EIG Coalition Meeting

As a member of the Economic Innovation Group (“EIG”) Opportunity Zones Coalition, Kirkland & Ellis recently participated in a meeting with coalition members, the IRS and commentators to discuss issues related to investing in Opportunity Zones (“OZs”). OZs were one of the most significant tax incentive programs for investment and economic development created by the Tax Cuts and Jobs Act, and EIG is the leading industry group lobbying for clarity on OZs. The text of the new OZ provisions can be found [here](#).

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The following are the key points Kirkland & Ellis took away from the meeting.

- **Gains eligible for investment.** Both short-term and long-term capital gains are expected to be eligible for investment in Opportunity Funds (“O Funds”). Ordinary income is not likely to be eligible.
- **Partnership gains.** Gains realized by partnerships are likely to be eligible for investment by either the partnership or its partners, but not both. Partners are likely to be eligible to invest gains realized by a partnership after receiving notification by the partnership of the gain and of the partnership’s election not to invest the gain at the partnership level.
- **On-ramp issues.** O Funds will likely be required to satisfy the statutory 90% test on semi-annual testing dates without any grace period. Therefore, without any “on-ramp”, O Funds may have to quickly invest any cash (a non-qualifying asset) received into OZs. OZ Businesses, which are corporations or partnerships held by O Funds, may have more flexibility if they can hold cash as working capital.
- **OZ Business “substantially all” requirement.** In addition to taxpayers being able to look to facts and circumstances, a safe harbor may be provided that allows OZ Businesses to meet the requirement that “substantially all” tangible assets be qualifying property.
- **Debt-financed gains.** The treatment of debt financing in the context of O Funds continues to be a significant area of uncertainty. It is possible that a distribution of debt proceeds by an O Fund could cause investors to recognize deferred gain. Further, any debt-financed gains in an O Fund investment may not qualify for the exemption upon a 10-year hold.
- **Interim gains and exit structuring.** Interim gains reinvested into OZs are not likely to qualify for the deferral and exemption benefits under the statute. Further, it is likely that disposition of investors’ investments in an O Fund, rather than sale

of underlying assets, will be required to obtain the benefit of the exemption for a 10-year hold. Single-asset O Funds may therefore be significantly favored.

- **Timing.** While the IRS may issue additional guidance informally on its website, most guidance is expected to be issued through regulations subject to notice-and-comment procedures. Guidance on simpler mechanics like electing deferral and O Fund status is likely over the next several months. Guidance on larger substantive issues is not likely until the end of 2018 or later.

Despite the significant issues to be resolved, Coalition members including investors, state and local government officials, impact investment stakeholders, developers, accounting and law firms, and banks are enthusiastic about receiving favorable guidance from the IRS and the prospects for O Funds. Already, several single-asset O Funds are reportedly being formed to take advantage of the legislation.

For further background on these points and other open questions on the OZ legislation, read [EIG's Opportunity Zone Coalition Letter](#) and the [Novogradac & Co Working Group's Request for Guidance](#).

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