O-Zones & TCJA Tax Update

PERKINS & CO

EPC OF SW WA

JANUARY 22, 2019

AGENDA

- Opportunity Zones (O-Zones)
  - Investor Tax Benefits and Qualifications
  - Qualified Opportunity Fund Qualifications and Operations
  - Where are They Locally?
- Tax Cuts and Jobs Act (TCJA) Tax Changes
  - Gift and Estate Tax Update
  - Individual Income Tax Update
  - Pass-through Entity Tax Update
  - Other Items of Interest
- Questions

O-Zones

QUALIFIED OPPORTUNITY ZONES

- **December 2017** — Created as part of Tax Cuts & Jobs Act
- **April 2018** — Geographic designations began
- **October 2018** — Proposed Regulations issued, providing additional guidance

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

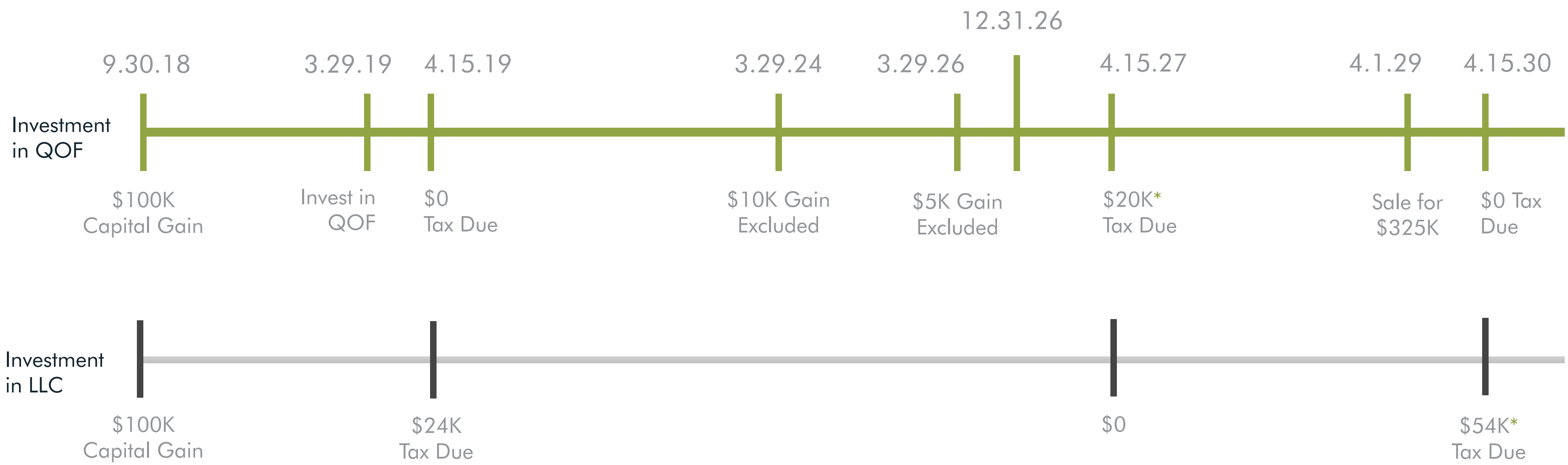
TAXPAYER REQUIREMENTS

- 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)

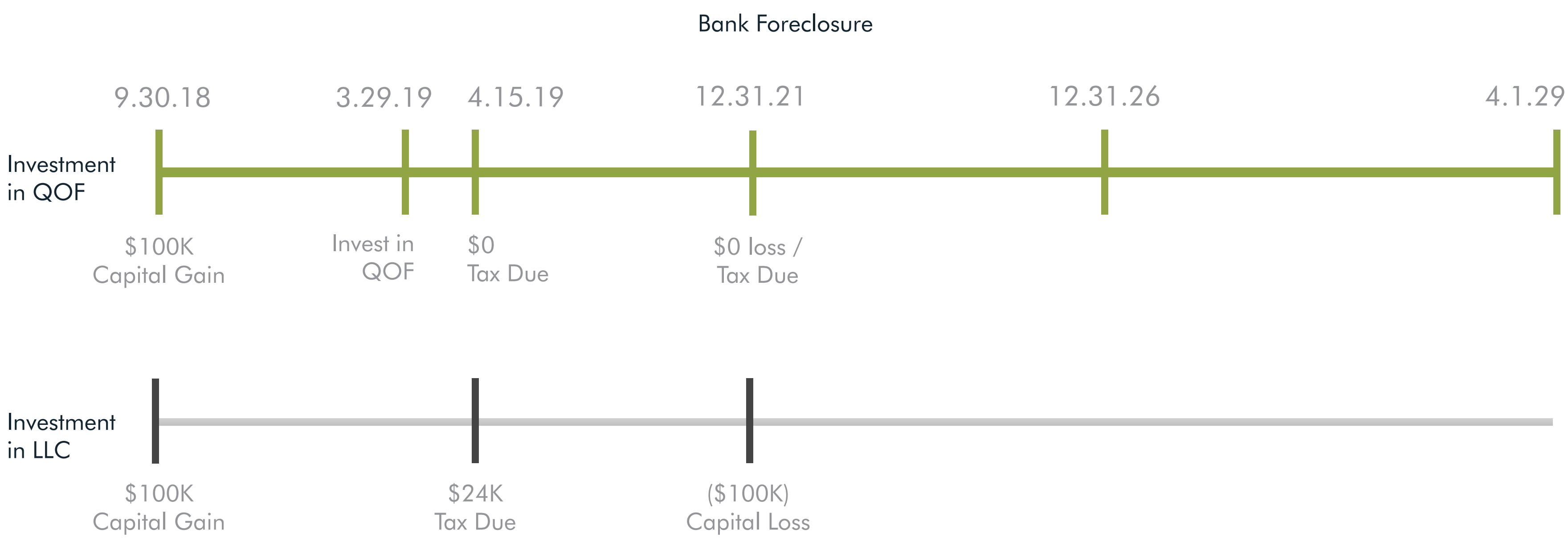
- Gain can't result from sale to related party (20% test)
- Must pay deferred tax no later than 12/31/2026
  - Deferred gain retains its original character (i.e., short-term, long-term, etc.)
  - Rates in effect in 2026 apply

CASE STUDY #1



*Assuming WA resident subject to NIIT, no changes to tax rates: 20% + 3.8%

CASE STUDY #2



*Assuming WA resident subject to NIIT, no changes to tax rates: 20% + 3.8%

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

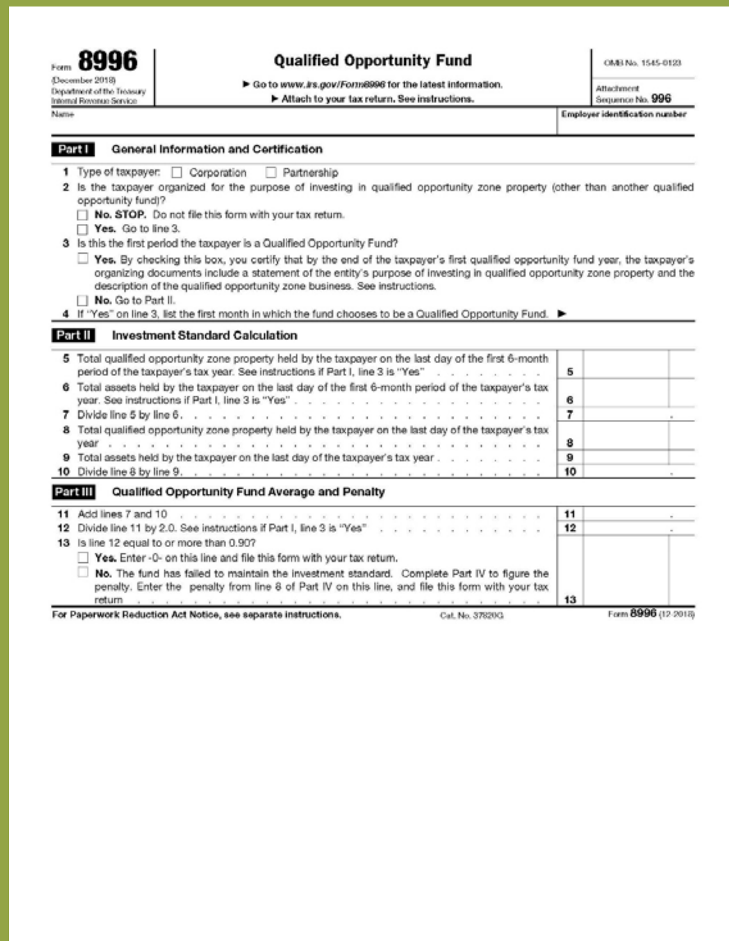
QOF REQUIREMENTS (CONTINUED)

- “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
  - <u>AND</u>, 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. ►

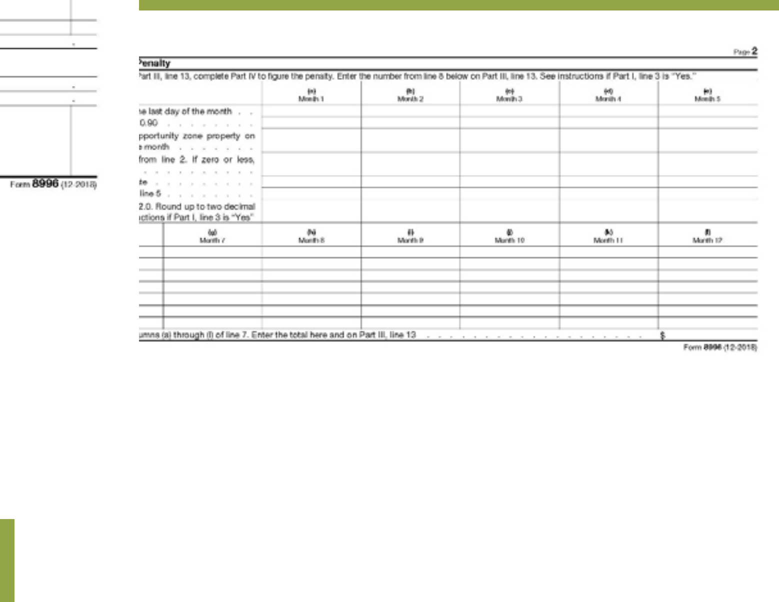
Part II **Investment Standard Calculation**

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 taxpayer'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 0.90?
☐ **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

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 37820G Form **8996** (12-2018)



Page **2**

Penalty

Part 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
he last day of the month . .					
0.90 . . .					
pportunity zone property on e month . . .					
from line 2. If zero or less, . . .					
te . . .					
line 5 . . .					
2.0. Round up to two decimal ictions if Part I, line 3 is "Yes"					

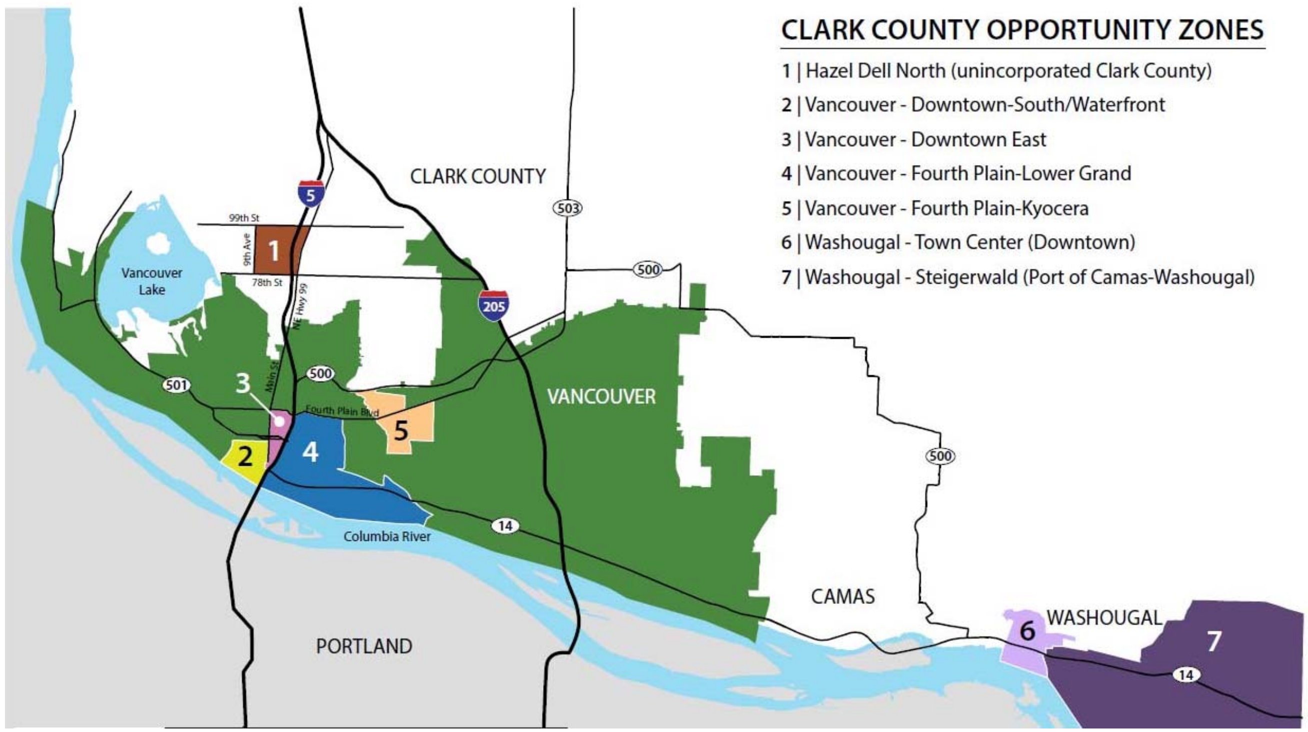
(g) Month 7	(h) Month 8	(i) Month 9	(j) Month 10	(k) Month 11	(l) Month 12

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

Form 8996 (12-2018)

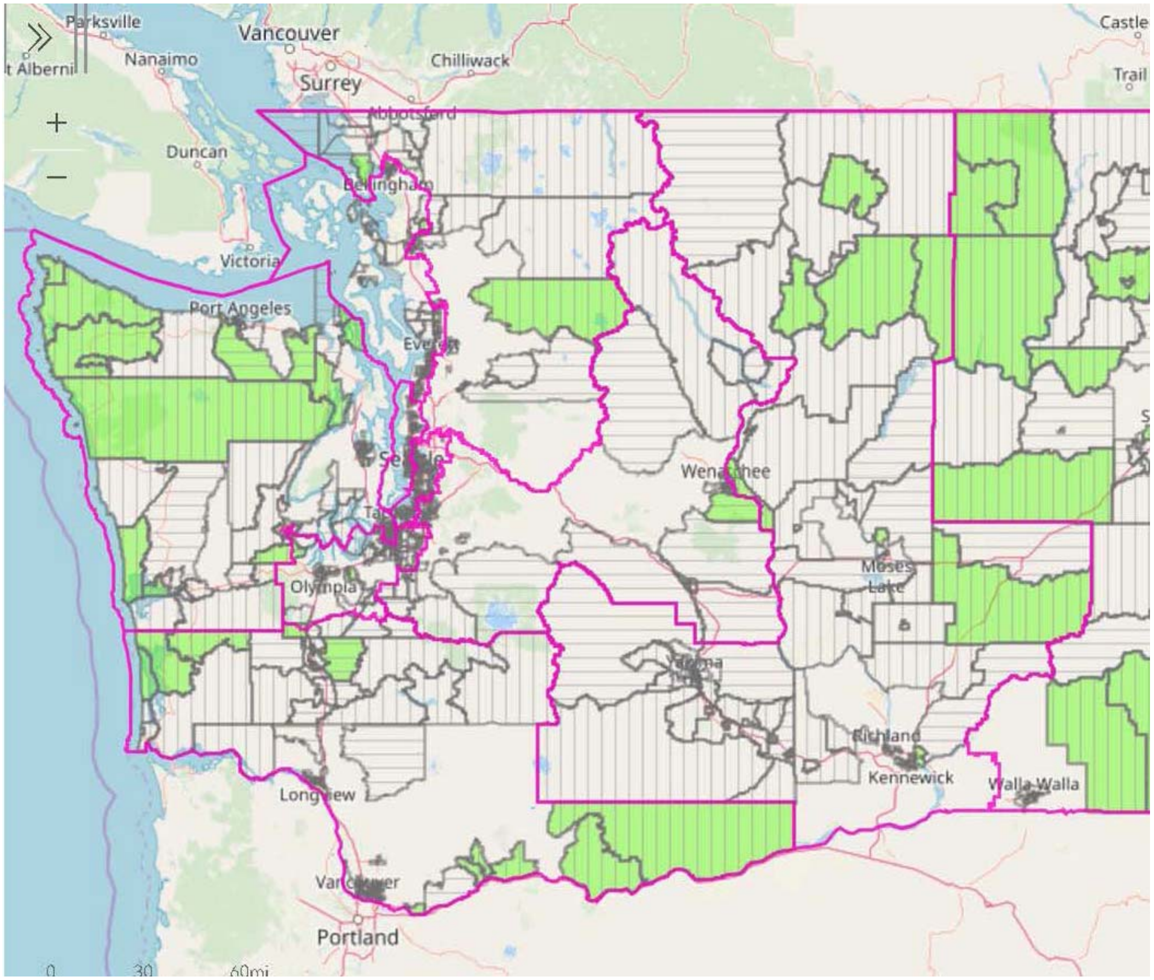
O-ZONES
OF INTEREST

CLARK COUNTY



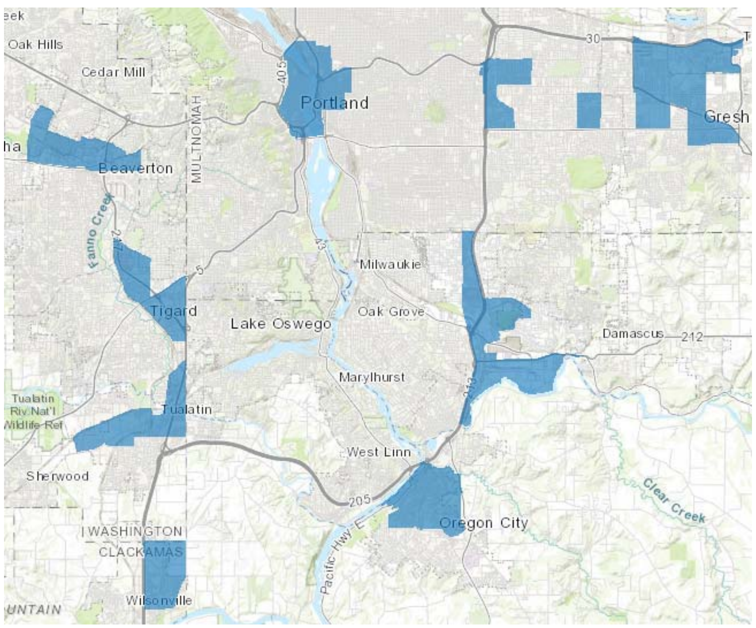
O-ZONES
OF INTEREST

STATE OF WASHINGTON

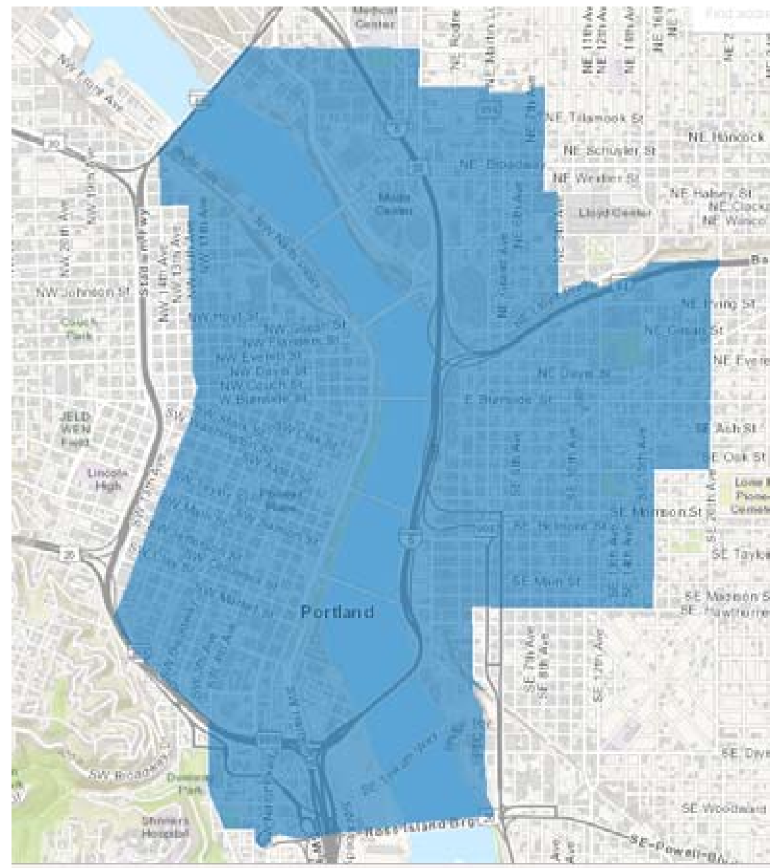


O-ZONES OF INTEREST

PORTLAND METRO

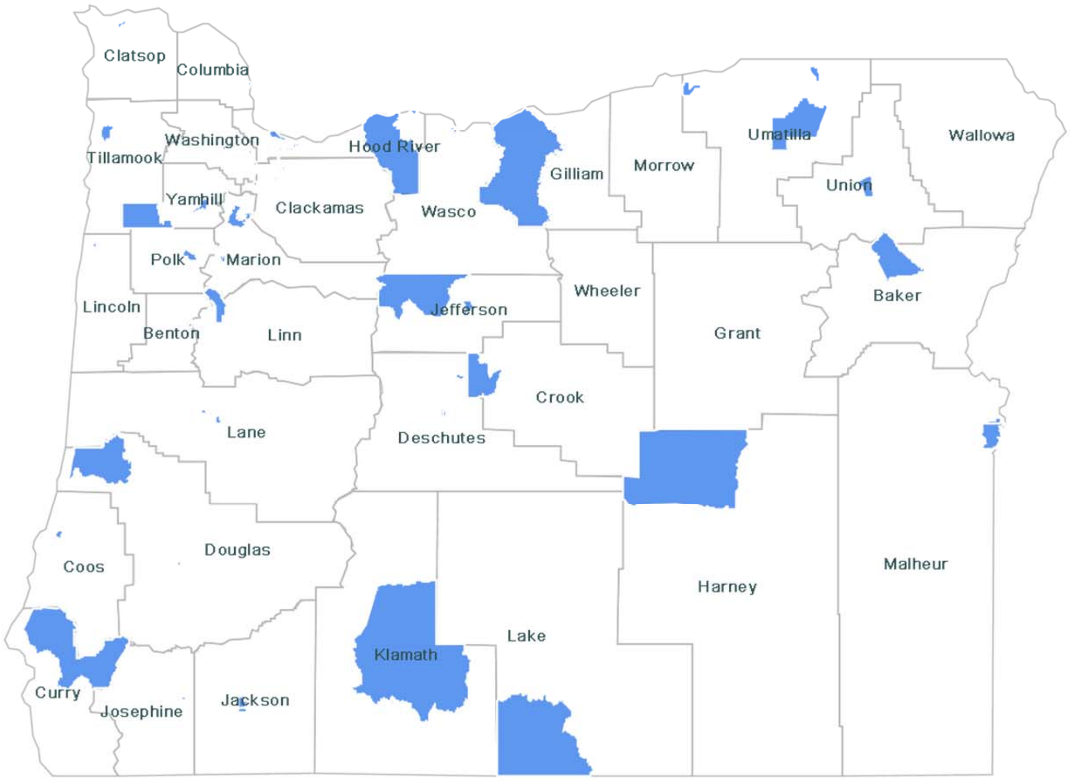


PORTLAND - PEARL, SOUTH WATERFRONT, DOWNTOWN AND INNER EASTSIDE



O-ZONES
OF INTEREST

STATE OF OREGON



WHAT WE DON'T KNOW?

- Testing for cash invested (90% test)
- Substantially improved
- Exit after 10+ years (QOF investment)
- QOF investments in operating trades or businesses
- Interaction with partnership tax law (basis, depreciation, carried interest)

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

TCJA TAX UPDATE

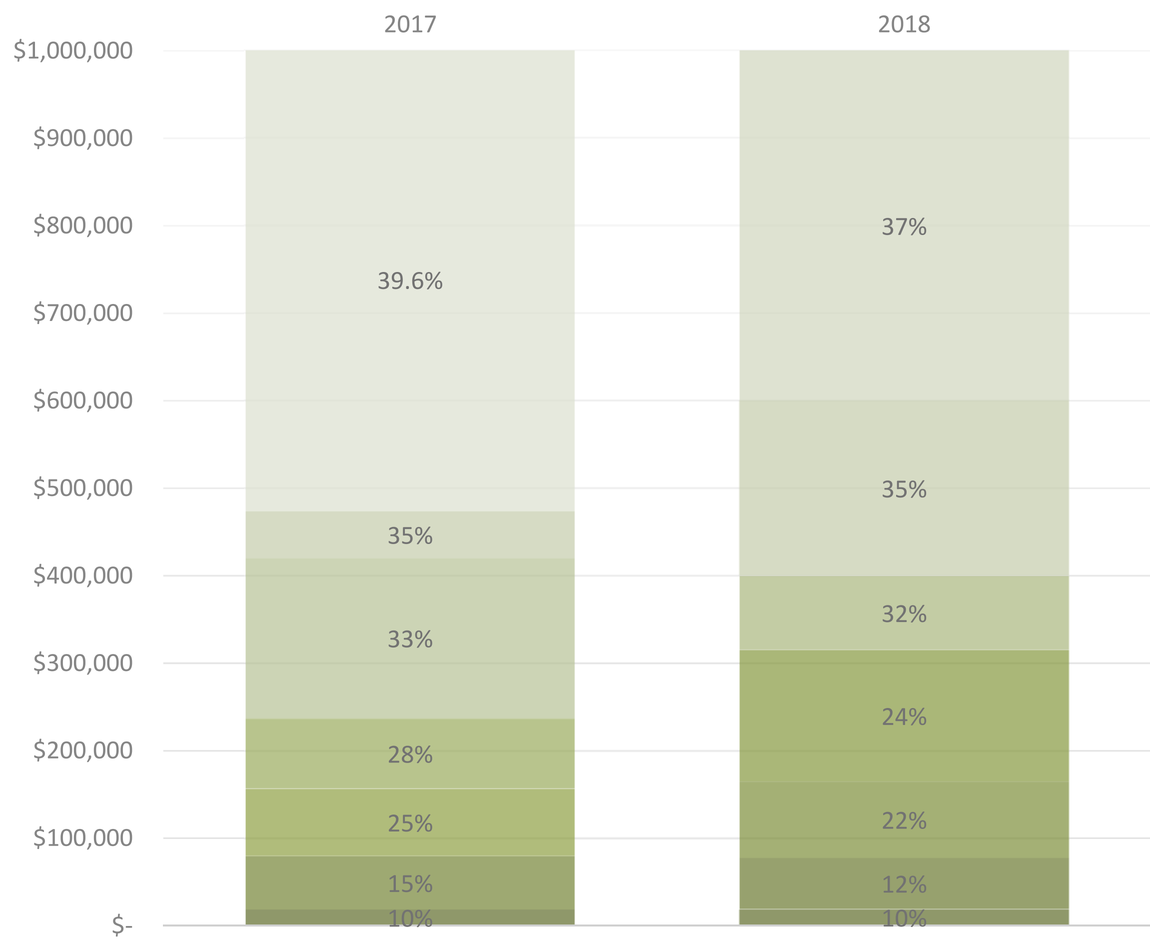
ESTATE PLANNING

- 2019 Exclusion Amounts / Maximum Rates
  - Federal - $11,400,000 (double with portability) / 40%
  - Washington - $2,193,000 (no portability) / 20%
  - Oregon - $1,000,000 (no portability) / 16%

INDIVIDUAL
TAX REFORM

- Effective January 1, 2018
  - Sunsets after 2025
- Lower tax brackets
  - Top rate of 37% starting at $600k ($500k single)
- Exemptions are eliminated

MARRIED FILING JOINTLY RATES



CASE STUDY
EXAMPLE 1

- Family of five taking standard deduction
  - Two adults and three children (all K-12)
  - Wages = $90k/year

CASE STUDY – EXAMPLE 1

Family of 5, standard deduction	2017	2018
Wages	90,000	90,000
Exemption	(20,250)	~~(20,250)~~ 0
Standard deductions	(12,700)	(24,000)
Total deductions	(32,950)	(24,000)
Taxable income	57,050	66,000
Federal tax (before credits)	7,629	7,539
Child tax credits*	3,000	6,000
Net federal tax	**4,629**	**1,539**

Note credits **not available for children 17 and older*

ITEMIZED DEDUCTIONS

- Medical expenses
  - 7.5% of AGI floor for 2018
- State and local taxes
  - Income/sales/property taxes capped at $10k
- Mortgage interest
  - Mortgage interest limited to $750k on new loans after December 15, 2017
  - HELOC interest deduction suspended (but allowable for renovations or improvements)

ITEMIZED DEDUCTIONS

- Charitable contributions
  - Limit increased to 60% of AGI (from 50%)
  - Eliminated deduction for payments in exchange for athletic seating rights
- Miscellaneous 2% of AGI deductions suspended
  - Employee business expenses
  - Tax prep and investment fees
- 3% limitation on overall deductions eliminated
- Standard deduction increased to $24k ($12k single)

CASE STUDY
EXAMPLE 2

- Married wage earners renting condo in the Pearl
  - Two adults, both working, no children
  - Renting home
  - Wages = $250k/year

CASE STUDY – EXAMPLE 2

DINKs, renting	2017	2018
Wages	250,000	250,000
Exemption	(8,100)	0
Charitable contributions	(13,000)	(13,000)
State tax deductions	(20,000)	~~(20,000)~~ (10,000)
Total itemized deductions	(33,000)	*(23,000)
Standard deductions	(12,700)	(24,000)
Taxable income	208,900	226,000
Federal tax	**45,377**	**42,819**

Planning opportunity to bundle charitable deductions for several years into one. Planning would provide **$3,360 in federal savings** over two years in this example.

**Note this is less than the standard deduction. Charitable contributions do not provide any extra tax benefit.*

CASE STUDY
EXAMPLE 3

- Retired couple who own home outright
  - Two adults, both retired, no dependents
  - Own home; no mortgage

CASE STUDY – EXAMPLE 3

Retired couple, no mortgage	2017	2018
Interest, dividends, IRA distributions	250,000	250,000
Exemption	(8,100)	0
Charitable contributions	(14,000)	(14,000)
State & property tax deductions	(25,000)	~~(25,000)~~ (10,000)
Total itemized deductions	(47,100)	*(24,000)
Taxable income	202,900	226,000
Federal tax	**44,272**	**42,819**

**Note this is less than the standard deduction. Charitable contributions do not provide any extra tax benefit.*

CASE STUDY – EXAMPLE 3 VERSION 2

Planning opportunity to contribute IRA distributions directly to charity if age 70 ½. Planning would provide **$3,360 in federal savings** for the year in this example.

Retired couple, no mortgage	2018 No IRA to charity	2018 IRA to charity ($14K)
Income	250,000	(~~250,000~~) 236,000
Standard deduction	(24,000)	(24,000)
Taxable income	226,000	212,000
Federal tax	**42,819**	**39,459**

$3,360 federal savings

OTHER INDIVIDUAL TAX CHANGES

- Sec. 529 Plans allow distributions for elementary and high school tuition up to $10,000 annual limit
- Tax on alimony and deduction eliminated for agreements executed after 2018
- Alternative Minimum Tax is nominally retained
  - Increased exemption of $109,400 joint ($70,300 single)
- Roth conversions still allowed, but recharacterizations no longer available

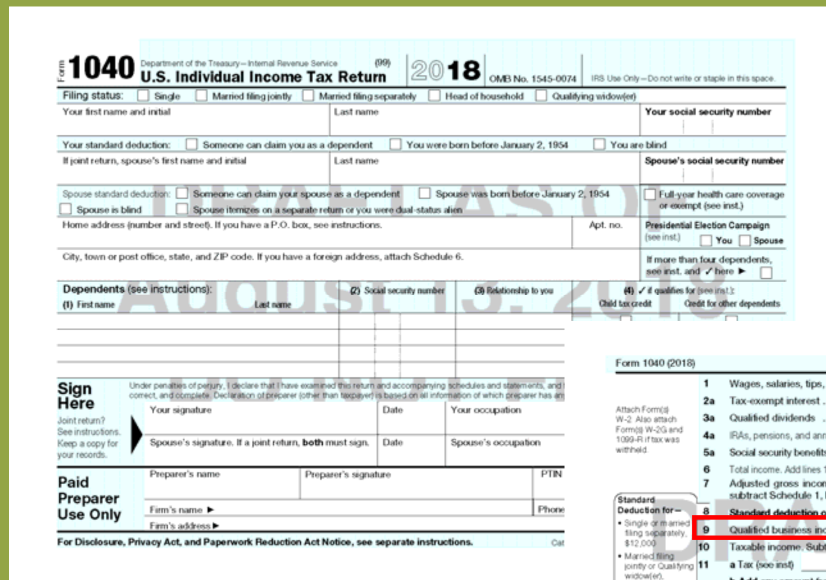
20% QBI DEDUCTION (AKA 199A DEDUCTION)

- 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 EACH trade or business
  - W2 wages
  - UBIA
  - QBI
- Oregon disconnect

QUALIFIED BUSINESS INCOME DEDUCTION

- 20% deduction for qualified business income (QBI)
  - S corporations
  - Partnerships/LLCs
  - Sole proprietors/rental activity
  - Trusts
- Deduction is applied to adjusted gross income
  - Does not reduce AGI for other threshold purposes
- No material participation requirement

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 — Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

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.

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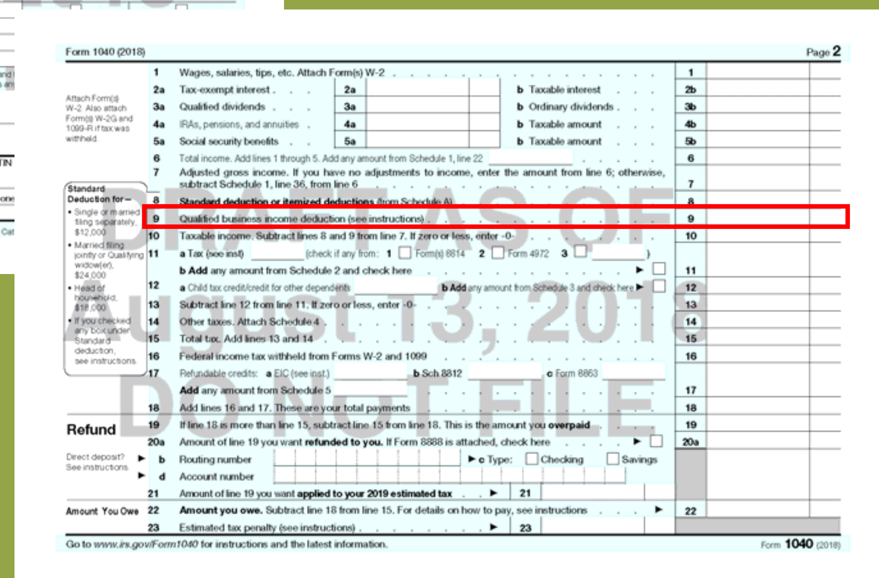


Form 1040 (2018) Page 2

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
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
19	Refund — 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
b	Routing number ► c Type: Checking Savings		
d	Account number		
21	Amount of line 19 you want applied to your 2019 estimated tax 21		
22	Amount You Owe — 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		

Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

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.

Direct deposit? See instructions.

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

DRAFT AS OF August 13, 2018 DO NOT FILE

CASE STUDY
EXAMPLE 4

- High wage earner vs. real estate developer

CASE STUDY – EXAMPLE 4

	2018 High wage earner	2018 Real estate developer
Income	3,000,000	3,000,000
20% pass-through deduction	-	(600,000)
Charitable contributions	(50,000)	(50,000)
Mortgage interest expense	(50,000)	(50,000)
Property & Oregon income tax	~~(400,000)~~ (10,000)	(10,000)
Total itemized deductions	(110,000)	(110,000)
Taxable income	2,890,000	2,290,000
Federal tax	**1,033,429**	**786,679**

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

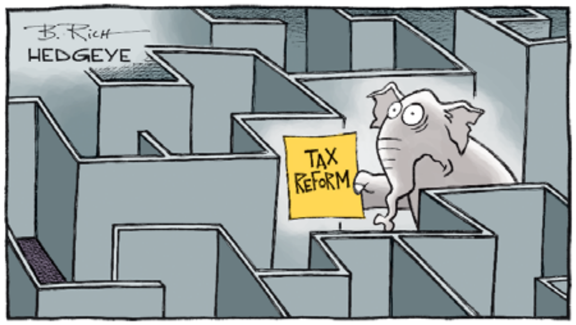
OTHER BUSINESS CONSIDERATIONS

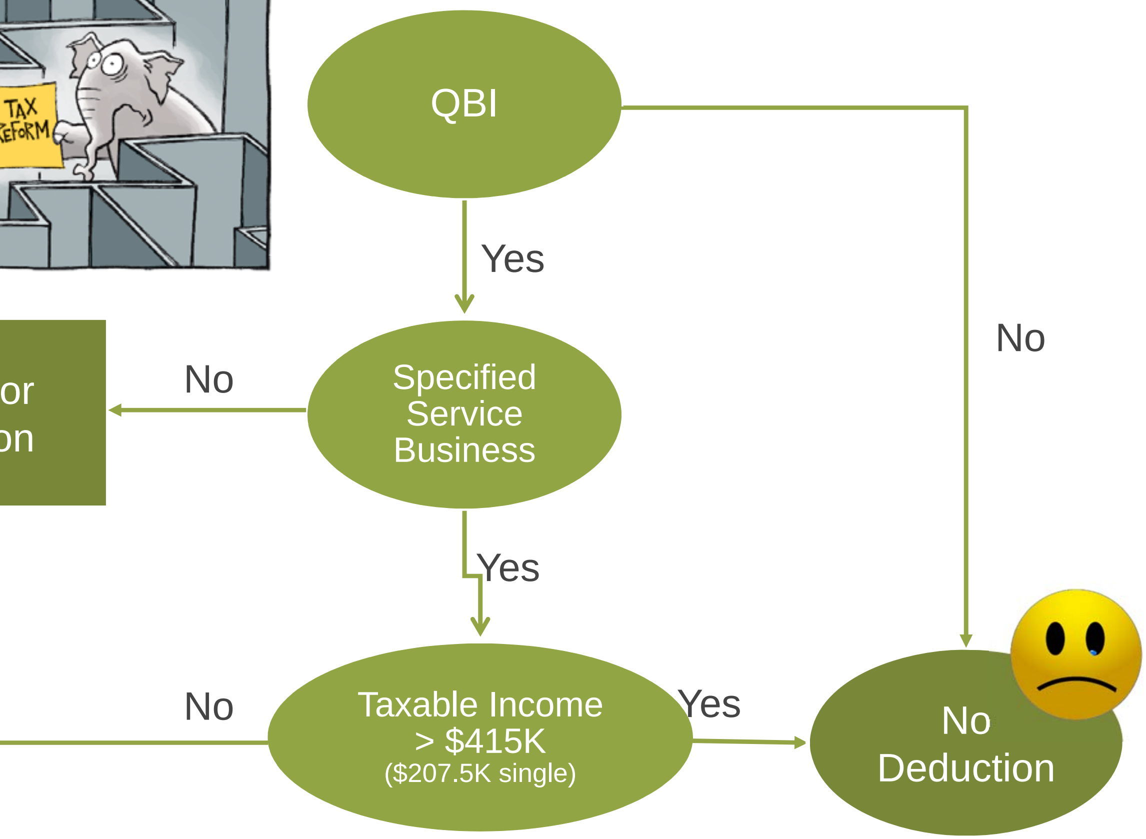
- Business interest expense limitation
- Net operating losses
- Excess business losses
- Carried interest
- 1031 exchanges/cost segregation
- Entertainment/meals expense & qualified transportation fringes for employees
- Oregon apportionment based upon "economic nexus" vs "cost of performance"
  - Change 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

APPENDIX

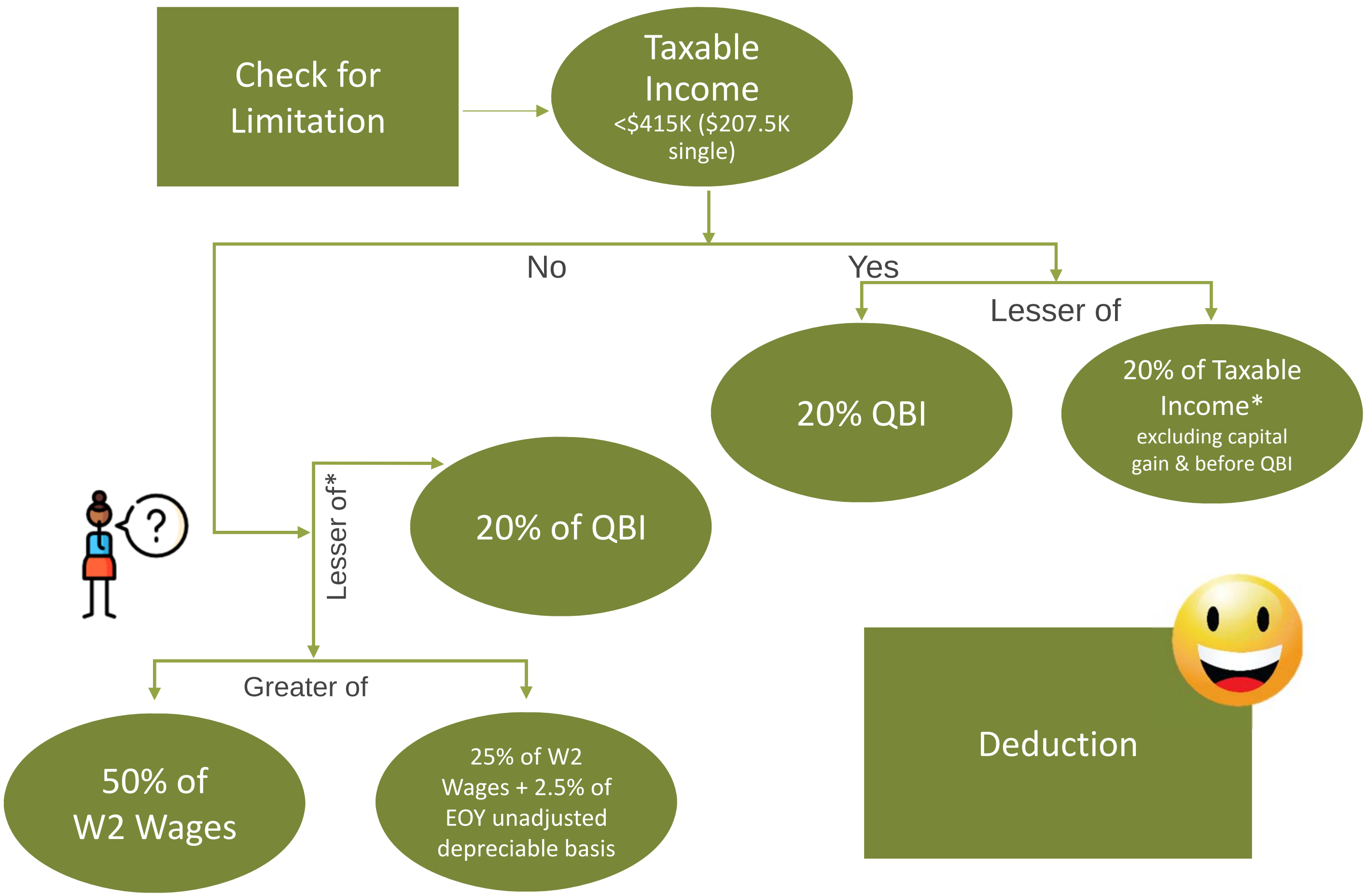
ADDITIONAL DETAILS

20% DEDUCTION — QUALIFIED BUSINESS INCOME (QBI)





20% DEDUCTION — QUALIFIED BUSINESS INCOME (QBI)



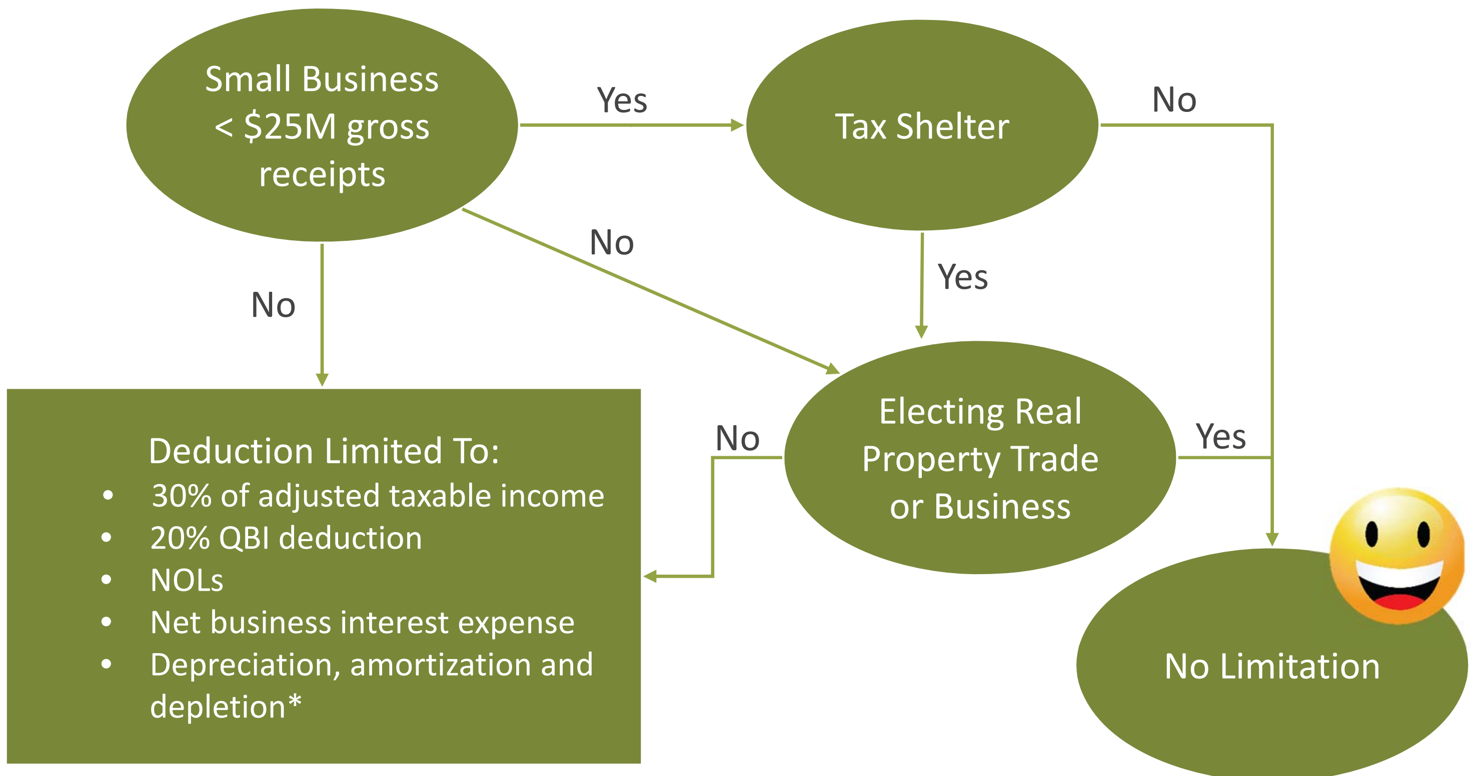
**Deduction still limited to 20% of taxable income*

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

- Unrelated business taxable income (UBTI)
  - IRA investors beware
- City of Portland Tax
  - Rate increased to 2.6%
  - Owners Comp deduction increased to $125,000

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

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