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UNDERSTANDING OPPORTUNITY ZONES

Presented to: Opportunity Fund Stakeholder Meeting

October 30, 2018

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AGENDA

- Why invest in an Opportunity Zone fund?
- Steps in the Opportunity Zone process
- Opportunity Zone property
- “Substantial improvement”
- Some of the things to think about
- Questions?

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WHY INVEST IN AN OPPORTUNITY ZONE FUND?

- The short answer . . . If the investor meets the requirements (of which there are many):
  - Defer federal income tax on current recognized capital gains
  - Have a portion of that deferred gain forgiven
  - Avoid federal income tax on appreciation in Opportunity Fund investment

HOW DID OPPORTUNITY ZONES COME TO BE?

- Creation of the Tax Cuts and Jobs Act of 2017.

- Goal is revitalization of economically depressed geographies.

- Attempt to implement lessons learned from prior efforts . . .
  – Requisite long term investment to maximize benefits.
  – Attempt principally to capture investor’s gains from other successful investments.
  – Broad – but not unlimited categories of qualifying investments.
  – To fully benefit from the Opportunity Zone provisions, the taxpayer needs to make astute opportunity zone investments.

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STEPS IN THE OPPORTUNITY ZONE PROCESS

- Step 1: A taxpayer realizes and recognizes capital gain.
  - Shares of stock
  - Real estate
  - Partnership interest that result in capital gain
  - Other property

- Step 2: The taxpayer invests the gain dollars in a “Qualified Opportunity Fund” (Fund)
  - Timing: Investment within 180 days for realization/recognition event
  - Taxpayer cannot invest directly in property, even if it’s in opportunity zone
  - The Fund can self-certify

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STEPS IN THE OPPORTUNITY ZONE PROCESS

- Step 2: The taxpayer invests the gain dollars in a “Qualified Opportunity Fund” (continued).
  - Fund must be “organized as a corporation or partnership (including an LLC)”
  - Purpose of the entity must be to invest in opportunity zone property
  - Initial adjusted basis in the Fund is 0
- Step 3: Fund makes equity investment in “opportunity zone property”
- Step 4: Fund must hold 90% of its assets in opportunity zone property
  - Twice annual testing
  - Penalty for failure to comply
  - Draft IRS Form 8996 is out

STEPS IN THE OPPORTUNITY ZONE PROCESS

- Step 5: If the taxpayer holds its Fund interest for 5+ years, the taxpayer receives an increase in his/her adjusted basis of 10% of the deferred gain
- Step 6: If the taxpayer holds its Fund interest for 7+ years, the taxpayer receives an increase in his/her adjusted basis of 5% of the deferred gain

STEPS IN THE OPPORTUNITY ZONE PROCESS

- Step 7: If you still hold your investment at 12/31/2026, there is a “deemed disposition,” so that all the deferred gains related to the investment in the Fund ends and gain is recognized.
  - The gain is the lesser of:
    - The original deferred gain, or
    - The FMV of the taxpayer’s Fund investment
  - Reduced by the taxpayer’s basis the Fund investment.

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STEPS IN THE OPPORTUNITY ZONE PROCESS

- Step 7 (continued): Putting the “deemed disposition” rule in context . . .
  - The deferred gain is the building block for the tax on the deemed disposition
  - So, protecting the cash on sale attributable to the adjusted basis from the originating transaction is paramount
  - The basis adjustment (up to 15%) essentially is free . . .
  - Taxpayer has interest-free use of the adjusted basis dollars until, say, April 15, 2027

- Step 8: If the taxpayer holds the Fund investment for 10+ years, the taxpayer is permanently exempt from capital gains from the sale of his/her Fund interest

OPPORTUNITY ZONE PROPERTY

- Category 1: Opportunity Zone Property
- Tangible property
  - Real property
  - Land and improvements to real property
  - Equipment and other personal property
- “Substantially all” of the tangible property needs to be in the Opportunity Zone during Fund’s holding period. This is defined as 70%

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OPPORTUNITY ZONE PROPERTY

- Category 2: Opportunity Zone Stock or Partnership Interests
  - Fund is not limited to direct ownership of real estate
  - The stock or partnership interest can be an investment in a domestic operating business.
  - “Substantially all” of the business tangible property must be:
    - Acquired by purchase from unrelated third parties after 2017, and
    - Used in the opportunity zone during “substantially all” of the business’s holding period.
  - Among other things, at least 50% of the business’s gross income comes from the “active conduct” of the business in the OZ.
  - A “substantial portion” of the intangible property of the entity is used in the active conduct of the trade or business in the OZ.

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OPPORTUNITY ZONE PROPERTY

Category 2: Opportunity Zone Stock or Partnership Interests:

- The balance sheet cannot contain too much financial property, which would imply the business’s focus is investment speculation, rather than economic development
  - Less than 5% of average aggregate unadjusted basis is “nonqualified financial property”
- By statute, certain businesses don’t qualify (golf courses, country clubs, massage parlors, hot tub or sun tan facilities, race tracks, gambling, package liquor stores)

“SUBSTANTIAL IMPROVEMENT”

- An Opportunity Zone Fund has a 30-month window to improve property
- Working Capital Safe Harbor for 31 months at the Business Level not at the Fund Level
- Amount of improvements must exceed acquisition basis in the building
- Basis allocable to land excluded
- Example : Acquisition of $10 million dollars

  Appraised Value of land is $4 million dollars

  You must spend at least $6 million rehabbing the building.

ADDITIONAL ITEMS

- Proposed Regs allow for a disposition of an interest in one QOF and a subsequent investment in another QOF within 180 days.
- Regs are still just Proposed Regs and comment period is open

QUESTIONS?

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- For Questions please contact

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