



CPAs & BUSINESS ADVISORS

OPPORTUNITY ZONES

Understanding The Opportunity

DISCLAIMER

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This information is of a general nature and based on authorities that are subject to change.

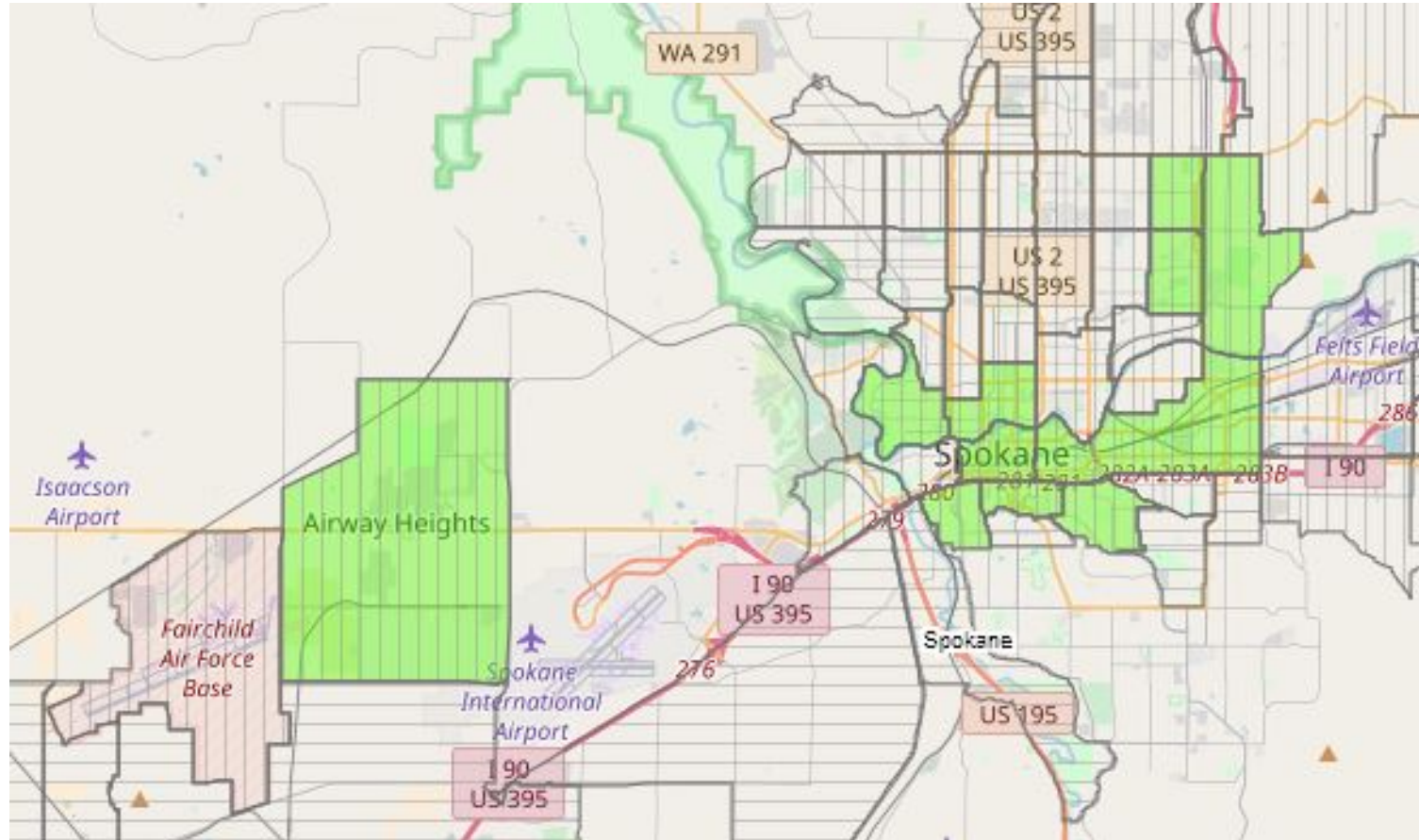


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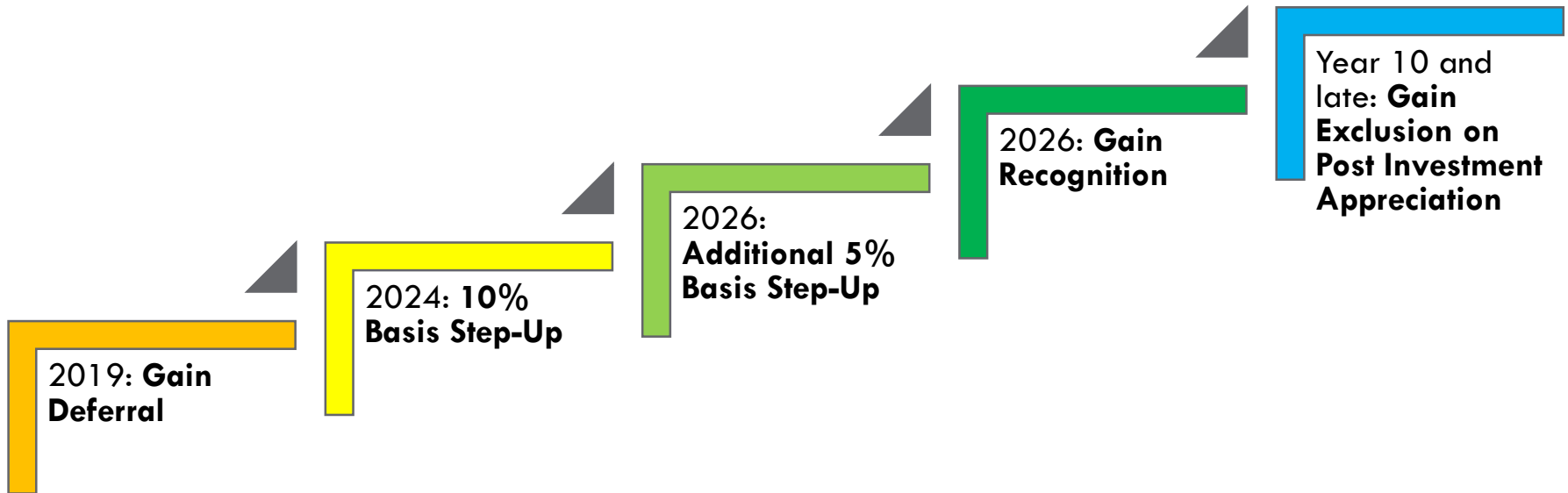
AGENDA

- Quick recap of the operative provisions
- Focus on the “opportunity” even though there are some unknowns
- What do we know currently and what is happening right now
- Anticipated guidance

OPPORTUNITY ZONE MAP SPOKANE COUNTY



TAX BENEFITS



THE OPPORTUNITY

- **Flexibility**
 - No set structure- compare to other government incentivized investment programs like the NMTC
 - Can be a state law LLC or LP or any other entity classified as a partnership or corporation for tax purposes (just need to self-certify)
 - Taxpayers are free to use existing models that developers and investors are already familiar with
 - No minimum or maximum amount of investment, and taxpayers are free to roll over all or a portion of their gain
 - No like-kind requirement (compare to section 1031 exchanges)
 - Ability to use mixed investments (non-qualified gains, leverage, etc.), but note only the qualified gain investment is eligible for the OZ tax benefits

WHAT IS WORKING RIGHT NOW

- Real estate in all forms
 - Hotel development
 - Affordable housing
 - Many others
- Large funds sponsored by national banks
- Regional and local funds
- Not all OZ's are necessarily created equal

INVESTMENT

- Types of investment
 - QOF directly holds real estate or other business property
 - 90% requirement
 - Can either acquire land and build new, or
 - Acquire existing property and make “substantial improvements”, meaning \$1 of improvement for every dollar of purchase price allocated to the building (not including land)
 - QOF invests into a business entity
 - 70% requirement- favors the two tiered structure (discussed on following slides)
 - Current 50% gross receipts requirement

KEY TERMS

- QOZ property= QOZ stock, QOZ partnership interest, or QOZ business property
- QOZ stock and QOZ partnership interest = acquired post 2017
 - During substantially all of the QOF's holding period, the corporation/partnership qualifies as a QOZ business
- QOZ business property= tangible property used in trade or business purchased from unrelated party (20 percent threshold)
 - Need original use or substantial improvement
 - During substantially all of the QOF's holding period, substantially all of the use of the property in QOZ

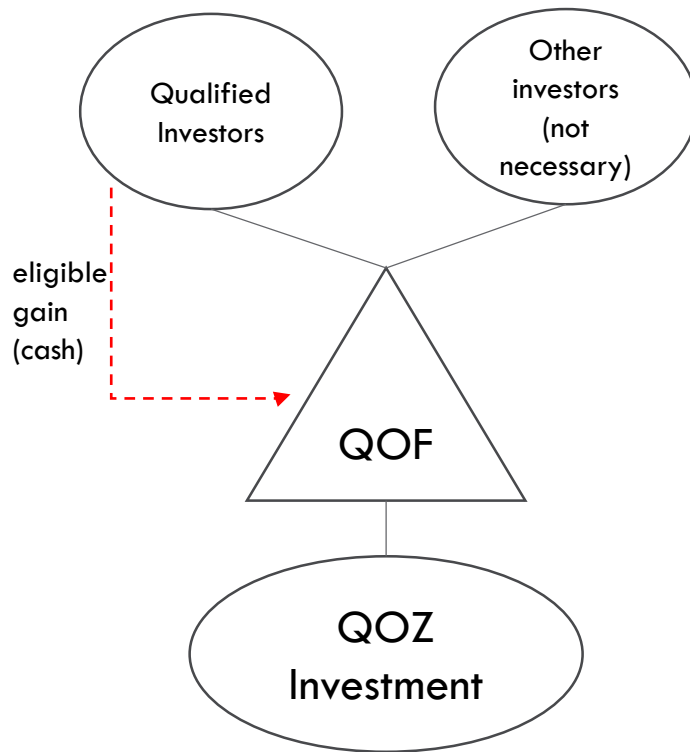
KEY TERMS

- QOZB
 - Substantially all (70 percent) of tangible property owned or leased by the business is QOZB property
 - 50 percent or more gross income from active conduct of business in OZ
 - Substantial portion of intangible property used in trade or business
 - Can't hold 5% or more of assets as certain financial assets
 - Not a “sin business”= golf course, country club, massage, suntan, hot tub, racetrack/gambling, store with principal purpose of selling alcohol

KEY TERMS

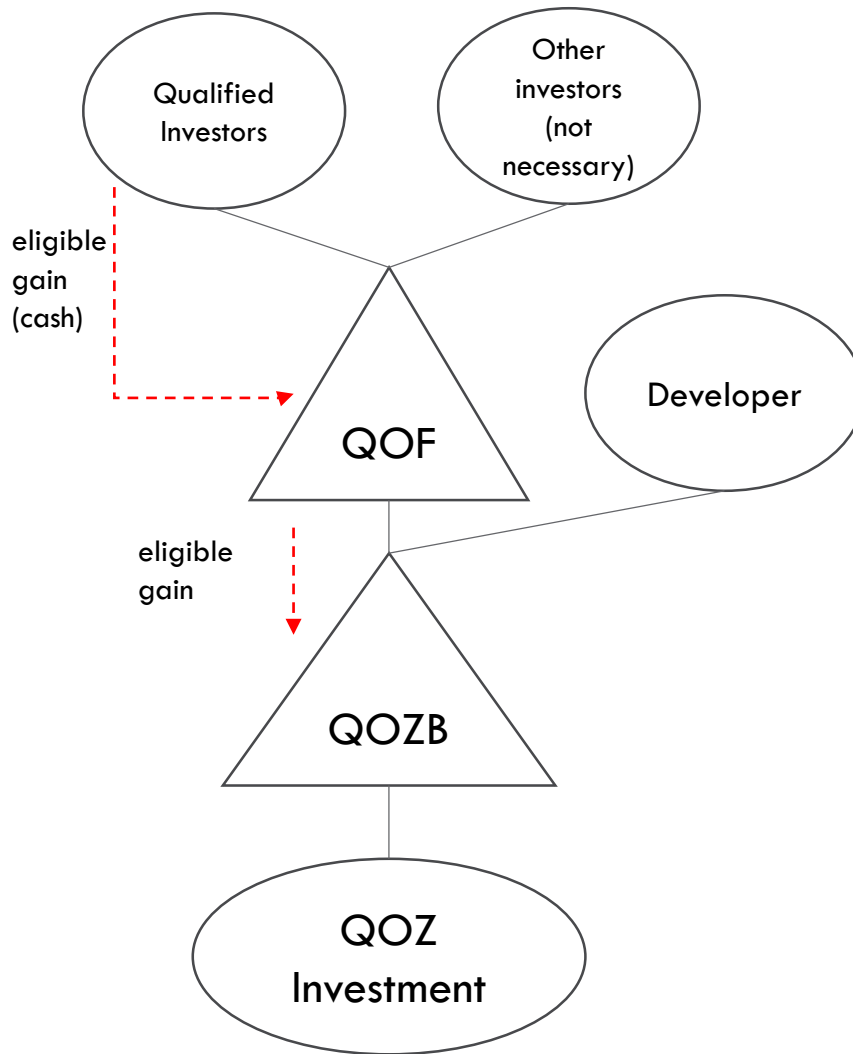
- Working capital safe harbor allows QOZB to treat working capital as “reasonable” for a period of up to 31 months if there is a:
 - Written plan to use capital
 - Written schedule consistent with ordinary start up of a business
 - Working capital used in a manner consistent with schedule

BASIC STRUCTURES- DIRECT INVESTMENT



- 90 percent of assets must be QOZB property
- May be hard to deploy cash within 6 months
- Led to focus on two tier structure (next slide)

BASIC STRUCTURES- INDIRECT INVESTMENT



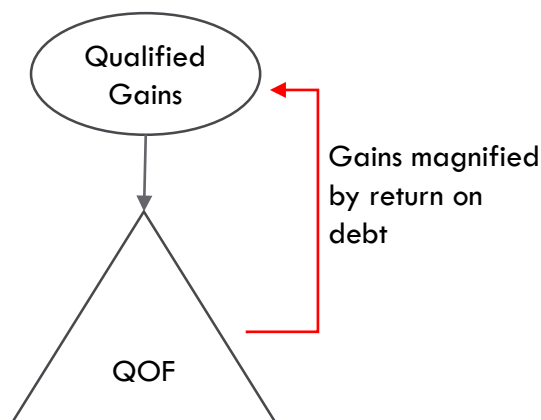
- 70 percent of tangible property owned/leased by business is QOZB property
- 50% of gross income from trade or business within OZ
- Can use working capital safe harbor
- More flexible than direct investment structure (prior slide)

KEY DATES AND TIMELINES

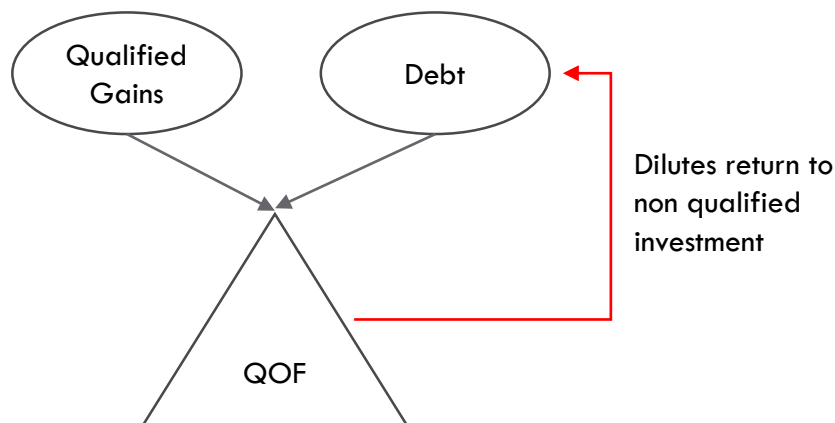
- If sell capital asset directly, taxpayer has 180 days to reinvest the gain
- If a partnership sells the assets
 - Partnership has 180 days to roll gain over
 - If the partnership does not do so, the partner can elect to reinvest the gains within 180 days of the close of the partnership's tax year (end of June for calendar year partnerships) or within 180 days of the partnership's sale (assuming the partner has the requisite information)

THE USE OF DEBT

- Debt does not create a separate investment for OZ purposes, per the proposed regulations
- Appears to favor using leverage inside a QOF rather than using leverage to purchase a fund interest



- QOF uses gains and debt to make qualified investments
- Assuming all requirements met, no dilution of return



- QOF uses gains and debt to make qualified investments
- Assuming all requirements met, results in dilution

DEPRECIATION RECAPTURE?

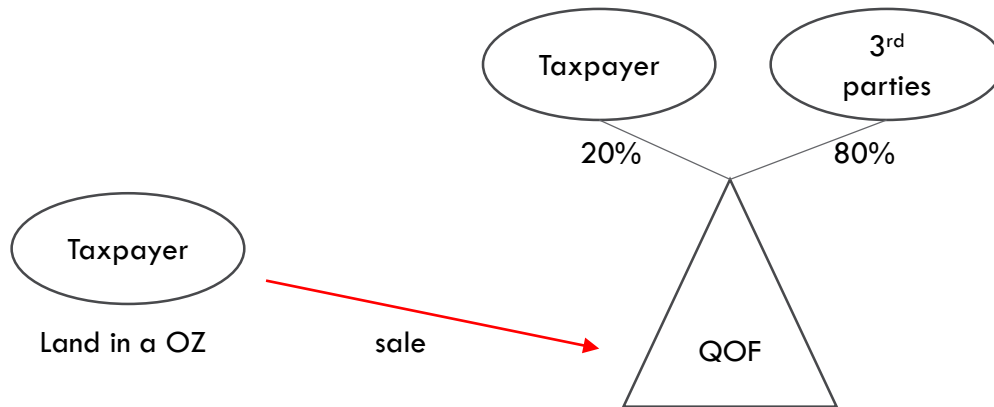
- General tax principles allow for debt financed deductions but also may result in recapture at back end
- For example, partnership uses \$20 of equity and \$80 of debt to purchase \$100 of property with a 10 year depreciable life
 - Produces \$10/depreciation per year
 - Partners can include properly allocated debt into basis to absorb depreciation
 - At end of 10 years, could be depreciation recapture
- But what about QOF interest “stepped-up” to FMV at 10 year mark- is there a gain exclusion + no depreciation recapture

OWNING PROPERTY/BUSINESS IN A OZ

- Owning property and/or a business in a OZ may not provide any immediate tax benefits
- Just selling property and/or a business located in a OZ does not necessarily produce any tax benefits unless the owner decides to invest the qualifying capital gain into a QOF
- But the property and/or business may be an attractive investment for a QOF

OWNING PROPERTY/BUSINESS IN A OZ

- Selling property to own fund and reinvest gain? Only if willing to give up control



LIQUIDITY AND EXIT CONSIDERATIONS

- What is the source of cash for the tax payment due in 2026
- The statute and proposed regulations, as currently drafted, appear to only allow the gain exclusion on the sale of an interest in a QOF, not on an asset sale
 - What will the market be for a QOF interest in 10 years
- Possible legislative corrections and/or further IRS guidance
 - Allowing a step up to the basis of QOF assets
 - Perhaps allow for redemptions from a QOF- is a redemption the same as a sale

COMPLIANCE POINTS

- Individual
 - Form 8949- gain deferral election
- QOF self certifies with Form 8996
 - Testing dates on last day of the first 6 month period of the tax year and on the last day of the tax year

STATE AND LOCAL GOVERNMENTS

Unclear what state and local governments may do to enhance the program, particularly in states with no income tax

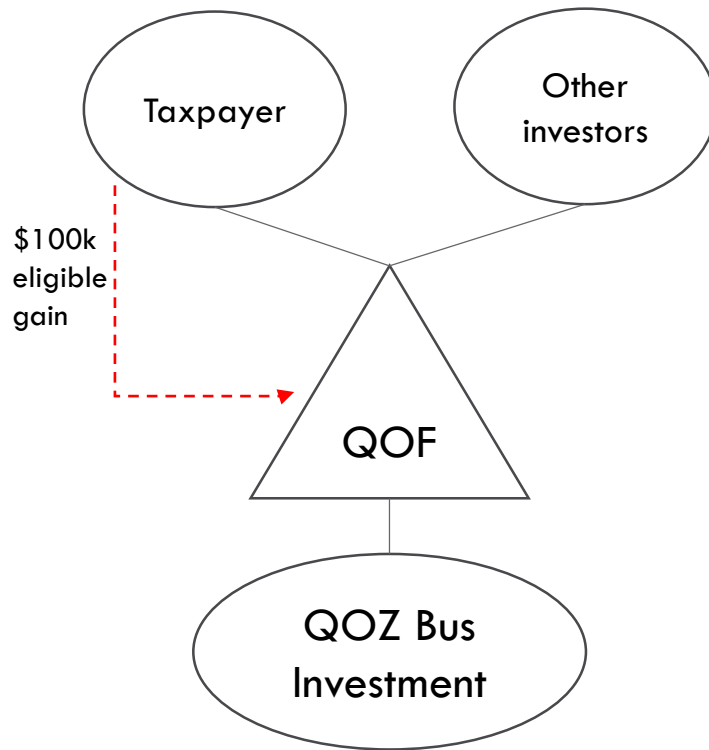
Possible Approaches

- **Tax incentives**
 - Property tax abatements
 - Sales and use tax exemptions or refunds
- **Non-tax incentives**
 - Grants – cash / property
 - Discounts – utilities and other costs
 - Other assistance

OPPORTUNITY ZONE EXAMPLE

- Taxpayer sells publicly traded stock for \$200k in 2018 that was purchased for \$100k, triggering **\$100k of gain**
- Under new code section 1400Z-2, taxpayer elects to invest the **\$100k of gain** into a QOF (an LLC treated as a partnership for federal tax purposes) within 180 days of the sale of the stock

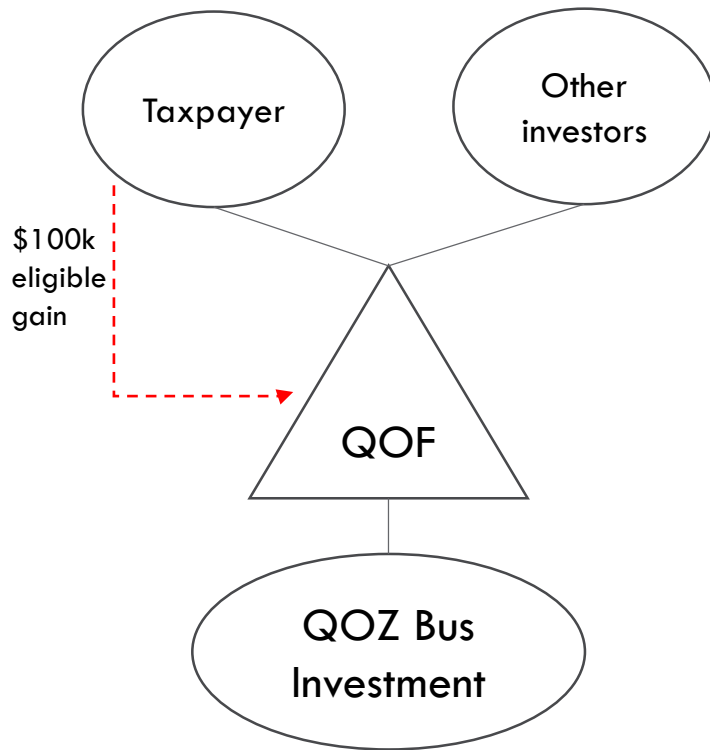
OPPORTUNITY ZONE EXAMPLE 2018



- Taxpayer defers the \$100k of gain in year 1 (meaning no tax recognized) by filing requisite **IRS Form 8949**
- QOF self-certifies with the IRS that it is initially qualified (**Form 8996**)
- QOF also files annual report certifying it meets all requirements
- Taxpayer takes a \$0 tax basis in its QOF interest

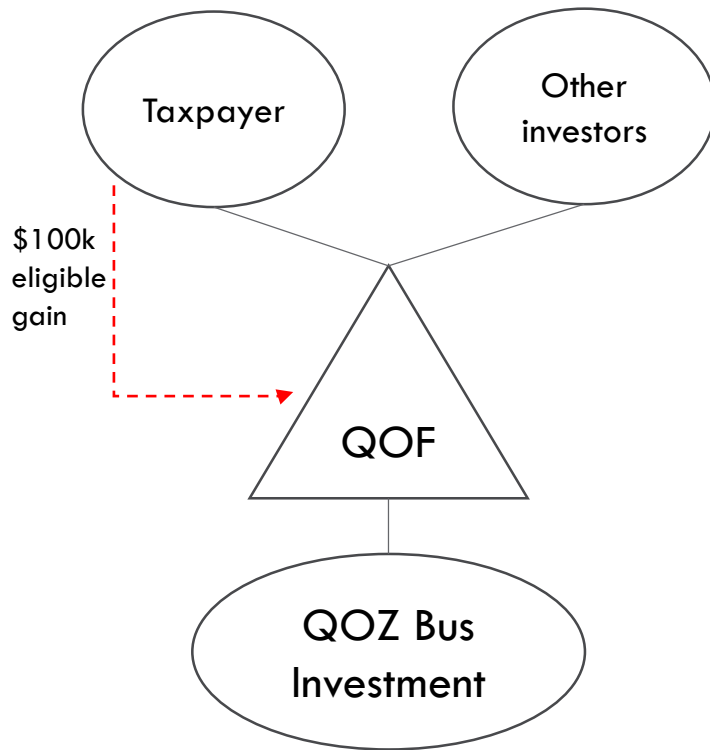
Important note: This is a simplified example for illustrative purposes and this example assumes all statutory and regulatory requirements are met

OPPORTUNITY ZONE EXAMPLE 2026



- Assume QOF interest now worth \$150k (\$50k appreciation)
- Taxpayer receives basis step-up of \$15k (\$10k at year 5 and additional \$5k at year 7)
- Taxpayer's 2026 basis= \$15k
- Deferred gain recognized in 2026= \$85k of original \$100k

OPPORTUNITY ZONE EXAMPLE 2028



- 2028- Assume QOF interest now worth \$200k and taxpayer sells interest
- Taxpayer's basis= \$100k (\$15k basis step-up plus \$85k of gain recognized in 2026)
- The \$100k of gain (\$200k proceeds minus \$100k of basis) permanently excluded from income

UNANSWERED QUESTIONS

- Does a building straddling an OZ qualify
- The meaning of “substantially all”
- What happens if a QOF liquidates before the 5, 7, or 10 year mark, or sells a portion of its assets
- Can a QOF make debt financed distributions
- Can investors roll gain from one QOF into another QOF and tack the holding period
- Treatment of leased property used in a OZ

QUESTIONS

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