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The ABCs of OZ

How Opportunity Zones Can Help Spokane Prosper

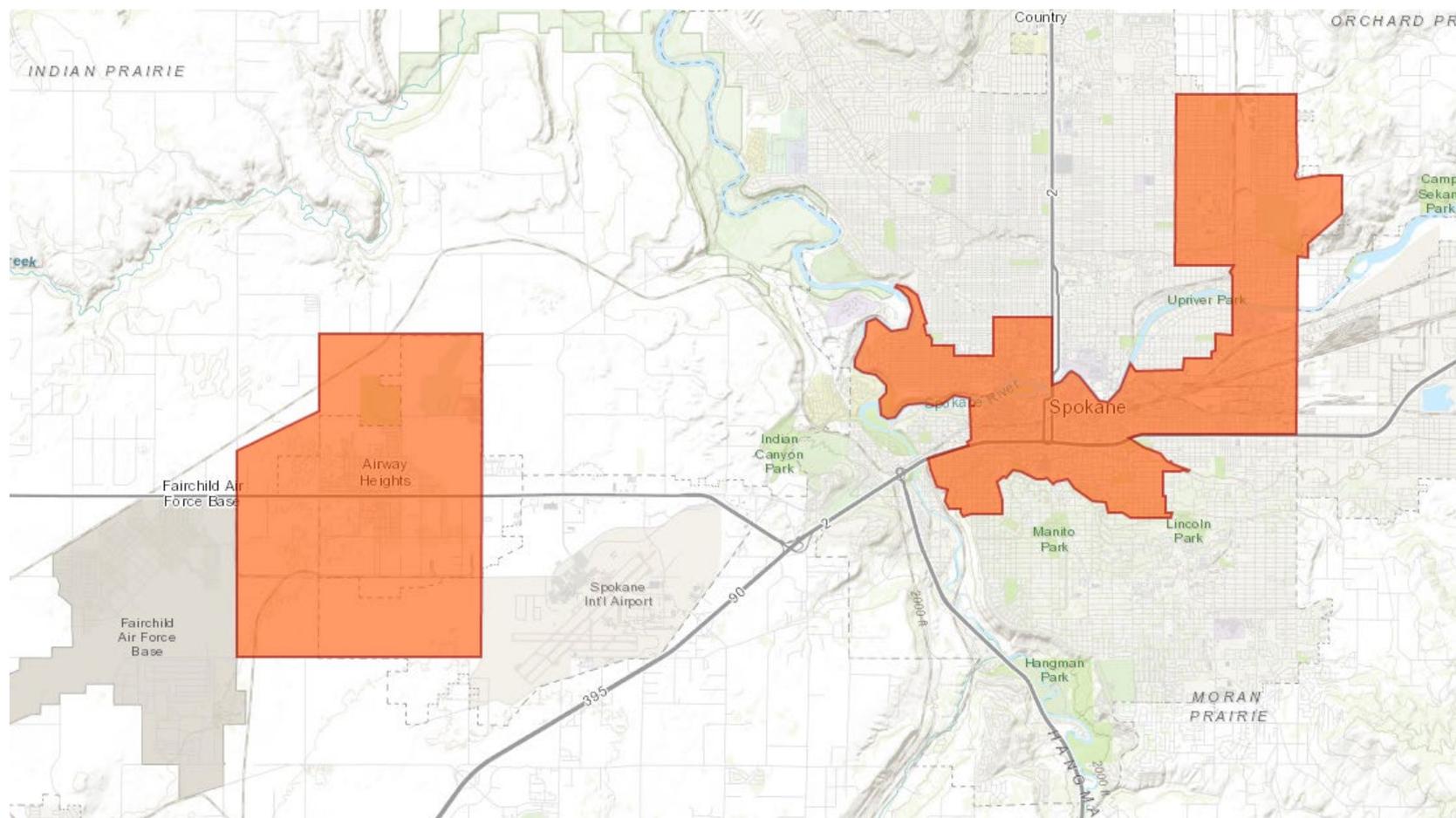
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THE ABCs OF OPPORTUNITY ZONES

- How can OZ help Spokane prosper?
- Policy
- Players
- Mechanics
- Definitions
- Other terms and conditions
- Qualifying businesses
- Tax analysis
- Pending questions
- What should you be doing *now*?

HOW CAN OZ HELP SPOKANE PROSPER?

- Treasury designated 11 tracts in Spokane as Opportunity Zones, pictured below.



HOW CAN OZ HELP SPOKANE PROSPER?

- Zone locations include:
 - Downtown; Kendall Yard; North Bank; Lower South Hill & Medical District; University District; Sprague Union District; The Yard & Market St. Area; Between Fairchild Air Force Base and International Airport
- Opportunity Zones have the potential to:
 - Attract developers by decreasing cost of capital
 - Attract investors with tax benefits, potential ROI
 - Stimulate economy throughout the region
 - Create well-paying jobs

THE POLICY

- The Opportunity Zones program was enacted as part of the tax reform bill in December 2017
- Goal is to stimulate economic development, activity and growth, and to create jobs, in low income communities
- A descendent of Empowerment/Enterprise Zones, and New Markets Tax Credit



THE PLAYERS

- Investors with capital gains
- Urban and rural economic development authorities, developers, entrepreneurs, innovators, businesses and others
- Fund developers and managers
- “People *with* money, people who *need* money, and people who can *manage* money”

THE MECHANICS



THE DEFINITIONS

- Opportunity Zone:
 - Low-income census tract nominated by state governor and designated by the Treasury Secretary as an OZ. Designations expire in 2028.
- Opportunity Fund:
 - Any investment vehicle organized as a corporation or partnership for the purpose of investing in Opportunity Zone property
 - Funds can be a mix of capital gains, non-capital gains and borrowed funds (but only capital gains share qualifies for special tax treatment)

THE DEFINITIONS

- Opportunity Zone Property:
 1. OZ stock in an OZ business
 2. OZ partnership interest (capital or profits) in an OZ business
 3. OZ business property
 - Tangible property used in a trade or business
 - Acquired by purchase (capital lease) after 12/31/2017
 - Original use in the OZ begins with the Opportunity Fund
 - Substantially improved property (1:1)
 - Substantially all the use is in an OZ

THE DEFINITIONS

- Opportunity Zone Business:
 - Substantially all the tangible property owned or leased is OZ business property
 - At least 50% of gross income derived from active trade/business
 - Substantial amount of any intangible property is used in the active trade or business
 - Limits on financial property (deter passive investment)
 - No “sin” businesses

OTHER TERMS AND CONDITIONS

- Can invest until 2026 (but may not qualify for all the benefits by waiting)
- Opportunity Funds must self-certify to Treasury that they meet requirements
- Failure to meet 90% investment test results in penalties
- Basis in Opportunity Fund investment increased by gain recognized on deferred capital gains (deferral less increase in basis)
- May be able to “twin” with New Markets Tax Credit and other federal, state, and local incentives

QUALIFYING BUSINESSES

- Active, not passive
- Real estate
 - Residential
 - Commercial
- Manufacturing
- Distribution/warehouse
- Research
- Energy
- Start-ups & incubators



TAX ANALYSIS

- How the 5, 7 and 10 year tax benefits work

No Investment in OZ Fund

- \$500,000 capital gains
 - * 23.8% (20% capital gains + 3.8% NIIT)
-
- \$119,000 tax owed 2018

5 year Investment in OZ Fund

- \$500,000 capital gains tax deferred
 - * 90% (10% increase in basis)
 - * 23.8%
- \$107,100 tax owed year 5

Basis in OF is \$450,000 (\$500K*90%)

7 year Investment in OZ Fund

- \$500,000 capital gains tax deferred
 - * 85% (15% increase in basis)
 - * 23.8%
- \$101,150 tax owed year 7

Basis in OF is \$425,000 (\$500K*85%)

10 year Investment in OZ Fund

Basis deemed equal to fair market value of investment at time of sale or exchange; disposition is federal income tax free.

PENDING QUESTIONS ABOUT OZ

- Statute drafted quickly, questions remain
- IRS regulations expected soon
- What constitutes “original use”
- Mechanics of “substantial improvement”
- Transition periods
- How is 90% test calculated
- Treatment of leased property
- Requirements to certify an OF

WHAT SHOULD YOU BE DOING TO PREPARE?

- Don't wait until IRS Q&A to begin
- Understand the mechanics, the math and the potential of the program
- Identify/educate projects and investors
- Consider terms of the deal, including fund structure, complementary incentives and financing
- Organize funds and get other paperwork/legal in order – build in resiliency for regulation results
- Be staged to go when regulations released

QUESTIONS?

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