



HUSCH BLACKWELL



Opportunity Zones

Overview and Guidance

December 14, 2018



Agenda

- Opportunity Zone Overview
- Benefits of the Opportunity Zone Incentive
- Qualified Opportunity Zones
- Qualified Opportunity Funds
- Qualified Opportunity Zone Property
- Combining with Other Incentives
- Next Steps



Opportunity Zone Overview

“Opportunity Funds are private sector investment vehicles that invest at least 90 percent of their capital in Opportunity Zones. U.S. investors currently hold trillions of dollars in unrealized capital gains in stocks and mutual funds alone—a significant untapped resource for economic development. Opportunity Funds provide investors the chance to put that money to work rebuilding the nation’s left-behind communities. The fund model will enable a broad array of investors to pool their resources in Opportunity Zones, increasing the scale of investments going to underserved areas.” <https://eig.org/opportunityzones/about>



Benefits of the Opportunity Zone Incentive

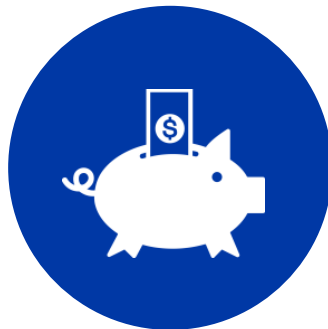


Taxpayers can get
capital gains
tax deferral
(& more)



*for making
timely
investments in*

Qualified
Opportunity Funds
(QOFs)



*which
invest in*

Qualified
Opportunity Zone
Property





3 Tax Incentive Benefits

1. ■ Gain
Deferral

2. ■ Partial
forgiveness

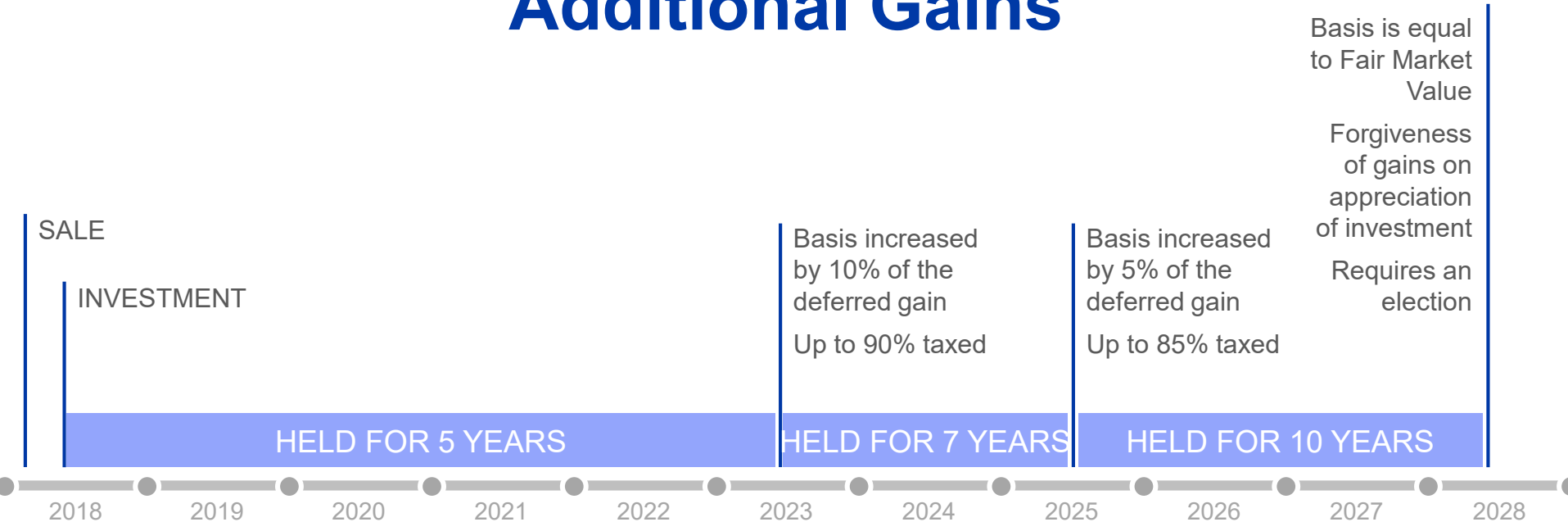
3. ■ Forgiveness of
additional gains

Period of Deferral & Amount Recognized

- Deferral period ends upon the earlier of:
 - Sale of QOF interest or
 - December 31, 2026
- Amount of capital gain tax recognized:
 - Lesser of:
 - Amount of gain deferred or
 - The fair market value of the investment in the QOF interest
 - Minus
 - Taxpayer's basis in the QOF interest (basis in QOF interest initial is deemed to be zero)



Partial Forgiveness and Forgiveness of Additional Gains





Sample Investment

Jan. 2, 2018

Taxpayer enters into a sale
that generates \$1M of capital
gain

June 30, 2018

(Within 180 days), Taxpayer
contributes entire \$1M of capital
gain to a Qualified Opportunity
Fund

- Taxpayer is deemed to have a \$0 basis in its QOF investment
- QOF Invests the \$1MM in Qualified Opportunity Zone Property

2018

2019

2020

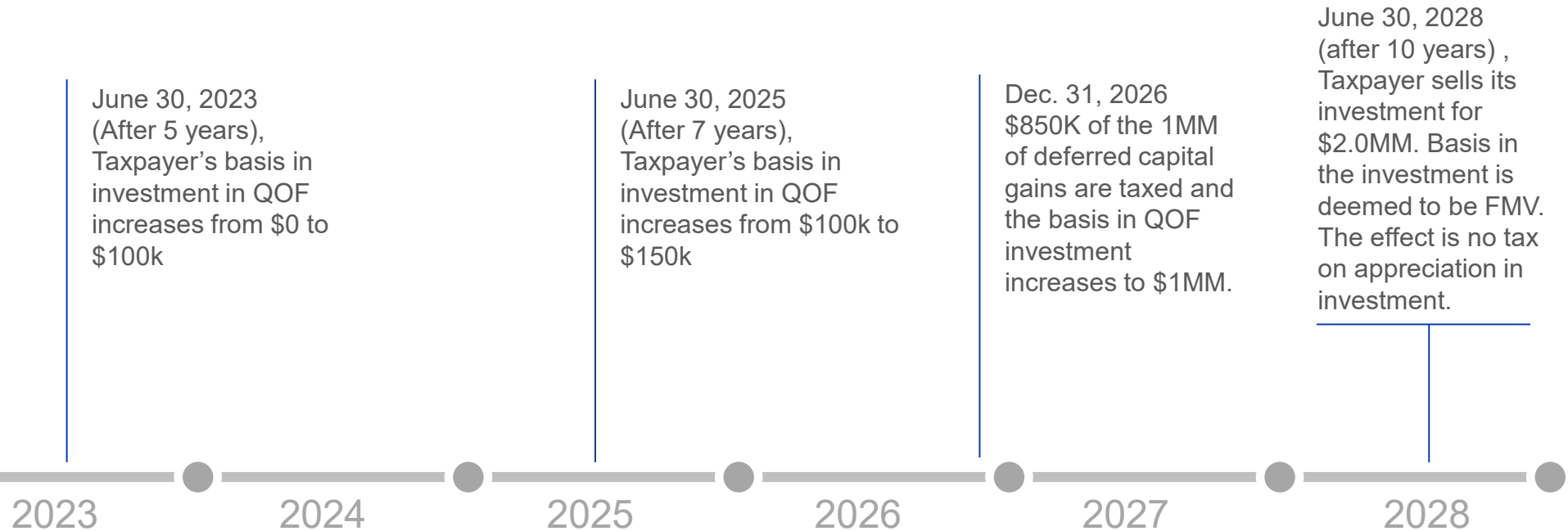
2021

2022

2023



Sample Investment



Mixed Investments

Day 1

Disposition of Asset results in \$2,000,000 of proceeds – return of capital of \$1,000,000 and capital gain of \$1,000,000

All proceeds are invested in QOZF.

\$1,000,000
Capital Return

\$1,000,000
Capital Gain

Day 3,653 (10 years, 1 day)

Disposition of OZ Fund interest results in proceeds of \$4,000,000 – return of original \$1,000,000 investment; \$1,000,000 of “original” capital gains, and \$2,000,000 of new capital gain. All proceeds are held by investor.

\$1,000,000 Capital Return
No Tax

\$1,000,000 new gain on original capital
Taxed at Capital Gains Rate

\$1,000,000 “original” capital gain.
Tax due in 2027, so no tax on
disposition of OZ Fund interest

\$1,000,000 new gain on OZ Fund
investment.
Basis = FMV, so not taxed

Total Tax¹ = \$212,500 on invested capital gain
\$250,000 on non-Opportunity Zone new gain
\$462,500

Instead of \$750,000 without Opportunity Zone treatment

¹ Assuming no changes in rates.

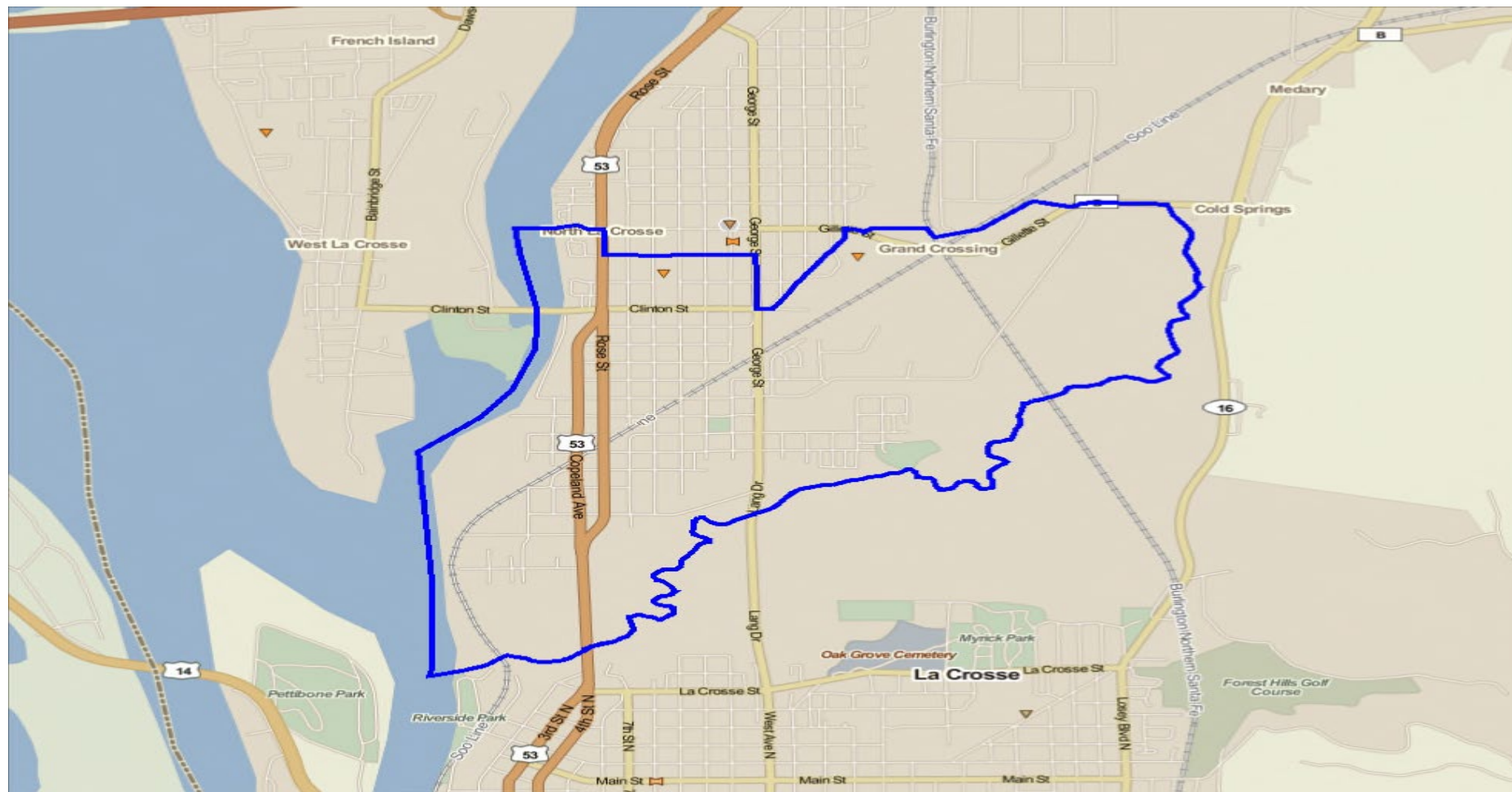


Qualified Opportunity Zones

Opportunity Zones in La Crosse

- Census Tract 2 and Census Tract 4 are the approved Opportunity Zones in La Crosse, Wisconsin. The following table gives a glimpse as to how these census tracts compare to the regional average.

	Census Tract 2	Census Tract 4	Regional Average
Poverty Rate	36%	65%	14%
Household Income	\$30,814	\$19,748	\$52,004
Homeownership	30%	7%	67%
Unemployment Rate	10%	8%	5%
Adults that have a high school diploma	84%	93%	94%
Adults that have a bachelor's degree or higher	16%	43%	31%







Qualified Opportunity Funds

Qualified Opportunity Fund

- Statutory definition:
 - An **investment vehicle** organized as a **corporation** or a **partnership** for the purpose of investing in **Qualified Opportunity Zone Property (QOZP)**.
- Opportunity Funds self certify
- Noncompliance Penalty
 - 90% asset test
 - Per month penalty equal to % of shortfall x underpayment rate
 - No penalty for reasonable cause



Qualified Opportunity Zone Property





Qualified Opportunity Zone Stock and Partnership Interests

- The investment must be **acquired after December 31, 2017** in exchange for cash;
- Must be a **qualified opportunity zone business**, or is being organized for the purpose of being a qualified opportunity zone business;
- Must remain a qualified opportunity zone business for **substantially all** of the qualified opportunity fund's holding period



Qualified Opportunity Zone Businesses (QOZB)

A trade or business in which **substantially all** of the tangible property owned or leased by the taxpayer is **qualified opportunity zone business property** (QOZBP) and:

- At least 50% of income derived from Active Conduct
- Substantial portion of intangible property used in active conduct of business
- < 5 percent unadjusted basis of property is nonqualified financial property

No “sin businesses” permitted

- A private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises



Qualified Opportunity Zone Business Property (QOZBP)

- ✓ Tangible property used in a trade or business
- ✓ Acquired by purchase from an unrelated party (20% standard) after December 31, 2017
- ✓ During substantially all of holding period, substantially all the use is in a QOZ
- ✓ Original use in the QOZ commences with the taxpayer

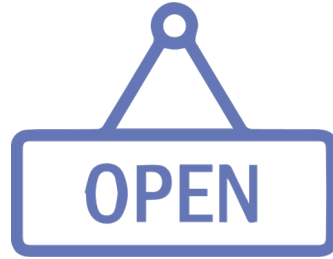
OR

- ✓ Taxpayer substantially improves the property
 - ✓ during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period

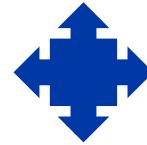
Readily Identifiable Investment Types in Opportunity Zones



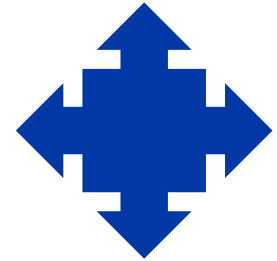
Commercial Real Estate Development and Renovation in Opportunity Zones



Opening New Businesses in Opportunity Zones



Expansion of Existing Businesses into Opportunity Zones



Large Expansions of Businesses already within Opportunity Zones



1031 Comparison

- **No “like kind” requirement**
- **No qualified intermediary necessary**
- **180 days to reinvest**
- **No initial property identification necessary**
- **Benefits to tax payer in addition to deferral**
- **No continuous deferral - taxes on original gain must be paid in April 2027**
- **Potential cash flow issues when taxes are due**

Basic Process Review - Opportunity Zones

- Taxpayers get capital gains tax deferral & forgiveness of certain capital gains for making timely investments in Qualified Opportunity Funds (QOFs) which subsequently invest in Qualified Opportunity Zone Property (QOZP)
- **Basic Process**
 - A fund is formed as a partnership, corporation or limited liability company and certified to the IRS on the date of its first tax return
 - An investor uses capital gains realized to invest in the fund within 180 days
 - The fund acquires partnership interests, stock or tangible business property in businesses located in opportunity zones
 - The Investor must retain its original investment in the fund at all times to continue to benefit from the gain deferral and other tax benefits
 - Recognition of Original Capital Gains on the earlier of December 31, 2026 or the disposition of the investment
 - 10% of the deferred gain is permanently forgiven if held for 5 years prior to 12/31/2026
 - Additional 5% of the deferred gain is permanently forgiven if held for 7 years prior to 12/31/2026
 - If the Investor holds the investment for at least 10 years – they are entitled to FMV basis step-up, whereby all appreciation to value is excluded

- **Investing to Improve Our Communities**
 - These investments, which are similar to standard real estate investment transactions, are designed to have a positive impact in our communities. Improving not only the economics of the area, but also having a positive impact on the lives of the people who live and work in the area
- **Temporary Deferral of Capital Gains**
 - Investors can defer tax on existing capital gains until the earlier of December 31, 2026 or the date on which the investment is sold or exchanged, if the amount of the capital gain is invested into a QOF within 180 days
- **Potential for Reduced Tax Liability on Deferred Capital Gains**
 - A portion of Original Deferred Capital Gains may be forgiven based on the length of the investment. Taxes may be due on 100%, 90% or 85% of the Original Deferred Capital Gain.
 - > Held 5 years: 10% of the Original Deferred Gain is permanently forgiven
 - > Held 7 years: An additional 5% of the Original Deferred Gain is permanently forgiven
- **Permanent Exclusion of Additional Capital Gain Recognition of Appreciated Investment**
 - If the QOF investment is held for 10 years and is eventually sold with an appreciated investment price, and assuming a FMV Basis Election is made, then there is no additional capital gain tax recognized on the investment

Types of OZ Funds

- **Proprietary Funds** – Single Investor with one or more investments into QOZ Properties
 - Pros
 - > Timing and coordination of gains
 - > Investment Strategy
 - Cons
 - > May have limited investment equity
- **Single Asset Funds** – Single QOZ Property with one or more Investors
 - Pros
 - > Underwriting
 - > “Club Fund”
 - Cons
 - > Timing and coordination of gains
 - > Variable investment strategies
- **Multi-Investor Funds** – Multiple investors & multiple QOZ Properties
 - Pros
 - > Diversification
 - Cons
 - > Securities rules
 - > Investment tracing
 - > Timing and coordination of gains



Market Trends: Deals Being Sought

- **Substantial Improvement Requirement**
 - QOZ Property is treated as substantially improved by the QOF if during any 30-month period beginning after the date of acquisition of the property, additions to basis exceed an amount equal to the adjusted basis at the beginning of the 30-month period.
- **Preferred Equity Investments**
 - Affordable Housing Development
 - Market-Rate Housing Development
 - Community Facilities
 - Commercial Real Estate Development
- **Federal Investment Credits**
 - Federal Historic Tax Credits
 - Solar and Energy Tax Credits
- **State Investment Credits**
 - State Historic Credits
- **Other Potential Investments**
 - Low Income Housing Tax Credit
 - New Market Tax Credit

Key Points

Investors

- Tax incentive is most valuable for 10-year investments in appreciating assets
- Six months to invest after realizing a capital gain
- Capital is required to be an equity investment – loans from investors are not eligible for the tax incentive

Funds

- All capital must flow through an Opportunity Fund to be eligible for the tax incentive
- Funds are self-certified via an IRS tax form
- Fund must be established for the purpose of investing in Opportunity Zones
- 90% of fund assets must be invested in Zones to maximize the tax incentive

Eligible Investments

- Must be equity investments
- Real estate investments must include substantial rehabilitation - doubling basis within 30 months
- “Sin businesses” are not eligible
- Other requirements include property use in “active conduct of business” and limits on assets held in cash

Key Dates

180-Days	Time for the Investor to make its investment into a QOF
5 Years	Basis Allocation of 10% is allowed if prior to 12/31/26 and held for 5 years Essentially 10% of deferred gain is permanently forgiven (if before 12/31/2026)
7 Years	Additional Basis Allocation of 5% is allowed if prior to 12/31/26 and held for 7 years Essentially an additional 5% for a total of 15% of deferred gain is permanently forgiven (if before 12/31/2026)
10-year Holding Period	The post-acquisition gain on the QOF is excluded from income.
Deferred Tax is due with the 2026 tax return	This is the amount of capital gain that was originally deferred and invested in a QOF. The amount of capital gain tax due will be adjusted for the 5 Year and 7 Year holding periods, if applicable.
Last day to make an QOF Investment	June 29, 2027 Allows for capital gains recognized in 2026 to be invested in QOFs
End of the QOF Investment Period	December 31, 2047 The proposed regs allow 10 years after the last day to make a QOF investment period's 10-year hold to dispose of the QOF investment. Must dispose of the QOF investment prior to January 1, 2048.

Additional Information

IRS – OZ Frequently Asked Questions

<https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions>

CDFI – List of QOZs

<https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx>

Code of Federal Regulations – 26 U.S. Code Subchapter Z – Opportunity Zones

<https://www.law.cornell.edu/uscode/text/26/subtitle-A/chapter-1/subchapter-Z>

Map of Opportunity Zones

<https://eig.org/news/opportunity-zones-map-comes-focus>



Takeaways for Real Estate Developers

- **New construction in an OZ works well**
- **Renovations of existing structures must meet substantial improvement test**
- **Potential that “original use” test could be applied to vacant structures**
- **If the QOZB is an operating company, the company may only need to locate in an OZ but not construct or substantially improve a structure**
- **OZ capital can be layered with other financing incentives**



Takeaways for Municipalities

- **Know your Opportunity Zones and the assets in them**
- **Add OZ notifications on any marketing materials for city-owned real estate in OZs**
- **Consider alignment with Tax Increment Districts**
- **Communicate with core developers and corporate stakeholders about OZ benefits**
- **Consider facilitating a local fund for local projects**
- **Consider creating a dedicated OZ webpage**



Takeaways for Small Business

- **Source of capital for expansion/relocation**
- **Restrictions on eligible businesses**
- **NQFP**
- **Tangible property**
- **Intangible property**
- **Sin businesses**
- **Active conduct**
- **Must remain in OZ for substantially all of the holding period**
- **How to attract OZ investment**
- **Issues with selling equity interests**



Takeaways for Lenders

- **Tax due in 2027 with no corresponding cash event = lending opportunity**
- **Guidance for bank customers**
- **Pair with OZ funds to provide complete package**

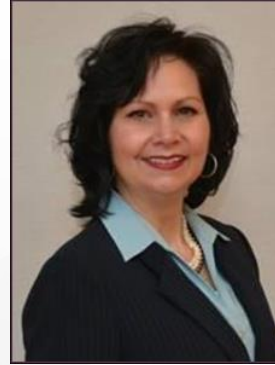
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