

Opportunity Zones Overview: Basics and Concepts

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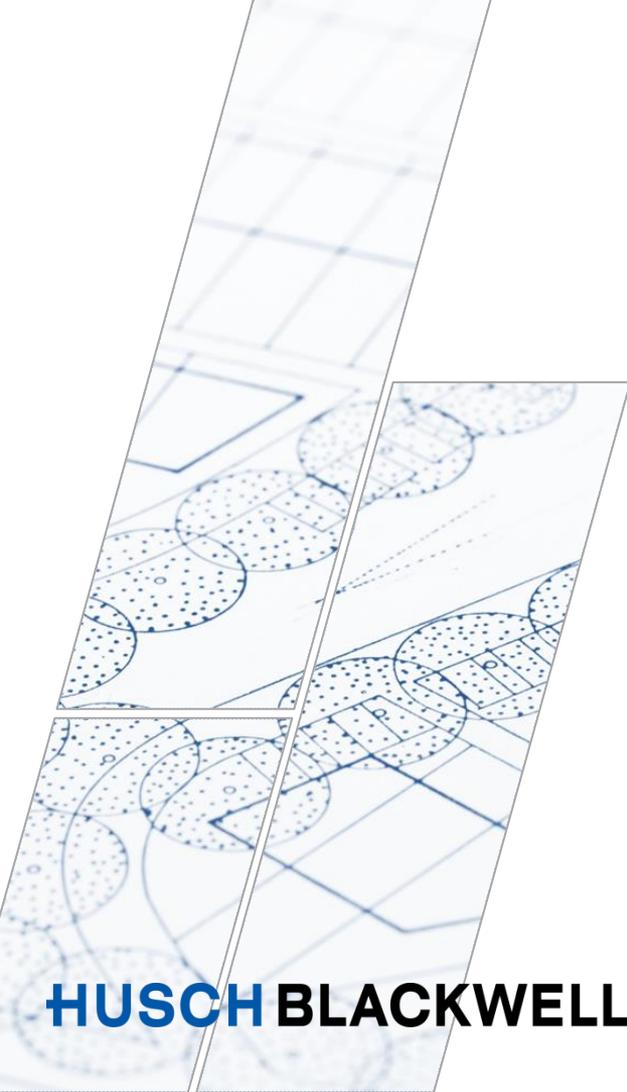
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The logo for Plante Moran, featuring the company name in a serif font with a stylized blue wave or underline beneath the word "moran".

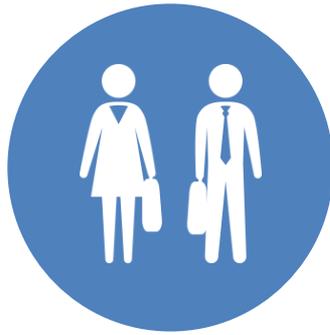


Benefits of the Opportunity Zone Incentive

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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

Opportunity Zone Benefits

- Time Value of Deferred Obligation – earlier of:
 - Date the investment is sold or exchanged; or
 - Outside date of December 31, 2026
- Gain Recognition
 - Amount of gain (or fair market value)
 - Less: the taxpayer's basis in the opportunity zone fund
- Partial Forgiveness of Gain – The Basis Step Up
 - 5 year hold = 10%
 - 7 year hold = 15%
- Forgiveness of Additional Gain/Investment Appreciation
 - 10 year hold
 - Basis step up

Sample Investment

Jan. 2, 2019

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

June 30, 2019

(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

2019

2020

2021

2022

2023

2024

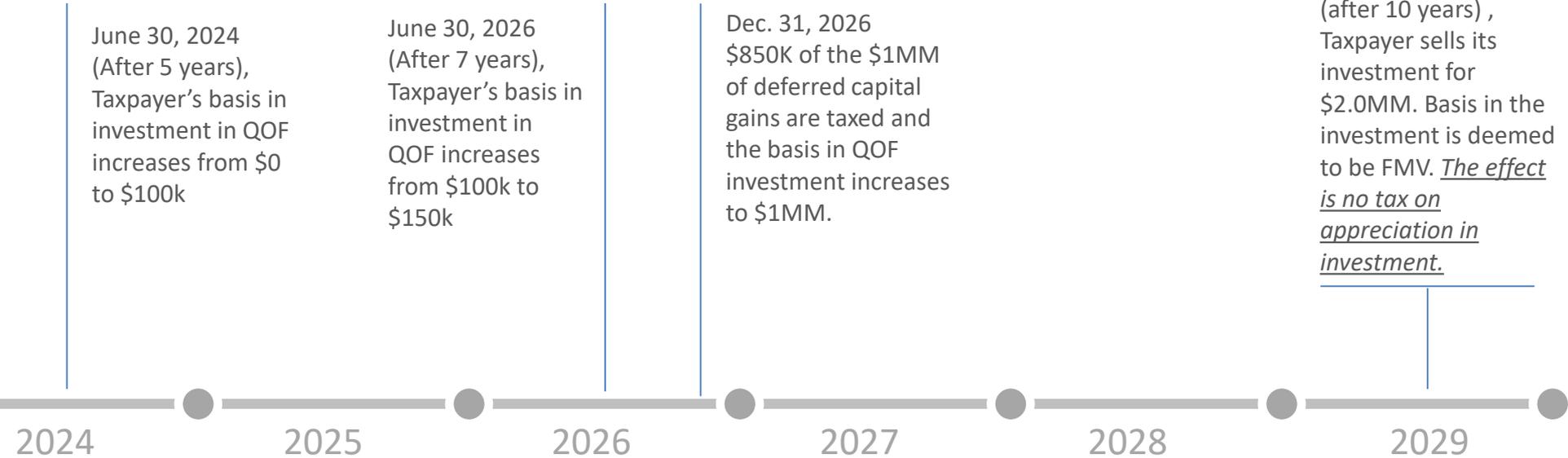
Sample Investment

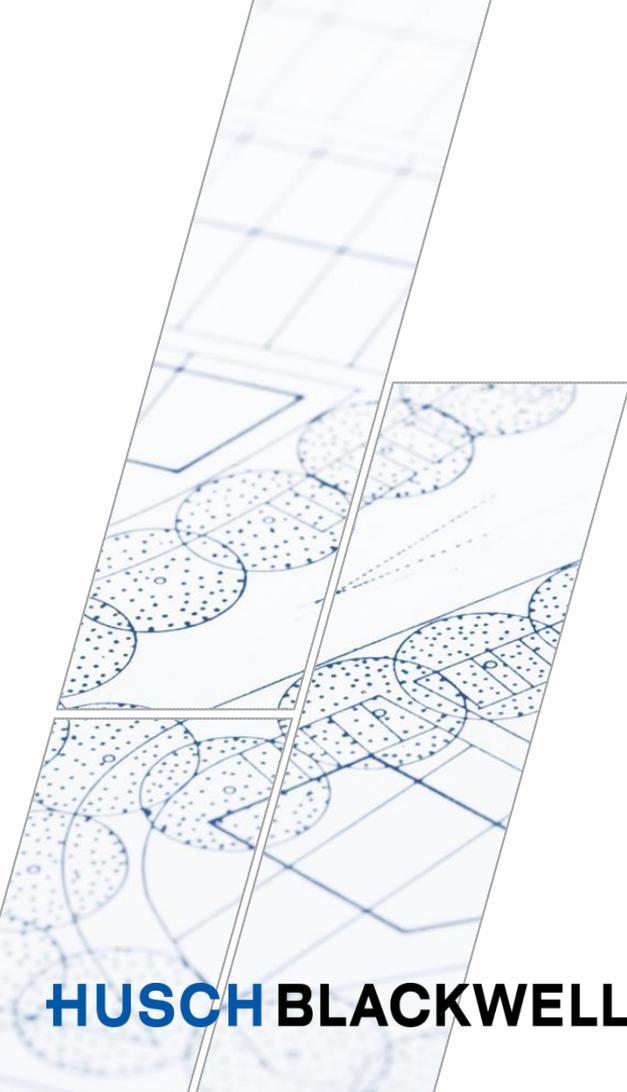
June 30, 2024
(After 5 years),
Taxpayer's basis in
investment in QOF
increases from \$0
to \$100k

June 30, 2026
(After 7 years),
Taxpayer's basis in
investment in
QOF increases
from \$100k to
\$150k

Dec. 31, 2026
\$850K of the \$1MM
of deferred capital
gains are taxed and
the basis in QOF
investment increases
to \$1MM.

June 30, 2029
(after 10 years) ,
Taxpayer sells its
investment for
\$2.0MM. Basis in the
investment is deemed
to be FMV. The effect
is no tax on
appreciation in
investment.





Qualified Opportunity Funds and Investments

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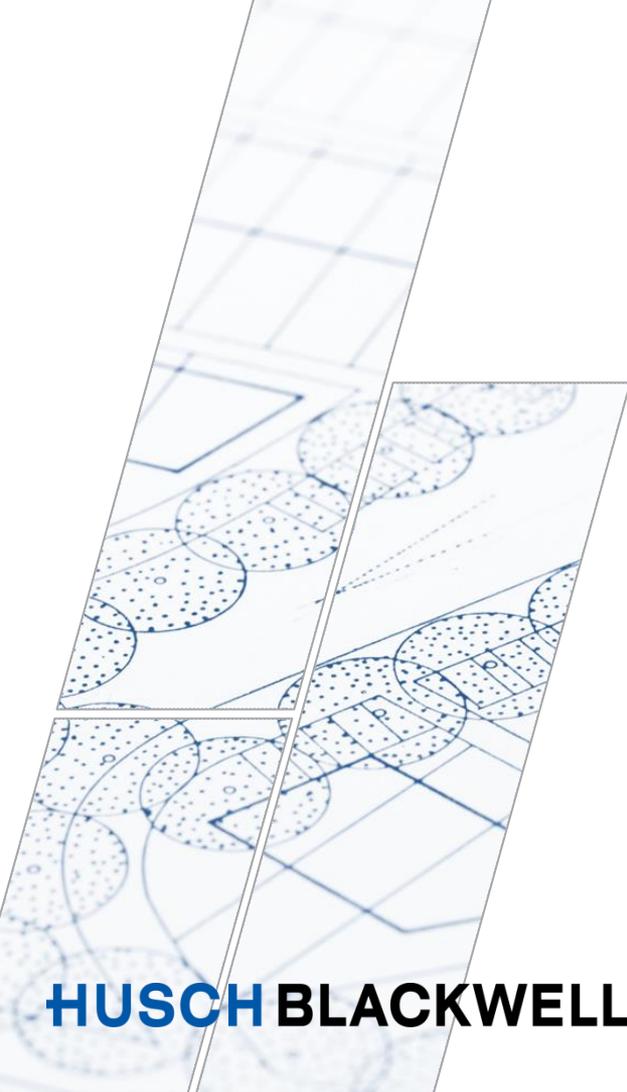

Qualified Opportunity Fund

- Statutory definition:
 - An **investment vehicle** organized (classified) as a **corporation** or a **partnership** for the purpose of investing in **Qualified Opportunity Zone Property (QOZP)**.
- Opportunity Funds **self certify** (IRS Form 8996)
- 90% Asset Test
- Noncompliance Penalty
 - Per month **penalty equal to shortfall x underpayment rate**
 - No penalty for reasonable cause



Restrictions to Consider

- “New” Property – must be acquired by purchase from an unrelated party (20% standard) after December 31, 2017
- Active Conduct – At least 50% of income derived from Active Conduct of a trade or business located in an OZ
- No more than 5% of the asset base of the opportunity zone business can be “nonqualified financial property”
- Prohibition on “Sin Businesses” (hot tub facilities, liquor stores, etc.)
- Original use or substantial improvement – either:
 - Original use of the property within an OZ commences with the opportunity zone business; or
 - The opportunity zone business substantially improves the property



2018 Treasury Guidance

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Proposed Regulations: Key Points

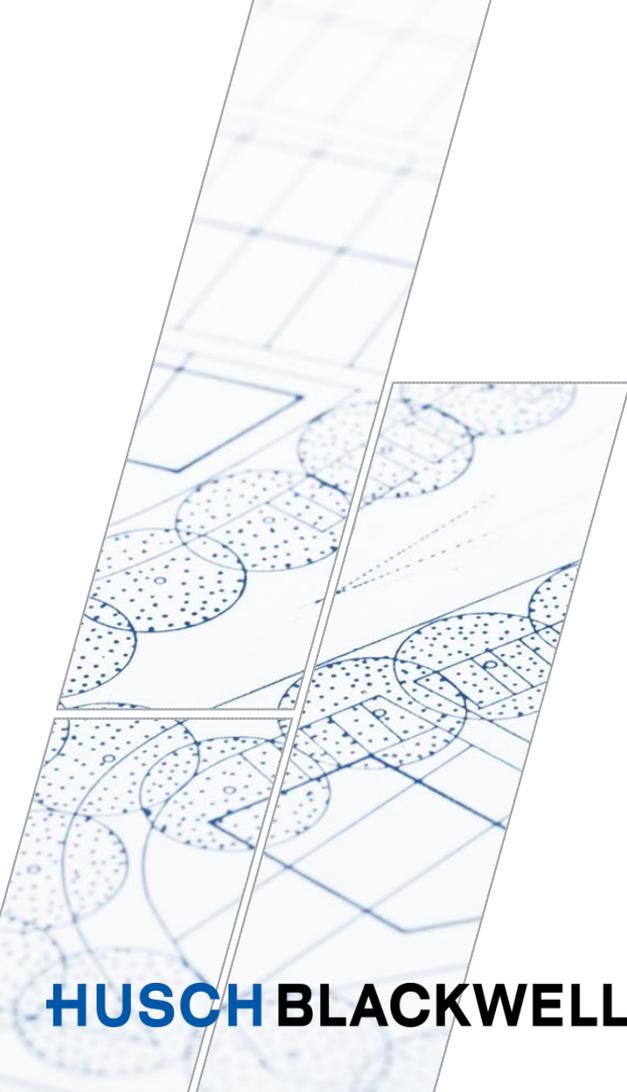
- The OZ incentive applies to *capital gains*
- A wide variety of taxpayers are eligible (including individuals, corporations, partnerships, common trust funds, RICs, REITs, etc.)
- Entities *classified* as corporations or partnerships (including LLCs, LPs and LLPs) can be Qualified Opportunity Funds
- Either a partnership or its partners can elect to designate capital as an OZ investment
- OZ investments can be financed with debt
- OZ investments can be held until 12/31/47

Proposed Regulations: Key Points (Continued)

- A Qualified Opportunity Fund can calculate compliance with the 90% test by using asset value reports on applicable financial statements, or cost (if no financial statements available)
- A qualified OZ business needs at least 70% of its qualifying tangible assets to be located in an OZ
- Qualified OZ businesses can avail themselves of a 31-month safe harbor by creating and executing on a plan for working capital
- For qualification of a real estate development as a “substantial improvement”, land is excluded from the basis calculation

Open Questions

- Treatment of any gains from qualifying assets that are reinvested in other qualifying assets (the “interim gains” issue)
- Timeframe for reinvestments by a Qualified Opportunity Fund of proceeds from the sale of qualifying assets (without triggering a noncompliance penalty)
- Conduct that leads to potential decertification of a Qualified Opportunity Fund
- How to define the active conduct of a business in an Opportunity Zone



Opportunity Zone Concepts and Issues

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Investment Strategies

- Real Estate
 - Opportunity Fund direct ownership of real estate can qualify
 - Remember requirement for purchase from unrelated party after 12/31/17
 - Must meet original use or substantial improvement test
- Private Equity
 - Stock or partnership interest must be acquired for cash after 12/31/17
 - Underlying company must be a qualified opportunity zone business (“substantially all” of qualifying tangible assets located in an OZ)
 - Underlying company must satisfy original use or substantial improvement test
 - Outright acquisition of existing company may prove challenging. Consider formation of subsidiaries or operating companies to hold qualifying assets

Fund Structuring Considerations

- Should all interests in the Fund (including a GP or managing member interest) be seeded with gain to ensure alignment of investment strategies/priorities?
- Will each investor have the right to withdraw at any time? Should the Fund prohibit withdrawals in order to prevent forced sales of qualifying assets?
- How will the Fund finance/source operating expenses, tax obligations and asset management fees?
- What will be the timeline for wind-down of the Fund? What voting rights will investors have with respect to wind-down activities, and what are the ultimate terms of the wind-down?

Other Considerations

- If a taxpayer established ownership of land or other tangible property located in a OZ prior to 12/31/17, can that property become QOZBP in the hands of that taxpayer?
- Can vacant or underutilized property be treated as “original use” property?
- Can the “10-year step-up to fair market value” rule enable an investor to avoid depreciation recapture?
- What should be included in the written plan and written schedule in order to satisfy the “reasonable working capital” safe harbor?
- If the project ultimately fails and is foreclosed upon (i.e. the equity gets wiped out), do the opportunity zone investors still owe taxes on the original gain?

Other Considerations (Continued)

- What is the impact of a debt-financed distribution on the investment? If I put my money in and refinance a property and immediately take the money out, do I still have a valid investment?
- How does a carried interest impact the exclusion? If I sell my partnership interest that is eligible for the carry, do I still get the exclusion?
- What is the character of the gain in 2026 if I defer short-term capital gain?
- How is the 90% test applied if I make a direct investment versus an investment in a subsidiary entity?
- If a taxpayer disposes part of their QOF interest, can they reinvest the proceeds in another QOF and continue to defer the gain. What if they dispose 100% of the interest?
- How does an existing entity become a QOF?

Q&A