Opportunity Zone Program
Tax Cuts and Jobs Act

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Overview

- History of Opportunity Zone Program
- Opportunity Zones – Qualification and Designation
- Tax Benefits of the Opportunity Zone Program
- Opportunity Funds – What are the rules, how do you qualify?
- Opportunity Zone Businesses and Opportunity Zone Business Property – What are these?
- Possible Types of Investments

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Certain Tax Incentive Programs

- **New Markets Tax Credits** (subsidy program for commercial projects and businesses): Kept
- **Investment Tax Credit** (Solar): Kept
  - Bonus depreciation
- **Historic Tax Credits** (subsidy for rehabilitation of older buildings):
  - No 10% credit
  - 20% tax credit is kept but is now taken over 5 years instead of in the year of placed in service.
- **Investment in Opportunity Act**
  - New program – Opportunity Zones (O-Zones)

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History – Investment in Opportunity Act

- Drafted in 2016/Introduced February 2017
- Bipartisan Legislation
  - Rep. Tiberi (R)
  - Rep. Kind (D)
  - Sen. Scott (R)
  - Sen. Booker (D)
- Goal to encourage private capital investment in economically distressed areas.

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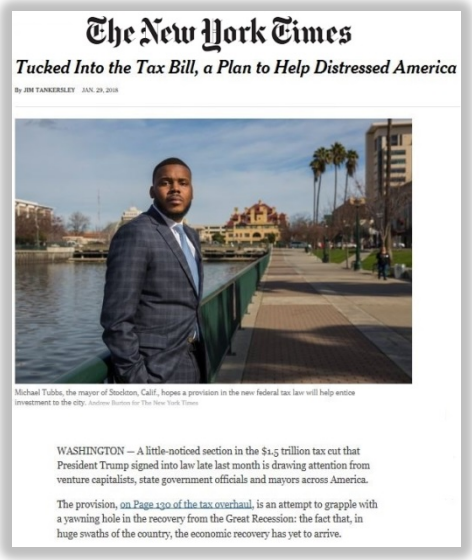
Opportunity Zone Program

- Opportunity Zone Program
  - The Investment in Opportunity Act was included in the Tax Cuts and Jobs Act.

- December 22, 2017

- New York Times and USA Today



The New York Times

Tucked Into the Tax Bill, a Plan to Help Distressed America

By JIM TANKERSLEY JAN. 29, 2018

Michael Tubbs, the mayor of Stockton, Calif., hopes a provision in the new federal tax law will help entice investment to the city. Andrew Burton for The New York Times

WASHINGTON — A little-noticed section in the $1.5 trillion tax cut that President Trump signed into law late last month is drawing attention from venture capitalists, state government officials and mayors across America.

The provision, on Page 130 of the tax overhaul, is an attempt to grapple with a yawning hole in the recovery from the Great Recession: the fact that, in huge swaths of the country, the economic recovery has yet to arrive.

USA TODAY

Sen. Tim Scott: New Tax Law Will Spur Opportunity in Distressed Communities

Tim Scott Published 10:40 a.m. ET Feb. 14, 2018 | Updated 10:51 a.m. ET Feb. 14, 2018

The Investing in Opportunity Act gives investors incentive to put their sidelined capital gains into struggling areas in every zip code.

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(Photo: Mark Wilson, Getty Images)

Poverty has long been one of the most challenging social crises of our time. Despite good-intentioned efforts to generate positive change, currently 52 million Americans continue to face the dire circumstances of a lack of jobs, education, and the confidence that things will get better.

I will be at the White House on Wednesday with President Trump, administration officials and community leaders to discuss the Investing In Opportunity Act. The IIOA, which was included in last year's tax reform package, seeks to direct trillions in capital gains to distressed communities in every state.

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How do Taxpayers Benefit?

Taxpayers can defer *and potentially reduce* taxation on (capital) gains

by making timely investments in

Opportunity Funds

which invest in

Opportunity Zone Property

Source: Novogradac & Company LLP

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3 Tax Incentive Benefits

1. Temporary Deferral of (Capital) Gain
   - *Applies to any (capital) gain from the sale or exchange of any property to an unrelated person*
   - *$6 trillion of potential eligible capital*

2. Partial reduction of Deferred Gain
   - *Income Tax is still paid on a large portion of the Deferred Gain*

3. Forgiveness of Additional Gain
   - *Applies to the Appreciation in the Investment*

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Temporary Deferral of Gain

- Applies to any Individual, Business Entity, or Trust
- Sale or Exchange of Property to an Unrelated Person
- On or before December 31, 2026
- Election is made by the Taxpayer
- Deferred Gain: The Aggregate Amount Invested That Does Not Exceed the Amount of Gain Generated
  - In an Opportunity Fund (O-Fund)
  - Within 180 days of the sale/exchange

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Deferred Gain: When & How Much

When: Includable in taxable income on the earlier of:

- **Investor's sale of its interest in the O-Fund; or**
- **December 31, 2026**

How Much: Subject to income tax is based on the lesser of:

- **Amount of the Deferred Gain**

or

- **The fair market value of investment in the O-Fund**

Less

The Taxpayer's basis in the O-Fund

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Partial Reduction of Deferred Gain (Tax Basis)

- **Taxpayer has an Initial Basis in the O-Fund of Zero**

- **Hold for 5 Years**
  - Investor's tax basis in the O-Fund is increased by 10% of the amount of the Deferred Gain

- **Hold for 7 Years**
  - Investor's tax basis in the O-Fund is increased by an additional 5% of the amount of the Deferred Gain

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Full Forgiveness

- Where Investor holds its interest in the O-Fund for 10 years and 1 day:
  - Tax basis step-up to FMV of Investor's interest in the O-Fund on the date of the sale or exchange
    - *Significant benefit but must hold long term*
  - The result is no gain on the appreciation above Investor's original investment in the O-Fund.
    - *Perhaps no income tax on depreciation recapture?*

- Phantom income issue arising on December 31, 2026
  - Issue for O-Funds
  - Date may need to be corrected

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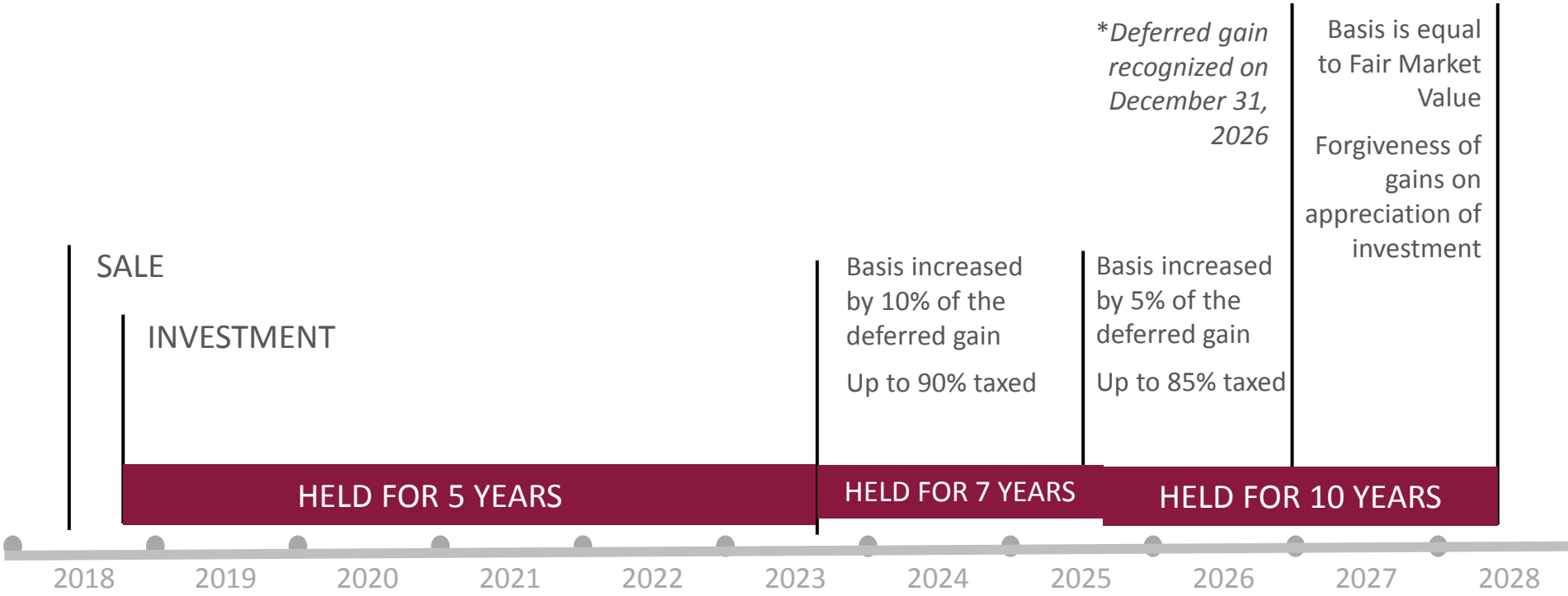
Deferral, Partial Reduction, and Forgiveness of Additional Gains



Source: Novogradac & Company LLP

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Example*

- Investor sells stock for $30M ($20M of long term capital gain) on July 1, 2018
- Investor invests $20M in an interest in an O-Fund on November 1, 2018.
  - Does not need to invest the entire $30M
- December 31, 2026:
  - Investor's tax basis in the O-Fund was increased by $3M (15% of $20M)
    - $2M on November 1, 2023, and $1M on November 1, 2025.
  - Investor has to pay tax on $17M long-term capital gain
- November 2, 2028:
  - Investment in the O-Fund has appreciated from $20M to $60M ($40M in potential gain)
  - If the investment in the O-Fund is sold, then there is no taxable gain on the $40M of appreciation.

* Results/outcomes may vary

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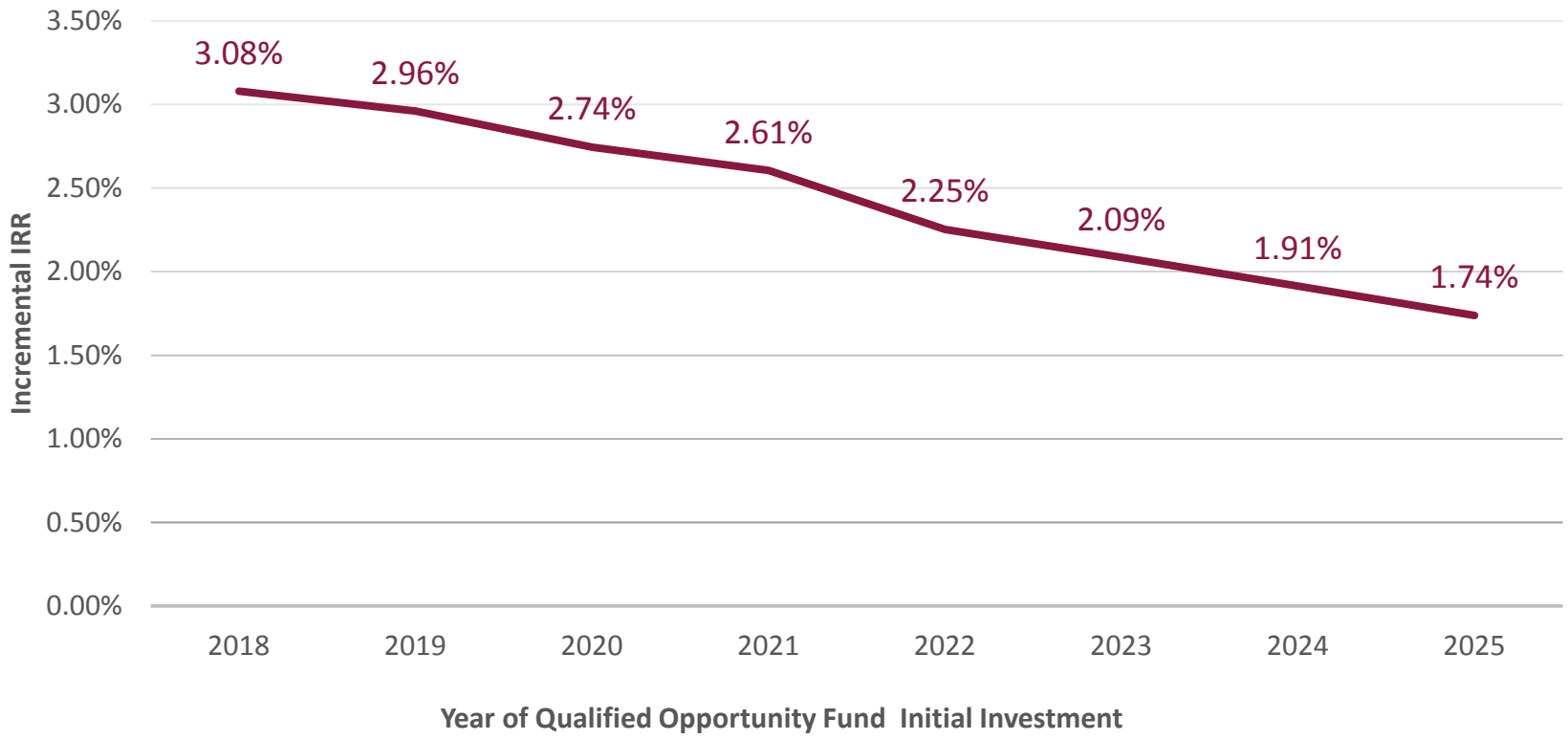
Perishability of Deferral Incentive



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What is an Opportunity Zone (O-Zone)

- Population census tract that is a low-income community (LIC)
  - Approximately 75,000 total census tracts in the U.S.
  - 37% of the census tracts in the United States are LICs
- What is a LIC
  - Same definition for NMTCs
    - Based upon poverty rate (20%) or median family income (80%)
- Timely nominated by each Governor
- 25% of the LICs were eligible for nomination
  - Approximately 8,700 census tracts
  - 5% of the tracts to be nominated can be contiguous tracts

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What is an Opportunity Fund (O-Fund)

- Intermediary Between Investors and the Investments in the Opportunity Zone

- Statutory Requirements:

  - Organized as a Corporation or Partnership
  - An **investment vehicle** organized for the purpose of investing in **Opportunity Zone Property**.
  - 90% Requirement

- Certification Process

- Penalty imposed for Noncompliance

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Opportunity Fund Certification

- Self-Certification
- A taxpayer merely completes a form
  - To be released in the Fall of 2018
  - Completed form is attached to the taxpayer's federal income tax return for the taxable year.
- The return must be filed timely, taking extensions into account.
- No cap on the number of O-Funds or the amounts to be invested in the O-Funds

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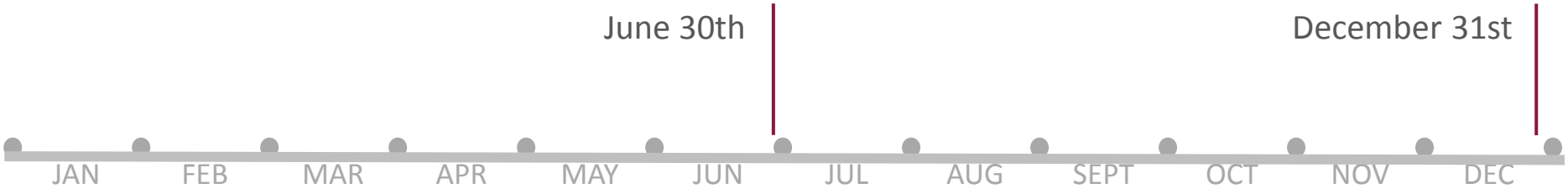
Opportunity Fund – 90% Requirement

Must hold at least 90% of assets in Opportunity Zone Property, determined by the average of the percentage of Opportunity Zone Property held on:

- The last day of the first six month period of the fund's taxable year

And

- The last day of the fund's taxable year



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Penalty for Noncompliance with the 90% Requirement

Failure to meet the 90% Requirement:

Monthly penalty for failing to meet the 90% Requirement

% Shortfall
x Underpayment Rate*
Penalty

*Federal short-term rate plus 3%) – **Currently 5%**

No penalty if it is shown failure is due to **reasonable cause**

O-Fund Partnerships: Penalty Imposed upon the Partners

Source: Novogradac & Company LLP

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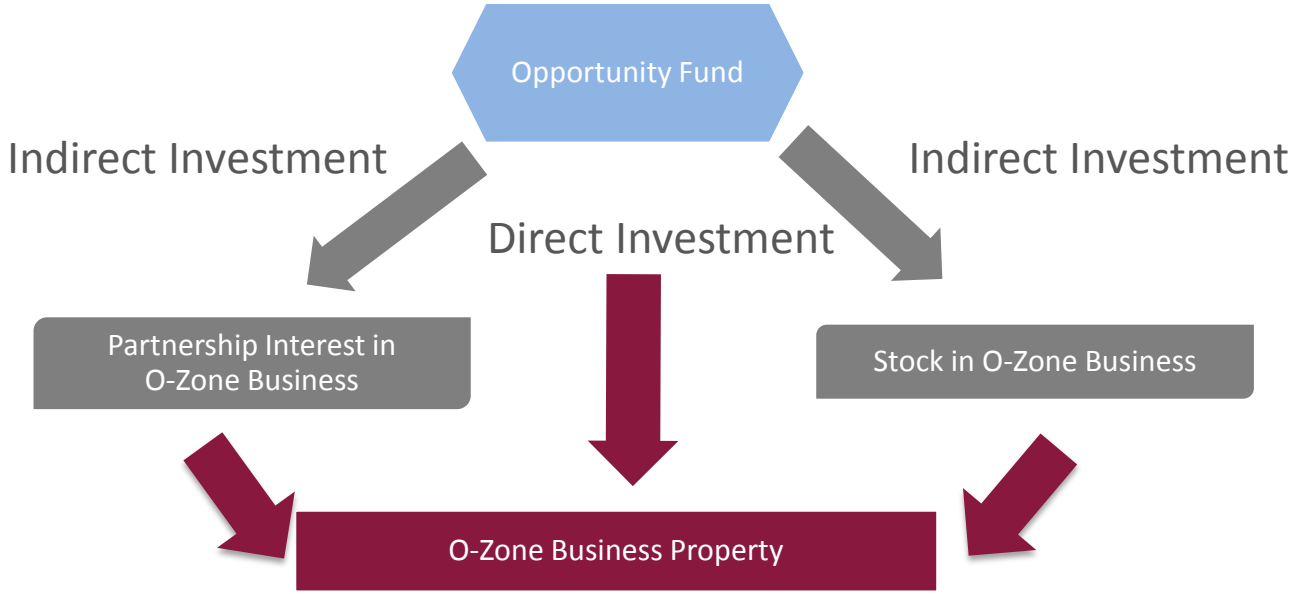
Opportunity Zone Property

- Broad Definition - However, no debt.
- Investments that constitute O-Zone Property are:
  - Indirect Approach: Equity investment in an Opportunity Zone Business (an O-Zone Business).
  - Direct Approach: Direct purchase of Opportunity Zone Business Property (O-Zone Business Property).



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Indirect Investment

- **Original Issuance:** Stock or a partnership interest in a **qualifying entity after December 31, 2017**, in exchange for cash.
  - Could be issued through an underwriter

- **Qualifying entity:** Domestic Corporation or Partnership (including LLCs)

- **Opportunity Zone Business (an O-Zone Business): At time of issuance** or is organized for the purpose of being an O-Zone Business (for newly formed entities).

- **Must remain an O-Zone Business:** For **substantially all** of the O-Fund's holding period.

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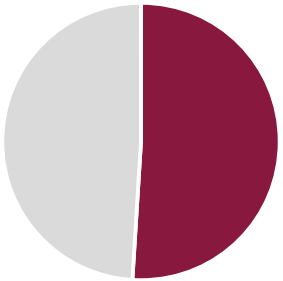
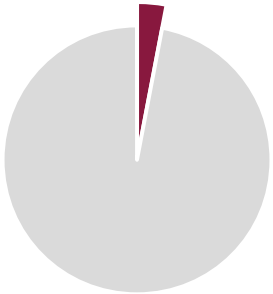
Opportunity Zone Businesses

*A trade or business in which **substantially all** of the **tangible property** owned or leased by the taxpayer is **O-Zone Business Property** and:



At least 50% of income derived from active conduct of trade or business

Substantial portion of intangible property used in active conduct of business



< 5 percent unadjusted basis of property is nonqualified financial property (cash, cash equivalents, long term loans)

Source: Novogradac & Company LLP

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Opportunity Zone Businesses - Summary

- Tangible Property Test
  - "Substantially All"
  - Tangible Property that is Leased or Owned
  - Must be Opportunity Zone Business Property
- Intangible Property Test
  - "Substantial Portion"
  - Must be Used in Active Conduct of a Trade or Business
- Gross Income Test
  - 50% of the Income
  - Must be Derived from the Active Conduct of a Trade or Business
- Non-Qualified Financial Property
  - Less 5% of average of its assets can be cash or "cash type" assets
  - Exception for reasonable working capital, short term loans, and A/Rs
  - Similar to the NMTC rules

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Excluded Businesses

Can't be a "Sin Business"

- Golf Course
- Country Club
- Massage Parlor
- Hot Tub Facility
- Suntan Facility
- Racetrack (or other gambling facilities)
- Any store the principal business of which is the sale of alcoholic beverages for consumption off premises

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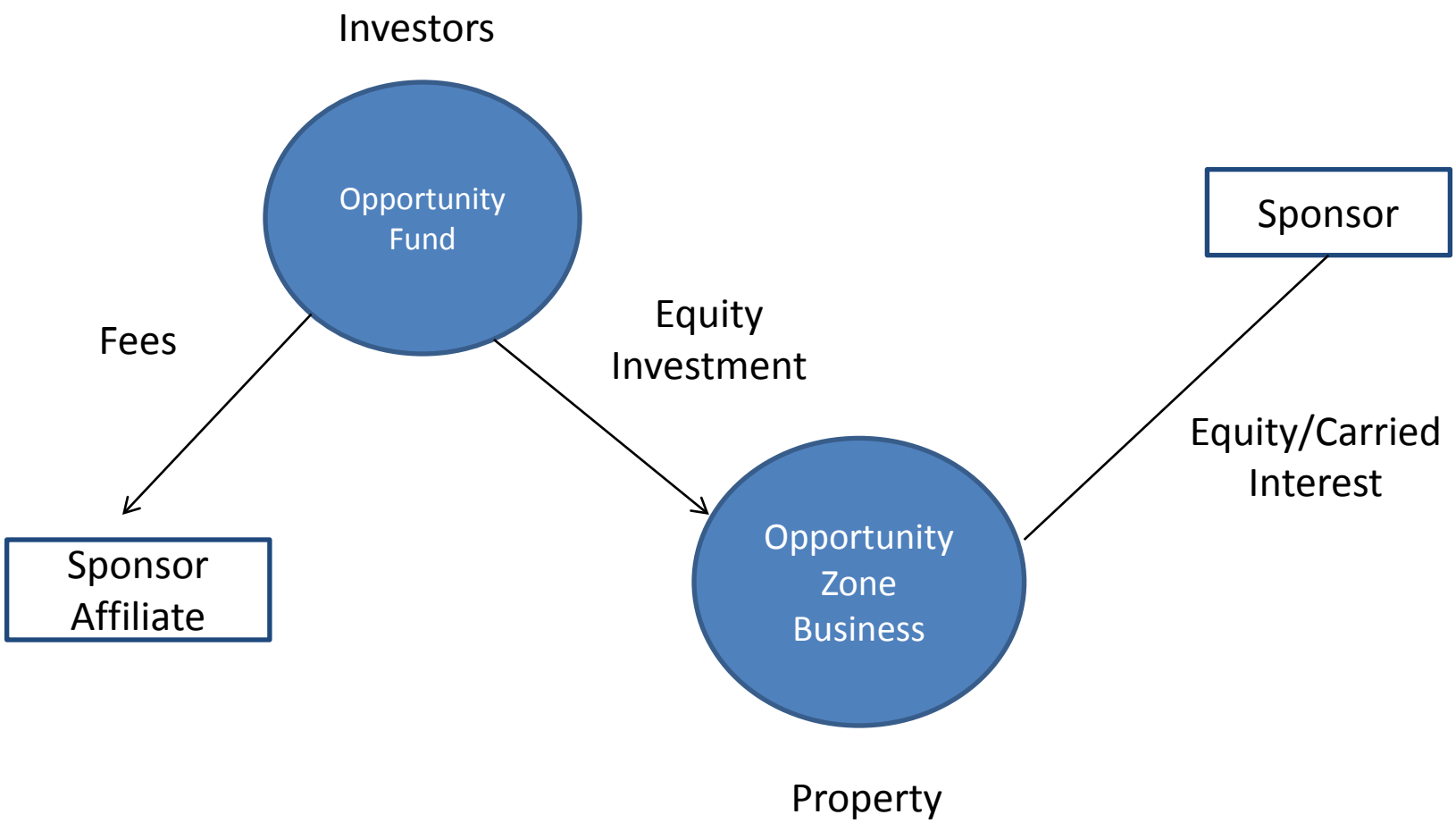
Indirect Approach Structure



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Direct v. Indirect Approach

	Direct	Indirect
% Invested in Opportunity Zone Business Property	90%	70 – 90% of Tangible Property Must be Opportunity Zone Business Property
% of Cash that can be held on measurement dates	10%	Less than 5% + Reasonable working capital
% of Assets that can be intangible property	10%	Unlimited. But, a "substantial portion" must be used in the business
% of Property that must be tangible property	90%	No minimum
Ineligible businesses	No Prohibitions	"Sin Businesses" are prohibited

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O-Zone Business Property

- **Key Definition (Especially for Real Estate)**
  - **Used in both the Direct and Indirect Approach**
- **Requirements:**

(1) **Tangible property** used in a **trade or business;**

(2) Acquired by **purchase from an unrelated party** (more than 20% standard) after **December 31, 2017;**

(3) **Original use in the Opportunity Zone** must commence with the O-Zone Business (or O-Fund); and

(4) During **substantially all** of the holding period, **substantially all of** the use is **in an Opportunity Zone**

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Alternative to the Original Use Requirement

- The O-Zone Business (or the O-Fund) **substantially improves** the property
  - Key issue for real estate
  - Can you be an original user of real estate?

- What does it mean to "substantially improve"?:

*(1) Over a **30-Month** Period*

- *Statute: "During **any 30-month period** beginning after the date of acquisition"*
- *Regulations?*

*(2) **Additions to basis** that **exceed** the adjusted basis of such property*

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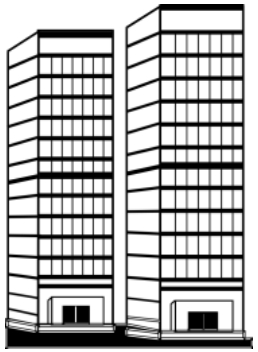
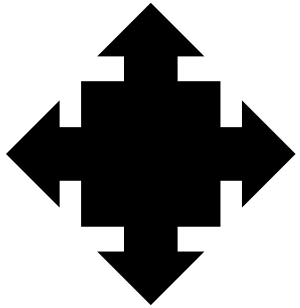
Possible Investments in Opportunity Zones



Real Estate Development and Significant Rehabilitations in Opportunity Zones

Opening New Businesses in Opportunity Zones

Acquiring an Existing Business and Relocating it (with Expansion) in an Opportunity Zone



Large Expansions of Businesses already within Opportunity Zones

Source: Novogradac & Company LLP

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Opportunity Zones – Status

- Treasury has certified the nominations of and designated the Opportunity Zones for all states.
- Guidance is needed to address many important issues:
  - Self certification requirements of Opportunity Funds
  - Grace periods for Opportunity Fund and Opportunity Zone Business to make investments
  - Clarification of the definition of taxpayer when a partnership recognizes a gain
  - Basis for applying various tests, i.e., adjusted tax basis or FMV
  - Meaning of “active” (to determine implication on triple net leases)
  - Meaning of “substantially all” and “substantial portion”
- Expectation is that the IRS will release Guidance in the Fall of 2018
- OMB is reviewing the Regulations

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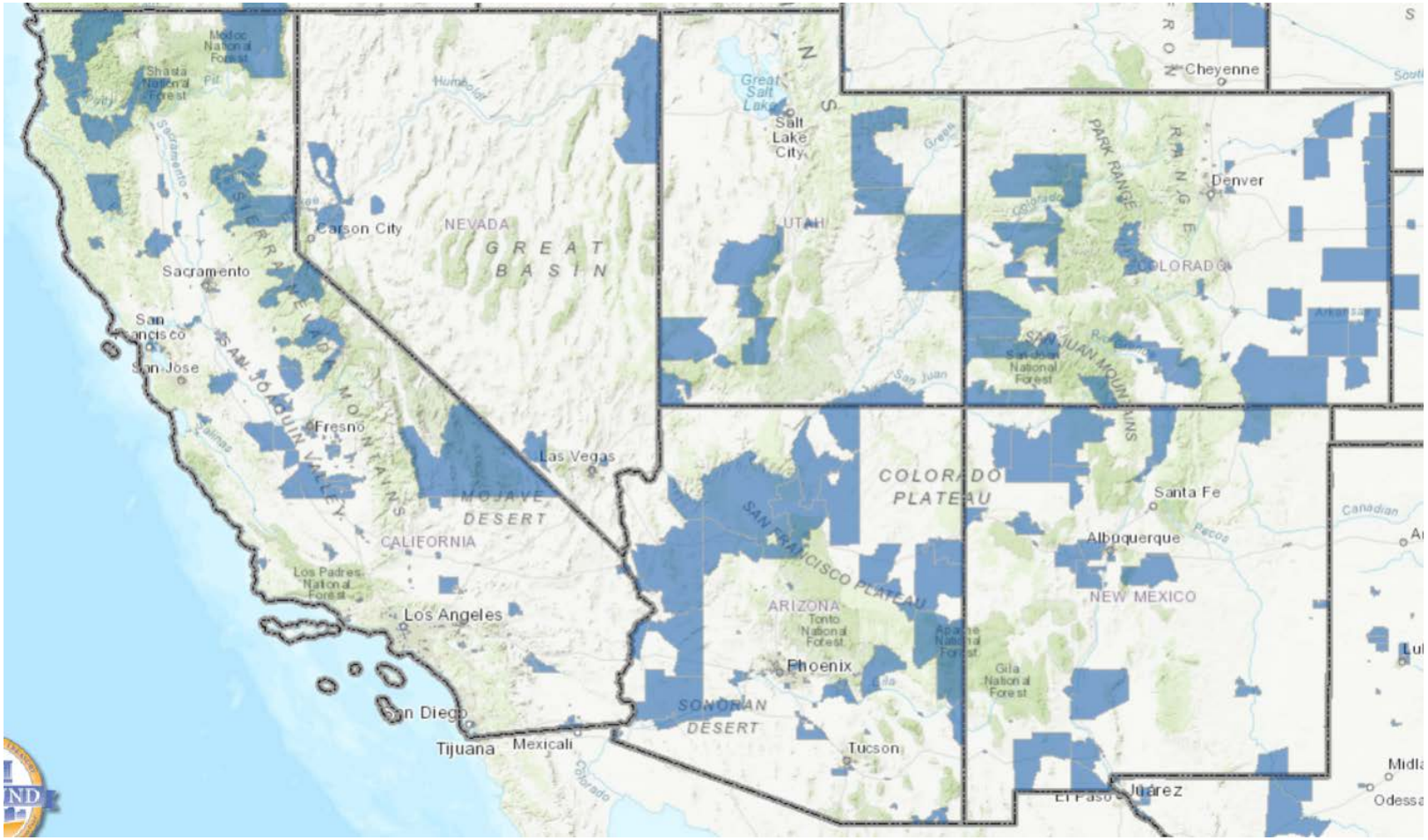
O-Zones in the Southwest



For an Interactive Opportunity Zone Map, please visit : www.CDFIFUND.gov

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Arizona

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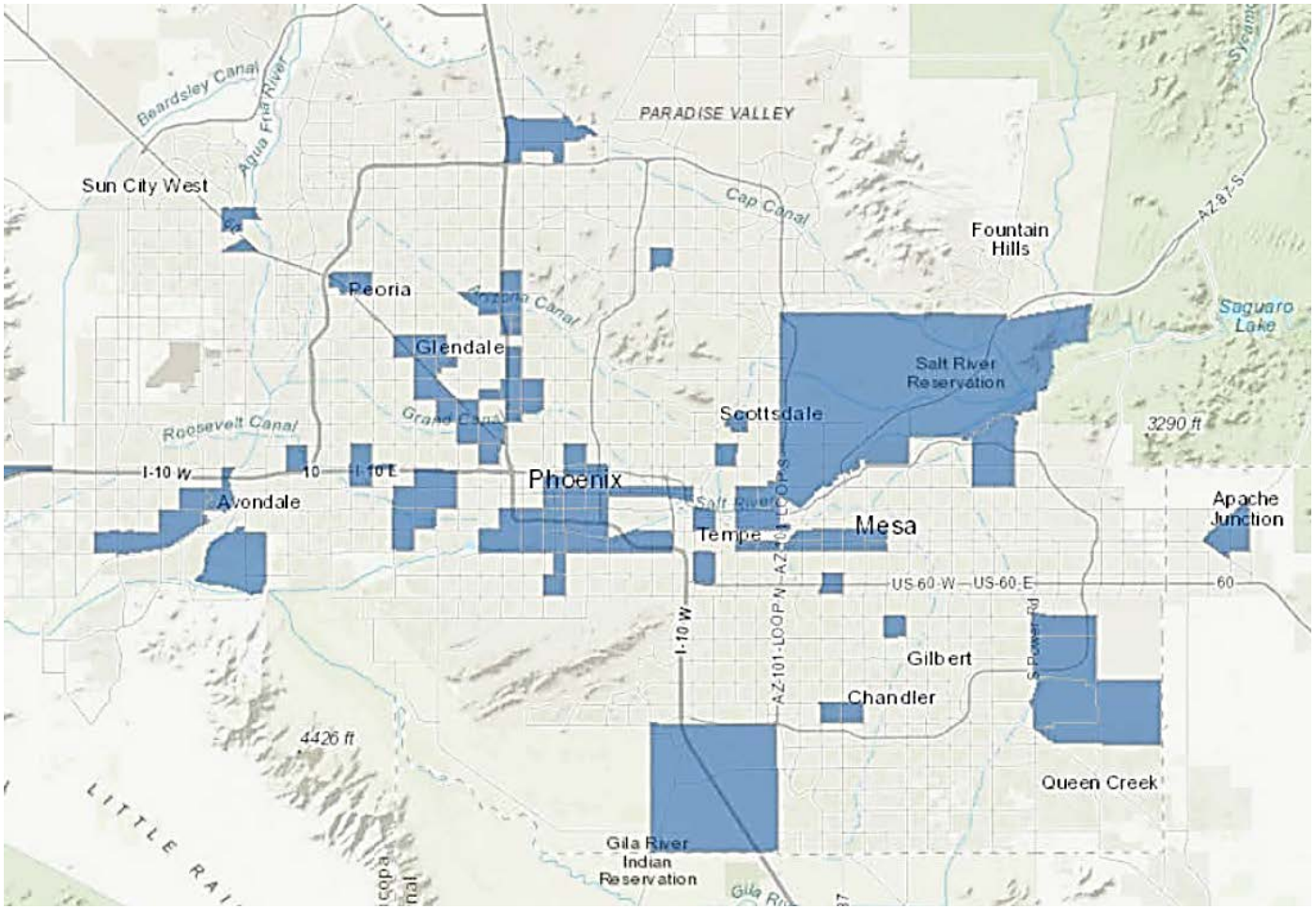
O-Zones in the Phoenix Metropolitan Area



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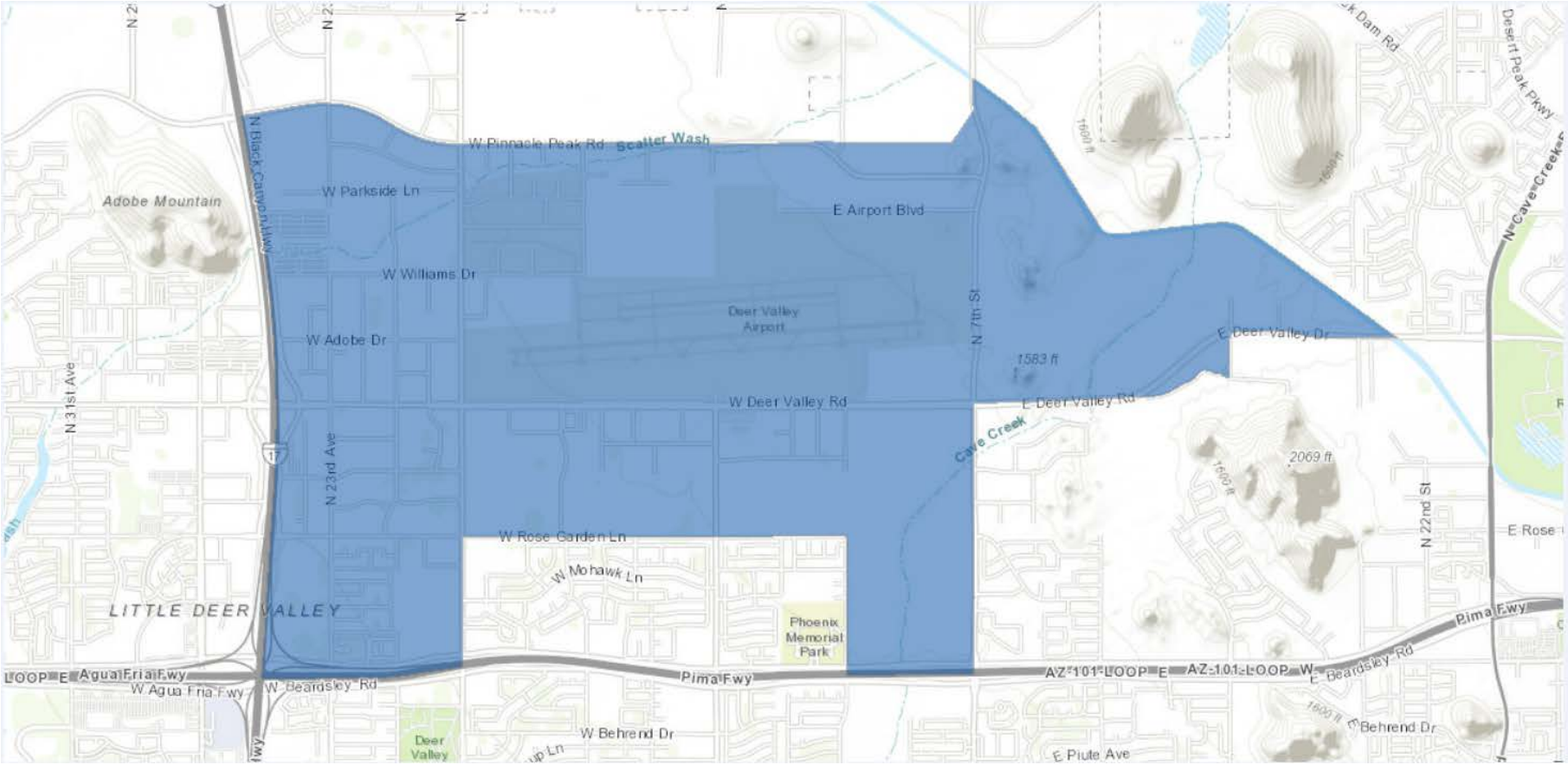
O-Zones near Deer Valley Airport



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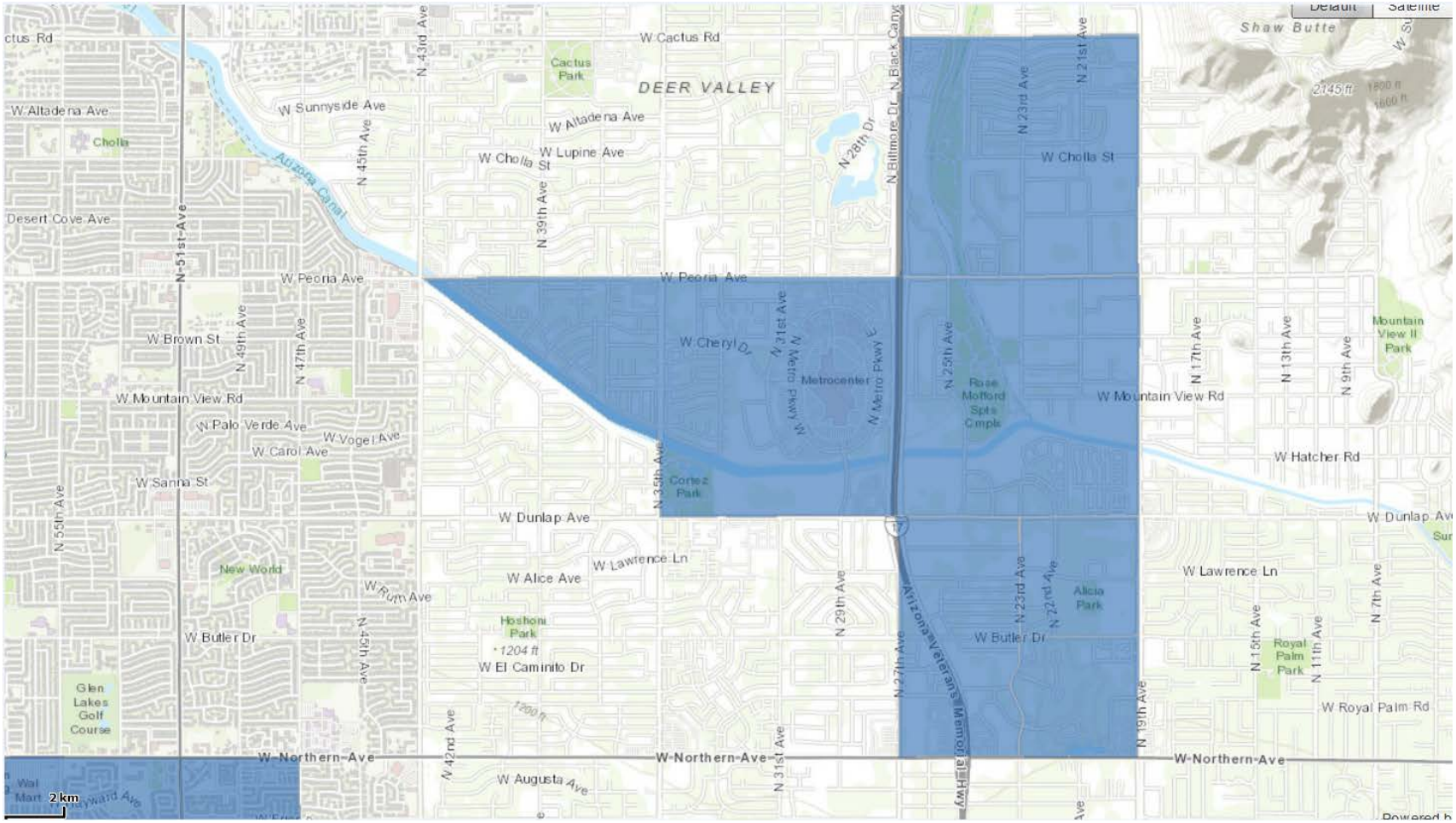
O-Zones along the I-17 Corridor



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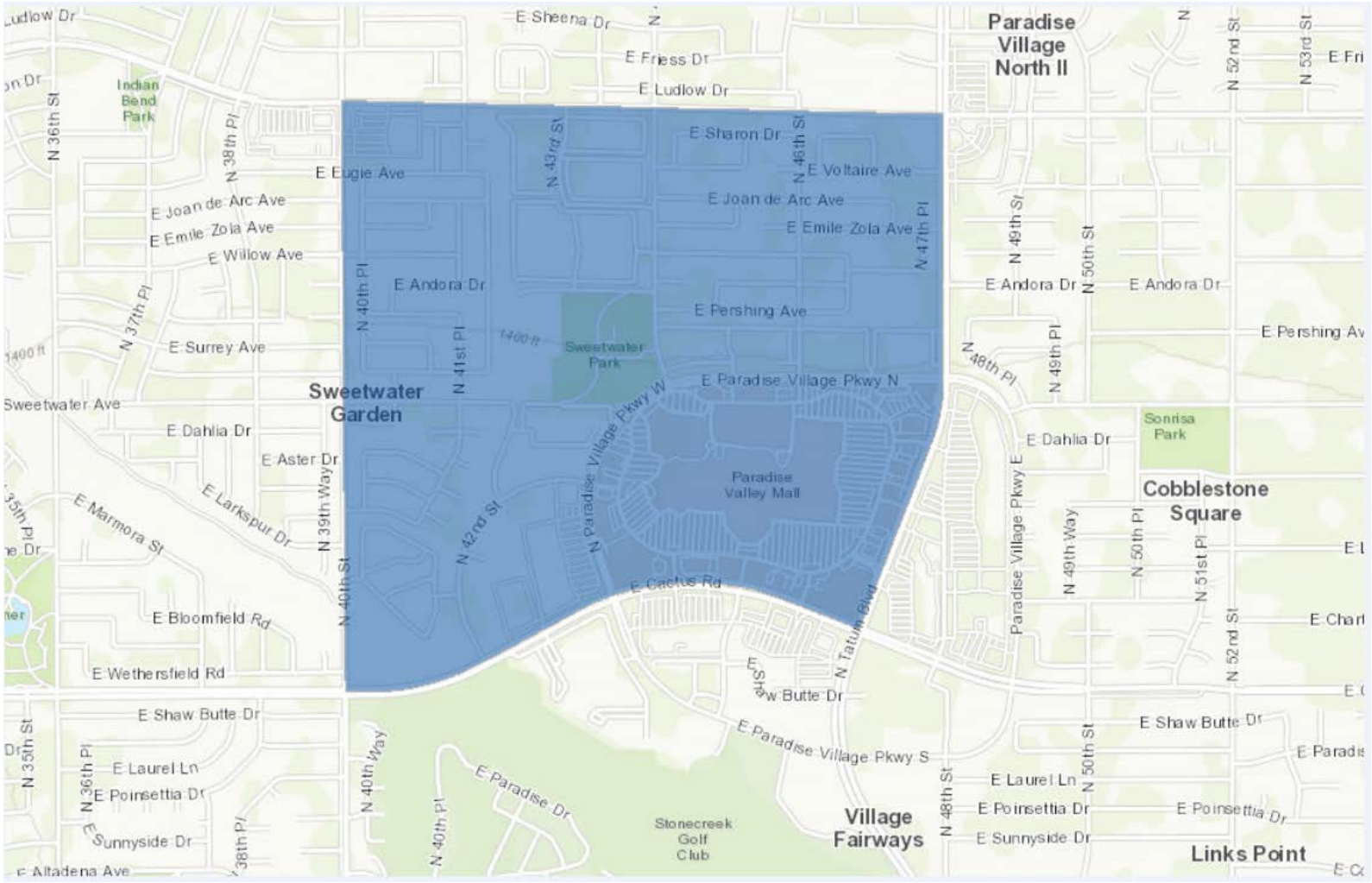
O-Zones near Paradise Valley Mall



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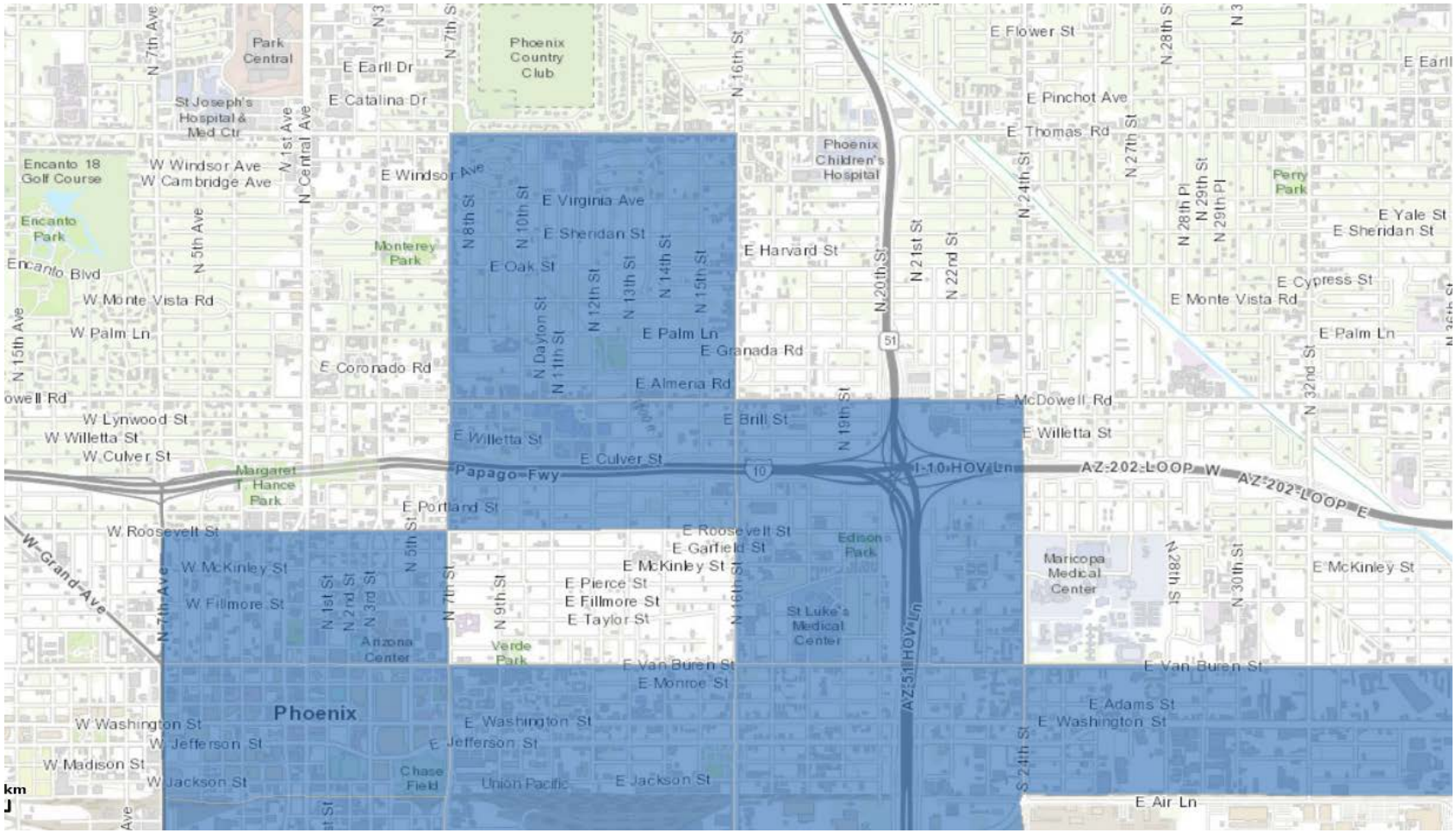
O-Zones (North I-10)



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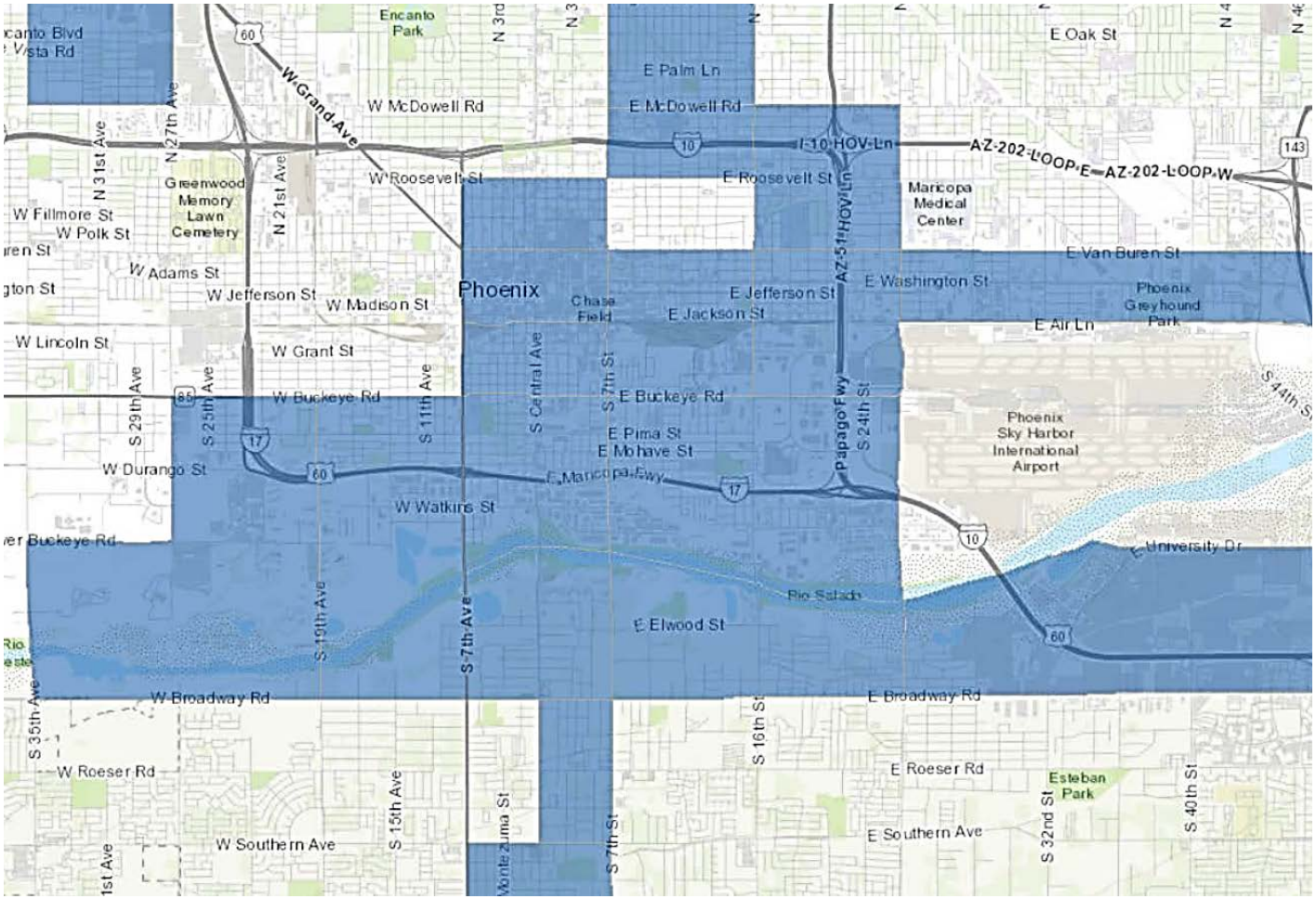
O-Zones in Downtown Phoenix



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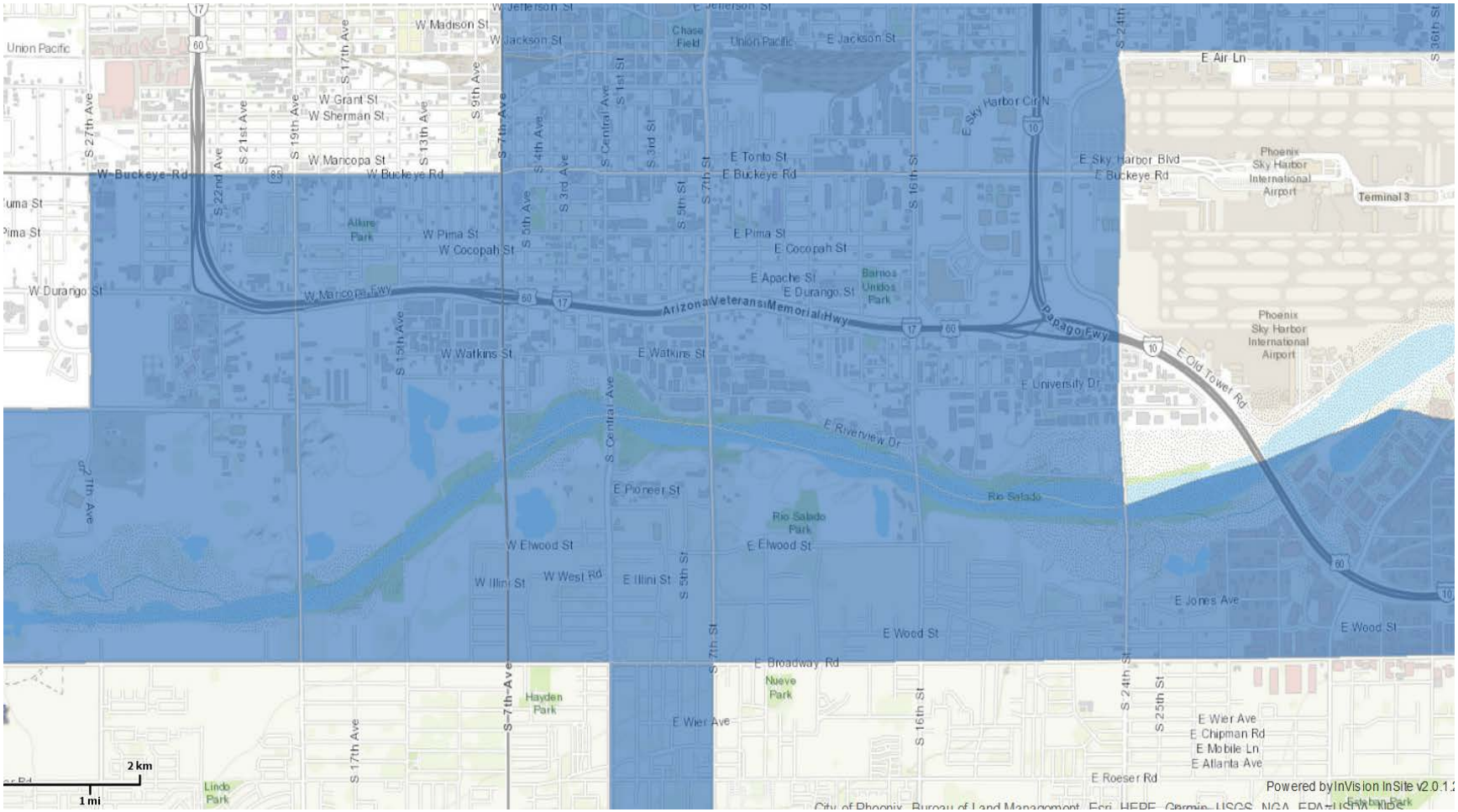
O-Zones near Phoenix Riverfront



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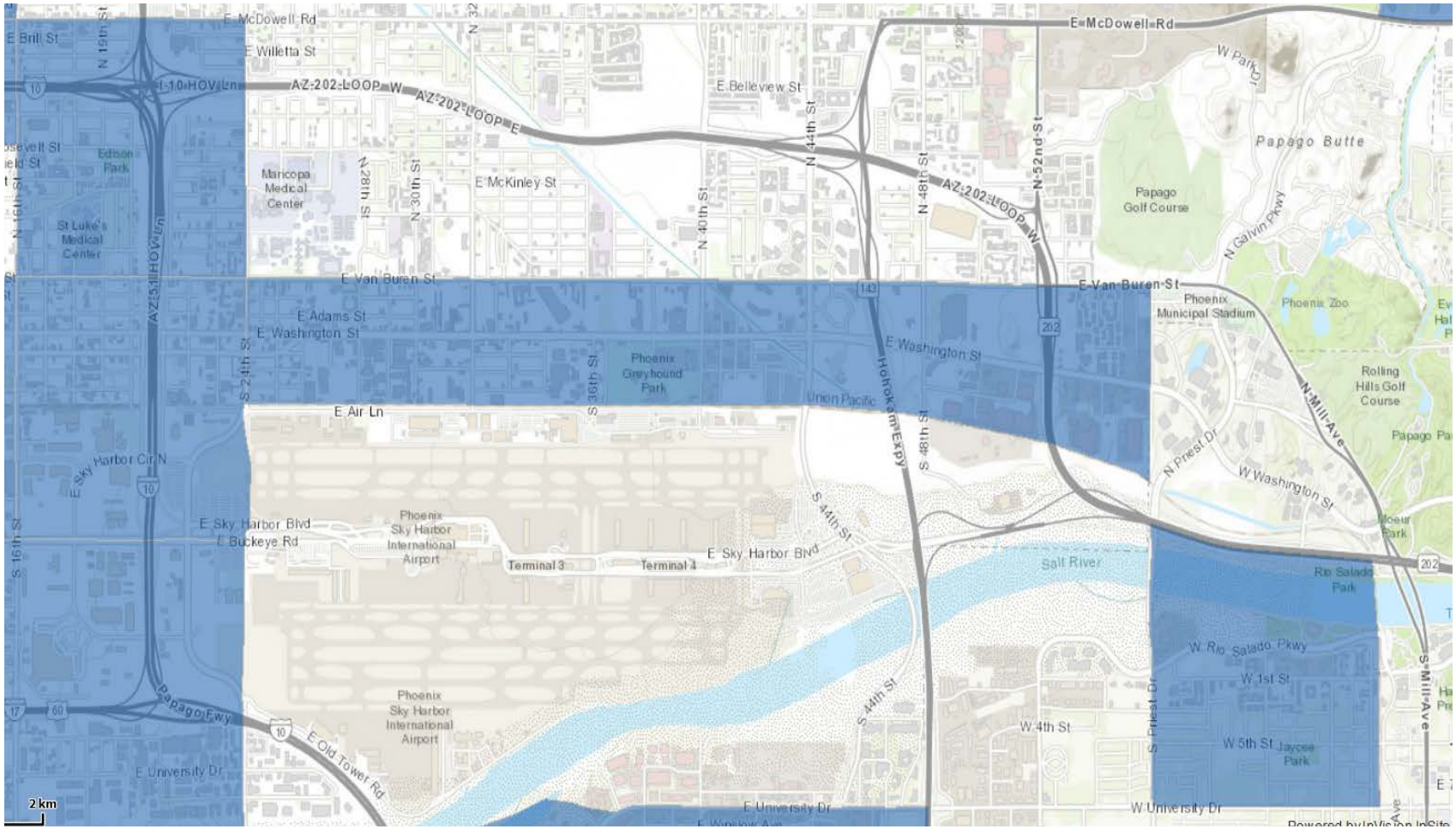
O-Zones (Washington Corridor)



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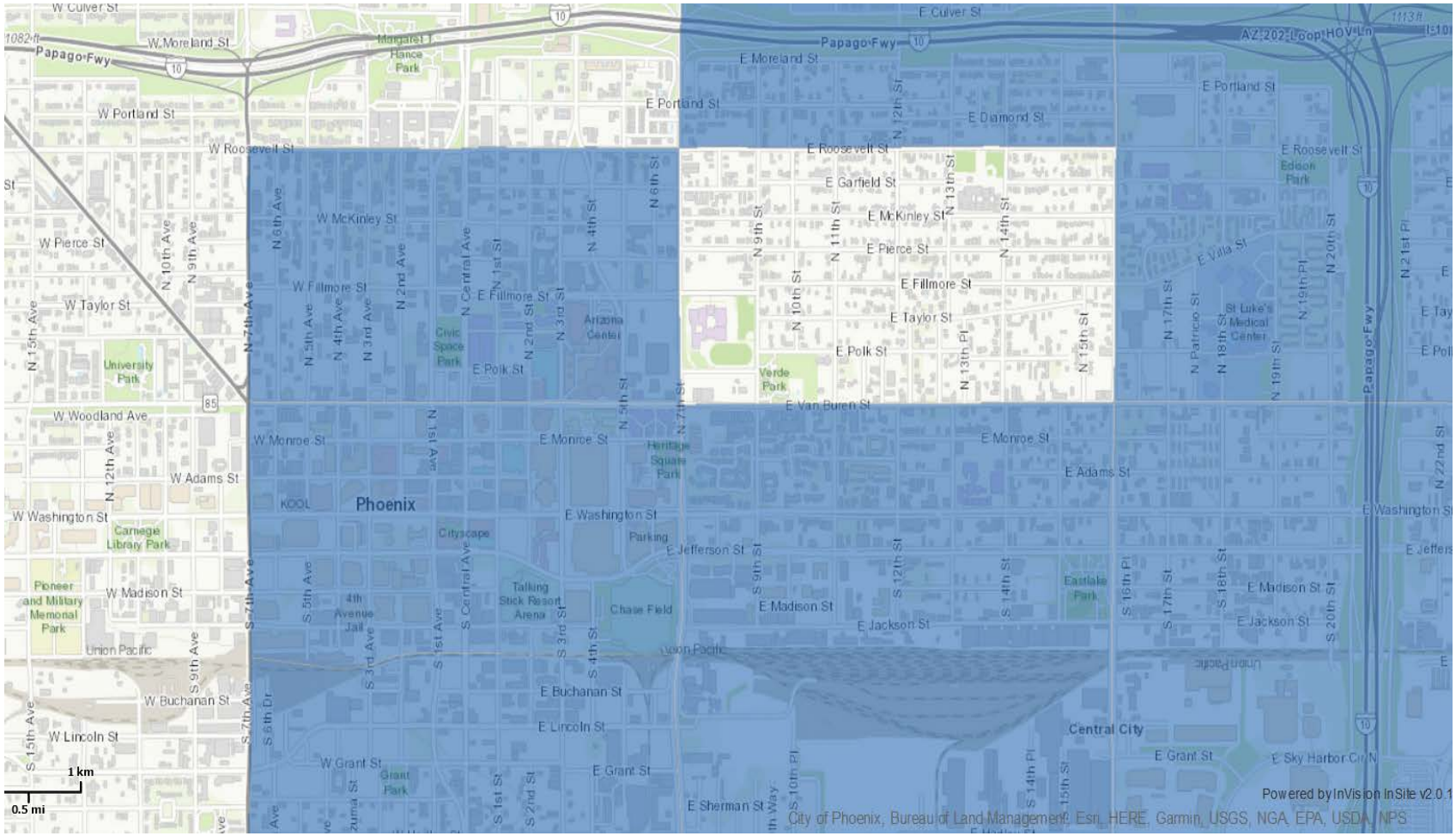
O-Zones (Arizona Center)



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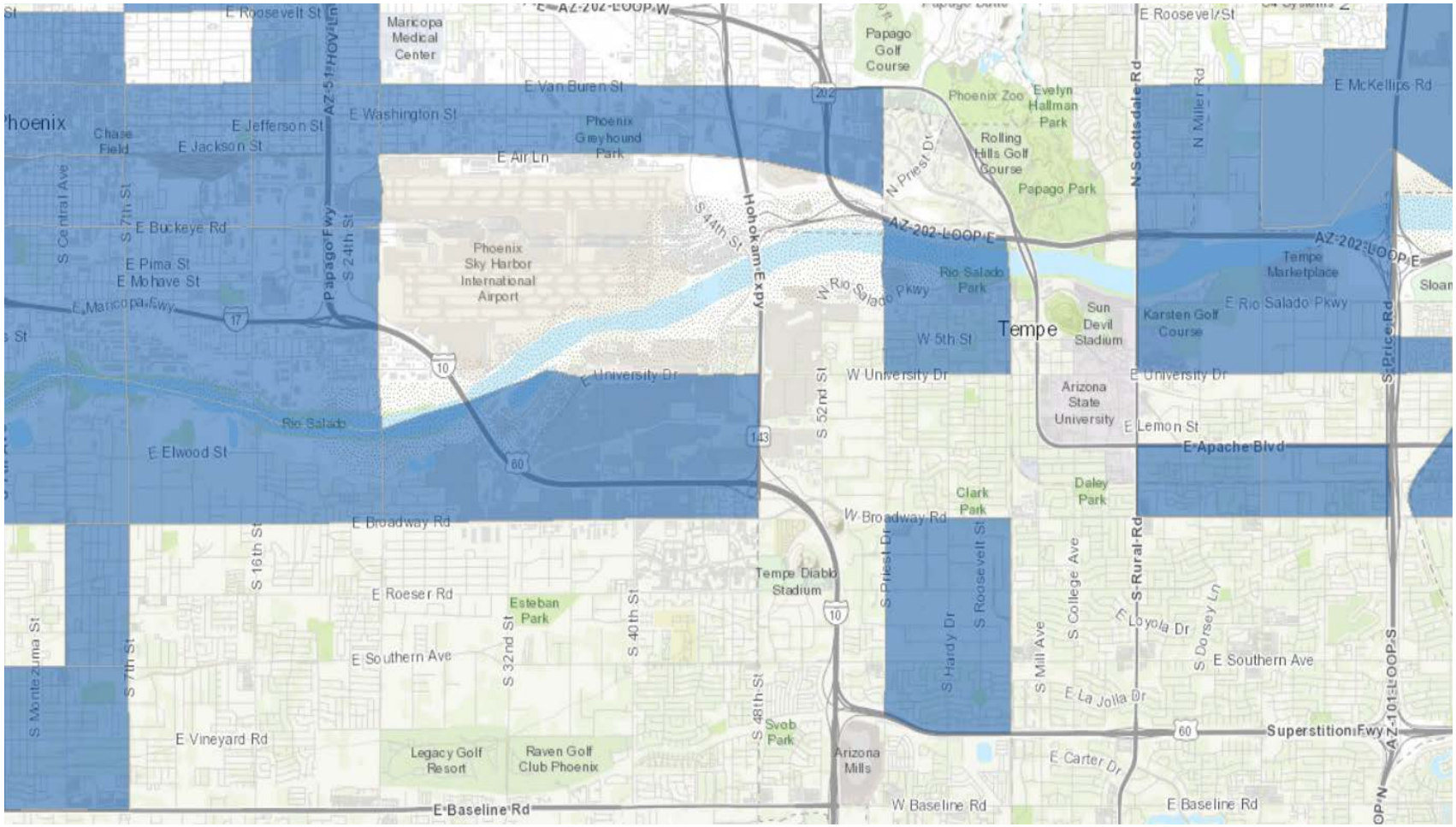
O-Zones (Sky Harbor)



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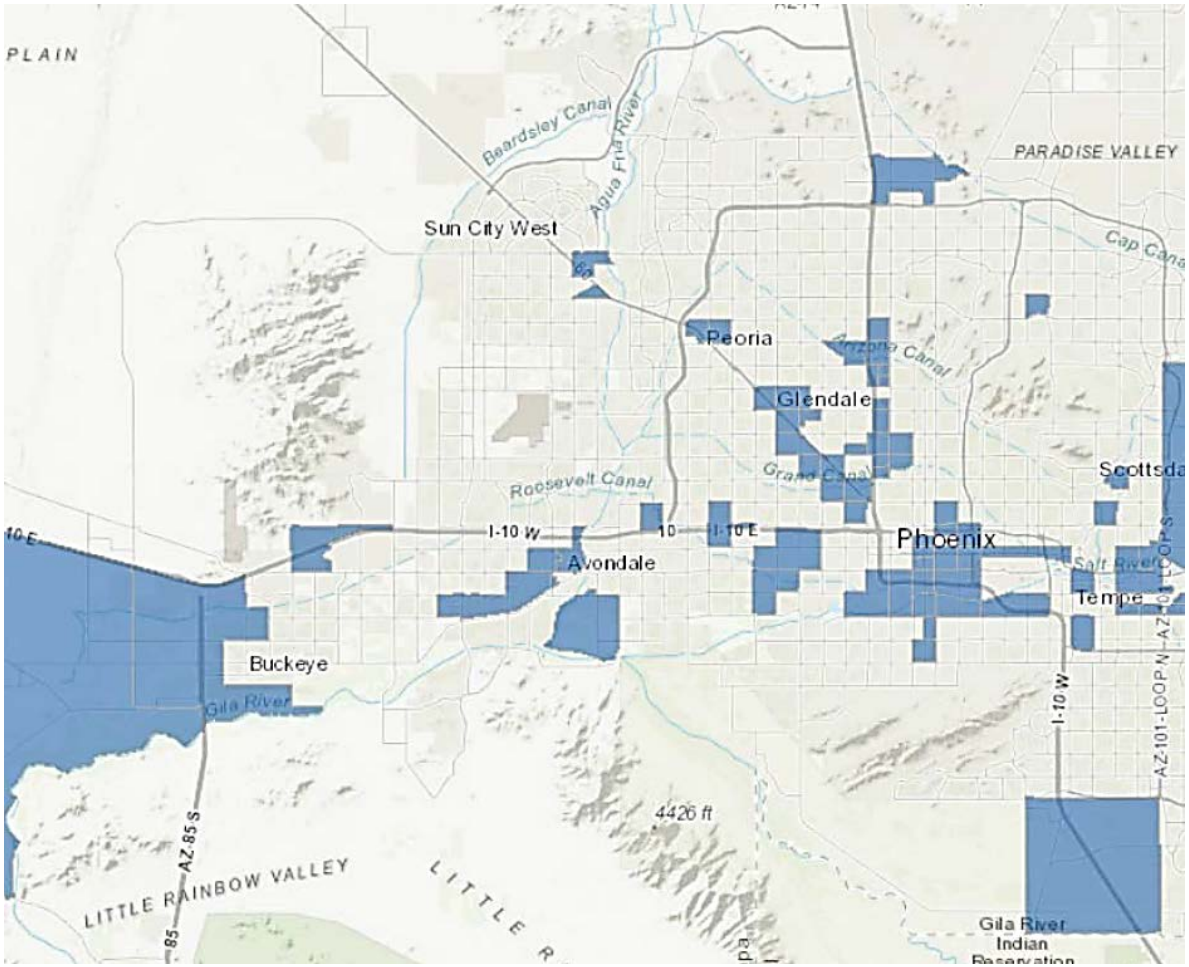
O-Zones in the West Valley



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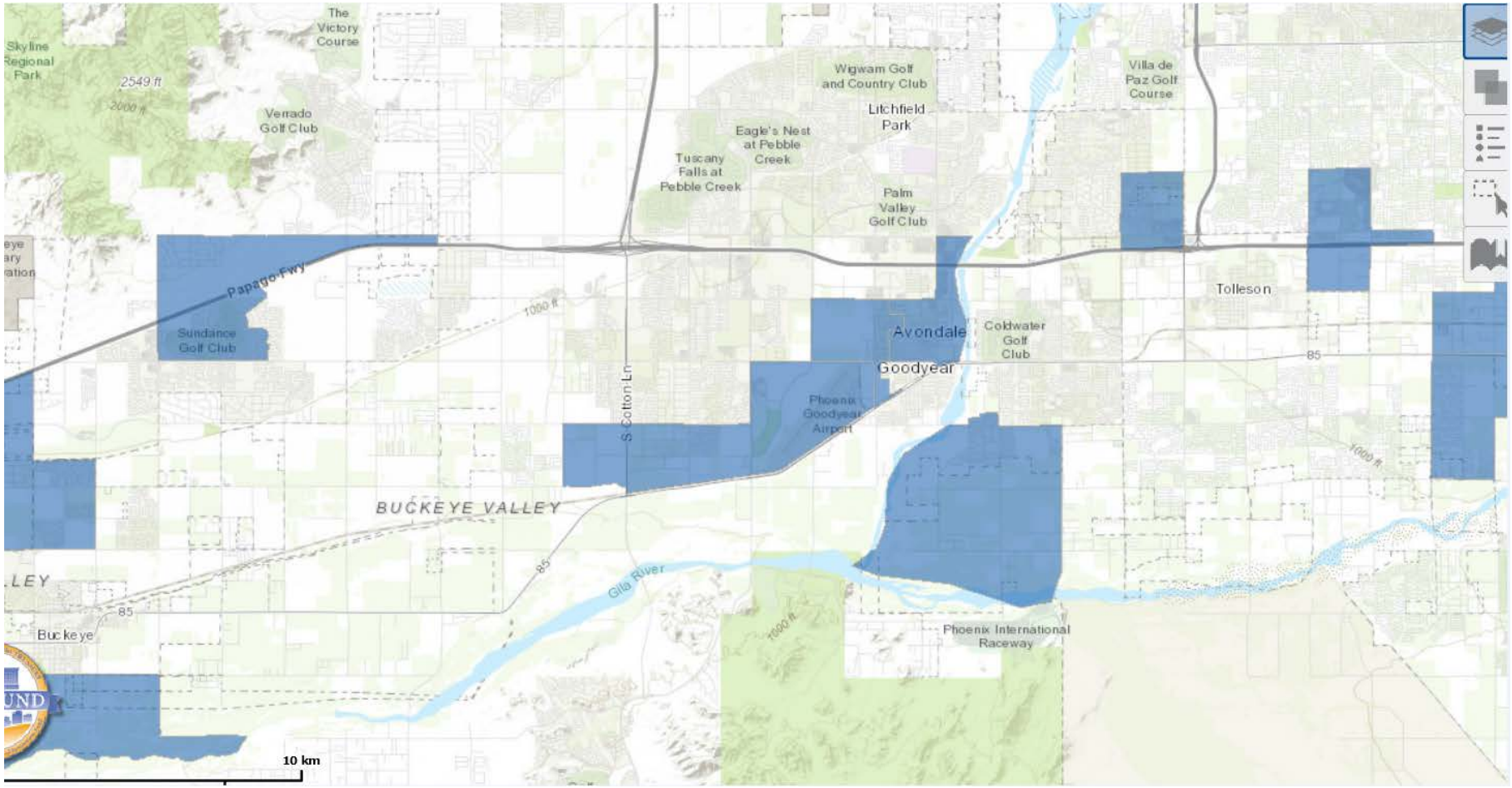
O-Zones along I-10 (west)



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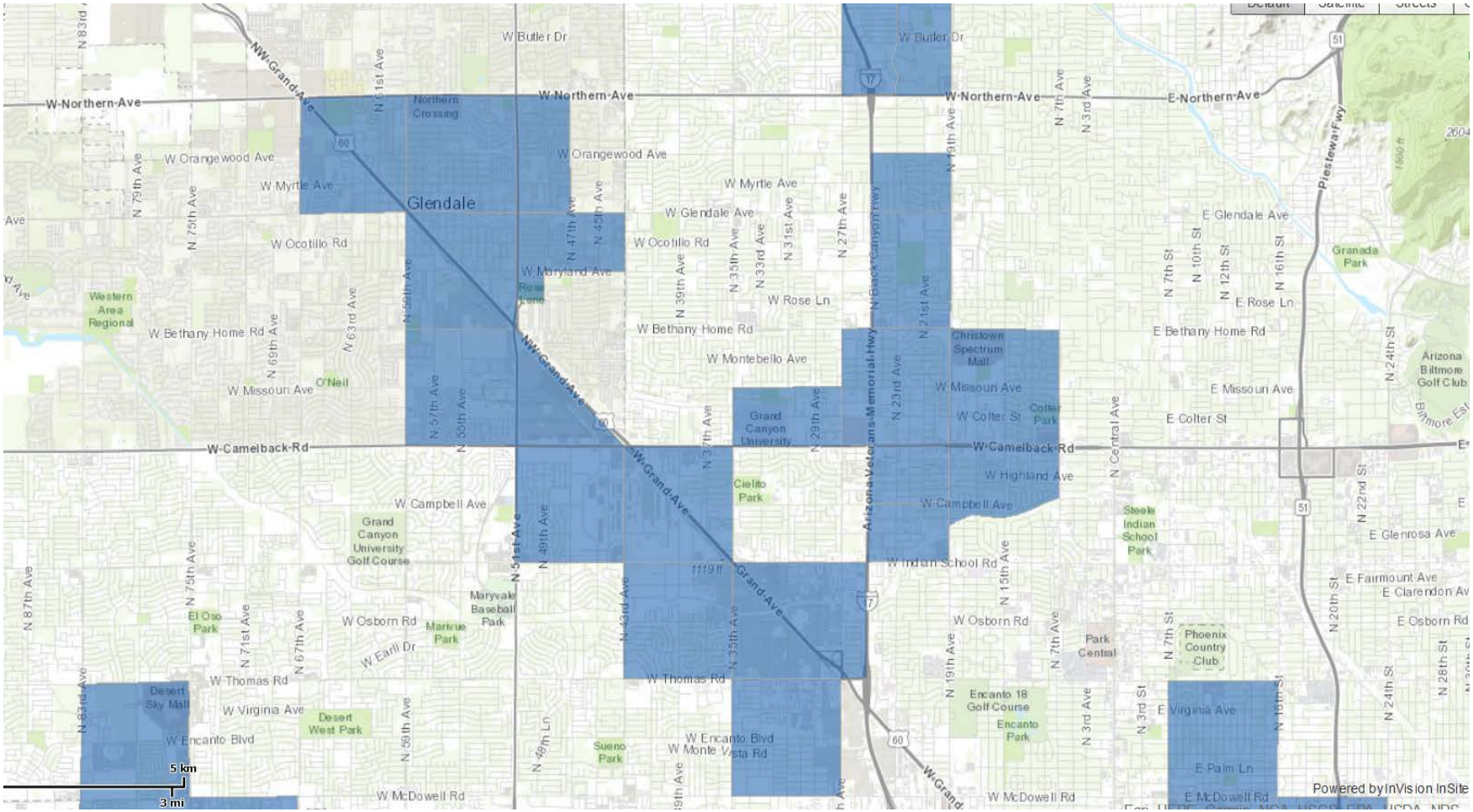
O-Zones near Grand Canyon University



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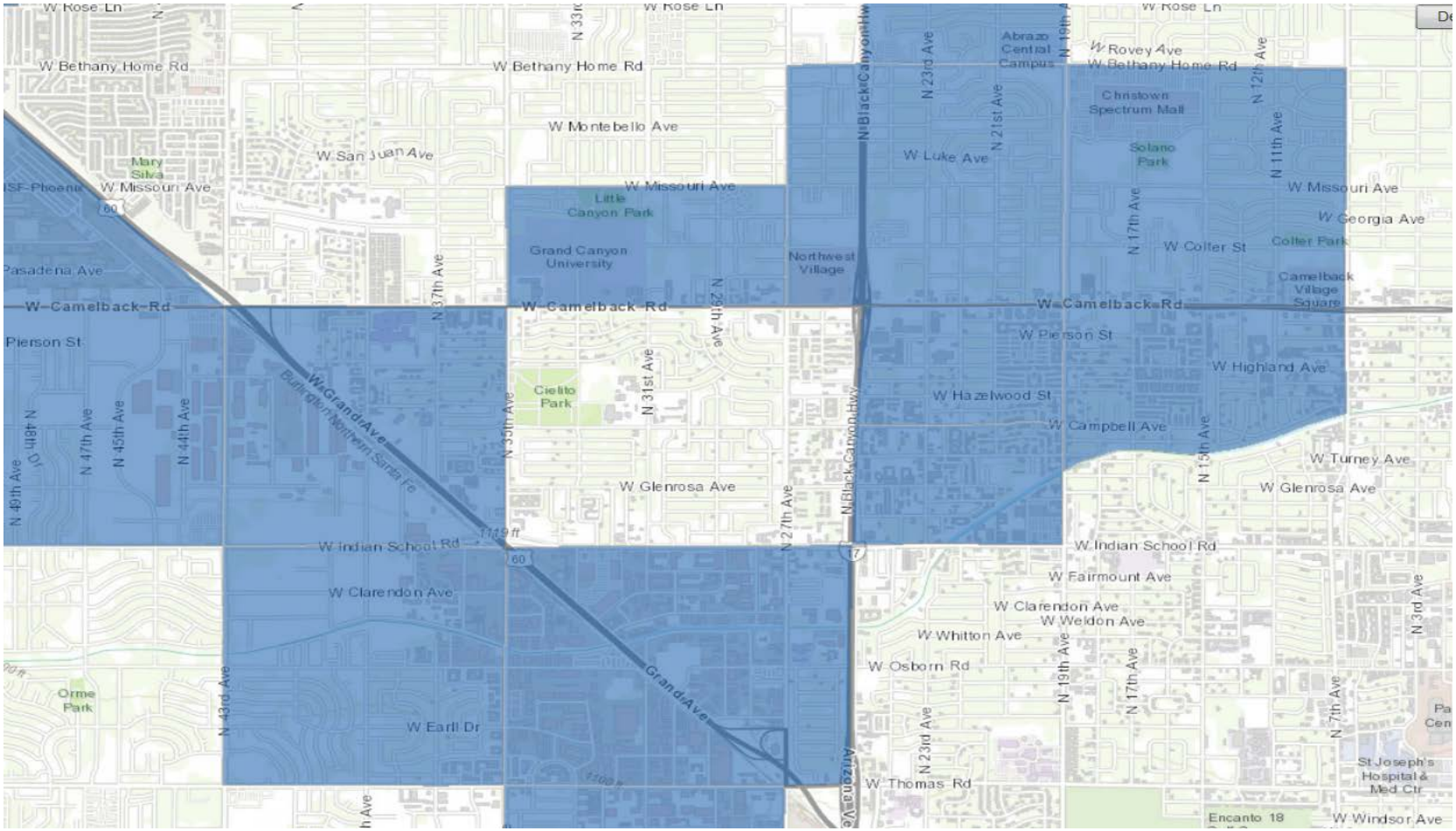
O-Zones Surrounding Grand Canyon University



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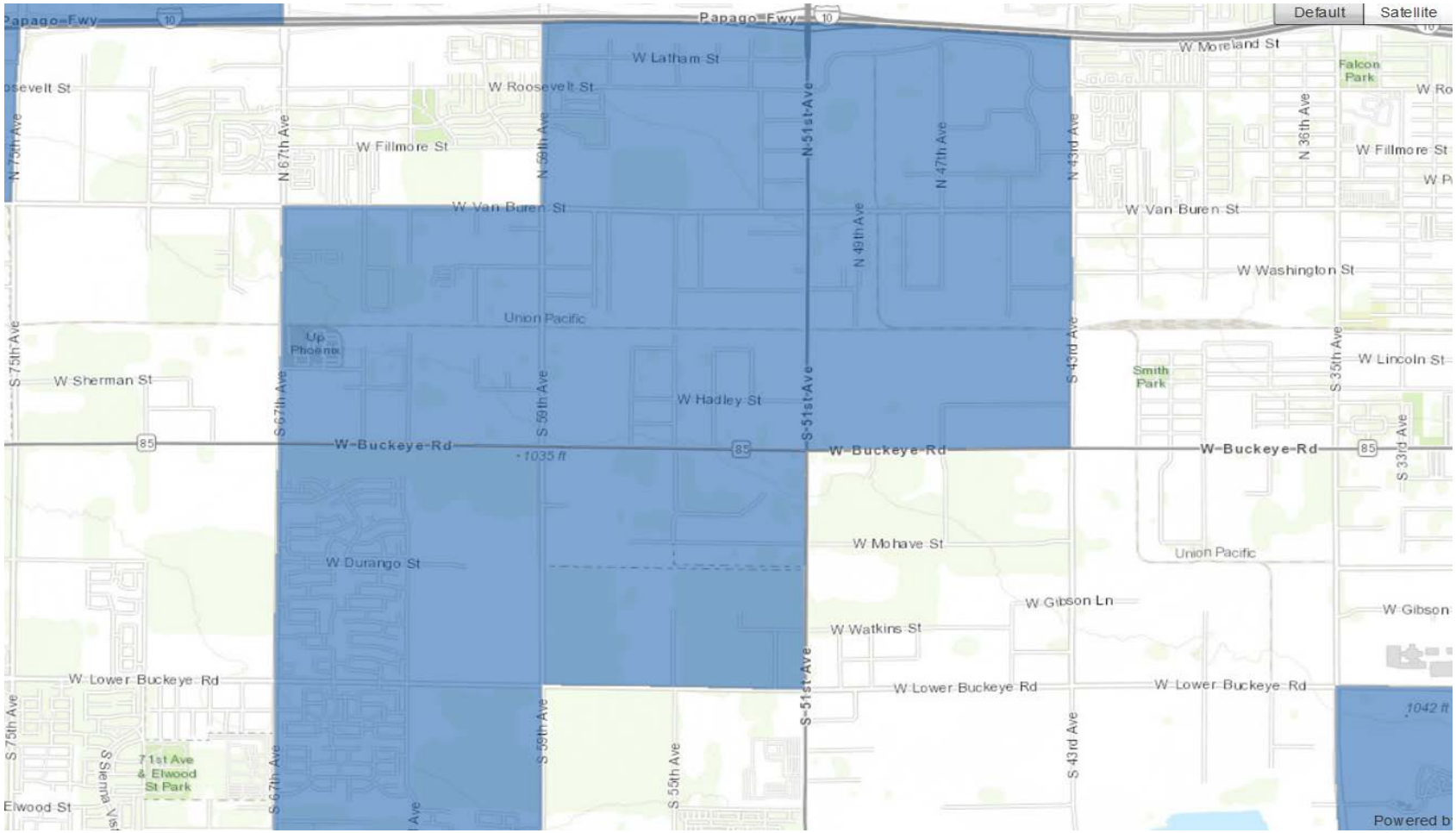
O-Zones (51st Avenue/Buckeye)



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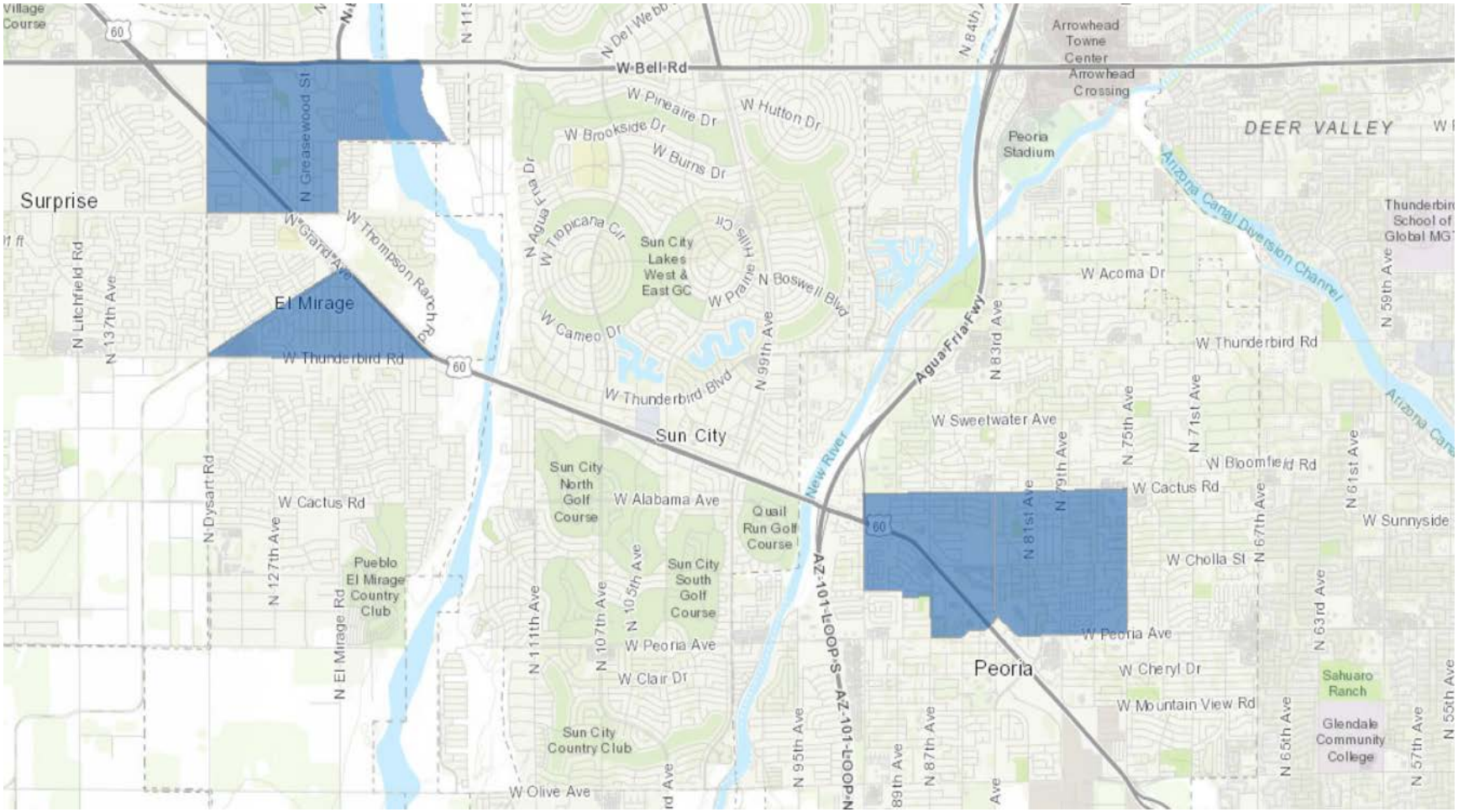
O-Zones In Peoria/Surprise



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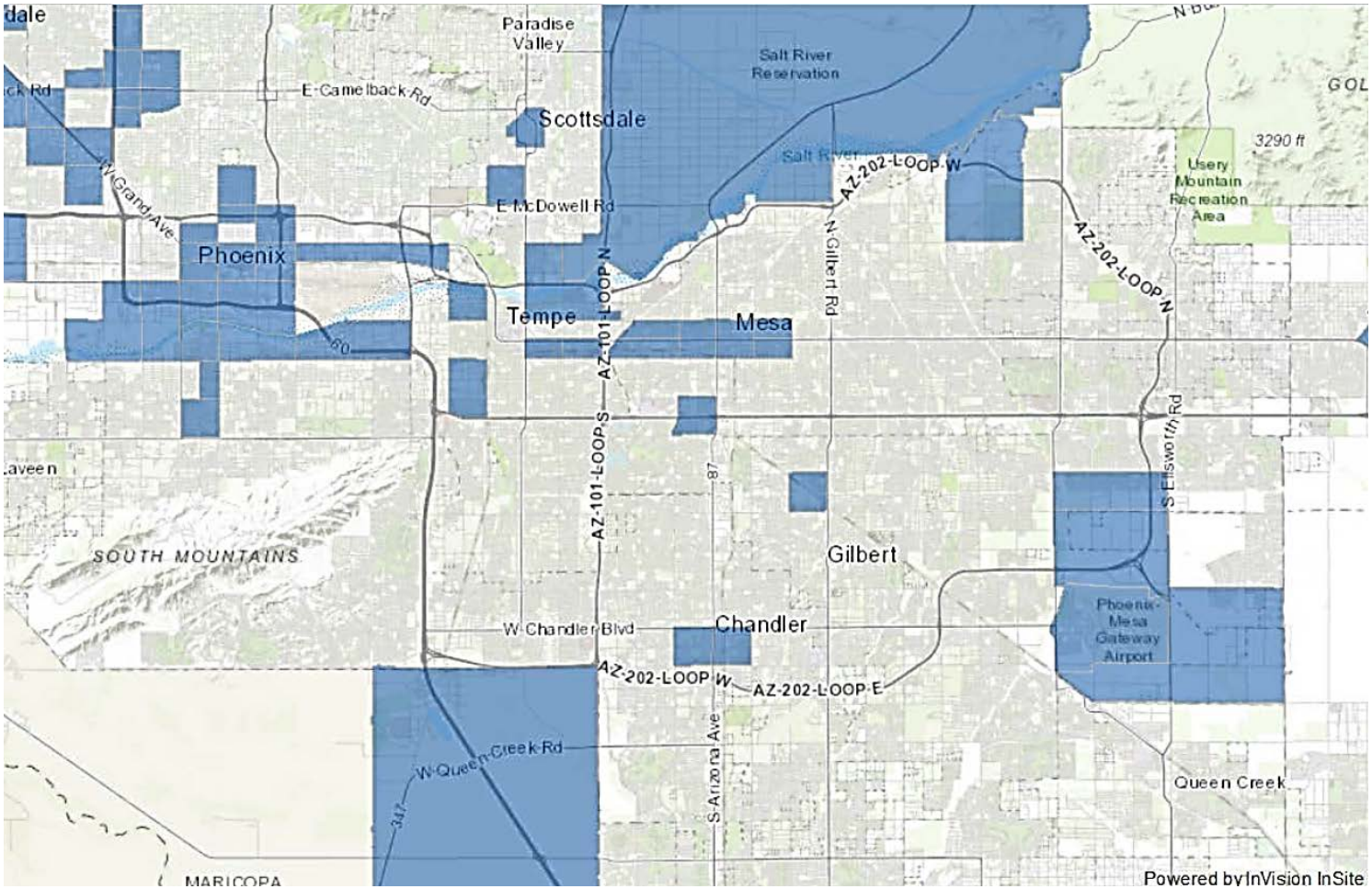
O-Zones in the East Valley



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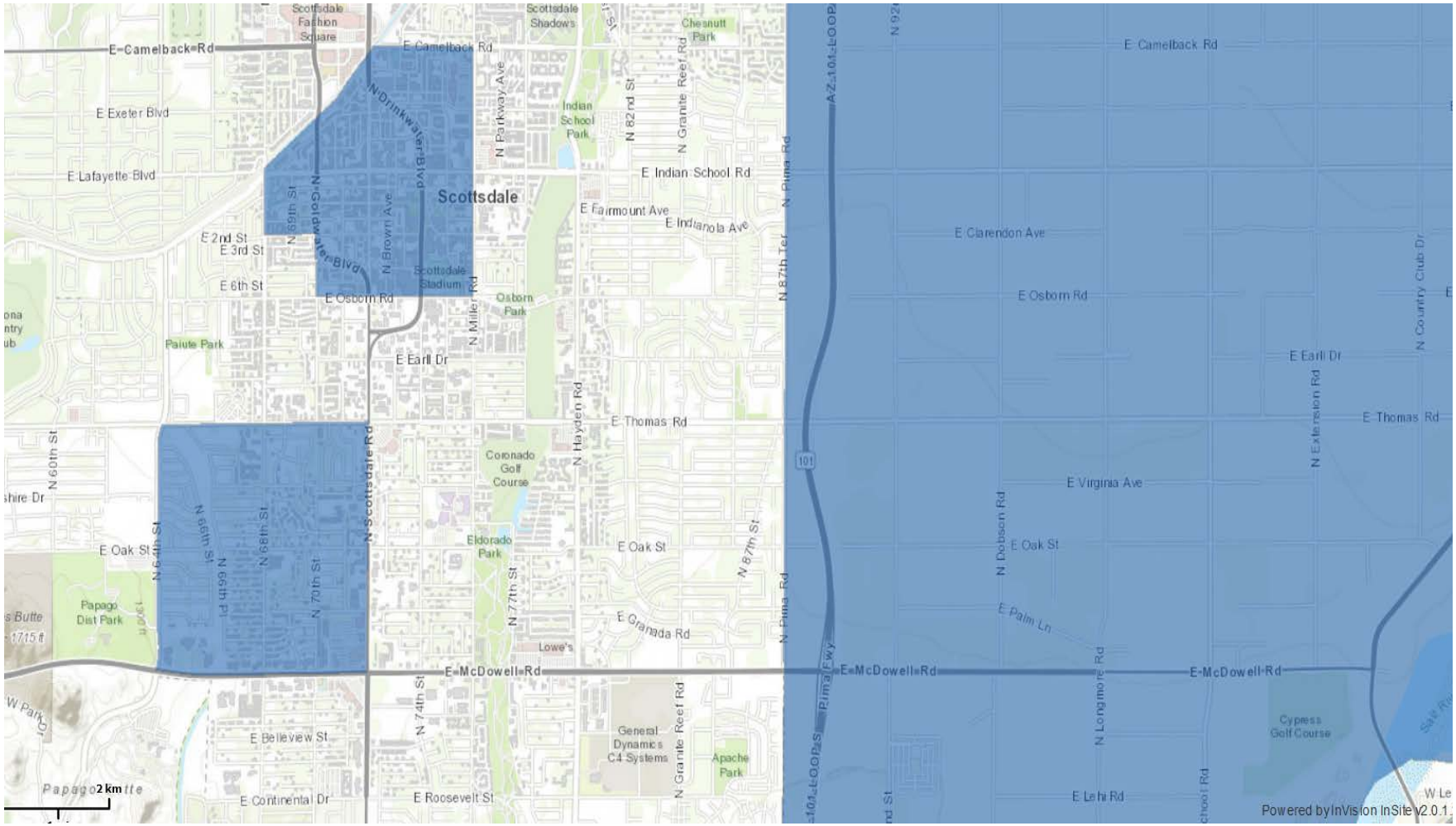
O-Zones in Scottsdale



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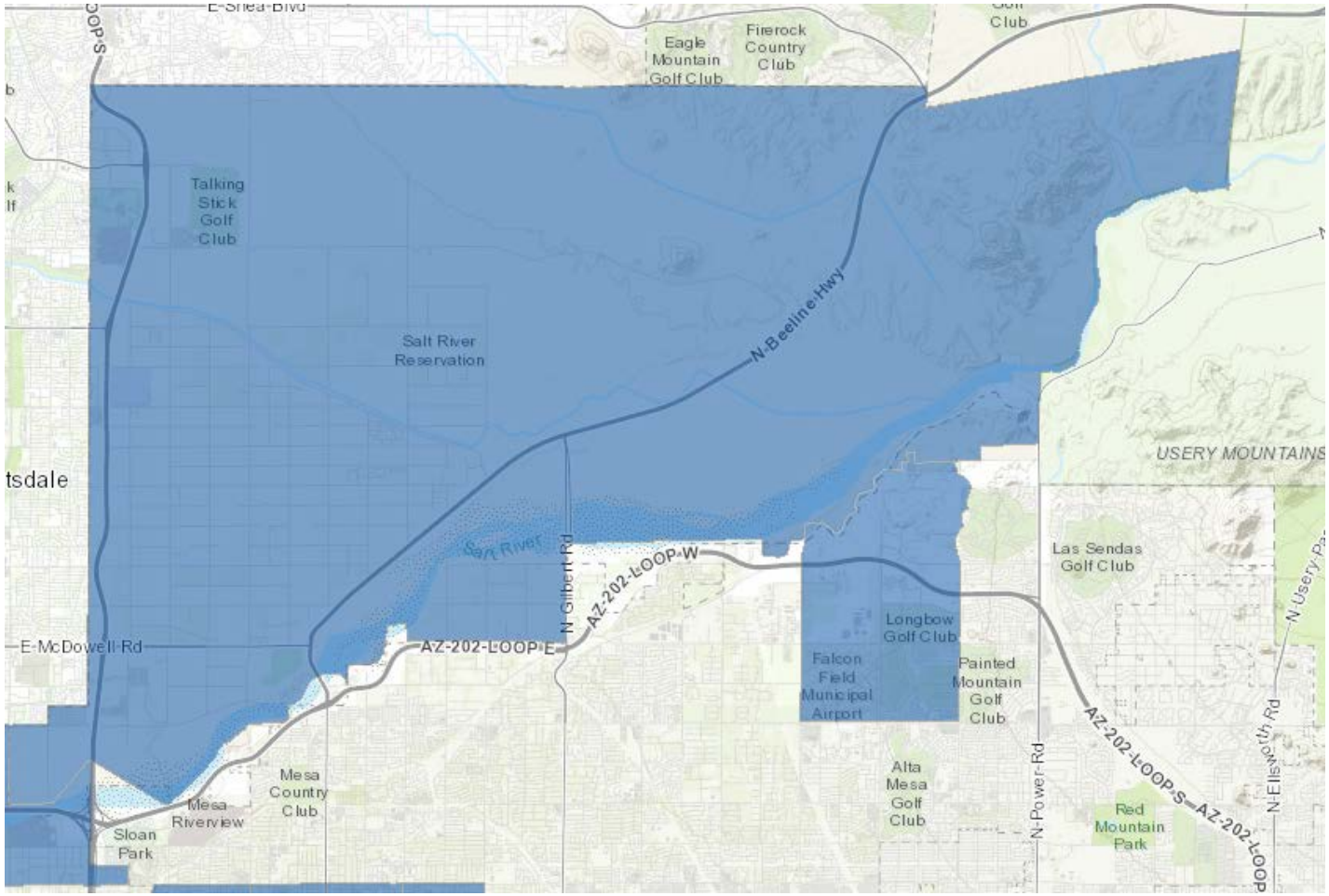
O-Zones Salt River



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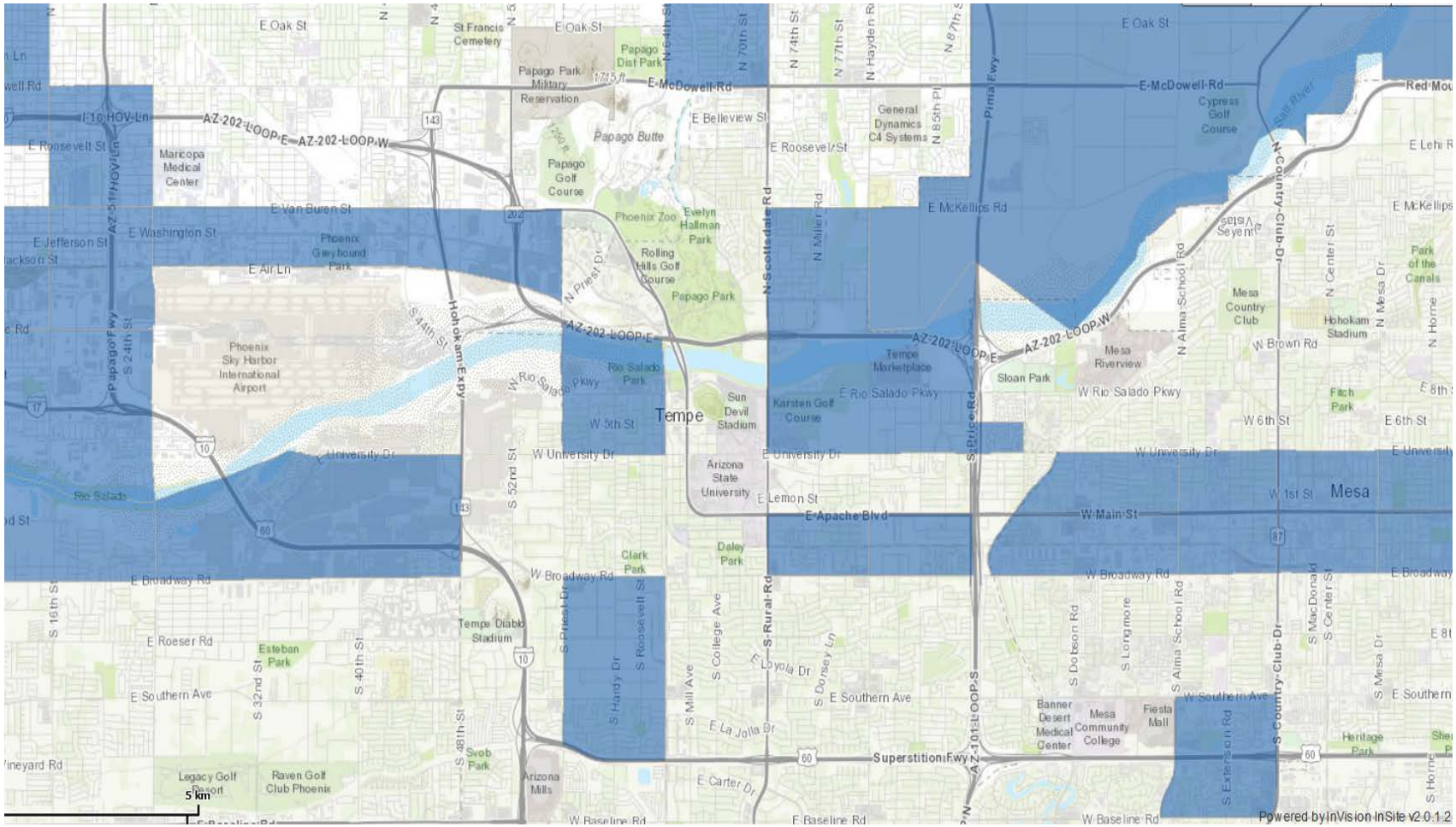
O-Zones in Tempe



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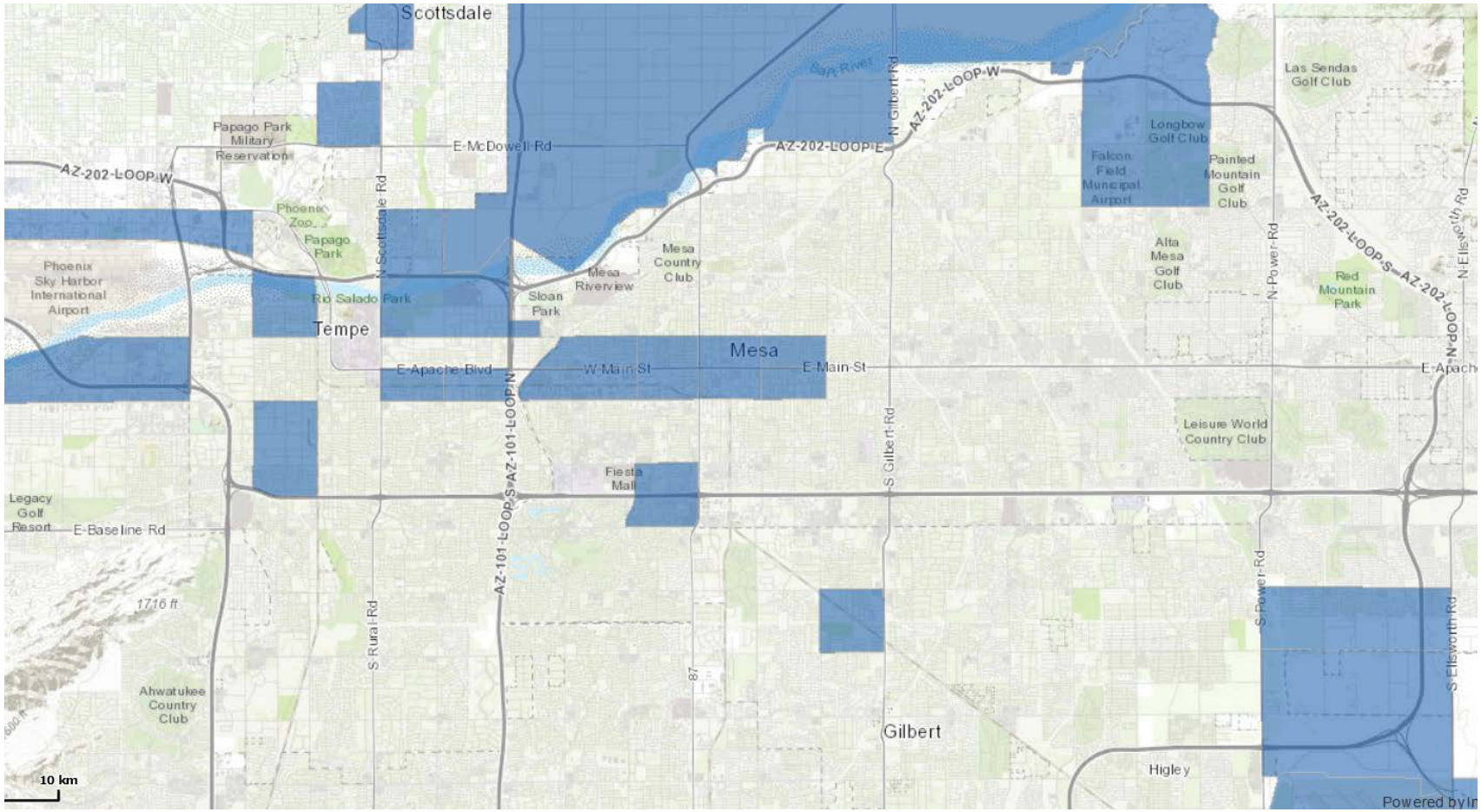
O-Zones in Mesa



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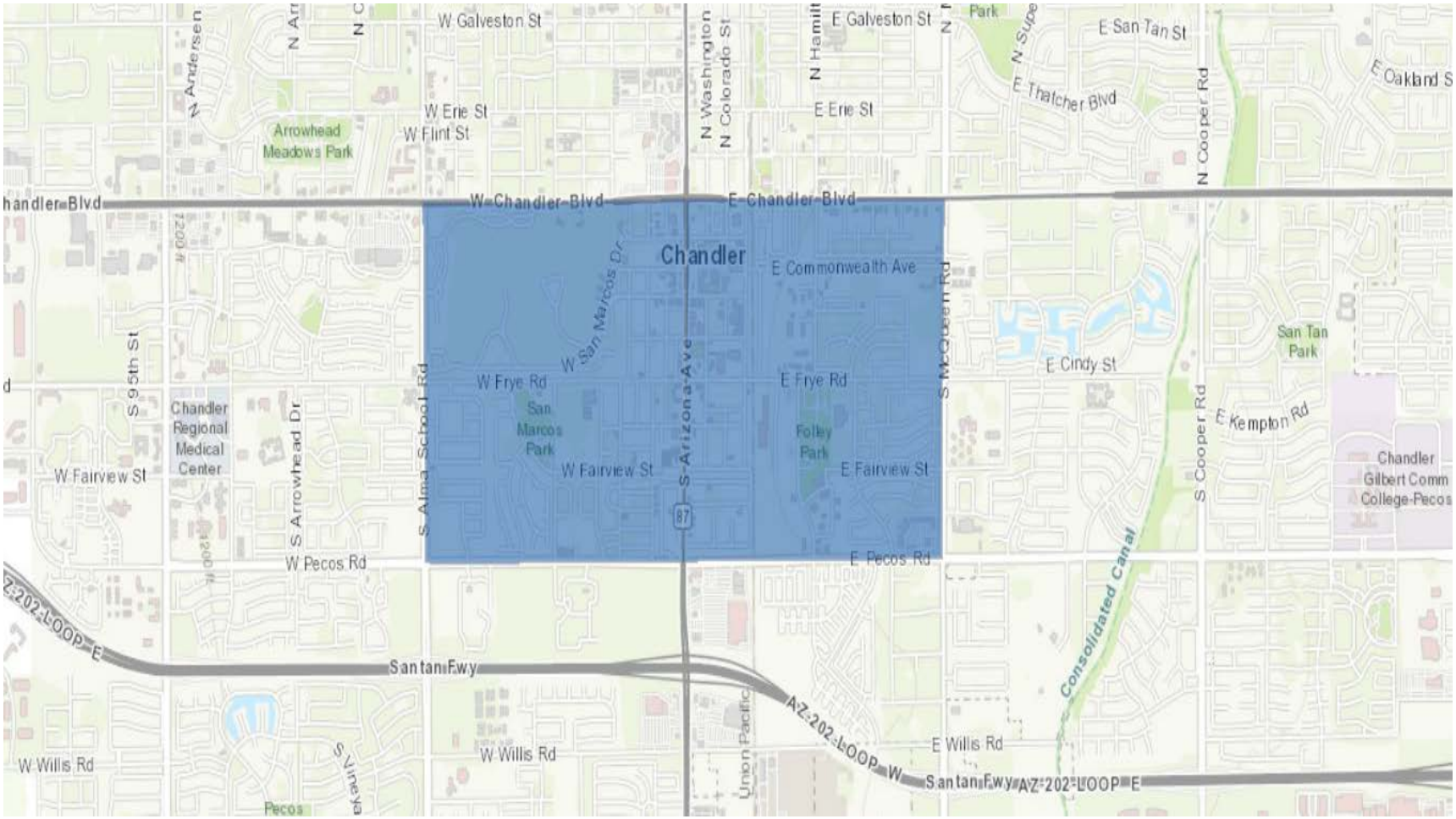
O-Zones in Chandler



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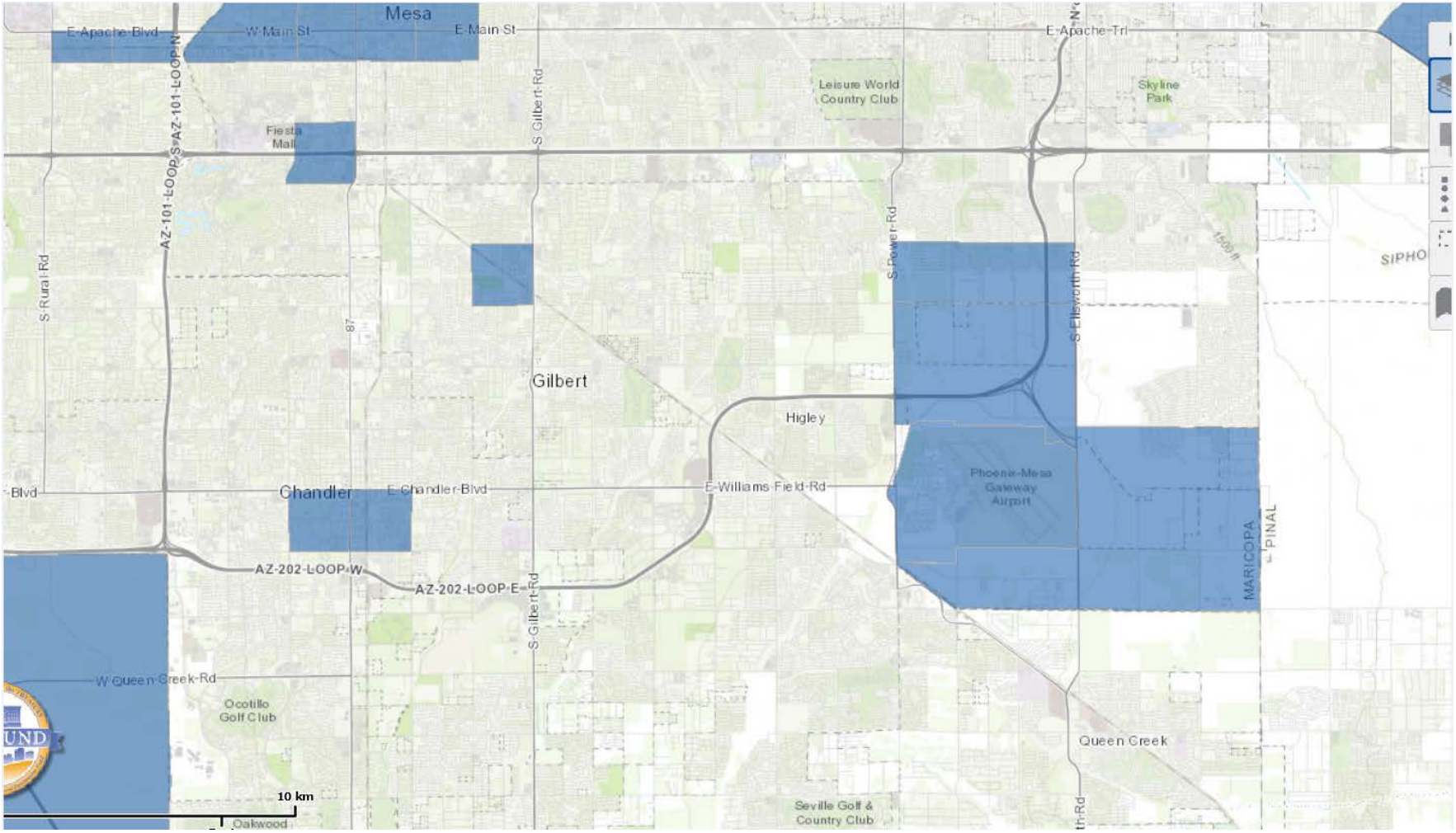
O-Zones near Phoenix-Mesa Gateway Airport



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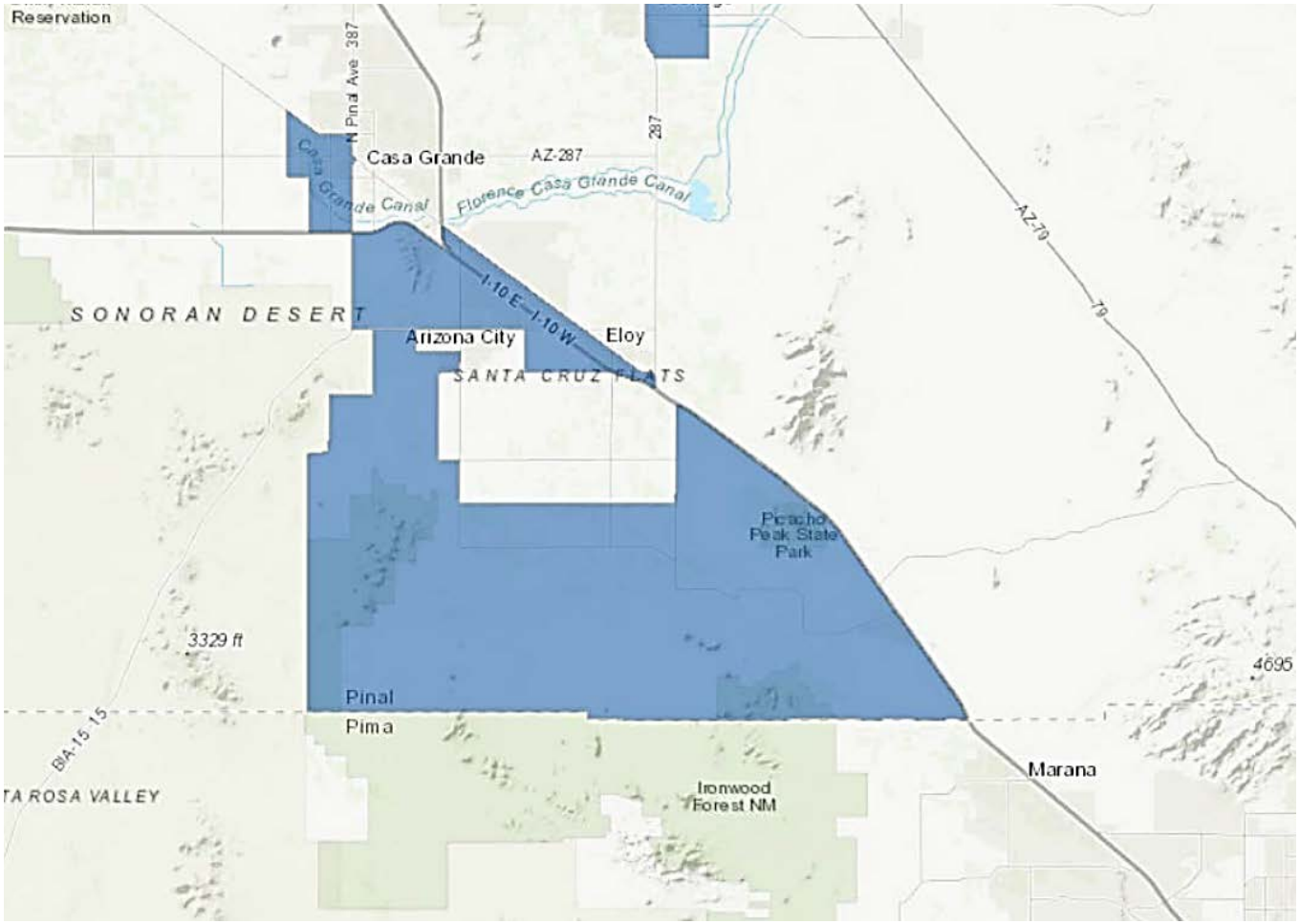
O-Zones in Pinal County



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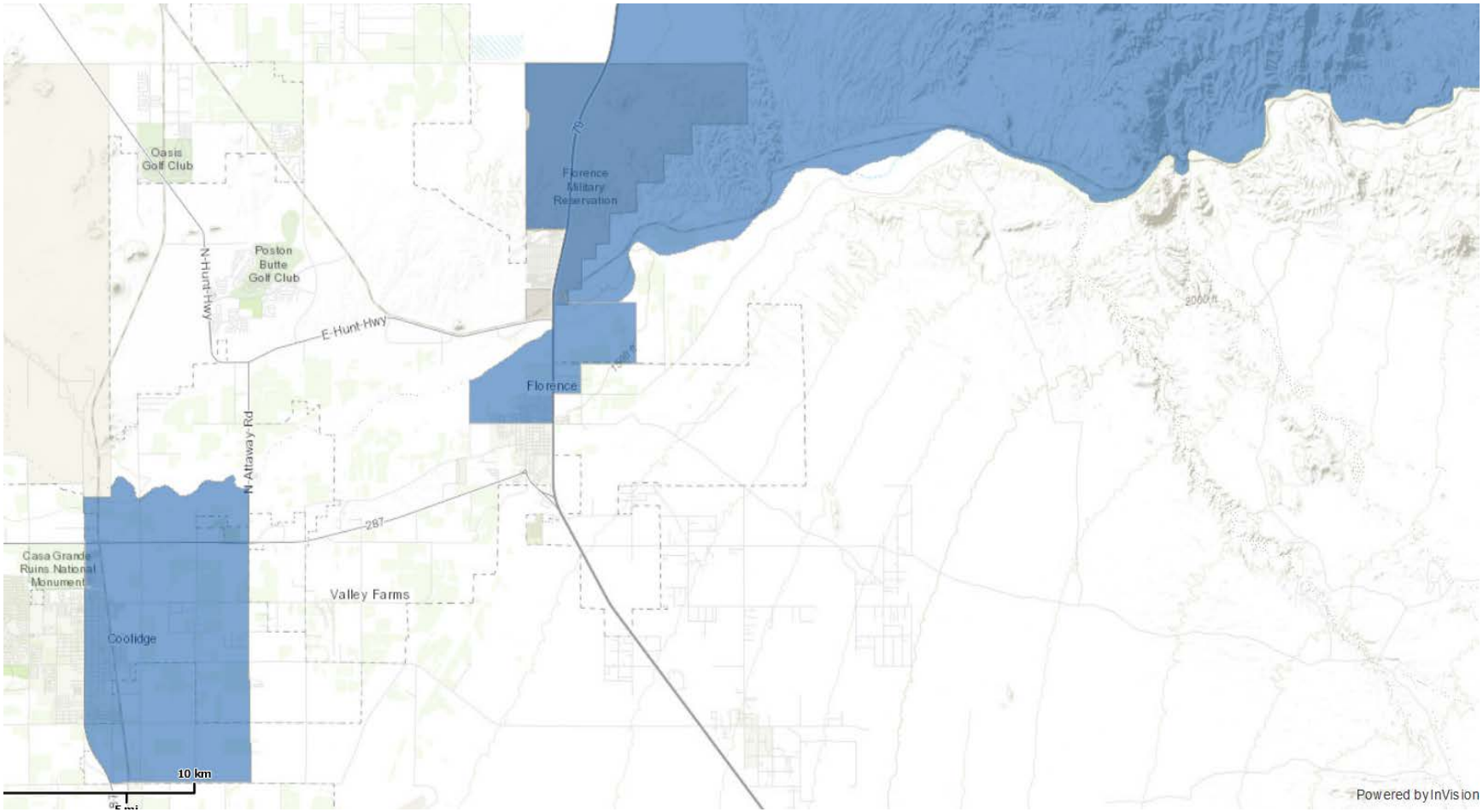
O-Zones in Florence



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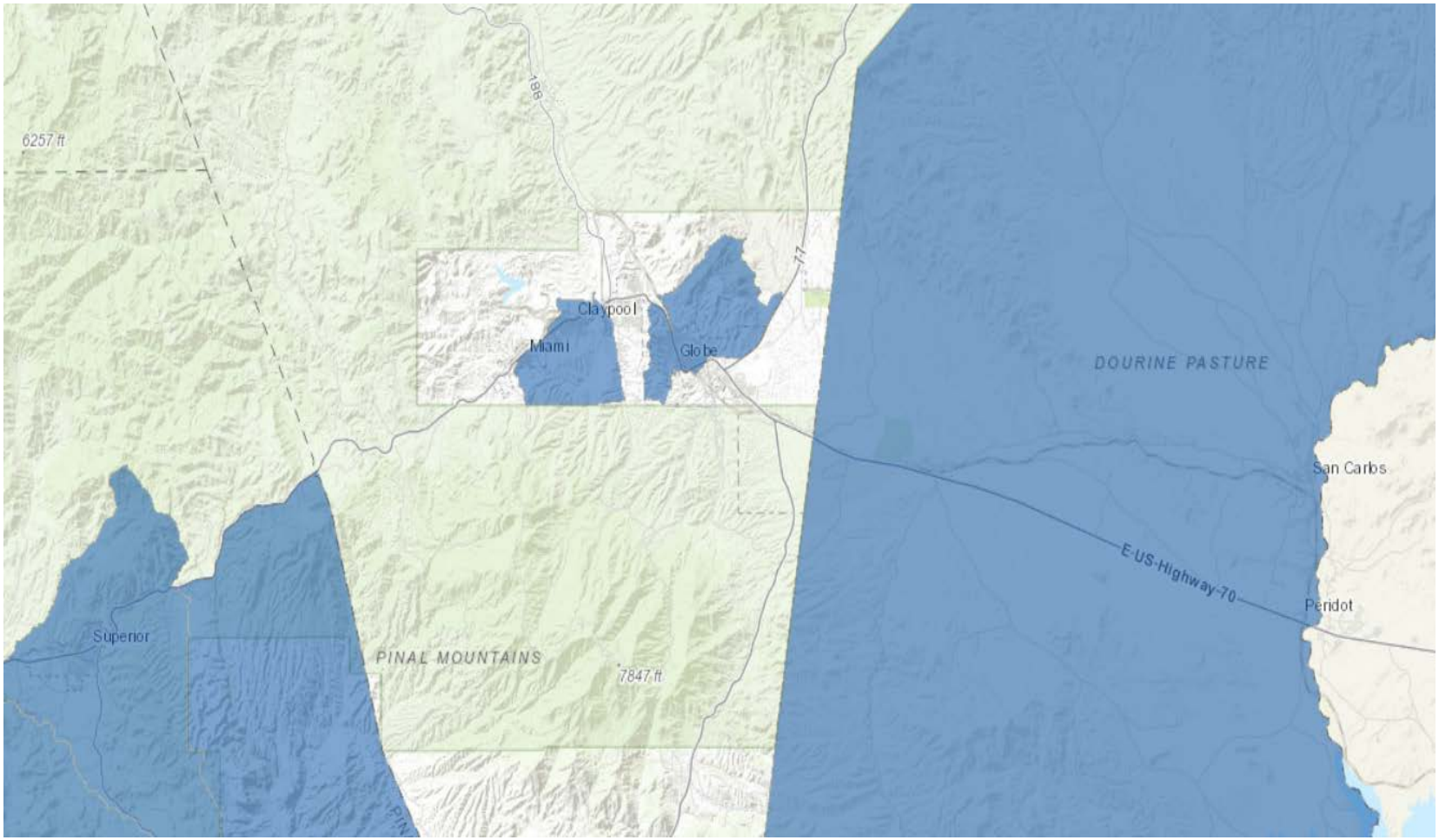
O-Zones in Globe



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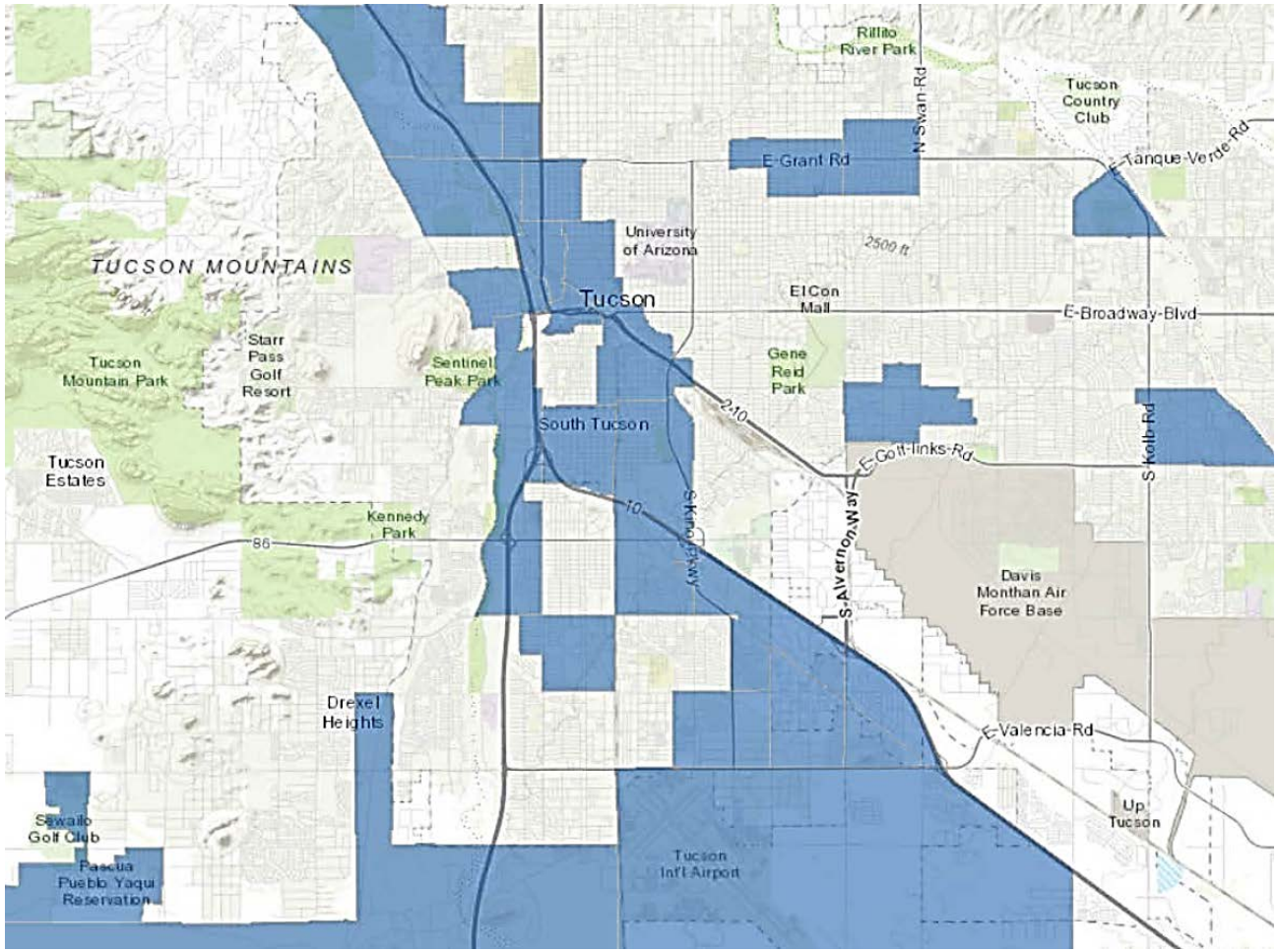
O-Zones in the Tucson Metropolitan Area



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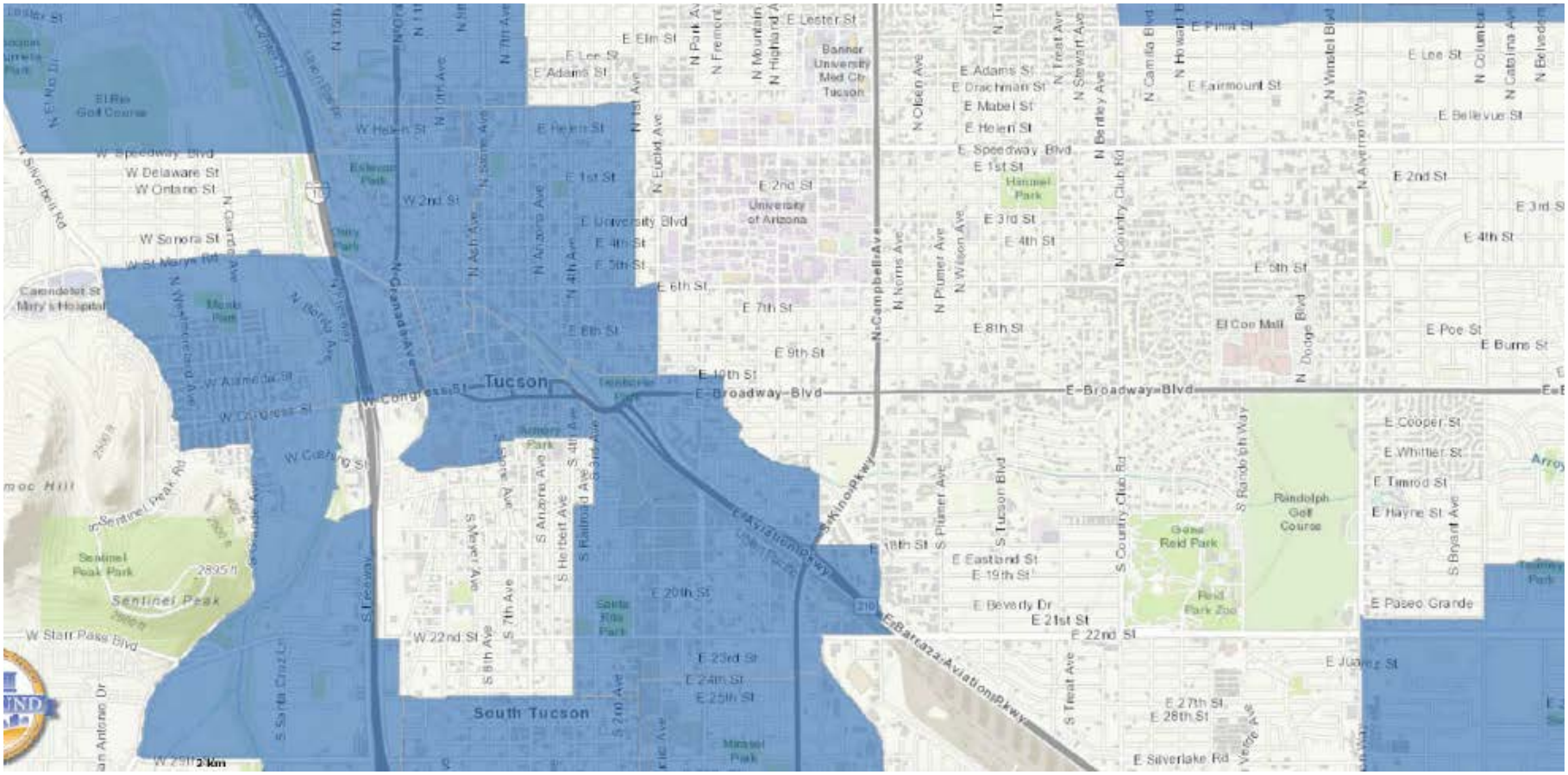
O-Zones in Downtown Tucson



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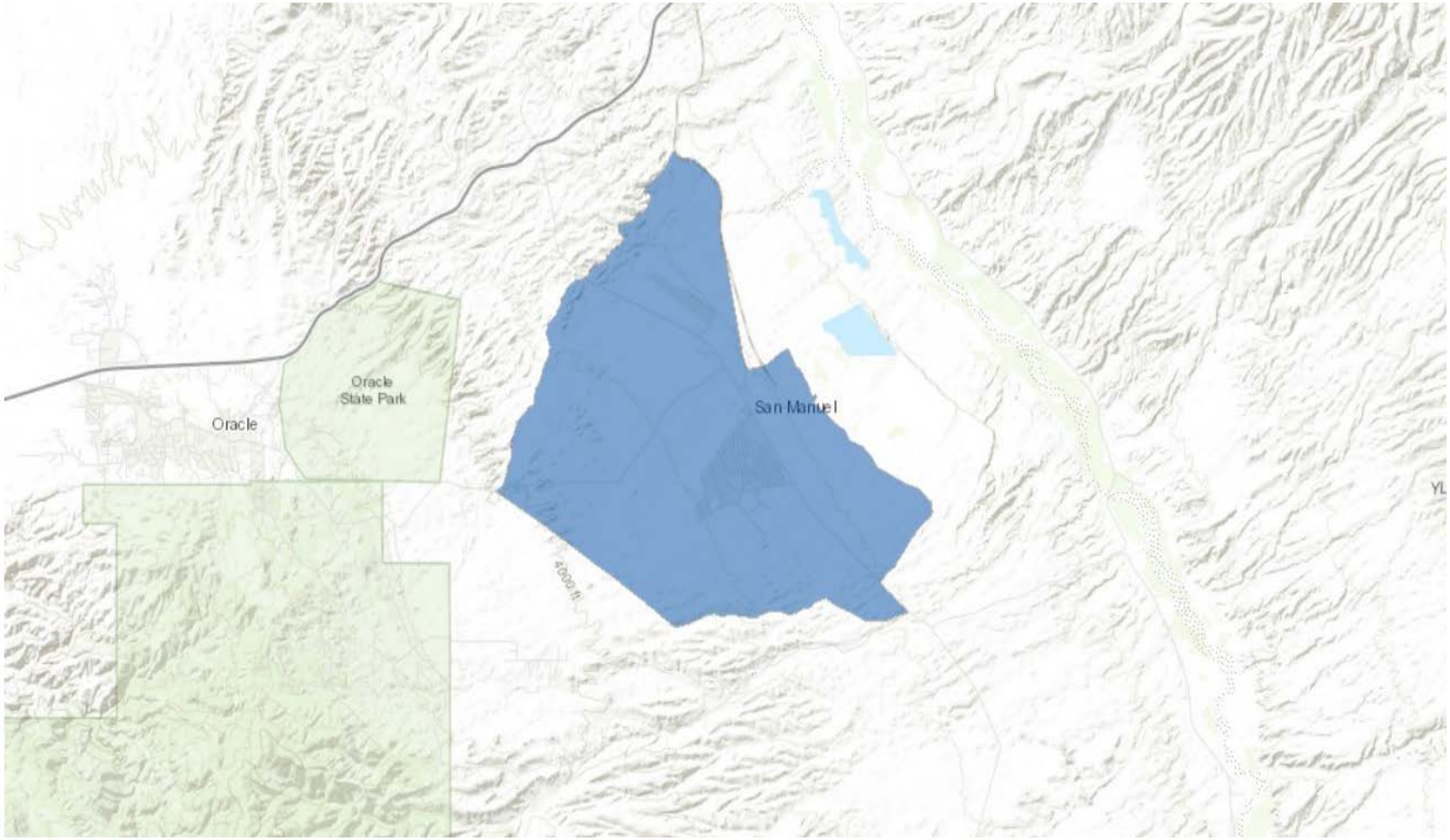
O-Zones in San Manuel



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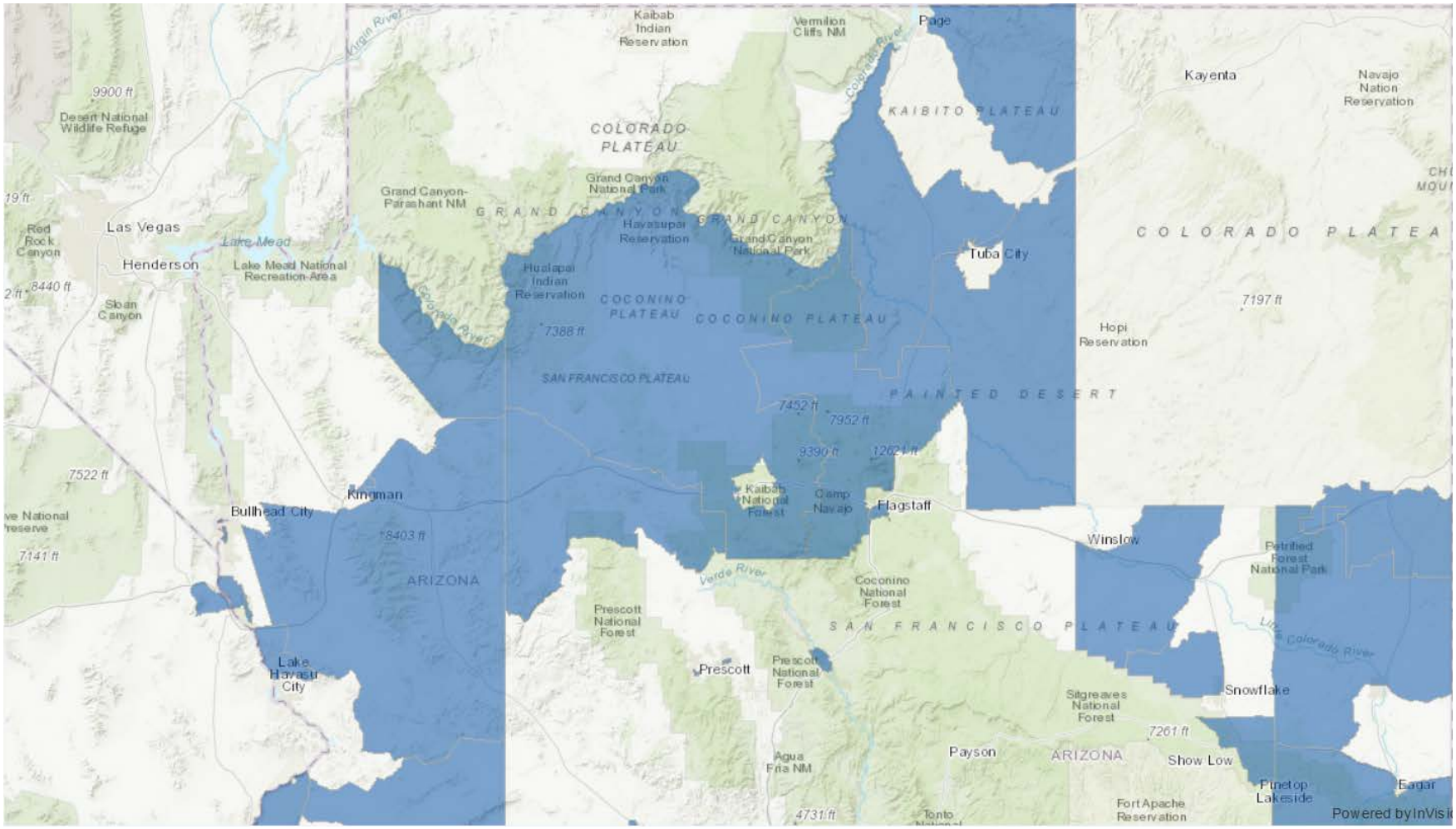
O-Zones in Northern Arizona



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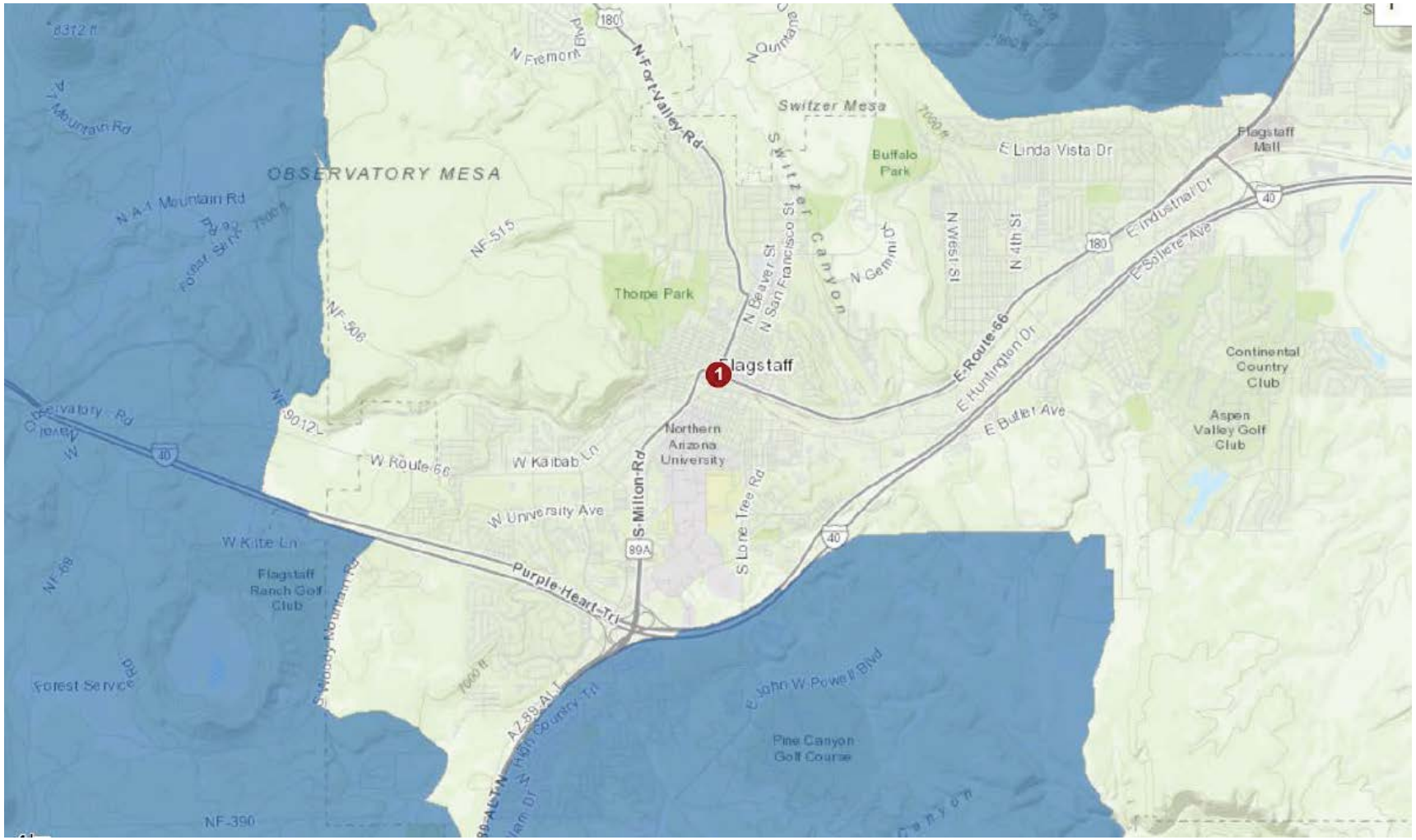
O-Zones near Flagstaff



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O-Zones near Prescott

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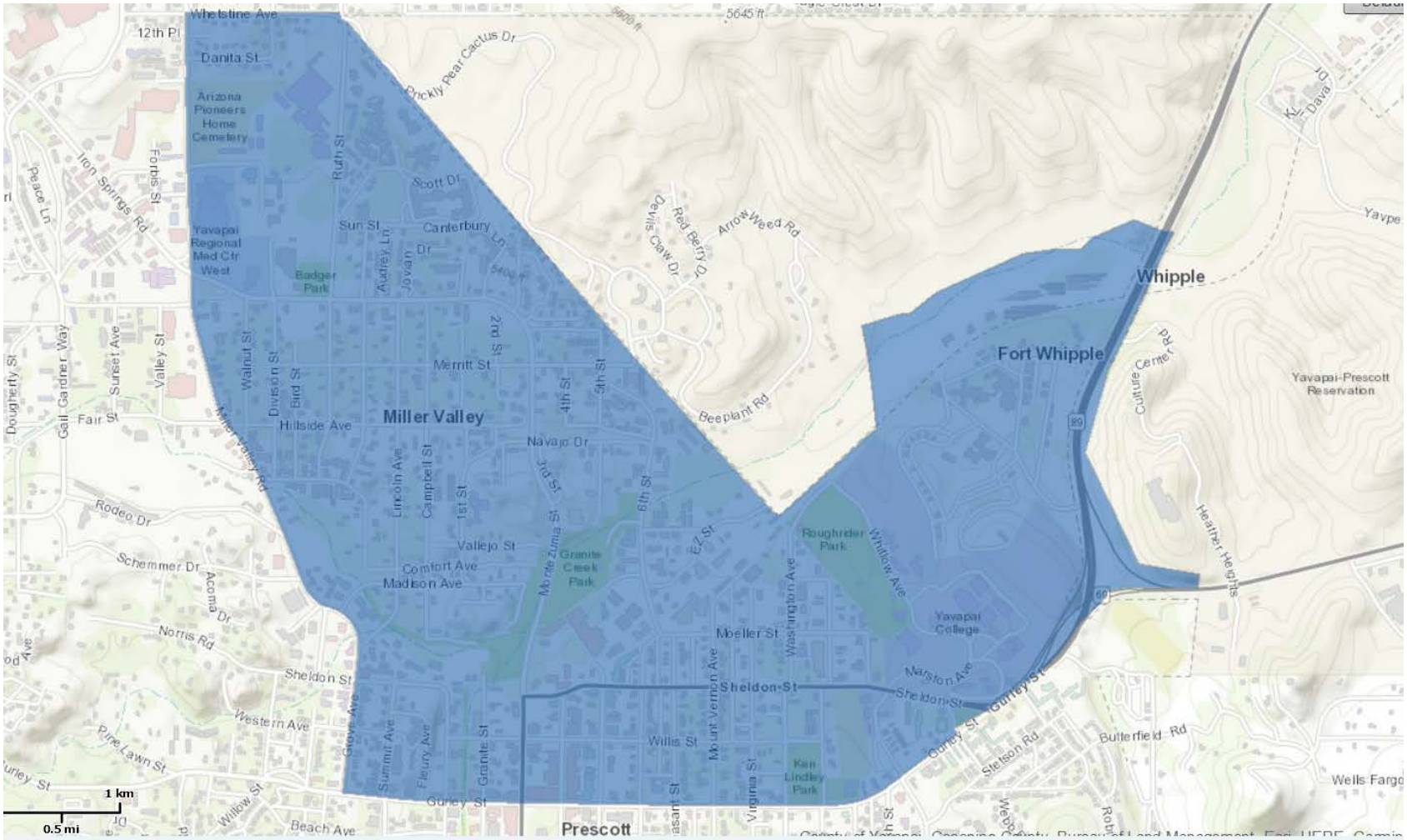
O-Zones in Prescott



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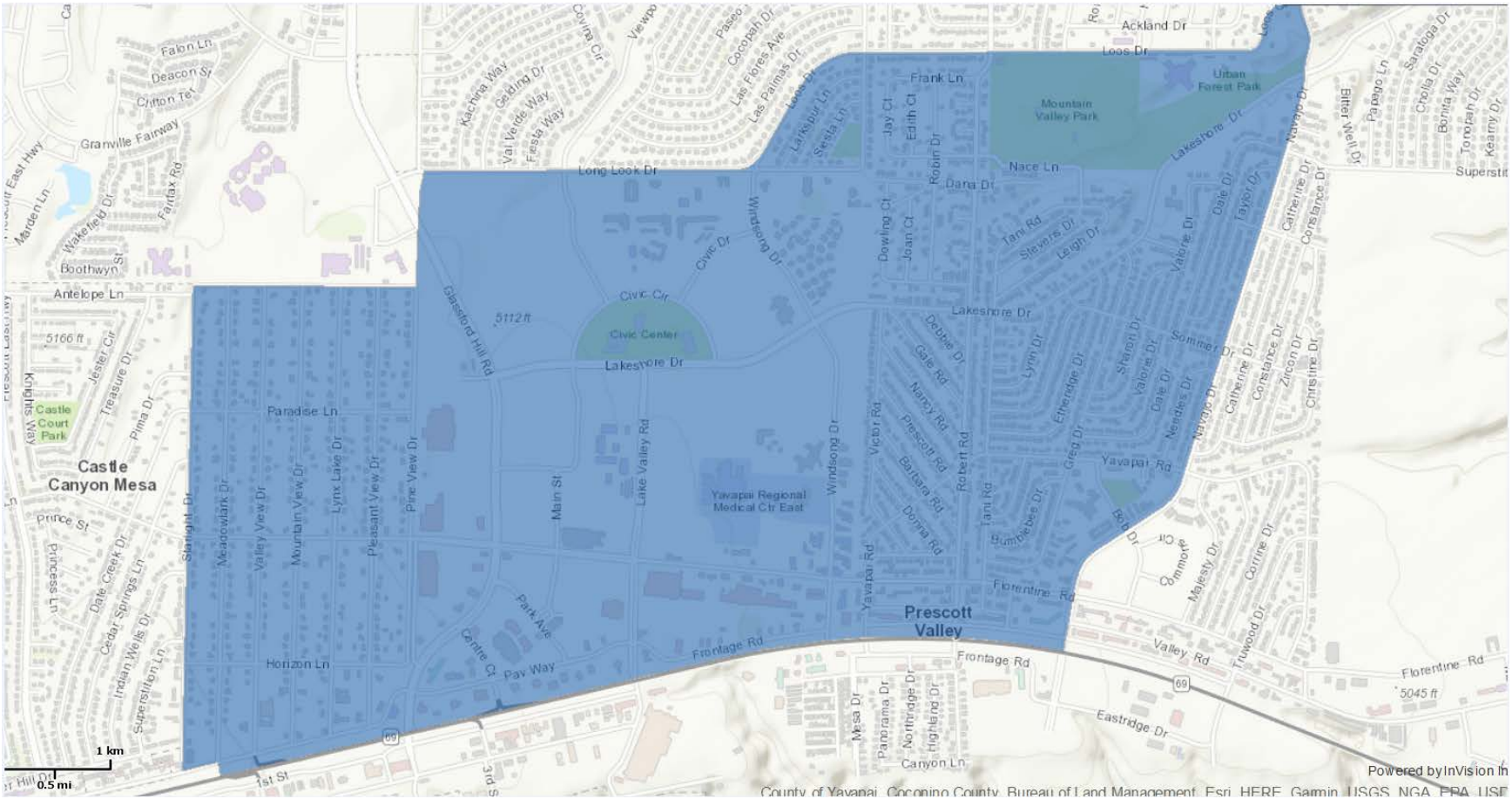
O-Zones in the Prescott Valley



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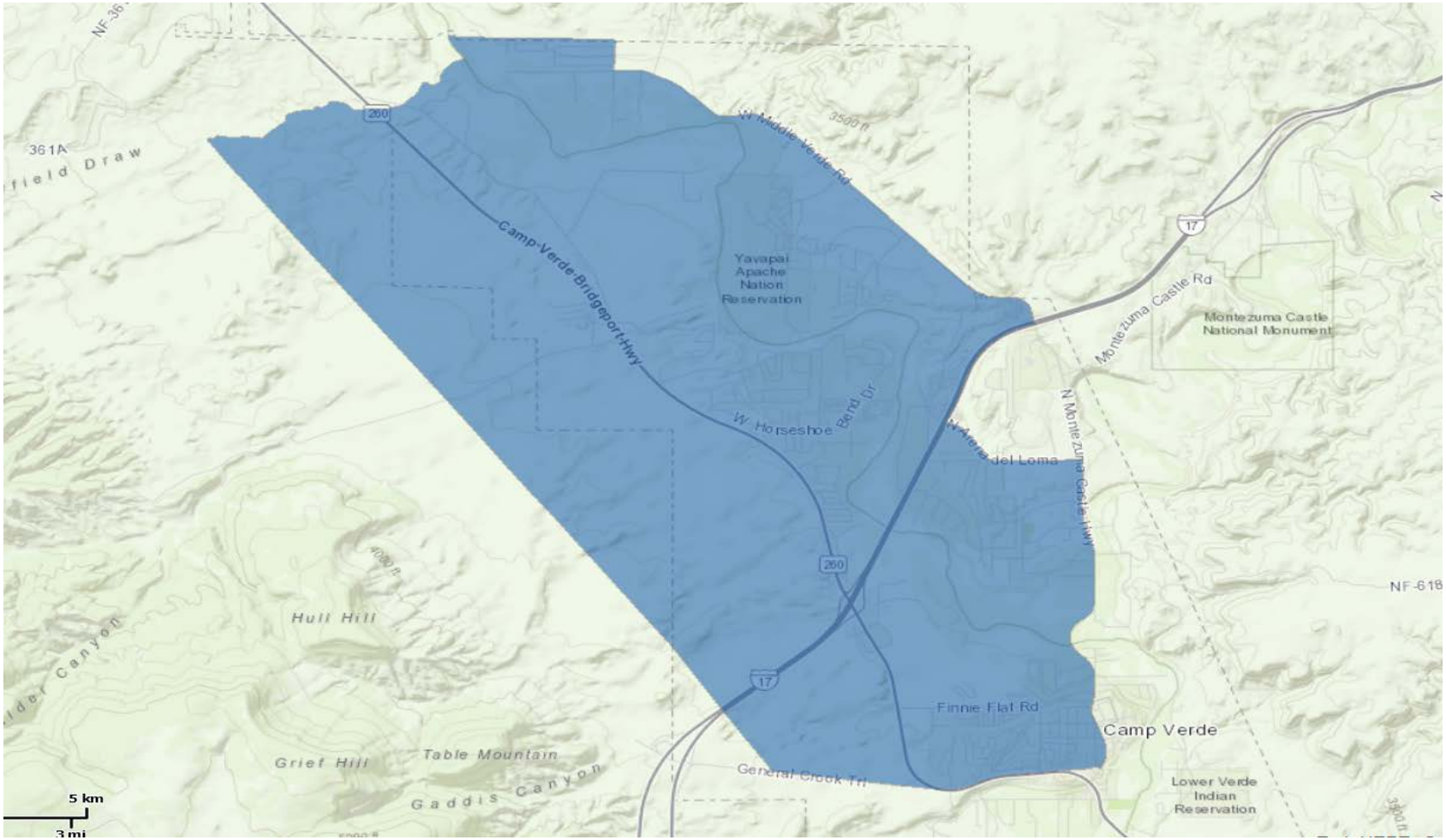
O-Zones in Camp Verde



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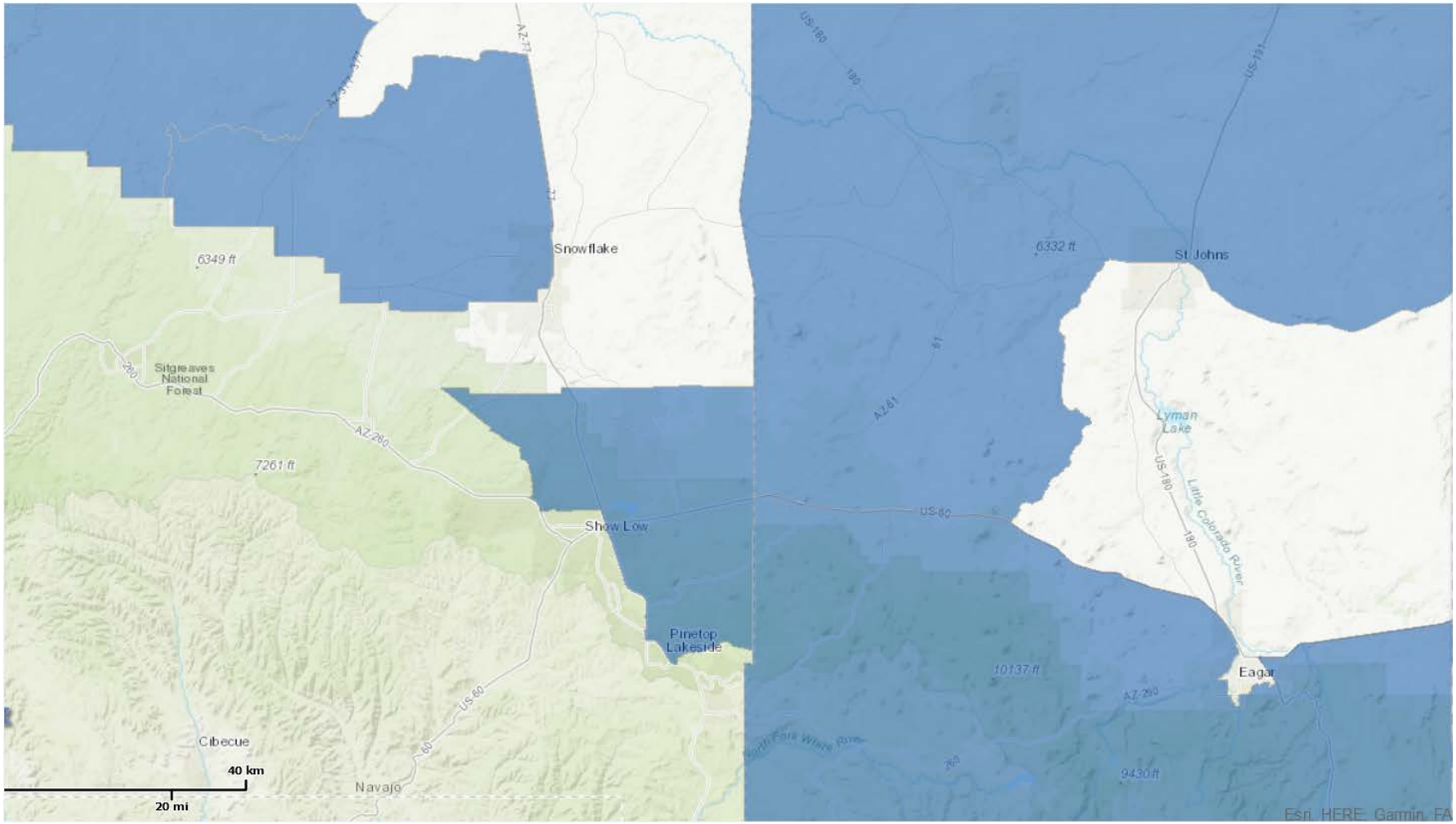
O-Zones in Show Low



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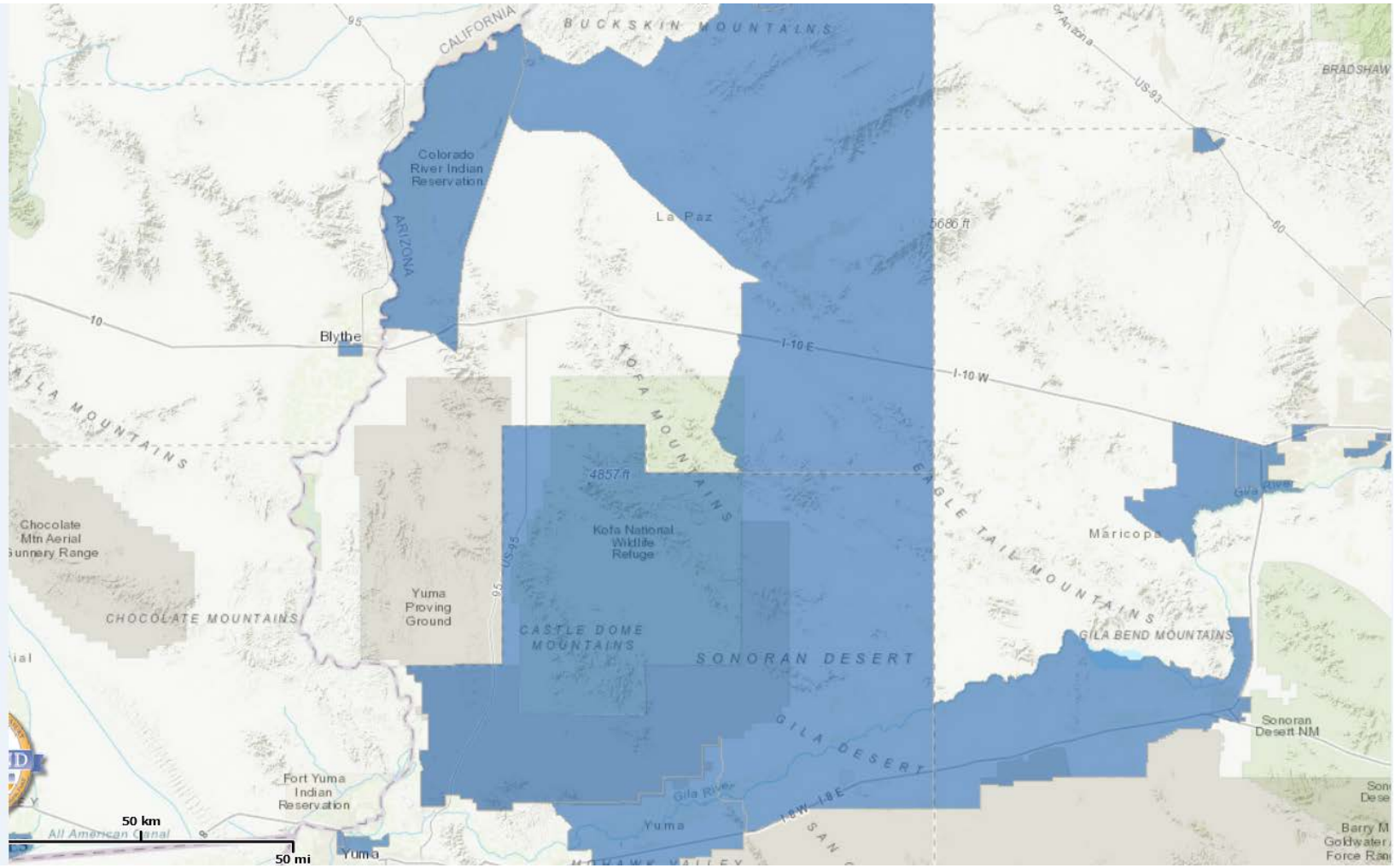
O-Zones in Western Arizona



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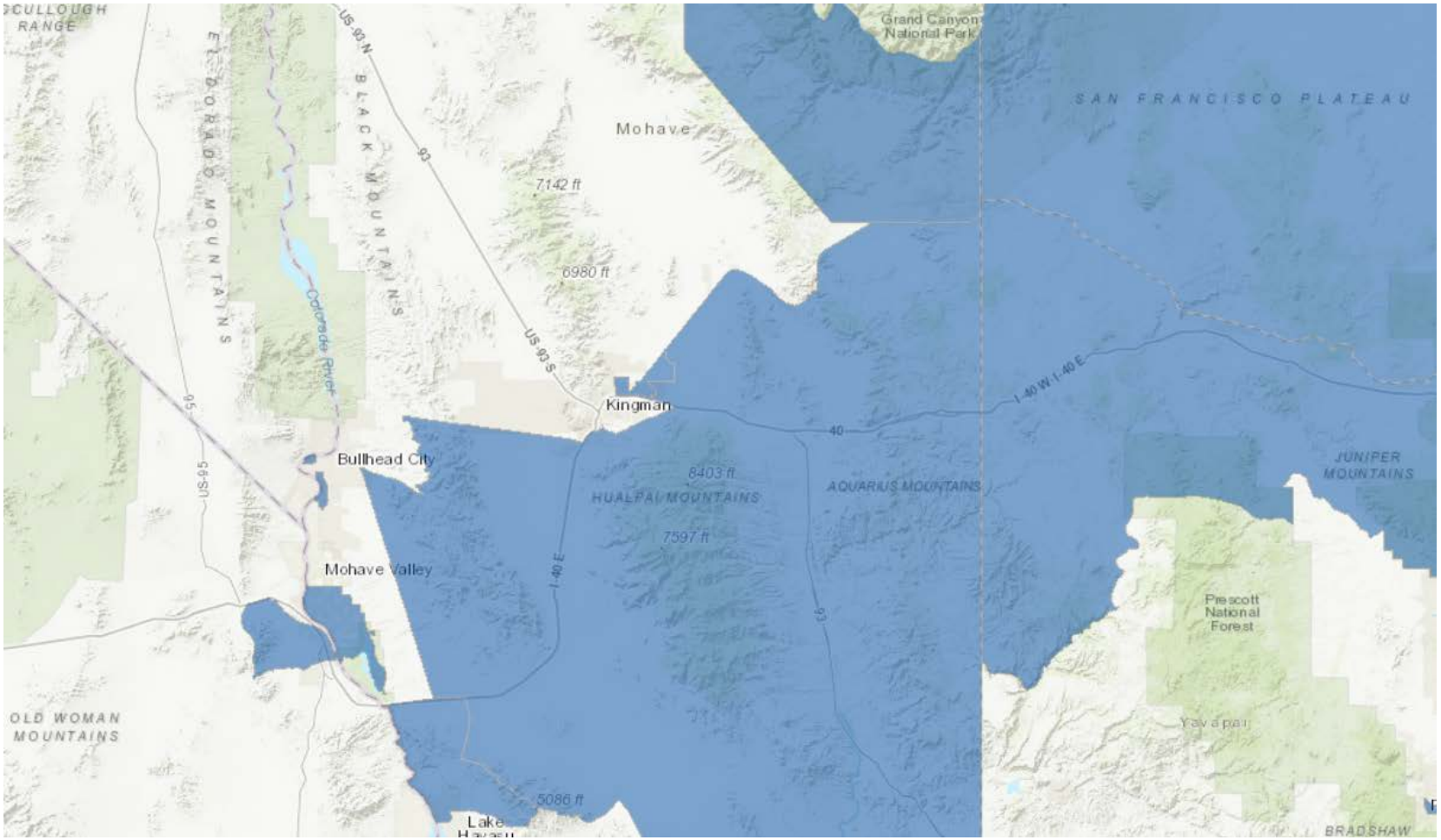
O-Zones in Kingman



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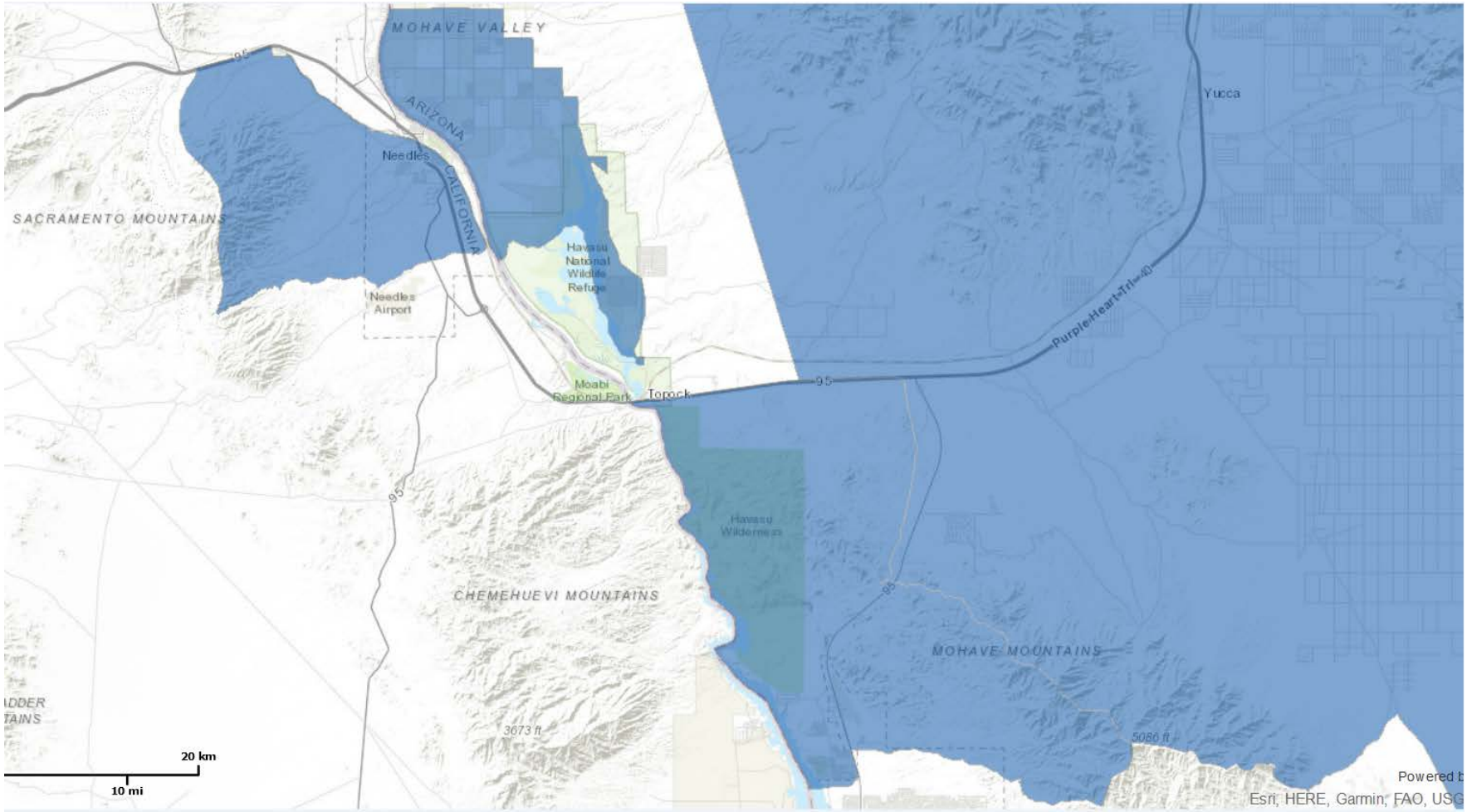
O-Zones Near Lake Havasu



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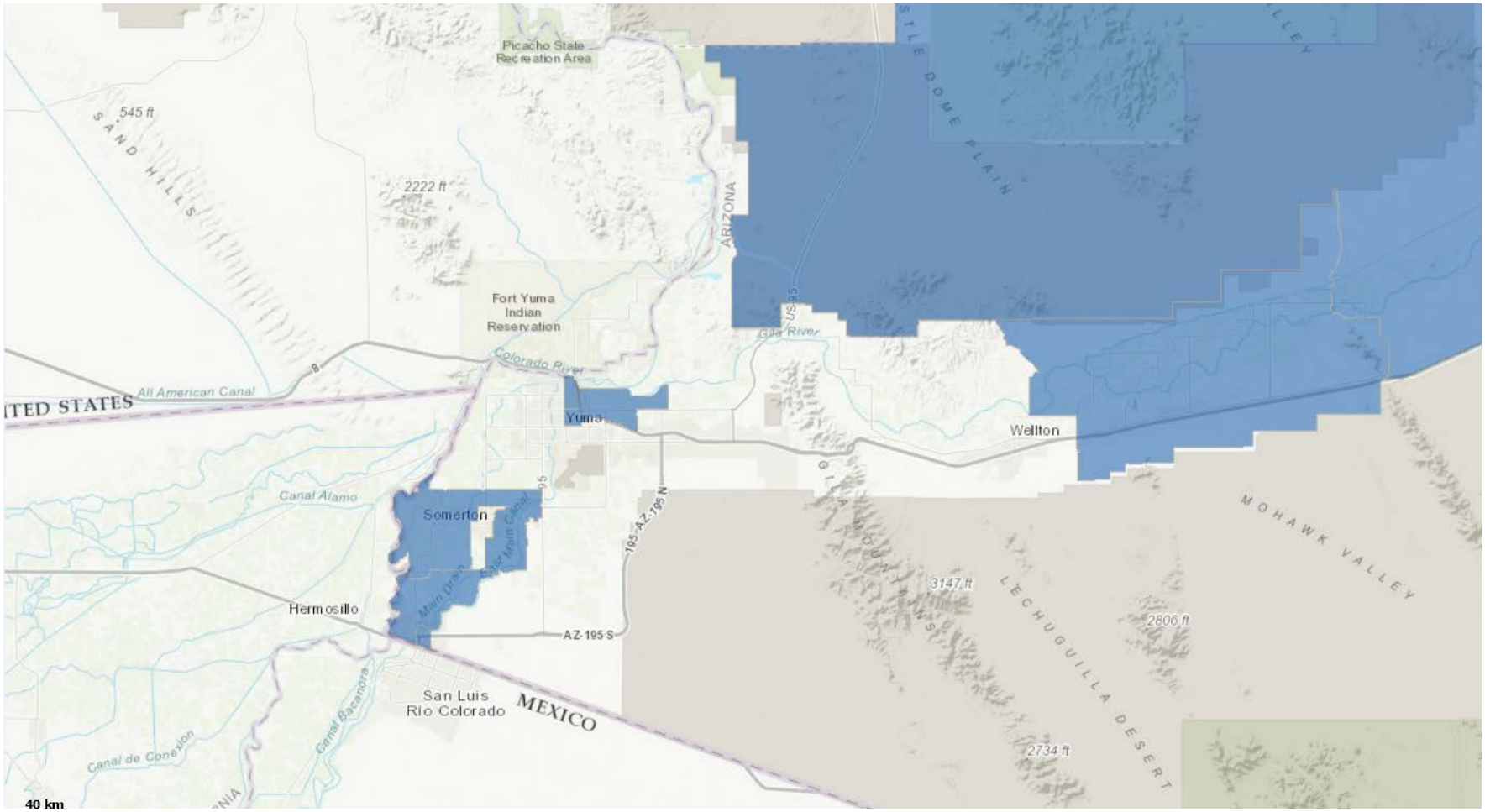
O-Zones in Southwest Arizona



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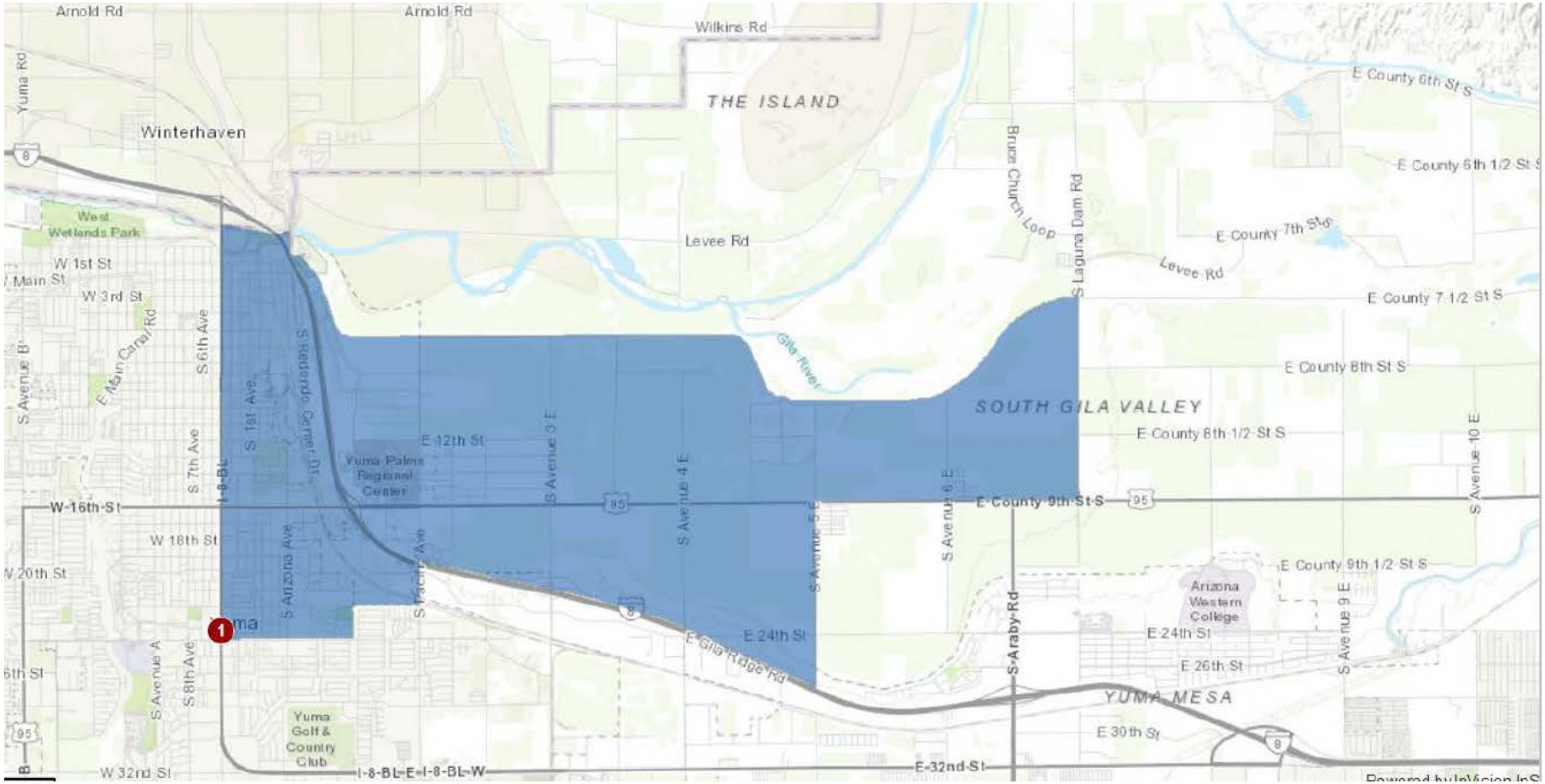
O-Zones in Yuma



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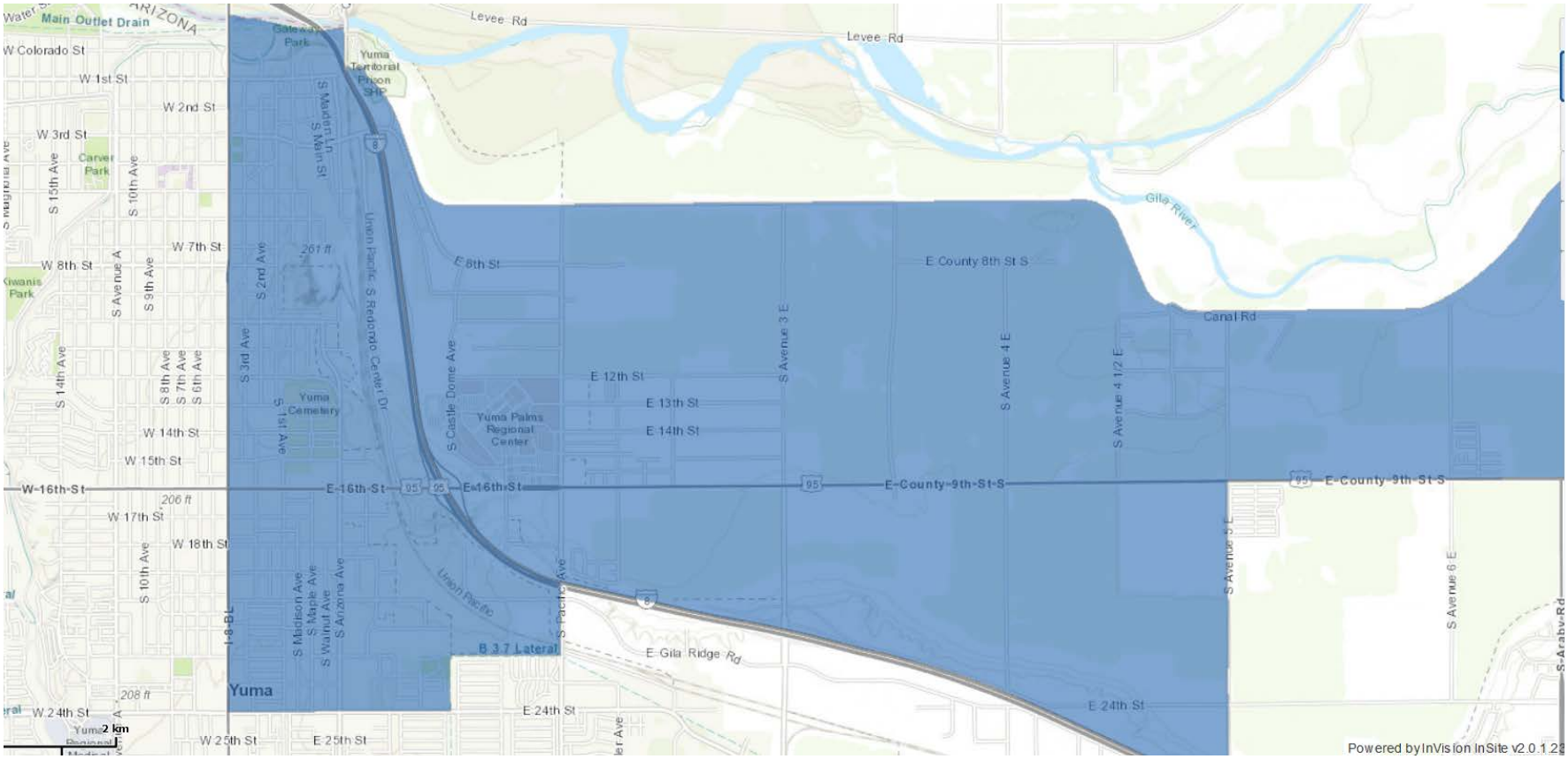
O-Zones in Yuma (close-up)



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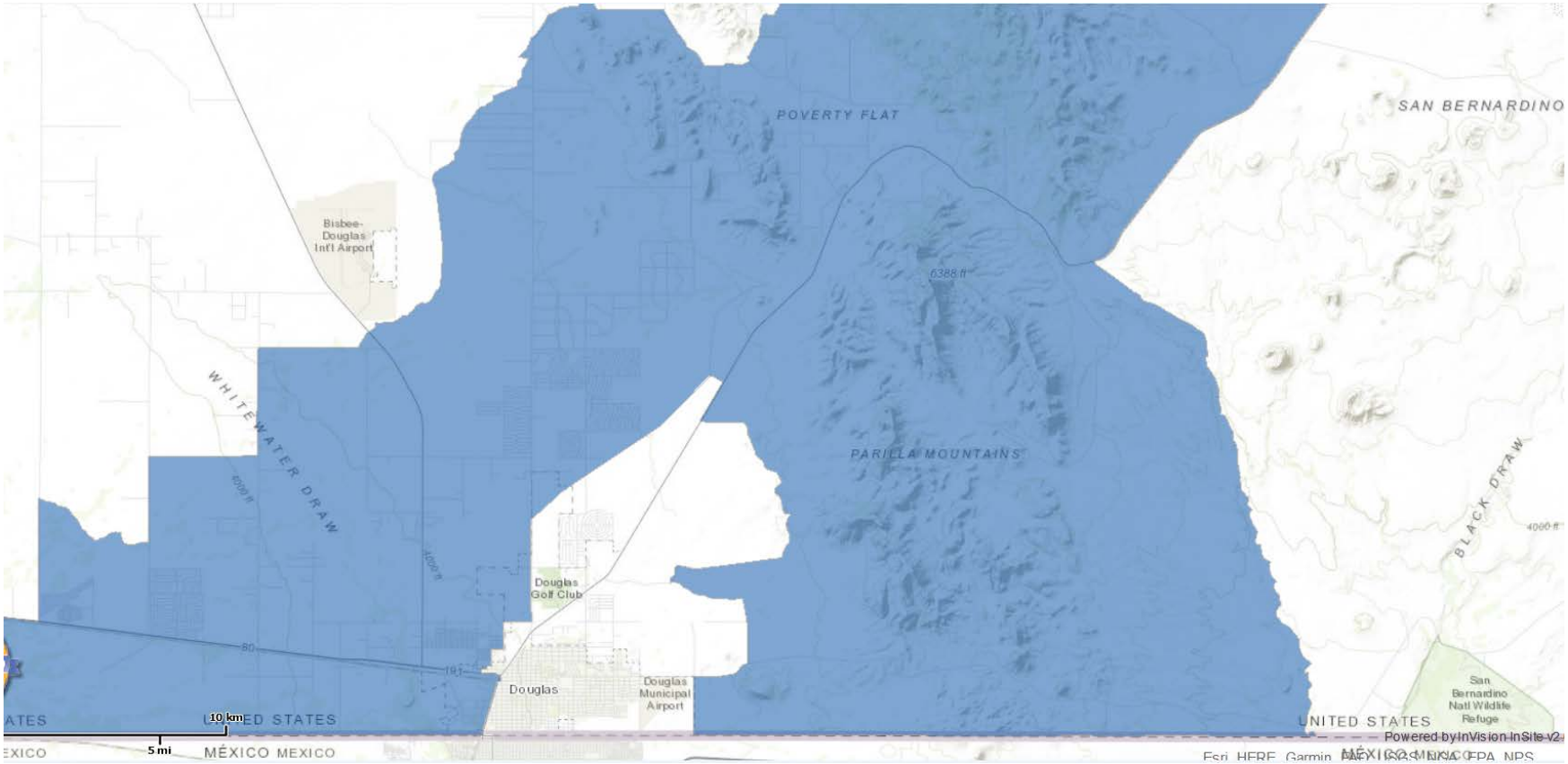
O-Zones in Southeast Arizona



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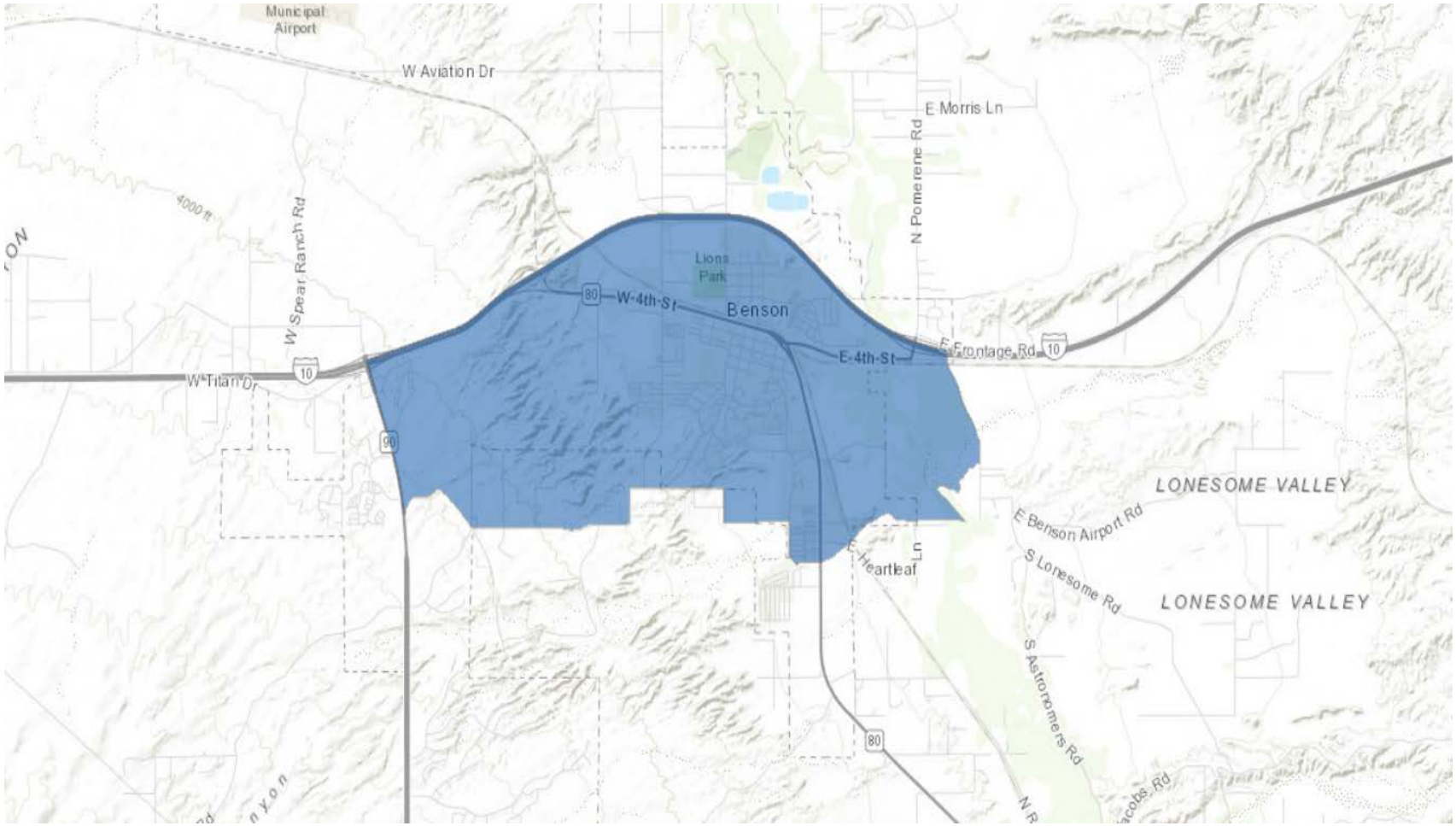
O-Zones in Southeast Arizona (Benson)



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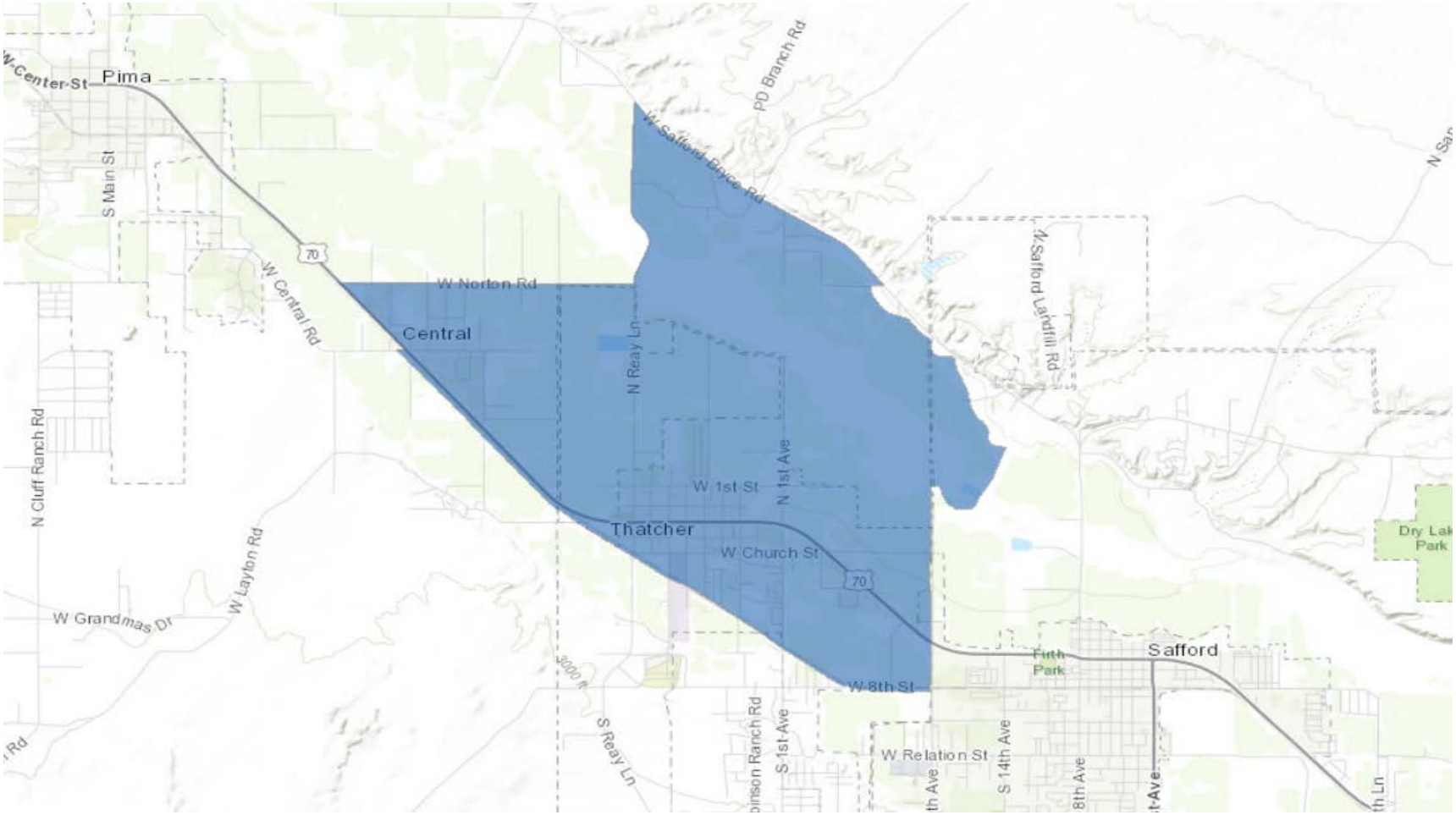
O-Zones in Southeast Arizona (Safford)



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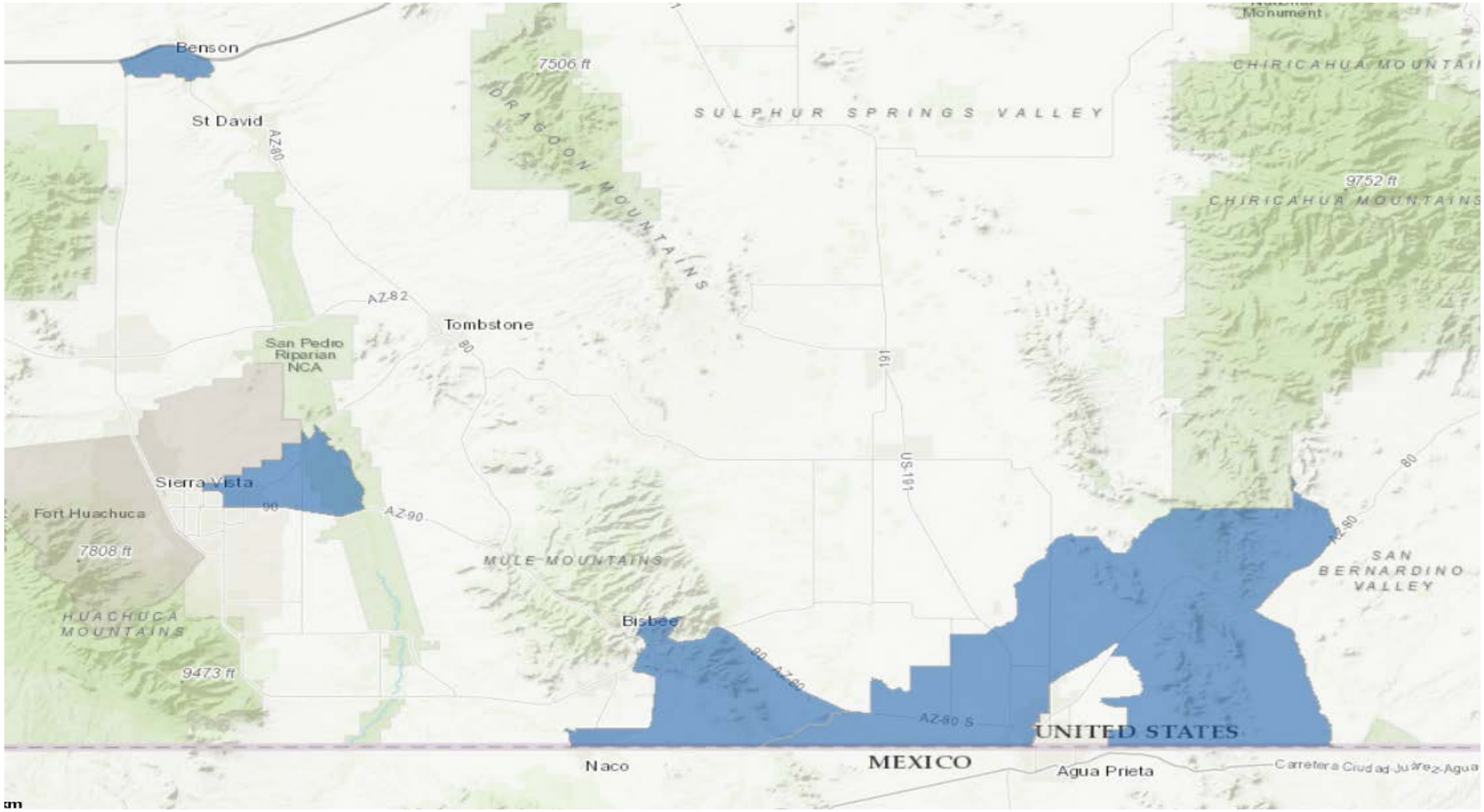
O-Zones in Southeast Arizona (Sierra Vista)



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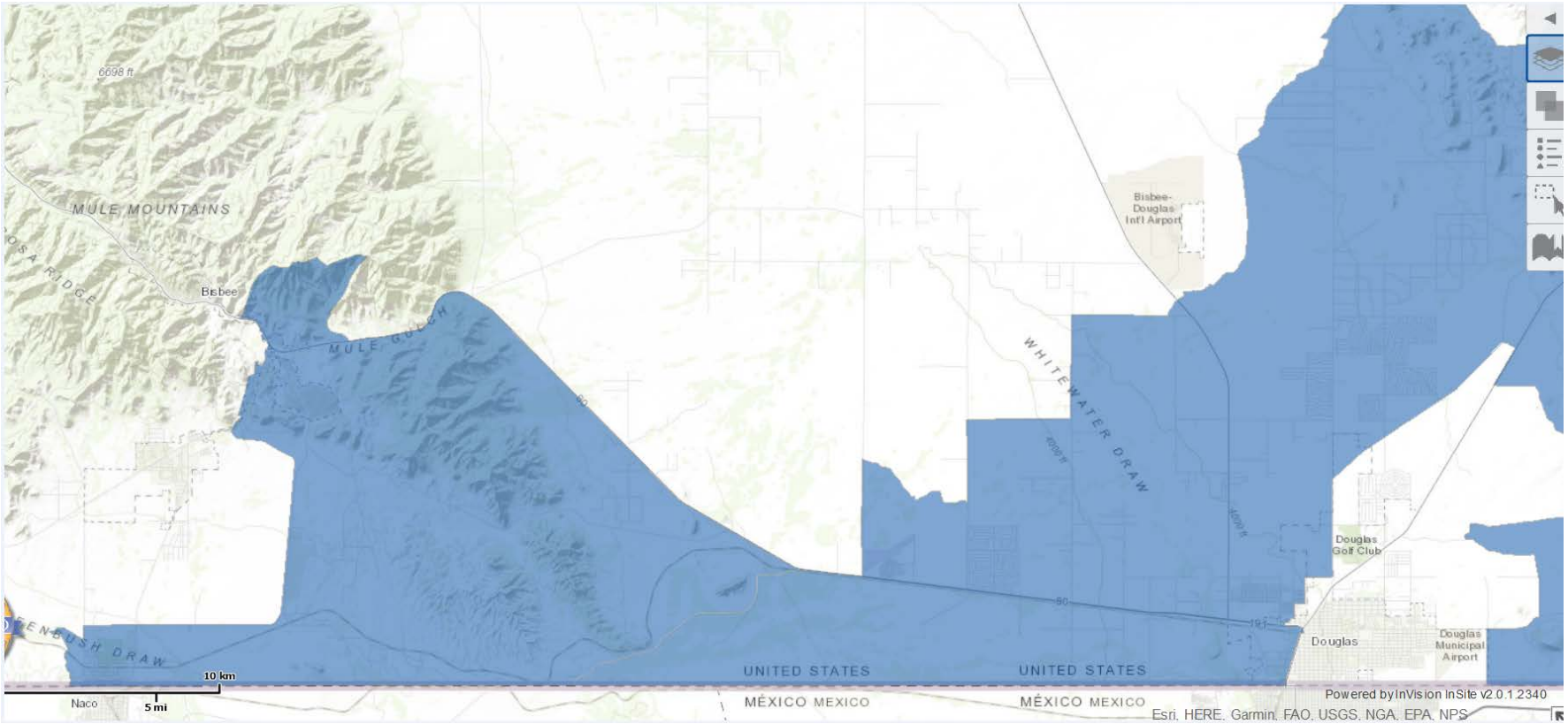
O-Zone in Southeast Arizona (Border)



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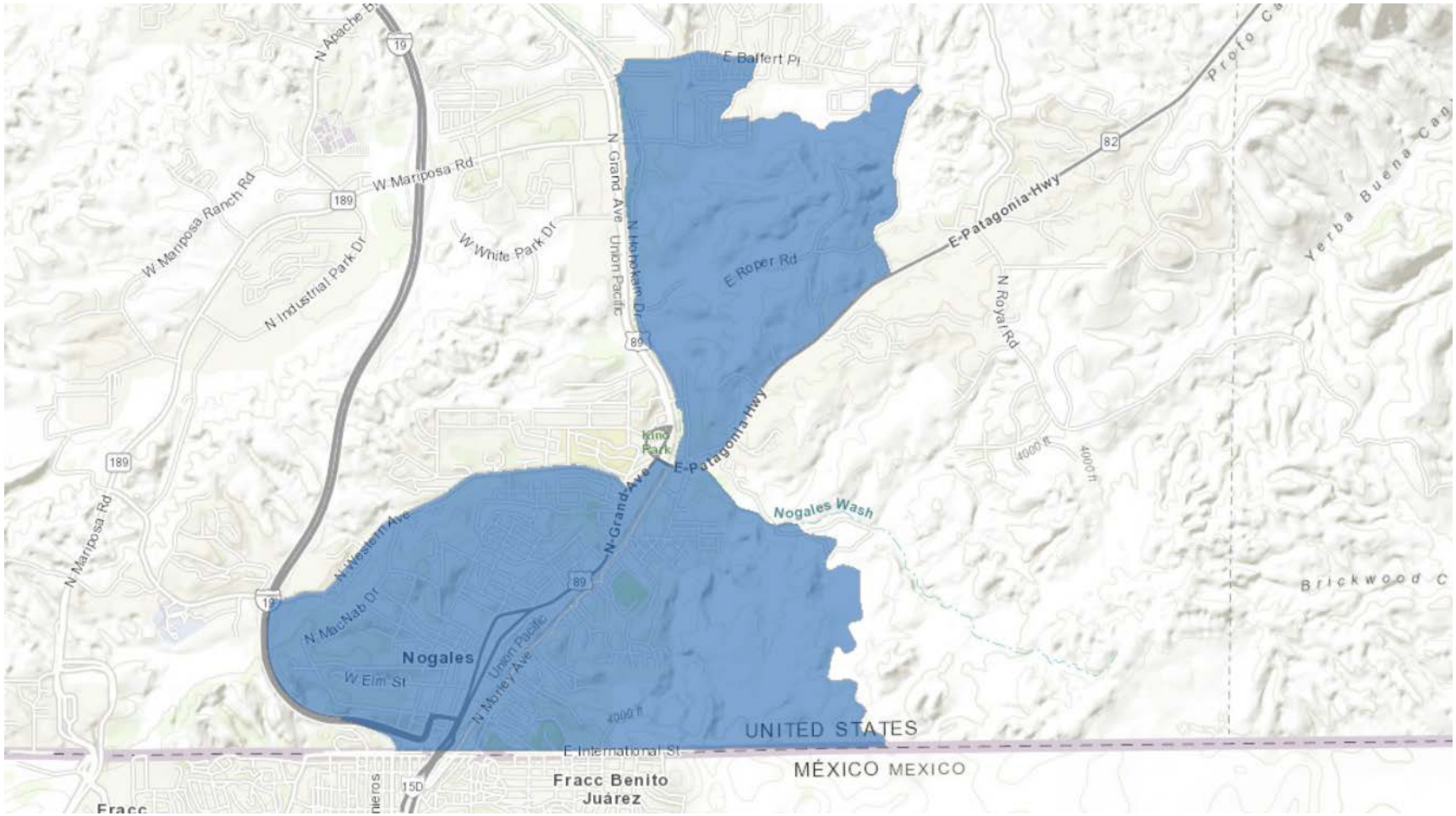
O-Zones in Southern Arizona (Nogales)



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