Introduction to the Opportunity Zones Incentive
52 million Americans (1 in 6) live in economically distressed communities.
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. Capital Gain Deferral
2. Partial forgiveness
3. Forgiveness of additional gains
Tax Incentives Timeline

Maximum benefit is achieved by holding the QOZ investment for 10 years

- **5 years**: Investment and deferral of Capital Gain (up to 180 days after event triggering the gain)
- **7 years**: 10% Step up in basis of deferred gain
- **10 years**: Taxes paid on deferred gain, Additional 5% Step up in basis of deferred gain, Permanent Exclusion of gains accrued in the Opportunity Fund
# Opportunity Zone Incremental Benefit

## Standard After Tax IRR vs Total IRR

<table>
<thead>
<tr>
<th>Year</th>
<th>Standard After Tax IRR</th>
<th>Total IRR</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Year</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>5 Year</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>7 Year</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>12/31/2026</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>10 Year</td>
<td>6.00%</td>
<td>9.08%</td>
</tr>
</tbody>
</table>

## Incremental OZ Benefit

<table>
<thead>
<tr>
<th>Year</th>
<th>Incremental OZ Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Year</td>
<td>1.44%</td>
</tr>
<tr>
<td>5 Year</td>
<td>2.08%</td>
</tr>
<tr>
<td>7 Year</td>
<td>1.95%</td>
</tr>
<tr>
<td>12/31/2026</td>
<td>1.71%</td>
</tr>
<tr>
<td>10 Year</td>
<td>3.08%</td>
</tr>
</tbody>
</table>

## OZ Investment IRR

<table>
<thead>
<tr>
<th>Year</th>
<th>OZ Investment IRR</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Year</td>
<td>7.44%</td>
</tr>
<tr>
<td>5 Year</td>
<td>8.08%</td>
</tr>
<tr>
<td>7 Year</td>
<td>7.95%</td>
</tr>
<tr>
<td>12/31/2026</td>
<td>7.71%</td>
</tr>
<tr>
<td>10 Year</td>
<td>9.08%</td>
</tr>
</tbody>
</table>

## Percentage Increase

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Year</td>
<td>35%</td>
</tr>
<tr>
<td>5 Year</td>
<td>32%</td>
</tr>
<tr>
<td>7 Year</td>
<td>29%</td>
</tr>
<tr>
<td>12/31/2026</td>
<td>51%</td>
</tr>
</tbody>
</table>

*Rates and prices displayed in this and next slides are for demonstration purposes only and may not be indicative of actual figures available at market, depending on type of taxpayer, location of investment, and various other factors.*
Perishability of Incentives

*In order to maximize benefits, gain must be invested in QOF by 12/31/2019.
Location of Zones – Major Metros
New York
Los Angeles
Chicago
Chicago
Gains, Attributes of Gains, and Taxpayers
Eligible Gains

• Limited to gains treated as *capital gains* for Federal income tax purposes
  • Recognized before January 1, 2027
  • Multiple elections can be made for various parts of a single source of gain
• Includes additional deferral of previously deferred gains recognized
• Deemed gains under 1256 contracts, but only net gains for a year
• Gains from offsetting-position transactions (e.g. straddles) do not qualify
Attributes of Gains

• Deferred gains triggered have the same attributes in taxable year of inclusion that they would have had if tax on the gain had not been deferred

• Including attributes taken into account by
  • §1(h) – Maximum capital gains rate
  • §1222 – Term of Capital Gains
  • §1256 – Mark to Market Contracts
  • Other applicable provisions of the code
Eligible Taxpayer

A person that may recognize gains for purposes of Federal income tax accounting. Includes:

- Individuals
- C corporations
- RICs
- REITs
- S Corporations
- Trusts and Estates
Eligible Interests in QOFs

Only equity interests

- Including preferred stock or partnership interests with special allocations
- Excludes debt instruments

Eligible interests are not impaired if used as collateral for a loan
QOF Contributions

- Investments in QOFs must be cash, or property, and does not include services
- Property contributions – deferral election is limited to tax basis of property contributed
- Value received by an investor for appreciated property or provision of services is treated as property contributed for which an election is not made
  - Results in a mixed funds investment
180-Day Period

Begins on the day on which gain would be recognized for Federal income tax purposes assuming no deferral
Special Rules for Pass-through Entities

• A partnership (or other pass-through entity) may elect to defer capital gains at the entity level

• If a partnership (or other pass-through entity) does not elect to defer some or all of gains realized, a partner (or other owner) can elect to defer their distributive share of the gain
  • Generally, beginning of 180-day period is last day of the pass-through entity’s taxable year
  • Partner (or other owner) may elect to use pass-through entity’s 180-day period.
Qualified Opportunity Funds, Qualified Opportunity Zone Businesses & Qualified Opportunity Zone Business Property
Qualified Opportunity Funds (QOFs)

Two requirements for eligibility:

1. Investment vehicle to be organized as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zone Property

2. At least 90 percent of its assets is held in Qualified Opportunity Zone Property

*Funds can be structured to invest in multiple assets, or as a single-asset special purpose vehicle. However, Opportunity Funds cannot be structured to invest in other funds, thereby prohibiting a ‘fund-of-funds’ model.

**Failure to meet 90% threshold causes a monthly penalty equal to the federal underpayment rate (6% for April – June) multiplied by the excess of 90% of fund assets over fund QOZP, subject to a reasonable cause exception – no penalty imposed if failure due to reasonable cause. Failure not covered by reasonable cause could result in penalty or possibly decertification.
Certification of QOF

- Entity classified as a corporation or partnership for Federal tax purposes is eligible – LLCs taxed as corporations or partnerships OK
- Self-certification using Form 8996
  - Identify first taxable year the entity wants to be a QOF
  - Identify the first month the entity wants to be a QOF
  - Anticipated additions to 8996 = EINs of QOZBs and $$ invested in QOZs
- Investments before “first month” not eligible for deferral
- QOFs have 6-months to invest proceeds, even if QOF investment is made during second half of QOF tax year (new provision; must be cash or debt due <= 18 mos)
- Penalty doesn’t apply to months before the “first month”
- No legal barrier to pre-existing entities becoming a QOF (or Qualified Opportunity Zone Business (“QOZB”))
Qualified Opportunity Fund – Assets Test

Must hold at least 90% of assets in QOZP, determined by the average of the percentage of QOZP 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

June 30th

December 31st

*If proceeds are held as cash, cash equivalents, and debt instruments with terms of 18 months or less, QOFs with contributions in later half of tax year may apply 90% test excluding contribution in first year.

**QOF has a reasonable time to reinvest interim gains from sale of QOZP. Reasonable time is defined as 12 months.
Qualified Opportunity Zone Property: Direct and Indirect Investments

- The investment must be acquired after December 31, 2017 solely 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
  - Now defined by new proposed regulations as 90% of the holding period
Operating Business
- New business
- Existing business expanding into Opp. Zone
- Improving existing business

Rental real estate
- New construction
- Substantial improvement (100%)
Qualified Opportunity Zone Businesses (QOZB)

A trade or business in which substantially all (70% per Proposed Regulations) 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 average aggregate unadjusted basis of property is nonqualified financial property

*Non-qualified financial property is, generally, debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, etc. that do not relate to the OZ investment.*
More on Direct v. Indirect

• **Example 1 (Indirect):** QOF has $1M, it invests $900,000 in a QOZB, receiving back a partnership interest and holds $100k in cash. QOZB uses the cash to buy a $700,000 new building in an OZ, and a $200,000 building not in an OZ. So, 7/9, or 77% of its assets (i.e., more than 70%) are good, and therefore, the entire $900,000 partnership interest qualifies. Finally, 900K/1M of the Opportunity Fund’s assets, or 90%, are good, and it meets the 90% test.

• **Example 2 (Direct):** Opportunity Fund has $1M, it buys a $700K new building in an OZ, a $200K building not in an OZ, and keeps $100K of cash. This FAILS, because only 70% of the QOF assets are qualified.
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 – now defined as 70%
- **Original use in the QOZ** commences with the taxpayer (PIS date for depreciation or amortization purposes)
  - 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
Thank you.

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