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Introduction to Opportunity Zones

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Opportunity Zones – Policy Objectives

- Designed to spur long-term private sector investments in economically disadvantaged areas
- Some areas are not so distressed
- Way to reinvest realized capital gains into distressed communities
- 1st new national community investment program in over 15 years
- Potential to scale into the largest economic development program in the U.S.
- Specifically designed to channel more equity capital into overlooked markets

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

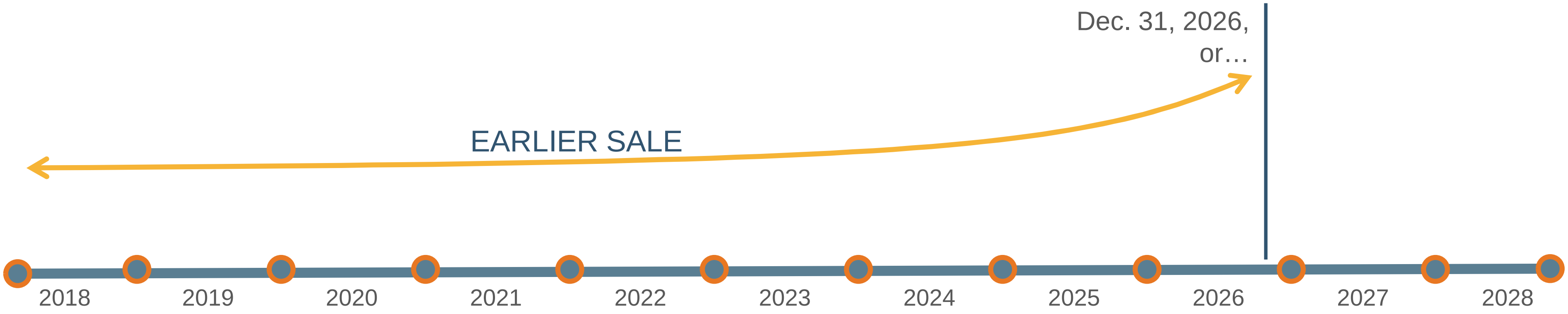
Qualified Opportunity Zone Property

Tax Benefits

1. Capital Gain Deferral
2. Partial forgiveness
3. Forgiveness of additional gains

Period of Deferral

The period of capital gain tax deferral ends upon the earlier of:



Amount Recognized

THE LESSER OF:

1. Amount of capital gain deferred

or

2. The fair market value of investment in QOF interest

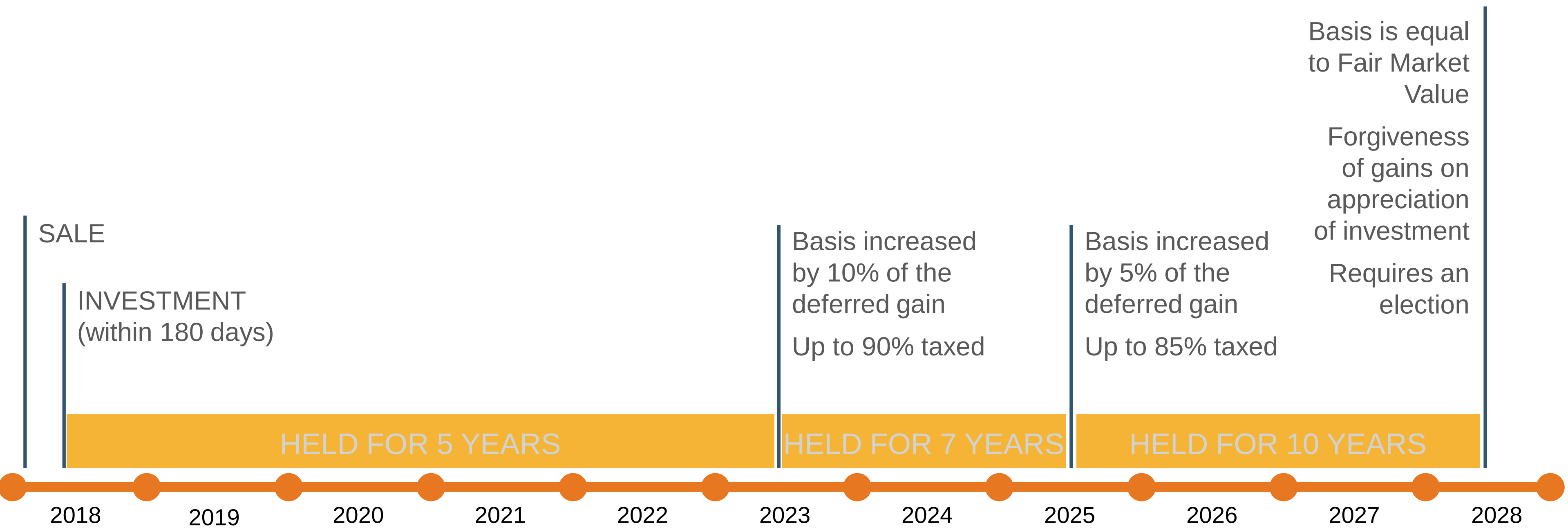
MINUS:

Taxpayer's basis in the QOF interest

Note: The taxpayer's basis in the Opportunity Fund is initially deemed to be zero.

Note: Per the proposed regulations, the attributes of the original gain will remain when the gain is eventually recognized into income.

Partial Forgiveness and Forgiveness of Additional Capital Gains

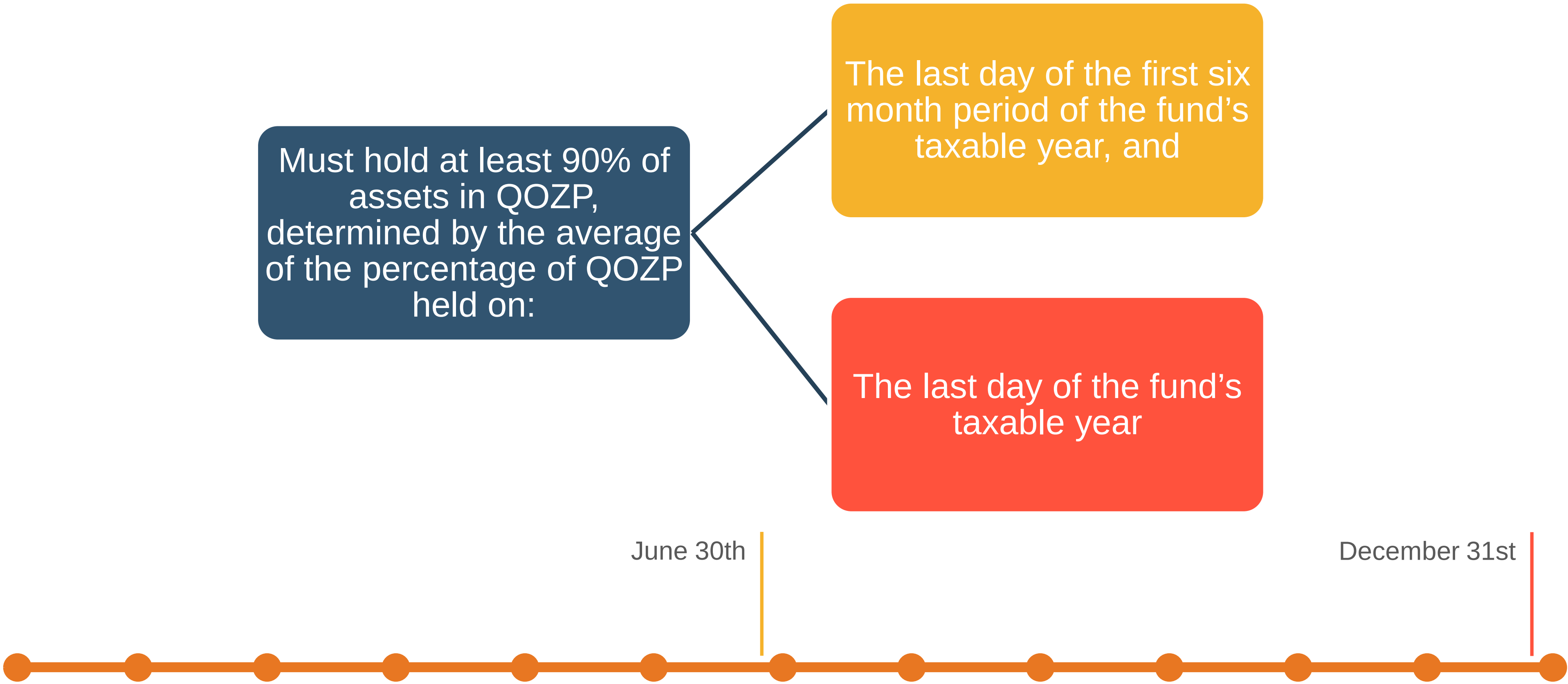



Qualified Opportunity Fund

Qualified Opportunity Fund

- An investment vehicle taxed as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zone Property (QOZP)
- Must hold at least 90% of its assets in QOZP
- Entity self-certifies using IRS form 8996

Qualified Opportunity Fund – Assets Test



*Note that testing dates may not be June 30 and December 31; depends on formation date, taxable year of fund and IRS guidance

Qualified Opportunity Fund – Noncompliance Penalty

Failure to meet 90% investment standard

Per month penalty for failing to meet 90% test	% shortfall x underpayment rate Penalty (Federal short-term rate plus 3%) – currently 5%	No penalty if is shown failure is due to reasonable cause

Qualified Opportunity Zone Business and Qualified Opportunity Zone Business Property


Qualified Opportunity Fund
Qualified Opportunity Zone Partnership Interest (Qualified Opportunity Zone Business)
Qualified Opportunity Zone Stock (Qualified Opportunity Zone Business)
Qualified Opportunity Zone Business Property

Qualified Opportunity Zone Stock and Partnership Interests

- 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

Qualified Opportunity Zone Businesses (QOZB)

A trade or business in which substantially all (70 percent) 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

Note: QOZB cannot be an Excluded Business.

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

Note: The land purchased along with a building is excluded from the original use and substantial improvement provisions.

More About QOZBs

- We expect future funds to focus on QOZBs considering that gains from the sale of the businesses can qualify for all of the QOF benefits.
- Requires substantially all of the business' tangible property to be in an OZ.
- Substantial improvement: if QOF buy a business, must double the investment in tangible property.
- Substantial portion of intangible assets (*i.e.*, goodwill) must be used in an active business.
  - What does this mean?

Comparison of Requirements by Direct and Indirect Investment by Opportunity Fund

Requirement	Direct Investment	Indirect Investment
Percentage of Opportunity Fund's assets that must be invested in qualified opportunity zone business property	90%	N/A
Percentage of Opportunity Fund's assets that must be invested in stock or partnership interests	N/A	90%
Percentage of Opportunity Fund's assets that may be held in cash or other liquid investments	10% (together with intangible property)	5% plus reasonable working capital
Percentage of Opportunity Fund's assets that may be held in intangible property	10% (together with cash)	Unlimited, but intangible property must be used in trade or business
Percentage of Opportunity Fund's assets that must be invested in tangible property	90%	No minimum
Percentage of gross income that must be derived from active conduct of business	None	50%
Ineligible Businesses	None	Sin Businesses
31 Month Working Capital Safe Harbor	No?	Yes

Proposed Regulations/Administrative Guidance

Summary of Proposed Regulations

- Gains, Taxpayers and Gain Attributes
  - The OZ incentive is available for capital gains only
  - Further defined taxpayers eligible to defer capital gains
  - Clarified treatment relevant to gains of partnerships
  - Attributes of deferred gain when included in income

Summary of Proposed Regulations

- Qualified Opportunity Funds
  - Entities eligible to be a QOF
  - Designating when a QOF begins
  - Valuation method for applying the 90-percent asset test
  - Effect of Section 752 deemed contributions

Summary of Proposed Regulations

- OZ Businesses
  - Substantially all for purposes of tangible property test
  - Reasonable working capital safe harbor
- Other
  - Preexisting entities
  - Effect of expiring OZ designations

Summary of Revenue Ruling 2018-29

- The original use of the building in the QOZ is not considered to have commenced with the QOF.
- The requirement that the original use of tangible property in the QOZ commence with a QOF is not applicable to the land on which the building is located.
- A substantial improvement to the building is measured by the QOF's additions to the adjusted basis of the building (excluding the land).
- The QOF is not required to separately substantially improve the land upon which the building is located.

Additional Guidance?

- Grace periods for QOF and QOZB to make investments?
- Refinancing distributions?
- Interim gains issues (reinvestment)
  - Avoiding the penalty while holding cash
  - Not having an allocation of taxable gain to investors
  - How long would the QOF have for reinvestment?
- Vacant land – substantial improvement?
- Multi-asset funds – Exit Mechanics?
- Meaning of the term “active”?

Second tranche of guidance expected soon

REITS and QOFs

- What is a REIT?
  - A real estate investment trust.
  - Generally a corporation for U.S. federal income tax purposes that predominantly invests in real estate
  - If complex tax rules are met, a REIT generally pays no corporate income taxes
- How to combine?
  - QOF could be a REIT or QOF could invest in REIT subsidiaries as QOZBs
- Why a real estate investment trust (REIT) and a QOF?
  - Simplifies exits under current rules: REIT can liquidate to step up tax basis
  - Mixed funds: a REIT is an “unrelated business taxable income” blocker for tax-exempt investors
- Why not?
  - Increased compliance costs: REITs have their own complex tax regime with substantial compliance
  - A QOF that is a REIT or invests in REITs must focus in real estate and not businesses
  - May be unnecessary: the IRS and Treasury are aware of the exit problem and should address in future guidance

Questions?

Thank you!

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