



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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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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Eligible Gains

- Eligible Gains
 - Capital Gains
 - Long-term
 - Short-term
 - Section 1231 Gains
 - Section 1250 Unrecaptured Gain
- Not Eligible
 - Depreciation recapture (Ordinary Income)
 - Inventory
- Tax Attributes are Retained



Temporary Deferral of Gain

- Applies to any Eligible Taxpayer
- 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) as an Eligible Interest
 - Within 180 days of the sale/exchange



Eligible Taxpayers

- Individuals
- C Corporations
- RICs
- REITs
- S Corporations
- Partnerships (LLCs and LPs)
- Trusts and Estates



180-Day Period

- Must invest in an Eligible Interest in an Opportunity Fund within 180 days from the Sale or Exchange of the Property
- Multiple Elections are Possible within a Single Gain:
 - Invest in different funds
 - Must use same 180-day period
- Special rule for Pass-through Entities



Eligible Interest

- Must be Equity
 - Preferred Stock
 - Partnership Interest with Special Allocations
- No Debt Instruments
- May acquire Eligible Interest with debt proceeds
 - Must be equity owner for tax purposes
- 752(a) Deemed Contribution



Pass-Through Entities (Special Rule)

- Taxpayers can be the partnership and/or the partners when a partnership generates an Eligible Gain
- Investment Period
 - Normal 180 Days Rule for Partnerships
 - Special Rule for Partners
 - Commence on the last day of Partnership's Taxable Period
 - Election to use Partnership's Taxable Period
- Example



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 (LLC can be an O-Fund)
 - An **investment vehicle** organized for the purpose of investing in **Opportunity Zone Property**.
 - 90% Requirement
- Certification Process
- Penalty imposed for Noncompliance

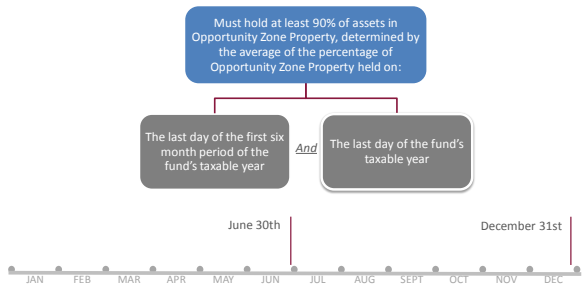


Opportunity Fund Certification

- Self-Certification using Form 8996
 - Attached to the taxpayer’s federal income tax return for the taxable year, taking into account extensions.
- Identify the “first taxable year” and “first month” entity wants to be an O-Fund
- Investments made before the first month not eligible
- Where less than 6 months remaining in taxable year from first month then 90% Requirement is measured on last day of year



Opportunity Fund – 90% Requirement





Measuring the 90% Requirement

- If an O-Fund has an “applicable financial statement” (AFS), then the value of assets are as reported on the AFS:
 - Financial statements prepared for SEC or other federal agency (not the IRS)
 - Certified audited financial statement prepared in accordance with US GAAP
- If no AFS, then value is cost of the asset



Penalty for Noncompliance with the 90% Requirement

Failure to meet the 90% Requirement:

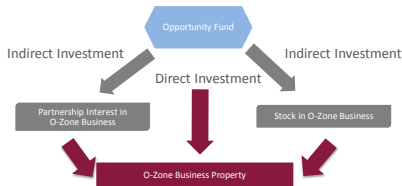
Monthly penalty for failing to meet the 90% Requirement	$\% \text{ Shortfall} \times \text{Underpayment Rate}^* \text{ Penalty}$	No penalty if it is shown failure is due to reasonable cause
	*Federal short-term rate plus 3% – Currently 5% Annually	

Source: Novogradac & Company LLP



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).



Source: Novogradac & Company LLP

Direct v. Indirect Approach

	Direct	Indirect
% Invested in Opportunity Zone Business Property	90%	70% of Tangible Property Must be Opportunity Zone Business Property
% of Cash that can be held on measurement dates	10%	Less than 5% + RWC
% 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
 - Can you be an original user of real estate?
 - Special Rule for Buildings/Revenue Ruling 2018-29
- 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"
 - With respect to such tangible property
 - (2) **Additions to basis** that **exceed** the adjusted basis of such property

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Special Rule – Acquisition of a Building

- Acquiring a Building an Underlying Land
 - Substantial improvement requirement met by improving the building
 - Revenue Ruling 2018-29
 - 60/40 (Land/Building)
 - Re-purposing of the building
 - Adding to the basis of the building (125%)
 - Cannot have original use with respect to land
 - What does this mean for vacant land?



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



Opportunity Zones – Status

- Guidance is needed to address many important issues:
 - *Grace periods for Opportunity Fund and Opportunity Zone Business to make investments*
 - *Refinancing distributions*
 - *Interim gains issue (Reinvestment)*
 - *Avoiding the Penalty while holding cash*
 - *Not having an allocation of taxable gain to Investors*
 - *How long would the O-Fund have for reinvestment*
 - *Vacant Land – Substantial Improvement?*
 - *Multi-Asset Funds – Exit Mechanics*
 - *Meaning of the term “active” (to determine implication on triple net leases)*
 - *Residential Rental Property – Is it a problem for an O-Zone Business*
 - *Meaning of the other “substantially all” and “substantial portion”*
- Second tranche will be released in early 2019



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