Charleston Urban Renewal Authority

Basics of Opportunity Zones
(26 U.S.C. § 1400Z-2, *et seq.*)
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Agenda

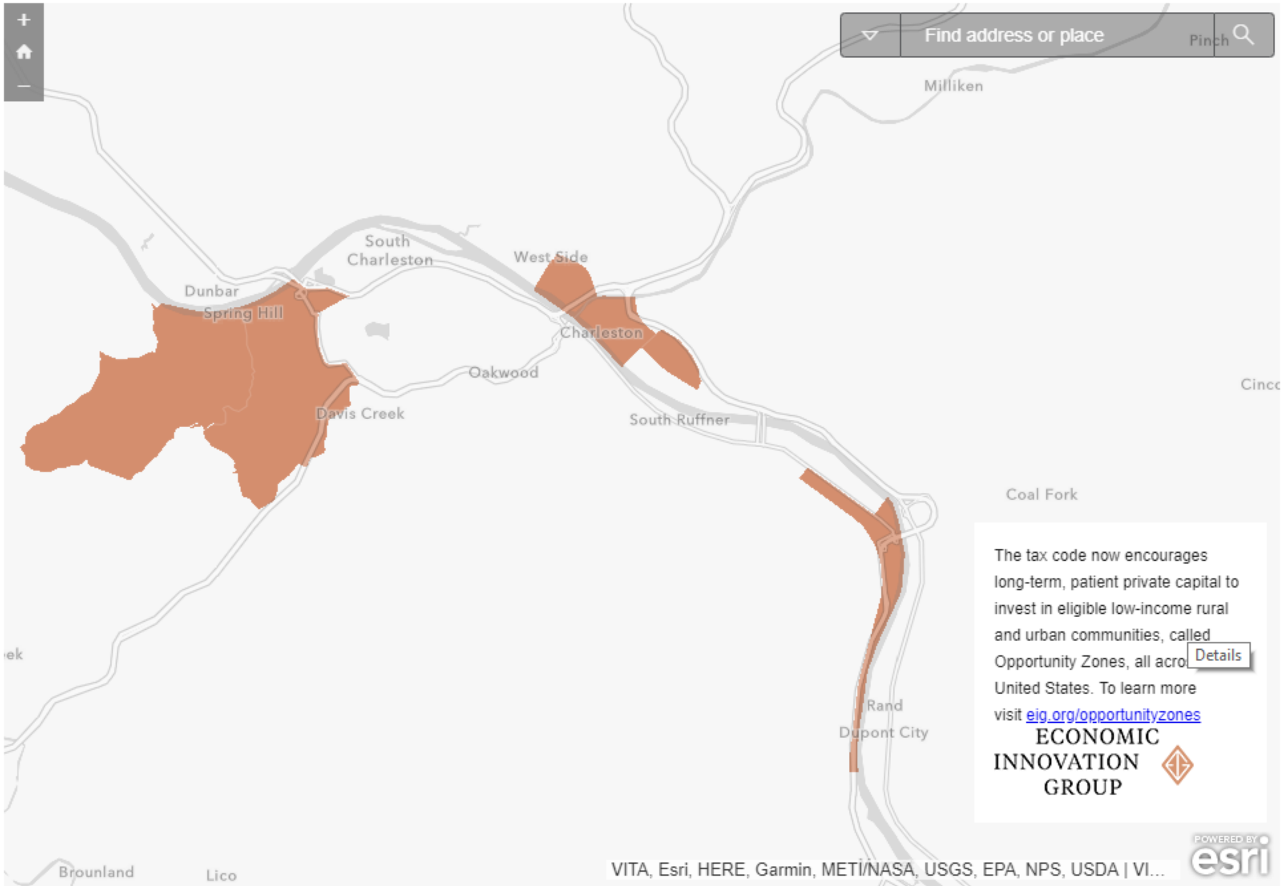
- Background of the program
- Benefits of the program
- Step-by-step guide
- Potential leveraging tools to boost returns
- Timing
- Questions
- Appendix

OPPORTUNITY ZONES

WHAT ARE OPPORTUNITY ZONES?

- Opportunity Zones are part of the 2017 Tax Cuts and Jobs Act
- Mechanism to incentivize investment in underserved communities across the nation.
- The goal is to spur long term investment in low-income urban and rural communities; to create economic and community development; and to create more opportunities for startups and new businesses.
- There are approximately $6 trillion of unrealized capital gains held by U.S. investors; Opportunity Zones present a tax preferred method to reinvest those gains.
- Opportunity Zones incentivize investment in distressed areas through a deferral of capital gains tax owed, a step up in basis, and a permanent exclusion of future capital gains invested in qualified zones.

Where are Opportunity Zones Located?



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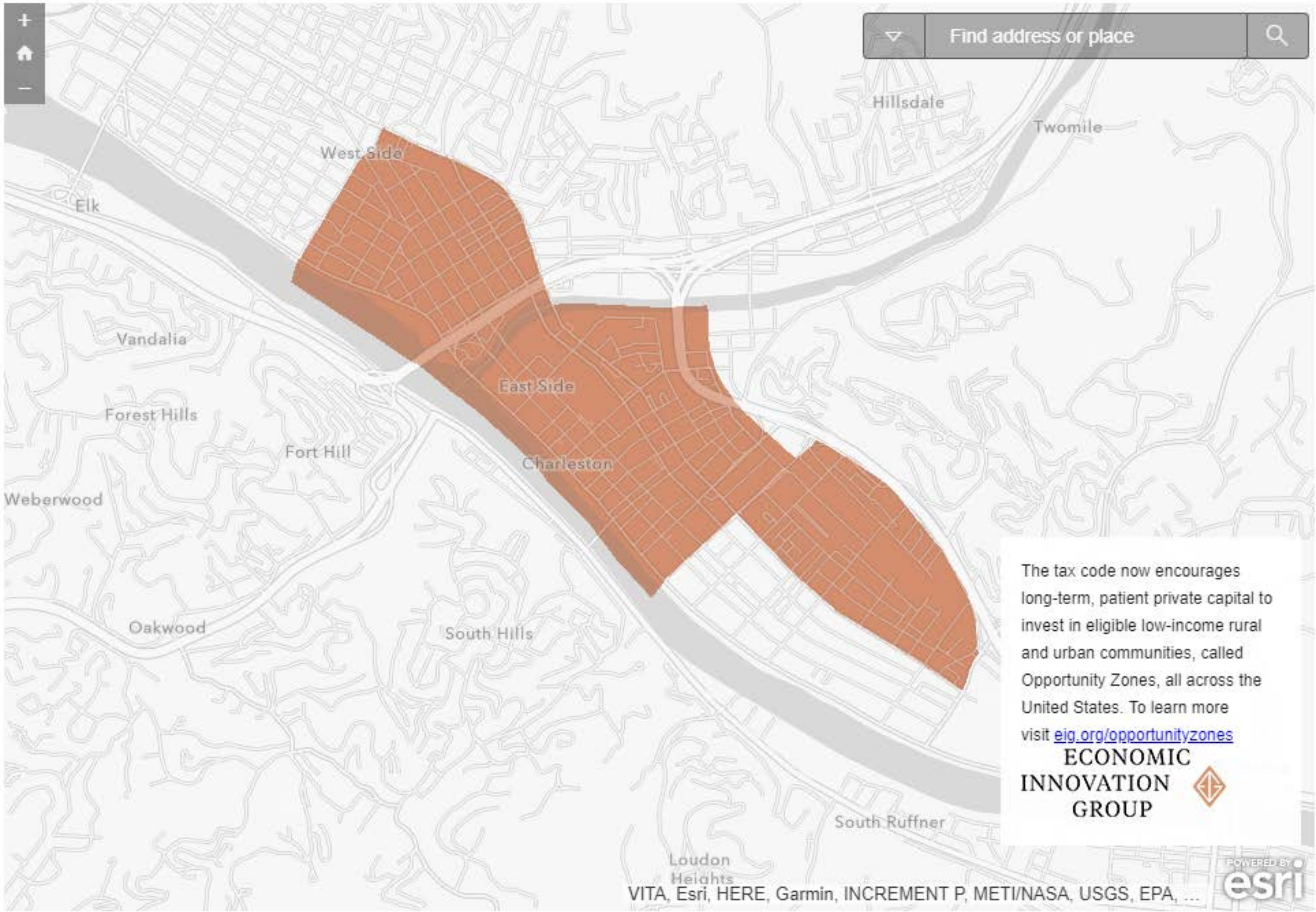

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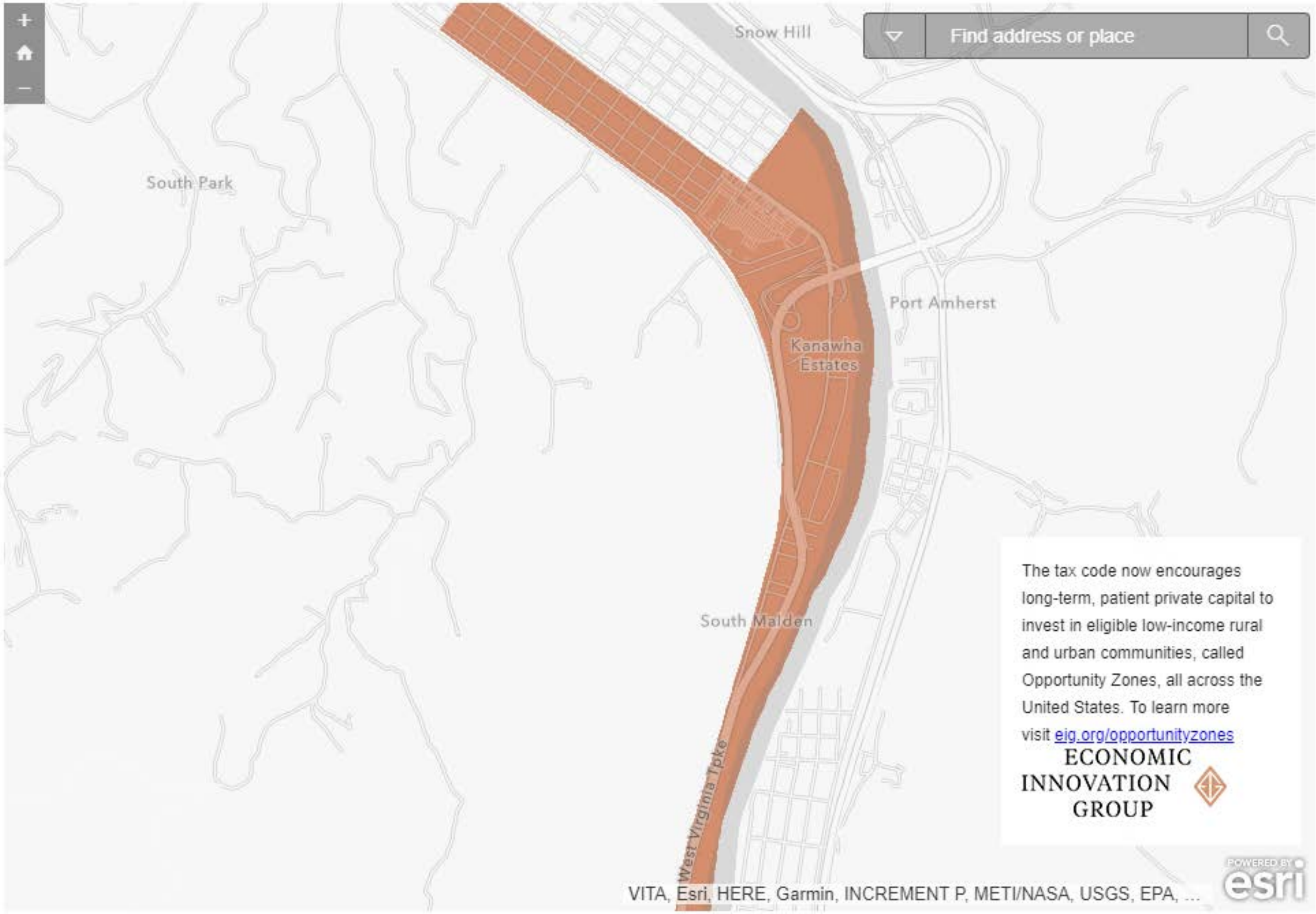

BENEFITS OF THE PROGRAM
(AKA WHAT’S IN IT FOR ME?)

Benefits for the Investor

- Deferral of Capital Gains
  - Capital gains rolled into an Opportunity Fund pay capital gains tax only at December 31, 2026 or sale of the investment, whichever occurs first
- Basis Step-Up
  - Potential for a **10% basis step-up** on rolled-over capital gains for holding the investment for 5-years
  - Potential for an **additional 5% basis step-up** on rolled over capital gains for holding the investment for 7-years
  - **Total basis step-up on rolled-over capital gains of 15% over 7-years**
- Elimination of capital gains tax on any appreciation of rolled-over capital gains
  - If held for 10-years, investor may elect to **eliminate appreciation on any rolled-over capital gains** once the investment is sold
  - **<u>AKA no taxes</u>**

Potential Types of Investors

- Individuals
- Corporations (including RICs and REITs)
- Partnerships
- Family Offices
- Private Equity and Venture Capital
- Hedge Funds
- Common trust funds under Section 584
- Qualified settlement funds
- Disputed ownership funds
- Other entities taxable under Section 1.468B

Benefits for the Business Owner or Property Developer

- Access to **<u>patient equity capital</u>**
- This is not a debt program, only equity investment is eligible

Potential Types of Projects

- Real Estate
  - Multi-family & Single Family
  - Commercial (Industrial/Retail/Etc.)
  - Mixed Use
  - Historic Redevelopment
- Businesses
  - Existing Operating Businesses
  - Start-ups
  - Oil & Gas Development

STEP-BY-STEP GUIDE

Step 1: Investor Realizes Capital Gains

- Investor realizes capital gains on a previous investment
- Ex: Investor sells stock he invested $100 dollars in for $120. Investor has $20 capital gain.

Step 2: Investor Rolls Over Capital Gains into QOF

- Investor rolls over his capital gains into an **Opportunity Fund** <u>*within 180 days*</u> of realizing the investment
- Ex: Investor takes his $20 in capital gains and invests them into an **Opportunity Fund** within 180 days from the sale of the stock
- Once rolled into a **Opportunity Fund**, deferral begins!

Step 2: Investor Rolls Over Capital Gains into QOF

Investor

Qualified Opportunity Fund (QOF)

Step 2: Investor Rolls Over Capital Gains

- So what is an **Opportunity Fund (QOF)?**
- **Opportunity Fund:**
  - Any investment vehicle
  - Organized as a corporation or a partnership
  - For the purpose of investing in **qualified opportunity zone property** (other than another qualified opportunity fund)
  - Holds at least 90 percent of its assets in **qualified opportunity zone property**, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured-
    - (A) on the last day of the first 6-month period of the taxable year of the fund, and
    - (B) on the last day of the taxable year of the fund
- An Opportunity Fund can be **single-asset** or **multi-asset**
- **<u>Anyone can create an Opportunity Fund!</u>**

Step 3: Opportunity Fund Invests in Qualified Opportunity Zone Property

- The Qualified Opportunity Fund then invests in Qualified Opportunity Zone Property
- So what is **Qualified Opportunity Zone Property?**
- Three types (outlined in Appendix)
  - Partnership Interest
  - Stock
  - Qualified Opportunity Zone Business Property
- Ex: QOF purchases building for $5 and rehabs the building for $15.

Step 3: Opportunity Fund Invests in Qualified Opportunity Zone Property

Investor

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Qualified Opportunity Fund (QOF)

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Qualified Opportunity Zone Property

Step 4: Opportunity Fund Holds Investment for 5 Years

- If an investment is held for at least 5 years, **the basis of such investment increases by 10% of the amount of gain deferred**
- This means that the investor will only be taxed on 90% of the capital gains the investor rolled over into the investment
- Ex: Of the $20 capital gains the investor invested in the QOF, the investor is now only taxed on $18. The tax due will now only be $3.60 rather than $4.00 (assuming a 20% capital gains rate).

Step 5: Opportunity Fund Holds Investment for 7 Years

- If an investment is held for at least 7 years, **the basis of such investment increases by an additional 5% of the amount of gain deferred**
- This means that if the investor holds the investment another two years, the investor will only be taxed on 85% of the capital gains the investor rolled over into the investment
- Ex: Of the $20 capital gains the investor invested in the QOF, the investor is now only taxed on $17. The tax due will now only be $3.40 rather than $4.00 (assuming a 20% capital gains rate).

Step 6: Recognition Event

- Taxes on the deferred capital gains are paid on the earlier of:
  - The sale or exchange of the investment or **December 31, 2026**
- Recognition of the lesser of :
  - deferred capital gains less any applicable 5 or 7 year step-ups; or
  - The FMV of the investment
- Ex: It is now December 31, 2026. Investor has held $20 investment in QOF for 7 years, and now pays the $3.40 due (assuming a 20% capital gains rate).

Step 7: Investment is Held for 10 Years

- If the investment is held for at least 10 years, the basis of the investment is stepped up to the FMV of the investment once it is sold or exchanged.
- **<u>NO CAPITAL GAINS TAX</u>**
- Ex: QOF sells building for $75, realizing a $55 gain on the original rolled-over $20 capital gain. Investor gets to keep the $55 gain **<u>tax free</u>**.

POTENTIAL LEVERAGING TOOLS

Potential Leveraging Tools

- Examples of potential leveraging tools include:
- **Historic Tax Credits (HTC)**
  - 20% federal tax credit and 25% WV state tax credit for the substantial rehabilitation of certified historic commercial, agricultural, industrial or rental residential buildings
  - Raises 45% of rehab cost
- **Low-Income Housing Tax Credits (LIHTC)**
  - Two-types of credits: 9% and 4%
  - Raises between ~30%-70% of rehab cost
- **New Markets Tax Credit (NMTC)**
  - Allows individuals and corporations to receive a tax credit against income taxes for making equity investments into Community Development Entities. The CDE then makes investments in businesses in low-income communities.

IMPORTANT DATES

Important Dates to Keep in Mind

- **December 31, 2019** – Last day to invest in a QOF to take advantage of both the 10% and 5% basis step-up
- **December 31, 2021** – Last day to invest in a QOF to take advantage of the 10% basis step-up
- **December 31, 2026** – Recognition Event
- **December 31, 2028** – OZ designation expires
- **December 31, 2047** – Last day to sell or exchange QOF investment

Questions?

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APPENDIX

Qualified Opportunity Zone Partnership Interest

- Partnership Interest
  - Acquired by the QOF after December 31, 2017, from the partnership solely in exchange for cash,
  - As of the time such interest was acquired, such partnership was a **qualified opportunity zone business** (or, in the case of a new partnership, such partnership was being organized for purposes of being a qualified opportunity zone business), and
  - During substantially all of the qualified opportunity fund's holding period for such interest, such partnership qualified as a **qualified opportunity zone business**

Qualified Opportunity Zone Stock

- Stock
  - Must be a domestic corporation
  - Acquired by the QOF after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,
  - As of the time such stock was issued, such corporation was a **qualified opportunity zone business** (or, in the case of a new corporation, such corporation was being organized for purposes of being a qualified opportunity zone business), and
  - During substantially all of the qualified opportunity fund's holding period for such stock, such corporation qualified as a **qualified opportunity zone business**.

Qualified Opportunity Zone Business Property

- Qualified Opportunity Zone Business Property
  - Tangible Property used in a trade or business
  - Property acquired by the qualified opportunity fund by purchase (as defined in Section 179(d)(2)) after December 31, 2017,
    - Section 179(d)(2) covers related party rules
  - **Original use** of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund **substantially improves** the property, and
  - During substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone
- **Substantial Improvement**
  - Property shall be treated as substantially improved by the qualified opportunity fund only if, during any 30-month period beginning after the date of acquisition of such property, <u>**additions to basis**</u> with respect to such property in the hands of the qualified opportunity fund <u>**exceed an amount equal to the adjusted basis**</u> of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.

Qualified Opportunity Zone Business

- A trade or business (that meets these three requirements):
  1) In which **substantially all** of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting "qualified opportunity zone business" for "qualified opportunity fund" each place it appears in paragraph (2)(D)) (outlined below)
     - Property acquired by the qualified opportunity zone business by purchase (as defined in Section 179(d)(2)) after December 31, 2017
     - The original use of such property in the qualified opportunity zone commences with the qualified opportunity zone business or the qualified opportunity zone business substantially improves the property, and
     - during substantially all of the qualified opportunity zone business's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.
  2) Which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b) (outlined below), and
     - at least 50 percent of the total gross income of such entity is derived from the active conduct of such business,
     - a substantial portion of the intangible property of such entity is used in the active conduct of any such business,
     - less than 5 percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property
  3) Which is not described in section 144(c)(6)(B) (outlined below)
     - private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises