

Opportunity Zone Program Tax Cuts and Jobs Act

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3 Tax Incentive Benefits

1. **Temporary Deferral** of Eligible 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*

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



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

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

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

Deferred Gain: When & How Much

When: Includable in taxable income for the taxable year which includes 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

- Ability to Invest Previously Deferred Gain in new O-Fund

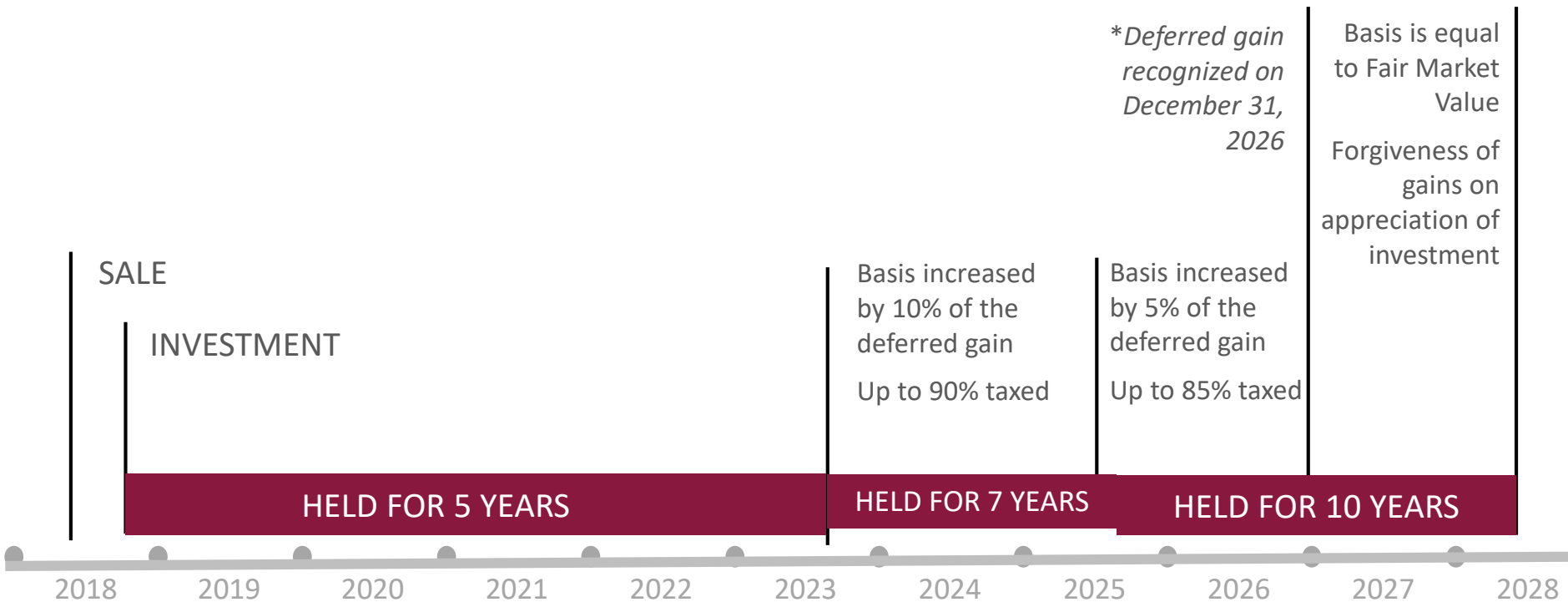
Partial Reduction of Deferred Gain (Tax Basis)

- 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

Full Forgiveness

- Where Investor holds its interest in the O-Fund for at least 10 years:
 - Elections to step-up the Tax Basis 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?*
 - **Sale or Exchange must be on or before December 31, 2047 in order to make the election**
- Phantom income issue arising on December 31, 2026

Deferral, Partial Reduction, and Forgiveness of Additional Gains



Source: Novogradac & Company LLP

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

Substantial Improvement

- The O-Zone Business (or the O-Fund) is required to **substantially improve** the property
- 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*

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

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

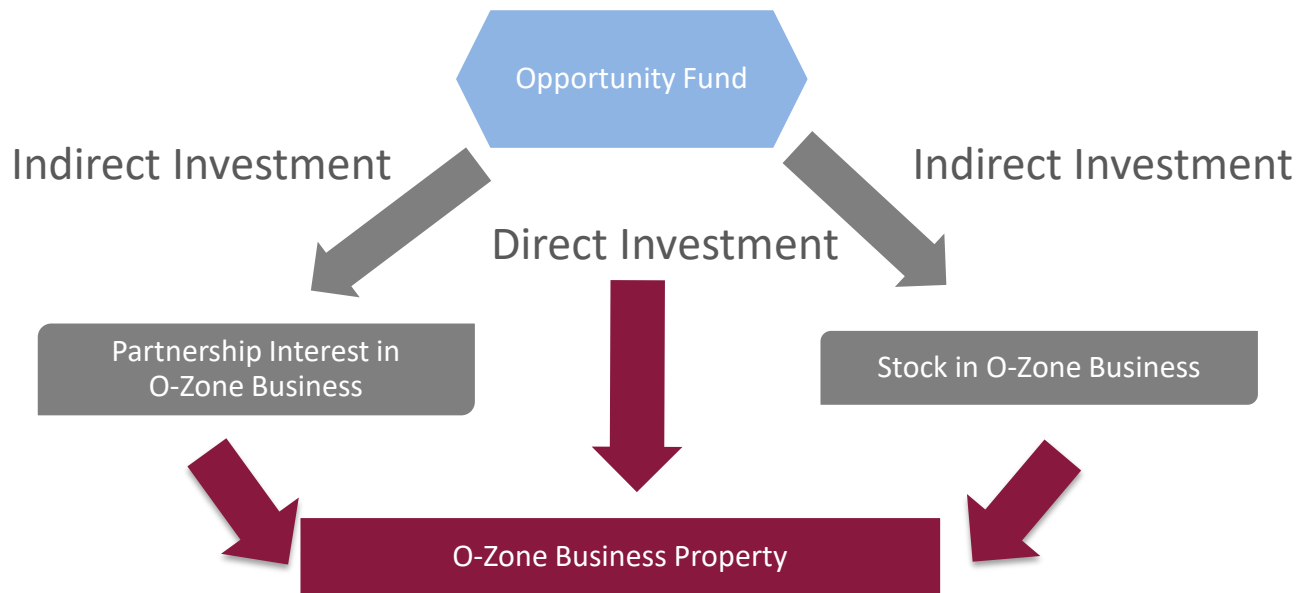
The last day of the fund's taxable year



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

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?

Opportunity Zone Businesses - Regulations

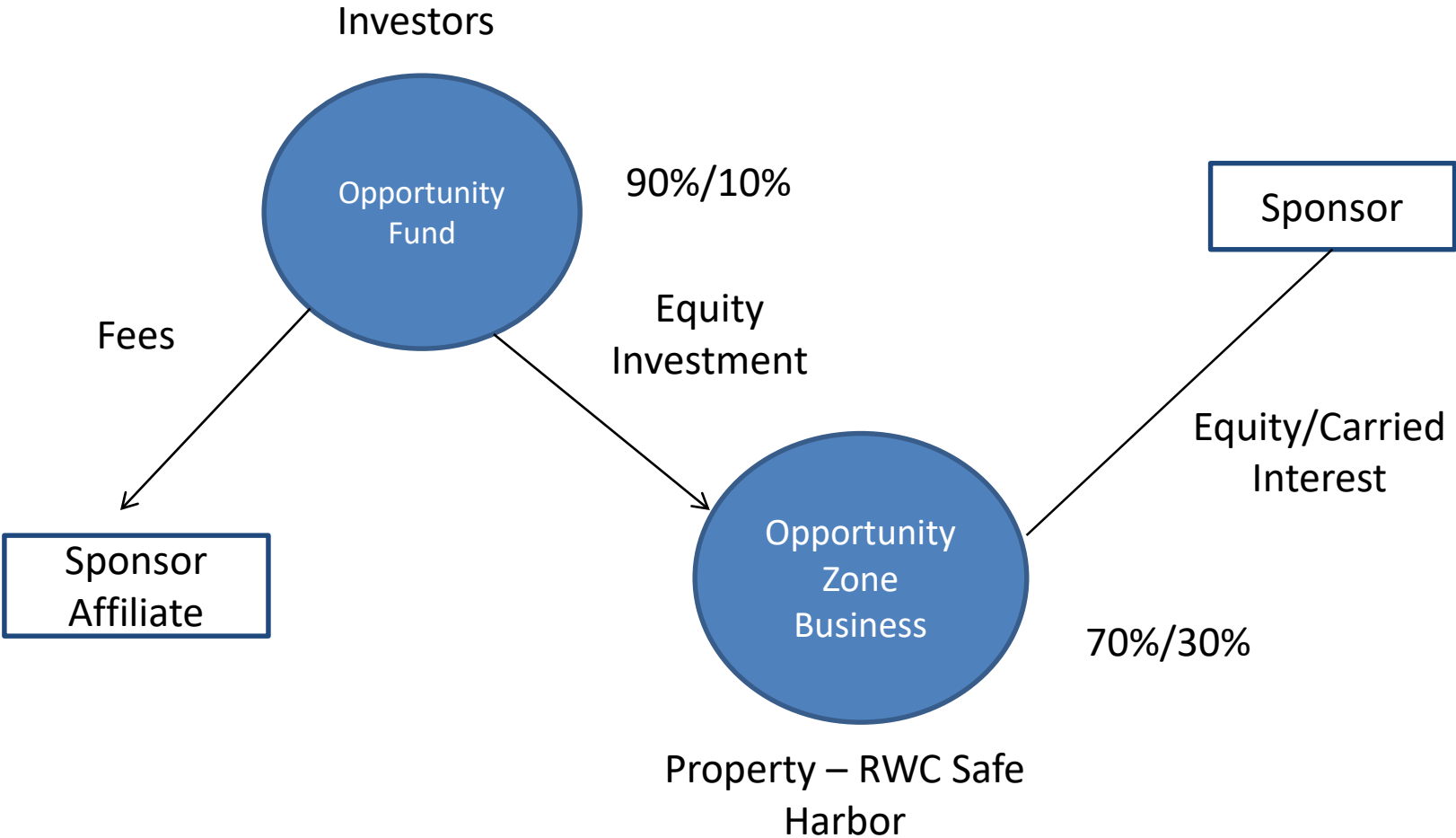
- Non-Qualified Financial Property
 - Less 5% of average of its assets can be cash or “cash type” assets
 - Does not include Accounts/Notes Receivable
 - Exception to NQFP for **reasonable amounts of working capital** (RWC) in cash, cash equivalents, or short term debt instruments (Working Capital Assets)
- **RWC– Safe Harbor-** Working Capital Assets are treated as RWC (Written Plan):
 - **Amounts designated in writing** for acquisition, construction, and/or substantial improvement of tangible property in an Opportunity Zone;
 - **Written schedule** consistent with ordinary start-up of a business for expending the Working Capital Assets within 31 months of receipt; and
 - Working Capital Assets are **actually used** in a manner that is **substantially consistent** with the previous provisions.

Excluded Businesses

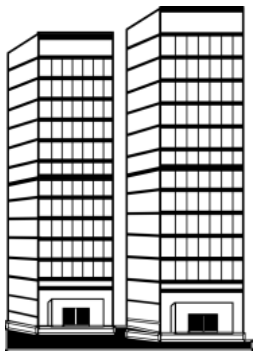
Can't be a "Sin Business"

- 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

Indirect Approach Structure



Possible Investments in Opportunity Zones



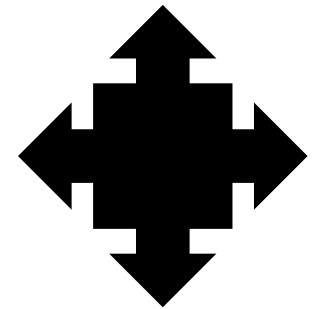
**Real Estate
Development and
Significant
Rehabilitations in
Opportunity Zones**



**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:
 - *Residential Rental Property – Is it a problem for an O-Zone Business*
 - *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)*
- Second tranche will be released in late 2018/early 2019

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