



HUSCH BLACKWELL

Opportunity Zones

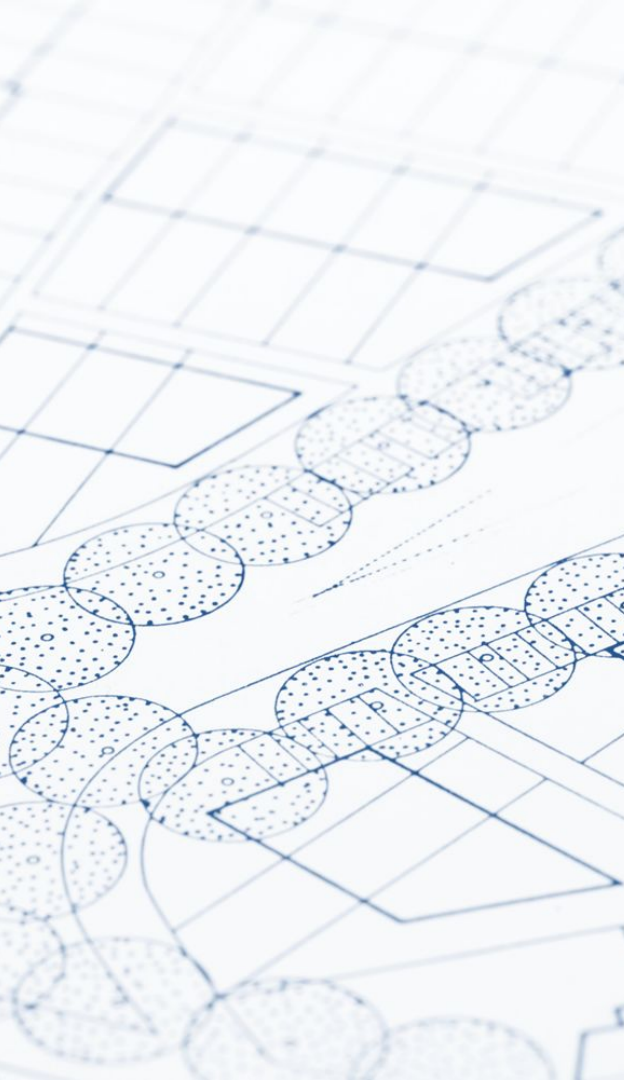
Overview and Guidance

February 21, 2019



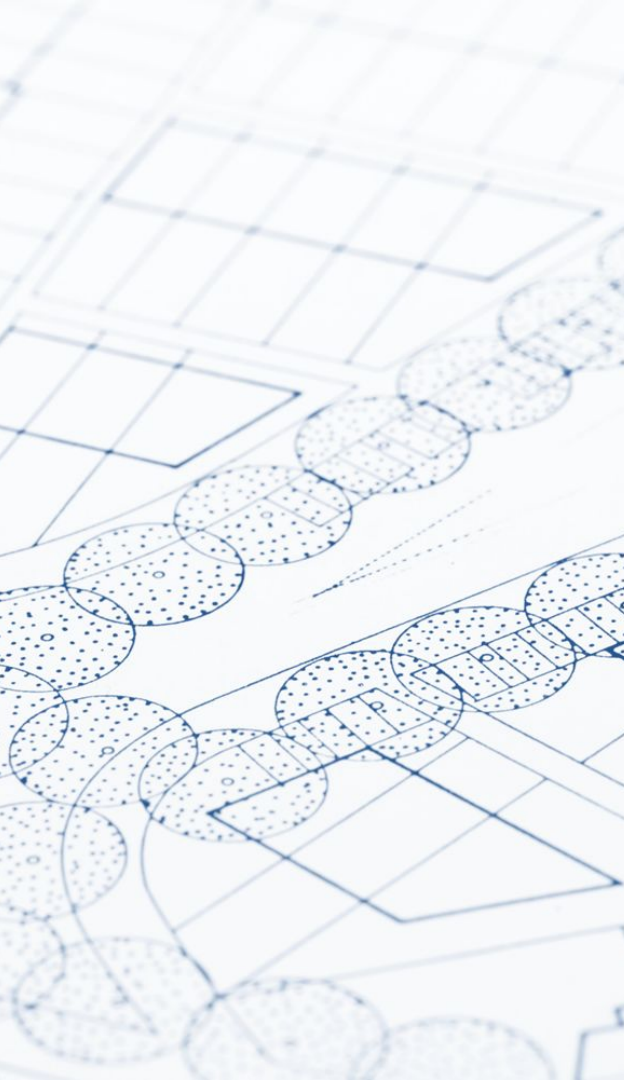
Agenda

- Opportunity Zone Overview
- Benefits of the Opportunity Zone Incentive
- Qualified Opportunity Zones
- Qualified Opportunity Funds
- Qualified Opportunity Zone Property
- Combining with Other Incentives
- Next Steps and Takeaways



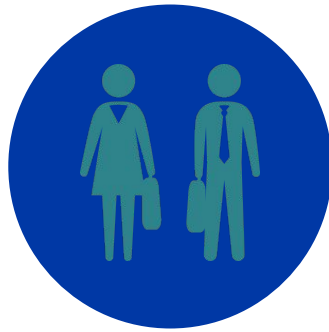
Opportunity Zone Overview

“Opportunity Funds are private sector investment vehicles that invest at least 90 percent of their capital in Opportunity Zones. U.S. investors currently hold trillions of dollars in unrealized capital gains in stocks and mutual funds alone—a significant untapped resource for economic development. Opportunity Funds provide investors the chance to put that money to work rebuilding the nation’s left-behind communities. The fund model will enable a broad array of investors to pool their resources in Opportunity Zones, increasing the scale of investments going to underserved areas.” <https://eig.org/opportunityzones/about>



Benefits of the Opportunity Zone Incentive

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. ■ Gain
Deferral

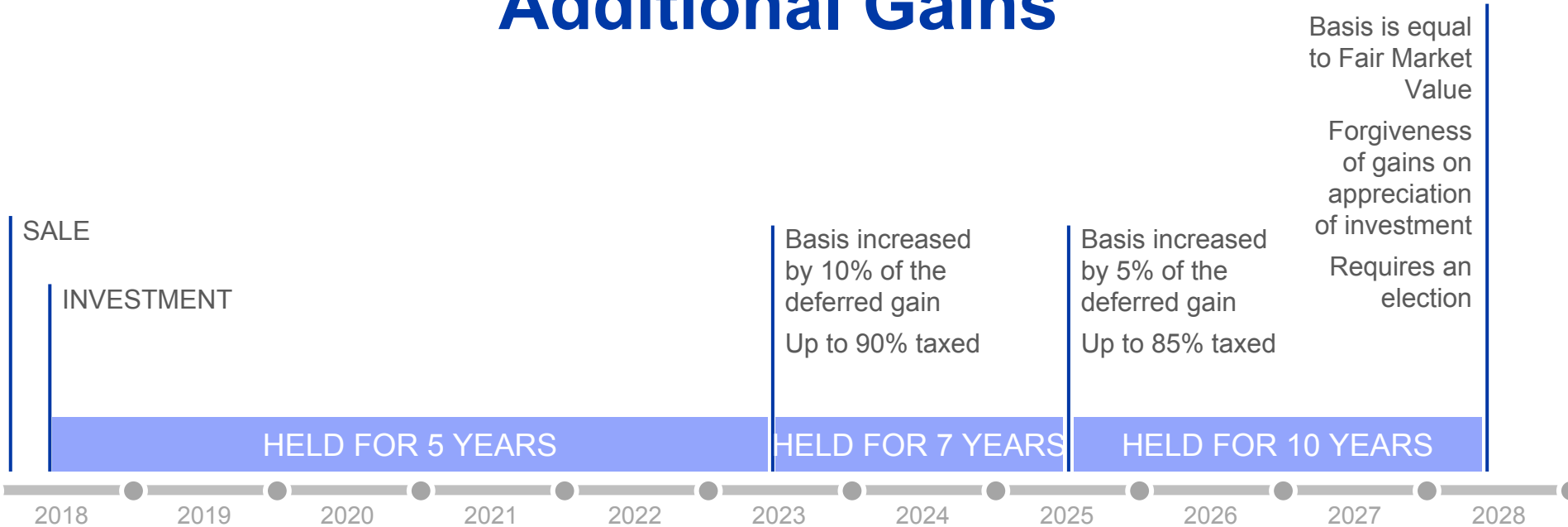
2. ■ Partial
forgiveness

3. ■ Forgiveness of
additional gains

Period of Deferral & Amount Recognized

- Deferral period ends upon the earlier of:
 - Sale of QOF interest or
 - December 31, 2026
- Amount of capital gain tax recognized:
 - Lesser of:
 - Amount of gain deferred or
 - The fair market value of the investment in the QOF interest
 - Minus
 - Taxpayer's basis in the QOF interest (basis in QOF interest initial is deemed to be zero)

Partial Forgiveness and Forgiveness of Additional Gains



Sample Investment

Jan. 2, 2018

Taxpayer enters into a sale that generates \$1M of capital gain

June 30, 2018

(Within 180 days), Taxpayer contributes entire \$1M of capital gain to a Qualified Opportunity Fund

- Taxpayer is deemed to have a \$0 basis in its QOF investment
- QOF invests the \$1MM in Qualified Opportunity Zone Property

2018

2019

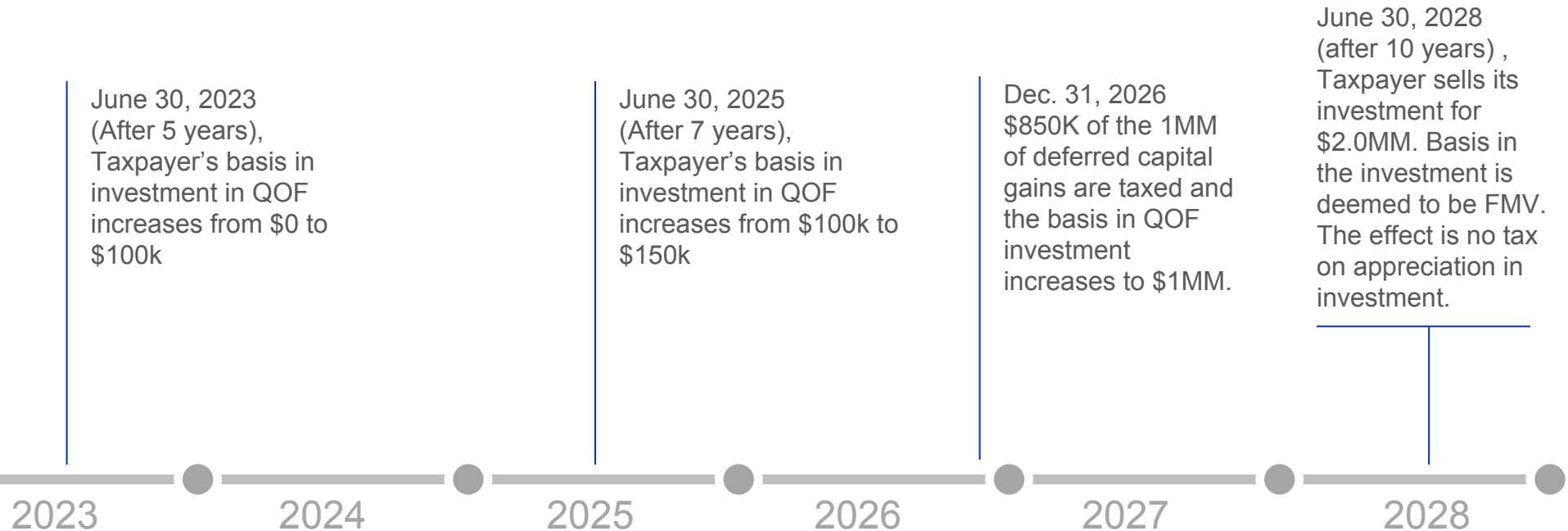
2020

2021

2022

2023

Sample Investment



Mixed Investments

Day 1

Disposition of Asset results in \$2,000,000 of proceeds –
return of capital of \$1,000,000 and capital gain of \$1,000,000

All proceeds are invested in QOZF.

\$1,000,000
Capital Return

\$1,000,000
Capital Gain

Day 3.653 (10 years, 1 day)

Disposition of OZ Fund interest results in proceeds of \$4,000,000 –
return of original \$1,000,000 investment; \$1,000,000 of “original”
capital gains, and \$2,000,000 of new capital gain. All proceeds are
held by investor.

\$1,000,000 Capital Return
No Tax

\$1,000,000 new gain on original capital
Taxed at Capital Gains Rate

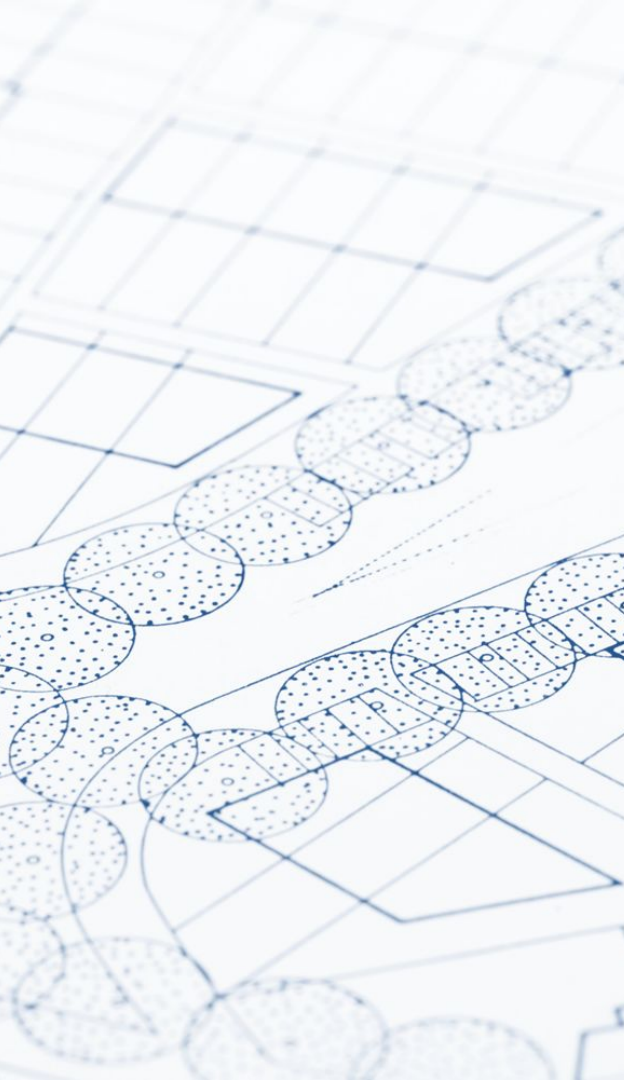
\$1,000,000 “original” capital gain.
Tax due in 2027, so no tax on
disposition of OZ Fund interest

\$1,000,000 new gain on OZ Fund
investment.
Basis = FMV, so not taxed

Total Tax¹ = \$212,500 on invested capital gain
\$250,000 on non-Opportunity Zone new gain
\$462,500

Instead of \$750,000 without Opportunity Zone treatment

¹ Assuming no changes in rates.

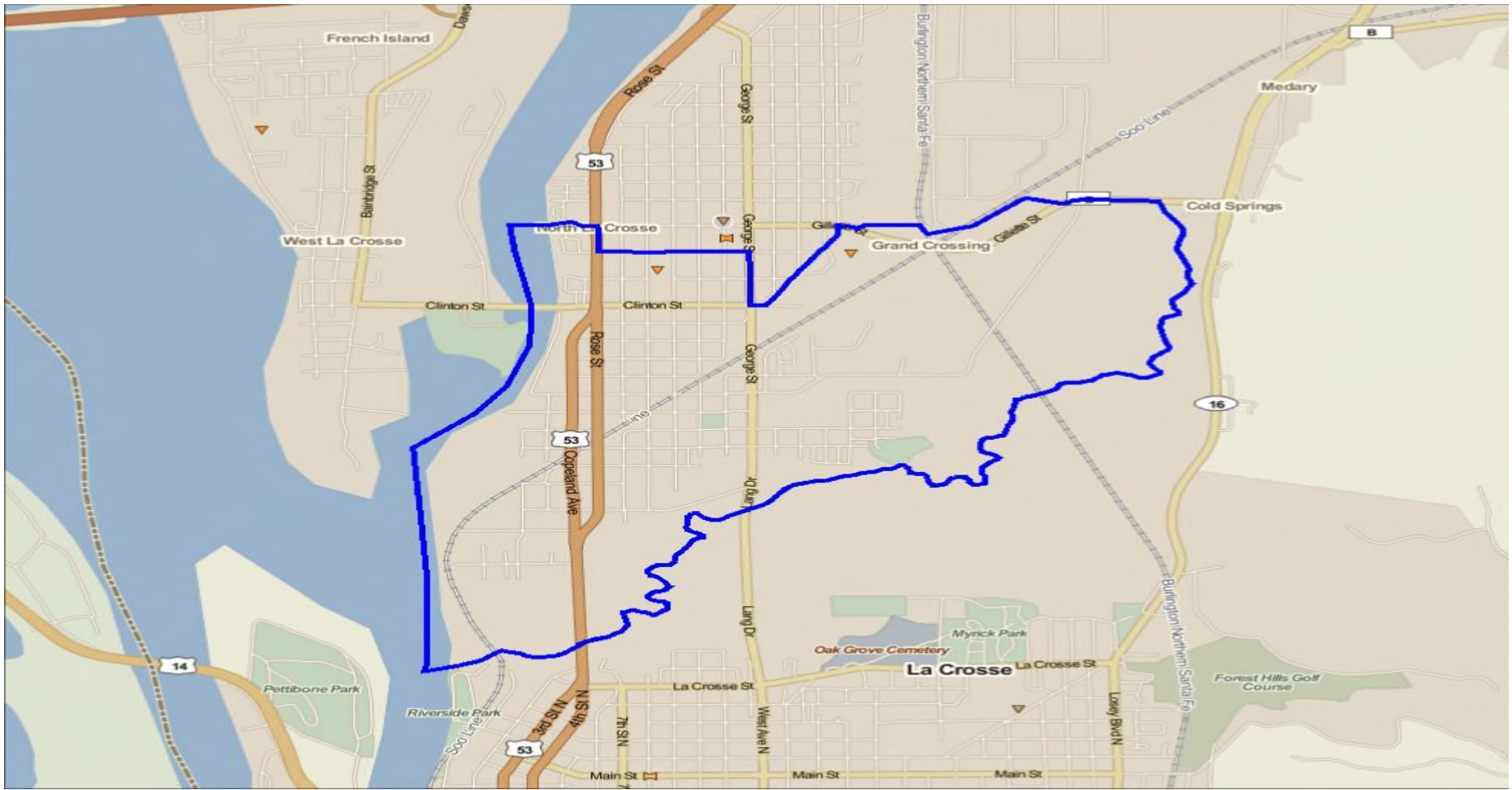


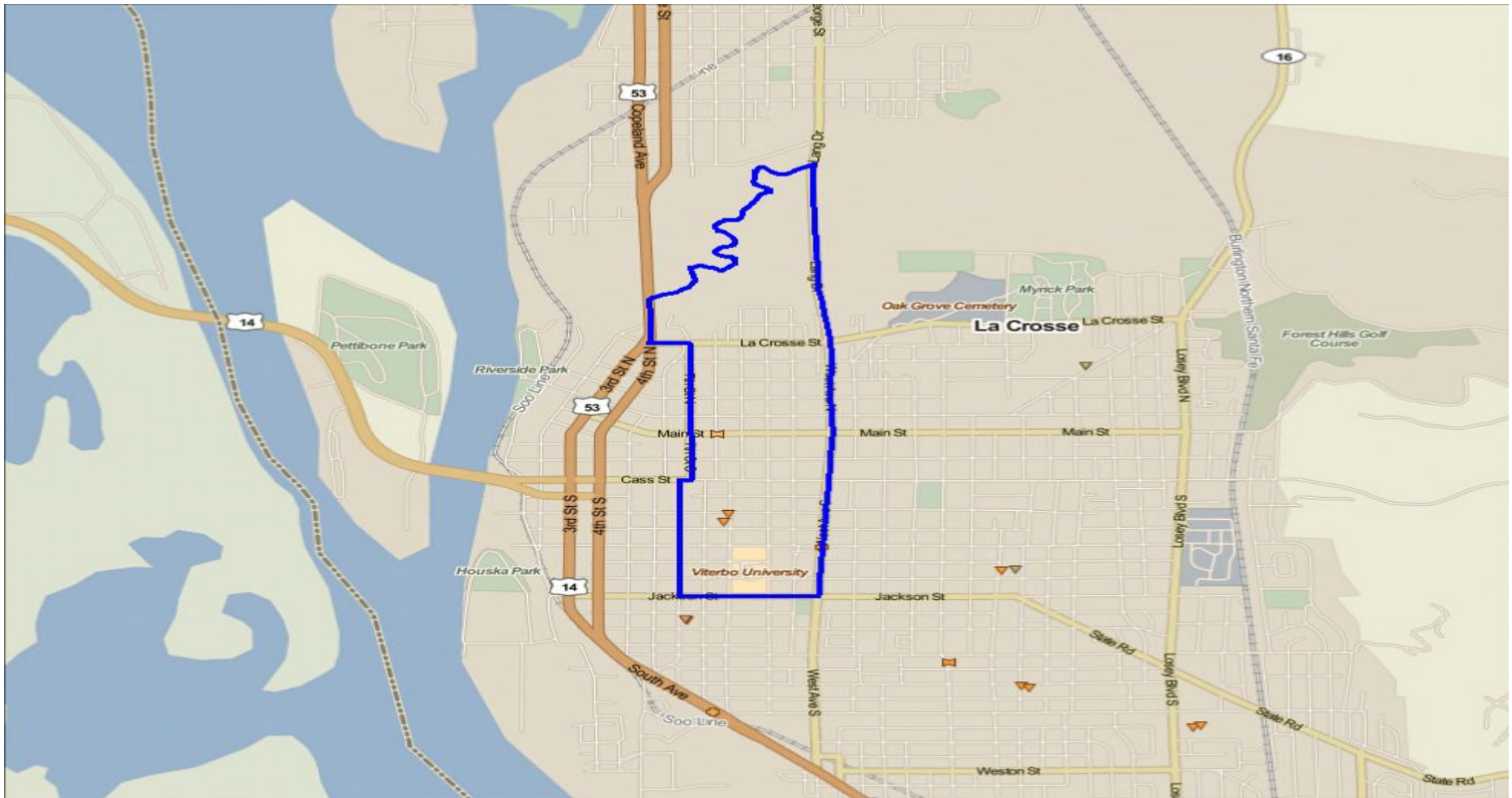
Qualified Opportunity Zones

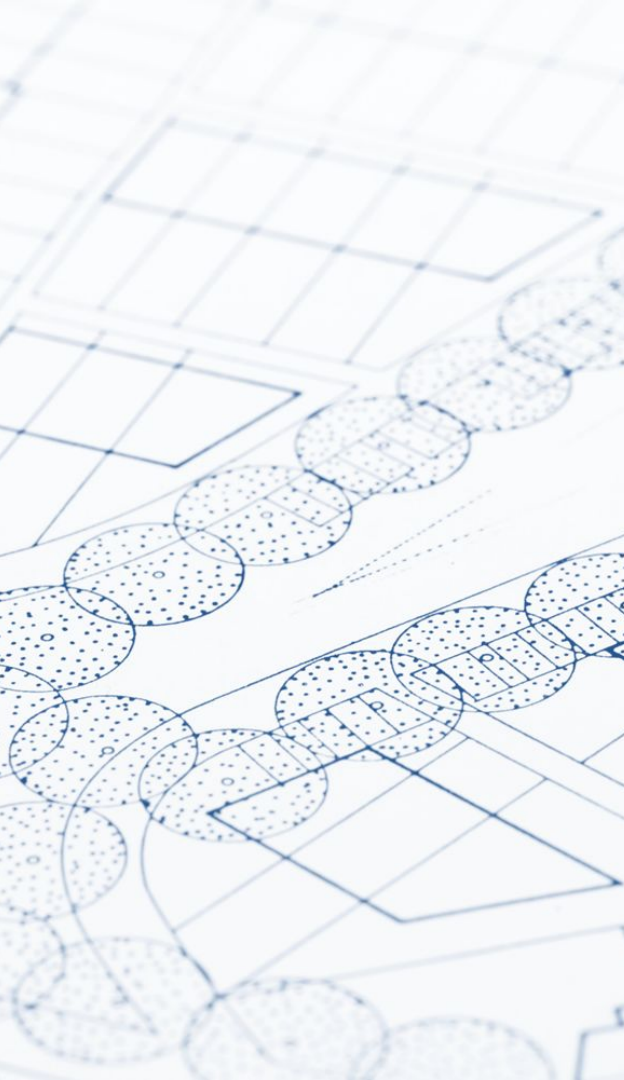
Opportunity Zones in La Crosse

- Census Tract 2 and Census Tract 4 are the approved Opportunity Zones in La Crosse, Wisconsin. The following table gives a glimpse as to how these census tracts compare to the regional average.

	Census Tract 2	Census Tract 4	Regional Average
Poverty Rate	36%	65%	14%
Household Income	\$30,814	\$19,748	\$52,004
Homeownership	30%	7%	67%
Unemployment Rate	10%	8%	5%
Adults that have a high school diploma	84%	93%	94%
Adults that have a bachelor's degree or higher	16%	43%	31%

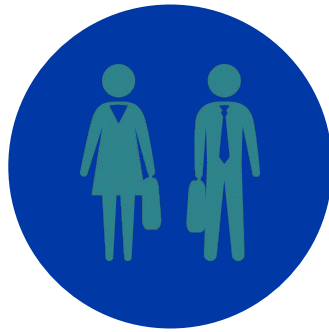






Qualified Opportunity Funds

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Qualified Opportunity Fund

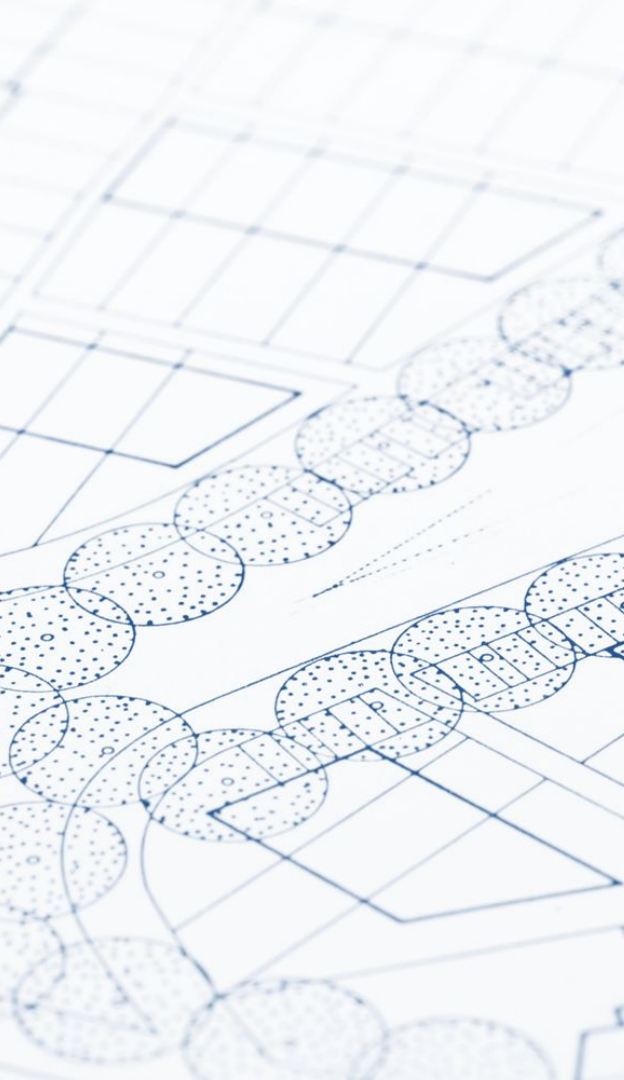
- Statutory definition:
 - An **investment vehicle** organized as a **corporation** or a **partnership** for the purpose of investing in **Qualified Opportunity Zone Property (QOZP)**.
- Opportunity Funds self certify
- Noncompliance Penalty
 - 90% asset test
 - Per month penalty equal to % of shortfall x underpayment rate
 - No penalty for reasonable cause

Types of Funds

- Self directed
 - Investing into the next project
- Targeted
 - Small groups/identified projects
- Large Funds
 - May be specialized; add management talent

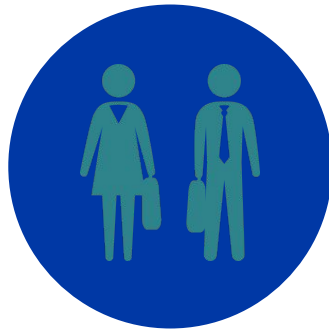
Securities Laws

- OZ Funds are investments and are subject to securities laws
 - Accredited vs. unaccredited investors
 - Crowdsourcing
 - In-state exemptions from federal acts
- Consult securities counsel!



Qualified Opportunity Zone Property

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Qualified Opportunity Zone Stock and Partnership Interests

- The investment must be **acquired after December 31, 2017** 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** 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

No “sin businesses” permitted

- A 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

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

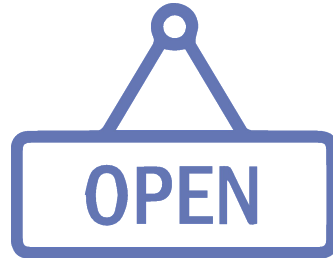
OR

- ✓ 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

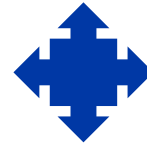
Readily Identifiable Investment Types in Opportunity Zones



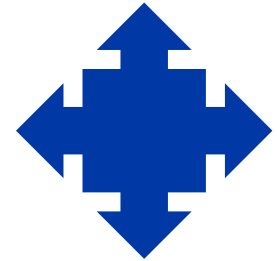
Commercial Real Estate Development and Renovation in Opportunity Zones



Opening New Businesses in Opportunity Zones



Expansion of Existing Businesses into Opportunity Zones



Large Expansions of Businesses already within Opportunity Zones

5 QOZB Tests

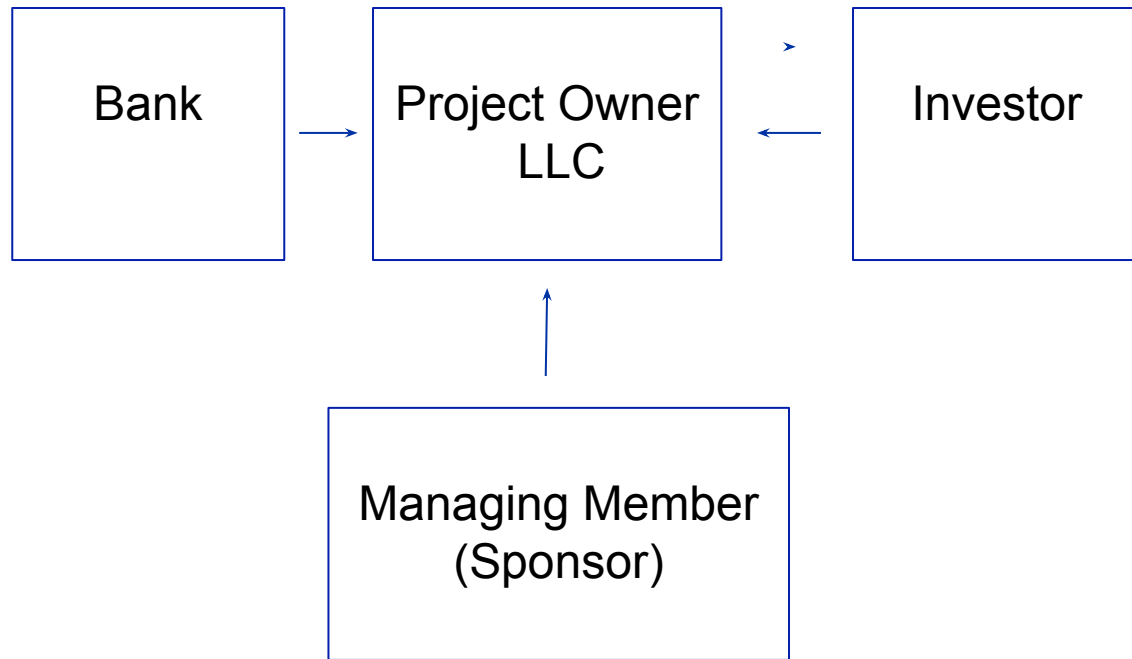
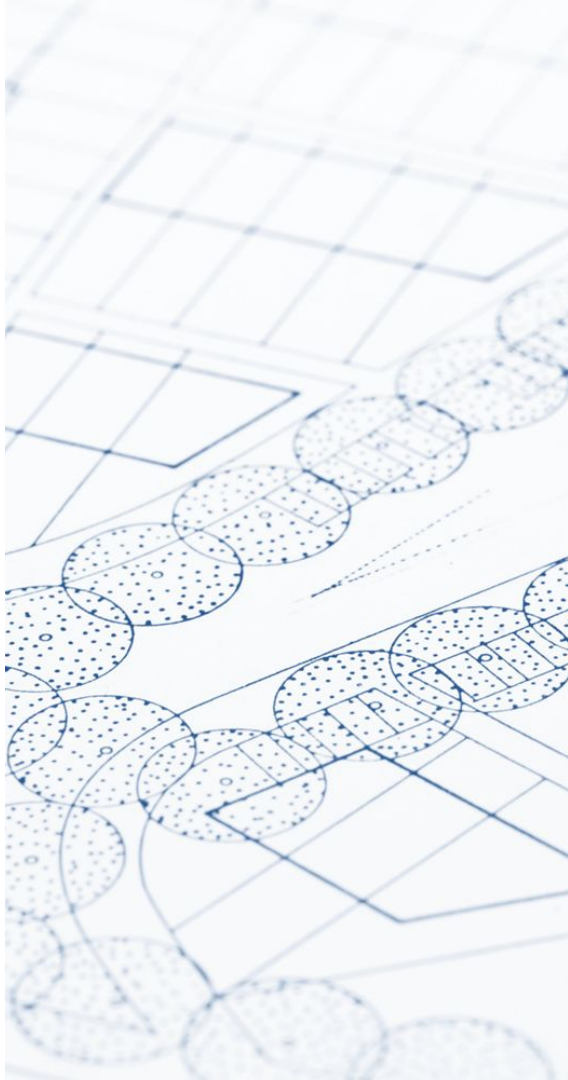
- ✓ Organized as a partnership or corporation for tax purposes
- ✓ 70% of tangible assets are QOZ Property
 - ✓ Acquired after 1/31/17
 - ✓ Used in an Opportunity Zone
 - ✓ Original Use or Substantial Improvement
- ✓ 50% of active gross income from OZ
- ✓ <5% NQFP
- ✓ Ineligible businesses

1031 Comparison

- **No “like kind” requirement**
- **No qualified intermediary necessary**
- **180 days to reinvest**
- **No initial property identification necessary**
- **Benefits to tax payer in additional to deferral**
- **No continuous deferral - taxes on original gain must be paid in 2027**
- **Potential cash flow issues when taxes are due**

Other Incentives

- **NMTC – 7 year hold vs 10 year hold**
- **Affordable Housing – 15 year hold includes the 10 year period; decrease in value makes 7 year hold desirable**
- **HTC – 5 to 6 year hold**
- **TIF – OZ funds viewed as additional equity**



Example: HTC

- **Credits taken over a 5 year period, based on QREs. Likely investment scenario is 5 – 7 years. Single tier structure with investor owning 99%**
- **Investor can be OZ Fund, project owner is OZB, and project is OZBP. May keep investment longer than sponsor anticipated. Enhances yield to Investor, therefore additional capital expected**
- **Sponsor can include OZ Fund, and project owner is OZB. Most valuable if project includes substantial non-QRE expenses**

Example: HTC

- **Project Owner can be the Fund and project is directly owned QOZBP. Conflicts with Investor**
- **Timing issue on pay in if the Investor is the OZ Fund or if the Project Owner is the Fund**
- **Potentially no outside loans needed**
 - **But watch NQFP issues**
- **Flip can cause interesting issues**

Example: NMTC

- **Investment Fund should not be the OZ Fund. That would make the Sub CDE into a OZ Business, which will have trouble meeting the NQFP test and tangible property tests**
- **Direct investment into project or project sponsor**
- **Ten year hold lasts past the New Markets period**



Takeaways for Real Estate Developers

- **New construction in an OZ works well**
- **Renovations of existing structures must meet substantial improvement test**
- **Potential that “original use” test could be applied to vacant structures**
- **If the QOZB is an operating company, the company may only need to locate in an OZ but not construct or substantially improve a structure**
- **OZ capital can be layered with other financing incentives**



Takeaways for Municipalities

- **Know your Opportunity Zones and the assets in them**
- **Add OZ notifications on any marketing materials for city-owned real estate in OZs**
- **Consider alignment with Tax Increment Districts**
- **Communicate with core developers and corporate stakeholders about OZ benefits**
- **Consider facilitating a local fund for local projects**
- **Consider creating a dedicated OZ webpage**



Takeaways for Investors

- **Timing of investment**
- **Don't forget to file elections!**
- **Ability of Fund to change or restrict investments**
- **Exit strategies**
- **Experience of Fund manager**



Takeaways for Fund Managers

- **Private Placement Memorandum/Offering materials**
- **Tax services offered to investors**
- **Fiduciary duty to investors**
- **Exit strategies**
- **Mixed fund issues/accounting**
- **Good legal and accounting counsel**



Takeaways for Small Business

- **Source of capital for expansion/relocation**
 - **Patient Capital**
 - **Lower Cost**
- **Be mindful of the 5 tests**
- **Active conduct**
- **Must remain in OZ for substantially all of the holding period**
- **How to attract OZ investment**
- **Issues with selling equity interests**

Takeaways for Lenders

- **Tax due in 2027 with no corresponding cash event = lending opportunity**
- **Guidance for bank customers**
- **Pair with OZ funds to provide complete package**
- **CRA compliance**
- **Underwriting as equity**

Questions?



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