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What is the Fundamental Objective?

• The OZ provisions are intended to get taxpayers to sell some of these appreciated assets and invest the resulting gain in designated low income communities, called “opportunity zones,” by delaying the tax that they would otherwise pay on the sale of the asset that they sold to make the investment, and eliminating the tax on increase in value of their OZ investment.

• To take advantage, taxpayers must invest in “Qualified Opportunity Funds, and these funds must, in turn, acquire opportunity zone business assets, and hold their Opportunity Fund investment in accordance with specified percentages and timetables.
What are the Tax Incentive Benefits?

1. **Defer Tax on Capital Gains**
   An investor can postpone paying tax on capital gains by as much as 8 years where an amount equal to this gain is invested in an Opportunity Fund. The drawbacks: the investor gets a 0 basis in its investment, and the gain is taxable at December 31, 2026, or on sale of the investment if earlier.

2. **Example:**
   A has a basis in publicly traded stock of $1m, which she sells for $5M. She would normally pay tax on the $4M of gain. If she invests $4M in an Qualified Opportunity Fund, she delays paying the tax.
What are the Tax Incentive Benefits?

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• Partial forgiveness
The investor’s basis in investment is increased from 0 to 10% for investments held for 5 years, and another 5% for investments held for 7 years, provided these dates are before 12/31/26. This effectively reduces the tax by 15%. Basis is also increased by the amount of gain recognized at December 31, 2026.

• Example:
A has a gain of $4M on November 2018 which she immediately invests in an opportunity fund. She gets back a membership interest in the fund with a zero basis. If she sold that interest in 2019, she would pay tax on the full sales price. In November 2023 (five years later), her basis is stepped up to $400K. If she sold that interest, she would pay tax on the sales price less $400K. In November 2025, her basis gets stepped up by another $200K, and in December 31, 2026, she becomes liable for tax of $4M (or the value of the investment, if less) less her basis of $600K. In a typical case, this would be $4M less $600K, or $3.4M
What are the Tax Incentive Benefits?

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- **Forgiveness of additional gains.**
  The investor’s basis in its investment is increased to fair market value for sales or transfers of the investment in the Fund after 10 years (until 12/31/47). Under current law, this step-up does not apply to a sale of assets owned by the Fund.

- **Example 1:** A has a gain of $4M on November 2018 which she immediately invests in an opportunity fund. She gets the step-ups and pays taxes as described in the preceding slide. In December 2030, when she has a basis of $4M in her interest in the fund, she receives an offer of $10M for her interest. If she elects, her basis is stepped up to $10M, so that she pays no tax on this sale. ($10M sales price less $10M of basis is zero).

- **Example 2:** Same facts as Example 1, except that in December 2030, the FUND owns property with a basis of $4M that it sells for $10M. This generates a $6M TAXABLE gain, and A will have to report her share.
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
Sample Investment (cont’d)

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2023</td>
<td>(After 5 years), Taxpayer’s basis in investment in QOF increases from $0 to $100k</td>
</tr>
<tr>
<td>June 30, 2025</td>
<td>(After 7 years), Taxpayer’s basis in investment in QOF increases from $100k to $150k</td>
</tr>
<tr>
<td>Dec 31, 2026</td>
<td>$850K of the 1MM of deferred capital gains are taxed and the basis in QOF investment increases to $1MM.</td>
</tr>
<tr>
<td>June 30, 2028</td>
<td>(After 10 years), Taxpayer sells its investment for $2.0MM. Basis in the investment is deemed to be FMV. The effect is no tax on appreciation in investment.</td>
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Where are Opportunity Zones?

- OZs are 25% of a state’s “low-income communities” (“LICs”) as designated by the governor. The designation period is OVER.
- There are 8,700 OZs; about 11% of all census tracts.
  - Full list of opportunity zones can be found on the CDFI Fund’s website. The links are in the document on the left.

OPPORTUNITY ZONES RESOURCES

The authority to implement IRC 14002-1 and 14002-2 has been delegated to the IRS. The CDFI Fund is supporting the IRS with the Opportunity Zone nomination and designation process under IRC 14002-1 et seq.

The IRS has issued an initial set of regulations and guidance on how the Qualified Opportunity Zone benefit under IRC 14002-2 (including the certification of Qualified Opportunity Funds and eligible investments in Qualified Opportunity Zones) will be administered, and has posted a list of Frequently Asked Questions about Opportunity Zones. Please send any comments or questions related to Opportunity Funds and Opportunity Zone Investments to CC/TA Section 14004@irscounsel.irs.gov.

Opportunity Zones
- List of designated Qualified Opportunity Zones (QOZs). This spreadsheet was updated June 14, 2018, to reflect the final QOZ designations for all States. (See IRS Notice 2018-45, 2018-28 Internal Revenue Bulletin B9, July 9, 2018, for the official list of all population census tracts designated as QOZs for purposes of Internal Revenue Code §§ 14002-1 and 14002-2.)
- For a map of all designated QOZs, click here.
  - To view all designated QOZs, click on the “Layer” tab on the menu on the right-hand side of the screen. Select “Opportunity Zone Zones (OZ)” and click “Add”.
  - To view a specific census tract, enter the tract number in the search bar, select “Tract” and click “Search.” The result will appear in blue.
  - To view a specific census tract, enter the tract number in the search bar, select “2011-2015 Census Tract” by clicking on the black box in the top left of the search bar, click “Search,” and selected the census tract number that appears in the results below.

Additional Resources
- IRS Revenue Procedure: Provides information on the eligibility criteria for census tract designation as a Qualified Opportunity Zone and the nomination and designation process.
- Opportunity Zones Information Resource: With sample lists by State of all census tracts originally eligible for designation as a QOZ.
- Opportunity Zones MapPack: This zip file contains a Geographic Information System (GIS) shapefile of all population census tracts designated as QOZs as well as all population census tracts originally eligible for designation as a QOZ. See Readme text file for additional details.
What is the Law?

• Section 1400z-1 of the Tax Code provided the rules for designating the OZs, and Section 400Z-2 provided the rules for Opportunity Funds.


• There are also FAQs at https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions

• Further Regs are expected soon.

• Even with the Code provision and the other guidance, the rules have lots of holes and uncertainties.
Investments in Designated Low Income Census Tracts | Possible projects:

- Commercial Real Estate Development and Renovation in Opportunity Zones
- Opening a New Business in an Opportunity Zone
- Expansion of an Existing Business into Opportunity Zones
- Expansions of Businesses already in Opportunity Zones
Key Timing (and other) Issues

1. Taxpayer must invest an amount equal to its capital gain no later than 180 days after the transaction in an Opportunity Fund.

2. The Fund can only make certain investments: it must invest in one of these: [indirect ownership] — Qualified Opportunity Zone Stock, Qualified Opportunity Zone Partnership Interest, [direct ownership] — Qualified Opportunity Zone Business Property
Basic Structures

INVESTORS

Qualified Opportunity Zone Fund

DIRECT Ownership

Qualified Opportunity Zone Business Property

Qualified Opportunity Zone Partnership Interest

INDIRECT Ownership

Qualified Opportunity Zone Stock

Qualified Opportunity Zone Business
Key Timing (and other) Issues

2 • There are 6-month and year end testing dates to assure that 90% of the Fund’s assets qualify as OZ business assets.

• When a Fund uses the indirect structure, and invests in a partnership, LLC, or corporation, there is a much easier percentage test: at least 70% of the subsidiary entity’s assets must qualify. (note that an LLC must be taxed as a partnership, **not** a single-member LLC)

• There’s a “safe harbor” if a subsidiary entity builds or rehabs a project within 31 months, pursuant to a written plan.

• Example: Opportunity Fund has $1M, it invests $900,000 in a partnership, receiving back a partnership interest. Partnership’s assets consist of a $700,000 new building in an OZ, and a $200,000 building **not** in an OZ. So, 7/9, or 77% of its assets (more than 70%) are good, and therefore, the **entire** $900,000 partnership interest qualifies. Finally, 900/1,000 of the Opportunity Fund’s assets, or 90%, are good, and it meets the 90% test.
Rehabilitating Used Property

• If a Fund starts with used property, then, over a 30-month period, an Op Zone business must incur additions to basis with respect to used property equal to the property’s basis at the start of the 30-month period.

• When computing the required capital expenditures for used property, you do NOT include land.

• Example: Fund acquires property for $5M, consisting of $1M of land and $4M of building. It must have capital expenditures with respect to the project of $4M.
Opportunity Zone Fund Formation

- An Opportunity Fund must be taxed as a Corporation or Partnership. This can include LLCs taxed as one of these (So: not a single-member LLC). Note that a “fund” does not have to be formed by a broker; it can be a simple partnership with two friends or family members.
- Organized in any State or in the Territory in which the Fund’s business is located
- Self-certified by filing a form with the IRS
- Because the “no tax after 10 years rule” applies to the investment IN the Fund, and NOT to the investment made BY the Fund, it most likely makes sense to have one Fund per asset.
- Example: if a Fund owns a hotel and a housing project, then you will have to find a buyer who wants both assets in order to use the 10 year rule. If you have two funds, with one owning the hotel and the other the housing, then you can sell each Fund to a different investor.
Qualified Opportunity Zone Stock and Partnership Interests

- 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 Business

- A trade or business in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property and
- At least 50% of income is derived from Active Conduct of a trade or business (proposed Regs add “in the OZ”)
- Substantial portion of intangible property is used in active conduct of business
- Less than 5% unadjusted basis of property is nonqualified financial property
- Not a “sin business”
Qualified Opportunity Zone Business Property

- Tangible Property used in a trade or business
- Acquired by purchase from an unrelated party (very high no more than 20% standard) after December 31, 2017
- During substantially all of the holding period, substantially all of the use is in an OZ
- Original Use commences with taxpayer OR the taxpayer substantially improves the property: during any 30-month period after acquisition, additions to basis exceed an amount equity to the adjusted basis of such property at the beginning of such period.
Who Can Invest

- Persons or Entities that recognize capital gain
- Pass-through entities (like partnerships, S corporations) can invest or its partners or shareholders can invest. This may enable a much longer than 180-day time table to invest.

- Leverage and liquidity:
  - The investor can borrow money to make the investment, and pledge interest in the Fund as collateral.
  - The Fund can borrow money to develop the Project. Don’t forget the NQFP and 31-month rules.
How to put a deal together:

• Find a developer who is willing to build, improve or develop in a qualified opportunity zone
• Find a business that wants to locate or relocate to a qualified opportunity zone
• Find an investor with a capital gain in the past 6 months or the ability to trigger one now
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How Builders & Developers Can Use the New 'Opportunity Zone' Tax Incentive Program

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