STOCKMAN KAST RYAN + COMPANY

Opportunity Zones

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Opportunity Zones

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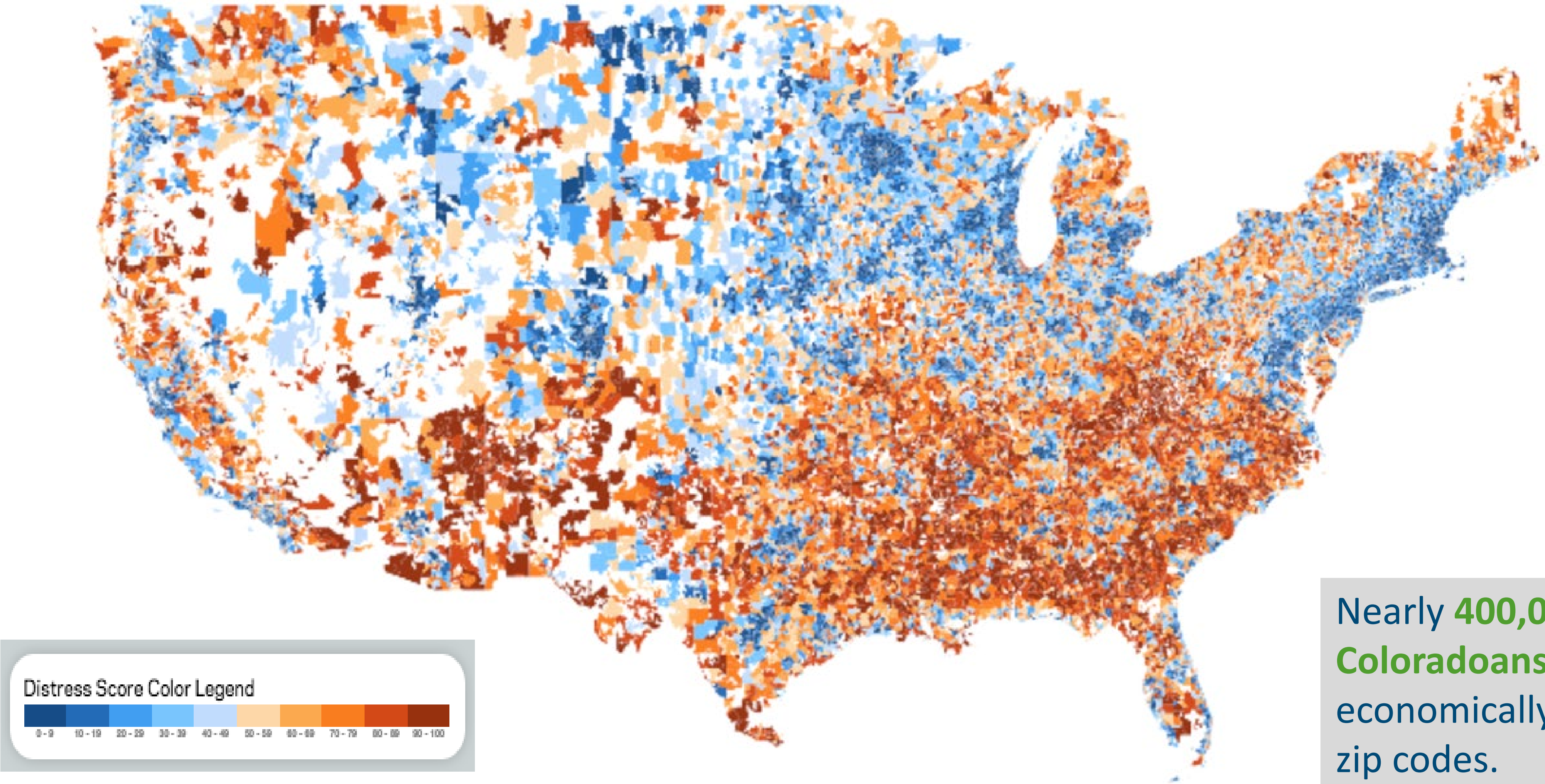
Opportunity Zones Facts

Opportunity Zones (OZ) are a **new incentive** of the Tax Cuts and Jobs Act of 2017.

OZs are designed to spur **long-term investment** in **low-income areas**, defined by census tract boundaries.

OZs are **federal tax incentives**, different from Enterprise Zones, which are **state income tax credits.**

52 million Americans (1 in 6) live in economically distressed communities.



Prosperous Distressed

Nearly **400,000 Coloradoans** live in economically distressed zip codes.

Source: EIG's "Distressed Communities Index;" Novogradac & Company LLP

Where are these zones?

- **126 statewide.**
- **Eight opportunity zones in El Paso County**:
    1. North Nevada Corridor
    2. West Downtown
    3. East Downtown
    4. The Citadel
    5. Powers Corridor
    6. Memorial Gardens
    7. COS Airport
    8. South Academy

How and why these zones?

- For El Paso County zones, local city, county and economic development groups completed a **"rigorous process to nominate census tracts for Opportunity Zone status."**
- Eligible census tracts had to have at least a **20% poverty rate** or a median **family income of no more than 80%.**
- Governors **could only designate 25%** of total number of low-income census tracts in the state.
- Department of Treasury approved the final certification of Opportunity Zones.
- Zones are certified and **locked in for 10 years**.

Up to Three "Wins" when you invest in OZs

1

Defer paying tax on original capital gain.

2

Reduce tax owed on original gain.

3

Eliminate tax on new capital gain earned from OZ investment.

Original Capital Gain Tax Owed

2

1

Sale of qualified stock or business property.
Capital gain of $1 million is realized; elect to defer.
You incur a $200k in capital gain tax.

Invest $1m gain in OZ Fund
Within 180 days of sale.

CAPITAL GAIN TAX DEFERRED

Recognize original capital gain tax;
by Dec. 31, 2026.

Pay $170k for original gain in 2026 tax filing.

2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029

HELD FOR 5 YEARS

HELD FOR 7 YEARS

Waiting period begins
to qualify for the reduced tax owed.

QOF Basis = $0

10% reduction
in capital gain tax owed.

QOF Basis = $100k

+5% reduction
in capital gain tax owed.

QOF Basis = $150k

Reduction of Tax Owed

Example

When you invest the original capital gain of $1M in a QOF, you will owe less of the original tax due when you hold the investment for:

Hold Period (years)	**Original Capital Gain Investment**	**Federal Capital Gain Owed** (20%)	**Reduction of tax owed on capital gain.**	**Unrealized Tax Savings** (realized when paid)
0 – 4.11	$1,000,000	$200,000	0%	$ -
5 – 6.11		$180,000	10%	$20,000
7+		$170,000	15%	$30,000

* Fictional example. Not tax advice.

Elimination of tax on additional gains

Sale of qualified stock or business property.
Capital gain of $1 million is realized; elect to defer.
You incur a $200k in capital gain tax.

Invest $1m gain in OZ Fund
Within 180 days of sale.

2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029

HELD FOR 5 YEARS | HELD FOR 7 YEARS | HELD FOR 10 YEARS

QOF Investment
Holding period begins.
QOF Basis = $0

10% Step-up in basis
QOF Basis = $100k

QOF Basis = $150k

Complete elimination of tax on new gain earned from OZ investment.
QOF basis = $1m

Updates from October 2018 Proposed Regs

Win 1
Defer

- Capital gain must be from a sale to an unrelated person (e.g., lineal ancestors, direct descendants, siblings, 20% entity ownership).
- Only investments from capital gain deferrals qualify for OZ benefits. Eligible gains:
  - Long term capital gain (including §1231 gains, 28%).
  - Short term capital gain.
  - Net §1256 contracts.
  - Capital gain dividends including REIT/RIC.
- Not all gains from an event must be invested.
- No tracing requirement for the cash investment.

Updates from October 2018 Proposed Regs

Win 1
Defer

- Does not apply to sales after 12/31/2026.
- Must invest in OZ fund **within 180 days**:
  - Direct sales – date of sale
  - Partners – last day of partnership's taxable year or partner may choose the date of sale.
  - Partnership – date of sale
  - REIT/RIC dividends received – date dividend received. Undistributed dividends – last day of RIC or REIT's tax year.
- No other deferrals allowed (includes like-kind exchanges and installment gains.

Updates from October 2018 Proposed Regs

Win 3
Eliminate

- After 10 years: Basis = your original capital gain deferral = the amount you originally invested in the QOF.
- Appreciation beyond 10 years is **forgiven until 2047.**

Unclear:

  - Is depreciation recapture also forgiven?
  - Interim gains – Fund-of-funds investments, debt-financed distributions.

State Tax Implication

- Colorado conforms to Federal law.
- Non-Colorado Opportunity Zone property may be taxed depending on each state's rules.
- In general consider:
  - State where gain was realized.
  - State(s) where the OZ fund has nexus, or sufficient physical presence.
  - State or residency of the taxpayer.

Qualified Opportunity Fund

Qualified Opportunity Funds

Partnership Interest
(In a Qualified OZ Business)

Business Property
(Buying in a Qualified OZ)

Stock
(In a Qualified OZ Business)

Direct v. Indirect OZ Investment Requirements

Requirement	Direct Investment	Indirect Investment
Percentage of QOF's assets that **must be invested** in qualified opportunity zone business property.	90% (70% within zone) or 63%	N/A
Percentage of QOF's assets that must be invested in **OZ stock or partnership interests.**	N/A	90%
Percentage of OZ Fund's assets that **may be held in cash or other liquid investments.**	10% (together with intangible property)	5% plus reasonable working capital
Percentage of OZ Fund's assets that **may be held in intangible property.**	10% (together with cash)	Unlimited, but intangible property must be used in trade or business
Percentage of OZ Fund's assets that **must be invested in tangible property.**	90%	No minimum
Percentage of **gross income** that must be derived from OZ.	None	50%
Ineligible Businesses.	None	Sin Businesses

Source: Novogradac & Company LLP

Indirect Investment: QOZ Stock and Partnership Interests

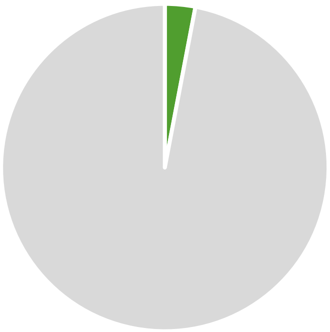
- The investment must be **acquired after December 31, 2017** in exchange for cash;
- Must be a **qualified opportunity zone business**, or is being organized for the purpose of being a qualified opportunity zone business;
- Must remain a qualified opportunity zone business for **substantially all** of the qualified opportunity fund's holding period.

QOZ Businesses

A trade or business in which **substantially all (70%)** of the tangible property owned or leased by the taxpayer is located in a **qualified opportunity zone** 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

QOZ Business Property

QOZ business property is tangible property meeting the following requirements:

1. Acquired after December 31, 2017
2. The “original use” commences with the QOF or the QOF has “substantially improved” the property
3. Substantially all of the use of the property is within a QOZ

QOZB: Excluded Businesses

Can't be a "Sin Business"

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.

Source: Novogradac & Company LLP

Qualified Opportunity Fund (QOF)

- **Intermediary between** investors and the investments in the Opportunity Zone
- **Statutory Requirements:**
  - Organized as a **Corporation or Partnership**
  - An **investment vehicle** organized for the **purpose of investing** in Opportunity Zone Property.
- 90% requirement.
- Certification process.
- Penalty imposed for noncompliance.

QOF Self-Certification

- A taxpayer completes **Form-8996.**
- Completed form is attached to the taxpayer’s federal income tax return for the **taxable year the capital gain event occurred.**
- The return must be filed timely, taking extensions into account.
- Does not appear to be a cap on the number of QOFs or the amounts to be invested in the QOF.

Source: Novogradac & Company LLP; Snell & Wilmer

90% Requirement for QOFs

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.

The last day of the fund's taxable year.

June 30

Dec 31

JAN FEB MAR APRIL MAY JUNE JULY AUG SEPT OCT NOV DEC

Source: Novogradac & Company LLP; Snell & Wilmer

Noncompliance Penalty for 90% Requirement

Monthly penalty = % Shortfall X Underpayment Rate

Underpayment rate = Federal short-term rate plus 3%, **Currently 5%**

- **Monthly penalty** for noncompliance.
- No penalty if it is shown failure is due to **reasonable cause.**
- Penalty QOF Partnerships: Penalty **imposed upon the Partners.**

Source: Novogradac & Company LLP; Snell & Wilmer

Proposed Regulations Working Capital Safe Harbor

- Applies to QOZ businesses that **acquire, construct or rehabilitate tangible business property** used in a business operating in an OZ.
- Cash, cash equivalents or debt instruments(term 18 months or less) are **considered working capital** if held by an OZ business for up to **31 months,** IF:

1. There is a **written plan** identifying working capital assets as held for acquisition, construction or substantial improvement of tangible property in OZ.
2. There is a **written schedule consistent** with ordinary start-up costs of a T/B for the expenditure of the funds within in 31 months
3. The working capital assets are **actually utilized** in a manner **consistent with the schedule**.

Proposed Regulations: Substantial Improvement

- Substantial improvement to an existing building within the OZ occurs if within 30 months after acquisition, additions to basis in the BUILDING (not Land) exceed the building's basis.
- Example: Property acquired for $1M. Land is $200k, Building is $800k. Improvements must exceed building basis of $800k, i.e. $800,001.
- Regulations do not address treatment of unimproved land.