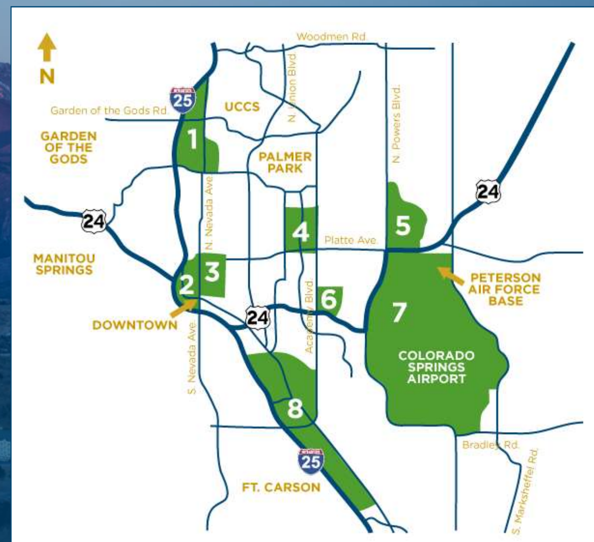


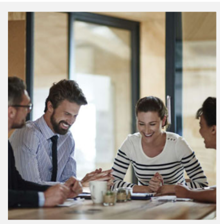
Opportunity Zones (OZ)

Defer • Reduce • Eliminate

Agenda


Overview +
Tax Perspective


Legal Perspective


Panel Discussion


Reception

OZ: Overview and Tax Perspectives

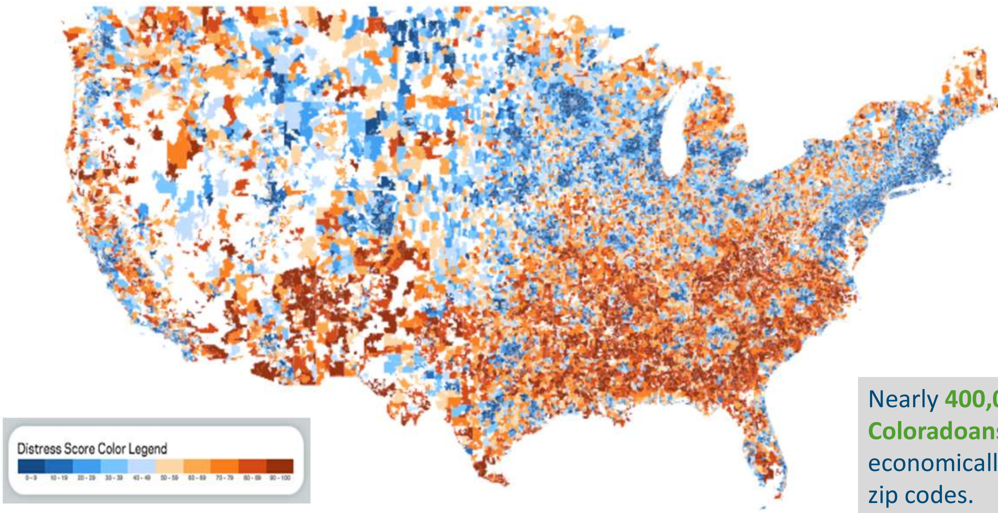
Trinity Bradley-Anderson
Managing Partner
Stockman Kast Ryan + Co

Jared Usrey
Senior Tax Consultant
Stockman Kast Ryan + Co

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.

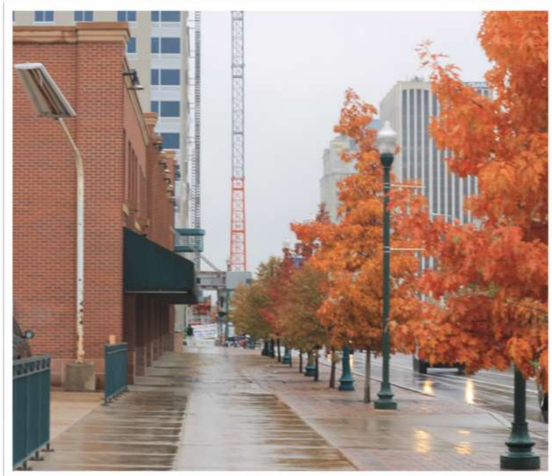
Source: EIG's "Distressed Communities Index;" Novogradac & Company LLP

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
- Search by address at www.skrco.com

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**.



Source: City of Colorado Springs

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Up to three wins of "OZ Tax Benefits"

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.

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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 Qualified Opportunity Fund (QOF)
Within 180 days of sale.

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

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

CAPITAL GAIN TAX DEFERRED

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

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

* Dates and details are tied to fictional example. Not tax advice.

Reduction of Tax Owed

2 1

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

3

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.

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

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

* Dates and details are tied to fictional example. Not tax advice.

Gains eligible for deferral

Win 1
Defer

- Capital gain must be from a sale to an unrelated party
  (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 net §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.

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Deferral timing

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.)

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Deferral of §1231 Gains

Win 1
Defer

- **§1231 Gains: sale of business property** (e.g., real property rental, manufacturing facilities).
- Gains must be combined with §1231 losses to determine net gain or loss.
  - Net §1231 **gains** are **eligible**.
  - Net §1231 **losses** are **not eligible**.
- QOF investments must be made **on 12/31/2019** to benefit from the 7-year hold and basis step-up in 2026.

Can partnerships make a deferral election for net §1231 gains?

Remains Unclear: *Most commenters presume that a partnership can make the deferral election.*

QOF Contributions

Win 1
Defer

- **Eligible for OZ tax benefit**: contributions that consist of:

Cash	
Property	(Does not qualify as QOZBP for asset tests)
Cash + Property	(Combination)

QOF Contributions – important caveats

- **Service contributions** (i.e., carried interest, profit interests, "promotes").
- **Mixed-fund investments** include contributions that are **eligible and ineligible** for OZ tax benefits.
- A capital gain interest with a **disproportionate allocation of profits** creates a mixed-fund investment where the service component is taxed.

Example: 25% of capital invested with 35% profit allocation. What qualifies for OZ tax benefit?

- 25% capital invested qualifies.
- 10% profit interest is taxed.

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Basis in QOF Investment

- Initial contribution of deferred gains creates **ZERO** basis in QOF investment.
- Distributions in **excess of basis** can result in recognition of deferred gain.
- Debt-financed distributions **after 2 years** are generally allowed.
- Basis increased by **4 events**:

1. Income from a QOZB.

2. 10% of original investment in QOF after 5-year hold.

3. Add'l 5% increase of original investment after 7-year hold.

4. Allocation of debt in a QOF partnership.

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Inclusion Events*

Inclusion Events

- S-Corporation – 25% aggregate change in ownership.
- Partnership – sale of a partnership interest when the partnership is invested in a QOF.
- Termination of the QOF.
- Transfer **of QOF investment** via gift.

Non-Inclusion Events

- Contribution of QOF interest to a grantor trust.
- Transfer of QOF interest at death.
- S-Corporation election or revocation.
- Contribution to a disregarded entity.

*Not a comprehensive list.

Operations/Interim Gains

- **Operating income and loss:** treated the same as other investments.
  - Income is taxed; loss is subject to basis limitations, active/passive limitations.
- **Sale of QOZBP** (stock or property) before end of 10 year holding period is a taxable event.
  - Example: If QOF or subsidiary has three buildings and sells one in year 8, the sale will be taxed.
- **Reinvest:** QOF will have **12 months to reinvest** the QOZBP sale proceeds in other QOZBP.
  - If the proceeds are held in cash and cash equivalents during the 12 month period, the excess cash will meet the 90% test.

Disposal of QOF assets

Win 3
Eliminate

HELD FOR 10 YEARS

- After a **minimum of 10 years,** basis will be set to the fair market value at the time of sale.
- Appreciation beyond 10 years is **forgiven until 2047.**

Sale of Interest vs Sale of Assets

Win 3
Eliminate

HELD FOR 10 YEARS

Sale of Interest

- Excludes **ALL** gain from income.

Sale of Assets

- Exclude ONLY capital gain resulting **from sale of QOZBP**.
- Gain on non-QOZBP assets **is taxable**.
- Must recognize ordinary income.
- Example of ordinary income recognition is the sale of inventory and receivables or depreciation recapture on equipment.

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.

Layering other credits/deductions with OZ incentives*

All regular operating deductions apply to QOF operations, including depreciation acceleration and 20% QBI deduction.

- Low Income Housing Credits – Federal and CO
  (5/17/19 CO credits $10M)
- FHA – 2/3 **reduction in fees** for multi-family projects in OZ where 90% of units qualify for LIHTC and deployment of a team to accelerate applications.
- New Market tax credits.
- CO Enterprise Zone tax credits.
- Tax Increment Financing funds.
- State incentives being rapidly developed.

*Not a comprehensive list.

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.
  - Investors must purchase interest in QOF for OZ benefits to apply.
- 90% of assets must be QOZBP.
- 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.

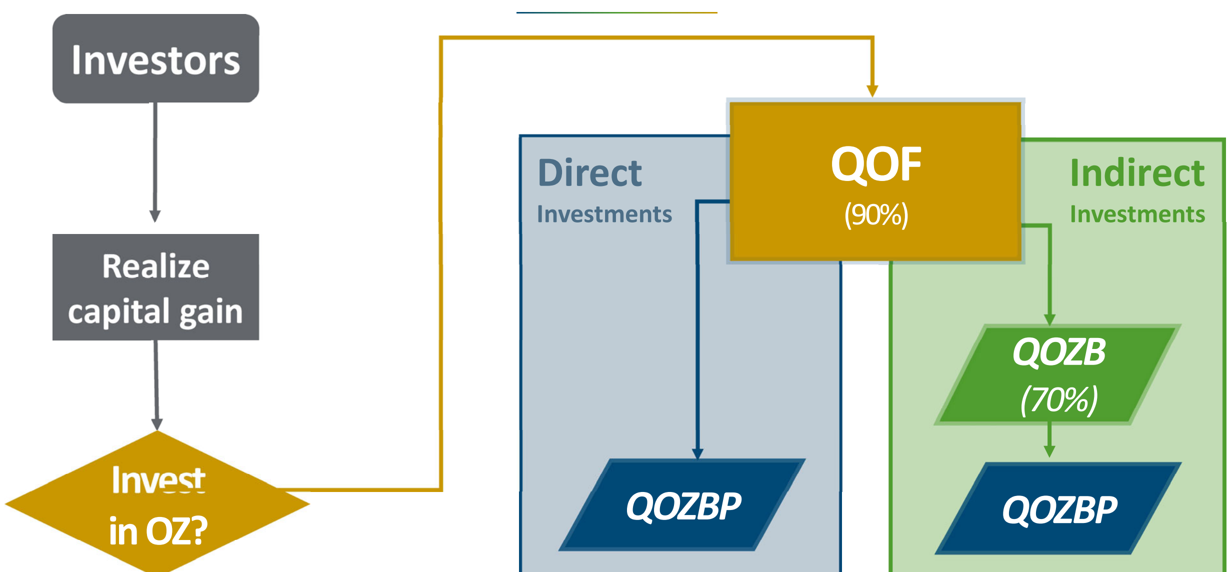
Source: Novogradac & Company LLP; Snell & Wilmer

Direct v. Indirect OZ Investments

Direct Investment (QOF directly owns QOZBP and operates business)	**Indirect Investment – Preferred Method**
90/10 Test If a Qualified Opportunity Fund (QOF) does not hold interest in subsidiaries, **90% of its assets** must be Qualified Opportunity Zone Business Property (QOZBP).	**70/30 Test**
No working capital safe harbor; absent further guidance, all cash would be counted toward the 10% of assets that can be non-QOZBP.	**Working Capital Safe Harbor applies** to allow unlimited amount of cash as long as entity substantially complies with a written plan of deployment of a trade or business including acquisition, construction and/or rehabilitation of property.
No active conduct standard.	50% gross income from active conduct of trade or business.
No prohibition on sin businesses.	No sin businesses.
No specific reference to the lease of property directly by a QOF.	A QOZB is able to lease property.
As currently written, this 5-year grace period does not apply to QOZBP held directly by a QOF.	Statue provides a 5-year grace period for characterization of property held by a QOZB as QOZBP.

Source: Bloomberg Law

Qualified Opportunity Fund



Asset test for QOFs

Must hold at least 90% of assets (either QOZB or QZOBP) 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

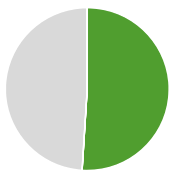
Source: Novogradac & Company LLP; Snell & Wilmer

Indirect Investment: QOZB - 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.

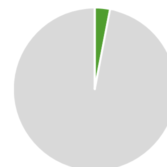
QOZB

A trade or business in which **substantially all (70% of assets used in QOZ for 70% of the time during 90% of the holding period = 40%)** 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.

40%
of intangible property used in active conduct of business.



< 5 percent unadjusted basis of property is nonqualified financial property.

50% Active Conduct of a Trade or Business

QOZB

- Includes leasing OZ property **as long as the lease is not a triple-net (NNN) lease.**
- Safe harbor test for Operating Business:
  - At least 50% of hours spent by employees and independent contractors are within the QOZ. (E.g. - If all employees are within the QOZ, the location of customers is irrelevant) OR
  - At least 50% of amount paid by a business to employees and independent contractors are for services performed within QOZ. (E.g. highly compensated employees are located in QOZ vs. larger number of employees outside of QOZ) OR
  - The tangible property located in QOZ and the management operations functions performed in the QOZ are each necessary for the generation of at least 50% of the gross income.

QOZB: Excluded Businesses

QOZB

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

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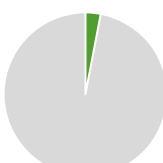
Cash - Working Capital Safe Harbor

QOZBP



< 5 percent unadjusted basis of property is nonqualified financial property

- Applies to QOZ businesses that are **developing a trade or business in OZ including the acquisition, construction or rehabilitation of tangible business property** in a QOZ.
- Cash, cash equivalents or debt instruments(term 18 months or less) are **considered working capital** if held by an QOZ business for up to **31 months,** IF:

1. There is a **written plan or schedule** which outlines the deployment of assets in either acquiring/constructing or rehabilitating QOZBP or developing a trade or business (identifying leased space, employee hiring plans, space plans, permits etc.)
2. The working capital assets are **actually utilized** in a manner **consistent with the schedule**.

Government delays constitute reasonable cause for delay in working capital deployment.

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90% or 70% asset test

QOZBP

QOZ business property (QOZBP) is tangible property meeting the following requirements:

1. Acquired or leased 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.

QOZBP: Acquired and Original Use

QOZBP

- Property must be purchased by the QOF/QOZB.
- **Property contributed to the QOF is eligible for the deferral election but NOT the acquisition provision.**
- Tangible property "Original use" – initial use for depreciation or amortization purposes must be in QOZ. E.g. QOF/QOZB purchases a used personal use vehicle – it would qualify because not previously depreciated.
- Buildings vacant for over 5 years purchased by a QOF/QOZB qualify.
- Vacant land purchased by a QOF/QOZB qualifies.

QOZBP: Leased Property

QOZBP

- Lease must be initiated after 12/31/2017 at Market value rate.
- Lease does NOT need to satisfy original use.
- QOF or QOZB is NOT required to substantially improve leased property
- Related Party leases are allowed with additional requirements:
  - No prepayments of more than 12 months of lease payments.
  - Leased tangible PERSONAL property (e.g. equipment, furniture and fixture)
    - Must either satisfy the original use requirement OR
    - QOF/ QOZB must acquire OTHER tangible property of equal value within 30 months of the lease inception.
  - Leased RP Real Estate property qualifies if there is no plan or expectation that the property would be purchased from less than FMV or the lease will not qualify as QOZBP.

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QOZBP: Leased Property

QOZBP

- Related Party Real Estate Leases – No plan or expectation that the property would be purchased for less than FMV or the lease will not qualify as QOZBP.
- Valuation for the 90% (direct) or 70%(indirect) asset tests:
  - the value on Applicable Financial Statements (Audits) OR
  - the present value of all lease payments for the term of lease on the date lease is entered.
- Planning Point – consider a land lease if land was purchased prior to 12/31/2017.

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QOZPB: Substantial Improvement

QOZBP

- 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.

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Substantial Improvement, cont

- Raw land does not need to be substantially improved.   However, a QOF or QOZB must conduct a trade or business and simply holding raw land will not meet that requirement. Presumption is that general anti-abuse provision will disallow treatment of raw land as QOZB if there is no intent to improve land.
- Tangible personal property is treated as substantially improved if the equivalent of it's basis is expended within 30 months on an asset by asset level. **Commentary: this is impractical. Push to convert to an aggregate basis.**

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QOF: Noncompliance Penalty for 90% Requirement

- No is a **monthly penalty** for noncompliance.

Monthly penalty = **% Shortfall** X **Underpayment Rate**

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

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

Note: QOF can elect to ignore un-deployed capital contributed within prior 6 months for purposes of the 90% test.

Source: Novogradac & Company LLP; Snell & Wilmer

Planning ideas: QOFs

- **Debt** can be a powerful tool within a QOF:
  - Debt allocated in a partnership QOF **gives rise to basis for loss deductions.**
  - Debt financed distributions are allowed two years after capital is contributed.
  - For investors/developers with §1231 gain: Consider **using debt as an initial funding** source to get projects started before year end.
- Partnerships are the structure with the **most flexibility for a QOF,** especially for a real estate holding.
- Consider a **land lease** with land held prior to 12/31/17.
- No **triple-net leases**; use a gross lease. NNN's are also harder to qualify under 20% QBI deduction.

Planning ideas: Operating Business

- Rules are geared to **new businesses**.
- All assets of an existing business are considered in asset tests.
- Difficult for an existing business to meet the QOZB requirements unless the business is **geared for growth** and a significant **capital spend** or a **new capital lease.**
- Consider creation of a **separate subsidiary** for a new location with the OZ.
- Leased premises within the OZ help increase QOZBP base.
- Inventory is included in Asset tests.
- Test is **asset driven** not employee driven.

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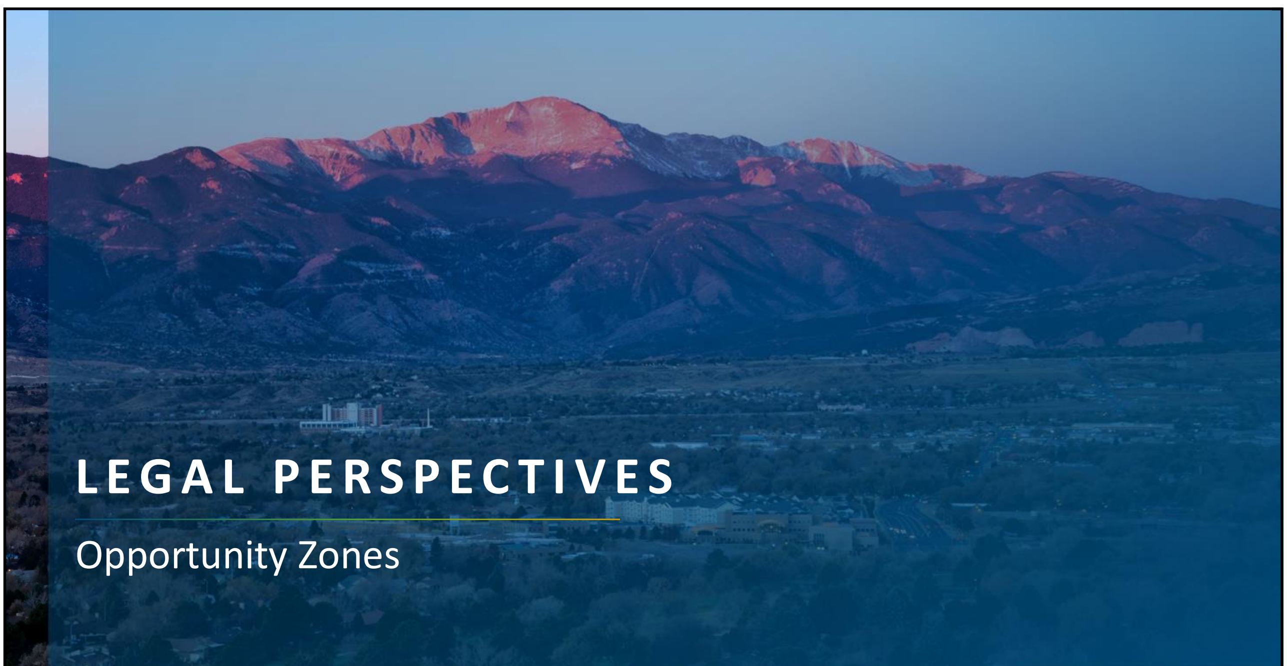

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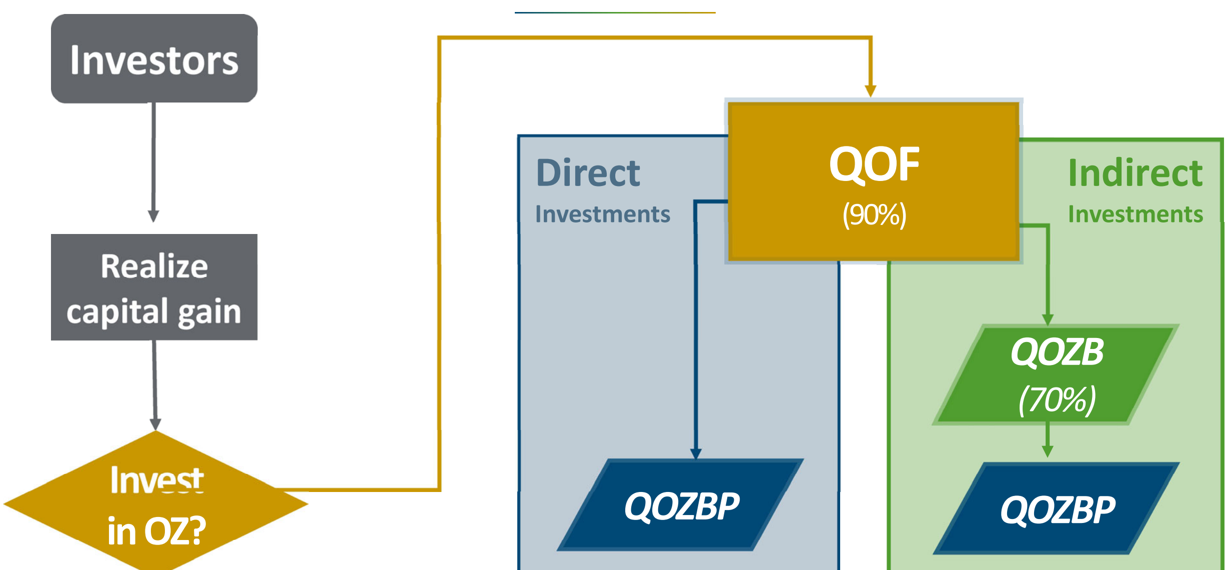
Qualified Opportunity Zone Fund (QOF)

*A **vehicle** for <u>realizing</u> Opportunity Zone **tax benefits.***

Dave Steigerwald

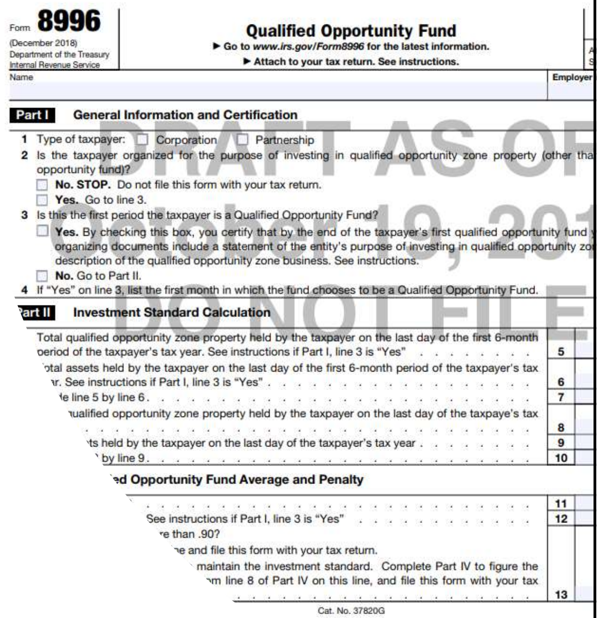
Managing Director

Qualified Opportunity Fund



QOF Requirements

- Corporation or Partnership (including LLC).
- Direct or Indirect Investment in Opportunity Zone Property.
- Self-certify under form 8996.



Form **8996**
(December 2018)
Department of the Treasury
Internal Revenue Service

Qualified Opportunity Fund
► Go to *www.irs.gov/Form8996* for the latest information.
► Attach to your tax return. See instructions.

Name | Employer

Part I General Information and Certification

1 Type of taxpayer: ☐ Corporation ☐ Partnership
2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other tha opportunity fund)?
☐ **No. STOP.** Do not file this form with your tax return.
☐ **Yes.** Go to line 3.
3 Is this the first period the taxpayer is a Qualified Opportunity Fund?
☐ **Yes.** By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund organizing documents include a statement of the entity's purpose of investing in qualified opportunity zo description of the qualified opportunity zone business. See instructions.
☐ **No.** Go to Part II.
4 If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund.

Part II Investment Standard Calculation

Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes" . . . 5
otal assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax r. See instructions if Part I, line 3 is "Yes" . . . 6
e line 5 by line 6 . . . 7
ualified opportunity zone property held by the taxpayer on the last day of the taxpaye's tax . . . 8
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by line 9 . . . 10

ed Opportunity Fund Average and Penalty

. . . 11
See instructions if Part I, line 3 is "Yes" . . . 12
e than .90?
e and file this form with your tax return.
maintain the investment standard. Complete Part IV to figure the m line 8 of Part IV on this line, and file this form with your tax . . . 13

Cat. No. 37820G

QOF Requirements, cont.

- **A QOF must be a partnership or a corporation.**
- **Investment must be in "equity" for income tax purposes**
  - Preferred equity is ok.
  - Partnership interests entitled to special allocations, such as cashflow or liquidation preferences, are ok.

QOZ Business Property

- Zone stock in zone business (indirect sub).
- Zone partnership interest in zone business (indirect sub).
- Equity ownership in OZ property or business (direct).

Partnerships vs. Corporations

- Tax reasons, generally.
- Investment requirements.

Fund Structure

- Operating Fund (equivalent to traditional VC – 2/20/pref).
- Real Estate Fund (similar but with additional fees and reduced risk).
- Direct Structure (preferred stock; “mom and pop”).

Fund Structure, cont.

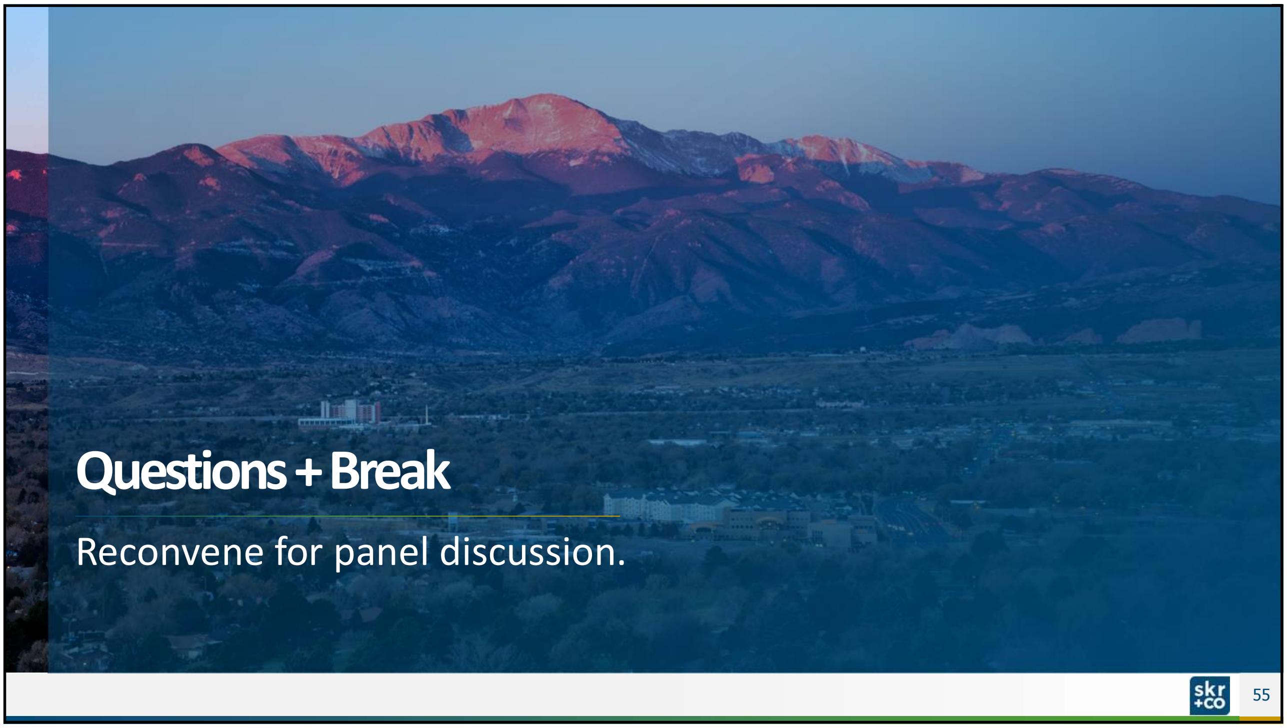
- Sidecar vehicle requirements / complications.
- Holding period for OZ real estate vs. OZ business property and traditional investment models.
- Ongoing capital gains requirement.

Fund Structure, cont.

- Initial deferral: 2026 phantom tax event and liquidity issues (closed end vs. open end funds.
- 10 year deferral only on invested gains, not entire fund.

Fund Structure, cont.

- Operating (equivalent to traditional VC – 2/20/pref).
- Real estate (similar but with additional fees and reduced risk).
- Sidecar vehicle requirements/complications.
- Holding period for OZ real estate vs. OZ business property and traditional investment models.


Questions + Break
Reconvene for panel discussion.
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Panel Discussion
Moderator
Judy Kaltenbacher, Tax Partner-in-Charge
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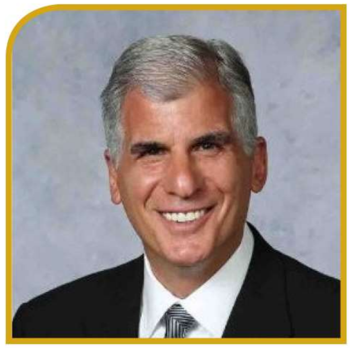
OZ Panel Discussion

John Foss, President
The Corundum Group



James DiBiase
Director & Principal
Olive Real Estate Group, Inc.

Tammy Fields
Chief Economic Development Officer
Colorado Springs Chamber & EDC

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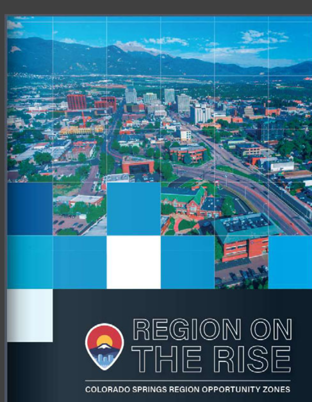
Prospectus



www.coloradospringschamberedc.com/doing-business/opportunity-zones/

OPPORTUNITY ZONE

Downtown Colorado Springs

Headlines tell the story of a reinvigorated downtown Colorado Springs: construction cranes, new business, improved streetscapes and connections, and much more.

Lured by a walkable environment, robust workforce concentration, one-of-a-kind shops, trail connectivity, state designation as a creative district and the largest concentration of locally owned restaurants in the region, developers and investors are rediscovering the value of Colorado Springs' city center.

That's amounted to nearly $1 billion in new investment into downtown in recent years, and the pipeline of new projects and investment continues to swell.

Zone Spotlight

Southwest downtown

Leveraging a Smart City partnership with Panasonic, this $1.8 billion new mixed-use district will include residential, office, retail and civic amenities. Anchoring it is the U.S. Olympic Museum and Hall of Fame opening in 2020 and a new outdoor stadium slated for 2021.

Urban living and hospitality

The downtown residential market has taken off, with 600 units recently completed or in the near-term pipeline. Demand also has surged for new hotels, with four new properties encompassing more than

Key Sectors

Hospitality
Multifamily
IT & cybersecurity

Active Investment

- Urban Renewal Authority
- State Regional Tourism Act
- Higher ed institutions
- Pikes Peak Enterprise Zone
- Downtown Development Authority
- Private investment

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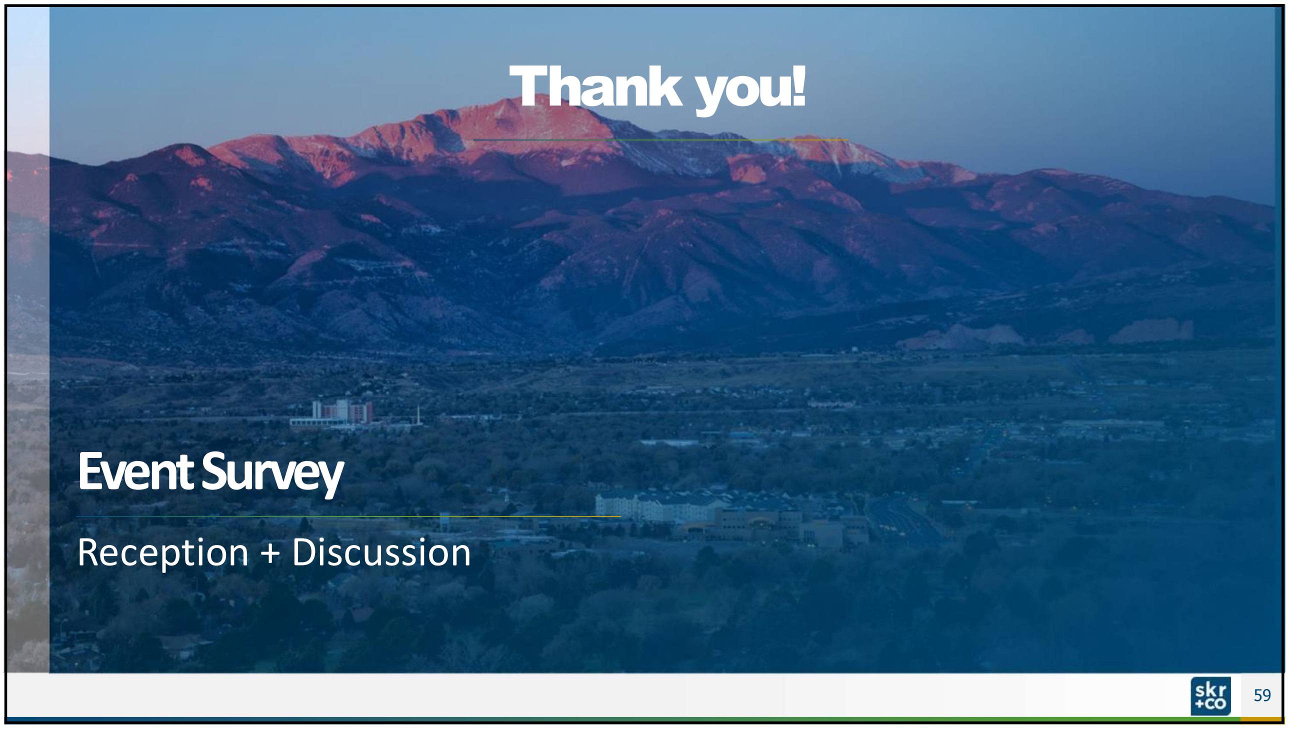
Thank you!
Event Survey
Reception + Discussion
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