Southern Colorado Opportunity Zone Summit

Defer • Reduce • Eliminate

OZ: Overview and Tax Perspectives

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STOCKMAN KAST RYAN + COMPANY

25 YEARS + COUNTING

A TOP ACCOUNTING FIRM, MOUNTAIN REGION

Accounting Today
2017, 2018, 2019

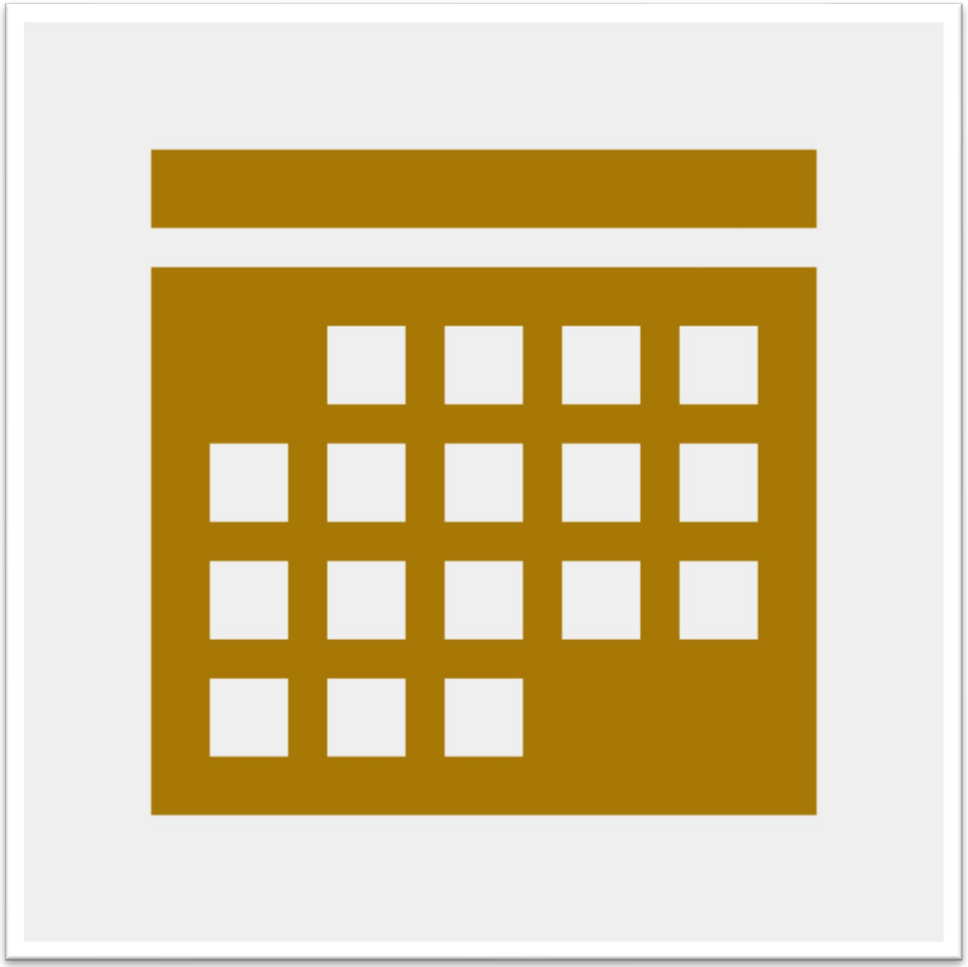
EMPLOYEES	PARTNERS	FOUNDED
75	9	'95

Brief Overview

QOZ Tax Incentives

Effective Dates of QOZ Final Regulations

- **Final QOZ regulations**
  - Issued December 19, 2019
  - Effective March 13, 2020
- **Until March 13, 2020:**
  - Taxpayers can **choose to apply either:**
    - The proposed regulations
    - Or, the final regulations for taxable years that begin on or before **March 13, 2020**



Opportunity Zones Facts

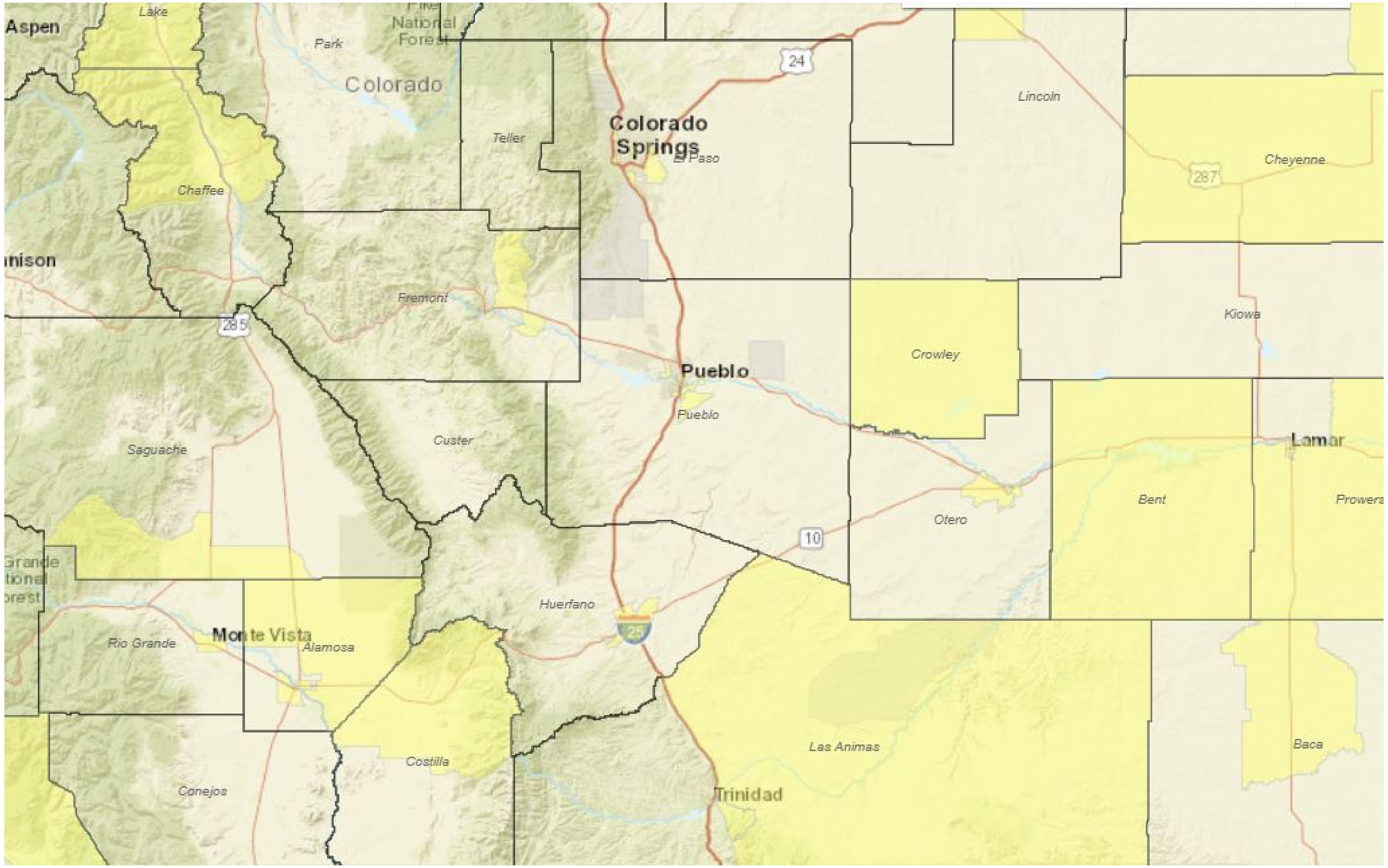
Opportunity Zones (OZ) are a **new incentive** of the Tax Cuts and Jobs Act of 2017.

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.**

Where are these zones?

- **126 statewide**
- Search by address at www.skrco.com



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.

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.

CAPITAL GAIN TAX DEFERRED

Recognize original capital gain tax;
by Dec. 31, 2026.
Pay $170k for original gain in 2026 tax filing.

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

HOLD FOR 5 YEARS

Waiting period begins
to qualify for the reduced tax owed.

HELD FOR 7 YEARS

10% reduction
in capital gain tax owed.

+5% reduction
in capital gain tax owed.

3

HOLD FOR 10 YEARS

New QOF investment
Holding period begins.

Complete elimination
of tax on new gain earned from OZ investment.

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

Gains Eligible for Deferral

Win 1
Defer

- 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
  - Installment sales
- **Not all gains from an event must be invested**
- No tracing requirement for the cash investment
- Deferral election made on Form 8949 and Form 8997

Gains Ineligible for Deferral

Win 1

Defer

- Capital gain cannot be from a sale to a related party (e.g., lineal ancestors, direct descendants, siblings, 20% entity ownership).
- No “Circular” Gains
  - Can not sell property to a QOF/QOZB and reinvest into the QOF for additional deferral and OZ benefits
- Gains taxed at ordinary rates

Basis in QOF Investment

- Initial contribution of deferred gains creates **ZERO** basis in QOF investment
- Zero basis may affect your ability to take losses
- 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.

Disposal of QOF assets

Win 3

Eliminate

HELD FOR 10 YEARS

- After a **minimum of 10 years**, an election can be made to set basis to the fair market value at the time of sale.
- Appreciation beyond 10 years is **eligible for elimination until 2047.**
- Interest in QOF must be **disposed of** by the end of 2047

State Tax Implication

[State Tax Code Conformity – Corporate Income]

[State Tax Code Conformity – Personal Income]

- 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.

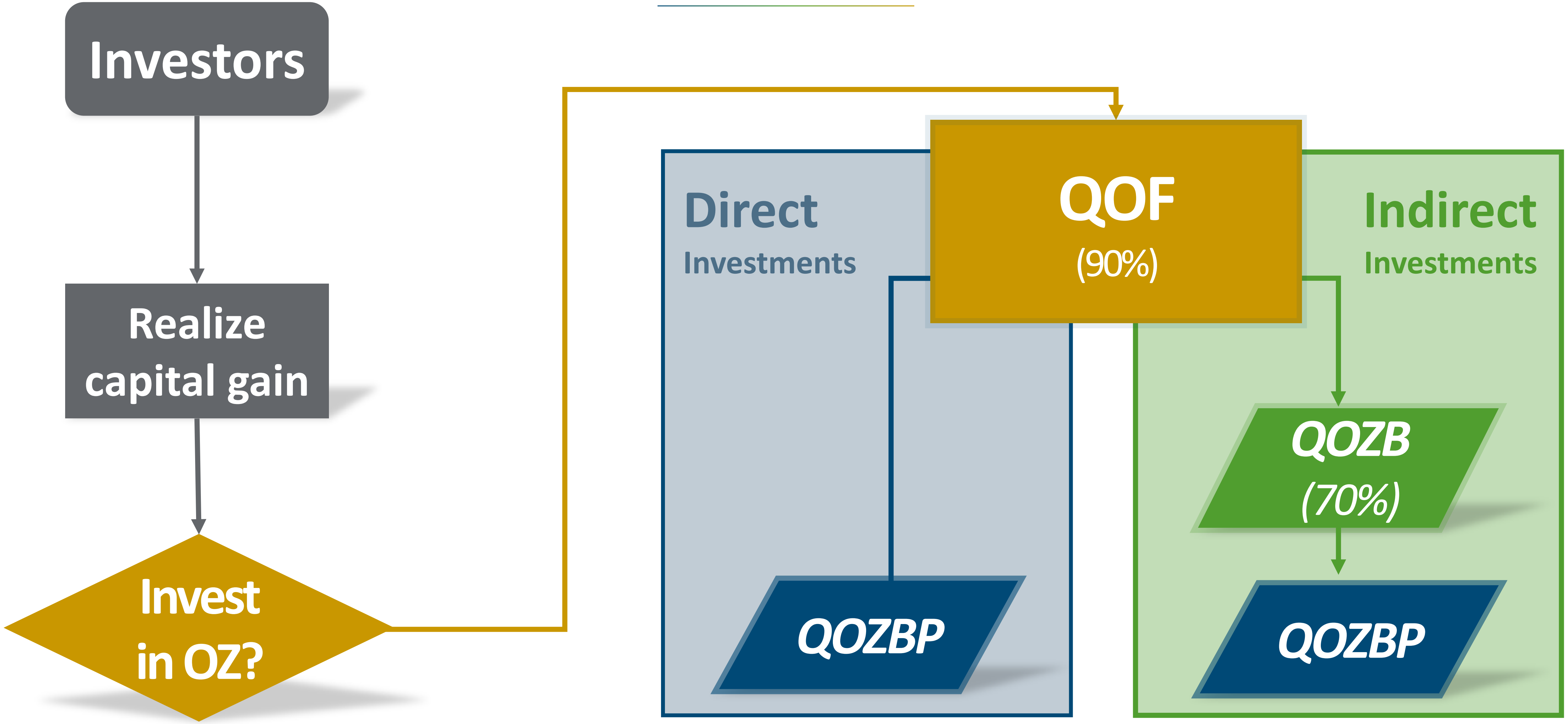
- Low Income Housing Credits – Federal and CO
  (5/17/19 CO credits $10M)
- FHA – 2/3 **reduction in fees** for multi-family projects in OZ where 90% of units qualify for LIHTC and deployment of a team to accelerate applications
- New Market tax credits
- CO Enterprise Zone tax credits
- Tax Increment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

*Not a comprehensive list.

OPERATING A QOF

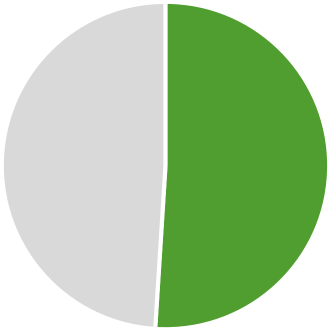
Qualified Operating Fund

Qualified Opportunity Fund (QOF)



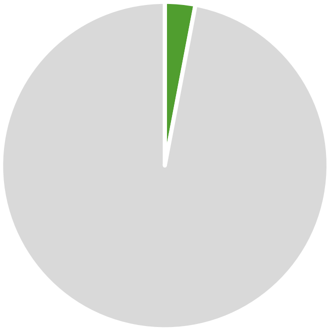
QOZB

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.

QOZPB: Substantial Improvement

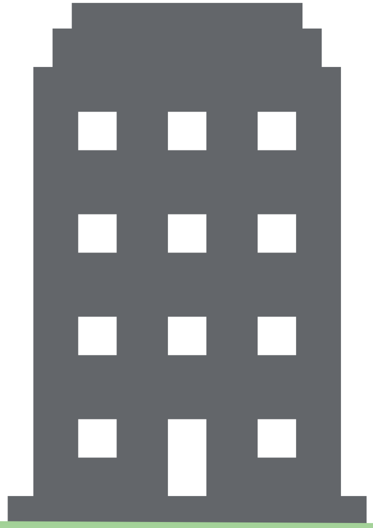
QOZBP

- 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.
- Non-qualified property (purchased from a Related Party or property contributed to a QOF) cannot be improved. Unclear how this relates to land.

QOZPB: Substantial Improvement

QOZBP

Non-qualified property (purchased from a Related Party or property contributed to a QOF) cannot be improved. It remains unclear how this relates to land.



30-Month Renovation Project

Initial Purchase
Hotel $4M
Land $1M

Structural Renovations
Structural Updates $1.5M

Non-structural Tangible Assets
Purchase Furniture* + Linens* $1M
Restaurant + Equipment $1M
Purchase Exercise Equipment $500k

New Basis After Renovation
Hotel $8M
Land $1M

$4M in substantial improvements

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. General anti-abuse provision disallows treatment of raw land as QOZB if there is no land improvement.
- Tangible personal property is treated as substantially improved if the equivalent of its basis is expended within 30 months on an aggregated basis and the new property improves the functionality of original non-qualified assets.