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MAYOR'S OFFICE OF ECONOMIC DEVELOPMENT

Opportunity Zones Overview

Definitions[1]

Opportunity Zones – a tax benefit designed to incent long-term equity investments in businesses and real property located in designated underserved communities.

Qualified Opportunity Zone - Low-income census tracts are places with an individual poverty rate of at least 20 percent and median family income no greater than 80 percent of the area median.

- A census tract that is not a low- income community may be designated as a qualified opportunity zone if the tract is contiguous with the low-income community designated as a qualified opportunity zone.
- Per state/ territory, up to 25 percent of the total number of census tracts that qualify as an Opportunity Zone can be designated as an Opportunity Zone.

Qualified Opportunity Fund – an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in an Opportunity Zone and that utilizes the investor's gains from a prior investment for funding the opportunity fund.

- A minimum of 90 percent of Opportunity Fund assets must be invested in Opportunity Zones.
- Opportunity Funds are envisioned as a market solution for investors who lack the information and wherewithal to execute investments in rural and low-income urban communities.
- The statute does not limit the number of funds that can be created, nor does it provide instruction on the nature of investments (i.e., risk/return profile).
- Pooling capital through a fund structure provides an opportunity for a broad array of investors throughout the country to engage in the program.

Qualified Opportunity Zone property – Asset types eligible for investment under the Opportunity Zones Program

- Qualified opportunity zone stock – any stock in a domestic corporation
- Qualified opportunity zone partnership interest – any capital or profits interest in a domestic partnership.
- Qualified opportunity zone business property – tangible property used in a trade or business of the qualified opportunity fund that substantial improves the property.[2]

[1] All definitions taken from https://www.enterprisecommunity.org/download?fid=8856&nid=6212

Opportunity Zones Background

- Enacted in tax reform (Tax Cuts and Jobs Act):
    - Investing in Opportunity Act, bipartisan support (114th, 115th Congress)
- Tax benefits to encourage individuals and corporations to invest in distressed communities – Opportunity Zones:
    - Internal Revenue Service (IRS) will oversee the program but it is not a tax program.
        - No reporting requirements, state oversight, or investment mandates as of 07/01/2018.
- Opportunity Fund vehicle could reduce transactional friction and connect investors to overlooked, but credit-worthy, investment opportunities.

Opportunity Funds:

- Must be certified by the U.S. Treasury Department.
- Must be organized as a corporation or partnership for the purpose of investing in Qualified Opportunity Zone Property.
- Must hold at least 90% of their assets in Qualified Opportunity Zone Property.
    - If this is not met, they face a penalty for each month it fails to meet the investment requirement.
    - The penalty equals the amount of investment shortfall, multiplied by the underpayment rate defined in Section 6621(a) (2) of the Internal Revenue Code.
- Qualified Opportunity Zone property includes newly issued stock, partnership interests, or business property in a Qualified Opportunity Zone business.
- Opportunity Fund investments include only equity investments in business, real estate, and business assets that are located in a Qualified Opportunity Zone. Loans are not eligible for the tax incentives. Opportunity Fund investments in real estate are subject to a substantial rehabilitation requirement.

Qualified Opportunity Zone Business / Property

1. Was acquired after 2017 (making investments in existing businesses trickier);
2. Either (i) experienced its original use with the Qualified Opportunity Zone Business or (ii) was "substantially improved" by the QOZB;
3. Was used in an Opportunity Zone during "substantially all" of the QZOB's ownership of the property.

Opportunity Zones as New Investment Tool

- Investments in OZ Funds are different than Section 1031 like-kind exchanges.

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[2] IRC 1400Z-2(d)(2)(D) provides that property is "substantially improved" when the value of the improvements made to the property during the 20-month period after acquisition exceed the original basis of the property when it is acquired.

    - One key difference is that only the gain needs to be reinvested in an OZ Fund. The principal of the original investment can be invested on an unrestricted basis.
- There is no statutory cap on the amount of gains that can be invested through the structure discussed above.
- There is no differential made in the Act between investing long – term and short – term capital gains in OZ Funds.

How Can OZ Funds Be Deployed? [3]

- There is no limitation on asset classes into which OZ Funds can make investments.
- OZ Fund controlled special-purpose entities can be involved in the development of new or existing commercial space through project and lease agreements with private developers using structures that ultimately provide better rates (and more investor security) than traditional loans.
    - Facilitate development of everything from new retail space to manufacturing to hospitals, community centers and even public assets.
- Strong potential for using OZ Funds to finance revenue-producing infrastructure investments, whether through direct private ownership or through public – private partnerships.
- Utilizing both OZ Fund investment with an additional tax incentive, like MNTC, Historic Tax Credits or Low-Income Housing Tax Credits could create situations where developers can undertake major projects with little to no personal equity commitment.
- Universities located in Opportunity Zones can take advantage of the designation to help capitalize startups commercializing their research and locate them nearby.

Tax Benefits of Opportunity Zones [4]

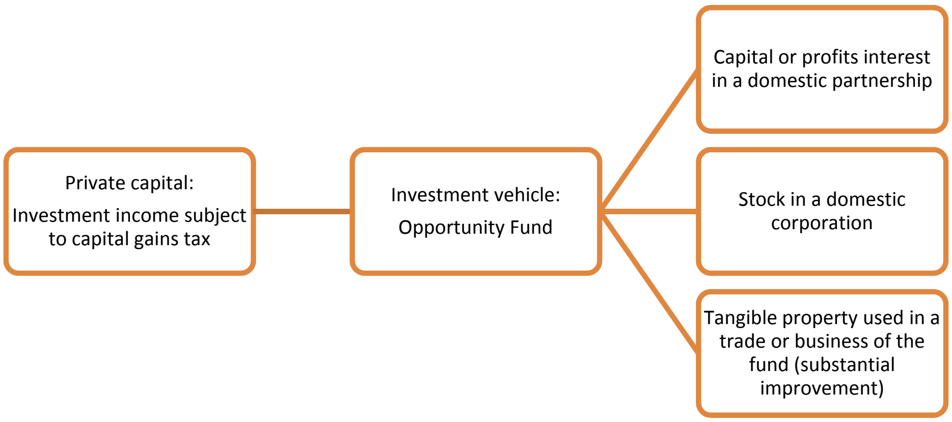
Investment Length	Benefits Received
Fewer than 5 years	Deferred payment of existing capital gains until the date that the Opportunity Fund investment is sold or exchanged.
5-7 years	Benefits above + 10 % of tax on existing capital gain is canceled.
7-10 years	Deferred payment of existing capital gains until December 31st, 2026 or the date that the Opportunity Fund investment is sold or exchanged (whichever comes first) + 15% of tax on existing capital gain is canceled.
Greater than 10 years	Benefits of 7-10 year investment + investors pay no capital gains tax on the Opportunity Fund investment (investments are exempt from any capital gains beyond those which were previously deferred).

- New gains earned on an Opportunity Fund investment are permanently excluded from taxable income.
    - Ten-year minimum

[3] https://www.jdsupra.com/legalnews/opportunity-zones-tax-reform-s-new-45827/

[4] All capital gains realized by an investor in the 180 days before an Opportunity Fund investment are eligible for the tax benefits of investment in Opportunity Funds.

Opportunity Zones Capital Flow[5]



References & Further Reading

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