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# OPPORTUNITY ZONES AND COMMERCIAL REAL ESTATE DEVELOPMENT

Franklin G. Daniels Email: fdaniels@nexsenpruet.com
O: 843.213.5403 C: 843.424.9306

Burnet R. Maybank, III Email: bmaybank@nexsenpruet.com
O: 803.540.2048 C: 803.960.3024

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# OPPORTUNITY ZONES CREATION

- The Opportunity Zone Program was created as part of the Federal Tax Bill
- It was co-sponsored by Senators Tim Scott and Cory Booker
- Purpose
  - Combat geographical inequality:
    - In the 1990s, half or more of all counties grew at the national rate. Now only 25% do
    - More than 50% of the country's distressed zip codes contained fewer jobs and places of business in 2015 than they had in 2010
  - This bill should expand the geography of economic growth


ffdaniels@nexsenpruet.com bmaybank@nexsenpruet.com www.nexsenpruet.com

# OPPORTUNITY ZONES
# PROGRAM INTENT

- The program provides incentives to investors to invest in new businesses and development in particular geographies
  - There is no public money as part of this program
  - The incentive is market based: investments must provide an attractive return on investment in order to attract investors
- The program is scalable and flexible
  - (Although rules are still being written) We do not expect there to be investment minimums or maximums required
  - Investors can invest in new businesses, new real estate, or substantial redevelopment of real estate (more than 100% of the acquisition cost spent on redevelopment)
  - Investors can NOT invest in so called sin businesses, defined as: golf courses, country clubs, massage parlors, hot tub facilities, tanning facilities, racetracks or gambling venues, or stores where the principal business is sale of alcoholic beverages for consumption off premises

# OPPORTUNITY ZONES
# HOW ARE OZs DETERMINED?

Governors of each state (and territory) were allowed to designate up to 25% of their low income census tracts

- Two approaches to designate:
  - Data
    - Population
    - Income
    - Urban/Rural
  - Local Input


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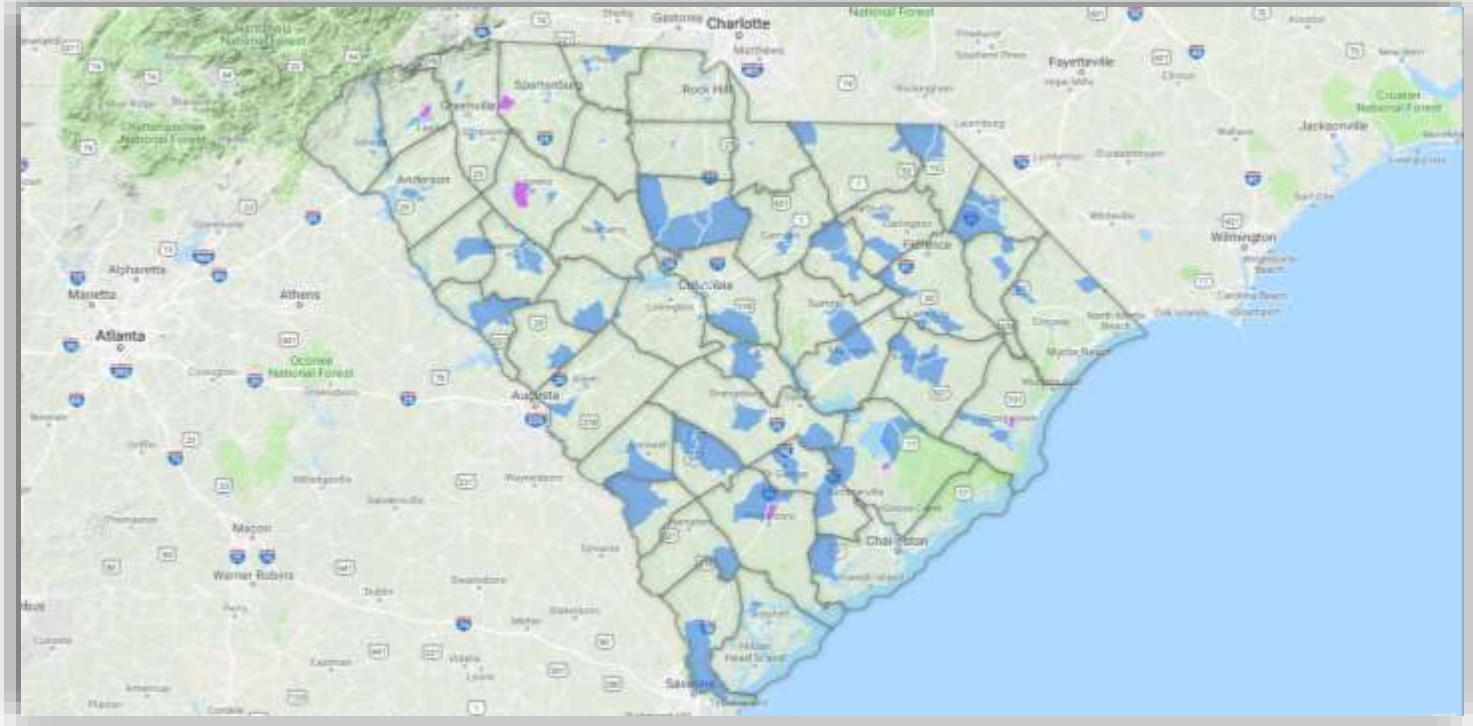
# OPPORTUNITY ZONES
# WHERE ARE THEY?




www.scopportunityzone.com

# CITY OF MYRTLE BEACH OPPORTUNITY ZONES (506 AND 507)

# OPPORTUNITY ZONES

On Friday, October 19, 2018, the U.S. Treasury Department issued its first set of guidelines for opportunity zones. That guidance included 74 pages of proposed regulations, a 5 page revenue ruling, an updated Q&A document and a draft of Form 8996 for qualified opportunity funds.

While the regulations are proposed, taxpayers and opportunity funds may rely on the proposed regulations, presuming they apply the rules in their entirety and do so in a consistent manner.

The IRS has indicated they will issue a second or third set of Regulations.

# OPPORTUNITY ZONES REQUIREMENTS

There are three requirements:

A. A **Capital Gain** must be invested in a

B. Qualified **Opportunity Fund** which invests in a

C. Qualified **Opportunity Zone**

D. Where such occurs, substantial Federal **Income Tax Incentives** are generated

# TAX INCENTIVES

Natch, I will go out of order and start with the tax incentives.

There are two forms of federal income tax incentives:

(1) A deferral and possible reduction of the ORIGINAL capital gain; and

(2) Elimination of the SECOND capital gain (if any) from the subsequent sale of the investment in the Opportunity Fund.

# TAX INCENTIVES
# ORIGINAL CAPITAL GAIN

The Opportunity Zones program offers two Income Tax Incentives for the underlying capital gain:

1) A deferral of inclusion in taxable income for capital gains reinvested in an Opportunity Fund. The deferred gain must be recognized on the earlier of the date on which the opportunity zone investment is disposed of or December 31, 2026; and

2) A capital gain reduction resulting from a step-up in basis for capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least 5 years and by an additional 5% if held for at least 7 years, thereby excluding up to 15% of the original gain from taxation.

3) The equity investment must be made by the end of 2019 in order to get the full 15% tax basis step-up.

# TAX INCENTIVES
# SECOND CAPITAL GAIN (IF ANY)

The Act provides a second tax incentive:

A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years, i.e., no tax will be due on the appreciation of the Qualified Opportunity fund other than the original deferred gain that must be recognized by December 31, 2026.

# QUALIFYING CAPITAL GAIN

The first Requirement above requires a capital gain.

The Legislation allows taxpayers to defer short or long-term capital gains due on the sale of any investment (stocks, bonds, real estate) if the capital gain portion of the sale is reinvested within 180 days in a Qualified Opportunity Fund.

If the capital gain results from the sale or exchange of real estate it must be with an unrelated party.

TRACING: Arguably, the taxpayer that owns the Opportunity Fund Investment must be the same individual or entity that recognized the gain. So, the eligible taxpayer must directly invest into a Opportunity Fund, rather than investing the proceeds into another entity (even a pass-through) which would then invest into the Opportunity Fund.

# QUALIFYING CAPITAL GAIN
# HOW DOES THE TAXPAYER DEFER THE GAIN

The proposed Regulations state that it is anticipated that taxpayers will defer the gain by making a deferral election on Form 8949 which will be attached to their Federal Income Tax Return for the taxable year in which the gain would have been recognized but for the deferral.

# TAX INCENTIVES
# STACKING OF THE CREDITS

The Opportunity Zone tax incentive can be stacked with both federal:

NMTC
Historic Rehabilitation

And state tax incentives:

Fee-in-Lieu/MCBP
Bailey Bill
Abandoned Building/Textile
Revitalization Acts
Infrastructure Credit

# QUALIFIED OPPORTUNITY FUNDS

The second requirement is that the capital gain must be invested within 180 days in a Qualified Opportunity Fund.

Corporate and partnership investments must be made in cash – i.e., in-kind contributions or promissory notes issued to a Qualified Opportunity Zone business are not qualified investments.

The gain must be invested in an Opportunity Fund within the 180-day period that begins on the date on which the taxpayer would otherwise be required to recognize that gain (the "Recognition Date"). In the case of a stock sale effected on an exchange, the Recognition Date is the trade date. In the case of a capital gain dividend received from a RIC or REIT, the Recognition Dated is the date that the dividend is paid. In the case of a taxpayer that is a partner (or "S" corporation shareholder or beneficiary), seeking to defer its share of gain realized by the partnership (or "S" corporation or trust or estate), the Recognition Date is the last day of the entity's tax year.

# QUALIFIED OPPORTUNITY FUNDS SELF CERTIFICATION

The IRS recently issued a FAQ which states in part:

**Q.** How does a taxpayer become certified as a Qualified Opportunity Fund?

**A.** To become a Qualified Opportunity Fund, an eligible taxpayer self certifies. (Thus, no approval or action by the IRS is required.) To self-certify, a taxpayer merely completes a form (Form 8996) and attaches that form to the taxpayer's federal income tax return for the taxable year. (The return must be filed timely, taking extensions into account.)

The proposed Regulations confirmed the self-certification.

# QUALIFIED OPPORTUNITY FUNDS

The statute outlines two requirements:

(1) The entity must be organized as a corporation or partnership; and

(2) must maintain at least 90 percent of assets in “Qualified Opportunity Zone property,” including investments in “Qualified Opportunity zone stock,” “Qualified Opportunity zone partnership interest,” and “Qualified Opportunity business property.”

Business Property is covered below.

# QUALIFIED OPPORTUNITY FUNDS
# QUALIFYING OPPORTUNITY ZONE BUSINESS PROPERTY

The qualifications as “Qualified Opportunity zone stock,” “Qualified Opportunity zone partnership interest,” and “Qualified Opportunity zone business property” encompass investments in (1) new or (2) substantially improved tangible property, including commercial buildings, equipment, and multi-family complexes.


ffdaniels@nexsenpruet.com bmaybank@nexsenpruet.com www.nexsenpruet.com

# QUALIFIED OPPORTUNITY ZONE BUSINESS

In IRS Information Letter 2018-0018, the IRS stated:

"A qualified opportunity zone business is a trade or business in which the taxpayer owns or leases substantially all the tangible property as qualified opportunity zone business property (Section 1400Z-2(d)(3)). The qualified opportunity zone business must meet the requirements of paragraphs (2), (4) and (8) of Section 1397C(b), and not be of the type described in Section 144(c)(6)(B)."

This is explained below.

# QUALIFIED OPPORTUNITY ZONE BUSINESS

A Qualified Opportunity Zone business is a trade or business:

- In which *substantially all* of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property;
- At least 50 percent of the business' total gross income is derived from the active conduct of the trade or business;
- A substantial portion of the business' intangible property is used in the active conduct of the trade or business;
- In which less than five percent of the average of the aggregate unadjusted bases of its property is attributable to nonqualified financial property; and
- Which is not 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.

# QUALIFIED OPPORTUNITY ZONE BUSINESS

Qualified Opportunity Zone business property means any tangible property used in a trade or business if:

- The property was acquired by the Qualified Opportunity Fund by purchase after 2017;
- The original use in the Qualified Opportunity Zone commenced with the Qualified Opportunity Zone or the Qualified Opportunity Zone substantially improves the property; and
- During substantially all of the Qualified Opportunity Zone's holding period, substantially all of the use of the property was in a Qualified Opportunity Zone.

# OTHER ISSUES TO COVER:

- 90% Qualified Property Allocation Test
- Definition of Substantial Improvement
- Additional Proposed Regulations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# QUESTIONS OR COMMENTS?

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