Opportunity Zones

ULI's Housing Opportunity Conference

February 6, 2019

Blake Christian, CPA/MBT
Tax Partner
HCVT LLP

HCVT
HOLTHOUSE | CARLIN | VAN TRIGT LLP

TOP 10 OPPORTUNITY ZONE MISCONCEPTIONS

1. 100% of the gain proceeds must be reinvested.

A. Only the **capital gain** portion is eligible for all OZ benefits
B. Must be U.S.-sourced gain
C. Taxpayer can elect to reinvest 100% or less

2. Only long-term capital gains are eligible

A. Both **short-term** and **long-term** gains are eligible
B. §1250 depreciation (likely) but not §1245 depreciation

3. OZ Fund investment can include both cash and property

A. **Only cash is allowed.** No property contributions.
B. Problematic for traditional structuring and for “Carried Interest” in Private Equity structures

4. IRC 1031 transactions are likely still better than OZ Fund investing

A. Post-2017 IRC Section 1031 rules are now limited to real estate
B. **Cost Segregation** studies present additional “ordinary” exposure upon disposition
C. Taxpayers in CA and other non-adopting states should consider 1031 before OZ Fund
D. Older or unhealthy taxpayers should prefer 1031 transactions
E. 1031- requires full proceeds and debt matching

TOP 10 OPPORTUNITY ZONE MISCONCEPTIONS

5. OZ Program is really only appropriate for real estate reinvestments

A.. Start-ups or investing into an existing operating business may yield a higher ROI than real estate

B. Consider a C Corp to potentially qualify for IRC Section 1202 Small Business Stock

6. Reinvestment must take place within 180 days from date of sale

A. Generally true-but 180-day period begins December 31st for flow-through gains

B. 180-day test relates to funding or investing into an OZ Fund

7. "Original Use" requirements

A. Land – technically can never be "original use" but next set of Regulations should clarify

B. Land/ Building – Regulations bi-furcate the land and building and only the building needs to be improved (200% of cost basis

C. Other OZ Property

8. All states have adopted the Federal OZ provisions

A. While every state (and U.S. Territories) have OZ census tracts, only 28 states have adopted the federal provisions

B. State taxes can be a mine-field for those investing in OZ Funds or OZ Property in other states

TOP 10 OPPORTUNITY ZONE MISCONCEPTIONS

9. OZ Funds can only accept taxpayer’s capital gains

A. OZ Funds can accept both capital gains as well as investments of after-tax funds

B. In such cases the OZ Fund is bi-furcated and **only the capital gain funds are allowed the step-ups and ultimate exemption after 10 years.**

10. OZ Funds can never generate tax losses.

A. Provided the investor has sufficient “outside” tax basis in the fund, losses can flow through to investors. Interim taxable income will also flow through if the Fund is a partnership.

B. Upon disposition of the Fund interest, a loss may be recognized after the full step-up (when deferred gain is recognized) in December 2026. **If disposed prior to December 31, 2026, tax loss is uncertain.**

OPEN ISSUES - PENDING REGULATIONS

1. Refreshing eligibility of OZ land when developer owns 20% or more of project
   - If the land has been vacant for a specified period of time should be treated as “original use” property when acquired by a OZ fund or OZ business
2. Leveraging the OZ Fund assets. Will the debt portion allow full gain exemption after 10 years?
3. How are leases valued for purposes of determining the 90% and 70% tests?
4. Active vs Passive classification of properties
   - Grouping election for tax purposes
5. Intangible Assets- value and “substantially used” in the OZ business
6. De-Certification events
7. “Reasonable Period” guidance
8. 18 / 31-Month Working Capital Relief – documentation requirements? Extension for entitlement delays?
9. OZ Funds operating as an LLC Partnership, clarification is needed regarding how the inside / outside tax basis step-ups in years 5, 7, and 10 will operate. Fund step-up vs. underlying entity/ property?
10. Several taxpayers have suggested that a fund-of-fund structure should be allowed

HOLTHOUSE | CARLIN | VAN TRIGT LLP

FOR ADDITIONAL INFO

Blake E. Christian, CPA/MBT
Blakec@hcvt.com
(435) 200-9262 Office
(562) 305-8050 Cell

Alejandra Lopez
Alejandra.Lopez@hcvt.com
(562) 216-5516

HCVT Tax Alerts and Articles
https://www.hcvt.com/insights-alerts.html

www.hcvt.com