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The Opportunity Zones Database

Opportunity Zones For Financial Advisors

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Who Can Invest in OZs?

- U.S. taxpayers with capital gains
- Accredited investors
- HNW/UHNW investors and family offices
- Large capital gains (at least $50,000)
- Patient money (10-year holding period)
- Liquidity needed in 2027

Opportunity Zones:
The Greatest Tax Incentive Ever Created?

- Policy Background
- Opportunity Zone Facts & Figures
- Technical Terminology
- Overview of Opportunity Zone Tax Benefits: **Unlimited Tax-Free Growth**
- DSTs/1031s vs. Opportunity Zones
- State Tax Conformity
- Qualified Opportunity Funds
- Updates: Marketplace & Legislative
- How To Invest

Policy Background

Wealth inequality widened following the recession of 2008-09.

Wealthy areas recovered. Low-income areas got left behind.

Policy challenge: How can we incentivize wealthy individuals to invest some of their wealth into low-income areas, to create new jobs and increase the local tax base?

How do you incentivize private capital to flow into low-income communities?

Solution: Opportunity Zones

The incentive: Tax deferment + tax-free growth

Policy Goals:

- Investment return + massive tax savings for investor
- Economic revitalization for downtrodden communities

What Are Opportunity Zones?

Bipartisan tax policy. Economic development tool that incentivizes private capital investment in low-income communities.

- Tax Cuts & Jobs Act created IRC §1400Z -- December 2017
- Opportunity Zone nominations -- Early 2018
- Opportunity Zone designations finalized -- July 2018
- Final IRS regulations -- December 2019
- Reduction benefits expired -- End of 2019 and 2021
- Program sunset -- December 31, 2026

Opportunity Zone Facts & Figures

- 8,764 census tracts designated as Opportunity Zones
- 35 million people and 12% of landmass
- Estimated $100 billion of equity already invested through 2021

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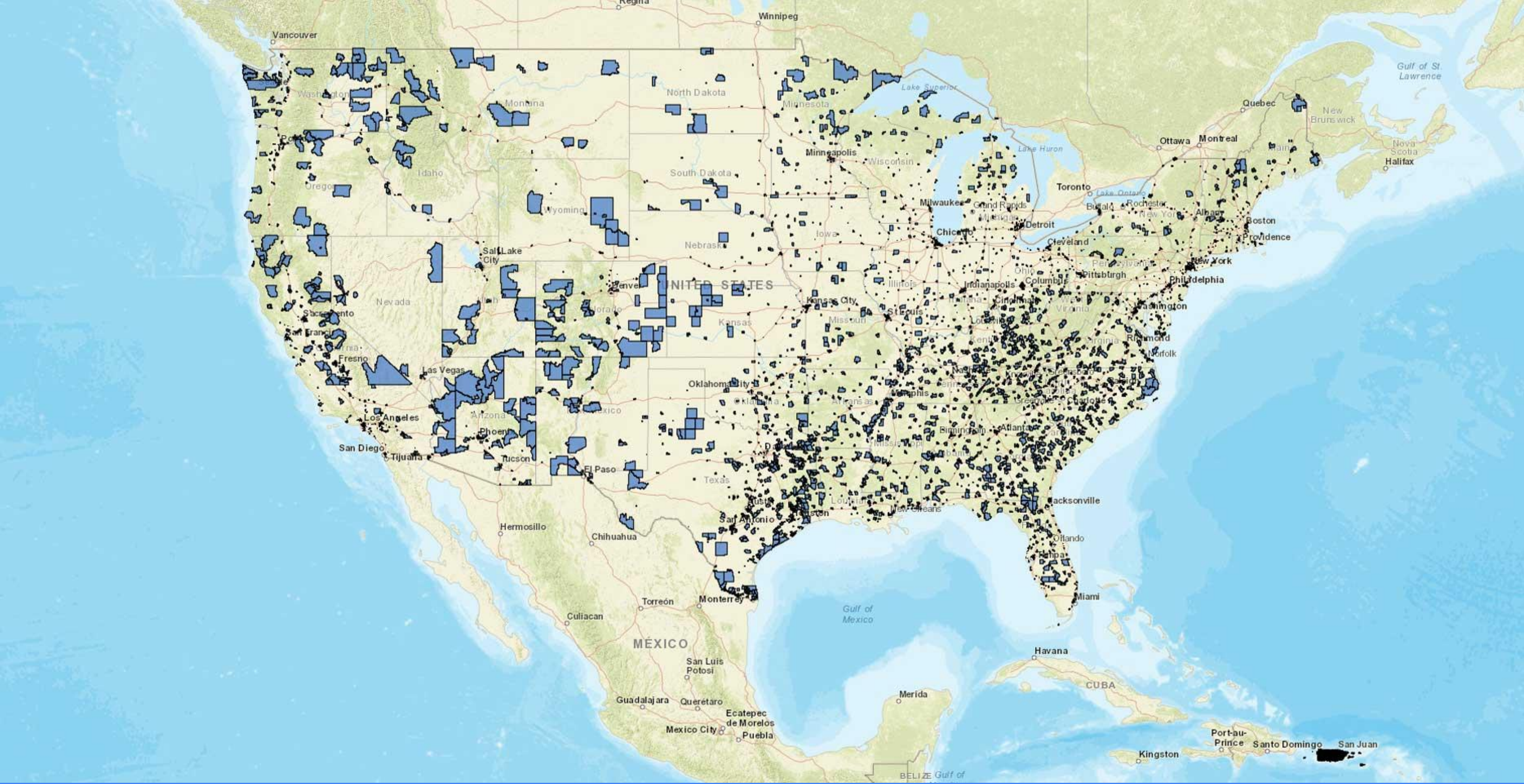

Opportunity Zone Map (Continental United States) -- Source: https://opportunitydb.com/map/

Technical Terminology

- **QOZ** - Qualified Opportunity Zone (a/k/a **OZ**)
    - Designated census tract.
- **QOF** - Qualified Opportunity Fund (a/k/a **OZ fund**)
    - Investment vehicle.
- **QOZP** - Qualified Opportunity Zone Property
- **QOZB** - Qualified Opportunity Zone Business
- **QOZBP** - Qualified Opportunity Zone Business Property
- **1400Z** - IRC Section that defines Opportunity Zones

Opportunity Zones Tax Benefits

An investor who has triggered a capital gain by selling an asset like stocks or real estate can receive special tax benefits if they roll that gain into an OZ investment within 180 days. There are ~~three~~ two main tax benefits…

Benefit #1
Deferral

Until Dec 31, 2026

~~**Benefit #2**~~
~~**Reduction**~~

~~10% basis step-up after 5-year holding period~~

Benefit #3
Elimination

No capital gains tax on OZ gains after a 10-year holding period

OZ Investment Example

Example: Taxpayer has $10 million capital gain

- Assume 23.8% federal capital gains tax rate
  - We'll ignore state taxes to keep it simple.
- Normally: $2.38 million tax liability due next April leaves $7.62 million net
- Instead: within 180 days of triggering a gain, taxpayer invests $10 million in Qualified Opportunity Fund (QOF)

Benefit #1: Deferral

Temporary deferral of capital gains recognition until December 31, 2026

- Essentially a $2.38 million interest-free loan from Uncle Sam
- Benefits: TVM and a greater amount of compounding
- Important: tax on this gain does eventually come due
- Risk: The 2026 tax rate applies; tax rates could rise
  - But this could actually be to your benefit in the long-run! See Benefit #3.

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~~Benefit #2: Reduction~~

Reduction original gain recognition amount

- 10% reduction in amount of gain recognition after 5-year hold in the QOF
- So long as holding period is achieved by December 31, 2026
- **This benefit expired on December 31, 2021**

Benefit #3: Elimination

Pay ZERO TAX on capital gains realized from OZ investment after a 10-year holding period

- Tax-free growth within Opportunity Zone investment
- Example: $10 million appreciates to $50 million
- $0 due on the $40 million capital gain from the OZ investment
- Important: OZ gain must be recognized by December 31, 2047
- Note: If tax rates goes up, this benefit becomes more valuable!

Opportunity Zone Investment vs. DST/1031 Exchange

Investment Aspect	Opportunity Zone Investment	DST/1031 Exchange
Full Tax Benefit Timeline	After a 10-year holding period	Upon death
Triple Net Leasing	Limited	Allowed
Capital Gain Eligibility	Any type of gain. Can be invested into a QOF that holds real estate and/or operating business(es).	Must be gain from real estate. Can only be invested into another real estate investment property.
Investment Amount	Tax benefit applies only to the gain. Can rollover full or partial gain.	Principal and gain amount must be rolled over for the full benefit.
Focus	Capital Appreciation Ground-up, redevelopment, or start-up	Varies (Traditional 1031) Stable Cash Flow (DST)
Timeline For Investment	180 Days	45-Day Rule & 180-Day Rule
Ease Of Investment	Self-Certification	Qualified Intermediary
Geographic Restriction	Limited to 8,764 census tracts, most of which are “low-income”	No geographic restriction

Other Considerations

- OZs can be a fallback for a failed 1031 or DST investment.
    - 45-Day Rule failure: 135 days left to do an OZ investment.
- Is Section 1014 (stepped-up basis upon inheritance) in jeopardy?
- Are OZs here to stay?

List of States with Conformity Issues

Most states either: a) fully conform with the federal incentive; or b) do not tax capital gains. States that do not conform, with top marginal rates (2022):

- California (13.30%)
- Massachusetts (5.00%)
- Mississippi (5.00%)
- New York (8.82%) *
- North Carolina (4.99%)

* New York passed legislation to de-couple from the federal incentive on April 19, 2021. Effective for tax years beginning in 2021.

Qualified Opportunity Funds

- Create your own QOF
- Invest in a third-party QOF

Captive QOF

- Self-funded QOF
- Investing in your own projects
- Or alongside other QOFs
- Proposed legislation would allow for investment directly into other QOFs
- Easy to create and file annually (IRS Form 8996)
- Compliance burden
- Capital deployment burden

Investing in Third-Party QOFs

- Similar to investing in a private equity fund.
- Variety of flavors.
- Multi-asset vs. single-asset.
- Who is the operator?
- Vast majority are Reg D offerings under Rule 506(b) or Rule 506(c).
- In most cases, these funds are limited to accredited investors.
- Fee structure: 1-2% asset management fee + 20% carried interest.
- File IRS Form 8997 annually.

Qualified Opportunity Fund

Statute created new investment vehicle through which all qualifying Opportunity Zones investments much flow: the QOF (regulated by IRS)

IRS is not going to allow you to reap the tax benefits without complying with a number of requirements. Two key requirements:

- 90% asset test
- Original use or substantial improvement

(Plus many more requirements.)

Qualified Opportunity Fund

- A regarded entity with its own EIN.
- Self certifies (elects) to be treated as a QOF (IRS Form 8996).
- Thousands of funds. No limit on capital.

Investor Risks

- Tax rate risk … cap gains rate could go up (but mitigating additional risk)
- Market risk … tax benefit could move the market … timing of purchase and timing of sale
- Liquidity risk … when tax comes due in April 2027

Marketplace Update

- Estimated $100 billion of OZ equity raised as of the end of 2021.
- Estimated $500 billion of OZ projects in existence currently.
- Other estimate: Novogradac QOF Survey (Q1 2022)
- Other estimate: GAO Report on OZs (Thru Tax Year 2019)

Legislative Update

- Proposed bipartisan legislation introduced in April 2022
- *Opportunity Zones Improvement, Transparency, and Extension Act*
  - Extend the tax incentive for two years (2028 end-date)
  - Reopen Benefit #2 (initial gain reduction)
  - Expand reporting requirements
  - De-certify high-income OZs
  - Allow for fund of funds
- Sponsored by original co-sponsors in House and Senate

Applying OZs to a Client’s Portfolio

- How to apply to a client’s portfolio - low basis/high gains locked in from market run-up. (short or long)
- Search for Qualified Opportunity Funds on the investment platform that your firm uses.
- Remember: OZ investing is opportunistic, with a focus on capital appreciation.

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How to Invest

Who: Accredited investors with capital gains (typically $50,000 or more)
How: Invest via Qualified Opportunity Funds (QOFs)

Next Steps...

- Research QOFs: https://opportunitydb.com/funds/
- Watch OZ Pitch Day: OZPitchDay.com
- Learn More: Opportunity Zones Podcast on YouTube, Apple, and Spotify

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