

Opportunity Zones & Funds



**Presented to the Greater
Albuquerque Association of Realtors
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WHAT ARE THEY? HOW TO BENEFIT FROM THEM AND AVOID RISKS.



Presented by Joe Farr, CCIM



- ▶ Owner and President of Duke City Commercial LLC
- ▶ Worked for an institutional commercial investor/owner for 20 years in 46 markets, 14 states
- ▶ Over \$400 million of commercial transactions
- ▶ Licensed Broker in New Mexico since 1994
- ▶ Manage and Lease over a million square feet of commercial properties in Albuquerque
- ▶ Completed first commercial lease almost 40 years ago, at 16 years old

DISCLAIMER



- ▶ The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by Duke City Commercial LLC to the reader. The reader also is cautioned that this material may not be applicable to, or suitable for, the reader's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The reader should contact his or her tax professional prior to taking any action based upon this information. Duke City Commercial LLC assumes no obligation to inform the reader of any changes in tax laws or other factors that could affect the information contained herein.

Purpose



- ▶ Created by the Tax Cuts and Jobs Act of 2017
- ▶ Formed to generate economic activity and job creation in low-income communities
- ▶ Encourages investment of unrealized capital gain into these low-income community projects/businesses

HOW and WHY???

WHAT DOES OPPORTUNITY ZONE
LEGISLATION AND FACEBOOK HAVE IN
COMMON?

Sean Parker, founder of Napster,
former Facebook executive



ZONES



- ▶ Limited to 25% of low-income communities
- ▶ Approximately 20% of all parcels are QOZ's
- ▶ Set in stone as of last year
- ▶ Contiguous tracts cannot make up more than 5% of census tracts designated in the state as QOZ's

BENEFITS



- ▶ **Deferral** of capital gains
- ▶ **Reduction** of deferred gain over time
- ▶ **Permanent gain exclusion** on appreciation of the investment (provided the rules are followed)

BENEFIT-Deferral



- ▶ **Deferral** of capital gains
 - ▶ *Deferred until investment is sold, or*
 - ▶ *Dec. 31, 2026 whichever comes earlier*
 - ▶ *If investment is not sold before Dec. 31, 2026 any remaining deferred gain is recognized at that time*

BENEFIT-Reduction of Gains



- ▶ **Reduction** of deferred gain over time
 - ▶ **10% step up in basis after 5 years**
 - ▶ **Another 5% step up in basis after 7 years**

BENEFIT-Gain Exclusion



- ▶ **Permanent Gain Exclusion** for investments held 10+ years
- ▶ *At sale, election made to step up basis in investment to FMV (Like a Roth IRA for real estate)*
- ▶ *Election results in a permanent exclusion from income of any post-acquisition capital gain*
- ▶ *Results in permanent benefit for depreciation deductions*
- ▶ *Taxpayers can recognize losses by not making the permanent exclusion election*

TIMING



- ▶ From date original asset sold – 180 days to put into a QOZ Fund
- ▶ No need for a qualified intermediary
- ▶ The date the money is transferred to fund will be the start of the 10 year hold window

TIMING (Example)



\$1,000,000
Investment

Year 5 10%
step up
(\$900,000)

Year 7 5%
step up
(\$850,000)

**By 12/31/26
Pay tax on
original gain**

Year 10+ Sell
for \$3 million &
**NO TAX ON
GAINS**



Comparison to 1031 Exchange



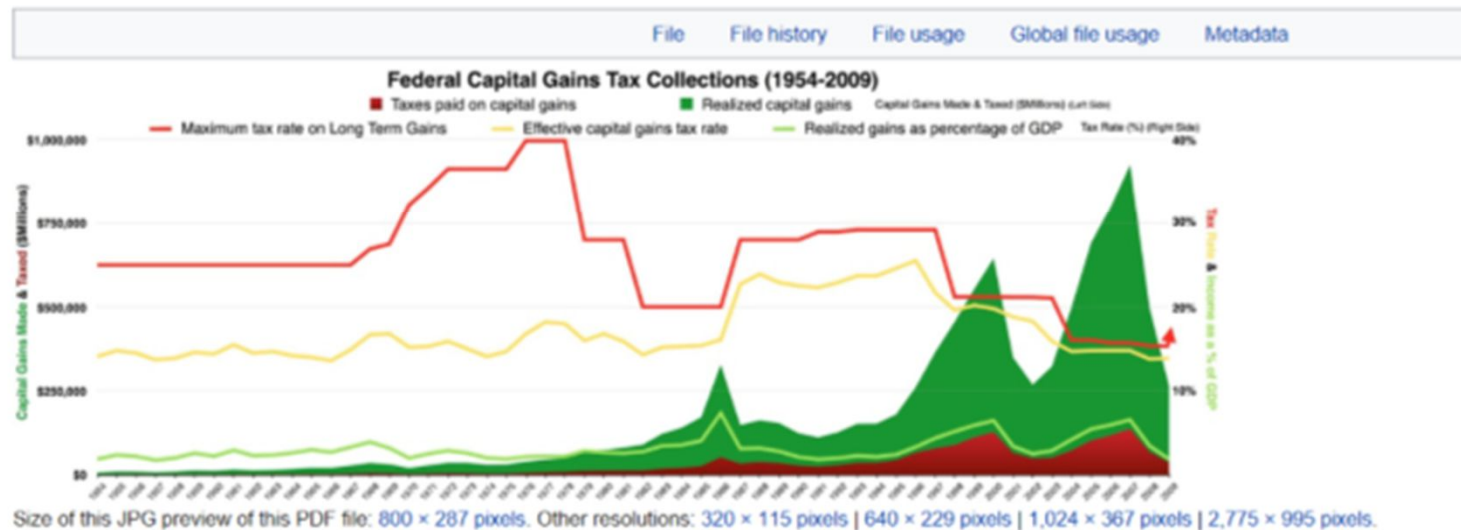
- ▶ Does NOT have to be like-kind property
- ▶ Real or personal property
- ▶ Geographically limited to OZ's
- ▶ No identification of replacement property requirement
- ▶ Only need to invest **gain** from sale
- ▶ Can invest in partnership interests and stock
- ▶ Gain deferral and reduction
- ▶ Gain exclusion if held for 10+ years

Tax Rate Risk



File:Federal Capital Gains Tax Collections 1954-2009 history chart.pdf

From Wikipedia, the free encyclopedia



ABQ & NM Zones



- ▶ NM has 63 designated OZ's
- ▶ 59 Low-Income Communities and 4 Non-Low-Income Contiguous Tracts.
- ▶ Bernalillo has 14 Zones
- ▶ Mapping:
<https://www.cdfifund.gov/pages/opportunity-zones.aspx>

Some of the Rules



- ▶ Fund can be any partnership or corporation that holds at least 90% of its assets in QOZ property
- ▶ Must follow guidelines outlined by statute and the Treasury
- ▶ Self certify on form 8996 and submit with Federal income tax return



There's more!?!

WHAT ELSE CAN YOU DO?

QOZ Business



- ▶ A Trade or business in which substantially all (70%) of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (QOZBP)
- ▶ Additionally:
 - ▶ At least 50% of income is derived from Active Conduct
 - ▶ Substantial portion of intangible property used in active conduct of business
 - ▶ No more than 5% of property is nonqualified financial property

QOZ Business Property defined



- ▶ Tangible Property used in a trade or business
- ▶ Acquired by purchase from an unrelated party after Dec. 31, 2017
- ▶ Original use commences with investment
- ▶ **OR**
- ▶ Property is substantially improved, which requires that the costs of constructing, renovating, or expanding the property during any 30-month period beginning after the date of acquisition of the property **must exceed 100%** of the adjusted basis for the property at the start of the 30-month period

Development Safe Harbor

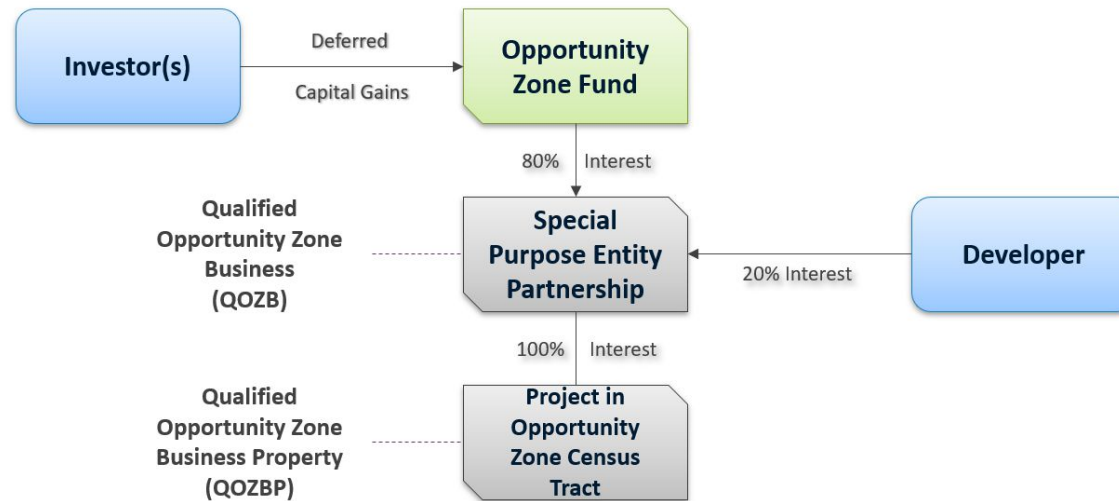


- ▶ You have **31 months** to implement your working capital plan
- ▶ *“Exceeding the 31-month period does not violate the safe harbor if the delay is attributable to waiting for government action the application for which is completed during the 31-month period”*

Common Structure



Investment Structure – Indirect Investment



Round 2 Proposed Guidelines



- ▶ 12 months to reinvest proceeds from the sale of an asset in an Opportunity Fund
- ▶ Unimproved land does **not** need to be substantially improved to qualify, however, the land needs to be used in a trade or business rather than investment purposes.
- ▶ “Substantially All” —70% of the QOZ Business property must be used in a QOZ
- ▶ “Original Use” — Begins on the date when the property was placed into service in the QOZ for purposes of depreciation (If the building was vacant for at least 5 years, the purchased building will still qualify); land is not depreciated, so the original use starts once you build on it

Round 2 Proposed Guidelines (continued)



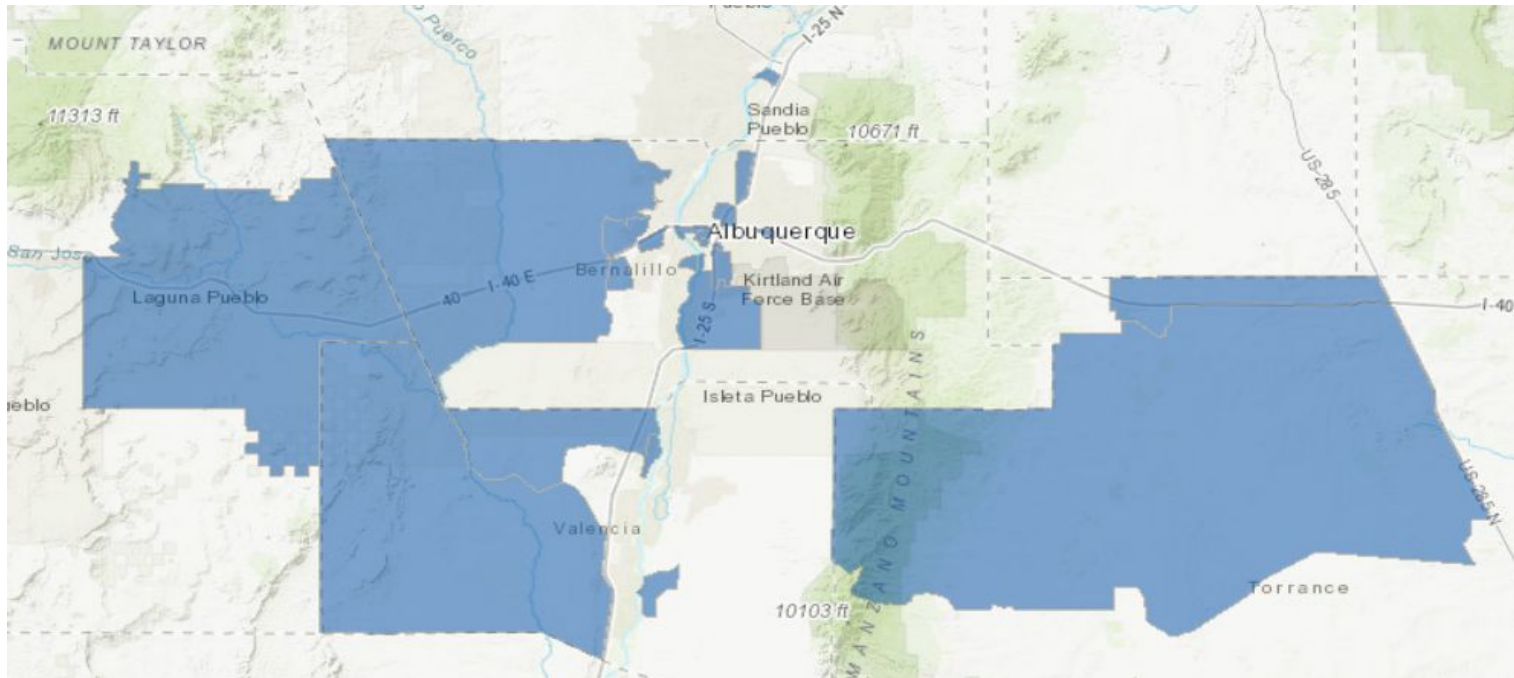
- ▶ Leased tangible property qualifies as QOZ business property, provided:
 - ▶ -Must be acquired under a lease after 12/31/17
 - ▶ -Substantially all of the use must be in a QOZ during the lease
- ▶ There is no original use or substantial improvement requirement imposed on tangible leased property
- ▶ No longer need to sell the fund after 10 years, now you can sell investment in the fund to qualify for tax benefits
- ▶ Deferred gains may be taxable if an investor transfers their QOZ interest by gift, but not by death to an estate or revocable trust

Joe's Rules of Thumb



- ▶ The desire of investors to avoid or defer capital gains tax should not outweigh the desire to invest in a project that makes sense (remember TIC's?)
- ▶ **Final guidelines have yet to be published**
- ▶ Seven year step up may go away by default
- ▶ investors in hedge funds and other partnerships likely have a deadline of June 29, 2019 to be able to qualify (too late!)
- ▶ This incentive should be project driven, not capital driven

Albuquerque OZ Map



Additional Resources



- ▶ **Joe Farr (505) 246-9800** jfarr@dukecityllc.com
- ▶ <https://www.nmopportunity.com/>
- ▶ <https://www.nar.realtor/qualified-opportunity-zones/qualified-opportunity-zones-toolkit>
- ▶ <https://www.arcgis.com/apps/webappviewer/index.html?id=c4ae1c124bf44d42b08b25777ae8a62e>