

Opportunity Zones: Overview and Updates

IMAGINE THE POSSIBILITIES OF OZ

- Affordable & workforce housing
- Commercial real estate
- Start-ups & space-sharing
- Energy
- Agriculture
- Services
- Day care facilities
- Medical clinics
- Grocery stores
- Retail & hospitality
- Industrial



Most types
of
real estate
projects can
qualify for
OZ
benefits

Virtually any type
of for-profit business
can qualify for OZ
benefits

WHAT IS THE OPPORTUNITY ZONE INCENTIVE

- OZ is a mechanism to encourage and facilitate private investment in disadvantaged areas
- Investors receive tax benefits for investing in operating businesses and real estate projects located in Opportunity Zones
- Certain requirements must be met by all parties to qualify

WHAT IS THE OPPORTUNITY ZONE INCENTIVE

- Significant tax benefits for investors with capital gains
 - Defer tax until 2026 on capital gains invested in Opportunity Funds
 - 10% increase in basis if investment held 5 years
 - Capital gain on investments held at least 10 years completely free from federal income tax

WHAT IS THE OPPORTUNITY ZONE INCENTIVE

- Can decrease cost of capital for entrepreneurs/developers
- Incentivizes investment in areas that might otherwise be overlooked, including disaster areas
- Applies to investments in active trades and businesses, real estate, many types of project financing, and more
- A mechanism for impact investing
- Can be twinned with other federal, state and local incentives

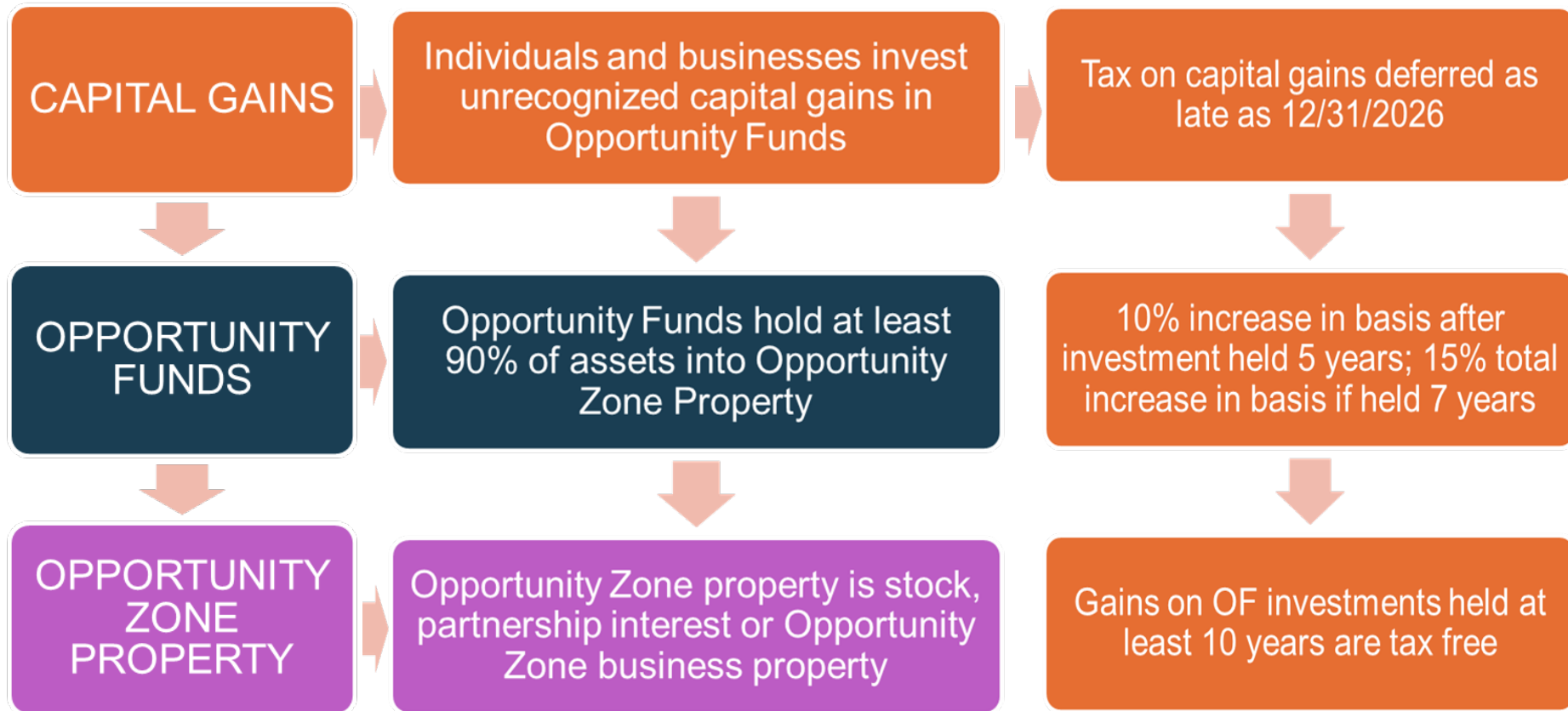
OZ IS A SUPERCHARGER

- OZ incentive is a *supercharger* for other benefits
 - Section 1202 Qualified Small Business Stock
 - Federal tax credits
 - State and local tax credits, abatements, and exemptions
 - Government grants
- Development in OZs is *supercharged*
 - Trump WHORC Council prioritizes OZ projects
 - Mandate to ease federal (and sometimes state and local) permitting and approvals and accelerate processing times
 - Governmental, tax exempt, educational & community partners

OZ IS A SUPERCHARGER

- OZ will draw attention to and incentivize interest in underserved areas that may otherwise be overlooked, including rural communities
- OZ can be an integral part of the capital stack in coordination with governmental and charitable loans and grants, private investment
- OZ can attract housing, mixed use, small businesses making products and providing services more readily available
- Jobs, economic base, wealth building

THE MECHANICS OF OZ



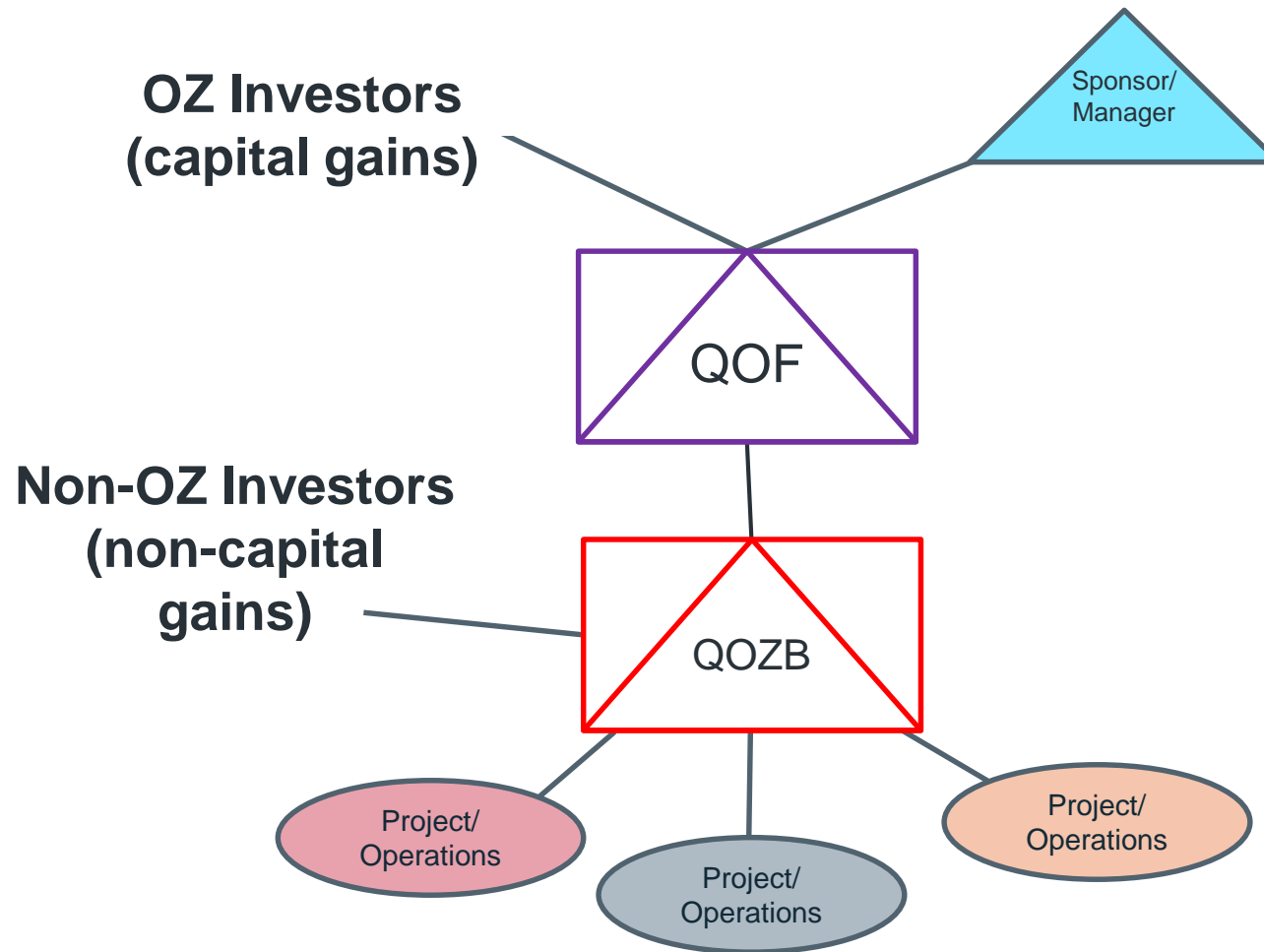
THE ANATOMY OF AN OZ



THE PLAYERS

- Investors with capital gains, including businesses, family offices, and impact investors
- Developers, entrepreneurs, farmers, innovators, businesses, universities, tribes, public sector entities who partner with private investors, foundations
- Urban and rural economic development authorities
- Fund sponsors and managers
- Communities, local government and business leaders, faith community in Opportunity Zones
- “People *with* money, people who *need* money, and people who can *manage* money”

INVESTMENT MODEL



THE DEFINITIONS

- Qualified Opportunity Zone Property (QOZP):
 1. OZ stock in an OZ business
 2. OZ partnership interest (capital or profits) in an OZ business (includes multi-member LLCs)
 3. OZ business property (QOZBP)
 - Tangible property used in a trade/business of the QOF
 - Acquired by purchase or lease after 12/31/2017
 - Original use in the OZ begins with the QOF or substantially improved property (improvements at least double basis). Land not considered.
 4. 90% QOF holding period applies

THE DEFINITIONS

- Qualified Opportunity Zone Business (QOZB):
 - Substantially all the tangible property owned or leased is OZ business property. 70% threshold applies.
 - At least 50% of gross income derived from active trade/business. 3 safe harbors/facts & circumstances.
 - Substantial amount of any intangible property is used in the active trade or business (40% threshold)
 - Limits on financial property (deter passive investment)
 - Safe harbors for working capital (new 62 month cap)
 - Must maintain assets in cash, cash equivalents, or short-term debt
 - No “sin” businesses, including gaming, country clubs, golf courses, tanning salons and liquor stores
 - New: final regulations allow less than 5% de minimis exception

OTHER TERMS AND CONDITIONS

- Must invest in QOF within 180 days after recognizing capital gain (day 1 is date of transaction)
 - Final regulations include many alternatives to date of transaction
- Stock/partnership interest and tangible property must be acquired post 12/31/2017
- Related party rules apply (20% threshold)
- Can invest until 2026 (but may not qualify for all the benefits by waiting) and hold until 2047
- Failure of QOF to meet 90% test may result in penalties
 - Can disregard new investments within prior 6 months
 - 1 year to reinvest gains

OTHER TERMS AND CONDITIONS

- Investors can invest in a QOF located anywhere
- QOF can invest in QOZB located anywhere
- Special rules for QOFs and QOZBs in territories

FINAL REGULATIONS PROVIDE CERTAINTY, FLEXIBILITY

- Safe harbors, thresholds, other mechanisms make it easier for operating businesses and real estate projects to qualify
- The Administration and Congress *want* Opportunity Zones to be a success
- Regs provide intentional flexibility to maximize OZ participation

FINAL REGS PROVIDE CLARITY, CERTAINTY AND FLEXIBILITY TO ENCOURAGE PROJECTS & BUSINESSES

- Existing businesses
- Cure period for 90% test
- 10-year exclusion election for sales of assets by QOZBs
- Leasing rules
 - Normal related party rules don't apply. Can lease to your QOF/QOZB. Market rate & other rules apply.
 - Deemed relief from market rate for leases with tribes, government, unrelated parties
- Flexibility in timing
- Flexibility in entity structure, mergers and reorganizations
 - Continuity of QOZB status

FINAL REGS PROVIDE CLARITY, CERTAINTY AND FLEXIBILITY TO ENCOURAGE PROJECTS & BUSINESSES

- Safe harbors and percentages
 - 50% gross income
 - 31 month written plan
 - Overlapping and sequential OK, up to 62 months
 - Deemed to be QOZB
 - 62 month written plan for start-ups
 - Deemed to meet QOZB tests
 - 70% use
 - 20%/14 days outside OZ/30 day leases
 - Sin business
 - <5% by space or revenues
 - 70%/30% test
- Flexibility on valuations, inventory
- Flexibility on triple net leases

FINAL REGS PROVIDE CLARITY, CERTAINTY AND FLEXIBILITY TO ENCOURAGE PROJECTS & BUSINESSES

- Brownfields, government-owned assets, disaster areas
- Tolling for government delays
- Original use test
 - Vacancy rules
 - Newly constructed property
- Substantial improvement test
 - Straddle tracts
 - Aggregation of new and used
 - Aggregation of multiple used
 - Aggregation of used and used

NOTICE 2020-39 GIVES MORE TIME

- Many projects went on an involuntary hold with COVID
 - General economic uncertainty
 - Regional uncertainty
 - Sector uncertainty
 - Valuations difficult
 - Credit difficult
 - Capital gains reduced
 - Investors wary
- IRS Notice 2020-39 bought investors and projects more time

NOTICE 2020-39 GIVES MORE TIME

- If normally April 1, 2020 or later ...
 - 180 day period for QOF investors extended to December 31, 2020
 - Failure to meet 90% QOF investment standard deemed due to reasonable cause (no penalty)
 - 90% test disregarded for purposes of whether QOF or investment in QOF meets OZ statutory and regulatory requirements for any taxable year of the QOF
 - 30-month substantial improvement period tolled between April 1 and December 31, 2020
 - Working capital safe harbor extended by 24 months
 - 12-month reinvestment period extended by 12 months (if the original 12-month period includes January 20, 2020)
 - Must otherwise comply with reporting and other OZ requirements

STATE OF PLAY – A CHANGE IN SEASONS

- “OZ Winter” – OZ went somewhat dormant for a while after onset of COVID
- Now it’s “OZ Spring” – projects and businesses are beginning to bloom
 - Investors have to act before the end of 2020 to get OZ benefits
 - Delayed projects starting up – carrying costs adding up
 - Credit available
 - Light at the end of the tunnel
- Discernable pivot to ESG focus (environmental, social, governance)
 - BLM, social events contributed to this
- More interest in OZ businesses
- More focus on OZ communities and residents – building wealth, skin in the game
- More focus among tax exempt/charitable sector on using OZ

LOOKING AHEAD – BIDEN OZ AGENDA

- What would Joe Biden do with OZ?
 - “Fix it” not repeal it
 - Believes incentive not living up to full potential
 - Shift focus to OZ communities and residents - ESG
 - Incentivize OZ businesses to:
 - Partner with non-profits and other stakeholders
 - Identify community needs
 - Focus on job creation
 - Build wealth in OZ communities

LOOKING AHEAD – BIDEN OZ AGENDA

- Subject OZ projects to Treasury review to ensure they meet social, economic and environmental objectives
- Detailed reporting and public disclosure of OZ investments and benefits to community and residents, including impact on poverty levels, affordable housing, job creation
- Make New Markets Tax Credit permanent
- Allow QOFs to invest in CDFIs

LOOKING AHEAD – OTHER IDEAS

- Information reporting – accountability and transparency
- Extending statutory timeframes
 - 15% step up
 - Recognition of capital gains
- Repeal and replace (or expand) zones
- Facilitating investments
- Making OZ more compatible with Low Income Housing Tax Credit and New Markets Tax Credit
- Revamping to allow residents to have more involvement and build wealth

WHAT YOU SHOULD BE DOING NOW

- Identify Opportunity Zones
- Get good counsel – OZ is *NOT* a DIY project
- Coordinate political, business, economic, social, faith leaders
- Identify needs, strengths and weaknesses
 - Growing business sectors
 - Infrastructure
 - Skilled workforce
 - Housing availability
 - Proximity to educational institutions
 - Land availability
- Identify potential sources of public and private funding, availability of other incentives, streamlined processes
- Develop materials – make yourself competitive

DON'T LEAVE MONEY ON THE TABLE

- Don't walk away from OZ because it seems too complicated
- It *is* complicated, but the complexity creates flexibility
- Administration and Congress want OZ to be a success – both for operating businesses and real estate
- OZ is here to stay, even with a Biden presidency
- President's WHORC council is cutting the red tape and prioritizing OZ projects for grants, loans, etc.
- 8766 Opportunity Zones. It's competitive.
- Prepare! Market! Collaborate!
- Be ready to welcome new projects and businesses!

**QUESTIONS? VISIT OUR WEBSITE & VIEW
OUR OZ VIDEO:**

www.klgates.com/oz

OZ Video – click [here](#)



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