INTERNATIONAL
ECONOMIC DEVELOPMENT
COUNCIL

The Power of Knowledge and Leadership

The Power and Possibility of Opportunity Zones

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October 30, 2018

The Path to Passage

- The Tax Cuts and Jobs Act (H.R. 1) was signed into law by President Trump on December 22, 2017.
- The sweeping tax overhaul legislation included provisions from S. 293, the Investing in Opportunity Act
- Original Opportunity Zones legislation sponsored by Sen. Tim Scott (R-SC); originally co-sponsored by Sen. Cory Booker (D-NJ)
- House of Representatives counterpart, H.R. 828, sponsored by Reps. Pat Tiberi (R-WI) and Ron Kind (D-WI)
- Bipartisan support
    - 14 Senate co-sponsors
    - 81 House co-sponsors

Opportunity Zones Tax Incentives

Opportunity Zones offer investors three incentives for putting their capital to work in economically distressed communities:

Temporary Deferral

A **temporary deferral:** An investor can defer capital gains taxes until the end of 2026 by rolling their gains directly over into an Opportunity Fund.

Step-Up In Basis

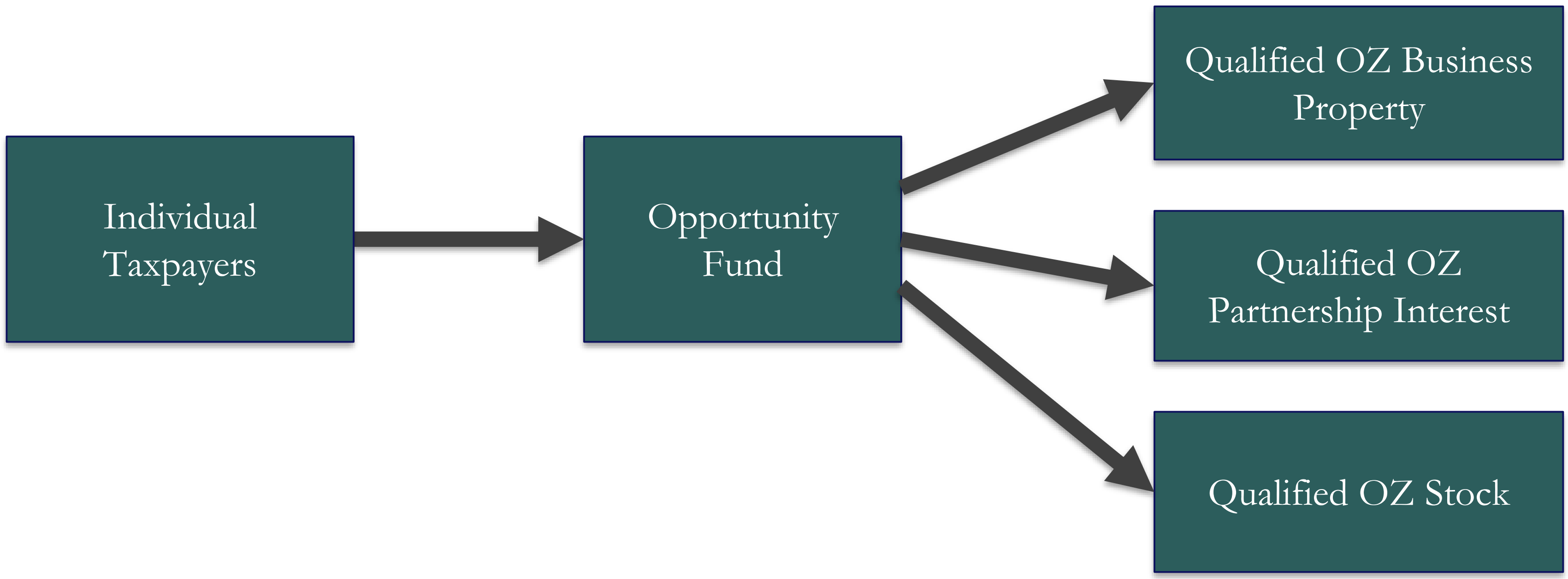
A **tax liability reduction:** The deferred capital gains liability is effectively reduced by 10% if the investment in the Opportunity Fund is held for 5 years and another 5% if held for 7 years.

Permanent Exclusion

A **tax exemption:** Any capital gains on subsequent investments made through an Opportunity Fund accrue tax-free as long as the investor stays invested in the fund for at least 10 years.

Graphics courtesy of Economic Innovation Group

Mechanics of Opportunity Zone Investments



Opportunity Zones In Practice

There are three major components to Opportunity Zones:

Investments:
Opportunity Funds make equity investments in businesses and business property in Opportunity Zones.

Funds:
Opportunity Funds are investment vehicles organized as corporations or partnerships for the specific purpose of investing in qualified Opportunity Zones.

Zones:
States and territories nominated 25% of their eligible low-income census tracts as Opportunity Zones. Treasury approved final map.

Assets Eligible for Opportunity Zone Investments

There are three types of property eligible for Opportunity Zone investment:

Stock of a qualified Opportunity Zone **corporation**

Partnership interest in a qualified Opportunity Zone partnership

Business property used in qualified Opportunity Zones

- A qualified Opportunity Zone business must use **"substantially all"** of its tangible property within a zone and meet a few additional basic tests***. Treasury just released draft regulations setting the "substantially all" test at 70% of the basis of the building itself excluding the cost of land***
- Investments that **do not** qualify include funds of funds, "sin" businesses (e.g. golf courses, package stores, casinos), and financial institutions
- A **substantial improvement** test applies unless the business property is original use

Investment Impact of Opportunity Zones

The early movers are seeking to shape the future of Opportunity Zone investing, and with it the character of neighborhood and community development in the U.S. for at least the next decade.

-Dennis Pierce, ImpactAlpha, "Early Movers are Getting a Jump on Opportunity Zones – and the Future of Community Investing"

- Deferral of capital gains taxation affords Opportunity Zone investors larger investments upfront
- Basis step-up explicitly reduces deferred taxation of invested capital gains, rewarding long-term commitment to Opportunity Zone communities
- Capital gains tax on investment returns eliminated entirely for 10-year investors

Opportunity Zone Investment: A Simplified Example (1)

December 2018

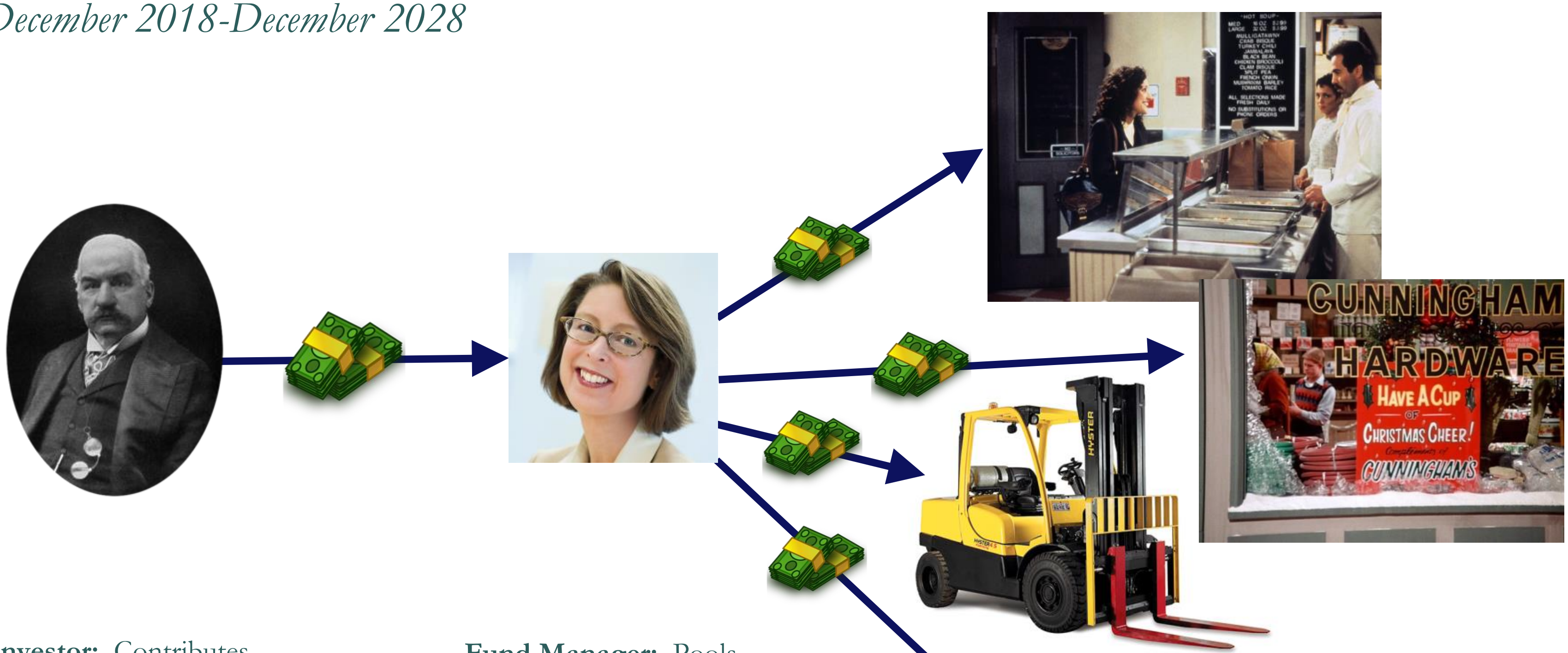
Opportunity Zone: Offers deferral of federal tax on realized capital gains, plus elimination of taxes on returns to OZ investments held for 10 years

Investor: Buys 10 shares of technology stock at 100; sells at 200. Realizes capital gain of $1,000. Two options: Pay federal income tax today, or invest in Opportunity Zone.

Capital Gains Tax: Federal law provides for up to 23.8% tax on long-term capital gains. Many states levy additional capital gains taxes.

Opportunity Zone Investment: A Simplified Example (2)

December 2018-December 2028

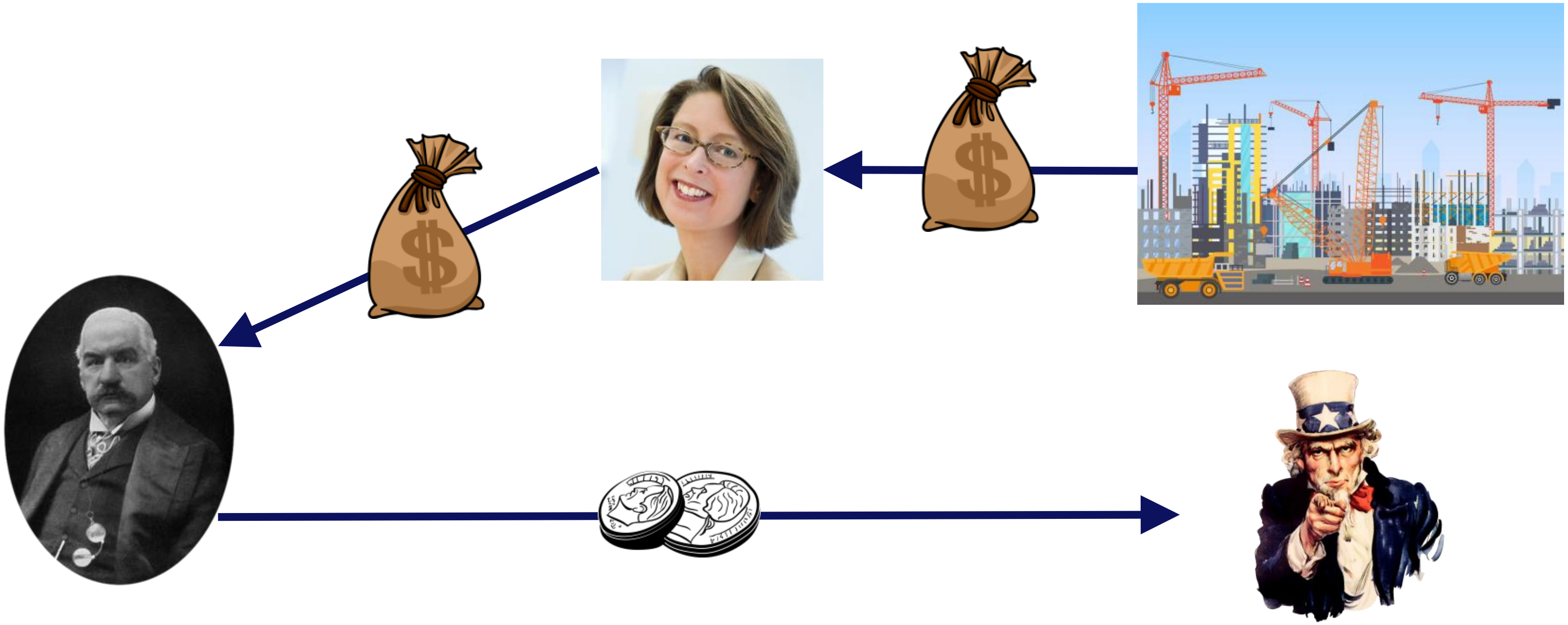


Investor: Contributes $1,000 in realized capital gains, otherwise taxable, into a qualified Opportunity Fund.

Fund Manager: Pools contributed funds from multiple investors and invests in equity, real estate, and equipment in businesses and housing located in Opportunity Zones

Opportunity Zone Investment: A Simplified Example (3)

December 2028

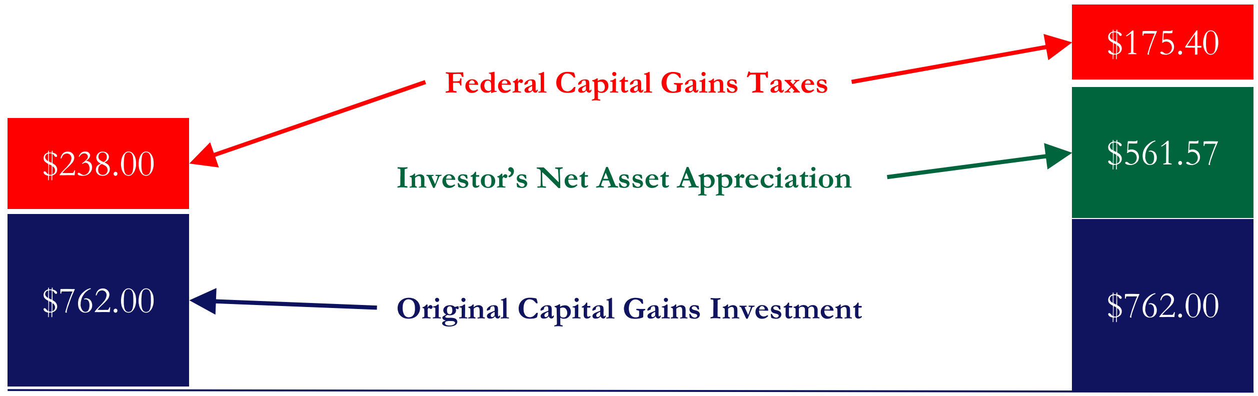


Investor: Has held Opportunity Fund investment for 10 years.

- Completely exempt from capital gains tax on appreciation of Opportunity Zone holding
- Entitled to 15% basis step-up on deferred capital gains tax of original investment; tax liability deferred until end of 2026

Opportunity Zone Investment: A Simplified Example (4)

Non-Opportunity Zone Investment of Realized Capital Gains

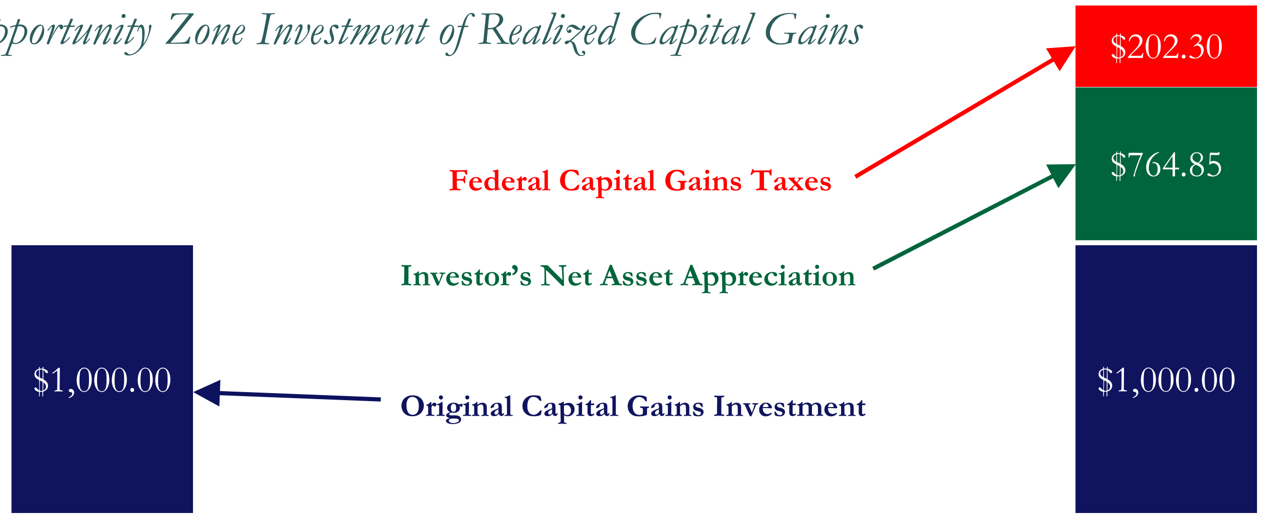


$238.00
<u>$175.40</u>
$413.40

$762.00
<u>$561.57</u>
$1,323.57

December 2018 *December 2028*

Opportunity Zone Investment of Realized Capital Gains



$202.30

$1,000.00
<u>$764.85</u>
$1,764.85

December 2018 *December 2028*

Graphics not to scale.

Impact Analysis of Opportunity Zone Provisions

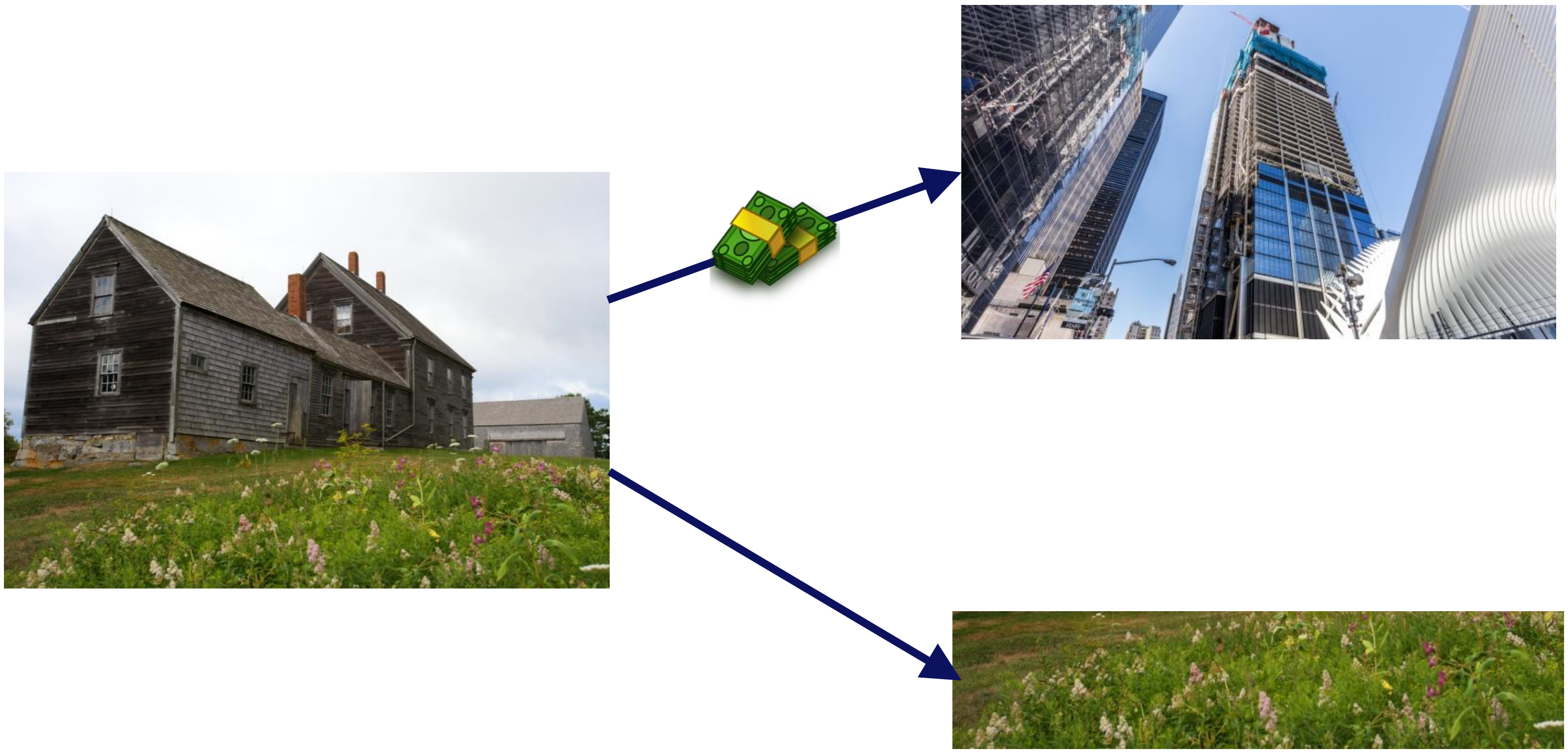
	Capital Gains	Basis Step-Up	Initial Tax Load	Net Invested Funds	Gross Value of Investment at End of Holding Period, 7.0% Annual Return	Gross Return on Invested Funds	Tax Load on Gross Return, End of Holding Period	Deferred Tax Load on Original Invested Funds	Cumulative Tax Load	Net Return on Invested Funds	Net Investment Value after Holding Period
Non QOZ	$ 1,000.00	0%	$ 238.00	$ 762.00	$ 1,068.74	$ 306.74	$ 73.01		$ 311.01	$ 233.74	$ 995.74
QOZ, 5 Yr Holding Period	$ 1,000.00	10%	$ -	$ 1,000.00	$ 1,402.55	$ 402.55	$ 95.81	$ 214.20	$ 310.01	$ 92.54	$ 1,092.54
							Cumulative Difference in Net Investment Returns				**$ 96.81**
Non QOZ	$ 1,000.00	0%	$ 238.00	$ 762.00	$ 1,223.61	$ 461.61	$ 109.86		$ 347.86	$ 351.74	$ 1,113.74
QOZ, 7 Yr Holding Period	$ 1,000.00	15%	$ -	$ 1,000.00	$ 1,605.78	$ 605.78	$ 144.18	$ 202.30	$ 346.48	$ 259.31	$ 1,259.31
							Cumulative Difference in Net Investment Returns				**$ 145.56**
Non QOZ	$ 1,000.00	0%	$ 238.00	$ 762.00	$ 1,498.97	$ 736.97	$ 175.40		$ 413.40	$ 561.57	$ 1,323.57
QOZ, 10 Yr Holding Period	$ 1,000.00	15%	$ -	$ 1,000.00	$ 1,967.15	$ 967.15	$ -	$ 202.30	$ 202.30	$ 764.85	$ 1,764.85
							Cumulative Difference in Net Investment Returns				**$ 441.28**

Treasury Department Latest Guidance

- Treasury Department released a long-awaited first round of guidance on implementation of Opportunity Zone provisions on October 19, 2018. It is available at https://www.irs.gov/pub/irs-drop/reg-115420-18.pdf.
- The comment period on this round of guidance is open until December 28, 2018. Comments can be submitted at https://www.federalregister.gov/documents/2018/10/29/2018-23382/investing-in-qualified-opportunity-funds.

Land and Buildings

- Land does not require substantial improvement, but buildings do
- "Substantial improvement" is investment that meets or exceeds the cost basis of the buildings (excluding the land)



'Substantially All' Threshold

- **90%** of the assets of any Opportunity Fund must be situated in Opportunity Zones or invested in Opportunity Zone businesses.
- Qualified Opportunity Zone businesses must have **"substantially all"** of their tangible property located within an opportunity zone.
- According to the new guidance, **"substantially all"** is defined as **"at least 70%"** for determining whether substantially all of the tangible property owned or lease by a taxpayer is qualified opportunity zone business property (as defined under section 1400Z-2(d)(3)(A)(i)).

Opportunity Fund Self-Certification

Opportunity Funds will self-certify their compliance with applicable requirements using IRS Form 8996.

Form **8996**
(December 2018)
Department of the Treasury
Internal Revenue Service

Qualified Opportunity Fund
▶ Go to *www.irs.gov/Form8996* for the latest information.
▶ Attach to your tax return. See instructions.

OMB No. 1545-0123
Attachment Sequence No. **996**

Name | **Employer identification number**

Part I **General Information and Certification**

1 Type of taxpayer: ☐ Corporation ☐ Partnership
2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)?
☐ **No. STOP.** Do not file this form with your tax return.
☐ **Yes.** Go to line 3.
3 Is this the first period the taxpayer is a Qualified Opportunity Fund?
☐ **Yes.** By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and the description of the qualified opportunity zone business. See instructions.
☐ **No.** Go to Part II.
4 If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund.

Part II **Investment Standard Calculation**

5	Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	5	
6	Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes"	6	
7	Divide line 5 by line 6	7	
8	Total qualified opportunity zone property held by the taxpayer on the last day of the taxpaye's tax year	8	
9	Total assets held by the taxpayer on the last day of the taxpayer's tax year	9	
10	Divide line 8 by line 9	10	

Part III **Qualified Opportunity Fund Average and Penalty**

11	Add lines 7 and 10	11	
12	Divide line 11 by 2.0. See instructions if Part I, line 3 is "Yes"	12	
13	Is line 12 equal to or more than .90? ☐ **Yes.** Enter -0- on this line and file this form with your tax return. ☐ **No.** The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return	13	

Cat. No. 37820G Form **8996** (12-2018)

Form 8996 (12-2018) Page **2**

Part IV **Line 13 Penalty**

If you checked "No" in Part III, line 13 complete Part IV to figure the penalty. Enter the number from line 8 below on Part III, line 13. See instructions if Part I, line 3 is "Yes."

		(a) Month 1	**(b)** Month 2	**(c)** Month 3	**(d)** Month 4	**(e)** Month 5
1	Total assets on the last day of the month					
2	Multiply line 1 by .90					
3	Total Qualified Opportunity Zone Property on the last day of the month					
4	Subtract line 3 from line 2. If less than zero, enter -0-					
5	Underpayment rate					
6	Multiply line 4 by line 5					
7	Divide line 6 by 12.0. Round up to two decimal places. See instructions if Part I, line 3 is "Yes"					

	(f) Month 6	**(g)** Month 7	**(h)** Month 8	**(i)** Month 9	**(j)** Month 10	**(k)** Month 11	**(l)** Month 12
1							
2							
3							
4							
5							
6							
7							

8 **Penalty.** Add columns (a) through (l) of line 7. Enter the total here and on Part III, line 13 $

Form **8996** (12-2018)

Opportunity Fund Organizational Structure

- Qualified Opportunity Funds can be:
  - LLCs
  - Partnerships
  - Corporations.
- Taxpayers eligible to elect deferral under section 1400Z-2 ("gain deferral election") are those that recognize capital gain for federal income tax purposes. These taxpayers include:
  - Individuals
  - C corporations (including Regulated Investment Companies and Real Estate Investment Trusts)
  - Partnerships, and
  - Certain other pass-through entities.

Working Capital Safe Harbor

The safe harbor allows qualified opportunity zone businesses to apply the definition of working capital provided in section 1397C(e)(1) to property held by the business for a period of up to **31 months**, if three requirements are met:

1. There is a **written plan** that identifies the working capital assets as property held for the acquisition, construction, or substantial improvement of tangible property in the opportunity zone
2. There is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets, and under that schedule, the **working capital assets are spent within 31 months of the receipt by the business** of the financial property
3. The working capital assets are actually used in a manner that is **substantially consistent with the schedule**.

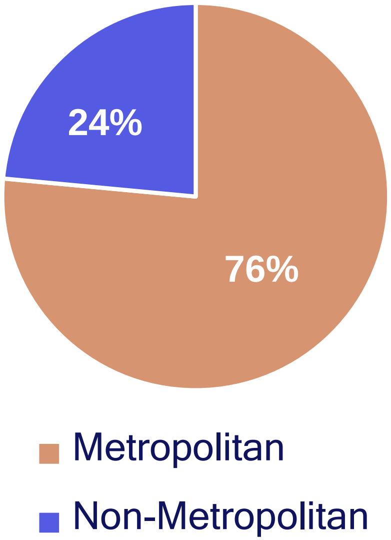
Key Features of Opportunity Zones

- ✓ **Flexibility:** Low income communities come in many different shapes and sizes. All have different needs. This tool is capable of supporting a variety of mutually reinforcing activities within the same community
- ✓ **Scalability:** There is no statutory cap on the amount of capital that can flow into Opportunity Zones in any given year. As such, this tool has the potential to help fuel economic renewal on a national scale
- ✓ **Simplicity:** Opportunity funds do not compete for fixed allocations of public-sector financing, and as a result do not require pre-approval of their investments. This should lower the cost, time and risk to business transactions, and encourage broad participation

Opportunity Zones Across The United States

- Of the 74,134 census tracts in the US and its territories, 8,762 (11.8%) have been designated as Opportunity Zones
- Opportunity Zones are now designated for 10 years
- Opportunity Zones (indicated in dark blue) are both urban and rural
  - Urban areas are less visible on the map, but very much part of the QOZ initiative
  - For example, the city of Chicago alone has 133 QOZs
- The Treasury Department's CDFI Fund has published a complete list of Opportunity Zones at https://www.cdfifund.gov/pages/opportunity-zones.aspx

Profile of America's Opportunity Zones



31.3 million residents
(35.0 million including Puerto Rico and other US territories)

1.6 million businesses

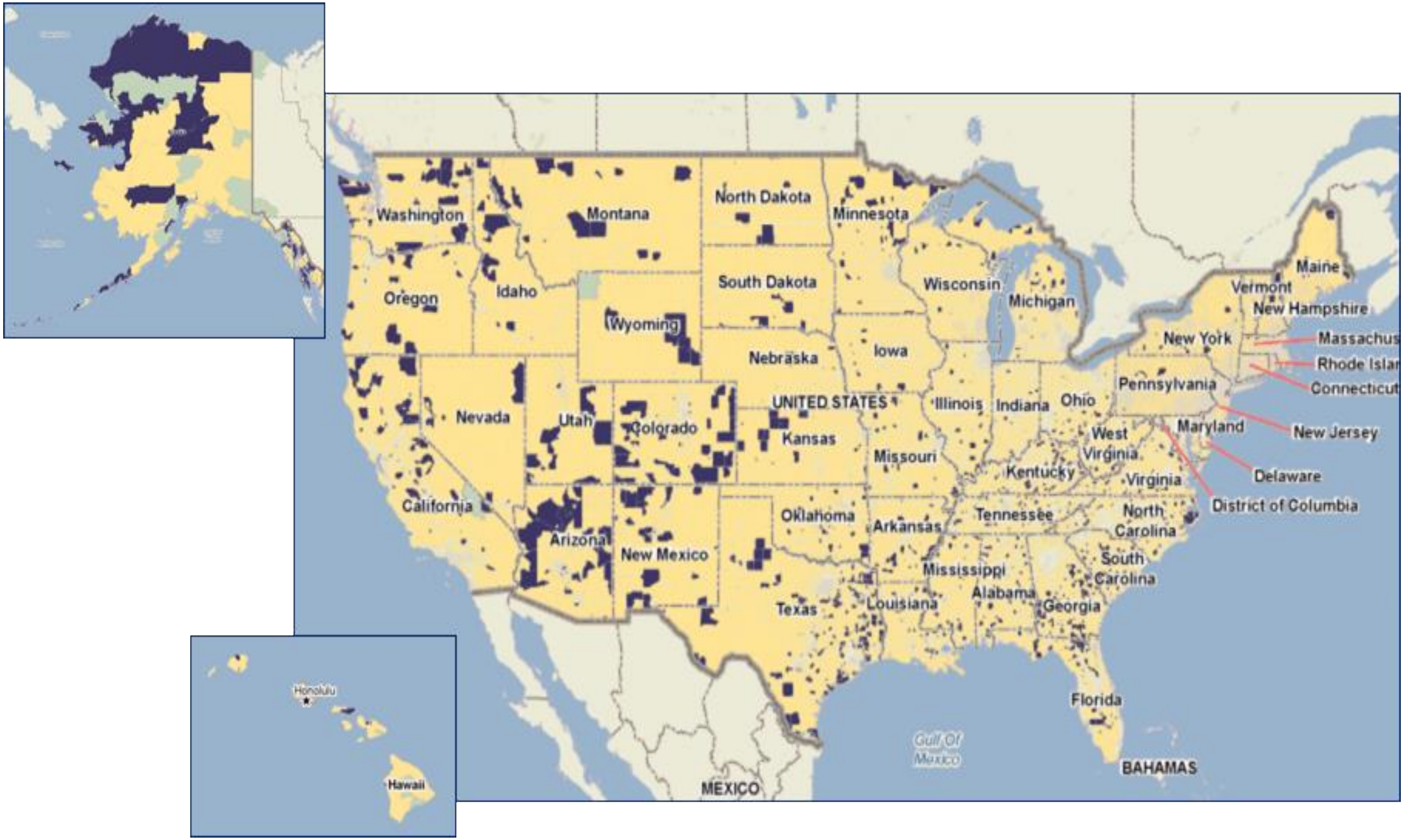
24 million jobs

¾ of Opportunity Zones lie within metro areas

10 percent of the nation's population resides within an Opportunity Zone

A strong foundation of businesses and jobs on which to expand

Opportunity Zones Across The United States



Map provided by US Department of the Treasury.

Opportunity Zones Investment Strategy for Distressed Communities

This is the moment for local leadership. The map is set. It is time to mobilize in the Opportunity Zones.

- State and local governments can lead by:
  - Convening stakeholders and key constituencies, including anchor institutions
  - Engage the local community to determine its needs and develop an investment plan for the zone
  - Promoting inclusive and equitable economic growth for existing residents and businesses by aligning existing incentives and infrastructure investments in support of expanding access to opportunity
  - Implementing protections that prevent displacement
  - Incentivizing investments geared toward high social benefit

Community Development Policy Tools

Tax Credits

- Low Income Housing
- New Markets

Debt Financing

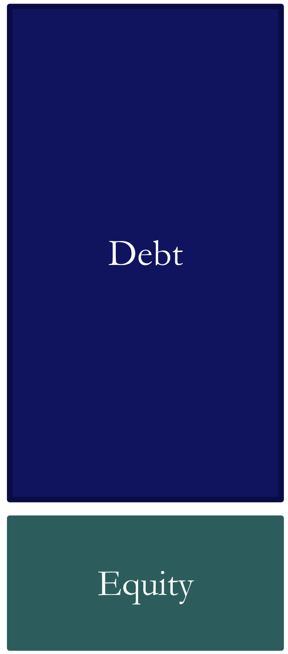
- Tax Exempt Capital Markets
- Federal Credit Programs: HUD, USDA

Community Targeting

- Opportunity Zones
- HUBZones
- Disaster Areas
- Other Criteria

Complementary Roles: Debt and Equity

- Opportunity Zones can be part of an integrated, holistic approach to boot-strapping community development investment
- Opportunity Zone boost to equity investment complements existing incentives on the debt side, including federal credit programs (e.g. HUD, USDA) and tax-exempt capital markets
- Guidance specifically states Opportunity Zones should complement, not replace, other initiatives



Key Tools for Local Governments

- ✓ **Land use:** Address land use zoning as a means to protect/preserve affordable "commercial workspaces and locations"
- ✓ **Planning:** Local governments' proactive participation in negotiating redevelopment plans designed to prevent displacement of micro- and/or small businesses
- ✓ **Knowledge:** Conduct economic impact assessments that measure the value of business services to a city's resident base
- ✓ **Social Impact:** Small businesses are often more than service providers: they are social supports, particularly for lower-income communities
- ✓ **Incentives and Community Investment:** Economic incentives from Tax Increment Financing, Community Development Block Grant investment, infrastructure development, workforce training, and others contribute to creating stronger communities

How Are Things Likely To Proceed From Here?

2018

- ✓ Opportunity Zones certified and final map in place
- ✓ Q3-Q4: Early mover funds form and capitalize
- ✓ Q4: IRS/Treasury release further guidance
- Q4: IRS released Opportunity Fund self-certification form

2019

- Bulk of funds form and capitalize
- Investment starts to flow

2020 and 2021

- Funds begin to invest at scale
- Funds reach 90 percent thresholds
- Investors continue to pile on in advance of the 2021 deadline to get the 5-year step-up by 2026
- First real picture of impact takes shape

A Holistic Approach to Success

Community
Members and NGOs

Local Institutions

Institutional Investors

States and Localities

Federal Government

Housing

Small
Businesses

Large Businesses

Education

Infrastructure

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