

Novogradac 2018

Opportunity Zones Conference





Qualified Opportunity Zone Businesses

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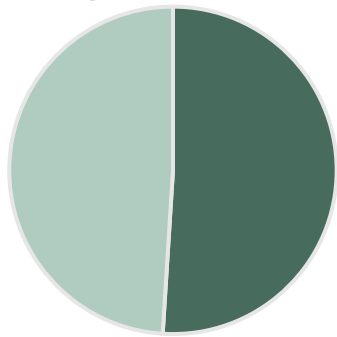
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Qualified Opportunity Zone Businesses (QOZB)

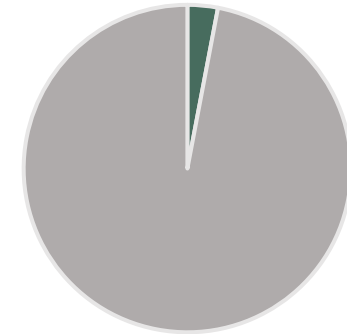
A trade or business in which **substantially all** of the tangible property owned or leased by the taxpayer is **qualified opportunity zone business property (QOZBP)** and:



**At least 50% of
income derived from
Active Conduct**



**Substantial portion of
intangible property used in
active conduct of business**



**< 5 percent unadjusted basis of
property is nonqualified
financial property**



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QOZB: Excluded Businesses

Can't be a "Sin Business"

A private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.



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Qualified Opportunity Zone Business Property (QOZBP)

- ✓ **Tangible property used in a trade or business**
- ✓ **Acquired by purchase from an unrelated party (20% standard) after December 31, 2017**
- ✓ **During substantially all of holding period, substantially all the use is in a QOZ**
- ✓ **Original use in the QOZ commences with the taxpayer**

OR

- ✓ **Taxpayer substantially improves the property**
 - ✓ during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period





Is it possible for a **Qualified Opportunity Fund** to operate a business **directly at the fund level** rather than indirectly through a business entity?

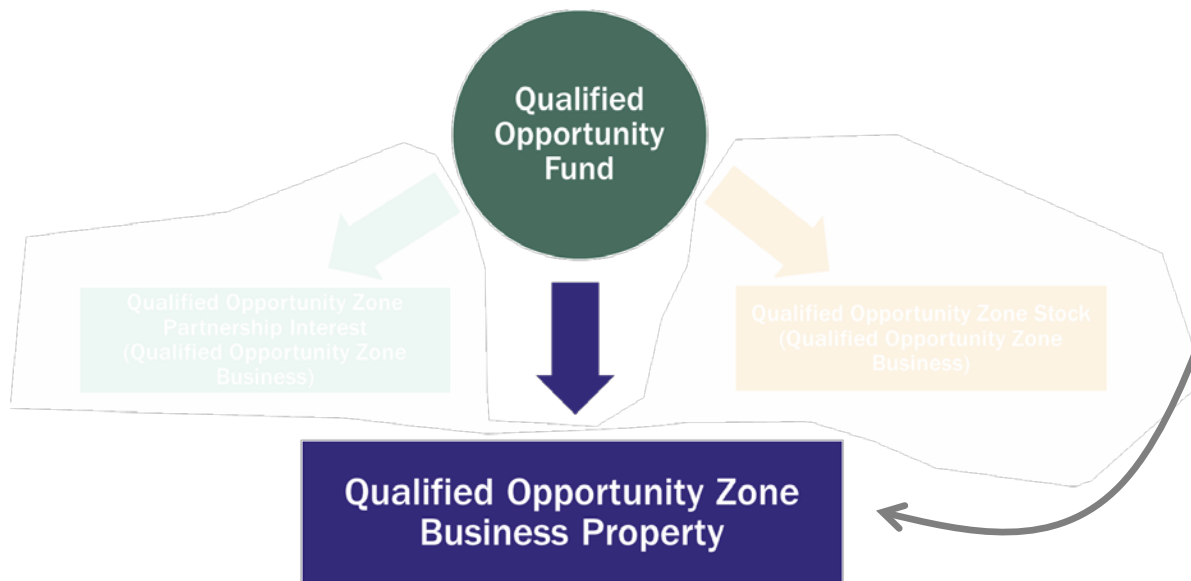


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QOF Requirements for Direct Structure



- **90% of assets** must be QOZBP
- Timing of investments and **90% test** at 6 months and year end
- Failure of 90% test and **reasonable cause**
 - What is reasonable cause? Could holding cash due to timing of QOZB investment = reasonable cause?
- Other business assets – cash, accounts receivable, intangibles – can't exceed 10%





QOF Requirements for Indirect Structure

- If QOF invests via the “**indirect**” method, 90% of assets would have to be **partnership interests or stock in QOZBs**
- QOZB Rule: Substantially all of **tangible property** is QOZBP – no “90% of assets” test
 - Owned and leased is considered
 - Awaiting guidance on “substantially all” threshold
 - Calculation method is unclear– cost, adjusted basis, FMV
- No **minimum** tangible property requirements
- Nonqualified financial property (NQFP) test
 - Any expected relief for proceeds to be spent within prescribed timeframe (like NMTC)?



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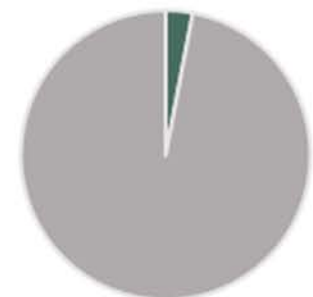
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**Does a triple net lease of real estate
constitute an active trade or business
for purposes of a Qualified
Opportunity Zone Business?**



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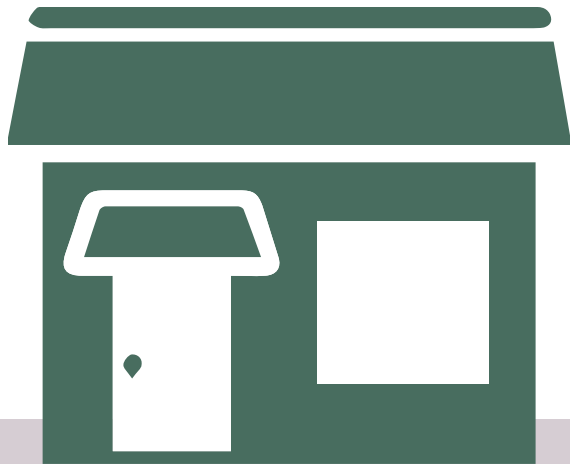
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EXAMPLE

Qualified Opportunity
Zone Business

NNN Lease

Large
Retailer



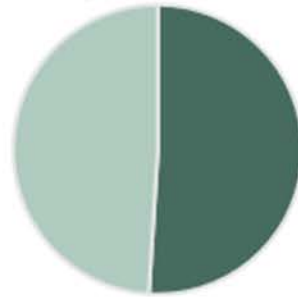
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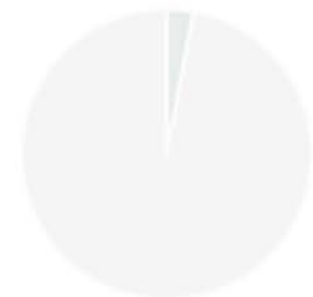
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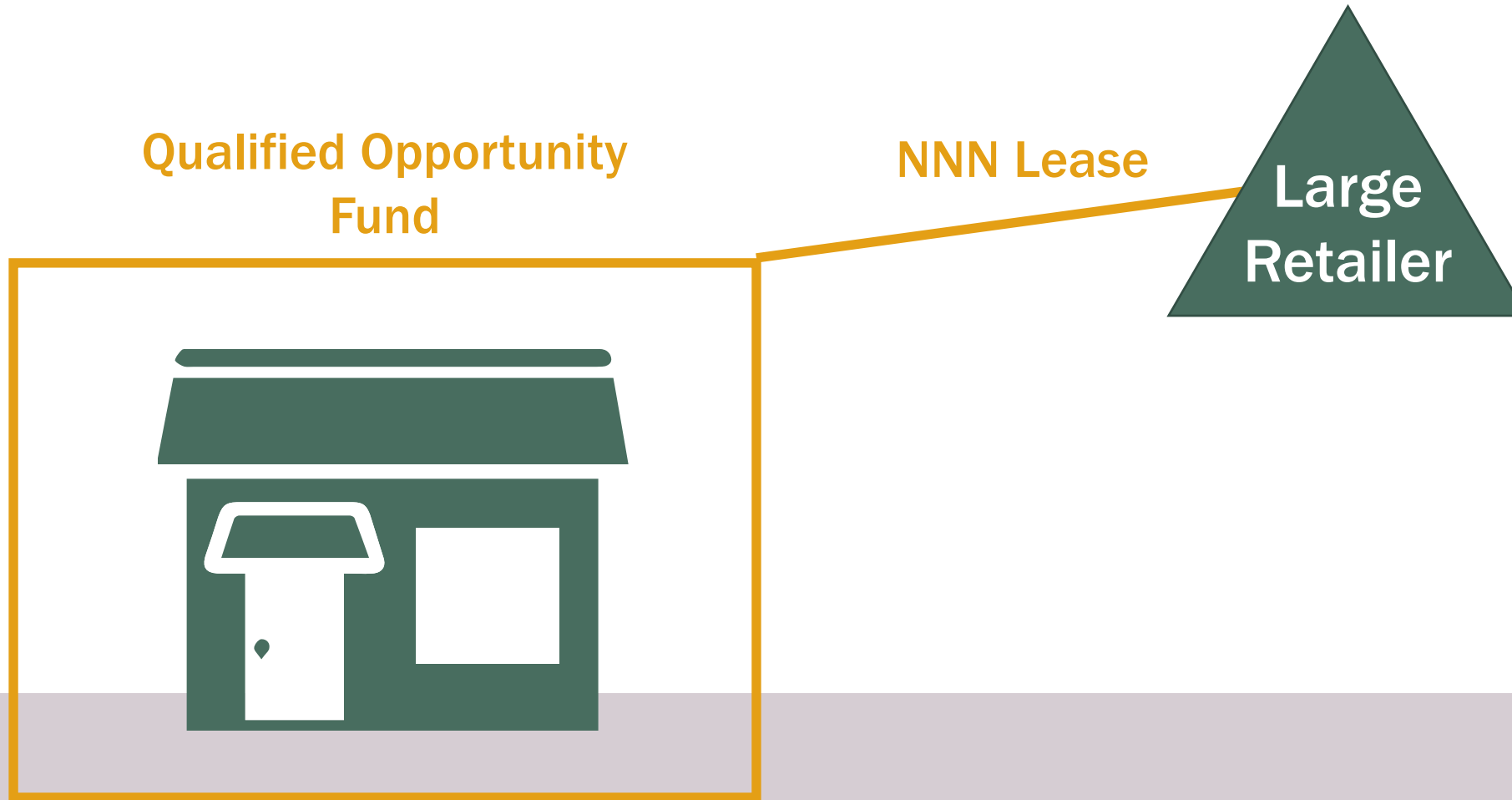
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EXAMPLE



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A trade or business in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (QOZBP) and:



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Triple Net Leases

- Does a triple net lease of real estate constitute an active trade or business for purposes of a Qualified Opportunity Zone Business?
- Can a triple net lease of real estate in any event meet all the requirements of Qualified Opportunity Zone Property if the real property is owned directly by the Opportunity Fund?
- No requirement for at least 50% of income from active conduct of business if tested at Opportunity Fund level.
 - Needs to have 90% of assets invested in QOZBP.





How is leased property valued for purposes of substantially-all test for tangible property owned or leased by a Qualified Opportunity Zone Business?



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Leased Property

- QOZB needs to have “**substantially all**” of tangible property owned or leased as QOZBP
- Definition of QOZBP – includes requirement of property to be **acquired by purchase** (no mention of lease)
- Lease value considerations:
 - Fair market value
 - Value of lease in arms-length transaction



How can an **existing business** located in an Opportunity Zone raise capital and meet the requirements of a Qualified Opportunity Zone Business?

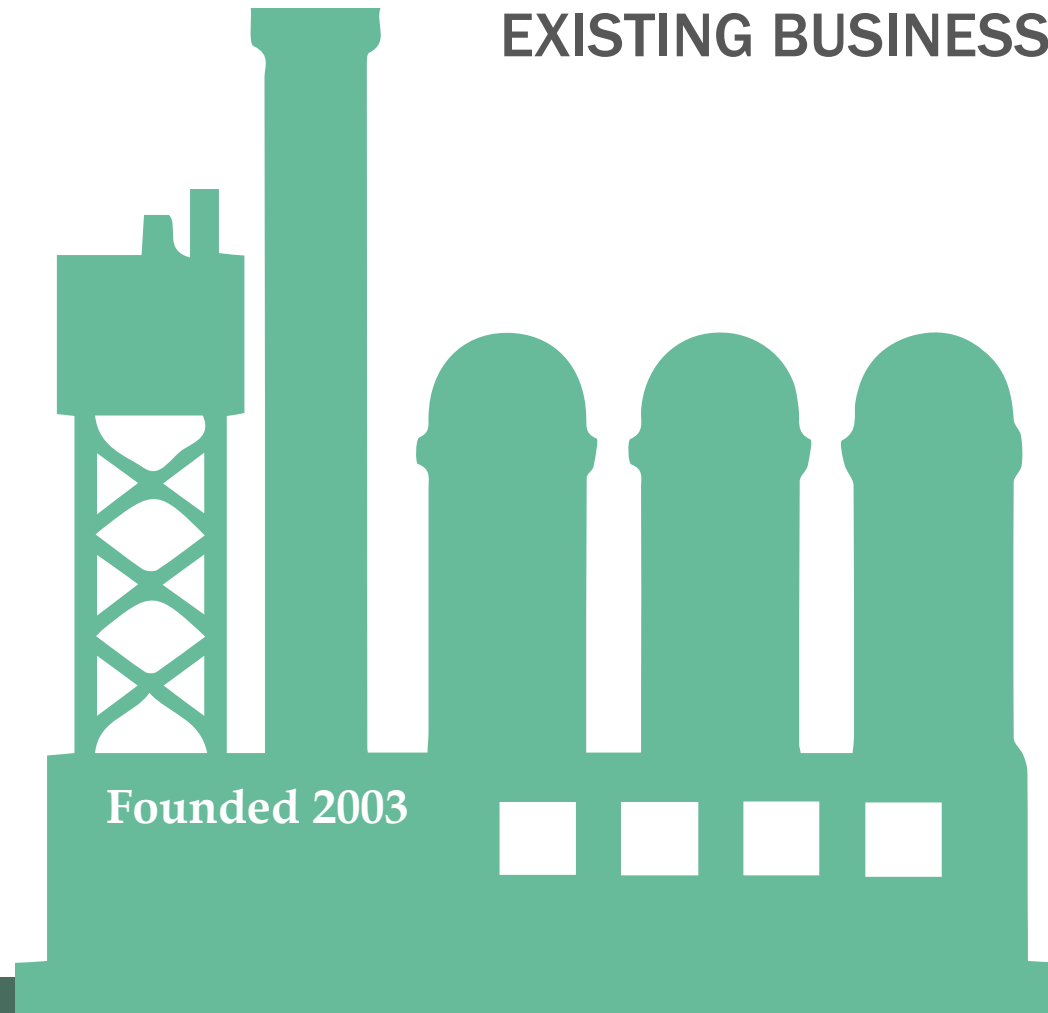


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EXISTING BUSINESSES, SCENARIO 1

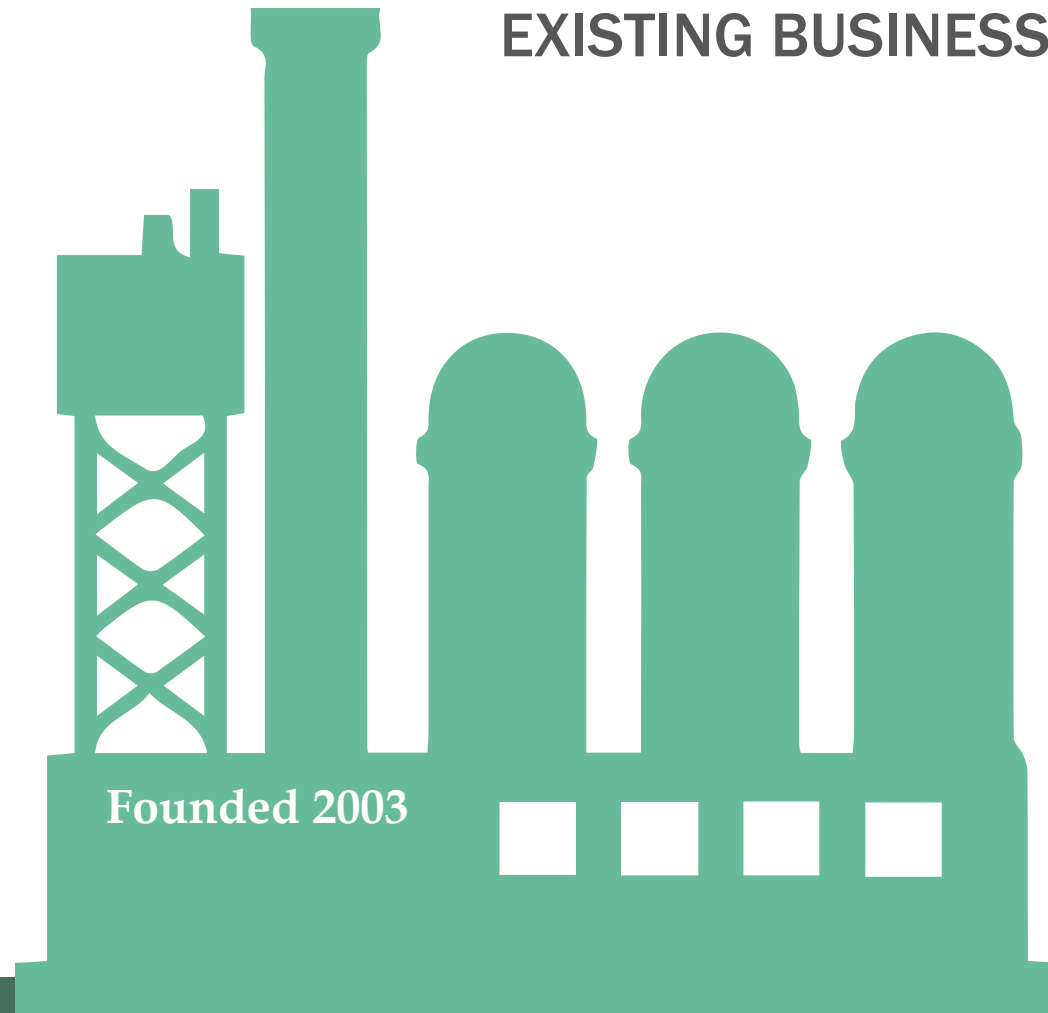


Management:
Let's buy all new
manufacturing
equipment and
replace some of what
we have!



QUALIFIED OPPORTUNITY ZONE

EXISTING BUSINESSES, SCENARIO 1



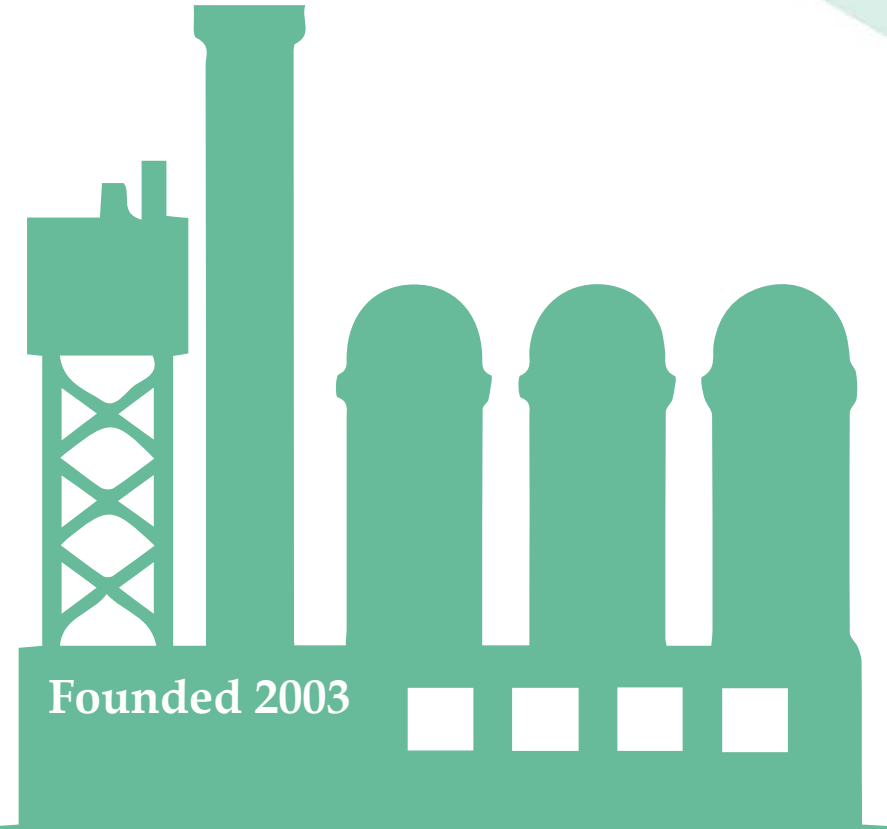
Management:
Do you think we'll
pass the sub-all test
for Opportunity Zones
now?



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EXISTING BUSINESSES, SCENARIO 2

Management:
Do you think we
should expand this
current business into
the Opportunity Zone
to qualify?



Founded 2003

QUALIFIED OPPORTUNITY ZONE

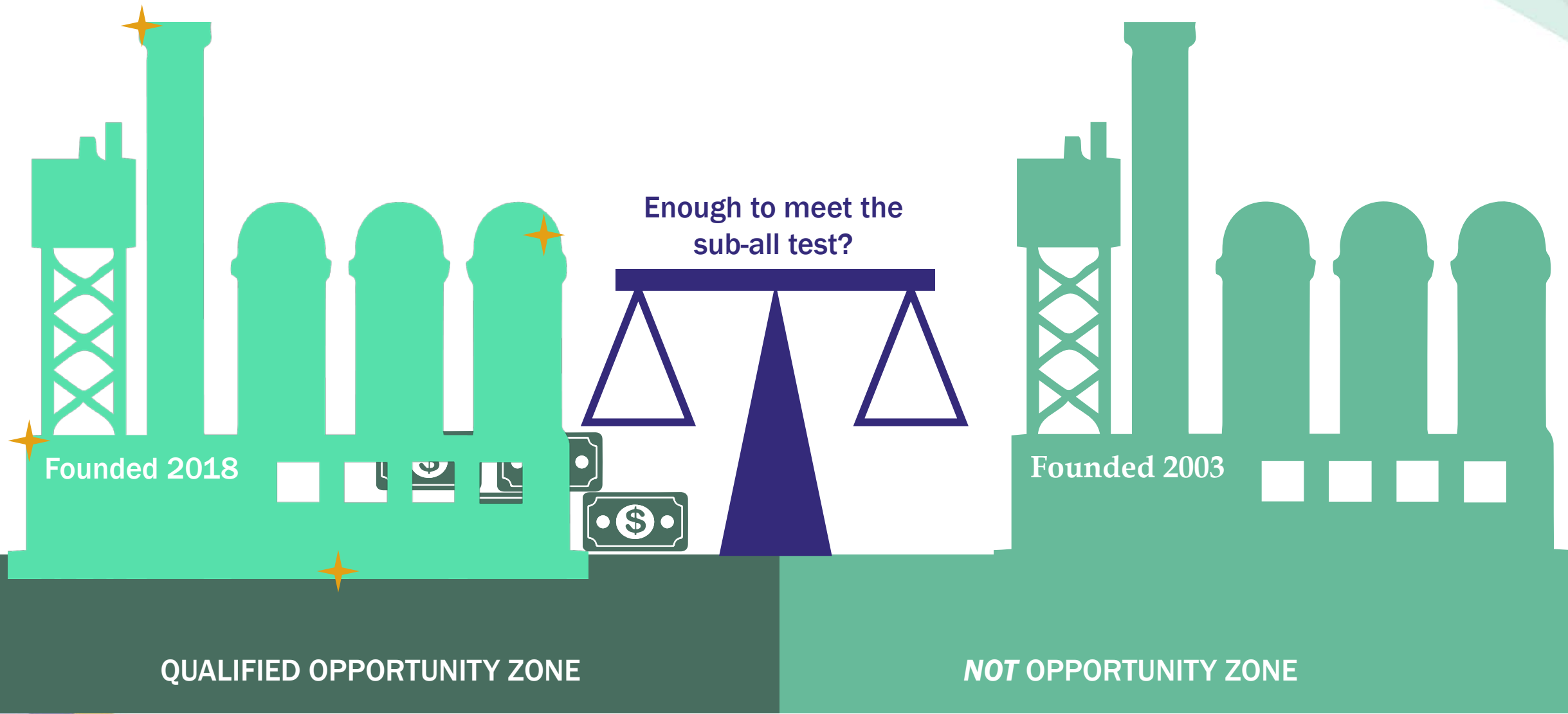
NOT OPPORTUNITY ZONE



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EXISTING BUSINESSES, SCENARIO 2



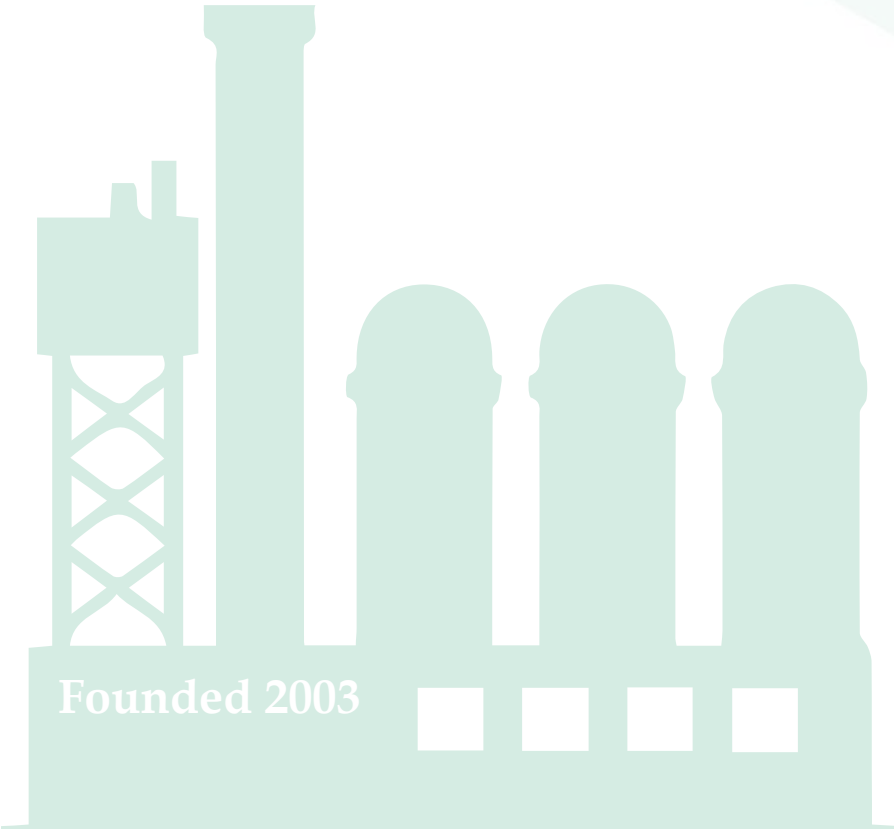
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EXISTING BUSINESSES, SCENARIO 2



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EXISTING BUSINESSES, SCENARIO 2

Create NewCo /
Affiliate entity

Founded 2018

QUALIFIED OPPORTUNITY ZONE

Founded 2003


NOT OPPORTUNITY ZONE



Can a business meet the qualifications of a QOZB if it leases property at a site in an Opportunity Zone, but maintains **various business operations outside the zone?**

EXAMPLE 1

“Property Management Company”

A stylized illustration of a blue building with white horizontal lines representing windows. A white speech bubble with a grey drop shadow originates from the building, containing the text "Yes, one moment, let me transfer you to our onsite manager." Two green trees are positioned in front of the building on a dark green ground plane.

“Yes, one moment, let me transfer you to our onsite manager.”

- Company leases office space in building in QOZ
- Some employees work on premises in the qualified opportunity zone; some employees work offsite at property locations not in QOZs

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EXAMPLE 1

- ✓ **Substantially-all** of tangible property owned *or leased* is QOZP

- ✓ No payroll/ employee services test

- ✓ **QOZP:**

- ✓ Acquired by **purchase** after **December 31, 2017**

- ✓ During **substantially all** of holding period, substantially all the use is in a QOZ

- ✓ **Original use in the QOZ** commences with the taxpayer

OR

- ✓ Taxpayer **substantially improves** the property

- ✓ during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period



EXAMPLE 2

- A manufacturing business makes widgets inside of a qualified opportunity zone
- However they:
 - Store their widgets outside of the OZ, and
 - Continue to own their widgets while in transit to delivery destinations



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- A manufacturing business makes widgets inside of a qualified opportunity zone
- However they:
 - Store their widgets outside of the OZ, and
 - Continue to own their widgets while in transit to delivery destinations

**During substantially all of holding period,
substantially all the use is in a QOZ.**



EXAMPLE 2

✓ **Substantially-all** of tangible property owned *or leased* is QOZP

✓ **QOZP:**

✓ Acquired by **purchase** after **December 31, 2017**

✓ During **substantially all** of holding period, substantially all the use is **in a QOZ**

✓ **Original use in the QOZ** commences with the taxpayer

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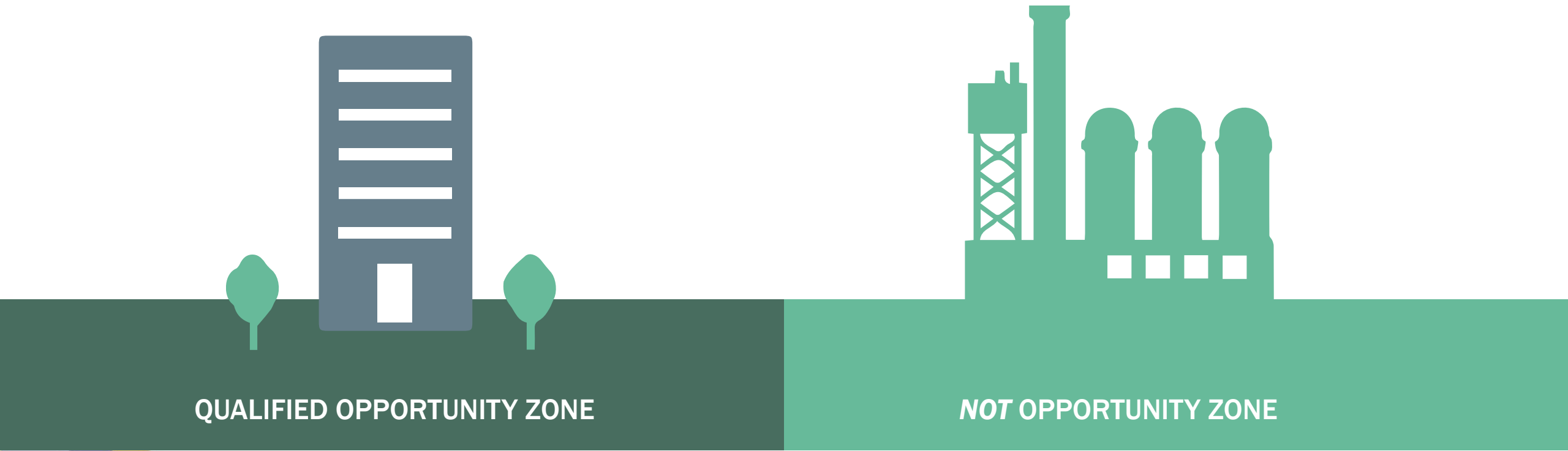
✓ Taxpayer **substantially improves** the property

✓ during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period



EXAMPLE 3

- A business operates in the qualified opportunity zone
- However, the business contracts manufacturing in China using intangibles that are developed in the zone
- Are “intangible assets” used in the active conduct of trade or business?



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- How
- in th
- Are

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EXAMPLE 4

Software Company
Founded April 30, 2018



- Technology company located in qualified opportunity zone
- Equity raised to be used over several years to fund payroll, software development, operations.
- Will funds be considered “reasonable working capital” or will they constitute NQFP?
- Is development of technology application and related revenue “intangible used in trade or business”?

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