# Opportunity Zones Webinar Q&A

From a webinar hosted by CCC on June 19, 2018

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Q: **What impact might this have on the GSE's?**

A: Direct effects depend on whether the GSEs have capital gains, indirect effects depend in part on level of GSE lending activity in the designated Opportunity Zone ("OZ") tracts. GSEs likely will find greater lending opportunities in OZ areas.

Q: **What is LP interest? Referred to on Application to Affordable Multifamily Housing slide.**

A: An LP interest is a Limited Partnership interest in a Limited Partnership, commonly the investment vehicle used for a Low-Income Housing Tax Credit ("LIHTC") investment by an investor.

Q: **We set up a partnership to undertake a LIHTC project prior to creation of Opportunity Zones. The subject property ended up being located within an Opportunity Zone. All of the approvals are in the name of this existing partnership. Can this existing partnership still be set up as a Qualified Opportunity Fund ("QOF")? Or do the General Partner and Limited Partner need to be QOFs?**

A: Subject to a detailed review of the specific facts, the partnership may be able to be a QOF, or the GP and/or LP may be able to choose to be a QOF. A critical question is when the property was acquired, on or before 12/31/2017. If the property was acquired before 1/1/2018, a follow-up issue will be the level of costs incurred.

Q: **For opportunity zones, re rehab, does the acquisition basis include the value of the land?**

A: Yes, acquisition basis generally includes the land.

Q: **How will the elimination of gain taxation affect the amount of exit taxes at the end of the LIHTC period where there is a negative capital account?**

A: Subject to IRS confirmation, gain associated with a negative capital account may not be taxable if the QOF investment is held for ten years.



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Q: **If I have a failed Like-Kind Exchange (LKE), after the 180 day period, do I get another 180 days to invest in a QOF?**

A: The answer is unclear. The OZ 180 day investment requirement date is from the "sale or exchange" of the property. Query if it is 180 days from a gain recognition sale or exchange, or 180 days from the sale or exchange of the LKE transferred real property.

Q: **So once the taxpayer/investor sells the first asset and receives a capital gain, then invests within 180 days into a QOF; how long does the fund have to purchase land and or begin construction?**

A: Absent further IRS guidance, for calendar year taxpayers, there is a June 30 testing date and a December 31 testing date. For formation year of a calendar year QOF, you may have six months from the date of formation, as opposed to the initial June 30 date.

Q: **Can the fund be capitalized with non-capital gain cash and start the acquisition of the land and entitlements which may take 1-3 years and the fund would then raise $$ over time from capital gain investors and pay back the original cash investors in the fund?**

A: Depends on how the capitalization is structured and IRS guidance on use of fund level short-term financing. Generally speaking though there does not seem to be anything prohibiting acquiring a property with seed money, but the timing considerations for improvement set forth in the regulations will apply and more guidance is required.

Q: **Could an owner of a seller carryback installment sale invest the deferred capital gain proceeds of the installment note once it is paid back?**

A: Likely no, since sale or exchange of property likely occurred more than 180 days earlier. Query whether an owner could sell the installment note, which may trigger a new sale or exchange, and then be eligible.

Q: **In combining OZ funds with New Market Tax Credit ("NMTC") funds, would the NMTC equity portion of the investment be treated as gain upon put/call in year 7?**

A: Assuming the NMTC Community Development Entity ("CDE") is the QOF, and makes an equity investment; a sale of the interest in the CDE would be a sale of the QOF interest. Note, the basis equal to FMV election would not be available, as ten years would not have lapsed.

Q: **Do expenditures on real property from qualified opportunity zone investments generate qualified rehab expenditures for HTCs and eligible basis for LIHTCs?**

A: As a general matter, we believe yes, they could qualify.



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Q: **Under your example of original purchase for $500 and a sale for $600 you used a gain of $100. What if the property was depreciated over time such that the tax basis is now $200? How is the $300 of capital gain treated vs the $100?**

A: We believe the additional gain may not be recognized. Additional guidance from the IRS on the treatment of debt, as well as depreciation recapture, is needed.

Q: **Is depreciation recapture exempt from recapture tax if the asset is held for 10 years?**

A: There are arguments suggesting yes, and suggesting no. Unclear at this point.

Q: **"Opportunity zone business property" is defined in part as "property acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2))." If an affordable housing partnership constructs an apartment development using developers related to the general partner (i.e. more than 20% common ownership for purposes of 1400Z-2), is such property considered to be acquired by "purchase" from an unrelated party and able to qualify as QOZ property?**

A: It is unclear how the “purchase” requirement applies to self-constructed property. As such, the answer is not clear. [The related party test is 20% so if it is more than 20% it probably would not count as a purchase from an unrelated party]

Q: **How will cash flow received before Dec 31, 2026 be treated? Can it be distributed? What about if there is a long term loan put in place after stabilization? How are any excess proceeds treated?**

A: We believe the general partnership (or corporation) tax rules apply during the intervening years. Such that operating cash could be distributed, and, for partnerships, taxable income would allocated to its partners and be subject to tax. Treatment of cash distributions, particularly debt financed distributions, are less clear.

Q: **For a LIHTC deal, could a developer take down land with a QOF, spend an equal amount on site work (1:1 ratio), and then lease the land for a LIHTC development? Would they then be eligible to receive the benefits for the funds in the QOF?**

A: The answer is unclear as to whether a triple net lease arrangement would rise to the level of an active trade or business. Note: substantial improvement rule requires that additions to basis exceed adjusted basis at the beginning of the 30-month measuring period.



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Q: **How will depreciation be treated? Suppose an OZ property is purchased for 10 and depreciated to 4 and then in 2026 it is sold for 15. Is all of the capital gain of 9 (from 4 to 15) tax free or only the increase of 5 (from 10 to 15)?**

A: See answer above. Unclear as to how debt and depreciation recapture is treated, which affect the tax consequences.

Q: **Are predevelopment, finance, legal and development fees included in the "rehab" basis for determining eligibility?**

A: As a general matter, they would be eligible, subject to general capitalization rules.

Q: **Is it possible for foreign investors to invest in a Qualified Opportunity Fund?**

A: The OZ statute does not contain any explicit limits on a foreign investor's ability to invest in a QOF. The statute focuses on an investor that has capital gains.

Q: **IRC 1400Z-2 states that the investor's initial basis in the OZ Fund is $0 at closing and is increased by 10% in 5 years, 5% in 7 years, and finally up to the amount of the original investment on 12/31/2026. Does this mean that tax credits and cash flow distributions would be hampered by basis issues in at least the first 5 years of the OZ Fund's life?**

A: For partnership QOFs, with no entity level debt, losses would generally be suspended, and cash distributions would generally be taxable. Low-income housing tax credits in most scenarios would be allocated to the QOF investors, as they have capital account, albeit no tax basis, associated with their investment. Note that gain recognized in 12/31/2026 is not always equal to deferred gain, less 5% and 10% basis adjustments, as applicable.

Q: **Are the capital gains eligible for the benefits only for investments made after December 31st 2017?**

A: No, can go before 1/1/2018, so long as invested in a QOF within the 180 days.

Q: **Will subsequent capital gains invested in QOZ funds be eligible for benefits, or only capital gains from 2018?**

A: You can make investments in QOFs through 12/31/2026, but not after then.

Q: **If we invest equity to close a transaction, can we refinance that equity out of the deal after the initial closing? What would be the tax implications of that approach?**

A: Unclear as to how operating cash or debt financed distributions are treated.



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Q: **How does the panel see projects utilizing both LIHTC and Opportunity Zones given that they each have different maturation periods and seemingly competing ownership requirements?**

A: We actually think they line up quite nicely. OZs are ten years, LIHTC generally 15.

Q: **Opportunity Zone Funds - Related party test for selling assets. Is the threshold 20% or 50%?**

A: Likely 20%, similar to the purchase related party rule.

Q: **I believe that you said a QOF must be funded within 180 days of the prior capital gain. I also thought I heard you say that the actual underlying investment in QOZBP or a QOZB would not have to happen on that same date – perhaps it could be a few days/weeks/month later? Is that a set time period, or driven by the tax calendar?**

A: Absent further IRS guidance, for calendar year taxpayers, a June 30 testing date and a December 31 testing date. For formation year of a calendar year QOF, you may have six months from the date of formation, as opposed to the June 30 date.

Q: **I have a property that will probably have 50% rehab costs compared to the basis, so it does not qualify. Are there creative solutions – such as owning the building in one entity and leasing it to a QOF so I can at least get the tax benefits on the rehab costs? Alternatively, could I put my 50% rehab building in the same QOF as an operating business (or ground-up construction project) such that the rehab + operating business basis is greater than the building acquisition basis?**

A: Too detailed a structuring question to answer here.



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