



Opportunity Zones (OZ)

Presented by:

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Opportunity Zones



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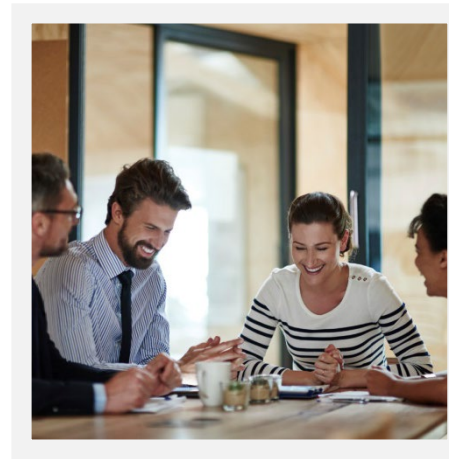
Agenda



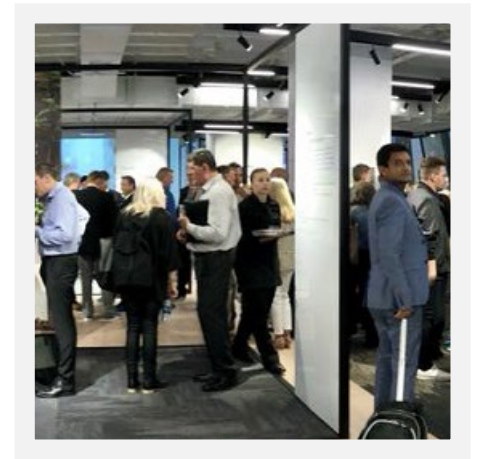
OZ Overview



Tax Perspective



OZ Investments



Local Initiatives

Opportunity Zones Facts



Opportunity Zones (OZ) are a **new incentive** of the Tax Cuts and Jobs Act of 2017.



OZs are designed to spur **long-term investment** in **low-income areas**, defined by census tract boundaries.



OZs are **federal tax incentives**, different from Enterprise Zones, which are **state income tax credits**.

Where are OZs locally?

- Eight census tracts are designated as OZs in El Paso County.
- OZs are located in six areas:
 1. North Nevada
 2. Downtown
 3. Cimarron Hills
 4. Southeast
 5. Airport
 6. Fountain

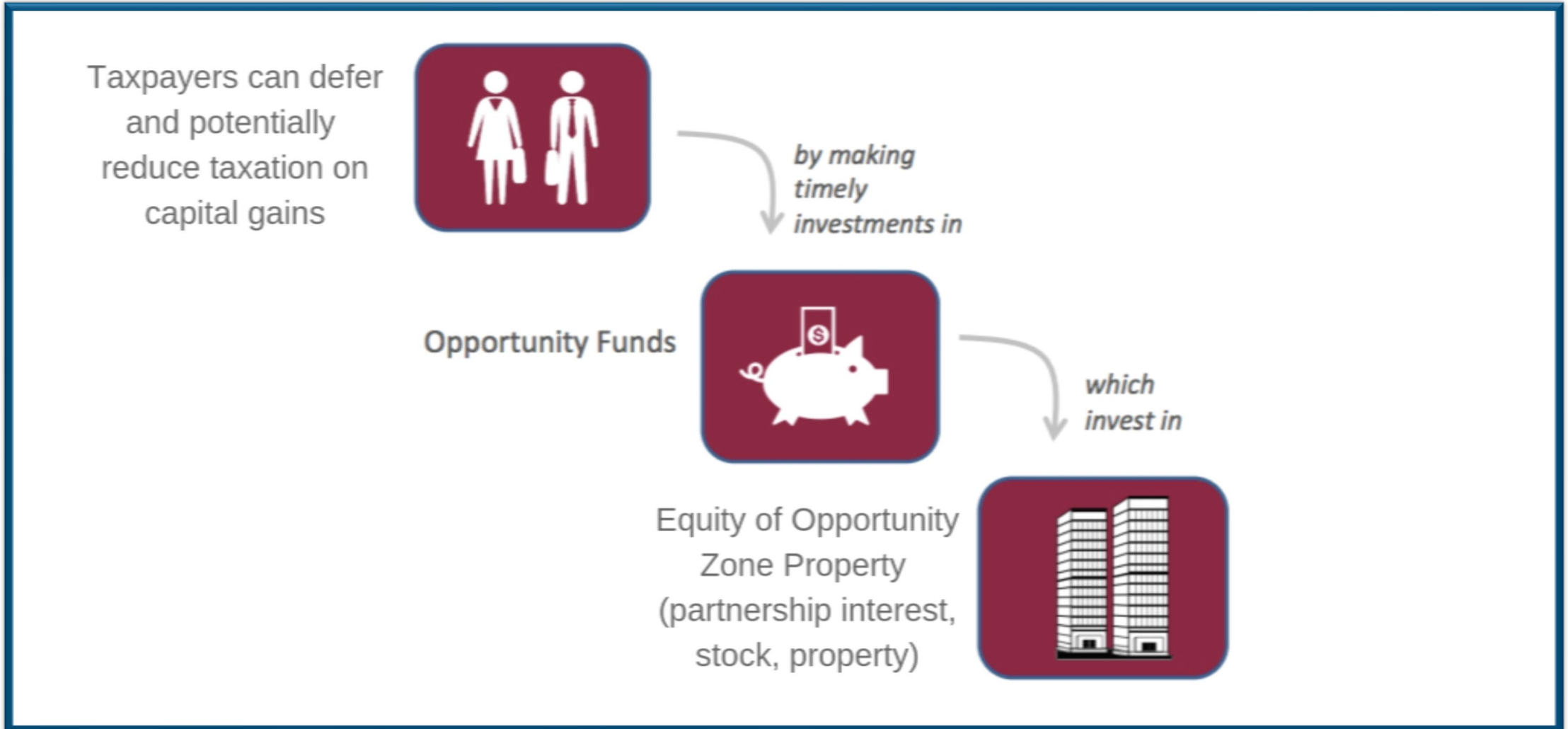


How and why these zones?

- For El Paso County zones, local city, county and economic development groups completed a **“rigorous process to nominate census tracts for Opportunity Zone status.”**
- Eligible census tracts had to have at least a **20% poverty rate** or a median **family income of no more than 80%**.
- Governors **could only designate 25%** of total number of low-income census tracts in the state.
- Department of Treasury approved the final certification of Opportunity Zones.
- Zones are certified and **locked in for 10 years.**



How do taxpayers benefit?





TAX PERSPECTIVE

Defer • Reduce • Eliminate

Up to three wins of “OZ Tax Benefits”

1

Defer paying tax on original capital gain.

2

Reduce tax owed on original gain.

3

Eliminate tax on new capital gain earned from OZ investment.

Original Capital Gain Tax Owed

2

1

Sale of qualified stock or business property.

Capital gain of \$1 million is realized; elect to defer.
You incur a \$200k in capital gain tax.

Invest \$1m gain in Qualified Opportunity Fund (QOF)

Within 180 days of sale.

Recognize original capital gain tax;
by Dec. 31, 2026.

Pay \$170k for original gain in 2026 tax filing.

CAPITAL GAIN TAX DEFERRED

2018

2019

2020

2021

2022

2023

2024

2025

2026

2027

2028

HELD FOR 5 YEARS

Waiting period begins to qualify for the reduced tax owed.

QOF Basis = \$0

HELD FOR 7 YEARS

10% reduction in capital gain tax owed.

QOF Basis = \$100k

+5% reduction in capital gain tax owed.
QOF Basis = \$150k

Reduction of Tax Owed



Example

When you invest the original capital gain of \$1M in a QOF, you will owe less of the original tax due when you hold the investment for:

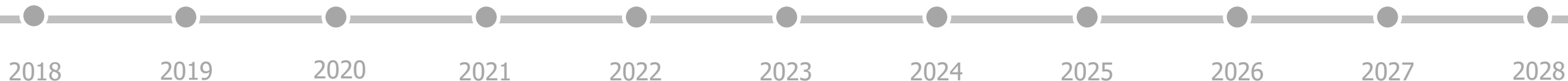
Hold Period (years)	Original Capital Gain Investment	Federal Capital Gain Owed (20%)	Reduction of tax owed on capital gain.	Unrealized Tax Savings (realized when paid)
0 – 4.11	\$1,000,000	\$200,000	0%	\$ -
5 – 6.11		\$180,000	10%	\$20,000
7+		\$170,000	15%	\$30,000

Elimination of tax on additional gains

Sale of qualified stock or business property.

Capital gain of \$1 million is realized; elect to defer.
You incur a \$200k in capital gain tax.

Invest \$1m gain in OZ Fund
Within 180 days of sale.



HELD FOR 5 YEARS

HELD FOR 7 YEARS

HELD FOR 10 YEARS

QOF Investment

Holding period begins.

QOF Basis = \$0

10% Step-up in basis
QOF Basis = \$100k

Complete elimination
of tax on new gain
earned from OZ
investment.

QOF basis = \$1m

QOF Basis = \$150k



INVESTING

Qualified Opportunity Funds (QOFs)

OZ investment types



Improve land with new vertical construction.



Renovate an existing building using basis plus \$1.



Start an operating business in an opportunity zone.

QOF Contributions

Win 1
Defer

- **Eligible for OZ tax benefit:** contributions that consist of:

Cash

Property (Does not qualify as QOZBP for asset tests)

Cash + Property (Combination)

Gains eligible for deferral

Win 1
Defer

- Capital gain must be from a sale to an unrelated party (e.g., lineal ancestors, direct descendants, siblings, 20% entity ownership).
- Only investments from capital gain deferrals qualify for OZ benefits.
Eligible gains:
 - Long term capital gain (including net §1231 gains, 28%).
 - Short term capital gain.
 - Net §1256 contracts.
 - Capital gain dividends including REIT/RIC.
- Not all gains from an event must be invested.
- No tracing requirement for the cash investment.

Deferral timing

Win 1
Defer



- Does not apply to sales after **12/31/2026**.
- Must invest in OZ fund **within 180 days**:
 - Direct sales – date of sale
 - Partners – last day of partnership’s taxable year or partner may choose the date of sale.
 - Partnership – date of sale
 - REIT/RIC dividends received – date dividend received. Undistributed dividends – last day of RIC or REIT’s tax year.
- No other deferrals allowed (includes like-kind exchanges and installment gains.)

QOF Contributions – important caveats



- **Service** contributions (i.e., carried interest, profit interests, “promotes”).
- **Mixed-fund investments** include contributions that are **eligible and ineligible** for OZ tax benefits.
- A capital gain interest with a **disproportionate allocation of profits** creates a mixed-fund investment where the **service component is taxed**.

Example: 25% of capital invested with 35% profit allocation. What qualifies for OZ tax benefit?

- 25% capital invested qualifies.
- 10% profit interest is taxed.

Basis in QOF Investment

- Initial contribution of deferred gains creates **ZERO** basis in QOF investment.
- Distributions in **excess of basis** can result in recognition of deferred gain.
- Debt-financed distributions **after 2 years** are generally allowed.

- Basis increased by **4 events**:

1. Income from a QOZB.

2. 10% of original investment in QOF after 5-year hold.

3. Add'l 5% increase of original investment after 7-year hold.

4. Allocation of debt in a QOF partnership.

Inclusion Events*

Inclusion Events

- S-Corporation – 25% aggregate change in ownership.
- Partnership – sale of a partnership interest when the partnership is invested in a QOF.
- Termination of the QOF.

Non-Inclusion Events

- Contribution of QOF interest to a grantor trust.
- S-Corporation election or revocation.
- Contribution to a disregarded entity.

*Not a comprehensive list.

Gift + Estate Tax Planning Issues

Transfer of QOF investment:

Via Gift

- Deferred gain is recognized regardless of whether the recipient is an individual or a tax-exempt entity.

Upon Death

- Is ***not*** an inclusion event unless there is a disposition by the estate, beneficiary or surviving owner, then the deferred gain is income in respect of a decedent (IRD).

Operations/Interim Gains

- **Operating income and loss:** treated the same as other investments.
 - Income is taxed; loss is subject to basis limitations, active/passive limitations.
- **Sale of QOZBP** (stock or property) before end of 10 year holding period is a taxable event.
 - Example: If QOF or subsidiary has three buildings and sells one in year 8, the sale will be taxed.
- **Reinvest:** QOF will have **12 months to reinvest** the QOZBP sale proceeds in other QOZBP.
 - If the proceeds are held in cash and cash equivalents during the 12 month period, the excess cash will meet the 90% test.

Disposal of QOF assets

Win 3
Eliminate

HELD FOR 10 YEARS

- After a **minimum of 10 years**, basis will be set to the fair market value at the time of sale.
- Appreciation beyond 10 years is **forgiven until 2047**.

Sale of Interest vs Sale of Assets

Win 3
Eliminate

HELD FOR 10 YEARS

Sale of Interest

- Excludes **ALL** gain from income.

Sale of Assets

- Exclude ONLY capital gain resulting **from sale of QOZBP**.
- Gain on non-QOZBP assets **is taxable**.
- Must recognize ordinary income.
- Example of ordinary income recognition is the sale of inventory and receivables or depreciation recapture on equipment.

State Tax Implication



- Colorado conforms to Federal law.
- Non-Colorado Opportunity Zone property may be taxed depending on each state's rules.
- In general consider:
 - State where gain was realized.
 - State(s) where the OZ fund has nexus, or sufficient physical presence.
 - State or residency of the taxpayer.

A close-up photograph of a hand holding a silver pen, poised to write on a document. The hand has light-colored nail polish. The document is slightly out of focus, showing some text and lines. A semi-transparent blue horizontal bar is overlaid across the middle of the image, containing the text 'OPERATING' and 'Qualified Operating Funds'.

OPERATING

Qualified Operating Funds

Qualified Opportunity Fund (QOF)

- **Intermediary between** investors and the investments in the Opportunity Zone.
- **Statutory Requirements:**
 - Organized as a **Corporation or Partnership**.
 - An **investment vehicle** organized for the **purpose of investing** in Opportunity Zone Property.
 - Investors must purchase interest in QOF for OZ benefits to apply.
- 90% of assets must be QOZBP.
- Certification process.
- Penalty imposed for noncompliance.

QOF Self-Certification

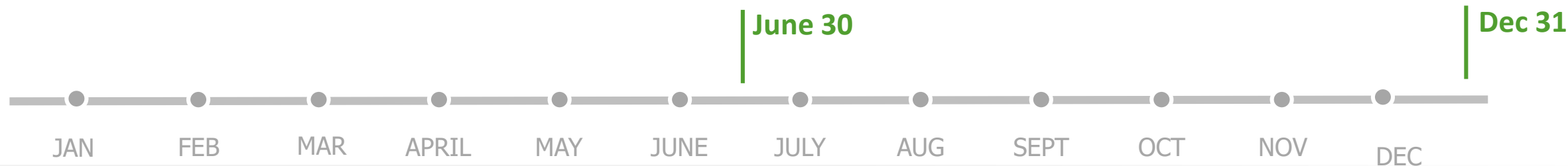
- A taxpayer completes **Form-8996**.
- Completed form is attached to the taxpayer's federal income tax return for the **taxable year the capital gain event occurred**.
- The return must be filed timely, taking extensions into account.
- Does not appear to be a cap on the number of QOFs or the amounts to be invested in the QOF.

Asset test for QOFs

Must hold at least 90% of assets (either QOZB or QZOBP) in Opportunity Zone Property, determined by the average of the percentage of Opportunity Zone Property held on:

The last day of the first six-month period of the fund's taxable year.

The last day of the fund's taxable year.



QOF: Noncompliance Penalty for 90% Requirement

- No is a **monthly penalty** for noncompliance.

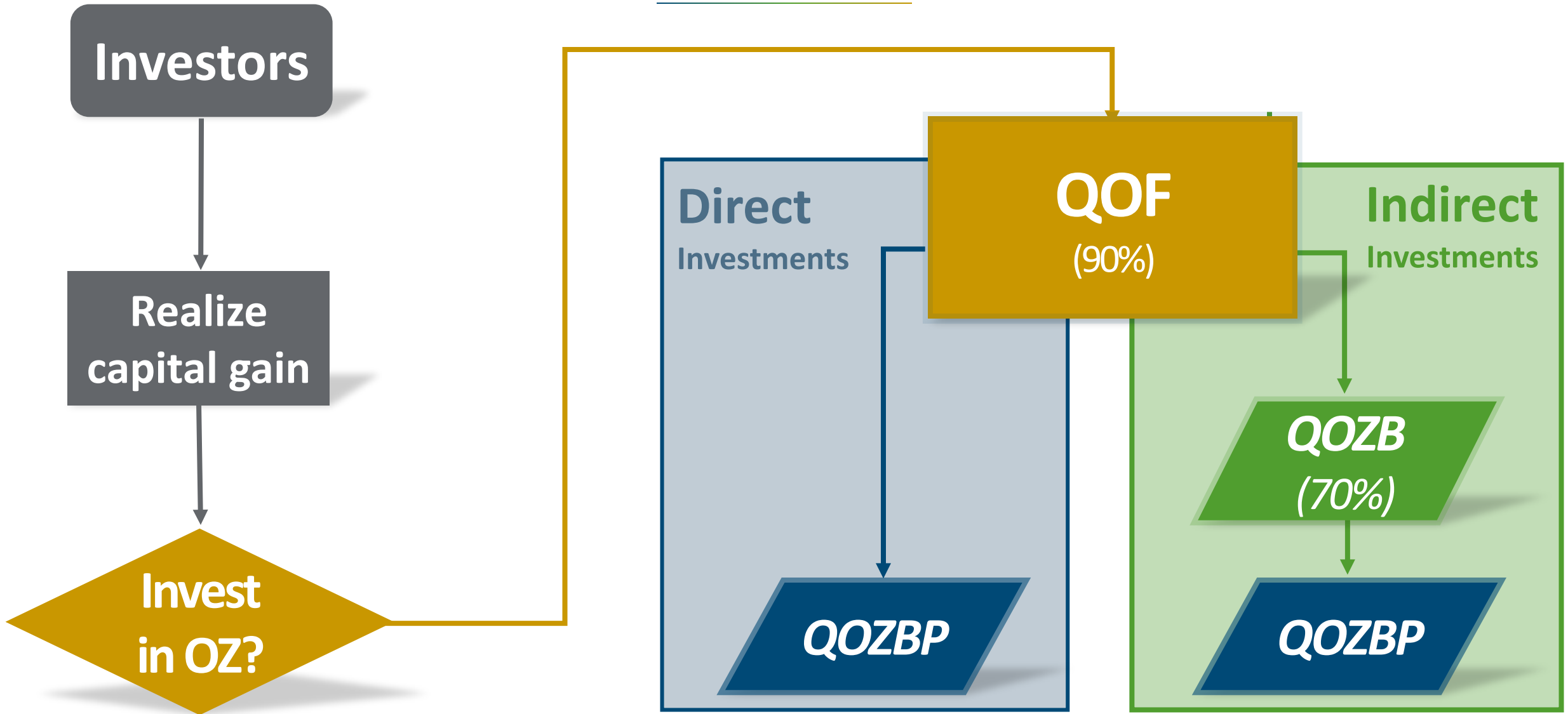
$$\text{Monthly penalty} = \frac{\% \text{ Shortfall}}{\text{Underpayment Rate}}$$

Underpayment rate = Federal short-term rate plus 3%, **Currently 5%**

- No penalty if failure is due to **reasonable cause**.
- Penalty QOF Partnerships: Penalty **imposed upon the Partners**.

Note: QOF can elect to ignore un-deployed capital contributed within prior 6 months for purposes of the 90% test.

Qualified Opportunity Fund



Direct v. Indirect OZ Investments

Direct Investment (QOF directly owns QOZBP and operates business)	Indirect Investment – Preferred Method
90/10 Test If a Qualified Opportunity Fund (QOF) does not hold interest in subsidiaries, 90% of its assets must be Qualified Opportunity Zone Business Property (QOZBP).	70/30 Test
No working capital safe harbor ; absent further guidance, all cash would be counted toward the 10% of assets that can be non-QOZBP.	Working Capital Safe Harbor applies to allow unlimited amount of cash as long as entity substantially complies with a written plan of deployment of a trade or business including acquisition, construction and/or rehabilitation of property.
No active conduct standard.	50% gross income from active conduct of trade or business.
No prohibition on sin businesses.	No sin businesses.
No specific reference to the lease of property directly by a QOF.	A QOZB is able to lease property.
As currently written, this 5-year grace period does not apply to QOZBP held directly by a QOF.	Statue provides a 5-year grace period for characterization of property held by a QOZB as QOZBP.

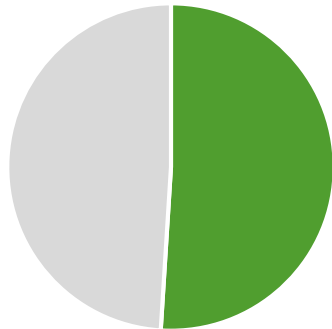
Indirect Investment: QOZB - Stock and Partnership Interests



- The investment must be **acquired after December 31, 2017** in exchange for cash;
- Must be a **qualified opportunity zone business**, or is being organized for the purpose of being a qualified opportunity zone business;
- Must remain a qualified opportunity zone business for **substantially all** of the qualified opportunity fund's holding period.

QOZB

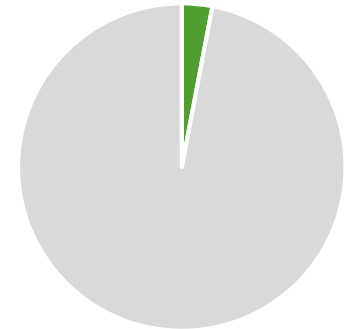
A trade or business in which **substantially all (70% of assets used in QOZ for 70% of the time during 90% of the holding period = 40%)** of the tangible property owned or leased by the taxpayer is located in a **qualified opportunity zone** and:



At least 50% of income derived from Active Conduct.



40% of intangible property used in active conduct of business.



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

QOZB: Excluded Businesses

QOZB

Cannot 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.



Direct Investment/QOZ Business Property

QOZBP



QOZ business property (QOZBP) is tangible property meeting the following requirements:

1. Acquired or leased after December 31, 2017.
2. The “original use” commences with the QOF or the QOF has “substantially improved” the property.
3. Substantially all of the use of the property is within a QOZ.

QOZBP: Acquired and Original Use

- Property must be purchased by the QOF/QOZB from a non-related party.
- **Property contributed to the QOF is eligible for the deferral election but NOT the acquisition provision.**
- Tangible property “Original use” – initial use for depreciation or amortization purposes must be in QOZ. E.g. QOF/QOZB purchases a used personal use vehicle – it would qualify because not previously depreciated.
- Buildings vacant for over 5 years purchased by a QOF/QOZB qualify.
- Vacant land purchased by a QOF/QOZB qualifies.
- Leased property may qualify as QOZBP.

QOZPB: Substantial Improvement

QOZBP



- Substantial improvement to an existing building within the OZ occurs if within 30 months after acquisition, additions to basis in the BUILDING (not Land) exceed the building's basis.
- Example: Property acquired for \$1M. Land is \$200k, Building is \$800k. Improvements must exceed building basis of \$800k, i.e. \$800,001.

Planning ideas: QOFs



- **Debt** can be a powerful tool within a QOF:
 - Debt allocated in a partnership QOF **gives rise to basis for loss deductions.**
 - Debt financed distributions are allowed two years after capital is contributed.
 - For investors/developers with §1231 gain: Consider **using debt as an initial funding** source to get projects started before year end.
- Partnerships are the structure with the **most flexibility for a QOF**, especially for a real estate holding.
- Consider a **land lease** with land held prior to 12/31/17.
- No **triple-net leases**; use a gross lease. NNN's are also harder to qualify under 20% QBI deduction.

Planning ideas: Operating Business



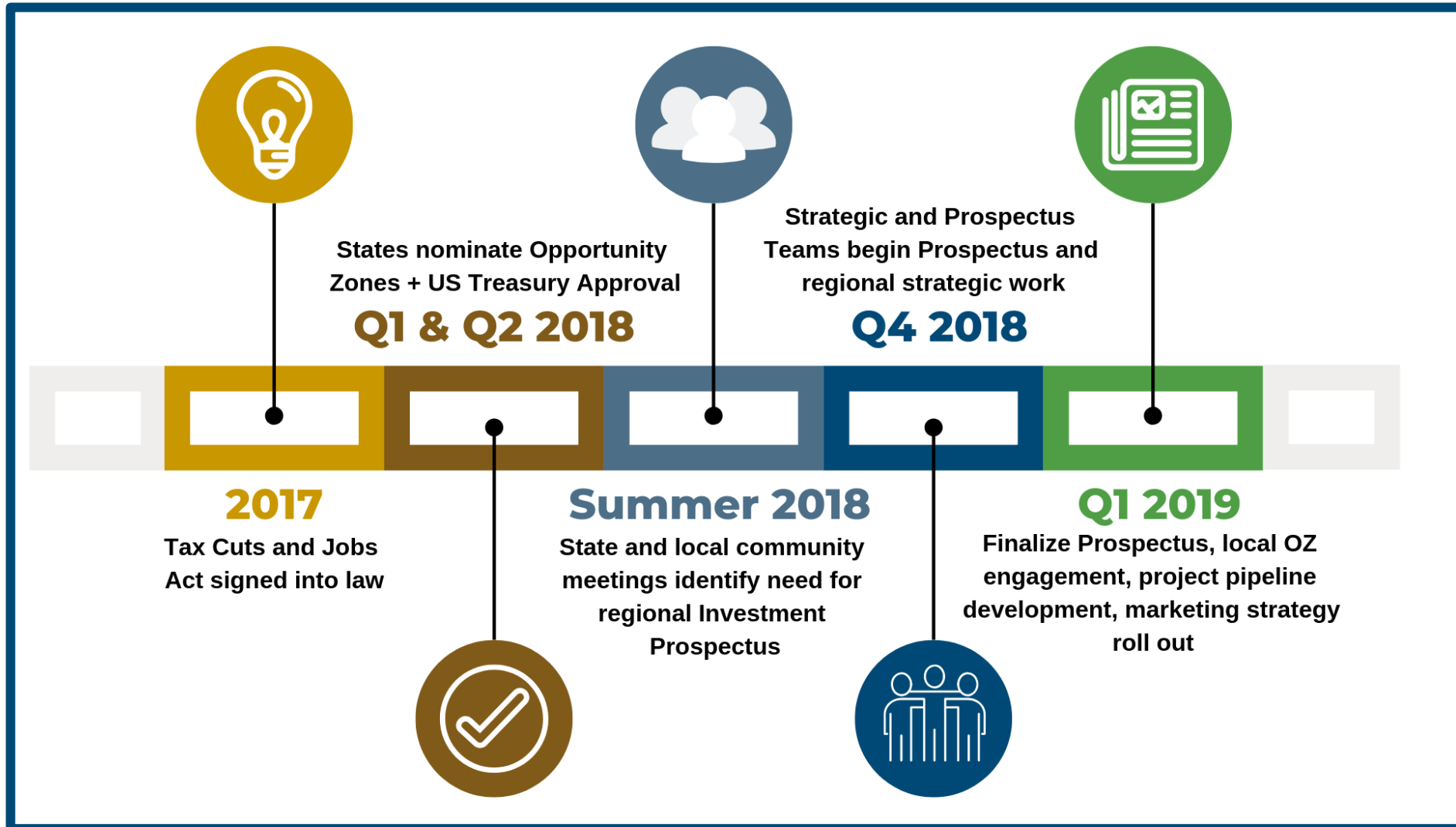
- Rules are geared to **new businesses**.
- All assets of an existing business are considered in asset tests.
- Difficult for an existing business to meet the QOZB requirements unless the business is **geared for growth** and a significant **capital spend** or a **new capital lease**.
- Consider creation of a **separate subsidiary** for a new location within the OZ.
- Leased premises within the OZ help increase QOZBP base.
- Inventory is included in Asset tests.
- Test is **asset driven** not employee driven.



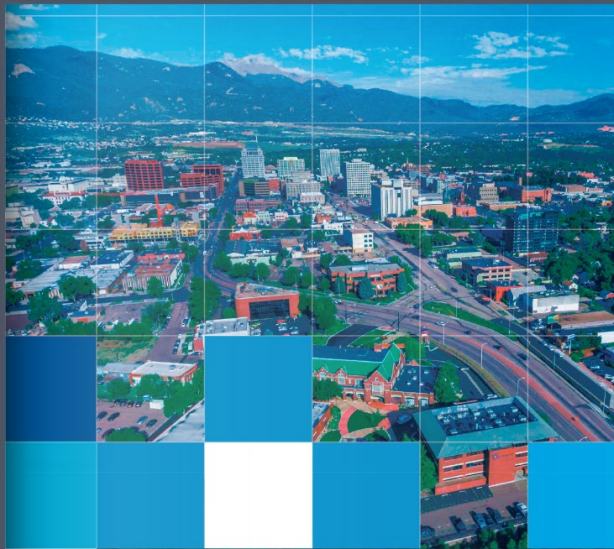
Local Initiatives

Pikes Peak region

COS strategic timeline for OZ investments



Prospectus



REGION ON
THE RISE

COLORADO SPRINGS REGION OPPORTUNITY ZONES

www.coloradospringschamberedc.com/doing-business/opportunity-zones/

OPPORTUNITY ZONE

Downtown Colorado Springs

Headlines tell the story of a reinvigorated downtown Colorado Springs: construction cranes, new business, improved streetscapes and connections, and much more.

Lured by a walkable environment, robust workforce concentration, one-of-a-kind shops, trail connectivity, state designation as a creative district and the largest concentration of locally owned restaurants in the region, developers and investors are rediscovering the value of Colorado Springs' city center.

That's amounted to nearly \$1 billion in new investment into downtown in recent years, and the pipeline of new projects and investment continues to swell.



Zone Spotlight



Southwest downtown

Leveraging a Smart City partnership with Panasonic, this \$1.8 billion new mixed-use district will include residential, office, retail and civic amenities. Anchoring it is the U.S. Olympic Museum and Hall of Fame opening in 2020 and a new outdoor stadium slated for 2021.



Urban living and hospitality

The downtown residential market has taken off, with 600 units recently completed or in the near-term pipeline. Demand also has surged for new hotels, with four new properties encompassing more than

Key Sectors

- ★ Hospitality
- 🏠 Multifamily
- 💻 IT & cybersecurity

Active Investment

- Urban Renewal Authority
- State Regional Tourism Act
- Higher ed institutions
- Pikes Peak Enterprise Zone
- Downtown Development Authority
- Private investment

Local efforts for OZ investments

- Tools available to spur investments.
- OZ project pipeline.





Questions?

Thank you!

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