CHUHAK&TECSON, P.C.
attorneys at law

# Opportunity Zones

## Considerations Surrounding Qualified Opportunity Zone Under the Tax Cuts and Jobs Act (2017)

chuhak.com

# Our Firm

At Chuhak & Tecson, your concerns become our concerns.

Our attorneys have the depth of experience to understand what you need and how to achieve results efficiently and effectively. We also help you look ahead to prevent problems down the road.

We work with you closely to develop legal solutions that are customized to meet your needs—and priced affordably.

Our strength lies in our reputation, our knowledge and our commitment to doing what's right for our clients and our community.

# Practice Groups

- Aviation Litigation & Transactions
- Banking
- Condominium & Common Interest Community Association
- Corporate Transactions & Business Law
- Employment
- Estate & Trust Administration & Litigation
- Estate Planning & Asset Protection
- Healthcare
- Litigation
- Not for Profit & Mission-Based Organizations
- Real Estate
- Tax & Employee Benefits

# Right there with you.℠

## Direct contact

Right from the start, you'll have the attention of highly qualified attorneys who work side-by-side with you to understand your unique situation and provide solutions customized to fit your needs.

## Smart answers

We foster collaborative communication within our firm to offer you the best counsel possible. You'll have the assurance of knowing your legal needs are being addressed by a team of highly knowledgeable attorneys working together on your behalf.

## We listen

Then we decide how best to solve your problem or support your goals, and we respond quickly. Our attorneys draw from years of experience to analyze the issues efficiently and help you develop attainable, cost-effective blueprints for success.

## Bigger picture

Our attorneys have the sophistication and foresight to not only address the needs at hand, but also recognize issues that may arise down the road. Thinking holistically, we tailor our advice to your best interests in order to always stay a step ahead in moving your goals forward.

# About Speaker: Kevin M. Coyne

- Practice Group Leader of Chuhak & Tecson, P.C.'s 19-attorney Real Estate Practice Group
- Practice Areas Focus on Commercial Real Estate Transactions and Related Municipal and Zoning Concerns
- Currently Serves on the City of Naperville City Council and formerly served on both the City of Naperville Plan Commission and City of Naperville Fair Housing Advisory Commission
- Holds an advanced law degree (LL.M.) from the John Marshall Law School's Real Estate Law Program
- Nearly 20 years experience as a real estate attorney in private practice

# What Are Opportunity Zones

- An Opportunity Zone is a community nominated by the state in which is located (and certified by the Treasury Department as qualifying for this program)
- As of June 14, 2018, the department certified zones in all 50 states
- Approximately 8,700 Opportunity Zones nationwide. A list can be found at https://www.cdfifund.gov/pages/opportunity-zones.aspx
- Opportunity Zones promise to direct potentially massive amounts of cash investment into America's most impoverished communities by offering wealthy investors and corporations a chance to erase their tax obligations
- *"If we can get the trillions of dollars of capital off the sidelines and get the best investment minds coming into our communities, we can end up creating jobs and opportunity".---U.S. Senator Cory Booker (D-NJ)*

# Why Were Opportunity Zones Created

- Intended to address persistent poverty in communities that are not attracting investment
- Incentivize investors to develop in under-served regions in exchange for significant tax breaks
- Designed to address largely urban areas that are not showing signs of economic resurgence or development
- As many as 50,000,000 Americans live in areas that could be described economically depressed
- *"In the Opportunity Zones, the poverty rate is over 30 percent…I look at it from a common-sense perspective and I ask myself, 'Is there a way for me to positively impact the lives of 50 million Americans by providing an incentive to unlock investments for those areas?"*---U.S. Senator Tim Scott (R-S.C.)

# How Do Opportunity Zones Encourage Development

- Temporary tax deferral for capital reinvested in an opportunity fund. No capital gain on disposed asset until 2026
- Step-up basis for capital gains reinvested in an opportunity fund. 10% step up if held 5 years, 15% step up if held 7 years (i.e. the gain is not just deferred, it is reduced!)
- Permanent exclusion from taxable income of capital gains from the sale or exchange of investment in an opportunity fund, if the investment is held for a minimum of 10 years
- **Benefits do not just apply to real estate**. Investments in businesses, business equipment and business property also can benefit
- *"The resources of the whole federal government will be leveraged to rebuild low-income and impoverished neighborhoods that have been ignored by Washington in years past."* ---U.S. President Donald Trump

# Public Policy Concerns

- Opportunity Zones will simply shift and relocate development, not create more development
- Opportunity Zones will lead to market rate development in poor communities that will displace, not help, the poor
- Track record of location-based incentives actually working is not strong
- The location of the Opportunity Zones is political, and some zones are far more distressed then others
- Huge incentives given away to developers with **little monitoring** as to whether the development actually benefitted the community
- *"There is a risk that instead of helping residents of poor neighborhoods, the tax break will end up displacing them or simply provide benefits to developers investing in already-gentrifying areas."*---Adam Looney, Tax Policy Center

# Who Is The Ideal Investor for Opportunity Zone Funds

- The investor is facing a large capital gain
- The investor is patient, well diversified, and willing to have investment tied up for lengthy period of time
- An investor  that cannot satisfy the requirements of a 1031 (such as the "like kind" requirement)
- The investor is liquid and not likely to need cash in short term
- The investor is not risk adverse and is otherwise properly diversified
- *"The goal was to make these funds accessible enough so that it wouldn't be only large institutional players that can participate."*

---John Lettieri, President and CEO of the Economic Innovation Group

# Where are the Qualified Opportunity Zones

- All the Qualified Opportunity Zones in the United States are divided by census tract in each state and outlined on the IRS website found athttps://www.irs.gov/pub/irs-drop/n-18-48.pdf
- The Qualified Opportunity Zones in Illinois are spelled out in more detail at the Illinois Department of Commerce and Economic Opportunity website found at https://www2.illinois.gov/dceo/Pages/OppZn.aspx
- Opportunity Zones in Chicago are highlighted on the City of Chicago website found at https://www.chicago.gov/city/en/depts/dcd/supp_info/opportunity-zones.html
- These "qualified opportunity zones" will be designated through a nomination of census tracts qualifying as "low-income communities" by the governor of each state and certified by the Treasury Department. There are limits on how many tracts that a governor can nominate (25% of eligible tracts can be nominated)
- Illinois has 327 Opportunity Zones (135 Opportunity Zones are in Chicago)

# How Do You Invest into Opportunity Zones

- Establish the Qualified Opportunity Zone Fund
- The Qualified Opportunity Zone Fund can be either a partnership or corporation. Specify the purpose is investing in Opportunity Zones
- At least 90% of the Assets in the Fund need to be in Qualified Opportunity Zone Property
- At least 50% of the Income derived by the fund need to be from Qualified Opportunity Zone Property
- Required to "self certify" that the requirements to treat as Qualified Opportunity Zone have been met on IRS Form 8996 (still being finalized).
- To preserve gain deferral, proceeds need to be invested within 180 days. <u>**Substantial improvement**</u> of the acquired property is also required
- Lots of reporting and tax filing questions exist. The tests above can be very complicated

# How Do OZ Funds Differ From 1031 Like Kind Exchanges

- Qualified Opportunity Zone Funds don't just defer capital gains, they can reduce them
- Qualified Opportunity Zone Funds do not require the involvement of an intermediary to hold the cash like 1031 Exchange does
- 1031 Exchanges only involve real estate, Qualified Opportunity Funds can involve any Qualified Property
- 1031 Exchange usually involve the acquisition of just one asset. Qualified Opportunity Fund can involve pools of a great many assets.
- Qualified Opportunity Funds don't require the acquisition of "Like" property
- 1031 Exchanges may be better suited for someone who might be looking to liquidate the asset in a short timeframe

# How Do Opportunity Zones Impact Other State Incentives

- In summary, there is no impact. It is possible to qualify as a Qualified Opportunity Zone Property AND receive state incentives such as tax increment financing
- Note the time restrictions have to be carefully monitored for purposes of deferring gains through the Qualified Opportunity Zone Fund

# Are There Disadvantages to Investing in Opportunity Zones

- Almost by definition, the investments are high risk and in areas that have not traditionally proved to be a source of good returns
- Poor diversification. The fund will be invested entirely into areas that have similarly poor track records as an investment
- Lots of uncertainty and technical tax questions remain unanswered. Tax preparers have no shortage of questions
- What happens on December 31, 2028 when the law creating Opportunity Zones is set to expire?
- There is a reason the federal government had to offer significant incentives to lead investors toward Opportunity Zones, they are often going to be higher risk investments
- 180 Days requirement to reinvest proceeds
- Obligation to <u>substantially improve</u> the Qualified Opportunity Zone Property

# What is Coming Next With Respect to Opportunity Zones

- More Treasury Department guidance is coming with respect to how Qualified Opportunity Zone Funds will be dealt with tax-wise
- Form 8896 , the “Self Certification” form, will be finalized (it is currently in draft form)
- Billions of dollars have been collected in by numerous already established funds that will be invested in Opportunity Zones
- Questions will be asked whether or not the funds are having the social impact that was intended
- If these funds are not clearly benefitting the neighborhoods intended to be helped, it may be viewed as a developer giveaway and unlikely to be renewed in Congress

# What has Happened in the Market with Respect to Opportunity Zone Funds

- Little by way of actual closed deals…that will change soon
- Large investment funds are being formed and focus on Opportunity Zones. Billions of dollars in capital is being sourced in these funds
- Lingering questions about tax reporting and administrative concerns surrounding the funds have stymied the funds
- Very significant amount of policy debate and study is going on right now with respect to these transactions
- Though few actual deals have occurred yet though it is expected that will change as Treasury Regulations clarify administrative questions surrounding these funds
- Capital Gain funds can be parked for up to 31 months before being invested.

# Conclusion

- The tax advantages offered to a Qualified Opportunity Zone Fund investor are very significant
- The risks are very significant as well. The qualifying areas by definition are high risk investments
- The idea underlying these funds presumes a long time hold and substantial improvement of the asset in order to qualify
- Such limitations and requirements do not exist with respect to 1031 investors
- Tread carefully with small investors that could need the cash value of their investment in the near term
- Be aware that the cost of a bad investment, that your client is expected to hold onto and improve, may not be worth the tax savings

# Questions?

Kevin Coyne

(312) 855-5441

kcoyne@chuhak.com