

Opportunity Zones And Opportunity Zone Funds – *How Can Your Municipality Benefit?*

85th Convention of the Arkansas Municipal League
Little Rock, Arkansas

General Session 2
Statehouse Convention Center
Governor's Hall IV
Friday, June 14, 2019
11:00 A.M. to 12:00 P.M.



GILL
RAGON
OWEN
ATTORNEYS



Presiding:

- **Mayor Joe A. Smith**, City of North Little Rock
 - President, Arkansas Municipal League

Panelists:

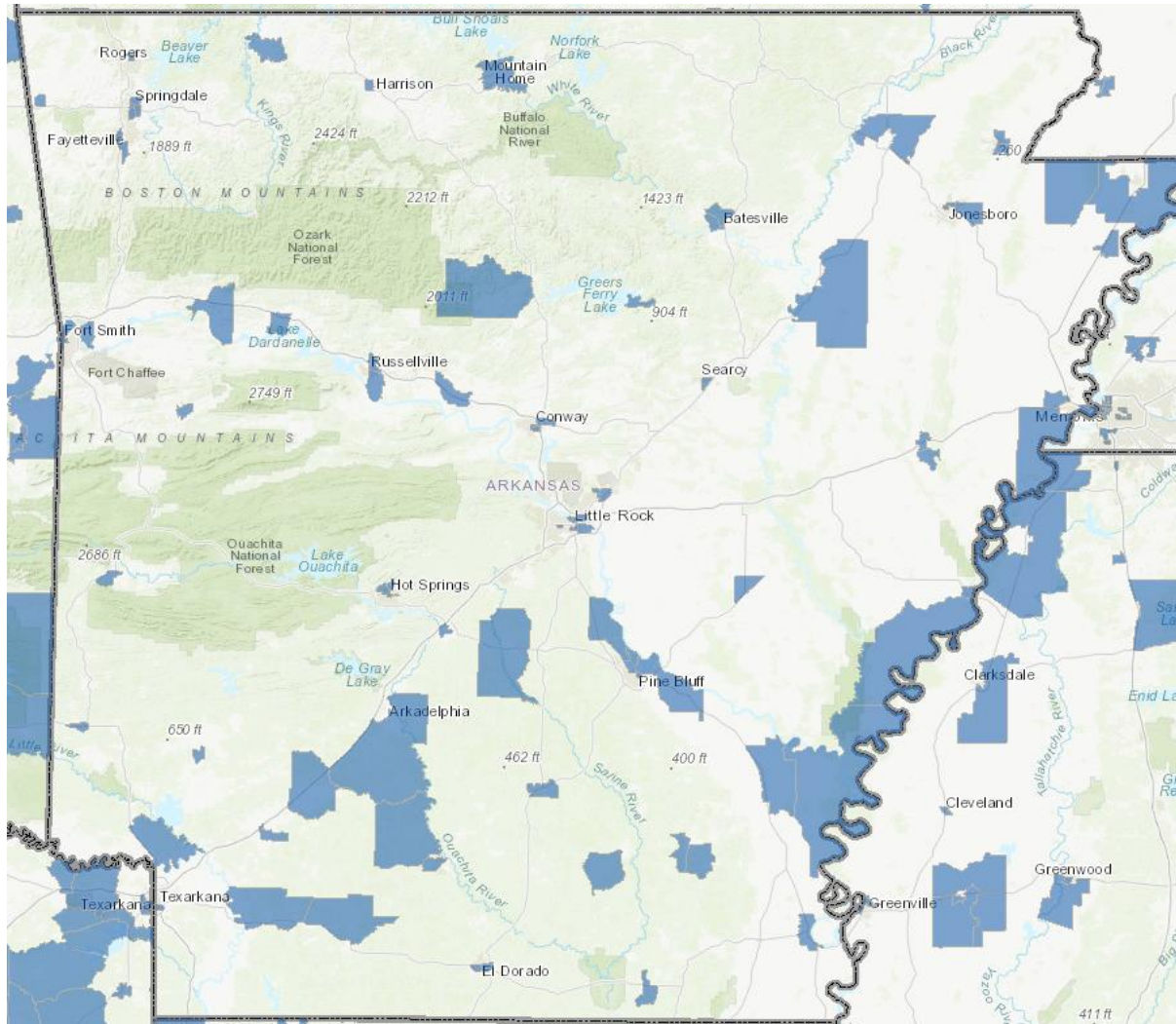
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 - City of Jonesboro



Presentation Agenda

- **Bryan:** Introduction -- Background on Arkansas Opportunity Zones
- **Adam:** Brief Overview Of Opportunity Zone Tax Benefits
- **Chris:** What Constitutes A Qualified Opportunity Zone Business?
- **Mike:** The 6 Ps of OZ Promotion
- **Q & A**

Arkansas Opportunity Zones

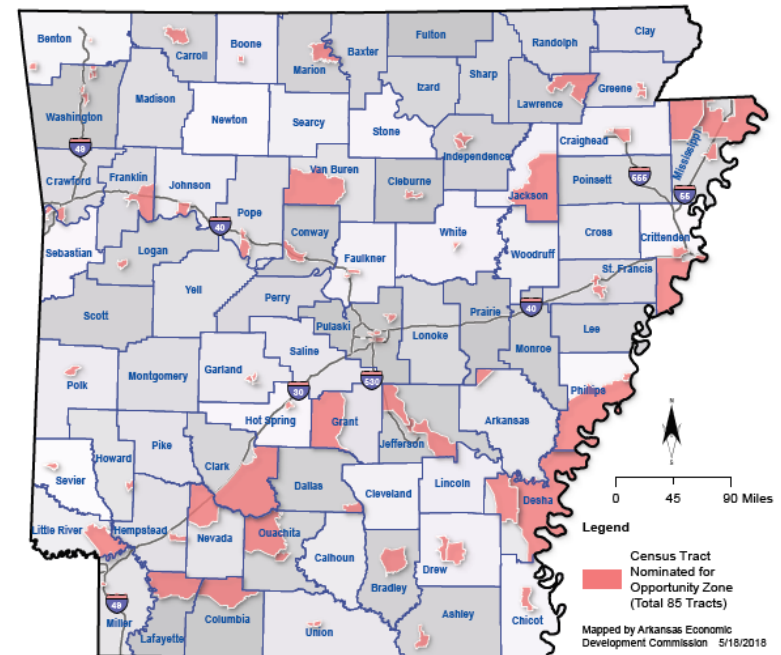


ARKANSAS OPPORTUNITY ZONE CENSUS TRACT NOMINATIONS

Approved by U.S. Treasury Department on 5/18/2018

To view details on an interactive map, [click here](#)

Nominated	Count	Nominated	Count	Nominated	Count
Arkansas	1	Crittenden	2	Howard	1
Stuttgart	1	Marion/ West Memphis	1	Nashville	1
05001480400		05035030703		05061950300	
Ashley	1	West Memphis/		Independence	2
Crossett	1	Edmondson/	1	Batesville	2
05003960600		Anthonyville/		05063490200	
Benton	2	Horseshoe Lake		05063490600	
Rogers	1	05035030600		Jackson	1
05007020301		Dallas	1	Beebeville/Newport/Grubbs/	1
Siloam Springs	1	Fordyce	1	Amagon/Weldon/Tupelo	
05007021101		05039970300		05067480400	
Boone	1	Desha	2	Jefferson	4
Harrison	1	Arkansas City/Watson	1	Pine Bluff	3
05009790501		05041950100		05069000502	
Bradley	1	Dumas/Mitchellville	1	05069001000	
Warren	1	05041950200		05069002500	
05011950300		Drew	2	Redfield	1
Carroll	1	Monticello	2	05069002400	
Berryville	1	05043490300		Johnson	1
05015950300		05043490400		Clarksville	1
Chicot	1	Faulkner	3	05071952000	
Lake Village	1	Conway	3	Lafayette	1
05017080300		05045030403		Buckner/Stamps/Lewisville	1
Clark	1	05045030702		05073470100	
Gurdon/Gum Springs/		05045030900		Lawrence	1
Whelen Springs	1	Franklin	1	Portia/Walnut Ridge/	
05019953900		Ozark/Altus/Denning	1	College City	1
Cleburne	1	05047950200		05075470100	
Heber Springs	1	Garland	3	Little River	1
05023480300		Hot Springs	3	Ogden/Ashdown	1
Columbia	1	05051010700		05081030102	
Magnolia/McNeil/Waldo	1	05051010800		Logan	1
0502795200		05051011500		Booneville	1
Conway	1	Grant	1	05083950500	
Morrilton	1	Poyen/Tull/	1	Marion	1
05029950300		Prattville/Leola		Flippin	1
Craighead	3	05053470300		05089960202	
Jonesboro	3	Greene	2	Miller	1
5031000101		Paragould	2	Texarkana	1
05031000502		05055480500		05091020500	
05031000602		05055480700		Mississippi	3
Crawford	1	Hempstead	1	Burdette/Dell/Blytheville	1
Van Buren/Fort Smith	1	Hope	1	05093010700	
05033020501		05057480300		Manila/Leachville	1
Hot Spring	1	05093010800		05093010800	
Rockport/Malvern	1	Osceola	1	05093011100	
05059020200					



Nominated	Count	Nominated	Count	Nominated	Count
Nevada	1	Pulaski	8	Union	2
Prescott	1	Little Rock	4	El Dorado	2
05099090200		05119000200		05139950900	
Ouachita	2	05119001800		05139951000	
Camden	1	05119004600		Van Buren	1
05103950600		05119004700		Clinton	1
Camden/Chidester/		North Little Rock	3	05141460200	
Reader	1	05119002500		Washington	6
05103950200		05119002800		Fayetteville	1
Phillips	2	05119003001		05143010600	
Helena-West Helena	1	Sherwood/Jacksonville	1	Greenland/Fayetteville	1
05107480400		05119003605		05143011101	
Helena-West Helena/		Sebastian	3	Springdale	2
Lake View/Elaine	1	Fort Smith	3	05143010200	
05107480600		05131000200		05143011200	
Polk	1	05131000300		Springdale/Fayetteville	2
Mena	1	05131000800		05143010302	
05113950400		Sevier	1	05143010301	
Pope	2	De Queen	1	White	1
Pottsville/Russellville	1	05133080300		Searcy	1
05115951600		St. Francis	2	05145070800	
Russellville	1	Forrest City	1	Grand Total	85
05115951300		05123960400			
		Caldwell/Forrest City	1		
		05123960600			

Opportunity Zone Tax Benefits - Overview

- **What are Opportunity Zones?**

- An Opportunity Zone is an existing census tract that has been designated as a “qualified” zone through which investors can receive substantial tax benefits for investments made within the zone.
- The Tax Cuts and Jobs Act of 2017 created the Opportunity Zones (“QOZ”) program under IRC Sections 1400Z-1 and 1400Z-2 as a way to incentivize private sector investment in low income areas.

- **Where are we now?**

- On May 18, 2018, the Department of Treasury approved Arkansas’s 85 nominated census tracts.
- On October 19, 2018, the IRS issued a first set of proposed regulations on QOZs.
- On April 17, 2019, the Treasury released the second set of regulations which provide more clarity to investors.
- Arkansas adopted 1400Z-2 on February 26, 2019.

- **Terminology:**

- **QOZ** or **Zone**: Qualified Opportunity Zone
- **QOF** or **Fund**: Qualified Opportunity Fund
- **QOZB**: Qualified Opportunity Zone Business
- **QOZBP**: Qualified Opportunity Zone Business Property

Opportunity Zone Tax Benefits - Basics

Three Main Tax Benefits For Investors:



Initial deferral of tax: Investors with existing capital gains from the sale or exchange of prior investments can elect to defer paying tax on these capital gains by investing an amount up to such gains into a qualified opportunity fund (QOF) within 180 days following the date of the sale or exchange giving rise to the original gain (“old gain”). This deferral lasts until the earlier of 2026 or upon exit from the QOF.



Reduction of tax on deferred capital gains after 5 & 7 years: Investors can receive a permanent reduction of tax on their deferred capital gain after holding their investment in a QOF for 5 and 7 years.

- 10% reduction after 5 years (via basis step up)
- 15% reduction after 7 years (via basis step up)



Exclusion of capital gains tax after 10 years: Investors can exclude tax on the appreciation of QOF investments after 10 years (“new gain”) by receiving a full step up in basis to their market value of the QOF investment valued as of the date the investment is sold

Qualified Opportunity Zone Investing



One or more investors defer tax on existing capital gains by investing cash in a Qualified Opportunity Fund (QOF)

The QOF receives capital from investors and must identify properties and/or businesses located in Qualified Opportunity Zones (QOZs) with development potential

The QOF invests capital in QOZ projects located in one or more cities, jumpstarting business development and economic activity

Opportunity Zone Tax Benefits - Important dates

- **December 31, 2017**
 - The date that serves as a “cutoff” date for purposes of determining which property counts as “qualified” property
- **December 31, 2019**
 - The latest date a QOF investment can receive the 7-year, 15% capital gain reduction (i.e., the latest date that investors seeking to take advantage of *all* the QOZ tax benefits must invest in a QOF)
- **December 31, 2021**
 - The latest date a QOF investment can receive the 5-year, 10% capital gain reduction
- **December 31, 2026**
 - The date on which investors must pay capital gains on their initial deferred capital gains (possibly reduced by the 10% or 15% reduction)
- **December 31, 2037**
 - The latest date a QOF investment can receive the 10-year “new gain” exclusion
- **December 31, 2047**
 - The last day investors may elect to exclude “new gain” on their QOF investment (i.e., after a 10-year hold)

General Anti-Abuse Rule

- **New Anti-Abuse Rule:** If a significant purpose of a transaction is to achieve a tax result that is inconsistent with the purposes of the OZ rules (based on all of the facts and circumstances), the IRS Commissioner is able to recast the transaction (or series of transactions) for federal tax purposes in a manner that achieves tax results consistent with those purposes.
- **Purpose:** The Preamble to the 2019 proposed regulations describes the purposes of the OZ program as follows:
 - [Sections 1400Z-1](#) and [1400Z-2](#) seek to encourage economic growth and investment in designated distressed communities (qualified opportunity zones) by providing Federal income tax benefits to taxpayers who invest new capital in businesses located within qualified opportunity zones through a QOF.

QUALIFIED OPPORTUNITY ZONE BUSINESS

- ❑ **TRADE OR BUSINESS:** Must be a “trade or business” as defined in Section 162 of the Code.
 - **NOTE:** The ownership and operation (including leasing) of real property is considered the active conduct of a trade or business. However, merely entering into a triple-net-lease with respect to real property owned by a taxpayer is not considered the active conduct of a trade or business by such taxpayer.
- ❑ **NO SIN BUSINESS:** Trade or business must NOT be 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.
- ❑ **MUST MEET ALL OF THE FOLLOWING:**
 - ❑ **THE 70% TEST;**
 - ❑ **THE 50%-OF-TOTAL INCOME-TEST;**
 - ❑ **THE INTANGIBLE PROPERTY TEST; and**
 - ❑ **THE NONQUALIFIED FINANCIAL PROPERTY TEST.**

Opportunity Zone Business Requirements

- If the QOF invests in a business (i.e., invests indirectly into a partnership or corporation), rather than directly investing in QOZBP itself, then that business must meet the following **five tests** in order to be a “qualified” opportunity zone business:
 1. At least 70% of the property owned or leased by the business in a QOZ is QOZBP during at least 90% of the holding period.
 2. The business derives at least 50% of its gross income from the active conduct of a trade or business in a QOZ.
 3. Use of at least 40% of its *intangible* assets in an “active” business.
 4. No more than 5% of the assets can be financial assets.
 5. No “sin” business investments (disqualified-business test):
 - Any 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 the premises.

QOZB's: 50% Gross Income Safe Harbor Tests

- **More Businesses May Now Qualify:**

- To qualify as a QOZB, the business must derive **at least 50 percent** of its total gross income during a taxable year from the active conduct of a qualified business in a zone. The new proposed regulations provide four safe harbor tests for determining whether a business meets this standard.

- **Four Tests Available For A Business To Qualify:**

1. **Employee Hours**: at least 50% of it's employees or independent contractors' hours are performed within the QOZ.
2. **Employee Wages**: at least 50% of its employees or independent contractors' wages are from services performed within the QOZ.
3. **Revenue**: at least 50% of the gross income is generated by tangible property of the business in the QOZ and the management or operational functions performed for the business in the QOZ.
4. **Facts & Circumstances**: at least 50% of the gross income of the trade or business is derived from the active conduct in the QOZ.

QOZBP: What Qualifies as Qualified Opportunity Zone Business Property?

- **QOZBP** is tangible property used in a trade or business of the QOF or QOZB within an opportunity zone if (among other requirements):
 - (i) the property is acquired by the qualified opportunity fund **by purchase** after December 31, 2017 from an unrelated person, and
 - (ii) either the **original use** of the property in the opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund “**substantially improves**” the property by doubling the basis of the property over any 30-month period after the property is acquired, and
 - (iii) **substantially all** of the use of the property is within an opportunity zone.

QOZBP: “Original Use” Requirement

- **New Relief From “Original Use” Test:**

- Originally, QOZBP was “tangible property used in a trade or business of a QOF, but only if” (among other things) “the **original use** of the property in the QOZ **commences with the QOF.**”
- The new regulations now provide further that the **original use** of tangible property acquired by any person **commences on the date** when that person or a prior person **first places the property in service** in the QOZ **for purposes of depreciation or amortization.**
- **Land:** The original use requirement does not apply to land, but land must be used in connection with the trade or business of the QOF or QOZB.
- **Improvements to the leased property** made by the lessee also satisfy the “original use” requirement and are considered purchased property for the amount of the unadjusted cost basis of the improvements.
- **Vacant Buildings:** If a building or other structure in a QOZ has been unused or vacant for an uninterrupted period of at least five years, original use in the zone commences on the date after the period of non-use or vacancy when any person first uses the property in the zone.
- **Used Property:** Used property can now meet this test if it has not been previously used within that QOZ in a manner that would have allowed it to be depreciated or amortized by any taxpayer.

QOZBP: Leased Property Treatment

- **Leased Property Eligible as QOZBP:**
 - Leased tangible property meeting certain criteria may now be treated as qualified opportunity zone business property for purposes of satisfying the 90% asset test under 1400Z-2(d)(1) and the substantially all requirement under 1400Z-2(d)(3)(A)(i).
- **General Criteria**
 - 1) Leased tangible property must be acquired under a lease entered into after December 31, 2017; and
 - 2) Substantially all of the use of the leased tangible property must be in a qualified opportunity zone during substantially all of the period for which the business leases the property.
- **Ownership and operation** of real property, including leasing, **is** deemed to be the active conduct of a trade or business.
- **“Original Use”** and **“Substantial Improvement”** tests do **not** apply to leased tangible property.

Implementing Opportunity Zones in Arkansas

Arkansas Opportunity Zones:*

- 85 Total Opportunity Zones
 - 45% located in Metro Areas, 55% Non-Metro Areas
- 364,000 Opportunity Zone Residents
- 279,000 Opportunity Zone Jobs
- 19,000 Opportunity Zone Businesses
- **Interactive Maps And Listings Of All Opportunity Zones:**
 - <https://www.cdfifund.gov/Pages.Opportunity-Zones.aspx>
 - <https://eig.org/opportunityzones>
- With over 8,000 QOZs across the United States, competition for investor funds is inevitable.

*Source: <https://eig.org>

The 6 Ps of OZ Promotion

Mike Downing, City of Jonesboro



Objectives

- Attract the right development for your community.
 - Applicable type of project.
 - Good deal financially for city.
 - Growth potential.
 - Positive PR – citizens, neighbors.
- Work with reputable developers.
- Win the deal.



1. Prioritize Sites/Projects

- Narrow down best project sites to a few, based on the size of the city.
- Type of priority project will depend on:
 - Surrounding land use, compatibility, utility capacity, etc.
 - Market needs, competition.
 - Feasible based on rooftops and wallets; or industrial.
- Think like a developer – PROFIT/RISK/TIME/HASSLE



2. Potential

- Evaluate and prepare information for high priority sites – varying radius:
 - Market conditions – nearby complementing and competing businesses.
 - Demographics – disposable income, etc.
 - Population growth projections.
 - Traffic counts.



3. Preparation

- Minimize or expedite the hassles and unknowns:
 - Environmental issues; Soil issues.
 - Land ownership – preferable to have under public ownership; or fixed price from owner.
 - Utilities – Either developed or plan for development.
 - Zoning, permitting, etc.
- Try to get problems worked out **before** you promote your priority sites.



4. Price

- Strategy for local incentives:
 - Infrastructure funding.
 - Land.
 - Business improvement district (special assessment).
 - Historic rehab credits; Other federal/state incentives.
 - Commitment to lease space by city or other public/non-profit entity?
 - Industrial: Tax Back, Property tax abatement; Other state/local.



5. Person

- Designate one knowledgeable person as the key contact (preferably local):
 - Familiar with the OZ program benefits and process.
 - Knows the benefits and circumstances of the priority sites.
 - Knows the zoning, permitting, land, utilities, environmental, and incentives issues.
 - Good salesman and negotiator.



6. Promotion (“Prospectus”)

- Marketing brochure/website for **each** of the priority sites
- Research who potential developers could be.
- Distribute it to the right places, answering the question of potential investors/developers –
 - **Why** should we choose here over all the other OZ options we have?



Examples of City OZ Prospectus



<http://www.stocktongov.com/files/StocktonOZProspectus.pdf>



<https://www.selectmesa.com/business-environment/incentives-programs/opportunity-zones/mesa-opportunity-zone-investment-prospectus>



https://louisvilleky.gov/sites/default/files/louisville_forward/louisville_prospectus_version_13_11.5.2018.pdf

Questions?



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