

Flagstaff City Council Meeting, Feb. 25, 2020

**ARIZONA COMMERCE AUTHORITY**

# Opportunity Zones



# What is an Opportunity Zone?

An Opportunity Zone is a lower-income Census tract that has been designated as an Opportunity Zone by the US. Department of the Treasury.

- Opportunity Zones were created in the 2017 tax overhaul.
- In early 2018, governors got to nominate 25% of the tracts in their states that met the low-income criteria for Opportunity Zones; Treasury approved the tracts.
- Those who invest capital gains in long-term investments in Opportunity Zones can qualify for significant tax benefits.



# Opportunity Zone Criteria

To qualify for Opportunity Zone status, most tracts had to have either:

- a 20+ percent poverty rate, or
- a median family income of no more than 80% of the state or metro area's median, whichever was higher.

Up to 5% of a state's Opportunity Zones could be slightly better off if they were adjacent to a qualifying tract that also was nominated. These are called contiguous tracts. **NOTE: Contiguous tracts could make up 5% of the total, not an extra 5%.**

Treasury's preferred data for qualification were from the 2011-2015 American Community Survey. 2012-2016 ACS data also were acceptable.

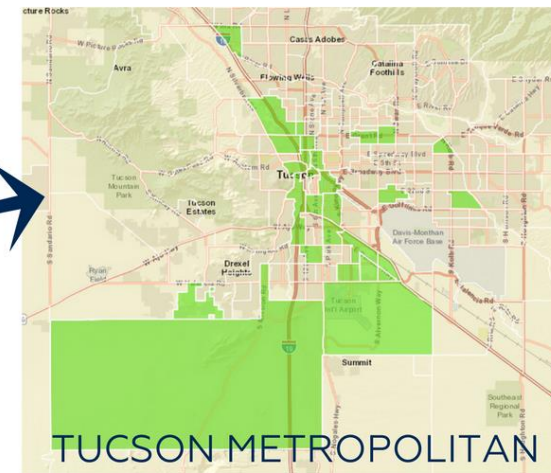
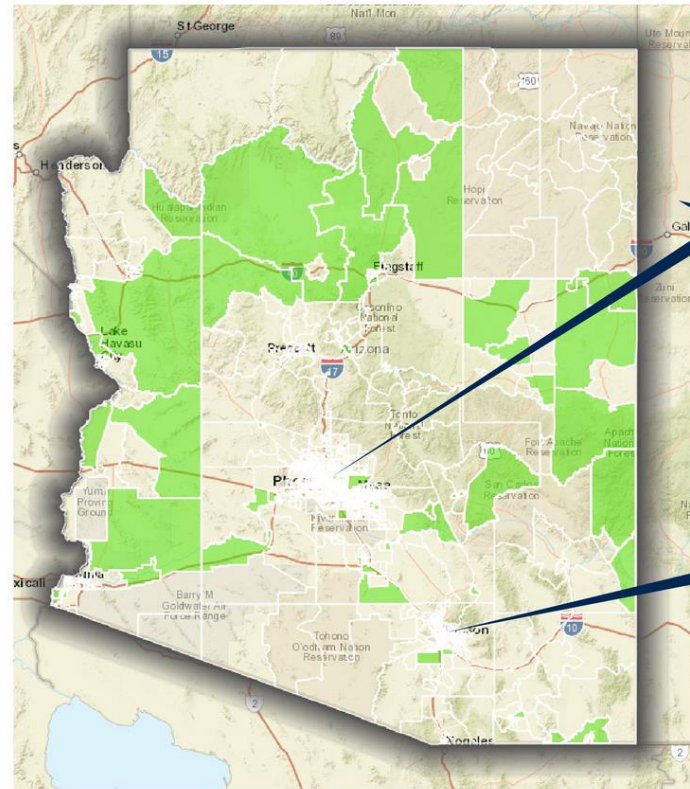
# What is a Census Tract?

“Census tracts are small, relatively permanent statistical subdivisions of a county.”  
–The Census Bureau

- A Census tract has about 4,000 inhabitants, on average.
  - Minimum: 1,200
  - Maximum: 8,000
- Census tracts do not cross county or state lines, but they do wash over city and tribal boundaries.
- Residential density affects the size and shape of tracts.
  - Urban tracts tend to be small and square or rectangular.
  - Rural tracts tend to be large and irregularly shaped.



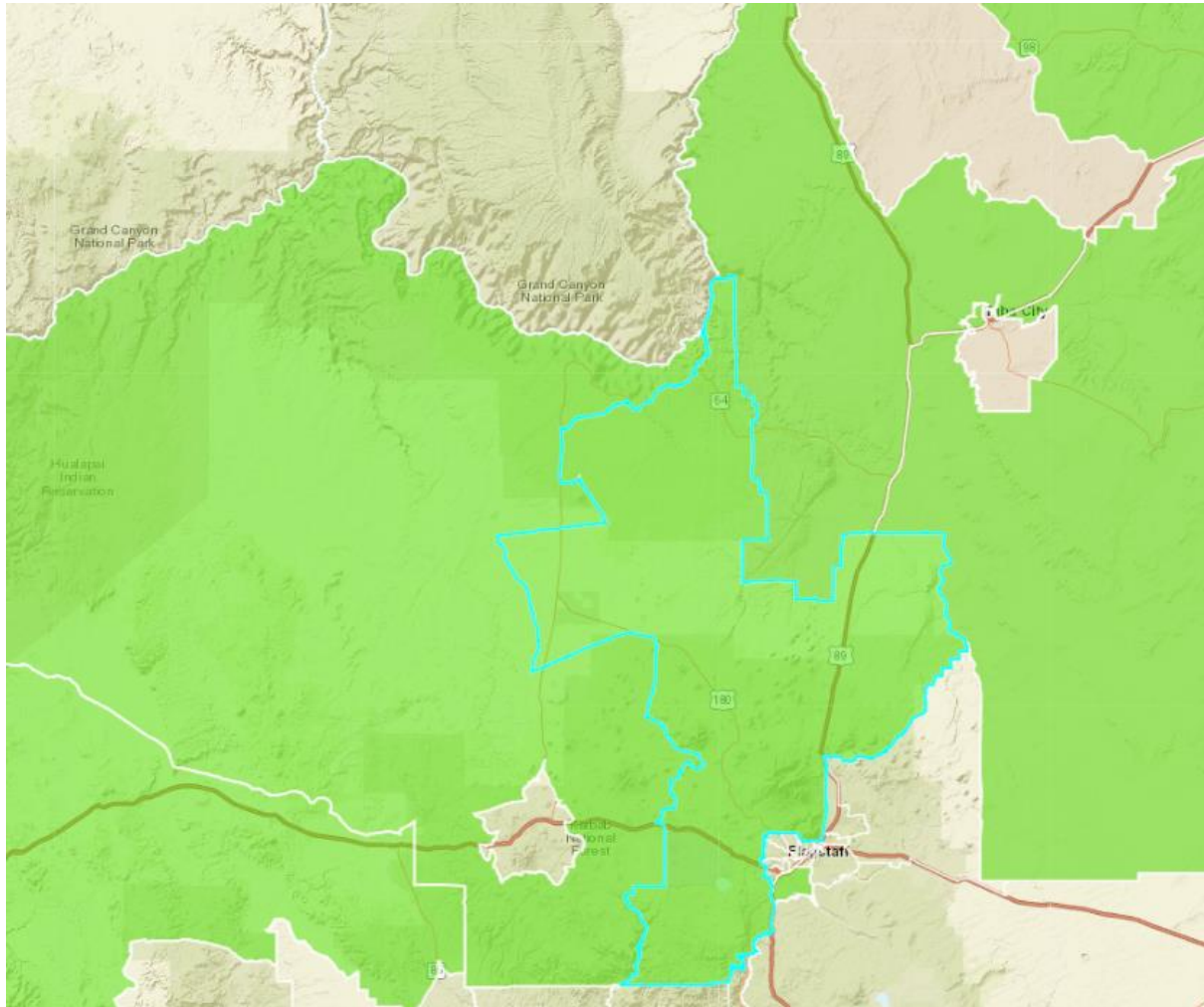
# Arizona's Opportunity Zones



[View Arizona's Opportunity Zones.](#)



# Nearby Opportunity Zones

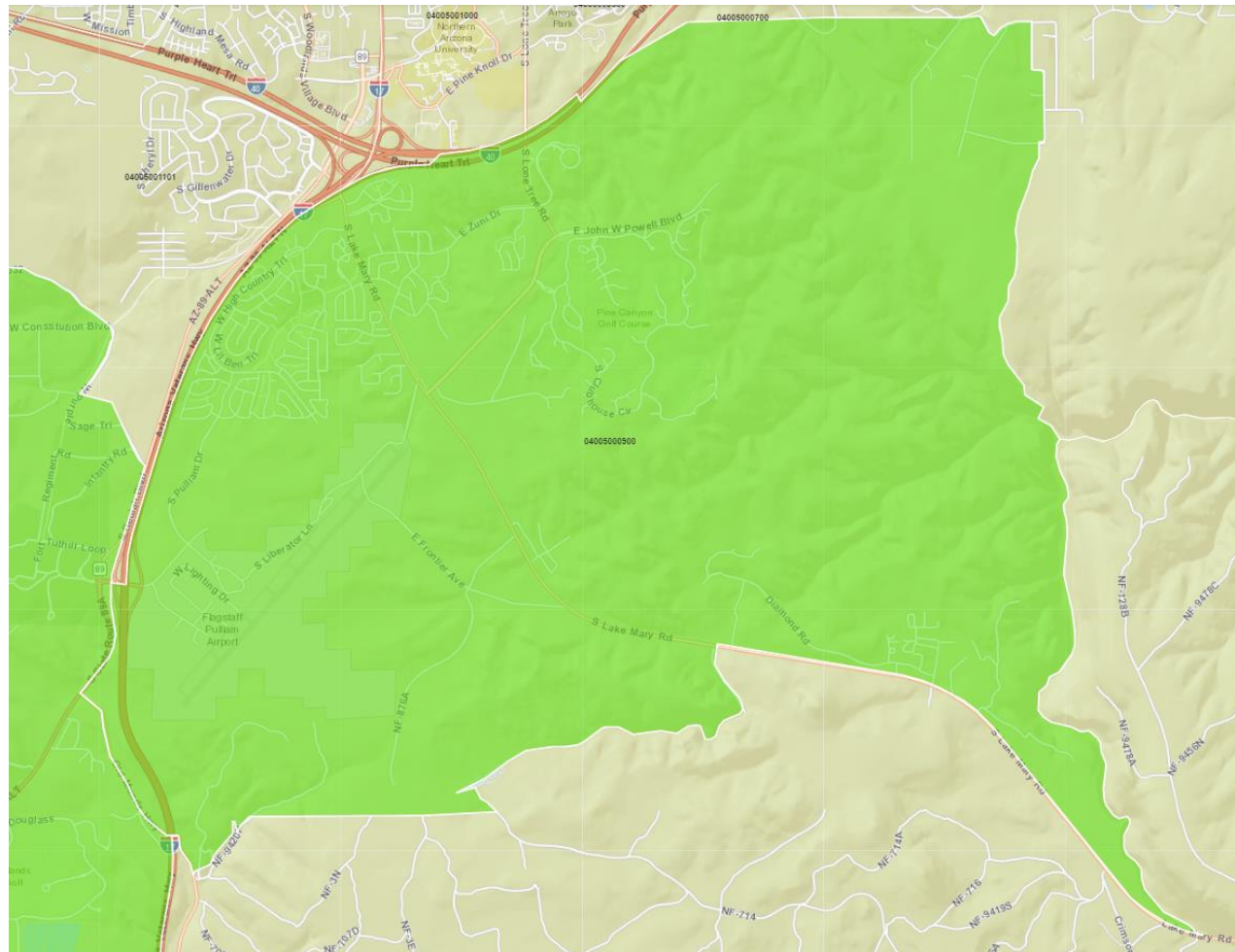


Outlined tract is a contiguous tract recommended by both Coconino County and the Navajo Nation.

[View Arizona's Opportunity Zones.](#)



# Flagstaff Area's Opportunity Zone



[View Arizona's Opportunity Zones.](#)





1,526

TOTAL ARIZONA  
CENSUS TRACTS

671

ARIZONA CENSUS TRACTS  
MEET CRITERIA\*

168

CENSUS TRACTS  
NOMINATED & APPROVED

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**REMARKABLE DEVELOPMENT OPPORTUNITIES ACROSS ARIZONA**

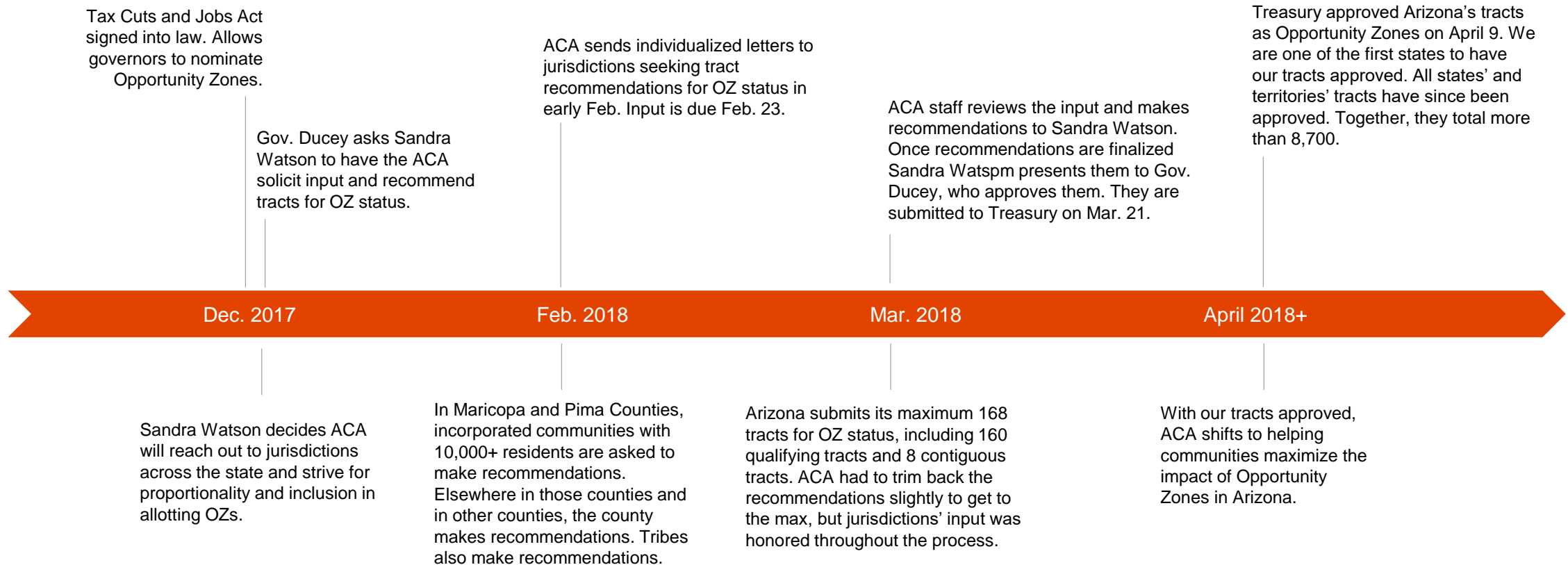
*\*CRITERIA BASED ON THE 2011-2015 AMERICAN COMMUNITY SURVEY DATA*

# Arizona's Opportunity Zones

- Arizona has urban, suburban and rural Opportunity Zones, as well as tribal Opportunity Zones. We have a zone for every project, and a community in need of meaningful investment in every zone.
- Every county has at least one Opportunity Zone. Coconino County has two, plus a contiguous tract recommended by both the county and the Navajo Nation.
- Arizona was permitted to have up to 9 contiguous tracts; the state opted to nominate 8. All 8 of those, plus the 160 qualifying tracts, were approved by Treasury.
- Arizona's OZs are on both their own map and on the Arizona Assets Map.



# Selecting Arizona's Opportunity Zones



# How Opportunity Zones Work

U.S. tax code provides capital gains benefits to encourage investors to:

- Sell passively held investments.
- Reinvest resulting capital gains in long-term investments in property or businesses in Opportunity Zones.
  - Requires use of an intermediary vehicle, an Opportunity Fund. Investors may place their money in someone else's Opportunity Fund or start their own.

The idea of Opportunity Zones had floated around for a while with bipartisan support, notably from Sens. Cory Booker (D-New Jersey) and Tim Scott (R-South Carolina). The idea originated with Sean Parker, formerly of Napster and Facebook.

# Federal Tax Benefits

1

## DEFERRAL

REALIZE A CAPITAL GAIN,  
REINVEST IT IN AN OPPORTUNITY  
FUND. TAXATION ON THAT GAIN  
DEFERRED UNTIL 12/31/2026.

2

## 10% REDUCTION

IF OPPORTUNITY FUND INVESTMENT  
HELD FOR 5 YEARS BY 12/31/26, TAX  
ON PREVIOUS DEFERRED GAIN  
REDUCED 10 PERCENT.

3

## 15% REDUCTION

IF OPPORTUNITY FUND  
INVESTMENT HELD FOR 7 YEARS,  
BY 12/31/2026, TAX ON PREVIOUS  
DEFERRED GAIN REDUCED 15  
PERCENT.

4

## ELIMINATION

IF OPPORTUNITY FUND  
INVESTMENT IS HELD FOR 10+  
YEARS, NO CAPITAL GAINS TAX  
ASSESSED ON THAT (SECOND)  
INVESTMENT.

# State tax benefits...

... depend on the state.

- Most states, including Arizona, conform to the federal tax code.
- Investing in a non-conforming state can create tax hassles and higher costs, as can living in a non-conforming state and making Opportunity Zone investments anywhere.
- Some states are considering extra incentives or giving an advantage to OZ projects when awarding grants. Arizona incentives apply statewide, including in all Arizona Opportunity Zones.
- *Conformity Source:* [Novogradac](#)



# Opportunity Fund Overview

- Must be organized as a corporation or partnership to invest in Opportunity Zones. LLCs are acceptable.
- May be organized to make a single investment/do a single project or to do multiple projects/investments.
- Must be certified by Treasury.
  - A fund “self certifies” by filling out form 8996 and submitting it with its federal tax return.
- Must have 90% of assets in qualified Opportunity Zone property.
  - Judged twice yearly, at mid- and end-point of tax year.
  - Penalty if failure to meet; may be waived if “due to a reasonable cause.”
    - Penalty is an amount equal to the excess of 90% of its aggregate assets over the aggregate amount of Opportunity Zone property held by the Opportunity Fund multiplied by the IRS’s underpayment rate.

# OZ Investments: 3 Options

Opportunity Funds may invest in:



**OZ BUSINESS  
STOCK**



**OZ BUSINESS  
PARTNERSHIP  
INTEREST**



**BUSINESS  
PROPERTY**

Purchases must be made for cash. Stock must be original issue. Opportunity Funds may not invest in “sin businesses.”

# 1031 VS. Opportunity Fund

1031 Exchange	Opportunity Fund Investment
Investor must reinvest principal AND capital gain within 180 days of sale.	Investor may reinvest capital gain ONLY within 180 days of sale (generally) to get tax advantages. May roll all or part of gain. However, only the reinvested portion gets tax benefit.
Only real estate qualifies.	Capital gains from real estate or other investments may be invested in an Opportunity Fund.
“Designed for single asset swaps.”	Can be used for “a pooled fund that invests in multiple assets.”
“Capital gains tax payments for the initial investment may be deferred indefinitely.” Only reduction is via “a step up in basis upon death.”	Capital gains tax on the initial investment may be deferred until Dec. 31, 2026. Basis step up of 10 or 15 points applies if Opportunity Fund investment made by 2019 (15) or 2021 (10).
Capital gains tax owed on final asset sale.	If Opportunity Fund investment held for 10+ years, basis = fair market value, so no capital gains tax due on appreciation upon sale. In AZ and most other states, state tax law conforms.

*Adapted from Fundrise site. Refers to federal tax policy only.*

# Opportunity Zone and Fund Context

Opportunity Zones and Funds are tax provisions. They are not programs in the way people think of programs.

- Dollars invested are not capped, but they must be capital gains to get the tax benefits and be invested within a limited time period (by end of 2026).
  - These are not government dollars, except to the extent of the tax reduction/elimination.
- No government application or pre-investment review for an Opportunity Zone project.
- No government review, rating or licensure of Opportunity Funds beyond self certification.
- No statutory requirement that investments in Opportunity Zones be aligned with community desires/needs or that investors engage communities in the development process.
- No public reporting requirements have been set yet, but IRS form 8996 has been revised to have some reporting requirements. Stay tuned!

# OZ Statute: Short but Complex

The OZ portion of the tax overhaul is just a few pages, but that leaves a lot to be sorted out in the regulatory process.

- Not atypical for it to take years to sort out this type of thing, but with OZ statute's time's limits, that has been challenging.
- Treasury has to digest the entire tax law through its regulatory process, not just OZ provisions.



# Substantial Treasury Guidance (1)

- October 2018
  - Provided guidance on setting up funds and how investors should let IRS know they were deferring tax payment.
  - Clarified that only capital gains (long- or short-term) would receive the Opportunity Fund-related tax benefits.
  - Established a working capital safe harbor for companies developing projects with Opportunity Fund support, making multi-year projects feasible.
  - Made rehab projects more desirable, if still somewhat challenging.
  - Made investing in businesses that are largely, but not wholly, in Opportunity Zones feasible.

# Substantial Treasury Guidance (2)

- April 2019
  - Delved into how to invest in operating businesses, including clarifying guidance from October 2018.
  - Explained how to invest Opportunity Funds on rented property.
  - Discussed tax implications of interim gains and rules for reinvestment, which comes up when a fund holds an investment for less than 10 years.

# Substantial Treasury Guidance (3)

- Final round of guidance released in mid-December 2019:
  - Makes it easier to invest 1231 gains and made exits after 10 years easier
  - Clarifies the tax implications of passing on an interest in an Opportunity Fund
    - Not taxable if transfer is upon death; is taxable if transfer is upon divorce
  - De minimis exception for sin businesses (5% of gross income of an OZ business can come from sin business)
  - Limits working capital safe harbor to 62 months
  - Makes substantial improvement test easier to meet—but rules are complex
  - Reduces how long a property must be vacant to be held to “original use” rules for redevelopment, to 3 years from 5 years
  - Make it easier for land leases with state/local governments and Native American tribes to be considered good property
  - Provided clarification on how to satisfy the intangible property test for operating businesses
  - Added anti-abuse rules, including anti-land banking examples

# OPEN FOR OPPORTUNITY

## ARIZONA OPPORTUNITY ZONES NETWORK

New, interactive tool designed to help further connect the Opportunity Zones community.

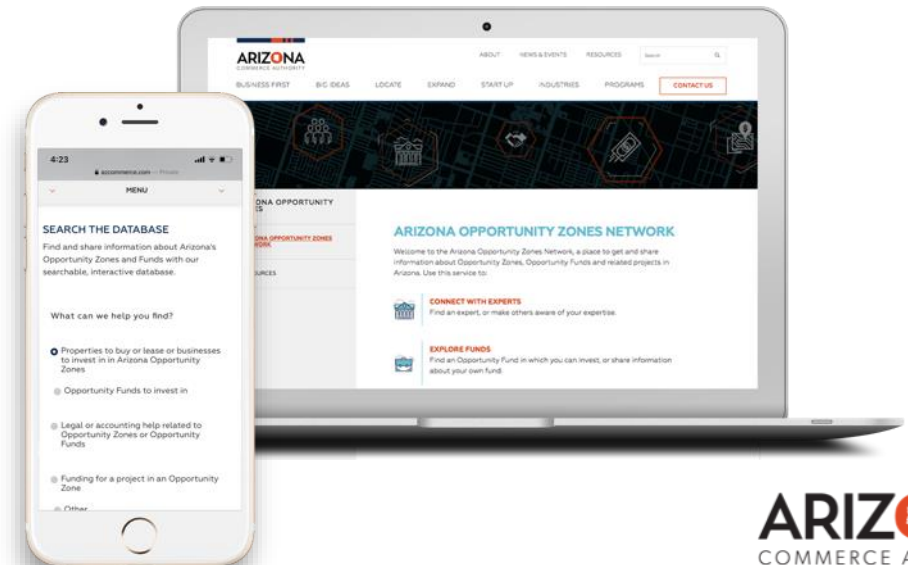
The searchable database allows users to:

- Connect with experts, investors or projects
- Find project, fund or investment opportunities
- Locate available properties
- List projects, investment opportunities or expertise

Visit the [Arizona Opportunity Zones Network](#) and add your information.

**+100** INVESTMENT OPPORTUNITIES ACROSS THE STATE

**DOZENS OF EXPERT AND FUND PROFILES**



# What Cities Can Do to Leverage OZs

- Identify the properties in your zone(s) most likely to be able to take advantage of Opportunity Fund financing in the next few years.
- Learn key details about those properties that will be essential to marketing the properties, including zoning, utility availability, neighboring uses, whether there are entitlement issues, etc.
- Be prepared to respond to requests for information about the properties in one business day.
- Determine whether there are conflicting zoning, permitting or building code regulations that need resolution.
- Identify likely investors, including existing Opportunity Funds and local investors who might be inclined to start their own funds.
  - [Novogradac](#) list
  - [NCSHA](#) directory



Questions?



# WE'RE HERE TO HELP!

ADDITIONAL QUESTIONS?



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