Michigan Opportunity Zone Initiative Update Webinar Q&A

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Is the 10 year hold subject to the 2026 deadline?
It is. The 10 year hold benefit is not subject to the deadline. The deadline is the date you have to recognize the gain. The program does not end in 2026, it's when you have to recognize the gain that you deferred but if you make an investment in 2025 then the program continues, we believe. The other thing is that people are hoping the program will be extended if it's successful.

What kind of gain qualifies?
The statute does not use the word capital gain, only the word gain. We're hoping for guidance for whether it really is as broad as it seems. People are quite sure that capital gain applies but people are not sure whether a general gain applies. Some types of in between 1245 or 1250 gain, maybe. We're waiting guidance on that.

Does a medical marijuana facility qualify as a business?
It's not listed in the sin businesses in the statute probably because the internal revenue code was written before medical marijuana facilities existed. I will say that most corporate investors in similar kind of programs have their own rules like banks and primarily insurance companies and they will mostly not invest in marijuana facilities. In time we'll find out more but now it will likely not be a popular investment.

Could an operating business sell a division of the gain and invest the proceeds in a fund and have the fund invest back in a real estate deal in an opportunity zone that is partially owned by ABC company?
You would need to think the related party rules that exist to find out whether you could do that. That's not something I can do without looking back at the statute.

How can you access opportunity funds to build industrial buildings for lease and what are the benefits of those funds vs. bank loans?
At this point I don't know of any opportunity funds that have been formed on a nationwide or regional basis. I don't know any that have been formed yet because of the complexity of doing multi property types funds. You'd be better off looking for local corporations that would have taxable gain that might have a reason to invest because they are local. There are community foundations that will have connections with high net worth investors that might be interested in investing in a community. I think right now, the way to find investors is within the local community and not through a group of funds that exist nationwide because that doesn't exist yet. The main benefit is that it's not a loan, its an equity investment and you won't have to pay interest on it. (there are a variety of other things to compare but that's the main one) Of course then you have a partner and you have to deal with the fact that you have a partner.

Is infrastructure qualified?
The issue on that one is that the business needs to be a domestic corporation or a partnership. So if you're talking about infrastructure that is owned by a governmental entity, then that wouldn't work. You need to have a private owner basically.

Will the property that is being rehabilitated in 30 months be considered qualified before their required level of approval is met?
I don't think we know how that is going to be monitored yet. That arises in other types of programs like the historic tax credit. There is a risk that you won't achieve what's planned. I would think that as long as you have a plan and it would qualify if you completed your plan, then a fund would probably go forward otherwise you wouldn't be able to get financing at all for it. I think rules will come out about that.

Is a tax on capital gains delayed until 2026 and then applied to the remaining 85% that is subject to tax?
Yes. To the extent of the amount you invest in an opp fund. If you have a gain of $100 and you invested $50 in an opp fund then you pay taxes on $50 and you would be able to defer the other $50—so it's the amount that you invest, it doesn't have to be all of the gains.

If I am a real estate developer of property in a zone, can I create a fund with the sole focus to develop my industrial park?
Yes I think you could. And I think you could actually invest your own money into that fund.

If a business has for example accounts receivable will it be disqualified due to these being not tangible properties?
No as long as the intangible properties used in the business.

If you are a developer and are selling other properties and are considered a dealer it is considered income and not a gain. Is there a way to defer into opportunity fund?
That's one of the questions we don't know the answer to. Although, it is doubtful. People generally don't think this is a way to defer ordinary income.

Do we expect this to be used in conjunction with other programs like Brownfield redevelopment efforts?
Yes, It is very much expected and maybe not intended intended to be used with a variety of other programs. It might be otherwise considered a somewhat shallow incentive by itself. It's very interesting to see models of combining it with LIHTC projects, NMTC projects, with other kinds of community development money. It really increases the return on those projects for the investor which could increase the equity into the project. In general I think there are many other community development programs that are available zones. They by their nature tend to have other programs would be combined to put as much money as possible into these projects.

Do debt financed distributions result in a sale or exchange for purposes of the end of the deferral period?
That's one of the questions that we're trying to get guidance on. There is nothing in the statute.

Who typically sets up an opportunity fund?
There are a variety of market segments that we think might be doing this. Very obviously there is a lot of interest in the field of syndicated LIHTC projects where the investors in those projects may be happy to add it on to their investment because it will increase their return. There is a market that already does that kind of project, but those projects don't have a huge amount of appreciation at the end of the holding period so the benefit that is about having tax reappreciation is not going to be as big in a project like that versus a market rate project.

There is also a group of people who are already involved in LIHTC projects who are now thinking of making a separate market segment that would do for example workforce housing that is not subsidized but is an area of need. That would be a new product for those groups and there is a lot of interest in figuring out how that could work.

Then there is the Real estate investment funds and the more private equity side of things who are not that used to community development, but who have access to investors who would like to defer their gain and would like to get tax appreciation on a real estate investment. And they will probably look at opp zones that are the closest to being gentrified or near communities that are already gentrified and that have a good potential for appreciation over a period of ten years. That group is totally different but really interested.

How can small businesses best access Opp Zones for their capital needs? New stock offering?
Sure! The question is not so much how you do it but how you access the investors. Which is a role that I think someone will play over the course of time and people on this call will help facilitate. I think at this point there's not a list of investors that you can talk to it’s just not yet to the point where you can easily find those investors, but as I said earlier through your own community. You could do it with stock if you’re a corporation so a stock offering would be a perfectly fine way to do it.

What do you anticipate the local municipalities' role being in writing policy or regulations to support opportunity zones?
I don’t really know how to respond except to say that in many states local municipalities had a big role in choosing the opportunity zones. The nomination by state governors of the zones in different states was handled very differently in different states but in many of them municipalities were pushing their own agendas with their state governors and succeeded and may have gotten zones that they already intended to apply other resources to, so now that they’re designated it’s going to be a local thing whether there is something for municipalities do to enhance zones that have already been identified.

After the 10 year investment in the Fund is done would any capital gains from a Fund investment be taxable?
So the investment can last longer than 10 years. It doesn’t really end in 10 years but if the investment is sold after 10 years then any capital gains over and above the deferred gain that you recognized in 2026 would not be taxable. That’s the exclusion from income of the gain on a sale after 10 years and that sale could happen one month after ten years or in year 15 if that made more sense from a market perspective.

Are non US companies allowed to invest capital gains in a US fund?
If they’re paying capital gains tax in the US then I think they would be but I have not had the question asked before. I don’t think there is anything prohibiting it.

Do you have any thoughts on the effect of an opportunity fund selling underlying property at a gain within the 10 year hold period, while the OZ investor still holds its interest and the clock ticks toward basis step-up?
That’s a question we’re also trying to get guidance on. There is a provision in the statute that talks about forthcoming regulations to deal with basically the concept of a redeployment it looks like, which is something you have in the new markets area. So that if you sold opp zones property within the holding period but within some reasonably short period of time and reinvested it in another qualifying property would that be ok? The gain wouldn't have to be recognized and the fund would still qualify?— We don’t know the answer to that yet. The question of whether for example if you wanted to buyout the investor and to do that you had to sell the underlying property and distribute the resulting proceeds, it would be nice if that distribution was also not taxable but we don’t know the answer to that yet. If thee sale of the opp fund interest gain on that is not taxable, but you could see that telling the property owner to take out the investor is sort of the same concept. We’re hoping to get guidance on that. This is one of those things

that makes multi-property multi-investor projects difficult because you may have different timing things going on. There are a lot of questions about how all of that would work out. Similarly multi-investor funds are tricky because in order for an investor to defer gains must make that investment within six months after it recognizes the gain. If you're trying to put into a fund multiple investors that meet that trigger and almost the qualified opp fund meet the 90% assets test for each of the investors coming in at different times, it's very complicated.

Does Holland & Knight service counsel to putting a fund together for an interested investor?
Yes, Holland & Knight does. We could represent any of the parties including a project developer or investor or a fund party. We do that in other areas—we are very active in the tax credit area representing syndicators and funds. Although I will say that there is a different market that may appear for this incentive because it may be that there are high net-worth individual investors. There may be focus on putting together funds for individual investors. The market in other areas existing in community development is mostly corporations and banks so that's a diff market.

There are real securities laws issues when you're offering an investment interest to individuals in particularly in a multi-investor basis there are exceptions available but you need to be very careful to follow the rules that would apply to a securities law area. That is not such an issue with LIHTC and new markets with a single investor typically.

Would infrastructure required by a municipality for project approval be qualified?
It makes me think the question is: if a private developer is required to instruct some infrastructure by a municipality, I think that would be qualified if the private developer was the owner and put the money into the infrastructure. That will probably be fact dependent.

Are there any pratfalls anticipated in structuring a NMTC deal with Opp Zone involvement?
There are. I would say that the easiest other program it seems to fit together with opp zones is the LIHTC program but the NMTC also fits together very well in a lot of ways and in some ways not as well. For example the qualified census tracts that were selected are the same basic census tracts that qualify for NMTC purposes. The location will qualify for both always. The NMTC over the course of time because it is a scarce resource that is allocated has become more competitive and as a result its been impossible to impose additional requirements on NM census tracts so that you have to invest in tracts that meet the basic requirements that opportunity zones do but also have criteria of higher distress, so although an OZ will always qualify for the basic requirements of NM deals they may not be the most distressed and won't qualify for additional requirements that a NM will need to have in order to make the investment. That's something that may or may not fit. NMTC are almost always done as loans and technically they can be done as equity but there are tax reasons that that is not the preferred approach. In contract OZ investments must be equity investments they can't be loans. Have to find a NM CDE willing to make an equity investment which is possible, and they would probably have to go back to the CDFI fund and amend their allocation agreement to permit them to make equity investments because most CDE's don't say they'll make equity investments. The CDFI has indicate that they would probably be receptive to that but some things need to be addressed to make it work.

Can the money I invest in the fund in turn invest in my business or property?
Yes. If you think about the simple example where the fund is itself, it's the entity that's developing the property, you're the developer undertaking the project, you have some money to invest and in fact maybe your project requires some equity on the development side in order to underwrite correctly, and if you had some gain from a prior sale you could invest equity that is in an amount equal to that gain and get the benefit of the opportunity zone investment. Right when this statute was enacted I was involved in a NMTC transaction where the developer was going to be putting in equity at a later stage and a substantial

amount was going to be required to make the deal work and I know that developer was already trying to figure out if he could take advantage of putting in money that he had recognize gain on. That is something that can be done.

Can a community foundation create an opportunity fund to address housing?
I don't see why not. You have to have the fund be a partnership. The managing member could be the community foundation or a related subsidiary and it could have a purpose to address housing.

If a business person is planning a separate LLC for real estate along with their operating business, could both be invested in by the same fund?
I think probably. I think we would need to think through issues about whether each of them counts as a trader business. They probably would. You'd have to go through all the criteria to make sure they both qualify. I don't think there is a rule that says an opp fund cannot invest in two aspects of the same operation. That will be fact dependent.

Can a state agency set up an opportunity fund? If so how would it best be utilized?
I think a state agency could set up an opportunity fund as long as it qualified as a partnership for tax purposes. A state agency itself couldn't be the fund but it could be a managing member or an affiliate could be. How it best be utilized will depend on the lay of the land and what the state agency's goals are.

Can you give an example of how an OZ investment could increase the return of Housing tax credit investor?
I can recommend to you most of the big accounting firms that are producing models that assume a particular return, obviously you have to make some assumptions but it definitely increases a return by quite a bit. I can't speak to numbers from my head but it is a substantial increase in return because the same money getting the benefit of the housing tax credit is also getting the benefit of the gain deferral, and interestingly in a LIHTC deal the 10 year hold is consistent with what you'd be doing any way. There is some thought that not only would they get the time value of money benefit and forgiveness of deferred gain, which increases the return, they may be able to also not pay tax on the phantom income that comes at the end of a LIHTC deal because of the negative capital account because that's gain. That's not 100% but that's why that might work.

Can a municipality, a DDA, or a Business Improvement District either start a Fund or be party to a fund?
That question is impossible to ask without knowing how it would be structured and the nature of the entities. It has to be able to be easy to partnership or a corporation for tax purposes. It sounds simple but is not always with state agencies or for example tribal governments. A tribal government can't be a taxable corporation so they would need to create a partnership or use a joint venture and would need to get private aspects in order to be able to do an opp fund. Which is not hard but the point is they just need to know the tribe itself wouldn't qualify most likely.

Can a nonprofit corporation be a qualified partner in an Opportunity Fund or Qualified Project?
To start with the project: since you would have to have an investment in either stock or a partnership interest, nonprofits don't have either, they can't themselves be a project very easily but they could form a partnership and be a partner of a partnership that issues stock for example.

Can they be a partner in an opportunity fund: I think the answer is yes but there are a lot of rules about having partnerships with both nonprofits and for-profit partners that may impact the tax results for the for-profit partners so you would need to have those rules in mind. Ideally they would have a very small interest and that would make it a bit easier.

Is residential rentals, like apartment buildings, a qualified property for opportunity zones property?
Yes it appears so.

Could an opportunity zone fund be a minority investment qualified property?
Yes. There is no limitation on how big an interest in a particular investment.

Are opportunity zone investors purchasing 'securities' when they purchase interests in an opportunity fund? If so, is the fund making a securities offering?
The basic answer I think is yes. The question is, is the offering exempt which makes it easier to ensure you're following the rules right. The most basic definition of a security is are you offering to take people's money and invest them in something you're saying will get them a return, which is what an opportunity fund would be doing. There are exemptions for certain classes of investors that can be taken advantage of. It is something to think about.

Could an opportunity fund also be a NMTC investment fund. IE, 1 fund serves 2 purposes, so that the NMTC investor could use a gain as its investment into a NMTC deal located in a Opp Zone?
Yes an opportunity fund could be also be a new markets tax credit investment fund subject to some of the things I mentioned before. You be combining the two types of subsidies and invest in projects that qualify for both. For the second part, the answer to that is yes. There are models that have figured out what the implications of those are and it does increase the return. YOu need to make sure that you have enough that it's an equity investment. Most NMTC have an upper tier have a combination of equity and debt and you need to figure out how much of it can be a deferred gain investment because some of the upper tier investment is debt. But it can be done.

Will a land syndication apply for OZ?
The problem with land is that there is a requirement for OZ property to have the original use of the original use of the property commence with the taxpayer unless the substantial improvement test is met. IF you're just dealing with land only there is authority in other areas saying that you can never be the original user of land because land has always been there. You can't just do a land deal. There are various tricky things about buying land and putting a building on the land. There is most likely authority that has that only the portion of the land that is necessary to the building, for example site improvements around the building will qualify but if there are 40 acres that is an orchard, that won't qualify.