USING OPPORTUNITY ZONE INCENTIVES IN LIHTC TRANSACTIONS

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What is a Qualified Opportunity Zone Business?

Qualified Opportunity Zone Business

» A trade or business;

» Substantially all (70 percent) of its tangible property (whether owned or leased) is Qualified Opportunity Zone Business Property;

AND…
What is a Qualified Opportunity Zone Business?

» At least 50 percent of its gross income must be from the active conduct of a trade or business in an Opportunity Zone.

» A substantial portion of its intangible property must be used in the active conduct of its business in an Opportunity Zone. New Rule: “substantial portion” means 40%.

» No more than 5 percent of the average unadjusted basis of its assets may consist of “non-qualified financial property.” (But see Working Capital Safe Harbor.)

» Cannot be a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off-premises.
Active Conduct of a Trade or Business Test

» 50% of gross income of the QOZB must be derived from active conduct of trade or business in the Zone.

» A substantial portion of the intangible property of the QOZB must be used in the active conduct of a trade or business in the Zone. New Rule: “substantial portion” means 40%.
Active Conduct of a Trade or Business

New Rule: Three Safe Harbors for 50% Gross Income Test

50% of Gross Income is considered to be from the active conduct of a trade or business in the Zone if:

» At least 50% of services performed (based on hours of employees / independent contractors) are performed within the Zone; or

» At least 50% of services performed (based on amounts paid to employees / independent contractors) are performed in the Zone; or

» **Tangible property** of the business that is in the Zone and the **management / operational functions performed** for the business in the Zone are each **necessary** to generate 50% of trade or business gross income.

» If no safe harbor applies, test can be met if, based on all the facts and circumstances, at least 50 percent of gross income is derived from the active conduct of a trade or business in the Zone.
What is Qualified Opportunity Zone Business Property?

Rule Where QOZB Owns Property

Qualified Opportunity Zone Business Property is tangible property used in a trade or business if:

» It is acquired by purchase (as defined in Section 179(d)(2) related party rules, but using a 20% related party test instead of 50%) after December 31, 2017;

» The original use in the Qualified Opportunity Zone commences with the Qualified Opportunity Zone Business

or

The Qualified Opportunity Zone Business substantially improves the property; and

» During substantially all of the holding period (New Rule – 90%) for such property, substantially all of the use of such property is in an Opportunity Zone.
What is Qualified Opportunity Zone Business Property?

New Rules for Original Use and Substantial Improvement

“Original Use” means the first date property is placed in service for depreciation or amortization (or that it would have been so treated if the taxpayer was the owner of the property).

Vacant Buildings: A building that has been vacant for at least five years is considered to meet the original use test on the first date that it is placed in service after its acquisition by a QOZB.

Land: Unimproved land does not have to be substantially improved BUT must be used in trade or business.
What is Qualified Opportunity Zone Business Property?

**Substantial Improvement Test.**

» If QOZB purchases Land and Building, only Building must be substantially improved. Tested against Building’s Basis excluding Land.

» “Substantial Improvement” is tested on asset-by-asset basis, not in the aggregate.
Substantial Improvement Test:

Property is treated as “substantially improved” if, during any 30-month period beginning after the acquisition of the property, additions to basis of the property exceed an amount equal to the adjusted basis of the property at the beginning of such period.

Rev. Ruling 2018-29

Property X – Purchased $800x
60% of purchase price for land ($480x)
40% of purchase price for factory ($320x)

Substantial Improvement Test met if at least $320x is spent with respect to the building within 30 months.
What is a Qualified Opportunity Zone Business Property?

What about Ground Leases?

» No original use requirement for land leased

» Improvements satisfy original use requirement and are considered “purchased” property for 70% test

» No related party prohibition (but some related party restrictions)

» Upfront lease payment may create non-qualified financial property issue – Section 467 lease