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Opportunity Zones: More Flexibility in New Guidelines Issued in April

The second tranche of guidance regarding the Opportunity Zone Program was released by the Treasury Department in mid-April and provided additional clarity for business owners, fund managers, investors, and others involved in the Opportunity Zone space. It's especially timely as Reno is currently one of the hottest commercial and residential real estate markets in the country. Given our state's favorable income tax laws, affordable cost of living, and continuing job growth, operating businesses, developers, and investors are flocking to Northern Nevada.

Originally rolled out in December 2017 as part of the Tax Cuts and Jobs Act, the Opportunity Zone Program was designed to incentivize long-term investment in underserved communities throughout the country. Jacey Prupas, Reno native and a partner at Snell & Wilmer, tapped her law firm colleagues – Mark Foster and Kade Miller – who practice in the firm's Opportunity Zone and Opportunity Funds practice group, to explore how the program is progressing, what changes she can expect to see in her hometown, and how Snell & Wilmer's Opportunity Zone team is helping its clients navigate the complexities of this new tax program.

Jacey Prupas: Let's start with gaining a better understanding of the breadth of the program. How many Opportunity Zones are there nationally, and how many are in Reno?

Kade Miller: A total of 8,762 qualifying census tracts were designated as Qualified Opportunity Zones, of which 61 are located in the State of Nevada, with 14 of those located in and around Reno. To give you a better sense of the investment and project development potential, a survey conducted by Novogradac & Company LLP revealed at least 123 active Opportunity Funds representing more than $27 billion in Opportunity Zone investment capacity.

Jacey Prupas: What should I be thinking about if I have a client with a business located in an Opportunity Zone?

Kade Miller: If your business or project is currently located within, or if you're contemplating expansion or relocation into, an Opportunity Zone, you should consider structuring the transaction through an Opportunity Fund to maximize the after-tax return-on-investment. The program has broad applicability and can be applied to operating businesses, including in connection with acquisitions, expansions, and relocations, as well as real estate acquisition and development.

Mark Foster: From a real estate perspective, we are seeing Opportunity Funds aggressively pursuing real estate development opportunities within Opportunity Zones. Because of the significant tax incentives associated with the Opportunity Zone program, Opportunity Fund investors are frequently outbidding traditional institutional real estate investors. Moreover, due to the requirements of the program once investors have placed their funds into an Opportunity Fund, the Opportunity Fund is strictly limited to investments in Opportunity Zones which again increases demand for qualified projects within Opportunity Zones.

Jacey Prupas: What are the ways for investors to become involved in the program, and is there a minimum threshold for entry?

Kade Miller: If a capital gain is triggered, the Opportunity Zone Program should come to mind. Investors, whether they be natural persons or legal entities, can defer, reduce, and eliminate capital gains by investing all or a portion of their capital gains in an Opportunity Fund. This program can be leveraged for self-directed investments, such as an investor who wants to re-invest capital gains into a new business venture or real estate project that they will identify and oversee, or alternatively, by passive investors who simply want to roll all or a portion of their gain into a third-party Opportunity Fund. In either situation, the investor can capitalize on the Opportunity Zone Program's tax benefits. While there is no legal minimum threshold for entry, the program is best suited for projects and new ventures that require a fairly substantial capital outlay, e.g., $2-3MM+, due to legal and accounting compliance costs. In addition, third-party funds often impose minimum investment thresholds and require that investors be accredited.

Jacey Prupas: Can you describe what is required in fund formation? How do you start one?

Kade Miller: An entity that is treated as corporation or partnership for tax purposes (including a limited liability company taxed as a partnership) may self-certify as an Opportunity Fund by completing Form 8996 and attaching it to the entity's tax return for the year in which the entity wants to become an Opportunity Fund. While the fund certification process is seemingly straightforward, the devil is in the details. For example, the Opportunity Fund is subject to federal and state securities laws and the fund's respective governing documents should include project details and safeguards to ensure compliance with the Opportunity Zone requirements.

Jacey Prupas: What type of redevelopment projects are in the works, both in Nevada and the Southwest?

Kade Miller: With the exception of certain "sin businesses," the program is industry agnostic, and we're seeing broad application across the private sector, ranging from hospitality and entertainment centered developments, renewable energy facilities, educational establishments, mixed-use commercial and residential housing, and various business relocations and expansions.

Mark Foster: Because the program requires a significant investment relative to the acquisition price, most of the real estate projects we see involve a substantial degree of rehabilitation, and in certain instances, a change in use to a higher density project. Given the current desire of Opportunity Fund managers to acquire assets before December 31, 2019 (i.e., in order to take full advantage of the tax reduction feature of the program), there is some concern that Opportunity Funds will build projects to meet Opportunity Zone program investment requirements as opposed to pursuing the use that makes the most sense for a site or the greater community.

Jacey Prupas: What are the key takeaways from the guidelines issued in April?

Kade Miller: The key takeaway was the flexibility of the Opportunity Zone Program. While the rules are detailed and require careful structuring and ongoing monitoring, the second tranche of regulations clarified important testing requirements and expanded the flexibility of the program, particularly with respect to operating businesses.

Jacey Prupas: What type of legal work is necessary for Opportunity Zones?

Kade Miller: The legal work varies based on the nature of the project, but generally involves vetting and structuring projects for compliance with the Opportunity Zone requirements, organizing Opportunity Funds, and preparing governing and offering documents for compliance with Federal and State securities laws. There is also legal work involved with the negotiation and drafting of other critical aspects of the transaction, such as acquisition of the land or a target company and the post-closing operation of the Opportunity Fund.

Mark Foster is Counsel in the Orange County office of Snell & Wilmer, and Kade Miller is an Associate in the firm's Las Vegas office.

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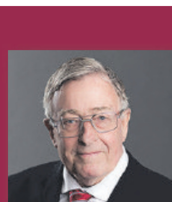
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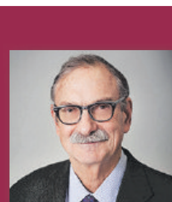
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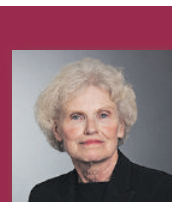
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