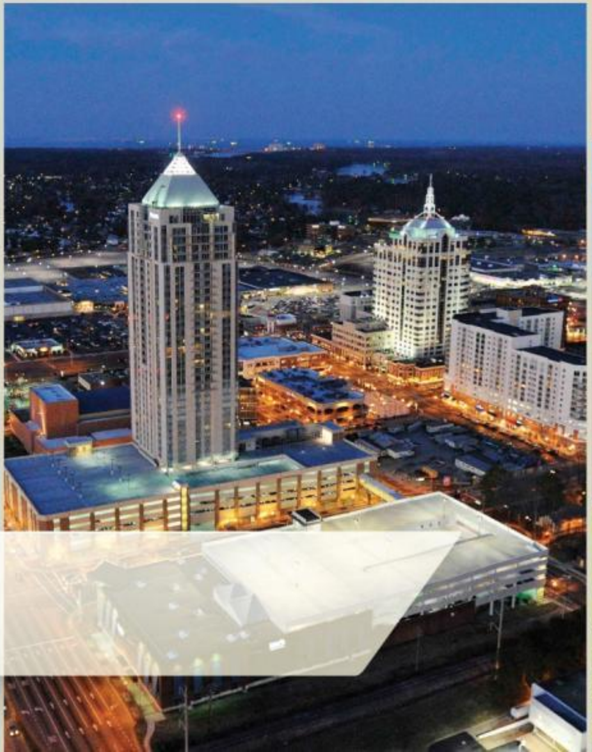
Welcome to the City of Virginia Beach

Opportunity Zone Open House

February 20, 2019

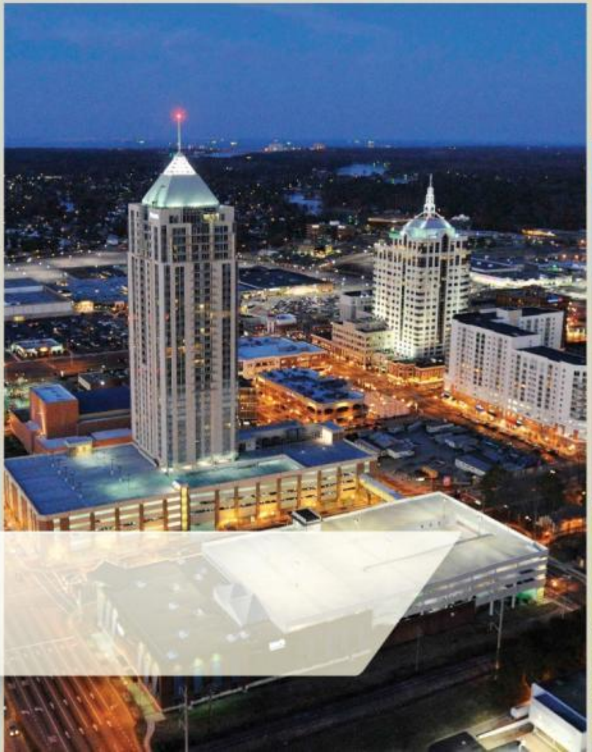
Zeiders Theater



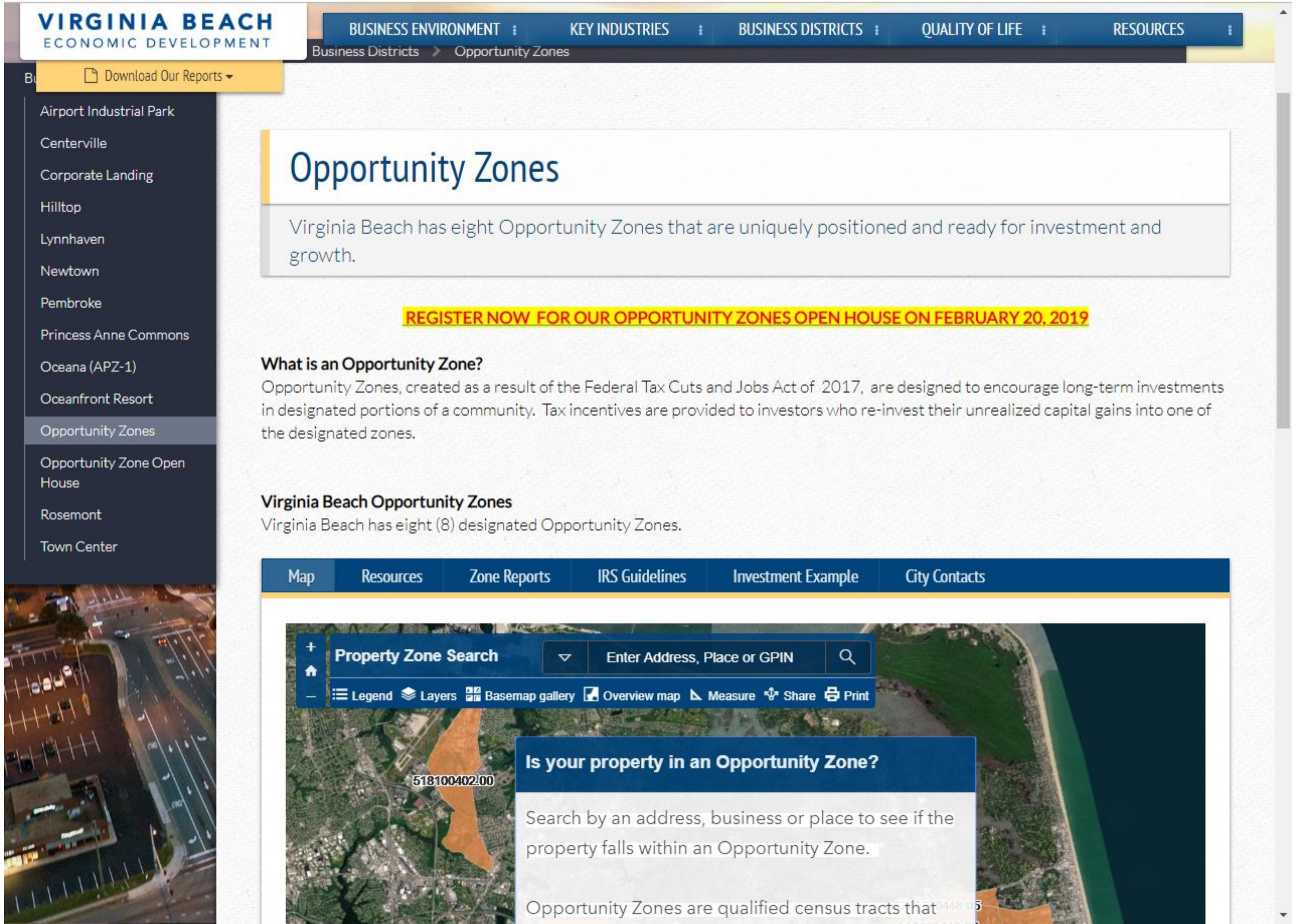
City of Virginia Beach

Opportunity Zone Resources

Steven Harrison



YesVirginiaBeach.com/OZ


VIRGINIA BEACH ECONOMIC DEVELOPMENT

BUSINESS ENVIRONMENT | KEY INDUSTRIES | BUSINESS DISTRICTS | QUALITY OF LIFE | RESOURCES

Business Districts > Opportunity Zones

Download Our Reports

- Airport Industrial Park
- Centerville
- Corporate Landing
- Hilltop
- Lynnhaven
- Newtown
- Pembroke
- Princess Anne Commons
- Oceana (APZ-1)
- Oceanfront Resort
- Opportunity Zones
- Opportunity Zone Open House
- Rosemont
- Town Center

Opportunity Zones

Virginia Beach has eight Opportunity Zones that are uniquely positioned and ready for investment and growth.

REGISTER NOW FOR OUR OPPORTUNITY ZONES OPEN HOUSE ON FEBRUARY 20, 2019

What is an Opportunity Zone?

Opportunity Zones, created as a result of the Federal Tax Cuts and Jobs Act of 2017, are designed to encourage long-term investments in designated portions of a community. Tax incentives are provided to investors who re-invest their unrealized capital gains into one of the designated zones.

Virginia Beach Opportunity Zones

Virginia Beach has eight (8) designated Opportunity Zones.

Map | Resources | Zone Reports | IRS Guidelines | Investment Example | City Contacts

VIRGINIA BEACH
ECONOMIC DEVELOPMENT

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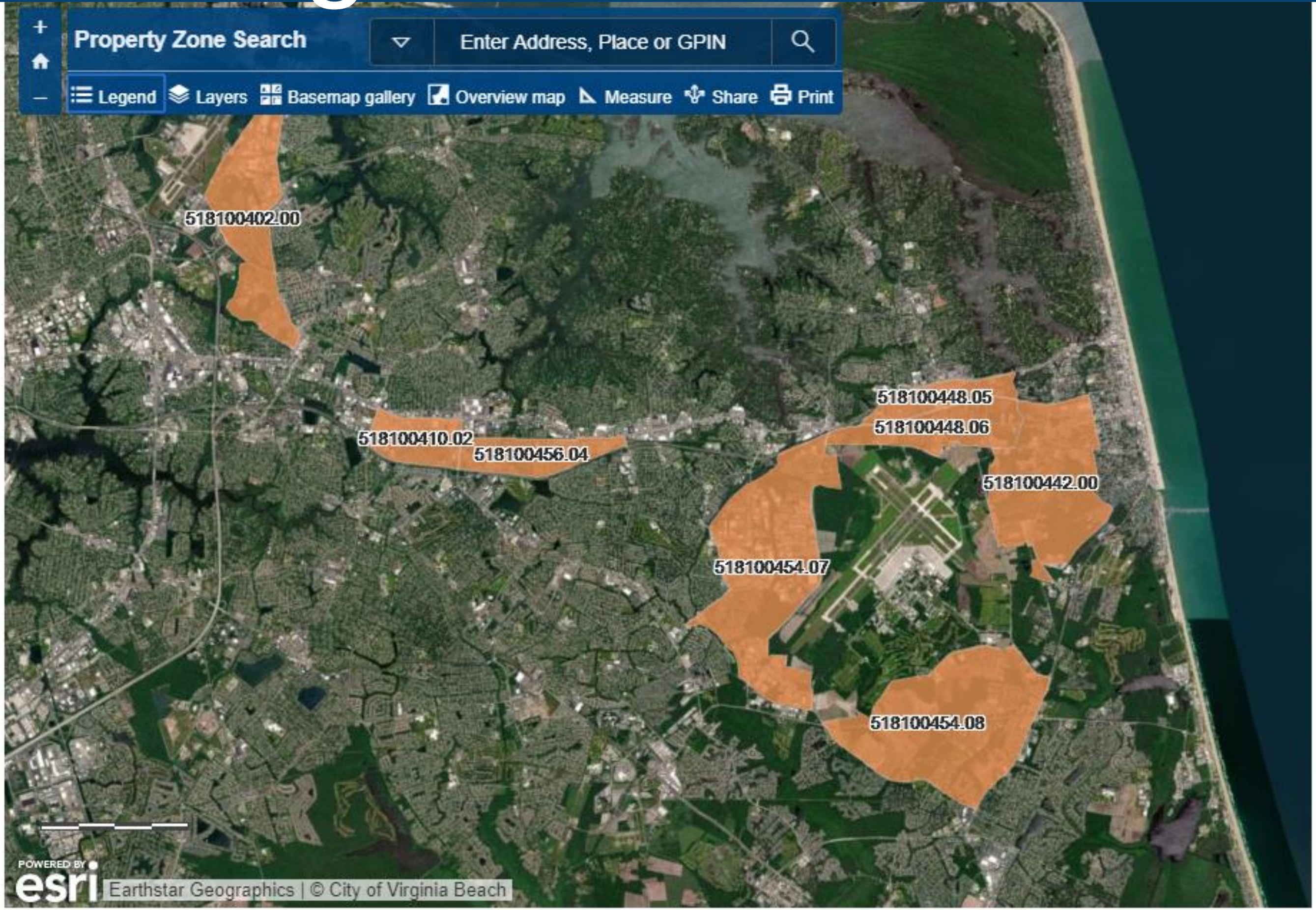
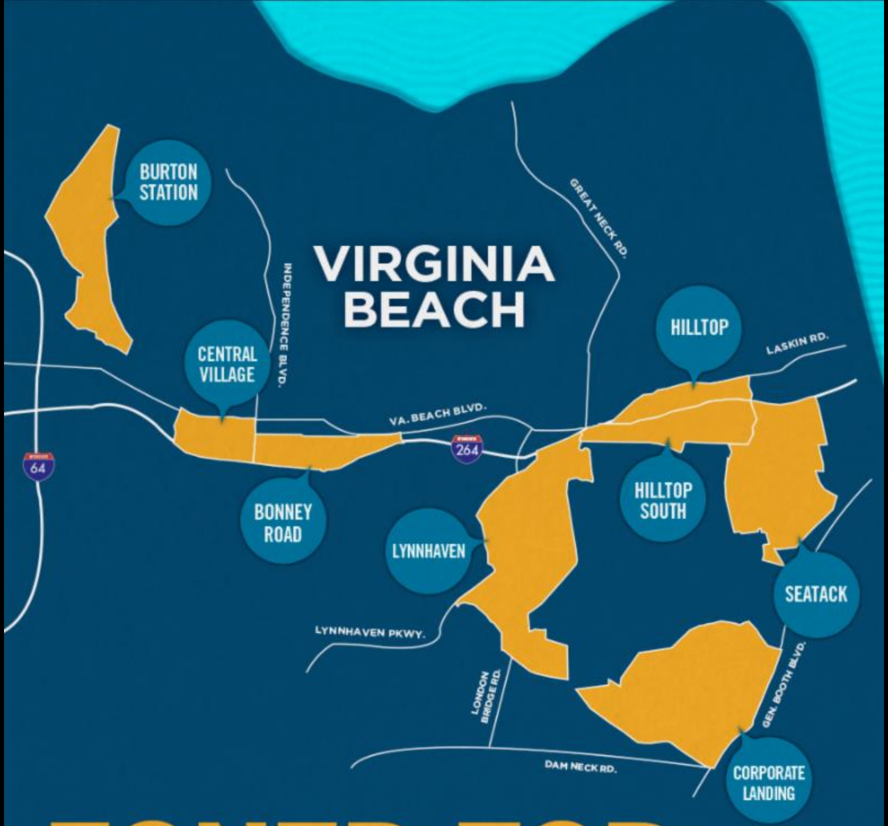


VIRGINIA BEACH
ECONOMIC DEVELOPMENT

YesVirginiaBeach.com/OZ

- Resources
- Zone Reports
- IRS Guidelines
- Investment Example
- Prospectus
- Contacts



ZONED FOR OPPORTUNITIES.

AN OVERVIEW OF QUALIFIED OPPORTUNITY ZONES

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TOPICS ADDRESSED

- Background on the change in the tax law
- What is a qualified opportunity zone
- How to identify a qualified opportunity zone
- Why consider investing in a qualified opportunity zone.

BACKGROUND OF THE LAW

- The potential for these investments came into existence with the Tax Cuts and Jobs Act of 2017 (TCJA) approved on December 22, 2017.
- Proposed Regulations were published by the IRS on October 29, 2018..
- Those proposed regulations were subject to a 60 day public comment period so it remains to be seen if there will be any significant changes to the regulations before, or if, they become final.
- The public hearing on the comments was postponed due to the government shutdown.
- The Qualified Opportunity Zone/Fund idea behind the law has broad bipartisan support and has been studied/considered for many years prior to inclusion with the TCJA.

WHAT IS A QUALIFIED OPPORTUNITY ZONE

- In short, qualified opportunity zones are designated low-income areas.
- Each state was allowed to propose certain areas to be designated as a qualified opportunity zone.
- The zones are delineated by census tract. There were an estimated 41,000 potential zones nationwide.
- The purpose of establishing a zone is to encourage investment, and specifically long-term investment, in historically economically distressed communities.
- There are zones located throughout the United States and its territories.
  - Locally, there are three in Chesapeake, four in Hampton, seven in Newport News, sixteen in Norfolk, eight in Portsmouth, one in Suffolk, and eight in Virginia Beach.

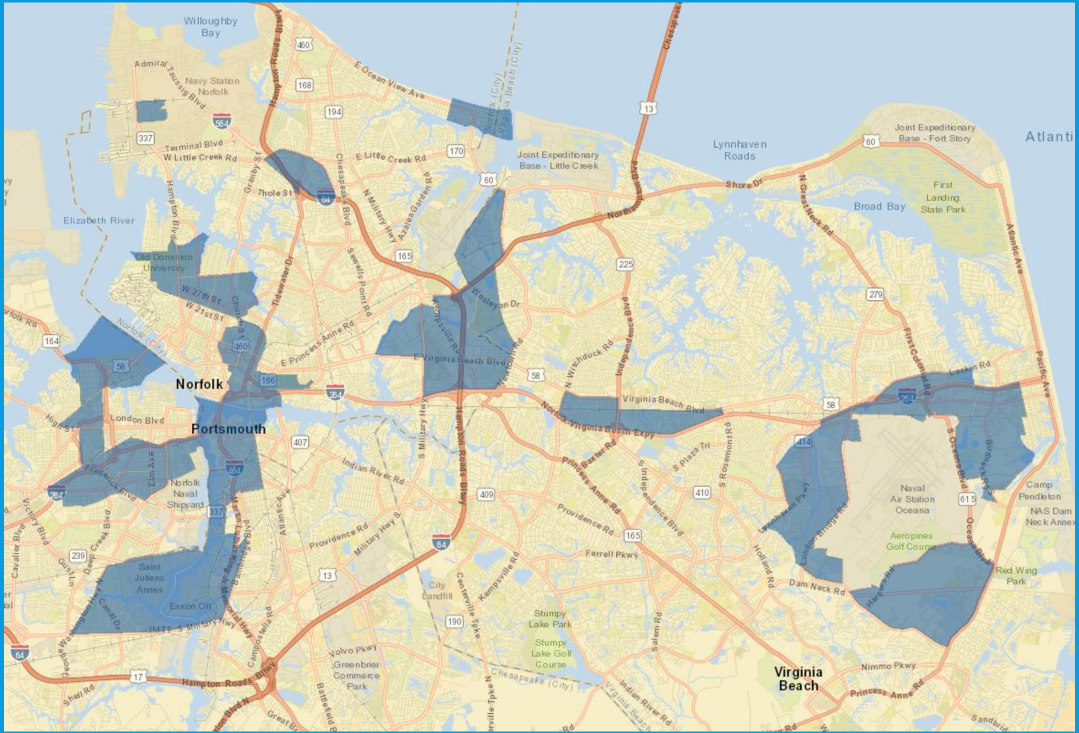
HOW WERE ZONES DECIDED?

- All eligible census tracts were submitted to the respective states for nomination as QOZs.
- States nominated select QOZs from the list of eligible census tracts (different priorities/processes for each state in selecting).
- Federal government accepted all nominated tracts from the states.
- Future zones may be added or be available depending on retention of this program and new income data for census tracts

DESIGNATED ZONES IN VIRGINIA BEACH

Virginia	Virginia Beach	51810040200	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810041002	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810044200	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810044805	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810044806	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810045407	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810045408	Low-Income Community	2011-2015
Virginia	Virginia Beach	51810045604	Low-Income Community	2011-2015

HOW TO IDENTIFY A QUALIFIED OPPORTUNITY ZONE



- This website has a function that allows you to search any address to determine if it is in a qualified zone.

WHY INVEST IN A QUALIFIED OPPORTUNITY ZONE?

- There are two main tax advantages.
- You can defer the capital gains tax on the sale of an asset if sales proceeds are invested in a qualified opportunity fund.
- You can reduce the amount of capital gains tax paid on the deferred amount invested within the qualified opportunity fund if you hold the assets for at least five years.
  - If you hold an asset for 5 years or longer, you increase your basis by 10% of the deferred gain;
  - If you hold an asset for 7 years or longer, you increase your basis by 15% of the deferred gain;
  - If you hold the investment for 10 years or more, upon disposition you may elect to increase the basis in that asset to **100%** of the Fair Market Value. This effectively means that you pay **NO** capital gains tax on the appreciation in the investment if you hold that investment for at least 10 years.
  - **The last day to make the increase in basis election under the proposed regulations is December 31, 2047.**

THINGS TO CONSIDER FOR INVESTMENT

- Appealing Investment within a Qualified Opportunity Zone
- Re-organization of physical business structures (need for new office, facility, etc.)
- Liquidation event creating capital gains
- Sale of secondary residence that does not qualify as primary residence
- Transaction poorly suited to 1031 exchange
- Remember "Makes a good deal better, but does not make a bad deal good!"

COMPARISON TO 1031 EXCHANGES

1031 Exchange

- Assets available to qualify for the exchange is limited to real estate.
- Gain on sale of capital asset deferred until subsequent sale of replacement asset. (unlimited deferral).
- Must reinvest the full amount of the sale to defer the gain.
- Replacement Property must be identified within 45 days of the initial sale.
- Closing on the replacement property must occur within 180 days of the initial sale.
- Replacement property must be of like kind of the property sold.
- Gain can be deferred successively, but will be due on the ultimate sale.

Qualified Opportunity Zone

- Deferral can apply to virtually all capital gain assets.
- Must recognize the initial deferred gain at the end of 2026. (required end of deferral)
- Only required to reinvest the gain to avoid current taxation. Return of basis is untaxed.
- 180 days to invest in replacement.
- If going through a qualified opportunity fund, potentially another 180 days for that fund to invest, and perhaps longer with working capital safe harbor.
- No like kind requirement. Only qualified zone requirements
- Gain on replacement can be eliminated if investment held for 10 years.

WHAT GAINS AND WHAT TAXPAYERS ARE ELIGIBLE TO CLAIM THE CAPITAL GAINS DEFERRAL

- Any gain that is to be treated as capital gain for Federal Income Tax purposes is eligible for deferral
- They can be long-term, short-term, capital gains of any type including distributions from a mutual fund.
- Eligible gains include capital gains from actual, or deemed, sales or exchanges if the gain would be recognized not later than **December 31, 2026**.
- The sale or exchange generating the gain cannot be to a person related to the taxpayer.
- The gain deferred cannot exceed the amount invested in the qualified opportunity fund within 180 days from the date of the sale or exchange that generated the gain.
- You can split your investment into multiple parts provided each of the parts meets the 180-day deadline.
- Virtually any entity that recognizes capital gains for federal income tax purposes is eligible to defer the gain – individuals, C Corporations, Regulated Investment Companies, Real Estate Investment Trusts, partnerships, and other pass-through entities (S-Corps).
- Partners and other pass-through owners can elect their own deferral if the partnership or pass-through entity does not elect to defer on the entity level.

WHAT IS A QUALIFIED OPPORTUNITY FUND (QOF)?

- The qualified opportunity fund is the investment vehicle that allows you to invest money into the qualified opportunity zone.
- You must purchase an eligible interest in a qualified opportunity fund to be eligible for tax deferral.
- You must purchase an equity interest in the qualified opportunity fund (i.e. – common or preferred stock, LLC membership interest or partnership interest).
- You cannot purchase a debt instrument as the qualifying eligible interest.
- Deemed contributions of money (such as in the context of some partnerships) also do not qualify.

REQUIREMENTS FOR THE FUND

- QOFs that are corporations or partnerships for tax purposes will be allowed to self-certify.
- There will be no pre-registration requirement.
- The QOF chooses the first month it is to be treated as a QOF. If it fails to choose, the first month of initial taxable year will be treated as the first month the entity is a QOF.
- **CAUTION: A DEFERRAL ELECTION CAN ONLY BE MADE FOR AN INVESTMENT TO AN ENTITY THAT IS A QOF. THEREFORE, THE QOF CANNOT CHOOSE AN INITIAL MONTH THAT IS AFTER THE DATE OF THE INVESTMENT.**

OZ Investment Structures

Virginia Beach – OZ Open House
February 20, 2019

Jenny H. Connors

WILLIAMS MULLEN

OZ Funds

> **Investment in an OZ Fund**

- What is an ***OZ Fund***?
  - Investment vehicle that:
    - Is a corporation or tax partnership for federal income tax purposes
    - Holds at least 90% of its assets in ***OZ Property***

The Asset Test

> **The 90% Asset Test**

- Based on the average percentage of OZ Property held on:
  - The last day of the first 6-month period of the taxable year of the OZ Fund, and
  - The last day of the taxable year of the OZ Fund
    - Ex. calendar-year taxpayer: June 30th and December 31st
  - If formed after 1st of year, based on first 6-month period of taxable year
  - If taxable year less than 6 months, only tested on last day of taxable year
- OZ Funds measure assets using financial statement values or, if none, cost

WILLIAMS MULLEN findingyes

OZ Fund Certification

> **Certifying as an OZ Fund**
  - OZ Funds self-certify by filing an IRS Form
    - Form 8996
    - Filed with timely federal income tax return for the year of OZ Fund certification
      - OZ Fund selects month when OZ Fund status commences
        - » If not, defaults to first month of taxable year
        - » If OZ Investment made before OZ Fund commencement date, it is not an eligible OZ Investment

OZ Property

> **What is OZ Property?**

- ***OZ Business Property (<u>Direct</u> Ownership)***
- ***OZ Stock (<u>Indirect</u> Ownership)***
- ***OZ Partnership Interests (<u>Indirect</u> Ownership)***

WILLIAMS MULLEN finding yes®

OZ Fund – Direct Ownership Structure

Direct Structure

OZ Fund

OZ Business Property

10% of Assets:

- Cash and other nonqualified financial property
- Intangibles
- Nonqualifying tangible property

<u>90%</u> of Assets:

- Tangible property used in trade or business
- Acquired by purchase after 12/31/17
- Original use in OZ or substantially improved
- Substantially all located in OZ during substantially all of holding period

WILLIAMS MULLEN findingyes

OZ Fund – Indirect Ownership Structure

Indirect Structure

OZ Fund

<u>90% </u>of Assets in OZ Partnership Interests (acquired after 12/31/17 for cash)

Max **<u>5%</u> of assets** Nonqualified financial property (excluding reasonable working capital)

OZ Business (**<u>No</u>** "Sin" Business)

<u>50%</u> gross income attributable to the "**active conduct**" of trade or business in OZ

<u>Unlimited intangibles</u> if substantial portion used in active conduct of business in OZ

At least **<u>70%</u> of tangible assets** must be **OZ Business Property**

WILLIAMS MULLEN findingyes®

Direct Vs. Indirect Structure

	Direct	Indirect
Gross income requirement	None	At least 50% derived from the **active** conduct of trade or business
Permitted intangibles	Together with nonqualified financial property (e.g., working capital), limited to10% of OZ Fund assets	No limit if used in the **active** conduct of QO Business
Working capital allowance	Together with intangible assets, limited to 10% of OZ Fund assets, no safe harbor	Reasonable working capital permitted (plus 31+ month safe harbor)
Prohibited activities	None	“Sin businesses”
Tangible property requirement	At least 90% of assets must be tangible property	None

Key Structuring Considerations

> **Key Provisions**
  - Purchase
    - Excludes acquisitions of property from "related" parties
  - Substantial Improvement
    - Occurs when, over a 30-month period, beginning after the date of acquisition, additions to basis by QO Fund exceed an amount equal to the adjusted basis of the property at the beginning of the 30-month period.
      - In the case of real estate, cost of land excluded from this calculation, lowering threshold

Key Structuring Considerations

> **Key Provisions**
- "Active Conduct"
  - Term yet to be defined
  - Presumably, higher threshold for indirect structure businesses
- "Sin" Business
  - Country club, massage parlor, hot tub facility, racetrack, health club or store the principal purpose of which is to sell alcoholic beverages for consumption off premises
    - No prohibition against these businesses in direct structure

Key Structuring Considerations

> **Key Provisions**

- Reasonable Working Capital
  - Safe Harbor
    - Available for OZ Businesses (Indirect Structure)
      - » Permits OZ Businesses to hold reasonable amounts of working capital for a period of up to 31 months
    - To satisfy safe harbor, must develop a written plan that:
      - » Identifies the financial property
      - » Provides a plan for the financial property
      - » Includes a written schedule for the deployment of financial property consistent with ordinary course of business operations

Mixed OZ Funds

> **Mixed Use Funds**

- OZ Investment and non-OZ Investment in OZ Fund treated as two separate investments
  - Tax deferral and exclusion only apply to qualifying OZ Investment
  - Requires tracking of eligible and non-eligible OZ Investments
- Deemed contributions to a partnership under Code Section 752 do not constitute non-OZ Investments giving rise to mixed-use OZ Fund

Questions & Contact Information

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Please note: This presentation contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Individuals with particular needs on specific issues should retain the services of competent counsel.

Qualified Opportunity Zone Businesses

MARK DESROCHES, CPA 757-498-3000 | mark@desrochescpas.com

Business Investment QOZ

- Small business start ups can be less capital intensive
- Ease of moving or expanding into an opportunity zone
- Business valuations using multiple of earnings can generate a greater return
- Benefits held more than 10 years would be tax-free
- New asset class

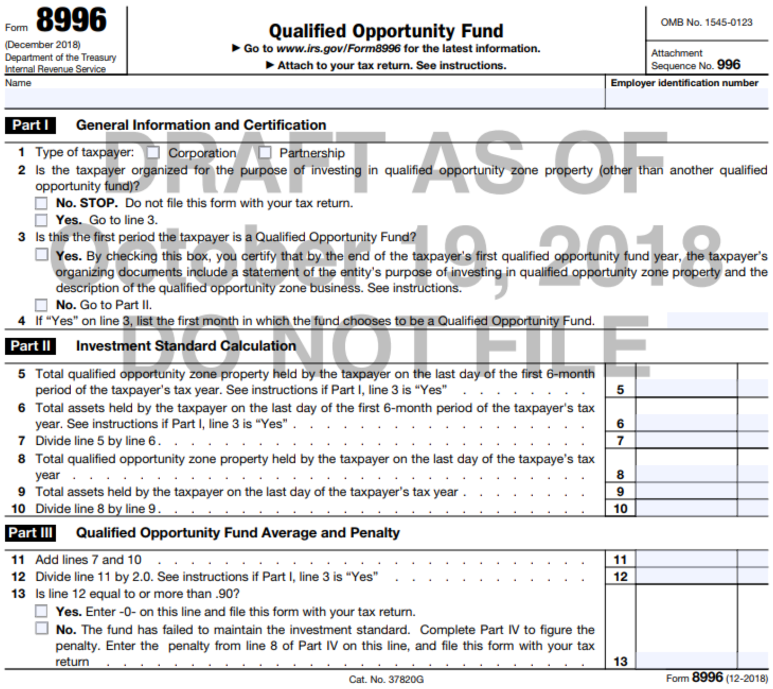
Self Certification and Semi-Annual Tests

Any corporation or partnership (including pre-existing entities) can self certify to become a QOF

Identity the first taxable year and first month the eligible entity wishes to be a QOF

Comply with the 90% asset test required of QOFs

Complete and attach Form 8996 with their tax return



Form **8996**
(December 2018)
Department of the Treasury
Internal Revenue Service

Qualified Opportunity Fund
▶ Go to *www.irs.gov/Form8996* for the latest information.
▶ Attach to your tax return. See instructions.

OMB No. 1545-0123
Attachment Sequence No. **996**

Name | **Employer identification number**

DRAFT AS OF October 19, 2018 DO NOT FILE

Part I **General Information and Certification**

1 Type of taxpayer: ☐ Corporation ☐ Partnership

2 Is the taxpayer organized for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund)?
☐ **No. STOP.** Do not file this form with your tax return.
☐ **Yes.** Go to line 3.

3 Is this the first period the taxpayer is a Qualified Opportunity Fund?
☐ **Yes.** By checking this box, you certify that by the end of the taxpayer's first qualified opportunity fund year, the taxpayer's organizing documents include a statement of the entity's purpose of investing in qualified opportunity zone property and the description of the qualified opportunity zone business. See instructions.
☐ **No.** Go to Part II.

4 If "Yes" on line 3, list the first month in which the fund chooses to be a Qualified Opportunity Fund.

Part II **Investment Standard Calculation**

5 Total qualified opportunity zone property held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes" 5

6 Total assets held by the taxpayer on the last day of the first 6-month period of the taxpayer's tax year. See instructions if Part I, line 3 is "Yes" 6

7 Divide line 5 by line 6 7

8 Total qualified opportunity zone property held by the taxpayer on the last day of the taxpayer's tax year 8

9 Total assets held by the taxpayer on the last day of the taxpayer's tax year 9

10 Divide line 8 by line 9 10

Part III **Qualified Opportunity Fund Average and Penalty**

11 Add lines 7 and 10 11

12 Divide line 11 by 2.0. See instructions if Part I, line 3 is "Yes" 12

13 Is line 12 equal to or more than .90?
☐ **Yes.** Enter -0- on this line and file this form with your tax return.
☐ **No.** The fund has failed to maintain the investment standard. Complete Part IV to figure the penalty. Enter the penalty from line 8 of Part IV on this line, and file this form with your tax return 13

Cat. No. 37820G Form **8996** (12-2018)

QO Zone Business Property

- QO Zone Stock
- QO Zone partnership interest
- QO Zone business property
  - Tangible real and personal property purchased after December 31, 2017 that is for used in an opportunity zone
  - Original use of tangible property commences with use of property in the Opportunity Zone OR
  - The business substantially improves the property during any 30 month period

Qualified Opportunity Zone Business (QOZB) Requirements

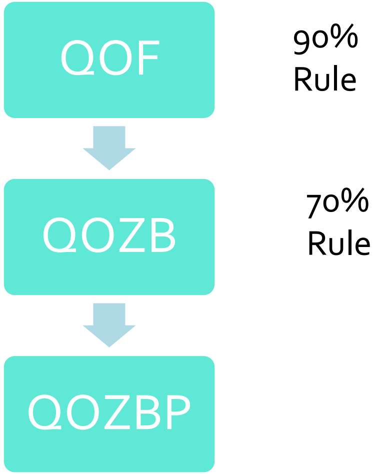
- 70% of the tangible property (real and personal) must be used in the opportunity zone
- 50% of the total gross income is derived from the active conduct of the business in an opportunity zone
- A substantial portion of the intangible property of the entity is used in the active conduct of the business
- Under 5% of the business property is attributable to nonqualified financial property which excludes reasonable working capital

The 70% Substantially All Rule & QOZ Subsidiary

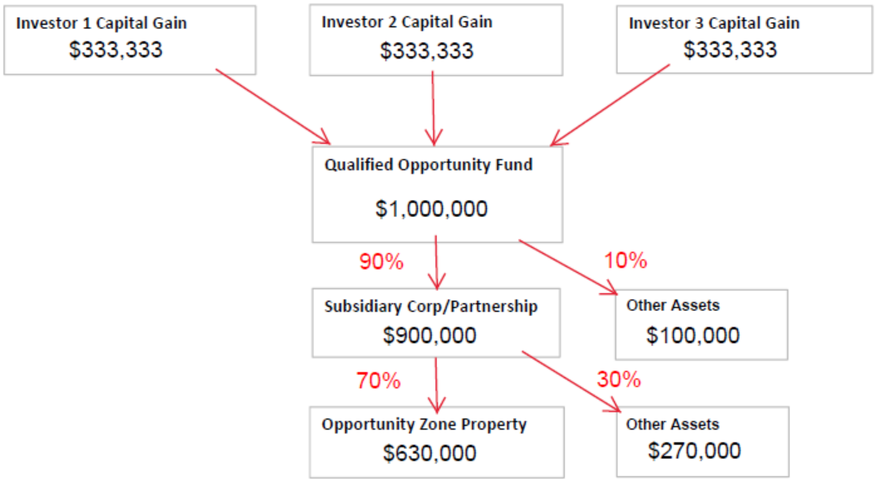
- In order for the taxpayer to be considered a Qualified Opportunity Zone Business (QOZB), substantially all or at least 70% of the tangible property owned or leased by the taxpayer must be QO Zone Business Property (QOZBP).
- QOZ Subsidiary must be owned by QOF and must meet the requirements of a QOZB

The Combined Structure

- By combining the 90% asset test for the QOF and the 70% substantially all test for the QOZB, the investment can have more other assets on hand to potentially diversify their investments
- In this scenario, the QOF would invest in a subsidiary QOZB, who would then invest in the qualified opportunity zone business property.



The Combined Structure



31-Month Working Capital Safe Harbor

A reasonable amount of working capital can be kept on hand by an opportunity zone business and not count against them in the calculation of qualified business property

1

For a QOZB, the amount held in working capital would count towards satisfying the 50% gross income test and the substantial portion of intangible property test being used in the active conduct of the business

2

The 31-month working capital safe harbor will provide comfort to developers and investors concerned about the 180 day timeline of getting capital gains from the QOF and into opportunity zone property

3

In the proposed regulations, there is no stipulated limit to how much money a company or fund can hold in working capital assets

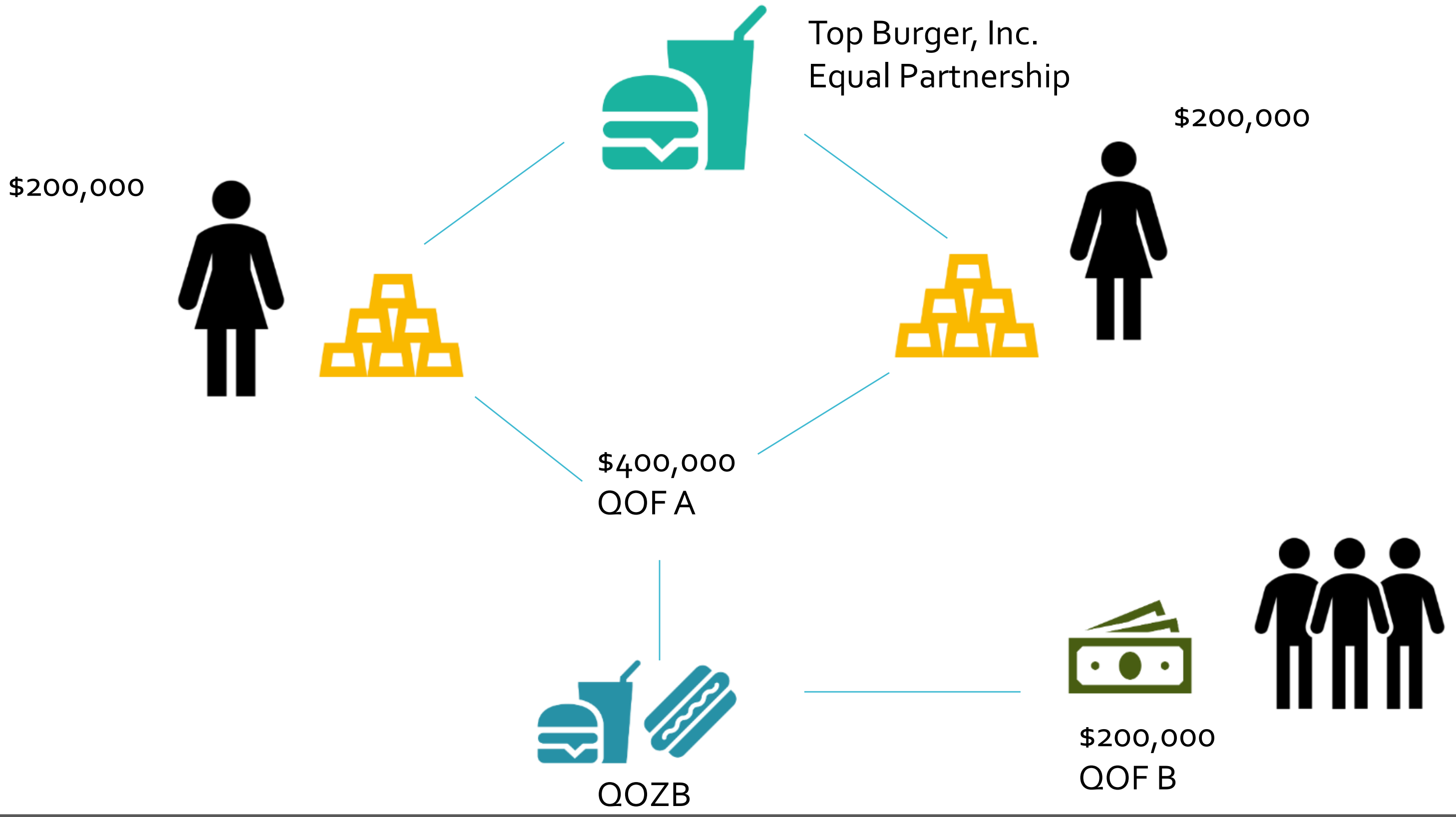
31-Month Working Capital Safe Harbor Requirements

The amount of working capital must be designated in writing for the acquisition, construction, and/or substantial improvement of tangible property in a QO Zone.

Must have a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets.

Capital must have been actually used in a manner that is substantially consistent with the above written designation and schedule.

Business Start Up Example



Technology Startup Incubator

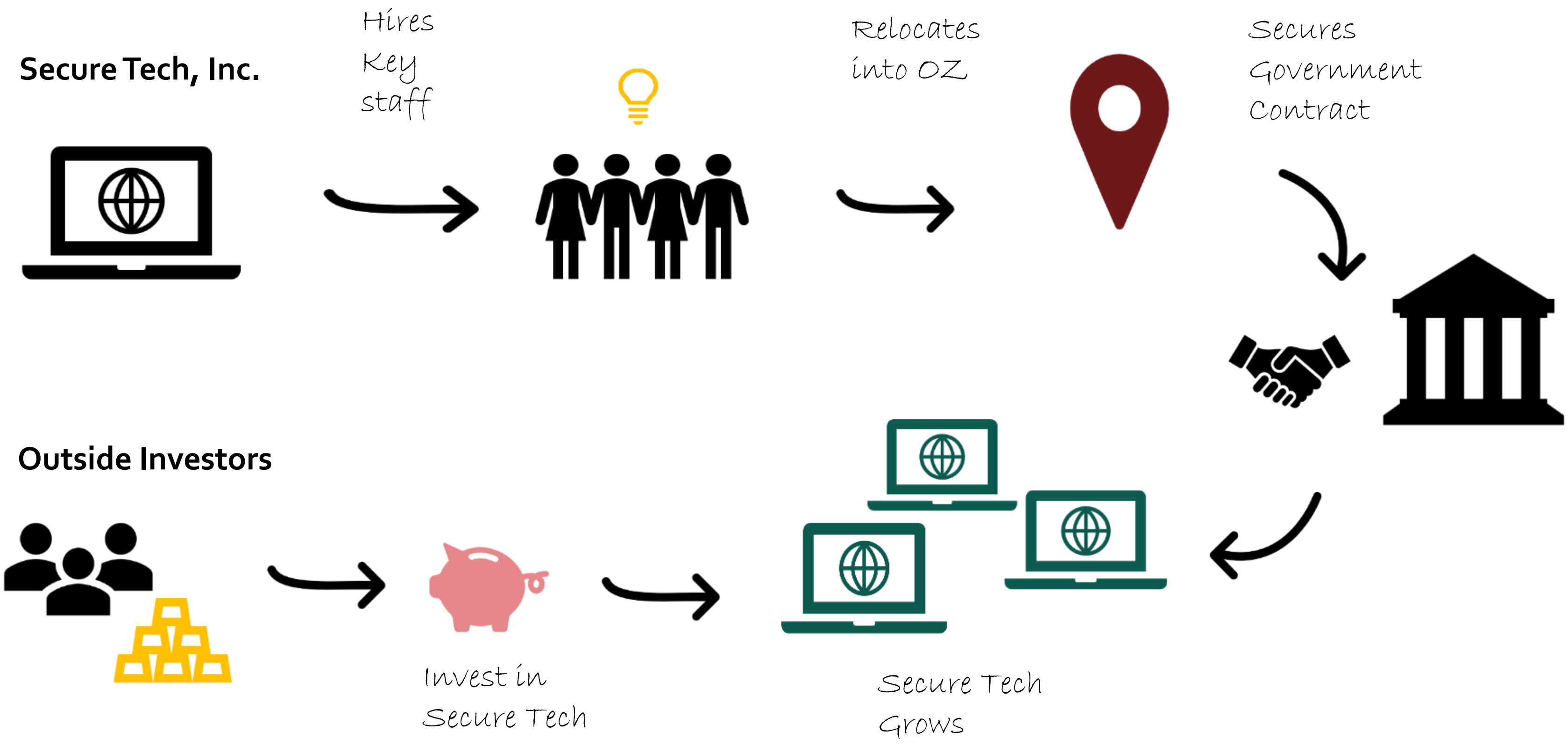
A startup incubator, which houses numerous early-stage startup businesses in one setting, is a natural fit for the opportunity zone program.

These highly scalable technology companies can hit it big (in which case you wouldn't pay the capital gains tax upon sale of your equity interest)

Pharmaceutical

- Drug development and other investment ideas that involve heavy research and development in the hopes to eventually land a key breakthrough or patent also lend themselves to the opportunity zone program.
- The downside is the same, but the upside can be significantly higher by reducing the capital gain expense you would normally have to incur when selling a higher appreciated asset.

Business Example: Government Contracts



Franchise Benefits

- Both the franchisee and the franchisor looking to expand in an opportunity zone location can roll capital gains (either their own or outside investors') into a QOF
- Both parties substantially improve the property
- After 10 years, the franchisor can sell his interest in the franchise to a new owner and pay no capital gains tax on the sale
- The Opportunity Zone program allows franchisee more incentive (ease of raising equity, higher after tax return on capital)

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CERTIFIED PUBLIC ACCOUNTANTS

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Zeiders Theater