Novogradac 2018
Financing Renewable Energy Tax Credits Fall Conference
Opportunity Zones
And Renewable Energy

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Opportunity Zones – Policy Objectives

• Designed to **spur long-term private sector investments** in LIC

• Frictionless way to **reinvest realized capital gains** into distressed communities

• 1st new national community investment program in over 15 years

• Potential to **scale** into the largest economic development program in the U.S.

• Specifically designed to channel more **equity capital** into overlooked markets.
Benefits of the Opportunity Zone Incentive
Taxpayers can get capital gains tax deferral (& more) for making timely investments in Qualified Opportunity Funds (QOFs) which invest in Qualified Opportunity Zone Property.
3 Tax Incentive Benefits

1. Capital Gain Deferral
2. Partial forgiveness
3. Forgiveness of additional gains
Period of Deferral

The period of capital gain tax deferral ends upon the earlier of:

- Dec. 31, 2026,
- or an EARLIER SALE.
Amount Recognized

THE LESSER OF:

1. Amount of capital gain deferred
   or
2. The fair market value of investment in QOF interest

MINUS:

Taxpayer’s basis in the QOF interest

Note: The taxpayer’s basis in the Opportunity Fund is initially deemed to be zero.

Note: Per the proposed regulations, the attributes of the original gain will remain when the gain is eventually recognized into income.
Partial Forgiveness and Forgiveness of Additional Capital Gains

**SALE**
-INVESTMENT (within 180 days)

<table>
<thead>
<tr>
<th>HELD FOR 5 YEARS</th>
<th>HELD FOR 7 YEARS</th>
<th>HELD FOR 10 YEARS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basis increased by 10% of the deferred gain</td>
<td>Basis increased by 5% of the deferred gain</td>
<td>Basis is equal to Fair Market Value</td>
</tr>
<tr>
<td>Up to 90% taxed</td>
<td>Up to 85% taxed</td>
<td>Forgiveness of gains on appreciation of investment</td>
</tr>
<tr>
<td>Requires an election</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028
Qualified Opportunity Fund
Qualified Opportunity Fund

- An investment vehicle taxed as a corporation or a partnership for the purpose of investing in Qualified Opportunity Zone Property (QOZP)

- Must hold at least 90% of its assets in QOZP

- Entity will self-certify using IRS form 8996
Qualified Opportunity Fund – Assets Test

Must hold at least 90% of assets in QOZP, determined by the average of the percentage of QOZP held on:

- The last day of the first six month period of the fund’s taxable year, and
- The last day of the fund’s taxable year

*Note that testing dates may not be June 30 and December 31; depends on formation date, taxable year of fund and IRS guidance*
Qualified Opportunity Fund – Noncompliance Penalty

Failure to meet 90% investment standard

Per month penalty for failing to meet 90% test

\[ \text{\% shortfall} \times \text{underpayment rate} \times \]

(Federal short-term rate plus 3%) – currently 5%

No penalty if it is shown failure is due to reasonable cause
Qualified Opportunity Zone Business and Qualified Opportunity Zone Business Property
Qualified Opportunity Zone Stock and Partnership Interests

• The investment must be **acquired after December 31, 2017 solely** in exchange for cash.

• Must be a **qualified opportunity zone business**, or is being organized for the purpose of being a qualified opportunity zone business.

• Must remain a qualified opportunity zone business for **substantially all** of the qualified opportunity fund’s holding period.
Qualified Opportunity Zone Businesses (QOZB)

A trade or business in which substantially all (70 percent) of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (QOZBP) and:

- At least 50% of income derived from Active Conduct
- Substantial portion of intangible property used in active conduct of business
- < 5 percent unadjusted basis of property is nonqualified financial property

Note: QOZB cannot be an Excluded Business.
Qualified Opportunity Zone Business Property (QOZBP)

- **Tangible property** used in a **trade or business**
- Acquired by **purchase from an unrelated party** (20% standard) after December 31, 2017
- During **substantially all** of holding period, substantially all the use is **in a QOZ**
- **Original use in the QOZ** commences with the taxpayer

**OR**

- Taxpayer **substantially improves** the property
  - during any 30-month period after acquisition, additions to basis exceed an amount equal to the adjusted basis of such property at the beginning of such period

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**Note:** The land purchased along with a building is excluded from the original use and substantial improvement provisions.
<table>
<thead>
<tr>
<th>Requirement</th>
<th>Direct Investment</th>
<th>Indirect Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of Opportunity Fund’s assets that must be invested in qualified opportunity zone business property</td>
<td>90%</td>
<td>N/A</td>
</tr>
<tr>
<td>Percentage of Opportunity Fund’s assets that must be invested in stock or partnership interests</td>
<td>N/A</td>
<td>90%</td>
</tr>
<tr>
<td>Percentage of Opportunity Fund’s assets that may be held in cash or other liquid investments</td>
<td>10% (together with intangible property)</td>
<td>5% plus reasonable working capital</td>
</tr>
<tr>
<td>Percentage of Opportunity Fund’s assets that may be held in intangible property</td>
<td>10% (together with cash)</td>
<td>Unlimited, but intangible property must be used in trade or business</td>
</tr>
<tr>
<td>Percentage of Opportunity Fund’s assets that must be invested in tangible property</td>
<td>90%</td>
<td>No minimum</td>
</tr>
<tr>
<td>Percentage of gross income that must be derived from active conduct of business</td>
<td>None</td>
<td>50%</td>
</tr>
<tr>
<td>Ineligible Businesses</td>
<td>None</td>
<td>Sin Businesses</td>
</tr>
</tbody>
</table>
ITC – Structuring Considerations
ITC Structuring Options

- Non-Tax Equity ITC with Direct OZ Developer Transaction Structure: Developer receives ITC and defers capital gain and received OZ benefits
- Partnership Flip ITC with Direct OZ Investor Transaction Structure: ITC investor defers capital gain and receives OZ benefits
- Partnership Flip ITC with Indirect OZ Investor Transaction Structure: Sponsor (or other non-ITC) investor(s) defers capital gain and receives OZ benefits
- Partnership Flip ITC with Indirect OZ Developer Transaction Structure: Sponsor (or other non-ITC) investor(s) defers capital gain and receives OZ benefits
- Master Tenant ITC with Indirect OZ Investor Transaction Structure: ITC investor defers capital gain and receives OZ benefits
- Partnership Flip with Back Leverage and Indirect OZ Developer Transaction Structure: Developer and Back Leverage receives OZ benefit and ITC investor receives ITC
Non-Tax Equity ITC with Direct OZ Developer Transaction Structure

Example 1

- Bank Loan
- Qualified Opportunity Fund
- Deferred Gain Investment
- Renewable Property Owner (RPO)
- 99% Ownership
- Managing Member
- 1% Ownership
- Developer & OZ Investor

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Non-Tax Equity ITC with Direct OZ Developer
Transaction Structure

Example 1

- Developer defers capital gain tax on some/all of investment and receives OZ benefits
- Developer receives and uses the ITCs
- RPO = QOF
  1. 90% of assets in QOZP
     - Property acquired after 12/31/17
     - Original use or substantial improvement
     - During substantially all of QOF holding period, sub all of use was in QOZ
  2. Testing dates
     - Last day of 1st 6 month period of taxable year
     - Last day of taxable year
- RPO ownership will not “flip”
Partnership Flip ITC with Direct OZ Investor
Transaction Structure

Example 2

- **Renewable Property Owner (RPO)**
  - 99% Ownership
  - 1% Ownership

- **Qualified Opportunity Fund**

- **Deferred Gain Investment**

- **Bank Loan**

- **Managing Member**

- **Tax Equity Investor & OZ Investor**
  - 99% Ownership
Partnership Flip ITC with Direct OZ Investor
Transaction Structure

Example 2

- Tax Equity Investor defers capital gain tax on some/all of ITC equity investment and receive the OZ benefits
- Tax Equity Investor also receives and uses the RETCs
- RPO = QOF
- RPO ownership will “flip” after compliance period
Direct OZ Transaction Structure - Issues

• Timing of Equity Investments (180 day OZ rule vs. typical ITC equity pay-in)
• Impact of ITC investor pricing
• Holding period of investment (OZ benefits at 5-year, 7-year, 10-year)
• Basis adjustment for ITC; OZ investment with limited or no initial basis (gain deferral amount = no basis)
• Capital Account/Income Allocations
Partnership Flip ITC with Indirect OZ Investor
Transaction Structure

Example 3

- Bank Loan
  - Renewable Property Owner (RPO)
    - Managing Member
      - 1% Ownership
  - Qualified Opportunity Zone Business
  - Qualified Opportunity Zone Property
  - 99% Ownership
  - Tax Equity Investments, LLC (Partnership)
    - 99.99% Ownership
    - Tax Equity Investor & OZ Investor
    - Other Members
      - .01% Ownership
      - 99% Ownership
Partnership Flip ITC with Indirect OZ Investor
Transaction Structure

Example 3

- Tax Equity Investor defers capital gain tax on some/all of ITC investment
- Invests in Partnership (QOF) that invests in RPO
- RPO = QOZB
  1. Sub all of tangible property owned or leased is QOZP
  2. 50% gross income derived from active conduct of business
  3. Substantial portion of intangible used in trade or business
  4. Less than 5% of assets - NQFP
  5. No “sin” businesses
Partnership Flip ITC with Indirect OZ Developer Transaction Structure

Example 4

Renewable Property Owner (RPO)

Qualified Opportunity Zone Business

Bank Loan

Qualified Opportunity Zone Property

Qualified Opportunity Fund

Managing Member & OZ Investor

99% Ownership

1% Ownership

Tax equity Investor

Partnership Flip ITC with Indirect OZ Developer Transaction Structure

Example 4

Renewable Property Owner (RPO)

Qualified Opportunity Zone Business

Bank Loan

Qualified Opportunity Zone Property

Qualified Opportunity Fund

Managing Member & OZ Investor

99% Ownership

1% Ownership

Tax equity Investor
Partnership Flip ITC with Indirect OZ Developer Transaction Structure

**Example 4**

- Managing Member is QOF (partnership)
- Non-ITC member(s) defer capital gain
Master Tenant ITC with Indirect OZ Investor Transaction Structure

Example 5

Bank Loan

Renewable Property Owner (RPO)

Qualified Opportunity Zone Business

Qualified Opportunity Zone Property

49% Ownership

Master Lease

Managing Member

51% Ownership

 Qualified Opportunity Fund

Qualified Opportunity Zone Business

Master Tenant

1% Ownership

Managing Member

Tax Equity Investor & OZ Investor

99% Ownership
Master Tenant ITC with Indirect OZ Investor Transaction Structure

Example 5

- ITC Investor defers capital gain tax on some/all of its ITC equity investment
- Master Tenant = QOF
  - 90% of assets in QOZP
  - Timing issues!
- Other Assets
- RPO = QOZB
- §731 Gain issues
Master Tenant Transaction Structure

**Issues**

- Could Master Tenant qualify as QOZB?
  - Investment in landlord, loan to landlord – NQFP Issues

- Master Tenant as QOF
  - Managing member (developer/sponsor) role of managing QOF
  - RPO = QOZB – will it qualify?

- Value of OZ tax incentive?
  - Investment holding period issues
  - Value at 10-year hold in flip structure
  - Value of investment given long-term master lease structure
Partnership Flip with Back Leverage and Indirect OZ Developer Transaction Structure

**Example 6**

- **OZ Investors “Back Leverage”**
  - 99% Ownership

- **Project Sponsor**
  - 1% Ownership

- **Managing Member**
  - 5% Ownership

- **Qualified Opportunity Zone Property**

- **Qualified Opportunity Zone Business**

- **Renewable Property Owner (RPO)**
  - 95% Ownership

- **ITC Investor**
  - 95% Ownership

- **Qualified Opportunity Fund**

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Partnership Flip with Back Leverage and Indirect OZ Developer Transaction Structure

Example 6

- OZ investors “Back Leverage” defer capital gain
- No outside debt needed
- Managing Member = QOF
- RPO = QOZB
Q&A
Can the Opportunity Zone incentive be used by developers to defer the tax gain recognized on sales of projects to tax equity partnerships or lessors?
If an Opportunity Fund that is a partnership borrows money to make an investment or build a project, does this count as cash contributed by the investor that may or may not correspond to capital gains?
Question 3

Can the 10-year step-up-to-fair-market-value rule enable an investor in equipment to avoid deprecation recapture?
Question 4

Are cash reserves held by an Opportunity Fund for investment in Qualified Opportunity Fund Property considered Qualified Opportunity Zone Property?

- Cash held for investment results in failure of 90% test
- Consideration of reasonable cause provision
Question 5

When are cash reserves held by a Qualified Opportunity Zone Business considered to be “reasonable amounts of working capital” for purposes of applying the nonqualified financial property rules?

• Three requirements must be met:
  • Intended uses are designated in writing
  • There is a reasonable written schedule
  • The working capital is used in a manner substantially consistent with the designated uses and written schedule.
Question 6

Meaning of “substantially-all”

• “...substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property...” defined as 70% of tangible property

• While the substantially all test for qualified OZ business property held by an OZ business was set at 70 percent, the definition of substantially all for other rules was left undefined
Question 7

Are debt-financed distributions that do not exceed a partner’s basis in the Opportunity Fund considered sales or exchanges for purposes of the end of the tax deferral period?

- Refinanced debt proceeds distributed to partners
- Timing considerations
Opportunity Zones And Renewable Energy

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