# The Land of “OZ” Real Estate Development in Houston

The Opportunity Zone program was created by the 2017 Tax Cuts and Jobs Act to encourage investment in low-income communities (“**Opportunity Zones**”). Under this program, a taxpayer can defer an unlimited amount of tax (and obtain additional tax exclusions if certain requirements are satisfied) on gains reinvested in a “Qualified Opportunity Fund” or “**QOF**”.

**The programs three main benefits are**:

1. **Tax Deferral.** Amount reinvested is not subject to tax until the earlier of December 1, 2026 or when the investment in the Qualified Opportunity Fund is sold.
2. **Reduction of Original Capital Gains Taxes.** 10% reduction if held for five years or more and 15% reduction if held for seven years or more. The holding period must be met by December 31, 2026.
3. **Exemption of Capital Gains Tax on Appreciation**. Complete exclusion of the tax on the appreciation of the QOF (but not the original gain) if it is held for 10 years or more.

**Structure:** A basic Opportunity Zone structure can be seen below. Opportunity Zone investments can be structured to satisfy investor and sponsor preferences. Investments can be made in cash or other property.

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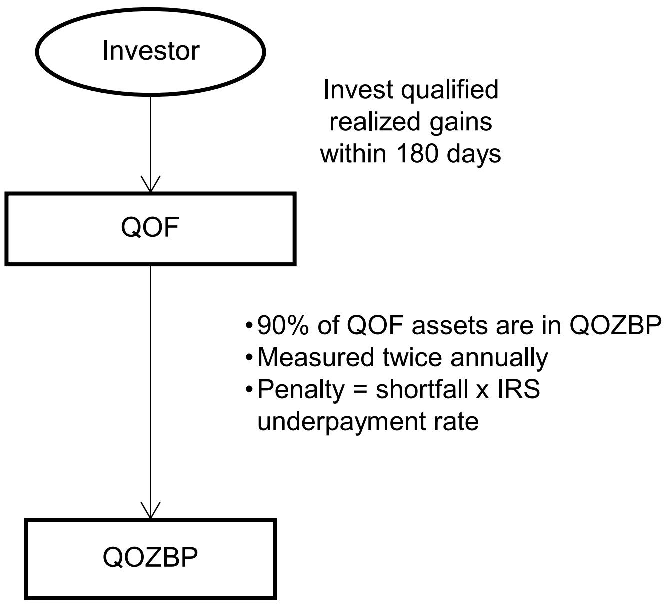
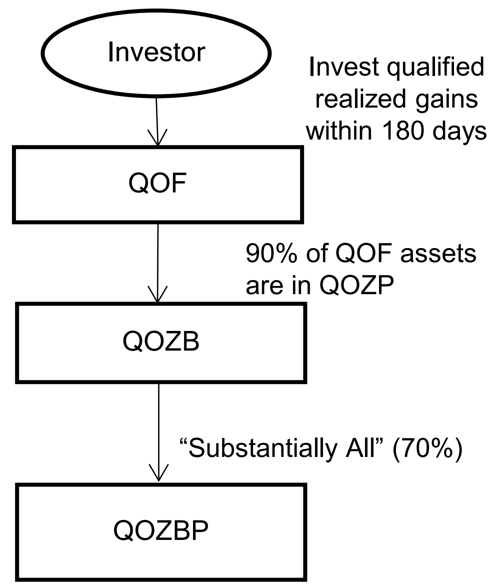
**QOF Direct Investment**




**QOF Indirect Investment**




**Qualified Opportunity Fund (“QOF”)** – an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in a Qualified Opportunity Zone (“**QOZ**”).

**Qualifies Opportunity Zone Property (“QOZP”)** – includes:

Qualified Opportunity Zone Business Property (“**QOZBP**”)
Qualified Opportunity Zone Business (“**QOZB**”) Stock or Partnership Interest

**QOZBP** is tangible property used in trade of business, if

1. Acquired by purchase after 2017
2. The original use of the property in the QOZ commences with the QOF or the QOF substantially improves the property
3. Substantially all of the use of the property is in a QOZ during substantially all of the applicable entity’s holding period
4. QOZBP cannot be acquired from a “*related person*” (20% common ownership)

**QOZB Leased Property**

1. Lease entered into after 2017
2. Lease must have market rate terms
3. Substantially all of the use of the property is in a QOZ during substantially all of the QOF’s or QOZB’s holding period
4. Lessee (except with respect to unimproved real property) cannot have plan/intent/expectation to purchase the property for less than fair market value as of the time the lease is entered into
5. Leases between related parties OK provided that (i) no prepayments for period of use exceeding12 months and (ii) if lessee is not the original user of leased tangible property, lessee must acquire other QOZBP that has a value not less than the value of the leased property

# The Land of "OZ": What do Opportunity Zones Mean for Houston?

**QOZB Qualification:** Taxpayers considering a QOF investment should consult advice from accounting and legal professionals to ensure the business qualifies. The basic criteria can be seen below.

**A QOZB must be a trade or business where:**

- At least 50% of total gross income is derived from the active conduct of the business within a QOZ.
- A substantial portion of the intangible property is used in the active conduct of the business.
- Less than 5% of the average aggregate unadjusted basis of property is attributable to "nonqualified financial property". *See* Working Capital Safe Harbor below.
- Cannot be a "sin business" (a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other gambling facility, or a store the principal business of which is the sale of alcoholic beverages for consumption off premises).

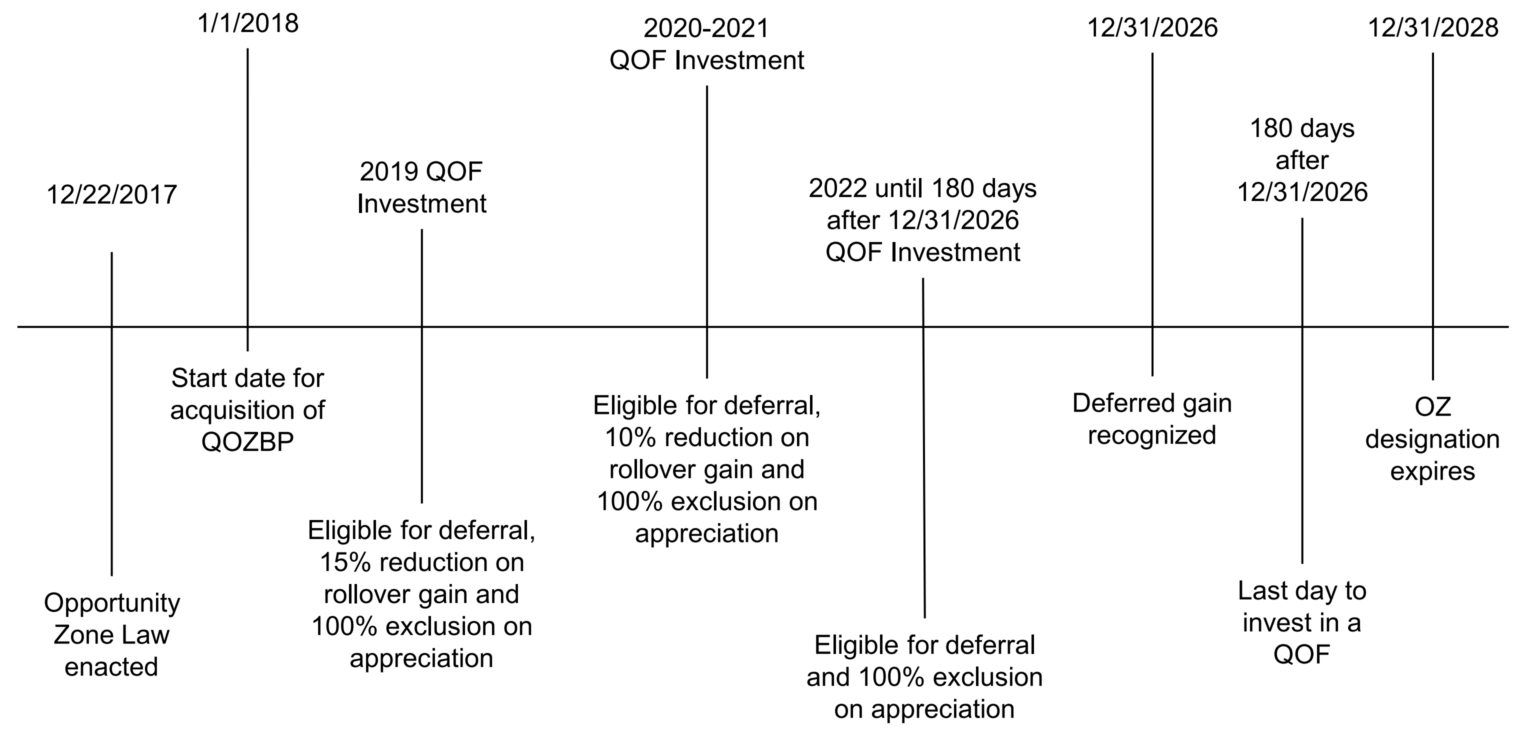
**Working Capital Safe Harbor:**

- Working capital for the development of a trade or business in a QOZ, including when appropriate the acquisition, construction, and/or substantial improvement of tangible property in a QOZ
- Written schedule for the expenditure of the working capital within 31 months
- QOZB can have multiple overlapping or sequential 31-month working capital safe harbors
- Exceeding the 31-month period does not violate the safe harbor if the delay is attributable to waiting for government action the application for which is completed during the 31-month period

**Original Use and Substantial Improvement**

- The "original use" of QOZBP must commence with a QOF (or its QOZB)
- Neither the original use or substantial improvement requirement is applicable to unimproved land, but unimproved land must be used in a trade or business (i.e., no land-banking).
- Property is treated as "substantially improved" if during the 30-month period after the acquisition of property, total additions to the property exceed the adjusted basis of the property at the beginning of such period.
- Land and an existing building can be substantially improved by expenditures in excess of the existing building basis without regard to land basis.

## Opportunity Zone Timeline:




**Contact:** For additional questions or comments, please do not hesitate to reach out to your panelists.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