

Opportunity Zones 2.0 Hawaii

Snell & Wilmer L.L.P.

Agenda

- 1) What is OZ 1.0
- 2) What's new in OZ 2.0
- 3) Using OZ 2.0 in 1.0
- 4) What is Next

Opportunity Zones under current law

“OZ 1.0”

What is OZ 1.0?

2017 Tax Cuts and Jobs Act (TCJA)

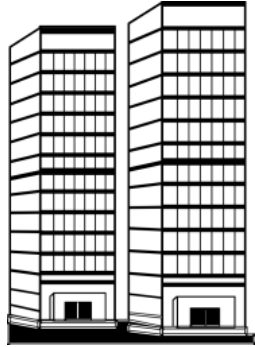
Placed based incentive

Benefits under the TCJA (“OZ 1.0”) were set to phase out

3 Income Tax Benefits

- Deferral of gains until December 31, 2026
- Partial exclusion of the deferred gains (currently phased out)
 - 10 - 15% reduction
- 100% exclusion of subsequent gains after a 10-year hold & sale of the OZ investment
- Includes exclusion of depreciation recapture

Possible Investments in Opportunity Zones



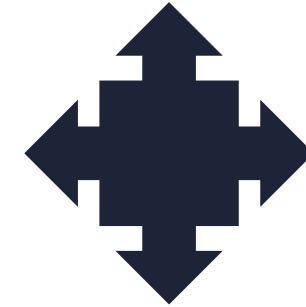
**Real Estate
Development and
Significant
Rehabilitations in
Opportunity
Zones**



**Opening
New
Businesses in
Opportunity
Zones**



**Acquiring an
Existing Business
and Relocating it
(with Expansion) in
an Opportunity
Zone**



**Large Expansions of
Businesses already
within Opportunity
Zones**

Example of OZ Investment



Investor in a business is allocated \$1M of eligible gains, reported on IRS Form K-1



Investor, within the applicable 180-investment period, contributes an amount equal to or less than the \$1M gain into a multi-member LLC treated as a “qualified opportunity fund” (the **QOF**)



QOF as 99% member, contributes at least 90% or \$900K to another LLC treated as a “qualified opportunity zone business” (the **QOZB**)— this is the project company that develops the RE or operating business. A second member contributes at least 1% equity to the QOZB.

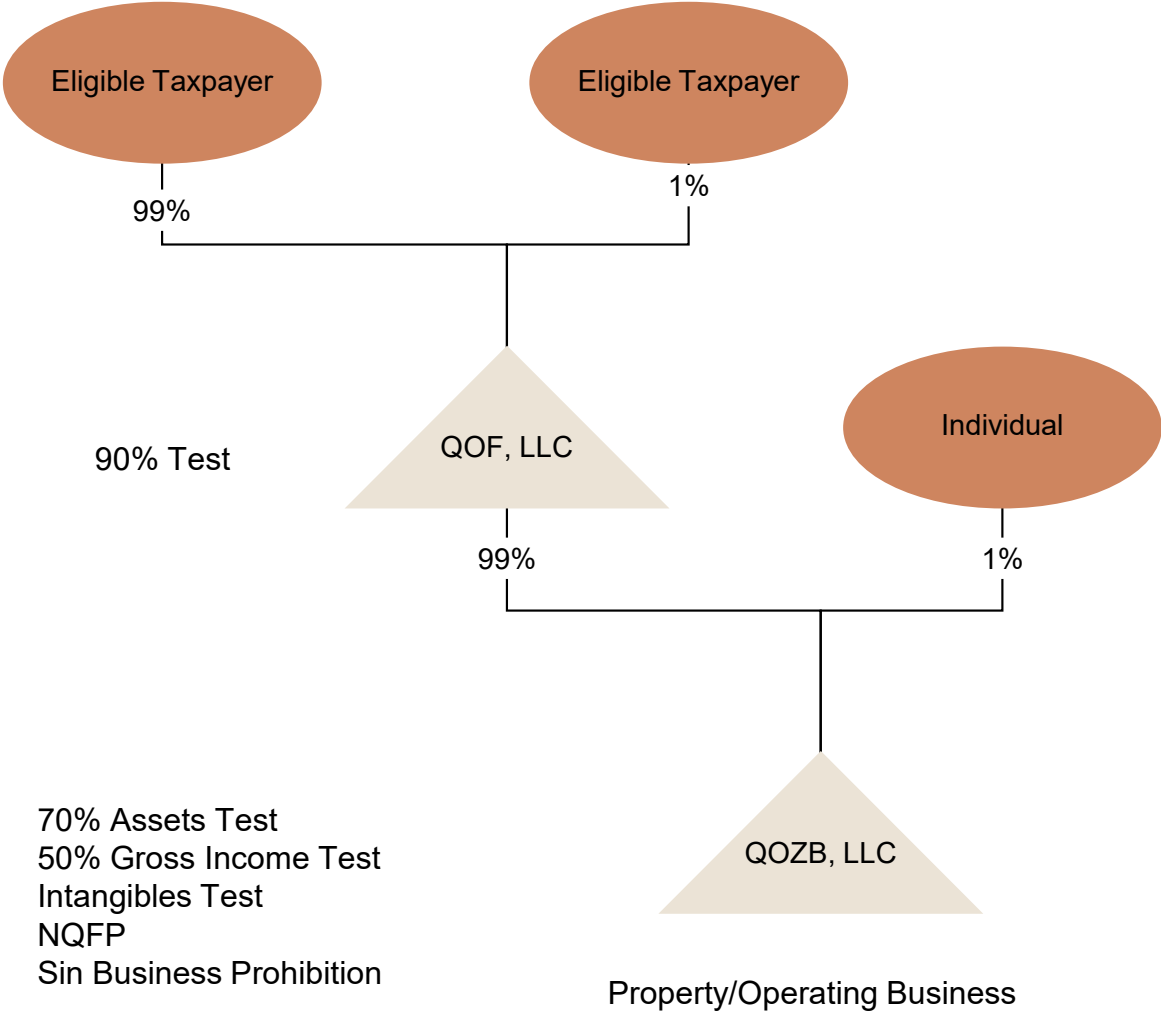


The QOZB develops the project within specific time frames, which can be strategically timed by the investor.



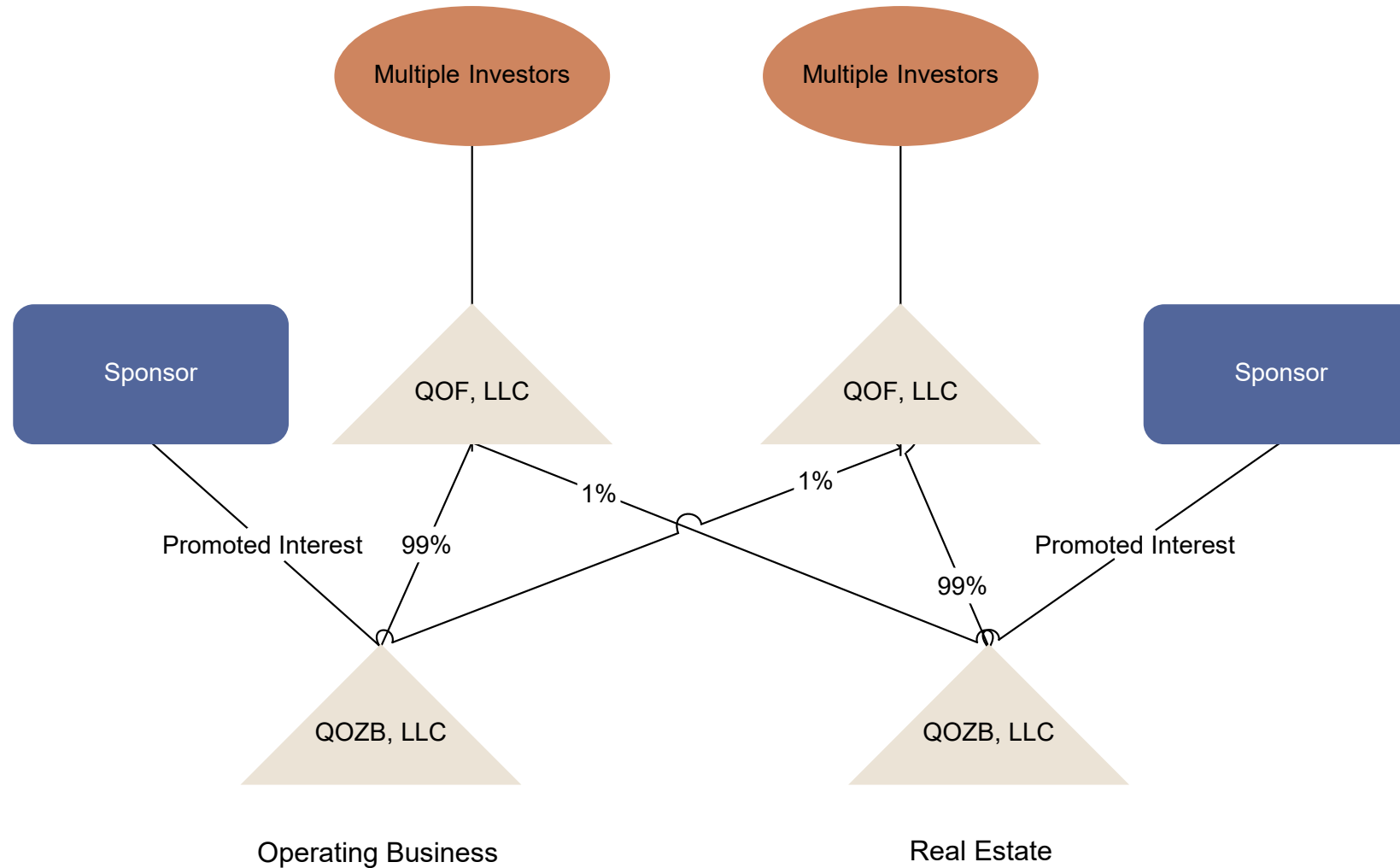
QOF investment held for 10 years can be sold tax-free without depreciation recapture.

Structure



- 1. 70% Assets Test
- 2. 50% Gross Income Test
- 3. Intangibles Test
- 4. NQFP
- 5. Sin Business Prohibition

3rd Party Sponsor Model



What is a Qualified Opportunity Fund (QOF)?



Investment vehicle between investors and the project in an opportunity zone



Statutory requirements:

Can be a corporation or partnership for tax purposes 90% of all property held by the QOF must be certain opportunity zone property (“**90% Requirement**”)

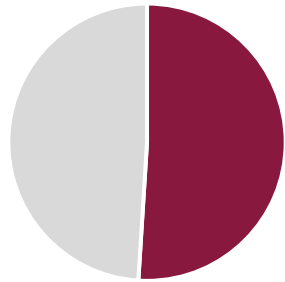
Must self-certify as a QOF on its income tax returns



Penalty imposed for noncompliance with 90% Requirement

Qualified Opportunity Zone Businesses (QOZBs)

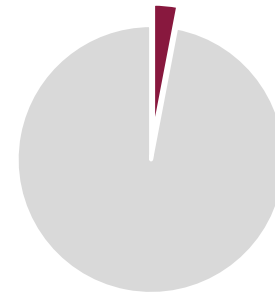
*A trade or business in which **at least 70%** of the **tangible property** owned or leased by the taxpayer is Qualified Opportunity Zone Business Property (“**QOZBP**”) and:



At least 50% of income derived from active conduct of trade or business within an Opportunity Zone



At least 40% of intangible property is used in active conduct of business within an Opportunity Zone



< 5% unadjusted basis of property is nonqualified financial property (cash, cash equivalents, long-term loans)

Qualified Opportunity Zone Business Property (QOZBP)

Key Definition (Especially for Real Estate)

QOZBP Requirements:

1. **Tangible property** used in a **trade or business**;
2. Acquired by **purchase from an unrelated party** (more than 20% standard) after December 31, 2017 (December 31, 2026, for OZ 2.0);
3. During substantially all of the holding period, at least 70% of the property's use must be within an Opportunity Zone ("70% Test"); and
4. **Original use** of tangible property begins in the Opportunity Zone with the QOZB (or QOF); **or substantially improves** such property.

QOZB – Important Cliff Issues

- Potential Circular Cash Flow Treatment
- QOZB as Lessor
 - Issue with lease treated as a financing lease?
 - Profits kickers
- QOZB as Lessee
 - Prepayments: IRC Section 467 Leases
 - Related Party lessor: Potential Recast as a Sale (Impact on the 70% Test)

QOZBP: Leasing

Leased Property can be QOZBP if:

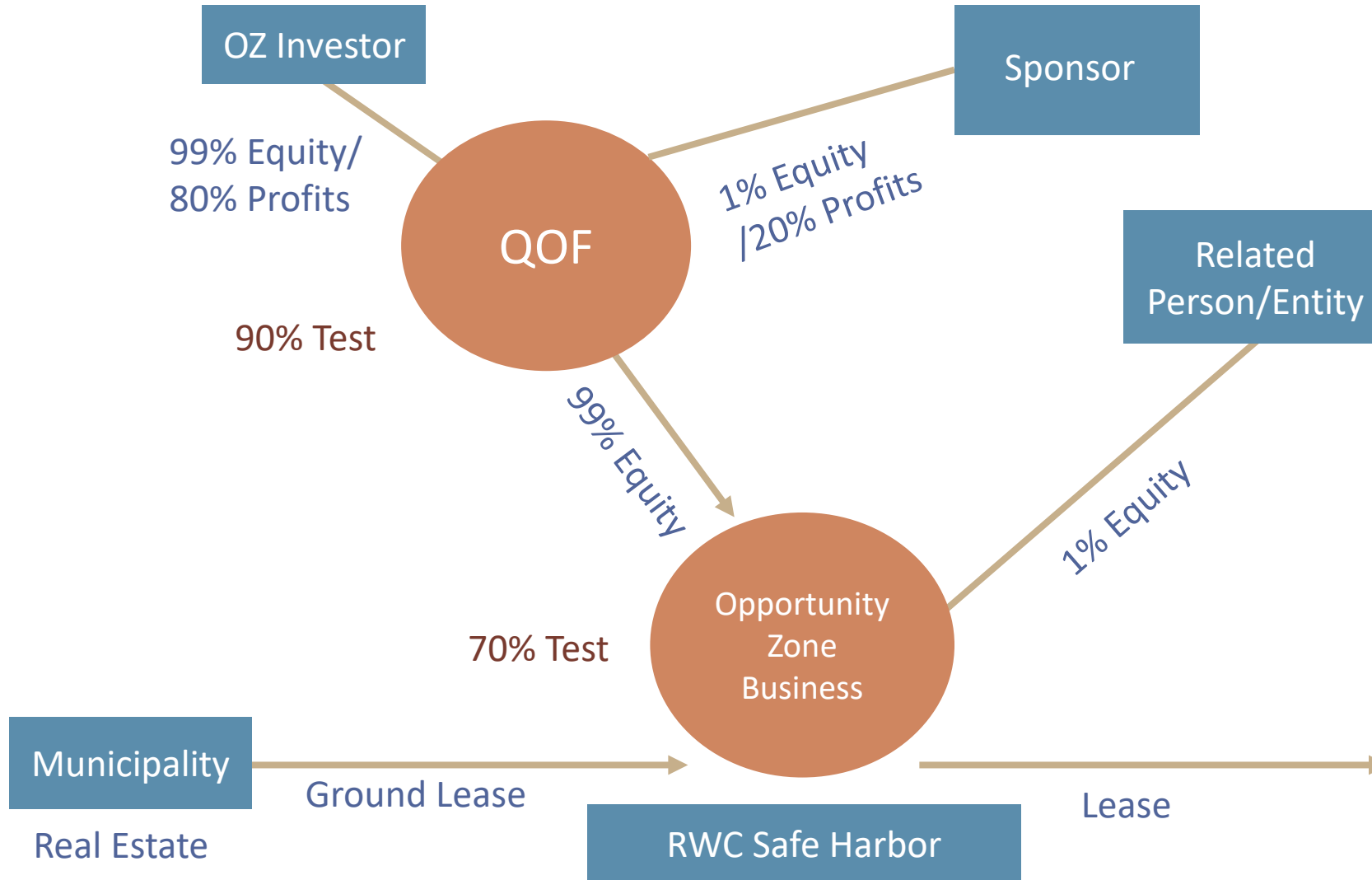
- Entered into **after December 31, 2017**
- Terms of the lease are **market rate**
 - Rebuttable presumption when unrelated.
 - No FMV needed when state or local government or Native American Tribe is Lessor

Value of Leased Asset Generally Based on FMV of Lease Payments for Both GAAP and Alternate Valuation

- GAAP Lease Rules
- Alternative Valuation – Present Value of Property at AFR

Acquisition of a leasehold interest – implications?

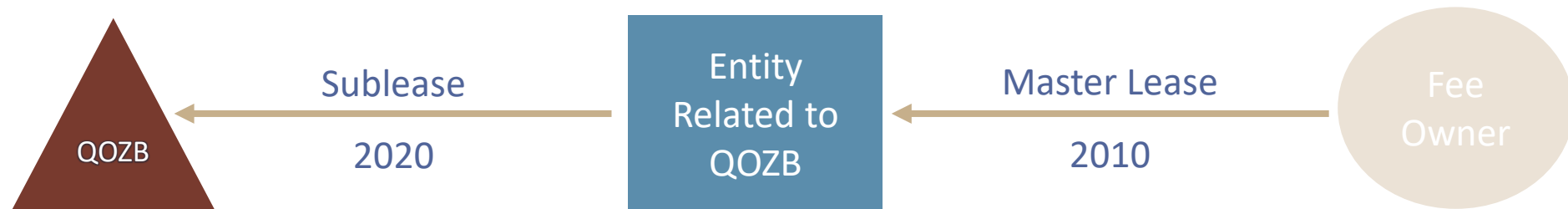
Lease Structure



Related Party Leasing

Additional Terms where lessor and lessee are related:

- No prepayments related to use of property exceeding 12 months
- Leased Tangible Personal Property: Lessee Must Acquire QOZBP to be used in same QOZ of equal or greater value of the leased tangible personal property.
 - Valuation of leased property



Related Party Leasing and NQFP

- Leasing Configurations May Become Complicated
 - Consider Exit Implications
 - Key Consideration is Arms Length and Market Value Components of Lease
- NQFP: Lease with Large Prepayments (Excess of \$250K) may Trigger IRC Section 467 Loan for Tax Purposes
 - Remember, Loans Receivable Typically Considered NQFP and Limited to Less than 5% of Unadjusted Property
 - Typically Limited to Unrelated Leases Due to Larger Prepayments, Not Allowed in Related Party Leasing Under OZ Incentive

Excluded Businesses

**Can't be
a "Sin
Business"**

Golf Course

Country Club

Massage Parlor

Hot Tub Facility

Suntan Facility

Racetrack (or other gambling facilities)

Any store the principal business of which is the sale of alcoholic beverages for consumption off premises

What's New in OZ 2.0?

OZ 2.0 Overview

Permanent Status

- Made permanent by the One Big Beautiful Bill Act (**OBBBA**)
- Redesignation cycles of the designated zones every 10 years

New Tax Incentive Structure

- Rolling 5-6-year deferral for capital gains invested post-December 31, 2026
- 10% basis step-up after 5-6 years for standard QOFs
- Tax-free growth capped at a 30-year fair market value; 10-year hold requirement stands
- Rural OZ offers enhanced benefits for investing in rural communities

Stricter Eligibility

- Census tracts must have (1) a poverty rate $\geq 20\%$ (excluding tracts with median income $> 125\%$ of state/metro median) or (2) a median family income $\leq 70\%$ of area median

Transparency and Reporting Enhancements

New Reporting Requirements

- Investors, QOFs, businesses, and states will be required to provide data about investments or face monetary penalties.
- QOFs must report location, NAICS codes, residential units, and full-time employee counts.
- Annual public reports to Congress on economic impacts (e.g., job creation, poverty reduction).

Penalties for Non-Compliance

- Fines up to \$10,000 (\$50,000 for large QOFs) for reporting failures.

Criteria for OZ 1.0 Designation

A census tract qualifies as a **Low-Income Community** if it meets either of the following:

- Poverty rate of at least 20%, or
- **Median family income** \leq **80%** of the area MFI (*based on 2011–2015 ACS data*)

Contiguous Tracts Exception

- Up to 5% of designated census tracts may be non-low-income, if:
- They are contiguous with low-income community census tracts, and
- Their median family income does not exceed 125% of the adjacent low-income tract's MFI

Not more than 25% of a state's qualifying census tracts can be designated as OZs

Stricter OZ-designation Criterion = fewer zones



The OBBBA imposes stricter criteria for OZ eligibility.



For future rounds of OZ designation, starting Jan. 1, 2027, a census tract will need to satisfy one of the following tests:

Median family income (**MFI**) below **70%** of the state (non-metro) or metro (metro areas) median (versus 80% in OZ 1.0).

• *or*

Poverty rate of 20% or greater (unchanged), plus a newly-established MFI cap set at 125% of the applicable state or metro median.



The MFI cap closes a statistical loophole that allowed a small number of high-income census tracts to qualify for OZ status.

OZ 2.0's Emphasis on Rural Investments

Enhanced Benefits for Rural OZs

Qualified Rural Opportunity Funds (QROFs)

- New category requiring $\geq 90\%$ of assets in rural OZ properties or businesses
- **30% Basis Step-Up** after 5 years (vs. 10% for standard QOFs)
 - Must invest $\geq 90\%$ of assets in **rural OZ tracts**.
- **Rural Definition:** See next slide
- Note: Definition poses administrative challenges for census tract application; Treasury to clarify

Lower Substantial Improvement Threshold

- Reduced from **100%** to **50%** of adjusted basis for rural OZ investments
- Makes projects that include existing buildings/improvements more feasible

Defining “Rural” in OZ 2.0

Rural OZ Definition

- Notice 2025-50: “Rural” area is defined as an area other than (i) a city or town with a population of greater than 50,000, and (ii) any urbanized area contiguous and adjacent to a city or town with a population of greater than 50,000.
- Notice 2025-50 applies for determinations made on or after July 4, 2026.
- Notice 2025-50 lists 3,309 opportunity zones which are currently rural areas.

Revenue Procedure 2026-12



Using OZ 2.0 in 1.0

6-year Deferral Period

Deferral is 5 years from when investment is made to a QOF

6-year deferral period applies when investment is made in the taxable year following the year the eligible gain is generated by a pass-through entity

Example: Asset sold in pass-through entity and eligible gain is allocated to owner

- Jan. 2027 – sale of asset by pass-through entity
- Jan. 2028 – owner receives Form K-1 allocating 2027 gain
- Sept. 2028 – owner invests in QOF
- April 2033 – five years after investment in QOF, gain is recognized on owner's tax return

Result: 2033 recognition is 6 years from year of sale, 2027.

Overlap of OZ 1.0 Zone Designations with OZ 2.0 Benefits



Key Dates:

Jan 1, 2027: OZ 2.0 designations effective; stricter criteria apply

Jan 1, 2027 - Dec 31, 2028: Overlap period where OZ 1.0 tracts remain eligible

Dec 31, 2028: OZ 1.0 designations expire



Investment Advantage: Invest after Dec. 31, 2026, in a QOF engaged in a OZ 1.0 tract

OZ 1.0 tracts (more lenient criteria: poverty $\geq 20\%$ or median income $\leq 80\%$ of area median) using OZ 2.0 benefits

OZ 1.0 includes tracts that may not qualify under OZ 2.0's stricter rules (*e.g.*, median income $\leq 70\%$ of area median)

OZ 2.0 Fund Investing in OZ 1.0 Tract

OZ 1.0 tracts remain designated through 2028

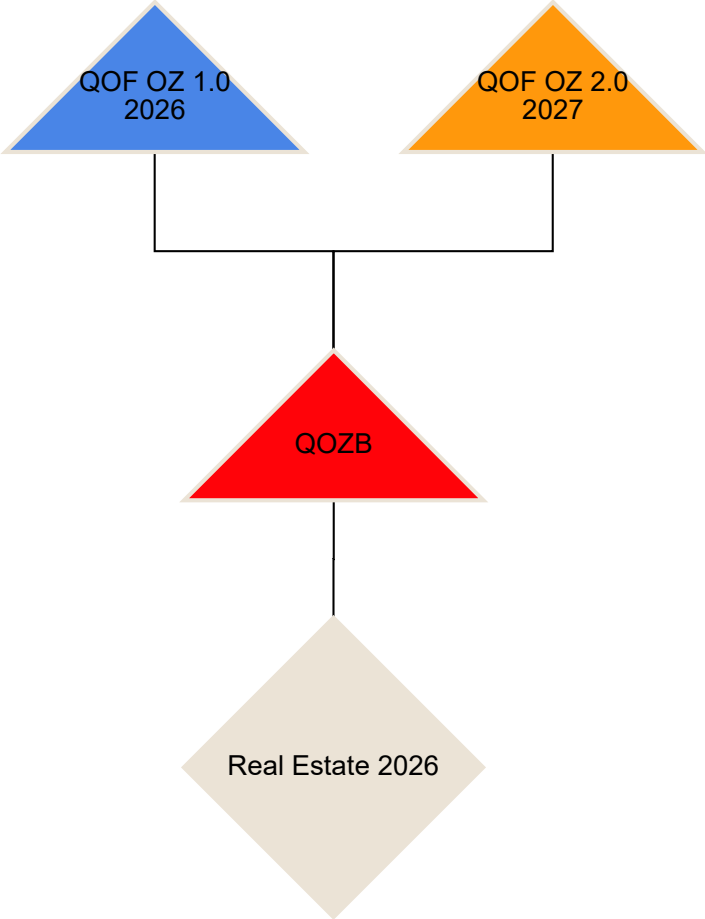
Transition rules are needed from Treasury Department

QOZB acquires property in an OZ 1.0 tract in 2026

OZ 2.0 QOF formed & funded on or after 1/1/2027 (when OZ 2.0 benefits take effect)

OZ 2.0 QOF invests into the QOZB

Combining OZ 1.0 and 2.0



Legend

- ◆ RE or Construction
- ▲ Partnership
- ▲ Partnership
- ▲ Partnership
- └ Ownership

Combining the Opportunity Zone Incentive



Historic Tax Credits

State and Federal

5 Year Recapture Period

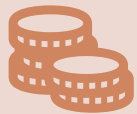
Can syndicate to 3rd parties or allocate to OZ investors



New Markets Tax Credits

Effectively a low interest loan with some forgiveness

7 Year Recapture Period



Energy Tax Credits

Transferable Tax Credits

Accelerated Losses (avoids depreciation recapture)

What is Next



July 1, 2026 – 90 Day Designation Period



Modifications to Regulations – Late 2026



Late 2026 – New OZs are certified



January 1, 2027 – OZ 2.0 QOF Investments Commence

Thank you!

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Thank You

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