Tucker Ellis LLP

CLIENT ALERT

U.S. TREASURY PROPOSES NEW OPPORTUNITY ZONE REGULATIONS

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On April 17, the U.S. Department of the Treasury issued its second set of proposed regulations to clarify the Opportunity Zones tax incentive created under the 2017 Tax Cuts and Jobs Act (the "Act"). Opportunity Zones were created to spur economic development and job growth by encouraging long-term investments in economically distressed areas. These new proposed regulations provide guidance under Internal Revenue Code Section 1400Z-2[1] and update portions of the first set of proposed regulations for Opportunity Zones introduced in October 2018.

While the newly issued regulations address several topics relevant to investors, funds, operating businesses, and developers leveraging Opportunity Zone investments, the more noteworthy changes and clarifications include the following:

- *Longer Period for QOF to Invest* – The new regulations have eased the time period for a Qualified Opportunity Fund (QOF) to invest capital received from investors. Previously, the amount of time the QOF would have to invest depended on the investor's 180-day period after realizing a capital gain. Under the newly proposed regulations, QOFs are granted six months from receipt of capital to put those funds to use in a Qualified Opportunity Zone (QOZ).
- *Longer Period for QOF to Re-Invest* – The Act provides a "reasonable time" to reinvest cash proceeds from the interim sale of Opportunity Zone Property into replacement Qualified Zone Property for purposes of satisfying the 90% investment test. Under the new regulations, that "reasonable time" is defined as 12 months.
- *50% Requirement Safe Harbors* – The proposed rules provide three potential safe harbors for a Qualified Opportunity Zone Business (QOZB) to comply with the requirement that 50% of its income be derived within a QOZ. If a QOZB fits into any of these safe harbors, the 50% test will be deemed satisfied if:
    - At least 50% of services (measured by hours) performed for such business by its employees and independent contractors are performed within the QOZ;
    - At least 50% of the services performed for the business by its employees and independent contractors are performed within the qualified QOZ, based on the amounts paid for the services performed; or
    - The tangible property and management functions of a business that is located in a QOZ generates 50% of the gross income of the trade or business.
- *Leased Property Can Be QOZB Property* – Previously unclear, the new regulations affirm that a business operating within a QOZ may count leased tangible property as part of the necessary investment so long as the lease occurs after December 31, 2017 and substantially all of the leased tangible property is located in a QOZ.
- *Treatment of Land* – While unimproved land needs to be used in a trade or business and not merely held for investment in order to be QOZB Property, there is no requirement for such land to be substantially improved as there is with improved real estate.
- *Interim Distributions* – A distribution by the QOF to an investor during the holding period is an inclusion event for tax purposes only to the extent that the distribution has a fair market value in excess of the investor's basis in its qualifying investment.

We are continuing to review the proposed regulations and will monitor and report on any forthcoming guidance regarding the Opportunity Zone program.

[1] 26 U.S.C.A. § 1400Z-2.

ADDITIONAL INFORMATION

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