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16 Takeaways from the Second Round of Opportunity Zone Regulations

Perhaps Treasury intentionally waited until after March Madness to release the long-awaited second round of proposed regulations on Opportunity Zones since the proposed regulations presents its own Sweet 16. While Treasury certainly provided a good deal of clarity to critical questions with respect to Opportunity Zones, here are what we believe to be the Sweet 16 of takeaways from the proposed regulations (as with Oscar nominations, we have separated these into categories but present them in no particular order):

<u>Relating to Qualified Opportunity Zone Business Property (“QOZBP”)</u>

1. Original use of the property commences when the property is first placed into service for purposes of depreciation or amortization in the Qualified Opportunity Zone (a “Zone”).
2. Original use test can be met if a building has been vacant for at least five years prior to its purchase by a Qualified Opportunity Fund (a “Fund”) or Qualified Opportunity Zone Business (a “QOZB”) and is placed back into service by the Fund or QOZB.
3. Leased tangible property can be QOZBP if the lease is dated after Dec. 31, 2017.
4. Property leased from related parties can be QOZBP provided that the lease is on market terms and does not allow for a prepayment of more than 12 months of rent.
5. Unimproved land does not require substantial improvement, but the land must be used in the conduct of a trade or business.
6. An Opportunity Zone project may straddle opportunity zone and non-opportunity zone real estate if the amount of real estate in the Zone is substantial compared to the real estate outside of the Zone.

<u>Relating to Qualified Opportunity Zone Businesses (“QOZB”)</u>

7. Merely entering into a triple net lease of real property does not qualify as the active conduct of a trade or business.
8. The 31-month working capital safe harbor may be extended if there is a delay due to government action or inaction.

9. Three safe harbors for meeting the 50% gross income test were provided—including tests based on the services performed in the Zone (based on hours and based on amounts paid) by the QOZB's employees and independent contractors.

Relating to Qualified Opportunity Funds (and qualified investments therein)

10. Cash invested in the Fund within the six months prior to the Fund testing date is excluded from the calculation of the 90% test.
11. Cash resulting from the Fund's sale of Qualified Opportunity Zone Property ("QOZP") will be treated as QOZP for purposes of the 90% test if the proceeds are reinvested in QOZP within 12 months and the proceeds are continuously held in cash, cash equivalents and short-term-debt instruments until reinvested in QOZP. However, the Fund and its investors are not shielded from the tax consequences of such a sale unless the 10-year hold period is met at the time the gain would be recognized (see takeaway #15).
12. Profits/promote interests provided for services rendered to the Fund will not be eligible for the Opportunity Zone tax benefits.
13. A taxpayer can acquire an eligible interest in a Fund by directly purchasing the interest from an existing partner or shareholder in the Fund.

Other Takeaways

14. Debt-financed distributions from the Fund (subject to the normal disguised sale rules) are permitted.
15. Investors in Funds that are partnerships or REITs may exclude their allocable share of capital gain arising from the Fund's sale of QOZP if the investor has held its interest in the Fund for 10 years, allowing for an easier exit for Funds owning multiple properties/assets.
16. A general anti-abuse rule requires that the Opportunity Zone rules be applied in a manner consistent with the purpose of the intent of the legislation.

With this latest set of regulations, Treasury has continued to widen the lanes for allowable activity to encourage investment in Opportunity Zones while attempting to maintain the original spirit of the legislation. Our team of attorneys will continue to assess the impact these rules will have on investment in Opportunity Zones and how clients can take advantage of the tax benefits.

Click here for our previous analysis on Opportunity Zones.This document is intended to provide you with general information regarding tax policy updates. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions

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