What to Know about the Second Round of Proposed Opportunity Zones Regulations

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Effective Implementation, Alignment, and Transparency

- Second Round of Proposed Regulations
  - Comments due July 1, Hearing scheduled for July 9
  - EIG’s initial summary of the regulations
- RFI on Data Collection - Comments due May 31
- RFI from US Dept. of Housing & Urban Development - Comments due June 17
- White House Opportunity and Revitalization Council Implementation Plan
  - Scott Turner named Executive Director, kicks off listening tour
  - White House Opportunity Conference
- S. 1344 introduced on May 8 to reinstate reporting requirements and expand transparency
- Forthcoming proposed legislation to provide a one year extension of deferral date through end of 2027
Takeaways: Second Round of Proposed Rules

The success of this policy starts with a regulatory framework that facilitates investment into new and growing operating businesses and improves the built environment in Opportunity Zones.

The second round of proposed rules addresses many key gating issues and provides clarity needed for investors and fund managers to deploy capital.

- Provides clarity to investors on the timing requirements for capital deployment and reinvestment, as well as Opportunity Fund exits
- Issues guidance on the applications of tests outlined in the statute for leased property
- Defines key terms and their applications, such as original use, substantially all, and substantial improvement
- Provides additional flexibility for the working capital safe harbor and the 50% gross income test
Opportunity Fund Operations
Key Issues: Opportunity Fund Operations

Life Cycle of an Investment

- QOF Formation
  - Satisfaction of 90% asset test

- Operation
  - Distributions to investors
  - Dispositions of assets/reinvestment

- Exit/Wind-Up
Qualified Opportunity Fund Formation

- 90% Asset Test - Average of percentage measured at the end of six months and at the end of the taxable year

- Proposed regulations provide option to disregard working capital received within six months for purposes of the 90% test
  - Opportunity funds effectively have a minimum of six months (and potentially up to nearly 12 months) to deploy capital once received from investor

- Valuation of assets can be based on either value reported on applicable financial statement or unadjusted cost basis
  - Same valuation option applies for requirement that 70% of a qualified opportunity zone business’s tangible property be qualified opportunity zone business property
Operation

- Basis in Opportunity Fund
  - Outside basis starts at zero
  - Increased by allocable share of debt and operating income
  - Increased by 10% and 5% basis increases after holding five and seven years, respectively
  - Inside basis is carryover, which creates inside-outside basis disparity

- Distributions not in excess of basis are not inclusion events and do not trigger deferred gain

- Interim Gains
  - 12-month reinvestment period, if proceeds held as working capital
  - Does not trigger deferred gain
  - However, flow-through income is taxable to investors
Key Issues: Opportunity Fund Operations

Exit/Wind-Up

- Sale of Qualified Opportunity Fund Interests
  - Election to step-up basis of qualified opportunity fund assets to avoid “hot asset” income

- Fund Sale of Qualified Opportunity Zone Property
  - Election to exclude qualified opportunity fund capital gains (from sale of qualified opportunity zone property) reported on K-1
Operating Businesses
Key Issues: Operating Business

- **Working Capital Safe Harbor**
  - Extended to operating businesses
  - Extension for delays attributable to waiting for government action
  - Multiple 31 month-periods

- **50% Gross Income Test**
  - Qualified opportunity zone business must derive at least 50% of its gross income from active conduct of trade or business “in the qualified opportunity zone”
  - New safe harbors
    - Services performed in the zone (by hours)
    - Services performed in the zone (by amount paid)
    - Tangible property and management in the zone

- **Intangible Assets:** 40% of intangible property must be used in the active conduct of a trade or business in the opportunity zone
Key Issues: Operating Business

- **Leased Property**
  - Treated as qualified opportunity zone business property if meet certain requirements
  - No original use or substantial improvement requirement
  - Related party leases permitted if meet certain requirements
  - Valuation = present value of lease payments

- **Original Use and Substantial Improvement**
  - Original use of tangible property commences on date placed in service in the opportunity zone for purposes of depreciation or amortization
  - Substantial improvement determined asset by asset
Real Estate
Ownership or operation of real property (including leasing) constitutes **active conduct of a trade or business**
- “Merely” entering triple net lease is not active conduct

Treatment of IRC Section **1231 gains**
- Net section 1231 gains are eligible for deferral
- 180-day investment period begins on last day of tax year

Original use or substantial improvement
- Placed in service in the opportunity zone
- Buildings vacant for five years treated as original use
- No substantial improvement requirement for unimproved land
Next Steps: Submit Comments and Sign Up to Testify

- Second Round of Proposed Regulations
  - Comments due **July 1**
  - Hearing scheduled for July 9, submit request to testify by July 1
- RFI on Data Collection
  - Comments due **May 31**
- RFI from US Department of Housing & Urban Development
  - Comments due **June 17**
Appendix
Select Resources for Additional Information

Our Research and Resources:

- The State of Socioeconomic Need and Community Change in Opportunity Zones (December 2018)
- Opportunity Zones: The Map Comes Into Focus (June 2018)
- 2018 Distressed Communities Index (2018)
- Additional information can be found on our website.

External Resources:

- Novogradac | Opportunity Zone Resource Center
- Drexel University | Nowak Metro Finance Lab
- The Governance Project | Opportunity Zones
- Accelerator for America | Opportunity Zones
- Internal Revenue Service | Opportunity Zones FAQ
- U.S. Treasury Department | Opportunity Zone Resources
- NCSHA | Opportunity Zone Fund Directory
- Council of Development Finance Agencies | Opportunity Zones
- Georgetown’s Beeck Center | Opportunity Zones
- Impact Framework for Investors | OZ Framework
The Opportunity Zones Coalition is a group of organizations working together with a broad array of public and private stakeholders to ensure the timely and effective implementation of the policy.

If you are interested in learning more about the Coalition, please contact info@eig.org.

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