# OPPORTUNITY ZONES SERIES

## Final Regulations Enhance Tax Incentive Program

In December 2017, the Tax Cuts and Jobs Act of 2017 added the Opportunity Zones program to the Internal Revenue Code. The Opportunity Zones program provides for the deferral and reduction of capital gains tax and possible permanent exclusion from federal income taxation of eligible capital gains. Taxpayers realize these benefits by investing in Qualified Opportunity Funds that have assets invested in designated low-income census tracts and designated adjacent tracts. New York State has 514 low-income and adjacent census tracts designated as Opportunity Zones, of which 208 are located in Upstate New York. A full listing of Opportunity Zones can be found at: [https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx](https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx).

The rules that apply to the Opportunity Zones program are complex. The U.S. Treasury Department issued proposed regulations in May 2018 and October 2019. On January 13, 2020, final regulations were published in the Federal Register (https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-27846.pdf) and Frequently Asked Questions released (https://home.treasury.gov/system/files/136/Treasury-Opportunity-Zone-Final-Regulations-FAQ-12-19-19.docx ).

Members of our Opportunity Zone Working Group are available to discuss the program, formation of a Qualified Opportunity Fund, local government participation, tax planning and investment, and compliance with the rules by investors, developers and businesses.

**Overview of Opportunity Zone Program**

*Qualified Opportunity Fund:* A Qualified Opportunity Fund (QO Fund) is an investment vehicle which is organized as a corporation or a partnership for the purpose of investing at least 90% of its assets (90% investment standard) (1) in qualified opportunity zone stock or qualified opportunity zone partnership interests of a qualified opportunity zone business (QOZ Business) or (2) directly in qualified opportunity zone business property (QOZ Business Property). The tax benefits increase the longer the taxpayer holds an investment in a QO Fund.

*Deferral and Reduction of Capital Gains Tax: 180 Day Investment Period:* A taxpayer can defer the tax on capital gain realized on a third-party sale or exchange of property if such gain is reinvested in a QO Fund generally within 180 days of the sale or exchange. Under the program, the deferral lasts until the earlier of: (1) the date on which the investment in a QO Fund is sold or exchanged; or (2) December 31, 2026.

Opportunity Zones Team

Jean S. Everett 212.381.4870 jeverett@bhlawpllc.com
Susan R. Katzoff 315.701.6303 skatzoff@bhlawpllc.com
Laurence G. Bousquet 315.701.6383 lbousquet@bhlawpllc.com
Philip S. Bousquet 315.701.6309 phil@bhlawpllc.com
Paul M. Predmore 315.701.6305 ppredmore@bhlawpllc.com
Julia J. Martin 315.701.6474 jmartin@bhlawpllc.com
Michael W. Tyszko 315.701.6366 mtyszko@bhlawpllc.com
Kevin M. Sayles 315.701.6408 ksayles@bhlawpllc.com
Maria C. Zumpano 315.701.6395 mzumpano@bhlawpllc.com
J.P. Paraschos 315.701.6458 jparaschos@bhlawpllc.com

If a taxpayer holds the QO Fund investment for 5 years, the taxpayer may benefit from a reduction in the tax based on a 10% step-up in the basis of its investment. If a taxpayer invested on or prior to December 31, 2019 and holds for 7 years, the taxpayer may also benefit from an additional 5% step-up in basis.

*No Capital Gains on Appreciation of QO Fund Investment:* A qualifying investment held in a QO Fund for at least 10 years may also benefit from a step-up in tax basis of the investment to fair market value, allowing a taxpayer to avoid income taxes on a sale or exchange of that QO Fund investment.

*Continued on next page*

*Qualified Opportunity Zone Business:* A Qualified Opportunity Zone Business (QOZ Business) is a corporation or partnership (entity) that satisfies several tests including (1) an investment standard that at least 70% of the tangible property owned or leased by the entity is QOZ Business Property (as discussed below); and (2) except as discussed below, not engaging in the following trades or businesses: a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off-premises.

*Qualified Opportunity Zone Business Property:* Qualified Opportunity Zone Business Property (QOZ Business Property) is tangible property located in an Opportunity Zone acquired by purchase from an unrelated party or leased, after December 31, 2017. Generally, among other things, the tangible property must be used in a trade or business conducted in an Opportunity Zone; and either (1) the original use of the tangible property commences with the QOZ Business (or for direct investments, the QO Fund) or (2) the QOZ Business (or QO Fund) substantially improves the tangible property.

**Final Regulations - Some of the Clarification and Enhancements**

*Easier to Invest Gains from Sale of Certain Business Property:* The final regulations revise the proposed regulations to increase the types of gains that are eligible for the program by allowing a taxpayer to invest the entire amount of gains from the sale of Section 1231 business property (generally real property or depreciable property used in a trade or business and held for more than 1 year) without netting losses.

*Clarification of Direct Sales of Assets by a Partnership/QOZ Business:* The final regulations allow the gain exclusion (available for holding a qualifying investment in a QO Fund partnership for at least 10 years) to apply to gain arising from direct sales of assets by a QOZ Business partnership.

*Changes Allow for Investment in Brownfield Sites:* The final regulations respond to suggestions from the U.S. Environmental Protection Agency to provide that both the land and structures in a Brownfield site redevelopment are considered to be original use property as long as the QO Fund or QOZ Business makes investments into the Brownfield site to improve its safety and compliance with environmental standards.

*Working Capital Safe Harbor Facilitates Longer Term Development Projects and Start Ups:* The final regulations refine the Working Capital Safe Harbor which will help longer term development projects and start-ups satisfy the 90% and 70% investment standards and certain other tests. An entity may add up to 31 months for a total of a 62-month Working Capital Safe Harbor for start-up businesses, subject to complying with the three requirements for the Working Capital Safe Harbor.

*Aggregation of Property Helps Satisfy Substantial Improvement Prong for QOZ Business Property:* The substantial improvement prong for QOZ Business Property is measured on additions to the basis of the tangible property acquired by an entity. Additions to the final regulations allowing aggregating certain new personal property with the property being improved and grouping of two or more buildings located on the same parcel(s) of land may make satisfying the substantial improvement prong easier for QOZ Businesses acquiring existing buildings to be renovated.

*More Vacant Buildings Qualify under Original Use Test for QOZ Business Property:* The final regulations reduce the 5-year vacancy requirement in the proposed regulations to a 1-year vacancy requirement, if the property was vacant for at least 1-year prior to the Opportunity Zone designation and remains vacant through the date of purchase. For other vacant property, the previously proposed 5-year vacancy requirement is reduced to 3 years. In addition, property involuntarily transferred to local government (e.g., tax foreclosure, abandonment or condemnation for blight) can be treated as original use property when purchased from a local government.

*De Minimis Prohibited Businesses Permitted:* A QOZ Business may have a de minimis amount (less than 5%) of its gross income derived from operation of prohibited businesses or may lease a de minimis amount (less than 5%) of property to prohibited businesses, adding some flexibility for certain QOZ Businesses, such as hotel or shopping center operators. The statute does not prohibit a QO Fund directly investing in QOZ Business Property to operate such property for any prohibited business.