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Treasury Announces Second Round of Opportunity Zones Guidance

Treasury announced the second round of proposed guidance for opportunity zones on April 17, in tandem with the White House Conference, as a follow-up intended to address comments and provisions left unclear from the initial guidance released in October of last year. Similar to the last proposal, the proposed regulations were designed to be investor-friendly and as flexible as possible within the statutory limitations created by the law.

A significant number of questions left unresolved in the first go around were addressed in the proposal, including the 50 percent gross income requirement, issues surrounding leased property, and what is included in the 90 percent asset test that funds must undergo.

50 Percent Gross Income Requirements. A topic of concern among the private sector and lawmakers, the "50 percent requirement" in the law required that to qualify as an opportunity zone business, the company must derive 50 percent of its gross income from business conducted within a qualified opportunity zone. The guidance provides a safe harbor for businesses whose employees and contractors perform 50 percent of their services (based upon hours or amounts paid to employees) in a qualified opportunity zone. Additional safe harbor protection is provided to companies whose tangible business property is in an opportunity zone and whose operational or management functions required for at least 50 percent of gross income are located within an opportunity zone. Additional safe harbors may apply based on a "facts and circumstances" test.

Leased Property. Property leases entered into after December 31, 2017, with substantially all of the tangible property located in an opportunity zone during substantially all of the period it is leased for, qualify to be treated as an opportunity zone business property. There is no "original use" requirement, and a property may be acquired from a related lessor, allowing businesses to transition properties by leasing them to related entities. To qualify, property must be leased at a "market rate." Prepayment of the lease must not exceed 12 months for related lessors.

Leased tangible personal property (defined as personal property that can be physically relocated), have different restrictions and improvement requirements.

90 Percent Semi-Annual Testing, Reinvestments, and New Investments. The guidance clarifies that qualified opportunity funds will generally have excluded from the "90-percent asset test" both newly invested capital (six-month exemption) and proceeds from the sale of a qualified opportunity zone property or business (twelve-month exemption). The 90-percent test dictates that 90-percent of a qualified opportunity fund must be invested in qualified opportunity zone property or businesses, and will be verified every six months.

Carried Interest. Carried interest in a qualified opportunity fund in return for services offered to the fund do not qualify for the preferential tax treatment provided by opportunity zones.

Debt-Financed Distributions. Distributions not in excess of the investor's basis in the qualified opportunity fund may be debt-financed.

Triple Net Leases will not qualify as the active conduct of an opportunity zone trade or business.

In addition to other issues, the guidance also addresses REIT asset transfers, questions surrounding "substantial improvement" and "substantially all" tests, transfers upon death, and many others. The full guidance is available here.