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Opportunity Zone Tax Incentive – A Summary of the Newly Announced Second Set of Regulations

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At White House Conference on Opportunity Zones, President Trump and Secretary Mnuchin Announce Second Round of Regulations

The Department of the Treasury released its second set of proposed rules for the tax-incentive program designed to encourage economic development in distressed areas throughout the U.S. known as the Qualified Opportunity Zone Program.

Becker Senior Government Relations Consultant Clarence Williams attended an invitation-only White House conference on Opportunity Zones where Secretary Steve Mnuchin outlined some of the more high-profile proposed regulations before and after speeches given by HUD Secretary Ben Carson, Council on Economic Advisors Chairman Kevin Hassett, and President Trump himself.

The 169-page proposal gives investors interested in these areas additional leeway and a more flexible timeline, according to Secretary Mnuchin. The rules also give investing funds a one-year grace period to sell assets and reinvest the proceeds, thus avoiding penalties intended to prevent funds from sitting on the cash. Some of the proposed regulations outlined at the event include:

Leased Property

The guidance permits tangible property acquired after Dec. 31, 2017, **under a market rate lease**, to qualify as "qualified opportunity zone business property" if during substantially all of the holding period of the property, substantially all of the use of the property was in a qualified opportunity zone. However, the regulations do NOT appear to allow a land owner to sell the property in a lease-back situation and repurchase the property later, according to the Treasury's

Dan Kawalski.

Clarification of the "substantially all" requirement

The new regulations clarify the "substantially all" requirements for the holding period and use of the tangible business property:
• For use of the property, at least 70% of the property must be used in a qualified opportunity zone.
• For the holding period of the property, tangible property must be qualified opportunity zone business property for at least 90% of the qualified opportunity fund's or qualified opportunity zone business's holding period.
• The partnership or corporation must be a qualified opportunity zone business for at least 90% of the qualified oportunity fund's holding period.

"Original Use"

The statute contains a requirement that tangible property acquired by purchase have its "original use" in a qualified opportunity zone commencing with a qualified opportunity fund or qualified opportunity zone business, or be substantially improved, in order to qualify for tax benefits as also found in other sections of the Code. However, the proposed regulations clarify that used tangible property will satisfy the original use requirement so long as the property has not been previously used in a manner that would have allowed it to depreciate or amortize by any taxpayer.

Even more importantly, the regulations allow that the "original use" requirement be disregarded for properties and structures that have been vacant or abandoned for five years or more.

Investment and Development Deadlines

Under existing tax law, investors race to meet deadlines that require them to invest their capital gains income within 180 days of selling the stock or business.

The new proposed rules permit more flexibility to include more than one investment in a fund, according to Treasury official Dan Kawalski who led a breakout panel on the regulations during the event. Investors would like to create multi-asset funds to reduce the risk of a single bad project wiping out any return. The rules allow investors to get special tax treatment if they've held their stake in the fund for at least ten years, **even if the fund didn't own the asset for a full decade.**

Additionally, multi-phase projects are authorized under the new regulations to be developed using each individual phase's own "shot clock", so to speak. As an example, a city in California discussed that they are in the midst of a multi-use convention center, consisting of retail, office, meeting, and lodging space, as well as housing City Hall. Under the new regulations, each "phase" of development will have its own 30-month development period financed by its own fund. In this example, City Hall is the first phase and will have a separate 30-month “clock” from the second-phase convention space.

The 50% Rule

Before the circumstances that led to Amazon abandoning the second HQ project in New York, it was widely assumed that the company’s investors could take advantage of the location being within an opportunity zone. Later, it was assessed that, because Amazon is a global company AND the planned project was for headquarters, none of its revenue would be generated in the opportunity zone and therefore it would not be eligible as an opportunity zone business.

This has been a problem flagged by many investors looking to create startup businesses as well: the requirement that businesses generate at least half their gross income within their opportunity zone. That works for an apartment building or a grocery store, but would be a disaster for a business hoping to manufacture a product to be sold widely, or provide services online.

The rules give funds three different ways to prove that they are conducting enough business from within the zone. Treasury will allow businesses to qualify if at least 50% of the hours the employees work are within the zone, as long as it performs at least half of its services within the area, or if there are significant management and operational functions present. Businesses can also appeal their specific case. Fifty percent of the sales do not have to come from within the geographic zone in certain instances.

Working Capital

For the purposes of the initial six-month asset test, Secretary Mnuchin stated that working capital would NOT be counted toward the initial test, nor would the expenditure of working capital start the 30-month clock on deployment. This relieves some of the burden in starting projects from the ground up with regard to hiring personnel and the many processes that go into preparing a project for development.

Delay Waivers

An interesting inclusion in the regulations is a section that allows a waiver of the 30-month requirement in case-by-case instances where local or state regulatory requirements delay development for extended periods of time.

Penalties and Research

This round of regulations doesn’t impose reporting requirements that would allow the IRS to assess penalties on those who violate the rule. The Treasury Department released a document Wednesday soliciting public input on how to best measure economic activity in opportunity zones and how to collect this information. This follows comments from Senators Booker and Scott that they would be introducing a bill requiring the collection of data to influence future decisions on how to make the program work best toward its desired outcomes. This small piece would be a departure from other tax incentive programs implemented previously and looks to ensure that this program is not just a tax give-away.

We will update you with more detailed information as we study the newly proposed regulations. The public comment period will end with a hearing on July 9, 2019.

Should you need any further information, please contact Senior Government Relations Consultant Clarence Williams. To learn more about our Opportunity Zones Team, visit our website at https://www.flopportunityzoneadvocacy.com/.

