

Opportunity Zones Fact Sheet Updated November 2019

Since the establishment of the Opportunity Zones community development program in late 2017, the Treasury Department has released two sets of proposed regulations to clarify the statute. The relevant clarifications are detailed below under the additional Opportunity Zone guidance section. Additionally, after calls from Congressional leaders and front-line community advocates, there have been hearings and legislation introduced that seek to address the Opportunity Zone program's reporting inadequacies. The Opportunity Fund transparency section outlines these legislative efforts. Finally, this addendum examines upcoming changes to census tract definitions and how that will impact Opportunity Zones.

Additional Opportunity Zone Guidance

Following appeals from the business community to broadly reduce the regulatory burden for Opportunity Zone investors, the Treasury Department released the [second set of proposed regulations](#) for the Opportunity Zone program on April 17, 2019. The new rules streamline the Opportunity Zone program's investor requirements and specify unclear components of the statute.

Substantial Improvement Test for Operating Businesses

- The first tranche of proposed regulations stated that qualified OZ businesses were subject to the substantial improvement requirement on an asset-by-asset basis. The proposed regulations allow tangible properties to pass the original use test if it has not been depreciated by any other taxpayer.

Gross Income Test

- The first set of proposed regulations required that 50 percent of qualified OZ businesses' gross income originate from the active conduct of a trade or business within the OZ. The proposed regulations adopt three safe harbors that OZ businesses may use to satisfy the gross income test. They are as follows:
 - A minimum of 50 percent of employees or independent contractors' service hours are performed in the OZ;
 - A minimum of 50 percent of employees or independent contractors' wage-earning services are performed in the OZ; or
 - Tangible property and management and operational functions necessary to generate 50 percent of gross income are located in the OZ.
- Also, the regulations create a 'facts and circumstances' test for those businesses that don't satisfy one of the above safe harbors. Under the proposal, businesses can qualify as an OZ business if, based on all facts and circumstances, at least 50 percent of its gross income is generated in an OZ.

Opportunity Fund Timing Flexibility

- The proposed regulations allow Opportunity Funds to discount investments received within the previous six months to meet the 90-percent asset test. Additionally, an Opportunity Fund that fails to meet the 90 percent asset test does not immediately lose its Opportunity Fund Status, instead, it is penalized. The penalty has yet to be determined.

Original Use

- The regulations clarify that original use of tangible property begins when it is first placed in service in the OZ for the purposes of depreciation or amortization.

Valuation Methods

- The first tranche of regulations stipulated that either an applicable financial statement or the cost of the assets (if it has no applicable financial statement) determined asset valuation. The proposed regulations allow taxpayers to utilize the net present value of lease payments for leased property or the unadjusted cost basis of the property for asset valuation.

Interim Gains

- The proposed regulations dictate that Opportunity Fund compensation associated with the sale of an OZ business property remains treated as OZ business property, given that the proceeds are reinvested within 12 months. The proceeds must be held in cash, cash equivalents, or debt instruments with an 18-month term.

Vacant Property

- The proposed regulations define OZ properties as original use rule compliant if the property has been vacant or unused for five years consecutively.

Substantially All

- The first tranche of regulations created a 70-percent threshold for defining whether “substantially all” of an OZ business property’s tangible assets are in a qualified OZ. The proposed regulations define references to the substantially all requirement as 70 percent for the use in OZ requirement and 90 percent for the holding period requirement.

Inventory in Transit

- The proposed regulations clarify that raw materials and inventory held outside of an OZ in transit do not lose their OZ business property status.

Leased Properties

- The proposed regulations dictate that leased tangible property can be considered OZ business property if it meets the 90-percent asset test and 70-percent substantially all requirement. Leased property is exempt from the original use or the substantial improvement requirements, and leased property can be purchased from a related party. Additionally, these regulatory changes are pertinent to tribal communities, who often lease land to the federal government.

Exiting and Opportunity Zones

- The proposed regulations create a flexible exit structure for the sale of Opportunity Funds. Opportunity Fund investors, who have invested for at least ten years, may elect to exclude from gross income capital gain associated with the asset transfer on the investor’s Schedule K-1.

1231 Gains

- The proposed regulations clarified that the 180-day period for 1231 gains starts on the last day of the relevant tax year.

Partner’s Basis

- The proposed regulations state that if an Opportunity Fund is a partnership, the partner’s basis in the partnership interest begins at zero and is subject to adjustments within the partnership tax rules.

Land

- The proposed regulations stipulate that land can qualify as an OZ business property if it is used in the business or trade of the OZ business or Opportunity Fund. Additionally, unimproved land does not need to meet the original use or substantial improvement requirements.

Active Conduct

- The definition of a business or trade is referenced to the standard for deducting business expenses. The proposed regulations generally maintain the definition of active conduct, but they do clarify that it includes the ownership and operation (including leasing, except for triple-net leases) of real property.

Efforts to Increase Opportunity Fund Transparency

The IRS released an [updated draft tax form](#) for Opportunity Zone program investors on October 31, 2019. The proposed Form 8996 would require Opportunity Funds to disclose the funds' structures and assets, census tract numbers, investment business's assets, and employer identification numbers. These measures to increase programmatic transparency come in the wake of growing scrutiny from Congress and impacted-community advocates, who fear that investors prioritize personal profit above community development.

- Last May, Senators Corey Booker (D-NJ) and Tim Scott (R-SC) introduced a bill ([S. 1344](#)) to establish Opportunity Zone reporting requirements. Representatives Ron Kind (D-WI) and Mike Kelly (R-PA) introduced an accompanying bill ([H.R. 2593](#)) in the House. Both bills have stalled in their respective Committees.
- The House Committee on Small Business held a public hearing on October 17, 2019, to examine inadequate reporting standards.
- The Oversight and Select Revenue Measures subcommittees of the House Ways and Means Committee held a private meeting to examine reporting and transparency concerns on October 29, 2019.
- On November 4, 2019, Senate Finance Committee ranking member Ron Wyden (D-OR) and House Ways and Means Committee Chairman Richard Neal (D-MA) sent [a letter to Treasury Department Secretary Steve Mnuchin](#). The letter inquired about potential abuses of power within the Treasury Department. Two days later, Senator Wyden and Rep. Neal announced an official investigation.
- On November 6, 2019, Senator Wyden introduced a bill ([S.2787](#)) that amends the IRS Code of 1986 to require Qualified Opportunity Fund reporting. Representatives Kind (D-WI), Kelly (R-PA), and Sewell (D-AL) introduced [accompanying legislation](#) in the House.
- On December 5, 2019, Senator Scott (R-SC), along with 7 Republican cosponsors, introduced a bill ([S.2994](#)) to amend the IRS Code of 1986 to require Qualified Opportunity Fund reporting. Although the bill is comparable to the bill introduced by Senator Wyden, it mandates fewer substantial changes to the original Opportunity Zones program.

Upcoming Changes and Deliberations

- The 2020 census is set to revise census tract boundaries, which could grant state governments' additional latitude to expand Opportunity Zones in their states. The Treasury Department has indicated, through its [Community Development Financial Institutions Fund](#), that projects on shrinking tracts will be grandfathered into the program and retain their eligibility.