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OPPORTUNITY ZONE REGULATIONS PART 2:

QUESTIONS ADDRESSED BY THE REGULATIONS

Author: Glenn A. Graff

Contributors: Dan Klaff, Eric Mittereder, Benjamin Swartzendruber

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On April 17, 2019, the Department of Treasury released a second round of Opportunity Zone ("OZ") proposed regulations ("Round 2 Regulations"). Although the Round 2 Regulations are 169 pages long, there are still some open issues and at least one additional round of regulations is expected. However, the Round 2 Regulations provide significant additional guidance which should give meaningful comfort to investors looking to make OZ investments. This paper highlights some of the questions addressed by the regulations. Applegate & Thorne-Thomsen continues to review the voluminous regulations and expects to issue further guidance, and updates to this document may be made. For additional articles on Opportunity Zones, please visit our website's News and Events page at: https://www.att-law.com/news-events/.

Interim Gains and Reinvestments – Prior to the issuance of the regulations, some of the most significant issues in evaluating OZ transactions related to the treatment of sales of property by a Qualified Opportunity Fund ("Fund" or "QOF") and Qualified Opportunity Zone Business ("QOZB"). The Round 2 Regulations provide some clarity, but substantial issues remain.

1. **If a Fund Sells Qualified Opportunity Zone Property ("Zone Property" or "QOZP") After 10 Years, Do the OZ Investors of the Fund Recognize Gain?** NO**.** The Fund investors can make an election to exclude the capital gain from gross income.

   Significant Impact! – This expansion of the rules provides an ability for Funds to sell property rather than for investors to have to sell their interests in the Funds. It is unclear whether the Fund could take such non-taxed funds and reinvest them in additional Zone Property and perhaps avoid gain again after another 10 years.

   Significant Impact! – Due to lack of clarity of exit rules, many Funds have been set up as entities that only own an interest in a single QOZB so that it would be easier for Fund investors to dispose of their interests in Funds after 10 years. The ability for a Fund to dispose of Zone Property, including interests in an individual QOZB, will likely open the door to Funds that own multiple QOZBs.

2. **If a Fund Taxed as a Partnership ("Fund Partnership") Has Held an Interest for 10 Years in a QOZB that is a Partnership and the QOZB Partnership Sells Property, Do the QOZB Partnership and Its Members Recognize Gain?** PROBABLY**.** The Round 2 Regulations do not address whether gain can be avoided for QOZBs, although comments on this issue have been requested. In the absence of a regulation addressing the issue, it would appear that gain would be currently taxable.

3. **If a Fund Sells Stock, Partnership Interests or Tangible Property Qualifying as Zone Property, How Long Does the Fund Have to Reinvest the Proceeds in Additional Zone Property?** ONE YEAR**.** However, the proceeds of the sale must be continuously held in cash, cash equivalents or debt instruments of less than 18 months.

   Significant Impact! – This rule provides a reasonable amount of time for Funds to reinvest proceeds without having to worry about the proceeds causing the Fund to fail to meet the requirement that 90% of the Fund assets be Zone Property (which does not include cash) (the "90% Asset Test").

   Impact – The current regulations do not extend the reinvestment period down to the QOZB level. Treasury has requested comments on this point. The failure to extend the rule to QOZBs will be an impediment to QOZBs moving into and out of assets over the potentially 10 year or longer period in which Funds invest in the QOZBs.

Fund Contributions/Distributions, Fund Interest Transfers and Gain Recognition

4. **Does a Contribution of Services to a Fund Allow Capital Gain to be Deferred and Other OZ benefits to be received?** NO.

   Significant Impact! – Carried interests cannot qualify for OZ benefits.

   Structuring Suggestion – If a partner is both performing services and contributing capital, an effort should be made to differentiate between the interest received for services rendered and the interest received for the contribution of cash or property.

5. **Can an Acquisition of an Eligible Interest in a Fund from an Owner of Such Interest Count as an Eligible Investment in a Fund, thus Allowing Deferral of Capital Gain and Other OZ Benefits for the Buyer?** YES. In a taxpayer friendly expansion of the rules, Proposed Regulation Sections 1.1400Z-2(a)-1(b)(9)(iii) and (b)(10)(iii) provide that if a taxpayer makes an investment in a Fund and elects to defer capital gain, the taxpayer can subsequently sell that interest to a buyer that can elect to defer capital gains tax on the amount of its purchase price and then potentially qualify for the other OZ benefits.

   Example – Assume A has $1,000,000 of capital gain on March 1, 2019. A invests in Fund Partnership Z on May 1, 2019. On February 1, 2022, A sells its interest to B for $1,500,000. B realized $1,500,000 of capital gain on December 1, 2021 and elects to defer tax on the capital gain. A would have to recognize and pay tax on the full $1,000,000 of deferred

capital gain as well as the $500,000 profit from its sale of its interest in Z. B's investment is eligible for OZ benefits and B would defer tax on the $1,500,000 of capital gain. However, December 31, 2026 would arrive prior to B achieving either a 5- or 7-year holding period and thus B would not avoid 10% or 15% of the tax due on the capital gain. Thus, on December 31, 2026, B would owe capital gains tax on the deferred $1,500,000. In addition, B would not qualify for the 10-year benefit and step-up its basis to fair market value until February 1, 2032, which is almost 3 years longer than A would have had to wait.

Significant Impact! – This rule may promote the creation of a significant secondary market in Fund interests, at least until December 31, 2026. There may be a gold rush of people selling appreciated interests before December 31, 2026 because buyers would not be able to get any OZ benefits, especially the tax-free basis step-up, for purchases after that date. An interest sold with OZ benefits on December 31, 2026 should fetch a premium over an interest sold without such benefits on January 1, 2027!

6. **Do All Transfers Upon Death Trigger Deferred Capital Gain and End Other OZ Benefits?** NO. Transfers of Fund interests, including by gift, are generally inclusion events that trigger tax on deferred capital gain and end other OZ benefits ("Inclusion Events"). However, transfers at death are exceptions to the general rule and are not Inclusion Events.

7. **Can Contributions to a Fund Followed by a Subsequent Distributions of Cash Impair OZ Benefits?** SOMETIMES. To qualify for OZ benefits, the investment in a Fund Partnership must be a contribution. If the transaction is recast as something else, it will not qualify for OZ benefits. For example, under general partnership tax rules contributions of non-cash property to a Fund Partnership followed by a cash distribution can be treated as a disguised sale of the asset to the Fund Partnership rather than a contribution of property by a partner. Such disqualified sale treatment disqualifies the investment for any OZ benefits. The Round 2 Regulations also provide that a cash investment in a Fund Partnership won't qualify for OZ benefits in certain situations that are similar to disguised sales. Application of these rules is still unclear but could create a presumption that distributions to a Fund investor made within two years of the investment will scuttle expected OZ benefits.

   Significant Impact! – The author will be contacting the IRS and Treasury to get clarification of these rules. Until further clarification is received, investors in Funds may want to avoid concrete plans to receive cash distributions from the Fund, especially within 2 years unless those distributions come from taxable income of the Fund.

8. **If a Fund Partnership Interest Is Sold After 10 Years with an Election to Step-Up the Basis of the Fund Interest to Fair Market Value, Will the Fund Investor Have to Pay Tax on any Ordinary Income from Depreciation Recapture?** NO. The Round 2

Regulations provide that when electing to step up basis when selling a Fund Partnership interest after 10 years, a Section 754 election can be made that will step up the basis of all the Fund Partnership assets. The result is that all Fund Partnership assets are stepped up and there will be no ordinary or capital gain.

Significant Impact! – One of the unresolved issues after the first round of proposed regulations issued last year ("Round 1 Regulations") was whether Fund Partnership investors might still be stung with ordinary due to deprecation recapture. The Round 2 Regulations and the Explanation included in them seem to resolve this favorably.

9. **In a Fund Partnership, Is the Gain Triggered on December 31, 2026 Based on the Lower of Deferred Gains and Fair Market Value of the Fund Interest?** MOSTLY. The general rules in the OZ statute say that the gain recognized in 2026 is based on the lesser of the deferred capital gain or the fair market value of the Fund interest, less the Fund investor's basis in the Fund. There are some transactions such as Low-Income Housing Tax Credit ("LIHTC") transactions where value may have decreased by December 31, 2026 and thus less gain should be recognized. However, for Funds that are partnerships or S corporations, Proposed Regulation Section 1.1400Z-2-(b)(1)(e)(4) has a special rule for gain recognition both at 2026 and for earlier sales of Fund interests. The special rule omits listing the fair market value of a Fund as a factor in determining how much gain will be recognized, thus raising the question of how to calculate the amount of deferred gain that is recognized if a Fund investment has lost value. The regulation does refer to "the gain that would be recognized on a fully taxable disposition of the qualifying investment that gave rise to the inclusion event." The impact of this rule is to treat the Fund interest as sold for fair market value on December 31, 2026 and determine the regular gain that would be owed. The deferred gain that is recognized is the lesser of that amount or the deferred gain less any 10% or 15% basis adjustments. Our current assessment is that in the 2026 context, for projects that have lost value, the gain that would be recognized under the foregoing language would the fair market value of the Fund investment, but not less than the amount of debt of the Fund and/or QOZB less the investor's basis in the Fund including the investor's share of any Fund or QOZB debt.

   Significant Impact! – For investors in Funds that may lose value by December 31, 2026, such as LIHTC transactions, the gain recognized on December 31, 2026 would be less than the full deferred gain but due to the use of debt the deferred gain recognized may be more than the fair market value of the interest less debt. Overall the ability to recognize less gain than the full amount of deferred gain (less possibly 10% or 15%) is a strong positive impact on the yields of such transactions. However, the fact that debt may limit the reduction in deferred gain means this result is somewhat less helpful than had previously been hoped.

10. **Can Distributions that Are Not Treated as Disguised Sales Impact OZ Benefits?** SOMETIMES. Distributions to a taxpayer that exceed the taxpayer's basis in its Fund

interest will be an Inclusion Event and will trigger recognition of deferred capital gain and end future OZ benefits to the extent of the Inclusion Event.

Significant Impact! – Distributions of profits or debt-financed distributions not treated as disguised sales should be ok.

Opportunity - Subject to additional clarity on this point, it may become viable for Funds or QOZBs to plan to borrow funds around the end of 2026 and use those borrowed funds to make a distribution up to Fund members that could be used to pay the tax on the deferred gain that gets triggered on December 31, 2026.

Gains Qualifying for Deferral

11. **Can Capital Gains from the Sale of Property Used in a Trade or Business be Deferred?** NET GAINS FOR THE YEAR CAN BE DEFERRED. When property used in a trade or business is sold, gain up to the amount of previously taken depreciation is subject to depreciation recapture and treated as ordinary income. As a result, such gain cannot be deferred. For gain above and beyond depreciation recapture, such gain is considered Section 1231 gain. Section 1231 gains and losses for a year must be netted by a taxpayer and if the net amount for a year is positive, then such amount is a capital gain.

    Impact: Investors need to be aware that a gain from the sale of business property could be offset by a loss in the sale of other property. This could reduce the amount of gain that can be deferred under the OZ rules.

12. **When Does the 180-Day Investment Period Start for 1231 Gains?** 180 DAYS FROM THE END OF THE INVESTOR'S TAX YEAR. Because an investor will not know what his/her net 1231 gains are until the end of the year, the 180-day period does not start until the end of the year.

    Impact: Investors need to be aware that if they sold 1231 property during a year, that they can't make an investment until the 180-day period starts to run at the end of the year.

Clarification of Qualifying Active Trades or Businesses – When a Fund invests in a partnership or corporation that qualifies as a QOZB (the "Indirect Method"), the QOZB is required to meet additional requirements including that 50% of its gross income be from the conduct of an "active" trade or business. The Indirect Method is the preferred method of investing in real estate because such QOZBs have access to a 31-month safe harbor to spend working capital (see items 14 and 15 below or our prior publications for a discussion of the working capital safe harbor), whereas Funds do not enjoy such a safe harbor.

13. **Does Rental Activity Count as An Active Trade or Business for a QOZB** – GENERALLY, YES. Proposed Regulation Section 1.1400Z-2(d)-1(d)(5)(ii)(B)

specifically states that the ownership and operation (including leasing) of real property is the active conduct of a trade or business.

Impact – LIHTC transactions as well as market rate and workforce housing projects can be owned by QOZB Partnerships with Fund investors. This result was expected.

14. **Does Triple Net Leasing Activity Count as An Active Trade or Business for a QOZB** – NO. Proposed Regulation Section 1.1400Z-2(d)-1(d)(5)(ii)(B) specifically provides that merely entering into a triple net lease is not the active conduct of a trade or business.

    Impact – Constructing a building in a Qualified Opportunity Zone ("Zone" or "QOZ") that will be triple net leased for the use of other businesses in the Zone will not meet the active business requirement under the Round 2 Regulations on its own. It is not clear how much additional operating responsibilities a QOZB lessor would have to conduct in order to be considered the active conduct of a trade or business. Would paying property taxes be enough? Paying insurance? Assuming responsibility for maintenance is arguably a significant operational responsibility.

    Impact –Historic Tax Credit Lease Pass Through transactions are typically done as triple net leases. Such transactions would have to be modified to no longer be triple-net leases so that the landlord QOZB would be considered to be participating in the operation of the property. Similarly, many New Markets Tax Credit transactions have Qualified Low Income Community Businesses ("QALICBs") whose business is to triple-net lease property to a master tenant and/or affiliate of the sponsor. Such transactions would also have to be modified to work with OZ structures.

15. **What Does a "Substantial Portion" Mean for the Requirement that a Substantial Portion of Intangible Assets Are Used in the Active Conduct of a Trade or Business?** FORTY PERCENT.

16. **How Does a QOZB Measure Whether 50% of its Gross Income Comes from the Active Conduct of a Trade or Business?** 4 different ways to satisfy requirement:

    a. 50% of Hours – Measured by employee/independent contractor hours in the Zone over total hours.

    b. 50% of Amounts Paid – Measured by amounts paid to employees/independent contractors in the Zone compared to total amounts paid.

    c. Tangible Property and Business Functions in the Zone Necessary to Generate 50% of Gross Income – The tangible property of the trade or business located in a Zone and the management or operational functions performed in the Zone are each necessary for the generation of at least 50% of the gross income of the trade or business.

d. Facts and Circumstances Test – Showing that at least 50% of the QOZB's gross income is derived from the active conduct of a trade or business in a Zone.

Impact – These rules provide flexibility for business that are conducted in a Zone but sell products and/or services outside the Zone. For example, companies that develop software in a Zone but sell it over the internet to any location would qualify if at least 50% of employee/contractor hours are in a Zone or at least 50% of employee/contractor wages are paid for services in a Zone.

Expansion of Working Capital Rules – The Round 1 Regulations provided a safe harbor that working capital would be deemed reasonable if it was to be used for the acquisition, construction or improvement of tangible property in a Zone within 31 months and (1) there was a written designation of the working capital, (2) a reasonable schedule to use the working capital within 31 months, and (3) the working capital was used reasonably consistently with the foregoing.

17. **Can Non-Real Estate Businesses Use the 31-Month Working Capital Safe Harbor?** YES. Proposed Regulation Section 1.1400Z-2(d)-1(d)(5)(iv)(A) was expanded to provide that the safe harbor applies to the development of a trade or business and is no longer limited to the acquisition, construction or improvement of tangible property.

    Significant Impact! – The development of an operating trade or business via the Indirect Method can now use the 31-month safe harbor to receive investments from Funds and develop a trade or business. The business will need to meet the same requirements: (1) designation of working capital in writing, (2) a reasonable written schedule to spend the working capital within 31 months, and (3) actually expending the working capital in a manner reasonable consistent with the foregoing.

    Example – The Round 2 Regulations contain an example of fast food business receiving a cash contribution and then, during the a 20-month period (shorter than the maximum 31-months permitted), using the funds to identify favorable locations in the Zone, lease a building suitable for such a restaurant, outfit the building with appropriate equipment and furniture (both owned and leased), pay for necessary security deposits, obtain a franchise and local permits, and then hire and train kitchen and wait staff.

18. **If an Entity Received Multiple Cash Injections Over Time, Does It Get Multiple 31-Month Periods to Spend Working Capital?** YES. Proposed Regulation Section 1.1400Z-2(d)-1(d)(5)(iv)(D) provides that an entity can receive multiple overlapping or sequential 31-month periods, provided they all satisfy the working capital requirements.

    Impact – Entities that receive working capital at multiple times, whether from multiple member contributions or from loan proceeds, can now safely employ such proceeds within the 31-month period. This can also extend the period of time to complete a project or business beyond 31-months if cash is received over time.

Example – The Round 2 Regulations contain an example of a technology startup using an initial contribution from a Fund of cash for research and development of a new technology over 30-months. The entity then receives a subsequent cash contribution from the Fund 18 months into the original 30-month period. The additional funds are planned to be used to create a new software application over another 25 months.

Testing Rules for Funds and QOZBs

19. **Do Funds Have Any Lead Time to Invest Contributions Before an Approaching 90% Asset Test Date?** YES, Funds HAVE 6 MONTHS. Proposed Regulation Section 1.1400Z-2(d)-1(b)(4) allows a Fund to exclude from both the numerator and denominator of its 90% calculation those contributions made within the previous 6 months if such amounts are continuously held in cash, cash equivalents, or debt instruments with a term of 18 months or less.

    Significant Impact! – This alleviates a significant concern whereby Funds would have had very little time to invest contributions into Zone Property prior to an upcoming the 6-month testing date. For example, without this rule a calendar year Fund that received a contribution on December 1 would only have 30 days to invest in Zone Property before year-end testing date. Now every Fund will have at least 6 months to invest its contributions.

    Opportunity – Funds that receive funds with just less than 6 months of the year remaining would have almost a year to invest the funds. For example, a Fund that received a contribution on July 2, 2019, would have until June 30, 2020 to invest the funds into Zone Property.

20. **Are Funds and QOZBs with GAAP Financial Statements Required to Use Such GAAP Statements?** NO. The Round 1 Regulations created an unfortunate situation where an entity with Applicable Financial Statements (basically GAAP financial statements), was required to use such statements for (i) the 90% Asset Test whereby Funds are required to have 90% of their assets invested in Qualified Opportunity Zone Business Property ("Zone Business Property" or "QOZBP") and (ii) the 70% test whereby QOZBs have to have 70% of their tangible property be Zone Business Property ("70% QOZBP Test"). This had the strange result that entities could fail these tests over time merely through GAAP depreciation. The Round 1 Regulations allowed entities without U.S. GAAP financial statements to use the cost of assets. Round 2 Proposed Regulation Section 1.1400Z-2(d)-1(b)(1) and (d) (3)(ii)(B) clarify that all entities can choose the "Alternative Valuation Methodology" where original tax cost is used without applying depreciation.

    Significant Impact! – This is a significant benefit for entities that may have failed to meet either the 90% Asset Test or the 70% QOZBP Test due to depreciation over time. This is also a much-needed simplification for entities because it allows them to avoid the

requirement to forecast GAAP financial statements many years into the future to ensure that the requirements would be met for at least the 10-year holding period necessary get the tax-free basis step-up. Now entities can look to original cost and make simpler and more definite projections of their expected compliance over time.

Original Use of Property – One of the requirements for Zone Business Property is that its original use in the Zone must be with the Fund or QOZB.

21. **What Does Original Use Mean?** PLACEMENT IN SERVICE. Original Use is measured by the first person to place the property in service for depreciation purposes. In other words, property is "originally used" by the first person to have the property be ready for its intended use in a trade or business.

22. **Does Unimproved Land Have to Be Substantially Improved?** GENERALLY, NO. Proposed Regulation Sections 1.1400Z-2(d)-1(c)(8)(ii)(B) and (d)(4)(ii)(B) provide that leased or purchased land does not have to be substantially improved. However, Proposed Regulation Section 1.1400Z-2(d)-1(f) limits the foregoing by saying that such rules may not be relied upon where (a) a Fund or QOZB purchased land with an intention to not improve the land by more than insubstantial amount within 30 months, and (b) in fact does not improve the land or only minimally improves the land.

23. **Can Vacant Used Property Be Treated as Originally Used by a Fund or QOZB?** YES. Proposed Regulation Sections 1.1400Z-2(d)-1(c)(4)(i)(B)(6) and (c)(7)(i) provide that property that has been unused or vacant for 5 years will be treated as originally used by a Fund or QOZB that leases or purchases such property.

Treatment of Leased Property – The treatment of leased property under the statue and Round 1 Regulations was unclear. The Round 2 Regulations have added significant certainty, although some issues remain.

24. **How Does Leased Property Qualify as Zone Business Property?** Proposed Regulation Section 1.1400Z-2(d)-1(c)(4)(B) provides that leased property qualifies as Zone Business Property if the following requirements are satisfied:

    a. Date Requirement - the lease is entered into after December 31, 2017,
    b. Market Rate Terms- the terms of the lease were market rate at the time the lease was entered into,
    c. Holding Period and Use Requirements – during at least 90% of the Fund's holding period at least 70% of the use of the leased property is in a Zone, and
    d. No Plan for Non-Fair Market Value Purchase – for real property (other than unimproved land), there was no plan, intent, or expectation for the real property to be purchased for other than fair market value
    e. 2 Special Requirements for Related Party Leases (more than 20% overlap)
        i. Limited Rent Prepayments – not of more than 12 months

ii. Either:
(1) for tangible personal property, the entity has the original use of the leased property in the Zone, i.e. first entity to place property in service in the Zone or property had no use or was vacant for 5 years, or
(2) within the earlier of (A) 30 months of obtaining possession under lease, or (B) the last day of the lease, the entity becomes the owner of other Zone Business Property that has a value no less than the value of the leased property. There must be substantial overlap of the zone(s) in which the owner of the property so acquired uses it and the zone(s) in which that person uses the leased property. For example, don't lease property in a Zone in Illinois from a related party and then try and meet the "other property test" by purchasing property in a Zone in Georgia. The use of the leased and owned property should substantially overlap.

Impact – There is no requirement to substantially improve leased property that is leased from an unrelated party on market rate terms. This is a significant improvement for operating businesses that may lease space in a Zone and opens the door to leases with no substantial improvement where a purchase of the same property would have required a substantial improvement. The impact of the rule on entities that rent real estate is still under review as the rule seems to allow a lease of real property by a Fund or QOZB that then rents the real property to users without requiring any substantial improvement in the property or other impact on the Zone. However, there may be other tax or economic issues that reduce the incentive to lease real property without making any substantial improvement.

Opportunity – There is substantial room to work with related party leases. Personal property could be leased from a related party if the Fund or QOZB leasing the property brings it into the Zone and is the first entity to use it in the Zone. If property was previously used in a Zone, for example real property which cannot easily be moved, such leased property will count as Zone Business Property as long as additional Zone Business Property is acquired and used in the same Zone or substantially overlapping the Zone and there is no prepayment of rent for more than a year.

25. **Do Improvements to Leased Property Count as Zone Business Property?** YES. Improvements to leased property count as purchased property, and therefore count as Zone Business Property based on the cost of the improvement.

26. **How Do the 90% Asset Test and the 70% QOZBP Test Account for Leased Assets?** LEASED ASSETS MUST BE VALUED. For both (1) entities using selecting the Applicable Financial Statement methodology and using GAAP financial statements, and (2) entities using the Alternative Valuation Methodology which generally uses unadjusted tax cost, leased assets must be valued. Under the Alternative Valuation Methodology, a lease's value is equal to the present value of all payments under the lease discounted using the Federal Applicable Federal Rate as provided in Code Section 1274(d)(1). New U.S.

GAAP rules also provide a methodology for value leases based on lease payments. See Accounting Standards Codification Topic 842.

Substantial Improvement of Property – In order for tangible property previously used in a Zone to count as Zone Business Property owned by a Fund, the property needs to be substantially improved.

27. **If a Used Building Is Purchased or Leased, Can the Requirement to Substantially Improve the Building by at least the Cost of Acquisition Be Met by Aggregating Improvements?** NO. Substantial improvement is measured asset by asset. The IRS is studying whether assets should be allowed to be aggregated, but the current regulations do not allow aggregation.

    Significant Impact! – This unfortunate result may limit the ability for some business to receive any OZ benefits. If a building were purchased, for substantial improvement purposes one could not count the cost of equipment brought into the building which is not considered part of the building. For example, bringing a significant number of computers and servers into a building would not count towards the question of whether the building has been substantially improved. The IRS continues to study this issue and it is hoped that an aggregation approach will be adopted in future regulations.

Holding Period and Use Requirements – For stock or partnership interests to qualify as Zone Property for a Fund, during substantially all of the holding period the corporation or partnership must be a QOZB. Similarly, tangible property of a Fund or QOZB, will only count as Zone Business Property if during substantially all of the holding period for such property, substantially all of the use of the property is in a Zone.

28. **How Is Substantially All Defined for Holding Period Purposes?** NINETY PERCENT.

    Impact – For Funds investing in corporations or partnerships, such entities must qualify as QOZBs for 90% of the Fund's holding period. For tangible property of a Fund or QOZB, during 90% of the holding period substantially all of the use of the property has to be in a Zone.

    Open Issue – How a holding period is determined is not addressed by the Proposed Regulations.

29. **How is Substantially All Defined for Usage in a Zone?** SEVENTY PERCENT. Measured by value of tangible property in the Zone over value of all tangible property owned.

    Impact – This allows up to 30% of the use of a Fund's or QOZB's property to be outside a Zone.

30. **Will Inventory in Transit to a Customer Outside a Zone Result in Assets Used Outside of the Zone Thus Creating Problems Qualifying as Zone Business Property?** NO. Under a safe harbor, inventory and raw materials will not be treated as used outside of a Zone just because they are being shipped into the Zone from a vendor or are in transit leaving a Zone to a customer.

    Impact – This clarification in the regulations is a significant benefit to businesses that create products in a Zone but sell them outside of a Zone. Such businesses could manufacture physical products or even develop software/technology.

Consolidated Groups of Corporations

31. **Can One Member of a Consolidated Group of Corporations Elect to Defer a Capital Gain If Another Member of the Consolidated Group Invests in a Fund Taxed as a Corporation ("Fund Corporation") Within 180 Days?** NO. Based on the Explanation contained in the Round 2 Regulation, it appears that the IRS felt that many complex rules would need to be created to serve both the purposes of the consolidated return rules and the OZ rules.

    Impact – These rules will necessitate that the consolidated group member that incurs a gain directly make the investment in a Fund. This may not serve the ideal organizational structure for consolidated groups.

32. **Can a Corporation That Wholly-Owns a Fund Corporation Include the Fund Corporation in Its Consolidated Group?** NO.

    Impact – In addition to the inability to consolidate the activities of a Fund subsidiary, this means that a corporation investing in a corporate Fund would not be able to use LIHTCs that may be earned or allocated to the Fund.

For more information about this article, please contact Glenn Graff, Ben Swartzendruber, Dan Klaff, Eric Mittereder or any of your contacts at Applegate & Thorne-Thomsen.

Glenn Graff
312-491-3313
ggraff@att-law.com

Ben Swartzendruber
312-491-2209
bswartzen@att-law.com

Dan Klaff
312-491-4405
dklaff@att-law.com

Eric Mittereder
312-491-4409
emittereder@att-law.com

Applegate & Thorne-Thomsen
ATTORNEYS AT LAW

425 S. Financial Place, 19th Floor
Chicago, IL 60605
312-491-4400