

OPPORTUNITY ZONE REGULATIONS - PROPOSED QUESTIONS AND ANSWERS

BACKGROUND

Section 1400Z-2 provides certain tax benefits to a taxpayer that invests recognized gains in a "qualified opportunity fund" (a "QOF"). Pursuant to section 1400Z-2(a), a taxpayer can elect to defer an amount of gain not in excess of the gain recognized by the taxpayer "from the sale to, or exchange with, an unrelated person of any property held by the taxpayer" provided that the taxpayer invests such amount in a QOF "during the 180-day period beginning on the date of such sale or exchange." Thus, in order to avail itself of section 1400Z-2, (1) a taxpayer must recognize gain from the sale or exchange of property held by the taxpayer, (2) such sale or exchange must be to an unrelated person, (3) the taxpayer must make the requisite election to defer all or a portion of such gain, and (4) the taxpayer must invest an amount equal to the gain elected to be deferred in a QOF during the 180-day period beginning with the date of the sale or exchange.

Qualified Opportunity Fund Requirements

Section 1400Z-2(d)(1) provides that a QOF is "any investment vehicle organized as a corporation or partnership for the purpose of investing in qualified opportunity zone property (other than another [QOF]) that holds at least 90 percent of its assets in qualified opportunity zone property." The following definitions are used below:

- QOZ Property - qualified opportunity zone property;
- QOZ Business - qualified opportunity zone business;
- QOZ Stock - qualified opportunity zone stock
- QOZ Interest - qualified opportunity zone partnership interest;
- QOZ Business Property - qualified opportunity zone business property

QOZ Property consists of "property which is (i) qualified opportunity zone stock, (ii) qualified opportunity zone partnership interest, or (iii) qualified opportunity zone business property." QOZ Stock or a QOZ Interest is QOZ Property if it (i) "is acquired by the [QOF] after December 31, 2017 at its original issue ... from the [issuer] solely in exchange for cash," (ii) "at the time such [QOZ Stock or QOZ Interest] was issued, such [issuer] qualified as a qualified opportunity zone business (or in the case of a new [issuer], such [issuer] was being organized for purposes of being a [QOZ Business])", and (iii) "during substantially all of the [QOF's] holding period for such [QOZ Stock or QOZ Interest], such [issuer] qualified as a [QOZ Business]."

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QOZ Business Property is "tangible property used in a trade or business of the qualified opportunity fund if (1) such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017, (2) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property, and (3) during substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone."

Section 179(d)(2) provides that a "purchase" is "any acquisition of property, but only if (A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), (B) the property is not acquired by one component member of a controlled group from another component member of the same controlled group, and (C) the basis of the property in the hands of the person acquiring it is not determined - (i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or (ii) under section 1014(a) (relating to property acquired from a decedent)."

For these purposes, section 1400Z-2(d)(ii) provides that property is "treated as substantially improved ... only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund."

Section 1400Z-1(a) defines a "qualified opportunity zone" as "a population census tract that is a low-income community that is designated as a qualified opportunity zone." The designation is made by the Secretary of the Treasury. Section 1400Z-1(b)(1)(B). Section 1400Z-1(f) provides that "[a] designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation."

Qualified Opportunity Zone Business

Section 1400Z-2(d)(3)(A) defines a QOZ Business as "a trade or business (i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity

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zone business property (determined by substituting 'qualified opportunity zone business' for 'qualified opportunity fund' each place it appears in paragraph (2)(D)) [(the "QOZ Business Property test")], (ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b) , and (iii) which is not described in section 144(c)(6)(B)."

To satisfy the requirements of section 1397C(b)(2) and (4), a QOZ Business must derive "at least 50 percent of its total gross income...from the active conduct of [its] business" (the "gross income test") and must use "a substantial portion of [its] intangible property... in the active conduct of any such business" (the "intangible asset test"). In addition, pursuant to section 1397C(b)(8), "less than 5 percent of the average of the aggregate unadjusted bases of the property" of the QOZ can be attributable to "nonqualified financial property" (the "financial property test"). Section 1397C(e) provides that "'nonqualified financial property' means debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property specified in regulations; except that such term shall not include (1) reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less, or (2) debt instruments described in section 1221(a)(4)." Finally, the trade or business cannot include any 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 (or the provision of land for any of the foregoing) (the "qualified business test").

Thus, in order to satisfy the requirements of section 1400Z-2(d)(3)(A), a corporation or partnership will be required to operate a trade or business (the "trade or business test") and satisfy each of the following tests:

- (1) the QOZ Business Property test,
- (2) the gross income test,
- (3) the intangible asset test,
- (4) the financial property test, and
- (5) the qualified business test.

Effect of Election

Section 1400Z-2(b)(1) provides that a taxpayer that makes a valid election under section 1400Z-2(a)(2) will not be required to include the deferred gain in gross income until the earlier of the date on which the investment in the QOF is sold or exchanged or December 31, 2026.

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Section 1400Z-2(b)(2)(B)(i) states that, except as otherwise provided by section 1400Z-2(b)(2)(B) or (c), the taxpayer's basis in its investment in the QOF is zero. Pursuant to section 1400Z-2(b)(2)(B)(iii) and (iv), if the taxpayer holds the investment in the QOF for at least 5 years, the taxpayer's basis in its investment is increased by 10 percent of the amount of gain deferred and by another 5 percent of the gain deferred if the taxpayer holds the investment in the QOF for at least 7 years. In addition, section 1400Z-2(b)(2)(B)(ii) provides that the taxpayer's basis in its investment in the QOF is increased by the amount of gain included in income pursuant to section 1400Z-2(b)(1) (on December 31, 2026 if the investment has not been previously sold or otherwise disposed of). Further, section 1400Z-2(c) provides that, if the taxpayer makes a valid election under section 1400Z-2(a)(2), "[i]n the case of any investment held by the taxpayer for at least 10 years ..., the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged."

The following Q&As illustrate certain aspects of the operation of section 1400Z-2.

	QUESTION	ANSWER
1. Sale After Designation Period Lapses	<p>A fund (the "Fund") satisfies the requirements of section 1400Z-2(d)(1) to be classified as a QOF with respect to a QOZ Business in a qualified opportunity zone designated on April 9, 2018. The Fund otherwise satisfies the requirements of section 1400Z-2(d)(1). Taxpayer A recognizes gain in 2018 and contributes cash to the Fund in an amount equal to such gain in accordance with section 1400Z-2(a). Taxpayer A makes a valid election under section 1400Z-2(a)(2). Taxpayer A makes no further contributions to the Fund, holds its interest in the Fund until 2037, and then sells its interest for an amount in excess of the cash that it invested in the Fund. The Fund satisfies the requirements of section 1400Z-2(d)(1) at all times through the 2037 sale date other than the designation of the relevant qualified opportunity zone which lapsed after the close of December 31, 2028 - the end of the 10th calendar year beginning after the date of the qualified opportunity zone's designation.</p> <p>Is the basis of Taxpayer A's interest in the Fund equal to the fair market value of such interest on the date of sale pursuant to section 1400Z-2(c)?</p>	<p>Pursuant to section 1400Z-2(c), Taxpayer A's adjusted basis in its interest in the Fund on the date of sale is equal to the fair market value of such investment on such date. Nothing in section 1400Z-2 provides that the expiration of the 10-year designation period pursuant to section 1400Z-1(f) causes an investment in a QOF to fail to qualify under section 1400Z-2(c) if the QOF otherwise maintained its status as a QOF during the designation period. Similarly, the statute does not mandate that a taxpayer sell his interest in the QOF either (i) immediately before the expiration of the designation or (ii) immediately following the tenth anniversary of taxpayer's acquisition of the interest in the QOF in order to be entitled to the benefits of section 1400Z-2. Accordingly, Taxpayer A's adjusted basis in its interest in the Fund on the date of sale is equal to its fair market value on that date.</p>
2. Start-Up Business - Trade or Business Test	<p>Section 1400Z-2(d)(3) provides that a "'qualified opportunity zone business' means a trade or business (i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting 'qualified</p>	<p>Yes, a new corporation or a new partnership satisfies the trade or business test of section 1400Z-2(d)(3) during the start-up period if the conditions below are met.</p> <p>Section 1400Z-2(d)(2)(B)(i)(II) provides that a new corporation formed for the purpose of being a QOZ Business is treated in the same way as a</p>

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	<p>opportunity zone business" for "qualified opportunity fund" each place it appears in paragraph (2)(D)), (ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b), and (iii) which is not described in section 144(c)(6)(B)." Section 1400Z-2(d)(3) thus requires a trade or business. In addition, section 1397C(b)(2) and (4) (the gross income test and the intangible asset test) presuppose that the business is an active trade or business.</p> <p>Can a new corporation or a new partnership satisfy the "trade or business" test of section 1400Z-2(d)(3) during the start-up period?</p>	<p>QOZ Business for purposes of the statutory requirements set forth therein. Section 1400Z-2(d)(2)(C)(ii) provides the same with respect to a new partnership.</p> <p>It is common for a new business to undergo a start-up period where it is still exploring its options, has not hired employees, does not generate revenues, and has not fully deployed its capital. Notwithstanding that such business may not generally constitute a "trade or business" during the start-up phase for US federal income tax purposes, such a new business can nevertheless qualify as a trade or business for purposes of section 1400Z-2(d)(3) and, assuming it otherwise satisfies the requirements of section 1400Z-2(d)(3)(i) through (iii) (discussed in Q&A 3-7, below), as a QOZ Business. In such instance, the shares of the new corporation or interests in the new partnership would qualify as QOZ Property.</p> <p>The New Markets Tax Credit (NMTC) provisions of section 45D (addressing qualified low-income community business) have statutory language similar to that of sections 1397C and 1400Z-2(d). Addressing start-up businesses, Treas. Reg. section 1.45D-1(d)(4)(iv) provides that an entity will be deemed to be engaged in the active conduct of a trade or business if, at the time the relevant investment is made, the NMTC fund reasonably expects that the entity will generate revenues within three years. The principles applicable to determine whether an investment in a start-up business qualifies for purposes of the NMTC are equally appropriate for similar determinations under section 1400Z-2.</p> <p>Accordingly, for purposes of section 1400Z-2(d)(2)(B)(i)(II) and 1400Z-2(d)(2)(C)(ii), a new corporation or partnership will be treated as satisfying the trade or business test of section 1400Z-2(d)(3) (and engaged in an active trade or business for purposes of section 1400Z-2(d)(3)(A)(ii)) if, at the time the QOF acquires its interest in such new corporation or partnership, the QOF reasonably expects that the entity will generate revenues within three years that will satisfy such</p>

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		<p>requirement.</p> <p>The following example illustrates this.</p> <p>Example. Taxpayer B recognizes gain of \$10x and contributes cash in the amount of \$10x to an investment vehicle (the "Fund") that is organized for the purpose of investing in QOZ Property (other than a QOF). Taxpayer B elects to defer such gain and complies with the provisions of section 1400Z-2(a). Promptly upon receipt of the contribution from Taxpayer B, the Fund contributes such funds to a new corporation or a new partnership ("X") that was formed for the purpose of being a new QOZ Business as described in section 1400Z-2(d)(2)(B)(i)(II) and 1400Z-2(d)(3)(C)(ii). At the time of such contribution, (1) X has no income and begins to expend amounts for a new business that it is starting and (2) the Fund reasonably expects that X will satisfy the requirements of section 1400Z-2(d)(3)(A)(ii) within three years of the date of such contribution. The Fund receives no other contributions and acquires no other investments during such three-year period. For purposes of section 1400Z-2(d)(3), X is considered to have satisfied the trade or business test.</p>
3. Start-Up Business: QOZ Business Property Test/Intangible Asset Test	How does a corporation or partnership determine whether it satisfies the QOZ Business Property test and intangible assets test of section 1400Z-2(d)(3)(i) during a start-up period?	As noted above, during a start-up period, a corporation or a partnership may not yet own or have leased any tangible property or may still be acquiring property to install in its premises in a qualified opportunity zone. Accordingly, during its start-up period, if the corporation or partnership satisfies the requirements of Q&A 2 and its business plan reasonably projects that it will own substantially all of its tangible property in one or more qualified opportunity zones when it begins to generate revenues, the corporation or partnership will be deemed to have satisfied the QOZ Business Property Test of section 1400Z-2(d)(3)(3)(A)(i) during the start-up period.

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	QUESTION	ANSWER
4. Start-Up Business: Gross Income Test	How does a new corporation or new partnership determine whether it satisfies the gross income test of section 1400Z-2(d)(3)(ii) during a start-up period?	<p>For purposes of the NMTC provisions, section 45D(d)(2)(A)(i) imposes a gross income requirement identical to the gross income test of section 1400Z-2(d)(3)(A)(ii). Treas. Reg. section 1.45D-1(d)(4)(A) provides that a business can satisfy that gross income requirement based on all the facts and circumstances. In addition, Treas. Reg. section 1.45D-1(d)(4)(A)-(C) provides that a business is deemed to satisfy the gross income requirement of the NMTC rules if (i) at least 50% of its tangible property is used within the qualified low income community or (ii) at least 50% of the services performed by the employees of the business are performed within the qualified low income community.</p> <p>Given the identical statutory language of section 45D and section 1397C(b)(2) (the relevant provision for purposes of the gross income test of section 1400Z-2(d)(3)(A)(ii)) and the similar objectives of the NMTC provisions and qualified opportunity zone provisions, the gross income test of section 1400Z-2(d)(3)(A)(ii) shall be interpreted in a manner similar to the gross income requirements of section 45D(d)(2)(A)(i).</p> <p>Thus, whether a business satisfies that gross income test of section 1400Z-2(d)(3)(A)(ii) will be based on all the facts and circumstances. In addition, a corporation or a partnership will be deemed to earn 50% of its gross income from the active conduct of a business within a qualified opportunity zone if at least 50% of its tangible property is used within the zone or if at least 50% of the services performed by the employees of the business are performed within the qualified opportunity zone. These rules will apply both during and after any start-up period (including any period during which the business does not in fact have any gross income for US federal income tax purposes).</p>

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5. Working Capital	<p>Can a QOZ Business hold working capital?</p> <p>How is income earned on working capital treated for purposes of the gross income test of section 1400Z-2(d)(3)?</p>	<p>Yes, a QOZ Business can have working capital. Under the financial property test, a QOZ Business can hold reasonable working capital.</p> <p>Income generated by reasonable working capital is treated as income that satisfies the gross income test of section 1400Z-2(d)(3)(A)(ii).</p>
6. Working Capital - Formation, Acquisition, and Expansion	<p>Can reasonable working capital include amounts that will be used to fund the formation, acquisition, or expansion of a QOZ Business?</p>	<p>Amounts that are reasonably expected to be used for the formation or acquisition of a new QOZ Business (including any property to be used in such business) shall be treated as reasonable working capital during the start-up period referred to in Q&A 4. In addition, amounts that are reflected in the business plan, marketing plan, or development plan of an existing business and reasonably expected to be used in that business shall be treated as reasonable working capital.</p>
7. Leased Property	<p>a) Must a QOZ Business own all of its tangible property or is a QOZ Business permitted to lease tangible property?</p>	<p>a) A QOZ Business is not required to own all of its property. Section 1400Z-2(d)(3)(A)(i) expressly contemplates that a QOZ Business may lease tangible property.</p> <p>Accordingly, a QOZ Business can lease its premises in the qualified opportunity zone.</p>

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	<p>b) If a QOZ Business leases tangible property, how is such property treated for purposes of the requirements set forth in section 1400Z-2(d)(2)(D) and -2(d)(3)(A)?</p>	<p>b) A lease that is not otherwise treated as conferring ownership of the underlying asset on the lessee for US federal income tax purposes is intangible property for purposes of section 1400Z-2(d)(2)(D) and -2(d)(3)(A).</p> <p>For US federal income tax purposes, a lease of property that is not otherwise treated as causing the lessee to be treated as the owner of the property for U.S. federal income tax purposes is not treated as the acquisition of such property. If a QOZ Business enters into a new lease entitling it to use the leased property, the lease is treated as an intangible asset for purposes of section 1400Z-2(d)(2)(D) because neither the lease nor the underlying property was purchased by the QOZ Business. Accordingly, the underlying property is not taken into account for purposes of section 1400Z-2(d)(2)(D). Thus, the original use of leased property used in a QOZ Business need not have commenced with the QOZ Business.</p> <p>Any other result would preclude a new QOZ Business from leasing premises in existing facilities, which would frustrate the purposes of section 1400Z-2. In addition, including leased property as part of QOZ Business Property would permit taxpayers to frustrate the policy of section 1400Z-2 because it would artificially inflate the value of property held in the qualified opportunity zone. This would permit the business either to hold more assets outside of the qualified opportunity zone than would otherwise be the case or acquire tangible property from a related party, in each case, in contravention of the policy behind the statute.</p>

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	c) Is an QOZ Business permitted to lease tangible property from a person described in section 179(d)(2)(A) in an arm's length transaction?	<p>The result is the same if the QOZ Business enters into an arm's length lease with a related party as the entry into a lease is not an acquisition of property for U.S. federal income tax purposes. The lease is not tangible property in the hands of the QOZ Business and the QOZ Business is not treated as having acquired property for U.S. federal income tax purposes.</p> <p>Any other result would favor leases with third parties and disfavor leases by a QOZ Business with related persons for no sound policy reasons. For example, such a rule would preclude the owner of unimproved real estate from leasing the real estate to a related entity for development by such related entity but would permit a lease and development of the same property by an unrelated person. The purchase of property from a related person is prohibited by section 1400Z-2(d) because the policy underlying section 1400Z-2 is to have taxpayers re-deploy capital from non-qualified opportunity zone investments to qualified opportunity zone investments - a sale of qualified opportunity zone property from a taxpayer to a related taxpayer could serve to defeat this policy as no capital is being re-deployed. The same cannot be said of a lease of premises where the capital invested in the QOF is attributable to the sale of an existing non-opportunity zone asset and is being used to build a new business.</p>
		<p>The following examples illustrate the above.</p> <p>Example 1. A business acquires \$50x of tangible property in a transaction that does not qualify as a purchase as defined in section 179(d)(2). The tangible property is used in a business in a qualified opportunity zone. The business also enters into a new lease of premises in a qualified opportunity zone with a person not described in section 179(d)(2). The building is valued at \$1000x at the time of the lease. The business has no other assets and operates its business in the leased premises.</p> <p>The business is treated as owning \$50x of tangible property for purposes of section 1400Z-2(d)(3)(A) and 1400Z-2(d)(2)(D). The tangible property is not QOZ Business Property because it was not acquired by purchase.</p>

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		<p>Accordingly, none of the tangible property of such business satisfies the requirements of section 1400Z-2(d)(2)(D)(i) and the business does not qualify as a QOZ Business.</p> <p>Example 2. A business acquires \$50x of tangible property in a transaction that qualifies as a purchase as defined in section 179(d)(2). The tangible property is used in a business in a qualified opportunity zone. The business also enters into a new lease of premises in a qualified opportunity zone with a person described in section 179(d)(2). The building is valued at \$1000x at the time of the lease. The business has no other assets and operates its business in the leased premises.</p> <p>The business is treated as owning \$50x of tangible property for purposes of section 1400Z-2(d)(3)(A) and -2(d)(2)(D). The tangible property is QOZ Business Property because it was acquired by purchase. Accordingly, the tangible property of such business satisfies the requirements of section 1400Z-2(d)(2)(D)(i) and the business qualifies as a QOZ Business. The arm's length lease with a person described in section 179(d)(2) is not tangible property in the hands of the business.</p>
8. Section 1400Z-2(d)(2)(D)(i)(ii) - Original Use	What constitutes "original use" for purposes of section 1400Z-2(d)(2)(i)(II)?	<p>The term "original use" is not defined in section 1400Z-2. The term is used in certain other Code provisions that are similarly designed to encourage investment and growth in low-income communities, including the empowerment zone bond provisions of section 1394.</p> <p>For purposes of section 1394, the Treasury interpreted the term "original use" to provide that, "if a property is vacant for at least a one-year period including the date of zone designation, use prior to that period is disregarded for purposes of determining original use." Treas. Reg. section 1.1394-1(h). In addition, "de minimis incidental use of property, such as renting the side of a building for a billboard, are disregarded."</p> <p>Given the difficulty of applying an original use standard to land and buildings, and because section 1400Z-2 and section 1394 were both intended to spur investment in property the original use of which will</p>

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		<p>commence in designated low-income communities, it is appropriate to apply the same standard in both Code provisions.</p> <p>Accordingly, for purposes of section 1400Z-2(d)(2)(D)(i)(II), if real property in a qualified opportunity zone is vacant for at least a one-year period that includes the date of the designation of such qualified opportunity zone pursuant to section 1400Z-1, any use prior to the one-year period is disregarded for purposes of determining original use. In addition, for this purpose, de minimis incidental uses of property, such as renting the side of a building for a billboard, are disregarded.</p> <p>The following example illustrates the above.</p> <p>Example 1. A business acquires a lot and the building on the lot in a qualified opportunity zone for \$1000x from a person not described in section 179(d)(2). The taxpayer intends to make some improvements to the property before renting it out but not in an amount sufficient to constitute substantial improvements pursuant to section 1400Z-2(d)(2)(D). The property was vacant for at least a one-year period that the date of the designation of the relevant opportunity zone. The property satisfies the requirements of section 1400Z-2(d)(2)(D)(i)(II).</p>
9. Section 1400Z-2(d)(2)(D)(i)(ii) - Substantial Improvements	What constitutes a "substantial improvement" of real estate for purposes of section 1400Z-2(d)(2)(D)(ii)?	<p>Section 1400Z-2(d)(2)(D)(i)(II) requires that either the original use of the tangible property in the qualified opportunity zone commence with the QOZ Business or the QOZ Business substantially improve the property. Property is be treated as substantially improved only if, during any 30-month period beginning after the acquisition date of such property, additions to basis by the QOZ Business exceed an amount equal to the adjusted basis of such property in the hands of the QOZ Business at the beginning of such 30-month period.</p> <p>For purposes of section 1400Z-2(d)(2)(D)(i) and (ii), where land (improved or unimproved) is acquired in a single transaction, the land and</p>

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		<p>any improvements thereon (whether purchased or subsequently made) are treated as a single asset notwithstanding that they are treated as two assets for other federal income tax purposes (e.g., determining gain on sale, depreciation). Accordingly, amounts expended for the erection of a building on such land or additions to basis with respect to either the land itself (e.g., grading or sewage lines) or an existing building on the land are treated as additions to basis of a piece of property for purposes of determining whether the QOZ Business satisfies the substantial improvements test of section 1400Z-2(d)(2)(D)(ii).</p> <p>Similarly, where a QOZ Business acquires land and improves it through the demolition and construction of a new building, the land and any improvements are treated as a single asset for purposes of determining whether the QOZ Business satisfies the substantial improvements test of section 1400Z-2(d)(2)(D)(ii).</p> <p>The following example illustrates the above.</p> <p>Example 1. A corporation or partnership (X) acquires two contiguous parcels of land (Parcels A and B) and plans to erect one office building and some auxiliary buildings on the parcels. The cost of the land was \$50x per parcel. X makes \$101x of capital expenditures to erect the office building within a 30-month period described in section 1400Z-2(d)(2)(D)(ii). Such expenditures relate to the office building which will occupy both parcels. X satisfies the substantial improvements requirement of section 1400Z-2(d)(2)(D)(ii) because X has expended more than an amount equal to the adjusted basis of the parcels at the beginning of the 30-month period.</p>

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	QUESTION	ANSWER
10. Start-Up Businesses: Sale of QOF Interest	<p>The facts are the same as in the Example in Q&A-2 above. Taxpayer B holds its interest in the Fund for 10 years and the Fund holds the interest in X for 10 years. Immediately after the tenth anniversary of its investment in the Fund, Taxpayer B sells the interest in the Fund for an amount greater than \$10x.</p> <p>What are the consequences to Taxpayer B on the sale of the interest in the Fund?</p>	<p>Pursuant to section 1400Z-2(c), on the sale by Taxpayer B of its interest in the Fund, Taxpayer B's basis in the interest in the Fund will equal the fair market value of such interest. Thus, Taxpayer B will realize no gain or loss on such sale.</p> <p>As noted in Q&A-2, the Fund qualifies as a QOF from the time that Taxpayer B makes its contribution. Because X has satisfied the requirements of section 1400Z-2(d)(3) at all times during the Fund's ownership of the interest in X and Taxpayer B has owned the interest in the Fund for at least 10 years as required by section 1400Z-2(c), Taxpayer B's basis in the interest in the Fund will equal the fair market value of such interest on the date of sale.</p>
11. Examples	<p>Example 1. On July 1, 2018, a QOF organizes a partnership (X) in which the QOF is a partner and the other partner is an entrepreneur (B) who intends to open a manufacturing business in a qualified opportunity zone. The QOF makes a contribution of \$99x to X and B makes a contribution of \$1x to X.</p> <p>The proposed business is a qualified business. X's business plan reasonably projects that X will be generating revenues within three years. X leases space in an existing building in a qualified opportunity zone and contracts with a third party to build out the space for its needs. The build-out process takes 18 months. During the build-out phase, X maintains the \$100x (less any amounts expended for rent, the build-out, and other start-up activities) in an interest-bearing account that meets the requirements of section 1397C(e)(8).</p> <p>During the start-up period, X registers its trade</p>	<p>During the start-up period and thereafter, X satisfies the requirements of section 1400Z-2(d)(3).</p> <p>During its start-up period, X satisfies the trade or business test as, in accordance with the provisions of Treas. Reg. section 1.45D-1(d)(4)(iv), its business plan reasonably projected that it would generate revenues within three years. In addition, because its business plan reasonably projects that it will satisfy the QOZ Business Property test when it begins generating revenues, it will be deemed to satisfy the QOZ Business Property test of section 1400Z-2(d)(3)(A)(i) and the intangible assets test of section 1400Z-2(d)(3)(A)(i) during the start-up period.</p> <p>Although X has no revenues (other than interest income) during its start-up period (its first 18 months under these facts), the interest income earned on reasonable working capital will be deemed satisfy the gross income test of section 1400Z-2(d)(3)(A)(ii). X's working capital will be reasonable if the \$100x contributed to X provides it with amounts reasonably required to begin its operations and a reserve appropriate for a start-up business.</p> <p>For purposes of the QOZ Business Property test, after the start-up period has expired, X will own \$50x of property located in the qualified</p>

	QUESTION	ANSWER
	<p>name (and variations thereof) under which it intends to market its products.</p> <p>At the end of the 18 months, X purchases and leases from third parties manufacturing equipment to be used in its trade or business. During the 18 month period, X expended amounts on rent and service providers (architects and industrial engineers among others) in preparation for the commencement of business. During the start-up period, X expends \$50x for the purchase of equipment that is stored outside of the qualified opportunity zone during the start-up period. After such purchase, X has \$40x of cash and cash equivalents in an amount reasonable for its business needs. Such amounts are intended to provide X with sufficient working capital to meet the reasonable needs of the business as it begins to generate revenues.</p> <p>At the end of the 18 month period, the purchased and leased equipment has been installed at the leased premises, and X begins to manufacture its product at the site and makes sales directly to third parties through its website. X fulfills those orders from its manufacturing site. X also makes sales to wholesalers directly.</p>	<p>opportunity zone and the financial property. Thus, X will own substantially all of its tangible property in a qualified opportunity zone. (X's lease of its premises is an intangible asset not included under the QOZ Business Property Test.) Moreover, because X uses its intangibles in its business, it will satisfy the intangibles asset test. X's financial property is reasonable for its business needs and thus X will satisfy the financial property test.</p> <p>X will derive gross income from the sale of its product manufactured in the qualified opportunity zone or from its financial assets. X's gross income from its sales will satisfy the gross income test, as will its income from financial assets that satisfy the financial property test.</p> <p>X satisfies the qualified business test because its business is not described in section 144(c)(6)(B).</p> <p>For the period commencing with its organization, X has satisfied the requirements of section 1400Z-2(d)(3), i.e., the trade or business test, the QOZ Business Property test, the gross income test, the intangible asset test, the financial property test, and the qualified business test.</p> <p>If X continues to satisfy the requirements during its operating history which continues through December 31, 2028 (or otherwise satisfies the requirements of section 1400Z-2(d)(3)(B)), the stock of X will constitute QOZ Stock for purposes of section 1400Z-2(d)(2)(A)(i) in the hands of the QOF.</p>

	QUESTION	ANSWER
	<p>Example 2. On July 1, 2018, a QOF organizes a partnership (X) in which the QOF is a partner and the other partner is a real estate developer. X intends to develop and lease commercial real estate (an office building with several retail establishments on the lower floors) in a qualified opportunity zone. The QOF makes a contribution of \$99x to X and B makes a contribution of \$1x to X.</p> <p>The proposed business is a qualified business. X expends \$10x to purchase land. The land was vacant for at least a one-year period that the date of the designation of the relevant qualified opportunity zone. X next begins the process of obtaining the proper zoning and other permits and thereafter begins construction of a building on the land.</p> <p>X's business plan reasonably projects that X will be generating revenues within three years. During the construction process, X maintains the \$90x (less any amounts expended to obtain the permits and for other start-up activities) in an interest-bearing account that meets the requirements of section 1397C(e)(8). As progress payments on the construction becomes due, X funds such amounts from this capital and from borrowings from third party lenders.</p> <p>Prior to the completion of construction, X begins marketing the building to prospective tenants. At the end of the 36 months, the building is completed and X begins to collect rental</p>	<p>During the start-up period and thereafter, X satisfies the requirements of section 1400Z-2(d)(3).</p> <p>During its start-up period, X satisfies the trade or business test as, in accordance with the provisions of Treas. Reg. section 1.45D-1(d)(4)(iv), its business plan reasonably projected that it would generate revenues within three years. In addition, because its business plan reasonably projects that it will satisfy the QOZ Business Property test when it begins generating revenues, it will be deemed to satisfy the QOZ Business Property test of section 1400Z-2(d)(3)(A)(i) and the intangible assets test of section 1400Z-2(d)(3)(A)(i) during the start-up period.</p> <p>Although X has no revenues (other than interest income) during its start-up period (its first 36 months under these facts), the interest income earned on reasonable working capital will be deemed satisfy the gross income test of section 1400Z-2(d)(3)(A)(ii). X's working capital will be reasonable if the \$100x contributed to X provides it with amounts reasonably required to acquire the land, develop the building, and begin its rental activities, as well as a reserve appropriate for a start-up business.</p> <p>For purposes of the QOZ Business Property test, after the start-up period has expired, X will own \$90x of property located in the qualified opportunity zone and the financial property. Thus, X will own substantially all of its tangible property in a qualified opportunity zone. Moreover, because X uses its intangibles in its business, it will satisfy the intangibles asset test. X's financial property is reasonable for its business needs and thus X will satisfy the financial property test.</p> <p>X will derive gross income from the lease of its property in the qualified opportunity zone or from its financial assets. X's gross income from its leasing activities will satisfy the gross income test, as will its income from financial assets that satisfy the financial property test.</p> <p>X satisfies the qualified business test because its commercial real estate business is not described in section 144(c)(6)(B).</p>

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	QUESTION	ANSWER
	<p>payments from its tenants. Not all of the space in the building is leased out immediately.</p> <p>X has no meaningful intangibles assets but they are all related to its activities as the owner and developer of the real estate. After completion, X maintains \$10x of cash and cash equivalents. Such amounts are intended to provide X with sufficient working capital to meet the reasonable needs of the business as it begins to generate revenues.</p> <p>Substantially all of the retail space is leased to businesses that are qualified businesses.¹</p>	<p>For the period commencing with its organization, X has satisfied the requirements of section 1400Z-2(d)(3), i.e., the trade or business test, the QOZ Business Property test, the gross income test, the intangible asset test, the financial property test, and the qualified business test.</p> <p>If X continues to satisfy the requirements during its operating history which continues through December 31, 2028, the stock of X will constitute QOZ Stock for purposes of section 1400Z-2(d)(2)(A)(i) in the hands of the QOF.</p>

¹ The statute is unclear as to whether this is required. If the lease requires the lessee's to pay a portion of their revenues or profits to the lessor as additional rents, it may be necessary to include this provision.