# OPPORTUNITY ZONE FINAL REGULATIONS: FIRST IMPRESSIONS

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**U.S. Opportunity Zones Alert**

By: Olivia S. Byrne, Ed Dartley, Adam J. Tejeda

Almost exactly two years after enactment in the Tax Cuts and Jobs Act, Treasury has released final regulations on the Opportunity Zone ("OZ") tax incentive. The regulations combine two rounds of proposed regulations published in October 2018 and May 2019. While it will take some time to fully process the 544 pages of final rules and prepare a more comprehensive analysis, this alert is intended to quickly provide readers with highlights of changes to some key issues between proposed and final regulations.

As a general matter, the new rules will make it easier for investments, projects, and businesses to qualify for OZ benefits, and no investor-favorable provisions appear to have been scaled back. Notably, the regulations do not include the robust information reporting requirements recently proposed by Congress. Treasury officials acknowledge that the regulations will not answer every question that could arise but hope that they have crafted sufficient flexibility into the regulations to allow stakeholders to apply their facts and circumstances to OZ policy so they can make decisions and proceed with confidence and certainty. The final regulations will be effective 60 days after they are published in the Federal Register and taxpayers can continue to rely on the proposed regulations until that time.

## HIGHLIGHTS OF KEY CHANGES IN THE FINAL REGULATIONS

- Section 1231 gains can be invested on a gross basis beginning on the date the gain is realized. This is a substantial change from the approach in the proposed regulations that limited investments to net section 1231 gains and required investors to wait until the end of the tax year before they could make the investment. Treasury concluded that requiring investors to wait until the end of the year deterred opportunity zone investments in favor of other types of investments.
- Similarly, capital gains from regulated investment companies and REITs now can be invested as soon as the date of the dividend distribution, rather than waiting until the end of the year. Investors can continue to wait until the end of the taxable year to begin the 180-day clock if desired.
- Currently recognized capital gains on installment sales can be deferred even if the sale occurred before 1/1/2018. The 180-day period to invest in a qualified opportunity fund ("QOF") can begin either on the date the installment payment is received or the last day of the investor's taxable year.
- The 180-day period to invest capital gains flowing from a pass-through entity begins on the due date of the pass-through return (without regard to extensions to file) instead of the last day of the pass-through's calendar year. This gives investors waiting on K-1s more time to act

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- Capital gains from the sale of property by an opportunity zone business now qualify for the special 10-year exclusion election. Previously, the exclusion was available only for sales of property by qualified opportunity funds.
- The working capital safe harbor is doubled from 31 months to 62 months for start-up businesses. This is intended to encourage the use of the opportunity zone incentive for innovative businesses where it can often take a long time for them to launch.
- Personal property used in an opportunity zone business can be counted for purposes of meeting the substantial improvement test. This includes section 1245 property that is not included in the basis of a building.
- Buildings now can be aggregated for purposes of meeting the substantial improvement test if they are on the same or contiguous land. Determining whether substantial improvements have been made at a group level will help projects to qualify where some units do not require much rehabilitation while other structures require extensive work.
- The vacancy period to meet the original use test has been reduced from five years to one year if a building was vacant at the time the OZ designations were announced and through the time it was acquired by an eligible entity. If the building was not vacant at the time of designation, the vacancy period is three years.
- Leases from state and local governments and tribes are not required to be at market rate. This policy is intended to facilitate arrangements where governments hope to encourage development by offering favorable leasing terms.
- Leases that are not between related parties are presumed to be at market rate.
- The working capital safe harbor is extended 24 months, for a total of 55 months, when a project is delayed due to a disaster and the opportunity zone is located in a federally declared disaster area.
- Up to 20 percent of tangible property of a business used both inside and outside an opportunity zone can be counted toward the 70 percent use test if the property is used by employees of the business, and the business has a location inside the zone. This policy is intended to address situations where a business provides services to customers both in and out of the zone.
- Either a square footage test or an unadjusted cost test can be used to determine if real property straddling an opportunity zone is within the zone. Treasury adopted both tests after inadvertently including both of them in the second round of proposed regulations.
- Both land and structures can be considered as meeting the original use test in the case of brownfield remediation. This is intended to encourage and facilitate the clean up of these sites.
- Less than 5 percent of assets in a property and the gross income of a business can be attributable to a "sin" business (i.e., country club, golf courses, liquor stores, tanning salons) without making the business ineligible for OZ benefits. This policy could be beneficial to businesses like hotels housing tanning salons or a grocery store selling alcohol.

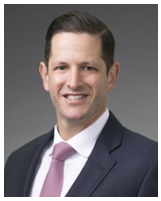
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- A C corporation QOF now can be treated as a member of the consolidated corporate group. Proposed regulations required a C corporation QOF to be treated as a standalone corporation.

## CONCLUSIONS

This alert identifies some of the important changes between the proposed and final opportunity zone regulations that will facilitate OZ investments and make it easier for OZ projects and businesses to qualify. Please look for our comprehensive analysis of the final regulations in January. In the meantime, please contact any of the authors or members of the K&L Gates OZ team with specific questions or concerns, or for assistance in understanding more about and implementing any aspect of the OZ incentive. Visit our webpage at klgates.com/opportunity-zones-ozs-practices/ to learn more about our K&L Gates OZ team and to access our full library of OZ alerts.

# KEY CONTACTS



**ADAM J. TEJEDA**
LEAD PRACTICE AREA LEADER - CORPORATE

NEW YORK
+1.212.536.4888
ADAM.TEJEDA@KLGATES.COM



**OLIVIA S. BYRNE**
PARTNER

WASHINGTON, DC
+1.202.778.9412
OLIVIA.BYRNE@KLGATES.COM



**ED DARTLEY**
PRACTICE AREA LEADER - ASSET MANAGEMENT AND INVESTMENT FUNDS

NEW YORK
+1.212.536.4874
ED.DARTLEY@KLGATES.COM

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