



# TAX LAW UPDATE

## Qualified Opportunity Zones

### Final Opportunity Zone Regulations

By Doug Jones

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On December 19th the Department of Treasury released its final Regulations governing Opportunity Zones (the “Final Regulations”). This alert assumes the reader has some familiarity with the existing Opportunity Zone rules and summarizes some of the important guidance contained in the Final Regulations.

#### **Demise of the Sell-In Strategy to Deal With Previously Owned OZ Property**

In the Final Regulations, Treasury has decided that a taxpayer cannot sell assets to a QOF and then re-invest the resulting proceeds into the QOF as eligible gain. Under previous guidance, taxpayers with previously owned property in an Opportunity Zone could have considered setting up a QOF in which they owned 20% or less, selling such previously owned property to the QOF and then re-investing the resulting gain into the QOF. The Final Regulations take this option off the table.

#### **Mitigation of Discrepancy Between Asset Sales and Equity Sales After a 10-Year Hold**

Under previous guidance, there was a discrepancy between the tax treatment of an exit after a 10-year hold between a sale of assets and a sale of equity in a QOF. Under an asset sale, only capital gain resulting from the sale of qualifying assets would qualify for the 10-year hold tax benefit. Thus, proceeds from sales of inventory, cash basis receivables, assets subject to ordinary income depreciation recapture or non-qualifying assets

would not be eligible for tax benefits. However, if the exit were structured as an equity sale, proceeds relating to these assets would qualify for tax benefits. The Final Regulation mitigate this discrepancy by providing that under as asset sale only proceeds from the sale of inventory will remain ineligible for tax benefits and proceeds from the sale of the other types of assets discussed above, including non-qualifying assets, will now qualify for tax benefits. Further, the Final Regulations make it clear that this benefit is available for sales of assets by a QOZB, not just a QOF. This new rule makes it much easier to structure multi-asset QOFs.

#### **New 62-Month Safe Harbor for Start-Ups**

Certain start-up businesses will now be able to use a 62-month working capital safe harbor rather than the normal 31-month safe harbor.

#### **1231 Gains**

1231 assets are depreciable property and non-depreciable real estate used in a trade or business for over a year. Previous Opportunity Zone guidance required gain from 1231 assets to be netted against 1231 losses and only allowed the resulting net 1231 gain as eligible gain for Opportunity Zone purposes. Further, under this previous guidance, the 180-day period for investing such 1231 gains did not begin until December 31 of the year in which the sale of the 1231 asset occurred. Under the Final Regulations, gross 1231 gains

may be eligible gains for Opportunity Zone purposes and need not be netted against 1231 losses and the relevant 180-day period begins on the date of the sale of the 1231 asset.

#### **Installment Sales**

The Final Regulations clarify taxpayers have an option with respect to the 180-day period for gains resulting from a sale reported on the installment method. A taxpayer may treat each installment payment received during a year as its own gain with its own 180-day period beginning when the payment is received or a taxpayer may treat the 180-day period for all payments received during a year as beginning on the last day of such year. Further, installment payments currently received that relate to sales occurring before the enactment of the Tax Cuts and Jobs Act may be treated as eligible gains.

#### **Relaxation of 180-Day Window Relating to Pass-Through Entities**

If a pass-through entity passes gain through to its partners or shareholders, previous guidance allowed the 180-day period to begin on the last day of the tax year of the pass-through entity. The Final Regulations give taxpayers the option to delay the beginning of the 180-day period to the due date of the entity’s tax return for the year the gain was realized.

### **“Original Use”**

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The Final Regulations have changed the rules relating to vacant buildings. Now a building that has been vacant may be purchased and considered original use if (i) it has been vacant for 1 year and was vacant when the QOZ was designated or (2) it has been vacant for 3 years and was not vacant when the QOZ was designated. Manufacturers can also consider property that they manufactured to be “original use” property so long as the manufacturing process began after 2017.

property that satisfies the original use test as long as that property improves the functionality of the property being improved. Finally, the Final Regulations allow, in limited circumstances, the substantial improvement test to be satisfied on an aggregated, not asset-by-asset, basis.

### **Qualifying Property**

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Improvements made to non-qualified property (such as property contributed to the QOF by an investor) will not be considered qualifying property.

### **“Substantial Improvement”**

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The Final Regulations make it clear that it is the adjusted basis of property, not its cost, that must be doubled in the 30-month period in order to be considered “substantially improved.” The Final Regulations also allow the improvement of property by purchasing other

For more information on how this could impact your organization, contact:

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