

Prop. Reg. Section 1400Z-2(d)-1(a)

Qualified Opportunity Funds



(a) Becoming a Qualified Opportunity Fund (QOF)

(1) Self-certification. Except as provided in paragraph (e)(1) of this section, if a taxpayer that is classified as a corporation or partnership for Federal tax purposes is eligible to be a QOF, the taxpayer may self-certify that it is QOF. This section refers to such a taxpayer as an eligible entity. The following rules apply to the self-certification:

(i) Time, form, and manner. The self-certification must be effected at such time and in such form and manner as may be prescribed by the Commissioner in IRS forms or instructions or in publications or guidance published in the Internal Revenue Bulletin (see Sec. § 601.601(d)(2) and 601.602 of this chapter).

(ii) First taxable year. The self-certification must identify the first taxable year that the eligible entity wants to be a QOF.

(iii) First month. The self-certification may identify the first month (in that initial taxable year) in which the eligible entity wants to be a QOF.

(A) Failure to specify first month. If the self-certification fails to specify the month in the initial taxable year that the eligible entity first wants to be a QOF, then the first month of the eligible entity's initial taxable year as a QOF is the first month that the eligible entity is a QOF.

(B) Investments before first month not eligible for deferral. If an investment in eligible interests of an eligible entity occurs prior to the eligible entity's first month as a QOF, any election under section 1400Z-2(a)(1) made for that investment is invalid.

(2) Becoming a QOF in a month that is not the first month of the taxable year. If an eligible entity's self-certification as a QOF is first effective for a month that is not the first month of that entity's taxable year-

(i) For purposes of section 1400Z-2(d)(1)(A) and (B) in the first year of the QOF's existence, the phrase first 6-month period of the taxable year of the fund means the first 6 months each of which is in the taxable year and in each of which the entity is a QOF. Thus, if an eligible entity becomes a QOF in the seventh or later month of a 12-month taxable year, the 90-percent test in section 1400Z-2(d)(1) takes into account only the QOF's assets on the last day of the taxable year.

(ii) The computation of any penalty under section 1400Z-2(f)(1) does not take into account any months before the first month in which an eligible entity is a QOF.

(3) Pre-existing entities. There is no legal barrier to a pre-existing eligible entity becoming a QOF, but the eligible entity must satisfy all of the requirements of section 1400Z-2, including the requirements regarding qualified opportunity zone property, as defined in section 1400Z-2(d)(2). In particular, that property must be acquired after December 31, 2017.

(b) Valuation of assets for purposes of the 90-percent asset test.

(1) In general. For a taxable year, if a QOF has an applicable financial statement within the meaning of §1.475(a)-4(h), then the value of each asset of the QOF for purposes of the 90-percent asset test in section 1400Z-2(d)(1) is the value of that asset as reported on the QOF's applicable financial statement for the relevant reporting period.

(2) QOF without an applicable financial statement. If paragraph (b)(1) of this section does not apply to a QOF, then the value of each asset of the QOF for purposes of the 90-percent asset test in section 1400Z-2(d)(1) is the QOF's cost of the asset.

(c) Qualified opportunity zone property.

(1) In general. Pursuant to section 1400Z-2(d)(2)(A), the following property is qualified opportunity zone property:

(i) Qualified opportunity zone stock as defined in paragraph (c)(2) of this section,

(ii) Qualified opportunity zone partnership interest as defined in paragraph (c)(3) of this section, and

(iii) Qualified opportunity zone business property as defined in paragraph (c)(4) of this section.

(2) Qualified opportunity zone stock.

(i) In general. Except as provided in paragraphs (c)(2)(ii) and (e)(2) of this section, if an entity is classified as a corporation for Federal tax purposes (corporation), then an equity interest (stock) in the entity is qualified opportunity zone stock if-

(A) The stock is acquired by a QOF after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

(B) As of the time the stock was issued, the corporation was a qualified opportunity zone business as defined in section 1400Z-2(d)(3) and paragraph (d) of this section (or, in the case of a new corporation, the corporation was being organized for purposes of being such a qualified opportunity zone business), and

(C) During substantially all of the QOF's holding period for the stock, the corporation qualified as a qualified opportunity zone business as defined in section 1400Z-2(d)(3) and paragraph (d) of this section.

(ii) Redemptions of stock. Pursuant to section 1400Z-2(d)(2)(B)(ii), rules similar to the rules of section 1202(c)(3) apply for purposes of determining whether stock in a corporation qualifies as qualified opportunity zone stock.

(A) Redemptions from taxpayer or related person. Stock acquired by a QOF is not treated as qualified opportunity zone stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of the stock, the corporation issuing the stock purchased (directly or indirectly) any of its stock from the QOF or from a person related (within the meaning of section 267(b) or 707(b)) to the QOF. Even if the purchase occurs after the issuance, the stock was never qualified opportunity zone stock.

(B) Significant redemptions. Stock issued by a corporation is not treated as qualified opportunity zone stock if, at any time during the 2-year period beginning on the date 1 year before the issuance of the stock, the corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of the 2-year period. Even if one or more of the disqualifying purchases occurs after the issuance, the stock was never qualified opportunity zone stock.

(C) Treatment of certain transactions. If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of paragraphs (c)(2)(ii)(A) and (B) of this section, that corporation is treated as purchasing an amount of its stock equal to the amount that is treated as such a distribution under section 304(a).

(3) Qualified opportunity zone partnership interest. Except as provided in paragraph (e)(2) of this section, if an entity is classified as a partnership for Federal tax purposes (partnership), any capital or profits interest (partnership interest) in the entity is a qualified opportunity zone partnership interest if-

(i) The partnership interest is acquired by a QOF after December 31, 2017, from the partnership solely in exchange for cash,

(ii) As of the time the partnership interest was acquired, the partnership was a qualified opportunity zone business as defined in section 1400Z-2(d)(3) and paragraph (d) of this section (or, in the case of a new partnership, the partnership was being organized for purposes of being a qualified opportunity zone business), and

(iii) During substantially all of the QOF's holding period for the partnership interest, the partnership qualified as a qualified opportunity zone business as defined in section 1400Z-2(d)(3) and paragraph (d) of this section.

(4) Qualified opportunity zone business property of a QOF. Tangible property used in a trade or business of a QOF is qualified opportunity zone business property for purposes of paragraph (c)(1)(iii) of this section if-

(i) The tangible property satisfies section 1400Z-2(d)(2)(D)(i)(I);

(ii) The original use of the tangible property in the qualified opportunity zone, within the meaning of paragraph (c)(7) of this section, commences with the QOF,

or the QOF substantially improves the tangible property within the meaning of paragraph (c)(8) of this section (which defines substantial improvement in this context); and

(iii) During substantially all of the QOF's holding period for the tangible property, substantially all of the use of the tangible property was in a qualified opportunity zone.

(5) Substantially all of a QOF's holding period for property described in paragraphs (c)(2), (3), and (4) of this section. [Reserved].

(6) Substantially all of the usage of tangible property by a QOF in a qualified opportunity zone. [Reserved].

(7) Original use of tangible property. [Reserved].

(8) Substantial improvement of tangible property.

(i) In general. Except as provided in paragraph (c)(8)(ii) of this section, for purposes of paragraph (c)(4)(ii) of this section, tangible property is treated as substantially improved by a QOF only if, during any 30-month period beginning after the date of acquisition of the property, additions to the basis of the property in the hands of the QOF exceed an amount equal to the adjusted basis of the property at the beginning of the 30-month period in the hands of the QOF.

(ii) Special rules for land and improvements on land

(A) Buildings located in the zone. If a QOF purchases a building located on land wholly within a QOZ, under section 1400Z-2(d)(2)(D)(ii) a substantial improvement to the purchased tangible property is measured by the QOF's additions to the adjusted basis of the building. Under section 1400Z-2(d), measuring a substantial improvement to the building by additions to the QOF's adjusted basis of the building does not require the QOF to separately substantially improve the land upon which the building is located.

(B) [Reserved].

(d) Qualified opportunity zone business.

(1) In general. A trade or business is a qualified opportunity zone business if-

(i) Substantially all of the tangible property owned or leased by the trade or business is qualified opportunity zone business property as defined in paragraph (d)(2) of this section,

(ii) Pursuant to section 1400Z-2(d)(3)(A)(iii), the trade or business satisfies the requirements of section 1397C(b)(2), (4), and (8) as defined in paragraph (d)(5) of this section, and

(iii) Pursuant to section 1400Z-2(d)(3)(A)(iii), the trade or business is not described in section 144(c)(6)(B) as defined in paragraph (d)(6) of this section.

(2) Qualified opportunity zone business property of the qualified opportunity zone business for purposes of paragraph (d)(1)(i) of this section.

(i) In general. The tangible property used in a trade or business of an entity is qualified opportunity zone business property for purposes of paragraph (d)(1)(i) of this section if-

(A) The tangible property satisfies section 1400Z-2(d)(2)(D)(i)(I);

(B) The original use of the tangible property in the qualified opportunity zone commences with the entity or the entity substantially improves the tangible property within the meaning of paragraph (d)(4) of this section (which defines substantial improvement in this context); and

(C) During substantially all of the entity's holding period for the tangible property, substantially all of the use of the tangible property was in a qualified opportunity zone.

(ii) Substantially all of a qualified opportunity zone business's holding period for property described in paragraph (d)(2)(i)(C) of this section. [Reserved].

(iii) Substantially all of the usage of tangible property by a qualified opportunity zone business in a qualified opportunity zone. [Reserved].

(3) Substantially all requirement of paragraph (d)(1)(i) of this section.

(i) In general. A trade or business of an entity is treated as satisfying the substantially all requirement of paragraph (d)(1)(i) of this section if at least 70 percent of the tangible property owned or leased by the trade or business is qualified opportunity zone business property as defined in paragraph (d)(2) of this section.

(ii) Calculating percent of tangible property owned or leased in a trade or business

(A) In general. If an entity has an applicable financial statement within the meaning of § 1.475(a)-4(h), then the value of each asset of the entity as reported on the entity's applicable financial statement for the relevant reporting period is used for determining whether a trade or business of the entity satisfies the first sentence of paragraph (d)(3)(i) of this section (concerning whether the trade or business is a qualified opportunity zone business).

(B) Entity without an applicable financial statement. If paragraph (d)(3)(ii)(A) of this section does not apply to an entity and a taxpayer both holds an equity interest in the entity and has self-certified as a QOF, then that taxpayer may value the entity's assets using the same methodology under paragraph (b) of this section that the taxpayer uses for determining its own compliance with the 90-percent asset requirement of section 1400Z-2(d)(1) (Compliance Methodology), provided that no other equity holder in the entity is a Five-Percent Zone Taxpayer. If paragraph (d)(3)(ii)(A) of this section does not apply to an entity and if two or more taxpayers that have self-certified as QOFs hold equity interests in the entity and at least one of them is a Five-Percent Zone Taxpayer, then the

values of the entity's assets may be calculated using the Compliance Methodology that both is used by a Five-Percent Zone Taxpayer and that produces the highest percentage of qualified opportunity zone business property for the entity.

(C) Five Percent Zone Taxpayer. A Five-Percent Zone Taxpayer is a taxpayer that has self-certified as a QOF and that holds stock in the entity (if it is a corporation) representing at least 5 percent in voting rights and value or holds an interest of at least 5 percent in the profits and capital of the entity (if it is a partnership).

(iii) Example. following example illustrates the principles of paragraph (d)(3)(ii) of this section.

(A)

Example. Entity ZS is a corporation that has issued only one class of stock and that conducts a trade or business. Taxpayer X holds 94% of the ZS stock, and Taxpayer Y holds the remaining 6% of that stock. (Thus, both X and Y are Five Percent Zone Taxpayers within the meaning of paragraph (d)(3)(ii)(C) of this section.) ZS does not have an applicable financial statement, and, for that reason, a determination of whether ZS is conducting a qualified opportunity zone business may employ the Compliance Methodology of X or Y. X and Y use different Compliance Methodologies permitted under paragraph (d)(3)(ii)(B) of this section for purposes of satisfying the 90-percent asset test of section 1400Z-2(d)(1). Under X's Compliance Methodology (which is based on X's applicable financial statement), 65% of the tangible property owned or leased by ZS's trade or business is qualified opportunity zone business property. Under Y's Compliance Methodology (which is based on Y's cost), 73% of the tangible property owned or leased by ZS's trade or business is qualified opportunity zone business property. Because Y's Compliance Methodology would produce the higher percentage of qualified opportunity zone business property for ZS (73%), both X and Y may use Y's Compliance Methodology to value ZS's owned or leased tangible property. If ZS's trade or business satisfies all additional requirements in section 1400Z-2(d)(3), the trade or business is a qualified opportunity zone business. Thus, if all of the additional requirements in section 1400Z-2(d)(2)(B) are satisfied, stock in ZS is qualified opportunity zone stock in the hands of a taxpayer that has self-certified as a QOF.

(B) [Reserved]

(4) Substantial improvement of tangible property for purposes of paragraph (d)(2)(i)(B) of this section.

(i) In general. Except as provided in paragraph (d)(4)(ii) of this section, for purposes of paragraph (d)(2)(i)(B) of this section, tangible property is treated as substantially improved by a qualified opportunity zone business only if, during any 30-month period beginning after the date of acquisition of such tangible property, additions to the basis of such tangible property in the hands of the qualified opportunity zone business exceed an amount equal to the adjusted basis

of such tangible property at the beginning of such 30-month period in the hands of the qualified opportunity zone business.

(ii) Special rules for land and improvements on land.

(A) Buildings located in the zone. If a QOF purchases a building located on land wholly within a QOZ, under section 1400Z-2(d)(2)(D)(ii) a substantial improvement to the purchased tangible property is measured by the QOF's additions to the adjusted basis of the building. Under section 1400Z-2(d), measuring a substantial improvement to the building by additions to the QOF's adjusted basis of the building does not require the QOF to separately substantially improve the land upon which the building is located.

(B) [Reserved].

(5) Operation of section 1397C requirements incorporated by reference.

(i) Gross income requirement. Section 1400Z-2(d)(3)(A)(iii) incorporates section 1397C(b)(2), requiring that for each taxable year at least 50 percent of the gross income of a qualified opportunity zone business is derived from the active conduct of a trade or business in the qualified opportunity zone.

(ii) Use of intangible property requirement.

(A) In general. Section 1400Z-2(d)(3) incorporates section 1397C(b)(4), requiring that, with respect to any taxable year, a substantial portion of the intangible property of an opportunity zone business is used in the active conduct of a trade or business in the qualified opportunity zone.

(B) Active conduct of a trade or business. [Reserved].

(iii) Nonqualified financial property limitation. Section 1400Z-2(d)(3) incorporates section 1397C(b)(8), limiting in each taxable year the average of the aggregate unadjusted bases of the property of a qualified opportunity zone business that may be attributable to nonqualified financial property. Section 1397C(e)(1), which defines the term nonqualified financial property for purposes of section 1397C(b)(8), excludes from that term reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less (working capital assets).

(iv) Safe harbor for reasonable amount of working capital. Solely for purposes of applying section 1397C(e)(1) to the definition of a qualified opportunity zone business under section 1400Z-2(d)(3), working capital assets are treated as reasonable in amount for purposes of sections 1397C(b)(2) and 1400Z-2(d)(3)(A)(ii), if all of the following three requirements are satisfied:

(A) Designated in writing. These amounts are designated in writing for the acquisition, construction, and/or substantial improvement of tangible property in a qualified opportunity zone, as defined in section 1400Z-1(a).

(B) Reasonable written schedule. There is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the

working capital assets. Under the schedule, the working capital assets must be spent within 31 months of the receipt by the business of the assets.

(C) Property consumption consistent. The working capital assets are actually used in a manner that is substantially consistent with paragraph (d)(5)(iv)(A) and (B) of this section.

(v) Safe harbor for gross income derived from the active conduct of business. Solely for purposes of applying the 50-percent test in section 1397C(b)(2) to the definition of a qualified opportunity zone business in section 1400Z-2(d)(3), if any gross income is derived from property that paragraph (d)(5)(iv) of this section treats as a reasonable amount of working capital, then that gross income is counted toward satisfaction of the 50-percent test.

(vi) Safe harbor for use of intangible property. Solely for purposes of applying the use requirement in section 1397C(b)(4) to the definition of a qualified opportunity zone business under section 1400Z-2(d)(3), the use requirement is treated as being satisfied during any period in which the business is proceeding in a manner that is substantially consistent with paragraphs (d)(5)(iv)(A) through (C) of this section.

(vii) Safe harbor for property on which working capital is being expended. If paragraph (d)(5)(iv) of this section treats some financial property as being a reasonable amount of working capital because of compliance with the three requirements of paragraph (d)(5)(iv)(A)-(C) and if the tangible property referred to in paragraph (d)(5)(iv)(A) is expected to satisfy the requirements of section 1400Z-2(d)(2)(D)(1) as a result of the planned expenditure of those working capital assets, then that tangible property is not treated as failing to satisfy those requirements solely because the scheduled consumption of the working capital is not yet complete.

(viii) Example. The following example illustrates the rules of this paragraph (d)(5):

Example.

(A) Facts. In 2019, Taxpayer H realized \$w million of capital gains and within the 180-day period invested \$w million in QOF T, a qualified opportunity fund. QOF T immediately acquired from partnership P a partnership interest in P, solely in exchange for \$w million of cash. P immediately placed the \$w million in working capital assets, which remained in working capital assets until used. P had written plans to acquire land in a qualified opportunity zone on which it planned to construct a commercial building. Of the \$w million, \$x million was dedicated to the land purchase, \$y million to the construction of the building, and \$z million to ancillary but necessary expenditures for the project. The written plans provided for purchase of the land within a month of receipt of the cash from QOF T and for the remaining \$y and \$z million to be spent within the next 30 months on construction of the building and on the ancillary expenditures. All expenditures were made on schedule, consuming the \$w million. During the taxable years that overlap with the first 31-month period, P had no gross income other than that derived from the amounts held in those working capital assets. Prior to

completion of the building, P's only assets were the land it purchased, the unspent amounts in the working capital assets, and P's work in process as the building was constructed.

(B) Analysis of construction.

(1) P met the three requirements of the safe harbor provided in paragraph (d)(5)(iv) of this section. P had a written plan to spend the \$w received from QOF T for the acquisition, construction, and/or substantial improvement of tangible property in a qualified opportunity zone, as defined in section 1400Z-1(a). P had a written schedule consistent with the ordinary start-up for a business for the expenditure of the working capital assets. And, finally, P's working capital assets were actually used in a manner that was substantially consistent with its written plan and the ordinary start-up of a business. Therefore, the \$x million, the \$y million, and the \$z million are treated as reasonable in amount for purposes of sections 1397C(b)(2) and 1400Z-2(d)(3)(A)(ii).

(2) Because P had no other gross income during the 31 months at issue, 100 percent of P's gross income during that time is treated as derived from an active trade or business in the qualified opportunity zone for purposes of satisfying the 50-percent test of section 1397C(b)(2).

(3) For purposes of satisfying the requirement of section 1397C(b)(4), during the period of land acquisition and building construction a substantial portion of P's intangible property is treated as being used in the active conduct of a trade or business in the qualified opportunity zone.

(4) All of the facts described are consistent with QOF T's interest in P being a qualified opportunity zone partnership interest for purposes of satisfying the 90-percent test in section 1400Z-2(d)(1).

(C) Analysis of substantial improvement. The above conclusions would also apply if P's plans had been to buy and substantially improve a pre-existing commercial building. In addition, the fact that P's basis in the building has not yet doubled does not cause the building to fail to satisfy section 1400Z-2(d)(2)(D)(i)(III).

(6) Trade or businesses described in section 144(c)(6)(B) not eligible. Pursuant to section 1400Z-2(d)(3)(A)(iii), the following trades or businesses described in section 144(c)(6)(B) cannot qualify as a qualified opportunity zone business:

(i) Any private or commercial golf course,

(ii) Country club,

(iii) Massage parlor,

(iv) Hot tub facility,

(v) Suntan facility,

(vi) Racetrack or other facility used for gambling, or

(vii) Any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

...