

Newly Proposed Opportunity Zone Regulations Further Encourage Redevelopment, New Business Growth And Leasing Opportunities

By Matthew J. Schiller

On April 17, 2019, the IRS released its second round of proposed regulations concerning the Opportunity Zone program (the OZ Program) created under the Tax Cuts and Jobs Act of 2017. The new regulations supplement and amend the October 2018 proposed regulations and guidance and provide substantial additional guidance concerning development, operational and leasing matters under the OZ Program.

To date, most of the attention concerning the OZ Program has focused on investing capital gains through Qualified Opportunity Funds (QOFs) in new developments and redevelopment projects. While incentivizing new development in Opportunity Zones (OZs) is a key aim of the OZ Program, it is also critical to remember that the growth of new businesses within OZs is an equally important goal that can benefit real estate operators. For example, Qualified Opportunity Zone Businesses (QOZBs) can be attractive tenants at new or existing projects since they will likely have lease terms of 10 years or more in order for the QOZB to maximize the OZ Program's tax incentives. Moreover, businesses in the "active conduct or trade" of leasing and operating real property may qualify as QOZBs. Accordingly, the OZ Program will have a broader impact on the real estate industry than simply serving as a new means to raise capital for real estate developments.

The initial proposed regulations provide critical guidance as to how QOFs and QOZBs can satisfy the "substantial improvement" test upon acquiring previously improved property (i.e., in the case of previously improved real estate,

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double the basis of the improvements on the property within a 30 month period). As cash does not constitute QOZ Property, QOZBs are given a 31 month "working capital safe harbor" under the October 2018 regulations to deploy sufficient capital to satisfy the substantial improvement test. The newly proposed regulations modify these requirements by excluding buildings that have been vacant for five years or more from the substantial improvement test. Thus, the redevelopment of qualified vacant properties will be considered an "original use" onsite. Moreover, the new regulations toll the 31-month working capital safe harbor for delays caused by government inaction (provided that a complete zoning application is submitted in a timely manner prior to the expiration of the safe harbor period). Thus, the new regulations should ease concerns that qualified redevelopment projects in New Jersey can comply with the timing requirements of the OZ Program.

The newly proposed regulations also provide significant guidance as to how QOZBs can operate and lease property in OZs.

For leased property to constitute QOZ Property, it must simply be subject to a lease (i) entered into after December 31, 2017, and (ii) on market terms, and need not satisfy the substantial improvement or original use test. Moreover, qualified leases between related parties can now potentially constitute QOZ Property. This change is critical because parties who owned real estate in OZs prior to December 31, 2017 can now potentially operate their own new QOF or QOZB on their property (which was previously prohibited).

QOZBs must generate at least 50% of their gross income within an OZ. The proposed regulations provide the following three safe harbors and a facts and circumstances test to determine whether sufficient income from a QOZB is being derived within an OZ: (i) the volume of services performed within an OZ (based on hours worked), (ii) the amount paid to QOZB employees working in an OZ, and (iii) the amount of tangible property and management or operational functions performed in an OZ. By providing such guidance, owners and tenants can now better identify which kinds of operations may occur within an OZ.

QOZBs must be engaged in the active conduct of a trade or business within the OZ. The new regulations provide that the ownership and operation (including leasing) of real property used in a trade or business has been deemed to be an active conduct of a trade or business. Accordingly, new real estate businesses may constitute QOZBs, however be cautioned that merely entering into a triple-net lease and/or holding land for investment purposes may not qualify.

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A Message From President Wescoe

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will add 300ft. Riparian Zone buffers to both the 749 river miles and their tributaries.

While these protections are likely justified in many instances, certain designations appeared to be based on poorly documented data and sampling that threw into question the validity of the expanded protections. Accordingly, NJBA asked DEP to restart the rulemaking with a new, more encompassing and thorough stakeholders' process. NJBA will keep members apprised of any new information as DEP evaluates public comments.

Our association will be busy over the next year as we continue to build a more affordable, sustainable and vibrant housing and retail and industrial market in New Jersey. With the support of our members, we will be able to accomplish much for New Jersey residents and the homebuilding community.

I want to thank each of you for the opportunity to represent you as NJBA President. I am proud to be at the helm of an association that is working to help all New Jersey's residents obtain the American Dream of homeownership. I look forward to seeing you all on August 19 at the NJBA Annual Golf Outing at the Cherry Valley Country Club in Skillman.

IRS Makes QOZs Compelling But You Have To Mine The Regulations

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of the law will have to be grandfathered if the law were to change.

Notable Rules Governing the Investment in the QOF

Not only is the federal government reducing the amount of deferred gain recognized by up to 15% it is also indemnifying a portion of this investment by effectively stating that a taxpayer with a bad investment might avoid paying the tax on some or all of the 85% remaining

amount deferred. When the final reckoning comes on the deferred gain the gain will be recognized on the earlier of the date the QOZ investment is disposed of or by December 31, 2026. Furthermore, if the deemed sale date is December 31, 2026. Furthermore, if the deemed sale date is December 31, 2026, the amount of gain will be computed by subtracting the taxpayer's basis in the QOZ investment on that date from the lesser of the remaining deferred gain or the fair market value of the QOZ interest on that date. This is a gift! If the investment in the QOF is doing well the deferred gain ultimately recognized is capped at the amount deferred. If the investment is doing poorly it is possible the recognized gain can be lower than the amount deferred.

In addition an investment can be made in-kind and qualify for deferral. However, services to a QOF -- carried interests -- are not considered an investment resulting in an interest in a QOF that will qualify for tax benefits.

The Real Impact, Liability And Cost Of NJDEP's New Groundwater Mounding Requirements

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values which would otherwise produce overly conservative results. While these additional engineering services will undoubtedly increase the design cost, the potential for savings during construction makes it an investment well made.

Groundwater mounding is an important factor to be assessed in any good storm-water management design. To ensure that a design is effective but not overly taxing on the budget, it is important to engage initially with a skilled engineering team who understands these intricacies and can recommend an appropriate scope of engineering and testing to provide a comprehensive design protective of both the neighbor's "perpetually dry basement" as well as the developers bank account.

Controlled Insurance Programs On Construction Projects

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subjected to background checks. On the other hand, they will typically be entitled to refunds on their regular policies for the time and effort spent on CIP projects. At the end of the day, whether a CIP project is good for you or not is open to debate, but CIPs are becoming much more commonly used in construction, and contractors, developers, and owners should know about them.

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This article merely highlights several of the many amendments and supplemental provisions provided in the April 2019 proposed regulations. The Treasury is scheduled to conduct a public hearing in July 2019 concerning the OZ Program, and additional regulations will likely be released later this summer. Notwithstanding that the OZ Program is a "work in progress," developers, landlords and entrepreneurs should be conscious of the OZ Program's many real estate benefits as well as the December 31, 2019 deadline to maximize the OZ Program's tax incentives. Those seeking to participate under the OZ Program should promptly speak with their attorneys and accountants to discuss how they can best take advantage of the OZ Program.