The Tax Joys of Opportunity Zones

Table of Contents

I. Introduction

The 2025 tax bill extends and expands the tax benefits to taxpayers that have capital gain and invest an amount equal to the realized gain to acquire an interest in a "Qualified Opportunity Fund," which in turn invests in certain low-income areas designated by the Department of the Treasury. This article provides a summary of the revised rules. To make the complex rules somewhat understandable, we have left off a number of details, simplified the discussion, used our best judgment to fill in some missing gaps, and added several of our own defined terms that do not match the terms used in the statute or regulations but are helpful to understanding the revised rules. We also assume that the regulations issued under the prior statute will continue to apply where applicable but that those regulations will have to be updated. It is thus critical to consult with a tax advisor based on your particular facts before relying on this summary.

II. Definitions

Here are the definitions used in this article:

- "Deferred Gain" means the Gain that is deferred by investing in a Fund.
- "Electing Taxpayer" means any individual or entity that elects to convert Gain to Deferred Gain by investing in a Fund.
- "Excluded Property" means a 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 premise.
- "Five Year Holding Period" means, for each Electing Taxpayer, five years after acquiring the Fund Interest.
- "Fund" means an entity that is a Qualified Opportunity Fund meeting certain requirements, as discussed in the "Requirements for Funds" section below.
- "Fund Interest" means equity ownership (including preferred equity) in a Fund.
- "Gain" means all capital gain that is subject to U.S. tax, including (1) short-term capital gain, (2) capital gains on collectibles (normally taxed at a special rate), (3) distributions and allocations from pass-through entities that are treated as capital gains to the owners, (4) gain on Section 1231 property (property used in a trade or business), (5) gain taxable to non-residents, and (6) gain recognized upon a sale of an interest in a Fund or upon an Inclusion Event. Gain does not include recapture income that is taxed as ordinary income. For real estate, only the excess depreciation over straight-line is recaptured as ordinary income, and the balance of the depreciation is recaptured as capital gain (and thus Gain), albeit at a 25% tax rate.

- “Inclusion Event” means an event that accelerates recognition of Deferred Gain, discussed in Section III.

- “Rural Area” means an area in a Zone that is not in any city or town with more than 50,000 inhabitants or in an “urbanized area” that is adjacent to, or contiguous with, such a city or town. Although not stated in the legislation, it is likely that Rural Areas will be specifically designated at the time Zones are designated for each Ten Year Zone Period and that the designation will apply for the entire Ten Year Zone Period even if the local population increases beyond 50,000.

- “Sub-Fund” means an entity in which a Fund invests that meets certain requirements, as discussed in the “Requirements for Sub-Funds” section below.

- “Sub-Fund Interest” means a Fund’s equity ownership (including preferred equity) in a Sub-Fund.

- “Ten Year Zone Period” means each ten year period for the designation of Zones, discussed in Section V.

- “Zone” means certain low-income areas designated by the Department of Treasury, as discussed in the “Zones” section below.

- “Zone Property” means tangible property that meets certain requirements, as discussed in the “Zone Property” section below.

- “Zone Working Capital” means cash, cash equivalents, or debt instruments of less than eighteen months if there is a written plan and written schedule for the use of such assets to develop a trade or business in a Zone or to buy or substantially improve Zone Property within thirty-one months and such assets are spent in substantial accordance with the written plan.

III. Benefits of Investing Gain in a Fund

Investing in a Fund provides significant tax benefits to any Electing Taxpayer, namely:

1. Tax on the Gain (including the 3.8% net investment income tax) is deferred until the earlier of (i) an “Inclusion Event” or (ii) the end of the Five Year Holding Period. IRC §1400Z-2(b). An “Inclusion Event” is one of the events listed in Treas. Reg. §1.1400Z2(b)-1(c), which include:

a. If the Fund Interest is disposed of in any manner (even by gift or in a tax free transaction), other than (i) upon death (because the estate is subject to tax on the Deferred Gain as income in respect of a decedent upon the earlier of an Inclusion Event with respect to the estate or the end of the Five Year Holding Period), (ii) a contribution to a grantor trust or wholly owned LLC, (iii) a contribution to a partnership, in which case the partnership inherits the Deferred Gain, and any later recognition must be allocated to the contributing partner; or (iv) a merger of two partnerships.

b. If the Fund makes a distribution to the Electing Taxpayer in cash or the fair market value of property that exceeds the Electing Taxpayer's basis in the Fund Interest.

c. If the Fund ceases to exist for tax purposes.

d. If the entity no longer meets the requirements for being a Fund.

e. If the Electing Taxpayer is a partnership, an Inclusion Event with respect to a partner in the partnership triggers recognition of that partner's share of the Deferred Gain of the partnership, and the partner is required to give notice of the Inclusion Event to the partnership. Treas. Reg. §1.1400Z2(b)-1(h)(2).

Happily, an Inclusion Event does not include the Electing Taxpayer taking out a loan against the Fund Interest. If an Electing Taxpayer has an Inclusion Event, the basis in the Fund Interest is increased immediately before the Inclusion Event by any recognized Deferred Gain.

2. In all cases, the recognized Deferred Gain is capped at the value of the Fund Interest at the time it is taxable. IRC §1400Z-2(b)(2)(A)(i). The character of the Deferred Gain when ultimately recognized is the same as in the year of the original sale, but the tax rate depends on the tax rate in the year of recognition.

3. Ten percent of the Deferred Gain is excluded entirely if the Fund Interest is held for the Five Year Holding Period. IRC §1400Z-2(b)(2)(B). If at least 90% of the assets of the Fund (or its Sub-Funds) is in Rural Areas (a "Qualified Rural Opportunity Fund"), the 10% exclusion is increased to 30%.

4. For investments held at least ten years, *there is no tax on any later sale of the Fund Interest, even if the entity no longer qualifies as a Fund after the Electing Investor's Five Year Holding Period, as long as it is sold within thirty years of the date of investment in the Fund,* and there is no recapture of depreciation, even if the Fund holds "hot assets" under IRC §751 or there is debt in excess of basis. IRC §1400Z-2(c); Treas. Reg. §1.1400Z2(c)-1(c). The regulations expand this tax benefit to the Electing Taxpayer's share of income recognized by a Fund or Sub-Fund on the sale of property after ten years (including depreciation recapture that would be taxed as ordinary income), but the Electing Taxpayer in that case would have to recognize ordinary income just on the sale of inventory in the ordinary course of business. Treas. Reg. §1.1400Z2(c)-1(b)(2)(ii). If the investment in the Fund is held for more than thirty years, the basis of Fund Interest becomes the market value of the Fund Interest at the end of thirty years.

5. The recognized Deferred Gain (either at the end of the Five Year Holding Period or upon an Inclusion Event) increases the basis of the Fund Interest.

The Electing Taxpayer must give notice to the Fund upon an Inclusion Event. Treas. Reg. §1.1400Z2(b)-1(h)(3). After an "Inclusion Event," the exemption of realized gain on the Fund Interest after ten years will no longer apply.

Whenever a Fund Interest is bifurcated into a qualified portion and non-qualified portion (such as if the investment in the Fund exceeds the Deferred Gain), the two portions are treated as separate interests, and the tax benefits and rules outlined above apply only to the qualified portion, and normal tax rules apply to the non-qualified portion.

IV. Technical Requirements

The technical requirements for obtaining the tax benefits of investing in a Fund are as follows:

1. The benefits apply to the reinvestment of any Gain recognized by all individuals and entities on sales to unrelated parties (not more than 20% overlapping ownership for sales to or by entities), including any Gain recognized on a sale of a Fund Interest, including Deferred Gain. The benefit applies to Gain that would otherwise be offset by capital losses or net operating losses. The benefits do not apply if (a) the Electing Taxpayer held an offsetting position that substantially diminished the risk of holding the property that was sold, whether or not either of the positions were publicly traded or (b) the Gain is attributable to the sale of property to a Fund (or its Sub-Fund) to the extent that the selling taxpayer invests the sale proceeds in that Fund, since the sale and investment are treated as a deemed contribution of property under the step-transaction and circular cash flow doctrines.

2. The Electing Taxpayer must elect these benefits on IRS Form 8949, filed with the tax return for the year the Gain is recognized. For Gain recognized by pass-through entities, either the entity or the owners may make the election. Treas. Reg §1.1400Z2(a)-1(c). If a pass-through entity makes the election, it must give notice of the election to its owners. Treas. Reg. §1.1400Z2(b)-1(h)(1).

3. The Fund Interest must be acquired within 180 days starting on the date on which the Gain is recognized. IRC §1400Z-2(a)(1)(A). An investment in a Fund *prior* to Gain being recognized does not work, but it may be possible to effectively achieve that result by either (a) the Electing Taxpayer first loaning money to a Fund (perhaps through an affiliate) and later making the investment and having the Fund pay off the loan after Gain is recognized or (b) having a party that is related to the Electing Taxpayer acquire the Fund Interest and later having the Electing Taxpayer purchase the Fund Interest from the related party during the 180-day period. If property is sold for a note and Gain is reported on the installment method, the 180-day period runs from either (at the Electing Taxpayer's election) (a) receipt of each payment on the note or (b) the end of the tax year that the payment is received. Treas. Reg. §1.1400Z2(d)-2(b)(1).

If a pass-through entity does not make the election, the owners may elect to start the 180 days from either (a) the date when the entity recognizes the Gain, (b) the end of the entity's tax year, or (c) by the due date of the entity's tax return without regard to extensions. Treas. Reg. §1.1400Z2(a)-1(c). The regulations apply this rule to trusts other than grantor trusts. Gain allocated to shareholders of a real estate investment trust (REIT) is considered to occur on the last day of the year. Treas. Reg. §1.1400Z2(a)-1(b)(4)(i).

As long as the 180-day requirement is met, the Gain can be recognized prior to the start of the applicable Ten Year Zone Period for the relevant Fund.

4. The investment must be made in an entity that qualifies as a Fund at the time of the investment; any earlier investment will not qualify even if the entity later becomes a Fund.

5. The Fund Interest may be acquired either (a) directly on original issue from an entity that is a Fund at the time of the investment or (b) from a current owner of a Fund Interest (and there is no prohibition on acquiring a Fund Interest from a related party). Treas. Reg. §1.1400Z2(a)-1(c)(5)(iii).

6. All the benefits (including the exclusion of tax on the sale of a Fund Interest after ten years) apply only to the extent of the lesser of (a) the Deferred Gain or (b) the "amount invested" to acquire an interest in the Fund. IRC §1400Z-2(b)(2)(A). If more than this amount is invested, the Fund Interest is allocated pro rata between the qualifying portion and non-qualifying portion for purposes of calculating the tax benefits to the qualifying portion. Tracing of cash from the Gain to the "amount invested" is not required. The "amount invested" appears to include debt (even non-recourse debt) that is borrowed by the investor to acquire an interest in the Fund, but not any portion of the debt of the Fund that is allocated to the investor under IRC §752.

The "amount invested" can also include any non-cash property contributed to a Fund (as long as the transaction is not recharacterized as a disguised sale), but it is unlikely that Electing Taxpayers will contribute non-cash property to a Fund, because the property would not qualify as Zone Property, which requires that the property be purchased by a Fund. Treas. Reg §1.1400Z2(d)-2(b)(1)(i).

The "amount invested" is reduced by any cash distributed by the Fund within two years before or after the investment. Treas. Reg. §1.1400Z2(a)-1(c)(6)(iii)(A). If the Fund Interest is acquired from a current owner of the Fund Interest, the "amount invested" is the cash and net fair market value of any property transferred by the Electing Taxpayer for the interest. Treas. Reg. §1.1400Z2(a)-1(c)(6)(iv).

7. Funds are subject to extensive reporting requirements, both to the IRS (to be filed electronically) and to investors that sell an interest in the Fund, with substantial penalties for failure to file the required reports on a timely basis.

V. Zones

The precise boundaries of low-income areas qualifying as Zones will be designated by the Department of Treasury at some time during the last six months prior to each Ten Year Zone Period, with the first Ten Year Zone Period commencing January 1, 2027. For example, the Zones that are applicable for the 2027 through 2036 Ten Year Zone Period will be designated at some time during the last six months of 2026. Zones must be located in the United States and its possessions. The designation of an area as a Zone remains throughout the applicable Ten Year Zone Period. IRC §1400Z-1(f).

VI. Requirements for Funds

The principal requirements to qualify as a Fund are as follows:

1. A Fund must be a corporation (even an S corporation or a REIT) or a partnership (including an LLC) for tax purposes. IRC §1400Z-2(d)(1). As a practical matter, a Fund will almost always be formed as an LLC with multiple owners, to provide limited liability and pass-through partnership characterization for tax purposes. The regulations provide extensive rules applicable only to Funds formed as corporations, but those rules are not discussed in this article, because based on our experience most Funds will be formed as partnerships for tax purposes.

2. The "organizing documents" (probably the articles) for the Fund must state that the purpose of the entity is to invest in a Zone and the description of the business. The Fund must be formed in the U.S. or in a U.S. possession if it invests in a Zone that is in that possession.

3. The entity must elect to be a Fund on IRS Form 8996 and must file this form annually. On this form, the entity designates the first month that it is a Fund, and if it does not make this designation, it is a Fund for that year from the first day the entity was formed.

4. The Fund must hold 90% of all its gross assets in the form of (a) Sub-Fund Interests acquired for cash directly upon original issue from an entity that is a Sub-Fund (and not also a Fund) at the time of acquisition and for 90% of the Fund's holding period of the Sub-Fund (Treas. Reg. §1.1400Z2(d)-1(c)) or (b) Zone Property (which, as discussed below, must be tangible property). IRC §1400Z-2(d). Critically, this test is applied to *all* assets of a Fund, so intangible assets, such as patents, copyrights, and, most importantly, cash, which do not count as Zone Property, could disqualify an entity from being a Fund. The one exception is that a Fund may exclude cash (and the income earned on it) for six months if it is attributable to the issuance of a Fund Interest. Treas. Reg. §1.1400Z2(d)-1(b)(2)(i)(B). If this is the only asset the Fund has, the Fund is treated as meeting the 90% test.

5. For any period that the Fund does not meet this test, the Fund must pay penalty interest on the amount of the shortfall. IRC §§1400Z-2(f) and 6621(a)(2). It is not clear what happens if the Fund continues to fail to meet this test; presumably at some point it is disqualified as a Fund, which would be an inclusion event, causing the investors to recognize the Deferred Gain. If the 90% test is not met due to a Sub-Fund held by the Fund not qualifying at the end of any six-month period, the Sub-Fund is allowed one six-month period to cure the problem without the Fund being subject to the penalty.

6. The Zone Property or Sub-Fund Interests must be acquired by the Fund *after* the start of the applicable Ten Year Zone Period, so property owned prior to that date will not qualify, even if it ends up being in a Zone under the new area designations.

7. The 90% test is measured each year based on the average of the value of all assets at the end of (a) the first six months of the tax year (or the first six months from commencement as a Fund for its first year) and (b) the end of each tax year, as reported on IRS Form 8996 each year. IRC §1400Z-2(d)(1). Thus, new Funds have some time to invest in Sub-Funds or Zone Property, but the timing of formation of the Fund becomes critical.

8. Critically, there is no look-through to the assets of a Sub-Fund, even if it is a pass-through for tax purposes, so many Funds will be forced to meet the 90% test by holding interests in Sub-Funds, because the requirements for the assets of Sub-Funds are more lenient than for Funds, as discussed in Section VII below. This means that the typical structure will be a Fund that is an LLC with multiple owners (to be treated as a partnership for tax purposes), owning interests in one or more Sub-Funds that are also formed as LLCs with multiple owners (to also be treated as partnerships for tax purposes).

9. A Fund is allowed one year to reinvest in a Sub-Fund or in Zone Property if it sells a Sub-Fund Interest or Zone Property (Treas. Reg. §1.1400Z2(f)-1(b)), but the sale is taxable to the owners of the Fund if it is a pass-through for tax purposes, unless (a) they make a further election to defer the Gain by investing that amount in the same or a different Fund (which probably requires a distribution and recontribution of the sale proceeds) or (b) the Fund or Sub-Fund completes an IRC §1031 exchange into other Zone Property.

VII. Requirements for Sub-Funds

The principal requirements to qualify as a Sub-Fund are as follows:

1. Like a Fund, a Sub-Fund must also be a corporation or a partnership (including an LLC) for tax purposes. As a practical matter, a Sub-Fund will almost always be formed as an LLC with multiple owners, to provide limited liability and pass-through partnership characterization for tax purposes. It does not appear that the organization documents for a Sub-Fund must state the purpose of the entity is to invest in a Zone and the description of the business (as is the case with Funds), but it would be prudent to do so. The Sub-Fund must be formed in the U.S. or in a U.S. possession if it invests in a Zone that is in that possession. Treas. Reg. §1.1400Z2(d)-1(a)(i)(B).

2. At least 70% of the gross *tangible* assets of the Sub-Fund must be Zone Property. Treas. Reg. §1.1400Z2(d)-1(d)(2). The property remains Zone Property for five years even if it is moved out of the Zone (as long as the entity owns it). IRC §1400Z-2(d)(3)(B). Note that this test is more lenient than the 90% asset test for a Fund and is applied only to all tangible assets, but it is also all or nothing, as opposed to the interest charge imposed on Funds while they do not meet the 90% test. IRC §1400Z-2(f) (by negative implication, because the penalty rate only applies to Funds).

The regulations suspend the 70% tangible property test for the duration of the time that the Sub-Fund complies with Working Capital Safe Harbor, discussed below.

3. The Zone Property must be acquired by the Sub-Fund *after* the start of the applicable Ten Year Zone Period, so property owned prior to that date will not qualify, even if it ends up being in a Zone under the new area designations.

4. As opposed to Funds, Sub-Funds do not have to file IRS Form 8996 each year, but the same test applicable to Funds applies; *i.e.,* value is measured each year based on the average of the value of all assets at end of (a) the first six months of the tax year (or the first six months from commencement as a Sub-Fund for its first year) and (b) the end of each tax year. IRC §1400Z-2(d)(1).

5. The following requirements apply to Sub-Funds but (oddly) not to Funds:

a. At least 40% of intangible property (such as trademarks, patents, copyrights, and working capital) of the Sub-Fund must be used in connection with an active trade or business that is conducted in the Zone. Treas. Reg. §1.1400Z2(d)-1(d)(3)(ii). Zone Working Capital is treated as meeting this test. Other intangible property qualifies if it is customarily used in the conduct of the trade or business and the use of the intangible property contributes to the income generated by the trade or business. Critically, it does not appear that the property to be acquired must be identified at the time the written plan is made.

b. At least 50% of the gross income of the entity must be from an active trade or business conducted in the Zone. Income from Zone Working Capital counts as qualifying income for this purpose. Treas. Reg. §1.1400Z2(d)-1(d)(3)(i). In determining whether other income qualifies, Sub-Funds can apply any of the tests below:

i. Income can be allocated based on the location of employees and independent contractors based on hours worked.

ii. Income can be allocated based on the location of employees and independent contractors based on compensation paid.

iii. The test will be met if the operations in the Zone and Zone Property are necessary for the generation of at least 50% of the gross income of the Sub-Fund.

iv. The Sub-Fund can make the allocation based on all the facts and circumstances.

c. Less than 5% of the assets of the Sub-Fund can be investment property (including stock, partnership interests, and debt) other than Zone Working Capital. IRC §1400Z-2(d)(3)(A)(ii).

d. Less than 5% of the assets of the Sub-Fund can be Excluded Property. Treas. Reg. §1.1400Z2(d)-1(d)(4).

VIII. Valuation of Property

For purposes of the 90% of all assets test for Funds and the 70% of tangible assets test for Sub-Funds, the test is based on an annual election by the Fund or Sub-Fund to use either (a) the values stated on certified audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) or (b) original cost. Treas. Reg. §1.1400Z2(d)-1(b). Under this approach, the asset values include debt (even non-recourse debt) incurred in connection with acquiring the assets. Funds and Sub-Funds may elect annually to exclude all inventory from the calculation.

In the case of leased property, the test can be based on certified audited financial statements prepared in accordance with GAAP only if those statements include the value of leased property based on the present value of the rent due under the lease. Treas. Reg. §1.1400Z2(d)-1(b)(2)(iii). In all other cases, leased property is included based on the present value of the rent due under the lease calculated upon commencement of the lease (including all extensions at the lessee's election at a pre-defined rent), discounted at the short-term applicable federal rate (based on semi-annual compounding) in effect under IRC §1274. Treas. Reg. §1.1400Z2(d)-1(b)(2)(iii).

IX. Zone Property

Zone Property must meet the requirements set forth in Treas. Reg. §1.1400Z2(d)-2(a)(2), as follows:

a. The property must be tangible property, including land, buildings, and personal property, excluding all Excluded Property.

b. At least 70% of the use of the property must be within a Zone during 90% of the Fund's or Sub-Fund's holding period of the property. Inventory outside the Zone is treated as being in the Zone if it is being shipped to or from the Zone unless the Fund or Sub-Fund has elected to exclude all inventory from the calculation for that year. Short term leases of personal property outside a Zone can count as Zone Property if the property is leased from a business operated in a Zone.

c. The property must be acquired or leased by the Fund or Sub-Fund after the start of the applicable Ten Year Zone Period.

d. *Other than leased property*, the property must either be constructed by the Fund or Sub-Fund (including improvements to leased property) or acquired by purchase by a Fund or Sub-Fund from an unrelated third party (not more than 20% common ownership), and there cannot be any plan or intention to later sell the property back to the seller.

e. In the case of leased property, the lease must provide for arm's-length rent (unless the lease is to a government entity), although a lease to an unrelated party is presumed to be arm's-length. In addition, if the lease is for anything other than unimproved land, there cannot be any plan or intent for the lessee to acquire the property for any amount other than the value of the property at the time of purchase. If the lease is from a related party, (i) the lessee cannot prepay more than one year's rent and (ii) if the property is *personal* property that was used in the Zone before the lease, the lessee must purchase other Zone Property with a value at least equal to the value of the leased property within thirty months of commencement of the lease.

f. *Other than land and leased property*, the property must either be (i) placed in service in the Zone for the first time by the Fund or the Sub-Fund (including used property previously used outside the Zone or constructed property that has not yet been placed in service in a trade or business), (ii) already in the Zone but a least 80% vacant for at least three years, or (iii) already in the Zone and within thirty months the Fund or Sub-Fund invests in the property an amount equal to at least 100% (50% for property in a Rural Area) of the Fund's adjusted basis of the property as measured at the start of the thirty months ("Percentage of Cost Test"). IRC §1400Z-2(d)(2)(D)(ii); Treas. Reg. §1.1400Z2(d)-2(b)(4). This Percentage of Cost Test applies only to buildings on real estate as a practical matter, and only the cost allocated to the acquired buildings or that "improves its functionality" (such as all the personal property purchased for a hotel) is included for purposes of the test. The acquired buildings and all costs meeting the Percentage of Cost Test count as Zone Property during the thirty months. Treas. Reg. §1.1400Z2(d)-1(b)(4)(ii). The calculation of the investment in the buildings includes all costs that are capitalized to the buildings, such as the cost of new fixtures and costs relating to getting permits or plans to use the buildings for a different purpose. Two or more buildings can be aggregated for purposes of the Percentage of Cost Test if they are either (i) on a single parcel and acquired with one deed or (ii) contiguous and operated as part of an integrated business. If the land is in a Brownfield site, the structures existing on the land qualify as Zone Property without improvement as long as the Fund or Sub-Fund invests to improve the safety and compliance with environmental standards. If the Percentage of Cost Test is <u>not</u> met, improvements to non-Zone property are not treated as Zone Property.

g. The property must be used in a trade or business (or for Sub-Funds, in an active trade or business) in the Zone. Any lease of real property is treated as meeting this test unless it is triple net leased, so the lessor should retain liability for at least either property taxes, insurance, or maintenance. Treas. Reg. §1.1400Z2(d)-1(d)(3)(iii)(B). Property being constructed or improved is treated as used in an active trade or business even before it is placed in service for tax purposes.

h. *Other than for leased property*, unimproved land (presumably including due to tearing down any existing buildings) or minimally improved land (such as agricultural land) is included as Zone Property only if the Fund or Sub-Fund has the intention to improve the land by more than an insubstantial amount within thirty months after acquisition. Treas. Reg. §1.1400Z2(d)-2(b)(4)(iv).

X. Conclusion for Real Property

In most cases, Funds will be a real estate play, so putting it all together, the rules for real property are as follows:

1. The property must be acquired or leased after the start of the applicable Ten Year Zone Period.

2. The property must be used in a trade or business (or for Sub-Funds, in an active trade or business) in the Zone, which includes leasing other than a triple net lease. This test is deemed satisfied during construction on, or improvement of, the property.

3. Property leased to the Fund or Sub-Fund qualifies even if (a) it is leased from a related party, (b) the property is already improved and used in the Zone, and (c) the lessee merely subleases the property other than on a triple net basis.

4. In the case of purchased property:

a. It must be acquired from an unrelated party, and there cannot be any plan or intention to later sell the property back to the seller.

b. If the property is unimproved (presumably including due to tearing down any existing buildings) or minimally improved, the Fund or Sub-Fund must improve the land by more than an insubstantial amount within thirty months after acquisition.

c. If the property is improved, the buildings on the land will not count as Zone Property unless the Percentage of Cost Test is met with respect to such buildings.