December 28, 2018

Office of Associate Chief Counsel (Income Tax and Accounting)
Attention: Erika C. Reigle and Kyle C. Griffin
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

CC:PA:LPD:PR
(REG-115420-18)
Room 5203
Internal Revenue Service
P.O. Box 7604
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RE: Comments to the Proposed Regulations under Section 1400Z-2--Qualified Opportunity Zone Legislation

Dear Ms. Reigle and Mr. Griffin,

As the Treasury Department begins the process of promulgating regulations and answering questions on IRC Section 1400Z-2 as authorized by the Tax Cuts and Jobs Act of 2017, H.R. 1 (115th Congress), the undersigned ("Working Group") would like to offer recommendations for clarifying and effectively ensuring program implementation in connection with the Proposed Regulations under Section 1400Z-2.

The Working Group is comprised of service professionals from the legal and accounting industry along with real estate developers and licensed broker dealers that have experience in financing real estate projects and operating businesses in low-income communities throughout the country. This includes working with the federal Low-Income Housing Tax Credit as well as the New Market Tax Credit.

The Working Group is excited about the potential for the Opportunity Zone program to facilitate public-private resources to attract capital and encourage economic development into low-income communities in the United States and its territories. We understand that the goal of the program is to help incentivize investments in these communities and to support the effective implementation of this program without creating unforeseen complications or unintended consequences. We encourage Treasury to consider our recommendations to ensure community development best practices are included in the proposed regulations involving Qualified Opportunity Funds and Qualified Opportunity Zone Property. Below is a summary of our recommendations:

I. In rulemaking provide relief related to the 180-day investment period for individuals during the first year of implementation of the Opportunity Zone program due to lack of regulatory guidance;

II. In our initial recommendation to Treasury, we sought a rule that would allow Qualified Opportunity Fund a 12-month period in which to originally invest dollars before being penalized.

We continue to recommend this approach with both initial deployment and any required redeployment. In addition, if a 12-month grace-period is not granted, we request that the Qualified Opportunity Fund penalty calculation be assessed only on the qualified investment proceeds in a Qualified Opportunity Fund with mixed investments or debt financing;

III. In rulemaking, provide a bright line clarification as to the definition of Original Use under Section 1400Z-2(d)(2)(D)(i)(II), including as it relates to buildings that have not received a certificate of occupancy or have been vacant for a period of time;

IV. In rulemaking, clarify that a trade or business is "active" when it begins generating gross revenues and that the "activity" requirement will be satisfied by any trade or business that generates gross revenues within three years after the investment is made;

V. In rulemaking, modify the Proposed Regulations so as to permit the election under Code Section 1400Z-2(c) to be made at any time after a 10-year holding period is accomplished, even if the election is made after 2047 by the taxpayer;

VI. In rulemaking, provide clarification and illustrations regarding what circumstances qualify under the reasonable cause exception of Code Section 1400Z-2(f)(3).

VII. In rulemaking, clarify the meaning of the phrase "substantially all" used in Code Section 1400Z-2 where it has not already been defined;

VIII. In rulemaking, extend the Opportunity Zone benefit with regard to capital gains arising from a sale or exchange of Section 1231 assets which results in Section 1245 depreciation recapture;

IX. In rulemaking, clarify that there is no loss of investor benefits as a result of the Qualified Opportunity Fund's failure to meet the 90 percent test (provided that the investment and operation of the fund are otherwise conducted in good faith); that the penalty calculation relates only to the qualifying investment.

The Working Group makes the following specific recommendations:

I. Relief Period for Qualified Opportunity Fund investments in 2018

While the proposed regulations provide clarity and flexibility associated with when the 180-day reinvestment period commences, many taxpayers who recognized a gain after January 1, 2018, were unable to comply with the 180-day investment requirement due to lack of guidance. Our recommendation is that Treasury provide relief by allowing taxpayers, regardless of whether they recognized the gain at the individual level or through ownership in an entity, the ability to commence the 180-day period at the end of calendar year 2018.

II. Qualified Opportunity Fund 12-month grace period for equity capital

In order to maximize the equity capital raised for investment in Opportunity Zones, many Qualified Opportunity Funds will raise capital prior to the time it is needed for investment in Qualified Opportunity Zone Property. The Proposed Regulations generously provide a 31-month safe harbor for qualified opportunity zone partnerships and corporations in which a Qualified Opportunity Fund invests. However, this safe harbor does not apply to Qualified Opportunity Funds that intend to directly own and operate Qualified Opportunity Zone Business Property. Also, the 31-month safe harbor can only be used by qualified opportunity zone partnerships and corporations that have written plans for the construction of particular tangible property. Effectively, this rule makes it very difficult for a fund to accumulate investments and make more than one planned investment. Cash held while seeking further investments would fail the requirements of the safe harbor unless and until the subsidiary entity adopted a written plan, and then only for the particular project being undertaken by the particular subsidiary entity. For this reason, the Working Group recommends that cash raised by a Qualified Opportunity Fund be treated as Qualified Opportunity Zone Property for all purposes of Section 1400Z-2 for a period of 12 months after such cash is invested in the Qualified Opportunity Fund. If and to the extent the equity capital contributed to a Qualified Opportunity Fund is not invested in Qualified Opportunity Zone Property within the 12-month period, such capital would no longer be treated as Qualified Opportunity Zone Property for purposes of Code Section 1400Z-2(f) unless the Qualified Opportunity Fund can demonstrate reasonable cause for failing to satisfy the 12-month rule. Under this rule, a Qualified Opportunity Fund would have 12 months to deploy equity capital by investing in a qualified opportunity zone partnership or corporation (which could itself then utilize the existing 31-month safe harbor) or by acquiring Qualified Opportunity Zone Business Property.

As it relates to the above, without any such grace period, Qualified Opportunity Funds that have invested directly in Qualified Opportunity Zone Business Property face the very real possibility of a penalty as a result of failing the 90% asset test. Proceeds that reside at the QOF level, even if deployed for purposes of constructing, acquiring, or rehabilitating tangible property, are not afforded the 31-month safe harbor that has been extended to the indirect Opportunity Zone business model. Moreover, as a practical matter, it may be difficult for Qualified Opportunity Funds to now modify their structure as a result of significant contractual obligations that reside within the entity. As a result, the Qualified Opportunity Fund will be required to self-assess a penalty. When calculating this penalty, the statute and self-certification/annual reporting documentation describe the Qualified Opportunity Fund "assets" as the basis for the calculation. Many of these Qualified Opportunity Funds were formed as mixed investments, representing gain proceeds as well as other nonqualified contributions. It would be an onerous penalty if the calculation was to include both types of investments, but the self-certification/annual reporting documentation makes no reference to a Qualified Opportunity Fund formed as a mixed investment and the resulting penalty determination. Given that the first reporting period will soon be upon us, we request that Treasury make clear that if our recommendation for a 12-month grace period is not provided, that the resulting penalty calculation is based on the "assets" representing only the qualified gain proceeds that have yet to attain status as Qualified Opportunity Zone Property.

III. Original Use

In rulemaking, provide a bright line clarification as to the definition of Original Use under Section 1400Z-2(d)(2)(D)(i)(II).

The Working Group recommends that the original use definition apply to buildings that have not received a certificate of occupancy in addition to buildings that have been vacant for a period of time (vacant as in no tenant has occupied the building). We recommend adopting a standard of two (2) years.

IV. Active Conduct of a Trade or Business.

The Working Group recommends that the "active conduct" of a Qualified Opportunity Zone Business is defined in a manner consistent with the New Markets Tax Credit program under Code Section 45D. Consequently, the "active conduct" requirement would be satisfied if the Qualified Opportunity Zone Business generates revenue within three years after the date the Qualified Opportunity Zone Property is acquired. As noted above, this approach is similar to Treas. Reg. Section 1.45D-1(d)(4)(iv)(A) in connection with the New Markets Tax Credit program. We believe a three-year period for generating revenue is consistent with the legislative intent of the statute. Given that the legislation permits a full 30 months for the substantial improvement of an existing property, allowing 36 months for the Qualified Opportunity Fund or Qualified Opportunity Zone Business to be engaged in the active conduct of a trade or business is reasonable.

Further, the reasonable cause exception under Code Section 1400Z-2(f)(3) should be available if the Qualified Opportunity Zone Business is expected to generate revenue within three years of the acquisition of the Qualified Opportunity Zone Property, but ultimately does not.

V. Modify the Proposed Regulations so as to permit the election under Code Section 1400Z-2(c) to be made at any time after a 10-year holding period is accomplished, even if the election is made after 2047 by the taxpayer.

The Working Group recommends that the basis step-up in the taxpayer's investment in the Qualified Opportunity Fund can be made at any time the investment is sold or exchanged if the requisite 10-year hold is achieved, and that the fixed date of 2047 be removed so as to not require the taxpayer to effectuate a sale when it may not be in the taxpayer's best interest to do so. Given the intent of the legislation is to attract long term investment into communities, allowing investors to make very long term investments beyond 2047 would achieve that policy goal.

VI. Provide clarification and illustrations regarding what qualifies under the reasonable cause exception of Code Section 1400Z-2(f)(3).

There is clarification needed concerning qualification for the reasonable cause exception to the 90 percent requirement of Code Section 1400Z-2(d)(1). In determining whether such a failure is due to reasonable cause, the real estate investment trust ("REIT") income test rules could be used as an analogous provision. In the REIT context, there is reasonable cause if the REIT exercised ordinary business care and prudence, and not willful neglect, in attempting to satisfy the requirements and such care and prudence is exercised at the time each transaction is entered into by the REIT. Likewise, the Qualified Opportunity Fund could be held to a similar standard over the holding period of the investment, demonstrating the requisite ordinary business care and prudence to meet the reasonable cause exception.

VII. Clarify the meaning of the phrase "substantially all" used in Code Section 1400Z-2:

We recommend the phrase "substantially all" to be defined as follows:

Definition of "substantially all" in connection with the holding period by the Qualified Opportunity Fund in Code Section 1400Z-2(d)(2)(B)(i)(III), Code Section 1400Z-2(d)(2)(C)(iii) and Code Section 1400Z-2(d)(2)(D)(i)(III)

The Working Group recommends that a majority of time be used as the definition of "substantially all" when referencing the holding period of the Qualified Opportunity Fund for stock, partnership or business property. The Qualified Opportunity Fund should have the ability to measure meeting the substantially all holding period test either by a direct tracking method, in which the Qualified Opportunity Fund would be able to directly trace each stock certificate, partnership interest or business property from initial purchase through the sale of said investment. A safe harbor should also be available to the Qualified Opportunity Fund so long as it does not control the Qualified Opportunity Zone Property. Rules similar to the New Markets Tax Credit program under Treas. Reg. Section 1.45D-1(c)(5) are recommended.

VIII. Extend the Opportunity Zone benefit with regard to capital gains arising from a sale or exchange of Section 1231 assets which results in Section 1245 depreciation recapture

Section 1231 assets are certain assets used in taxpayer's trade or business that were held for more than one year at the time of disposition. These assets include depreciable tangible and intangible personal property, and real property, whether or not depreciable. Section 1231 nets gains and losses to arrive at a net of long-term capital gain.

Section 1245 depreciation recapture converts Section 1231 gains into ordinary income to the extent of depreciation claimed on the property. Section 1245 recapture does not exist without the 1231 capital gain.

We ask that Treasury apply the Opportunity Zone statute as it relates to Section 1245 and characterize gains that are subject to depreciation recapture or ordinary income treatment as eligible for inclusion in a QOF, permitting the capital gain transaction to qualify for Opportunity Zone incentives, but in the future treating these gains as giving rise to ordinary income when the taxable event, or December 31, 2026, occurs.

IX. Clarify that there is no loss of investor benefits as a result of the Qualified Opportunity Fund's failure to meet the 90 percent test

Under Code Section 1400Z-2(f)(1), if a Qualified Opportunity Fund fails to satisfy the 90 percent requirement, subject to a reasonable cause exception, the Qualified Opportunity Fund is subjected to a monthly penalty charge equal to the excess of 90 percent over the percentage of its assets that constitute Qualified Opportunity Zone Business Property, multiplied by the IRS underpayment interest rate. In the case of Qualified Opportunity Funds taxed as partnerships, Code Section 1400Z-2(f)(2) states that each partner is required to take into account its distributive share of the penalty. It is unclear which, if any, of the investor-level tax benefits may be lost as a result of a Qualified Opportunity Fund's failure to meet the 90 percent test. In addition, the mechanics of the penalty calculation, as described in Section II, require clarification.

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The Working Group considers the Opportunity Zone legislation to have the potential to significantly assist underserved and underinvested communities. Drawing on our many years of experience in the finance, law, accounting, and real estate industries, we offer recommendations we believe will help the legislation achieve its policy goals. We sincerely appreciate consideration of these recommendations.

Yours very truly,

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