

**The Honorable David J. Kautter**

Acting Commissioner of the Internal Revenue Service and  
Assistant Secretary of the Treasury for Tax Policy  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

June 18, 2018

Dear Acting Commissioner Kautter:

We write as a broad coalition of stakeholders regarding implementation of Opportunity Zones, a provision in the Tax Cuts and Jobs Act providing tax benefits for certain private investments in America's low-income communities.

Opportunity Zones have the potential to become the most impactful federal incentive for equity capital investment in low-income communities ever enacted. This incentive is designed to tap the country's vast unrealized corporate and individual capital gains holdings, encouraging investors to redeploy their earnings to finance new and expanded business activity in low-income areas nationwide. Congress envisioned a broad array of investors, funds, and use cases in the design of the Opportunity Zones provision and intended it to find application in a wide variety of urban, suburban, and rural communities. Timely implementation by the U.S. Department of Treasury and the Internal Revenue Service will be crucial to achieving the outcomes Congress intended.

In particular, it is essential that forthcoming administrative rules and guidance preserve and enhance the key characteristics of the Opportunity Zones design. These include:

- **Flexibility:** Low-income communities have a wide range of financing needs. The flexibility of the Opportunity Zones incentive provides the potential to support a variety of mutually reinforcing activities within a single community as well as across a broad spectrum of communities.
- **Scalability:** There is no statutory cap on the amount of capital that can flow to Opportunity Zones in any given year. As such, Opportunity Zones have the potential to help fuel economic renewal in distressed communities on an unprecedented scale.
- **Simplicity:** Complexity has often been the Achilles heel of policies aimed at unlocking private capital in low-income areas. Complexity adds cost, time, and risk to business transactions, biasing programs towards a narrower set of stakeholders and more risk-averse outcomes, often precluding the very types of business investments that are most likely to have transformative benefits for communities.

To realize Congressional intent and preserve these key characteristics in practice will require regulatory clarity and simplicity. Congress gave Treasury broad authority to craft rules and guidance to ensure the benefit works in practice as intended. We urge you to use the full extent

of that authority in establishing a guidance timeline and framework that will be attractive to investors and beneficial for communities.

Attached are a number of technical comments and recommendations we believe will be useful in accomplishing the objectives noted above. These materials incorporate input from dozens of experienced stakeholders from a diverse set of backgrounds united in a common desire to see Opportunity Zones succeed in boosting economic opportunity throughout the country. While by no means exhaustive in scope, we focused these comments on implementation issues we believe to be among the most fundamentally important to both the early creation of an Opportunity Fund ecosystem and the long-term success of Opportunity Zones communities.

We appreciate your leadership and look forward to working with you throughout the implementation process.

Sincerely,

Access Ventures  
Advantage Capital  
Alliant Strategic Impact Housing Funds  
Arctaris Impact Fund  
Balch & Bingham, LLP  
California Forward  
Calvert Impact Capital  
Capalino + Company  
Capital Impact Partners  
Chicago Community Loan Fund  
CohnReznick LLP  
Community Development Bankers Association  
Community Development Venture Capital Alliance  
Community Reinvestment Fund, USA  
Detroit Opportunity Fund  
Economic Innovation Group  
EJF Capital  
Fund for Our Economic Future  
Greenberg Traurig, LLP  
High Ridge Venture Partners  
International Franchise Association  
Key Bank  
Kirkland & Ellis LLP  
Launch NY, Inc.  
Launch Tennessee  
Local Initiatives Support Corporation (LISC)

National Development Council  
Newark Venture Partners  
Novogradac & Co./Novogradac Consulting LLP  
Opportunity Finance Network  
Peachtree Providence Partners  
Plante Moran, PLLC  
Polsinelli PC  
The Rural Community Assistance Partnership  
Redbrick LMD  
Reinvestment Fund  
Rural Opportunity Initiative at Georgetown University McDonough School of Business  
Sorenson Impact Center  
Sorenson Impact Foundation  
Stonehenge Capital Company, LLC  
The Enterprise Center  
The Pelican Groups  
Urban Atlantic  
Virtua Capital Management  
War Horse Cities  
Weller Development Company

Enclosure:

Opportunity Zones Coalition Guidance Request: Discussion and Requested Guidance  
Attachment 1: Clarifying Guidance for Qualified Opportunity Funds (“QOFs”) and Qualified Opportunity Zones (“QOZs”)  
Attachment 2: Suggested Regulatory Provisions Under §1400Z-2(d)

cc:

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## **Opportunity Zones Coalition Guidance Request: Discussion and Requested Guidance**

### **1. Definition of a Qualified Opportunity Fund**

#### **a. Qualified Opportunity Fund Investment and Reinvestment**

Guidance is needed to ensure adequate time for the deployment and reinvestment of capital by a Qualified Opportunity Fund (“QOF”).

#### ***Discussion***

A QOF must hold at least 90 percent of its assets in Qualified Opportunity Zone Property (“QOZ Property”), which includes stock or partnership interests in a Qualified Opportunity Zone Business (“QOZ Business”), as well as QOZ Business Property.<sup>1</sup> Treasury was given broad authority to issue regulations necessary to carry out the purposes of the Opportunity Zone provisions.<sup>2</sup> The statute explicitly notes that Treasury guidance is needed to provide a reasonable time for a QOF to reinvest returns or proceeds from the sale of QOZ Business Property held by a QOF.<sup>3</sup> In addition, it is clear that a QOF needs – and Congress intended Treasury to provide – a reasonable period of time to *initially* deploy the funds invested in the QOF. Finally, just as a QOZ Business needs time for an orderly disposal of property that no longer qualifies as QOZ Business Property, a QOF needs sufficient time to dispose of its interests in businesses and property that cease to qualify as QOZ Businesses and QOZ Business Property. Although the statute provided QOZ Businesses with a five-year period to dispose of property that ceases to qualify as QOZ Business Property,<sup>4</sup> Congress left the details of all of these QOF transition periods for Treasury to determine in regulations.

#### ***Requested Guidance***

1. QOFs need adequate time to invest or reinvest cash received from any source, including new investments, investment returns or property sales proceeds. In general, we suggest that Treasury provide guidance specifying that for one year after receipt of any cash proceeds, such cash (or certain cash equivalents, including Government securities) be deemed to be QOZ Property. This is consistent with Treasury Regulations which allow for a one year period of reinvestment in the New Markets Tax Credit (“NMTC”) context.<sup>5</sup> In addition, in order to allow a QOF to follow customary and prudent business practices with respect to funding construction projects and disbursement timelines for investments in operating businesses, Treasury guidance should provide that any funds that have been committed to a QOZ project and for which an initial disbursement of funds has been made, will be considered to be QOZ Property for a period of up to 30 months.
2. In addition, QOFs need an adequate start-up period of time to make initial investments. This is especially true right now, as the tax benefits for investors in QOFs are time-

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<sup>1</sup> Section 1400Z-2(d)(1).

<sup>2</sup> Section 1400Z-2(e)(4).

<sup>3</sup> Section 1400Z-2(e)(4)(B).

<sup>4</sup> Section 1400Z-2(d)(3)(B).

<sup>5</sup> See Treas. Reg. § 1.45D-1(d)(2).

limited, but significant uncertainty still exists regarding the rules for QOFs. Therefore, we suggest that generally a QOF be given a start-up grace period of at least 18 months (three testing periods) from the time the QOF is formed before it must participate in its first semi-annual testing date.<sup>6</sup> In addition, because of the considerable uncertainty now and the need for additional guidance regarding fund operations and investments, we suggest that for all QOFs established prior to June 30, 2020, this start-up grace period be extended through December 31, 2021, provided the QOF makes bona fide efforts to invest the funds in qualifying investments during the start-up period. This would provide an initial start-up period of up to approximately three years, which would be consistent with analogous start-up periods.<sup>7</sup>

3. Finally, we suggest QOFs holding QOZ Business Property directly be given the same five-year grace period that is given to QOZ Businesses to dispose of QOZ Business Property that ceases to qualify as such. For interests in QOZ Businesses which cease to qualify as QOZ Businesses, we suggest a three-year grace period for QOFs to dispose of these interests. Moreover, additional guidance should provide specific situations in which divestment will not be required, such as when a QOZ Business is acquired by a larger company, but continues to operate as a separate business with all profits used in that business.

## **b. 90% Asset Test – Valuation**

### ***Discussion***

The statute is silent regarding how to measure or value a QOF's assets for purposes of meeting the requirement that 90 percent of a QOF's assets be QOZ Property ("90% Asset Test"). There are various possible ways to determine asset values, including fair market value ("FMV"), adjusted tax basis, or original cost basis. Because FMV fluctuates, if this measure were chosen, QOFs would incur additional costs to measure FMV periodically, and additional rules would be necessary regarding frequency and methods for determining FMV.

### ***Requested Guidance***

1. To provide flexibility for each QOF to adopt the valuation method most appropriate for it, we suggest Treasury provide that, for purposes of the 90% Asset Test, asset values may be measured using any reasonable method, provided that the method chosen is used consistently by the QOF.
2. In the alternative, if a single standard of asset valuation for purposes of the 90% Asset Test across all QOFs was desired, for simplicity we recommend that the original cost basis be used.<sup>8</sup> In addition, to avoid the complexity and administrative burden of determining the original purchase price of property purchased by a QOF (or QOZ Business) prior to January 1, 2018, guidance should allow the value of such property to be determined by using the adjusted tax basis as of December 31, 2017.

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<sup>6</sup> This is consistent with a minimum initial testing grace period in the enterprise zone context of 18 months. See Treas. Reg. § 1.1394-1(c)(4)(i).

<sup>7</sup> See, e.g., Treas. Reg. § 1.1394-1(c), providing up to 3 to 5 years for a startup period in the enterprise zone context.

<sup>8</sup> Note that using cost basis would be consistent with the valuation method specified for the QALICB asset test in the NMTC context. See Treas. Reg. sec. 1.45D-1(d)(4)(B).

### c. 90% Asset Test – Holding Period for QOZ Businesses

#### *Discussion*

A QOF may invest in newly formed or existing businesses;<sup>9</sup> however, for the QOF's investment in the business to qualify as QOZ Property, the business must qualify as a QOZ Business during "substantially all" of the QOF's holding period.<sup>10</sup> The term "substantially all" is not defined by the statute, but as discussed further in regard to the definition of a QOZ Business, below, the term has been used throughout the code to mean various percentages, ranging from 70 percent upwards. In addition, just as new QOFs need a grace period to deploy invested cash, newly formed QOZ Businesses need a similar grace period to purchase QOZ Business Property and commence operations so that a QOF can invest in a newly formed business. Finally, because a QOF's holding period does not end until the property is disposed of, investors and QOF managers will be uncertain of whether an interest in a business will qualify as a QOZ Business Interest (and thus QOZ Property) in any year prior to disposal.

#### *Requested Guidance*

1. Treasury should provide guidance interpreting "substantially all" consistent with other places in the statute.<sup>11</sup>
2. Treasury guidance should provide that a newly organized business should be deemed to be a QOZ Business for purposes of the QOF holding period test during a reasonable start-up period of at least 18 months, if the business intends to meet the QOZ Business requirements by the end of the start-up period. This is consistent with the requested QOF start-up period noted above.
3. Finally, Treasury should provide a safe-harbor provision allowing the QOF holding period test to be met on an annual basis, rather than only over the QOF's entire holding period. This holding period safe-harbor should be consistent with guidance in the QOZ Business Property context, discussed below.<sup>12</sup>

### d. Intangible Assets of a QOF

#### *Discussion*

QOZ Property includes QOZ Business Property, which is tangible property used in the trade or business of the QOF that meets certain additional tests. A QOF may also have intangible property, some of which may be used in the conduct of a trade or business of the QOF. For a QOZ Business, the statute provides that "substantially all" of its tangible property (whether owned or leased) must be QOZ BP, while a "substantial portion" of its intangible property must be used in the active conduct of its trade or business. The statute is silent regarding intangible property of a QOF other than QOZ Business Interests, which count as QOZ Property for purposes of the 90% Assets Test. This issue is important and we are continuing to consider it for future comment.

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<sup>9</sup> Section 1400Z-2(d)(2)(B)(i)(II) and (C)(ii).

<sup>10</sup> Section 1400Z-2(d)(2)(B)(i)(III) and (C)(iii).

<sup>11</sup> See discussion of "substantially all" in section 2, Definition of a QOZ Business, below.

<sup>12</sup> See discussion of the substantially-all-use test in section 3, Definition of QOZ Property, below.

## 2. Definition of a QOZ Business

Clarity is needed with respect to how much of the tangible property of the QOZ Business must be QOZ Business Property and how new and existing businesses operating in the QOZ can qualify as QOZ Businesses eligible for QOF funding.

### *Discussion*

A QOZ Business is defined as one “in which substantially all of the tangible property owned or leased by the taxpayer is [QOZ Business Property]” and that meets certain additional requirements.<sup>13</sup> Clarity is needed regarding when the “substantially all” threshold has been met. The term “substantially all” is not defined in the statute; however, the term has been used throughout the tax code in different contexts to require various percentage thresholds ranging from 70 percent upwards. In the context of the NMTC and empowerment zones, “substantially all” has been interpreted to mean 85 percent.<sup>14</sup> Although perhaps tempting to simply borrow from these regulations, Treasury should consider whether another, lower threshold might better further Congressional intent in this statute.

It is clear from the statute that Congress intended to incentivize investment in businesses operating in QOZs, bringing both jobs and economic growth to distressed communities. We know from experience with the NMTC, however, that the 85 percent “substantially all” threshold was a barrier for investment in active operating businesses, which often don’t fit neatly within the boundaries of a census tract, leading to NMTCs being used to fund predominately real estate developments.<sup>15</sup> A lower threshold for “substantially all” would provide the needed flexibility for operating businesses to qualify as QOZ Businesses, as intended by Congress. And Treasury has in the past used lower “substantially all” thresholds in various provisions. For example, regulations pertaining to the New York Liberty Zone Credit define “substantially all” to mean 80 percent or more,<sup>16</sup> and the term has been defined to mean 70 percent in several places in the Code.<sup>17</sup> Thus, because Treasury has the discretion to define “substantially all” lower than the 85 percent used in the NMTC context, and because Congressional intent for this provision will be more effectively furthered by allowing more flexibility, Treasury should define “substantially all” at a lower threshold than 85% for purposes of section 1400Z-2.

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<sup>13</sup> Section 1400Z-2(d)(3)(A).

<sup>14</sup> See, e.g., Treas. Regs. § 1.1394-1(l) and § 1.45D-1(c)(5) interpreting “substantially all” as 85%.

<sup>15</sup> Lauren Lambie-Hanson, *Addressing the Prevalence Real Estate Investments in the New Markets Tax Credit Program*, Federal Reserve Bank of San Francisco Community Development Investment Center (2008).

<sup>16</sup> Treas. Reg. § 1.1400L(b)-1. “Substantially all” has been defined to mean 80 percent in other places in the Code. See, e.g., Treas. Reg. § 1.41-4(a)(6) (substantially all means 80 percent in the context of the section 41 research credit); Treas. Reg. § 1.279-3(g)(3) (corporation derives substantially all of its income from sources without the United States if more than 80 percent of its income is from sources without the United States); Treas. Reg. § 301.7701(i)-1(c)(2)(ii) (with respect to definition of a taxable mortgage pool, stating that “if less than 80 percent of the assets of an entity consist of debt obligations (or interests therein), then less than substantially all of the assets of the entity consist of debt obligations (or interests therein)”).

<sup>17</sup> See, e.g., Treas. Reg. § 301.6111-3(b)(3)(i)(D) (substantially all tax benefits are considered to be provided to natural persons if 70 percent or more of the tax benefits from a reportable transaction are provided to natural persons); Rev. Proc. 77-37 (providing a safe harbor that, in the context of corporate reorganizations under section 368(a)(1)(C), substantially all means at least 70 percent of gross assets).

In addition, it is clear that Congress intended for QOFs to invest in both new businesses and existing businesses in a QOZ, as the statute expressly refers to investments in existing corporations and partnerships, as well as to investments in new businesses.<sup>18</sup> An existing business may have difficulty meeting the substantially all assets test, if the definition of QOZ Business Property is read narrowly to require QOZ Business Property of a QOZ Business, and not just the QOZ Business Property of a QOF, to have been purchased after December 31, 2017. In addition, an existing business may have difficulty determining or documenting whether it met the substantially-all-use test or original use test for property acquired prior to December 31, 2017. Treasury guidance is needed to provide appropriate modifications to the QOZ Business Property tests to ensure that existing businesses operating in a QOZ can qualify as QOZ Businesses and attract QOF funding.

Finally, as noted above, guidance is needed to ensure that QOFs can invest in newly formed businesses, which may need some time to purchase QOZ Business Property.

### ***Requested Guidance***

1. To best further the purposes of the statute to encourage investment in active QOZ Businesses, Treasury should interpret “substantially all” to mean 70%. Providing a flexible standard will give QOZ Businesses, and QOFs that want to invest in them, certainty of their status and the flexibility to create active businesses which will create jobs and benefit the QOZ.
2. Further, Treasury guidance should provide that an existing trade or business that otherwise meets the requirements to be a QOZ Business will not fail to qualify as such merely because its property was acquired prior to December 31, 2017. Indeed, it would be impossible for an existing QOZ Business to have done otherwise. In addition, to ensure that existing businesses do not fail to qualify merely because their prior operations may not have conformed with new statutory standards, we recommend that for businesses existing prior to January 1, 2018, the original use test in section 1400Z-2(d)(2)(D)(i)(II) be deemed to have been met and that, for purposes of the use test in section 1400Z-2(d)(2)(D)(i)(III), the holding period for property be treated as starting on the first day of the first taxable year starting after December 31, 2017. While the statutory tests for QOZ Business Property may be appropriate for QOFs and new QOZ Businesses, imposing them without modification would disqualify many businesses currently existing in QOZs that Congress clearly intended would be the recipients of QOF funding.
3. Finally, as noted previously, Treasury guidance should provide that a newly organized business that intends to qualify as a QOZ Business by the end of a reasonable start-up period of at least 18 months should be deemed to qualify as a QOZ Business during that start-up period.

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<sup>18</sup> Section 1400Z-2(d)(2)(B)(i)(II); section 1400Z-2(d)(2)(C)(ii).



### 3. Definition of QOZ Business Property

Because qualification as a QOZ Business (or QOF) depends on holding and using QOZ Business Property, Treasury guidance is needed to provide clear and administrable rules that effectuate the intent of the statute so that investors, QOFs and QOZ Businesses know what property qualifies as QOZ Business Property and thus, which entities qualify as QOFs and QOZ Businesses.

#### *Discussion*

The statutory definition of QOZ Business Property appears in section 1400Z-2(d)(2)(D), as part of the definition of a QOF, because a QOF can meet its percent-of-assets test by holding QOZ Business Property directly, in addition to holding equity interests in QOZ Businesses, which in turn hold QOZ Business Property. To qualify as a QOZ Business, “substantially all of the tangible property owned or leased by the [QOZ Business]” must be “qualified opportunity zone business property (determined by substituting ‘qualified opportunity zone business’ for ‘qualified opportunity fund’ in each place it appears in paragraph (2)(D).”<sup>19</sup> It is clear Congress intended the definition of QOZ Business Property to be consistent for both QOFs and QOZ Businesses, even if some adjustments are necessary to adapt the definition of QOZ Business Property originally drafted in the QOF context for use with QOZ Businesses.

QOZ Business Property is tangible property used in a trade or business that meets three tests: an acquisition test, an “original use” test, and a “substantially all” use test.<sup>20</sup> Clarifying guidance is needed for each of these tests, and Congress granted Treasury broad authority to issue regulations necessary to carry out the purposes of the Opportunity Zone provisions.<sup>21</sup>

The acquisition test states that the property must be “acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017.”<sup>22</sup> This cross reference to section 179, prevents acquisitions from related parties, like kind exchanges, inheritances, bequests, and devises from qualifying as purchases for purposes of this subsection. However, in an apparent attempt to prevent abuse by limiting purchases to those meeting the section 179 definition, the language could be read to imply that QOZ Business Property cannot be acquired by lease. This cannot be the case. Section 1400Z-2(d)(3) expressly indicates that both owned and leased tangible property count as QOZ Business Property for purposes of the QOZ Business percent-of-assets test, and leased property should be treated the same for the QOF percent-of-assets test.<sup>23</sup> Further, acquisition of leased tangible property should be subject to the same related party limitations as when such property is purchased, whether held by a QOF or held by a QOZ Business.

The “original use” test has two alternative prongs. It requires that either the original use of property in the QOZ commence with the QOF or that the QOF substantially improve the

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<sup>19</sup> Section 1400Z-2(d)(3)(A)(i).

<sup>20</sup> Section 1400Z-2(d)(2)(D)(i).

<sup>21</sup> Section 1400Z-2(e)(4).

<sup>22</sup> Section 1400Z-2(d)(2)(D)(i)(I).

<sup>23</sup> As noted previously, these percent-of-assets tests are parallel tests and should be interpreted consistently. In addition, interpreting them differently here would have the anomalous result of disallowing a QOF from holding directly what it could create a corporation or partnership to hold indirectly, increasing administrative costs for no apparent policy reason.

property.<sup>24</sup> Congressional intent to stimulate economic activity in distressed communities can be furthered both by encouraging new property to be built or brought into the zone, and by putting existing property to new use within the zone. Just as used property can be brought into the QOZ and have its “original use” in a QOZ Business, vacant property within the QOZ that is purchased or leased by a QOZ Business or QOF should be considered to meet the “original use” test to encourage the use of zone property that is currently under-utilized. This is consistent with existing regulations in the empowerment zone context, where a similar “original use” test was considered to be satisfied if property in the zone was put to use after having been vacant for a year.<sup>25</sup>

Alternatively, property that is “substantially improved” by the QOF will meet this test. Property will be treated as substantially improved if “during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.”<sup>26</sup> Guidance is needed to provide certainty to QOZ Businesses, QOFs and investors that property which is in the process of substantial improvement qualifies as QOZ Business Property. Otherwise, QOZ Businesses would have to wait until the end of the substantial improvement period, up to two and half years later, to know whether such property would qualify as QOZ Business Property. In addition, guidance should clarify how the original use test applies to land within the QOZ, which certainly will have been used before, and how land can qualify as having been substantially improved.

The “substantially all” use test requires that “during substantially all of the [QOF’s or QOZ Business’s] holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.”<sup>27</sup> As noted above, the term “substantially all” is not defined in the statute. For ease of administrability, we suggest giving this term the same meaning in each place it occurs in the statute, including both times it is used in this test and where used in the QOZ Business percent-of-assets test.

In addition, clarifying guidance is needed regarding when certain property will be considered to be used in the QOZ. There is a high use-of-assets test for both QOFs and QOZ Businesses, because use of assets within a QOZ is a proxy for the stimulation of economic activity within the QOZ. However, without clarifying guidance, the statutory language could unintentionally inhibit development of certain kinds of businesses and favor others. This was certainly not intended by Congress.

For example, assume a business manufactures or assembles products at a facility in an inner city QOZ and sells those products to customers across the country. During the transit time for the raw materials or parts to reach the QOZ, and during the transit time for the finished goods to reach their customers, the inventory property will not be in the QOZ. But this does not change the fact that the desired economic activity and job creation is happening within the QOZ. This is

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<sup>24</sup> Section 1400Z-2(d)(2)(D)(i)(II).

<sup>25</sup> See Treas. Reg. §1.1394-1(h). These regulations also clarify that de minimis use of property is disregarded.

<sup>26</sup> Section 1400Z-2(d)(2)(D)(ii).

<sup>27</sup> Section 1400Z-2(d)(2)(D)(i)(III).

also true if the inventory is stored for temporary periods outside the QOZ while en route to the QOZ or to the customers. Similarly, vehicles owned by a QOZ Business that are used to deliver products manufactured in the QOZ to places outside the QOZ should not be considered used outside the QOZ, thereby discouraging the development of businesses that manufacture goods for export from the QOZ to more affluent areas. In fact, these are exactly the kinds of businesses that are likely to be successful and that the statutory provisions were intended to promote. Another example would be a business located in a QOZ that employs sales representatives based within the QOZ to travel to customers outside the QOZ. The fact that employees use company owned vehicles, and take computers, equipment and other property with them to customer sites does not change the fact that the business is generating jobs and economic activity in the QOZ. Congress did not intend to discourage these types of businesses; thus, neither should the “substantially all” use test.

Finally, this test can present significant practical problems because, of course, a QOF or QOZ Business’s holding period will not be known until property is disposed of – which could be many years in the future. Guidance is needed in order to give investors, QOFs and QOZ Businesses certainty that a property meets this test and qualifies as QOZ Business Property currently, and, thus, that investments will qualify for the new tax incentives.

### ***Requested Guidance***

Based on the discussion above, we request that Treasury provide guidance clarifying the QOZ Business Property requirements. Specifically:

1. Acquisition test. Treasury guidance should clarify that QOZ Business Property of both QOFs and QOZ Businesses may be either owned or leased, and that the related party restrictions of section 179(d)(2) apply to all property acquisitions entered into on or after January 1, 2018.
2. “Original use” test. Treasury guidance should provide that if property, including land, is vacant for at least a one-year period, use by a QOF or QOZ Business will be considered “original use” within the QOZ. This is consistent with the definition of original use in the Empowerment Zone context.<sup>28</sup> In addition, guidance should clarify that the period of vacancy should be determined with respect to only that portion of the property acquired by the QOF or QOZ Business, and de minimis incidental uses of property should be disregarded. We also suggest that Treasury guidance provide that land on which property is substantially improved shall be treated as substantially improved as well, consistent with the treatment in the DC Zone context.<sup>29</sup> Finally, Treasury guidance should provide certainty to QOZ Businesses, QOFs and investors that begin to substantially improve property to meet the original use test. Treasury guidance should provide that property will be deemed to qualify as substantially improved during any tax year of the 30 month improvement period if the QOZ Business has a plan to substantially improve the property and the QOZ Business makes reasonable efforts to carry out that plan.

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<sup>28</sup> See Treas. Reg §1.1394-1(h).

<sup>29</sup> Section 1400B(b)(4)(B)(i).

3. “Substantially all” use test. Treasury guidance should specify that “substantially all” means the same percentage in all places in the statute. In addition, guidance should provide that certain uses of property will be deemed to be “used within a QOZ.” For example, property being transported to a QOZ or from a QOZ to customers outside the QOZ, including property stored en route to or from a QOZ and property used in the transport of such property, should be deemed to be used within the QOZ. Similarly, property used by employees of a QOF or QOZ Business whose principal place of business is within the QOZ should be considered to be used in the QOZ. Finally, Treasury guidance should provide a safe harbor allowing the “substantially all” use test to be met on an annual basis, rather than only over the entire holding period of the property, so that QOZ Businesses, QOFs and investors can have certainty currently regarding their qualification for the tax incentives in this provision.

#### **4. Additional Issues**

##### ***Partnerships***

The statute does not address how the partnership tax rules will apply in conjunction with the QOF provisions for QOFs taxed as partnerships and Treasury guidance is needed to clarify the interactions of subchapter K and section 1400Z. For example, several questions have been raised regarding determination of a partner’s basis, particularly if the partnership takes on debt. In addition, without clarifying guidance, it seems that a QOF partner would be immediately taxed on interim gains realized by the QOF when a QOF exits an investment before the 10-year mark, contrary to the clear intent of the statute to defer gains. This is an important issue that we are considering for future comment.

##### ***Other Credits***

The statute does not prevent investments in a QOZ from also qualifying for other tax incentives, such as the New Markets Tax Credit, the Low-Income Housing Tax Credit, and the Rehabilitation Tax Credit. Indeed, the ability to combine various community development tools to address both debt and equity capital requirements will significantly enhance positive outcomes in low-income communities. This is an important issue that we are continuing to consider for future comment. In the meantime, Treasury should confirm that these tax credits may also be used in conjunction with QOF investments.

##### ***Reporting Requirements***

Reporting requirements are not addressed in the statute but were discussed in the Conference Report, and Treasury has sufficient authority to require reporting by QOFs to support later reports to Congress. To avoid unnecessary burden, we recommend that Treasury collect a limited, baseline set of data at the point of certification and specify any additional data that will be needed for ongoing reporting, so that QOFs know what data they will need to collect at the outset. To do so, Treasury will need to revise forms and identify data to collect and we further recommend that, prior to requiring reporting on any new or existing form, the public be given notice and an opportunity to comment on the proposed data collection. We are continuing to consider appropriate levels of reporting for future comment.

***CRA Credit***

The statute does not address whether investments through QOFs will qualify for credit under the Community Reinvestment Act (“CRA”). We suggest that the Treasury Department provide guidance regarding the extent to which investments in QOFs will satisfy regulated institutions’ requirements under the CRA.

***Treasury Confirmation***

Finally, attached to this letter (as Attachment 1) is a list of issues that have generated questions from potential investors and QOF managers. We believe that these questions are adequately addressed by the statute; however, because these questions are being raised and may inhibit investment in QOFs, we request that Treasury confirm, either formally or informally (e.g., in an FAQ on the IRS website), that our understandings are correct.

**Attachment 1:**  
**Clarifying Guidance for Qualified Opportunity Funds (“QOFs”)**  
**and Qualified Opportunity Zones (“QOZs”)**

For several of the questions raised by potential QOF managers and investors, we believe that the answer is clear from the statute and regulatory action by Treasury is not necessarily required. However, because these questions have been raised frequently regarding the following issues, it would provide comfort and facilitate QOF formation and investment if Treasury would confirm the conclusions below in either formal or informal guidance.

**1. QOF Definition**

**a. Entities that may be QOFs**

***Discussion***

Several have questioned whether QOFs can be organized as limited liability companies. The statute indicates that a QOF is “any investment vehicle organized as a corporation or a partnership.”<sup>30</sup> An LLC with more than one member may choose to be treated as either a corporation or a partnership for tax purposes; thus a QOF may be organized as an LLC.

***Requested Confirmation***

Treasury should clarify that a QOF can be organized as a limited liability company which is treated as a corporation or a partnership for tax purposes.

**b. QOF investments in multiple QOZs**

***Discussion***

Some have questioned whether a QOF can invest in multiple QOZs. The statute does not mandate that QOF investments be made only in one QOZ.

***Requested Confirmation***

Treasury should clarify that a QOF can invest in and hold property in multiple QOZs.

**c. QOF assets**

***Discussion***

Some have questioned whether investor commitments of capital to a QOF (prior to the time that the QOF actually receives the committed funds) are counted as QOF assets for purposes of the 90% Asset Test.<sup>31</sup>

***Requested Confirmation***

Treasury should confirm that only assets actually received by the QOF are considered for purposes of the 90% Asset Test; commitments of capital to the QOF do not count as assets of the QOF until they have been received.

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<sup>30</sup> Section 1400Z-2(d)(1).

<sup>31</sup> Section 1400Z-2(d)(1).

## 2. Certification of QOFs

### *Discussion*

Some have questioned whether a QOF must meet the requirement<sup>32</sup> that a QOF hold 90% of its assets in Qualified Opportunity Zone Property (“QOZ Property”) before it may be certified. Others have questioned whether investors may invest in a QOF before it has been certified. Currently, there is no mechanism for certification and confusion regarding the certification process may impede QOFs from being created and funded. The statute does not require the assets test to be met prior to certification. Indeed, investors will only receive tax benefits for investing in QOFs that have been certified – and a QOF can only purchase QOZ Property after it has raised investor funds. Therefore, it would be impossible for a QOF to meet the 90% Asset Test prior to certification. Neither does the statute require the fund to have been certified prior to accepting funding – the FAQs currently on the IRS website imply as much, noting that investors may invest in QOFs now, even though forms for QOF self-certification are not yet available.

### *Requested Confirmation*

Treasury should confirm that a fund that is organized for the purpose of investing in QOZ Property and makes good faith efforts to operate as a QOF will be treated as a certified QOF from the date of its formation until at least 90 days after Treasury issues further guidance regarding how and when a QOF can be certified.

## 3. QOZ Business Property – Substantial Improvement

### *Discussion*

To qualify as QOZ Business Property, the QOF must either make “original use” of the property in the QOZ or it must “substantially improve” the property.<sup>33</sup> The statute further provides that property will be considered “substantially improved” if, during a 30-month period, additions to the property’s basis exceed the property’s adjusted basis at the beginning of the period.<sup>34</sup> Some have questioned whether environmental clean-up costs qualify as additions to basis for purposes of the substantial improvement test.

Environmental remediation costs generally qualify as expenses incurred for “permanent improvements or betterments made to increase the value of any property” which may be capitalized and added to the basis of property under sections 263(a) and 198.

### *Requested Confirmation*

Treasury should confirm that all additions to basis, including environmental remediation costs, are additions to basis for purposes of meeting the substantial improvement test to qualify as QOZ Business Property.

## 4. Related Party Definition

### *Discussion*

The statute states that “for purposes of this section, persons are related to each other if such persons are described in section 267(b) or 707(b)(1), determined by substituting ‘20

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<sup>32</sup> Section 1400Z-2(d)(1).

<sup>33</sup> Section 1400Z-2(d)(2)(D)(i)(II).

<sup>34</sup> Section 1400Z-2(d)(2)(D)(ii).

percent’ or ‘50 percent’ each place it occurs in such sections.”<sup>35</sup> Some have questioned in which parts of the statute this definition is applicable.

***Requested Confirmation***

Treasury should confirm that the 20 percent definition for determining whether a person is a related party is applicable in both:

- i. Section 1400Z-2(a)(1), the requirement that the gain elected for deferral result from a sale or exchange with an unrelated person; and
- ii. Section 1400Z-2(d)(2)(D)(i)(I), the requirement that QOZ Business Property be acquired by the QOF by purchase (as defined in section 179(d)(2) to exclude acquisitions from certain related parties).

## **5. Tax Rate for Gain Inclusion**

***Discussion***

The statute provides that deferred gain invested in a QOF is recognized and included in taxable income at the earlier of time the investment is sold or exchanged or December 31, 2016. The statute does not provide rules for the tax rate that is applicable to this gain inclusion. Some have questioned whether the tax rate for calculating the tax on the deferred gain is the rate applicable to the taxpayer in the year of deferral or the year of inclusion.

***Requested Confirmation***

Treasury should confirm that the tax rate applicable to the gain included under section 1400Z-2(b) is the tax rate applicable to the taxpayer in the year of inclusion. This is in line with other gain deferral provisions, and follows from the fact that the gain is deferred, not the tax.

## **6. QOZ Designation – Effect of QOZ Sunset**

***Discussion***

The statute provides that QOZ designations expire at the end of the tenth calendar year beginning on or after the date of designation.<sup>36</sup> All QOZs must be designated in 2018; thus the designations will expire on December 31, 2028. The statute makes clear that investors may receive tax benefits for investments in QOFs of gains realized on or before December 31, 2026,<sup>37</sup> but it is clear that QOFs must continue to operate for at least 10 years so that the intended investor tax benefits may be realized.

***Requested Confirmation***

Treasury should confirm that the only effect of the expiration of QOZ designations is that new investments may not be made in an expired QOZ, but that existing QOZ Businesses and QOZ Business Property will continue to qualify as such for as long as they continue to be held by the QOF.

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<sup>35</sup> Section 1400Z-2(e)(2).

<sup>36</sup> Section 1400Z-1(f).

<sup>37</sup> Section 1400Z-2(a)(2)(B).



**Attachment 2:**  
**Suggested Regulatory Provisions Under §1400Z-2(d)**

**Qualified Opportunity Fund Definition**

**(a) Qualified opportunity fund assets test.**

(1) In general. For each tax year, a qualified opportunity fund must hold at least 90 percent of its assets in qualified opportunity zone property, determined in accordance with these regulations by taking the average of the percentage of qualified opportunity zone property held by the fund as measured on two testing dates, namely, the last day of the first 6-month period of the tax year of the fund and the last day of the tax year of the fund.

(2) Cash proceeds. For purposes of meeting the 90-percent assets test of section 1400Z-2(d)(1), for a period of one year after receipt of cash from any new investment in the qualified opportunity fund or from the sale or other disposition by the fund of any qualified opportunity zone property, the cash (or an equivalent amount of cash items (including receivables) or Government securities) shall be deemed to be qualified opportunity zone property.

(3) Project commitment. For purposes of meeting the 90-percent assets test of section 1400Z-2(d)(1), if a qualified opportunity fund has legally committed to fund a project in a qualified opportunity zone and an initial disbursement has been made for the project, cash equal to the amount committed but not yet disbursed (or an equivalent amount of cash items (including receivables) or Government securities) shall be deemed to be qualified opportunity zone property for a period not exceeding 30 months from the date of the initial disbursement.

(4) Start-up period. A new fund which intends to qualify as a qualified opportunity fund will be deemed to meet the 90-percent assets test of 1400Z-2(d)(1) on each of the testing dates described in section 1400Z-2(d)(1)(A) and (B) occurring during the first 18 months after the date of formation of the fund.

(5) Extended start-up period. For funds created before June 30, 2020, the start-up period described in paragraph (3) shall be extended through December 31, 2021, provided that

(A) as of the beginning of the start-up period, it is reasonably expected that such fund will be a qualified opportunity fund at the end of such period; and

(B) such fund makes bona fide efforts to qualify as such a fund before the first testing date after December 31, 2021.

(6) Disposal period. For purposes of meeting the 90-percent assets test of section 1400Z-2(d)(1), property that ceases to be qualified opportunity zone property shall continue to be treated as qualified opportunity zone property for the lesser of –

(A) the date on which such property is no longer held by the qualified opportunity fund; or

- (B) (i) if the property is tangible property, 5 years after the date on which such tangible property ceases to be so qualified; or
- (ii) for all other property, 3 years after the date on which the property ceases to be so qualified.

The periods in subparagraph (5)(B) may be extended (up to the date on which the qualified opportunity fund disposes of the property) in the interest of fairness or if such extension would be consistent with the purposes of the statute in accordance with guidance published in the Internal Revenue Bulletin or by determination of the Commissioner.

(7) Asset valuation. For purposes of meeting the 90-percent assets test of section 1400Z-2(d)(1), the value of such a qualified opportunity fund's assets may be measured determined using any reasonable method, provided that such method of valuation is used consistently by the qualified opportunity fund.

**(b) Qualified opportunity zone property holding period.**

(1) In general. Qualified opportunity zone property includes qualified opportunity zone stock defined in section 1400Z-2(d)(2)(B), qualified opportunity zone partnership interests defined in section 1400Z-2(d)(2)(C), and qualified opportunity zone business property defined in section 1400Z-2(d)(2)(D). For stock of a company or a partnership interest in a partnership to qualify as qualified opportunity zone stock or a qualified opportunity zone partnership interest, the company or the partnership, as the case may be, must qualify as a qualified opportunity zone business described in section 1400Z-2(d)(3) during substantially all of the qualified opportunity fund's holding period of the stock or partnership interest.

(2) Substantially all. For purposes of subsections 1400Z-2(d)(2)(B)(i)(III) and 1400Z-2(d)(2)(C)(iii), the term "substantially all" means 70 percent of the qualified opportunity fund's holding period.

(3) Business start-up period. For purposes of meeting the qualified opportunity fund holding period requirements of subsections 1400Z-2(d)(2)(B)(i)(III) and 1400Z-2(d)(2)(C)(iii) and the 90-percent asset test of section 1400Z-2(d)(1), stock or partnership interests shall be deemed to be qualified opportunity stock or qualified opportunity zone partnership interests, as the case may be, for the first 18 months following the formation of the corporation or the partnership provided that—

(A) the corporation or partnership was organized for the purpose of being a qualified opportunity zone business described in section 1400Z-2(d)(3); and

(B) the corporation or partnership makes bona fide efforts to be a qualified opportunity zone business by the end of the 18-month start-up period.

(4) Annual holding period safe harbor for business interests. For any tax year of a qualified opportunity fund, the holding period requirement of subsection 1400Z-2(d)(2)(B)(i)(III) or 1400Z-2(d)(2)(C)(iii) will be considered to be satisfied if, during substantially all of the qualified

opportunity fund's holding period of the stock or partnership interest during the tax year, such company or partnership qualified as a qualified opportunity zone business and—

(A) the holding period requirement was considered satisfied for such stock or partnership interest for all of the prior tax years in the qualified opportunity fund's holding period; or

(B) or during substantially all of the qualified opportunity fund's holding period of such stock or partnership interest prior to the tax year, the company or partnership qualified as a qualified opportunity zone business.

### **Qualified Opportunity Zone Business Definition**

#### **(a) Qualified opportunity zone business.**

(1) In general. A trade or business will not qualify as a qualified opportunity zone business defined in section 1400Z-2(d)(3) unless substantially all of the tangible property owned or leased by the trade or business is qualified opportunity zone business property.

(2) Substantially all. For purposes of the section 1400Z-2(d)(3)(A)(i), the term “substantially all” means 70 percent.

(3) Existing businesses. A trade or business that was in existence on December 31, 2017 that otherwise qualifies as a qualified opportunity zone business will not fail to qualify as such merely because (i) any or all of its tangible property was not acquired after December 31, 2017; or (ii) tangible property acquired on or before December 31, 2017 does not meet the original use or substantial improvement requirement in section 1400Z-2(d)(2)(D)(i)(II). In addition, for purposes of the use requirement in section 1400Z-2(d)(2)(D)(i)(III), the holding period of the existing business's tangible property may be treated as commencing on the first day of the first tax year beginning after December 31, 2017.

### **Qualified Opportunity Zone Business Property Definition**

#### **(a) Qualified opportunity zone business property.**

(1) In general. Qualified opportunity zone business property is tangible property used in a trade or business of a qualified opportunity fund or a qualified opportunity zone business that —

(A) satisfies the acquisition test in section 1400Z-2(d)(2)(D)(i)(I);

(B) satisfies the original use or substantial improvement test of section 1400Z-2(d)(2)(D)(i)(II); and

(C) satisfies the zone use test of section 1400Z-2(d)(2)(D)(i)(III).

#### **(b) Acquisition test.**

(1) In general. The acquisition test in section 1400Z-2(d)(2)(D)(i)(I) will be satisfied if the qualified opportunity fund or qualified opportunity zone business acquires the tangible property after December 31, 2017 in a transaction that is considered an acquisition by purchase (within the meaning of section 179(d)(2)), as defined in paragraph (b)(2).

(2) Acquired by purchase. Tangible property owned or leased by a qualified opportunity fund or qualified opportunity zone business will be considered to have been acquired by purchase (within the meaning of section 179(d)(2)) if –

(A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants);

(B) the property is not acquired by one component member of a controlled group from another component member of the same controlled group; or

(C) the basis of the property in the hands of the person acquiring it is not determined—

(i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) under section 1014(a) (relating to property acquired from a decedent).

**(c) Original use or substantial improvement test.**

(1) Original use. For purposes of section 1400Z-2(d)(2)(D)(i)(II), the term “original use” means the first use to which the property is put within the qualified opportunity zone. If property, including land, is vacant for at least a one-year period, use prior to that period is disregarded for purposes of determining original use. For this purpose, de minimis incidental uses of property, such as renting the side of a building for a billboard, are disregarded. The period of vacancy is determined with respect to only the portion of the property acquired by the qualified opportunity fund or qualified opportunity zone business.

(2) Substantial improvement safe harbor. For purposes of section 1400Z-2(d)(2)(D)(i)(II) and 1400Z-2(d)(2)(D)(ii), property shall be considered to be “substantially improved” by a qualified opportunity fund or qualified opportunity zone business, as the case may be, if the additions to basis with respect to the property made during a 30-month period beginning after the date of acquisition of the property exceed the adjusted basis of such property in the hands of the qualified opportunity fund or qualified opportunity zone business at the beginning of the 30-month period. For purposes of this test, property shall be considered substantially improved for any tax year ending on or before the last day of the 30-month period if –

(A) as of the beginning of such 30-month period, there is a written plan to substantially improve the property by the end of the 30-month period and it is reasonably expected that such property will be substantially improved at the end of such 30-month period; and

(B) the qualified opportunity fund or qualified opportunity zone business makes bona fide efforts to substantially improve the property during the tax year.

(3) Treatment of land. If property used by a qualified opportunity fund or qualified opportunity zone business meets the substantial improvement test of section 1400Z-2(d)(2)(D)(ii), land on which such property is located will also be considered to meet such test.

**(d) Zone use test.**

(1) Substantially all. For purposes of the zone use test in section 1400Z-2(d)(2)(D)(i)(III), the term “substantially all” means 70 percent.

(2) Use within a qualified opportunity zone. For purposes of meeting the zone use test in section 1400Z-2(d)(2)(D)(i)(III), tangible property used in a trade or business of a qualified opportunity fund or qualified opportunity zone business shall not be considered to be used outside the qualified opportunity zone if—

(A) the property is primarily used by employees whose principal place of business is within the qualified opportunity zone;

(B) the property is in transit to or from the qualified opportunity zone (or between qualified opportunity zones). For this purpose, storage of such property for a period less than 180 days shall be considered to be in transit to or from the qualified opportunity zone; or

(C) the Commissioner has determined that the property should not be considered used outside the qualified opportunity zone.

(3) Annual zone use test safe harbor. For any tangible property used in a trade or business of a qualified opportunity fund or qualified opportunity zone business, the zone use test of section 1400Z-2(d)(2)(D)(i)(III) will be considered to be satisfied for a tax year if substantially all of the use of the property was in a qualified opportunity zone during the holding period for the property during the tax year and –

(A) the property satisfied annual zone use test safe harbor in all prior tax years, or

(B) for substantially all of the holding period of the property prior to the tax year, substantially all of the use of such property was in a qualified opportunity zone.