



November 29, 2019

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Draft Form 8996, Qualified Opportunity Fund

Dear Commissioner Rettig:

I write on behalf of a broad coalition of stakeholders to provide comments in response to the draft Form 8996, Qualified Opportunity Fund, released on October 30, 2019. We appreciate the ability to comment on Form 8996 before finalization. The enclosed comments provide suggestions for improving the clarity of Form 8996 as currently drafted, as well as suggestions for additional information to be collected to ensure that Qualified Opportunity Funds (“QOFs”) are in regulatory compliance and prevent taxpayers from taking advantage of the Qualified Opportunity Zone (“QOZ”) provisions in a manner unintended by Congress. We believe that this information can also help the Department of the Treasury and the Internal Revenue Service (“IRS”) evaluate the success of the QOZ tax incentive on increasing investment and economic activity in low-income communities.

We appreciate your consideration of the attached recommendations and look forward to the issuance of a final version of Form 8996 and its instructions. If you have any questions about these comments, please contact Catherine Lyons, Manager of Policy and Coalitions, at catherine@eig.org.

Sincerely,

John Lettieri
President and CEO
Economic Innovation Group



Enclosure: Comments on Draft Form 8996, Qualified Opportunity Fund

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Jeffrey Van Hove, Senior Advisor, Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Sunita B. Lough, Deputy Commissioner, Services and Enforcement, Internal Revenue Service
Douglas O'Donnell, Commissioner (Large Business & International), Internal Revenue Service
Eric C. Hylton, Commissioner (Small Business/Self Employed), Internal Revenue Service
Hon. Michael Desmond, Chief Counsel, Internal Revenue Service
Kathryn Zuba, Associate Chief Counsel (Procedure & Administration), Internal Revenue Service

Comments on Draft Form 8996, Qualified Opportunity Fund

A. Suggestions to Improve the Clarity and Content of Form 8996

We believe that the clarity and ease of use of Form 8996 could be improved through the correction of certain ambiguities in the information requested.

1. Tangible Property

a. Discussion

Specifically, in Part V, the form asks for a listing of the QOZ business property held directly by the QOF in columns (b) through (e). Column (a) requests every census tract where QOZ business property held directly by the QOF is located. It is not clear based on the interaction of those two sets of columns whether a QOF is supposed to aggregate all of its tangible property located in a census tract on a single line, or if the QOF is supposed to list each piece of tangible property that it owns line-by-line.

In Part VI of the form, the same ambiguity is present, namely that for property held indirectly by the QOF through a QOZ business, the QOF must list in column (a) the census tract in which the property is located, and in columns (d), (e), (g), and (h) the tangible property owned or leased by the QOZ business. For Part VI, the problem is more acute because QOZ businesses are more likely than a QOF to hold tangible property directly. Further, the draft Form 8996 provides more lines on which to list the tangible property of a QOZ business in Part VII, which spans a full page on page 4 of the form. The presence of so many lines suggests the form intends that a QOF list each piece of tangible property owned or leased by the QOZ business. For an operating business, such an interpretation would be particularly burdensome, as it would require the tedious listing of all equipment, office furniture, raw materials, inventory, etc. owned or leased by the business.

Furthermore, the listing of the tangible property in reference to column (a), the census tract, creates an ambiguity for property that travels or is used in multiple locations, for example, vehicles and equipment used by field employees. It is not clear in which census tract or tracts this property is located.

b. Recommendations

We recommend that the instructions to Form 8996, include guidance on how to list the tangible property of the QOF and QOZ businesses. For operating businesses, we recommend that such guidance allow for aggregation of tangible property to minimize burden and specifically describe how to report tangible property that moves or is used in multiple census tracts.

2. Apportionment

a. Discussion

Another issue that could cause confusion is the question in columns (c) and (f) of Part VI, which asks for the value of the QOF's interest in the QOZ business as apportioned to each census tract. If a QOZ business operates in more than one census tract, there is no clear method of how the QOF should apportion the value of the whole QOZ business, which could include self-created intangibles such as goodwill, to the various census tracts. Apportionment could be burdensome for operating businesses that operate in multiple census tracts, as it appears to impose a requirement in addition to what is already required by the statute and regulations.

b. Recommendation

We recommend that the apportionment requirement be based on where the property is used for purposes of section 1400Z-2(d)(2)(D)(i)(III) and Prop. Treas. Reg. § 1.1400Z2(d)-1(c)(6), -1(d)(2)(iv).¹ Please see our recommendation in section B.2, below, regarding how compliance with the use requirement should be reported.

3. Organizing Documents

a. Discussion

In Part I of Form 8996, the text next to the “Yes” checkbox on line 3 requires that the QOF's organizing documents include a statement of the entity's purpose of investing in QOZ property and a description of the trade or business(es) that the QOF is engaged in either directly or through a QOZ business. Generally, organizing documents are filed at the time of creation of an entity. Although a QOF should know its purpose of investing in QOZ property at that time, the QOF will not necessarily know at the time of its formation which trades or businesses it will invest in, particularly if the QOF intends to invest in a portfolio of QOZ businesses. For

¹ All section references are to the Internal Revenue Code of 1986, as amended (the “Code”), and to the Treasury Regulations thereunder.

example, the QOF may invest in QOZ business opportunities that arise after its formation, or its business plans may evolve over time. Of course, the trade or business(es) that the QOF is engaged in will be known at the time the QOF files its annual Form 8996.

b. Recommendation

Part I line 3 should be revised to require the QOF to include in its organizing documents its purpose to invest in QOZ property, but the requirement that the organizing documents include a description of the trade or business(es) that the QOF is invested in should be removed. Instead, the QOF should be required to disclose on Form 8996 a description of the trade or business(es) in which the QOF is invested. This would enable the IRS to determine whether the QOF is in compliance with several statutory and regulatory requirements: the active trade or business requirement;² the prohibition on the operation of a trade or business that is a “sin business,” namely a private or commercial 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 premises;³ and the anti-abuse rule.⁴

4. Six-Month Grace Period

a. Discussion

Part II of Form 8996 requires the QOF to list the total QOZ property and total assets held by the QOF for purposes of computing the 90-percent test for the QOF on the testing dates (and Part IV requires this information by month). Under the proposed regulations, a QOF would not need to list and would exclude from both the numerator and denominator of this computation of any investments received within the last six months that held in cash, cash equivalents, or debt instruments with a term of 18 months or less.⁵ However, this may not be readily apparent to return preparers who are not intimately familiar with the QOZ regulations, and they may interpret the phrase “total assets” on line 7 to mean all assets of the QOF. In addition, we note that excluding the investments from both the numerator and denominator could lead to anomalous results (specifically, a quotient of zero) if the QOF owns nothing but the contributed cash at a particular testing date.

² Prop. Treas. Reg. §1.1400Z2(d)-1(d)(5)(ii)(B).

³ Section 1400Z-2(d)(3)(A)(iii).

⁴ Prop. Treas. Reg. § 1.1400Z2(f)-1(c)(1).

⁵ Prop. Treas. Reg. § 1.400Z2(d)-1(b)(4).

b. Recommendation

The instructions to Form 8996 should clarify that in Part II, QOFs should exclude from lines 6 and 7 any investments received by the QOF within the last six months that are held in cash, cash equivalent, or short-term debt instruments. Alternatively, if the final regulations revise this rule, consistent with various comments received, to include such investments in the numerator and denominator, then the instructions should be revised accordingly.

B. Suggestions of Information to Collect in Furtherance of Tax Compliance

Section 6001 of the Code provides the IRS with broad authority to require taxpayers to report information necessary to ensure compliance with the Code: “Whenever in the judgement of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.” Consistent with this authority, the IRS can and should request more information from QOFs to ensure that they are complying with the myriad of requirements under the QOZ statute and regulations. The Treasury Department and the IRS determined that regulations were necessary to reduce uncertainty for potential QOF investors regarding the requirements for qualifying investments under the tax incentive and ensure that QOFs interpreted these requirements consistently.⁶ Notwithstanding this fact, Form 8996 does not touch on many of the prerequisites that a fund must meet to qualify as a QOF.

1. Compliance with QOZ Business Requirements

A QOF must be invested in a qualifying QOZ business in order to be a qualifying QOF under the statute.⁷ Form 8996 could request more information from QOFs to ensure that they are following the QOZ business requirements of section 1400Z-2(d)(3) and Prop. Treas. Reg. § 1400Z2(d)-1(d)(1). The Form 8996 should have a series of questions, many of them “yes” or “no” checkboxes, like that used on the Form 990 or Form 1065 that require the taxpayer to certify that they are in compliance with the various requirements. We believe that the yes/no checkboxes strike an appropriate balance between ensuring compliance without imposing a significant burden. They also serve an educational function for QOFs, in effect providing a checklist of requirements that they must determine they satisfy.

⁶ 84 FR 18,652 (May 1, 2019), at 18,670.

⁷ Section 1400Z-2(d).

Specifically, we recommend that the IRS include the following questions in order to gauge compliance with the QOZ business requirements:

- **70-percent QOZ business property test.** The proposed regulations provide that at least 70 percent of the tangible property owned or leased by a QOZ business must be QOZ business property.⁸ Part VI of the current draft Form 8996 requires a listing of the tangible property held by the QOZ business, but it does not distinguish between tangible property that qualifies as QOZ business property and tangible property that does not. We do not believe that the QOF should be required to list all QOZ business property that it owns because, as discussed above, such a listing of every piece of tangible property owned or leased would be onerous for operating businesses. However, we believe it is appropriate to include “yes” or “no” checkboxes for the statement that for each QOZ business of the QOF, the ratio of QOZ business property to total tangible property is at least 70 percent.
- **Gross income test.** The proposed regulations provide four methods by which a trade or business can establish that it meets the requirement that at least 50 percent of its gross income derive from the active conduct of a trade or business in the QOZ.⁹ There are currently no questions regarding this requirement on the Form 8996. We recommend a series of questions to determine compliance with this requirement. First, the Form 8996 should have a “yes” or “no” question as to whether at least 50 percent of the gross income of all applicable businesses derives from the active conduct of a trade or business in a QOZ. Second, the form should have the QOF select which of the following computation methods it is relying on: (1) at least 50 percent of the services performed by employees or independent contractors (based on hours) are performed in the QOZ; (2) at least 50 percent of the amount paid for services are for services performed by employees or independent contractors in the QOZ; (3) the tangible property and management and operational functions needed to produce at least 50 percent of gross income are located in the QOZ; or (4) facts and circumstances. We believe that disclosure of the data underlying the safe harbors would be burdensome and potentially require very detailed and complex instructions.
- **Intangible Property.** The proposed regulations require that a substantial portion, defined as 40 percent, of the intangible property of a QOZ business be used in the active

⁸ Prop. Treas. Reg. §1.1400Z2(d)-1(d)(3)(i).

⁹ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(5)(i).

conduct of a trade or business in the QOZ.¹⁰ Because it is unclear under the current rules how such use will be measured, the Form 8996 should ask only a certification of “yes” or “no” as to whether the intangible property owned by the trade or business(es) of the QOF are used in the active conduct of a trade or business in a QOZ. Such a good faith certification should prevent abuse by businesses setting up “intangible boxes” in the QOZ that place ownership of passive-income generating intangibles in a QOZ business without conducting any other significant activity in the QOZ.

- **Nonqualified financial property.** The statute requires that a QOZ business cannot have more than 5 percent of its total basis in property be attributable to nonqualified financial property.¹¹ The QOF should be required to certify “yes” or “no” that no more than 5 percent of the total basis of property held by the QOZ business(es) is attributable to nonqualified financial property. This would prevent appreciation in portfolio investments, such as marketable stock or securities, from being sheltered from taxable income as a result of the QOZ benefits.
- **Working capital safe harbor.** The proposed regulations provide QOZ businesses a safe-harbor period of 31 months to invest capital in the development of a trade or business including the acquisition, construction, and/or substantial improvement of tangible property pursuant to a written plan for expending such capital.¹² The Form 8996 should require a “yes” or “no” certification of whether any of the QOZ businesses owned by the QOF are relying on this working capital safe harbor, and secondly, whether the QOZ business has a written plan that complies with Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(5)(iv).

2. Compliance with QOZ Business Property Requirements

In addition, the IRS could ask questions to determine whether the tangible property owned directly or indirectly by the QOF is QOZ business property in order to gauge compliance with the requirements of section 1400Z-2(d)(2)(D) and Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(2). Specifically, we recommend that Form 8996 include the following questions:

- **Date of acquisition of property.** QOZ business property must be acquired after December 31, 2017.¹³ The Form 8996 should include a “yes” or “no” certification that at

¹⁰ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(5)(ii)(A).

¹¹ Section 1400Z-2(d)(3)(A)(ii).

¹² Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(5)(iv).

¹³ Section 1400Z-2(d)(2)(D)(i)(I).

least 70 percent of the property owned by any QOZ businesses was acquired after December 31, 2017. For real property owned indirectly or directly by the QOF, the QOF could be required to list the date of acquisition of such property.

- **Purchase from an unrelated party.** QOZ business property purchased by the QOF or QOZ business must have been purchased from an unrelated party.¹⁴ The Form 8996 should require a “yes” or “no” certification that at least 70 percent of the value of tangible property owned by any QOZ businesses was purchased from an unrelated party as described in Section 1400Z-2(e)(2).
- **Original use or substantial improvement.** Tangible property owned directly or indirectly by the QOF must be either originally used in the QOZ or substantially improved.¹⁵ For compliance with this requirement, the IRS should ask on Form 8996 a “yes” or “no” question as to whether at least 70 percent of the tangible property owned by any QOZ businesses is either original used by the QOZ business in the QOZ or substantially improved. For real property owned directly or indirectly by the QOF, the IRS could ask additional questions:
 - Is the real property being or has it been substantially improved by the QOF or QOZ business?
 - If yes, what is the purchase price of the property and what portion of that is attributable to buildings as compared to land?
 - How much did the QOF or QOZ business add to the basis of the building(s) on the property?
 - How long was the period of improvement of the property by the QOF or QOZ business?
- **Leased property.** The proposed regulations create certain requirements for tangible property leased by QOFs directly or indirectly.¹⁶ The Form 8996 should have a section on leased property that asks a series of “yes” or “no” questions regarding any leased property:
 - Does the QOF have an interest directly or indirectly in tangible property that has been acquired pursuant to a lease?
 - Was all applicable leased property acquired pursuant to lease(s) entered into after December 31, 2017?

¹⁴ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(2)(i)(A).

¹⁵ Section 1400Z-2(d)(2)(D)(i).

¹⁶ Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(2)(i)(B).

- Are the terms of the lease(s) market rate?
- Are any of the lessors of such property related under Section 1400Z-2(e)(2)?
- If question 4 is answered in the affirmative, then additional “yes” or “no” certifications that:
 - There have been no prepayments under the lease in excess of 12 months.
 - Either the original use of the leased personal property in the QOZ commenced with the QOZ business, or the lessee became the owner of tangible property having a value at least equal to the leased tangible property within 30 months.
- **Use of property.** The proposed regulations require that to qualify as QOZ business property, at least 70 percent of the use of the property be within the QOZ for at least 90 percent of the QOF or QOZ business’ holding period of the property.¹⁷ For compliance with these requirements, the Form 8996 should ask a “yes” or “no” certification of (1) whether at least 70 percent of the use of the QOZ business property of the QOZ business is within the QOZ, and (2) whether (1) is true for at least 90 percent of the QOF’s holding period for such property.

C. Suggestions of Information to Collect for Evaluating Increased Economic Activity

Form 8996 should be used to collect data described in the Request for Information on Data Collection and Tracking for Qualified Opportunity Zones, 84 FR 18648, (“RFI”) issued on May 1, 2019. In particular, the RFI stated that Form 8996 should collect information of a sufficient granularity for “evaluating the success of the QOZ tax incentive on increasing investment and economic activity within QOZs.” We refer to our comments filed on the RFI dated May 31, 2019, which discussed this point in detail.¹⁸

¹⁷ Prop. Treas. Reg. § 1.1400Z2(d)-1(c)(5) and (6).

¹⁸ Economic Innovation Group, *Request for Information on Data Collection and Tracking for Qualified Opportunity Zones*, 84 FR 18648 (May 1, 2019), available at: <https://www.regulations.gov/document?D=TREAS-DO-2019-0004-0036>.