June 11, 2021

Via Federal eRulemaking Portal at www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG-121095-19)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Re: REG-121095-19 (Proposed Regulations on Requirements for Certain Foreign Persons and Certain Foreign-Owned Partnerships Investing in Qualified Opportunity Funds and Flexibility for Working Capital Safe Harbor Plans)

To Whom It May Concern:

I write on behalf of the broad array of stakeholders in the Opportunity Zones Coalition to provide comments in response to the Notice of Proposed Rulemaking, Requirements for Certain Foreign Persons and Certain Foreign-Owned Partnerships Investing in Qualified Opportunity Funds and Flexibility for Working Capital Safe Harbor Plans, issued April 14, 2021 ("NPRM").[1] We appreciate the continued work of staff at the Department of the Treasury ("Treasury") and Internal Revenue Service ("IRS") to provide guidance to clarify the Qualified Opportunity Zone ("QOZ") rules. We write to provide a few areas in which further clarification is needed.

Specifically, we offer the following recommendations:

1. With respect to the proposed rule permitting QOZ Businesses to amend or rewrite their written plans or schedules in the context of a federally declared disaster, we recommend that Treasury and the IRS:
    a. Finalize the proposed rule.
    b. Clarify that, outside the context of a federally declared disaster, a QOZ Business can generally amend its written plan and schedule in response to changed circumstances that arise during the ordinary course of developing a trade or business.
    c. Clarify that the 24-month extension of the working capital safe harbor automatically applies for QOZ Businesses located in a QOZ impacted by a federally declared disaster.

[1] 86 Fed. Reg. 19,585, REG-121095-19 (Apr. 14, 2021).

2. With respect to the proposed rules requiring security-required persons to obtain an eligibility certificate, we recommend that Treasury and the IRS:
    a. Modify the definition of security-required persons in the NPRM to exclude U.S. partnerships that are required to withhold U.S.-source gain of their foreign partners.
    b. Modify the procedure to provide for filing the required materials with the security-required person's tax return at the time the deferral election is made, instead of an up-front application process. Alternatively, security-related persons should be allowed to elect to waive deferral in lieu of obtaining an eligibility certificate.
    c. Expand the types of acceptable security to include bonds.
    d. Clarify that an investor may apply for an eligibility certificate and a withholding certificate at the same time.
    e. Clarify that until final regulations are issued, foreign investors may make deferral elections under the existing regulations.
3. We recommend that Treasury and the IRS amend the existing regulations to provide that certain tax-exempt organizations may elect to defer gains invested in a qualified opportunity fund ("QOF"), even if such gains are not taxable.

I. Working Capital Safe Harbor ("WCSH") Plans and Federal Disasters

The existing regulations provide for a 31-month safe harbor period for a QOZ Business to expend working capital without violating the limitation on nonqualified financial property if three requirements are satisfied:

1. The amounts are designated in writing for the development of a trade or business in a QOZ, including the acquisition, construction, and/or substantial improvement of tangible property in a QOZ;
2. There is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets within 31 months of the date on which the business received the assets; and
3. The QOZB must actually use the working capital assets in a manner that is "substantially consistent" with the written plan and written schedule.[2]

The NPRM adds flexibility for QOZ Businesses to revise or replace their original written WCSH written plan and schedule in response to a federally declared disaster, provided the remaining working capital assets are expended within the original 31-month period plus up to 24 additional months provided in Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D).[3] The NPRM additionally provides

[2] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(A)-(C).
[3] Prop. Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D).

that QOZ Businesses have up to 120 days after the close of the incident period to adopt amendments to their plans and schedules.[4]

We appreciate this clarification that QOZ Businesses can amend or even adopt new written plans and schedules in response to a federally declared disaster. This rule recognizes that the pre-disaster plan and schedule may no longer be feasible in light of the disaster. We also agree with permitting a reasonable amount of time after the end of the disaster to adopt a revised plan that takes into account the full impact of the disaster on the development of the trade or business. Although 120 days after the close of the incident period may sound generous in the context of a long-term disaster such as the COVID-19 pandemic, it seems reasonable and necessary in the context of most federally declared disasters, such as hurricanes or floods, to give the QOZ Business time to assess the impact of the disaster.

However, the proposed rule raises questions for practitioners as to what changes may be made to written plans and schedules outside the context of a federally declared disaster. By delineating circumstances in which a QOZ Business may revise its written plan and schedule, the NPRM creates the possible inference a QOZ Business cannot revise its plan in other circumstances. Practitioners have interpreted the "substantially consistent" standard in the regulations[5] to allow for reasonable amendments to be made to a written plan or schedule to address ordinary uncertainties in developing a trade or business or changes in circumstances. We believe such an interpretation is appropriate and consistent with the language of the existing regulations, and that the NPRM appropriately permits amendments of a more significant nature over a longer period of time. Nonetheless, clarifying this point would be helpful.

Additionally, the existing regulations provide that a QOZ Business "may receive not more than an additional 24 months to expend its working capital assets."[6] Questions have been raised by many practitioners as to whether the 24-month extension is automatic or whether QOZ Businesses located in the disaster area must justify such relief and, if the latter, how the relief is to be justified. The NPRM does not address this question, but guidance on this point would be helpful.

Recommendation:

We recommend that Treasury and the IRS finalize the proposed rule permitting QOZ Businesses to amend or rewrite their written plans or schedules within 120 days after the close of the incident period for a federally declared disaster.

In addition, we recommend that final regulations clarify that a QOZ Business can generally amend its written plan and schedule in response to changed circumstances that arise during the ordinary course of developing a trade or business, and that the proposed rule for federally

[4] *Id*.
[5] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(C).
[6] Treas. Reg. § 1.1400Z2(d)-1(d)(3)(v)(D).

declared disasters was intended to permit more significant revisions or replacements of the written plan and allow for the expenditure of working capital assets over a longer period of time. Final regulations should also clarify that the 24-month extension of the working capital safe harbor automatically applies for QOZ Businesses located in a QOZ impacted by a federally declared disaster.

II. Foreign Persons and the Withholding Rules

A. Security-Required Persons

The NPRM provides that "security-required persons" may not make a gain deferral election with respect to a "security-required gain" unless they first obtain an eligibility certificate from the IRS specifying the deferral amount.[7] Security-required persons include foreign persons and specified partnerships—*i.e.*, those that are at least 20 percent foreign-owned, are closely held, and either are seeking to defer at least $1 million in gain or hold at least 25 percent of the value of their assets in U.S. assets.[8] A security-required gain means gain from a "covered transfer" (*i.e.*, a transfer subject to withholding).[9]

We note that the definition of security-required persons in the NPRM includes U.S. partnerships. Under the existing regulations, if a U.S. partnership makes a deferral election, the previously deferred gain is included by the U.S. partnership with the same tax attributes in the year of inclusion.[10] These attributes include those taken into account by sections 1(h), 1222, 1231(b), 1256, and any other applicable provisions of the Code."[11] Presumably this means that the U.S. partnership would be required to withhold on its foreign partners with regard to inclusion of the deferred gain as effectively connected with the conduct of a trade or business within the United States, thereby ensuring that the deferred tax will be subject to collection. Accordingly, we do not believe that it is necessary to include U.S. partnerships within the scope of the definition of security-required persons.

Recommendation:

We recommend that final regulations modify the definition of security-required persons in the NPRM to exclude U.S. partnerships that are required to withhold U.S.-source gain of their foreign partners.

B. Eligibility Certificate

To obtain an eligibility certificate, the security-related person must submit an application to the IRS, which must include acceptable security (such as a standby letter of credit) to secure the tax

[7] Prop. Treas. Reg. § 1.1400Z2(a)-1(a)(3).
[8] Prop. Treas. Reg. § 1.1400Z2(a)-2(b)(1), (3).
[9] Prop. Treas. Reg. § 1.1400Z2(a)-2(c).
[10] Treas. Reg. § 1.1400Z2(a)-1(c)(1)(i).
[11] *Id*.

on the ultimate gain, a designation of a U.S. agent, and an agreement to timely file a tax return and pay tax on the deferred gain.[12] A default under these requirements would constitute an inclusion event. The eligibility certificate may be used as a basis for reducing or eliminating withholding. Specifically, the NPRM provides that the IRS may issue a withholding certificate to withhold a reduced amount (including zero) if the transferor has obtained an eligibility certificate.[13]

We understand and agree with the need for guardrails to ensure that tax on the deferred gain is paid, but the requirements to obtain an eligibility certificate are burdensome and time-consuming for both taxpayers and the IRS. The NPRM establishes a full application process, which includes obtaining a letter of credit and designating a U.S. agent, all before the security-required person may defer an eligible gain. Although the IRS undertakes to act on an application for an eligibility certificate within 90 days after the date that "all information necessary for the IRS to make a determination is received,"[14] it is not clear at what point the IRS will view the application to be complete. Thus, it is unclear that a security-required person would have sufficient time to determine a gain is eligible, apply for an eligibility certificate, and make an investment in a QOF within the 180-day time period.

We believe that a procedure that involves filing the required materials at the time the deferral election is made with the security-required person's tax return, similar to a gain recognition agreement, would be preferable to an up-front application process. It would be less burdensome and time-consuming but would still protect the government's interest in collecting the tax on the deferred gain while unlocking capital from foreign persons.

Alternatively, because the requirement for an eligibility certificate appears intended to protect the government's interest in collecting tax on the deferred gain, final regulations could provide security-related persons the option to waive the deferral benefit in lieu of obtaining an eligibility certificate.[15]

The proposed regulations refer only to "an irrevocable standby letter of credit" as acceptable security.[16] Treasury and the IRS should expand the types of acceptable security to include bonds, such as recapture bonds, that were used in the past to secure against potential Low-Income Housing Tax Credit recapture events. Bonds are often less onerous to obtain than a letter of credit, while still providing sufficient security for the possible liability.

It is also unclear whether the withholding certificate and eligibility certificate can be applied for, and issued, together. If the certificates must be obtained sequentially, it is uncertain that the foreign person would be able to timely obtain the certificates to avoid withholding.

---

[12] Prop. Treas. Reg. § 1.1400Z2(a)-2(d)(2)-(6).
[13] Prop. Treas. Reg. § 1.1445-3(e)(5); Prop. Treas. Reg. § 1.1446-6(c)(1)(iv); Prop. Treas. Reg. § 1.1446(f)-2(c)(5).
[14] Prop. Treas. Reg. § 1.1400Z2(a)-2(d)(1).
[15] Under this option, security-required persons would still be permitted to elect to step-up their basis in the QOF interest after 10 years.
[16] Prop. Treas. Reg. § 1.1400Z2(a)-2(d)(6)(ii).

Finally, the NPRM states that the rules contained therein are not applicable until after they are published as final regulations.[17] The NPRM states both that foreign investors may not make a deferral election without receiving an eligibility certificate, and that taxpayers should not submit applications for eligibility certificates before the date the rules are finalized, leaving foreign investors to question how to make an investment in a QOF prior to the finalization of the rules. We believe that, until final regulations are issued, the rules in the existing regulations should govern.

Recommendations:

We recommend that final regulations modify the rules proposed in the NPRM as follows:

1. Modify the procedure to provide for filing the required materials at the time the deferral election is made with the security-required person's tax return, instead of an up-front application process. Alternatively, security-related persons should be allowed to elect to waive deferral in lieu of obtaining an eligibility certificate but still be eligible to receive the basis step up benefits of the QOZ statute.
2. Expand the types of acceptable security to include bonds, such as recapture bonds.
3. Clarify that an investor may apply for an eligibility certificate and a withholding certificate at the same time, and during the period in which a withholding agent has been notified that a withholding certificate has been applied for, the withholding agent shall retain the withheld amount until the withholding certificate is issued.
4. Clarify that until final regulations are issued, foreign investors may make deferral elections under the existing regulations.

III. Rules For Charitable Organizations

The final regulations issued in December 2019 limit the investments that are eligible for the benefits of the QOZ statute to the amount of capital gains that would be recognized *and subject to tax under subtitle A of the Internal Revenue Code* before January 1, 2027 if section 1400Z-2(a)(1) did not apply to defer recognition.[18] The preamble to the 2019 regulations explained that "[s]ection 1400Z–2 defers the time when eligible gains are included in income, and there would not be any taxable income to defer for a gain that is not subject to Federal income tax."[19] The preamble also expressed an administrative concern that it would be difficult for the IRS to verify whether the gain is an eligible gain if it is not taxable.[20]

[17] 86 Fed. Reg. at 19,590.
[18] Treas. Reg. § 1.1400Z2(a)-1(b)(11)(i)(B) (emphasis added).
[19] 85 Fed. Reg. 1866, 1871 (Jan. 13, 2020).
[20] 85 Fed. Reg. at 1871 (noting that "particularly with respect to foreign persons, the lack of any requirement that a gain be subject to Federal income tax would make it difficult for the IRS to verify the extent to which the amount being invested in a QOF was, in fact, with respect to a capital gain.").

We believe this rule unduly restricts the ability of charitable organizations, whose capital gains are reported annually to the IRS on Form 990 series returns, to invest in QOFs. Many charitable organizations were surprised by the limitation of investments eligible for QOZ benefits to taxable gains under subtitle A, and the final regulations stopped many discussions regarding QOZ investments by charitable organizations.

Organizations that are exempt from tax under section 501(a) generally do not have gains that are taxable under subtitle A, except to the extent of unrelated business taxable income or unrelated debt-financed income (although some are subject to excise taxes on gains, which should also be eligible for deferral under section 1400Z-2(a)). However while tax-exempt organizations may not have taxable gains to defer, the 10-year basis step-up benefit is valuable nonetheless, as investments made in a QOF by tax-exempt organizations will in many cases generate taxable income to the organization, because the QOF has debt financing that results in unrelated business taxable income.[21] Because the 10-year basis step-up election is limited to qualifying investments of eligible gains for which a deferral election has been made under subsection 1400Z-2(a) of the statute, tax-exempt organizations find themselves in somewhat of a catch-22 – they do not have *taxable* gains, so they cannot make the deferral election, but after 10 years, they will have a gain on their investment in a QOF that will generally be taxable. Thus, they are disincentivized to invest in QOFs.

We believe that investments by certain tax-exempt organizations are consistent with the QOZ program and should be incentivized. In particular, organizations that are exempt from tax under section 501(a) and described in section 501(c)(3) ("charitable organizations") are likely to make investments in charitable and mission-related projects, particularly in communities in which they are located. As a result, charitable organizations, such as hospitals or educational institutions, are well-positioned to serve as anchor organizations in QOZs and can attract more investors by signaling to the market which QOFs are likely to have charitable impact. Charitable organizations should have the same ability as other investors to invest capital in their communities without incurring a tax liability upon exiting that investment. In addition, because such entities must apply for tax-exempt status with the IRS and file annual information returns disclosing their activities, there is sufficient transparency associated with these organizations and their investments.

Recommendation:

We recommend that Treasury and the IRS amend the existing regulations to provide that organizations exempt from tax under section 501(a) and described in section 501(c)(3) may elect to defer gains invested in a QOF, even if such gains are not taxable, so that they may receive the benefit of the 10-year basis step-up.

---

[21] Section 512(b)(4).

We appreciate the ability to provide feedback on the NPRM and your consideration of these recommendations. If you have any questions about these comments, please contact Kenneth Megan at kenneth@eig.org.

cc: Mark Mazur, Acting Assistant Secretary (Tax Policy) and Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Hon. Charles Rettig, Commissioner, Internal Revenue Service
Thomas West, Deputy Assistant Secretary, Domestic Business Tax, Department of the Treasury
Jose E. Murillo, Deputy Assistant Secretary, International Tax Affairs, Department of the Treasury
William M. Paul, Acting Chief Counsel, Internal Revenue Service
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Kevin Nichols, Acting International Tax Counsel, Department of the Treasury
John Moriarty, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Peter H. Blessing, Associate Chief Counsel (International), Internal Revenue Service
Colin Campbell, Jr., Attorney Advisor, Department of the Treasury
Michael Novey, Associate Tax Legislative Counsel, Department of the Treasury
Kamela Nelan, Attorney Advisor, Department of the Treasury
Erika C. Reigle, Senior Technician Reviewer (Income Tax & Accounting), Internal Revenue Service
Subin Seth, Senior Counsel (International), Internal Revenue Service
Milton M. Cahn, Attorney (International), Internal Revenue Service
Ronald M. Gootzeit, Attorney (International), Internal Revenue Service
Kyle C. Griffin, Attorney (Income Tax & Accounting), Internal Revenue Service