EIG
OPPORTUNITY ZONES
COALITION

The Honorable Scott Bessent
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

July 10, 2026

Dear Secretary Bessent,

The Economic Innovation Group's ("EIG") Opportunity Zones Coalition appreciates the opportunity to provide recommendations to the Department of the Treasury and the Internal Revenue Service (collectively "Treasury") as you develop guidance to implement the Working Families Tax Cuts Act's ("WFTC") opportunity zone ("OZ") provisions.

OZs were originally enacted as a temporary tax policy in the Tax Cuts and Jobs Act ("TCJA") in 2017. After eight years and more than $100 billion in investment, the WFTC establishes OZs as a permanent pillar of U.S. economic development policy driving capital into low-income and high-poverty communities nationwide. Key to the real-world success of the OZ incentive was Treasury's extensive work — including the consideration of hundreds of stakeholder comments — to issue prompt regulations (the "Final 2020 OZ Regulations")[1] that provided certainty for taxpayers and designated communities.

The EIG Opportunity Zones Coalition includes fund managers, investors, financial institutions, community leaders, and service providers. Our recommendations are consensus priorities among stakeholders that would enhance and align the Final 2020 OZ Regulations with Congress's intent to facilitate additional investments in operating businesses, affordable housing, and existing mission-aligned programs. We also offer comments on various transition issues from the original OZ incentive to the new incentive as enacted by the WFTC.

We appreciate your consideration and look forward to continued engagement as Treasury advances this important next phase of OZ implementation.

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[1] 85 Fed. Reg. 1,866 (Jan. 13, 2020), https://www.govinfo.gov/content/pkg/FR-2020-01-13/pdf/2019-27846.pdf.

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Please reach out to Catherine Lyons, Senior Director of Policy and Coalitions at the Economic Innovation Group, at catherine@eig.org should you have any questions.

Sincerely,

John W. Lettieri
President and CEO
Economic Innovation Group

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Opportunity Zone 2.0 Guidance Request

I. <u>Executive Summary</u>

The EIG Opportunity Zones Coalition recommends the following modifications to the Final 2020 OZ Regulations to more closely reflect Congress's intent for the OZ policy, with a focus on provisions that would remove barriers to investments into non-real estate operating businesses, affordable housing, and mission-aligned Community Development Financial Institutions ("CDFIs"). We also offer recommendations to address certain transition issues in implementing the changes enacted by the WFTC. Capitalized terms used in this summary are defined herein or in the sections below.

Despite Congress's intention to unleash a new wave of business and real estate investment in distressed places, OZ investment into non-real estate operating businesses has been relatively limited. The following recommendations would enable more investment into new and existing operating businesses and allow for the recycling of capital into qualifying OZ investments without disruption to the investor's benefits, consistent with congressional intent and the needs of designated communities.

- Regulations should support Qualified Opportunity Fund ("QOF") investments into pre-existing operating businesses by clarifying the Substantial Improvement Test so that tangible property purchased on or before the beginning of an OZ designation may be treated as Qualified Opportunity Zone ("QOZ") business property if the business makes other substantial investments in the acquisition of new tangible property that exceeds the basis of existing property during the substantial improvement period, consistent with the rule for related-party leases of tangible personal property under Treas. Reg. § 1.1400Z2(d)-2(c)(3).[2]

- Regulations should provide that tangible property incorporating modest amounts of non-qualifying property does not "taint" the entire property as non-qualifying property if the taxpayer overwhelmingly improves the non-qualifying property.

Treasury should also use authority under section 1400Z-2(e)(4)(B) to issue regulations to defer gain on the sale of property and treat a taxpayer's investment as continuous if the gain would have been eligible for non-recognition after the ten-year holding period and the QOF reinvests the proceeds from the sale of QOZ business property or other QOZ property.

We urge Treasury to modify the substantial improvement requirement for certain affordable and workforce housing projects. The following modifications would greatly increase

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[2] Unless otherwise indicated, all "section" references are to sections of the Internal Revenue Code of 1986, as amended (the "Code") and all "Treas. Reg. §" references are to sections of regulations promulgated thereunder.

the production of much-needed affordable housing in OZs and are consistent with President Trump's directive for all departments and agencies to pursue appropriate action to lower the cost of housing and expand housing supply.[3]

- Regulations should allow property converted to affordable housing to be considered as satisfying the Original Use Requirement, similar to special exceptions in the Final 2020 OZ Regulations allowing vacant property and brownfields to meet the Original Use Requirement without having to meet the Substantial Improvement Requirement. Regulations should provide that property converted to affordable housing satisfies the Original Use Requirement if at least 20 percent of units are restricted to households at or below 80 percent of the area median income and the property includes a new 30-year land use restriction agreement.

- Regulations should also provide that investments in existing affordable rental housing should meet the Substantial Improvement Requirement if the property is improved by more than 20 percent of the unadjusted cost basis and subject to a new or existing 30-year land use restriction agreement, similar to the standards in section 42(e) for the treatment of rehabilitation expenditures.

We urge Treasury to allow QOFs to deposit working capital into mission-aligned institutions.

- Regulations should provide an additional reasonable cause exception from the 90/10 Test and allow QOF investments and working capital deposits into a CDFI to be excluded from the 90/10 Test, as CDFIs are mission-aligned and have a longstanding track record of serving many of the communities also designated as OZs.

Finally, we ask Treasury to issue guidance as soon as is practicable on a number of issues affecting the implementation of WFTC.

- Notice 2026-40 offered helpful clarity on several transitional issues. Questions remain, however, about circumstances not described in the Notice's examples. Proposed regulations should offer additional clarification on the circumstances under which pre-existing OZ projects located in tracts with expired designations may take on additional OZ equity investments through the tract's expiration, so that otherwise qualifying investments made in the final years of a tract's designation do not fail to qualify as QOZ business property. Regulations should also clarify that existing

[3] 90 Fed. Reg. 8,245 (Jan. 28, 2025) "Memorandum of January 20, 2025 Delivering Emergency Price Relief for American Families and Defeating the Cost-of-Living Crisis," https://www.govinfo.gov/content/pkg/FR-2025-01-28/pdf/2025-01904.pdf.

investments in expired zones will be considered as located within an OZ for compliance purposes.

- Guidance should clarify how Treasury will ask QOFs to measure the job impact of their investments under new annual reporting requirements so that fund managers may collect adequate information throughout the year.

- Guidance should clarify what additional data may be used to demonstrate that a tract satisfies the OZ eligibility requirements under § 1400Z-1(c)(1), per Section 4 of Revenue Procedure 2026-14.

II. Regulations Should Be Conducive to Investments in Non-Real Estate Operating Businesses

A. Regulations Should Clarify the Substantial Improvement Test to Allow Property Purchased Before December 31, 2017 to be Treated as Qualified Property

Congress intended that existing businesses with expansion and growth potential would qualify for OZ tax benefits. In the press release announcing the introduction of the *Investing in Opportunity Act*, the legislation enacted in the TCJA to create the OZ incentive, the sponsors Senators Scott (R-SC) and Booker (D-NJ) and Representatives Tiberi (R-OH) and Kind (D-WI), underscored that this incentive was intended to draw capital to OZs both to help existing businesses grow and to spur creation of new businesses.[4] The sponsors of the legislation stated, "*The Investing in Opportunity Act* can provide the chance that entrepreneurs and small businesses are looking for to grow, innovate and create jobs."[5]

The Final 2020 OZ Regulations state that "there is no legal barrier to a pre-existing eligible entity qualifying as a QOF or qualified opportunity zone business," but the pre-existing entity must satisfy all of the applicable requirements of the statute and regulations.[6] In practice, these regulations add difficulty for existing businesses to qualify as an OZ business and, counter to the congressional intent of the law, existing businesses have found it challenging to raise additional equity capital from QOFs.

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[4] Press Release, Sen. Tim Scott (R-SC), Senator Scott Introduces the Bipartisan *Investing in Opportunity Act* (Oct. 5, 2017), https://www.scott.senate.gov/media-center/press-releases/senator-scott-introduces-the-bipartisan-investing-in-opportunity-act/.

[5] *Id*.

[6] Treas. Reg. § 1.1400Z2(d)-1(a)(2).

Section 1400Z-2(d)(2)(D) provides that tangible property will be treated as QOZ business property if the tangible property is used in a trade or business of the QOF and satisfies three requirements:

- (i) the QOF acquired the property after December 31, 2017, from an unrelated party (the "Post-2017 Acquisition Requirement");
- (ii) the original use of the post-2017 acquired tangible property in the QOZ must begin with the QOF (the "Original Use Requirement"), or the QOF must substantially improve the post–2017 acquired tangible property (the "Substantial Improvement Requirement"); and
- (iii) during substantially all of the QOF's holding period for such post–2017 acquired tangible property, substantially all of the use of post–2017 acquired tangible property has been in a QOZ.

The Post-2017 Acquisition Requirement and the requirement that the OZ business property must be used in the OZ for substantially all of the entity's holding period makes it difficult for a pre-existing business to qualify as an OZ business.

Further, under section 1400Z– 2(d)(2)(D)(ii) and Treas. Reg § 1.1400Z2(d)-2(b)(4)(i), the Substantial Improvement Requirement is met only if, during any 30-month period beginning after the date of acquisition of the post–2017 acquired tangible property, there are "additions to basis with respect to such property" held by the QOF that, in the aggregate, exceed the adjusted basis of the post–2017 acquired tangible property held by the QOF as of the beginning of that 30-month period. As a result, a QOF must, within a 30-month period, make improvements to property whose cost is greater than the QOF's adjusted basis in the building (not including land) at the time the property was acquired (referred to herein as "the Doubling of Basis Test").[7]

Because taxpayers have found it difficult to meet the Doubling of Basis Test, OZ investment has predominantly flowed into real estate projects, resulting in a significant boost in housing supply in designated areas. In particular, pre-existing operating businesses are often unable to qualify as an OZ business unless starting as a new business in the OZ consistent with the Original Use Requirements.

To support investments into pre-existing operating businesses, Treasury should look to the Final 2020 OZ Regulations' treatment of leases of tangible property from related parties. The Final 2020 OZ Regulations provide that tangible property acquired by lease may qualify as QOZ business property if the tangible property was acquired under a lease after December 31, 2017,

[7] Treas. Reg § 1.1400Z2(d)-2(b)(4)(i).

and the terms are at arm's-length rates.[8] The Final 2020 OZ Regulations also provide a special rule that leases of tangible property from related parties can be treated as QOZ business property subject to meeting additional requirements: (1) the lessee does not make any prepayment in connection with the lease that exceeds 12 months, and (2) the lessee purchases additional tangible property that is QOZ business property having a value not less than the value of that leased tangible personal property during the 30-month period after the lessee receives possession of the leased tangible personal property.[9]

In the preamble to the proposed regulations, Treasury stated that the purpose of sections 1400Z-1 and 1400Z-2 is to increase business activity and economic investment in qualified OZs that is generally measured by increases in tangible business property used in the qualified OZ.[10] Treasury further stated the proposed regulations included leased property as QOZ business property to achieve this general statutory purpose, prevent the unintended consequences of excluding certain investments, and ensure parity among diverse types of business models.[11] However, because "taxpayers generally do not have a basis in leased property that can be depreciated, . . . the proposed regulations do not impose a requirement for a lessee to 'substantially improve' leased tangible property within the meaning of section 1400Z-2(d)(2)(D)(ii)."[12]

Treasury should adopt a similar rule for pre-existing operating businesses to ensure parity in investment in real estate and non-real estate property that would increase business activity and economic investment in qualified OZs consistent with the statutory purpose. For example, the Substantial Improvement Requirement could be modified to allow non-qualifying tangible property to be treated as QOZ business property if the business makes other substantial investments, such as the acquisition of new tangible property, that exceeds the basis of existing property during the substantial improvement period, similar to the rule for related-party leases of tangible personal property. The regulations would need to clarify that for purposes of the "substantially all of the use" for "substantially all of the holding period" of the QOZ Property requirement, the holding period requirement begins upon the certification of the QOF.

To allow existing businesses to take advantage of the special rule, Treasury would also need to issue a rule treating stock or partnership interest in businesses that do not yet qualify as QOZBs to qualify as qualified opportunity zone property for the 30-month substantial improvement period if there is a reasonable expectation that the business will qualify as a QOZB

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[8] Treas. Reg. § 1.1400Z2(d)-2(c)(1)-(2).

[9] Treas. Reg § 1.1400Z2(d)-2(c)(3)(i)-(ii).

[10] 84 Fed. Reg. 18,652, 18,656 (May 1, 2018), https://www.govinfo.gov/content/pkg/FR-2019-05-01/pdf/2019-08075.pdf.

[11] *Id.*

[12] *Id.*

by the end of the 30-month period. Section 1400Z-2(d)(2)(B)(i)(II) and 1400Z-2(d)(2)(C)(ii) require a corporation or partnership to be organized as a QOZB at the time stock is issued or partnership interest is acquired for a QOF's investment to qualify as QOZ Property. This makes it difficult for an existing business to receive investment from a QOF if the business needs to use the investment to qualify as a QOZB.

Treating stock or partnership interests in businesses reasonably expected to become QOZBs as QOZ property would be consistent with existing regulations for the treatment of tangible property during the substantial improvement period. Treas. Reg. § 1.14000Z2(d)-2(b)(4)(ii) treats tangible property undergoing substantial improvement but not yet placed in service as QOZ property if there is a reasonable expectation that the property will be substantially improved and placed into service by the end of the 30-month substantial improvement period.

<u>Suggested Language</u>:

Amend at Treas. Reg. § 1.14000Z2(d)-2(b)(4):

(i) In General*. Except as provided in paragraphs (b)(4)(iv) and (vi) of this section, for purposes of paragraph (b)(2) of this section, tangible property is treated as substantially improved by an eligible entity only if it meets the requirements of section 1400Z-2(d)(2)(D)(ii) during the 30-month substantial improvement period. The property has been substantially improved when the additions to basis of the property in the hands of the QOF exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the QOF (substantial improvement requirement).*

Insert at Treas. Reg. § 1.14000Z2(d)-2(b)(4):

(vi) Special Rules for Non-Real Estate Operating Businesses

- ***(A) In General.*** *Used tangible property held by a non-real estate operating business is treated as meeting the substantial improvement requirement under paragraph (b)(4)(i) of this section if, during any 30-month period after the tangible property is acquired, the QOF or qualified opportunity zone business becomes the owner of tangible property that is qualified opportunity zone business property having a value more than the adjusted basis of such property at the beginning of the 30-month period in the hands of QOF or qualified opportunity zone business.*

- ***(B) Non-Real Estate Operating Business Requirements.*** *The term non-real estate operating business means a trade or business that derives less than 10 percent of its gross income from the rental of real estate.*

Insert at Treas. Reg. § 1.14000Z2(d)-2(d)(3):

(iii) Special Rule for Pre-Existing Non-Real Estate Operating Businesses. *For purposes of determining whether a pre-existing non-real estate operating business satisfies the 90-percent qualified opportunity zone business property holding period test described in paragraph (d)(3)(i) of this section, the holding period requirement begins on the date of the certification of the QOF pursuant to § 1.1400Z2(d)-1(a).*

Insert at Treas. Reg. § 1.14000Z2(d)-2(d)(4):

(ix) Special Rule for Non-Real Estate Operating Businesses. *For purposes of determining whether a non-real estate operating business satisfies the 70-percent use-test described in paragraph (d)(4)(ii) of this section, the holding period begins on the date of the certification of the QOF pursuant to § 1.1400Z2(d)-1(a).*

B. Regulations Should Provide that Tangible Property Incorporating Modest Amounts of Non-Qualifying Property Should Not Be Tainted as Non-Qualifying Property if the Taxpayer Overwhelmingly Improves the Non-Qualifying Property

The preamble to the Final 2020 OZ Regulations implies that capital improvements to non-qualifying business property can never be qualified opportunity zone business property. If true, this means that businesses with property acquired before 2018 or acquired in a transaction that does not satisfy the definition of a purchase in Section 179(d)(2) are doubly penalized. First, such improvements are not counted for purposes of satisfying the 70 percent test, and second, such improvements, by being treated as non-qualifying property, would raise the nominal threshold of qualifying property for the 70 percent test. In short, such an interpretation creates the perverse incentive to not improve non-qualifying property.

As described above, the statute limits qualifying property to property acquired after 2017 and from an unrelated party. Improvements to existing property do not fall into either of these two categories.

We urge Treasury to issue regulations to provide that non-qualifying property does not "taint" any new improvements made by a QOF or QOZ business. These regulations should treat the improvement as separate property for the purposes of the 70-percent tangible property asset test under section 1400Z-2(d)(2)(D)(i) and Treas. Reg. § 1.1400Z2(d)-1(d)(2) that satisfies the Original Use Requirement. Treating the improvements as separate property is consistent with the treatment of leasehold improvements as separate property for purposes of section 1400Z-2(d)(2)(D)(i) and, therefore, as satisfying the Original Use Requirement.[13] It is also consistent with the treatment of rehabilitation expenditures with respect to a qualified low-income building,

[13] Treas. Reg. § 1.1400Z2(d)-2(b)(3)(ii).

which is accounted for as separate property under general tax rules.[14] We note, under such a rule, nonqualifying property would generally need to be "overwhelmingly improved" for a business to satisfy the 70 percent test. For example, if a business had $300,000 of non-qualifying property, then to satisfy the 70 percent test, the property would generally need to be improved by $700,000 to meet the 70 percent test. In short, it becomes a 233 percent improvement test ($700,000/$300,000).

Treasury stated in the preamble to the Final 2020 OZ Regulations that treating the portion of non-qualifying property that is overwhelmingly improved as qualifying business property to satisfy the Original Use Requirement would impose "administrative burdens" for taxpayers and the IRS from tracking improvements and therefore declined to adopt such regulations.[15] However, if issued, this rule would not impose additional burdens, as taxpayers are already required to track improvements separately for accounting purposes and depreciation purposes.[16]

Further, the Final 2020 OZ Regulations' exclusion of overwhelmingly improved non-qualifying property is inconsistent with treatment of lessee's improvements to land, which the Final 2020 OZ Regulations affirm can qualify as separate property to meet the Original Use Requirement.[17]

Some have expressed concern that adopting such a rule could dilute the 70-percent asset test, freeing up 30 percent of the QOZ business' assets to invest outside of a QOZ. Because the new rule would apply to property that is overwhelmingly improved, we believe it would encourage transformative investments that have the potential to make the largest impacts in a QOZ. However, such a rule would need to be balanced with protections to ensure that it does not facilitate investments that are inconsistent with the purpose of the statute.

<u>Suggested Language</u>:

Insert at Treas. Reg. § 1.1400Z2(d)-2(b)(3):

(vi) Overwhelmingly Improved Tangible Property.

(A) ***In General.*** *An eligible entity that acquires tangible property that would not otherwise satisfy the purchase requirement in section 1400Z-2(d)(2)(D)(i)(I) and*

[14] Section 42(e).

[15] 85 Fed. Reg. at 1,909.

[16] *See e.g.,* section 263A (requiring capitalization of direct and allocable indirect costs incurred in producing or improving real or tangible personal property); Treas. Reg. § 1.263(a)-3 (requiring taxpayers to capitalize direct and indirect costs of an improvement to tangible property).

[17] Treas. Reg. § 1.1400Z2(d)-2(b)(3)(ii).

paragraph (b)(1) but improves the non-qualifying property and incorporates such improvement into the non-qualifying property may treat such improvement as a separate asset for purposes of the 70-percent tangible property asset test under § 1.1400Z2(d)-1(d)(2) and as satisfying the original use requirement in section 1400Z-2(d)(2)(D)(i)(II).

III. Regulations Should Allow QOFs to Reinvest the Proceeds from the Sale of QOZ Property in Other QOZ Property Without Interrupting the Intended OZ Tax Benefits for Investors

Section 1400Z-2(c) provides that gains realized on the sale of investments in the QOF held for at least 10 years are excluded from gross income. The Final 2020 OZ Regulations provide an additional mechanism for excluding gain from the sale of underlying business assets held at the QOF or a lower-tier QOZ business level after the QOF has been held for 10 years. Taxpayers can exclude gains even when the QOF or its subsidiary sells business assets, as long as the taxpayer has held the QOF interest for 10 years.

However, the gain on the sale of business assets held less than 10 years are included in income. As a result, under the Final 2020 OZ Regulations, when a QOF exits one of its investments before the end of the 10-year period, the tax benefit to the QOF's investors is interrupted, even if the QOF does not distribute the proceeds and reinvests those proceeds into a new QOZ investment. Under the traditional partnership tax rules in Subchapter K of the Internal Revenue Code, all items of income — including gains — flow through to the individual partners. Each time a business asset is sold before the end of the 10-year period, the partners recognize the full amount of gain.

The result is that investments are impeded into non-real estate operating businesses and for-sale homes, among other use cases. Non-real estate operating businesses are typically financed by traditional private equity or venture capital firms which often liquidate investments and reinvest proceeds in other operating businesses on a shorter timeline — often within five years of the initial investment. As a result, operating businesses in OZs struggle to attract investment — contrary to the purposes of the OZ program to attract investment in underserved areas and defeating the purposes of the OZ incentives.

Permitting the recycling of capital at the QOF and QOZB level would also allow for more production of for-sale homes in OZs, consistent with the Administration's priority to increase opportunities for more widespread homeownership. The OZ incentive is now one of the most powerful policies in the federal toolkit to increase the supply of rental housing. Our research demonstrates that the incentive is directly responsible for the creation of an estimated 416,000 new units of housing nationwide. Currently, OZ investors cannot sell newly constructed homes before the end of the ten-year holding period, limiting the sale of homes to owner-occupants to a small number of rent-to-own communities. If QOFs could reinvest the proceeds from selling homes, investors would be able to sell units directly to homeowners and recycle capital into the production of more for-sale homes in OZs, expanding the power of the incentive to create new for-sale housing supply.

In a letter to the Secretary of the Treasury in 2019, the congressional sponsors of the *Investing in Opportunity Act* affirmed that Congress intentionally tied the OZ tax incentive to the duration of an investor's ownership interest in a QOF, rather than to the QOF's ownership of any particular investment. As these sponsors note, this distinction is critical for investing in operating businesses due to this investment churn that occurs in partnerships. From the beginning, there has been bipartisan consensus that fund-level recycling of capital "should in no way disallow the tax benefit to the Opportunity Fund's investors, provided they do not take distributions from the fund or sell their fund interest prior to meeting the 10-year holding period."

For this reason, Congress granted the Secretary of the Treasury broad authority to prescribe regulations to carry out the purposes of the OZ program, including specific authority to issue regulations to ensure a QOF has a "reasonable period of time to reinvest the return of capital from investments in [QOZ] stock and [QOZ] partnership interests, and *to reinvest proceeds received from the sale or disposition of [QOZ] property*."

Congress specifically directed the Secretary of the Treasury to issue regulations to carry out the purpose of the program related to the investment of proceeds from the sale of QOZ property — which includes business assets. Congress's use of the term "proceeds" rather than "cash proceeds" or "net proceeds" indicates that Treasury can provide regulations to ensure the full amount of proceeds can be reinvested consistent with the purposes of the OZ program.

Courts have held that the words of a statute must be given their plain, ordinary, and literal meaning. The term "proceeds" generally refers to everything a seller receives from a sale or disposition, not just the after-tax proceeds. If Congress has used a term such as "cash proceeds" or "net proceeds," this could have limited Treasury to issuing regulations that allow for the reinvestment of proceeds only after taxes had been paid on the gain recognized by the partnership. Instead, Treasury has authority to issue regulations to align the Final 2020 OZ Regulations with the intent of the OZ program and allow for the recycling of capital into qualifying OZ investments without disruption to the investor's benefits. This will clear the way for more investment into new and existing operating businesses, as well as for-sale home development.

We urge Treasury to use this broad authority to issue regulations to allow a taxpayer to defer gain on the sale of property by a QOF or QOZB as long as gain would not be recognized on the property being sold if it was held continuously for ten years and the QOF reinvests the proceeds from the sale in other QOZ property within 12 months. Treasury could provide an adjustment to the basis of the replacement property to preserve the gain if the replacement property is sold.

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IV. Regulations Should Provide Additional Flexibility to Increase the Supply of Affordable Housing

Opportunity Zones have been highly successful at boosting housing supply nationwide. As noted above, EIG's research found that the OZ incentive caused the creation of 416,000 new housing units through the first quarter of 2025, increasing the supply of new housing in designated communities by an estimated 70 percent. Additional regulatory flexibility would make the OZ incentive an even more effective tool for housing supply — especially as it relates to affordable housing projects that face the highest hurdles in attractive investment.

On his first day in office, President Trump issued a memorandum, "Delivering Emergency Price Relief for American Families and Defeating the Cost-of-Living Crisis," directing all agencies and executive departments "to pursue appropriate actions to lower the cost of housing and expand housing supply."[18] Consistent with President Trump's directive, we urge Treasury to provide additional flexibility to use OZs to attract private capital and investment to create more affordable housing.

As noted above, section 1400Z-2(d)(2)(D)(i)(II) requires that QOZ business property either meet the Original Use Requirement or the Substantial Improvement Requirement. If the property was previously placed in service by any person in a QOZ, then the property must be substantially improved. The Final 2020 OZ Regulations further provide that property is substantially improved if, during any 30-month period beginning after the property is acquired, additions to the basis of the property exceed an amount equal to the adjusted basis at the start of the 30-month period.[19]

Affordable housing developers that intend to rehabilitate or convert existing property to affordable housing have a difficult time meeting these regulatory requirements.

Providing additional flexibility for affordable housing is consistent with the Final 2020 OZ Regulations' special rules for vacant property, brownfields, and property involuntarily transferred to a local government, which allow such property to meet the Original Use Requirement without meeting the Substantial Improvement Requirement.[20]

The preamble to the Final 2020 OZ Regulations noted that the infusion of capital investment into vacant property "would achieve a core policy objective" of OZs and "spur

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[18] 90 Fed. Reg. at 8,245.

[19] Treas. Reg. § 1.1400Z2(d)-2(b)(4).

[20] *See* Treas Reg. §§ 1.1400Z2(d)-2(b)(3)(i)(B), 2(b)(3)(ii) (Commencement of Original Use of Vacant Property); 1.1400Z2(d)-2(b)(3)(iv) (Brownfield Sites); 1.1400Z2(d)-2(b)(3)(v) (Property Involuntarily Transferred to a Local Government).

capital investment into needed areas."[21] Similarly, the preamble stated that "[c]leaning up and reinvesting in [brownfield] properties increases local tax bases, facilitates job growth, utilizes existing infrastructure, takes development pressures off of undeveloped, open land, and both improves and protects the environment."[22] Finally, the preamble acknowledged that treating property held by a local government as a result of an involuntary transfer as satisfying the Original Use Requirement "would facilitate the ability for local governments to increase capital investment in underused property and increase economic activity in their respective communities."[23]

We urge Treasury to issue regulations allowing property converted to affordable housing to be considered to meet the Original Use Requirement, similar to the special exceptions for vacant property, brownfields, and property involuntarily transferred to a local government provided in the Final 2020 OZ Regulations.

Treasury's regulations should provide that property converted to affordable housing satisfies the Original Use Requirement if the property sets aside at least 20 percent of units for individuals whose income is 80 percent or less of the area median income and includes a new 30-year land use restriction agreement. A 20 percent requirement would be consistent with requirements for the New Markets Tax Credit.

Treasury's regulations should also provide that investments into existing affordable rental housing should be treated as meeting the Substantial Improvement Requirement if the property is improved by more than 20 percent of the unadjusted cost basis and subject to a new or existing 30-year land use restriction agreement. A 20-percent standard would mirror the Low-Income Housing Tax Credit's substantial rehabilitation threshold to ensure that rehabilitation expenditures are treated as a separate new building.[24]

Additional flexibility for converting market-rate to affordable housing to satisfy the Original Use Requirement and the Substantial Improvement Requirement would not require affordable housing developers to make cost-prohibitive investments that would otherwise limit investment in affordable housing in OZs. Similar to the rules for vacant property, brownfields, and property involuntarily transferred to a local government, a special rule for converting market-rate to affordable housing would allow OZs to bring a wave of new investment in affordable housing and further the objectives of the OZ program by providing additional investment in needed areas that utilizes existing housing stock and facilitates additional job growth.

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[21] 85 Fed. Reg. at 1,910.

[22] *Id*.

[23] 85 Fed. Reg. at 1,911.

[24] Section 42(e)(3)(A)(ii)(I).

Suggested Language:

Insert at Treas. Reg. § 1.1400Z2(d)-2(b)(3):

(vii) Converting Real Property to Affordable Housing.[25]

> ***(A) In General.*** *Any real property (including land and structures thereon) that is converted to a qualifying affordable housing project may be treated as satisfying the original use requirement in section 1400Z-2(d)(2)(D)(i)(II).*
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> ***(B) Qualifying Affordable Housing Project.*** *A qualifying affordable housing project means property of one or more buildings that--*
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> > ***(1)*** *meets the requirements contained in section 42(g)(1), as determined by substituting "80 percent" for "60 percent"; and*
> >
> > ***(2)*** *includes a long-term agreement that meets the requirements of section 42(h)(6)(B)(i) through (vi). For purposes of this paragraph, the extended use period in section 42(h)(6)(B)(i) shall be the 30-year period starting on January 1 of the year after the property is placed in service and the applicable fraction shall be 80 percent, and the income limitation applicable to the building in section 42(h)(6)(B)(ii) is modified as provided in subparagraph (3)(vii)(B)(1) above. Owners must correct any noncompliance with the rules of this subparagraph within a reasonable period after any noncompliance is discovered or reasonably should have been discovered.*

Insert at Treas. Reg. § 1.14000Z2(d)-2(b)(4):

(vii) Special Rules for Investments in Existing Affordable Housing.[26] *An eligible entity will be treated as meeting the substantial improvement requirements for investments in a qualifying affordable housing project as defined in subparagraph (b)(3)(vii)(B) when the additions to the unadjusted cost basis of the property under section 1012 in the hands of the eligible entity exceed 20 percent above the original unadjusted cost basis of the property in the hands of the eligible entity.*

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[25] Note that our recommendations in section II.B above would add at Treas. Reg. § 1.1400Z2(d)-(2)(b)(3)(vi) the overwhelmingly improved property changes to meet the Original Use Requirement.

[26] Note that our recommendations in section II.A above would add at Treas. Reg. § 1.1400Z2-(d)(B)(4)(vi) the Special Rules for Non-Real Estate Operating Businesses to meet the Substantial Use Requirement.

V. Regulations Should Provide a Reasonable Cause Exception from the 90/10 Test for CDFI Investments

Section 1400Z-2(d)(1)(A)-(B) and the Final 2020 OZ Regulations require a QOF to hold at least 90 percent of its assets in QOZ property as of two testing dates — the last day of the QOF's first six month period of the taxable year and the last day of the taxable year.[27] If the average is less than 90 percent, a QOF may be subject to penalties, unless the failure was due to reasonable cause.[28]

To address taxpayers' requests for guidance as to what constitutes reasonable cause to avoid penalties and to provide additional flexibility to allow QOFs to deploy capital into qualifying investments, the Final 2020 OZ Regulations provide a special rule regarding recently contributed property.[29] Under this rule, a QOF can choose to exclude cash contributions and cash equivalents received six months prior to a testing date from both the numerator and denominator of the 90 percent asset test calculation.[30] To qualify, the contributed amounts must be continuously held in cash, cash equivalents, or debt instruments with a term of 18 months or less, from the fifth business day after contribution until the testing date.[31] This rule may be elected in circumstances when a QOF is unable to deploy its capital into QOZ property.[32]

The regulations should provide that a QOF's investment or deposit of working capital into a CDFI can be excluded from the fund's 90 percent asset test as a reasonable cause exception under section 1400Z-2(f)(3), as these are institutions that are mission-aligned and have a track record of serving many of the same communities designated as OZs.

Treasury previously issued similar regulations for the New Markets Tax Credit ("NMTC") to allow for investment returns to be temporarily reinvested into a CDFI.[33] Under the NMTC, investors make a qualified equity investment ("QEI") into a community development entity ("CDE") that the CDE uses to make investments in qualified low income community investments ("QLICI").[34] Investors then claim the NMTC over a seven-year period. QLICIs

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[27] Treas. Reg. § 1.1400Z2(d)-(1)(a).

[28] Section 1400Z-2(f)(3) ("No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause.").

[29] 85 Fed. Reg. at 1,941.

[30] Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(B).

[31] Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i)(B)(1)-(3).

[32] 85 Fed. Reg. at 1,941.

[33] *See* Treas. Reg. § 1.45D-1(d)(10)

[34] Treas. Reg. § 1.45D-1(c)(1)(ii).

often involve loans or investments that return principal to the CDEs and the NMTC regulations require that these funds be reinvested into new QLICIs no later than 12 months after receipt in order to be treated as continuously invested.[35]

The NMTC regulations include a special reinvestment rule for proceeds from a non-real estate QEI that are reinvested in a non-real estate qualified active low-income community business ("QALICB").[36] A CDE can reinvest returns in another non-real estate QALICB under the general rules, or a portion can be reinvested in a "qualifying entity" — defined in the NMTC regulations as a CDFI — up to a certain amount for each year of the credit period if the returned capital is reinvested in the CDFI no later than 30 days from the date of receipt.[37]

This special rule allows CDEs to temporarily place returned capital in a separate, unrelated certified CDFI, and then later reinvest the returns into a qualifying business. This rule helps with liquidity and working-capital needs to encourage investments in non-real-estate businesses.[38] This special rule also encourages investment in CDFIs and provides additional liquidity to CDFIs to make investments in the same communities benefiting from the NMTC.

<u>*Suggested Language:*</u>

Insert at Treas. Reg. § 1.1400Z2(d)-1(b)(2)(i):

(D) Option for QOFs to disregard deposits in a Certified Community Development Financial Institution.

> ***(1)*** *A QOF may choose to determine compliance with the 90-percent investment standard by excluding from the numerator and denominator of the test any deposit or any other investment in a certified community development financial institution. A QOF need not be consistent from one semiannual test to another in whether it avails itself of the option in this paragraph. A QOF may avail itself of this option in addition to the option to disregard recently contributed property in paragraph (b)(2)(i)(B) of this section.*
>
> ***(2) Certified community development financial institution defined.*** *The term certified community development financial institution means any community development financial institution (as defined in section 103 of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702)) that is certified by the Secretary.*

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[35] Treas. Reg. § 1.45D-1(d)(2)(i).

[36] Treas. Reg. § 1.45D-1(d)(10)(ii).

[37] Treas. Reg. § 1.45D-1(d)(10)(ii)(D) (A qualifying entity will also include any other entity designated by the Secretary of the Treasury in the Internal Revenue Bulletin).

[38] 77 Fed. Reg. 59,544, 59,545 (Sep. 28, 2012), https://www.govinfo.gov/content/pkg/FR-2012-09-28/pdf/2012-23985.pdf.

Additional Items for Immediate Guidance

I. Confirm Eligibility of Qualifying Investments in OZ 1.0 Tracts During Overlap Period for OZ 2.0 Benefits

Investors and fund managers have expressed significant concern about uncertainty as to whether they will be able to invest in tracts designated under the original OZ map during 2027 and 2028 and receive the modified benefits codified in the WFTC. The WFTC clearly institutes the new benefit structure effective January 1, 2027, without any exception for zones designated prior to that date. We recommend Treasury confirm that investors may choose to invest in any Opportunity Zone with an active designation to receive the full suite of OZ benefits.

II. Transition Rules for Legacy Projects

We thank Treasury and the IRS for the timely publication of Notice 2026-40 outlining transitional guidance on Qualified Opportunity Zones. We appreciate the guidance's clarification regarding the number of OZ tracts eligible for nomination in 2026, the eligibility of gains realized on OZ investments for deferral, and circumstances under which an existing OZ investment may continue to receive investment after the expiration of a zone's designation. We also look forward to forthcoming regulations allowing QOFs and QOZBs to treat expiring OZs as OZs for the tests outlined in 1400Z-2(d). We plan to issue a separate letter in response to this guidance shortly that will request the regulations align with the clear statutory intent to allow investments to continue in current OZ tracts through their expiration on December 31, 2028.

III. Additional Reporting Requirements Determined by the Secretary

WFTC listed certain information that each QOF must provide in their annual tax returns beginning in the 2026 taxable year, including "the approximate average monthly number of full-time equivalent employees of such corporation or partnership for the year (within numerical ranges identified by the Secretary) or such other indication of the employment impact of such corporation or partnership as determined appropriate by the Secretary" for each investment held by the QOF. We ask Treasury to issue guidance as soon as is practicable clarifying how it will ask QOFs to measure job impact so that QOFs may keep adequate records throughout the taxable year.

We recommend that Treasury collect information on job creation similar to that required of New Markets Tax Credit ("NMTC") allocatees. In the first year of an investment, QOFs should submit for each investment the expected number of permanent full-time equivalent jobs to be created or retained at the financed business, the expected number of full-time equivalent construction jobs to be created, and the full-time equivalent jobs expected to be created or retained at tenant businesses. Beginning in the third year of their investment, QOFs should report the actual number of permanent full-time equivalent jobs created or retained at the financed business, the actual number of full-time equivalent construction jobs created, and the actual number of full-time equivalent jobs expected to be created or retained at tenant businesses.

To maintain taxpayer privacy while allowing for the production of timely reports, we recommend collecting this data separately from taxpayers' disclosures on Form 8996. Information collected on tax forms carries a higher standard for data protection. While we respect the need to maintain taxpayers' confidentiality, Opportunity Zone researchers and practitioners would benefit greatly from more frequent, current reports than what can be produced when all OZ impact data is collected via tax form.

IV. Clarification on Rural Guidance

IRS Notice 2025-50 provided a list of current OZ tracts qualifying for the lower 50 percent substantial improvement threshold under WFTC. The Notice states that the lowered threshold applies to "any determination made on or after July 4, 2025, as to whether any tangible property located in a 2018 QOZ comprised entirely of a rural area meets the substantial improvement test described in § 1400Z 2(d)(2)(D)(ii)." The language of the notice indicates that any property located entirely in a rural area that has achieved the 50 percent substantial improvement threshold will qualify as substantially improved for any determinations made after July 4, 2025, regardless of the date that the improvements were made. However, some stakeholders have expressed confusion as to whether certain properties may qualify, including properties that were previously determined not to be substantially improved at the 100 percent threshold and properties that met the 50 percent threshold prior to July 4, 2025 but for which no determination had yet been made.

We ask Treasury to clarify that a property in a rural OZ may qualify as substantially improved as of July 4, 2025 if, during any 30-month period, the additions to basis of the property exceed 50 percent of the adjusted basis of the property at the beginning of the 30-month period.

V. Flexibility on Designations for Census Tracts with Limited ACS data

The WFTC modified the eligibility criteria for Opportunity Zones going forward. Census tracts may still qualify for designation on poverty or median family income (MFI), but those tracts that qualify on poverty must not exceed 125 percent of metro MFI if urban or state MFI if rural. Tracts that qualify on MFI must not exceed 70 percent of metro MFI if urban or state MFI if rural, reduced from 80 percent in the first round.

Rev. Proc. 2026-14 provided a list of 25,332 census tracts that meet this statutory definition according to the latest American Community Survey (ACS) data from 2020-2024. The Rev. Proc. also notified states that Treasury will consider nominations of tracts not on the official list of eligible tracts if accompanied by "a detailed analysis, including current data collected at the census tract level, demonstrating the nominated population census tract satisfies the requirements under §1400Z-1(c)(1)."

We recognize the inherent limitations of the ACS dataset and the interest in providing flexibility to state executives to nominate off-list tracts they believe should be eligible for OZ designation, especially those that fall within the reported margins of error. We also recognize the challenge states will face in interpreting the requirements laid out in Section 05.04 of Rev. Proc. 2026-14, which can be read as circularly referencing criteria that governors will have already established the tract does not meet.

Accordingly, we recommend that Treasury provide clear and narrow guidance on how states may demonstrate that any proposed “off-list” tract meets statutory requirements. Specifically, we urge Treasury to set a high bar by requiring several additional data points to corroborate a census tract merits designation and is aligned with statutory intent.

While we fully grasp the limitations of ACS data, the ACS is still the most credible national source of information on neighborhood-level well-being available today. Any data quality issues with the ACS will not be solved by relying on data of worse quality. However, states or other federal government agencies may have administrative data (on benefits claims from a given area, for example) that could serve as a valid foundation for making OZ determinations based on the poverty or income profile of a community. Where possible, we encourage Treasury to guide states towards verifiable, public, administrative data sources when making their case.

We believe that “off-list” census tracts merit heightened scrutiny because of the clarity with which Congress laid out the qualifying criteria in statute. To that end, we offer the following list of additional data points governors should use to corroborate their case that an off-list tract meets the spirit and intent of the law. These are intended to be supplemental checks to prevent misaligned designations from being made. They should be levied after governors establish distress on the terms enumerated in §1400Z-1(c)(1). We recommend any requested tract must meet three of the following four criteria:

- Should not exceed state or national median household income (MHI), whichever is higher;
    - This looks to the next best income variable in the ACS, derived from a larger sample, to corroborate that the tract in question is not actually high-income.
- Should not exceed national Bachelor’s degree (BA) attainment rate;
    - Given the strong correlation between adult educational attainment rates and local area well-being, this offers a non-income-based way to credibly establish that the tract lags behind the national average.
    - Treasury should also implement a series of checks to be sure that university campuses and adjacent communities where off-campus student populations may distort the standard low-income community metrics are not inadvertently let into the OZ pool. We recommend examining the poverty rate for non-student segments of the population as well as the share of residents that are enrolled in college and university.

- Consistently met OZ eligibility criteria in two of out of the three most recent ACS;
    - This allows for a history of distress to be established in cases where a large margin of error in the most recent vintage may be overstating local area well-being. We recommend referencing multiple prior vintages in part so governors can demonstrate that the off-list tracts are subject to statistical noise and not on an upward trajectory that suggests the most recent ACS has indeed accurately captured their eligibility status.
- In urban areas, is substantially adjacent to eligible OZ tracts (at least 2/3 of its perimeter touches census tracts that are OZ eligible); in rural areas, is substantially adjacent to at least one other qualifying tract.
    - This allows consideration of tracts that are substantially embedded in distressed and low-income areas, establishing that the tract in question exists within a milieu targeted by the policy.

Together, these tests are designed to certify the underlying economic need of the tract and to fully ensure that the census tract is not in fact prosperous, thereby aligning with Congress's intent for the policy. In other words, any grey zone tracts should still be subject to bright line tests that disprove prosperity so that Treasury does not inadvertently let any tracts qualify that do not align with the policy's purpose.

We also encourage Treasury to offer guidance on the circumstances under which a zero-population census tract, which by definition is impacted by the limitations of a population-based survey such as the ACS, may be eligible for off-list nomination and OZ status.

We also recommend strictly limiting the number of off-list tracts that governors can request in order to maintain the integrity of the policy, retain fidelity to the criteria enumerated in statute, and keep the nomination process manageable for both states and the Treasury.

Finally, Treasury should clarify that the total number of tracts states can nominate will not change from what was provided in the Rev. Proc., calculated by taking 25 percent of the eligible low-income census tracts listed. Any successful petition for an off-list census tract should be counted as part of the overall total allotted to each state.

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We appreciate your consideration of these recommendations and look forward to the issuance of additional guidance and regulations that will facilitate more and continued investment in distressed communities across America.

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